

SMALL AND MEDIUM BUSINESSES FACING FISCAL COMPETITION

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Abstract: Globalisation is not a new phenomenon but it had opened up the national economies and created the global market, where capital and labour can move freely. Combine with the fiscal competition phenomenon it influences the evolution of the national and international businesses environment.

The authors are trying to underline, in this paper, the connections between globalisation, fiscal competition and the small and medium businesses sector because these businesses are the most affected businesses by the fiscal policies decisions, that are subject to the globalisation phenomenon and the fight against the negative effects of the fiscal competition phenomenon.

Key words: globalisation, fiscal competition, small and medium businesses sector, economic growth, tax heaven

Globalisation, the creation of the goods and services common market in the European Union, the complete liberalisation of international financial transactions, capital and labour, the monetary unification, all these, have led to the rethinking the national fiscal policies especially in the direct taxation area. Every national jurisdiction has to answer to questions like: "What tax rate should be used to impose the revenues?", "How to uphold the small and medium businesses sector?", "What facilities should be granted to this sector?", "How to attract new investors or how to make the national territory more attractive?".

Globalisation will lead to the creation of a economy after the operating and organisational model of the existing states (Depoutot, 2003) and this will have as effect a higher capital mobility than labour mobility.

Fiscal competition is differently seen by the economic agent (the small and medium business) and by the state. While the state (the public actor) is seeing the fiscal competition like an obstacle to achieve its sovereignty forcing it to drop certain fiscal revenues so some tax payers categories will not emigrate and invest in some other places, the small and medium businesses are seeing the fiscal competition like an opportunity. This opportunity regards the favorable fiscal regulations that will permit an increasing activity and capital mobility and so the result after tax will have the higher possible value.

From the economic theory point of view the fiscal competition can be seen both as a negative and positive externality. The state how is losing capital through its run away will assimilate the fiscal competition to an negative externality, but the receiving state, the state where the capital has relocated, will assimilate the fiscal competition to a positive externality.

At the European Union level the fiscal competition is underlining the conflicts that are emerging from the base model of the European Union its self (Pisany & Ferry, 2005): the competition space between the system the state, for some, and the cooperation and reconstruction space for a collective sovereignty, for others. And nevertheless, the different policies regarding the social standards, the public investments and the macroeconomic policies are influencing the fiscal competition not only at the European Union level but also at international level. In Europe the fiscal competition is shown clearly by the low profit rates applied to companies and we can add the facilities promoted by Holland, Denmark, Belgium and Sweden and many other European countries where the holding revenues are tax free. You can also obtain fiscal advantages in the form of decreasing taxes by applying the stipulations of some Conventions regarding the double taxation avoidance or through the European Union Directives in reference to dividends and interests.

Fiscal competition can be defined as the non cooperating competition between different fiscal administrations that are wishing for the increase of their national territories through an advantageous fiscality (Le Cacheux, 2000).

Starting from the free circulation of the capital, labour, services, goods and under the globalisation effect the states are still maintaining differnt fiscal systems when it comes to direct taxation.

The indirect taxes, like the value added tax, are harmonised in the European Union through a series of directives and regulations this way thier negative impact upon the european market is reduced at minimum. But when it comes to direct taxation and especially to the profit tax there are no common regulations and only proposals. The European Commission has proposed the establishment of an common unique consolidate bases, but until now no political agreement has been signed. In the European Union the national fiscal systems are divers (27 systems) some beeing characterized by tax free (Greece, Portugal, Denmark) when it comes to tax the mobile bases or by lower taxes applied to the mobile bases in comparison whit the taxes applied to the less mobile bases. The most talk about subjects are the profit tax and the tax on the revenu obtain by placing capital, case these two are very mobile and can easily influence the fiscal pressure.

