Tax systems and tax reforms in Europe: Rationale and open issue for more radical reforms

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Abstract
This paper is a part of a wider research on European taxation, carried out in this Department, under the direction of L. Bernardi and P. Profeta, and the supervision of. V. Tanzi. The paper tries to evaluate whether recent European tax reforms have really been suitable for to-day fundamental needs of Europe. Almost all of such reforms have been narrow in size and often conflicting in scope. The results were therefore not very impressive. Historically diverse, European tax systems did not converge as it would be required for the efficiency of the single market. Furthermore, a primary weight must be due to the long lasting decline of European growth rates. A recovery requires (amongst many other things) for taxation to be substantially reduced on labor and corporations. This is not an easy task. Increased fiscal and social fairness could however sustain welfare, by matching growth decrease. Finally tax reforms should be aware of the incoming European Constitution and EU moves to an increasingly Federal state. They should therefore copy with a careful reallocation of powers and financing among the new government tiers. They finally should provide for a basic common level of social protection within European countries (and those soon join the Union).

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Politics is a slow and strenuous overcoming of hard difficulties (but *) the possible would never be achieved if in the world the impossible had not always been tried again.*

MAX WEBER, 1919☆

1. Introduction*

From the early 1990s near all the European Countries' tax systems were subject to a lot of changes. Many others are currently under way or in the planning stages (for the details see Gandullia 2003 and Joumard 2001). The forces which shaped the reforms were several (e.g. Tanzi 2003) and often conflicting. Fiscal systems were requested to raise revenue, in order to fulfill the Maastrich requirements and then of the Stability Pact (e.g. De Novellis and Parlato 2003). A reduction of fiscal pressure was also called for to boost declining growth and employment. To sustain this proposal a recurring argument was the comparison with the US whose growth was higher but taxes very lower. Fiscal competition in an increasingly integrated world affected tax rates and structures of the most mobile bases. Common opinions called on for more efficiency, thus stressing the need for making taxes more simple and neutral. Political factors however, i.e. the pressure of lobby groups (Profeta 2003), prevented this process from going very far.

The same constraints were at odds with the most radical proposals of fiscal reforms. These proposals were thus fated from the outset, possibly lacking electoral support (but also budget means). As it usually happens, a grater degree of fairness was invoked but on the contrary income tax top rates almost anywhere were reduced. The unavoidable result so far has been a difficult mix of tax cuts and tax increases, reiterate shifts of tax sources and continuous minor tax codes updates. As a bottom line, a further consequence could not be avoided. Most 1990s European Countries' tax changes were namely narrow in size and limited in scope, i.e. "marginal" in Optimal Taxation (OT) language.

☆ *Polik als Beruft, Wissenschaft als Beruft.*

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Are these really the most suitable fiscal reforms for the fundamental, present needs of European Countries? My answer is quite negative. The most authoritative views, including the main International organizations (e.g. EU Commission 2000; Joumard 2001) stress the urgent need to make taxation more supply-friendly, by taking off labor and productive capital to some extent. The burden should be shifted on consumption, immovable properties and environment externalities whereas heavy losses on revenues from capital incomes should be avoided. The basic features of main national taxes should be brought closer, to make the overall "European" tax system more neutral and efficient. The working of the single market would be thus improved.

These suggestions are sure enough well founded on qualitative grounds, but the true question simply and suddenly arises: how much and how far? Such question comes from three current key factors which heavily impinge on European tax systems and any future changes hoped for:

(i) several years of tax competition and harmonization efforts have failed up to now to set out a basic common framework for an "European" tax system. We mean a system suitable for the mixed "Confederation"-to-"Federation" to-day EU institutional setting, and really enabling a mobility of people, goods and capitals, within the single market and free from fiscal distortions;

(ii) the European economy's growth rate decrease seems at this point almost endless. Prospects for future recovery are continuously postponed. The outlook of economic decline cannot be excluded, even amongst the more established countries. Could fiscal reforms really contribute to enhancing economic growth? Furthermore, how should the tax system be shaped in order to keep up the level of welfare of the Pigouvian "national dividend," by matching the decreasing growth rate with increased levels of fairness?

(iii) the rebuilding of the European institutional setting is just starting out. Common historical heritage of the Federal States leads to predict profound changes in allocation of government tiers' taxing and spending powers. Constitutional guarantees for the satisfaction of a basic level of social protection is likely to be strengthened.

The next three paragraphs of the paper are devoted to opening an intuitive discussion of how tax reforms should be shaped in order to be consistent with the environment just depicted. I am well aware that my remarks frequently may appear somewhat general and vague. I look at this as the due price required to afford and not to evade the largest and fundamental topics we have to copy with and not to continue instead going on with endless debates about minute (if not irrelevant at all) issues. Thus, last paragraph reports my preliminary main conclusions but also stresses the need of further research efforts devoted to pinpoint fiscal reforms best suitable for Europe essential needs.

2. The missing common basic framework of the European tax systems

2.1. The survival of countries' tax-clusters

At the early of the 1970s, European[1] Countries were almost all mid-to-high fiscal pressure countries. The total figure (taxes and social contributions) was about 33 per cent of GDP,[2] and was already over that of both the US (about 27 per cent) and Japan (still at about 22 per cent) (EU Commission 2000; Eurostat 2000; OECD 2001). This book's selected countries were more or less close to the continental average, the only relevant exceptions being the then low taxing Italy (27.5 per cent) and even more, Spain (25.6 per cent). The picture looks quite different by splitting overall pressure into its main headings. A wide dispersion emerges among direct taxes and social contributions from country to country (see Table 1). Countries' indirect taxes (then prevailing on direct ones') were closer to the average figure. By combining these differences, four countries' tax-clusters[3] come out, going back to the Europe historical, economic and institutional roots.

(i) Nordic Countries:[4] the fiscal pressure was very high. It was made up in large amount by direct and (at lesser size) indirect taxes, to pay for a comprehensive and advanced welfare state.

(ii) Rhine Countries: the fiscal pressure was somewhat higher than the European average. Direct taxes prevailed in some countries, indirect ones' elsewhere. Anywhere however, social

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[1] EU 9 up to 1979 and EU 15 thereafter.

[2] Gandullia (2003) gives more details on the structures of European tax systems during last decades.

[3] Such clusters aren't just a convenient paradigm. The estimated correlation coefficients (country data sets of Table 1) generally are in line with the values expected according to the tax-clusters' hypothesis both for 1970 and 1997 (data not reported here and available from the Author).

[4] Nordic Countries have not been considered in this book, both for their marginality with respect to the Euro-area and for their economic and social peculiarities.

contributions raised a high size, in order to financing a well generous Bismarckian welfare state.

