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**Tax Reform: Lessons from Successful Small Open Economies**

Facilitator – Scott Hodge, President, Tax Foundation:

I’ll ask our next panelist to come up – Mr. Neneman and Mr. Tvaroska and Mr. O’Loghlin.

Introduction (Scott Hodge): The reason I’m so optimistic about tax reform in the United States is really because of the examples being set by the countries represented by our next three speakers – representing Ireland, Poland and Slovakia. I had the fortunate opportunity last summer to visit Poland and the year before that to visit Ireland. And I hope to visit Slovakia this year to see how tax reform is working there. But what I’ve seen so far in Ireland and Poland is really nothing short of remarkable.

On my trip to Poland this year, I talked to a business executive in Warsaw, who told us that he was so enthusiastic about turning his sights away from the East, as the marketplace, mainly the Russian Federation, etc., and turning his sights to the West, towards Germany and France. And he said, with our lower taxes and our cost structure, we are going
to be so much more competitive that the Germans and the French will not know what hit them. That’s quite a remarkable testament to how they’re seeing their new opportunities, not only joining the European Union, but also what their tax reforms are doing to their competitiveness.

Our three panelists today – I’ll introduce them all at once and then we’ll go one by one. Our first panelist will be Charles O’Loghlin who is currently serving as the Executive Director at the IMF and who served formerly as Assistant Secretary for Budget and Economic Policy in Ireland. And he served many roles within the Irish government.

Our next speaker will be Jaroslaw Neneman, Under-Secretary of State at the Ministry of Finance in Poland, an economist by trade. Mr. Neneman taught at the University of Laults [phonetic] and was Chief of Political Cabinet within the Ministry of Finance before being appointed — in fact just a few weeks ago, on September 6, as Under-Secretary of State within the Ministry of Finance in Poland. And our last speaker on this panel will be Mr. Vladimir Tvaroska, State Secretary within the Ministry of Finance in Slovakia. Previously he served as an advisory to the Deputy Prime Minister of Economic Affairs who I think was their version of Dick Armey and Jack Kemp in pushing fundamental tax reform within Slovakia.
I want to turn your attention to a handout within your packets. The principles of tax reform in Slovakia that are posted on the Finance Ministry’s Web site – I was so thrilled when I saw this because it looked like it had come from a Tax Foundation document. Within, there are promotional materials for tax reform 19% -- that’s their flat tax. I just have to say they highlight the fact that their tax reform will be based on the principles of neutrality, simplicity, effectiveness, and fairness. And that would be good advice for all of us in the United States as we move toward investigating the opportunities for fundamental tax reform.

So we’ll begin our panel today and thank you very much ... to Mr. O’Loghlin.

Charles O’Loghlin: Thank you Scott. I offer my few words about the experiences of the Celtic tiger and the key elements that we contribute to our recent economic advance that will offer you some insights of value as you go through the day. I’m going to begin by a consideration of the broad economic policy framework rather than explicitly taxation alone – that includes taxation but for sustained economic success. Policy we think must address many more issues.

To provide a wider backdrop, I propose to visit Irish economic history since independence, addressing four themes:
the failure of lack of solidarity I call the first one. The limit on the progress of trying to pursue openness while also trying to retain elements of our former protection from ’56 to ’87 will be second. Third, the key contributors to the Celtic tiger’s performance of the ’90s, and fourth, a few observations on taxation. With the budget about two weeks to go I’m not going to be very specific -- an Irish budget I mean.

First the failure of lack of solidarity. In 1921 Ireland was heavily dependent on agriculture and industry and secular decline, at least in terms of providing growth and employment in living standards. You knew about our Guinness but there were a few other significant indigenous businesses and very few that could compete abroad.

And we had little enough of other natural resource wealth, so we tried to grow Irish business under a shield of protection - high custom duties, import quarter restrictions, fiscal support and anything else you like. Sheltered in this way we hoped that infant industries would grow and ultimately generate the foreign earnings which we needed to import the things we couldn’t produce like cars or airplanes that we weren’t sophisticated enough to do.

