

Challenges to Taxation

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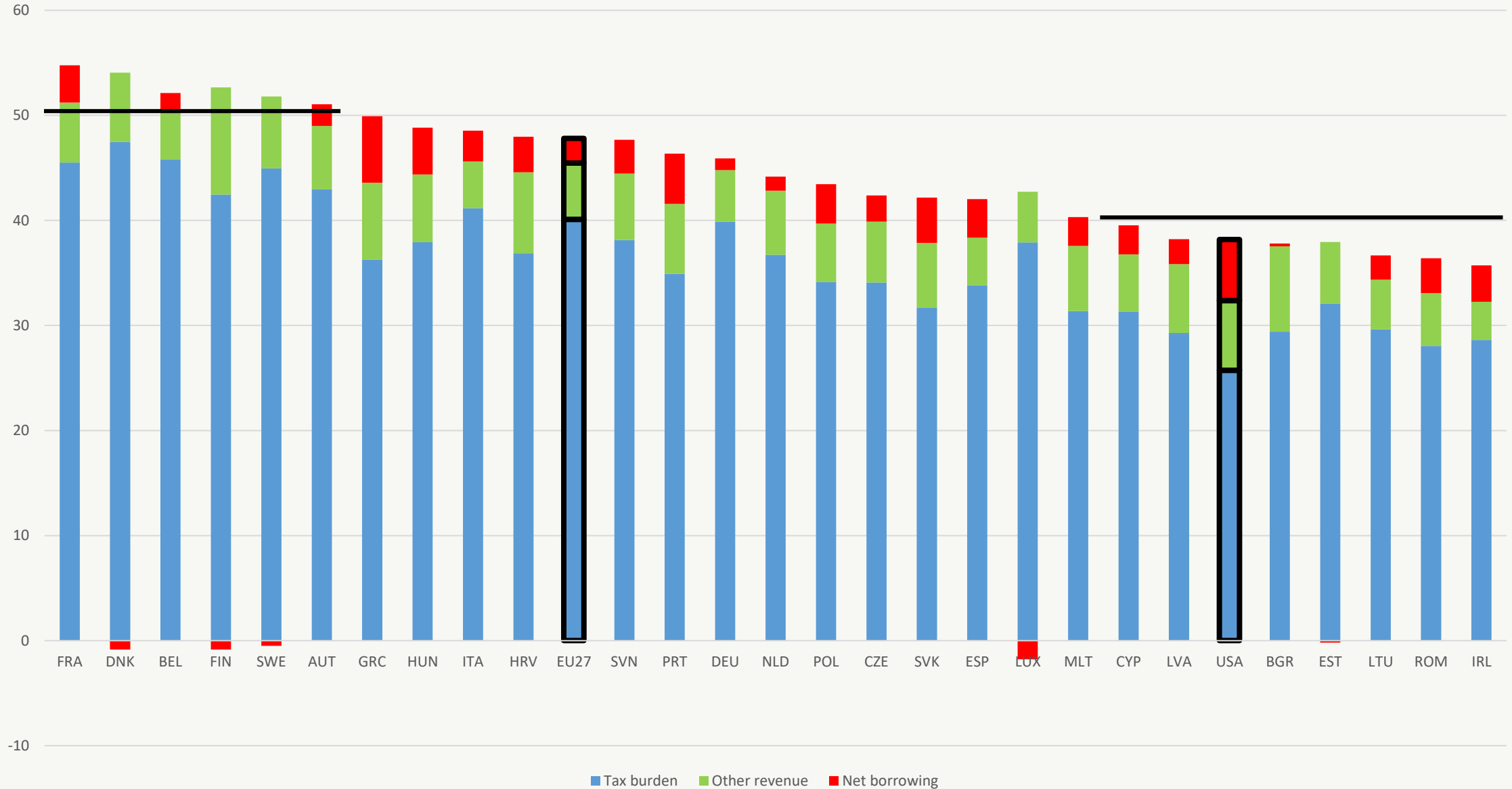
Brussels

28 November 2022

Purpose of taxation

- The main purpose of taxation is to finance public expenditures
 - On average during 1999-2019, for the EU27
 - Public expenditures amounted to 48% of GDP
 - Taxation financed 83% of public expenditures and amounted to 40% of GDP
 - But there important differences across EU countries
- Taxation has also other important functions:
 - Redistribution
 - Behavioural change

