FISCAL POLICY AND WELFARE STATE IN THE ENLARGED EUROPEAN UNION

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Abstract: It is considered that fiscal competition is able to determine a reduction of tax rates, a greater efficiency in the use of public funds and a better allocation of equity. On the other hand, fiscal competition can affect the transfer effects of taxation on the economy impeding the normal functioning of international trade and capital markets. The bitter competition inside Europe, following the elimination of the borders, of the free goods, services, and individuals' flow, produces a huge pressure on the national protection systems in order to reduce social costs. Taxation can contribute to development and to welfare through three sources: the firstan foremost the tax system must collect enough funds in order to finance public services and social transfers at a high level of quality. Secondly, taxation influences the economic decisions and should offer incentive for more employment and for an efficient and lasting use of the natural resources.

Keywords: fiscal policy, welfare state, tax competition

1. The welfare state in European Union

In order to induce the people's welfare, the social state welfare state acts in the following directions: pensions' system and benefits for descendents, healthcare and transfers in cases of illness or disability, the system of family supports, the social assistance area and the unemployed support. The social politics' main instrument is the social insurance system. The public system's social insurance benefits are financed by employees, employers and state's contributions. The corporations and the insurance agents, with self-administration, perform programs based on occupational insurance schemes. Today the welfare state manifests itself differently; each country adapts and/or reforms the social politics starting from the two classical models: the residual one, the achievement model and the redistributive one. At this moment, the great majority of documents issued by the European Institutions make reference to the *„European Social Model"*. Presently, in Europe there are as many social models as number of member states. The literature dealing with the welfare state makes a distinction between four models: Nordic, Continental, Mediterranean, and Anglo-Saxon, the later is also named the liberal or the residual model. Anglo-Saxon states, UK and Ireland have economies focused on the free marked in assigning resources, promoting the decrease of the state position and the markets liberalization. These states resorted to cut-off in wages combined with a policy based on diminishing the social rights for those unemployed; diminishing the providence-state budget's costs were accompanied by a powerful tax relaxation, which offered advantages in the global tax competition. The Anglo-Saxon countries have a less extensive welfare state where social assistance is seen as a last resort and primarily oriented to people in working-age. The Continental European states, more conservatives - Austria, Belgium, France, Germany and Luxembourg – promoted the insurance based on labour and on bended rights. The politics which were promoted in those countries had to realize the concern's harmonisation of the busiest (beneficiary of a large system of social security) and of the not-busiest (more and more numerous and very dependent on the first category). Scandinavian states – Sweden, Denmark, Finland and Nederland - insist on the generality of social welfare and on solving politically, then economically, the society's evolution. The Mediterranean countries, including Greece, Italy, Portugal, and Spain, focus their welfare spending on old-age pensions and typically concentrate on employment protection and early retirement to exempt groups of the working age population from participating in the labour market. Strong labour unions in the formal sectors have compressed the wage structure. In Europe there is a social submodel in transition, where neither the neo-liberal solutions, nor the social state built in Occident are applicable. The Eastern Europe needs a social model which has to provide a new type of sustainable balance between the social security and the economic competition. The growth of the investments in infrastructure and in research-development are elements of public politics compulsory for the Eastern countries, and especially for Romania. These elements will bring to the society's general development, to the consumption growth, to business development and the most important, to more and better paid employment positions (jobs). The concept of this principle remained intact during all the crises which affected those states, proving in the same time the resistance towards external transformations. At the end of the last century, a new program entered the European Institutions' agenda. In 2000, the European Council met in Lisbon and adopted a series of needed measures in order to have *„the most competitive economy the world had ever known",* the central binominal being the two dimensions: *economic dimension and social dimension.* One year later, in Gothenburg, to those two dimensions it was added a third one, thus referring to the environment protection.

From the realities of great importance with which the Union economy deals and which put their print on the political decisions from Brussels, we mention: The European Union passes an economic recession period; the social inequalities are growing; the providence-state is less and less capable to reduce inequalities, due to the fact that it has difficulties to finance social projects (their financing supposes tax growth; but this action affects the competition of the European economy); a process of population ageing with an ascending trend; environment protection supposes high costs, more and more difficult to support.

