

SGI Sustainable Governance
Indicators 2009

Economy and employment

Taxes report



Indicator Tax policy*Question* Does tax policy realize the goals of equity, competitiveness and the generation of sufficient public revenues?

30 OECD countries are sorted according to their performance on a scale from 10 (best) to 1 (lowest). This scale is tied to four qualitative evaluation levels:

- 10-9 = Policies are equitable, competitive and generate sufficient public revenues.*
- 8-6 = Taxation policies fail to achieve one of the three principles.*
- 5-3 = Taxation policies fail to achieve two of the three principles.*
- 2-1 = Taxation policies fail to realize all three key principles.*

Canada

value 9

In general, Canada's tax system improves equity and provides more-than-sufficient public revenues at both the federal and provincial levels but could be improved to enhance competitiveness. Progressive personal income taxation, the most important source of government revenue, contributes to a reduction in inequality. The average tax burden increases with the level of income. In 2006, a single person earning 67 percent of the average income paid 19.1 percent in taxes, as compared to 24.2 percent and 27.4 percent for single persons earning 100 percent and 167 percent, respectively, of the average income.

The tax burden for businesses in Canada is generally competitive. At 43 percent of gross profit, Canada's total tax rate for businesses is the 10th lowest among OECD countries. The 2006 federal budget brought a reduction in the general corporate income tax rate from 21 percent in 2007 to 19 percent in 2010 as well as the elimination of the 3-percent corporate income surtax after 2006. The federal Goods and Services Tax (GST) has also been reduced from 7 percent to 6 percent.

Some provinces are also improving the competitiveness of their tax systems. In 2007, for example, Alberta, Ontario, Manitoba and Quebec were all reducing either one or both of their corporate and capital tax rates. Canada's tax system is non-neutral in that there are large differences in rates faced by different industries. For example, small businesses benefit from lower corporate tax rates, and natural-resource-related industries also enjoy additional tax benefits. These discrepancies may arguably contribute to the development and preservation of an industrial mix that is detrimental to Canada's overall economic performance.

Taxes generate sufficient public revenues. In fact, Canada benefits from a large structural surplus that provides sufficient flexibility to gradually improve the tax system. In general, the annual surplus is used to reduce the federal debt, which is already at a relatively low level.

Finland

value 9

Finland's tax system performs effectively and guarantees sufficient revenues. Adjustments in recent years have made the taxation system less complex and more transparent. The relatively high tax burden is widely accepted by citizens, because it constitutes the basis for the welfare state's services. Therefore, low levels of tax evasion compared to many other countries are reported. The imbalance between the relative tax burdens of wage earners on the one hand, and taxation of corporate profit and capital revenue on the other, renders horizontal equity somewhat problematic. In contrast, vertical equity of taxation is promoted by the Finnish tax system to a high degree.

Luxembourg

value 9

In 2002, a coalition government including the Christian Social People's Party and the Democratic Party implemented one of the most substantial tax reforms ever undertaken in Luxembourg. The new rules were clearly inspired by Anglo-Saxon liberal-conservative models of taxation. The reform reduced the income tax for individuals and companies. Guaranteed minimum income payments remained entirely exempt from taxation. Tax rates on the highest incomes were fixed at levels that are among the lowest in the European Union. The government also decided to scale back the corporate tax rate from 37.45 percent to 30.38 percent. Tax rates generally are lower than in other OECD countries. The average total of income tax and social security contributions paid on labor income, about 12 percent, is well below the OECD average of about 28 percent, and is particularly advantageous compared to the tax rates prevailing in the three neighboring countries.

Vertical distribution is generally judged as fair, but beneficiaries of the guaranteed minimum income could not take advantage of recent tax decreases because they do not pay tax. In order to improve the tax system further, a negative tax is under discussion. There is little doubt that taxes raise sufficient public revenue, as Luxembourg has enjoyed budgetary equilibrium for the last 20 years.