Public expenditures, by sources of financing, 1999-2019 averages, as % of GDP



Principles for taxation

- Efficiency: taxation generally creates distortions, although some specific taxes may correct distortions
- Equity: taxation may be progressive or regressive
- Stabilisation: taxation may help stabilisation but not always
- => There are often trade-offs between them, but not always
- Much depends on the **level** and **composition** of taxation

Future of taxation

- Demand/need for public expenditure will probably increase
- Hence taxation may have to increase too
 - Is this feasible and desirable?
 - Is there a limit in the taxation **level**? Has it reached in some MS?
 - Is the current tax **structure** adequate and sustainable?

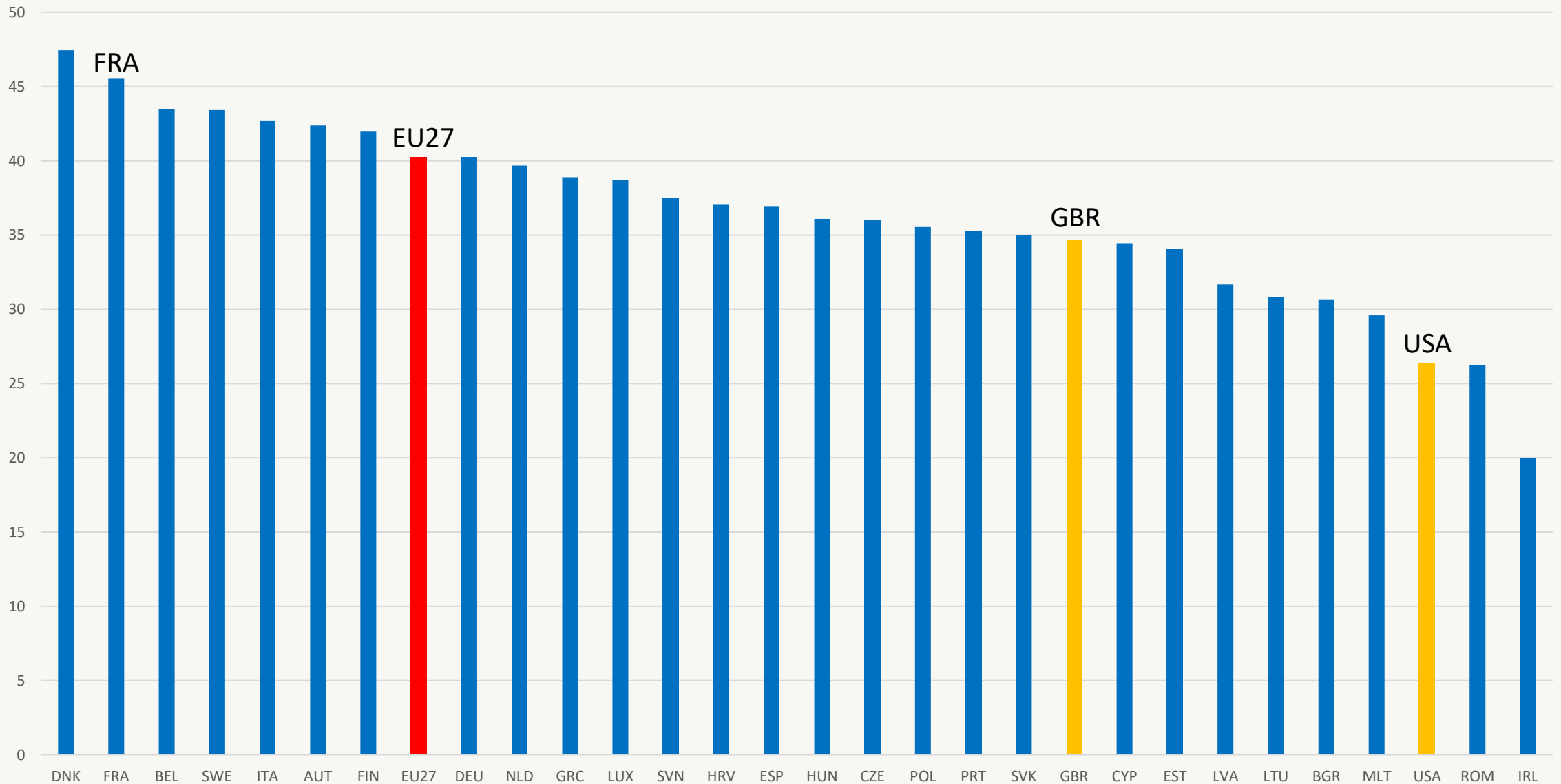
The level of taxation (1)