The bitter competition inside Europe, following the elimination of the borders, of the free goods, services, and persons' traffic, produce a huge pressure on the national protection systems in order to reduce social costs. „The solution" which came from the European Institutions in order to remove the competition considered to be unfair proved to be that of *„national social regimes harmonisation",* first of all regarding the right to work. Certainly, after the new member states integration, the tax competition of the East led to pressures regarding the diminution of the taxation in the EU of the 15 countries. This competition can be also considered unfair. In this sense we can forecast two scripts. The first script is considered to be tax harmonization at direct taxation level (we mention that the majority of indirect taxation depends already on the union politic), so to avoid cross-border corporate mobility and, implicitly, problems of labour forces in the tax inactive states. A second scenario, which we considered better, would be to adopt at the level of the first member states a politic of tax relaxation. In this way a pulse of the aggregated offer will be given to the economic growth.

2. GDP and the social protection expenditure

Economic progress is ultimately measured by the gross domestic product (GDP) of a country. GDP is the central measure of national accounts, summarising the economic position of a country or region. GDP is equal to the market value of all final goods and services produced in a given period of time. GDP per capita in purchasing power standards (PPS) may be used to measure the material living standards of a country, one way of determining wealth. The PPS is essentially an artificial currency, whose exchange rates with the euro and other European currencies are calculated using purchasing power parities (PPP). One PPS buys the same volume of goods/services in all countries. Thus, use of the PPS eliminates price level differences between countries, allowing a fairer comparison of living standards. To the level EU-25 in the year 2005, GDP per capita is of 23500 euro. The new members states NMS-10 have the values much more (euro per capita): Latvia 11000, Poland 11700, Lithuania 12200. The states with the values most big (euro per capita) am: Ireland 32299, Denmark 29900, Netherlands 28900, The Austria 29700. Is remarked Luxemburg with eldest value, 58000 euro per capita. Romania and Bulgaria have most little values scilicet 8100 respectively 7500. If social protection expenditure is expressed in terms of. Outside EU-25, expenditure is highest in Norway (9154 per-capita PPS (purchasing power standards), the PPS), just below Luxembourg differences between countries are more pronounced. Within EU-25, Luxembourg had the highest expenditure in 2004 (12180 PPS per capita), followed by Sweden (8756 per capita) and Denmark (8470 per capita). The countries with the lowest expenditure is the Baltic States: Latvia (1220 per capita), Lithuania (1448 per capita), Estonia (1625 per capita). In Romania the social protection expenditure in 2004 is 1089 per capita. The disparities between countries are partly related to differing levels of wealth and also reflect differences in social protection systems, demographic trends, unemployment rates and other social, institutional and economic factors. In 2004 gross average social protection expenditure accounted for 27.3% of GDP in the EU-25 countries. In 2004 the EU countries with average or above-average ratios (27.3% or more) accounted for 42.2% of the EU population, the group with between 22% and 27.3% for 32.7% of all EU inhabitants, those spending between 17% and 22% of their GDP on social protection for 23.6% and countries spending less than 17% of their GDP for only 1.5% of the EU population. The countries with the highest ratios — Sweden (32.9%), France (31.2%), Denmark (30.7%), Germany (29.5%), Belgium (29.3%), Austria (29.1%) and the Netherlands (28.5%) — spend (in relation to GDP) more than twice as much as the three with the lowest ratios — the Baltic countries Latvia (12.6%), Lithuania (13.3%) and Estonia (13.4%). Taking the EU-15 countries as a whole (for which long series dating back to 1990 are available), after peaking at 28.7% of GDP in 1993, social protection expenditure fell to 26.9% by 2000. This ratio then rose continuously from 2001 to 2003 (27.7%) to end on 27.6% in 2004. Over the period 2000-2004, expenditure on social protection as a percentage of GDP in EU-25 was about 0.3% lower than in EU-15. Significant rises were recorded in Belgium (26.5% to 29.3%), Ireland (14.1% to 17%), Luxembourg (19.6% to 22.6%) and Portugal (21.7% to 24.9%). The situation was somewhat different in countries which continued to show strong GDP growth. In 2004 in particular, the share of social protection expenditure in GDP decreased in the Estonia (14% to 13.4%), Latvia (15.3% to 12.6%), Lithuania (15.8% to 13.3%) and Slovakia (19.3% to 17.2%). This increase reflects faster growth in social protection expenditure than in GDP, which slowed down in the European Union in 2003 in comparison with 2002 and speeded up in 2004 in comparison with 2003. Social protection expenditure goes to areas that either are not particularly affected by the economic situation (such as health expenditure and pensions) or are in fact countercyclical (unemployment or social exclusion). In 2004 out of the total EU-25 expenditure on social protection, social benefits accounted for 96.2%, administration costs 3.1% and other expenditure 0.7%. The structure of social protection expenditure in EU-25 in 2004 is following: old age (39.9%), sickness/health care (27.2%), family/children (7.5%), disability (7.8%), survivors (4.3%), unemployment (6.3%), housing (1.9%), administration costs (3.1%), social exclusion (1.4%) and other expenditure (0.7%).

