COMMISSION ON TAXATION
AN COIMISIÚN UM CHÁNACHAS

PART 4
THE MACROECONOMIC FRAMEWORK AND THE BALANCE OF TAXATION

Part 4:
The Macroeconomic Framework and the Balance of Taxation

Section 1 is an introduction.

Section 2 deals with the Irish economy.

Section 3 deals with the balance of taxation on income, capital and spending.

Section 4 deals with issues of fiscal sustainability.

Appendices 1 and 2 contain supplementary information.

Our recommendation in this Part is as follows:

4.1	The base-broadening measures in our Report should be introduced on a revenue neutral basis. In this context priority should be given to lowering the tax burden on labour.

Section 1:
Introduction

Our terms of reference invited us to consider how best the tax system can support economic activity and promote increased employment and prosperity while providing the resources necessary to meet the cost of public services and other Government outlays in the medium and longer term.

We were also asked, in the context of maintaining an equitable incidence of taxation and a strong economy, and having regard to the commitments on economic competitiveness and on taxation contained in the Programme for Government[1] to *"examine the balance achieved between taxes collected on income, capital and spending"*.

To address these issues, we examined the following elements:

- The balance between tax on income, capital and spending
- Issues of fiscal sustainability

In considering this macroeconomic perspective on taxation, this Part of our Report provides a brief overview of the Irish economy (Section 2). It then examines the balance between taxes on income, capital and spending (Section 3) and suggests an approach to determining that balance in the future in a manner that will best serve long-term economic growth, in the context of wider social objectives. Section 4 examines issues of sustainability of the fiscal balance into the medium and longer term.

Under our terms of reference, our focus is primarily concerned with the medium and longer term. While the fiscal difficulties that exist at the time of writing are likely to persist for some time, the main and intended focus of our Report is strategic as is consistent with our terms of reference.

Section 2:
The Irish economy

2.1 Economic background

The Irish economy has experienced dramatic change since the reports of the previous Commission on Taxation more than 25 years ago. In the intervening years Ireland has experienced significant economic growth with living standards converging on, and in some cases surpassing, those of other developed economies.

Average economic growth of over 6% was achieved from 1987 to 2007.[2] The economic and social impact of this is perhaps best seen in the labour market: the number of people in employment almost doubled from 1.1 million in 1987 to 2.1 million in 2007; and unemployment correspondingly decreased from 17% to 4.5% over the same time period. The sources of economic growth varied over this time period, with domestic components becoming more prominent in recent years.

1 The commitments in question are listed in Section 1 of Part 2 of our Report.

2 This figure is for real growth in Gross Domestic Product (GDP); for Gross National Product (GNP) the real growth rate was 5.5%. Economic growth is valuable as both a policy objective and an indicator because typically it is highly correlated with employment and income. Policy on taxation, however, affects the interrelated areas of economic, social and environmental performance and thus the Commission is concerned with economic growth that is sustainable.

The economic environment changed quite suddenly in 2008 with Ireland entering into recession. Both domestic and international reasons lie behind this change in the economy. Domestic drivers of economic growth contracted and the world economy experienced its biggest downturn since the 1930s. This has led to a sharp increase in unemployment. The future environment remains uncertain as policy responses to the economic, financial and property market situations, both domestic and international, continue to develop.

Despite the current difficulties, research by the ESRI estimates that Ireland's 'potential' output growth rate is still around 3% a year. The International Monetary Fund (IMF) makes a more conservative estimate that potential output growth for Ireland is in the range of 2%, in the medium term[3]. Ireland's underlying strengths which will underpin this future growth include a young and highly educated workforce, a flexible labour market, the quality of our public servants, high levels of investment in modern infrastructure, access to the EU's internal market of almost 500 million people, a stable currency in the euro, an established presence in key business sectors, relatively low government debt entering the current downturn, an environment that supports enterprise, strong democratic and social institutions and a commitment to social cohesion and equity.