- The economics literature does not provide much guidance about the desirable or maximum level of taxation
 - Mirrlees Review (2011): “we do not recommend what the overall level of taxation should be”
 - Blanchard-Tirole Report (2021): “[we] recommend to tax better rather than taxing more”
- It’s basically up to politics to decide what the desirable level of public spending and taxation should be, but economics has a role to play in spelling out choices and potential trade-offs

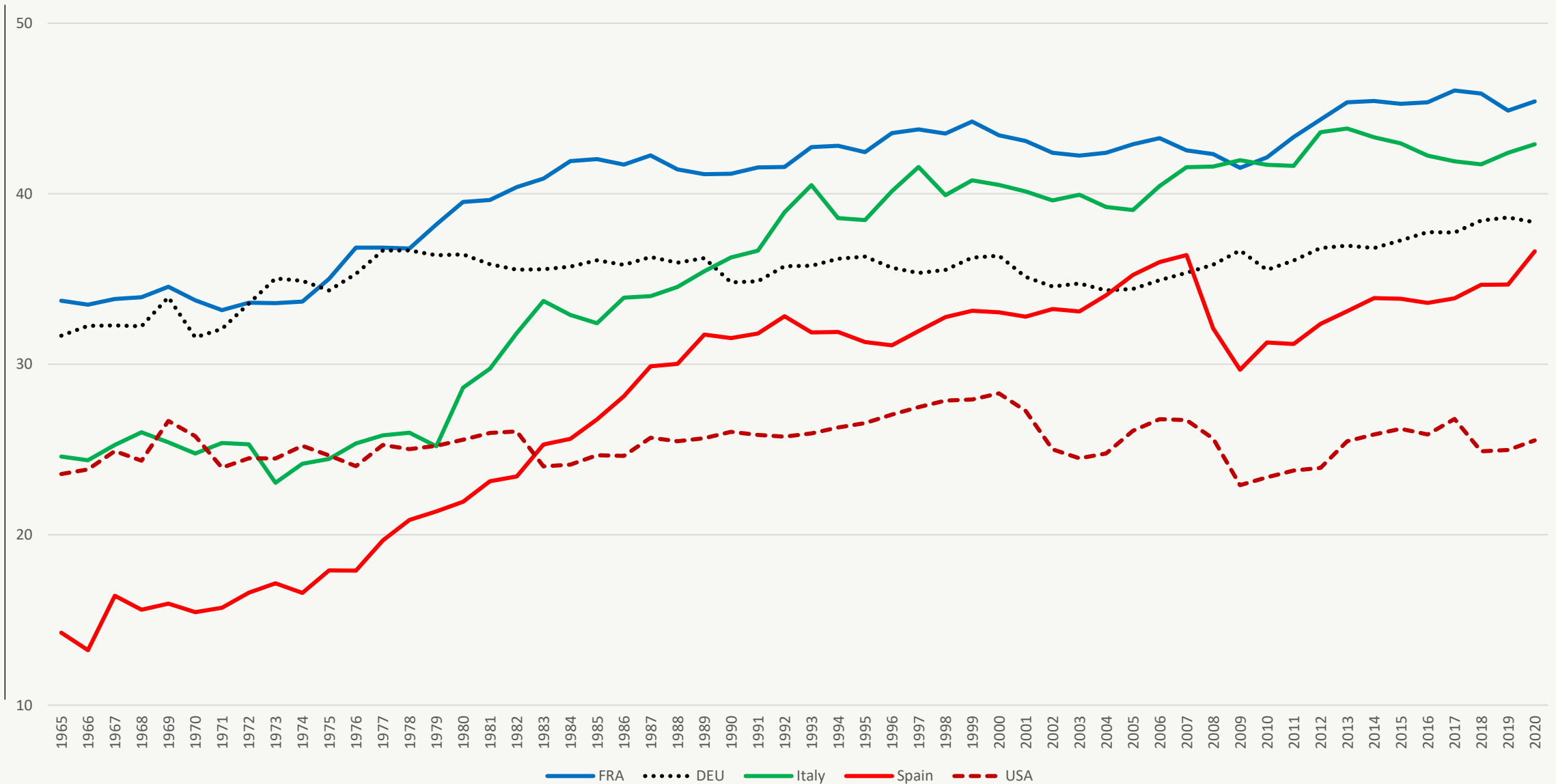
The level of taxation (2)

