THE FISCAL COMPETITION IN THE EUROPEAN UNION

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Keywords: fiscality, fiscal competition, taxation system.

Abstract: In planning of this paper I have started from the question whether those 27 states belonging to the European Union are able to promote, due to their fiscal systems, the fiscal co-ordination within the European Union or to accept the fiscal systems, consequently. The question has been raised because the systems in discussion have become lately more and more distorted. The inner logic as well as the fiscal competition should be blamed for it? Thus, the paper proposes a critical examination coming from the intervention among those 27 fiscal systems belonging to the countries of the European Union, as well as the presenting the fiscal competition generated by the considerable differences among them. The fiscal systems belonging to the newest member states of the union (Romanians and Bulgarians included) are, to a higher degree, different from the previous EU 15. This might be viewed as a sheer advantage because the general revenues arisen from taxes as well those accumulated profits taxes (effective and rated) are considerably diminished than those in the former 15 states, members of the EU. Therefore this type of advantage could create the proper premises for starting an efficient economical activity. The paper will ultimately display those differences among fiscal systems are able to set up a real implement in the process of convergence of the new membership, even though this type of approaching can not replace the fundamental reforms from business environment, the only capable of inducing the allocation of economical business in the European countries.

1. Introduction

Taxation, by using three main sources, can make up both developments and wellbeing:

-firstly, the taxation system has to attract income effect in order that public services should be properly financed, as well as social transfer at high standards;

-secondly, taxation persuades ultimately economical judgement and it would have to offer a stimulus for the key personnel to be deeply engaged. Moreover, the natural resources, efficiently used are consequently required;

-thirdly, the taxation system undeniably redistributes gainfulness and this has to be done in such a way that to strengthen the effective request as well as social balance that is the covering of huge misuses from the income distribution.

Regarding European fiscal policy, this one has to contribute towards the accomplishment of the general goal established by the European Union, namely, "by the end of 2010 the European Union economy should become the most competitive and dynamic from the world, capable of a long-lasting economical development, displaying the best places of employment as well as a greater social cohesion" (target established by the European Council, Lisbon, March 2000). This goal demands a drastically diminishing of a fiscality general level from the EU, and, consequently, requires that the taxable basis be extended so that a balance should be achieved among this diminishing financial consolidation supporting through public debts decreasing and proper investments in essential public services. [Sahra Wagenknecht, "Fiscal policy contribution to Lisbon Strategy", European Parliament].

Starting from this strategic target proposed by the official meeting in Lisbon, it has been concluded that home market should act a sole market. However, a great contradiction is to be noticed: the measures referring to taxation, the ones that develop inequality and halt the demand, are hardly supposed to achieve such an economical area with a dynamic economical growth, mentioned by the Lisbon Strategy.

Undeniably the question, whether the 27 states, members of the EU are able to contribute through their fiscal systems to the fiscal co-ordination within the EU is to be raised; in other words they have to accept the fiscal systems mandatory, systems that proved to be lately more and more distasted because of the inner logic of such fiscal competition.

The question raised is as judicious because the multinational cooperations are able to complete set of strategies of fiscal optimization provided that the capital is a mobile one.

The transfer facilitated for the profits relocation to the areas with a slight level of taxation as well as financial departments creation in so-called tax heavens/tax shelters are being used in order that investments should be financed by credit lines from the group. However such avoidance strategies not to pay taxes bring forth pressure on the governments; the countries with a raised fiscal pressure will record a decline in tax collection, and, thus Small and Middle Establishments will be disadvantaged not being able to use similar strategies. Notwithstanding, they will participate in competition using the same market. But then, in the very case when the multinational corporations reject to use profits, moreover, they use productive investments - in order to utilize the fiscal differences from various countries- the pressure shiningly raises, the taxation level should be lessened.

This kind of process, now known as: "fiscal competition" denomination, never comes into sight in the taxation field at the corporations level. Due to the fact that the financial prosperity is more changeable than profitably invested assets, the same logic refers to personal income taxes, capital gain taxes or capital gains.

