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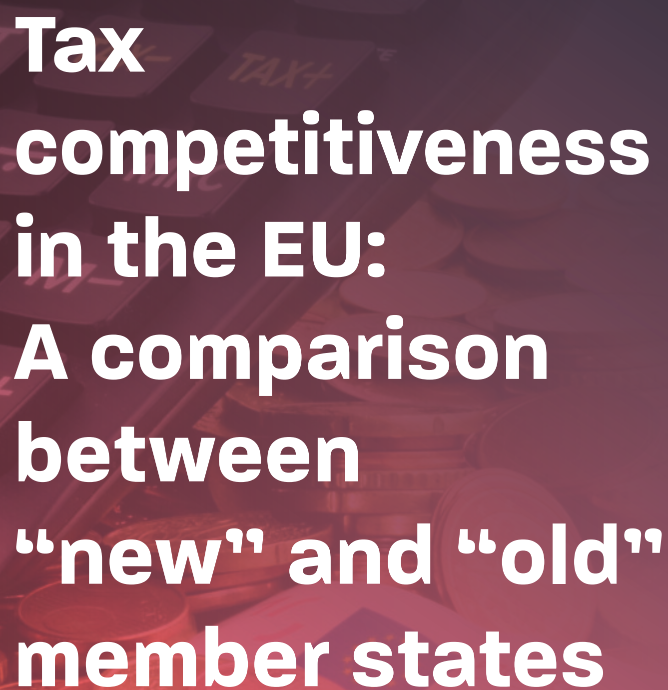

Tax competitiveness in the EU: A comparison between "new" and "old" member states

Abstract

The current state of globalization still implies a considerable degree of differentiation at both the country and regional levels. Even though financial globalization has resulted in the unification of monetary policy in the EU, the tax systems of countries are still among the few remaining pillars of national policies. Consequently, a major part of the particularities of national or spatial economies still stems from differences in tax systems. The policy brief summarizes the key findings and policy recommendations for the selected EU member states and candidates as regards tax competitiveness in the EU to support appropriate policy responses, which were highlighted in the ELF publication and webinar titled "Tax competitiveness in the EU: A comparison between "new" and "old" member states".

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Chapter 1

Fiscal policies and economic growth in the European Union

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The main aim of this chapter is to shed light on the potential link between fiscal (public expenditure) or taxation (direct and indirect taxes) policies and economic growth or competitiveness, for the 27 member countries of the European Union. We shed light on stylized facts regarding the link between the weight of public expenditure in GDP and economic growth in EU countries, between 2000 and 2021, using macroeconomic data from the AMECO database. And we also study the potential link between the structure of fiscal resources, between the respective shares of direct and indirect taxes, and indicators of economic growth or net exports in the EU.

Key Findings

- A weaker share of public expenditure in GDP (Ireland, Estonia), as well as a decrease of this share, are correlated with a higher economic growth.
- A higher relative share of indirect taxes is mainly correlated with a higher economic growth. Indeed, indirect taxation has a higher weight in Ireland or in 'New' European countries like mainly in Croatia, but also in Slovenia or in Estonia, where economic growth is on average higher.
- The relative share of direct taxes is positively correlated with the share of net exports in GDP. Indeed, a higher relative share of direct taxes (Germany) seems correlated with a higher current account surplus. On the contrary, a higher relative share of indirect taxes (Croatia or Estonia, but also France) is correlated with a higher current account deficit.
- Increasing the relative share of direct taxes can improve the current account balance, but the danger is to make a country more dependent on external demand.

Policy Recommendations

The first policy recommendation is to limit the share of public expenditure in GDP.

The second policy recommendation is to shift the tax burden from direct to indirect taxation, in order to increase economic growth.

Shifting the tax burden from direct to indirect taxation could favor an economic growth which is less dependent on external demand.

Chapter 2

The strategic role of tax in the new European order: Between encouraging competitiveness and discouraging harmful tax competition

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In the new globalized scenario, tax has become even an instrument to encourage the competitiveness of a country and, at the same time, to discourage the harmful tax competition within a new European tax order in which States set "limits on themselves" in the exercise of their tax sovereignties and recognize the importance of a policy based on mutual tax coordination. The aim of this paper is to draw the attention to the significance of the ongoing transformation of the national tax systems as a consequence produced by the changes generated by other tax systems due to tax competition processes, according to a logic of international normative osmosis. In this respect, it describes the evolution of personal income tax rates in the EU, by showing how the tax competition is taking the form of special tax regimes targeted to foreigners, often with high income or wealth. Thus, the study provides a snapshot of some preferential tax regimes introduced by Member States, including Italy, in these last recent years. In addition, this paper reviews the general trends in corporate taxation, extending also the fiscal competition analysis to other factors of attractiveness of investment over and behind the race to the bottom.

