Impact of changes in Spain's VAT rates during the economic crisis: A comparative analysis

Desiderio Romero-Jordán[1] and José Félix Sanz-Sanz[2]

VAT increases in Spain since the onset of the crisis have brought rates from among the lowest in the EU to in-line with the average. There is room for additional increases for items currently subject to lower rates, but this would be insufficient to remedy Spain's low VAT revenue ratio.[3]

The VAT reforms in 2010 and 2012 raised Spain's reduced and standard rates by 3 and 5 percentage points, respectively. Although these measures are in line with trends elsewhere in the European Union, they put Spain in the group of EU-27 countries (along with Hungary, Romania, Latvia, the Czech Republic and Estonia) in which VAT rates have risen furthest during the economic crisis. One of the direct consequences for Spain is that it has gone from having one of the lowest standard rates in the EU (along with Luxembourg) to now having a rate that is near the average. The tax rates applicable to certain representative items in households' shopping baskets (such as food, books, or medicines) are nevertheless lower in Spain than in its peers. However, this is not so in the case of other items which have a significant weight in the Spanish economy, such as the hotel and catering industry, where the rates are similar to those in neighbouring countries. In this context, the review of some of the goods subject to lower rates is an option to consider, although this would not solve the problem of a low VAT collection ratio and could make the tax regressive.

Introduction

The serious deterioration in Spain's public finances during the current economic crisis has triggered labour market reforms, public expenditure cuts in areas such as health and education, and increases in the majority of taxes (Sanz-Sanz and Romero-Jordán, 2012a). In the case of value added tax (VAT), the first rate increase came in July 2010 in order to offset the sharp drop in collection, which fell by 14% in 2008 and 30% in 2009. The reduced rate was increased from 7% to 8% and the standard rate went from 16% to 18%. The super-reduced rate was kept at 4%. Faced with a worsening in the public deficit in 2011 (9.44%), there was a second rise in September 2012, taking the reduced rate to 10% and the standard rate to 21%. Additionally, for the first time since 1992, certain changes were introduced in the tax base.[4] In short, in the space

[1] Universidad Rey Juan Carlos.

[2] Universidad Complutense de Madrid.

[3] The revenue ratio is the ratio between the actual revenue collected and the maximum revenue that would be collected in the absence of exemptions, reduced rates and tax evasion.

[4] A number of goods and services became subject to the 21% rate for the first time: theatre, cinema and circus tickets, digital television services, hairdressing, undertakers' services, flowers, plants, and works of art, school materials other than books.

In the space of less than two years, the reduced rate has risen by 3 points and the standard rate by 5 points. As a result, the VAT rate in force in Spain has gone from being among the lowest in the EU to the average.

of less than two years, the reduced rate has risen by 3 points and the standard rate by 5 points. As a result, the VAT rate in force in Spain has gone from being among the lowest in the EU to the average. These changes have paralleled those observed in other EU-27 countries since the start of the crisis. Indeed, almost half of the countries in the EU raised their VAT rates between 2010 and 2012 (standard and/or reduced rate) to increase the tax take. As a result of this trend, the average standard rate in the EU-27 rose by 1.8 points between 2008 and 2013, reaching 21.3% at the end of the period (European Commission, 2012, Eurostat, 2013).

The two VAT reforms mentioned, recommended on several occasions by the International Monetary Fund and the European Commission, set out to help correct the low revenue ratio from which the tax has traditionally suffered in Spain. According to the OECD (2012), Spain's VAT revenue ratio was 34%, well short of the average among its member countries of 55%. In the Commission's view, to meet this objective it is necessary to (i) raise tax rates, and (ii) increase the range of goods subject to the standard rate, as well as the frequently mentioned need to reduce fraud. Once the reduced and standard rates had been raised, the European Commission recommended (May 2013) implementing a "(...) wider limitation on the application of reduced VAT rates" given the high cost of collection. In fact, in 2011 this cost was estimated at almost 13 billion euros, equivalent to 18% of revenue (Sanz-Sanz and Romero-Jordán, 2012b). 66% of this fiscal expenditure corresponds to the reduced rate and 34% to the super-reduced rate. It should be borne in mind that the weight of the tax base subject to the standard rate is 46% in Spain, compared with 67% in the EU-15. The shares of the tax base subject to the reduced rate and super-reduced rate are 44% and 10% (25% and 9% in the EU-15) (European Commission, 2004).