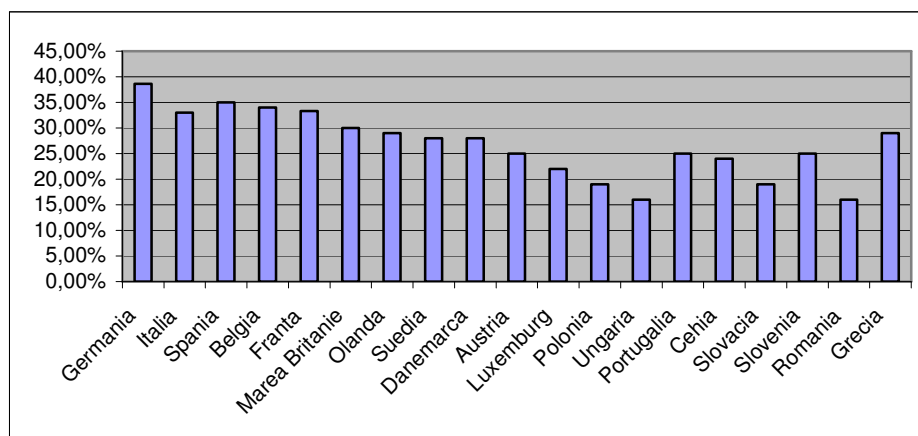
Starting from these aspects the European Commission is underlining the counter productive character of the fiscal competition and of the risks that can manifest at the level of the national public finances (OECD,1999). After 1999 again the European Commission took the first steps to align the national systems into a better coordination, excluding the discrimination and the double taxation of the profit and of the dividends this way reducing the fiscal evasion (COM, 2006, 823). These regulations are underlining the fact that in the absence of an coordination between the fiscal systems regarding the direct taxation we can get involuntary taxation or abuses, that will reduce the fiscal revenues of the state.

At the European Union level because of the adhesion of new state members with a lower fiscality, the ancients states have been forced to rethink their fiscal policy regarding the direct taxation because is clear that the activities are locating in these new areas. This way the Lisbon strategy is evidentiating a series of fiscal regulation that will help the small and medium business activity like: tax free, subventions for reserach and development or fiscal credits. Each country will have the capacity to use different mechanisms to support the small and medium businesses activities, for example, France is the first country to introduce a special fiscal system to sustain the innovating businesses. The stimulents are regarding:

- tax free for the first three years when the businesses are obtaining profits;
- decreasing the profit tax up to 50% in the next two years;
- tax free for a 8 year period for the social contributions afferent to the highly qualified labour.

We have to mention that the profit tax has been reduced in the majority of the european countries furthermore there are a large number of countries that are using the flat taxation: Republic of Estonia, Russian, the Republic of Serbia, Ukraine, Poland, Romania, the Czech Republic – see figure 1.

Figure 1. The nominal adjusted quota of the profit tax in the European Union in 2005



(Source: Eurostat)

Because of the fiscal competition some countries wishing to draw the mobile fiscal bases have modified the tax rate for the profit tax or are using different tax quotas for the small and medium businesses activities, because these are the main tax payers contributing with 70%-90% from the gross domestic product and are possessing the main part of the active labour. Furthermore some countries are practicing a different fiscality when it comes to this sector – see table 3.

Table 3. Tax quotas fro the small and medium bunisesses in 2006

Country	Quotas
Spain	30% if the profit is \leq 90.152 euro 35% for the rest
Estonia	0% for the reinvested profit 28,27% for the net distributed amount
France	15% if the profit is \leq 38.120 euro
Portugal	20% for a three years period or less if the annual turnover is \leq 149.639 euro
Romania	3% from the anuual turnover

(Source: *Direction de la legislation fiscale – The National Statistical Institute-Romania*)

We consider that Austria had fiscal competition in view when decided to change the tax quota for the small and medium businesses from 34% in 2003 to 25% in 2006, furtehrmore the state beeing neighbor with Poland and the Czech Republic where the quotas were lower. This measure has been partialy compensated by the inlargement of the tax base.

Starting from the fiscal competition concept the studies that have been realized at the European Union level (OEFE, 2007) have shown that the Europea Union countries can be pun, according to the medium global fiscal pressure determined at the Europea Union level (this value beenin 2005 13,1%) into three categories:

1. countries where the fiscal pressure upon enterprises is low –United Kingdom 9,7%, Holland 9,7%, Denmark 4,6%;
2. contries where the fiscal pressure is around the medium – Germany 13,3%, Belgium 13,3%, Spain 14,1%, Austria 12,2%;

countries where the fiscal pressure is high – Sweden 17,8%, France 17,8%, Italy 15,2%.

We have to take into consideration the fact that the country where the foreign investment will be done has to provide a high quantity and quality of public goods and services. But usually the quality of the public goods and services is higher where the fiscal pressure is higher, in contries like France, Germany or Denmark. This way the small and medium businesses will locate their activity according to the after tax outturn that, meaning, according to the redistribution public finance function, that the tax is seen as a payment for an received service, in this case a public one, and this is way the delocalisation of the capital will take place according to the optimal relationship between the taxes payed and the received public goods or services.

