LEVELS OF TAXATION AND FISCAL POLICIES IN THE EUROPEAN UNION

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Abstract

The European Union countries are bond in this changing economy, sharing same regulations and policies at different levels but still trying to learn to integrate them. Although it is hard to have comparable information of taxation levels in very short time for the 28 Member States we must learn to analyze and take lessons from trends of the last years. For example, tax revenues rose in 19 Member States in 2016 as a percentage of GDP in 2016 but the level of taxation in EU Member States differs greatly.

At the European level, the share of labour taxes in total tax revenues shrank progressively from 2010 to 2016 when it accounted for 49.8% - similar to its pre-crisis level. This show a consistent preoccupation in all member States to reduce the burden of working people. In the same time, corporate income tax revenues rose to 2.7% of GDP in 2016 compared with 2.6% in 2015, continuing their gentle increase since the crisis though not yet at pre-crisis levels.

Taxation is a top priority for Member States who want to develop robust and effective tax policies for the future, in the benefit of all countries part of the EU.

Keywords: taxation levels, European Union, fiscal burden, fiscal policies, economy

JEL Classification: H2, H3

1. European Fiscal Board (EFB) – helping the European countries

EFB is an independent advisory body of the European Commission. The Board was set up following the Five Presidents' Report Completing Europe's Economic and Monetary Union", with the aim to strengthen the current economic governance framework.

The main responsibilities of EFB are:

- evaluate of the implementation of the Union fiscal framework and the appropriateness of the actual fiscal stance at euro area and national level
- make suggestions for the future evolution of the Union fiscal framework
- assess the prospective fiscal stance appropriate for the euro area as a whole based on an economic judgment, as well as the appropriate national fiscal stances, within the rules of the Stability and Growth Pact
- cooperate with the National Independent Fiscal Councils
- provide ad-hoc advice to the Commission President

On 10 October 2018, the European Fiscal Board (EFB) published its second annual report. The report reviews the way the EU fiscal framework was implemented in 2017, highlighting positive and negative developments and scope for improvement. It welcomes the return to some timid fiscal consolidation in 2017 in the euro area as a whole, based on current estimates. At the same time, the Board regrets that some Member States with large fiscal imbalances missed the opportunity of the solid economic expansion to reduce their high public debt faster and build fiscal buffers. Flexibility should work symmetrically: after the fiscal framework was softened during the recovery, requirements should have been tightened and compliance more strictly ensured in better economic times. Looking ahead, the report proposes a simpler and more effective Stability and Growth Pact (SGP) than the current one.

The EFB's second annual report provides a comprehensive and independent assessment of how the SGP was applied in the last complete surveillance cycle, 2017. Economic activity was significantly more dynamic than expected and this helped governments reduce budget deficits and public debt as ratios to GDP. Countries representing around 40 % of the European

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economy achieved a sound fiscal position as defined by their medium-term budgetary objective; this is a positive sign. However, only part of the higher government revenue went into building fiscal buffers. It is problematic that some countries – critically, mostly those with high levels of public debt – spent higher revenue on expenditure slippages. As a result, their fiscal position deteriorated or did not improve by as much as required. In contrast, some countries with fiscal space consolidated further.

The Commission and the Council applied the EU fiscal rules firmly in some non-euro area countries but also showed forbearance in a number of other cases, both in setting fiscal requirements and when assessing compliance with requirements. The Commission also contributed to confusing intentions by calling for a sizeable fiscal expansion in 2017 that would have implied at least some deviation from the SGP requirements. Overall, in the 2017 fiscal surveillance cycle, the Commission acted as if the euro area were still in a fragile and uncertain recovery. The overall thrust in the implementation and interpretation of rules did not adapt to the much more favorable macroeconomic conditions.

To overcome the weaknesses and complexity of the current EU fiscal framework, the Board proposes a radical simplification of the rules and a clarification of governance. The reformed Pact would be based on one single target (sustainable public debt), one single instrument (controlling net expenditure growth) and one general escape clause.

2. Fiscal policies at the European level

Fiscal policies have a significant impact on economic growth, macroeconomic stability and inflation. Key aspects in this respect are the level and composition of government expenditure and revenue, budget deficits and government debt. Fiscal discipline is a pivotal element of macroeconomic stability. The need for fiscal discipline is even stronger in a monetary union, such as the euro area, which is made of sovereign states that retain responsibility for their fiscal policies. There are no longer national monetary and exchange rate policies to respond to country-specific shocks, and fiscal policies can better cushion such shocks if they start from a sound position.

Institutional arrangements

A number of institutional arrangements for sound fiscal policies have been agreed at the EU level, also with a view to limiting risks to price stability.

These include:

- the prohibition of monetary financing (Article 123 of the Treaty on the Functioning of the European Union),
- the prohibition of privileged access to financial institutions (Article 124 of the Treaty on the Functioning of the European Union),
- the no-bail-out clause (Article 125 of the Treaty on the Functioning of the European Union),
- the fiscal provisions to avoid excessive government deficits (Article 126 of the Treaty on the Functioning of the European Union, including the excessive deficit procedure), and
- the Stability and Growth Pact (secondary legislation based on Articles 121 and 126 of the Treaty on the Functioning of the European Union).

