FISCAL COMPETITION AND DIRECT FOREIGN INVESTMENTS: ROMANIA VERSUS POLAND

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The European Economic Community treaty defines indirect taxation common rules taking into consideration their impact upon free merchandise's circulation and upon international commercial exchanges.
Once the Roma treaty has been signed (1957) the established scope was creating a common market. But, how is it possible to create a common market without any monetary and fiscal instruments? Thus, these instruments have had to be created in order to achieve such an objective. If from the monetary point of view introducing euro as a common currency was a big step ahead, from the fiscal point of view things haven't evolved in such an easy manner. Fiscal objectives are achieved only if the national market is running normally and correctly.
Indirect taxation is harmonized base upon article 113 from the European Union Treaty, while regarding direct taxation legal recommendations and regulations approval we can't talk about harmonization but about fiscal competition. We are stating this because there are 27 states in the European Union and each one is sustaining its own direct taxation system. Furthermore, the taxation system (fiscal system) is influencing member states economical performances through economies, investments and human capital formation by affecting the revenue's distribution, research and development expenses level and type and by fiscal competition – an effect more and more profound. In this context we aim at analyzing the way fiscal competition had had a positive impact upon attracting foreign direct investments in Romania and Poland. We also aim at underlining positive and negative points for fiscal competition taking into consideration that not only a decrease in micro or macro-economic fiscal burden will have a positive impact upon investments in-flows and there are other factors to be taken into consideration, like: infrastructure, labor expenses, research and development expenses, internet access, etc. The research is mainly based upon a synthesis of the reached area in the special literature. The study continues a fundamental research using deductive and inductive research mechanism in order to delimit the used concepts.
Keywords: fiscal competition, foreign direct investments, fiscal systems, tax rate
JEL classification: H3

Introduction

European Union 27 states can make us think not only about fiscal competition but also about fiscal harmonization. But, is there even possible a fiscal harmonization of all 27 fiscal systems? For now at European level only a fiscal harmonization of the indirect taxes, VAT and excises, has been possible. Furthermore, according to the European fiscal policy strategy there is not necessary a total fiscal harmonization, member states being free to have their own fiscal system but within the European practices framework.
Nevertheless the European Union insists upon eliminating fiscal barriers for trans-national economic activities but, at the same time, intensifying the fight against harmful fiscal competition and fiscal fraud (European Commission). These objectives are sustained also by the new European 2020 strategy which states that the European space should become an intelligent and durable economy which favors economical, social and territorial cohesion.

Fiscal competition is an old concept but politically speaking the interest towards this concept has increase significantly in recent years, especially after the economical and financial crisis emerging since 2007. For a very long period of time the differences in tax levels between states were not significant enough to generate mass movements of capital or tax-payers. Starting from the 20th centaury the fiscal burden has increase significantly generating at the same time a series of restrictions fro trans-national movements: high tariffs, capital strict control, low currency convertibility degree and inflexible and harsh immigration regulations. In this context each states aims through its proposed and implemented fiscal regulations to attract at national level as many foreign investors as possible. Fiscal competition is mainly manifested by the way of direct taxation, which is what we aim to underline from this point forward.

Fiscal competition – present developments

The unique European market and the North American Free Trade Accord (NAFTA) have lead to intense capital and labor movements with the possibility of directing the investments flow towards other countries. In the European Union fiscal competition has started to manifest it's self mostly after 2004, when 10 ex-communist countries have adhered to the union.

As a reaction to these adhesions some countries have changed their taxation systems and have started using flat rates instead of progressive rates. The first state to adopt the flat rate was Estonia (the flat rate was 26%) and this has lead to an average economic growth of 4.3% per year. Following this example states like Latvia and Lithuania have adopted flat rates, 25% and 33%.

Describing the fist fiscal competition mechanism is attributed to Zodrow and Miesykowski. The created model was based upon two states with interdependent fiscal policies: fiscal revenues from one state were depending upon the other state tax rate. This is explained by the fact that a high tax rate in the first state will determine a transfer of the mobile tax base in the second state increasing this state's fiscal revenues. This model suggests that states are competing "towards a minimum limit" regarding taxation, each state trying to attract as much capital as possible by decreasing its tax rate. At equilibrium tax rates will be under those from a model with no fiscal competition having as effect a decrease under the optimum for public goods financed by taxes (Zodrow and Miesykowski, 1986: 365:370). Other authors (Bucovetsky and Wilson, 1991 333:350) have underlined that the states dimension can alter significantly the model previsions.