Netherlands

value 9

Taxation policy in the Netherlands addresses the trade-off between equity and competitiveness reasonably well. There is horizontal equity in that the taxes levied do not discriminate between different societal groups or enterprises. The Netherlands has a progressive system of income taxation: the higher the income, the higher the percentage of tax on that income. The fact that taxes are dependent on income

contributes to vertical equity. In general, income tax rates range between 30 percent and 50 percent. For high incomes, there are some tax benefits, such as favorable arrangements on mortgage interest. Personal income taxes are also levied on businesses that are not subject to the corporate tax system.

Corporate tax rates are also relatively low in the Netherlands. In 2006, the rate stood at 25.5 percent for up to €22,689 of earned profits and at 29.6 percent for any amount exceeding that figure. In January 2007, taxes were reduced to 20 percent on the first €5,000 of earned profits, 23.5 percent on profits up to €60,000, and 25.5 percent for profits exceeding that figure.

Insofar as state-levied taxes cover most government expenses, it can be said that taxation generates sufficient income. Competitiveness, however, may be harmed by the fact that the total of taxes and premiums on mandatory social insurance is relatively high when compared with international standards. The relatively low rates of taxation cannot offset the effect of payments into the social insurance system.

New Zealand

value 9

Taxation policy promotes two of three important goals. It has strengthened New Zealand's competitive position, and it clearly generates sufficient public revenues, as the national budget's operating balance shows. Following a prolonged period of fiscal deficits, New Zealand has achieved surpluses since 1993 – 1994 although the current government has correctly noted that change in the public capital stock should also be taken into account, an analysis that would diminish the apparent budget surplus. However, there is an inherent conflict between horizontal and vertical equity in the tax system.

Although policymakers have acted to broaden the tax base, some types of capital gains and rental income taxes from owner-occupied housing are still not included in the taxation scheme. On the other hand, the equal treatment of tax types, which was rendered possible only by setting relatively low rates, has undermined the principal of vertical equity by effectively pushing the average industrial worker to the top marginal income tax rate.

The individual income tax is very simple: there are only three tax rates, 19.5 percent for relatively low earners, 33 percent for middle incomes and 39 percent for higher incomes. There is little scope for tax rebates. Thus, the majority of taxpayers do not file an application for a tax return. The tax rates do not depend on marital or family status but apply separately to every individual, a provision that some critics argue treats single-earner families unfairly. In response, the government has introduced a support program for which large families of even relatively high income are eligible. The corporate tax rate is 33 percent, while tax rates for sole proprietorships coincide with the individual tax rates (but apply to net profits). Hence, there is a slight discrimination between companies and sole proprietorships. However, the simple tax system reduces administrative costs substantially and creates considerable transparency. In fact, the Inland Revenue Department's Web site allows anybody to estimate their tax bill using just a calculator.

Annotation:

New Zealand Treasury, “New Zealand Economic and Financial Overview 2007,” <http://www.treasury.govt.nz/economy/overview/2007> (accessed 15 October 2007).

Norway

value 9

Norway imposes a heavy tax burden on consumers, both through very high consumption taxes and relatively high labor income taxes. Corporate taxation is by contrast moderate compared with other countries, although the tax rate on dividends has been recently increased.

An important fiscal reform introduced in 1992 equalized taxation on different types of capital. However, residential capital is taxed at a significantly lower rate. In general the tax code is simple and equitable, and tax compliance is high.

A large share of the tax revenues is spent on personal transfers in the context of the welfare state, which contribute to making Norway a low-inequality society. The government also spends significant resources on infrastructure and the provision of public goods. However, expenditure on infrastructure is characterized by a strong (and arguably excessive) emphasis on remote regions. The high level of tax receipts, combined with significant oil revenue, make public revenue sufficient to sustain the government’s ambitious expenditure policy.