There were a few successes. I’m sure a few of you have ordered a glass at home but overall the approach failed. Irish business did substitute a range of imports but for the most
part it failed to develop technologies and products to challenge overseas’ markets. Our main export until the 1960’s and through the ’60 was people – immigration to find jobs we weren’t creating at home. For two generations, just to put a concept of how heavy it was, virtually half of our children had to go abroad to earn a living. And growth in Irish living standards lagged Europe and the U.S.A. That dismal outcome promoted a change in the late 1950’s to openness but we kept a bit of protectionism, I’m afraid.

We did start to look outward. We introduced export sales relief in 1956. This effectively eliminated corporate tax liability on export sales and manufactured goods, and, at the same time, we strengthened our industry and grants regime. The point of this measure being to focus producers on export markets and to offset the deterrent to investment which our small scale domestic markets represented.

The second opening – signing the Anglo-Irish Free Trade Agreement in 1963, which assured investors located in Ireland of 60 million rather than 3 million customers. And joining the European Union in ’73 made Ireland a potential base for addressing a market more or less the same size of the U.S.A., apart, of course, from allowing us to avail a common agricultural policy prices. I’m sorry skip that one.
While our main export market expanded by over 3% annually from 1963, our exports rose twice as fast as that—you’ll see at the far side. We had some export success over the semi-open period. EU membership, particularly because of its support for agriculture, brought life our EGDP after entry. And those two positives offset the drag which agriculture’s secular decline continued to exercise on Irish employment, but it didn’t push us into catch-up mode.

As you can see here Ireland at the far side, relative to Europe, didn’t catch much between 1960 and 1987. Why? Because in changing course, I think, we did not discard all of the paraphernalia of protectionism and I’ll give you one brief example.

We used to get you to export your cars in completely knocked-down form and we assembled them in Ireland and we kept that going until 1980. I won’t tell you what the relative price of our cars were as a result. And with opening we kept some other domestic developments... sorry, policy developments, in ways in which were in some respects only helpful. Being more open to global cyclic influences we began to use fiscal policy to manage fluctuations in demand and to stimulate growth. By 1980 you can see we had taken fiscal activism too far, with a deficit of 12% in 1980 we couldn’t use it any further.
The second, wage negotiations tended to focus on gaining compensation for past inflation, leading to non-competitive outcomes. Those factors combined with a continued reluctance to tackle inefficiencies built up under protectionism sapped confidence and contributed to low rates of business investment over the period of ’57 to ’87, although better than over the period up to ’57.

EU membership also led to a major corporate tax change. On joining, our export sales relief was considered an effective subsidy to export sales in conflict with common market rules. So we replaced this from 1980 with a 10% corporate tax rate on manufacturing industry, which, of course, doesn’t discriminate between home and export sales. It’s unclear to us how this change impacted sentiment because, of course, some of the negatives were also holding down investment.

Whatever the truth of that – performance during our first 15 years of EU membership dictated a deeper effort to integrate into the global economy. And through the 1980s as the temporary boost of cap prices and fiscal activism fell away they’re the ones who gave us a good increase if per capita consumption from ’73 to ’79 or ’80. And employment declined and unemployment dropped in the ‘80s. Unemployment rocketed despite presumed immigration, all adding up to another period
of decline in relative living standards, which you can see in
the latter through the ‘80s.

Why the Celtic tiger? Well first, we had some strengths to
build on if we chose to build upon them. We had a business-
friendly regulatory environment. We had plentiful water – the
Irish climate, relatively cheap and plentiful land space to
accommodate new enterprise and proximity to a market, which had
spending power. And flowing from a 1968 decision to provide
the equivalent of an U.S. middle and high school education free
of charge, we were experiencing an explosive increase in the
proportion of Irish teenagers who were just completing second
level.

For example, in Germany because its education level was
high in 1970, it couldn’t raise it that much faster by the year
2000. Because ours was relatively low in 1970, the average
education had improved and continued to improve quite a bit.

Policy added to those strengths within Ireland through the
newly established what we call social partnership. Strength of
concept, recognition that Ireland depends critically on success
in global markets, consensus around a consistent policy
framework supporting competitiveness, willingness to accord
priority to the needs of sustained economic growth, which means
putting investment before consumption. And social partnership
also gave us an ability to minimize distribution of conflict.
Partnership was aimed at getting agreement among all the key economic factors on what’s a realistic medium term profit. What fiscal monetary and income parameters need to be observed for success? And what are the key priorities that public policy should address?