2.2 The current environment

The ESRI lists four major challenges for the Irish economy in 2009: the restoration of order to the banking system, the structural re-balancing of the Government accounts, the correction of the serious loss of competitiveness, and the economic and social consequences of the increase in unemployment. A similar analysis is offered by NESC who suggest that in this current environment Ireland faces five interrelated challenges: banking, fiscal, economic, social and reputational.[4]

Any recovery in the Irish economy will not be brought about by taxation policy alone but rather, as the ESRI notes, "is likely to occur initially through a recovery in world demand, increasing the demand for Irish exports".[5] Thus while our long-term structural proposals will make a contribution to the short-term challenges facing this country, they will primarily address the fiscal situation and not the overall economic downturn. Nevertheless, in the medium to longer term, the structure of the taxation system will play a significant role in enabling Ireland to achieve its economic and social policy objectives.

2.3 Fiscal policy

Our intention since we commenced our work in early 2008 has been to propose a new structure for the tax system that could be adopted in a revenue neutral manner. Our terms of reference make it clear that we are to have regard to keeping the overall tax burden low. Under this approach the extra revenue that is raised by our proposals for new taxes and reforming existing taxes and tax expenditures should be available to reduce the existing tax burden, particularly the tax burden on labour. In this way our structural reform should allow the taxation system to collect a set amount of revenue with less distortion to the economy and in a more equitable manner.

Despite the fact that events have overtaken our work and the downturn in the Irish economy has had adverse consequences for the Government's fiscal position, our emphasis remains on a new

3 'Ireland: 2009 Article IV Consultation', International Monetary Fund, June 2009. For a similar estimate see also 'Potential Output in Ireland', K. Whelan, TCD-DEW conference, 20 May 2009.

4 'Ireland's Five-Part Crisis: An Integrated National Response', NESC, No. 118, March 2009.

5 'Recovery Scenarios for Ireland' ESRI, May 2009.

tax structure which can be delivered in a revenue neutral manner. Our terms of reference are to consider the structure of the taxation system for the "medium and longer term". Our remit is not about broader fiscal policy and the short-term pressures facing Government. A well-structured tax system will raise a given amount of tax revenue in a way that both causes least harm to the economy and is equitable; deciding on the exact quantum of tax revenue to be raised involves wider fiscal and macroeconomic issues and is a matter for Government.

We believe that the extra revenue our proposals raise should primarily be used to lower labour taxes. In particular, the extra revenue that is raised from reforming the various tax expenditures discussed in Part 8 of our Report should be re-used within the labour tax system to maintain Ireland's competitive labour tax wedge. Keeping labour costs competitive, including the direct tax costs as measured by the labour tax wedge, supports demand for labour and employment levels; this important fiscal objective is explored in Part 7 of our Report. This use of the revenue - raised on the basis of our tax expenditure reform proposals - would mean that in the longer term the percentage of tax revenue that comes from labour will remain the same but, by coming from a broader labour tax base, will have less distorting impact on the economy. In addition, the broadening of the overall tax base by introducing an annual property tax, a carbon tax and water charges facilitates the reduction of the tax burden on labour.

We are conscious of the impact that the new base-broadening measures could have on individuals and households. We believe that each new individual measure is justified on its own merits, as outlined in the respective Parts of our Report. The desired overall impact of our proposals is optimised when the burden of labour taxes is reduced. As well as maintaining the low tax wedge, a reduction in the labour tax burden would lessen the cumulative impact of these measures on the disposable income of individuals and households and also sustain labour force participation. This focus on labour-force participation is important because of the impact the waivers and exemptions in our proposed property tax, carbon tax and water charges, in particular, will have on the rewards of work and incentive to seek employment.

The additional revenue raised by the broadening of the tax base could reduce the overall labour tax burden on individuals in a number of ways: reducing the standard or higher rate of income tax, reducing the income levies, increasing the main credits or widening the standard rate bands. For example, each extra €1 billion in revenue raised as a consequence of our recommendations would finance one of the following options: the standard rate could be reduced by two percentage points, the higher rate could be reduced by five percentage points, the income levy rates could be reduced by 50%, the personal and the employee tax credits could be increased by €300 each or the standard rate band could be widened by approximately €7,000. There is of course a variety of possible combinations of these options, and we recognise that these are choices for Government to make in the context of future budgetary policy.