Slovakia

value 9

The Dzurinda government adopted a radical tax reform in 2004 which introduced a uniform (“flat”) tax rate of 19 percent for personal income, corporate income and consumption (VAT). It also abolished existing taxes on real estate transfers, gifts, dividends and inheritance, and closed a number of tax loopholes. The tax reform, which has received much international acclaim, has substantially increased the Slovak tax system’s competitiveness. And by stimulating economic growth, it has also helped improve the country’s fiscal stance. Although the tax system is less progressive than before, most citizens have benefited from the net effects of the tax and welfare reforms adopted. In the wake of reform implementation, the Dzurinda government resisted the temptation to water down some of the more unpopular changes, but left the high social insurance contributions untouched. Despite campaign promises to undo the “unsocial” flat tax, the Fico government has so far refrained from initiating major changes to the tax system.

Sweden

value 9

Sweden's tax policy is highly ideological. As a result, any assessment of the Swedish tax system is inevitably colored by the political leanings of the person performing the assessment. All in all, however, it is fair to say that the tax system meets the three goals of maintaining equity, fostering competitiveness and generating sufficient public revenues.

Although the tax system bears the marks of the extensive period in which the Social Democrats held power, it nevertheless bears some surprises. For example, Sweden has traditionally levied high taxes on individuals and low taxes on corporations. This tax mix is a compromise between fostering competitiveness and generating sufficient resources.

However, the tax system has occasionally had problems responding to international competitiveness, as skilled professionals have often chosen to work abroad where they receive larger salaries and pay lower taxes. Recent changes in tax legislation have made it possible for short-term, highly qualified visitors to Sweden to pay lower taxes. The current center-right government has also made some amendments in tax legislation aimed at promoting the creation of more working initiatives. At the same time, however, not all of the government's changes have promoted this goal, particularly its abolishment of real estate taxes.

Taken as a whole, however, unequal aspects of the Swedish tax system (e.g., the high taxes on consumption) have been balanced by high job security, a good labor environment and a complex social welfare system.

Switzerland

value 9

By international comparison, Switzerland has a low tax rate, particularly for businesses. Taxation policies are competitive and generate sufficient public revenues. As the country is a traditional "lean state," with a relatively small public sector and a low level of redistribution, the need for tax revenue is less than in other countries. However, the right given to municipalities and cantons to set their own tax rates leads to competition between areas, sometimes resulting in large differences between tax burdens for businesses and individuals. This limits the country's ability to maintain an equitable taxation policy.

Australia

value 8

Australia has traditionally maintained a very complex system of taxation, in which considerable administrative resources are devoted to ensuring compliance and reducing opportunities for evasion. The system is further complicated by the federal-state relationship, with the Commonwealth having the sole right to levy income tax.

At the federal level, taxation generates sufficient revenues, and budget surpluses have been substantial in recent years, despite several rounds of cuts to personal income tax rates. On the other hand, the states – having substantial responsibilities for expenditure – regularly complain that grants from the federal government are insufficient to provide services that are part of their responsibilities.

The income tax system is progressive except for indirect taxes, but progressivity has decreased over time. It is also essentially successful in achieving horizontal equity, the notable exception being that the self-employed are more favorably treated than employees. The top marginal personal income tax rate is currently 45 percent, but 80 percent of taxpayers face a marginal tax rate of 30 percent or less. The company tax rate is also 30 percent, although this is effectively not paid on dividends that are paid to Australian residents.

In spite of extensive debates about the current tax system, reform efforts have been minimal, with the single exception of an indirect consumption tax introduced in 2000. This was designed to replace a large number of small, inefficient taxes collected by the states. However, many have not yet been abolished. The tax system is widely regarded as too complex and too costly to comply with, but resources expended on tax compliance in Australia in fact compare quite favorably with other countries.

Austria

value 8

Due to Austria's extensive welfare system and public sector, the rates of taxes and public expenditure are generally high. The Austrian tax system is mainly based on income tax, while property tax and other forms of taxation only play a minor role. A major reform of the taxation system in 2005 has made Austria more attractive to foreign capital, particularly that of multinational companies using Austria as a gateway to Eastern Europe.

Disputes between those favoring an income-tax regime and those behind a property-tax regime have led to the current debates on future tax reforms. One main point of criticism is the disproportionate burden that the income-tax regime imposes on middle-class taxpayers, an increasing number of whom pay the maximum tax rate of 50 percent. The government has announced a tax reform for 2010, which is expected to entail a shift away from the dominance of income taxes.

