Renata Perić, Ph.D., Full Professor, Faculty of Law in Osijek
University of Osijek
Ljubica Kordić, Ph.D., Assistant Professor, Faculty of Law in Osijek, University of Osijek
Vedran Mesarić, mag. iur.

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THE ROLE OF TAXATION DURING THE FINANCIAL CRISIS 2008-2013: SELECTED ISSUES

Abstract: Reduction of government economic activity in the past 30 years was accompanied by a proportionate decrease in the scope and form of government taxation. The financial crisis that erupted in 2008 changed this paradigm, as it was expected from the state to once again intervene in order to restore calmness to markets. In this context, taxation became the most important tool of government policy. Therefore, in this paper an examination of the nature of the government policy during the crisis was undertaken. After the nature of government taxation policy was determined, and its importance for the state itself established, a case study in the form of a comparative analysis was undertaken. By using the example of Croatia as a reference, taxes of goods and services, inheritance taxes and personal income taxes were analyzed. In the last part of the paper conclusions were driven concerning Croatian taxation policy with reference to the financial crisis 2008-2013.

Keywords: taxes, financial crises, taxation policy, Croatia

1. INTRODUCTION

The great recession that swept the globe in 2008 unleashed a tremendous shockwave whose aftermath unveiled serious problems in some of the world's economies, most notably in Europe. The crisis that started with the collapse of major U.S. investment banks in the autumn of 2008 was mostly alleviated by the end of 2009 through intervention of world's major economies by a unified response agreed within the framework of the G20 group. This response concentrated mostly on the reform of the existing financial system, coupled with massive bailouts (as was the case with the United States) and stimulus packages (in case of the People's Republic of China) whose purpose was to stabilize the market. Just as the world economy was picking up its pace, another predicament struck in the form of a simple statement by the then Greek finance minister, George Papaconstantinou, at a meeting of the Eurozone's finance ministers. In this statement, the Greek government made public their conclusion that the country's budget deficit would not be 3.7%, as they previously predicted, but could reach as much as 12%. In addition to such a discrepancy, the country was also having difficulties collecting taxes. Such a statement, coming from a country which previously enjoyed above EU-average yearly GDP-growth rates, and was also a member of the Eurozone, not only resulted in Greece's sovereign credit rating soon being degraded to "junk" status, the spread between its referential 10 year government bond yield compared to that of Germany reaching new heights and the unemployment rate reaching the highest levels in modern Europe, but also caused a financial collapse in other European "perimeter" countries (Portugal, Italy, Ireland, Spain) that have joined Greece in a club that had derisively been lumped together under the acronym "PIIGS". Naturally, such a downfall, especially in major European countries like Italy and Spain, could not pass without trace in other European countries, above all those (like France) which had important investments in some of the "PIIGS" countries. Today, the year is 2013 and the crisis in Europe has no end in sight. To make matters worse, additional European countries (like Cyprus) had to be placed under EU-IMF supervision, while the latest information being released by the relevant authorities in the newest EU member state Croatia predict the same destiny for this former Yugoslav republic. Rise in unemployment, emigration, suicides and public debt coupled with a fall in industrial production, birth rates and average wages had its counterpoint in the ever-growing gap between the rich and poor. A similar trend could also be observed in the United States, as well as in Japan, which experienced its own, albeit domestic, version of the great recession at the end of the 1980-es. Keeping in mind the above mentioned circumstances, it is surprising that the governments of countries most hit by the recession have been hesitant at best to try to spread the tax burden by laying it more on the top earners. In the process of balancing a budget most countries were tending to save on expenditures which would benefit the general population, while at the same time they increased such taxes and general tax forms which target wide masses of population, especially those not necessarily being in the top earners bracket.

After a short introduction, an overview of the "tax response" to the crisis will be offered, according to the forms that it has taken. At first, philosophical, legal and economic notions on which the analysis is based will be presented.. The main part of the paper is focused on a comparative analysis, based on the example of Croatia, which will then be compared with examples and developments (including most recent ones) from other countries whenever possible. The example of Japan is of special importance for this paper, both because the ongoing discussions there concerning the imminent increase in the consumption tax rate will allow a presentation of the latest considerations of relevant economists also tackling with this subject, and because Japan (or rather its present condition) can offer an interesting "look into the future" from the point of view of both Europe and to a degree also the United States: Japan's rapidly ageing population, ballooning public debt (with highest debt/GDP ratio in the world), increasing expenditures on social and medical care as well as increasing competition with other global powers mean that this country has to face today the problems that await the western world tomorrow. It is also important to say that these analyses are by no means exhaustive, but merely serve to give an appropriate overview of the investigation into the topic. Hopefully, a continuation of this investigation in the future will be possible.

2. ON THE NATURE AND ORIGIN OF TAXES

Famous British-Pakistani writer and filmmaker Tariq Ali mentioned a wave of triumphalism being emitted from liberal and capitalist circles after the end of the Cold War.[1] Indeed, even before the Berlin Wall fell, an article entitled "The End of History?" by noted American political scientist Francis Fukuyama was published in the National Interest magazine. Presenting a variation of