- Levels of taxation vary a lot across EU countries, in line with their levels of public expenditures
- Levels of taxation have generally increased in the past 50 years, in line with increasing levels of public expenditures
- Have we reached the limit in taxation in terms of overall level?
 - Probably yes in some countries (recall Blanchard-Tirole)
 - Probably no in others

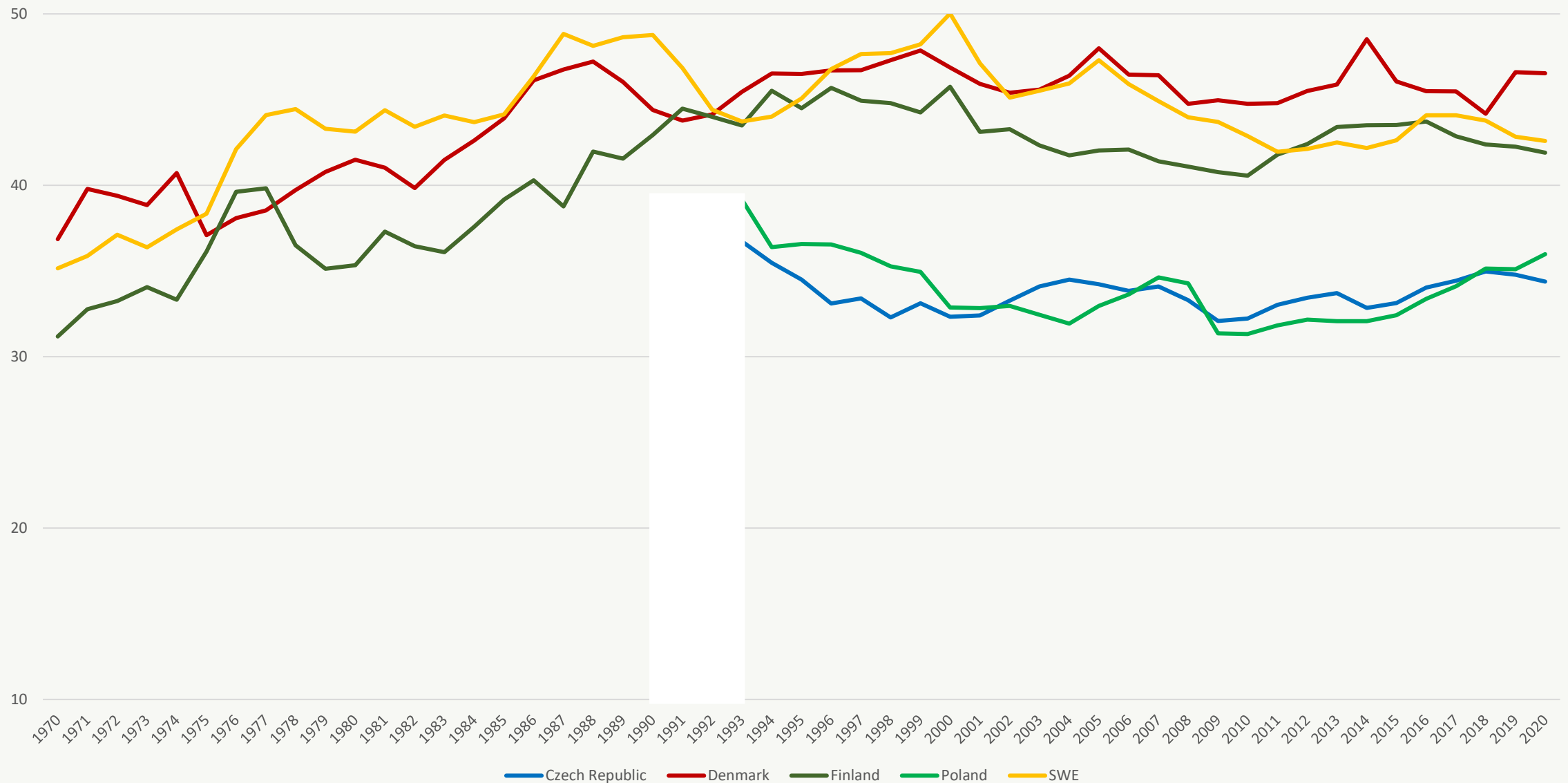
The tax burden in 2020, as % of GDP



The evolution of the tax burden, 1970-2020, as % of GDP



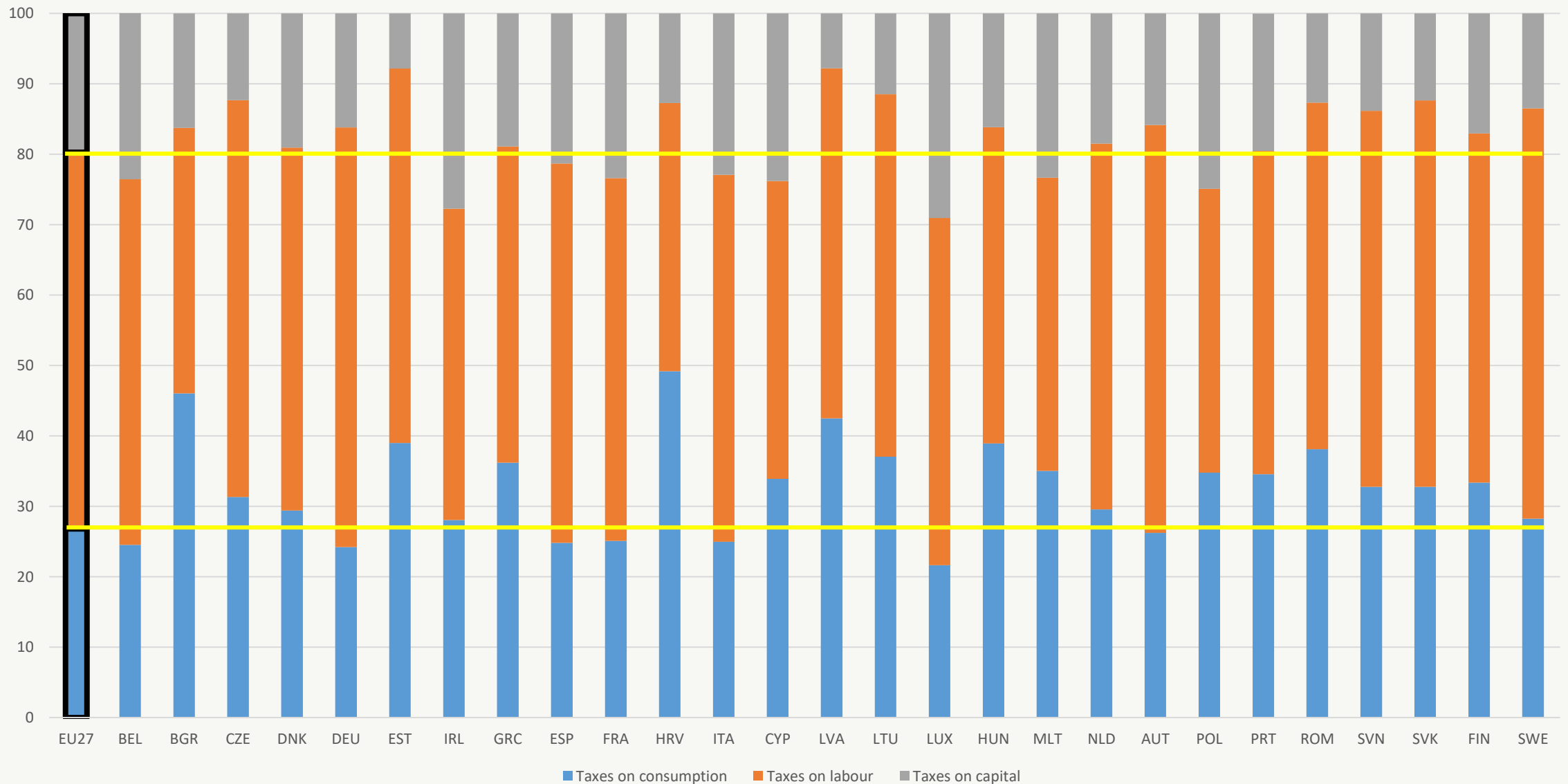
The evolution of the tax burden, 1970-2020, as % of GDP



