UACES 42nd Annual Conference

Passau, 3-5 September 2012

Dr.Tatiana Houbenova
Professor in International Economics

Economic Research Institute at the
Bulgarian Academy of Sciences
Sofia, Bulgaria
stefanovatatiana@gmail.com

The Fiscal Sovereignty and the Tax Policies of the New EU Member States: The EMU Challenges and Prospects of Fiscal Governance Reform

The paper is focused on issues of fiscal policy coordination in the Eeuro area and the challenges to the new EU member states from Central and Eastern Europe in implementation of different national fiscal policy options while preparing for the entry of the EMU. The main research question concerns the evaluation of the impact of the fiscal sovereignty in the new EU member states in implementing their national tax systems in preparation to join the Euro area. The paper discusses the ways in which the new EU member states adjust their national tax systems by making better use of introducing the appropriate tax structure and fiscal systems in order to reflect the specific conditions and priorities of the national economic policy and to achieve the required in the EMU sustainability of public finances in medium and long term aspect. The evaluation of options of tax reforms in the new EU member states is done with regard to the problems of rising fiscal deficits as a result of higher Government expenditures and the reduction of revenues during the Global economic and financial crisis. Conclusions are drawn for the main trends in the EU governance reform and the fiscal sustainability of the EMU member states.

JEL: H32.
Key words: fiscal policy, tax system, tax policy, tax harmonization, EU governance reform.

1. Introduction

The preparation for entry in the European Monetary Union (EMU) has important implications for the fiscal policies of the new EU member states from Central and Eastern Europe (CEE). The common trends of the adjustment of the fiscal policies of the CEE countries to the EU requirements for fiscal coordination and tax harmonization have been a result of process of deep structural changes with regard to the EU accession and membership. With the preparation for entry in the EMU by the new EU member states the fiscal policy coordination has been considered as inseparable part of their future membership status in the EMU. The fact that for the EMU entry the "opt-out" clause was excluded at the very beginning of the accession negotiations with the EU makes the present situation of evaluating the progress of new EU member states of achieving convergence to the Euro area countries much more important. The Euro area countries whose fiscal sustainability is in crisis undergo fiscal adjustment with considerable effort. This poses new challenges to the new EU member states as the rules based EU fiscal framework is under consolidation now. The need for compliance with the Maastricht criteria has become a priority goal in all countries under review since the preparation for accession from year 2000 onwards. Though each EU member state retains its fiscal sovereignty, the EMU requirements for fiscal sustainability have influenced to some extent the limits of freedom of choice of the CEE countries in their national policies. The paper discusses some aspects of the changing limits of the fiscal sovereignty of the new EU member states in their preparation for the EMU.

The economic and financial crisis since 2008 has caused rising divergences among EMU countries as regards their public deficits, public debt and other macroeconomic indicators. Thus the degree of compliance achieved has worsened and the issues of fiscal sustainability and nominal convergence have acquired new importance to be reconsidered in consolidation of the EMU. During the crisis many Euro area countries have exploited the maximum degree of flexibility offered by the Stability and Growth Pact in designing their national responses and allowing for higher budget deficits. According to a study of the ECB Fiscal Policies Team at the end of 2009, 13 out of the 16 euro area countries were subject to an excessive deficit procedure, with extended deadlines to return to deficits below the reference value of 3% of GDP ranging from 2010 to 2014.[1] The European Commission adopted in September 2010 a legislative package to strengthen the economic governance of the Union by introducing more strict ruled-based macroeconomic convergence of the individual states in the EMU. The aim is to make surveillance of budgetary and macroeconomic policies more effective and to carry out structural reforms within the framework of implementing the fiscal sustainability objectives.
As regards the new EU member states from Central and Eastern Europe in recent years their economic differences from the old member states have been considered as an issue of concern for the application of the common EU fiscal governance framework. Eller,M., P.Mooslechner, D. Ritzberger-Grünwald (2011) point out that the EU fiscal framework applies the same rules to all EU member states but in this way the economic peculiarities of the countries from Central and Southeastern Europe may not be not fully taken into account. Their fiscal space is much more limited compared to the old EU members. The public expenditure needs of the new EU member states with regard to infrastructure creation and catching up process raise the question that there may be

special needs which should be taken into account by the fiscal policy.[2] With the fiscal sovereignty taken into consideration we may consider that in the future the common EU fiscal framework application may demand new additional policy adjustments in the new EU member states to increase their fiscal space. But this is a research question yet to be studied. No doubt fiscal discipline in the EU framework may provide an improved access to the sources of investments and a more effective use of international funds in the new EU member states.

