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TAX POLICY IN EU NEW MEMBERS: SLOVENIA

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KEYWORDS: Taxation, Tax Reforms, EU New members, Slovenia

TAX POLICY IN EU NEW MEMBERS: SLOVENIA

by

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Abstract

In this paper we first deal with the general tax system of Slovenia, entering EU in 2004, and we compare the evolution of its shares of direct taxes, indirect taxes and social security contributions with the ones for EU-15 and New Members. Then, we describe the quantitative and institutional features of main taxes showing that, even if the total fiscal revenue as percentage of GDP did not radically change through the 1990s, the structure by economic functions varied rather drastically. We also consider the overall impact of the tax system on the effective purchasing power of Slovenian households and we discuss the incentives aimed at encouraging foreign direct investments. Finally, we describe the proposals for new individual and corporate income taxes, currently under discussion, and draw some conclusions about some other directions of reform which may possibly increase overall efficiency of Slovenian economy and tax system.

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1. Introduction and executive summary

The present paper is devoted to the description of Slovenian fiscal system. Among all the East European countries, Slovenia not only presents the social and economic structure most similar to the current UE members, but it has also been often considered by international comparative surveys, so that many data are available.

Slovenia is a small country, covering an area of 20,273 Kmq (approximately half of Switzerland) and being populated by 2 million inhabitants. Since its foundation in 1918, Slovenia was part of the Kingdom of Serbs, Croats and Slovenes, later evolved in Federal People's Republic of Yugoslavia in 1945. In April 1990 there were the first democratic elections, followed in December 1990 by a referendum in which 88.5 percent voted in favor of an independent State. Slovenia officially declared its independence on 25 June 1991, and on January 1992 was officially recognized by EU. On 1st February 1999 came into effect the association agreement with EU: Slovenia will effectively enter EU in 2004.

Local currency is the Slovene Tolar, SIT, whose exchange rate in November 2003 was 236 SIT = 1 €. Slovenian GDP in 2003 is expected to be about 24,580 Million €, near 12,208 € per capita, about 60 percent of the EU average (unweighted PPP values) . Real GDP has grown by 3 percent in the last two years, sustained by robust export expansion, both to EU - mainly Germany, Italy, France, Austria and Croatia - and to non-EU markets. On the contrary, in 2003 and 2004 it is expected to be mostly a strong domestic demand to push GDP growth up to 3.5 percent per year.

Unemployment rate has remained stable at 6.4 percent in 2002, while inflation continues to stay at relatively high levels, despite it is expected to fall from 7.5 percent in 2002 down to 4.5 percent in 2004 - according to the latest government estimation - and it is now a priority target by Bank of Slovenia.

Monetary policy in 2002 was tightened to some extent, leading to a slower growth in monetary aggregates M3. However, as a result of high capital inflows, an overall large monetary expansion has put downward pressure on interest rate.

Consolidated general government deficit was reduced to 1.8 percent of GDP in 2002 and it is expected to reach just 1.2 percent in 2004, thus, altogether with the stock of public debt constant at 40 percent of GDP, contributing to fulfill Maastricht criteria (EU Commission, 2003).

The overall fiscal burden in Slovenia amounted to 40.5 percent of GDP in 1998 - a level that lies in between the average for EU-15 and the one for New members - constituted by near two-third of tax revenues and by the remaining one-third by social contributions. The latest available indicator for the fiscal burden, referred to 2002, is slightly lower, by amounting to 39.5 percent of GDP. Tax revenue was composed mostly by indirect taxes (18.9 percent of GDP): in particular, VAT represented the largest source of government financing, contributing for more than 22 percent to the total fiscal burden. As a consequence, indirect taxes and social contributions seem to be actually too high in comparison with the other EU countries. The dominant role of these two sources of fiscal revenue is sharply in contrast with the suggestions by Mitra and Stern (2003), who indicate a recommended level for both indirect taxes and social contributions at about 10 percent of GDP each.

In conclusion, economic efficiency could be improved by raising rates of direct taxes, specially on corporate and business, in particular on self-employed income and on financial activities . Analysis of total taxation by functions, in fact, confirms that consumption and labor are by far the most heavily charged, while taxes on capital and business play a really marginal role. The same figure emerges from the analysis by Čok (2003) of average tax rates on active households, whose total burden from indirect taxes and social contributions amounted, on average, to 37.3 percent of gross income over a total burden of 45.8 percent. Also the recent proposal by the Slovenian government to prepare, among the others, a new law on corporate income tax seems to confirm the need to reform the fiscal system in the above direction.