The social partnership was also based on a commitment to key economic framework parameters – a firm exchange rate, a budget framework that reduced it because it had gone pretty high with past deficits. As I said, prioritizing public investment in business-oriented infrastructure and creating cost certainty because social partnership gave us the success of a three-year internationally competitive wage pact.

It also helped by gaining support for actions needed to make the economy less than competitive or more competitive. Actions to streamline the public service. Like, for example, commercializing our privatizing state entities and closing down quite a few loss makers. Action to enhance human resources like substituting active labor market measures as we call them for passive income support. And deepening competition like effectively a competition authority which challenges all forms of monopoly and ending state monopolies and, indeed, opening some public services to the private sector.

In addition, policy went in the direction of deepening incentives. Incentives to effort – this is how in 1987 a
three-rate tax system developed into a currently two-rate tax system with the rates going down. This will give you an idea of how tax reductions generated as large take home from a much lower gross. Those are all in real terms, by the way, they’re not nominal, they’re real and adjusted for inflation, which incidentally throughout the period is of the order of two-ish percentage except during the period of Euro weakness at the end of the ‘90s and incentives to enterprise.

We had, as the previous speaker mentioned, a corporate tax rate standard around the 40s to 50s, depending on when during the 1980s you’re talking about, plus the 10% rate. The standard rate has effectively brought down and we now have a combined twelve and a half percent rate.

Interestingly, I might add that the effective rate of tax on oversea companies – rules from the 1950s through to now because export sales relief would have given an Intel, for example, or a Microsoft or whoever, a better net take home of every dollar than a 10% rate. And a 10% rate would obviously give you a slightly better net take home than 12.5% rate.

The yellow bar represents the tax take – all taxes, Social Security and everything, out of the gross pay of somebody at five times our average industrial wage. And you can see it drop. He took home 45% of his gross back in 1987 and he takes home 61% now, and that’s in effect approximately 2% per annum.
increase on average over the period. Capital gain taxes were also cut in half – from 40 to 20, which might be of interest also to a relatively high-paid domestic or overseas manager.

Now what role did tax reform play in the rise of the Celtic tiger? It’s difficult to disaggregate the effects of several contemporaneous and with the mutual support of policy changes, but there were some noticeable shifts and I’ve just mentioned three of them. Married female, labor force participation went up and very substantially, obviously releasing or realizing a new known resource.

Long-term unemployment in particular fell dramatically with the tax wage between gross and take-home earnings falling, a larger gap emerged between welfare incomes and income from work. And such employed obviously would have benefited – relative on my last slide where you saw the tax burden falling on higher incomes. And that, in turn, may have induced stronger investment but stronger incentive . . . but rather the trend towards higher self-employment could also be a national response simply to the fact that we were growing faster and there were more opportunities.

The second question that was posed on the agenda we got was what has been the impact on tax revenues and tax compliance? Tax compliance – certainly lower tax rates should encourage compliance by reducing incentives to invasion, but
over the period we also improved the powers of our revenue commissioners, and they use computers and capacity to link information together to chase after recalcitrance so it’s difficult, again, to attribute to lower tax rates. Indeed anything for what I suspect they did, but I don’t know how much they did, for either reducing evasion or increasing tax yield.

Now looking forward, as I said at the beginning, I’m not going to suggest where America or anyone else should go but I do think there are a few questions that need to be asked. And I say this from the standpoint, not as a tax expert, which I don’t claim to be, but rather as an individual who was challenged with trying to help a minister to get through a budget. And as the man trying to pluck the geese of the greatest amount of feathers with the least amount of hissing.

I think that anyone who pushes for tax changes should spell out clearly how they expect society will be affected and who is going to have to pay because there is no free lunch. I wonder whether we periodically review the effects of past tax changes to see if they actually deliver on what they were claimed to do. I wonder do we have a recognized and robust framework to evaluate the impact of tax changes so that we always ensure that all of them are evaluated. And that we insist that they have specific objectives attached as a basis
for measuring whether they actually deliver or whether we should sunset them if they don’t.

If I were to think about lessons from Ireland I would say there are three: the first one is, in my view, that it’s good policy in all areas that impact competitiveness - not excellence and taxation alone. That’s the foundation for progress. I think that lower rates with fewer exemption systems are more supportive of growth than higher rate exemption-filled ones.