Iceland

value 8

Tax policy remains a mixed success. For years, Iceland's taxes were considerably lower than the OECD average, but this is no longer the case. General tax receipts rose from 38 percent of GDP in 1990 to 49 percent in 2005, the largest such increase in the OECD over this period. However, central and local government expenditures have increased much less, from 42 percent of GDP in 1990 to 45 percent of GDP in

2007, compared with an average of 47 percent in the euro zone area in both years. The increased level of taxes since 1990 reflects the government's determination to repay rather than to keep accumulating public debt.

Four tax policy features stand out. First, corporate taxes have been lowered in order to encourage business activity. These fell from 49 percent to about 18 percent. This has worked well, helping to increase competitiveness.

Second, the level of household income at which income becomes taxable has slipped in real terms as price levels have increased, without a compensating adjustment in the tax-free limit. This has significantly increased low-income households' tax burden, and has made the distribution of disposable incomes less equal, as measured by the Gini index. Tax policy has thus been distinctly regressive.

Third, capital gains are taxed at significantly lower rates than labor income, adding a further regressive element to the government's tax policy. Tax policy bears a major responsibility for an unprecedented increase in the Gini index from 1993 onwards.

Finally, Iceland has a rather high value added tax (VAT) rate of 24.5 percent, affecting most goods and services except food. In March 2007, the VAT on books, heating, and a bundle of other goods was lowered from 14 percent to 7 percent.

Ireland

value 8

Since the 1950s, Ireland has used a low (and occasionally reaching zero) rate of corporate taxation as an instrument for attracting FDI. Owing in part to pressure from the European Union, this method has been modified over the years, and now a uniform 12.5 percent tax is applied to all corporate profits. There has been a consistent, cross-party consensus on the importance of preserving this rate of corporate tax to serve as a cornerstone for the economy's competitive position and favorable investment environment. Ireland introduced reductions in personal income tax rates in the late 1980s in order to promote wage moderation and foster international cost competitiveness, and thereby foster economic recovery.

The tax system seeks to impose vertical equity by using a system of tax bands with higher levels of taxation for money earned beyond certain income-defined thresholds. The level of these thresholds depends upon marital and familial status. Nevertheless, the extent to which the system actually is equitable is open to debate.

Overall, Irish tax revenue as a percentage of GDP is close to the OECD average. However, should tax rates and public financial needs come into conflict, the Irish public generally prefers to have a curtailment of ambitious public spending programs rather than an increased tax burden. This preference is the opposite of that held in many continental European countries. Increased prosperity, however, has recently facilitated increased public spending without jeopardizing the maintenance of a low tax burden. Rapid growth has also allowed the country to enter a cycle in which tax cuts have fueled growth while the state of public finances has still dramatically improved.

United Kingdom

value 8

Corporate taxes in Britain have been competitive since the end of the 1980s. Britain has been a forerunner in the European tax competition, which has attracted investors worldwide. Britain's European competitors have since lowered their corporate taxes as well, but Britain continues to have one of the most favorable conditions for investors.

In 2008, the corporation tax is to be cut from 30 pence per pound to 28 pence per pound, which will give Britain the lowest company tax rate of all major economies. However, lower corporation taxes have meant an increase of consumption taxes, which have hit lower-income individuals the hardest. Although personal income tax levels have been fairly equitable and moderate, the shift from direct to indirect taxation has distorted overall equity. Then again, taxation policy has been aimed at redistributing income from the top brackets to the bottom quintile. This has, in part, been the goal of various tax credits such as those mentioned under "labor market policy."

In terms of sufficiency, for decades, tax revenues have been inadequate in financing public services and infrastructure. Although the share of government investment in GDP has risen in recent years, it remains relatively modest in international comparison.