2. The structure of the system at the end of the 1990s

2.1 A broad view at the current structure of taxes and social security contributions

In 1998 the overall fiscal burden in Slovenia amounted to 40.5 percent of GDP, an intermediate value as compared to European averages referring to EU 15 and New members. Total tax revenue accounted for 26.7, whereas social security contributions went to make the remaining 13.8 percent.

The structure of taxation system depicted in Table 1 shows that indirect taxes at the end of the 1990s were the most important component of total tax revenue, reaching 18.9 percent of GDP. Within this largest source of government financing, VAT played the dominant role: it contributed for more than 22 percent to total taxation and its revenue as percentage of GDP was larger than the direct taxes one.

More specifically, direct taxes accounted for about 19 percent of total fiscal revenue. Thus the share of taxation on personal income was in line with all selected New members, but lower as compared to EU average. However the most relevant feature concerns corporation tax whose revenue, in terms of percentage of GDP, exceeded one percent only from 1997, being slightly higher in the following years.

Social security contributions represented more than 34 percent of total taxation at the end of the 1990s. As in other EU New members, the highest share is formally (or by law) charged to employees.

As regards the splitting of total fiscal revenue by receiving administrative levels, local government obtained only 3.1 percent of GDP, that is 7.8 percent of total taxation. Central government collected instead 23.6 percent of GDP, about 10 points more than social security institutions (pensions and health).

Comparing all these figures to the benchmark case proposed by Mitra and Stern (2003) it may be concluded that in Slovenia indirect taxes and social security contributions are actually too high. Cutting these two headings and increasing the share of direct taxes, specially on self-employed income, could possibly improve the economy efficiency.

2.2 The development of the system from the early to the late 1900s

According to theoretical literature suggestions, Slovenia started to cut social security contributions from 1994: the reduction was gradual but continuous and in 1998 this source of fiscal revenue reached 13.8 percent of GDP, the lowest value that characterized also the following year (Table 1). Among the chargeable persons,

Table 1 Structure and development of fiscal revenue in Slovenia, selected candidates and EU average as % of GDP, 1992-98

	1992			*1994*			*1996*			*1998*		
	Slovenia	*New Members*	*EU*	*Slovenia*	*New Members*	*EU*	*Slovenia*	*New Members*	*EU*	*Slovenia*	*New Members*	*EU*
Direct Taxes, of which	*7.4*	*10.1*	*13.5*	*7.8*	*10.0*	*12.9*	*7.7*	*9.6*	*13.4*	*7.8*	*9.2*	*13.7*
Personal income	6.8	6.4	9.6	6.9	7.0	9.3	6.8	7.1	9.3	6.6	6.7	9.3
Corporation income	0.6	3.6	2.3	0.8	2.9	2.4	0.9	2.5	2.7	1.2	2.5	3.0
Indirect taxes, of which	*14.5*	*15.6*	*13.4*	*17.4*	*16.5*	*13.7*	*18.2*	*16.9*	*13.7*	*18.9*	*15.5*	*13.9*
VAT	6.8	5.1	6.7	7.8	7.4	6.8	8.4	7.4	6.9	9.1	7.9	7.0
Excise duties	3.6	3.4	3.4	4.5	4.2	3.5	4.6	4.1	3.4	4.4	4.1	3.5
Others	4.1	9.3	3.3	5.2	5.0	3.4	5.2	4.9	3.4	5.5	3.6	3.5
TOTAL TAX REVENUE	21.9	25.7	26.9	25.2	26.4	26.6	25.9	26.5	27.1	26.7	24.7	27.6
Social contributions	*18.6*	*16.1*	*14.5*	*17.1*	*15.7*	*14.9*	*14.7*	*14.3*	*15.3*	*13.8*	*14.2*	*15.0*
Employers	7.6	10.0	8.1	7.4	9.0	7.9	5.2	8.0	8.3	4.4	7.9	8.2
Employees	10.1	5.3	4.8	8.9	5.11	5.2	8.7	4.8	5.1	8.5	4.8	5.0
Self employed	0.9	1.8	1.6	0.7	1.6	1.8	0.8	1.5	1.9	0.9	1.6	1.9
TOTAL FISCAL REVENUE	40.5	41.8	41.4	42.3	42.2	41.5	40.6	40.8	42.4	40.5	38.9	42.6
Administrative level												
Central government	18.6	25.9	22.8	21.6	25.8	22.4	22.9	25.4	22.4	23.6	23.9	22.9
Local government	3.3	3.0	3.0	3.6	3.5	3.2	3.0	3.4	4.0	3.1	3.7	4.0
Social Security	18.6	12.9	14.5	17.1	12.9	14.9	14.7	11.5	15.2	13.8	11.4	14.9

Sources: EU Commission (2000) for Slovenia and selected candidates (unweighted average); Eurostat (2000) for Eu 15 (1997 unweighted average).