And lastly, I think one in thinking about looking for a tax change or a tax exemption or relief, should ask what’s the desired outcome? Might it be better and more efficiently achieved by eliminating some of the barriers that stop whatever this desired outcome is being realized - barriers we put up for other reasons? I did feel that you ought to be challenged as tax practitioners. Thank you.

[applause]

Jaroslaw Neneman: It is a great honor and pleasure for me to speak to such an honorable audience. Due to the excellent presentation done by Charles, in fact, I have very little to add because, more or less, I agree with you almost totally. But I will give you some comments from the taxation in Poland. I also agree with you that taxation is not a key aspect in
successful stories. Taxation didn’t spoil the work of the economy but I’m not sure whether it helped the growth.

I’ll tell you about the recent changes in the tax system. In fact our current tax system was built some 12 years ago when at the beginning of 1990s we introduced corporate income tax, personal income tax and VAT, and since then we are all the time talking about tax reform. But, in fact, the main reform is still to be done. This year we reduced the standard to a corporate income tax rate from 27% to 19% and that was the biggest change. We also introduced the so-called tax option – that is an option for the taxpayers, a person running a business that now they can pay a flat tax rate at the rate of 19%.

In fact this creates some inconsistency to that taxation system in Poland because the laborer is taxed at a progressive taxation plus the profits from the business are taxed at a flat rate. It is important in Poland as small firms constitute an important part of the economy. We did observe the changes in the tax structure in the OECD countries with Poland full of the same people.

We decreased the share of the direct taxation and we increased significantly the role of VAT and excise taxation. It means we are focusing on taxing consumption rather than the
savings. And, on the other hand, it gave us the stable revenue source – I mean stable over the economic cycle.

You can see the changes in the corporate tax rate in Poland. Nowadays we’ve got 19% and that’s supposed to continue. It’s part of the drop of the tax rate -- the revenue from corporate income tax or revenue from business -- measures in relation to GDP is more or less stable because it is not the rate that defines the revenue but the profitability of enterprises and the compliance – the lower the rate, the higher the compliance.

Fortunately nowadays we have the period of strong economic growth so the profitability is higher. And despite a lower rate and due to a broad base, our revenue from the corporate taxation is higher. In fact what we did in Poland we just followed what happened in Europe. As you can see in most countries of our region, the corporate income tax rate is lower than it was some years ago – even a year ago.

But the question is whether the rate is important or not. The first issue is to what rate should we look upon? Is it the marginal rate or the effective rate or is just the effective rate more important? But, in fact, if you compare just statutory rates that gives you no information.

So the question is whether the rate is important. In my opinion, it’s not important. I couldn’t say it’s not important
at all but it’s of little importance. Other things are more important. And in Poland we did surveys on the investors and they say that they have problems not with the rates, they have problems with instability of the tax code, lack of certainty and low quality of tax administration -- as usual bureaucracy.

I’ll just give you one example of the bureaucracy. The time to register property in Poland is around 200 days, whereas in Norway it’s one day and in Sweden it’s two days and in Germany it’s 40 days. We know that for investors and for business, generally speaking, it is not that the tax rate is not important but the tax environment is more important.

For next year we will introduce advance rulings and advance price agreements and this year we started the so-called large tax offices that deal with business only. So far the tax office has dealt with both national persons and business – nowadays they’re kind of split.

What is important for the business?

I would say that taxation is important but not so important. The growth rate is more important. A low labor cost is more important. Infrastructure is important. I’ll just give you one example of productivity. This year the growth is high – it’s around 6%. Export is booming and unemployment is falling. Maybe one of the reasons is high productivity and the growth rate – the level of productivity in
Poland is low but the growth rate is high. It’s much higher than the growth rate of wages.

What should be done to the Polish tax system? We heard a lot about simplification. In Poland each government, each Minister of Finance talks about simplification. We talk about each year the tax code is bigger by, let’s say, 10% and it’s more and more complicated but life is complicated and that’s obvious.

I agree that there’s a tradeoff between simplification that implies low compliance cost and equity, for example, a simple tax affects a huge group of taxpayers. Some are better off and some are worst off. That’s the political cost — maybe it pays off and I’m not sure.