However, reviewing the VAT base does not seem to be on the Spanish government's agenda, at least in the short term. It should be noted that

While possible changes in the tax base remain on hold, the two reforms looked at have already meant a significant effort for Spanish households. In particular, the 2012 reform has had an average impact per household of 356 euros.

the goods taxed at the 4% super-reduced rate are basically unprepared foodstuffs, medicines, books, newspapers, prostheses and vehicles for disabled persons. Likewise, the basket of goods taxed at the reduced rate of 10% includes water, prepared foodstuffs, glasses, housing, passenger transport, and hotel accommodation. While possible changes in the tax base remain on hold, the two reforms looked at have already meant a significant effort for Spanish households. In particular, the 2012 reform has had an average impact per household of 356 euros (Sanz-Sanz and Romero-Jordán, 2012b).

In this context, this study has two aims. Firstly, to perform a comparative analysis of the current state of play and changes in VAT rates in the EU-27 since 2008. Secondly, in light of the latest proposals from the European Commission, to compare the tax rates on a basket of basic goods, including, among other things, foodstuffs, water, restaurant services, hotel accommodation, and admission to cultural services. As a starting point, section 2 gives an overview of the VAT rates in effect in 2013. Sections 3 to 5 discuss changes in both the general rate and the reduced rates over the period 2008-2013. Section 6 compares the rates applicable to a selection of items in different countries.

The starting-point: VAT rates in 2013

The VAT-rate structure currently in effect has its origins in Directive 92/77/EEC of October 19th, 1992, which introduced the value added tax to accompany the creation of the common internal market. Thus, since 1993 the standard rate has coexisted with one or two reduced rates, a super-reduced, a zero rate, and a lesser known rate, referred to as the "parking" rate. In other words, the directive set a standard rate of 15%, and

Table 1

VAT rates applied in January 2013

Member States	Standard rate	Reduced rates	Super-reduced rate	Parking rate	Zero rate
EU-15					
Denmark	25	-			Yes
Sweden	25	6 / 12			Yes
Finland	24	10 / 14			Yes
Greece	23	6.5 / 13			
Ireland	23	9 / 13.5	4.8	13.5	Yes
Portugal	23	6 / 13		13	
Belgium	21	6 / 12		12	Yes
Spain	21	10	4		
Netherlands	21	6			
Italy	21	10	4		Yes
Austria	20	10		12	
United Kingdom	20	5			Yes
France	19.6	5.5 / 7	2.1		
Germany	19	7			
Luxembourg	15	6 / 12	3	12	
EU-12					
Hungary	27	5 / 18			
Romania	24	5 / 9			
Poland	23	5 / 8			
Latvia	21	12			
Lithuania	21	5 / 9			
Czech Republic	21	15			
Bulgaria	20	9			
Slovakia	20	10			
Slovenia	20	8.5			
Estonia	20	9			
Malta	18	5 / 7			
Cyprus	18	5 / 8			
Rate range EU-15	15-25	5-14	2.1-4.8	12-13.5	
Rate range EU-12	18-27	5-18			
Arithmetical Mean EU-27	21.2				
Arithmetical Mean EU-15	21.4				
Arithmetical Mean EU-12	20.8				

Source: European Commission (2013).

established a series of specific cases governed by the following rules. Firstly, countries were allowed to apply one or more reduced rates of not less than 5% on a list of goods explicitly set out in the directive.[5] Secondly, countries that had been applying a rate of less than 5% (including the zero rate) were allowed to retain it in their VAT structure. Thirdly, countries that taxed goods and services not included on the list at a reduced rate in 1991 were allowed to apply a "parking rate" of not less than 12%. Lastly, countries such as Spain, where the standard rate increased by more than two points, have been allowed to apply a super-reduced rate to the list of goods referred to above.

