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TOWARDS A LOWER TAX BURDEN IN POLAND

Summary: The purpose of this paper is to analyze the possibilities and implications of reducing the income tax burden for the Polish economy. Two major proposals are presented: 1) halving the tax-GDP ratio to below 20% and changing the structure of budget expenses to reflect the real needs of the society (e.g. public order and safety, education, R&D, health, infrastructure); and 2) reducing, and finally abolishing income taxes to positively influence economic growth and welfare in Poland. Several implications on the conduct of these proposals are discussed. Paper findings are subject to a discussion concerning the flat tax debate.

Keywords: tax burden, budget deficit, flat tax, income tax, government spending.

1. Introduction

The direct stimulus for writing this paper was the publication of the article entitled "Great flat tax myth" (in original: "Wielki mit podatku liniowego") by Wernik [2008]. In April (financial year end) or in months preceding the elections it often happens that the idea of substituting a progressive personal income tax with a flat personal income tax (including some modifications, for example tax allowance amount) re-emerges. Proposals in this matter are generally encumbered with two faulty presumptions.

Firstly, it is assumed that the role of government (that directly influences the tax burden) should be the same as now – significant. And even if it should not, then it is and there is nothing that can be done to decrease it in the short-run (and thus never as we constantly have a short-term perspective).

Secondly, it is considered obvious that at a given level of the fiscal burden the government revenue must also derive from income taxes. The cases of some countries allow us to question the correctness of this statement. Therefore, the introduction of a flat tax may be regarded as a solution just slightly raising the fiscal system quality and yet so controversial.

The objective of the article is to present arguments for a restructuring and a strong reduction of government spending. Provided these objectives are finally attained, a decrease in government revenue becomes real and therefore allows for, first, eliminating CIT and then PIT. Thus, the stage of flat personal income tax can be omitted as it is encumbered with defects typical for income taxes altogether.

2. Reduction of government spending and alteration of its structure

Without immersing into tangled definition matters, whether it is gross domestic product, gross national product or gross national income that should be the basis, one can assert that indirect (for example VAT, excise tax) and direct (income tax, capital gains tax, inheritance tax and all taxes paid by business entities) taxes, as well as all quasi-fiscal charges are significant in many countries. Taking history and international comparison into consideration, one can judge the tax burden to be relatively heavy. The arguments for decreasing the role of government in the economy and keeping it at the newly achieved low level are widely known; however, they are not necessarily shared by everyone: leaving greater financial resources at the disposal of private entities, allowing them to declare preferences by means of expenditure; better resource allocation; higher effectiveness of private economy; lower corruption etc. Nevertheless, the problem is the lack of confidence among the politicians, and often the economists, that no one should regulate some areas of life, including economic ones. Should it be possible to shape the level and the structure of government expenses from scratch, it may turn out we have more confidence to limit the tasks of government mainly to national defence, police (internal and external security), infrastructure, health care, technological innovations, high level education and maybe a few other areas. Meanwhile, the government in Poland and in many other countries interferes with many areas of life, also by means of government spending. Nevertheless, there are considerable differences among particular economies. According to OECD, the estimated share of tax income (above all personal and corporate income tax, wealth tax, turnover tax and social security) in the gross domestic product fluctuated in 2008 from 21.1% in Mexico and 23.5% in Turkey, through 26.9% in the USA, 29.4% in Switzerland, 34.9% in Poland (as of year 2007) to 48.3% in Denmark and 47.1% in Sweden. The unweighted average for the OECD economies amounted to 36.1% (as of 2007). Meanwhile, among the non-OECD economies the share of tax income in 2007 was much lower: 13.4% in Singapore, 21.5% in Chile, 26.3% in Republic of South Africa, about 11.5% in Malaysia (as of 2006). Therefore, one cannot state that a higher level of participation of government in the redistribution of income is a condition of high economic growth or high level of technological development.

The structure of government expenditure is of the same importance or even more important than the absolute or relative magnitude of the expenses. After all, modification of the structure is necessary in Poland regardless of the level of expenditure. This issue requires a lot of wide-ranging work. Nevertheless, it is worth mentioning once again that the main problem lies in the lack of the awareness of necessity for changes and the political will to introduce them.

If we compare the budget structure of Poland and of the countries that achieve economic success or take the highest places in entrepreneurship rankings, it may be easier for us to accept the exigency of substantial changes. Moreover, it would be clear in which direction we should follow.

