WHAT FUTURE FOR TAXATION IN THE EU?

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The 11th EUROFRAME[1] Conference on economic policy issues in the European Union was held in Paris on 6 June 2014. The aim of the conference is to provide an economic forum for debate on economic policy issues relevant in the European context. In June 2014 the Conference topic was: "What future for taxation in the EU?". The programme and conference papers are available at the EUROFRAME Conference webpage: www.euroframe.org. Six of the papers given at the Conference are released in this issue of the *Revue de l'OFCE*.

European economies have high taxation levels, which allow financing the European Social Model, characterised by a high level of public and social spending. In 2012, the tax-to-GDP ratio was 39.4% for the whole EU, 40.4% for the euro area, as compared to 39.4% for Japan and 24.5% for the US. There are however wide disparities within the area. The tax-to-GDP ratio is higher than 45% in Denmark, Belgium and France, and ranges between 45% and 40% in Sweden, Finland, Italy and Austria. But it is below 35% in Greece, Spain, Poland, and Portugal; 30% in Slovakia, Ireland, Romania, and Bulgaria. There was no trend in the tax-to-GDP ratio developments at the EU level over the last 20 years.

Taxation issues are especially important in Europe, and have generated a huge number of analyses, reports and debates. Three elements of debate seem crucial to us. The first one lays in the tax reforms needed at domestic level. Some advocate a less heavy and a more neutral taxation. Others wish to keep and even strengthen the redis-

1. EUROFRAME is a network of ten independent European research institutes: WIFO (Austria), ETLA (Finland), OFCE (France), DIW and IFW (Germany), ESRI (Ireland), PROMETEIA (Italy), CPB (Netherlands), CASE (Poland), NIESR (United Kingdom).

tributive and incentive role of taxation. There seems to be some consensus on the need to increase progressively environmental taxation and to reduce the tax burden on labour (but is this consistent with social protection financing?). The second element of debate deals with tax harmonisation and tax coordination at the EU level. Some wish to combat tax evasion (which leads Member States to deprive themselves of tax revenues in order to cut taxes on the wealthiest and on large companies; to combat 'tax tourism' (which allows the wealthiest and large companies to choose their tax residence in order to avoid taxation). On the contrary, others wish to let competition play in order to oblige countries to cut their public spending levels. Many are in favour of European taxation, to accompany a rise in the EU budget, either to combat tax evasion, or to favour environmental transition or to reduce the size of finance. Last, a third element of debate deals with the role that tax reforms could play in the resorption of euro area current imbalances. Some advocate substituting fiscal devaluations to monetary devaluations, which can no more be implemented in a monetary union, but fiscal devaluations should be coordinated at the euro area level. Should economic activity be supported by large tax cuts (at the risk of widening public deficits), offset by public spending cuts (at the risk of being detrimental to output and to the European social model)? Should wealth taxation be increased to reduce public debts and deficits?

Structural taxation issues

The paper given by Leon Bettendorf – *Study on the impacts of fiscal devaluation*[2] – analyses the consequences of fiscal devaluation, i.e. of employers' social contributions cuts offset by rises in VAT. The country implementing such a policy will benefit from competitiveness gains, which will be all the more large and long-lasting than wages and social contributions are not price-indexed. This measure can also be analysed as a once for all tax on capital in place. However, as VAT and social contributions have more or less the same tax base (value added minus investments versus value added minus profits), the total impact on output, employment or trade balance is small in the medium-term.

2. Not released in this issue. The paper is available as a European Commission taxation papers, *Working paper* No. 36, 2013.
http://ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/economic_analysis/tax_papers/taxation_paper_36_en.pdf.

In *Carbon Tax, Pensions and Public Deficits: The hidden cost of the compartmentalization of expertise,*[3] Emmanuel Combet and Jean-Charles Hourcade argue that analyses on social spending trends linked to population ageing and policies to combat climate change are intertwined. The authors advocate to finance the rise in pensions spending through a rise in environmental taxation accompanied by employers social contributions cuts and higher income tax, so as to generate a triple dividend: financing social protection, reducing CO2 emissions, and rising employment. One may fear however that the paper overestimates the positive effects of the carbon tax.