And following the risk discussion about the flat rate in personal income taxation. For many, the flat rate means simplification of the tax code— for me it’s not. Flat rate does not change anything. The removal of preferential treatment that’s a real simplification but very hard to get.

We think about signification of the rates in VAT. That makes a lot of sense to have just one rate — it’s good. And employment in Poland is the biggest amount . . . it’s now almost 20%. It’s a cost, in my opinion, mainly to the huge tax rate. Fortunately we’ve done the tax reform but one of the consequences of tax reform is that the Social Security
contributions are very high. Before it makes a lot of sense to increase VAT revenues to pay and then to lower the Social Security payment.

We think about property taxation, in fact the real estate taxation, nowadays it’s negligible and it’s based on the area of the real estate not the income. We also plan to do some big reform of tax administration. We are likely to separate our tax rates from the common activity of the Ministry of Finance. We also think to merge the Fiscal with Custom and Duty Administration.

What are the barriers to tax reform? You see here four, but in the meantime I think there’s another one but that’s the obvious one and I want to continue on that – lack of knowledge. In Poland, we say that everyone knows a lot about medicine, economics and especially taxation. Poland’s taxes are difficult because the world is difficult and the finance is difficult. For the society the distinction between the marginal rate and the effective rate is not obvious – if we are talking about taxes, effective rate is important, whereas for people, the marginal rate is important. A lack of continued knowledge.

In Poland unfortunately each summer we got a new Minster of Finance and it means that one minister does this and the other does that – there is little reason and there’s no
stability. Timing is also important because in democratic societies you’ve got elections, you’ve got presidential campaigns and parliamentary campaigns and the elections to the local government.

So it means that each three years there are elections so there is no good time to do something. Usually politicians are enthusiastic if it operates after the election. And you must not forget that it takes two, three or four years to produce a good tax code, but it takes a while to amend it and usually longer to change the tax rate. It’s one step to amend it but to rewrite the tax code, I don’t know, three or four years. And the European Union – we are very happy in Poland to be a member of the European Union but in the case of taxation it creates a lot of problems.

In the European Union we might say that we are harmonizing our system with respect to goods and services. There’s some discussion on capital that was directed from interest payment and the like. There was no harmonization, no discussion on labor -- maybe it’s okay. But I’ll give you the example – let’s say that Italian company employed Frenchmen that will work in the Hungary branch office and, in fact, he will spend more of the time let’s say in the Czech Republic. That person could, in fact, pay taxes in four different places.
In terms of money it’s nothing but in terms of political pressure that’s something we cannot forget. The question is do we need harmonization and the other question is it possible. In the European Union we’ve got 25 countries and in each country we’ve got a Prime Minister, Minister of Finance, and Central Bank and the like. It means that we’ve got many different opinions on stock issues.

All the decisions we’ve got in taxes should be taken as a UN meeting. It means that decisions that deal with controversial issues are very hard to obtain. I would say it’s not possible to obtain. This means that the harmonization, as it was let’s say 10 or 15 years ago in the European Union, nowadays it’s not possible.

Now some concluding remarks. Taking into account our political situation and the need to do something with taxation I think that Poland is likely to follow Slovakia. I would be happy to listen to what’s going in Slovakia. But the reform of taxation . . . if we talk about rates that’s simple, but if we talk about the tax code that’s complicated. We should think about the reform of tax legislation. Maybe it’s high time to say we had a National Council and this council could produce legislation and then parliament should either accept it or reject because the normal procedure of parliament on how to work on taxation.
And I do not know the situation here but I can imagine it’s similar. In Poland, the government has an idea from the officials or the Minister of Finance. The law is sent to parliament and the parliament starts the job. And after a month or two we’ve got something else that we hoped for. So maybe big change is possible. Maybe the legislation should be done in other places. Thanks a lot.

[applause]

Vladimir Tvaroska: Thank you very much. First I would like to thank you for the invitation to this excellent conference. It is indeed an honor for me to have the possibility to present our experience from Slovakia. And honestly I’m thinking about if I do desire this honor because some of my colleagues and very good friends would say that I, during the preparation of the reform, only complicated the whole tax reform with stupid questions about the impact on the budget and about the analysis of the revenues. So at least I had to promise them that I would start also my presentation here and give the view on the fiscal position and on the budget in our country.