The main issue regarding the VAT rates in force in the EU-27 is their high degree of dispersion: Standard rates range from 15% to 27% and reduced rates from 5% to 18%, a difference of between 12 and 13 points between the lowest and highest rates.

Bearing these premises in mind, Table 1 shows the VAT rates in force in January 2013 in the EU-27 (sorted by standard rate). The information is broken down into two groups: the EU-15 and the EU-12. The main issue regarding the VAT rates in force in the EU-27 is their high degree of dispersion: standard rates range from 15% to 27% and reduced rates from 5% to 18%. That is to say, in both instances there is a difference of between 12 and 13 points between the lowest and highest rates. This rate dispersion is widest in the case of the reduced rate in the EU-12 where the highest value is 18% in Hungary –equal to the standard rate existing in many European countries. One important source of differences is that, with some exceptions, super-reduced, parking or zero rates are not applied in the EU-12 as a consequence of the date of accession of this group of countries.

Trend in the standard rate during the crisis

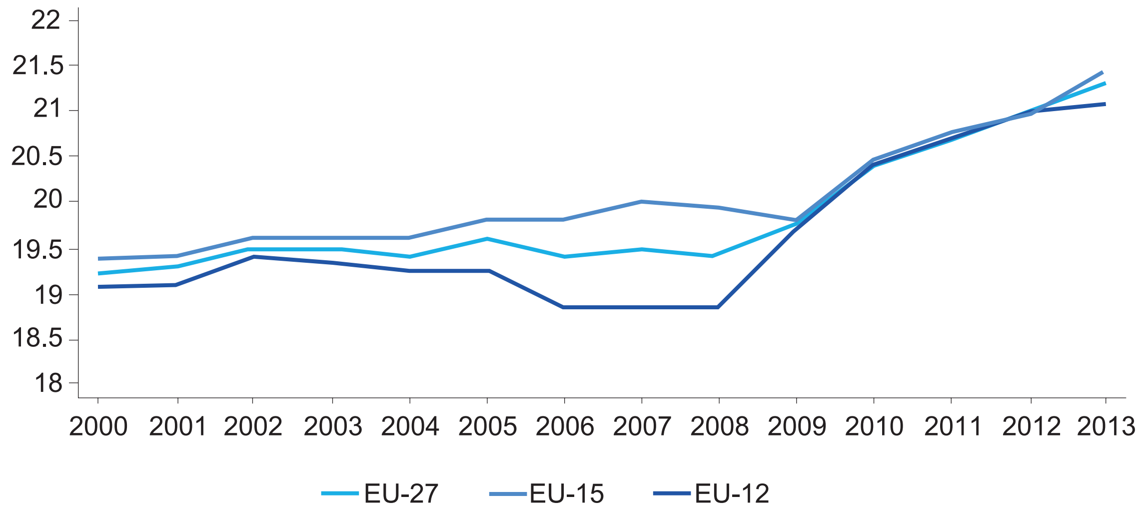
The interval in the standard rates in force at the start of 2013 was 12 percentage points, ranging from 15% in Luxembourg to 27% in Hungary. The highest rates are in the Nordic countries (Denmark and Sweden with 25% and Finland with 24%), in the three countries bailed out pre-2013 (Greece, Ireland and Portugal with 23%) and Hungary (27%), Romania (24%) and Poland (23%). Most EU-27 countries have a standard rate of over 20%, with the exceptions being Luxembourg (15%), Cyprus (18%), Malta (18%), Germany (19%), and France (19.6%). The dispersion of the standard rate observed in the EU-15 is 6 points, if we exclude Luxembourg as an outlier, compared with 10 points in the EU-12. Spain's standard rate is currently very close to the averages for both the EU-15 (21.4%) and the EU-27 (21.2%).

