

ADVANTAGES AND DISADVANTAGES OF TAX COMPETITION IN THE EUROPEAN UNION

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Abstract

With the expansion of globalization, economic integration and the mobility of production factors at the local and global level have been facilitated. In Europe, the process of economic and monetary integration began when barriers to the free movement of goods, capital and labor were formally abolished, although cultural barriers still exist. The need and justification of tax competition is that it can lead to greater efficiency in the use of public sector resources and more efficient allocation of capital. The main advantages of tax competition are those related to the reduction of tax rates, which can lead to boosting consumption and investment. The method used to achieve the objective is complex, from statistical and economic analyzes of fiscal data to a comparative technique at the level of the European Union. The database used is from Eurostat sources and other European Commission work on taxation in the Member States of the European Union.

Keywords: direct taxes, indirect taxes, tax competition, fiscal policy, the European Union

JEL classification: F38, G38

1. Introduction

In the context of the general policy of the European Union, fiscal policy is considered essential for all the Member States of the European Union. Currently, there is no integrated tax system in the European Union, but a place where different national tax systems are encountered. In practice, the diversity of tax systems has made them sometimes competitive, generating tax competition.

The use of the concept of tax competition is present in the literature in terms of its significance. Thus, a definition of tax competition through its effects, seen as externalities, is given by Winner [18], which considers it to be "a situation where tax jurisdictions in a particular jurisdiction induce tax externalities in other jurisdictions."

According to other opinions, tax competition "may cause a country to adopt lower tax rates or more generous tax incentives to attract foreign investment and capture tax bases with great mobility" [11].

According to the scope of intervention, tax competition can be seen as: tax competition on tax rates, which manifests when the government reduces the tax rates in order to attract capital; the tax competition on the tax base, which is manifested by the diminishing of the tax base due to some facilities granted by governments (deductions, exemptions).

Fiscal competition exists when economic subjects can reduce fiscal pressure by relocating capital and / or labor from highly taxed jurisdictions to poorly taxed jurisdictions. This migration disciplines governments that employ large amounts of public money and rewards states that reduce tax rates and promote fiscal reforms that support economic growth. Fiscal competition is particularly important for the current globalized economy, and this process has led many countries to implement fiscal policies specific to the market economy [9].

Tax policy is an element of national sovereignty aimed at attracting revenue to finance public spending, as well as redistribution of revenue. At the level of the European Union, fiscal

policy decisions are adopted by each Member State of the European Union, which may delegate part of this responsibility from central to regional or local level, depending on the functional or administrative structure of that state.

It should be noted that the European Union does not seek to standardize national tax systems, but it is hoped that the fiscal measures will adopt the provisions of the Treaty establishing the EC.

2. Events on tax competition

It is known that within the European Union, there are significant differences in tax law regarding the structure of taxes in total tax revenues. At the same time, it is common knowledge that while developed countries have direct tax systems, less developed countries apply tax systems focused on indirect taxes and large social contributions.

The main tax revenues in all EU Member States are: direct taxes, indirect taxes and social contributions their weight in the total revenues of each state, depending on the concrete conditions and policies adopted by the public authorities in the respective countries.

Table no. 1. **The structure of tax revenues in the Member States of the European Union at the level of 2015**

Member States of the European Union	Indirect taxes	Direct taxes	Contributions
Belgium	29,3	38,9	31,81
Bulgaria	53,5	19,4	27,1
Czech Republic	36,5	21,3	42,3
Denmark	35,2	65,8	0,1
Germany	28,5	32,4	39,2
Estonia	43,2	23,4	33,4
Ireland	37,3	46,3	16,4
Greece	44,5	26,1	29,4
Spain	35,5	31,7	34,2
France	35,0	28,7	36,9
Croatia	52,4	15,9	31,7
Italy	35,5	34,4	30,1
Cyprus	45,1	29,5	25,4
Latvia	44,4	27,0	28,6
Lithuania	41,4	18,8	40,0
Luxembourg	32,3	38,9	28,8
Hungary	48,4	18,0	33,5
Malta	40,7	42,3	17,0
Netherlands	31,0	31,1	37,7
Austria	33,4	32,9	33,6
Poland	40,1	21,4	38,9
Portugal	42,4	31,4	26,1
Romania	47,6	23,5	28,8
Slovenia	40,7	19,8	39,5
Slovakia	34,1	23,0	42,9
Finland	32,5	38,5	29,0
Sweden	51,1	42,5	6,4
United Kingdom	39,0	42,6	18,4
EU 28	35,14	34,2	30,9