If states have relatively equal dimensions then same decisions regarding the taxation system can be made and the well-being will be equally influenced. When states dimension differ, the smaller state is prone to decrease its tax rate and has less to suffer (Genschel and Schwarz 2001, 339 - 370).

The indirect correlation between the fiscal competition and foreign direct investments has emerged in the context in which attracting more investments to national level has became an important goal for both develop and developing countries. Thus, the study done for EU 25 is demonstrating that the corporate tax is influencing profits repartition and at the same time the foreign direct investments (Wolf 2007, 327 - 346).

Fiscal competition and foreign direct investments flow analysis in Romania and Poland

The fiscal policy analysis realized in 2008 upon 106 states has revealed that the European Union states have the lowest corporate tax rates (KPMG 2008, 14-15). The average tax rate is 23.2% in EU, 26.7% in the OECD countries, 26.6% in Latin America and 28.4% in Pacific Asia; all these rates were lower than the ones from 2007. But a decrease of the direct tax rates has as a direct consequence the increase in indirect taxes. Thus, the average indirect tax rate was 19.5% in the EU, 16.9% in the OECD countries, 14.3% in Latin America and 11.14% in Pacific-Asia (KPMG 2008, 14-15).

In 2008, 7 European states have decrease their corporate tax; in Germany the tax has been decreased until it reached 29.8% and in Italy it was registered a decrease of 5.9 percentage points until it reached 31.4%. None of the European countries has increased their tax rates in the same period.
As goes for Romania and Poland in order to underline if the fiscal policy had had an impact upon attracting foreign direct investments, we will analyze several elements.
In the European fiscal context each of these two states will try, on one hand to increase fiscal revenue percentage in the gross domestic product, thus to finance public expenses and on the other hand will try to attract investors through different facilities like decreasing tax rates for certain taxes.
By comparison the maximum revenue tax rates for both personal and corporate revenues are presented in the following tables.

Table no. 1 maximum tax rate for personal revenues, Poland and Romania

	2000	2010	2011
Poland	40%	32%	32%
Romania	40%	16%	16%

Source: data eurostat

We can see that even the two states had had the same revenue tax rate in 2000 (40%) but Poland has decreased its revenue tax rate to 32% and Romania to 16%. As regarding the corporate tax rate Poland had had a higher decrease than Romania.

Table no. 2 Corporate tax rate evolution in Poland and Romania

	2000	2010	2011
Poland	30%	19%	19%
Romania	25%	16%	16%

Source: data eurostat

Although corporate tax rates have decreased in both countries the percentage from these taxes have registered almost the same evolution: in both countries in the year the corporate tax rate was cut back the percentage in the gross domestic product from these revenues has decreased (figure no 1).

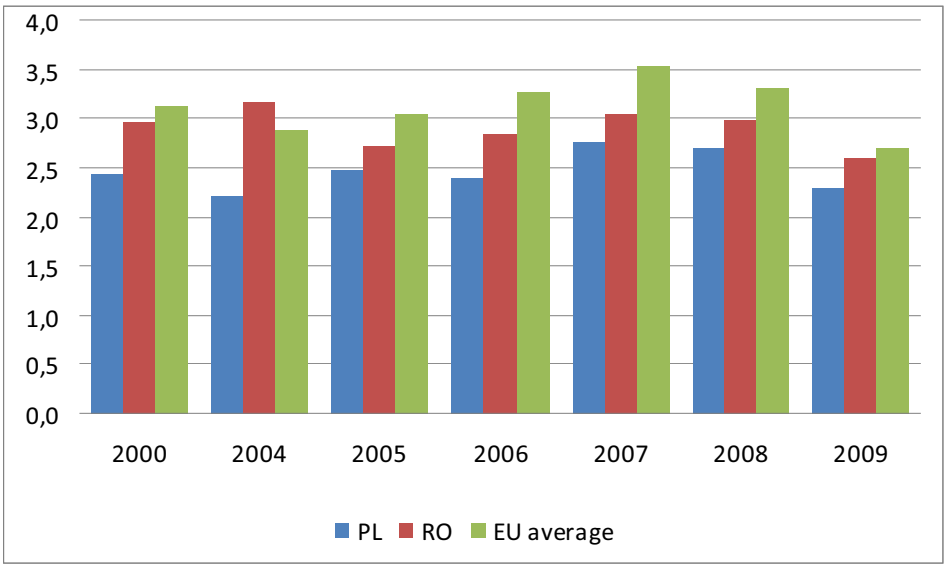
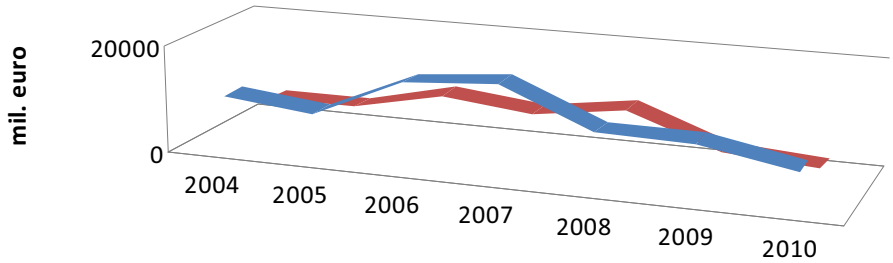