For the new EU member states that are preparing for the EMU the new requirements present a challenge to introduce more strict fiscal discipline in order to maintain fiscal sustainability and convergence with the EMU. Since 2007 members of the EMU have become Slovenia, Slovakia, and Estonia and their experience with fiscal adjustment and tax policy has also presented significant cases of multi-year fiscal consolidation.The evidence on the extent of convergence for the EU accession countries up to year 2005 is mixed. For example, Kozluk (2005) finds that some of the EU accession countries are better prepared for the single currency membership than some of the more established members were at the introduction of the EU.[3] However, a number of authors find evidence of some nominal rather than real convergence which remains a problem to be tackled in the new EU member states. The issues of real convergence are raised in a number of studies with regard to the currency regimes and the monetary convergence.4The issues of the fiscal criteria's convergence have been less often the focus of research studies though they are discussed in all Convergence reports for the countries preparing for the EMU entry as well as the reports on the tax harmonization in the EU.[5]

The compliance with the fiscal sustainability criteria has gained new aspects of importance as the present European sovereign debt crisis has evolved since 2010. As previewed by Mongelli (2002) the costs from negative external effects may become very high for the EMU if one, or more, member countries were to run sizeable and protracted budget deficits, accumulating an unsustainable public debt, eventually some pecuniary externalities might ripple through the currency area.[6] For example, based on the contradictory way of risk management of the Greek crisis the fear is still present that the European sovereign debt crisis could rise again and that such debt might have to be monetised. This might cause problems of the worsening the divergencies from the convergence criteria and weakening the fiscal discipline in the Euro area.

The paper discusses the fiscal sustainability as a goal to be achieved by maintaining the general government revenues in a better way to meet the challenges of rising government expenditures. In Part 2 the paper makes comparisons and evaluation of the degree of fiscal adjustment and the forms of tax harmonization of the new EU member states as regards the transfer of tax burden from direct to indirect taxes. Part 3 of the paper is based on the study of the statistical indicators for comparison of the tax structure in the EU countries concerned.
The conclusions are drawn on the basis of the quantitative analysis of the increased tax burden in the new EU member states after their entry in the EU and due to the recent crisis. The need of compliance of the new EU member states with the convergence criteria for public finances is considered with regard to the options for better coordination of fiscal policies in the Euro area countries.

2. Specific aspects of the fiscal adjustment of the new EU member states from Central and Eastern Europe

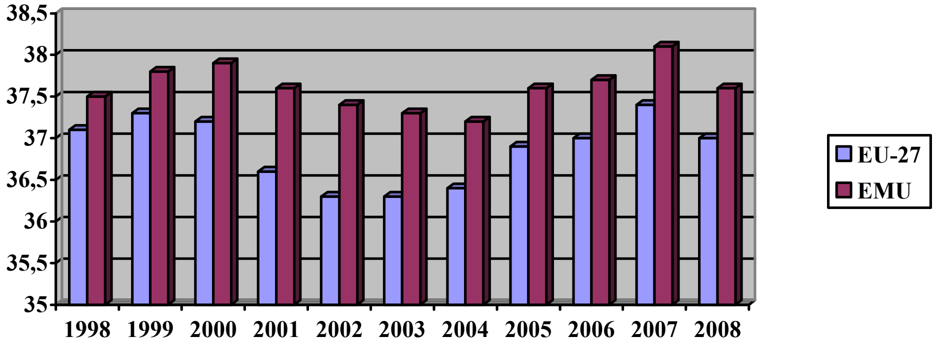
The differentiation of fiscal policies of the EU Member States as well as the specific features of the national tax systems and tax structures are not new phenomena in the EU. With the exception of the 1973 enlargement, the inclusion of new Member States has led to a significant rise in the *dispersion of tax ratios* as measured by the coefficient of variation. As a result of each enlargement of the EU there have been observed bigger tax divergences at first but then typical trend of some kind of tax convergence has been attained in a long term period. However according to some authors with the Eastern enlargement of the EU the debate over issues of taxation has entered a new dynamic phase. While pursuing the adjustment to convergence criteria the new member States have been characterized as "tough opponents' of any EU move towards tax harmonization".[7] There have been complaints on the side of old Member States that tax reforms in the CEE countries lead to tax competition. Fears have been raised that fiscal divergences resulting in tax competition among different member states may threaten with erosion of the tax harmonization achieved in the EU Single market.
On the other hand the tax reforms in the CEE countries are also revealed as "deepening the neoliberal European integration project". Some observers even consider that CEE countries "in fact function as a sort of a 'template' for fiscal reform in the EU" by introducing the flat rate system and further reduction of tax burden on capital and direct taxes especially.

The views on the impact of the tax burden reshifting in the CEE countries' tax systems are at the same time rather controversial. Some authors consider that the reduction of tax burden of the direct taxes and the reshifting of the burden to the indirect taxes are at the same time underestimated as factors contributing to the tax competition in the EU. [8] But other studies underline the positive effects which the tax reform of transferring the tax burden may have on the economic growth and employment.

In the CEE countries the trend for consistent transfer of the tax burden to the indirect taxes and the gradual removal of a number of tax exemptions from the general taxation regimes has continued for more than a decade. By revealing the overall impact of the tax reforms in the CEE countries some studies have drawn the attention to some positive consequences of the discussed tax reforms of the CEE countries.[9] Thus the impact of the fiscal reforms of the new EU member states may be evaluated from different aspects but as a whole the changes that are ongoing have become greatly dependent on the model of economic growth applied and on the foreign capital inflows and thus on the creation of tax incentives to absorb foreign capital financing.