If further tax revenue is to be raised, we believe that raising extra revenue by broadening the tax base, both within particular tax heads and across the taxation system, will impact less negatively on economic growth than simply increasing tax rates. Our macro perspective on the balance between different tax categories, presented in the next section, includes a ranking of different taxes according to their impact on economic growth.

2.4 Conclusion

The Commission's intention since we commenced our work in early 2008 has been to propose a new structure for the tax system that could be adopted in a revenue-neutral manner. The recent change in the economic environment has impacted greatly on the country's fiscal position. We recognise that the timing of the proposed compensatory measures is challenged by the current fiscal situation. However, it is still our approach that by broadening the base of the tax system, revenue is made available to reduce the existing tax burden on labour.

Recommendation 4.1

The base-broadening measures in our Report should be introduced on a revenue neutral basis. In this context priority should be given to lowering the tax burden on labour.

Section 3
Balance of taxation on income, capital and spending

3.1 Definitional issues

We have interpreted the terms 'income', 'capital' and 'spending' in the terms of reference as meaning the following:

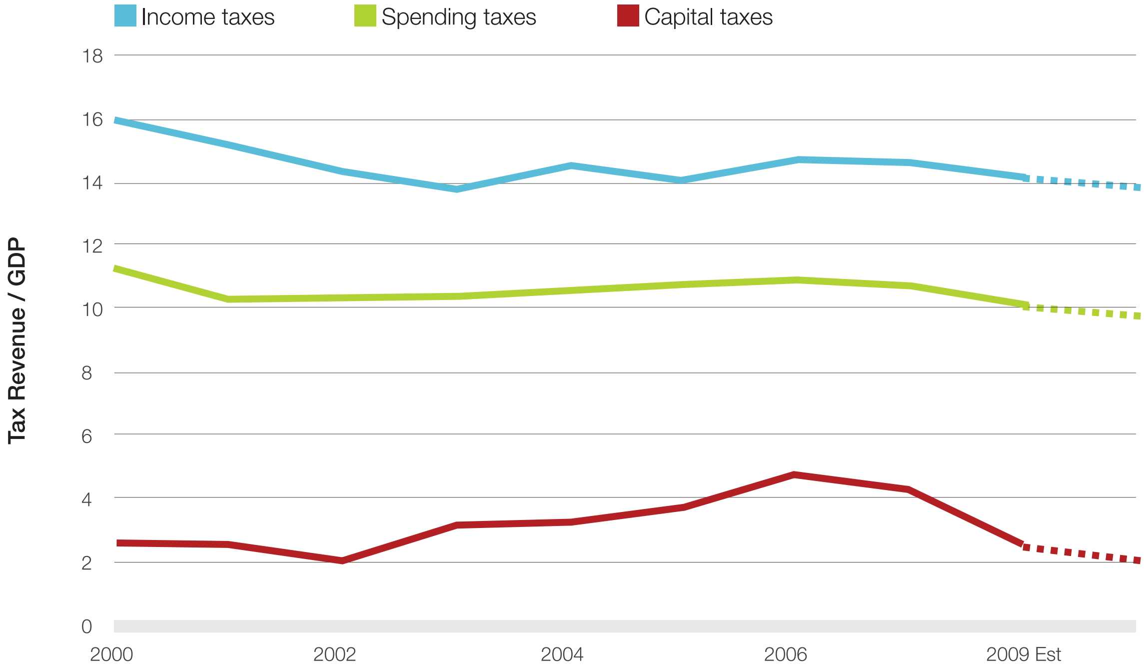
- *Taxes and levies on income:* This relates to all taxes and levies on income and includes both income tax and corporation tax[6] as well as employer and employee PRSI
- *Taxes on capital:* This covers taxes on capital assets, including property, whether on gains on the disposal of such assets or on the acquisition or holding of such assets. It includes stamp duty, capital acquisitions tax and local authority rates
- *Taxes on spending:* This covers VAT and excises (and would include a carbon tax if one were in place)