Notes: Czech data start in 1993 and social security is only health.

employers are the most advantaged: their share of social security contributions as percentage of GDP fell down from 7.6 in 1992 to 4.4 in 1998, whereas in the same period, the cut in the share charged to employees was only 1.6 percentage points.

On the other side, from the early to the late 1990s, there was a significant increase in the revenue from indirect taxes. In 1992 they accounted for 14.5 percent of GDP against 18.9 percent in 1998. VAT realized the most important rise exceeding 9 percent of GDP, that is 22 percent of total taxation at the end of the period. Excise duties showed their highest value in 1996 and then started to slightly decline. Direct taxes alternately rose and fell, but their changes were not too significant. In particular, corporate income revenue as percentage of GDP doubled from the 1992 to 1998 however reaching only 3 percent of total taxation. Personal income tax was instead always around 6.7 percent of GDP.

As a consequence of all these changes, total tax revenue rose by 4.8 percentage points, whereas total fiscal revenue was stable at about 40.5 percent of GDP.

2.3 The apportionment of revenue among government layers

The gradual but continuous reduction of social security contributions from 1994 and the related increase of indirect taxes affected also the distribution of fiscal revenue by levels of government. As showed in Table 1, during the 1990s there was a rise of 5 percentage points in central government resources and a symmetric fall in the social security institutions (pensions and health) revenue. As a consequence, in 1998 tax receipts belonging to central government were more or less a quarter of GDP whereas the share going to social security bodies stayed below 14 percent. The apportionment of fiscal revenue to local government remained almost stable at around 3 percent of GDP.

According to OECD (2002), the total sub-national revenue accounted in 2000 for 5.3 percent of GDP, and 12.4 percent of total government revenue. It was composed for about 59 percent by tax revenue, especially taxes on incomes and on property, for 18 percent by non-tax revenue, such as surpluses of trading enterprises, property income, administrative fees and charges, and for over 23 percent by general or specific grants from central government. The sub-national budget being on balance guaranteed that the total current sub-national government expenditure amounted in the same year to 5.3

percent of GDP, mainly represented by expenses in education, housing, general public services, transports and recreational activities, while the consolidated government expenditure reached a share equal to the 44.1 percent of GDP.

2.4 A comparative view against other main new members and the average of EU[1]

According to the available data summarized in Table 1, in 1998 Slovenia total fiscal pressure was at an intermediate value as compared to European averages, whereas in the previous years, except 1992, it was nearer the lower figure of selected New members (Poland, Hungary, the Czech Republic, Slovenia and Estonia). The same can be said as concerns total tax revenue as percentage of GDP.

At the beginning of the 1990s, social security contributions were higher than in the other New members and European countries, but thanks to the important reduction started from 1994, their levels became closer to closer to the averages of reference.

On the other hand, the share of direct and indirect taxes in Slovenia as percentage of GDP showed a very different tax structure both with respect to New members and to EU 15 countries. In particular, Slovenian direct and indirect taxes are respectively the lowest and the highest as compared both with those of selected New members and with EU countries. This is in contrast with the suggestions by part of economic literature (among the others, Mitra and Stern 2003) about a necessary reduction of indirect taxes financed by an increase in direct taxes.

Slovenia total Government spending in relation to GDP was around 44 percent in 2000, a value in line both with those of the existing 15 EU countries (45 percent) and other New members (40 percent). However the decentralization of this expenditure was very different: in Slovenia the share of total sub-national spending in GDP always in 2000 was 5.3 percent, about 2 percentage points lower than the New members' average and only a third if compared to EU countries' level which stayed at 16.2 percent. However, this is not an uncommon feature of economies in transition such as Slovenia.

Moreover, as concerns the composition of sub-national receipts, tax revenue was 15 percentage points higher, while central government grants were a little more than an

[1] A detailed discussion may be found in Mitra and Stern (2003).

half in comparison with EU members' mean value. Sub-national authorities are given some freedom to determine their non-tax revenue that in Slovenia reached 18.1 percent of total receipts, one of the highest level among New members (OECD 2002).

3. Some quantitative and institutional features of main taxes

3.1 The Personal Income Tax-PIT (Dohodnina)

Individuals are subject to national income tax, property tax and inheritance and gift tax.