Small and medium businesses are very important in Romania because:

- they are contributing with almost 70% to the formation of the gross domestic product;
- assuring almost 2.600.000 working places that beeing 60% of the total active population in economy;
- contributing with 60% to the formation of the state revenues;
- contributing directly to the romanian exports – almost 50% of those are done by the small and medium businesses sector.

In order to make more attractive the romanian territory from a fiscal point of view and in order to reduce the brain-drain phenomenon the fiscal system makes the following amendments:

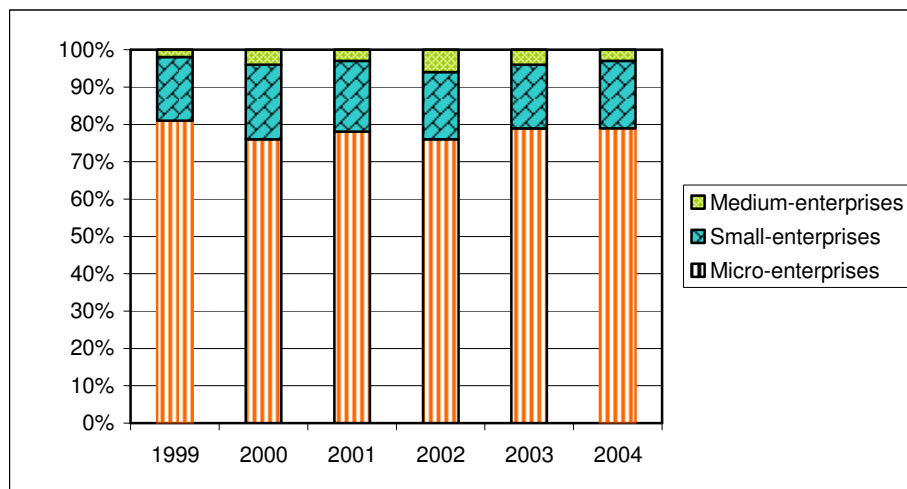
- the possibility to choose an absorption system fitted with the development strategy of the enterprise;
- deductibility of the credits interest;
- fiscal regime to integrate the revenues;
- the possibility to choose between being a profit tax payer (16% applied to profit) or being a revenue tax payer (2,5% applied to the annual turnover). We mention that this quota has been increase from 1,5% in 2004 to it's actual level 2,5% and in 2009 it will be 3%.

In Romania the legal aspects regarding the taxation of the labour are paying an important role in the emigration phenomenon of the highly educatated “brains”, even if here since 2005 the taxation of the revenues is done according to a flat tax by 16% and the quotas of the contribution have been reduced, but at the same time the bases have been increased! When Romania adhered to the European Union in 2007 contrary to all that was aspected – that between 40% to 60% of the existing small and medium businesses will fail, because of the lack of experience and working capital, lower competitiveness – in 2007 the number of wiping off decreased with 74,14% in comparison with 2006, at the same time the number of small and medium businesses that registered a higher profit in 2007 in comparison with 2006 has been in increasing with 4-5% and the numer of small and medium businesses that registered losses in the same period of time has been decreasing with 3-4%.

Fiscal competition (through the use of the same flat tax to impose both the revenues and the profits) had had a positive effect in Romania increasing the number of new created small and medium businesses with international and mixt capital, in 2007 in comparison with 2006 by 9,15%. Another positive aspect is that the cost of labour in Romania in comparison with other european countries is lower. An example in this sense is the new location of the Nokia Factory in Romania from Germany.

From the economic growth point of view the year 2006 has been a better year for the small and medium businesses in the European Union then 2005 registrating an increase of the annual turnover by 10% and in some countires even a higher level – Romania and Estonia 24% and at the opposite position Cyprus and Portugal with an increase by only 4%. In Romania the small and medium businesses structure has registered an evolution similar to the one presented in the following figure.