The impact of the EU accession of the CEE countries for the progress of the fiscal policies' coordination may be discussed from several main aspects.
First, the Eastern enlargement of the EU has taken place in times of global changes in the competitiveness of nations. The global competition together with other (mainly domestic and European transborder) pressures for structural adjustment of the EU economy present great challenges to the coordination of the government budget policies and the fiscal discipline among EU Member States. Taking into consideration that 3 per cent fiscal surplus has been approved as a permanent threshold of fiscal sustainability by all new EU Member States the issue of collecting adequate Government revenues has become a priority task in the fiscal reform process.
Second, the fiscal policy coordination has involved measures which aim at stimulating economic growth, investment activity and employment. It has been targeted at improving the effectiveness of the structural adjustment of the economy by re-allocation of public resources towards priority fields and enhancing the quality of public finances.
Third, due to the coordination in the EU the changes in the institutional framework of the fiscal policy have played and still have to perform a significant role in the overall design of the macroeconomic policy mix. Further improvement of the quality of public finances through enhancement of the strategic planning systems, the adherence to tight budgetary constraints by all economic agents both in the public and private sectors, and the effective control over the appropriate, expedient and provident spending of the available budget resources remain the main principles of the fiscal policy's institutional framework. Within the framework and the concept of introduction of EU priorities of macroprudential policies, the new EU Member States are to meet the challenges of better risk surveillance and structural adjustment.
Fourth, fiscal policies have contributed to the ongoing restructuring of the CEE countries in the following main aspects: 1) changing the role of government in providing public goods and services; 2) reforming the tax and social security systems in order to create incentives for the private sector and make efficient the use of public resources; 3) better management of public debt, including the sustainable governance of the external payments.
On the other side the fiscal policy coordination with the EU requirements has contributed to: a) the improvement of the effectiveness and the efficiency of the public budget process; b) the implementation of medium term budget programming within the framework of the specific for each CEE country Convergence programmes' requirements; c) creating incentives for economic growth.[10]
Fifth, the main changes introduced in the tax structure of the new EU Member State have followed the model of the old EU member States, for instance the introduction of the VAT and excise duties which have replaced the turnover tax. The tax harmonization with the EU has been undertaken since the pre-accession period for all CEE countries thus accelerating the reform of the tax systems and tax structure.
The overall tax burden in the European Union, measured by total taxes (including social security contributions) as a percentage of GDP, is relatively high by international standards. In 2008, the overall tax-to-GDP ratio in the EU amounted to 39.3% , more than one third higher than the levels recorded in the United States and Japan, and 3½ percentage points higher than the arithmetic OECD average (including 19 EU countries). The dispersion of tax burdens diminished rather steadily between 1996 and 2007. In 2008 and 2009, it picked up as a consequence of the uneven impact of the economic and financial crisis on tax revenues. While in countries with important housing bubbles, such as Spain and Ireland, the tax ratio started to fall markedly already from 2008, in other countries, such as Germany and Austria, tax ratios stabilised or even rose. Some of the new EU member states have also been hit by the falling tax revenues in recent years.With the effects of the crisis on tax revenues gradually abating; the dispersion of tax burdens is projected to decrease further in 2013.

Figure.1. Average tax burden in the Member states of the EU27 and the EMU during the period 1998-2008



Source: Taxation trends in the European Union: Data for the EU Member States, Iceland and Norway, European Commission, Taxation and Customs Union, 2010 Edition

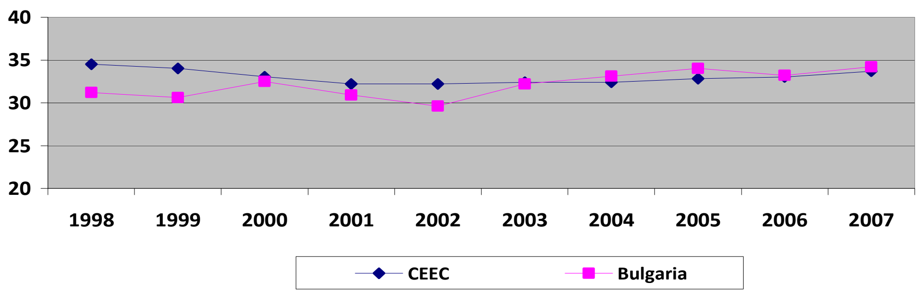
The new EU member states rely *on lower Government revenues* than the older states. As Fig.1 shows the EMU countries have on average much higher tax revenues as share of the GDP. This is a great challenge to them for making the Government budget instrumental for achieving economic goals. Thus as percentage of GDP the tax revenues in 2010 are at the highest level among the EU states in the following countries: Denmark (55.5%), Sweden (52.7%), France (49.2%), Austria (48.7%), Italy (46.8%), and Germany (44.9%). This indicator amounts to 34.9% for Bulgaria, 39.1% for the Czech Republic, 37.2% for Poland, 46.9 % for Hungary, 34.6% for Latvia, 34.3% for Lithuania .

Since 2008 and 2009, the economic and financial crisis had generated a reduction in government revenues and an increase in government expenditures in terms of GDP. This had resulted in substantially deteriorated Government deficits in the EU.

In 2010, revenues and expenditures tended to stabilise in terms of GDP, with a slight improvement in the deficit. In 2010, total EU-27 general government expenditure stood at 50.3 % of GDP while total general government revenue fell to 44.0 % of GDP, which produced a deficit of 6.4 % of GDP for EU27. These EU-27 averages do not show significant differences in the situation of individual Member States.