Individuals who have their permanent residence or usual domicile in Slovenia (that is who stay there at least 183 consecutive days in a calendar year) are residents for tax purposes. They are generally taxed on their worldwide income.

Each individual is treated as a separate taxpayer: there is no taxation of an household as a whole. The taxable base of each source of income is computed separately. The net results are aggregated at the end of the year.

The main sources of income are the *personal income*, which includes employment income, pensions, remuneration received under temporary contracts and state prizes and awards, the *income from agriculture*, given by the cadastral income from farmlands and woodlands, the *income from property*, as generated from profit-sharing and dividends (whose taxable base is the gross amount received reduced by 40 percent, as a way to mitigate double taxation), and from interest on loans (with the important exemption of interests on bank accounts and securities), the *income from property rights*, derived from copyrights, inventions, trade marks and technical innovations, irrespective of whether they are protected by law, the *capital gains*, derived from the sale of real estate, shares or other securities if realized within three years after the date of subscription, and, finally, the *profits from business and professional activities*, which is computed in the same way as profits derived by legal entities (see par. 3.2). Regarding the latter, note that individuals who perform independent professional services and who have no employees may request that, instead of computing their profit on the basis used by private business, they determine their taxable base by making a lump-sum deduction of 40 percent from their gross income.

Exempt income includes retirement bonuses and severance payments, part of unemployment benefits, student grants, while incentives and benefits provided to employees are subject to personal income tax.

The final liability is computed after the deduction, up to a maximum 3 percent of the tax base, of certain personal expenses - such as the ones for the acquisition of long-term securities issued by the Republic of Slovenia or by funds which are earmarked for investments in research and developments, for the acquisition and maintenance of residential buildings, for the purchase of medical aid, medicines, textbooks and tuition fees, for donations to non-profit organizations - and of personal allowances. Concerning the latter, notice that, besides allowances given to individuals with family responsibilities (10 percent of average annual salary allowance for the first child, 5 more percentage points for each additional child, and 10 percent for each adult family member without income), all taxpayers are entitled to a deduction from their income tax base in an amount equalling 11 percent of the average annual salary in Slovenia. Taxpayers above 65 years are entitled to an additional 8 percent allowance of average annual salary.

The final tax liability is computed by applying the tax rates (Table 2) to the aggregate taxable income. Marginal tax rates show a sharp progressivity, going from 17 percent of income below 5,420 € up to 50 percent for income above 32,520 €.

Table 2 Personal Income Tax 2002

Taxable income (€)	*Rate (%)*
0 to 5,420	17
from 5,420 to 10,840	35
from 10,840 to 16,260	37
from 16,260 to 21,680	40
from 21,680 to 32,520	45
over 32,520	50

Source: EU Commission (2000)

3.2 Corporate Income Tax -CIT (Dovek Od Dobicka Pravnih Oseb)

Slovenia adopts a classical corporate income tax system: corporate profits are subject to taxation on profits at the company level, and then subject again at the shareholder level. Dividends received by resident individuals, however, are only taxable on 60 percent of the gross dividends received, while inter-company dividends are not subject to tax, provided profit tax has been paid by the paying company on its taxable profits.

All legal persons, except public enterprises, non profit organizations and few other exemptions (see also par. 4.3) are subject to the tax. Resident companies are taxed on worldwide income.

The starting point for the computation of the taxable base is the income reported in the profit and loss account, with the further qualification that only the expenses directly incurred on the performance of the activities are allowable. Several specific tax incentives aimed at encouraging investments and employment opportunities are available (see also par. 4.3).

Profit tax is levied at the rate of 25 percent. Notice that the rate has been recently reduced from a previous 30 percent. A business loss may be carried forward for five years.

In addition to profit tax, all registered legal and natural persons who pay wages and salaries to individual are obliged to pay a payroll tax on the gross amount of such remuneration, with a tax rate between zero and 14.8 percent. A special withholding tax is levied on remuneration paid to persons employed under temporary contracts at a rate of 25 percent.

3.3 Value Added Tax –VAT (Davek Na Dodano Vrednost)

A VAT system, based on the Sixth EC Directive, replaced the sales tax on 1st July 1999. Taxable persons are entrepreneurs - individuals, partnerships and companies - whose annual turnover exceeds SIT 5 million, approximately 21,000 euro. The taxable amount is determined according to the Sixth EC Directive, and it coincides with the total consideration agreed upon and charged to the person receiving the goods or services.