(iii) Anglo-Saxon Countries: the fiscal pressure was still close to the European average. Taxes' share was largely over that of social contributions. The public health service was paid out from general tax revenues. The public Beveridgean pension schemes were tightened to dispense just low-amount social security treatments.

(iv) Mediterranean Countries: the development's delay kept total fiscal pressure at a still low level. Tax systems had social contributions close to the European average. Taxes (especially direct ones') still stood well below European standards.

European fiscal pressure anywhere increased from the early 1970s to the late 1990s (see Table 1), apart from in Ireland and in the United Kingdom.[5] It was pulled up (six points) by a growing social expenditure essentially during the 1970s (Eurostat 2000; van den Noord and Heady 2001) and a final Maastricht queue (1.8 per cent in the 1990s). The current total average figure thus rose to more than 42 per cent of GDP in 2000, thus leaving well behind both that of Japan (increased to 27.9 per cent) and of the US (near kept still at 28.3 per cent). After the mythic peak of 1997, just some minor and scattered tax cuts were adopted.[6] The questionable forces of Stability Pact were and continue to be at work, forcing European Member Countries to keep up fiscal pressure (e.g. De Novellis and Parlato 2003).

The wide tax levels' dispersion among countries, already apparent at the early of the 1970s, essentially continued to hold firm. The growth of direct taxes and social contributions was however very fast, whereas the profile of indirect taxes on the contrary was almost flat. The main features of tax-clusters did not generally undergo dramatic changes. The shift to the "Dual Income Tax System" (Soerensen 1994) did not significantly change the fiscal structure of Nordic Countries. In the Rhine area, fiscal pressure grew yet more. Personal income tax jumped up and social contributions effected a further upward turn. The Anglo-Saxon

[5] Do not forget to be careful when compare international fiscal data sets, mainly when welfare provisions and financing show different institutional arrangements. One should take account, *inter alia*, of the spread between gross and net social expenditure and of fiscal pressure's reduction due to the existing tax expenditures (Adema 2001). Eurostat 2002 data suggest that total (public+ private) welfare demand and supply is very close to a common figure within European Countries.

[6] Among our selected countries, Italy, The Netherlands and, at a very low extent, Germany and Ireland, reduced total fiscal pressure up to 2001, the remaining three did not cut or increased their taxes (OECD 2002a).

Table 1 Structure and development of fiscal revenues in European Countries as % of GDP, 1970-1997.

	1970								*1997*							
	D	*E*	*F*	*IRL*	*IT*	*NL*	*UK*	*EU*	*D*	*E*	*F*	*IRL*	*IT*	*NL*	UK	*EU*
Direct Taxes	*10.9*	*7.1*	*7.3*	*9.4*	*5.3*	*12.9*	*17.4*	*8.9*	*10.1*	*11.9*	*11.3*	*14.7*	*16.5*	*13.4*	*15.6*	*13.7*
Personal income	8.2	4.8	4.4	7.0	0.1	9.7	11.1	5.5	7.8	8.3	8.1	10.4	9.6	6.8	9.3	9.3
Corporation income	1.7	1.2	2.1	1.5	2.4	3.0	2.9	2.2	1.9	2.1	2.2	3.7	4.3	4.6	4.3	3.0
Indirect taxes	*13.2*	*6.6*	*15.0*	*19.4*	*10.5*	*10.9*	*14.2*	*13.0*	*12.7*	*10.9*	*15.8*	*14.8*	*12.7*	*13.5*	*14.6*	*13.9*
VAT	5.9	0.0	8.9	0.0	0.0	5.4	0.0	5.1	6.6	5.8	7.9	7.3	5.7	7.0	7.1	7.0
Excise duties	3.4	1.5	2.9	10.2	4.9	3.0	6.6	3.5	2.9	3.0	3.0	5.1	4.0	3.4	4.0	3.5
TOTAL TAXES	24.1	13.7	22.3	28.8	15.8	23.8	31.6	21.9	22.8	22.8	27.1	29.5	29.2	26.9	30.2	27.6
Social contributions	*11.6*	*11.8*	*12.7*	*2.8*	*11.7*	*13.5*	*5.6*	*11.7*	*19.0*	*12.8*	*19.2*	*4.5*	*14.9*	*18.9*	*7.0*	*15.0*
Employers	5.4	9.3	9.3	1.4	7.9	6.1	2.8	7.2	8.2	8.9	12.2	2.8	10.3	3.6	3.7	8.2
Employees	4.9	1.9	2.4	1.3	1.7	5.7	2.6	3.5	7.2	2.24	5.6	1.5	2.9	11.9	3.1	5.0
Self employed	1.4	0.7	1.0	0.0	0.4	16.5	0.2	1.0	3.6	1.7	1.6	0.2	1.7	3.7	0.2	1.9
TOTAL REVENUES	35.7	25.6	35.1	34.7	27.5	36.0	36.9	33.5	41.8	35.5	46.6	34.0	44.1	45.8	37.2	42.1
Administrative level																
Central government	95.9	94.9	96.5	96.0	97.8	99.4	95.5	96.4	94.7	89.3	4.6	95.2	94.4	96.5	98.2	95.8
Local governments	4.1	5.1	3.5	4.0	2.2	0.6	4.5	3.6	5.3	10.7	5.4	4.8	5.6	3.5	1.8	4.2

Source: Eurostat (2000).

Notes: Minor items are omitted. EU 9 up to 1979, EU 15 thereafter. Local revenues do not include sharing to national taxes. Data stop at 1997 to be consistent with those of Table . 2, not available for subsequent years.

Countries were left at the starting post: fiscal pressure did not increase, nor was its structure dramatically changed. Med club countries marked the main change. The total fiscal pressure of the European development newcomers[7] increased by about 10-15 points. Tax structure changed markedly in favor of direct (in Spain also indirect) taxes.

2.2. Not enough convergence and narrow reforms: macro and micro issues

Table 2 shows a set of macro-indicators pertaining to tax systems' convergence in our selected countries, going from 1970 to 1997. As to the simple ratios to GDP, the convergence processes (by competition or harmonization) seem to have impinged upon direct[8] and still more indirect taxes.[9] Neither total taxes nor social contributions show clear signals of convergence. What about tax burden? An analysis by economic functions (i.e. main aggregates of internal resources or employments, Eurostat 2000) as ratio to their overall value (more or less the GDP), points out strong evidences of convergence for consumption and far lower for capital (be aware that "capital" here means all the heterogeneous incomes which constitute operating surplus in national accounting). Convergence for labor and total fiscal burden seem to have been almost not existing at all. However different degrees of tax base buoyancy rather muddy such evidence, thus calling for a closer look at the movement of tax structure as depicted by the implicit rates (i.e. the revenues on single factor or employment as a ratio of a national accounts potential tax basis: Martinez-Mongay 2000). Taxation on labor increased by almost 50 per cent and at the same time diverged, heterogeneous capital was affected by a stable rate converging taxation, while for consumption it remained much the

[7] Italy adopted a fundamental tax reform in 1972, Spain not many years after (see Italy's and Spain's chapters).