There are great differences among the new EU Member States as well. Since the end of the 90s Bulgaria has had tax revenues which as a share of the GDP amount averagely between 31% -34% от GDP. In comparison with the EC27 this is rather lower indicator. As Fig.1 shows this ratio is much lower than the average one for the rest of the Central and East European countries. Since 2004 the tax burden has started to grow and thus its value is higher than the one for the CEE countries that have joined the EU.

Figure 2: Tax revenues of Bulgaria and the rest of the new EU member states from Central and Eastern Europe in the period 1998-2007



Thee tax ratios in the CEE countries for the 2004-2011 are generally lower compared to the rest of the EU states and thus the dispersion across the Member States has been increased after the last enlargement. In 2008 the total tax-to-GDP ratio in the new Member States was six percentage points lower than the average of the former EU15. The differences reflect, national choices as regards tax burden and its structure, e.g. the choice of low corporate tax and income tax rates in order to help private sector creation or create investment incentives. The introduction of the flat rate in some of the new EU member states has also presented a considerable difference from the old member states. Other factors do matter as well: some Member States have the legacy of their

unreformed systems of social or economic assistance via tax reductions rather than direct government spending, while social transfers are exempted from taxes and social contributions. These factors affect the measured tax-to-GDP ratios without reflecting differences in the underlying tax burden.
However, there has been a general trend of some convergence of tax ratios over time, with new Member States often adjusting their tax ratios rather quickly towards the mean. Since 2004, for instance, tax ratios have risen in most of the twelve new Member States. This, together with the expansion of the Euro area to a growing number of new Member States, has largely eliminated the positive gap of the tax ratio in the euro area. The dispersion of tax burdens diminished rather steadily between 1996 and 2007. In 2008 and 2009, it picked up again as a consequence of the uneven impact of the economic and financial crisis on tax revenues.[11] The different national approaches to taxation during the crisis reveal the need of maintaining fiscal sovereignty as instrumental for the national structural adjustment.

3. The differences of the tax structure of the EU Member States and the shaping of the model of the tax systems in the CEE countries

The common understanding as regards the fiscal adjustment in favour of sustainability is reflected in the Lisbon Treaty. The Treaty of Lisabon has acknowledged the right of each EU member state to introduce the appropriate tax structure which is to reflect the conditions and priorities of the economic policy in order to maintain the sustainability of its public finances in medium and long term aspect.
First, the economic and financial crisis since 2008 has had so far a strong impact on the choice of the individual EU member states to resort to specific changes in their fiscal policies. Changes of the tax structure have been carried out since the transition started with regard to improving the stability of the general government budget. As the present crisis evolved in 2009, the peak year of the crisis, all Member States but one saw their GDP shrink - EU-27 GDP contracted by 4.2 %. The depth of the slump differed considerably among the new EU Member States – the GDP performance in 2009 ranged from -18.0 % in Latvia, which suffered the world's deepest decline, to +1.7 % in Poland.
Second, the discussions on the further steps of tax harmonization also present interesting issues of different approaches from individual EU states. Before and during the economic and financial crisis the variable level of taxation among the EU states has created *possibilities for capital, tax and regulatory arbitrage* to be made use by the companies. The recovery from the economic crisis depends to a great extent on further changes of government fiscal policy and tax coordination could be much better than tax competition for the growth of the Single Market.
Third, with the Eastern enlargement the differences among the EU states increase as regards the taxation of labour and capital. These trends do not improve by any means but much rather diminish the readiness of the EU member states for introducing further tax harmonization. That is the case with the debate about common consolidated corporate tax base (CCCTB) proposed by the European Commission for introduction in 2008.Nearly all of the new member States (not only in CEE but Malta and Cyprus as well) have joined Britain and Ireland in opposing the CCCTB.
The achieved level of EU tax harmonization can be done by revealing the main trends of the implicit tax rates (ITRs) on capital, labour and consumption in the EU. (See Table 1).
During the present crisis while the drop in the ITRs for labour and capital are consistent with the nature of the taxes, the drop of the ITR on consumption is surprisingly sharp given the proportional nature of indirect taxes, mirroring the weakness in VAT revenues recorded in the recession. The drop is even more surprising considering that several countries increased consumption tax rates in 2009, which should provide a boost to the ITR on consumption. This phenomenon can nevertheless be explained by a combination of factors. First, the depth of the recession is likely to have shifted consumption patterns towards primary goods, which are normally subject to lower VAT rates. Second, in a number of countries where there has been a credit expansion in the real estate business, the ITR on consumption is affected by the decline in construction activity. In addition, other factors are also at work as the overall contraction of aggregate demand, the inventories involuntarily accumulated by businesses during the recession, rising bankruptcies etc. as causing reduction of VAT revenues. Last but not least, many countries have introduced measures aimed at granting companies the possibility to defer tax payments, including VAT as well as to apply reduced VAT.