Denmark

value 7

The Danish system of taxation is clearly capable of generating sufficient public revenues. Since 1998, the general government budget has been in surplus, and public debt ratios have been falling dramatically. In general, the taxation policy has also been competitive, as can be seen by the fact that it has not substantially reduced the competitiveness of companies. Although their tax burden is high, companies and individuals still perceive it as bearable, and politicians who demand general tax cuts risk losing voters because it gives rise to the suspicion that it will diminish the public sector. At the same time, however, the rather high marginal income tax level (currently 63 percent) has often been singled out as problematic. Some believe that it destroys incentives to work more and makes it difficult for Danish companies to recruit foreign expertise. With equity, the problem is more difficult. In principle, Danish laws aim for the equal taxation of various types of income, and the tax burden placed on both individuals and companies is about the same. Moreover, according to some surveys, the amount of untaxed (or "black") labor is thought to be rather low. There is, however, the problem that several international companies operating in Denmark have been allowed to bend the rules to the extent that they do not pay any taxes in Denmark at all, which is undoubtedly a substantial failure when it comes to ensuring equity.

South Korea

value 7

Tax policies in Korea generate sufficient public revenues without impeding the competitiveness of the economy, but they are not designed to achieve a more equitable society. The tax burden in Korea is one of the lowest in the OECD, although it is projected to climb closer to the OECD average in the future. This is a necessary and inevitable development if public goods and services are to be improved. The government has advocated tax increases to finance various welfare programs for people in need, while government spending and the number of civil workers have increased.

Tax revenues are today sufficient to finance government spending, as the relatively small fiscal deficit proves. However, this positive situation is due mainly to the early stage of social security build-up. Today, social security systems have many contributors and few recipients, creating surpluses. In the future, this will change dramatically, as Korea has the lowest fertility rate and one of the fastest-aging populations in the OECD. The majority of government revenues come from a value-added tax that has a regressive effect.

Furthermore, the proportion of indirect taxation in South Korea is higher than other OECD countries. When the government increases taxes, companies simply raise prices in order to pass the burden to consumers. This also happens for direct taxes. The Roh Moo-hyun administration introduced a tax reform plan in 2005, in an attempt to curb property speculation and add a redistributive aspect to the tax system. However, when property tax or composite real estate tax has increased, owners of houses typically make tenants or buyers pay the related taxes.

Spain

value 7

Taxation policies are vertically equitable, although political parties argue over where boundaries of tax intervals should be. The business community complains about their tax burden, but the business climate is still competitive. However, it is increasingly believed that public revenues collected are not sufficient to enlarge the welfare state. It should be noted that Spain's black economy circumvents taxation. The sustainability of public finances overall is not adequately guaranteed. Although the positive effects of increased immigration help manage the rising costs of an aging population in the near term, a long-term strategy is required to tackle rising expenditures for the pension and health care systems.

As the central government is mainly responsible for collecting taxes while most of the management of expenditures is decentralized, it is difficult to exercise restraint over public expenses.

Competitiveness had traditionally been one of Spain's main weaknesses, but the reform of the tax system enforced January 2007 has directly addressed this problem. The corporate tax burden was lowered from 30 percent to 25 percent for small and midsize businesses and from 35 percent to 30 percent for larger firms. At the same

time, the reform introduced changes in personal income tax to foster equity. Tax reform directed the system toward a uniform treatment of savings and increased monetary incentives to work. The number of tax brackets was reduced to four and the top marginal tax rate was reduced from 45 percent to 43 percent. In addition, personal and family allowances were increased. Estimates are that personal tax payments will on average be reduced by 6 percent, while payments will decrease by even 17 percent for 60 percent of taxpayers in the lowest-income brackets, representing a remarkable victory for the equity of the tax system. With an intensified fight against tax fraud and money laundering and the phasing out of tax credits available to companies, (excepting those for R&D investment) tax evasion should be contained.

United States

value 7

The strong point of the U.S. tax system is its competitiveness. By OECD standards, it has a very low top marginal tax rate for both individuals and corporations, and one of the lowest levels of taxation as a percentage of GDP. The average rate for individuals who earned more than \$1 million in 2005 was 31 percent.