The standard rate is 20 percent, while a reduced rate of 8.5 percent applies, among the others, to basic foodstuff, medicines, hotel accommodation and books.

3.4 Environment Tax and Excise duty on petrol and mineral oils

The Environment Protection Act of 1996 and the Decree on CO_2 Tax of 1996-98 established that any person who buys fossil fuels (motor or heating fuels) and who incinerates organic wastes has to pay 0,013 € (3 SIT) on each kilogram of emitted CO_2 gas. Exemptions are connected with the use of mineral oils. Table 3 summarized the rates of the excise duty on petrol and mineral oils which revenue belongs to central government budget.

Table 3 Excise duty on petrol and mineral oils

Product designation	*According to the law (1998)*	*Government Decree (1999)*
	€/ 1000 litres	€/ 1000 litres
Leaded petrol	483,06	333,92
Unleaded petrol	406,78	282,61
Gas oil used as motor fuel	355,94	288,56
Gas oil used as heating fuel	25,42	25,42
Kerosene used as motor fuel	355,94	318,31
Kerosene used as heating fuel	25,42	25,42
	€/ 1000 kilograms	€/ 1000 kilograms
Heavy fuel oil	25,42	15,25
Liquid petroleum gas used as motor fuel	193,22	163,73
Liquid petroleum gas used as motor fuel	0	0
Methane	0	0
	€/ one cubic meter	€/ one cubic meter
Natural gas	0	0

Source: EU Commission (2000).

3.5 Taxes on property (Davek Od Premoženja)

Individuals, owners or users, who posses or use buildings, parts of buildings, apartments, garages and owners of ships with size at least 8 meter (not used for attending activities) must pay taxes on property whose revenue goes to local government.

As regards buildings or second homes, their values depend on specific "points" determined yearly by municipalities and every year multiplied by the cost of living index. Unity tax rates are decided by the State and they vary from 0.15 to 1.5 percent There are some exemptions concerning, for example, buildings of less than 160 Mq (but not second homes), buildings used for agricultural purposes and cultural or historical monuments. For tax payer with more than 3 family members living with him, the tax is decreased by 10 percent for forth and every additional member.

An annual lump-sum tax of 110 € is established for ship with a length between 8-9 meters: this fixed amount is increased for each additional meter and decreased for every additional year of age of the ship.

3.6 Social Security Contributions (Prispevki Za Socialno Varnost)

Within this category there are contributions for pension and disabled insurance that are paid to the pension fund, contributions for medical care and sickness leave that go to the health fund and, finally, contributions for unemployment insurance and maternity leave that increase the central government budget. These contributions are withheld by employer and they are calculated with respect to the amount of gross wages and other remunerations, including benefits in kind or the profit for self employed person. The rates charged to employers and employees are given in the Table 4. It is immediate to see that even if relatively higher on employees, the rates for social security contributions are still much lower than the ones for EU members.

Table 4 Social Security Contributions' rates

Contributions for:	*Employer (%)*	*Employee (%)*
pension insurance	8.85	15.50
health insurance	7.09	6.36
unemployment	0.06	0.14
maternity	0.10	0.10
Total	16.10	22.10

Source: Taxation in Slovenia (2003).

4. The fiscal burden

4.1 The distribution of taxation charge

Fiscal data for Slovenia, available only since independence in 1992, show that the total fiscal revenue as percentage of GDP not radically changed through the years, remaining around 40 percent. On the contrary, it is the structure by economic function that varied rather drastically. Indeed, recent economic literature showed an increasing interest in classifying the fiscal receipts in terms of economic function, in particular according to consumption and production factors, in order to evaluate their impact on the economic incentives and choices.

Even if a consensus methodology is still under investigation, we refer to a classification based on two main categories: taxes on consumption and taxes and contributions on the production factors, in turn divided in employed labor and capital and business.

As regards consumption, taxes, namely VAT (sales tax before 1999) and excises duties, raised from 14 percent of GDP in 1992 to over 16 percent from 1994 on about 40 percent of total taxation.

On the other hand, taxation on employed labor decreased by 3.6 percent of GDP since 1992, still ensuring half of the overall fiscal revenue and accounting for 20 percent of GDP.