Key Findings

- According to the 2022 International Competitiveness Index, in recent years Italy has had unsatisfactory performances.
- Technological innovation plays a key role for competitiveness. Italy ranks fourth to last among advanced European countries and is followed only by Spain, Portugal and Greece which, however, are marked by high growth rates in the last recent years
- The current corporate income tax system in Italy is complex and it implies a large tax burden on companies.

Policy Recommendations

Consider and improve policies that affect the most relevant factors of competitiveness and growth, by ensuring the transparency of national institutions and domestic laws; decreasing and eliminating red tape; supporting the infrastructure's development.

The Italian NRRP supports measures for innovation and technology transfer processes, encouraging the systemic use of research results and strengthening the enabling conditions for the development of research and innovation activities.

Moving towards a tax system which is more in line with tax systems elsewhere in the EU, will increase the international competitiveness of Italian companies and might attract foreign investment.

Chapter 3

Green tax reform – Experiences in old EU member countries and guidance for the new ones

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The main goal of the green tax reform (GTR) is to start taxing bad things (pollution, use of natural resources) instead of good things (income, capital). The goal of all states that implemented a comprehensive GTR was to simultaneously reduce social contributions (fiscal neutrality) while increasing green taxes, thus increasing the competitiveness of their own economy. The aim is to improve the situation, both in an environmental and economic sense (double dividend). Papert presents fiscal importance of green taxes in new and old EU member states, an analysis of the results of the green tax reform in the old EU member states and a description of some dilemmas related to its introduction. In the final subchapter, based on the experience in the old EU member states, the proposals for the implementation in the new member states are presented.

Key Findings

- Countries with comprehensive GTR reduced the size of income tax/contributions accordingly for the size of the newly introduced green taxes.
- The reform was introduced firstly by those countries with relatively high taxation of labor due to the benefits of "double dividend". Countries have achieved their restructuring goals and decoupling.
- The decrease in the share of collected revenues from green taxes in the old EU member states indicates that the political project of the GTR from the 90s has been complete.
- The share of green taxes in GDP is decreasing in the old member states and increasing in the new ones. Relatively high tax rates in the new member states limit the room for maneuver.
- Due to the regressiveness, a significant increase in green taxes is not to be expected.
- Cost increases due to higher green taxes can lead to a drop in competitiveness, reallocation of production factors and loss of market shares. All countries that implemented a GTR neutralized the negative effects.

Policy Recommendations

Effectively addressing regressivity is crucial in gaining wider public support for the implementation

At the industry level, green taxes may increase costs, but if labor costs are relieved, labor-intensive industries in particular may benefit (recycling).

The effectiveness of green taxes can be increased if introduced with other instruments (eco-subsidies, labels, certificates).

Predictability, consistency and gradualness in the introduction of green taxes increase the likelihood of their adoption.

Public support will be greater if an effective system of measures to neutralize harmful effects is created.

People do not believe promises that funds collected from a certain tax title will be spent on environmental programs, so commitment must be explicit and transparent.

It is necessary to take care of the coordination and implementation of the set tasks.

It is important to correctly assess the impact of the tax on the competitiveness of an individual sector.

Chapter 4

Tax reform in Poland in uncertain times: Challenges and opportunities

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The COVID-19 pandemic and the full-scale Russian invasion of Ukraine have created a challenging environment for policymakers around the world, including the European Union. Faced with unprecedented uncertainty, governments have been forced to adjust fiscal policy, largely by increasing budget expenditure to mitigate macroeconomic shocks. The aim of this chapter is to analyse and evaluate a major tax reform in Poland implemented in 2022, and to provide guidance to Polish policymakers on its effective implementation, identifying challenges and opportunities for tax policy.

Key Findings

- In terms of tax competitiveness, Poland is lagging behind other OECD countries. The Competitiveness Index for Poland has gradually deteriorated in recent years.
- The main weaknesses of the Polish tax law concern consumption taxes, property taxes and cross-border tax rules. Although Poland is quite competitive in terms of the rate and progressivity of wage taxation, the Polish individual tax system is perceived as relatively complex. The same applies to corporate taxation.
- The tax reform started in Poland in 2022 (called the Polish Deal) is one of the largest reforms of this kind implemented in the last three decades. Under the new law, the tax system is more progressive, eliminating areas of tax evasion and lowering the burden on lower-income taxpayers.
- Despite the sizeable scope of this reform, it was planned within a relatively short period, which led to confusion in its implementation.
- The planned lowering of the tax burden on low earners (which is desirable) came at the expense of increasing its complexity.
- The Polish Deal reform combined with the anti-inflation shields poses a serious challenge for public finance sustainability.