Table 1. Structure of the Government implicit tax rate revenues of Central and East European countries according to the economic function for 2007 (as % of GDP)

	Consumption	Labour	Capital
Bulgaria	18.4	10.8	5.5

Poland	13.0	13.4	8.8
Czech Republic	10.7	17.8	8.4
Slovenia	13.3	19.7	5.3
Hungary	14.5	9.9	5.3
Slovakia	11.3	11.6	6.5
Romania	11.9	12.1	5.4
Latvia	11.9	14.6	4.0
Lithuania	11.4	14.6	3.9
Estonia	13.6	16.8	2.6
Average EU-27	**12.4**	**17.2**	**8.0**

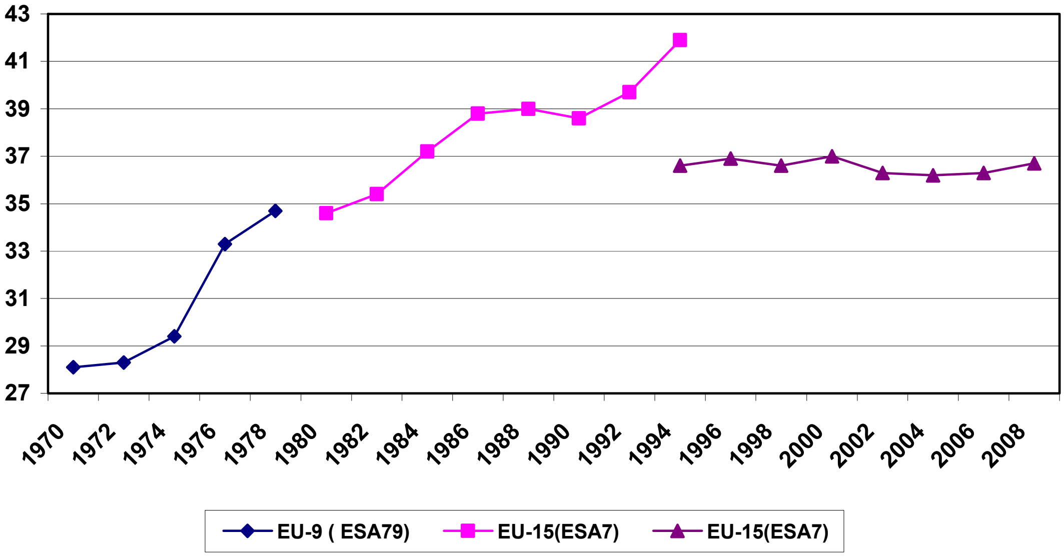
Source: Eurostat Statistical Books,2009.

As seen in Table 1. Bulgaria has the highest share of implicit tax rate revenues from consumption among the CEE countries. It ranks high in comparison for this indicator also among the EU 27. On the other hand, Slovenia and the Czech Republic present a case of higher tax burden on labour while the consumption tax has a smaller share of the GDP. In the rest of the new Member States from CEE the tax burden is comparatively evenly distributed between the consumption and labour. In Bulgaria the tax revenues from labour amount hardly to 10.8% of the GDP, which presents the lowest value among the EU countries. One of the factors contributing to this is the low wage on labour (contributing only 32.2% of the GDP).
The contribution of revenues from the taxes on capital to the GDP in all CEE countries is rather small with the exception of Poland and the Czech Republic where this indicator is above 8 % of the GDP.
Keeping in mind the specific impact of the crisis on the liquidity of economic agents and on the reduced demand one might expect the revenue impact of the crisis to differ by type of tax. Two effects may be distinguished, one linked to the size of the tax base, and the other to the progressivity of the tax itself. The first effect is straightforward: a deep recession typically affects some tax bases more than others; revenues from taxes based on profits, such as the corporate income tax, should fall substantially as many firms become loss making; transaction taxes may also suffer from reduced economic activity, whereas taxes levied on essential consumption items will normally see a modest reduction in revenue.
The main conclusion of the comparative analysis of the impact of the crisis is that the model of tax reforms followed by the new EU member states does not differ now much from the one implemented in the old EU countries but the reshifting of the tax burden from the labour and capital taxation to the taxation of the consumption has been undertaken at a more rapid pace. Most of the CEE countries have introduced changes in their tax systems before or since their entry in the EU in order to attract investments and improve their competitiveness. Otherwise under the impact of the present crisis limiting the tax relief has been a common trend in most of the EU countries where expenditure grew rapidly. The countries that increased the tax ratio (taxes as a percentage of GDP) most notably in 2009 had typically suffered a greater than average increase in the expenditure to GDP ratio during the crisis (Luxembourg, Slovenia, Slovakia) or were facing urgent budgetary consolidation needs (Estonia, Hungary).[12]The crisis has not reversed but seems to have proved that the trend to lower further corporate tax is no more to be continued because of the pending need of viable sources of Government revenues.

3.1.The Implicit tax rate burden on labour

The high level of taxes on labour combined with high social security contributions are considered typical for the tax systems of the old EU Member States. There are concerns that these features of the tax systems have a negative impact on the labour markets in the EU. On the side of the demand such taxation increases the labour costs of the companies. On the supply side, it demotivates the jobless to start looking for jobs. Since the start of the EMU there has been observed a small reduction of the implicit tax rate on labour in some of the old EU Member states. On the other hand a contributing factor to the increased tax burden on labour is also the reduction of the corporate tax rate. The high level of unemployment may be analyzed in relation to the excessive tax burden which raises the labour costs and provokes diminishing of the demand of labour. The concerns about adequate labour taxation in the CEE countries are the reason for undertaking some measures to limit to some extent the tax burden on labour. Part of these measures is related to the full reform of the social security systems while other measures are focused on the reduction of the social security contribution. Overcoming the typical approaches of the old EU Member States, in most of the new EU countries the goal of the reforms carried out

has been focused on the reduction of the implicit tax burden on labour. But as seen in Fig.3 this has been also the trend followed in the old EU member states at a slower pace after 2002 and reversed somewhat since 2008.
Figure 3.Iimplicit tax rate on labor in the EU15 member states in the period 1970-2008г.*