As an expected consequence, the fiscal competition leads to an essential alteration in the taxation framework; as a result, governments have to diminish fiscal pressure level for those factors having a raising mobility and, simultaneously, to the decrease the fiscal burden on less mobile sources, in order that the incomes be protected.

If a fiscal competition arises, taxes will be removed from the corporate incomes to those private ones, from all unearned income to those coming from earned incomes, from the raised income to the diminished one, endangered by manpower. In other words, taxes will be removed from assessment on income and well-being to expenditure tax. The main results of the taxation level evolution in the European Union, according to the last decades, confirm that such activity has already happened.

2. General examination on taxes in the European Union countries

The last century was characterized in the Western countries, by the public sector extensions, through economic and fiscal adjustments. In the fiscal area, the countries belonging to the EU have maintained the expenditure level as well as the public revenue at approximately 40% from Gross Domestic Product (GDP). These have partly supported financially supplying of standard public goods as the national defense, the public order, etc. The most important part of such public expenses rising has to be mentioned as work due to the state. This one refers to the public retirement benefits and public health which produce the most important transfers between generations and intergeneration: financial resources transfer from the active labor towards the unemployed, to the unskilled employees, to the college students, to the families with offspring, to the farmers, to the employed in certain industrial fields, characterized by the hard working conditions, or even to the settlers (or entrepreneurs) found in unfavorable areas. The same social security also refers to other social and professional classes.

According to the fiscal policy the public expenditures have been financed through the consumption taxation (indirect taxes) as well as through the income taxes (on individual's salary as on the firm profits on the company income tax).

With no doubt the European fiscal system differently affects both natural and fictitious persons because of the structural differences among them, with regard to incomes, specific consumptions or ownership. Moreover, all this occurs due to different rates of regulation or different methods of administration as well as of various possibilities to avoid the taxation system.

Today, 27 taxation systems coexist in the EU, afferent to the 15 member states, plus those taxation systems belonging to the 10 new states which joined on May 1st 2004, besides Romania and Bulgaria entered the EU at the beginning of 2007.

There are noticeable differences among all these states according to their fiscal policies regulations because the national fiscal policies signify a consistent of the member states sovereignty [Dracea R., 2006].

The tax system inherent heterogenity being taken into account, the significant differences between the former member states do not make anybody feel surprised at such diversity in tax systems.

The tax revenue structure will be analyzed in order to emphasize these differences through a comparison between the old member states with the new ones.

3. The tax revenue structure

The tax revenue structure differs between the new and the old member states because the later ones receive smaller sums from direct taxation (personal income tax and company income tax) and a larger one received from the indirect taxation (Value Added Tax - VAT) and public contribution (fig. 1).