1 The Blair Kitsch Project, http://monthlyreview.org/2000/01/01/the-blair-kitsch-proiect, 12.10.2013

Hegelian theory, Fukuyama stated that the breaking apart of the Soviet bloc represented a final triumph of both political and economic liberalism.[2] Teachings which pointed to a different nature of historical developments were unheeded, even in the case of Hegel's own idea of Zeitgeist (Ger. *Spirit of the age*). History, of course, neither ended in 1989, nor in 2001, nor in 2008. The events of only the last five years encourage us to turn to a famous fragment by the ancient Greek philosopher Heraclitus, who stated "We both step and do not step in the same rivers. We are and are not."[3] In line with this way of thinking is the work of British economists Joan Robinson and John Eatwell, who state that "The fundamental lapse … was the belief that market economy always tends to strike a balance, like a pendulum which, moving back and forth, always approaches a position of inaction. This analogy is false. Movement in space is possible forwards and backwards, while movement in history exists only in one direction, from past towards the future. The life of man lacks the possibility to predict accurately."[4] Also important is their critique of the "metaphysical" way of thinking in social sciences. By metaphysical is meant "a usage of language which does not convey real information, does not describe logical connections and does not provide detailed instructions, yet its goal is to influence behavior."[5] Also relevant for the upcoming analysis is a quote by Hiroyuki Kojima, professor at Teikyo University in Japan who said in an interview for the Asahi Shimbun newspaper that "If you compare economics with physics, the former still has a long way to go before it even gets to the Newtonian stage."[6] To this the reporter added "This must mean that the future of the economy cannot be predicted in the way the movement of heavenly bodies can be predicted."[7] Law and economics are both social sciences, yet for all the things that they have in common, one thing separates them: law is a static science, while economics is comparatively more dynamic. Analysis conducted in either sphere however, must not deviate from the knowledge that both the observer and the matter observed are subject to change. The analysis which lies at the center of this paper will be undertaken by parting from this fundamental notion, which should secure greater accuracy for its final result.

3. COMPARATIVE ANALYSIS

3.1. On economic importance of taxes

It has so far been established that taxes are income of the public authority, now an analysis of their importance both for the authority in question and for its society is to be undertaken. The best way to analyze economic importance of taxes is to use statistical information containing relevant data. Before passing onto this numerical analysis however, it would do well to present some opinions and statements which can be use to better explain numbers that will be provided.

2 Le Monde Diplomatique, Atlas Globalizacije, MASMEDIA, Zagreb, 2006, page 48

3 Heraklit, Fragmenti, Beograd, Grafos, 1979, page 29, quotation translated by Serbian by the author

4 Robinson Joan, Eatwell John, Uvod u suvremenu ekonomiku, Zagreb, Ekonomska biblioteka, 1981, page 68

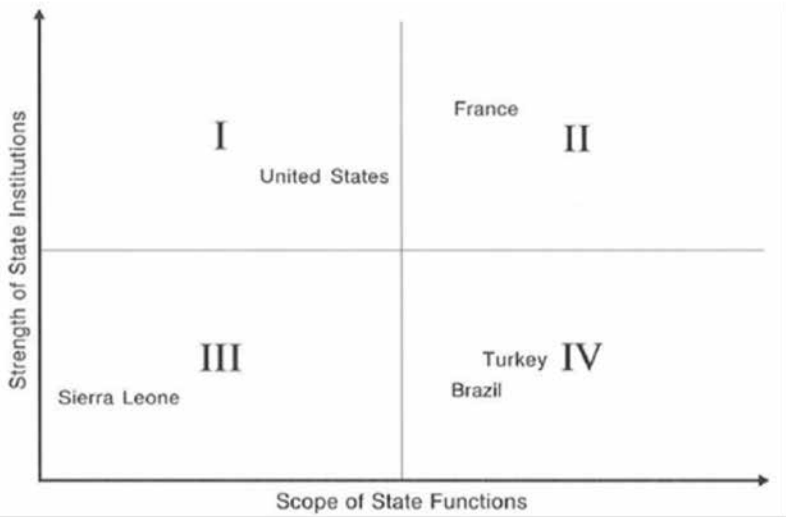
5 Cf. ibid., page 22-23, quotation translated from Croatian by the author

6 VOX POPULI: BOJ takes big gamble on nation's future, http://ajw.asahi.com/article/views/vox/AJ201304060026, 06.04.2013, 12.10.2013

7 Ibid.

Previously in the paper,[8] a notion of the purpose of the state has been introduced, which should influence both the way taxes are collected and the way they are spent. American political scientist Francis Fukuyama (also mentioned in the first *excursus*) developed a matrix on which countries can be placed according to the scope of their state functions and the strength of their state institutions, respectively.

Figure 1: State Scope and Strength



Source: Fukuyama Francis, The Imperative of State-building, Journal of Democracy, April 2004, page 23

Fukuyama explained that the positioning of the United States on the left side of the matrix was due to the fact that a smaller percentage of its GDP came from the state sector[9] (this fact will also be evident from the tables concerning tax income, presented below). He also stated that the role of the state generally increased from the beginning of the 20th century, up until the 1980-es, at which point state sectors in Europe and the United States consumed close to 50% of their respective annual GDP (in 1900 the figure was close to 10%). Such a development brought about an uprising among the (economically) liberal circles, whose champions aggressively pursued policies aimed at decreasing the role that the state played in the economy of a country.[10] These policies, indeed the theories of Fukuyama himself, seemed to present a radical change from the prevailing economic thought in the West in the 1970-es, when even American president Richard Nixon stated "Now we are all Keynesians."[11] In that time, the opinion expressed by British economist Joan Robinson that markets probably are efficient mechanisms for allocation of resources and the setting of prices, but they generally could not provide full employment or prevent major instabilities was taken almost for granted. Hence a role for the state (even in

8 Amplius, footnote 35

9 Fukuyama Francis, The Imperative of State-building, Journal of Democracy, April 2004, page 24

10 Cf. ibid., page 19

11 Boyer Robert, States Against Markets: The Limits of Globalization, Routledge, New York, 1996, page 84

the form of interventions) was thought to be necessary.[12] Today the liberal school of thought prevails in the Western world, despite its evident failure in the crisis that erupted in 2008. This however does not mean that the role of the state is unimportant. If the relevant figures, available from OECD are examined, it will be seen that income from taxes have been very robust, even increasing after the beginning of recession.[13]

Knowledge that taxes, which are one of the means that state has at its disposal for accomplishing its policies, play an important role in modern economies is a starting point for the analysis that will be undertaken as the main part of the paper.