3.2 Analysis of historical tax revenue data

Historical tax revenue data, with taxes grouped in accordance with the above definitions, are presented graphically in Figure 4.1 with tax revenue expressed relative to GDP. The data show a trend of increased reliance on taxes on capital with a reduced reliance on taxes on income and spending. This trend then reversed after 2006 as the yield from capital taxes declined. Within capital taxes, property related taxes grew in importance: in 2006 the proportion of total taxes accounted for by stamp duty was over twice that in 2000. Data from the Revenue Commissioners indicate that in the years 2005 and 2006, stamp duty on property accounted for about 75% and 82%, respectively, of all stamp duty receipts for those years.

6 In general, companies pay corporation tax on capital gains and it has not been possible to identify tax on capital gains of companies separately from tax on corporate income.

Figure 4.1: Irish balance of taxation 2000-2009



Source: Figures prepared by the Commission Secretariat based on Exchequer data obtained from the Department of Finance. Data for 2009 are estimates.

3.3 Analysis using Eurostat data

We examine Ireland's situation in an international context in Table 4.1 which shows Ireland's position in 2007, the latest year for which data are available, against the EU average in that year using the Eurostat classification of taxes under the headings of capital, labour and consumption. The Table also shows Ireland's average position over the period 2000 to 2007 compared with the average position in the European Union over the same period.

Table 4.1: Taxes on capital, labour and spending, as a % of total taxation

Eurostat Definitions				
	2007		Average 2000 to 2007	
	Ireland	EU 27	Ireland	EU 27
Capital	30.0	21.3	28.3	19.7
Labour	34.2	45.2	34.7	46.7
Consumption	35.8	33.6	37.1	33.8
Source: 'Taxation Trends in the European Union', Eurostat, 2009 Edition.				

Commission Definitions as set out in section 3.1

	2007	Average 2000 to 2007
	Ireland	**Ireland**
Capital	14.1	11.1
Income	49.2	51.4
Spending	36.6	37.5

Source: Data prepared by the Commission Secretariat based on Exchequer data obtained from the Department of Finance. Data for EU 27 using definitions as set out in section 3.1 are not readily available.

The Eurostat classification of taxes provides for different groupings from our classification as outlined in section 3.1 above. One key difference relates to the treatment of corporation tax and of income tax from self-employed persons. These taxes are treated as taxes on capital rather than taxes on labour. Appendix 1 provides further details of the Eurostat classification. For illustrative purposes, we include, in the lower part of Table 4.1, the relevant Irish data under our classification as set out in section 3.1.

Using the Eurostat data, it would appear that, for Ireland, the proportion of total taxes accounted for by labour is significantly below the EU average for 2007, as well as on average over the period 2000 to 2007. One important reason for this is the lower amount of social security contributions in Ireland as compared with many other Member States.

Analysing the data for each individual Member State indicates that there is no normative balance which ought to be put in place (see Appendix 2). Each Member State has followed its own policy with the result that a wide range of approaches is adopted across the European Union.

3.4 The balance of taxation and economic growth

In seeking to determine what the appropriate balance should be, a range of policy objectives is relevant including economic growth, international competitiveness, equity and environmental issues. Focusing on the first policy objective of economic growth suggests a hierarchy of different taxes in terms of their economic impact. This economic growth 'ranking' of taxes suggests that increases in corporate taxes are most harmful for growth, followed by increases in personal income taxes and then spending taxes. Annual taxes on immovable property appear to have the least impact.