For the countries of the EU-27 as a whole, the average value of the standard rate reached its historical peak in 2013, at 21.3%. Thus, between 2000 and 2013, the average standard rate rose by 2.1 percentage points. As Exhibit 1 shows, this tendency is basically explained by the sharp rise in rates since 2008, both in the EU-15 and the EU-12, coinciding with the onset of the current economic crisis. In the years leading up to the crisis, the trend was less clear: in the EU-15 there was a slight upward tendency, whereas in the EU-12 the opposite was the case. To illustrate the scope of the changes since 2008, Exhibit 2 plots the variation in the standard rate. As the exhibit shows, the rate has increased in the three bailed-out countries of the EU-15 (2 points in Ireland, 3 in Portugal and 4 in Greece) and in the Netherlands, Finland and Italy (2 points), the United Kingdom (2.5 points) and Spain (5 points). Thus, Hungary, Romania and Spain are the three countries with the steepest rise in the standard rate. There has

[5] See Annex H of Directive 92/77/EEC, which includes, among other goods, foodstuffs, medicines and apparatus for disabled persons, water, transport, admission to cinemas, theatres and shows, concerts or museums, social housing, sports facilities, and undertakers' services.

Exhibit 1

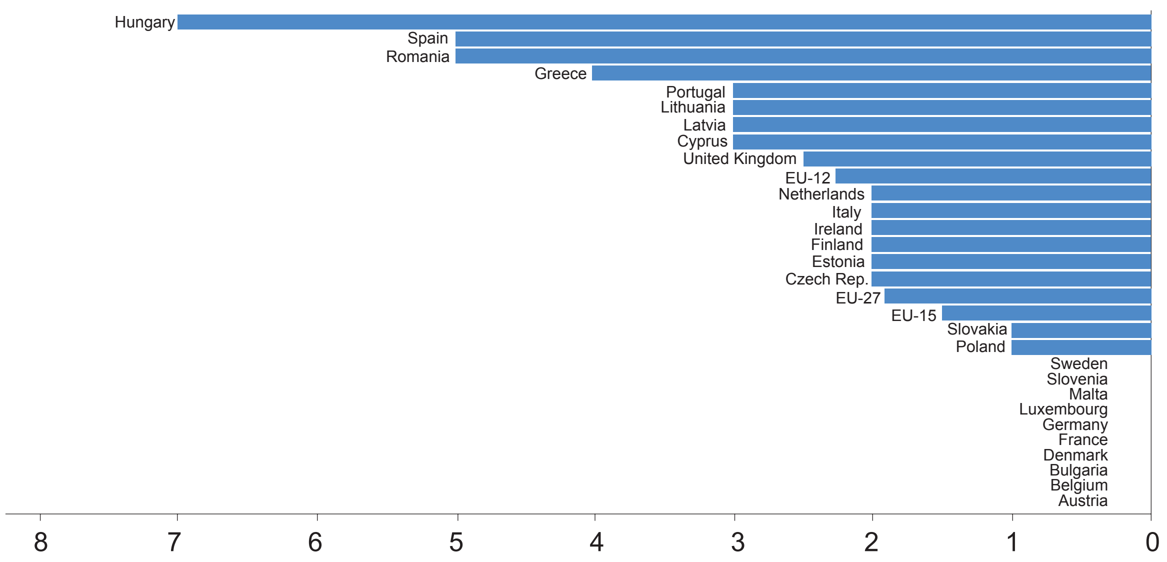
Trend in standard VAT rate



Source: Eurostat, Taxation trends in the European Union *(2013).*

Exhibit 2

Points variation in standard VAT rate between 2008 and 2013



Source: Eurostat, Taxation trends in the European Union *(2013).*

been no change over the last five years in any of the EU-15 countries. In the EU-12, the standard rate rose between 2008 and January 2013 in all countries except Malta, Slovenia and Bulgaria. The biggest increases were in Hungary (7 points), Romania (5 points), and Lithuania, Latvia and Cyprus (3 points).