3.2. Taxes on goods and services

"The following rule concerning the effect of taxes is to be observed in a market economy: the tax burden... always manifests in withholding from spending on the part of private individuals[14], so that necessary means would be available for state needs."[15] This quote by Jure Šimović will be of great use, not only concerning the role of taxes on goods and services, but for all the parts of the following analysis. The reduction in spending can be accomplished, generally speaking, in two ways: the public authority can tax the income of private persons which influences the pool of money available to them for consumption, or they can tax goods and services offered on the market so that they become more expensive for the buyer, which *ipso facto* reduces their purchasing power.[16]

The analysis begins with taxes on goods and services which, as it will be seen, play a very interesting role in tax systems of contemporary countries. The reasons for their importance can be attributed to the non-negligible quantity of money coming from them, the relative ease and cheapness of their collection as well as the relative stability of income deriving from them.[17] Data available from OECD make it clear that some countries derive more than a third of their total tax revenue[18] and up to 15% of their GDP[19] from taxes on goods and services. For the purposes of this comparative analysis, the examples will be limited to those of two countries: Croatia and Japan.

3.2.1 The example of Croatia

The Value-Added Tax (Cro. *Porez na dodanu vrijednost, PDV*) is by far the most important type of taxes on goods and services collected in Croatia. It was introduced in 1998 with a standard

12 Ibid.

13 Total tax revenue Taxation: Key Tables from OECD, http://www.oecd-ilibrary.org/taxation/total-tax-revenue_20758510-table2, 30.10.2013

14 Cf. section 2.2

15 Jelčić B., op. cit. (footnote 8), page 367, translated from Croatian by the author

16 Ibid.

17 Ibid.

18 http://www.oecd-ilibrary.org/taxation/tax-revenue-by-sector-2008_20758510-table8, 10.12.2013

19 http://www.oecd-ilibrary.org/taxation/total-tax-revenue_20758510-table2, 10.12.2013

rate of 22%[20], which remained unchanged until 2009 when it was increased to 23%[21] as part of the measures introduced to combat the crisis. It was once again increased in 2012 - this time to 25% (reduced rates being 10% and 5%)[22], which ranked Croatia second in the world (alongside Sweden, Denmark and Norway) in terms of highest VAT rate, behind only Hungary whose rate was 27%.[23] Such a high VAT tax rate in Croatia reflected on the amount of money collected from this source: in 1998 (the first year after the introduction of VAT in Croatia) 20.228.226.337 HRK were collected, which accounted for 30.12% of all the state income in that year (or more than 45% of all the tax income). In 2002, this amount increased to 25.952.486.272 HRK, or 35.01% of state income (53% of all tax income).[24] This upward trend continued, reaching its zenith in 2008 when 41.308.035.600 HRK was collected (35.68% of all state income, 59% of all tax income). 2009 saw a decrease to 37.050.353.600 HRK (33.60% of all state income, 58% of all tax income), notwithstanding an increase in VAT. The data for 2010 and 2011 remained almost the same, even if the share of VAT in total state income increased, mostly due to a significant fall in income flows from other sources. 2012 however saw a rebound almost to levels from 2008, as 40.652.023.100 HRK were collected (37% of all state income, 62% of all tax income).[25]

From the above given information it can be concluded that two increases in the VAT rate have compensated (from the point of view of Ministry of finance) a decrease in spending during the crisis. This however leads to another problem. Šimović correctly observed that a great advantage of taxes on goods and services is "their potential to be used as a very elastic and efficient instrument of economic policy."[26] This potential is based, among other things, on the fact that VAT is an indirect, objective tax, and a general tax[27] in most countries, meaning that it has to be paid by taxpayers no matter what. At the same time income from VAT can be spent as authorities see fit. Some of the effects of such policy were published in October 2013, when the IMF published its fiscal monitor, a half-yearly analysis of budget-balancing in member countries. The authors noted that increases in VAT rate have been a popular method for dealing with the crisis.[28] This trend has been coupled with a steady increase in indirect taxes and a decrease in direct taxes (especially for the top earners).[29] Such a tendency obviously overburdens the less wealthy individuals forced to pay high VAT. At the same time, no increase in the VAT base has been observed, even though certain high-end transactions (financial transactions for example) could be subject either directly to VAT or to a similar type of tax on goods and sales as well.[30] The fiscal monitor also examines the idea of increased income tax for top earners, but this will be analyzed in the section concerning income taxes.

20 Article 10, Zakon o porezu na dodanu vrijednost (Narodne Novine, br. 47/1995, 106/1996)

21 Article 10, Zakon o porezu na dodanu vrijednost (Narodne Novine, br. 94/2009)

22 Article 38, section 1, 2 and 3, Zakon o porezu na dodanu vrijednost (Narodne Novine, br. 73/13, 99/13)

23 VAT Rates Applied in the Member States of the European Union, situation at 1st July 2013, page 3, http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/how_vat_works/rates/vat_rates_en.pdf, 05.11.2013

24 Jelčić B. et al., Hrvatski fiskalni sustav, Zagreb, Narodne Novine, 2004, page 6

25 Ministarstvo financija, Državni proračun - siječanj - rujan 2013., http://www.mfin.hr/adminmax/docs/Drzavni%20proracun%20-%20sijecanj%20-%20rujan%202013.xlsx, 05.11.2013.

26 Jelčić B., op. cit. (footnote 8), page 367-368, translated from Croatian by the author

27 Cf. Indirect taxes, real (objective) taxes –page 13, and general taxes - page 14

28 World Economic and Financial Surveys, Fiscal Monitor, International Monetary Fund, October 2013, page 24

29 Cf. ibid., page 34

30 Cf. ibid., page 25

3.2.2 The example of Japan

All the information given above clearly shows that using income from VAT to strengthen the budget is approaching its limits in Croatia. On the other side of the world in Japan however, this source is just beginning to be tapped. Japan and Croatia have a couple of striking similarities that are essential to this comparison. Both of these countries are experiencing a decrease in their respective populations (thus also in their birth rate and workforce), accompanied by an increase in the number of elderly, retired people. Also, both of these countries experience a constant increase in their debt levels (although this is much more accentuated in Japan).[31] Lastly, both of Japan and Croatia have been struggling to get out of a recession, sometimes using same policies – a reduction in economic activity in Japan that started in 1989 and has been know as the lost decade, was characterized by government attempts to jump-start growth by a series of huge infrastructure projects.[32]