There are three related grounds for this ranking. First, the more mobile a factor is, the more responsive it will be to a change in taxation. Thus a tax on less mobile factors will cause less economic distortion. Second, this ranking accords with current international evidence in this area, as presented in a recent OECD review.[7] This paper suggests that a revenue neutral growth-oriented tax reform would be to shift part of the revenue base from taxes on personal and corporate income to less distortionary taxes such as annual taxes on immovable property or on spending. Third, our ranking is also in agreement with recent Irish research by the ESRI which predicts the impact different tax increases would have on the economy, using the country's main macroeconomic model.[8]

7 'Tax and Economic Growth', OECD Economics Department Working Paper No. 620, 11 July 2008. The document refers to economic growth as being growth in GDP per capita. A later OECD document *'Going for Growth 2009'* presents the key findings of this and other working papers in a less academic fashion. In May 2009, we also consulted with Professor Chris Heady, a co-author of this research.

8 'The Behaviour of the Irish Economy: Insights from the *HERMES* macro-economic model', A Bergin et. al., ESRI Working Paper No. 287, April 2009.

It is important to note that this ranking cannot be converted into a simplistic 'one size fits all' model for tax policy. The particular circumstances of a specific country may give reason to expect deviations from this ranking.[9] Examples of this could include countries with different levels of mobility or different cultural attitudes to taxation and its contribution to society. In this way different models may be appropriate for different countries. The appropriate ranking may also change at different points in time. The ranking proposed here is for incremental changes from the existing balance of taxation.[10]

Ireland is a small open economy with some particular characteristics related to mobility. Our history of emigration and geographical proximity to the UK, in particular, have resulted in Ireland having a very open labour market; and the structure of Irish industry shows the important contribution of mobile foreign direct investment (FDI). These issues affect both corporate taxes and labour-related taxes and are dealt with in more detail in Part 7 of our Report. However, it should be noted that Ireland already has a low and stable rate of corporation tax.

Using this ranking to guide the economic efficiency dimension of tax policy is in accordance with our base broadening approach to tax reform outlined in Part 2 of our Report. A well-balanced tax structure is one part of having a broad tax base and it enables lower tax rates. Broadening the base by introducing an annual property tax and a carbon tax is generally better for Irish economic growth than increasing rates of income tax. Reflections on applying this growth ranking to individual taxes in Ireland are presented briefly below.

The second aspect of base-broadening is to reform each individual tax by broadening its base and reducing tax rates. This policy of improving the design of individual taxes is a complement to changing the balance between different tax sources.

Both methods of base-broadening and rate reduction are likely to contribute to long-run economic growth. However, policymakers need to consider any trade-off between these growth-enhancing proposals and other objectives of tax policy, particularly equity.

3.5 Taxes on capital, specifically immovable property

The ranking outlined above indicates that annual taxes on immovable property are least damaging to economic growth. While taxes on capital increased as a proportion of total revenues in Ireland up to 2006, the growth was based to a large extent on transaction taxes on property at prices and levels which were cyclically–based and not sustainable. There is, therefore, a need to address this structural weakness in the capital tax base. An annual tax on residential property would help to achieve this.[11] In Section 4 we address the issue of long-term sustainability of tax revenue and fiscal balance.

3.6 Taxes on spending

Another implication of the ranking of taxes in section 3.4 is that a positive outcome for economic

9 The OECD paper notes that empirical results based on cross-country macroeconomic data only yield results that are true on average.

10 This ranking is based on empirical evidence, both Irish and international, relating to the existing balance of taxation, and thus strictly only holds for incremental changes from the existing balance. On a technical note, the marginal economic cost of raising revenue should be equated across each tax head in order to achieve an economically efficient balance across different categories of taxation. In general, the marginal cost of raising revenue from a tax head will increase as the tax rate increases. Therefore if there was a very large change in the tax rate pertaining to a particular tax head, the associated marginal cost would rise substantially, and thus the tax and growth ranking could change.

11 Businesses are already subject to an annual tax on property in the form of local authority commercial rates.

growth could be achieved through a shift to spending taxes, although such a move would reduce progressivity. This view is echoed by the European Commission document *Public Finances in EMU-2008* where, in the context of a discussion on alternatives to taxes on labour, it indicates that the shift from labour taxation or social security contributions to VAT may produce positive, but limited, employment and growth effects.

