

Tax Systems - Innovative Approaches

A well-functioning tax system is the cornerstone of relations between citizens and governments built on mutual accountability and responsibility. It plays a fundamental role in effectively raising and allocating domestic resources. Taxation also acts as a policy lever to reflect attitudes and choices. Even though an equitable and efficient tax system doesn't feature in the United Nations Sustainable Development Goals (UNSDGs), it is often critical to the fulfilment of many of them as it has become increasingly important to introduce regulatory and fiscal measures to achieve more sustainable production and consumption patterns.

Governments have started to use excise taxation as a way to limit the consumption of harmful products. From CO₂ emissions to waste management, mobility, non-communicable diseases and more, there are a range of policies that show how taxation can play a major role in reaching broad public policy objectives related to sustainability, either via negative incentives based on the 'polluter pays' principle, or positive ones focused on rewarding sustainable or less harmful products. Additionally, the rising popularity of the sharing economy redefines the ways in which we consume. Though challenging for traditional tax laws, innovative products can lead to a more holistic approach to taxation and long-term positive lifestyle changes in European societies.

Based on the roundtable discussion held at Tatra Summit 2018 between high-level representatives of the public and private sector, GLOBSEC recommends to governments the following:

- **Think about the future** – Climate change, overconsumption, population growth, rare resources, obesity and other health-related issues are putting pressure on our society. In order to overcome these challenges, every individual has to contribute by changing their consumption pattern. If state signatories want to achieve the UNSDGs, there is an increased urgency to implement innovative ways leading to behavioural changes. Taxation, when executed in a fair and equitable way, is one example of a powerful tool to shape more sustainable societies, although it is not yet utilized efficiently.
- **Understand how taxation shapes society** – Too often, taxation is approached from an old-fashioned perspective, identifying it only as a pure revenue-collecting tool. However, the differentiation in taxation of electric cars for example has shown that progressive tax systems encourage people to buy more sustainable products. Lower taxes for young people and fresh graduates have led to less brain drain. Understanding how consumers react to different types of taxation is the first step in steering consumption patterns in the preferred direction. After all, taxation is more than a mere number but indeed the numerical expression of the very values of a society.
- **Alternatives are key** – If we use taxation to limit certain behaviour, for example, the consumption of unhealthy products, such as cigarettes, fast food or sweet drinks, we need to maintain an incentivizing price differentiation in comparison with more sustainable substitutes and less harmful products. If people have no alternatives to replace the original with, increased taxation might have indirect negative consequences. Especially in case of addiction, low income households might face additional financial stress. In this context, the potential of taxation to achieve a healthier population is still underutilized. When the product's price is kept artificially high in comparison with the production costs, it might also lead to black markets, illicit trade, lower-quality products and fakes.
- **Experiment on a small scale** - Governments need to adopt a more social-entrepreneurial approach. Testing innovative approaches in a private setting leaves more room to manoeuvre than immediate nation-wide - or European - implementation. Different tax systems can be launched on a small scale to understand the behavioural changes it evokes in small private communities such as universities, canteens or big companies. Cooperation between the public and private sector in such projects can provide valuable insights.
- **Freedom of (bad) choice is a right** – Governments need to keep in mind that, in a free economy, people should keep the right to make their own choices. Although states should at all cost prevent these deliberately made choices from negatively affecting third parties, such as drinking and driving, they should also strive for a good balance. If governments adopt the right regulatory and fiscal frameworks, producers and consumers will deliver on the rest – bringing behavioural change. Especially in times of growing populism and a general loss of trust in the rule of law, regulations should aim to reward

sustainable behaviour instead of prohibiting certain consumption – i.e. force changes by empowering good behaviour.

- **Keep up with the progress** – Economies develop exponentially due to disruptive technologies. Traditional tax policy, however, often seems too rigid to adapt to changing realities. For example, increased robotization, e-commerce, digital services or the rise of shared-economy platforms demonstrate that traditional tax systems are too often reluctant to embrace sustainable innovations. Bearing this in mind, governments should anticipate continuously changing policy.
- **Harmonize** – The European Union should strengthen the internal market to eliminate discrepancies and unfair taxation between Member States. The European Council's unanimous voting system too often complicates far-reaching policy changes. It creates a business-unfriendly environment as national systems are not aligned and cross-border trade is slowed down by overly complicated paperwork. However, harmonization does not mean a one-size-fits-all approach: different systems encourage creativity and are more flexible to adapt. Innovative approaches are born in competitive environments.
- **Simplify and digitalize** – Cut the red tape by digitalizing. Strive for user-friendly products which are predictable and understandable for consumers and producers. Raise tax collection efficiency and fight fraud by using big data, algorithms and digital administration.
- **Build tax morale** – Taxpayers need to understand how taxes work. They need to be aware of the reasons why taxation is to their benefit. From an early age, education needs to provide an understanding of tax systems. Tax morale also depends on people's level of trust in state institutions. Strive for transparency and targeted communication. Public campaigns go hand in hand with tax systems that aim for behavioural changes.