Trend in the reduced rate during the crisis

With the exception of Denmark, all the countries of the EU-27 apply at least one reduced rate, which under community legislation may not be less than 5%. As Table 1 shows, a total of twelve EU-27 countries –including Spain– apply a reduced rate: the range varies from 5% in the United Kingdom to 15% in the Czech Republic, with a maximum value of 10% in the EU-15 and 12% in the EU-12. In half of this group the range is between 9% and 10% (Spain, Italy, Austria, and Slovakia apply a rate of 10%). In the remaining 14 countries, two reduced rates are applied, referred to here as minimum and maximum reduced rates. In 11 of these countries the minimum rate is between 5% and 6%. The maximum rate varies between 12% and 14% in the EU-15 (with the exception of France) and between 7% and 9% in the EU-12 (with the exception of Hungary, where it is 18%).

Exhibits 3a, 4a and 5a give an overview of the trend in average reduced VAT rates over the period 2000 to 2103. Similarly, Exhibits 3b, 4b and 5b show a ranking of countries with the biggest rate increases over the period 2008 to 2103. A number of conclusions emerge from this set of exhibits. Firstly, there has been an upward trend in the average rate in the EU-27 for the single reduced rate and the minimum reduced rate since 2006. However, the increase in the EU-15 average was more pronounced. Conversely, the maximum reduced rate has varied, with small changes over the period, between 10.5% and 11%. Secondly, over the period from 2008 to January 2013, the VAT rate increases have affected four countries in the EU-15 (Spain, Greece, Portugal and Finland) and five in the EU-12 (Latvia, Czech Republic, Estonia, Bulgaria and Romania). The increases have been biggest in Latvia (7 points), the Czech Republic (6), Estonia (4), and Spain (3), where a single rate is applied, as in Hungary where the maximum rate of 18% was reintroduced, Malta where a maximum rate of 7% was first introduced in 2011, and Greece, where the top rate went from 9% to 13%. The only country in which the rate was cut was Finland, with a reduction of 3 points.

The trend in the other rates

The other rates –super-reduced, parking and zero– have remained stable over the last few years, except in Ireland, where there have been minor changes since the legislation governing them came into force. The super-reduced rate is in force in five EU-15 countries: Ireland (4.8%), Spain (4%), Italy (4%), Luxembourg (3%) and France (2.1%). As Table A1 in the appendix shows, there is little uniformity in terms of the goods and services to which these super-reduced rates apply. Luxembourg makes most use of them, covering a wide range of goods (foodstuffs, children's clothing and footwear, hotel accommodation, housing, etc.). By contrast, in Ireland it only applies to certain foodstuffs, although there is a wide range of zero-rated goods (books, most foods for human consumption, medicines, prostheses, apparatus for disabled persons, etc.). In Spain, the super-reduced rate is applied to fresh foodstuffs, medicines, books, newspapers, and social housing.

Seven EU-15 countries (United Kingdom, Ireland, Belgium, Italy, Finland, Denmark and Sweden) and just one EU-12 country (Malta) have a zero rate. However, as Table A2 in the appendix shows, the range of zero-rated items is quite wide in the United Kingdom and Ireland, but limited mainly just to newspapers, and publications by non-profit-making organisations elsewhere. Similarly, the zero rate is applied to prescription medicines for human use in Sweden and the sale of farm land in Italy.

SEFO - Spanish Economic and Financial Outlook Vol. 2, N.º 4 (July 2013)