The structure of taxation

- For the EU27 aggregate, taxes on labour account for more than 50% of total taxes, taxes on capital [corporate income taxes plus property taxes] for 20% and consumption taxes for a bit less than 30%
- But the structure of taxation varies a lot across EU countries

The tax structure varies substantially across countries, 2020



A short digression on three data issues

- For taxation, EU27 aggregates can be misleading
 - Better to use not only weighted but also simple averages of the 27 MS
 - Tax burden as % of GDP: 40.3% weighted but 36.7% unweighted
 - Taxes on labour as % of tax burden: 53.5% weighted but 49.5% unweighted
 - Taxes on capital as % of tax burden: 19.7% weighted but 17.8% unweighted
 - Taxes on consump. as % of tax burden: 26.8% weighted but 32.7% unweighted
- There are discrepancies between EU and OECD data. Why?
- We lack adequate data on some behavioural taxes, like climate

Is the ability to tax likely to decrease in the future?

- Overall taxation has not fallen in the past 50 years despite major structural changes (globalisation, technology, demography), but the future may be different
- The main issue concerns labour taxation, given its importance
 - Will labour taxation decrease due to structural changes (G-T-D)?
 - Which alternative sources of taxation?
 - Not only a matter of revenue, but also
 - Fairness
 - Behavioural change (climate and environment)

A New Era for Europe – Report by the post-Covid HLG

- The HLG was convened by Commissioner Gentiloni to reflect on the EU's post-Covid economic and social challenges
- Challenges identified by the HLG:
 - Enabling a successful triple transition: climate, digital, and social
 - Rebuilding trust in public institutions
 - Managing regional and global geopolitical developments
- The HLG made five sets of recommendations to address these challenges, including one on taxation

Fair and effective taxation

- Specific recommendations:
 - Fighting tax evasion and tax avoidance
 - Putting more emphasis on behavioural taxes
 - Shifting the tax structure towards less elastic sources
 - Broadening the corporate tax base and adopting BEFIT (Business in Europe: Framework for Income Taxation)