In Singapore one differentiates between operating and development expenditures. The first ones constitute approx. 75% of the total, and allow for fulfilling current tasks by government units and other entities financed by the state budget by law. The other ones aim at fulfilling the same tasks in the future. The expenditure structure for the fiscal year 2009/10 (the fiscal year starts on 1 April and ends on 31 March) is shown in Table 1.

Table 1. The expenditure structure for the fiscal year 2009/10

Expenditure	Operating expenditure	Development expenditure	Total expenditure
Security and external relations	43.7%	7.6%	34.2%
Education	24.9%	6.0%	19.9%
Transport	1.2%	37.1%	10.6%
Health	9.6%	5.4%	8.5%
Trade and industry	2.3%	22.1%	7.5%
Community development, youth and sports	5.6%	1.3%	4.5%
National development	2.3%	10.2%	4.4%
Government administration	3.8%	4.4%	4.0%
Environment and water resources	2.3%	3.0%	2.5%
Manpower	2.7%	0.4%	2.1%
Information, communications and the arts	1.4%	2.4%	1.6%
Info-communications and media development	0.2%	0.1%	0.2%
Total expenditure (in mln S$)	32,156.8 (100%)	11,465.0 (100%)	43,621.8 (100%)

Source: [*Singapore Budget*… 2009].

The conclusion to be drawn from the data is the concentration of the expenditure on safety (the more detailed data show that external safety costs about four times more than internal). Education is ranked second – almost 20%. All other goals focus on much less financial means: transport, health, support for trade and industry, infrastructure[1]. When it comes to development projects, the preferred objectives are transport, trade and industry and infrastructure (housing and land-related).

[1] The main focus of the Government's expenditure is on the delivery of essential public goods and services to Singaporeans. The government spends to assure the nation of a secure future. Therefore, key areas of expenditure are on education, public housing, health care and national security. The Government is also committed to building and maintaining world-class economic infrastructure and services. This is evidenced by the fact that development expenditure accounted for around one-third of government expenditure on average over the last three decades. http://www.sgs.gov.sg/macro_ overview/macrooverview_ fiscal.html.

The statistical data in Singapore is shown in a way that omits debt servicing. Only S$25 million was spent in 2008 for interest payments. A similar amount is planned for the following fiscal year. This amount seems to be negligible, at least compared to operating and development expenditure. The fiscal debt was S$286 billion in the third quarter of 2009, but it is not a result of permanent deficits. Quite the opposite – Singapore faces usually surpluses. The reason of issuing debt was the development of the government bills market. The government of Singapore has a deposit at the Monetary Authority of Singapore (central bank) that amounts to about a half of the debt (approx. S$127 billion by the end of September 2009) [*Monthly Statistical*… 2009]. In addition, one should take into consideration the funds managed by the Government of Singapore Investment Corporation and Temasek Holdings Private Limited Company (sovereign wealth funds). The figures are not publicly known, but allegedly reach at least S$200 billion [*Budgeting*… 2006].

In the Cayman Islands the state budget used to be in equilibrium for many years. The budget deficits, never exceeding 10% of the revenue, occurred very seldom since 1992, at least till the last financial crisis. The surpluses have been more evident. As a result, the core budget deficit and entire public sector deficit did not exceed 10% of GDP. But in 2009, when the crisis emerged, the Cayman Islands were heading for bankruptcy. The ratio of the net debt[2] to core government revenues exceeded 80% and reached 86% mid-2009. The public debt exceeded 60% of GDP. As a result, the government decided to raise tariffs (by two percentage points), excise, registration fees and yearly fees for companies. Additional revenue CI$126.4 million was expected. The proposal made by the Her Majesty's Government in London to introduce the income tax was rejected. At the same time, expenditure cuts were introduced – creation of jobs in public sector, overtime and business travels etc. were limited. The action taken should allow a slight surplus in the fiscal year 2010/2011 to be achieved. Unfortunately, with debt servicing taken into consideration, a budget deficit of over C$30 million will emerge.

There are three major groups of budget expenditure in the Cayman Islands [*2010/11 Budget*… 2011]:

a) operating expenses (approx. CI$508 million[3] in the fiscal year 2010/11),

b) financing expenses (approx. CI$33 million[4]),

c) extraordinary items (none planned for the fiscal year 2010/11).

Table 2 presents the structure forecasts of operating expenses for the fiscal year 2010/2011.

