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Editorial

Tax Shifts in EU-Member States: The Growing Impact of (Shifting) Recommendations by the European Commission on National Tax Policy

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In 2010, EU-Member States committed to cooperate on the 'Europe 2020' strategy that embodies the decennial agenda for growth in the European Union.[1] In the framework of this agenda, the Member States also articulate their national targets. One of the priorities is economic (inclusive) growth aimed at higher employment and poverty eradication.

In addition, the sovereign debt crisis has shown that the European Union needs a more thorough monitoring and follow-up of Member States' budget policies. In light of this, an annual cycle of economic policy coordination was agreed upon in 2011, the so-called European semester. In the framework of this semester, the European Commission makes a detailed analysis of the plans for budgetary, economic and structural reforms in the EU-Member States and makes recommendations for the coming 12–18 months. The European semester was further streamlined in October 2015.[2] The semester starts when the Commission fixes its Annual Growth Survey. As a rule, this is done at the end of the year. The Commission clarifies the EU priorities for the coming year, which should boost employment and growth. Next, EU heads of state and government leaders indicate – usually in March of that year – the direction of their national policy on the basis of the Annual Growth Survey. Subsequently, in April they submit their stability and convergence programmes for healthy public finances as well as their national reform programmes aimed at 'smart, sustainable and inclusive growth'. In June, the Commission makes an assessment of these programmes and issues the necessary recommendations by country. The council further discusses these recommendations, which are then approved by the European Council.

One of the main recommendations that the European Commission has been giving the EU-Member States for years consists in decreasing the tax burden on labour income and shifting this burden to other tax bases that are less detrimental to growth. Previously, the presidency of J. Delors had already pointed out that the high (para)fiscal pressure on labour – and, in particular, the high social security contributions – can be detrimental for employment. Thus, the European Commission recommended in 1993[3] to reduce the (para)fiscal pressure on labour income – especially for low-skilled workers. The Commission made a similar recommendation in 2005.[4] The sovereign debt crisis later led to recommendations for the Member States to realize this reduction of the (para)fiscal burden as much as possible in a budget neutral way: tax cuts on labour income should be accompanied by a comparable increase of revenue from other tax sources, the so-called tax-shift, to be distinguished from a tax cut or tax lift. It is striking that the recommendations of the European Commission have slightly evolved in this regard, partly in function of the progressing economic and political insights.[5] The Member States were requested to compensate the reduction of the tax burden on labour with an increased tax burden on consumption and/or

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1 COMMUNICATION FROM THE COMMISSION EUROPE 2020, A strategy for smart, sustainable and inclusive growth Brussels, 3 Mar. 2010 COM(2010) 2020 final (http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2010:2020:FIN:EN:PDF).

2 COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL AND THE EUROPEAN CENTRAL BANK On steps towards Completing Economic and Monetary Union, Brussels, 21 Oct. 2015 COM(2015) 600 final (http://ec.europa.eu/priorities/economic-monetary-union/docs/single-market-strategy/communication-emu-steps_en.pdf).

3 Commission of the European Communities (1993), White paper on Growth, Competitiveness, Employment, COM (93), 700, 5 Dec. 1993 p. 139 http://europa.eu/documentation/official-docs/white-papers/pdf/growth_wp_com_93_700_parts_a_b.pdf: 'steps must be taken to reduce non-wage costs, particularly for less skilled labour'.

4 Commission of the European Communities (2005), The Contribution of Taxation and Customs Policies to the Lisbon Strategy, COM (2005), 532 final, 25 Oct. 2005, p. 3: '*Relatively heavy taxation on labour appears to have been a disincentive to the creation of additional jobs, especially low skilled jobs; but broadening the tax base by getting more people in work is still the most effective way for governments to raise revenues without raising tax rates. A shift from labour to consumption and/or pollution taxes could also help as part of a broader strategy to increase employment levels*.'

