

Skrivena javna potrošnja— Porezni izdaci: potreba ili udvaranje biračima?

Hidden public expenditure – Tax
expenditures: necessity or currying
favour with the voter?

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In years of economic hardship, it becomes crucial to save every kuna and put it to the best use possible in order to generate growth. Yet it seems that Croatia is spending a generous portion of its potential budget revenues without even knowing if such expenditures are justified and have any actual effect on development goals. If we add the inevitable fiscal harmonization with European Union standards, it becomes clear that the lack of transparency or analytical approach could become hamper Croatian authorities in efficiently controlling public finance. In this atmosphere, Vjekoslav Bratić and the Institute of Public Finance deliver an intriguing publication, published in Croatian, addressing the issues of one of the least transparent parts of the fiscal system – the issue of tax expenditures, focusing on corporate income tax. The very name of the book suggests that the inefficiency of the system is a result of characteristics intrinsic to this region's political elite – concealment and lack of political will. Professionals dealing with public finance can use this publication for personal upgrading or reference material, students of economics can use it as a textbook and policy makers can use it for its definitions of many problems and possible solutions and provision of certain guidelines. Parts of it could also be read at a sitting by citizens or journalists eager to understand what went wrong with Croatia's public finance.

Special tax advantages designed to aid certain industries, economic activities, areas or categories of taxpayers, in order to pursue objectives of the country's public policy, can normally be classified as tax expenditures. They tend to reduce the tax basis and liability and directly lower a country's revenues, which otherwise could have been put to other, more or less useful, public purposes. As opposed to direct public expenditure visible in the expenditure side of the budget, which is mostly transparent and simple to analyze, it is often hard to grasp the scope of a country's tax expenditure as it is hidden within the budget's revenue side and in developing countries with transitional economies its effects are rarely revised. When it comes to corporate income tax, its relatively small share in overall tax revenues and GDP is additionally reduced by the use of corporate income tax expenditure programs. This is the basis for outlining this publication's main objective: to give a systematic overview of tax expenditures, especially focusing on corporate income tax expenditure in Croatia, as well as in groups of benchmark countries. The author analyzes the factors that led to the use of tax expenditure and the effects that they have on public revenues and desirable economic and social targets. His intention is to identify the desirable goals and suggest adjustments for making the system as efficient and simple as possible, given the economic circumstances and the trends within European Union legislation.

Hidden public expenditure is divided into seven chapters, starting with an introduction, and ending with an appendix containing relevant data and a glossary. The introduction outlines the main subjects and goals of the book, and explains the basic ideas that compelled the author to give a thorough analysis of tax expenditure. The chapters are aligned to form a logical framework that first introduces the

reader to relevant theories: the theory of corporate income taxation and the theory of tax expenditure. This allows the book to be read and comprehended even if the reader has not yet gathered the theoretical knowledge about the subject, so it could be presumed that a number of university professors teaching fiscal theory will include this volume into their subject's auxiliary literature.

The second chapter sets out basic taxation theory. The purpose of taxation is explained and the basic principles are expounded. After that, the focus turns to corporate income taxation in modern fiscal systems. Social redistribution and other justifications of this tax model are explained, as well as some problematic issues regarding its negative effects on resource allocation and foreign investments. An analysis based on 27 EU countries shows that Croatia has followed a trend to the lowering of corporate income tax rate during the last decade. Data analysis shows that the new member states have on average lower corporate income tax rates than the old member states, and ten mostly Eastern-European transitional countries have lower rates than Croatia. Finally, the European Union's fiscal harmonization is explained and the financial effects of corporate income tax and its share in GDP and overall public income in Croatia and EU member countries are analyzed. Harmonizing the member countries' fiscal systems is one of the most important parts of the integration process for EU policy makers, with the final goal being to remove the obstacles that diminish the competitiveness of the common European market. However, most governments are opposed to relinquishing their fiscal independence, which represents a challenge for the future.

The third chapter deals with tax expenditure theory in general. The author analyzes tax expenditure in Croatia and a list of other countries. The instruments of tax intervention are defined and various definitions of tax expenditures are explained, as authors in different countries tend to use different variables and research methods. After that, different kinds of tax expenditures are introduced, along with their use in a set of benchmark countries. Finally, the author explains the positive and negative effects of tax expenditures. The general idea is that there are many negative effects generated by extensive use of tax expenditures, many of which are the result of governments' lack of will and interest to conduct analysis and change pre-existing inefficient systems. This chapter strives to show the reader that, *in order to increase the efficiency and equity of the taxation system, it is crucial to increase the level and the quality of tax expenditure management programs.*

Chapter four deals with ways developed countries handle, analyze and manage their tax expenditure programs. Even in developed countries problems of lack of uniform definitions, scope and international tax reporting standards emerge, so methodology and classifications in official reports differ so much from county to country. Authorities in developing and transitional countries normally do not analyze and publish data and projections on total tax expenditure. They either roughly estimate tax expenditures and their impacts, or do not even identify nor-

mative taxation structure, or analyze or publish real research. This leads to many developing countries losing a big share of taxation income as they are unable to assess the possibilities of control and saving resources.