Ever since the beginning of the Japanese post-war economic miracle in the 1950-es, the governments in Japan implemented policies that were much more economically liberal compared with countries in Europe. This also meant that there was a general tendency not to impose a sales tax as the prevailing opinion was that this would curb domestic economic activity.[33] This opinion changed however, once a series of misfortunes hit the Japanese economy after the asset price bubble collapsed in 1989. The above mentioned spending on numerous infrastructure projects, coupled with a rapidly ageing population, caused a massive increase in Japanese government debt.[34] The debt was then further increased as a result of reconstruction efforts after the Kobe earthquake in 1995. All these detrimental developments meant that new sources of revenue should be looked for in order to cover the spiralling increase in public costs. This leads us to Japanese consumption tax[35] (in the form of VAT). Even though its introduction was discussed as early as 1979, the consumption tax was only introduced in 1989, with a standard rate of 3%, which increased to 5% in 1997 (of which 4% was national consumption tax while 1% was prefectural consumption tax.)[36] These increases alone however, could not cover the massive public expenditure, especially after another earthquake hit the Tohoku region of Japan in 2011, after which all the nuclear reactors in Japan were shut down. This resulted in increased import of fossil fuels which in turn pushed Japanese trade balance deep into red.[37] Thus the time came for another increase in consumption tax rate. The law regulating the increase was passed during the premiership of Yoshihiko Noda, but it was also accepted by his successor, the current (at the time of writing of this paper) Prime Minister Shinzo Abe. Their plan calls for a gradual increase of the consumption tax rate, first to 8% in April 2014 and then to 10% in October 2015.

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31 Cf. footnote 98

32 Kingston Jeff, Contemporary Japan, Wiley-Blackwell, Chichester, 2011, page 26

33 McCormack Gavan, Sugimoto Yoshio, Democracy in Contemporary Japan, M.E. Sharpe, New York, 1986, page 39

34 It is interesting to note that the Japanese public debt, which amounts to 238% of its GDP, is the highest among all the developed countries, yet 90% of it is owned domestically, which enables Japan to enjoy a significant amount of independence, at least financially.

35 Jap. 消費税 (shohizei)

36 Confident Abe hikes consumption tax rate from 5 to 8 percent, Asahi Shinbun, http://ajw.asahi.com/article/behind_news/politics/AJ201310010077, 07.11.2013.

37 Source: Japanese customs agency, report for calendar year 2012 and first half of calendar 2013, http://www.customs.go.jp/toukei/shinbun/trade-st_e/2013/2013_316e.pdf, 07.11.2013.

What makes this development so different from the previous ones is also the same reason why the example of Japan has been chosen for comparison with Croatia. The extra income that is expected to be collected from these increases is destined for covering the increased social security payments as well as building new facilities for healthcare, which should help alleviate pressing burdens associated with the ageing of the Japanese population. This makes Japanese VAT an example *par excellence* of a specific tax.[38] Furthermore, since the previous increase in 1997 coincided with the Asian financial crisis, certain circles among the economists in Japan were (and remain) wary of the effect that such an increase could have on the sluggish economic recovery after the crisis and the earthquake.[39] This is why the Abe administration:

a) Waited for the results of the quarterly "Tankan" business optimism survey to confirm that the Japanese economy was firmly on the path to recovery[40]
b) Announced a simultaneous package of economic measures worth 5 trillion yen (around 50 billion dollars) centered on corporate tax breaks[41] and financial assistance to low income individuals and home buyers.[42]

Once the decision to go through with the consumption tax rate increase was announced, it became a question of analysis to determine the manner in which the money from the tax (projected to amount up to 8.1 trillion yen, or $82.7 billion, a year) would be spent. The question that remains to be answered is will even this significant new amount of income be enough to cover spiralling social security costs, let alone decrease Japan's public debt?[43] If the following figure is examined, it will be seen that Japanese public debt is projected to continue to grow, even if the consumption tax rate is increased and the GDP grows at the average rate of 2% - which is highly questionable. Another increase in the consumption tax rate, this time to 15%, for the purpose of decreasing government debt has been contemplated, but even this measure is considered to be too optimistic by many analysts.[44]

38 Cf. section 2.5.5

39 Compare with "Analysts divided over chilling effects of April consumption tax hike", http://ajw.asahi.com/article/economy/business/AJ201310020065, 07.11.2013

40 Tankan summary, September 2013, http://www.boj.or.jp/en/statistics/tk/gaiyo/2011/tka1309.pdf, 07.11.2013

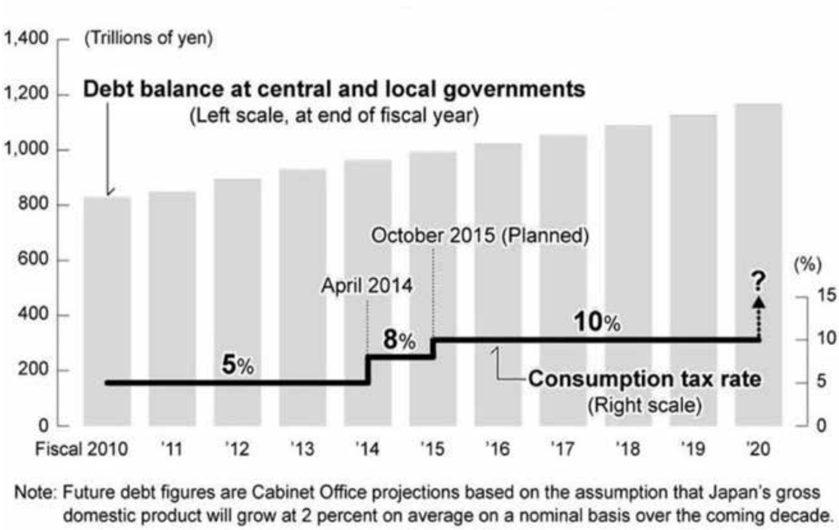
41 Interestingly enough, the corporate tax breaks concern taxes introduced after the earthquake in 2011, income from which was to be spent exclusively on reconstruction efforts. Another example of specific taxes in Japan.