The main changes which could be looked at are base-broadening and rate changes. There would seem to be merit in keeping the option of base-broadening open as a possibility for the longer term although there may be equity considerations associated with this topic which would have to be addressed. As indicated, questions of progressivity can arise. For example, if the VAT base was broadened and the standard rate of VAT (currently 21.5%) was reduced on a cost-neutral basis, this would imply a significant increase in the price of items which are currently zero-rated. In addition, the cost of luxury items would reduce in such an event. Having regard to this consideration, we are not recommending immediate action in relation to VAT.

Additional spending taxes may have a role to play as part of a broader based tax system. In this regard, our recommendations to introduce a carbon tax and water charges, for example, will lead to an increase in taxes on spending.

3.7 Taxes on personal income

The evidence underlying the growth ranking of taxes outlined in section 3.4 suggests that income taxes should be kept as low as possible with base-broadening and rate reduction being favoured where possible. With regard to the issue of base-broadening, our review of tax expenditures has brought forward a wide range of proposals which will assist in achieving such a purpose. There is some evidence that a flatter structure (i.e. a less progressive personal income tax system) may be better for growth. However, there is a potential cost in terms of equity and we therefore do not recommend such an approach. In practice, there will always be a need to balance the aim of economic growth against the principle of equity in the personal income tax system.

3.8 Corporation tax

There is a body of opinion that low and stable statutory corporate tax rates can lead to particularly large productivity gains in firms that are dynamic and profitable, and we are conscious of the positive employment consequences arising from this. In addition, low rates are one of the factors that encourage inward investment. Ireland already has a low corporate tax rate and our terms of reference require us to have "regard to the commitments on economic competitiveness and on taxation contained in the Programme for Government, in particular, the guarantee that the 12.5% rate of corporation tax will remain". The current rate of 12.5% is a strong brand for Ireland's domestic economic activity and inward investment and, as a rate, is appropriately low. We are supportive of Government commentary that there is no intention to move it either upwards or downwards. The stability of the rate over the last decade (following on from the existence of the 10% manufacturing rate for almost 30 years) is a significant reinforcement to the actual rate itself.

We thus omit corporation tax and suggest that the hierarchy for raising revenue is property taxes, spending taxes (especially environmental taxes), and income taxes in that order.

3.9 Conclusion

In striking the appropriate balance of taxation between income, capital and spending, Government in its approach to revenue raising should

- Seek to broaden the base within each tax head, and
- Look to property taxes, spending taxes (especially environmental taxes), and income taxes in that order

Section 4:
Issues of fiscal sustainability

4.1 EU Stability and Growth Pact (SGP)

Under Economic and Monetary Union (EMU), the Stability and Growth Pact sets out the framework in which Ireland's fiscal policy must operate. The sustainability required of member countries focuses on two criteria:

- Annual government deficit

  The ratio of the Government deficit to GDP must not exceed 3%. EU rules provide "for an exception if an excess over the reference value is only exceptional and temporary and if the ratio remains close to the reference value"
- Government debt

  The ratio of gross government debt to GDP must not exceed 60%

In addition to avoiding a deficit of more than 3% of GDP, the SGP requires member countries to adhere to a medium term budgetary objective of keeping their budget balance close to balance or in surplus. In March 2005, the European Council decided to allow greater flexibility in the rules. For example, where a deficit in excess of 3% arises, a member country may avoid an Excessive Deficit Procedure[12] if negative growth or a protracted period of low growth relative to potential growth is experienced; previously a fall in GDP of 2% was required to avoid a fine. The periods in which corrective action must be taken were also extended to account for circumstances where "unexpected adverse economic events with major unfavourable budgetary effects occur during the excessive deficit procedure".[13] In addition, to allow for investment, the scope for greater budgetary flexibility over the medium term was put in place for member countries with low debt and high potential growth.