Source: Taxation trends in the European Union: Data for the EU Member States, Iceland and Norway, European Commission, Taxation and Customs Union, 2010 Editionn, p. 107
*Note: The Average ITR on labour is calculated for employed labour only (so excluding the tax burden falling on social transfers including pensions).The implicit tax rate on labour should be seen as a summary measure that approximates an average effective tax burden on labour income in the economy. The ITR on labour according to the system of national accounts ESA79 is weighted to the total income of the employed while the calculation according to ESA95 is used the average weighted according to the GDP. The data according to ESA79 are available only for EC-9 и also for EC-15 (accordingly for 1970-1979 and 1980-1995 Structures of Taxation Systems in the EU).

According to the Eurostat data in the period 1995-2008 the reduction of the implicit labour tax rate burden has become a prevailing common trend in the transition economies in Central and Eastern Europe. Strong reduction of the implicit labour costs has been carried out in Bulgaria (from 38.7 to 27.6%) and in Latvia (from 39.2 to 17.7%). In the rest of the CEE countries the reduction was not that strong though the descending trends has been constantly applied for instance in Lithuania, the Czech Republic, Estonia.
The reform in the area of the income taxation vary considerable among countries as they may involve reduction of the tax rate, increasing of limit of nontaxed income, tax credit or the deduction of certain costs. In all EU countries the tax burden on labour and especially on the low and average income is reduced with the purpose to create labour incentives.
In the period 1995-2008 the income tax rates are reduced in all EMU with the exception of Belgium. Several new EU Member States have lowered personal income taxes (Bulgaria, Hungary, Lithuania) following the trend during the last decade in some countries like Finland, Germany, the Netherlands and Sweden. The flat tax reform in Hungary in 2011 brought the highest marginal tax rate down respectively from 32% (36% in 2009) to the 16 % flat rate while in Bulgaria since 2007 the 10% flat rate has been applied for income taxation. However, a larger number of the new EU member states countries (Czech Republic, Estonia, Latvia, Romania, Slovakia) raised personal income taxes, although on a more varied scale and often by means of changes to the tax base in a similar way as it has been the case of a number of EU countries (Denmark, France, Greece, Luxembourg, Ireland, Portugal, Spain, United Kingdom).

3.2.Implicit tax on capital

The corporate tax in the EU27 and the EMU has followed a clear trend of reduction. As seen in Table 2 the CEE countries have lowered considerably the corporate tax statutory rate since 2004. Since 2007 with the exception of Hungary all new EU Member States under review have retained the lower corporate rates. The so called “flat rate tax revolution” has been introduced in a number of East European countries following the example of

Estonia which was the first to introduce this tax system in 1994. The advantages and disadvantages of the tax rate system deserve a special analysis and are not the topic of the present paper. As regards the impact of the lower corporate rates of the flat tax systems on the Europeanization of the fiscal policies it is important to keep in mind two considerations. On one side, it is clear that the lower rates have been designed as instrumental for attracting investments and improving the competitiveness of the business environment. From a fiscal point of view these rates may not serve adequately enough the targets of fiscal consolidation as a long term priority of the EU.

Table 2: Adjusted top statutory tax rate on corporate income of EU member states
2004-2011, in %

	2003	2004	2005	2006	2007	2008	2009	2010	2011
EU-27	28.3	27.0	25.5.	25.3	24.5	23.6	23.5	23.3	23.1
EA-17	30.4	29.6	28.1	27.7	26.8	25.7	25.6	25.6	25.3
BG	23.5	19.5	15.0	15.0	10.0	10.0	10.0	10.0	10.0
CZ	31.0	28.0	26.0	24.0	24.0	21.0	20.0	19.0	19.0
EE	26.0	26.0	24.0	23.0	22.0	21.0	21.0	21.0	21.0
HU	19.6	17.6	17.5	17.5	21.3	21.3	21.3	20.6	20.6
LV	19.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0
LT	15.0	15.0	15.0	19.0	18.0	15.0	20.0	15.0	15.0
PL	27.0	19.0	19.0	19.0	19.0	19.0	19.0	19.0	19.0
RO	25.0	25.0	25.0	16.0	16.0	16.0	16.0	16.0	16.0
SI	25.0	25.0	25.0	25.0	23.0	22.0	21.0	20.0	20.0
SK	**25.0**	19.0.	19.0.	19.0	19.0	19.0	19.0	19.0	19.0

Source: Eurostat statistical books, 2011

On the other side, the tax divergencies which they create among the EU states are indicative of the contradictions over the tax competition in the Single market and the need to make progress in the tax harmonization in the EU. Mean while it is interesting aspect to observe that some EU countries have started introducing lower corporate taxes in adjustment to the varieties of statutory corporate tax rates. Thus as stated by Tommaso Pado-Schioppa, "the new Member States have put pressure for a reform of the tax regimes of other EU members that need to change".[13] The stability of the corporate tax regimes makes them fiscally reliable but unflexible due to this fiscal dependence. It is indicative that during the present crisis few corporate tax rate cuts were announced. The explanation may suggest that there was a belief that, given the weakness of aggregate demand, they would have been ineffective to bolster investment in the short run. Thus the complexity of the reform of the corporate taxes makes it necessary to look after a decision of common interest at European level in favour of the Single Market freedoms of the factors of production.