Policy Recommendations

The Polish policymakers should simplify the tax system to increase its international competitiveness. Non-transparent tax systems might distort the decision-making by economic agents and can contravene the sustainability of public finances. Policymakers should not put short-term financing needs or political objectives before long-term economic competitiveness.

The implementation of the new tax legislation should be carefully monitored and analysed. The impact of the Polish Deal ought to be analysed from a wider perspective. The fiscal policy effects should also be evaluated from the perspective of monetary policy and policy mix.

With inflation soaring in the post-pandemic period, the National Bank of Poland is rapidly raising interest rates. Any decrease in public revenue as a result of the Polish Deal might require a larger hike in interest rates and thus a greater interest burden on indebted economic agents.

Future reforms of tax legislation should be carefully planned and consulted with taxpayers. There is no point to add uncertainty in uncertain times by changing tax rules at very short notice as was the case with the Polish Deal.

Chapter 5

Tax competitiveness in the EU: Evidence from Slovenia

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The globalization trends, which have been additionally accelerated by digital transformation, reveal the obvious shortcomings of the existing tax systems, significantly affecting the overall tax competitiveness, especially in the new member states, including Slovenia. Therefore, it is crucial to modernize tax systems and policies by eliminating ineffective taxation practices, which may accelerate economic development and growth. Accordingly, the main aim of this chapter is to present tax competitiveness as well as the challenges and opportunities for tax policy in Slovenia compared with the EU/OECD situation.

Key Findings

- In terms of tax competitiveness, Slovenia is lagging behind Scandinavian, Baltic, Western and even some Central and Eastern European countries.
- Tax policy in Slovenia is favourable to businesses due to the relatively low statutory corporate tax rates, especially in terms of promoting investments.
- Slovenia has a large tax burden on labour, notably when it comes to highly educated workers.
- Due to increased globalization and digitalization, the current tax system in Slovenia no longer fits the modern economic context.
- The current tax system in Slovenia is outdated and complex, which makes it difficult for taxpayers to meet tax obligations.

Policy Recommendations

Redesign a tax system that will be adequate for increasing productivity and economic welfare while also raising living standards at a sustainable level and pace.

Maintain stimulating economic development through tax policy that promotes investments.

Rebalance the tax mix away from labour taxes, in particular employees' social security contributions, to consumption taxes that are less detrimental to economic growth.

Modernize the tax system in a way that meets the needs of a globalized and digital economy.

Improve the effectiveness and efficiency of the tax administration in order to prevent tax evasion, constrain illegal activities, provide fair taxation and, in turn, create higher economic growth.

Chapter 6

Tax competitiveness in the EU: Evidence from Croatia

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The Croatian tax system is a plural and young tax system, which has existed only since the independence of the country. From 2000 to 2018 the Croatian tax system has undergone numerous tax reforms in order to achieve greater tax competitiveness. This was followed by amendments to laws and sub-legislative acts, which ultimately resulted in specific tax impacts. Hence, the aim of the study is to present and describe the current state of tax policy, tax competitiveness, and challenges and opportunities for tax policy in Croatia. The aim of these tax reforms was to improve the current tax system and make it more transparent and efficient for taxpayers in Croatia. In addition, it is expected that with higher tax competitiveness, Croatia will become more attractive for foreign investors.

Key Findings

- The current tax system of the Republic of Croatia is subject to too frequent changes and reforms, which makes it extremely incomprehensible.
- The most significant year was 2017, when eight tax laws were amended due to the high tax burden.
- The tax system of the Republic of Croatia is characterized by a high tax burden and tax instability.
- Frequent changes in tax regulations and legal provisions lead to a low level of knowledge and understanding of the tax system on the part of taxpayers and also on the part of tax administration employees.
- The tax administration in Croatia is characterized as very administration-heavy
- The main categories of fiscal competitiveness, such as government subsidies, general government debt, and budget surplus/deficit, decline significantly in 2021.

Policy Recommendations

To increase tax competitiveness, new and improved tax incentives within corporate income tax is inevitable.

To reduce the tax burden on entrepreneurs in order to strengthen the economy and competitiveness.