[2] Net debt is defined as the outstanding balance of core government debt, self financing loans, and the outstanding balance of public authorities' guaranteed debt, less core government's liquid assets.

[3] 1 CI$ = 1,2 US$.

[4] Debt servicing cost for the year should be no more than 10% of core government revenue. However, in the fiscal year 2010/11 12.89% was planned [*2010/11 Budget*... 2011, p. 27].

Table 2. Structure of operating expenses in the Cayman Islands by function in the fiscal year 2010/2011 (forecast)

Expenses	Forecast
General government services	19.6%
Education	19.5%
Public order and safety	18.7%
Health	12.3%
Social security and welfare	8.1%
Transportation and communication	7.6%
Fuel and energy	1.3%
Recreational, cultural and religious	1.1%
Environmental protection	0.9%
Housing and community amenities	0.2%
Other economic affairs	10.7%
Total operating expenses (mln CI$)	507,753 (100%)

Source: [*2010/11 Budget*… 2011, p. 324].

The spending for general government services amounts to almost 20% of total expenses in the Cayman Islands. The share of education is similar to the share in Singapore (almost 20%). Public order and safety expenditures are only internal, because defence is the responsibility of the UK. Other expenditure items are: health (approx. 12%), social security and welfare as well as transportation and communication (approx. 8% each).

Appendix No. 2 to the state budget of Poland [*Wydatki budżetu*… 2010] shows that the structure of the expenditures diverges from the desired state. The major item (almost 27%) is “Other settlements”, mainly subsidies and subventions (for local governments and Farmers’ Social Security Fund) and projects co-financed by the European Union. Another major item is social insurance subsidies and subventions (23%). Debt servicing is ranked third with 12% and national defence fourth with 6%. The next four expenditure groups amounting to approx. 4% are social security, public order, higher education and general government services. Health expenditure is low (2%), however only with National Heath Fund omitted (otherwise the share would be about 17%). The share of R&D is very low – about 1.4%. The structure for 2008, 2009 and 2010 is very similar, which proves that no significant changes to the structure were applied. The only visible change is a systematic rise of debt service share.

3. Lowering and future abolishment of income taxes

If we accept the possibility of tax revenue as a percentage of GDP being lower than 50% or 35% and find it favourable, the question how to reach this goal arises. It should be done step-by-step and in the long term – for sure longer than four years. Thus, it makes implementation in a democratic state very difficult, if not impossible, as even less controversial ideas are rejected. Lets assume that expenditures fall and according to this also taxes may be lowered, for example income taxe.

Wernik [2008] in the quoted paper states that it is not realistic to expect flat tax to raise the growth rate to such an extent that compensates the revenue outcome of tax lowering. It should be noted that flat tax would make the tax system simpler and less time consuming. On the other hand, income tax cannot be "quite transparent and unambiguous". The tax base calculation itself is a demanding task. In addition, a person or a company may not to wish to disclose its income. Last but not least, income calculated for income tax purposes will be always higher than when calculated rationally.

Another controversial matter is the compensation of the tax revenue following the introduction of the flat rate. It seems that under current circumstances (high budget deficit) every change of the tax system should not be neutral but aim at the lowering of the tax burden.

Let us consider the arguments for the flat tax rate [*Monthly Bulletin* 2007, pp. 81--83]. The major one is simplicity followed by improved transparency, lower administrative costs and increased compliance. However, the empirical reports provide mixed results on the impact of flat tax systems. In some countries the simplicity of tax systems has increased only partially, whereas the complexity associated with various exemptions and the fiscal treatment of certain categories of income remains. Therefore, let us consider a far-reaching solution: an abolition of income tax, giving stimulus for hard work, investments and higher competitiveness internationally.

Firstly, flat tax is not sufficient to make the tax system simpler, because of the tax base calculation, tax reliefs, and room for interpretations.

Secondly, the introduction of the flat tax rate was accompanied by structural changes in several countries, which makes it difficult to measure the result of tax changes on the economy and tax revenues. It seems that the positive impact on the willingness to work and the work availability is out of question. As a result, lower social transfers would be necessary.

Thirdly, we face an international competition in direct taxation. Over 20 countries introduced a flat personal income tax rate (among them six EU member countries[5] and a few countries close to the EU[6]). Fortunately, the tax rates in some of these

[5] Bulgaria (10%), Lithuania (15%), Latvia (26%), Estonia (21%), Slovakia (19%), Romania (16%).