Table 5 Structure and development of taxation by function and by implicit tax rates in Slovenia, new members and EU 15, 1992-98

	1992			*1994*			*1996*			*1998*		
	Slovenia	*New members*	*EU*	*Slovenia*	*New members*	*EU*	*Slovenia*	*New members*	*EU*	*Slovenia*	*New members*	*EU*
Economic functions												
Consumption	13.9	13.6	10.9	16.1	14.5	11.2	16.4	14.7	11.3	16.0	13.5	11.4
Labor Employed	23.7	19.7	20.6	22.7	19.4	20.7	20.6	19.0	21.4	20.1	17.9	21.2
Capital & Business	2.9	7.2	9.6	3.5	7.8	9.2	3.6	6.9	9.5	4.4	7.1	9.8
Implicit tax rates												
Consumption	18.4	16.3	16.2	20.9	17.4	16.5	21.2	17.8	16.7	21.0	16.6	16.8
Labor Employed	36.9	37.1	39.0	39.2	38.3	40.2	37.6	37.4	42.0	38.4	38.0	41.9
Capital & Business	-	-	32.2	-	-	30.3	30.1	-	30.5	31.2	-	31.1

Sources: EU Commission (2000) for Slovenia and new members (unweighted average); Eurostat (2000) for EU 15 (1997 unweighted average).

Notes: Taxation according to economic function is as percent of GDP. Total may stay over Total fiscal revenue in Table 1 because of some double counting.

As to the other production factors, the total share of taxation on capital and business showed a significant increase during the 1990s, even if it represented in 1998 only the 4.4 percent of GDP and less than eight percent of total taxation. In particular, while the shares of taxes on self-employed labor and on financial activities (shares and savings) remained stable at about 1.3 and 0.4 percent of GDP respectively, taxes on entrepreneurial activities, rents and profits almost doubled in terms of percentage of GDP, reaching 2.5 percent in 1998.

About environmental taxes, their size with respect to GDP significantly increased, specially for energy and resources taxation, now contributing for about three percent of GDP.

The sharp increase in the importance of indirect taxation and the related decrease in the share of labor taxes are also confirmed by the analysis of the implicit tax rates.

First, we refer to implicit tax rate (ITR) on consumption as to the ratio of taxes on consumption and aggregate private and government consumption (net of government salaries). This rate increased in the 1990s as a consequence of the rise in indirect taxes: in 1995 it reached the highest value and then it stabilized at around 21 percent (Table 5).

Furthermore, the implicit tax rate on employed labor, defined as the ratio among taxes on employed labor and compensation of employees, shows that labor was the most heavily taxed factor with a rate of 38.4 percent in 1998, although the latter was still below the highest levels reached in 1993 and 1994.

Finally, it is possible to consider the ITR on capital and business, defined as the ratio between taxes on self-employed persons plus taxes on capital incomes at the numerator, and net operating surplus plus government interest payments at the denominator, only since 1995: it slightly increased up to 31.2 percent.

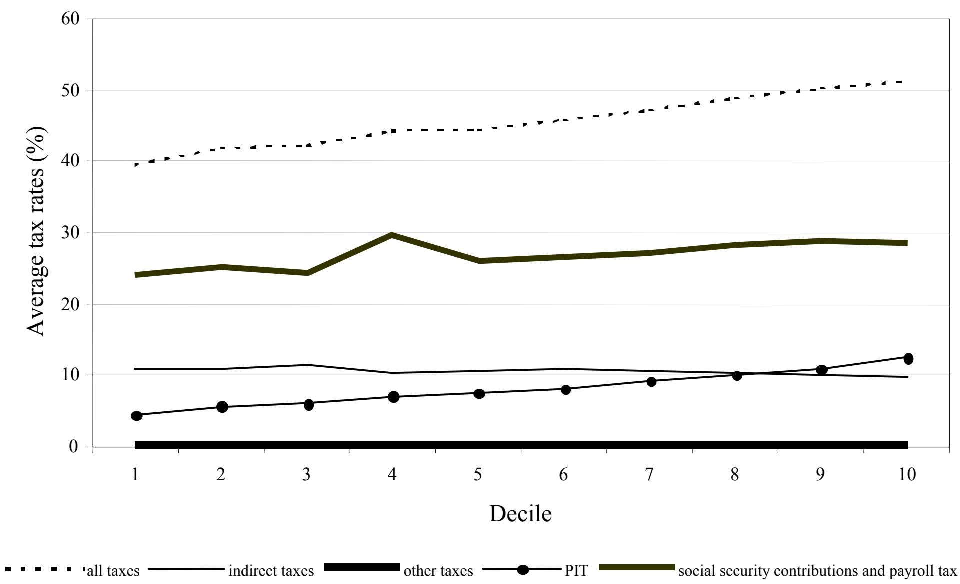
4.2 The overall tax burden on Slovenian households

Up to now we have described the structures and the rates of single tax in isolation. However it may be argued that what is probably more relevant from an individual point of view is the overall effect of the tax system on her effective purchasing power, rather than the average or marginal tax rates of a single type of tax.