4.2 A counter-cyclical fiscal balance

It is our view that, for the longer term, fiscal policy should pursue a cyclically adjusted budgetary approach. This approach would take into account that the budget balance is influenced by the position of the economic cycle.[14] When the economy grows rapidly, incomes, consumer spending, and company profits will all increase, leading to growing tax revenues. Conversely, as the economy slows, tax revenues may decrease while at the same time government spending

12 This is essentially an enforcement process exercised by the European Commission on behalf of the European Union.

13 Presidency Conclusions (P37) European Council Brussels, 22 and 23 March 2005, Ref. 7619/1/05 REV 1.

14 The term economic cycle refers to economy-wide fluctuations in production or economic activity over several months or years, around a long-term growth trend. It typically involves shifts over time between periods of relatively rapid economic growth (expansion or boom), and periods of relative stagnation or decline (contraction or recession).

increases to meet expanding social welfare commitments. This means that in the high growth years, a surplus might actually be a deficit in cyclically-adjusted terms, and thus fiscal policy might need to be tightened through decreased current spending or increased taxation. This way, when economic conditions are less benign, public spending may be increased and/or taxes lowered in order to support greater economic activity. In such a scenario the budget deficit may be cyclical and so consistent with a balanced budget over the course of the economic cycle.

The rationale for counter-cyclical fiscal policy in Ireland is now stronger because as a member of the euro we do not have our own currency and thus no longer have access to two national economic policy tools: exchange-rate policy and monetary policy. This places greater emphasis on the role of fiscal policy in demand management.

The structural deficit or surplus (the fiscal balance adjusted for the cyclical element) should be a prime focus of the budgetary process and should, for example, be given as much prominence in the written and oral presentation of the budget as the 'ordinary' fiscal balance. The projected pre-Budget cyclically-adjusted deficit or surplus should be published. While acknowledging the difficulty in measuring the structural balance, we believe that an independent body, for example the ESRI, might be requested to determine the beginning of the cycle and the point in the cycle in the form of a pre-Budget report. Our concern is for a counter-cyclical budgetary approach that achieves balance over the economic cycle. With regard to capital spending, we advise some flexibility, in particular so that the large costs that can be incurred by a 'start-stop' approach to large capital projects are avoided and best value for money is achieved.

4.3 Longer term sustainability

The long-term sustainability of the public finances is an important component of overall economic stability which is in turn critical to economic growth and increased employment. As indicated by Lane,[15] "a non-sustainable fiscal position is destabilising for the economy. Taxpayers and investors find it difficult to make commitments if there is excessive uncertainty about the future level of taxation."

In our view the general approach to fiscal policy in the longer term should be consistent with the following principles outlined by NESC:

> *"Public finances must be managed on a sustainable basis. Sustainability requires that the public finances are in a position to absorb the normal budgetary pressures that arise. From a longer term perspective, sustainability requires that the public finances are managed on a basis such that the longer term costs associated with the ageing of the population can be met."*[16]

In this regard, Part 10 of our Report discusses how the tax system can encourage long-term savings to meet the needs of retirement. That Part constitutes an input into the much larger question of pension provision within Ireland in the context of the changing demographics of the population. Taxation policy on its own cannot resolve the increasingly onerous pension issues that will confront our society over the coming decades.

A further element that is important in achieving a sustainable fiscal balance is that public spending

15 'A New Fiscal Strategy for Ireland', P. R. Lane, The Economic and Social Review, Summer 2009.

16 'NESC Strategy 2006: People, Productivity and Purpose', No. 114, December 2005.

should be based on a stable revenue base. Unstable sources of tax revenue can be pro-cyclical taxes which can intensify the business cycle and, as we have seen, fiscal policy is now more important in demand management post-EMU. This suggests, for example, a move away from a transaction-based tax on property (for example stamp duty), and towards introducing more stable revenue sources such as an annual tax on property, user charges and other local service charges.