[6] E.g. Russia (13%), Ukraine (15%); *KPMG's Individual Income Tax Rate Survey 2010*, September 2010, www.kpmg.com.

countries are relatively high. In addition, the systems are not "clean"; different rates apply for individuals and companies, basic allowance exists, capital gains are taxed differently etc. [*Monthly Bulletin* 2007, pp. 87-88]. Therefore, the abolition of income tax, first for companies, is a model solution. For example, Isle of Man introduced zero rate income tax for all resident and non-resident companies in 2006. Only banking business income and land and property income from IoM sources is taxed at a 10% rate. A very similar system was introduced in Jersey in 2009.

Every major change to the tax system requires the reduction of government expenditure simultaneously with the adjustment of the expenditure structure and the reduction of the income tax burden: first CIT, then PIT. Note that even total abolition of the income tax would not be sufficient for lowering the tax burden below 20%, as suggested by the author. The share of income taxes in the total budget revenue planned for 2011 equals approx. 25% or PLN 62.3 billion. To reach the goal (tax burden < 20%), other tax cuts would be necessary. Accordingly, the expenditure cuts needed for a balanced budget are higher due to the budget deficit (PLN 52.2 billion for 2011), which should be reduced to zero. In the course of time the debt service would be lower and lower.

Such a fundamental change (also in the way of thinking) would take years and bring us to the economy where no income taxes are levied and the state is only responsible for very few areas crucial for the development or for areas where intervention is necessary due to market failure. Both arguments are being abused in a democracy. This is one of the reasons why many industrialized countries face the indebtedness problem and are not able to make any substantial changes to the level and structure of budget expenditures.

According to the latest research, about 20% of Polish citizens generally agree that the role of the state should be diminished, as well as income taxes. Over 65% are convinced that lower taxes would make tax revenue higher [Pasternak-Malicka 2009, p. 276]. As noted earlier, the acceptance of a lower rate of redistribution is a goal – preferably as a result of better education of politicians and the society. We should vote for a model of responsibility where most goods and services are sold on the market and the higher share of income is at the disposal of individuals and companies. Mandatory social insurance should be replaced, to a great extent, by a private, voluntary one. It is very unlikely that these measures would have any adverse effect on the growth rate; quite the opposite.

The abolition or reduction of income tax would obviously change the structure of the budget revenue towards indirect taxation. Various positive effects are expected [*Macroeconomic Effects*… 2006]: higher employment, higher growth rate and accumulation of capital, and lower tax avoidance. Indirect taxes constitute about 30 to 50% of the tax income in the EU (including mandatory social security payments). In some countries this share is rising (e.g. in Cyprus, in Italy), the average amounting to 35%. Similar data for Singapore (relation to tax revenue only) shows over 35% and in the Cayman Islands about 60%.

It should be stressed that taxing work contracts especially (work as a factor of production) is a negative phenomenon, which should be avoided. The reduction of social contribution would give similar results as lowering the direct taxation [de Serres 2008].

4. Conclusions

It is not true that the high role of government in the economy is a must in the case of Poland because it is a medium-sized country (and not a small-sized country) and a member of the European Union, and most people expect it to be so. Leaving the majority of the national income at individuals' and business entities' disposal, unleashing the citizens' initiative, prevalence of hard-work attitude – it is all within reach of Poles. Nevertheless, the gauntlet has to be picked up. In spite of the crisis or maybe even confronting it.

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OGRANICZENIE OBCIĄŻEŃ PODATKOWYCH W POLSCE

Streszczenie: Celem artykułu jest zaprezentowanie argumentów za silnym ograniczeniem wydatków budżetowych w Polsce oraz za zmianą ich struktury. Autor prezentuje dwie główne propozycje: 1) obniżenie relacji obciążeń podatkowych i parapodatkowych do poziomu poniżej 20% przy jednoczesnym skupieniu się na faktycznych, najważniejszych potrzebach społeczeństwa (np. bezpieczeństwo publiczne, edukacja, badania i rozwój, zdrowie, infrastruktura) oraz 2) ograniczenie, a następnie całkowita likwidacja podatków dochodowych. Realizacja tych postulatów powinna przyczynić się do przyspieszenia wzrostu gospodarczego i bogactwa w Polsce. Artykuł nawiązuje do debaty na temat podatku liniowego od osób fizycznych, który choć bardziej pożądany niż progresywny, wykazuje on szereg wad typowych dla podatków dochodowych w ogóle.