EU Member States Tax Policy
Responses to the global financial crisis

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Outline

1. What happened to tax revenue during the crisis?
2. Taxation in « critical » countries: was it responsible – or was it the expenditure side?
3. What measures were taken by Member States?
4. What are the tax rates now and how do they compare with pre-crisis levels?
5. Assessing the tax reforms made in the last two years
What happened to tax revenue during the crisis?

- 2008: both revenue and expenditure contributed to worsen the government balance, but especially expenditure: -1.1% of GDP compared to -0.3%.
- 2009: similar pattern: revenue -0.7%, expenditure -3.9% of GDP.
- 2010 forecast: stabilisation – but tax revenue ratios to remain below 2007 level for years...
What happened to tax revenue during the crisis?

In euro area revenue decline stronger 2008, but weaker 2009 – overall no big difference from EU as a whole (see previous slide).

Overall, worsening in fiscal position is much more due to higher expenditure than lower revenues.

However, expenditure was made to sustain growth; had it been lower, tax revenue would have worsened more.
**Situation in Portugal, Ireland, Greece and Spain**

In 2009, Portugal, Ireland, Greece, Spain all showed a greater than average worsening in gov’t balance.

The worsening of the balance started earlier than in EU-27.

On average greater negative revenue component than the EU-27 (almost 2% compared to 0.5%).

Unlike EU-27, forecasts assume significant revenue-raising effort already in 2010.
Situation in other countries

• Tax-to-GDP ratios of Portugal, Ireland, Greece and Spain are all lower than EU average – but in some of these countries this is also due to the size of the grey economy. Debt and deficit ratios differ however significantly.

• Also UK had sizeable deterioration in balance, revenue component fairly strong in 2009 (not 2008 or 2010)

• IT below average deterioration, revenue component in line with EU average
What happened to debt ratio during the crisis?

- 2007: lowest debt to GDP ratio for a decade
- 2010 forecast: debt ratio 20 percentage points higher
- Demographic challenges: ageing related costs increase by 4.7 pp by 2060
- 2009 assessment: EU debt to GDP ratio could reach 100% as early as 2014 and 130% by 2020.
How have Member States reacted?

- Quite activist stance – MS have adopted wide range of measures (an average of 10 important measures per MS)
- Several headline measures involved key rate changes (eg VAT) or reforms of PIT or SSC with substantial budgetary impact (frequently in range 0.5 - 1 % GDP)
- .... but overall high number of targeted measures
- Over 2008-2010 we find both tax cuts and tax increases even in the same MS and type of tax
- This is because initial tax cuts have been followed by consolidation measures
How have Member States reacted? (2)

- A distinctive feature of this recession is the introduction of a high number of schemes aiming at sustaining corporate liquidity by deferring tax payments.
- Tax fairness has been a major concern: many countries increased PIT thresholds (also to offset indirect tax increases) or reduced taxation of food or basic items (frequent result = narrowing of tax base).
- Except UK, no widespread use of temporary indirect tax cuts to spur consumption, but many measures targeting expenditure on housing or business investment, or tourist expenditure.
- Substantial resort to increases in excise duties, particularly in tobacco and alcohol and in second phase of recession.
### Type of measures adopted: CIT

<table>
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<th>Corporate Income Taxation</th>
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<td>Base or special regimes</td>
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- This table shows the number of measures adopted and their impact (widening or narrowing of the base, changes in the rate, timing of tax payment)
- Most measures in corporate taxation involved tax relief
- Changes in the rate have been overwhelmingly cuts
- Most of the time the reforms have narrowed the CIT base although the opposite took place too
- Many measures eased the terms for paying taxes
**Type of measures adopted: PIT**

<table>
<thead>
<tr>
<th>Personal Income Taxation</th>
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<td><strong>Base or special regimes</strong></td>
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- Most measures in personal taxation have involved tax relief, but also many increases are present.
- Slightly higher number of **rate** cuts than increases.
- As in CIT, most reforms have **narrowed** the base but the opposite has frequently happened, too.
- Many measures **eased** the terms of payment.
## Type of measures adopted: VAT

<table>
<thead>
<tr>
<th>Base or special regimes</th>
<th>Rates</th>
<th>Timing (revenue effect)</th>
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- VAT stands out for its clear-cut patterns
- Clear prevalence of rate increases over cuts
- ... but also clear use of base narrowing measures to favour particular categories of goods
- Significant recourse of measures to ease the business liquidity
**Type of measures adopted: excise duties**

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- Excise duties have been **widely used** to raise revenue.
- Clear prevalence of **rate** increases over cuts.
- Limited use of **base** measures – mostly to widen base.
- No business liquidity measures.
What are tax rates now?
1 – VAT (standard rates)

EE: 18 -> 20
LV: 18 -> 21
LT: 18 -> 21
HU: 20 -> 25
ES: 16 -> 18
FI: 22 -> 23
EL: 19 -> 23
What are tax rates now?
2 – excise duties on fuel

Rate on diesel fuel, euros/ 1000 litres, EU 27 average
**What are tax rates now?**

3 – excise duties on alcohol and tobacco

**Excise duty on ethyl alcohol EU-27 average**

- 2007: 1480 EUR
- 2010: 1530 EUR

**Excise duty on cigarettes EU-27 average**

- 2007: 38 EUR
- 2010: 47 EUR
What are tax rates now?

4 - CIT

EU-27 - Average top CIT rates

- 37%
- 35%
- 33%
- 31%
- 29%
- 27%
- 25%
- 23%

What are tax rates now?
5 – top PIT rates

<table>
<thead>
<tr>
<th>Year</th>
<th>Average top PIT rates</th>
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<tbody>
<tr>
<td>1995</td>
<td>49%</td>
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Assessment of recent tax reforms (1)

• Although the most recent news point towards a prevalence of expenditure cuts, most tax systems will probably have to contribute to budgetary consolidation in the next few years.

• During the crisis, a wide range of measures have been adopted, but on balance we see a continuation of the recent trend towards higher indirect taxes and lower top PIT and corporate rates.

• The latest measures have mostly increased VAT and excise duties, while CIT has on balance been cut; PIT is less clear-cut owing to base measures going both ways.
Assessment of recent tax reforms (2)

Are these changes good or bad?

- From a growth viewpoint, there are arguments for cutting CIT and PIT and funding the change by increasing consumption and recurrent property taxes...
- .... but these reforms find resistance on equity grounds (consumption taxes) or simply because they are unpopular (recurrent property taxes)
- Apparently, many tax systems have used base narrowing to address equity concerns (by raising basic allowances), to sustain spending or just to bolster acceptance....
- .... but in the long run base narrowing drives up marginal rates, whose growth cost increases rapidly
Thank you!