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# Stimulus Packages in the EU

## - Tax Aspects -

# Financial Crisis

(trends that created the credit bubble)

- Shift of financial transactions to unregulated markets
- Steady worsening of the agency problem
- Pretense that all of finance can be mathematized

# Financial Crisis

## (foreplay)

- Interest rates at historical lows
  - Investors seek acceptable rates of return
  - Leveraging of investments
  - Shift to high-risk financial derivatives
- Result:
  - High leveraged financial system
  - Vulnerable to total collapse by just marginal defaults

# Role of Taxation

(origin and shape of current crisis)

- CITs are biased towards debt finance
  - High levels of corporate indebtedness
  - Stimulation of leveraged buyouts
  - Private equity funds
  - Mitigated impact by reduced tax rates and/or (bank)regulations
- Tax avoidance opportunities
- Mark-to-market accounting

# Economics of Tax Stimulus

- Aim: stimulate aggregated demand (and induce growth)
- Increased government spending (more substantial multiplier effect)
- Tax policy measures
  - Targeted at persons/firms with highest propensity to consume (highest multiplier effect throughout economy)
  - Targeted at economic operators that are credit constrained (by addressing cash-flow improvement)
- Timeliness and reversibility

# Containment measures

- General tax rate reductions (including cash refunds)
- Tax incentives for special economic sectors
- Tax cuts on poor / tax hikes on rich
- Deferrals on tax payments
- Other

# Temporary VAT Rate Reduction (economic effect?)

- Pass-through to **consumer prices** (tax incidence)
- Will **consumers spend** more?
  - Income effect
  - Substitution effect
- Will **depth of recession itself** change impact of stimulus?
  - Growth in uncertainty
  - Growth in number of families facing credit problems

# Fundamental measures

## *Initiatives to eliminate/reduce the bias towards debt finance*

- **Latvia**: introduction of notional interest deduction
- **Netherlands**: introduction of interest box resulting in 80% defiscalizing of group interest



# Possible future (structural) measures

- **Weaknesses in CIT-system**
  - Allowance for Corporate Equity (ACE)
  - Comprehensive Business Income Tax (CBIT)
  - Destination-based Hybrid Cash-Flow Tax
- **International taxation on capital flows**
  - Modified Tobin Tax