5 A nice overview of this evolution can be found in a recent study by M. Mathé, G. Nicodème & S. Ruà, *Tax Shifts*, Taxation Papers, Working Paper N.59-2015, October 2015, European Commission, 25 p.

pollution.[6] Indirect taxes are in fact deemed less detrimental for growth than direct taxes.[7] Afterwards, the insight gained ground that taxes as a means of redistribution can also influence (in)equality between taxpayers and hence can also indirectly influence growth. In an interesting study of April 2014, based on an empirical analysis, Ostry, Berg and Tsangarides[8] find a negative correlation between inequality and growth. Inequality slows down growth and renders it less sustainable. In their study, they come to the following important conclusions: (1) '*lower net inequality is robustly correlated with faster and more durable growth, for a given level of redistribution*' and (2) '*redistribution appears generally benign in terms of its impact on growth; only in extreme cases is there some evidence that it may have direct negative effects on growth*'. In line with these findings, Mathé et al. [9] suggest that 'more progressivity within direct taxation could hence possibly be an efficient tool to ensure both the financing of targeted labour tax cuts while reinforcing equity/redistribution within the taxation of income'.

In its first Annual Growth Communication of December 2010,[10] the Commission also recommends Member States to *broaden* their tax bases to compensate for the reduction of the tax burden on labour.[11] In the Annual Growth Communication for 2012,[12] the Commission for the first time points to wealth as an alternative to finance labour tax cuts. By further linking this proposal to a greater attention to the (economically) disadvantaged in society, the tax shift issue indirectly gains a redistribution dimension.

In subsequent years, the European Commission repeated this message.[13] Initially, Member States reacted by further increasing the tax burden, especially by increasing VAT rates.[14] However, the further insistence by the European Commission on a broader tax shift has gradually brought the Member States to more fundamental tax reforms.[15] Since 2014, we can even observe a clear trend: a decrease in social security contributions, an increase of indirect taxes and a (for the time being) budget neutral shift within direct taxes.[16] An important point in the development of a fundamental tax shift that also did not escape the European Commission,[17] is that too great a shift of the tax burden from direct taxes to indirect taxes can have a negative effect on redistribution. An increase of indirect taxes in fact implies the risk that a country's tax regime becomes less progressive and hence less redistributive. The scope for certain countries, whose share of indirect taxes in the

6 European Commission, *Monitoring Tax Revenues and Tax Reforms in EU-Member States 2010*, 6 European Economy 24 & 28, 39 (2010), http://ec.europa.eu/economy_finance/publications/european_economy/2010/pdf/ee-2010-6_en.pdf.

7 European Commission, *Annual Growth Survey: Advancing the EU's Comprehensive Response to the Crisis*, COM (2011), 11 final, 1 Dec. 2010, p. 4; M. Mathé, G. Nicodème & S. Ruà, Tax Shifts, Taxation Papers, Working Paper N.59-2015, October 2015, European Commission, 8: '*The results from the economic literature do not offer clear-cut and undisputed evidence but the big picture still lead to a strong indication that corporate/capital and labour taxes are the most detrimental for growth while consumption and recurrent property taxes are among the least damaging*.'

European Commission, *Monitoring Tax Revenues and Tax Reforms in EU-Member States 2010*, 6 European Economy 24 & 28, 39 (2010).

8 J.D. Ostry, A. Berg & D.G. Tsangarides, (April 2014) *Redistribution, Inequality, and Growth*, IMF Staff Discussion Note 1402, 9: This study is also quoted by M. Mathé, G. Nicodème & S. Ruà, Tax Shifts, Taxation Papers, Working Paper N.59-2015, October 2015, European Commission, 10. https://www.imf.org/external/pubs/ft/sdn/2014/sdn1402.pdf.

9 M. Mathé, G. Nicodème & S. Ruà, Tax Shifts, Taxation Papers, Working Paper N.59-2015, October 2015, European Commission, 10.

10 European Commission, *Annual Growth Survey: Advancing the EU's Comprehensive Response to the Crisis*, COM (2011), 11 final, 1 Dec. 2010.

11 European Commission, *Annual Growth Survey: Advancing the EU's Comprehensive Response to the Crisis*, COM (2011), 11 final, 1 Dec. 2010, 4 '*Some Member States may Need to Increase Taxes. Indirect Taxes are more Growth-Friendly than Direct Taxes and Broadening Tax Bases is Preferable to Increasing Tax Rates*'.