[8] This has been mainly due to the income tax, whose amount is largely prevailing inside this category. See below for corporate and capital incomes taxes.

[9] Do not forget that in 1970 a true income tax was still not in existence in many European Countries and VAT was in force only in France.

Table 2 Descriptive statistics of fiscal systems in selected European Countries 1970-1997

	PER CENT OF GDP				*ECONOMIC FUNCTIONS*				*IMPLICIT RATES*		
	1970				*1970*				*1970*		
	TOTAL	*DIRECT*	*INDIRECT*	*CONTRIB.*	*LABOR*	*CAPITAL*	*CONSUM..*	*TOTAL*	*LABOR*	*CAPITAL*	*CONSUM.*
Max. Value	36.9	17.4	19.4	13.5	18.9	11.8	16.0	37.2	34.2	55.4	21.1
Min. Value	25.6	5.3	6.6	2.8	8.4	4.7	5.3	25.6	16.1	16.6	7.3
Mean	33.3	10.0	12.8	10.0	13.9	6.3	10.7	32.6	26.6	29.2	16.1
St. Dev.	4.7	4.0	4.1	4.1	3.6	2.5	3.2	5.1	6.2	13.4	4.6
(Max-Min)/Mean %	33.9	121.0	100.0	107.0	75.4	112.4	100.3	35.5	68.0	132.9	85.9
SD/ Mean %	14.1	40.0	32.0	41.0	26.0	39.5	30.4	15.6	23.1	45.8	28.4
	1997				*1997*				*1997*		
	TOTAL	*DIRECT*	*INDIRECT*	*CONTRIB.*	*LABOR*	*CAPITAL*	*CONSUM.*	*TOTAL*	*LABOR*	*CAPITAL*	*CONSUM.*
Max. Value	46.6	16.5	15.8	19.0	23.9	10.0	12.9	46.4	50.7	42.1	23.7
Min. Value	34.0	10.1	10.9	4.5	12.9	4.0	9.8	34.0	26.5	20.5	15.7
Mean	40.6	13.4	13.6	13.8	19.4	7.9	11.3	40.7	39.7	30.7	18.8
St. Dev.	5.3	2.4	1.6	6.0	4.6	2.0	1.1	5.1	9.3	7.4	3.5
(Max-Min)/Mean %	31.0	47.8	36.0	105.1	56.6	75.9	27.4	30.5	61.0	70.3	42.6
SD/ Mean %	13.1	17.9	11.8	43.5	23.5	25.9	9.9	12.5	30.2	18.6	18.6

Sources: Data and our computations from Eurostat, 2000. Countries as in Table 1.

same story as before.

It looks to me quite impossible to claim that today EU[10] is working well and pursuing its declared aims, those being the status and the trends of its Member Countries' fiscal systems. Is it really possible to strengthen the single market, particularly as to the free movement of goods, people and capitals without fiscal interference, when max-min values of fiscal pressure, sorted by type of tax or their burden diverge by two digit figures? Notice further that the only process of convergence under way to this day seems have been due to the growth of the income tax, the harmonization of VAT and some tax competition on the most mobile capital. Again, the main and bad final result has been an increase of near 50 per cent in the labor average tax wedge during long years of declining growth and increasing unemployment.

The unavoidable flip side of the coin is that only wide reforms can correct such widely varying tax systems and structural differences and to substitute inefficient existing processes of tax competition and harmonization. These were not however the reforms pursued by many European Countries during the 1990s, which essentially brought about some simplifying and rationalizing effects of the existing systems, together with a lot of other minor changes (Gandullia 2003), but sometimes did not improve many already critical situations at all. Let us explore some of the main cases.

(*i) Corporate Tax* – It is commonly recognized that from the 1980s onwards corporations' statutory "all-in" tax rates decreased markedly, by about 15 points (from less than 47 to near 32 per cent in the EU average during the years 1980-2003-forecast figure) (Cnossen 2002). This has been commonly attributed to a greater fiscal competition, which in turn would result highly correlated with the increasing degree of globalization and capital mobility (Bretschger and Hettick 2002). The tax burden decrease was empirically confirmed for the *ex ante* but not the *ex post* effective rates. This trend of implicit (= effective *ex post*) rates is also due to the broadening of the bases that usually matched rates cuts (Devereux, Griffith and Klemm 2001). The final result might have been of no-incentive-investments reforms, as is suspected by Keen (2002) for the much vaunted German case and its planned Italian mirror opposite (Bernardi 2002b). If I am right, Keen's fine analysis of the German 2000 tax reform also hints between the lines at the fact that at least one reason for the alleged simplification

[10] EU may be now seen as an institution which falls between a "Confederation" and a "Federation." According to the common language of political philosophy, "Federation" means that the center and the states are coordinate and independent. The center is instead subordinate to the states in a "Confederation" (quotation in Cnossen 2002).

adopted (= participation exemption and end of the imputation system) has been also a reaction to the difficulties in coping with elusive practices and harmful competition.

(ii) Financial capital incomes – The original Razin and Sadka prophecy (1991) of this tax basis progressive vanishing has proved to be untrue without full mobility of assets and within imperfect capital markets. Inside EU Countries tax rates on interest unambiguously decreased during the last decade by about ten points (from nearly 46 per cent in 1990 to slightly less than 37 per cent in 2000), but this has been mainly due to the substitution of final withholdings for the inclusion in the income tax basis. The reduction of dividend rates was far less and statistically insignificant. The whole system of income capital taxation has diverged and become less neutral (Gorter and de Mooj 2001). Inside the large majority of countries the shift to low rate withholdings on interest enlarged a distortional spread with dividends taxation.[11] National models of interest taxation became more uneven (Joumard 2001; van de Noord and Heady 2001). Partial (Luxembourg, United Kingdom, The Netherlands) or total (Denmark, Germany, Spain, Ireland) inclusion in the income tax basis at marginal rates of up to 60 per cent are in force as well as final withholdings (Austria, Belgium, France, Finland, Greece, Italy, Portugal, Sweden) at rates going from 12.5 per cent (Italy) to 30 per cent (Finland and Sweden). Up to mid January 2003 non residents were generally exempt even if this was not formally the case in Greece and Portugal. The EU agreement of 21 January 2003 is based mainly on monitoring and information exchanges to allow taxation in the country of residence (except for Austria, Belgium and Luxembourg). The adopted solution is well informed to the better residence principle (vs. that of origin). It results however are somewhat deprived by the increasing exclusion of total interest income from progressive income tax base just over seen. Further one must hope that monitoring and information exchanges will be effective and really cooperative. Needless to say tax regimes for dividends and capital gains are still more fragmented than for interests. The same claimed "general" shift away from the imputation system (whatever its very doubtful merits) up to now has been realized by a minority of European Countries (van de Noord and Heady 2001). For income capital taxation these are the poor results of tax competition on the most mobile bases.