42 Confident Abe hikes consumption tax rate from 5 to 8 percent, Asahi Shinbun, loc. cit.

43 Another potential cause for increased government spending would be recent territorial disputes with the People's Republic of China.

44 ANALYSIS: Consumption tax numbers don't add up to reduced public debt, Asahi Shinbun, http://ajw.asahi.com/article/behind_news/politics/AJ201310020081, 07.11.2013

Figure 2: Debt and consumption tax rate increase in Japan 2010-2020



Source: Asahi Shinbun

Various other means to decrease debt and cover the rising cost of social security payments have been proposed: from increasing income taxes to levying higher inheritance taxes on wealthy citizens. Another potential source of revenue was identified in higher corporate taxes,[45] but the present administration in Japan seems to be moving in the opposite direction.[46] These contemplations however go beyond the present topic of taxes on goods and services. Concerning the example analyzed, one can conclude by saying that, much the Croatian government, the Japanese government has also recognized the great potential that consumption tax has as a source of government income, not least because it is levied on the entire population. The major difference between the two lies in the fact that, unlike the government of Croatia,

a) The Japanese government identified a specific reason for the consumption tax rate increase (in this case, expenses related to the social security), and the money collected from this increase is destined to go exclusively to programs related to covering of these expenses;
b) The Japanese government followed the recent tax increase (as well as the one in 1997) with a specific policy program aimed at easing the burden on taxpayers.

3.3. Inheritance tax

The previous analysis of the role of taxes on goods and services was completed by introducing new ideas that developed from the ongoing debate in Japan, foremost of which is the more

45 EDITORIAL: Abe must not lose sight of true purpose of tax hike, Asahi Shinbun, https://ajw.asahi.com/article/views/editorial/AJ201310020053, 07.11.2013

46 Cf. footnote 104

intensive usage of the inheritance tax. Inheritance tax has been a very popular notion, even historically, in circles that have been pushing for reduction of the wealth gap and consequently for greater equality among people.[47]

In modern Croatia, inheritance tax exists as a tax of local administration,[48] collected (along with other different taxes) for financing of one of 21 counties (Cro. *županija*) that the country is made up of.[49] Therefore, the relevant legal act is the Law on Financing Units of Local and Regional Administration (Cro. *Zakon o financiranju jedinica lokalne i područne (regionalne) samouprave*) – this fact differentiates it from other more important taxes, which are usually regulated by a separate law,[50] and serves as another testament to the fact that inheritance tax is to be considered an ancillary tax.[51] Further confirmation can be found if relevant articles in the above mentioned law are examined, since they have the legal institute of inheritance grouped with gift (Cro. *dar*, Lat. *donatio*), and they are both in turn subject to a tax on inheritance and gifts (Cro. *porez na nasljedstva i darove*). The relevant tax rate in this case is 5%, but marital partner, blood cognates, as well as other relatives living in the same household with the deceased, are freed from their tax obligation,[52] as are certain other organizations and individuals foreseen by the relevant *lex specialis*. Such regulation makes inheritance tax more of an exemption than a rule – consequently the amount of money collected through inheritance taxes is low, especially when compared to other taxes. As far as inheritance taxes in Europe are concerned, it can be established from the figure below (Figure 3) that, apart from notable exceptions of Belgium and Spain, European countries have relatively low inheritance tax rates. This happens despite the benefits of inheritance taxation in reducing both the distortion in the beneficiary's work effort and wealth disparities in the society as a whole.[53]

47 Marx K., Engels F., op. cit.,page 383

48 Amplius section 2.5.9

49 Jelčić B., op. cit. (footnote 88), page 41

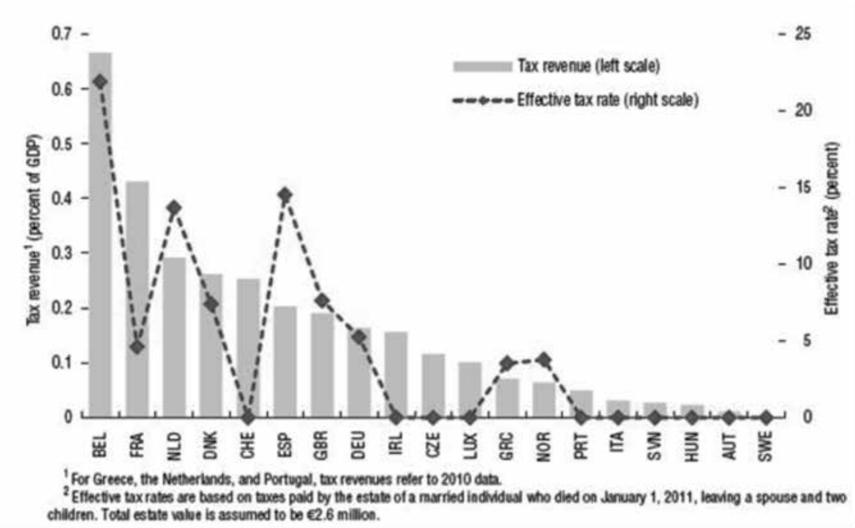
50 Cf. footnote 84

51 Amplius supra section 2.5.3

52 Article 13 and 14, Zakon o financiranju jedinica lokalne i područne (regionalne) samouprave, (Narodne Novine, br. 117/93, 69/97, 33/00, 73/00, 127/00, 59/01, 107/01, 117/01, 150/02, 147/03, 132/06, 26/07, 73/08, 25/12)

53 World Economic and Financial Surveys (footnote 93), page 39

Figure 3: Inheritance tax rate and revenue



Source: IMF, World Economic and Financial Surveys, Fiscal Monitor, October 2013, page 41

Certainly, the potential of this form of taxation remains great, and will certainly be used more intensively, with a broader base and with not so many exceptions from it if (and when) taxation of top earners becomes more widespread. This idea will be examined further in the section concerning the taxation of income.