3. Fiscal policy in European Union

Tax systems have, from the historic point of view, a national character, being drown in the specific conditions of the national economy. Thus, the volume, the structure, and the tax rates correspond with the allocated levels of stabilization and of redistribution. Tax systems can contribute to the increase of capitals mobility, to the development of financial markets, to the growth of competition, to a more efficient allocation of material and financial resources, with consequences on the economic development. Globalization amplified the elasticity and the mobility of tax bases but, raised a series of new problems regarding tax administration in the new conditions. Some countries reacted at the negative effects determined by globalization; they reformed the tax system, through the implementation of new profitable treatment measures for capital incomes, so that the capital wouldn't immigrate to other states. Taxation can contribute to development and to welfare through three sources: the first the tax system must draw enough funds in order to finance public services and social transfers at a high level of quality. Secondly, taxation influences the economic decisions and should offer incentive for more employment and for an efficient and lasting use of the natural resources. Thirdly, the taxation system reallocates the income, and this action must be done in a way it bonds the effective demand and the social balance through covering some gaps in income distribution. The tax systems of the EU member states suffered major changes from this point of view, by implementing various tax reforms. The measures regarding taxations, which raise much the inequality and strangle the demand, will hardly contribute to a dynamically growing economic region as called for in the Lisbon Strategy.

3.1 The consequences of tax competition

The question is if the EU Member States take advantage for the implementation actions of tax policy, which contributes to coordination in the EU, or accept the tax systems which are less and less distorted due to tax competition. If the capital is mobile and the taxation level defers from state to state, multinationals can use a full set of tax optimization strategies. The methods used are two: the transfer for profit shifting in low taxation areas and the implementation of some financial departments in fiscal paradises for financing investments. These types of strategies of non-payment of taxes put pressure on governments, because the states with a higher tax rates lose incomes and subsequently small or medium-sized companies (SMEs) hang back, because they can not use similar strategies; but with all this they take part to the competition on the same market. When the multinationals don't use profits, but the productive investments in order to use the tax differences between different states, the pressure grows further, in order to reduce finally the tax rate. This process, known under the name of tax competition, doesn't appear in the domain of corporate taxation. Due to the fact that the financial welfare is also more mobile as the invested capital from a productive point of view, the same logic can be applied to the taxes on personal capital income or on capital gains. Generally, labour force is less mobile than capital and labour force with a poor qualification is less mobile then labour force with a high qualification. A very immobile tax base is consumption, especially the consumption of primary commodities. Consequently, tax competition drives to an essential change in the tax structure. Governments are blackmailed regarding the reduction of tax level for factors with a high mobility and to raise the fiscal burden on sources less mobile, in order to protect the revenues. In the situation of a tax competition, taxes will shift, consequently from taxes on income and goods to taxes on consumption. The main results of the taxation evolution in EU during the last decades confirm exactly the fact that this phenomenon happened.