Exhibit 3a

Trend in single reduced VAT rate

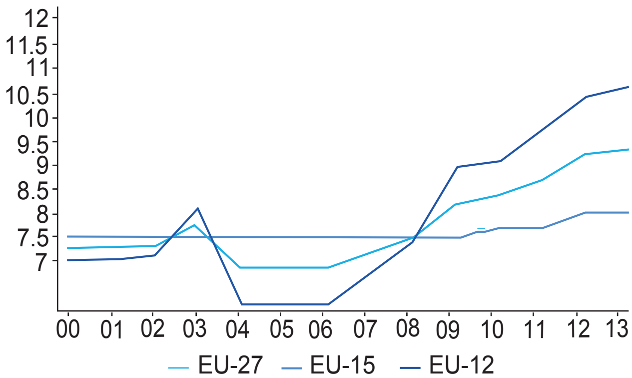


Exhibit 3b

Change in single reduced VAT rate between 2008 and 2013

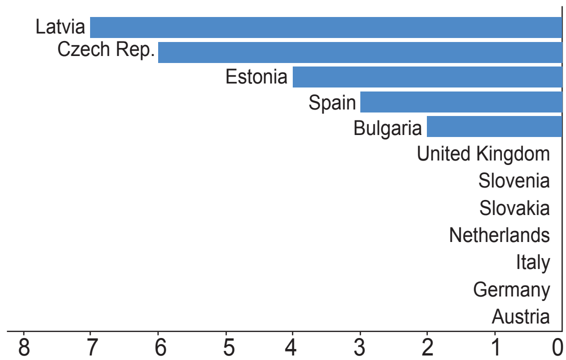


Exhibit 4a

Trend in minimum reduced VAT rate

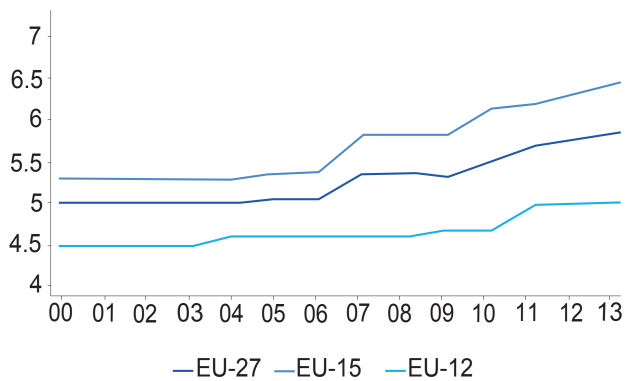


Exhibit 4b

Change in minimum reduced VAT rate between 2008 and 2013

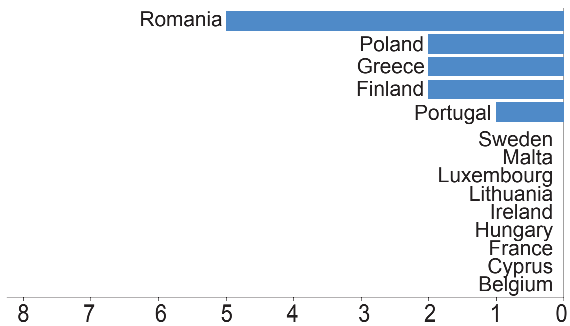


Exhibit 5a

Trend in maximum reduced VAT rate

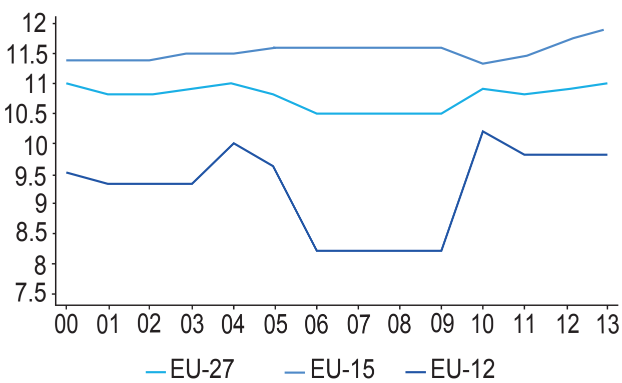
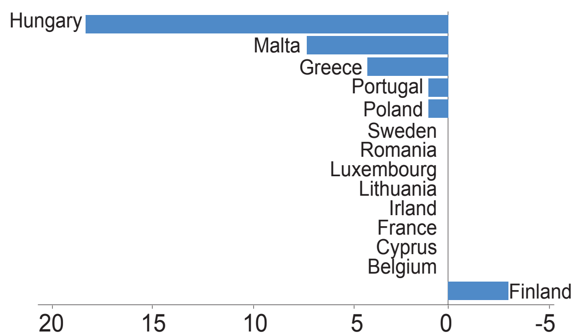


Exhibit 5b

Change in maximum reduced VAT rate between 2008 and 2013



Source: Eurostat, Taxation trends in the European Union *(2013).*

Finally, the parking rate is currently in force in Ireland, Luxembourg, Belgium, Austria and Portugal.[6] The use of the parking rate is entirely marginal, except in Ireland (see Table A3 in the appendix). For example, in Luxembourg, Austria and Portugal it is applied to certain types of wine. In Ireland, Luxembourg and Belgium it is applied to certain energy goods. In all these cases the tax rate is between 12% and 13.5%, and has remained unchanged since 1993.