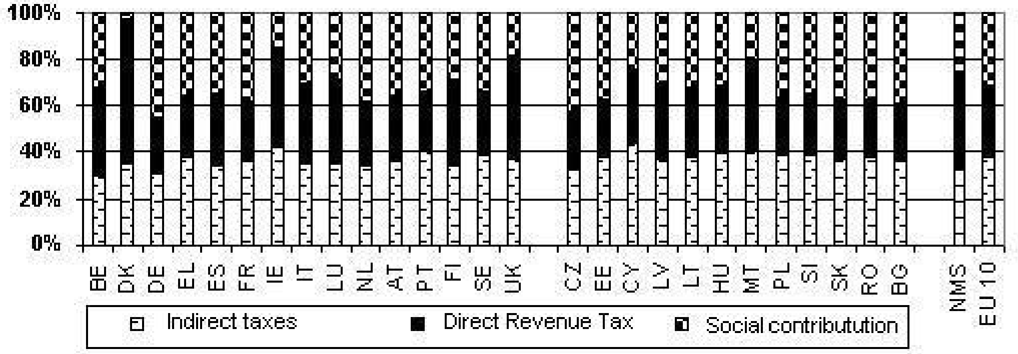


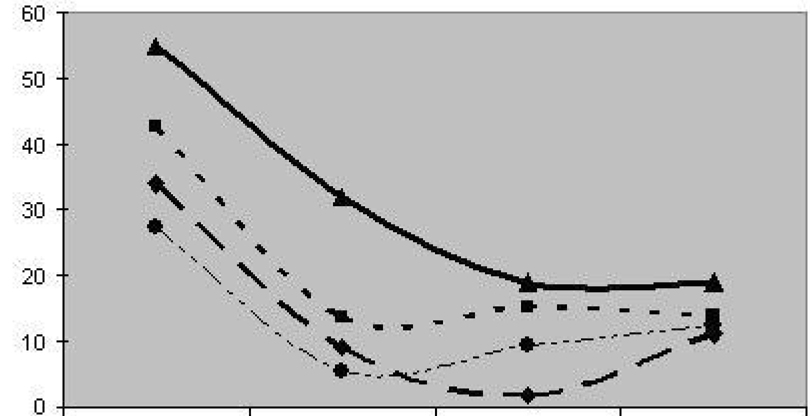
Fig. 1: The income taxes, 2006 (% from the fiscal income)

Source: The European Committee (2007)

As it can be easily noticed, the direct tax revenues represent on the average, for 2006, more than a third from the gross profit belonging to EU-15, and almost 20% in the new member states, in the same period of time.

The today fiscal policy of the EU member states both for indirect taxes and social contributions (viewed as weighable in GDP). But then, the weight incoming equals the minimum recorded by the union. Taking into consideration the unique rate, relatively reduced of income tax as well as of profit tax, Romania exhibits itself as a fiscal paradise in comparison with the other member states in EU; this may become a matter in dispute, European fiscal policy targets, especially the aiming at the fiscal competition.

This type of deviation becomes visible for 2004, being marked in 2005 and 2006, as a result of the unique rate application for incomes profits taxation.



	Fiscal Income/GNP	Direct Taxes/GNP	Social Contribution GNP	Indirect taxes/GNP
Romania	27,3	5,5	9,3	12,4
Minimum EU	34	9	1,7	11
Average EU	42,6	13,7	15,1	13,8
Maximum EU	55	32	19	19

Fig. 2: The Fiscal Income weight in GNP

Source: The European Committee (2007) and Romanian National Bank Reports (2007)

In the same time, in the new member states, the receipts coming from corporations' income taxes are obviously bellow those coming from the old member states, both as share in GDP and as share in tax revenues (fig. 3).

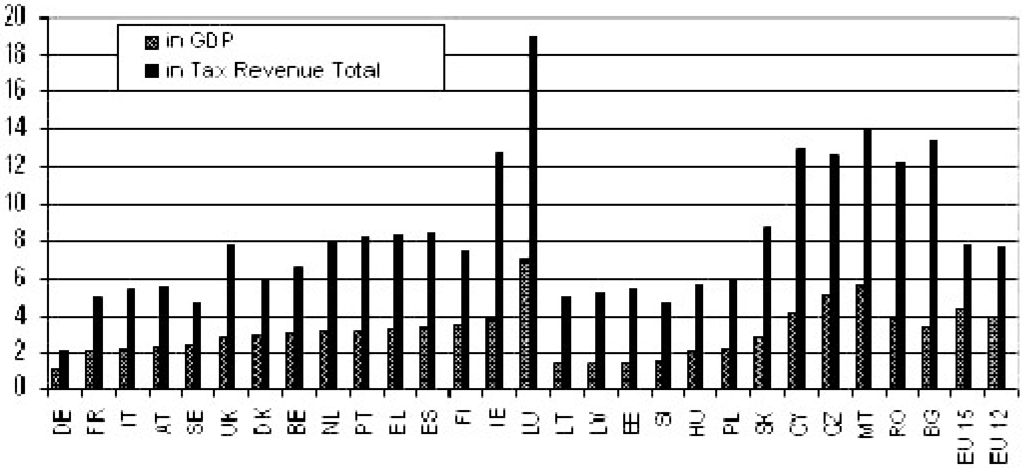


Fig. 3: The profit tax weight, 2006 (% from GDP, % from tax revenue total)

Source: European Committee (2007)

As regarding the taxation rates on profit, these have to be accepted as smaller in member states. Thus, while the revenue tax ratio in 2006 was about of 30%, this was, for the new member states approximately of 20%. As one can easily observe, the income tax rate in the old member states enormously fluctuates from 12,5% in Ireland to, roughly, 40% in Germany.