The Financial Transactions Tax

The paper by Stephan Schulmeister – *The struggle over the Financial Transactions Tax – A politico-economic farce –,* shows that financial markets speculation induces a strong volatility detrimental to growth. The Financial Transactions Tax (FTT) would allow to reduce this volatility. The proponents of this tax succeeded to have it advocated by the European Commission in September 2011. But under the counter-attack of liberal economists and of the financial lobby, the FTT lost a substantial part of its content and its implementation was delayed.

In *A step too far? The European financial transactions tax on the repo market*[4], Daniela Gabor also addresses the EU debate on the FTT. The author analyses the strong opposition of financial and banking lobbies to repo-FTT. Transactions in the repo market contributed to the expansion of shadow banking which increases the fragility, opacity and interconnection of the European banking system; taxing repos would have reduced the size of shadow banking, but governments abandoned this project under the pressure of the banking lobby, which put forward the threat of a rise in government borrowing costs.

The paper by Gunther Capelle-Blancard: *Securities Transaction Tax in Europe: First impact assessments*[5] analyses the impact of the securities transaction tax which was introduced in France and Italy. The paper shows that this tax reduces somewhat traded volumes, without increasing market liquidity or volatility.

3. Not released in this issue. The paper can be downloaded from: http://www.euroframe.org/conferences.html?aid=1#june2014

4. Not released in this issue. Available at: http://www.euroframe.org/conferences.html?aid=1#june2014

5. Not released in this issue. Available at: http://www.euroframe.org/conferences.html?aid=1#june2014

The paper by Maria Coelho, *Dodging Robin Hood: Responses to France and Italy's financial transactions taxes*[6] shows that market operators were able to reduce substantially the weight of these taxes, mainly through modifying the frequency and locations of their activities; market volatility was not significantly affected.

Country experiences

The paper by Sarah Godar, Christoph Paetz and Achim Truger, *The Scope for Progressive Tax Reform in the OECD Countries: A macroeconomic perspective with a case study for Germany*, shows that tax progressivity was clearly reduced in many OECD countries before 2007. The paper shows that there is very limited empirical evidence that high taxation rates reduces labour supply from the wealthiest and investment from large companies. But the rise in incomes inequality induced by tax cuts on high incomes and wealth, social benefits cuts, have negative impacts on demand and finally lead to a rise in the government deficit, which entails public spending cuts. The paper suggests coordinating at the international level taxes on high incomes and wealth, on domestic companies, and domestic policies to increase income redistribution, which would enhance growth and make it easier to meet fiscal targets.

The paper by Katharina Jenderny, *Tax progression and the German dual income tax*[7], provides an analysis of the impact of the introduction of a dual tax system in Germany in 2009. Capital incomes are no more taxed according to the progressive tax schedule, but at a flat withholding tax. The reform benefited higher incomes, reduced strongly the progressivity of the German income tax, especially for higher-earnings.

The paper by Henri Sterdyniak, *The Great tax reform: a French myth,* analyses the specificities of the French tax system: relatively low levels of income taxation and employers' social contributions; high taxation of capital incomes and higher incomes. The paper analyses, for each kind of tax, the reforms which could be introduced and discusses their relevance. In particular, the paper shows that replacing employers' social contributions by VAT is useless; it is desirable but difficult to raise environmental taxation. It is often recommended that France could be brought in line with the EU average thanks to fiscal devalua-

6. Not released in this issue. Available at: http://www.euroframe.org/conferences.html?aid=1#june2014
7. Not released in this issue. Available at: http://www.ecineq.org/ecineq_bari13/FILESxBari13/CR2/p216.pdf

tion, obtained through *via* strong cuts in employers' contributions and corporate taxation, financed by a rise in CSG; but this should be implemented only in a European context.

The paper by John FitzGerald, *Tax policy issues in Ireland*[8] shows that prior to the crisis, tax revenues in Ireland were relying heavily on property related activity and corporate taxation. Social contributions are very low. Since the beginning of the crisis, a third of the fiscal effort was done through taxation. A housing property tax was introduced, replacing transactions taxes on property. The author considers that raising the corporate tax rate (currently at 12.5%) would be detrimental to jobs in Ireland. However, corporate tax rate cuts in Ireland's neighbour countries reduces the advantage of Ireland, such that Ireland will have to adapt. The marginal income tax rate, at close to 50% should be cut and its base widened.