Tax rates applied to a basket of basic goods

As mentioned in the introduction, the European Commission has recommended that the Spanish government review the list of goods to which the reduced rates apply. Table 2 therefore sets out an initial overview of the differences in the way the goods and services consumed by households are treated. For these purposes, a selection has been made of ten representative goods in European shopping baskets, although the comparison has been restricted to the countries of the EU-15. With the exception of admission charges for cultural services (cinema, theatre, etc.), the goods examined are subject to the super-reduced or reduced rate in Spain. The information shown in Table 2 allows the following conclusions to be drawn:

i) In general, the tax treatment of the goods examined here is far from uniform. Medicines, for example, are zero-rated in the United Kingdom, taxed at the super-reduced rate in Spain, and at the standard rate in Germany. Another example is books, which are zero-rated in the United Kingdom and Ireland, but subject to the standard rate in Denmark. Yet another is that of water, which is zero-rated in the United Kingdom, but subject to the standard rate in Sweden.

ii) Denmark is an extreme case in the application of tax rates in that, in general, all the goods in the basket are subject to the standard rate of 25%. At the other end of the scale, in Luxembourg most of these goods are subject to the super-reduced rate. Likewise, as we saw in the previous section, Ireland and the United Kingdom apply a zero rate to a wide range of goods and services, such as foodstuffs, medicines, apparatus for disabled persons, or housing.

iii) Books, newspapers, medicines and apparatus for disabled persons, and foodstuffs, are subject to slightly lower rates in Spain as they benefit from the super-reduced rate. Conversely, the cost of admissions for cultural services is clearly higher in Spain since the 2012 VAT reform. Finally, the rates applicable to hotel accommodation and restaurant services, which have a significant weight in the Spanish economy owing to the role of tourism, are very similar to those existing in the other countries examined. In fact, hotel services are subject to a reduced rate in 12 of the EU-15 countries. Similarly, restaurant services are subject to a reduced rate in 9 countries, with only Germany, Denmark and the United Kingdom applying the standard rate.

To sum up, the analysis suggests that a review of the tax bases subject to the super-reduced and reduced rate is an option to be considered in Spain's case. Nevertheless, a reform of this nature should take the following points into account. Firstly, altering the tax treatment of any of the goods subject to VAT will not solve the problem of the low VAT revenue ratio referred to in the introduction. And secondly, the current VAT structure, with a super-reduced rate for goods such as foodstuffs and medicines and a reduced rate for services such as transport or water, avoids the tax being regressive and inclines it towards proportionality (Romero-Jordán and Sanz-Sanz and Castañer 2013). Raising the tax rates on these tax bases could upset this balance and make the tax regressive.

[6] In Italy it was eliminated in 1995, in the United Kingdom it was only in force in 1994, and in France it was applied in 1987.

Table 2
VAT rates applied in January 2013

ITEM	GOODS	SPAIN	Germany	Austria	Belgium	Denmark	Finland	France	Greece	Netherlands	Ireland	Italy	Luxembourg	Portugal	United Kingdom	Sweden
1	Foodstuffs	SR/R	R/S	R	R/S	S	R	SR/ R/S	R	R	Z/ SR/R	SR/R	SR	R/S	Z/S	R/S
2	Water suppliers	R	R	R	R	S	S	R	EX/R	R	EX/S	R	SR	R	Z	S
3	Pharmaceutical products	SR	S	R	R	S	R	SR/ R/S	R/S	R	Z/S	R	SR	R/S	Z	S
4	Medical equipment for disabled persons	SR	R	S	R/S	S	EX/S	R	R	R/S	Z/S	SR/S	SR/S	R	Z	EX/S
5	Transport of passengers	R	R/S	R	Z/R	Z/S	R	R	R	EX/R	EX	EX/R	EX/ SR	R	Z	Z/R
6	Books	SR	R	R	R/S	S	R	R/S	R	R	Z	SR/S	SR	R	Z	R
7	Newspapers	SR	R	R	Z/R/S	S	R/S	SR/S	R	R	R	SR/S	SR	R	Z	EX/R
8	Admission to cultural services (shows, cinema, theatre)	S	EX/R	EX/R	EX/R	S	R	R/S	R	R	EX/R	R	SR	EX/R	S	R
9	Hotel accommodation	R	R	R	R	S	R	R	R	R	R	R	SR	R	S	R
10	Restaurant and catering services	R	S	R	R	S	R	R	S	R	R	R	SR	S	S	R