Horizontally, it derives roughly comparable amounts of revenue from corporate as it does from individual taxes. The vertical equity of the U.S. system is controversial, especially since the Bush administration's tax cuts of 2001 and 2003. Critics have criticized them as primarily benefiting the wealthy. However, that results from the fact that the wealthy bear most of the tax burden, and the cuts were roughly constant across income categories in terms of percentages of tax paid. It has to be born in mind, though, that the distribution of income in the United States has become increasingly unequal over a 30-year period.

Furthermore, the use of the payroll tax to finance the Social Security retirement system adds an important regressive element to the tax system because the base for the 7.65-percent tax is limited to approximately the first \$100,000 of income. In this way, the payroll tax takes a much larger percentage of income from lower-income people than it does from high-income people. In principle, the tax system appears capable of raising adequate revenues in relation to the funds required by government, but policymakers have not been willing to sustain an adequate level of taxation to achieve that result.

Annotation:

Congressional Budget Office, *Historical Effective Tax Rates: 1979–2004*. (Washington D.C, 2006); Douglas Holtz-Eakins, *Equity in the Tax Code*, Testimony before the U.S. House Committee on Ways and Means, September 6, 2007.

Czech Republic

value 6

The tax system has roughly covered expenditure needs, although there have been annual deficits exceeding 3 percent of GDP since the late 1990s. The Czech tax system has been characterized by minimal levels of property tax and low levels of personal income tax (around 5 percent of GDP), which reflects the unpopularity of these types of taxes and the difficulty of introducing higher levels after the communist period, in which they were insignificant. The rise of a segment of society with reasonably high incomes has been accompanied by strong political opposition to any increase in either the level or progressiveness of personal income tax. The high level of taxation on companies inherited from the past has also been reduced owing to a desire by much of the political spectrum to not exceed the level of other countries in East-Central Europe. Except for these cuts, the center-left government did little to reform the tax system. The current center-right government launched more comprehensive tax reforms in August 2007.

Germany

value 6

By international comparison, the German tax system is seen as uncompetitive and extremely complicated, due to the number of exceptions it allows. However, this assessment may be a bit unfair. A large number of German social welfare policies, including sickness, accident, unemployment and old-age funds, are in fact financed primarily through insurance contributions and not by tax revenues per se. These contributions, generally split in equal shares between employer and employee, are not taken into account here, though it bears mention that such policies are likely to depress employment relative to policies funded through taxation.

The Schröder government undertook several reforms aimed at reducing the tax burden on industries. Angela Merkel's government has continued this trend, introducing a further industrial tax reform in March 2007. This reform aims to reduce the tax burden on industries from 38 percent to less than 30 percent. The federal and state governments receive approximately €140 billion euro in value-added tax (VAT) per year. The VAT was increased to 19 percent in 2005, leading to a marked increase in consumers' financial burden. Further reforms include the reduction of the highest tax rate from 45 percent to 42 percent and the abolition of tax subsidies for commuters and tax advantages provided to home-builders. Despite such reforms, the German public still feels that their tax system lacks transparency.

Japan

value 6

In 2006, 38 percent of Japan's central government expenditures were financed by new government bonds, demonstrating that revenues are not sufficient. Moreover, there are persistent criticisms that the country's personal, consumption and corporate tax systems are unfair. Indeed, the system does have equity issues, with indirect taxation levels, particularly consumption taxes, set too low. This disadvantages workers who cannot avoid direct taxation of their income. While the government's Tax Council has suggested raising the value-added tax, first introduced in 1989 (and currently set at 5 percent, the lowest rate among OECD countries), governments have hesitated, wary of political fallout. By the end of this reporting period, Prime Minister Abe had not yet set a specific date for an increase. Obviously, policymakers are concerned that a consumption tax increase could jeopardize the unstable business upturn.

Japan's corporate tax burden is in the middle range of OECD economies. However, this may underestimate tax offices' laxity in accepting small and medium enterprises' (SMEs) declarations of business losses, which allow them to avoid paying taxes in exchange for expected political support. While this may let SMEs stay competitive in the short term, it hinders the long-term development of a healthy business sector. In 2006, a medium-term fiscal plan was drawn up for the first time, based on the 1997 Fiscal Structure Reform Law. This is a potentially positive step toward giving companies and other actors a reliable framework; however, it is short on specifics.