Table 3. Adjusted top statutory tax rate on corporate income of the old EU Member States in the period 2004-2011, in %

	2003	2004	2005	2006	2007	2008	2009	2010	2011
BE	34.0	34.0	34.0	34.0	34.0	34.0	34.0	34.0	34.0
DE	39.6	38.3	38.7	38.7	38.7	29.8	29.8	29.8	29.8
DK	30.0	30.0	28.0	28.0	25.0	25.0	25.0	25.0	25.0
IE	12.5	12.5	12.5	12.5	12.5	12.5	12.5	12.5	12.5
EL	35.0	35.0	32.0	29.0	**25.0**	**25.0**	**25.0**	**24.0**	**20.0**
ES	35.0	35.0	35.0	35.0	32.5	30.0	30.0	30.0	30.0
FR	35.4	35.4	35.0	34.4	34.4	34.4	34.4	34.4	34.4
IT	38.3	37.3	37.3	37.3	37.3	31.4	31.4	31.4	31.4
LU	30.4	30.4	30.4	29.6	29.6	29.6	28.6	28.6	28.8
NL	34.5	34.5	31.5	29.6	25.5	25.5	25.5	25.5	25.0
PT	33.0	27.5	27.5	27.5	26.5	26.5	26.5	29.0	29.0
UK	30.0	30.0	30.0	30.0	30.0	30.0	28.0	28.0	27.0

Source: Eurostat statistical books, 2010

3.3. Implicit tax on consumption

The EU concept of tax harmonisation has been focused originally to indirect taxation. When considering the progress of the new EU member states made in the area of tax harmonization the reform of indirect taxation certainly deserves a special attention. The value added tax has been harmonised in 1977. In 1992 agreement of EU Member states was reached on the establishment of a 15 per cent minimum VAT as well as on the harmonisation of various excise rates, including the abolition of the intra-EU duty free sales on the 1st of July 1999. The VAT and excise duties are introduced by the CEE countries in the 90s when the excise harmonization has also begun. The EU membership imposes some limitations on the application of tax deductions for the business if these contradict the requirements for the state aid and the loyal competition.[14]. The EU accession and membership has influenced greatly the shaping of the tax system of the CEE countries and a lot of measures applied by the national tax systems were abolished upon entry in the EU.

Table 4: Changes in VAT standard rates by country, in % points

2008	2009	2010	2011
PT (-1)	EE (+ 2) IE (+ 0.5) LV (+ 3) LT (+ 1) HU (+ 5) UK (- 2.5)	CZ (+ 1) IE (- 0.5) GR (+ 4) ES (+ 2) LT (+ 2) PT (+ 1) RO (+ 5) FI (+ 1) UK (+ 2.5)	LV (+ 1) PL (+ 1) PT (+ 2) SK (+ 1) UK (+ 2.5)

Source: Taxation trends in the European Union , Commission services
Note: The reduction of VAT is marked with (-) and the raised Vat are marked with (+). The names of the EU Member States comply with the Eurostat system of presentation.

The growing importance of indirect taxes has direct implications for the EU because most indirect taxes, owing to their immediate impact on the functioning of the Single Market, are harmonised, unlike direct taxes. Increasing VAT rates make the fight against fraud more pressing and reinforce the need for addressing the distortions in the VAT regime. The review of the VAT regime that has started in December 2010 with the presentation of the Commission Green Paper on the future of VAT therefore comes at the right moment. Excise duties, too are for the most part harmonised. According to the European commission report in 2011, the increases recorded in energy excises have beneficial implications in terms of EU climate change policies, but are rather small – they are as yet insufficient to bring the ITR on energy, deflated for inflation, back to its 2000 levels. Furthermore, the latest data show a slight increase in divergence between energy tax levels, which are detrimental in terms of the Single Market. A better alignment of energy tax rates with their CO2content, however, as put forward in the Commission's proposed revision of the Energy Tax Directive in April 2011, would provide a stronger disincentive to emissions even at unchanged revenue levels. Extension of a CO2 tax to other, currently untaxed or undertaxed sectors, as proposed by the Commission, would instead gradually boost environmental tax revenues .[15]
Thus the impact of the crisis on the fiscal adjustment has been different for the individual new EU member states. The necessity of achieving of fiscal sustainability and fiscal discipline of the Stability and Growth Pact of the EMU have been acknowledged as a priority goal by the new EU member states in the adjustment process to enter the EMU. But the consolidation of public finances has been carried out in a specific way in order to maintain appropriate policy measures to cope with the crisis impact. The common priorities of fiscal policies as regards the maintaining of adequate limits of budget expenditures in order to achieve fiscal sustainability have been implemented in different ways. Since 2008 the economic and financial crisis has generated a decrease in government revenues and an increase in government expenditures in terms of GDP for all EU member states. This had resulted in substantially deteriorated deficits for a number of EU countries. In 2010, as data of the European commission confirms the share of the revenues and expenditures tended to stabilise in terms of GDP, with a slight improvement in the deficit. In 2010, total EU-27 general government expenditure stood at 50.3 % of GDP while total general government revenue fell to 44.0 % of GDP, which produced a deficit of 6.4 % of GDP. These EU-27 averages are indicative but the significant differences in the situation of individual Member States

deserve special attention. A small number of countries with limited or negative expenditure growth nevertheless maintained a cautious stance on the revenue side, usually because of particularly pressing consolidation needs (e.g. Hungary and Estonia, which in that period have had recourse to EU and IMF loan programmes).