Fig. no 1 Corporate tax revenue percentage in GDP, Poland and Romania

Source: data eurostat

We will next analyze how the modification of the corporate tax rate has influenced the foreign direct investments flow. Thus, Poland and Romania have registered in the period 2008-2010 the following foreign direct investments flow (figure no. 2)



	2004	2005	2006	2007	2008	2009	2010
Poland	10237	8330	15741	17242	10085	9863	6686
Romania	5183	5213	9059	7250	9496	3488	2220

Fig. no 2 Foreign direct investments flow in Poland and Romania, 2008-2010

Source:http://www.bnr.ro/Investitiile-straine-directe-(ISD)-in-Romania-3174.aspx, http://www.paiz.gov.pl/poland_in_figures/foreign_direct_investment, Accessed 18 April, 2012

The difference between the two flows in significant, thus the foreign direct investments value attracted by Poland is higher than the one attracted by Romania with 4,466 million euro, meaning that investors are not always guided by fiscal elements and are interested in other facilities given by the state in which they are trying to relocate their activity. Following the type of investors we will see that in Romania investors coming from Holland have occupied the first position with 20.7% from total flow, while in Poland investors coming from Luxembourg have the first position with a 25.88% from the total flow.

Another important aspect is the deductions system applied by each country. A state fiscal policy can be competitive not only by aiming to a lower tax rate but also by an expense deduction system or by exonerating from payment the reinvested profit. Starting from 2006 in Poland research and development expenses and acquisitions of new technologies expenses are deductible. Another measure to attract investors in Poland is referring to the so called "Special Economic Areas" meaning that companies located here are receiving tax dispensations. As return these companies have to maintain a certain number of employees, invest in fix assets and carry on the economic activity for a fix period of time (usually 5 years).

According to a study realized at European level regarding the fiscal attractiveness of a territory unfold in 10 different countries; the interviewed managers have nominated Poland 4 times the first place and 3 times the second place they would invest.

In Romania the tax rate modification didn't had as effect a significant increase of the foreign direct investments flow, due, in our opinion, to many other factors like: consecutive and

numerous VAT modifications, social contributions, para-fiscal taxes, bureaucracy, the long period of time necessary to create a firm.

Conclusions

We consider that just a decrease of the tax burden is not sufficient in order to increase investment flows, both national and foreign. Other factors like: infrastructure, educational level, labor costs, existing technologies and selling markets are very important when in comes to attracting investments. Thus, when a state is focusing upon increasing corporate tax rates and then uses the fiscal revenues to finance those domains there is the possibility that a positive effect emerges from foreign direct investment flows. Furthermore, a state focused upon increasing foreign direct investments flows should have a fiscal policy aiming to assure a high development of the public services like decreasing the reimbursement time for VAT and an efficient infrastructure.

We do consider that when in comes to fiscal competition we have both favorable and non-favorable effects, as shown in the following schema.

Favorable effects:
- Economy development and economical and social gaps reduction which might lead to decreasing the geographical disadvantage;
- Putting a stop to state's desire to increase fiscal burden;
- Imposing a certain behavior regarding spending public money and financing public expenses;
- Decreases corruption and bureaucracy.

Non-favorable effects:
- Can cause fiscal evasion;
- Taxes are often burdening upon less mobile factors (higher taxes levied upon labor than upon capital, because labor is a less mobile factor).

Schema no. 1 Favorable and non-favorable effects of the fiscal competition
Source: realized by the authors

As regarding attracting foreign direct investments Poland is more prone to be attracting more investments than Romania because of factors like: Poland is much more efficient in dealing with insolvability cases (it occupies the 87th place from 183 economies, while Romania is placed the 97th in the same top), services regarding electricity connection are more efficient in Poland than in Romania (Poland is placed 64th while Romania is placing 165th) and regarding the fiscal policy Poland is placed 128 and Romania just 154 (World Bank, 2012).

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