(iii) Social contributions and income tax – At the early 1990s the European average tax wedge on labor was already at about 50 per cent. The implicit rate was at 35 per cent, some

[11]This bad result somehow could be avoided by adopting a "true" "Dual income tax system" which should tax any kind of capital income at the same rate. As to 1998 this solution was however not yet adopted by all the same Nordic Countries (van de Noord and Heady 2001).

ten points above the US level (EU Commission 2000; Cnossen 2002). Inescapable was the conjecture that this had something to do with the different pattern of growth and employment then observed in the two areas. The suggestion to remove tax on labor, particularly non skilled labor, was obvious, it was first put forward by the authoritative voices of Drèze and Malinvaud (1994) and thereafter repeatedly raised both by the OECD and also by the UE Commission: it became mandatory for the Union Member States at the Lisbona's Council of 2000.

What has really been achieved? From 1990 to 2000 the implicit rate was increased by about two further points, equally distributed between social contributions and income tax (Martines-Mongay 2000). As to social contributions just small cuts were introduced, by no more than a few points, generally only at the lower end of the wage scale and not in all European Countries (Gandullia 2003 and EU Commission 2000).

Tax cuts of the income tax were similar (still Gandullia 2003 and EU Commission 2000), but usually they were extended also to the top rate, sometimes in quite a reasonable way (Germany and France for example), in other cases they were planned by a provocative heavy amount (Italy). The burden for the (most dense) central income classes kept usually relatively unchanged. The total redistributive[12] effect thus has not generally been particularly relevant. The enlargement of the no-tax area was certainly welcome, mostly as much as producing higher equity, incentives on the labor supply being instead so minute as to be in fact uncertain (see Gandullia 2003 and next paragraph). Unfortunately the price paid for the prevailing way adopted to put into operation this cut[13] was a large increase of marginal rates over the no-tax area. To (partially) correct this effect new decreasing deductions had to be introduced, going further to complicate a tax structure that any committed country would seek to simplify. Furthermore the no-tax area should have been enlarged up to a threshold able to cover the equivalent household level of poverty, what has rarely been achieved especially as more numerous was the households, i.e. by adopting a poor equivalence scale.

The reduction of top rates, very difficult to explain on the grounds of efficiency (the mobility of the highly skilled and their tax "dissatisfaction" have been alleged) is not easy to be

[12] Measured as usually by the difference between the Gini's index of *pre-* and *post-* tax incomes.

[13] Though an enlargement of deduction at the bottom scale, combined with reducing and flattening the rates. With respect to a more graduated rates schedule, this technique has the political advantage of an apparent greater visibility, but it implies the (not easy to be perceived) distortion in the equity and efficiency mentioned in the text. Then we are in front of a school case of lacking fairness in tax laws (see below, par. 4.2).

understood on political economy grounds either (Profeta 2003). The beneficiaries are few (usually not more than ten per cent of voters) and supposedly already in favor of the right-wing governments which made the job. One is thus forced to see this change as an ideological signal consistent with the various currents of though which e.g. from Locke to Nozik and Buchanan allege the existing of some “natural” or “implicit constitutional” limits to the power to tax. This stream of thinking about fiscal and social justice is however very questionable (e.g. Bernardi 2002a) and certainly not new. It has been revived by the recent diffusion of right-wing ideas and governments. As usual, some economists tried to refresh an old idea, whose essence dates back to Aristotle (5th century B.C.).[14]

Horizontal equity was, as ever, largely forgotten and usually did not cross the traditional border of adjustments in fiscal treatment of household or of different kinds of workers (Gandullia 2003). Within these boundaries a widespread innovation was however the more favorable regime granted to the aged and disabled people. The allowances for dependent parents also were widely augmented but the increase was substantial only in very few countries. Elsewhere they were dispersed among a largest number of minute benefits. The excess burden on single worker households remained almost anywhere under-corrected, the exception being the France’s well known case.

3. Reforms to enhance growth and to strengthen fairness within European countries

3.1. Reforms to enhance growth

When fiscal burden began to increase, public finance scientists became worried about its possible negative effects on growth. The first 1927 pioneering inquiry by the Colwyn Committee (Steve 1976) was however reassuring, at least regarding to labor supply. In the 1950s and 1960s the western countries’ fast growth and declining unemployment rate pushed the topic

[14] We here are making reference to the diffuse “entitlement based view” criterion of social justice, particularly when the latter is combined with social mobility, also referred to as equality of opportunity. In such a case some even argue that inequality in income due to differences in ability, talent and hard work, might not only be considered as a factor not to be compensated for, but may also be viewed as positive good (see e. g. Johnson and Reed 1996), among other things implying that the support for redistribution should be lower (Benabou and Ok 2001).

on one side. The same Musgrave's "Theory" reflects this feeling. 1970s supply siders and OT theorists brought the topic to light once more. Making tax systems supply friendly, by reducing rates and broadening bases, became thus the "buzz" word of the tax reformers of the 1980s, but the results were not as positive as expected (e.g. Bosworth and Burtless 1992, for the paramount US case). The taxation-to-growth link then became a topic of an endless discussion, maybe with just one evident robust conclusion up to now being reached. The story could be briefly summarized as follows.

(i) Supply and demand of labor – Today consensus opinion is that elasticity figures differ from zero, but in mid range remain relatively small, albeit with some differences between labor market core or marginal areas (particularly between men and married women, e.g. Blundell 1992). Gross average estimate in the US case has been set around 0.15[15] for total supply and 0.25 for demand. The more unionized European labor markets[16] sure enough allow for a somewhat higher supply value, but how much is not clear at all (Leibfritz *et al*. 1997).

(ii) Economic Theory - Neoclassical economic growth aggregate models *à la* Solow do not say very much about taxation effects, if not near the same post-Keynesian and plain common sense advise to promoting capital accumulation, i.e. taking off taxes as much as possible from investments and savings (at least as to their short-to-medium run effects). Endogenous growth models claimed to be able to provide much more robust and targeted prescriptions (Myles 2000). However empirical checks showed once again that the general level of average and marginal fiscal burden is of minimal relevance (still Myles 2000; Cassou and Lansing 2000). Specific allowances should be allowed to physical and human capital accumulation (Tanzi and Zee 1997), but once more the linking figure does not seem clear-cut (Besley 2000). Last, the so called "New theory of economic growth" stresses the need for taxes (e.g. Tanzi 2002; Jones 2002) and institutions (going back to North 1990) not hindering or meddling with economic transactions induced by the market. Up to now the list of specific prescriptions is still short and selective (for taxes) or somewhat vague (for institution).