Fighting tax evasion and tax avoidance

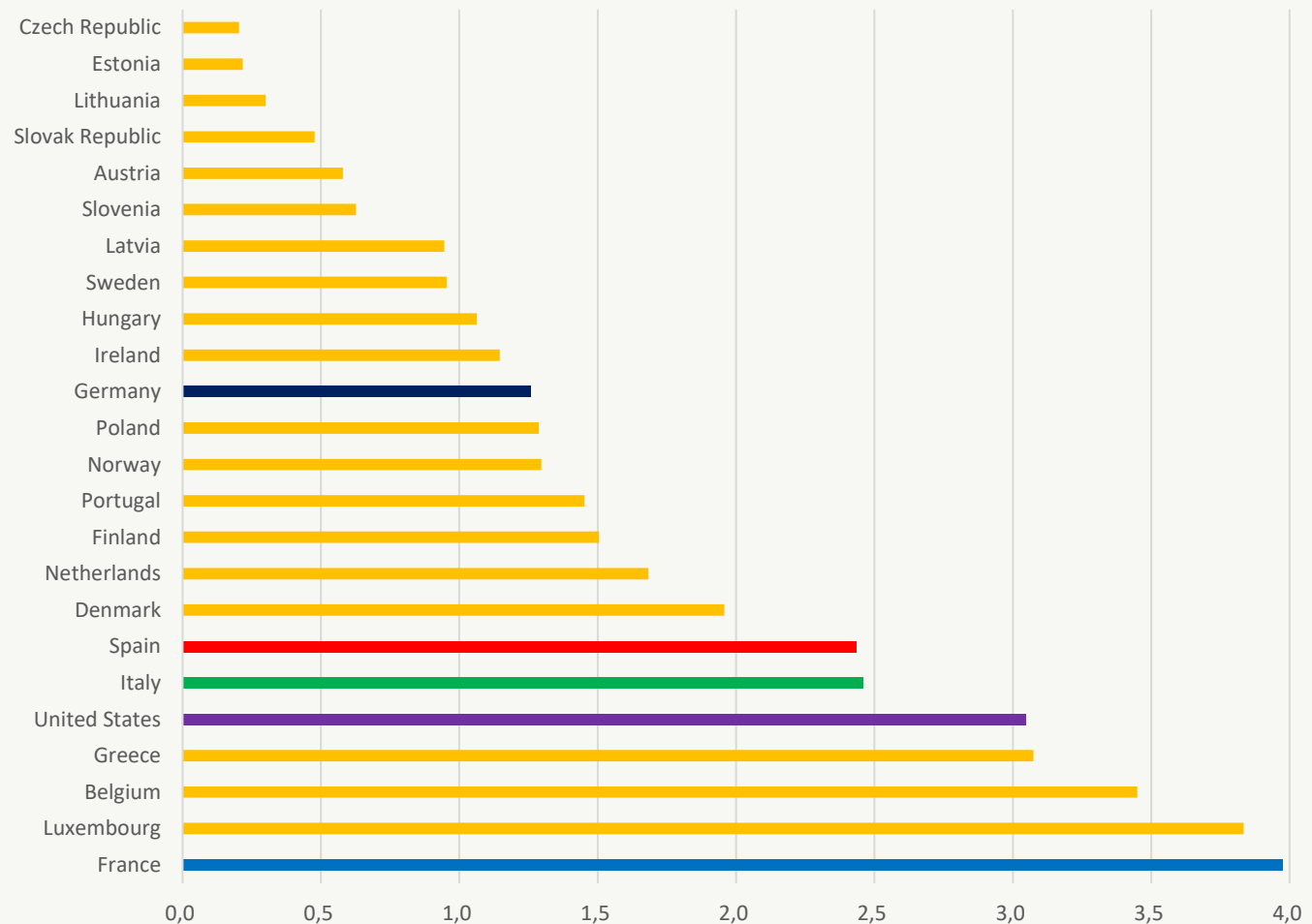
- Implement the OECD/G20 Inclusive Framework on Base Erosion and Profit Sharing (BEPS)
- Build on existing initiatives to increase transparency and exchange of information
- Eliminate the opportunities for tax avoidance that crypto assets have created
- Support Member States in strengthening their tax authorities
- Promote the use of digital technology and the simplification of national tax rules

Putting more emphasis on behavioural taxes

- Increase environmental taxes
- Promote fairness by paying special attention to flanking measures to maintain a desirable overall level of progressivity of the tax system
- Adjust taxes and redistribution schemes to offset regressive carbon taxes
- **NB:** carbon taxes in the EU vs. the US (Krugman's sticks vs. carrots)

Shifting the tax structure towards less elastic sources

- Tax more immovable property to reduce exposure to profit shifting
- Property taxes are low as a share of GDP (OECD data for 2020)




Broadening the corporate tax base and adopting BEFIT

- Go beyond the OECD/G20 Pillar 1 deal by looking at ways to include certain financial sector activities
- Consider setting up a High-Level Expert Group on reviewing the taxation of the financial sector
- Continue promoting closer cooperation among MS in areas where harmful tax competition leads to lose-lose 'races to the bottom' by keeping the political momentum at the EU level
- Adopt the BEFIT rulebook for corporate taxation

One additional personal recommendation

- MS/EU should consider correcting two tax distortions harmful to efficiency and equity, and (the first one, to stability)
 - Debt-equity tax bias (deductibility of interest payments)
 - Fatica, Hemmelgarn and Nicodeme (2022), DG Taxud, Taxation Paper
 - Labour-capital use tax bias (low marginal tax rate on capital use)
 - Acemoglu, Manera and Restrepo (2020), NBER WP
 - Beraja and Zorzi (2022), NBER WP
 - An automation/robotisation tax?

Questions for the discussion

- Has the tax burden reached the limit in some EU countries?
- Will revenues from labour taxes decrease in the future?
- Do you agree with the HLG recommendations for fair and efficient taxation?
- How do you assess the EU-US  towards carbon pricing/tax?

carrots vs sticks
- OK to reduce the tax biases in favour of debt and capital use?