European taxation issues

In *What future for VAT in the EU? Key challenges and strategies for reform*[9], Stephen Smith recalls the drawbacks of the current VAT system for intra-EU trade, in particular the risks of fraud and the problems which arise with the development of trade in services and e-commerce. But can the system be improved? No system combines all needed qualities: destination principle, freedom for EU members to set their VAT rates, equal treatment for domestic and intra-EU trade. An alternative system would be to set a uniform rate in the EU for all trade within companies; some fraud possibilities would be reduced, but it sometimes difficult to disentangle intra-company trade and final sales.

The paper by Sebastian Kessing, Vilen Lipatov and Malte Zoubek, *Optimal taxation under regional inequality*,[10] assumes that workers from poor regions (or countries) may increase their productivity in working in richer regions (or countries). From that perspective, redistribution between rich and poor regions (countries) through taxation and social benefits may restrain migration flows and hence be detrimental to total productivity. Accounting for this effect, reduces optimal redistribution at the domestic (or EU) level. The objective of European construction however remains to be set: increasing migration flows

8. Not released in this issue. Available at: http://www.euroframe.org/conferences.html?aid=1#june2014
9. Not released in this issue. Available at: http://www.euroframe.org/conferences.html?aid=1#june2014
10. Not released in this issue. Available as a *CESIFO Working Paper* No. 5152.

from poor to richer countries or ensuring productivity convergence in poor countries.

The paper by Mathias Dolls, Clemens Fuest, Dirk Neumann and Andreas Peichl, *An unemployment insurance scheme for the euro area: Evidence at the micro level*[11] proposes an empirical analysis of the impact of the introduction of an unemployment insurance scheme at the euro area level. Such a scheme will depend on the characteristics of the system. As countries with low unemployment rates would oppose a system entailing permanent transfers, EU benefits would be entitled to recently unemployed people only (i.e. between 3 to 15 months) and the gross replacement ratio would be 35% only. During the crisis, the system would have entailed transfers from Germany, Austria, and the Netherlands to Greece, Ireland, Portugal and Spain. But the stabilisation effect would be limited and would vanish over time. In our view, a system of this type cannot be a substitute for a satisfactory fiscal coordination in Europe, allowing each country to run a fiscal policy relevant in the domestic macroeconomic context.

The paper by Marcio de Andreis and Mauro Marè, *Why and how the EU budget should be reformed?*[12], makes a proposal for a comprehensive reform of the European budget, currently too small, rigid and with an outdated composition. The paper suggests the European budget should be financed by a EU VAT on intermediate consumption. The paper suggests to reorient expenditure from agriculture and social cohesion to public goods such as defence, border control, external affairs and security, R&D. In our view, the paper underestimates the role that the EU budget should play in redistribution between regions (and countries)

Labour income taxation

The paper by Michele Catalano and Emilia Pezzolla, *The interaction between labor tax wedge and structural reforms in Italy*, uses a DSGE model to analyse the impact of structural reforms (lower margin ratios for companies and lower wages) and various tax reforms (cuts in employers' contributions, income tax, IRAP, property taxation), or fiscal (cuts in public expenditure, public investment, social benefits). Prices are assumed to balance supply and demand for goods. Public expenditure has no specific usefulness. The most favourable to jobs

11. Not released in this issue. Available at: http://www.euroframe.org/conferences.html?aid=1#june2014
12. Not released in this issue. Available at: http://www.euroframe.org/conferences.html?aid=1#june2014

measure in the medium/long-term would be cuts in IRAP financed by cuts in social benefits, but neither the impact on households' welfare nor on partners' countries is analysed. Introducing structural reforms would allow for higher public investment, which would increase the initial positive impact of the reform.

The paper by Flavia Coda Moscarola, Ugo Colombino, Francesco Figari and Marilena Locatelli, *Shifting taxes from labour to property. A simulation under market equilibrium*,[13] suggests to increase the property tax in order to increase the tax credit on low incomes and make it refundable. This reform would reduce income inequalities and increase labour supply from the low-skilled, especially women.