Annotation:

OECD, "OECD Economic Survey of Japan," Volume 2006/13, July 2006. http://www.oecd.org/document/55/0,2340,en_33873108_33873539_37127031_1_1_1_1,00.html (accessed June 20, 2008)

Belgium

value 5

Taxes in Belgium are high. The corporate tax is 34 percent for large businesses and 25 percent for smaller companies; income tax can top 50 percent. The high corporate tax can be an impediment to the country's competitiveness, especially in attracting global enterprises that also have the option of settling in lower-tax regions.

Tax rates for individuals are fairly progressive, and therefore the tax system is vertically equitable. Horizontal equity, however, is not guaranteed. The tax system focuses excessively on labor income and too little on capital income.

The Belgian public deficit has been contained now for several years, and the country's debt-to-GDP ratio is falling. Net debt was 89 percent of GDP in 2005, down from 109 percent in 1996. This decline in debt shows that current tax policy generates sufficient public revenue.

Hungary

value 5 Tax policy under the Gyurcsány government has suffered from frequent changes. Substantial tax cuts in 2005 were followed by tax increases within the framework of the government's 2006 post-election austerity program. Changes have included the imposition of a 4 percent "solidarity tax" for companies and private entrepreneurs, as well as a broadening of the corporate income tax base, thus raising some concerns about a decline in Hungarian competitiveness. Unlike other countries in the region, Hungary has kept a progressive personal income tax. However, equity issues have been raised by the persistence of rampant tax evasion and the differential treatment of foreign and domestic enterprises.

Mexico

value 5 Taxation policies largely have failed either to abide by principles of equity or to generate sufficient public revenues. Mexico's level of tax revenue as a percentage of GDP ranks among the lowest of any OECD country. It is also low in comparison to countries with a similar level of development. In contrast, rates of tax evasion are among the highest in the OECD world, again highlighting deficiencies with regard to the rule of law. Thus, the advantage of a comparatively modest tax burden is undermined by the problems with obtaining sufficient resources to finance basic public goods, such as security or a well-functioning education system. In addition, public finances' excessive dependence on taxes levied on oil production and exports (rates here are close to 40 percent) have been for many years another major weaknesses of the Mexican tax regime. The exemption of food and medicines from the value-added tax, along with its relatively low rate (15 percent, though effectively lower due to exemptions) is another important weakness of the system.

Poland

value 5 Since 2004, when it cut the corporate tax rate from 27 percent to 19 percent, Poland has had one the lowest corporate income tax rates in the European Union. While the tax system thus is competitive, it suffers from a high tax wedge and massive tax evasion. Moreover, tax revenues have not been sufficient in financing government expenditures. The PiS government announced plans for tax reform for 2007 but failed to deliver. The main change in the tax system under the PiS government has been a significant reduction of the inheritance and gift tax.

Portugal

value 5

Portugal's current tax policy does not realize the goals of equity and competitiveness, and only realizes the goal of generating sufficient public revenues. Indeed, the government's main theme over the past two years has been to increase taxes enough to decrease the unacceptably high public sector deficit, which reached 6.0 percent in 2005. In general, taxes in this period have increased some 30 percent. Tax policy is not successful when it comes to guaranteeing equity. Those who are self-employed, for example, such as doctors and lawyers, are able to avoid taxation on their full incomes, which is not possible for those employed in the public sector or by private companies. Moreover, it is also unsuccessful in terms of competitiveness, as high taxes discourage investment.

Tax administration and collection have recently seen significant improvements as a result of updated registers, better use of electronic services, more reliable databases and a better use of cross-checking (all of which are mostly linked to reforms of the SIMPLEX program). The improved collection of existing taxes is one of the main reasons behind the increase in fiscal revenue. Nevertheless, there is still room for improvements in the tax framework, for example, by promoting a fairer and simpler business and tax environment (including measures such as further broadening the tax base, increasing the system's simplicity and predictability, reducing administrative and compliance costs, and upgrading Portuguese tax services).