Two years ago when we started to prepare the fiscal and the tax reform and the new government came to office, we had a fiscal deficit almost 6% of GDP, which is doubled as is required as our rules in the EU established. We think it was
very important for us to decrease the fiscal deficit because we needed to prepare the country for the aging population, which is a very difficult issue also for Slovakia. And also we are very small and open economy - foreigner trade makes something like 160% of GDP and it is very important for us to be a member of the EU as soon as possible. We think we are sure to improve the competitiveness of the economy.

So this was the reason why the major issue and main government objective was to reduce the fiscal deficit and we think it was a very important one. What I think was a crucial decision was that we are going to decrease deficit not by increasing taxes, by increased revenues, but by significant decrease of public expenditure. So we are decreasing the public expenditures from 44% of GDP in 2002 below 40% in 2006.

So this kind of reduction of the fiscal deficit also creates some space for the tax reform. And the tax reform was also top priority for the government. The government wanted to clearly improve the quality of the tax system, simplify the tax system and increase the fairness of the tax system. These were quite a few reasons why this was a priority but clearly the major reason was to improve the business environment because we are quite confident that for Slovakia for long-term competitiveness of the country will need to attract foreign
investors in order to bring the know-how to a structured economy and to decrease very high unemployment.

So clearly the major engine of the tax reform was the request to increase the competitiveness in a very high competition between the countries in Central and Eastern Europe to attract investment. This was clearly the major, major reason for the tax reform.

As I said also the budget was very important and the decision was that tax reform would be very important, fundamental but it must be revenue neutral. It was very difficult because it was very fundamental . . . I will describe in the next minutes a very fundamental reform. So it was very difficult really to make precise forecast of the revenues after the reforms will be implemented. We had very good cooperation also with the IMF. They had two suggestions and it was very useful.

We cooperated with independent entities in Slovakia in order really to be as sure as possible that we will know what the taxes will bring to the state budget in 2004. This was a very difficult task, especially at the beginning of 2003. We spent quite a long time on the prediction of the fiscal revenues after the tax reform.

As I described the tax revenues should be neutral or the impact from the tax reform should be neutral so it was clear
that after the tax reform there will be some winners but also losers. And the reason it was very important to choose the right sequences, to choose the right implementation strategy for the whole reform because it was not easy also from the political point of view obviously to go through the parliament. The decision for the first part of the reform, which was an unpopular part of the reform, was approved at first before the summer of last year. This was increase of the VAT and increase of excise duties.

The second much more popular part of the reform was a new income tax and abolishing of some taxes. This came after the summer of last year and these laws have been approved in the autumn of last year.

The third very important, although not so exciting part of the reform was linked to the entering to the EU, especially significant change in the whole VAT but also excise system to put in place from May this year. And this is the content of the reform, which is effective in Slovakia from January of this year.

Last year we had brackets of the personal income tax rate, from 10% to 38%. Today we have only one – 19% flat rate. The corporate income tax rate was 25% and now it’s 19% also. Last year we had a standard and low rate of the VAT, the first one was 20% and the second 14%. Today we have a unified rate at
the level of 19%. This is most heavily publicly discussed part of the reform because it’s about rates. But I think very important was also the second part of the reform which was simplification of the whole system and increased transparency.

It was, and not only in Slovakia - I’m sure in other countries also - many exemptions for special regimes. Virtually all of them were eliminated during the reform. And I think, and probably of you will agree, that this was also very important, maybe a crucial part of the reform. Definitely this was from the process of discussion in the parliament even much more difficult than the discussion about rates.

The most public part of reform was clearly the abolishment of some taxes. Today in Slovakia we don’t have a tax on dividends. We have no inheritance tax. We have no gift tax. And from January next year, also, the real estate transfer tax will be abolished. Also, we have a flat tax rate for the personal income, clearly there is also some progress in the system because we have a general deductible item which is at the level of about half of the average seller in the economy. So this is the effective rate for personal income tax. We have a flat tax but there is also quite significant progressivity in our system.

When I was talking about major impetus of the reform it was the attraction of the investment and this is how we would
like to support capital in-flow to Slovakia. We have only one tax on profit, which is 19% corporate income tax and there is no dividend tax. So a combination means 19% taxation and you can see the comparison with other countries.

