FISCAL COMPETITION IN EUROPE

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In the context of the free movement of goods, capital, labor and services, the fiscal competition is a government tool in gaining competitive advantages. The main objective of the fiscal system is to collect revenues for the government to support the public services. Each European state has the liberty to establish its own fiscal policy. The main objective of the paper is to underline the impact of fiscal measures that European governments prepare as a response to the deepening economic crisis, on their competitive advantage in the line of fiscal competition.

Key words: fiscal competition, fiscal policy, income tax.

JEL Classification: H2, H3

1. Introduction

The fiscal competition in Europe, as a government tool in gaining competitive advantages, it promotes a better match between local policies and the preferences of residents, in an environment where mobility of economic factors is high and growing.
The fiscal policy can be treated like a competitive field, as infrastructure and education, with the objectives of income redistribution and macroeconomic stabilization. The fiscal competition is a positive one if determines the best quality/price proportion for public services.
Fiscal competition aims to select and attract firms and individuals, business investment and tax bases.

2. Fiscal competition or harmonization?

In the emerging European Union, policy-makers decry the inhibiting effects on the public sector of fiscal competition among the member nations, emphasizing how fiscal policies affect the welfare (real incomes) of various groups and how these impacts depend on the mobility of resources.
Fiscal policymaking is affected by competitive pressures faced by governments, giving rise to all sorts of economic distortions. Harmonization of fiscal policies may also be used as a tool to reduce the negative effects of fiscal competition.
In the field of indirect taxation[180], harmonization includes the necessary measures for the Union Market functioning (limits in VAT taxation), with the accent on preventing the distortions and the obstacles of free mobility of goods and services. So, at community level we talk about fiscal cooperation between member states. Harmonization is an extreme form of fiscal cooperation, but not the ideal solution in all situations. There are objective reasons for the existence of different rules in taxation, like local market characteristics, exchange rates between local currencies and euros (until Euro becomes the single currency in European Union).

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180 In the case of indirect taxation the chances of harmonization are bigger than in the case of direct taxation.
Tulai I. Constantin, Şerbu Simona, Fiscalitate comparată şi armonizări fiscale, Casa Cărţii de Ştiinţă, Cluj-Napoca, 2005, p.138

In direct taxation harmonization of fiscal policies among the European countries is a measure of integration, but is hard to achieve. The reasons are the fiscal sovereignty of member states and the condition of unanimity in adopting a decision.

Maintaining fiscal sovereignty of member states will endanger the European Union goal to minimize the fiscal distortions between union states. Despite all doubtful implications, the fiscal harmonization allows the optimal allocation of resources, becoming indispensable for eliminating the fiscal distortions.

There are two possibilities to obtain fiscal harmonization: through the market (liberal doctrine) and through negotiation (between European states- democratic doctrine; both having their downturns.

In the case of harmonization trough the market, the fiscal competition leads to non-taxation of mobile factors and over taxation of immobile factors or cuts in public expenditures. Excessive power of national fiscal administrations can generate inequities and inefficiency in financing public expenditures.

On the other hand, the harmonization trough negotiation it is the opposite of liberal doctrine. It is a confrontation between the community (fiscal unity) and the national authority (fiscal sovereignty), but also between the member states, as a result of economic diversity (public expenditures, public budgets, currency, market characteristics and national fiscal policy).

The fact that the few fiscal harmonization measures adopted at European level are the response of the market, denote that at the moment each member state tends to have its one fiscal policy. Direct taxation affects the investments, personal and business establishment, employment decisions. From 1 January 2007, in the European Union we can find 27 different taxation systems, generating problems such double taxations of revenues in the European Community, fiscal competition with negative effects, and restriction of free mobility of goods, capital, labor and services.

Adopted in 3 June 2003, the Code of Conduct for Business Taxation is not mandatory for the member states. The countries intend to eliminate the taxes and the fiscal competition with negative effects on factor mobility and the issue of time-varying policies, commitment, and dynamic consistency.

3. Romanian and European Fiscal Policies

In the field of tax rates, there is wide variation throughout the European Union. The new member states in Central and Eastern Europe (CEE) which have joined since 2004 have lower rates, especially flat taxes[181], which have had a major impact, often stimulating growth.

The reason for the low rates in these countries is the fiscal competition, the need for revenue in the context of European factor mobility, the positive effects like: economic growth, greater purchasing power, reduced costs for companies.

In the latest years, personal income tax rates had fallen all over the world, including Europe. Romania remains competitive with low flat tax of 16%[182] in the region, Bulgaria has a 10% flat tax, and the Czech Republic, introduced a 15% rate. The highest personal income tax rates are paid by the people of Denmark, 59%, Sweden 55%, Netherlands 52%.

But a low rate of personal income tax may be offset by other factors, like high indirect taxes[183], tax on buildings that is several times greater than in the region countries, the lack of transparency, and the quality/price proportion for public services.

181 is the case of Romania, Bulgaria, the Czech Republic, Estonia, Slovakia, Lithuania

182 but no longer the lowest in the EU

183 value added taxes, goods and services taxes, customs duties and fees for specific services.