Additionally, the fiscal compact (as part of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union) foresees the implementation of a balanced budget rule at the national level and a further strengthening of the excessive deficit procedure within the Stability and Growth Pact.

Excessive deficit procedure

The basic rule of budgetary policy enshrined in the Treaty is that Member States shall avoid excessive government deficits. Compliance with this rule is to be examined on the basis of reference values for the general government deficit (3%) and gross debt (60%) in relation to GDP, whereby a number of qualifications can be applied.

In particular, only an exceptional and temporary excess of the deficit over the reference value can be exempt from being considered excessive, and then only if it remains close to the reference value.

The decision as to whether a Member State is in a situation of excessive deficit lies with the ECOFIN Council, acting upon a proposal from the European Commission.

If the Council decides that a Member State is in a situation of excessive deficit, the excessive deficit procedure provides for the necessary steps to be taken. These could lead to imposing sanctions on the country concerned.

Stability and Growth Pact

The Stability and Growth Pact provides an operational clarification of the Treaty's budgetary rules. It defines the procedures for multilateral budgetary surveillance (preventive arm) as well as the conditions under which to apply the excessive deficit procedure (corrective arm). The Pact is an essential part of the macroeconomic framework of the Economic and Monetary Union. By requesting Member States to coordinate their budgetary policies and to avoid excessive deficits, it contributes to achieving macroeconomic stability in the EU and plays a key role in securing low inflation and low interest rates, which are essential contributions for delivering sustainable economic growth and job creation.

The main rationale of the Stability and Growth Pact is to ensure sound budgetary policies on a permanent basis. The Pact lays down the obligation for Member States to adhere to the medium term objectives for their budgetary positions of 'close to balance or in surplus', as defined under country-specific considerations. Adjusting to such positions will allow Member States to deal with normal cyclical fluctuations without breaching the 3% of GDP reference value for the government deficit.

3. Taxation – promoting cooperation and growth at European level

Taxation is central to national sovereignty. Tax revenues provide governments with the money they need to exist and function effectively. In addition, tax laws reflect the fundamental choices of different EU countries in important areas of public expenditure, such as education, health and pensions. They influence private consumption and savings and set a financial framework for business activity and environmental issues. This is why the power to raise taxes and set tax rates lies with national governments.

What countries should do? First of all, taxation needs to be fair. This is not always easy to ensure, even at national level. It becomes a real challenge, however, when it comes to cross-border activities. Tax laws should not give businesses in one country an unfair advantage over competitors in another one. And the tax laws of one country should not allow people to escape taxation in another. That's why the countries of the European Union have agreed on several rules to tackle these issues. More and more companies and individuals are active in several countries, making it potentially easier to use legal means to pay the least tax possible ('tax avoidance') or to not pay taxes due ('tax evasion'). A single country cannot solve these problems on its own. This is why in recent years the countries of the EU have cooperated more closely to tackle the problems of tax avoidance and tax evasion and to ensure the fairness of taxation systems. Making the internal market function better The European internal market, also referred to as the single market, allows people and businesses to move and trade freely across the 28-nation group. However, the co-existence of different tax systems still makes life difficult for companies and individuals operating across borders. In some cases the tax laws may discriminate against foreign taxpayers or foreign income. But if they do there are EU laws in place to deal with the problem. In other cases, the individuals and companies may face taxation and compliance burdens in each of the countries involved leading to a very high overall level of taxation. This problem cannot be tackled under current EU law. That's why EU countries need to cooperate closely. Agreement on simplifying certain tax rules, and eliminating inefficiencies, could contribute to ensuring the free flow of goods, services and capital around the EU.

Promoting growth Policy decisions made by one country may affect other countries either in a positive or in a negative way. That's why the countries of the EU have agreed to cooperate in the preparation of their national budgetary and economic plans. The overall objective is to put public finances on a surer footing, promote stronger economic governance and discipline, and make fundamental structural reforms to boost competitiveness. This work also includes assessing how tax policy can help in achieving these goals.

In short National governments are broadly free to design their tax laws according to their national priorities. However, in doing so, they must respect certain fundamental principles, such as non-discrimination and respect for free movement in the internal market. The EU supplements this with cooperation procedures and a legal framework to ensure the fair and efficient taxation of cross-border activities in the EU.

People, goods, capital, services and companies in Europe are on the move. It follows that EU countries cannot operate their tax systems in isolation from each other or from the rest of the world. In the wake of the economic crisis, European and international efforts to combat tax avoidance and evasion have increased and are likely to be stepped up further. As a result, tax dodgers will have a tougher time, no matter where they are resident or where their assets are located. At the same time, European tax policy aims at facilitating free movement of people, goods, services and capital. The European Commission will continue to work on eliminating tax obstacles to free trade in Europe and internationally. It will continue to help EU countries grow and prosper.

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