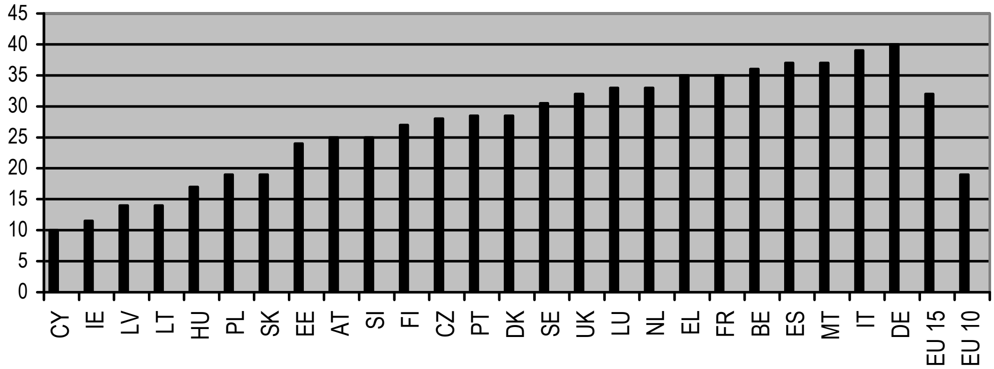


Fig. 4: The Nominal Rate from the Profit Taxes, 2006
Source: The European Committee (2007)

Eventually, while the old member states from EU-15 have decreased charge rates at the same time with the basis of assessment enlargement (still the 80's), the new member states dramatically diminished the rates, particularly in the second half of 1990.

We have to state precisely nominal tax rates offer too little information about the effective duty which affects companies (for example Germany collects low incomes from the companies taxation, despite the raising rates of the revenue tax), if taxation base is not taken into account.

Table 1

THE YEAR	EU 27	EU 15	THE NEW MEMBER STATES
1995	35.0	38.0	30.6
1996	35.0	38.1	30.4
1997	34.7	37.8	30.2
1998	33.9	36.7	29.6
1999	33.3	35.9	29.4
2000	32.1	35.3	27.4
2001	31.1	33.8	27.1
2002	29.7	32.6	25
2003	28.7	31.9	23.8
2004	27.4	31.4	21.5
2005	26.2	30.0	20.6
2006	25.8	29.5	20.3

Source: EUROSTAT

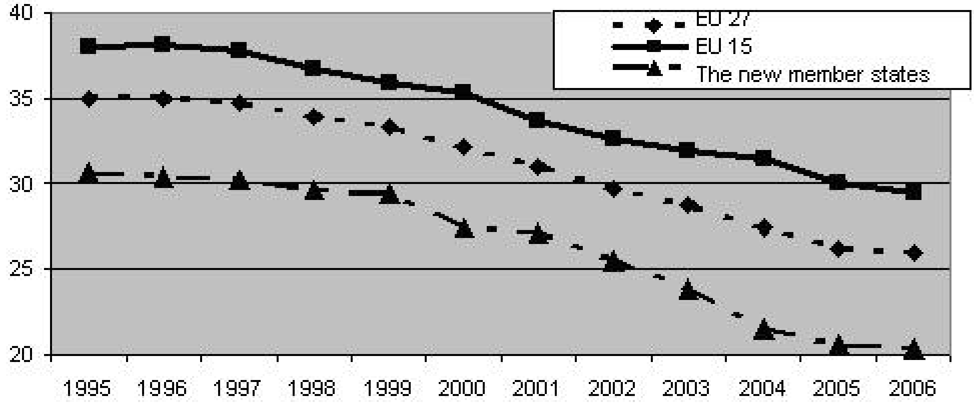


Fig. 5: The profit tax rate evolution (1995-2006)
Source: information processing on data basis offered by EUROSTAT

This way there is a huge difference between the accounting profit and the assessable one, the national legislations offering a range of remissions and allowances as:

- the income exclusion from the taxable basis
- the companies' resources to manage deductions from gross income
- a tax short rate application (tax allowance) to a certain sort of taxpayers
- payable tax discounts, also called tax credits
- the payment deadline extension (postponement) etc.