EX: exempt. Z: zero rate. SR: super-reduced rates. R: reduced rate. S: standard rate.
Source: European Commission (2013).

References

European Commission (2004).

European Commission (2012): "Tax reform in EU member States. Tax policy changes for economic growth and fiscal sustainability". *Working Paper* 34/2012.

European Commission (2013): "VAT rates applied in the Member States of the European Union (Situation at 14th January 2013").

Eurostat (2013): *Taxation trends in the European Union.* European Union.

OECD (2012): *Consumption tax trends 2012. VAT/GST and Excise rates, trends and administration issues. OECD publishing.*

Romero-Jordán, D., Sanz-Sanz, J.F. and Castañer, J.M. (2013): "Sobre la regresividad de la imposición indirecta en España en tiempos de crisis: un análisis con microdatos de hogares", *Papeles de Economía Española,* 135.

Sanz-Sanz, J.F. and Romero-Jordán, D. (2012a): "Efectos recaudatorios y distributivos en 2012 de algunas opciones de reforma del IVA. Impacto sobre el sector de los hogares". *Cuadernos de Información Económica,* 228, pp. 1-5.

— (2012b): "Efectos recaudatorios de la reforma del IVA de Julio de 2012". *Cuadernos de Información Económica,* 229, pp. 1-4.

Appendix

Table A1

Goods taxed at the super-reduced rate

Goods	Spain	Luxembourg	Ireland	Italy	France
Foodstuffs[1]	X	X	X	X	
Water (mineral and piped supply)		X			
Children's clothing and footwear		X			
Medicines	X	X			X
Books	X	X		X	
Newspapers	X	X		X	X
Hotels, restaurants, cinemas, theatres, sporting events, use of sports facilities		X			
Housing - repairs to housing	X	X		X	
Apparatus for disabled persons		X		X	

[1] Does not include all nutrition-related goods.

Table A2

Zero-rated goods

Goods	United Kingdom	Ireland	Malta	Belgium	Denmark	Italy	Finland	Sweden
Books	X	X						
Newspapers	X			X	X			X
Publications by non-profit-making organisations							X	X
Foodstuffs for human consumption	X	X	X					
Beverages for human consumption including water (except alcoholic beverages)	X	X	X					
Seeds, plants and ingredients normally intended for use in preparation of foodstuffs	X	X	X					
Fertilisers	X	X						
Foodstuffs for animals (excluding pets)	X	X						
Medicines for human consumption	X	X	X					X
Medicines for animal consumption		X						
Medical equipment - prostheses	X	X	X					
Children's clothing and footwear	X	X						
Housing for residential use	X							
Domestic passenger transport	X							
Sale of land for non-residential use						X		

Table A3

Goods taxed at the parking rate

Type / goods and services	Ireland	Luxembourg	Belgium	Austria	Portugal
Applicable rate	13.5%	12%	12%	13%	13%
Energy products for heating and lighting	X				
Petroleum products used as fuel		X	X		
Lignite, coke			X		
Agricultural diesel					X
Cleaning and washing products		X			
Sale of real property	X				
Cleaning and repair of properties	X				
Certain tourism services	X				
Short-term hire (less than 5 weeks) of vehicles, boats, canoes, etc.	X				
Veterinary services	X				
Driving schools	X				
Certain types of wine		X		X	X
Custody of shares and administration of loans		X			