3.2. The evolution of taxation in EU

Indeed, statutory tax rates of corporate income decreased drastically. From the evolution of statutory rate on corporate income tax (CIT) in the period 1995-2006 we can observe a decrease of these rate for the EU of the 15 member states (except Spain which maintains a statutory rate at the level of 35%) from an average of 38,0 % in 1995 to 29,5 % in 2006. We exemplify a decrease of the statutory rate in Ireland from 40% to 12.5%, Portugal from 39.60% to 27%, Greece from 40% to 29%, Luxembourg from 40.90% to 29.63%, Italy from 52.20% to 37.25%, Germany from 56.80% to 38.64%. At the level of the new member states we can also see a considerable reduction of the statutory rate for the corporate income during the period 1995-2006: in Cyprus from 25% to 10%, Latvia from 25% to 15%, Lithuania from 29% to 15%, Poland from 40% to 18%, Slovakia from 40% to 19%, the Czech Republic from 41% to 24%, Romania from 38% to 16%. But Malta (35%) and Slovenia (25%) kept the same statutory rate.

The process is far of being closed. Now, Germany prepares the new tax reform for corporations, carrying downwards the statutory rate under the level of 30%. Denmark intends to reduce this rate from 28 to 22%. These initiatives will certainly contribute to intensify the pressure on other countries. Due to the fact that the term „high-tax location " is a relative term, it isn’t foreseeable a “race till the finish”. It is known that the tax base differs from state to state; the fiscal authorities decide a number of deductions, exemptions, etc. This is why the tax base is changed, like the tax rate, and so result the effective tax rate. The literature supports the existence of some possibilities of calculation of the effective rate: a) using the data with a historical character b) anticipated approach. The effective rate obtained using data with a historical character are based on macroeconomic data (national accounting books) or from the aggregation of financial information offered by the corporations. The anticipated approach considers that the future forecasted taxes will be paid according to the corporations’ development projects. Two methods of calculate effective tax rates are formed of the effective average tax rate – EATR and the effective marginal tax rate - EMTR. These rates are generally more reduces then the statutory rates, but these also followed a descending curve since the mid-1980s.According to the Institute of Fiscal Studies, the EATR in the EU-15 declined between 1982 and 2005 by 11.0 percentage points, while the EMTR fell by 10.0 points. The figures provided by the Zentrum für Europäische Wirtschaftsforschung point to an even more pronounced downward trend, with an average decline of the EATR in the EU-15 of 13.6 points from 1984 to 2003. The fact that tax revenues from corporate income have remained broadly stable as a proportion of GDP (gross domestic product) (3%) in EU in 1995 is often taken as evidence against the hypothesis of harmful tax competition. From this can result the fact that the competition determines a growth of the corporate income tax rate but states broaden their tax base. It can not be determined an evident relation between a reduction of the statutory tax of the corporate income and of the collected incomes from this taxes. In the case of the new member states the diminished tax rate are accompanied many times by a low level of the corporate incomes related to the GDP, in opposition with the EU of the 15. One of the most frequently used indicators in order to express the real tax burden or effectively direct or indirect imposed on different types of economic income or on activities possible to be taxed by the member states are represented by the implicit tax rates. Implicit tax rates are different for each economic function. These are calculated as the ratio between total tax incomes coming from a category (consumption, labour and capital) and a representation of the potential tax base defined using the data about production and incomes from the national books. These rates allow tracking the tax burden level during the ages and in different states. The implicit tax rate (ITR) on capital that reached a value of 27.3% in 2005 for the EU of the 27 is is lower in the new Member States, like Lithuania (11.4%), Slovakia (14.4%) but, also, Germany (23.3%) and Greece (8.1%) record a low level of capital tax. But Sweden (46.5%) records the highest level.More and more EU Member States are starting to introduce a dual system of income taxation. While labor income remains to be taxed progressively, a flat tax that runs far below the top rates of labor income taxes is applied to capital income. Since capital income is much more concentrated than