The big disadvantage for Romania in the Central and Eastern Europe is the increase number of taxes that firms and individuals have to pay. The Finance State Department has identified 558 taxes, while The Czech Republic has 12, Hungary 14, Bulgaria 17, and Poland 40.
The private sector[184] had demonstrated that over 80% taxes bring just 5% from the budget revenues, and meanwhile determine bigger cost then revenues. On that matter, the Ministry of Finance had announced a cost-benefit analysis for each tax to determine the opportunity of maintaining or eliminate the tax.
As 2009 and 2010 seems to be years with negative economic growth, governments are trying to use fiscal policies as tools against economic crisis. The purpose is to stimulate the economy, encouraging economic growth and protecting the economic interest of individuals, to maintain the competitive advantages in both personal and business sectors.
From 1 January 2009, in Romania, interest income derived from term deposits and/or other saving instruments are deemed nontaxable income when derived by individuals, dividends are exempt from the tax on dividends if distributed and reinvested in the distributing company's own activity, or in the share capital of another Romanian legal entity, for the purpose of securing and creating new jobs.
Also from 1 January 2009, the pension reference unit was lowered to RON 697,5 from the number originally agreed under Governmental Emergency Ordinance (GEO) 192/2008 (repealed) of RON 763,7. Families of pensioners can no longer be disbursed the cash equivalent of train tickets not used in 2008, as previously allowed under GEO 71/2004.
The minimum social pension in 2009 is of RON 300 effective from 1 April 2009, and of RON 350 as of 1 October 2009 respectively. 2. Effective from 2010, the social pension amount is determined under the State Budget, and it can be raised under the relevant correction laws, in accordance with the macroeconomic indicators.
The GEO no.34/14.04.2009 on Budget Correction and regulation of some financial and tax measures proposes a series of so-called anti-crisis measures aimed at increasing budgetary revenues in Romania.
A new minimum corporate tax is imposed, a turnover tax on companies whether they are profitable or accumulate losses, according to gradual brackets of turnover ranges between fixed numbers as determined under the Ordinance.
Deductibility is no longer allowed for income tax purposes, for the fuel consumption for cars used by individuals in management positions, for VAT related to the acquisition of those cars and also for the VAT of the fuel for respective vehicles.
According to a Deloitte[185] study, Bulgaria had adopted a five-year corporate income tax holiday for investments in distressed regions and individual tax relief granted for young families paying interest on home loans, as response to the economic crisis.
The Czech Republic reduced the corporate income tax from 21% to 20%, as from 1 January 2009, and the social insurance rates to 34% for employers, 11% for employees.
Hungary, as a response to the economic crisis, shifted taxation from income to consumption, reducing the individual income tax and the social insurance contributions (33.5% for employers and 27% for employees). The VAT rate would increase from 20% to 23% from 1 July.
Those measures will determine an increased inflation in 2009 (3.9%), compared to previous foreseeing (3,1-3,4%) and an accentuation of the budgetary deficit (2,7-2,9% from GDP[186]) determining the reducing of public expenses with 200 billions forint in 2009 (around 670 million Euro), with 500 billions forint in 2010, 650 in 2011 billions forint.

184 At Business Standard initiative
185 „Tax Responses to The Global Economic Crisis"
186 recording Reuters, quoted by News In.

So the responses to the economic crisis do not stop in 2009 for Hungary. Beginning with 1 January 2010, they will abolish the 4% solidarity tax on businesses, resulting in a net reduction in the corporate tax rate of 1 percentage point. At the same time, they will increase the corporate income tax rate from 16% to 19%.

Hungary entered in a period of recession, the public revenues will suffer, but the budget has to stay in control to reach the commitments mead to FMI and UE, from whom they obtained a „saving fond" of 25,1 billion dollars.

The situation in Hungary is similar with the other new member states, including Romania. The governments have to create a balance between the need of encouraging the economy and the consumption, and the excessive public budgetary deficit, using the fiscal policy.

Fiscal policy tool against the economic crisis is used not only by the new member states, but also by old ones. In the case of Italy, a decree issued in November provides that compensation paid in 2009 for overtime work and for work related to increases in productivity is subject to a 10% tax up to EUR 6,000 gross. The tax is applied by the employer to employees who did not earn more than EUR 35,000 in 2008.

Spain responded to the economic crisis earlier than other countries, by abolishing the wealth tax applicable to individuals (by way of a 100% tax remittance) as from 1 January 2008.

In France, at first, the companies and the investments were in the center of the intervention plan. After a recovery plan announced in December 2008, for companies, the president announced measures for individuals, exemption from paying 2/3 of the annual income tax for taxpayers who are subject to the first bracket (income taxable at 5.5%).

In Germany, the tax measures mainly affect individuals, by reducing the entry-level tax rate from 15% to 14% and an increase in the tax-free amount.

4. Conclusions

The competitive advantage for Romania in the Central and Eastern Europe is the income tax rate of 16%; in the personal income sector in 2009 the advantage remains, but in the corporate taxation, the introduction of the new taxation system will put a new barrier in front of investments. A lot of firms suffer from the economic crisis, but the new corporate tax will enlarge this category, by taxing including the firms that don't obtain any profits. In case of bankrupts, the individuals will have to suffer to, the unemployment rate will rise and put new pressures on the public expenditure.

The weak points in the Romanian fiscal system are: fiscal instability, high social contributions, fiscal legislation that generates distorted competition, lack of transparency, fiscal birocracy, and inefficient fiscal administration resulting in fiscal evasion.

As a response to the economic crisis, the fiscal policies are the key to maintain enough monetary resources to the companies and individuals, to continue their business and to encourage the consumption.

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