Unavoidably, every country has its own remission and deduction history; therefore, bases of taxation from one country to another are difficult to be compared. However the general tax pressure could be appraised, using tax effective rates.

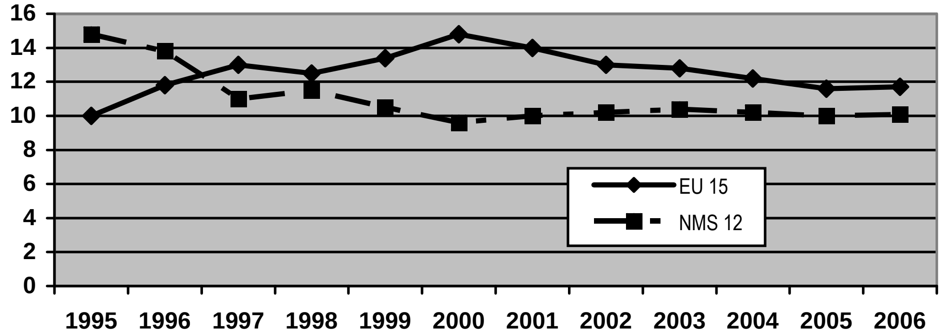


Fig. 6: The medium effective tax rate evolution on profit
Source: Information processing on data basis offered by EUROSTAT

Notwithstanding, such difference has stopped to be noticeable, although the new member states have made up the gap in taxation in comparison with EU15, in the second half of 1990. The true reason might have been the fact that new member states were obligated to remove tax shelters particularly in the adhering time and so make them attractive the foreign investors especially because those investors were not true to the EU principles with regards to state grants. In order to make up for this difference the new member states resorted to reduction of taxes applicable to companies.

4. Conclusions

The competition extension among the member states made them exceed themselves in order to attract a large number of economic operations. As it has already been shown "taxation" is one of the implements used. From this point of view, there is a sharp competition among these states, an issue which, inevitably, may cause disturbances in the assurance of the best level. Moreover, according to W. Koko, this type of conduct may lead to "such an extreme race" for taxes or income [W.Koko, 2003].

In the latest years, especially in the states from Eastern Europe, an increasing amplification has been registered regarding preferential fiscal systems promoting various investments, some of them even displaying high efficiency in attracting foreign investments.

This happens according to a well known opinion suggesting that preferential fiscal systems, the reduced taxation being included, may represent premises of an attractive location for foreign investments. [G. Nicodeme, 2003].

However, as it has been noticed form shown information, despite a falling-off registered in the corporate income tax, as well as such differences between fiscal systems, the tax is paid by EU companies represent a percentage of GDP relatively unchanged in the late decade both for old and new member states.

We agreed that the main reasons generating certain stability in collecting revenues are, on one side, raising the income tax but then, the existence of high profits in some member states.

These reasons doubled by significant differences between effective tax rates can confirm the hypothesis that the taxes on companies have not been decisive in affecting the investment decisions.

Normally, the taxation should arise as decisive variable later enough in that process of decision when the location of the investment has to be taken. The company is that which is capable of taken decisions about the location area in accordance with some factors aiming at the importance of the market, the foreign environment and general economic investment. Then, as a rule, companies estimate the microeconomic conditions. All these requests having been fulfilled, the next stage is the location country, in accordance with the tax system from that country.

All these grounds make us think that the fiscal system is only an essential factor in taking decisions about company investments. But then, it might be considered as less important factor than others.

As a consequence the Eastern countries look less attractive as potential locations for foreign investors, in comparison with other locations in EU; all these happens because their markets look limited as proportions, as well as the very point of the purchasing power.

It is true that the economic growth does not have to be viewed only on the basis of a limited taxation, a low fiscal pressure might remove some of these disadvantages.

Summing up, however much the differences in fiscal systems may be, they are able to make up a basic implement in that convergent process for the new member states; but then, all these can substitute fundamental reforms from the business environment, those reforms capable of moving business in Europe.

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