3.4 Income tax

In the part of the analysis that concerns taxes on goods and services, it has been stated that taxation always means "withholding from spending on the part of private individuals, so that necessary means would be available for state needs."[54] If one examines the desired effects of tax policies in modern states, one can generally divide them in three groups: those of fiscal, economic and social nature.[55] The above mentioned taxes on goods and services are, as it has been concluded previously, very efficient fiscally, but their economic and social effects are subject to criticism as they often have negative effect, especially when it comes to maintaining or increasing social justice.[56] On the other hand, income taxes tend to have a more balanced approach, and are able to fulfil more of the above stated demands of social and economic nature.[57]

If relevant OECD data is examined[58], it will be seen that income tax remains a significant source of tax income in most countries, even though the top tax rates were lowered significantly

54 Footnote 78.

55 Jelčić B., op. cit. (footnote 8), page 298-299

56 Supra, footnote 94

57 Jelčić B., op. cit. (footnote 8), page 299

58 http://www.oecd-ilibrary.org/taxation/taxes-on-personal-income_20758510-table4, 10.12.2013

in the Western world during and after the 1980-es.[59] It is interesting to observe however, that the advent of the recession brought about the following trend: most developed countries experienced an increase in the amount of money collected from personal income taxes while simultaneously experiencing a decrease in the amount of money collected from corporate income taxes. For developing countries (with the notable exception of Chile) such a decrease was to be observed both from corporate income taxes as well as personal income taxes.[60] It remains to be seen whether such a trend will remain for the future.

The comparative analysis will be concentrated only on personal income taxes in Croatia, compared with the situation in France, where current fiscal reform also includes an important increase in the income tax rate for top earners. The developments in these two countries may then well serve as a precursor for other states that find themselves in a similar position.

3.4.1 The example of Croatia

Personal income tax in Croatia was an analytic tax in the first years after Croatian independence in 1991, but with entry into force of the Law on Income Tax in 1994 (Cro. *Zakon o porezu na dohodak*), a new system for personal income taxation, based on the synthetic system, was introduced.[61] The reasons for this switch were based on the fact that the synthetic system was used in most countries in the world, and that it was more in line with market economics, recently introduced in Croatia.[62]

The above mentioned Law on Income Tax provided two progressive tax rates, the first of which was 25%, while the second was 35%. It is interesting to know that the minimum tax rate of 25% was among the highest minimum tax rates in modern countries, while the maximum tax rate of 35% was among the lowest maximum tax rates. Also, the difference of only 10% was among the smallest in income tax laws of European countries.[63] The law change in 1997 has reduced the minimum tax rate to 20%, which was then further reduced to 15% in 2001. The law change in 2001 also saw the introduction of an additional tax rate of 25% (for income bracket between those taxed at 15% and 35%). The year 2003 saw the reform of the law on income tax: four different tax rates were introduced: the minimum at 15%, the second at 25%, the third at 35% and the maximum at 45%.[64] Table 2 shows the amount of money that has flown into Croatian government budget in the last 10 years from taxation of personal income. [65]

59 Mankiw Gregory N. Principles of Microeconomics, Thompson South-Western; 4th edition, 2006, page 254

60 World Economic and Financial Surveys (footnote 92), page 26

61 On the difference between analytic and synthetic taxes, amplius section 2.5.4

62 Jelčić B., op. cit. (footnote 88), page 8

63 Cf. ibid., page 9

64 Cf. ibid., page 10

65 Ministarstvo financija, Državni proračun - siječanj - rujan 2013., http://www.mfin.hr/adminmax/docs/Drzavni%20proracun%20-%20sijecanj%20-%20rujan%202013.xlsx, 09.11.2013.

Table 2: Revenue from personal income taxation in Croatia 2002-2012

Year	Revenue (HRK)
2002	3,363,295,000
2003	3,114,581,000
2004	3,128,273,000
2005	3,106,476,000
2006	3,459,649,000
2007	1,772,708,000
2008	1,687,502,000
2009	1,399,411,000
2010	1,201,546,000
2011	1,307,486,000
2012	1,269,525,000

It should be added that another tax reform was introduced in 2010, which again reduced the number of tax rates to three: the minimum being 12%, the second (intermediate) being 25% and the maximum rate being 40%.[66] From the figures written above, a clear fall in the amount of income gathered from taxation of personal income starting from 2007 can be noticed. This fall coincided with the onset of the crisis in late 2007 and early 2008, and can be correlated to the fall in GDP in that time period.[67] This despite the fact that a special tax was introduced in the summer of 2009, by which all personal income between the amount of 3,000.00 and 6,000.00 HRK (netto, therefore after the taxation) was taxed at an additional rate of 2%, and all personal income above 6,000.00 HRK was taxed at a rate of 4%.[68] It was explained that this tax was necessary, because of the aforementioned fall in GDP, which had a negative impact on government income and expenses policy.[69] This taxation expired in the summer (for income taxed at 2%) and fall (for income taxed at 4%) of 2010, after which no similar increase in personal income taxation was observed, unlike the aforementioned increase in VAT, which, as it has been stated previously, became the main source of government income in the last couple of years.[70]

It can therefore be seen that tax policy in Croatia seems to be moving away from an increase in personal income taxation. What of the situation in other countries? Ever since the 1980-es, an important decrease in personal income taxation was to be observed in English speaking countries (above all in United States and United Kingdom).[71] The situation was not as drastic in France, where the role of central government was always important to begin with[72], and numerous

66 Article 8, section 1, Zakon o porezu na dohodak, (Narodne Novine, br. NN 177/04, 73/08, 80/10 , 114/11, 22/12, 144/12, 43/13, 120/13, 125/13)

67 Compare with GDP growth/fall graph on the web page of Croatian Statistics Bureau http://www.dzs.hr/, 10.12.2013

68 Article 11, section 2, Konačni prijedlog zakona o posebnom porezu na primitke od samostalne djelatnosti i ostale primitke, www.sabor.hr/fgs.axd?id=14656, 12.11.2013