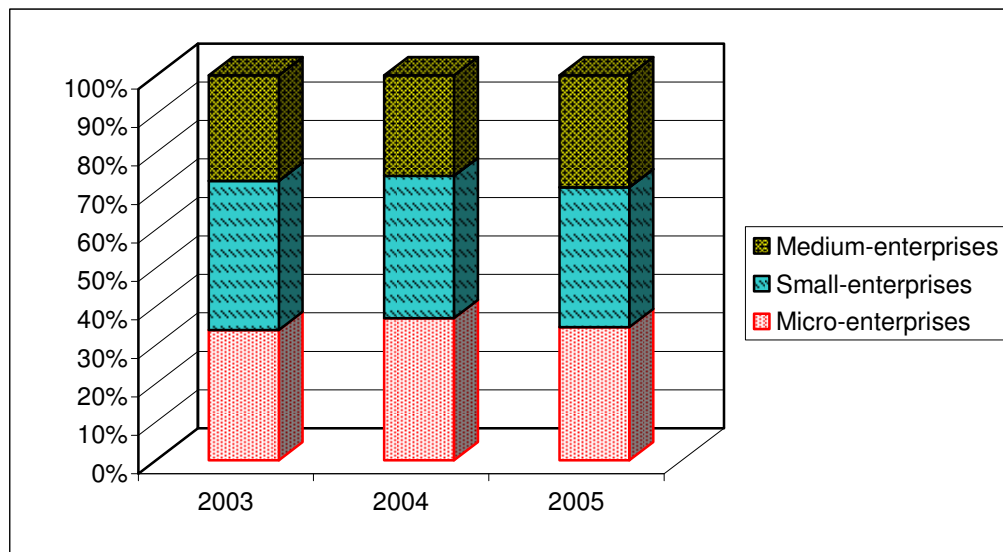
Figure 3. The evolution of the structure of the small and medium businesses



(Source: The National Statistical Commission, Romania)

We can see that the net profit had evolve in the three years analyzed and the most important change was in 2005, when the small and medium enterprises had been put to advantage by the decrease of the profit tax rate but drawback by the increase of the turnover tax rate. The turnover of the small and medium businesses is concentrated at the small businesses level although the micro enterprises are achieving one third of the small and medium businesses turnover their profit range is larger reaching almost 50% of the total.

Figure 5. The turnover structure according to the small and medium businesses types



(Source: The Public Finance Ministry)

For Romania the small and medium businesses are representing the engine of the economic growth and a vector for disseminating the research and development results. The increase of the small and medium businesses sector had a positive influence upon the businesses environment reducing the unemployment rate and increasing the productivity. It is necessary for the romanian state to rethink the fiscal system in order to better sustain the growth of the small and medium businesses sector taking into consideration that eventhough it's major role in the development of the country is known and admitted the support is not likewise. We think of this considering that eventhough the number of the small and medium businesses in Romania has grown, the number of small and medium businesses to 1000 inhabitants is under the number from the European Union (in Romania the number of small and medium businesses to 1000 inhabitants is 25 and in the European Union is 64). We should take into account the fiscal changes of our neighbour countries because in comparison Romania is not so attractive to foreign investments.

CONCLUSIONS

Fiscal competition in the context of globalisation is seen as the efforts done by the state to reduce the tax quotas (most times this is done in correlation with the inlargement of the tax base) because it is trying to attract as many activities as possible.

In the last years the majority of the European Union countries, especially in the context of the inlargement of the union – the last 12 countries adhered, have changed or have in view of changing their tax quotas: Austria has diminish the tax rate from 34% in 2004 to 25% in 2005, Irland has moved from a maximum tax rate by 40% in 1994 to one by 12,5%in 2003, Romania has decrease the tax quota from 25% in 2004 to 16% in 2005,Germany has as scope the decrease of the total fiscal expenditures levied on the firms (29,83% in 2010 in comparison with 38,6% in present), the Czech Republic has diminish the profit tax from 24% to 21% in 2008 and in 2009 it will be 19%, as for the dividend tax Poland is using a tax of 19%, Romania 16%, Bulgaria 5% and there are countries where this revenue is tax free like Croatia, Hungary, Slovakia.

This phenomenon has not only positive effects (increase of the gross domestic product, of the added value, decrease of the unemployment rate and the development of the small and medium businesses sector, the increase of the national and international competitiveness) it has also negative effects like: imposing the revenues of the plusvalue obtain after selling goods, public deficits and others.

This phenomenon is directly connected with the brain-drain phenomenon, the emigration of the high educated “brains” who are choosing to leave the origin country and to develop an activity in another one who is more suitable to their fiscal and public choices. The brain-drain phenomenon has both negative and positive effects – negative or positive externalities – in the origin country where the individual has been

educated and in the receiving country where the individual is developing his activity. Most times these externalities are monetary based.

We can assert that in the European Union the aim is not to harmonize the national fiscal systems because a loyal competition will contribute to the development of the countries, to the stimulation of the small and medium businesses sector who will take into account not only the characteristics of the fiscal system when it comes to locate their activity but also the geographical position, the labour cost and the infrastructure quality.

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