

ABSTRACTS OF THE ARTICLES

The elasticity of taxable income: estimates and flat-tax predictions using the Hungarian tax changes in 2005

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Flat-tax schemes are being adopted by many Central and Eastern European countries as a way of boosting their economies and tax revenues. Though there are signs that some countries do manage to improve in both respects, it is hard in general to distinguish the behavioural response to tax changes from the effect of increased tax enforcement. This study addresses this gap by estimating the elasticity of taxable income in Hungary, one of the outliers in terms of not having a flat-tax scheme. The authors analyse taxpayer behaviour using a medium-scale tax reform episode in 2005, which changed marginal and average tax rates but kept enforcement constant. We employ a Tax and Financial Control Office (APEH) panel dataset for 2004–5, with roughly 215,000 taxpayers. The results suggest a relatively small but highly significant tax-price elasticity of about 0.06 for the population earning above the minimum wage (about 70 per cent of all taxpayers). This value increases to about 0.3 for the upper 20 per cent of the income distribution, with some income groups exhibiting even higher elasticities (0.45). Using these results, the authors have quantified the impact of a hypothetical flat income-tax scheme. The calculations indicate that although there is room for parallel improvement of budget revenues and after-tax income, the gains are modest (2.0 and 1.4 per cent, respectively). Moreover, such a reform entails important adverse changes in income inequality, with the burden falling mostly on lower-middle income taxpayers.

Sharing of information among banks. When is full-list a good thing?

Iván Major

The author sets out to prove that so-called full-list sharing of client information is the optimum course for banks acting rationally on an infinite time-scale, i. e. the one to yield the highest profit, in cases where the proportion of bad risks in the banking population is high, the good risks are decreasingly likely to repay their loans, and banks operate at significantly different marginal costs. Further preconditions for the advantages of full-list are that each bank share its full client information and the information be reliable. However, where the proportion of bad risks is low or there is little difference in the banks' marginal costs, the dominant strategy will be for banks to refrain from sharing their client information. But both full information sharing and absence of information sharing are less favourable for good risks who service their loans on time than the so-called negative list, because in the former cases they pay a higher rate of interest than they would with negative sharing of information.

Dividend policy theories*Gergely Fazakas and Judit Kosárka*

The main question in dividend-policy literature is whether there exists an optimal dividend policy for shareholders, i. e. whether it is possible to create extra value for the holders through decisions affecting dividend policy. The basis of this article about dividend policy is a 1961 paper by Modigliani and Miller that focuses on the irrelevancy of the dividend policy: in a perfect market, dividend policy is of no interest and does not generate extra value. Since that article was published, it has become a point of reference for the profession: the analysis focuses on how conditions differing from a perfect market affect the dividend policy of a firm, and how the dividend policies applied that take into account these imperfections are priced by the market. The literature presents a vast majority of the factors influencing dividend policy: willingness of investors to take risks and diversify portfolios, tax rates for different investor groups, the investment period, future reinvestment and profitability expectations, the policies of competitors in the same sector and differences between sectors, the cost of alternative financing opportunities, different transaction costs, information situations and information games, and the behavioural finance to describe decisions made in uncertainty. In practice, all seem to affect the dividend policy decided on by firms, the market reception of the decisions, and alterations in those.

**Can the business associations of the SME sector be restored?
Stagnation and/or differentiation?***Andrea Gál Németh, Alfréd Sinkovics and Judit Szennyessy*

The authors consider the productivity and ROA, ROI, ROIC and other financial ratios of Hungarian joint SMEs between 1995 and 2003, and the results of an inquiry into 812 SMEs to assess how the development capacity of Hungarian SMEs may increase in the next few years. Comparing the most important profitability ratios of SMEs and large companies, the former have improved in the last decade, but the growth rate has been much lower than average in the SME sector, where the rate of return has remained below the yield on short and long-term bank deposits as well. This small return of capital has seriously damaged the economic positions and slowed the growth of SMEs, whereas large companies have been able to enjoy both higher returns and huge tax exemptions as well. The poorness of the return on capital in the SME sector was proved by an inquiry made by the authors in 2006 and 2007 into 812 Hungarian joint companies. Nonetheless, over 80 per cent of the SMEs were profitable. The data drawn from the research show that the SME sector has had less scope for development than large companies, so that the contribution of SMEs to accelerating Hungarian economic growth remains limited.