Hence, it seems interesting to report the main results found by Čok (2003) whose analysis, at the contrary, examines marginal and average tax rates for the comprehensive range of direct taxes and indirect taxes paid by the Slovenian households. The analysis in particular, considered a sample, based on the Household Budget Survey, of 1,860 households with at least one working member, employed or self-employed. Čok (2003) estimated direct taxes - income taxes, social security contributions and payroll taxes - for individual tax payers and added them together on a household level, and computed indirect taxes - VAT, excise duties and taxes on cars - on the basis of Engel curves on a household level.

Figure 1 represents the results found for the average tax rates, as percentage of the gross income, reported by active households, ranked in deciles according to the non-durable consumption per equivalent adult as the best measure of life-time permanent income.

Figure 1 Average tax rates (% of gross income) for active households

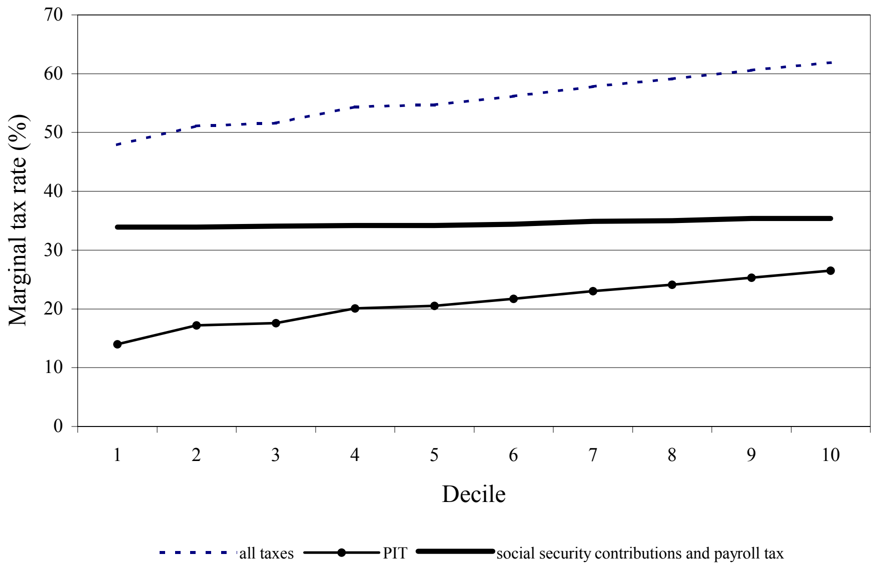


Source: Čok, M. (2003).

It may be noted that the average tax rate for a representative household is about 46 percent of the gross income, reaching the boundaries of about 40 and 51 percent respectively at the bottom and at the top of the ranking.

It is interesting to observe that proper personal income tax constitutes a rate of only 8.2 percent of the gross income, indirect taxes amount for 10.6 percent, while the overall effect of all the social security contributions represents by far the larger fiscal burden on the households, on average 25 percent of the gross income. The large share of indirect taxes and social contributions in the total fiscal burden on Slovenian households seems to be confirmed also by the analysis of the marginal, direct and indirect, tax rates (Figure 2).

Figure 2 Marginal direct tax rates (% of gross income subject to tax) for active households



Source: Čok, M. (2003).

4.3 The ability to attract foreign direct investments

The Slovenian tax system presents many incentives aimed at encouraging investments. For instance, all the investment funds which distribute at least 90 percent of profits from the preceding year by 30 November of the current year are completely exempt from payment of the corporate income tax, a regime that seems to be particularly attractive for foreign venture capital companies.

Moreover, specific tax incentives are available within the corporate tax structure. For instance, the 40 percent of the amount invested by a company in equipment and intangible long term assets can be deducted from the tax base, while up to the 10 percent of the taxable income can be allocated to an investment reserve and deducted for tax purposes.

Furthermore, in order to promote employment opportunities by incoming firms, companies which employ a trainee or a previously unemployed person may decrease their taxable profit by 30 percent of her gross wages for the first year of employment.

4.4 A comparative view against other new members and EU 15 countries[2]

Table 5 clearly shows that, in the period 1992-1998, both the share of taxation on consumption and the relative implicit tax rate were well above the EU and the New–members averages.

As regards the taxation of employed labor, during 1990s Slovenia remained always above the New-members' level, however approaching the EU average. At the same time, the Slovenian implicit rate on employed labor lied in between the New-members and the EU average (41.9 percent in 1998).