4. Conclusion

The implementation of fiscal consolidation might be a challenging task for the economies of the new EU member state, as the entry in the EMU will increase the expenditure side of the government budgets, while pressures to introduce tax reforms could shrink the revenue side. Finally, the structural nature of the fiscal imbalances would certainly not ease this task. The impact of the current global crisis has been significant in terms of fiscal imbalances and the lower GDP growth rate, though new EU MS did not experience great disequilibria. The crisis has caused emergency crisis management with the EU support and the IMF agreements of some countries but the investment and consumer confidence is still to recover. Therefore, a better way of responding to the crisis is to start the "second round of reforms" that are now overdue. The budget and fiscal policies may serve as an object of the intervention in stead of their being used as instruments of adjustment to encounter the rising macroeconomic consequences of the crisis – reduction of aggregate demand, unemployment, rising public and private sectors' indebtedness and economic slowdown. However, there is much room for further fiscal policy action - programmed budgets and public financial management improvement within the EU governance framework in return to the convergence path for the EMU.

---

[1] Ad van Riet (ed.) (2010) Euro Area Fiscal Policies and the Crisis, *ECB Occasional Paper Series*, No 109, p.9.

[2] Eller,M., P.Mooslechner, D. Ritzberger-Grünwald (2011) Limited Fiscal Space in CESEE: The Issue, Underlying Economic Conditions, Related Implications and Policy Options, National Bank of Austria, WORKSHOP NO. 17, Limited Fiscal Space in CESEE: Needs and Options for Post-Crisis Reform, 68th East Jour Fixe of the Oesterreichische Nationalbank, February 2011.

[3] Kozluk, T. (2005) CEEC Accession Countries and the EMU-An assessment of relative and readiness for Euro-area membership, *Journal of Economic Integration*, 20, 3, 439-74.

[4]Holmes, M., Ping Wang *(*2008) Real convergence and regime-switching among EU accession countries, *South-Eastern Europe Journal of Economics (*2008) 9-27. Holtemoller, O.(2005) Uncovered interest rate parity and analysis of monetary convergence of potential EMU accession countries, *International Economics and Economic Policy*, 2, 1, 33-63.

[5] European Commission (2010) Taxation trends in the European Union: Monitoring tax revenues and tax reforms in EU Member States, EC, 2010.

[6] Mongelli, F.P. (2002) New Views on the Optimum Currency Area Theory: What is EMU telling us?, in: *ECB,Working paper N 138, April 2002.*

[7] Kovacs, L. (2006) Making the EU tax –competitive, Speech of the Commissioner Laszlo Kovacs, First Business Round Table with the European Commission hosted by The Economist, 10 October Brussels.

Laar, M. (2005) The Impact of Central Europe's tax revolution, *The Economist*, 5 March 2005.

Mitchell,D.J.(2005) Will Europe 's Flat Rate Tax Revolution Spread from East to West?, in: *European Affairs* , winter 2005.

[8] Vliegenthart, A. and Henk Overbeek (2009) Corporate Tax Reform in Neoliberal Europe: Central and Eastern Europe as A Template for Deepening the Neoliberal European Integration Project, in: Contradictions and Limits of Neoliberal European Governance: From Lisbon to Lisbon, ed. Bastian van Apeldoorn, Jan Drahokoupil and Laura Horn, 2009, Pallgrave MacMillan.

[9] The results from some surveys show that the reduction of the difference between the gross and the net income of workers as a result of the reduction of taxes on labour has led to a decrease of 0.16 percentage points in the level of the structural unemployment and an increase of 0.14% in GDP.

At the same time some estimates show that the increase of VAT by 1 percentage point at the expense of the taxation of labour income leads to a GDP, higher by 0.24% in ten years compared to the base scenario, and by 0.35% in the long term, as well as to employment, higher by 0.29% in ten years compared to the base scenario, and by 0.31% in the long term.(See: Arpaia, A., W. Roeger, J. Varga, J. in 't Veld, I. Grilo, P. Wobst, 2007, Quantitative Assessment of Structural Reforms: Modelling the Lisbon Strategy, *European Economy, Economic Papers No. 282).*

[10] European Commission (2011) Taxation Paper No 28 from DG Taxation and Customs Union.

[11] European Commission (2010) Monitoring tax revenues and tax reforms in EU Member States

[12]European Commission (2011) Taxation trends in the European Union - Focus on the crisis: the main impacts on EU tax systems, 38 p.

[13] ECB (2004) Enlargement and 'old' Europe: Blow or Blessing? Speech by Prof.Tommaso Padoa-Schioppa, Member of the Executive Board of the ECB, Frankfurt am Main, 22 October.

[14]Economic Survey of Europe (2004) Chapter 5. Tax reforms in the EU acceding countries, www.unece.org/ead/pub/041/041c0.pdf

[15] Taxation trends in the European Union: Focus on the crisis, 2011.