(iii) Statistical inference - The simple checks of statistical correlation (a very poor although still popular tool of analysis) between taxes and growth dates back some thirty years.

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[15] This for instance means that a tax cut which can raise net wage by ten per cent will increase labor supply just by 1.5 per cent.

[16] According to a diffused opinion, labor market institutional setting might play a greater role than the level of tax wedge to explain the degree of unemployment, particularly in comparison between Europe and the US (e.g. Blanchard 1999).

During all this time and throughout a long list of exercises, assuming as the maintained hypothesis a negative (positive) correlation has been proved alternatively to be true, false and spurious, and finally also indeterminate (Agell *et al.*, 1997). Looking at present data one cannot however deny that some low taxes (especially labor and corporations) countries seem perform better, as Ireland and the United Kingdom among the Europeans.

As before pointed out, the story has then just only relatively robust conclusion. Negative relationships between taxes and growth seem do exist by their size is small and they can be caught up just by looking at selective channels. As a consequence growth enhancing tax reforms should be huge in amount and strictly targeted, i.e. the opposite from the prevailing ones mostly adopted by the European countries in the 1990s. The difficulty to find enough budget backing suddenly arises. The analysis provided by De Novellis and Parlato (2003) makes then clear that abiding also by the present “soft” rules of the Stability Pact prevents almost any European Country from having the room to reduce fiscal pressure, without compensating for this.[17] Expenditure cuts are commonly suggested (Tanzi 2003) foreword and more widely Tanzi and Schuknecht 1997) and may be useful in the long run, under the condition that the welfare state is not dismantled together with its contribution to economic growth, social cohesion and fairness (Atkinson 1999). De Novellis and Parlato (2003) warn us however that expenditure cuts, workable in the short to medium term, must already be devoted to fulfilling the Stability Pact requirements.

Wide and selective tax shifts thus become the last option to check out. The candidates are labor and corporate taxes to be taken off to a relevant extent. To have not just marginal effect, the reduction of their amounts must roughly reach near about one third for both the burdens.[18] This means in the EU average more or less one point of GDP for “all in” corporation taxes and near about five point of GDP in (mainly employers) social contributions (Eurostat data, see back Table 1). Income tax on labor should instead not to be dramatically changed for the reasons given at the end of this paragraph (i.e. lower contributions and more taxes in funding social security) and in the following one (i.e. vertical equity). On the contrary tax burden on consumption, rents and externalities (= environment) should become substantially heavier.

[17] Making the Pact more rational and less binding is also suggested, by substituting debt to deficit as the target for budget consolidation.

[18] This comes for labor from the quoted elasticity figures and for corporation from international past experiences (e.g. Ireland) and planned reforms (e.g. Germany).

These two latter may produce an higher yield of about two-to-three points of GDP.[19] Thus an increase in consumption taxes of the size of three-to-four points of GDP should be required at the end. It must come from VAT and not excise duties which have well more narrow bases and higher rates. Further notice that inflationary effects have not to be overestimated, the more consumption taxes substituting social contributions, i.e. an item of cost of labor at least in part passed on prices.[20]

The main open question is instead if is it really effective to reduce tax burden on labor by increasing consumption taxes. The topic is controversial and highly debated in multi-faceted literature. Hereafter we report just three main points which together lead to the (tentative) conclusion that more consumption taxes may allow to alleviate those which burden on labor, the two being not perfect substitutes.

(i) Theory - The traditional textbook equivalence of taxation on labor income and consumption obviously still has some good arguments (e.g. Cnossen 2002), but it is increasingly open to question, due to its lacking empirical frame (Carone and Salomaki 2001).[21] Further, the old proposition that heavier taxes on consumption may increase savings and investments still holds. Finally two central OT arguments should be reminded: first, consumption taxes do not change the inter-temporal consumption allocation and therefore its growth rate (Milesi-Ferretti and Roubini 1998); second, efficiency losses would be reduced if taxation is shifted at a lesser rate to a wider basis.

(ii) Econometric estimates - The last and more robust estimate has been performed by using the EU Commission's Quest II model. As to its main result, GDP one per cent shift from corporate to consumption tax would move GDP by 1.6 points and wages by 2.1 points from

[19] They could arrive from an increase of present European average to the level of the countries more taxing immovable property (United Kingdom, 3.5 per cent) and environment externalities (The Netherlands, 1.7 per cent) (Eurostat data).

[20] In 2000 private consumption in the Euro area amounted to 3674 billions euro at current price and to 3383 billions euro at constant (1995) prices (ECB Bulletin, 1 2003). Consequently consumption deflator was 1.086. It rises to 1.10 if charged by 0.7 GDP points of VAT increase, by assuming a five years planning period. The apparent large inflationary impulse of 1.3 points decreases to a half if one assumes that socials contributions are already embodied in labor cost by at least 50 per cent and decreases further to something more than 0.4 points, by limiting VAT shifting to 75 per cent. Consider further that both the hypotheses adopted in the previous calculations are rather conservative.

[21] EU taxes on consumption have a basis one third higher than labor income taxes. Tax basis for capital is half than that for labor.

the average European baseline levels. The same amount of shift but from labor to consumption taxes should increase employment by 0.6 and GDP by 0.7 points (Leibfritz *et al.* 1997).[22]

(iii) Political feasibility – Profeta (2003) introduces more than one caveat concerning the political feasibility of a the tax shift by an amount of about six point of GDP. This is probably still more true if the shift almost entirely goers from dependent workers to all the consumers (and producers). Some parts of the workers' contributions to their PAYG pension schemes is charged on other tax-payers-voters In my mind just one way can make this politically feasible. It could be done by charging on general taxes the financing of an universal social security safety net, that must include also minimum pensions, whose share on the total treatments can thus be subtracted from the funding through workers' social contributions.

3.2. Looking for strengthening fiscal and social fairness

From its very beginning, the "old" Welfare economics (obviously: Pigou 1929) clearly stated that the level of social welfare is given not just by the amount but also by the even distribution of the social "dividend" (= GDP), due to the principle of decreasing marginal utility. Thus it seems worthwhile to look for an increase in fiscal and social fairness to sustain the welfare and compensate the current decrease of the growth rate. Something like a Rawlsian society (Rawls 2001) is outlined in the background, i.e. the well ordered society of equal opportunities, highly endowed with freedom and social justice, particularly for the less advantaged. How to link tax reforms to fiscal and social fairness? The main way obviously requires to improve tax equity, some other features of tax systems are involved, having however well in mind that some final and maybe far more important traits of social fairness have little to do with fiscal systems. Looking of course only at these latter, here I limit myself to briefly speculating on three main points, and just in an intuitive way.

