



Tax reforms – challenges of transition, integration and beyond

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Considerations of tax reforms in transition countries



Main results of reforms: general trends and revenues structures



Tax integration process and current situation



Prospects



Tax reform considerations

General considerations of tax reforms

Any tax brings deadweight loss. Tax system should be neutral for decisions of economic agents. Three groups of costs: tax burden; costs of tax administration, and compliance costs of taxpayer -> **Efficiency principle**

Tax revenues should reflect costs of public goods, like education, health care, juridical system etc. -> **Incidence principle** (could be contradicted to efficiency principle)



Tax reform considerations

General considerations of tax reforms

Fair distribution of tax burden -> **equity principle**. This is hard to achieve. Each taxpayer should pay taxes equal to public goods he consumes (like roads, justice, education). Or second best, to limit tax avoidance and tax evasion (simple rules, low rates, fair administration etc.)

Tax system should be instrumental for stabilization of economic growth, and to be resistant for business-cycle, i.e. should be impermeable for fiscal crisis. Thus tax revenues should be based rather on consumption taxes than on profit taxes (which are subject to business-cycle) -> **stabilization principle**



Tax reform considerations

Specific considerations of tax reforms in transition countries

Unique opportunity due to **lack of adjustment processes** in economy. Reallocation of assets linked to transformation reduced costs of a tax reform. Transition to market regime meant reallocations of assets. A new tax system was only an element of a new institutional framework, which influences allocation decisions of any investor.

New role of taxpayers. Taxes played only limited role in planned economy. Number of taxpayers was low, and a range of discretion of tax officers high. Taxpayers, which were mostly state-owned enterprises, did not have the strong incentives to reduce (read: look for loopholes) their tax liabilities. This situation was changed dramatically in transition. There are many private firms, they operate in market environment, and therefore they have strong motivation to reduce their tax liabilities.



Tax reform considerations

Specific considerations of tax reforms in transition countries

Newly created tax administration. The tax administration was to much extend created during transition, and it had a very limited experience. Such situation has its own advantage. It is easy to promote and to train tax inspectors, because they don't have "old", useless habits and knowledge of previous tax system. Moreover a resistance for any change among high rank tax officers is limited. Nevertheless there is a high need for training and learning-by-doing process. In the first stage of tax reform, temporary revenue losses due to inexperience of operating and enforcing may be expected.

Tax evasion. Societies in transition countries used to operate in a very specific environment, in which not paying taxes was socially, accepted behavior. This is one of the reasons, why tax evasion is probably high.

Lack of clear vision of institutional strategy - newly designed tax system should be compatible with new institutional order.



Tax reform results

Tax reforms: process

First observation: process has not been uniform across countries. Hungary started in late 1980's, and Serbia introduced VAT as on Jan. 1, 2005.

Second: major changes took place and all transition 27 countries introduced CIT, PIT and VAT

Third: initial tax system were in most cases changed many times f.in. Slovakia reduced PIT rates from 6 to 1, but Slovenia still keeps 6 PIT rates

Fourth: tax system fulfilled many functions: to promote education, R&D, housing etc. In EU-8 these functions have been reduced.

Fifth: High discretion on tax issues has been preserved in CIS countries.



Tax reform results

Tax reforms: trends

Reduction of number of PIT rates

Limiting the tax exemptions and deductions available to taxpayers, thus broadening the tax base.

Reduction of number of CIT rates to one and reduction of the top rate

Limiting the tax expenditure for investors and discretion of tax officers

But clear division of EU-accession countries and CIS countries -> EU factor is probably the most important for tax reforms



Tax reform results

Tax reforms: revenues structure

Move from revenues from direct taxes towards revenues from indirect taxes (goal-> stability of tax revenues)

Significant decline of revenues from CIT (except Slovenia), mix trends in revenues from PIT

Increase of revenues from VAT and social contributions



Tax reform results

Tax reforms: revenues structure

Tax revenues in the transition countries during transformation (as % of GDP)