12 European Commission, Annual Growth Survey 2012, Brussels, 23 Nov. 2011.

COM(2011) 815 final, 5: *Greater efforts should be made to shift taxation away from labour towards taxation which is less detrimental to growth: for example, increasing consumption, environmental, wealth (for example, high value property) taxation can help to alleviate the tax burden on labour thus making hiring more attractive. Particular attention should be paid to the needs of the most vulnerable groups in any tax shifts.*

13 European Commission, Annual Growth Survey 2014, Brussels, 13 Nov. 2013 COM(2013) 800 final, 7: '*Tax should be designed to be more growth-friendly, for instance by shifting the tax burden away from labour on to tax bases linked to consumption, property, and combatting pollution'.*

14 European Commission, Annual Growth Survey 2014, Brussels, 13 Nov. 2013 COM(2013) 800 final, 17: '*When consolidating their finances, Member States have generally increased tax rates (standard VAT rates in particular) and not many have broadened the bases. Environmental and property taxes have increased but there is still room to make these taxes more efficient. All Member States have adopted some measures to counter tax evasion and improve tax compliance. Many Member States have increased the overall tax burden (direct and indirect taxes as well as social contributions). However, it is positive to note that tax shifts are taking place to some extent, such as reforms of property taxation and more emphasis on indirect taxes instead of labour taxation'.*

15 Member States' national reform programmes for the period 2010-2015 can be consulted on the website of the European Commission on Europe 2020: http://ec.europa.eu/europe2020/europe-2020-in-your-country/index_en.htm

European Commission, Annual Growth Survey 2016 Strengthening the recovery and fostering convergence, Brussels, 26 Nov. 2015, COM(2015) 690 final.

16 Eurostat Statistic Explained: Tax revenue statistics: http://ec.europa.eu/eurostat/statistics-explained/index.php/Tax_revenue_statistics#Taxes_and_social_contributions_received_by_state_and_local_governments_made_up_16.3_.25_of_total_tax_and_social_contribution_revenue_in_2014_in_the_EU-28; M. Mathé, G. Nicodème & S. Ruà, Tax Shifts, Taxation Papers, Working Paper N.59-2015, October 2015, European Commission, 13 & 15 (table). The authors point to a possible decrease of direct taxes in 2015 as a consequence of further efforts by Member States to decrease the tax burden on labour income.

17 European Commission, Annual Growth Survey 2015, Brussels, 28 Nov. 2014, COM(2014) 902 final, 15: '*On the revenue side, it is important to ensure an efficient and growth-friendly tax system. Employment and growth can be stimulated by shifting the tax burden away from labour towards other types of taxes which are less detrimental to growth, such as recurrent property, environment and consumption taxes, taking into account the potential distributional impact of such a shift*.'

whole of tax revenues is already considerably high, is therefore limited. Moreover, an increase in indirect taxes in these countries would also put them in a less competitive position compared to other Member States.

Therefore, the question arises if a shift to other direct taxes can offer a way out. Against an increase in corporate tax stands a loss of competitiveness of a country – pending a more harmonized/uniform approach within the EU.[18] Shifting taxes to wealth classically met with the objection of capital flight. However, the recent battle – also within the EU – against tax fraud and tax evasion,[19] as well as the related evolution to more transparency and exchange of information on a global scale, again offers countries more possibilities to review fundamentally direct taxes on these bases. Or as Mathé et al. rightly observe: '*the fight against fraud and evasion and a better identification of income recipients offer new innovative potential solutions that could be considered in a context of tax shift*'.[20]

Furthermore, we should not overlook the fact that the organization of social security and its funding varies widely between Member States. A decrease of social security contributions to soften the (para)fiscal burden on the factor labour can hence have very different implications for Member States and can disrupt the balance of the social security systems of the Member States. Finally, in certain Member States shifting the tax burden on labour to other tax sources can also be problematic due to these Member States' layered state structure. In such countries, the distribution of fiscal competences over different levels of government also needs to be taken into account. This division of powers often hampers a coherent, efficient and just tax shift in these countries.

In conclusion, we can argue that the debate on a fundamental tax shift that is currently held in many EU countries is significantly affected by the recommendations of the European Commission. In the formulation of its recommendations, the European Commission is guided by changing economic and political insights, and developments. It is important that the Commission pays sufficient attention to the (regulatory) specificities of each Member State in the fiscal and social security field.

18 On this point see: B. Peeters, 'EUCIT: for How Much Longer Will Political Objections Outweigh the Advantages?' EC Tax Review (2015), 128–131.

19 European Commission, An Action Plan to strengthen the fight against tax fraud and tax evasion, Brussel, Brussels, 6 Dec. 2012, COM (2012) 722 final.

20 M. Mathé, G. Nicodème & S. Ruà, Tax Shifts, Taxation Papers, Working Paper N.59-2015, October 2015, European Commission, 21.