To introduce a more socially just and functional tax collection system.

To digitalize public administration system, i.e. tax administration (more improved).

To support entrepreneurial activities based on the SDGs (poverty reduction, green economy, access to education).

To make tax system to be efficient, transparent and simple from the perspective of tax administration and taxpayers.

Chapter 7

Back to the drawing board: Guidelines for rethinking Bulgaria's tax competitiveness

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This brief details the reasons why Bulgaria's 'traditional' approach to tax competition failed to attract FDI, support growth and mobilise revenues. Addressing both the theoretical notion of 'tax competition' and its empirical development in the EU, the text highlights Bulgaria's unique position as the least attractive, yet the less taxing EU Member States. Unlike those who blame this unsuccessful catch-up on unfavourable preconditions, this brief emphasises the wrong assumptions that justified the current low-rate, fragmentary CIT regime. Concretely, the brief offers concrete guidelines that, instead of targeting low statutory and effective rates, aim at granting corporate taxpayers bang for their buck.

Key Findings

- Corporate-income taxation in Bulgaria is a rather complex matter. And many companies pay less than the statutory CIT rate due to loopholes and excessive complexity.
- Lower CIT rates is having 'a negative impact' on growth in Bulgaria,
- Not only FDI inflows decreased despite lower corporate-tax burdens, but their quality worsened due to those new rules.
- The 10%-low CIT rate caused a collapse in CIT revenues, as opposed to the increase due to a broadening the base that many economists expected.
- Most new Member States' approach to tax competition is radically different to one adopted by the old ones. And Bulgaria is an extreme case of 'traditional' tax competition gone wrong.

Policy Recommendations

Rationalising the CIT regime means abolishing all the sector-specific rules and closing as many loopholes as possible to widen the tax base. In so doing, one may expect significant revenue increases from both the betting and navigation sectors.

After having levelled the playing field, the government should introduce a two-bracket progressive CIT to fairly mobilise more revenues from this broader base. Crucially, the fear that may higher CIT burdens is disincentivising investments misplaced 'as long as the corporate tax does not completely deplete [the company's] economic profit [...]'

Finally, the government should set up and be accountable for a clear, growth-promoting investment plan to allocate the new CIT regime's increased revenues as investments in public education, transport and ITC infrastructures, R&D, and high-tech exports.

Chapter 8

Tax competitiveness as a mechanism to promote or distort small economies: The case of North Macedonia

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The globalization of the economy and trading (especially e-trade) has imposed international principles and standards for a business-friendly environment which push the developing and transition countries to undertake tax harmonization with the OECD and EU countries. In the last two decades, North Macedonia has implemented crucial structural tax reforms in response to international challenges and global practices on rational tax systems and fair tax competition. By adopting different fiscal measures (tax incentives, VAT exemptions and customs reliefs) and promoting competitiveness in the region, the country is listed among the countries with the lowest tax rates in Europe. Therefore, the small economies are challenged to decide whether to have regional competitive tax system or to restructure the tax system in order to accumulate more tax revenues for the central budget.

Key Findings

- The development of the Macedonian economy is based on the economic reform programmes within the framework of the EU pre-accession process. In addition, the country follows the international standards, programmes of World Bank and IMF, the OECD, and the EU recommendations for harmonisation.
- Flat taxation and a wide range of tax incentives are key features of the tax competition in North Macedonia. In addition, tax competition as a cornerstone for foreign direct investments is seen mostly through the FTiDZs. The FTIDZs (Free Techological Development Zones) are the main driver for promoting and attracting foreign investments in the country. On one hand, they have a significant impact on creating job vacancies and foreign exchange, but on the other hand, they burden the central budget.
- Political and legal uncertainty is followed by the health and energy crises.

Policy Recommendations

Although the Republic of North Macedonia has as its main focus the fulfillment of EU requirements, the government should follow recommendations and implement measures that are adequate for the socio-economic condition of the country.

This kind of strategy should be extended to other mechanisms and instruments that will accelerate the tax competition among domestic and cross-border companies. There is a need to improve efficiency in the allocation of real capital.

The governments should adopt fiscal strategies and policies that can be seen as a continuation of their efforts to improve and encourage the business environment. This will involve dialogue and debate with all stakeholders in the fiscal system (especially, the business sector, traders, and/or investors, as well as the academic society) to enhance fiscal transparency and efficiency while ensuring sustainability based on best practices in small economies. Additionally, it is recommended to refrain from postponing legal provisions in adopted tax laws.

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