The tax reform in Slovakia is effective from January this year or the most important parts are effective from January this year. It’s clearly too early to make a very comprehensive evaluation of the impact of the tax reform. We (and the Minister of Finance) plan to prepare a really comprehensive evaluation of the impact of the tax reform in the summer of next year. But already today we can see two of the most important results of the reform. The first one is there’s no doubt that we have significantly stronger interest from foreign investors to come to Slovakia, to visit, to discuss and many of them are already deciding for investment to Slovakia.

No doubt this is not the only one and probably this is not even the largest incentive for the investors to Slovakia. Definitely the membership in the EU and the NATO from this year - the educated and relatively cheap labor force definitely the location, in the center of Europe, is very significant.

Also other changes in the business environment and these changes were quite significant in the last few years. And also helped significantly to increase the FDI in-flow to Slovakia. But there’s no doubt that tax reform also significantly
improved the image of Slovakia as a business friendly country and I think tax reform in this respect really delivered what we have expected. Maybe even more than we had expected one year ago.

The second outcome of the reform is also for us very important - it’s the impact on the budget. It was indeed very difficult to make precise forecast of the tax revenues in this year. Too many changes not only in the tax system but also in the economy, EU membership so it was very difficult. Today we are six or seven weeks before the end of the year and we are quite happy to say that the tax revenues will be almost exactly as they were budgeted one year ago. So even I would say that the Minister of Finance was more precise in the tax revenue forecast than in previous years when the tax reform was not there. So we are quite happy and definitely we are quite lucky. We had a degree of luck in this prediction but the truth is that the tax revenues are virtually as they were budgeted.

And this is the result from the tax revenues point of view. The tax burden in Slovakia last year was 18.2% and this year it will be 17.6%, so there is a slight decrease but this decrease was not caused by the tax reform but by the structure of the GDP growth. Growth in Slovakia is quite high, about
5.5% this year. But the main engine of the growth is export, which is obviously not so rich for tax revenue.

So the tax reform was, as the legislation changes, were fiscally neutral. Clearly it was a shift from direct taxation, from 7% to 5% and an increase in indirect taxation from 11% to almost 12.5%

At the end I would like to say a few experiences or a few conclusions of what we think was most important in Slovakia during the preparation and implementation of the tax reform. The most important was, I think, to have a clear vision -- the clear vision which was easy to sell to the population and to the political party. I think it was very good that this vision was there in place briefly after the election because the timing was also very important. And I think the timing was probably the most important thing in the implementation of the tax reform. There are two levels or two areas why time was very important.

The first one is linked to the election cycle. In Slovakia where we have a coalition government, we have four parties in the coalition and a very narrow majority in the Parliament. It was very important to use the window of opportunity, which was briefly after the election.

So it was very important that the whole tax reform was approved in the Parliament we think one year after the
election. And also timing was important because of sequencing of the steps. It was very important that we were able to pass through Parliament at first an unpopular part of the reform, the increase of some taxes. And then we had a much more quiet environment for the second part of the reform. Very important also was the ability to resist lobbyists because indeed while abolishing the different special regimes and the exemptions there were so much lobbyists because not only in the U.S. – I think they are very well organized, but also in the countries of Slovakia. They were quite strong, and, especially in the Parliament, it was a long and tough discussion.

It was very important that we were not forced to make one compromise or two compromises because otherwise everything would go immediately. So it was very important that my Minister and the Prime Minister were deeply involved – the Prime Minister presently and they were able to really resist these lobbyists. And the result is that really virtually all exemptions and preferential regimes were abolished during the tax reform.

And also very important is that it is necessary to compensate the most vulnerable part of the population. The tax reform was not any one and I think it was very important that together with the tax reform, Slovakia also introduced the social system, which was prepared in the same year as the tax
reform. So these two reforms worked together, and the most vulnerable part of the population, which were suffered from the tax reform, were partially paid or improved their situation by the new social system.

So I think, although from the start of the implementation, our reform is only 10 months and it is, indeed, too early to tell. But in Slovakia we are quite confident that the reform broadens out and delivers what we have expected from the reform. And I hope very much this will not change in coming months and coming years when we will see really the impact of the reform on the whole economy. Thank you very much.