Finally, the peculiar feature of tax composition for Slovenia emerges considering the taxation on capital and business, whose share, as percentage of GDP, was at most half of the EU average (9.8 percent in 1998) and even significantly below the one for New-members, despite the fact that the related implicit tax rate was always comparable with the EU average (31.1 percent).

5. Tax reforms and further steps to get closer to the EU

5.1 Macroeconomic and budget outlook

[2] A detailed discussion may found in Mitra and Stern (2003).

Slovenia experienced a real GDP growth of 3 percent in 2001, a level that was lower than one achieved in 2000 and which was significantly explained by export dynamics. In 2002, despite export growth continued to be relevant, especially to non-UE markets, it was domestic demand, in particular investments, to push GDP growth to an estimated 3 percent of GDP. Available forecasts say that both domestic and external demand will push growth to a cautious 3.4 percent for 2003 and to 3.7 percent in 2004.

Domestic demand was mostly constituted by investments, which, stimulated by industrial restructuring, approaching EU membership and export growth, are expected to increase by over 4 percent in 2003 and by 5.5 percent in 2004. On the contrary private consumption, constrained by moderate increases in both real wages and employment rate, should increase by only 2.5 percent in 2003 and by 3.5 percent in 2004.

High net export growth in the last years contributed to a further sharp reduction in the trade deficit, from 3.3 percent of GDP in 2001 to one percent in 2002. At the same time the services account increased as well, which led to boost the current account surplus up to 1.8 percent of GDP in 2002.

Capital inflows, already strong in 2001, reached the record level € 1.5 billion in 2002 and were constituted mainly by foreign direct investment (FDI), driven by privatization in the banking sector (especially the case of Nova Lubljanska Banka) and in the pharmaceutical sector.

Because of modest production growth, industrial restructuring and the elimination of the government program to subsidize labor training, employment growth in 2002 was stagnant, while in the same year unemployment rate remained stable at 6.4 percent, both being expected to not vary too drastically in 2003 and 2004.

Inflation, still at high levels, continued to slowly decrease from 7.5 percent in 2002 to 6.2 percent at the beginning of 2003. This year, Slovenian government stated that reduction of inflation at least to four percent by June 2004 is a priority target, as it announced to intend to enter ERM II by 1st January 2005. However, for 2003 inflation forecasts are generally set at 6 percent and for 2004 at 5.5 percent, rates that are closer, but still well above the EU averages.

The overall government budget deficit, according to EU Commission (2003), was sharply reduced from 2.5 percent in 2001 to 1.8 percent in 2002, and it is expected to reach 1.2 percent in 2004.

5.2 Last years' and planned tax reforms

The most significant set of fiscal reforms in Slovenia started in 1990s. However, unlike in other countries with comparable economic situation characterized by fall in GDP and raised unemployment and retirement rates, this transitional period in Slovenia was not too dramatic, for instance keeping general government budget always on balance.

The most relevant reforms in the fiscal system after 1991 concerned the introduction of Value Added Tax in place of retail sales tax in 1999, its modifications in the following years, and the change in the retirement system in 1999.

In particular, VAT was introduced according to the Sixth EC Directive with the original standard rate of 19 percent and reduced rate of 8 percent. However, from 1st January 2002, the Budget Law increased the standard rate up to 20 percent and the reduced rate up to 8.5 percent. In the meanwhile, VAT administration also was modified. From 1st July 2001, three categories of liabilities have been identified for taxpayers according to their annual turnover. In addition, a new definition of foreign taxable person applied for purposes of the VAT Law.

In 2003 the Slovenian government has announced a proposal to launch new laws in three major areas.

First, the new law on personal income tax has almost completed the parliamentary debate. The main features regard the introduction of taxation of personal income on a worldwide base, and of interests from bank deposits and securities, at the present exempt. Furthermore, while on one hand it abolishes some generous allowances for income from property rights, on the other hand it raises the threshold for exempt income and gives higher tax allowances for children and students.

As regards the second proposal, the new law on corporate income tax is expected to reduce some investment tax allowances in order to enable the government to collect higher revenues from corporate profits, by still keeping the tax rate at 25 percent. However, as far as we know, no modification yet has been proposed for the fiscal treatment of self-employed income and financial activities, which at the moment seems to play a marginal role in the overall fiscal burden.

Finally, a comprehensive reform for health care, focusing specially on its financing, has been proposed, with the main objectives to induce better accessibility, quality and efficiency of the services.

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