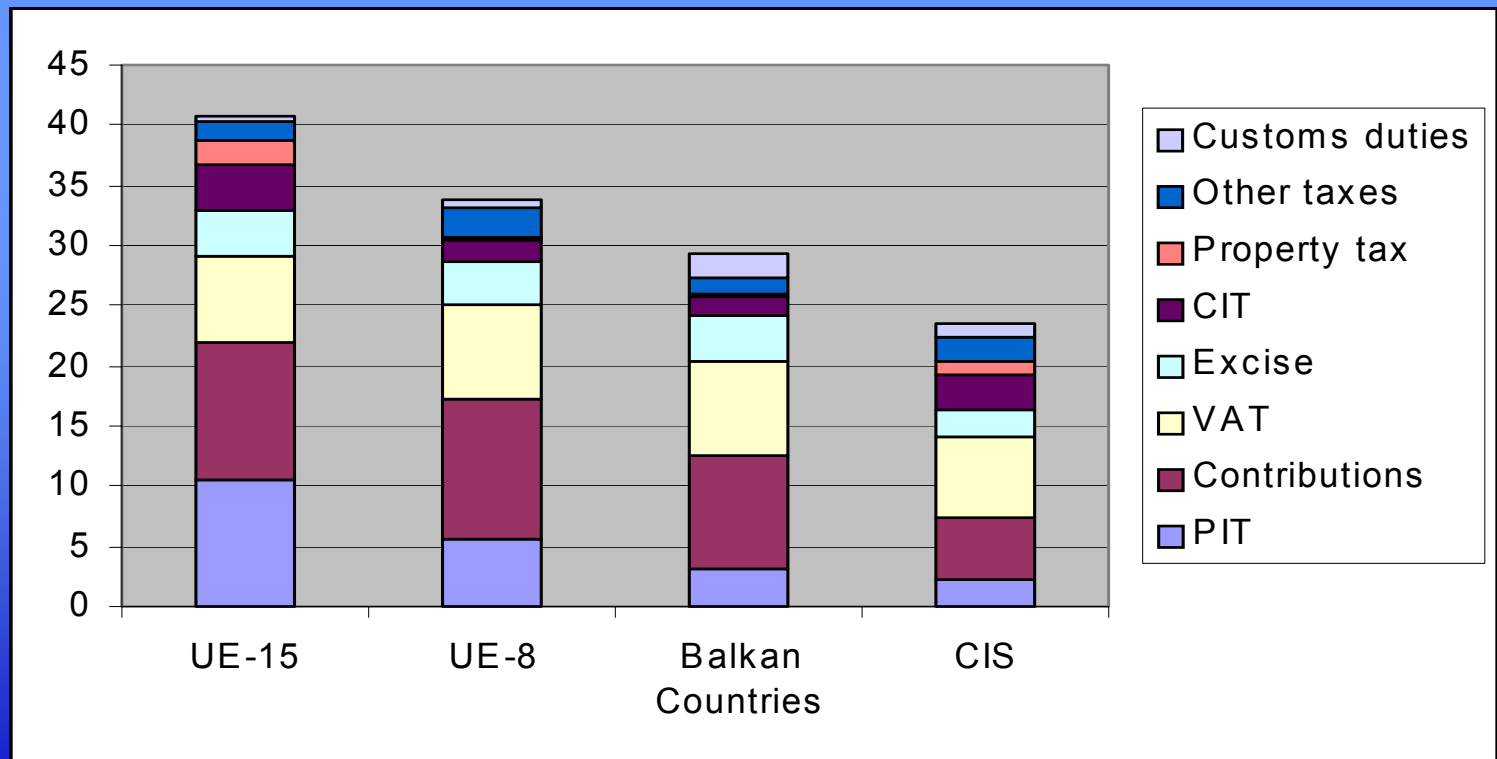
Country	PIT		CIT		VAT and excise		Contributions	
	91 – 95	99 – 02	91 – 95	99 – 02	91 – 95	99 – 02	91 – 95	99 – 02
EU-8 countries	5.9	5.7	5.0	1.8	10.8	11.4	11.1	11.5
Balkan countries	4.4	3.1	3.2	1.7	10.1	11.6	11.4	9.4
CIS countries	1.8	2.2	5.8	2.8	7.1	9.0	6.3	5.2



Tax reform results

Tax reforms: revenues structure in comparison

Revenues from main taxes in EU-15, EU-8, Balkans and CIS (as % of GDP, as in 2000)





Tax integration in the EU

Trends of CIT top rates in 2000-2003

Countries	countries which reduced the CIT rate	countries with a CIT rate lower than 25% (as of the end of 2003)
EU-8	7 out of 8	7 out of 8
Balkan countries	3 out of 7	7 out of 9
CIS countries	2 out of 12	6 out of 12
EU-15	10 out of 15	1 out of 15



Tax integration in the EU

Tax integration process

In form of the EU legal acts (harmonization):

- regulations and directives on customs, VAT, excises, IAS, savings,
- convention on transfer pricing disputes

In form of the EU soft regulations and mimic solutions in other countries (competition)

- classical method of taxation of dividends
- EU Council Code of Conduct (1997)
- Reduction of CIT top rates

In form of the European Court of Justice decisions, based mostly on Treaty's rules of freedom of movements and establishments, and non-discrimination



Tax integration in the EU



Crucial point is if and when competition may bring positive externalities and they overcome the negative ones.

Greater tax mobility leads to tax competition, and thus to lower tax burden on consumers and companies – it is hard to argue that taxes are not high in the EU, and limit economic growth

This may lead to provide public goods in more effective manner – government has less resources to spend and/or to reduce public intervention

Negative effects may be caused f.i. by tax benefits granted to non-residents



Tax integration in the EU

Tax integration prospects



Rule of unanimity for tax issues is preserved in the EU Convention – one may not expect major tax harmonization through legal regulations. Differences in providing public goods and public spending is even wider after enlargement than before. Policy objectives, administrative capabilities and economic conditions are different.



Integration through competition may lead to soft regulations, f.i. through open method of coordination and also depends on progress in other fields like financial markets and services integration.



Gradualist approach to further tax integration will be observed and competition among institutional settings will be preserved. Also due to globalization.