(i) Political process and fiscal exchange - Rawls (still 2001) stated some normative conditions, which can allow the political process to generate fair social outcomes. These

[22] The two sets of results may seem asymmetric, but one must take account of the non- linearities and the substitution effects embodied in the model.

however seem not likely to occur, according to Profeta's findings. Is it always the case? It is not lacking a vein of literature which stresses that interest groups' pressure may decrease during emergency times (e.g. Drazen and Grilli 1993).[23] Secondly, the "old" "Public choice" frequently argued that radical reforms, which deeply redistribute property rights, can go further than piecemeal and uncompensated cutting of single rents (e.g. Buchanan 1980).

Anyway the political process on taxation should be not just legitimated but also perfectly transparent. I stress this apparent obvious point (the real and not just only formal implementation of the principle "no taxation without representation") because we saw that some recent European tax reforms were not exactly transparent. Avoiding fiscal illusion is truly important to allow citizens to properly evaluate the fairness of fiscal exchange, being rational and well informed (further simplification of tax system may help), and also, if possible, somewhat altruistic.

(ii) Taxing rules and social behavior - The structure of tax rules has wide effects on social behavior, not just on tax compliance. The latter should obviously be empowered in order to make taxation reliable and sure, amnesties should be avoided, evasion and corruption should be heavily fought against, tax administration should be efficient and correct with tax-payers. Once more I recall obvious textbook features just because they in fact are largely absent in European Countries, especially the Mediterranean ones' (Bovi 2002). The social effects of taxing rules are however deeper and far reaching. These rules intervene in the most sensible relationship between the state and the citizens. Being well behaved and observed, they induce an higher degree of Kantian public ethics which in turn stimulates better educated behaviors, more social cohesion, more sound and altruistic preferences. All this is also welfare and it might to trigger a virtuous chain reaction with the growth rates.

(iii) Tax equity - Vertical equity (par. 3.2, over) was not strengthened but if anything weakened by recent European tax reforms. Tax progressivity has been largely contrasted by alleging both efficiency and ideological arguments. This theoretical and political stance is pretty questionable and seems not to compare favorably with the following three arguments. Taken together, these arguments should favor the empowering and not the dismantling the degree of vertical equity, i.e. of the redistributive purposes of tax system.

[23] One may however doubt if is this really the present state of affairs that (rational and well informed?) European citizens at present do perceive.

a) It is commonly alleged that redistributive targets can better be reached through the expenditure rather than through the revenue side of the budget (for instance: EU Commission 2002). But can we credit the underlying calculations? Ultimate demonstrations for an already long time have been given (e.g. Goodin and Le Grand 1987) according to which welfare and other public services are mostly captured by the middle class. The redistributive impact should then be due mainly to social protection and particularly to public pensions, thanks to their predominant amount. However the unavoidable suspicion is that these estimates are single generation ones, without considering together the effects of PAYG social contributions, usually proportional if lower net wages but regressive when passed on prices in non-competitive markets;

b) in a world and at a time in which inequality of *ex ante* incomes is rapidly (and worryingly) increasing (Atkinson 1999b), not to weaken the redistributive effects of taxation seems like a suitable and reasonable policy choice;

c) looking at the results by the most recent theoretical an empirical literature, it turns out that standard theory arguments against redistributive policies (i.e. their supposed incentive-reducing effects with respect to growth) do not seem to hold and perhaps need to be reversed.[24] Be careful of course to not mistake the general taxation-to-growth effect (see back, par. 2.4.1) for the differential impact of redistributive taxation.[25]

Vertical equity has also been eroded by the decreased burden on capital incomes due to fiscal competition. The Nordic "Dual income tax system" has then been viewed as a good compromise between equity and contrasting capital flights (Cnossen 2002). Really it is so only under the condition that income and wealth are evenly distributed and highly correlated. This may be the case in some countries, but not in all. For the first 1990s Wagstaff *et al.*

[24] The conventional OT idea concerning the unavoidable trade-off between equity and efficiency has recently been heavily challenged by a large number of empirical analyses. A negative correlation repeatedly was founded between inequality and growth. Still more surprisingly, growth rates seem positively influenced by redistributive policies, also if performed by increasing tax progressivity. The most convincing theoretical root of these evidences has been found with reference to economies in which wealth and human capital endowments are heterogeneous across individuals and capital markets are imperfect. The negative effects of inequality on growth might thus depend on: a) the reduction of investment opportunities; b) the worsening of borrowers' incentives; c) more macro-economic volatility (Aghion and Caroli 1999).

[25] The standard competitive analysis of labor markets usually considers labor tax progressivity (i.e. the degree of substitution effect) conflicting with employment. This result is however generally reversed by unionized markets analysis (e.g. Pissarides 1998).

(1999) report Gini coefficients on *ex ante* incomes ranging from 0.25 (Germany) to 0.41 (The United Kingdom). Also, an even level of capital income tax rate is required and this the case in many European Countries (see back, par. 2.3.2). Just as one example, for the middle 1990s Joumard (2001) reports rates on interests ranging from 12.5 per cent (Italy) to 30 per cent (Sweden, not surprisingly).

Horizontal equity seems not much to be at the center of political action. We have already discussed a widespread lack of equity in the fiscal treatment of households, with reference to the number of both earners and dependents. As to the latter, the modern "welfare view," restricting the need of allowances only to low-income families, is now contrasted by a renewal of the old "optimum size view," induced by the worries of a European declining population. According to this view, allowances should be extended also to the middle-to-high incomes and should reach a huge amount in order to work effectively.

A true fairness further should extend the concept of horizontal equity at least in two directions. Firstly, the tax system should contribute to make the social justice principle of equal opportunities effective. For instance, taxing human capital formation is not only inefficient, but it is also unfair. Similarly, inheritance taxes should be empowered and not written off, as it is largely occurring.

Second, the old fashioned qualitative discrimination among incomes (traditionally in favor of dependent work) should be enlarged and extended to encompass more features, for instance those that can differentiate the social merit of some income and wealth levels.[26] Thus the market distortions at the individual income levels (due to rents, information failures and under evaluation of social value of some activities) should be compensated by the fiscal system. For instance, (just Italian?) lawyers and football players should be more taxed, whereas less taxes should be charged on teachers and long term care nurses. The same could be said, looking also at efficiency targets, by considering the high difference which generally exists between labor supply elasticity of men and married women (e.g. Blundell 1992).

4. Tax Reforms and the incoming changes within the European institutional and policy setting

[26] Notice some likeness with Atkinson's (1996, cap. 15) "Participation Income Scheme," which was well received by 3rd edition (p. 270) of Muller's "Economics of Welfare".