69 Prijedlog zakona o posebnom porezu na primitke od samostalne djelatnosti i ostale primitke, www.sabor.hr/fgs.axd?id=14656, 12.11.2013

70 Footnote 89

71 Piketty Thomas and Saez Emmanuel, Income Inequality in the United States, 1913-1998, University of California, Berkley, the Quarterly Journal of Economics, Vol. CXVIII, February 2003, Issue 1, page 37

72 It is important to note that this dependence of French economy on the public sector also influences economic (and managerial) behaviour of French people and institutions. Amplius: Wim A. Van der Stede, "The Effect of National Culture on Management Control and Incentive System Design in Multi-business Firms: Evidence of Intracorporate Isomorphism", European Accounting Review, 2003, page 274

government policies required steady income, which in itself ruled out a “tax revolution” like the one experienced in the USA and in the UK. The onset of the crisis has even initiated an attempt in France to introduce a tax rate of 75% for top-earners. This policy makes France truly unique among its peers in the ranks of developed countries and certainly merits further examination.

3.4.2 The example of France

If the relevant statistical table[73] compiled by the OECD is consulted, it will be seen that at the end of 2011, the tax income of the French state was similar to other developed countries. Only in taxation of property[74] was France the leading state, with an amount equal to 3.7% of its GDP being collected from this form of taxation. The reason for this lies in the (unique for France) Solidarity Tax on Fortune (Fra. *L'impôt de solidarité sur la fortune*)[75], by which property of French individuals with tax residence in France (or foreign individuals with property in France) valued at above 1,300,000.00[76] Euros is being taxed progressively by up to 1.5%, for property valued at over 10,000,000.00 Euros.[77] According to data from the year 2010, exactly 593,877 households were subject to this tax, from which 3,6 billion Euros were collected, which represents an increase of 350,3 million Euros from 2009. Interestingly enough, one half of the total amount of tax income from this source was collected from Île-de-France alone[78], this being a region that comprises the capital city Paris and its wealthy suburbs like Neuilly-sur-Seine, Levallois-Perret and Courbevoie.[79]

Since this tax was directed at individuals with valuable property, there was ostensibly no need for high tax rates for top earners in taxation of income. Indeed, if one looks at the table on page 47, one can see that taxation of personal income in 2011 in France collected an amount equal to 7.5% of the French GDP, comparable to the levels in Germany (9.3% of GDP) and Spain (7.1% of GDP). In 2012, the French personal income tax rates and thresholds were as follows[80]:

Table 3: Personal income brackets and tax rates in France, 2013

Amount concerned	Relevant tax rate
From 0 to 5,963 €	0 %
From 5,963 € to 11,896 €	5.5 %
From 11,896 € to 26,420 €	14 %
From 26,420 € to 70,830 €	30 %
From 70,830 €s to 150,000 €	41 %
Above 150,000 €	45 %

73 http://www.oecd-ilibrary.org/taxation/tax-revenue-by-sector-2008_20758510-table8, 10.12.2013

74 http://www.oecd-ilibrary.org/taxation/taxes-on-property_20758510-table7, 10.12.2013

75 Taxation in France is regulated by one basic law, called the General Code of Taxes (Fra. *Code général des impôts*), that regulates all the taxes in force in the French Republic.

76 Article 885 A, Code général des impôts, Modifié par LOI n°2012-1509 du 29 décembre 2012 - art. 13 (VD)

77 Article 885 U, Code général des impôts, Modifié par LOI n° 2011-900 du 29 juillet 2011 - art. 1 (V), Modifié par LOI n°2012-1509 du 29 décembre 2012 - art. 13 (VD)

78 Atlas fiscal de la France : Édition 2010, Finances publiques, Les Cahiers de la DGFiP, page 18

79 For instance, 5374 individuals were subject to the tax in Neuilly-sur-Seine, 1025 in Levallois-Perret and 856 in Courbevoie, while 54691 individuals were subject to the ISF in Paris. Source: http://www.impots.gouv.fr/portal/deploiement/p1/fichedescriptive_6616/fichedescriptive_6616.xls, 13.11.2013

80 Source: Article 197, Code général des impôts, Modifié par Ordonnance n°2013-837 du 19 septembre 2013 - art. 3

It is important to note that the top bracket, for income above 150,000 Euros was introduced only in 2013. Before that, in 2012, the top rate was 41% for income above 70,830 Euros.[81] Interestingly enough, the election of François Hollande - the socialist party candidate for the French president in 2012 brought about the prospect of an introduction of another tax for top income earners, this time at 75% for individuals earning more than 1,000,000 Euros. This very idea frightened some of the richest people in France, such as the famous actor Gérard Depardieu[82] or Bernard Arnault[83], the chairman of luxury brands company LVMH, and made them consider moving abroad to evade taxation. This law has eventually been declared unconstitutional by the French Constitutional Council (Fra. *Conseil constitutionnel*) on the grounds of inequality among marital partners,[84] to which Hollande's prime minister, Jean-Marc Ayrault responded by presenting a slightly changed proposal for the tax rate for top earners to increase to 75%, the difference this time being that the tax is to be paid by the employer rather than the employee. This proposition in turn provoked a veritable outcry by the French football clubs, as 102 of their players were to be affected. At the writing of this paper, the tax has not yet entered into force, but the firmness of the Hollande administration in this regard is significant and deserves attention.[85]

Therefore it can be concluded that even though the amount of revenue collected by the French government from taxes on personal income and property is smaller when compared with more important public income sources like VAT and social security contributions,[86] the effort of the present French government to increase taxation of wealthier individuals can be noted. It remains to be seen if it will be successful in its quest, and if this change will influence government policy in other European (and World) countries.

4. CONCLUSION

Concepts related to the role of taxation in government policy, with a focus on the time period during the financial crisis of 2008-2013, have been the subject of this paper. The underlying philosophic notion of constant change (both generally and specifically in case of human society and economics), introduced at the beginning, serves as an anchor for further analysis presented in this work.