Another sustainability issue for countries within EMU is that, in the absence of a monetary policy lever at national level, fiscal policy instruments may be needed as a policy tool to help avoid asset price bubbles. Research into this area is still developing but it can be expected to mature in the next couple of years after the present economic crisis, with its roots in the financial markets, is thoroughly researched. Policymakers should follow this work as it progresses and as more definite conclusions become available.

4.4 Conclusion

Our preference is for a counter-cyclical budgetary approach that achieves balance over the economic cycle. We advise some flexibility with regard to capital spending. In addition, public spending should be based on as stable a revenue base as possible.

Appendix 1

Definitions used by Eurostat/European Commission in their publication 'Taxation Trends in the European Union' for the taxes on consumption, labour and capital

Definition of taxes on consumption

Taxes on consumption are defined as taxes levied on transactions between final consumers and producers and on the final consumption goods. These can be identified as the following categories:

- Value-added type taxes
- Taxes and duties on imports excluding VAT
- Taxes on products except VAT and import duties, which include excise duties except stamp taxes, and taxes on financial and capital transactions have also been recorded as capital taxes
- Other taxes on production, including taxes on international transactions, taxes on pollution and the under-compensation of VAT (flat-rate system)
- Other current taxes such as poll taxes, expenditure taxes, and payments by households for licences

Definition of taxes on labour

Taxes on labour fall into two categories – taxes on employed labour income and taxes on non-employed labour income.

- Taxes on employed labour income
  Taxes on employed labour comprise all taxes, directly linked to wages and mostly withheld at source, paid by employers and employees, including compulsory social contributions. They include compulsory actual employers' social contributions and payroll taxes, compulsory social contributions paid by employees and the part of personal income tax that is related to earned income

- Taxes on non-employed labour income

  Taxes on non-employed labour comprise all taxes and compulsory social contributions raised on transfer income of non-employed persons, where these can be identified. This transfer income includes social transfers that are paid by the State, for example, unemployment, invalidity and health care benefits and benefits from old-age pension schemes (both State and occupational pension schemes)

Definition of taxes on capital

The term 'capital' is defined broadly, including physical capital, intangibles and financial investment and savings. Capital taxes include taxes on business income in a broad sense; not only taxes on profits but also taxes and levies that could be regarded as a prerequisite for earning profit, such as property tax or motor vehicle tax paid by enterprises. Taxes on capital include capital and business income taxes and taxes on stocks (wealth) as follows:

- Capital and business income taxes

  These include taxes that economic agents earn or receive from domestic resources or from abroad. They includes taxes on income or profits of corporations, taxes on income and social contributions of the self-employed, plus personal income tax raised on the capital income of households (rents, dividends and other property income). In practice, this is mainly the personal income tax paid on dividends, interest and entrepreneurial activity and corporate income tax as well as other taxes on holding gains

- Taxes on capital stock

  These include wealth tax, capital taxes including inheritance tax, property tax or taxes on the use of fixed assets, professional and business licences and some taxes on products

Appendix 2

Taxes on consumption, labour and capital, as a % of total taxation, 2007

Sorted in descending order by reference to Member States' taxes on labour

	Labour %	Consumption %	Capital %
Sweden	59	26	15
Austria	55	28	17
Germany	55	27	18
Belgium	52	25	23
Finland	52	30	18
France	52	25	23
Slovenia	51	35	14
Denmark	51	33	16
Estonia	51	41	8
Netherlands	50	31	18
Hungary	50	37	13
Italy	49	24	27
Lithuania	49	38	13
Czech Republic	48	29	23
Latvia	48	39	13
Spain	46	26	30
Portugal	43	36	21
Greece	42	36	23
Luxembourg	42	27	31
Romania	41	40	19
Slovakia	39	38	22
United Kingdom	39	30	32
Poland	39	37	25
Ireland	34	36	30
Bulgaria	32	54	16
Malta	27	40	33
Cyprus	26	39	34
EU-27 arithmetic average	45	34	21

Source: 'Taxation trends in the European Union: Data for EU Member States and Norway', Eurostat / EU Commission, 2009 Edition. Data are rounded to the nearest 1%.