The paper by Etienne Lehmann, Claudio Lucifora, Simone Moriconi and Bruno Van der Linden, *Beyond the labour income tax wedge: The unemployment-reducing effect of tax progressivity*[14] shows in theory and empirically that labour taxation progressivity has in the end a positive impact on employment and decreases unemployment. Of course, the willingness to work, and productivity may be affected, but tax progressivity plays a wage moderation role and increases total labour demand, which is more sensitive to wage costs for low-skilled people.

Corporate taxation

The paper by Manuel Bonucchi, Monica Ferrari, Stefania Tomasini and Tsvetomira Tsenova, *Tax policy, investment decisions and economic growth,* gives a detailed analysis of labour costs and capital costs in Italy, accounting for changes in taxation. The paper provides an econometric analysis of the impact of demand and of the relative capital/labour cost on investment. The paper advocates active demand and public investment policies. Temporary measures of cuts in capital costs have had a strong impact and may be used for their counter-cyclical role. Last, cutting IRAP would have a more positive impact on jobs than corporate tax cuts.

The paper by Hendrik Vrijburg, *Do small and medium-sized enterprises respond to the corporate tax system?*[15], provides an econometric analysis on individual data of the impact of corporate taxation on Dutch companies. The paper makes a distinction between young and mature companies, between financially and non-financially

13. Not released in this issue. Available as *IZA Discussion Paper* No. 8832.
14. Not released in this issue. Available as *CESIFO Working Paper* No. 4348.
15. Not released in this issue. Available at: http://www.euroframe.org/conferences.html?aid=1#june2014

constrained companies. Corporate taxation would have a limited impact on investment, but a large impact on financing.

The paper by Arjan Lejour, *The foreign investment effects of tax treaties*[16], shows that international, bilateral or multilateral treaties on dividend transfers or parent-subsidiaries relationships increase strongly foreign direct investment flows and stocks.

Tax reforms

The paper by Gaëlle Garnier, Aleksandra Gburzynska, Endre György, Milena Mathé, Doris Prammer, Savino Ruà and Agnieszka Skonieczna (European Commission), *Recent reforms of tax systems in the EU: good and bad news*,[17] recall the tax reforms recommended by the Commission: reducing labour taxation, not increasing tax rates but widening tax bases, abolishing tax expenditures which are not very useful ; improving tax revenues collection (combating fraud and tax evasion), reducing the corporate tax bias towards indebtedness, increasing housing property taxation. In all these areas, progresses have been made, but they remain limited. We may regret that the European Commission does not mention the fight against income and wealth inequalities, the fight against financial instability and green taxation as a main objective.

The paper by Florian Wöhlbier, Caterina Astarita, and Gilles Mourre (European Commission), *Consolidation on the revenue side and growth-friendly tax structures: an indicator based approach*,[18] sets two objectives to tax reforms in Europe: lowering labour taxation (especially for low-skilled workers and for married women); contributing to public finance sustainability. The paper assesses which countries tax labour more heavily, which countries need to raise their tax revenues in the medium term, which countries have room for manoeuvre in terms of taxation not harmful to growth and jobs: property taxation, consumption taxes and environmental taxes. However, the paper does not account for macroeconomic considerations (the depressive impact of higher taxes); fairness (no tax on high wealth is considered); the effect of shifting taxation from labour to consumption is probably overestimated.

16. Not released in this issue. Available as a *CPB Discussion Paper*, No. 265.
17. Not released in this issue. Available as: European Commission taxation papers, *Working paper* No. 34, 2013.
18. Not released in this issue. Available as: European Economy *Economic Paper 513*, February 2014.

The paper by Margit Schratzentaller, *Sustainable tax policy, concepts and indicators beyond tax ratios*, gives a critical view on the current trend of international organisations, and of the Commision in particular, to assess tax reforms from the only perspective of economic growth. Equity and social cohesion considerations, as well as environmental sustainability are as much important and should be taken into consideration at the same level. The paper is in favour of broad indicators, accounting for these three aspects in an in-depth way. Thus, one should be cautious with too simple indicators, and build relevant indicators. For instance, one should account for gender inequalities, for the role of public expenditure in reducing inequalities, for the risk that environmental taxation weighs more heavily on the poorer than on the rest of the population.

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