France

value 4

Like their Scandinavian counterparts, French citizens and businesses carry one of the highest tax burdens of any European country, which limits France's competitiveness internationally. France's tax policy also places an undue burden on certain citizens; approximately 10 percent of taxpayers generate the majority of income tax obtained by the government. Also, taxes in France have continued to increase over the last three decades. Newly introduced taxes such as a "wealth tax" have not been able to contribute to the sustained reduction of France's budget deficit, but have instead exacerbated the growing problem of tax evasion in the country.

Italy

value 4

There are strong doubts about Italy's taxation policy in fulfilling the desired goals of equity, competitiveness and the generation of sufficient public revenues. A high degree of tax evasion on regular work, services and goods as well as the existence of a large black market (such as Mafia-related operations) have driven the whole system to a critical point. Opposition parties have suggested a tax-paying strike as one instrument in fighting against government parties. Italy's political culture seems

to exclude bipartisan efforts in backing programs to collect taxes. Due to massive fiscal evasion, taxation policy is equitable only on paper. In fact, to guarantee debt sustainability, the fiscal pressure must remain very high on those households or companies that do regularly pay taxes, which in turn results in lower disposable income and a general loss of competitiveness for those who are tax-compliant. Particularly for enterprises, official data has shown that the total tax rate on profits is extremely high, and certainly the highest among all OECD countries. A large part of the low rating given to the assessment of taxation policy is that revenue from high taxes is often used toward largely unproductive public spending. On a more positive note, the government under Prime Minister Romano Prodi has done a good job in fighting tax evasion, although a lot more remains to be done.

Greece

value 3

Greek fiscal policy is not only arbitrary, inequitable and complicated; it also leads, despite having a highest tax rate of about 40 percent, to very moderate national revenue. This can be verified by the high levels of national debt, currently more than 100 percent of GDP. The inequity and arbitrariness of the fiscal policy is proved by a notional assessment applied in many cases on a broad basis. For example, the revenues of certain assets, certain professions, small- and medium-sized enterprises as well as crafts enterprises are assessed at a fixed rate.

In the period under investigation, the incumbent government launched a plan to decrease corporate taxes and personal income taxes. However, taxation policies fail to adhere to the core principles of equity, competitiveness and the generation of sufficient public revenue. Taxation is particularly ineffective in terms of equity and competitiveness. Over time, there has been some progress in increasing public tax revenue, but the share of indirect taxes over direct taxes (about two-thirds of tax revenue comes from indirect taxes) prohibits taxation from functioning as a redistributive tool. Tax evasion is rampant, with the black-market economy estimated to amount to 30 percent to 35 percent of the country's annual GDP. The tax base itself is narrow, with wealth taxed hardly at all, and landed property taxed at very low rates. If tax policy is not streamlined, problems of fiscal sustainability will ensue.

Turkey

value 2

Turkish tax policy is not equitable or competitive. The taxation system creates a heavy burden both on wage-laborers and on business. The share of taxes (without social security contributions) amounts to 29.3 percent of GDP. The OECD average is 27.5 percent; and among low-income countries, the ratio is just 17 percent.

For wage earners, taxes and social security contributions total 42.7 percent of income, which represents the highest taxation rate among OECD countries. High

taxes are one of the main reasons for the country's large, informal employment sector that constitutes 32 percent of Turkey's overall economy – a situation which skews the competitive landscape.

Another serious source of inequity is the level of indirect taxes (for example, a tax on consumption rather than income or assets) which are paid equally by the poor and the wealthy. This includes value-added tax and various consumption taxes. Indirect taxes constitute about 70 percent of Turkey's total tax revenue (the EU average is around 35 percent).

Tax evasion is widespread and has grown in recent years. The ratio of actual tax control does not exceed 2 percent.

This report is part of the Sustainable Governance Indicators 2009 project, which assesses and compares the reform capacities of the OECD member states.

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