4.1. Structure and functions of government tiers

EU is now making relevant steps toward becoming a full fledged "Federation," leaving the "Confederation" model behind. The process may be slow-moving but eventual arrival is almost certain. This at least has been the common historical experience of existing Federal States. The outlining of tax reforms should then show awareness of EU institutional trends and not conflicting with them, difficult as they are to be precisely foreseen.[27] Due to this uncertainty, here we will not go beyond a brief discussion of some (personal) broad guesses. This somewhat daring aptitude is however necessary to pinpoint a fist (rough and uncertain) framework which might serve as a starting reference to begin and not evade a discussion of such relevant questions, commonly skirted and left to the speculations of few amateurs of European things.

The EU present institutional setting is made up of no less than five tiers of government: Union, National Countries, regions, local governments, the last usually split into counties and municipalities. It is very doubtful whether this arrangement could ultimately function, due to its huge transactions costs of and the large room for overlaps between upper and lower tiers.[28] A widespread opinion suggests that the national governments will not disappear at all but will result in being the losers, overwhelmed by the need to enlarge Union powers and the enforcement of subsidiarity's principle at the lower (regional+ local) tier.

Apart from some exceptions, the prevailing literature seems to favor an enlargement of the EU powers from time to time, provided that Europe government has been made democratically accountable. Stabilization function has begun a long, difficult and piecemeal shift from the states to the Union, but by common consent its present stage of transition is still quite unsatisfactory. Allocation function should go beyond current regulatory activities and the strengthening of internal market. A largely shared proposal is to gradually extend its role in its area of intervention, as to encompass defense, research & development and a European transport network.

[27] This is also true for the widespread processes of fiscal decentralization which are occurring in many European Countries (Gandullia 2003 and OECD 2002b).

[28] The figures are far from being reassuring. By considering only present EU Member Countries', Regional governments are in the order of about 150, counties, provinces and departments are about 400, municipalities stay well over 100 000, of which the most have less than 10 000 inhabitants (OECD 2002b). It is obvious that some restructuring will take place but it is also hard to precisely envisage possible future solutions.

The main open question relates to the distribution function, on top of the already existing programs of regional development, which however should continue to be in force. A particular emphasis must indeed be devoted to the recurrent proposal of making EU declared aims of social protection really effective, whereas up to now they merely consisted of high-sounding statements of rights.[29] New pressures to change may arrive by the incoming European Constitution, which most likely will adopt the Tobin's principle of "Specific Egalitarianism" as endorsed by the Nice 2000 "Charter of European Union's fundamental rights".[30]

The reason (Atkinson 1992) to put in operation social protection programs also at EU level is twofold. Member Countries' programs suffer from a severe weakness which is made evident by the about seventy millions of people (18 per cent of the total) at risk of poverty poor who still live in the core Europe. Social benefits reduce the risk but to very different degrees, ranging from only about ten per cent (Greece and Italy) to more than 70 per cent (Finland), 31 per cent being the European average (Eurostat 2002). Further and connected, differences in GDP level and in budget conditions may discriminate one country from the other as to their ability to cope with social protection needs. The proposal of a "European safety net" targeted to specific countries' lines of poverty might overcome the otherwise not easily solvable dilemma between countries' or individuals' targeted plans (still Atkinson 1992).[31] Such a proposal should be strongly welcomed in order to implement our suggestion of tax shift from social contributions to consumption tax, particularly VAT. This means that

[29] During the 1970s and 1980s EC's Acts basically took up the 1945 UN "Charter of human rights." In 1989 the "Charter of fundamental social rights" was adopted by the Community (although with the United Kingdom dissenting). Its aims were confirmed by the Social protocol annexed to the Maastricht Treaty (United Kingdom still dissenting). The central idea was to extend social protection to wider cohorts of beneficiaries and specifically target it to fight against poverty. A Social fund was effectively adopted but it was always made up of not more than some dozens of ECU/euro millions and mainly devoted to improve workers' mobility.

[30] Specific guarantees are stated regarding the right to: free mandatory education (art. 14); satisfactory, regular employment (art.15); getting high protection of health (art.35); being admitted to social protection and services, "in case of motherhood, sickness, labor accidents, dependency and old age, besides that in case of loosing the job, *according to Union's and national laws*" (italics our).

[31] Countries' plans should be preferred if inequality is rooted amongst countries', individuals' plans otherwise. Available data show a mixed picture not easy to be disentangled. We saw that at the early 1990s Gini on gross incomes ranged from about 25 per cent of Germany to about 41 per cent of the United Kingdom. Per capita income at PPPs in 2000 is relative close to an average of something more than 100 (mean figure for EU and US) albeit if with some outliers. But the poor Med Countries (Spain, Portugal and Greece) have an average figure of about near 80 (computations of Cnossen 2002). Number and distance of diverging countries will obviously dramatically increase with the arrival of current EU applicants. GDP per head at PPPs ranges from 24 (Bulgaria) to 82 (Cyprus), 100 being the EU level and about 45 the candidate countries weighted average figure (Eurostat 2002).

in any European Country, the “Safety net” should also cover the social security minimum pensions that in this way should paid out from general taxation.

The sharing of the remaining functions between national and local governments will probably depend on single countries preferences, traditions, institutions and *de facto* conditions. Once progressively deprived from stabilization function, national governments will probably concentrate on regional and personal distribution, higher educations, law and order, national infrastructures, general administration, and, obviously, debt service. Education, health, local transport and other services will probably implement the subsidiarity’s principle at the level of local governments, but on should always bear in mind that overlaps with constraints from, and monitoring by higher tiers will be widespread and not easily managed or disentangled.

4.2. The financing of EU and of lower levels of government

At the moment EU budget (Laffan 1997) is not (and must not be) higher than 1.27 per cent of Union’s GDP, i.e. near about 85 billions of euro. This plentiful amount of money comes from custom duties on extra Union imports (about 15 per cent of total resources), a sharing to member countries’ VAT (about 35 per cent), and, as to the residual amount (i.e. about 50 per cent), from countries’ contributions in accordance with their GDP. About half of these resources are absorbed by agricultural policy alone. One third goes to the so called “Structural actions,” i.e. to regional development and other cohesion initiatives. The small rest is dispersed among some minor items. Repeatedly during last years, both parliament and commission proposed some (marginal) budget increases and intra-resources shifts, looking also at the incoming arrival of the candidate countries, with an estimated cost of about ten billions of euro (e.g. Gretschmann 1998). At the 1999 Berlin Council, any proposal of this kind was rejected, including the budget enlargement for new members. National *premiers* remained stuck in their loved funny puzzles of EU budget.[32]

This essential information about EU budget allows us to go back to the discussion of tax reforms, and integrating this discussion with the previously outlined proposal about the allo-

[32] The words are by themselves amusing and enlightening: “British correction,” “Rotterdam or gateway effect,” “VAT frozen rate” and so forth.

cation of functions between government tiers. When (and if) fully implemented, such proposal would require resources near to ten per cent of GDP at the EU level,[33] something less than 25 per cent at the Nation level, and near about to 15 per cent for local tiers, provided that the total amount of public resources would more or less remain at to-day figure.