The volume's biggest contribution and scientific input is given in the fifth chapter, which reveals the inefficiencies of Croatian tax expenditure programs. It starts by explaining the Croatian taxation system in general and taxes are sorted into several categories. Next, it shows how tax incomes are divided among central, regional and local governments. After that, the focus turns to corporate income tax in Croatia. First, the characteristics and phases of corporate income tax reforms ever since Croatia gained its independence are described, and the effects of corporate income tax on budget revenues in the last decade are analyzed. After that, the author starts his main analysis, which will surely become valuable research input and reference material to researchers who will conduct further investigations on the subject. In nine years budget revenue loss due to corporate income tax expenditure rose by a factor of 8.6 and the level of revenues lost in the budget revenues from corporate income tax rose by 83 percent, from 3 to 5.5 percent, reaching its peak of 11.6 percent in 2005. Next, expenses and revenues of the tax administration in Croatia are analyzed, and their structure is explained. The expenses of the tax administration rose 80 percent, along with the number of employees, and their productivity remained at the same level, increasing in just the last few years. Unfortunately, due to the complexity that demands more precise tax administration data, this analysis could not make a negative connection between the increase in corporate income tax expenditures and tax administration efficiency. After that, the author conducts an analysis to see if different types of corporate income tax expenditures have justified their purpose. The period from 2001 to 2009 shows a decrease in the unemployment rate, so it could be presumed that it is partially due to corporate income tax expenditure, although the decline should be steeper in Areas of Special State Concern (ASSC) than in other parts of Croatia, which is not the case, so the privileges for ASSC should be revised. Again, the problem of a quality statistical database arises, as *despite a vast amount of expenditures... it is hard to connect [and quantify] them with the desired economic effects*. However, certain trends can be identified: pro-employment oriented subsidies and supports started to diminish after 2007, while the unemployment rate decreased until 2008, so it could be argued that these advantages helped lower the unemployment rate, although it is impossible to say how strong their effect was. Next, the focus turns to the city of Vukovar and areas of special concern. The author refers to other authors' research on the subject, which argued that the measures of corporate income tax expenditure programs for ASSC were inefficient and unable to contribute to their stronger development. The analysis of the city of Vukovar shows that from 2001 until 2006 the loss due to corporate income tax expenditures in the overall city budget increased from 22.3 percent to 76.4 percent. This surge represents a huge potential income loss. When the small number of corporate income tax expenditure users in Vukovar is taken into account, it becomes very questiona-

ble whether tax advantages helped to achieve the drop in the unemployment rate and increased economic development. Further analyses of ASSC show similar results. Special care areas did not develop as fast as the rest of Croatia. Many of them are still underdeveloped and facing low levels of personal income and employment rate, slower decrease of unemployment rate, lower company profitability and levels of entrepreneurial investment and other structural development problems. Another interesting feature is the fact that many companies doing business in ASSC normally do not make a high (if any) corporate income surplus. It might mean that corporate income tax advantages do not offer any benefits, and entrepreneurs are usually dissatisfied with local or central government's entrepreneurial incentives programs. It would perhaps be smarter to give direct transfers, personal income tax advantages or offer help with repaying investment loans.

The author starts chapter six by summarizing the book's research results. After that, he offers some practical solutions and guidelines. The authorities should refrain from constantly changing taxes and fiscal rules, and if they do they have to warn the public on time to ensure economic stability and healthy market decision making are not compromised. Research and a cost-benefit approach are crucial when introducing new tax advantages, to make sure they will reach certain goals. Reducing or eliminating ineffective tax expenditure programs would help to lower administration expenses and improving the simplicity and increase the yield of the taxation system. According to the author, when repealed, these advantages can be successfully replaced with other, more neutral, measures. The best way to do that is using direct budget transfers, because they can more transparently and efficiently hit the target objectives. Instead of giving special treatment to certain businesses, areas or activities, it seems wiser to try to lower the overall level of taxation. After that, the author states that, in order to make the system work efficiently, it is crucial to have a quality public tax expenditure database; research and revisions have to be conducted on regular basis; and special government tax expenditure monitoring teams have to be organized. Finally, the future of tax expenditure is discussed, with regard to Croatia's EU accession. EU authorities tend to create fiscal harmonization and neutrality, which means eliminating tax expenditure as soon as possible.

The appendix part is a valuable asset to this publication. It contains a lot of useful information and data on the Croatian taxation system, such as legislative changes in the last decade, a list of ASSC areas by different categories and explanations and overviews of public subsidies. It also contains a detailed overview of newly founded companies, local revenues and unemployment rates in ASSC in the last decade, an overview of Croatia's national budget, central budget and general budget revenues and the financial importance of corporate income tax in Croatia and EU countries.

To summarize, the author uses *ex post* research method (the revenue forgone method) comparing real with potential revenues. His focus is on the negative sides

of having corporate income tax expenditures, such as lowering potential budget income, in order to analyze whether their use is justified, regarding the assumed positive effects they should have on some key goals within the government's public policy. The first thing that strikes the reader is the changing and instable nature of the taxation code and institutional framework of corporate tax expenditures in Croatia. The question arises *if this tax, regarding such instabilities, could possibly have achieved the desired economic effects and fostered and enhanced the economic and social position of specific social groups, i.e. economic activity and/or geographical area*. The problem in analyzing tax advantages, especially corporate income tax expenditures in Croatia, is derived from the lack of abundant systematic data and detailed administrative reports to be used as basis for research. Therefore it is impossible to give quantitative connections between corporate income tax expenditures and some economic variables. Another problem that, no universal theoretical framework for researching tax expenditures exists, as the definitions and the scope differ so much from country to country and from author to author. However, data gathered and edited by the author and comprehensive analyses conducted in this publication give us a valuable insight into the current state of this part of the fiscal policy, its complexity and its many flaws and uncertainties. It clearly shows that despite a large number of tax expenditures in ASSC, those areas are still troubled with serious economic, structural, social and development issues, and in fact falling increasingly behind other areas in Croatia. Resources that could make a difference elsewhere are wasted, which is a sign of an inefficient and poorly managed system. This book reminds us: a modern country that wants to lead an efficient and coherent economic policy must take the tax expenditure and other public aid programs seriously, conduct thorough research on the subject, and strive to make the system transparent. Hopefully, policy makers will read it.