Prepared by AmCham member

Taxes and competitiveness: are they "joined vessels"?

"In this world nothing can be said to be certain, except death and taxes." (Benjamin Franklin, 1789) A rather sardonic proverb, yet still very true. Since then nothing much has changed. It basically means that we cannot divert the inevitability of paying taxes, nor may we take their amount for granted, as we may might have observed in the latest changes of to our tax legislation.

It might be interesting to compare Slovakia's tax policy development with that of a slightly less developed European economy, lets take Romania, for instance. In the past seven years, there has been a reduction in the tax burden in order to revive the business environment and to attract foreign investors. Since 2005, a rate equal to 16% of income tax has been introduced. The trend of reducing the tax burden, however, has been hampered by the economic crisis and the subsequent pressure to increase tax revenues. Throughout the crisis, indirect taxes have increased whereas the direct tax rate has remained at the same level. The tax rate on corporate income has dropped in recent years; for 2013 it represents a 16% tax rate, compared to the year 2000, when the tax rate was 25%.

The global trend supports a decrease in the tax burden of companies. This can be observed even in countries with a traditionally high contribution and tax burden, such as Sweden. In 2013 the Swedish government introduced a reduction in income tax corporation tax from 26.3% to 22%. According to the Swedish government the reason for this stems from efforts to improve the environment for job creation and investment in Sweden. Accordingly, they expect a significant reduction in taxes on corporate investment potential and strengthened Swedish growth. Along with the Swedish, Romanians obviously strive to provide the most attractive and long-term investment environment.

On the contrary, the Slovak government decided to pursue its own way forward on economic growth, rather different from what could be perceived as a "business and investors friendly policy". Along with higher costs for employees, companies are also facing increased tax expenditure from January 2013, rising to 23% for all legal entities. It seems that a growing package of measures to support Slovakia's fiscal condition, in fact reduces prospects for healthy public finances and public consumption, and worsens the overall business environment in Slovakia.

The general prognosis for 2014 is a decline in real wages, a further weakening of household consumption, lower prospects for domestic demand and reduced government investment. Some foreign investors in Slovakia, also joined by Slovak companies, have moved their operations to surrounding countries which have more favorable and competitive tax regimes. When the dust settles, this policy may lead to results other than those expected by the Ministry of Finance. Thus, at the end of the day, returns on income tax may be lower than expected.

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The day after tomorrow

Employment keeps on going down to dramatic numbers, non-motivated and underpaid teachers (not believing in our teachers, I cannot explain that to my children), an insufficient state budget to slash government deficit below 3% of GDP, economists downgrading Slovak growth estimates, and, above all, leaders who seem to be non-directive in what to do with Slovakia. I seem to enter Slovakia in challenging times. Understatement.

A core economic policy, strategy and vision is absolutely fundamental for this great country. So far, I have not been able to discover too many core projects (OK, the tax evasion plan is a good one) that should guide Slovakia through the "New Normal", be ready for the future, create new jobs and become that ultimate platform for successful entrepreneurship.

I would slightly reshape the words of Iron Lady Thatcher…"without entrepreneurship, you quickly run out of money". She was of course more referring to socialism. I have to think about this phrase when one just cannot avoid the news that millions will be missing in the budget as a result of weaker tax collection. Off course, the key reason given is the ongoing economic meltdown and discrepancy between economic development and collected tax. Or is the successful Slovak corporate the main scapegoat? Let's ask the corporate, the start-ups, and the entrepreneurs to pay more taxes. Right? Well, there may be a few good reasons why some would be willing to do so.

It is quite clear that in the next few years (5, 10 or 20?), this country which I call home now will (not 'might') be confronted by massive structural challenges. For example, can anyone imagine a prosperous Slovakia without the leading car brands? This is surely a future scenario we all have to think about, and get ready for. I absolutely support the NBS governor's words claiming that we should all prepare for that moment that the automotive industry will not be the driving force. For sure, that day will come. The good thing about it is we know it WILL come. Let's not run away from it, but seize the opportunity and focus on a more societal change towards promoting true Slovak entrepreneurship.

"Success is a lousy teacher, it seduces (smart) people into thinking they cannot lose". I always liked this pearl of wisdom by Bill Gates. Of course, the Slovak automotive industry is currently benefiting from fine structural production parameters, even in these times of crisis. Reality check as the dark days are by far not over yet; a top manager at a French Tier-1 supplier firm recently confessed that what he is seeing now, and expects to come, is nothing compared to 2009. Hence it is absolutely paramount to think in different terms as we should not take it for granted that the automotive industry will stay in Slovakia, despite many new production projects launched for 2013.

Leading a life here in Bratislava amongst the international community, I feel somewhat privileged when it comes to receiving real business insights from my colleague expats on what is really moving and shaking within their companies. And what keeps them awake at night. No, I do not want to read their company's P&Ls, nor am I interested in their quarterly press releases. I want to hear their real stories, and smell their threats and opportunities. I want to understand their drivers to adjust to the new world we are in, the new normal we all have to face, and adapt whether we like it or not.

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