Going on with this parable, we can now speculate that EU current resources should be increased up to near three points of GDP. The GDP contribute will cease to be in force but it might be more than compensated by attributing to EU level the total revenue accruing from VAT on imports from outside the Union itself together with the yields from the (increased) environmental levies. The new additional financial tools should be outlined according with sound criteria of tax design and fiscal federalism. Our choice is twofold, and seriously takes into account the previously outlined requirements about tax reforms being growth and fairness enhancing. First, for the working of a government that appears to be so distant from its citizens, a part of new revenues should be highly visible and keep politicians for their use. This task may be better performed by a EU VAT rate, that is made explicit to consumers, than by a sharing to income tax revenues, which on the contrary is hidden in the withholdings on labor incomes. At the moment such withholdings account in fact for three fourth of total tax yield. The VAT rate should be set at level that is sufficient to pay out for the "Safety net," thus giving further visibility to EU social protection and must add to present national rates. We know that this would mean three-to-four points in GDP terms. The second leading principle should be to directly attribute to the EU level those taxes that most require highly puzzling (e.g. Keen 1996; Haufler 1999) coordination, i.e. corporations and income capital taxes. Taking into account the need to alleviate corporation tax, altogether they could amount to about four per cent of GDP and should be set around an even same rate[34] (20 to 25 per cent). This rate should be applied to any kind of capital incomes (interests, dividends, capital gains) to be perceived though final withholdings. It could realize an acceptable "Dual income tax system," provided that income tax average rate was computed by Wagstaff *et al*. (1999) to range from nine per cent (France) to 33 per cent (Sweden), an average European un-weighted rated being at about 15 per cent.

[33] This amount is quite close to both US and Canadian figures and could make EU budget adequately exogenous macro-shock absorber.

[34] The proposal to shift Corporation tax at EU's level is certainly not new (e.g. Albi *et al*. 1997) and recently has been authoritatively brought in again (Cnossen 2002).

The end of the story provides for leaving a reasonably progressive income tax and the remaining social contributions at national level, where personal distribution function is concentrated. It would be appropriate to add excise duties: their cross border shopping distortions might be relevant at the local level, which does not seem to happen in the VAT case (Cnossen 2002). The circle would be thus closed by allocating to the conglomerate of local tiers present VAT, benefit taxes and tariffs (including in the category those on making a business) and on immovable property, the last to be substantially augmented in accord with our reform scheme. Notice that VAT can be a relatively good tool (at least vs. the possible alternatives) of financing local (= regional) tiers, to which it may be apportioned on the basis of easy statistical clearings in accordance with the amount of within boundaries private consumption. Its wide basis further allows to collect higher or lower yield through minor rate changes. Finally the basis is evenly enough distributed among regions and thus the need for equalizing transfers is lower with respect to other eventual resources (e.g. the German case, see Maffini's chapter). To conclude, notice that this structure of lower tiers financing would be also in line with a long theoretical tradition and the main examples of well established Federal States.

5. Some conclusions and the need for further research

A work like this raises many questions, gives some answers and open many further problems which deserve further research efforts. In my firm opinion, European Countries' tax reforms adopted from the 1990s introduced some improvements, mainly by streamlining existing systems, but they have been mostly narrow both in size and as to the aims. Sound fiscal choices that are targeted at Europe's should instead be more radical and intended to cope with our continent great events and fundamental needs. This, I admit, is a no easy way, nor by now well defined.

Many years of common market, the single market, and then the monetary union, together with the harmonization efforts of the (weak) European government, made not the original 1960s very different tax system converging as required by single market efficiency. Reducing remaining differences raises wide political, institutional and national-identity costs. It is not clear to which institutions and procedures the task of driving further convergence processes is to be assigning.

Before any further analysis, basic common sense suggests that (average) tax wedges on labor at around 45 per cent and implicit rates over 30 per cent for corporations have something to do with the European declining growth rate and increasing unemployment. Theoretical hints and empirical data suggest that tax reforms could help, but only if burden taken off from labor and corporate capital can be pushed to a relevant extent if it is to give some sizeable advantages. How to finance such huge tax-cuts is the subsequent puzzle.

The Stability Pact prevents the reduction of fiscal pressure and takes in any workable expenditure cuts, if not those which heavily would roll back the welfare state. Thus the escape route necessarily involves shifting the tax burden, from labor (social contributions, mainly those of employers) and corporations to rents, environmental externalities and, mainly, consumption (VAT). Theory and evidence are in fact not thoroughly reassuring about this policy while political economy predictions warn us to beware of an its no easy electoral feasibility. To climb over this last obstacle, I propose that the heavier consumption taxes shoud fund an universal social security safety net, which also encompasses minimum pensions treatments.

In a world where growth rates decline, one is forced to find an additional source of welfare by increasing social fairness, to which fiscal fairness may contribute. Firstly, through a legitimated and transparent political process of tax voting, secondly by establishing an equitable fiscal exchange and well behaved tax rules between state and citizens, finally through the most familiar channels of vertical and horizontal equity. The both have to be empowered and enlarged to better contribute to the society of pair opportunities. This direction of reform should get a general approval, but in fact it might raise a long list of ideological and vested interest oppositions.

European Countries should be aware that present tax reforms are to be applied in dramatically changing institutional setting. We can just (but must) speculate on the main (and uncertain) consequences. It is indeed necessary to have tentative frame within which one can discuss such relevant issues, being however aware that the overall effective scenario might be largely different and its moves could come very slowly in the time.

EU central functions will probably increase: here it is suggested that the financing should come partly from a transparent tax such as an (additional in our scheme) EU VAT rate which is visible to consumers (and better than a sharing to income tax revenues, which on the contrary is largely hidden in the withholdings on labor incomes). The remaining amount of financing can be found by attributing to the Union level both environmental levies and the two taxes which need more coordination, this being however particularly difficult, i.e. taxation on corporate and income capital at about a same and even rate.

National tiers should be the center of the distributional function and herein the financing should be assured particularly by a progressive income tax and by the remaining social contributions, plus excise duties, due to their relevant cross-border shopping distortion, when applied to lover tiers. In accordance with the subsidiarity's principles, many services may be scaled down to the conglomerate of local governments, where the best eligible candidates to build the tax systems are present VAT, increased taxes on immovable property, benefit and making a business taxes. Such choice is consistent with, also at the light of traditional theory of taxation and closely resembles main examples coming from the most established Federal States.

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