labor income, the shift towards dual income taxation corresponds to a large tax relief in favor of the wealthiest. As acknowledged by the EU Commission, the tax burden on labor income displayed an upward trend until the mid-1990s. It was recorded a level of about 36% in the EU of the 15 and has remained rather balanced since then. In 2005 the implicit tax rate on labour at the level of the EU of the 27 was 35.2%. Sweden (46.4%) is the state with the highest labour tax followed by Italia (43.1%), Belgium (42.8%), France (42.1%), Finland (42%), the Czech Republic (41.3%), Austria (40.9%), Hungary (40.4%). The lowest level of ITR on labour can be noticed in Malta (22.1%), Cyprus (24.6), UK (25.5%), Ireland (25.6%), Romania (26.7%). The analyse of the implicit tax rates evolution for the period 1995 and 2005 in EU shows a substantial growth of the implicit tax rate on labour starting with the first period of the '70 and till now, while the implicit tax rate on consumption kept balanced. The average effective capital tax fluctuated sometimes significantly from a year to the other. The implicit labour tax rate was always higher then the implicit rate on capital and consumption, and the difference grew during the analysed period. These ITRs are computed only in this report and are commented in detail in the next chapters. They are here juxtaposed to highlight three main facts: first, that average effective tax rates on labour remain well above those for consumption and capital; second, that the decline in labour taxation is slow and has indeed shown signs of slowing down; third, that nevertheless there seems to be some convergence between the ITRs as that on consumption and that on capital show signs of an increasing trend since their 2001 trough. During the ages, the worries concerning more and more the unsatisfied general performance of the EU labour market brought in light the high tax burden on labour and led to repeated calls to reduce it. The statutory tax rate on personal incomes diminished arriving in 2007 to 38.68% at the level of the EU of the 27, value which confirms the tax shift from individuals with high incomes to those with low incomes. Several member states had even introduced a general flat tax on personal incomes, (e.g. Romania 16% in 2005). In most EU states, the social contributions have a great impact at the ITR level on labour then the personal income tax (PIT). The exception is made by Denmark, Ireland and UK where the personal income tax has a greater weight then the social contributions. In Denmark the part of social contributions is very small so that the welfare costs are financed through general taxation. From the states with the highest weight of social contribution (but with a PIT not to small) we mention the Czech Republic, France and Italy. An other group of states would be Romania, Poland, Slovakia and Bulgaria who have a very high level of social contributions, but also the personal income tax under the level of 20% from the total of labour tax . Starting from 1990, the VAT was the first of the indirect taxes which grew, in order to equal the public revenues. To exemplify, member states with lower VAT level have used the existing corridor of between 15 and 25%, allowed by the European Directive with reference to VAT, in order to approach the upper limit of the spectrum.. Obviously, the share of VAT revenues in total taxation has been rising. Moreover, the tax burden on resources like energy or gasoline grew. The ecological effect of these taxes depends on whether the user has indeed a possibility to seek alternatives. Taxing the energy use of certain industries is most likely justified on ecological grounds, since energy-saving technologies are often available and become more attractive this way. In many other cases, however, the so-called „green" taxes have no other effect than to burden low-wage earners in particular, because poorer households spend a higher percentage of their income on energy bills and heating costs. As shown, the general predictions about the consequences of tax competition are confirmed by empirical proof. The main result is not so much a decline in total tax revenue, but a structural change in the tax system. This change primarily concerns the distributional impact of tax policy. All considered changes relieve high-income earners while raising the tax burden on the lower end of the income scale. This is true particularly for the shift from direct to indirect taxes, but also for the cuts in top personal tax rates and the trend to introduce a flat rate on capital income. Instead of reducing social contrasts the tax system further widens the gap between rich and poor individuals.

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