The main part of the paper is written in the form of a case study dealing with some aspects of the role of taxation in the financial crisis of 2008-2013. The first issue analyzed is the usage of taxes on goods and services: at first generally (regardless whether in times of crisis or in times of economic growth), then in Croatia both before the onset of the crisis and after it. The conclusion reached here is that financing of the Croatian government apparatus is increasingly becoming dependent on taxation of goods and services. At the same time, the specific usage of income from this tax form remains undeclared to the Croatian taxpayers. The example of Croatia thus

81 Compare with: L'impossible calcul de l'impôt de Gérard Depardieu, Le Monde, http://www.lemonde.fr/politique/article/2012/12/17/l-impossible-calcul-de-l-impot-de-gerard-depardieu_1807490_823448.html, 13.11.2013

82 Ibid. Mr. Depardieu eventually acquired Russian citizenship.

83 Bernard Arnault : „Je retire ma demande de nationalité belge", http://www.lemonde.fr/economie/article/2013/04/10/bernard-arnault-je-retire-ma-demande-de-nationalite-belge_3157073_3234.html, 13.11.2013

84 Conseil constitutionnel, Communiqué de presse - 2012-662 DC

85 Taxe à 75 %: Hollande reste ferme, la grève du foot maintenue, http://www.lemonde.fr/sport/article/2013/10/31/taxe-a-75-hollande-reste-ferme-les-dirigeants-du-foot-maintiennent-la-greve_3506644_3242.html, 13.11.2013.

86 Compare with OECD table http://www.oecd-ilibrary.org/taxation/tax-revenue-by-sector-2008_20758510-table8, 10.12.2013

described is then compared to that of Japan, where recent developments concerning the usage of taxes on goods and services are of unique value for comparison with European countries (including Croatia). Japanese consumption tax rate, albeit significantly smaller than that of European countries, is projected to grow in the coming years. This trend however is partly offset by greater clarity concerning the usage and the destination of income derived from this tax source. Second tax form analyzed is that of inheritance tax, albeit in the broadest terms, since this particular examination only serves to accentuate conclusions derived from the analysis of the two other tax forms. Lastly, the income tax is analyzed, initially on the example of Croatia. The diminishing importance of this tax form in Croatia is then compared with the French example, which well illustrates new potential usage of this tax form in the context of a "response" to the financial crisis.

The limitations of the paper are related to the vastness of tax forms analyzed, whose full presentation would require a work of much greater magnitude. However, it does find its place in the context of academic contemplations of the latest crisis.

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Prof. dr. sc. Renata Perić,
redovita profesorica Pravnog fakulteta u Osijeku
Doc. dr. sc. Ljubica Kordić,
docentica Pravnog fakulteta u Osijeku
Vedran Mesarić, mag. iur.

ULOGA OPOREZIVANJA ZA VRIJEME FINANCIJSKE KRIZE 2008-2013: IZABRANA PROBLEMATIKA

Sažetak

Vlade u zapadnom svijetu sve više smanjuju svoju ulogu u ekonomskoj politici. Ovo smanjenje ekonomske aktivnosti vlada u proteklih je 30 godina popraćeno proporcionalnim smanjenjem obujma i oblika državnog oporezivanja. Financijska kriza koja je izbila 2008. godine promijenila je ovu paradigmu s obzirom na to da se odjednom od države očekivala intervencija radi smirenja tržišta. U tom smislu je oporezivanje postalo najvažnije oruđe politika vlada. U ovom se radu ispituje priroda državne politike u vrijeme ekonomske krize u periodu 2008-2013. Nakon utvrđivanja prirode porezne politike vlada, kao i važnosti same porezne politike za državu, u glavnom je dijelu rada provedena je komparativna analiza. Polazeći od primjera Hrvatske, analizirani su porezi na robe i usluge, porezi na nasljedstvo i porezi na osobni dohodak. U završnom dijelu rada izvode se zaključci s posebnim osvrtom na poreznu politiku Republike Hrvtaske u kontekstu aktualne ekonomske krize.

Ključne riječi: porezi, financijska kriza, porezna politika, Hrvatska

Prof. Dr. Renata Perić,
Ordentliche Professorin, Fakultät für Rechtswissenschaften, Josip Juraj Strossmayer Universität in Osijek
Dr. Ljubica Kordić,
Dozenitin, Fakultät für Rechtswissenschaften der Josip Juraj Strossmayer Universität in Osijek
Vedran Mesarić, Mag. iur.

DIE ROLLE DER STEUERN IN DER FINANZKRISE 2008-2013: AUSGEWÄHLTE FRAGEN

Zusammenfassung

Die ökonomische Rolle der Regierungen in westlichen Ländern wurde in den letzten 30 Jahren stark beschränkt. Diese Beschränkung ging mit einer Verkürzung der Steuern zusammen. Dieses Paradigma wurde mit dem Beginn der Wirtschaftskrise im Jahr 2008 geändert, da eine Intervention in den Märkten vom Staat erwartet war. In diesem Zusammenhang sind auch Steuern zum Wichtigsten Mittel der Staatspolitik geworden. Deswegen wurde in dieser Arbeit die Analyse der Rolle des Staates während der Krise unternommen. Am Anfang wurde die staatliche Steuerpolitik analysiert und deren Wichtigkeit für den Staat bestätigt. Danach wurde eine Fallstudie in Form einer komparativen Analyse unternommen. Auf dem Beispiel Kroatiens als Basis, wurden Umsatzsteuern, Erbschaftssteuern und Einkommensteuern analysiert. Im letzten Teil der Arbeit wurden Schlüsse mit besonderer Rücksicht auf die Steuerpolitk der Republik Kroatien im Kontext der aktuellen ökonomischen Krise gezogen.

Schlagwörter: die Finanzkrise 2008-2013, die Rolle des Staates, die staatliche Steuerpolitik, Kroatien, Frankreich, Japan