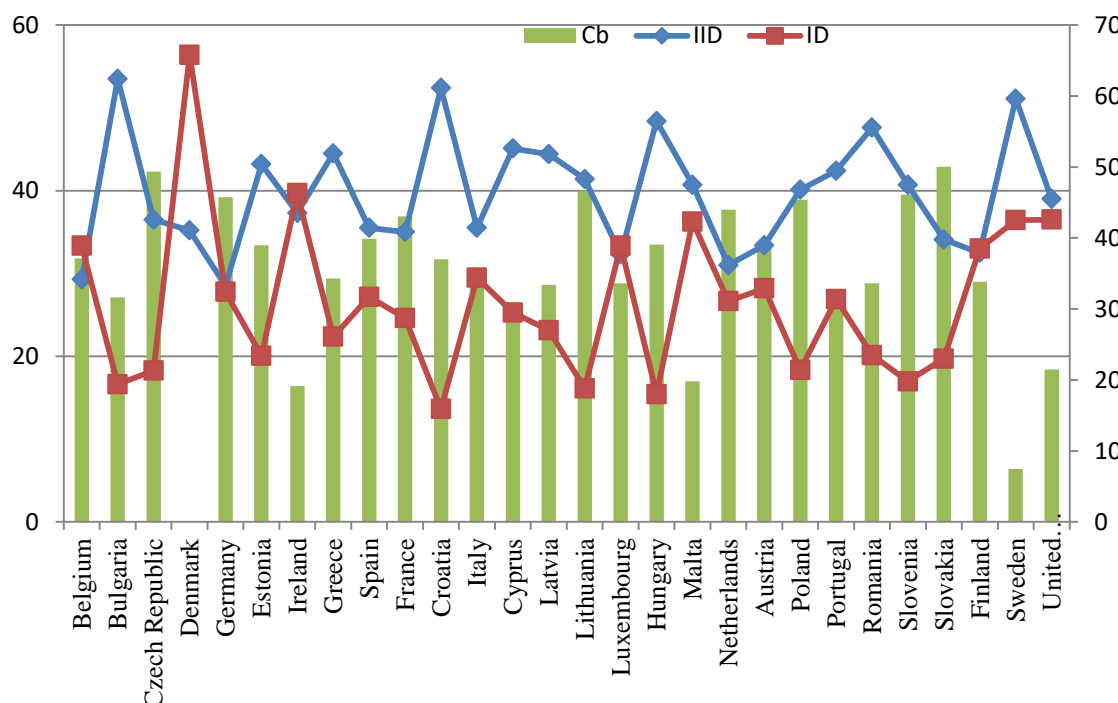
Source: www.ec.europa.eu

At European Union level, Community legislation on indirect taxes and their harmonization are based on the provisions of the EC Treaty Official Journal of the European Communities. At 2015, the average indirect tax weight in total tax revenue in the EU28 was 35.14%. Over the average, the following countries were: Bulgaria (53.5%), Czech Republic (36.5%), Denmark (35.2%), Estonia (43.2%), Greece (44.5%), Spain (35.5%), Croatia (52.4%), Italy (35.5%), Cyprus (45.1%), Latvia (44.4%), Lithuania (41.4%), Hungary (48.4%), Malta (40.7%), Poland (40.1%) Portugal (42.4%), Romania (47.6%), Slovenia (40.7%), Sweden (51.1%) and United Kingdom (39.0%).

There is no concern in the European Union for the harmonization of direct taxes, the current situation being a reaction to the existence of double taxation. There are countries with a different degree of development and different living standards in the single market. Thus, at the level of 2015, according to the data available at the level of the European Union, the states which have a direct tax weight in the tax revenues over the European Union are: Belgium (+ 4.7%), Denmark (+31.6%), Ireland (+12.1%), Italy (+0.2%), Luxembourg (+4.7%), Malta (+1.1%) and the United Kingdom (+ 8.4%).

At present, there is no plan to harmonize legislation on social security contributions at EU level. For this component of tax revenues, measures are being adopted focusing on the coordination of insurance systems in order to avoid double taxation of employees or persons practicing liberal professions. Within the European Union there are notable differences from country to country in this sphere (Table 1). Thus, at the level of 2015 the average share of contributions in the total tax revenues was 30.9%. Above this level of the EU28 share were the following states: Belgium (31.81%), Czech Republic (42.3%), Germany (39.2%), Estonia (33.4%), Spain (34%), France (36.9%), Croatia (31.7%), Lithuania (40.0%), Hungary (34.5%), the Netherlands (37.7%), Poland (38.9%), Slovenia (39.5%) and Slovakia (42.9%).

Figure no. 1 The structure of tax revenues in the Member States of the European Union at the level of 2015



The tax burden has been decreasing in recent years in most EU countries. A timely analysis of the tax revenue structure in the EU Member States shows that tax philosophy has changed,

reducing the share of tax on personal income and the share of social security contributions in tax revenue, and increasing the share of corporation tax and indirect taxes in these income.

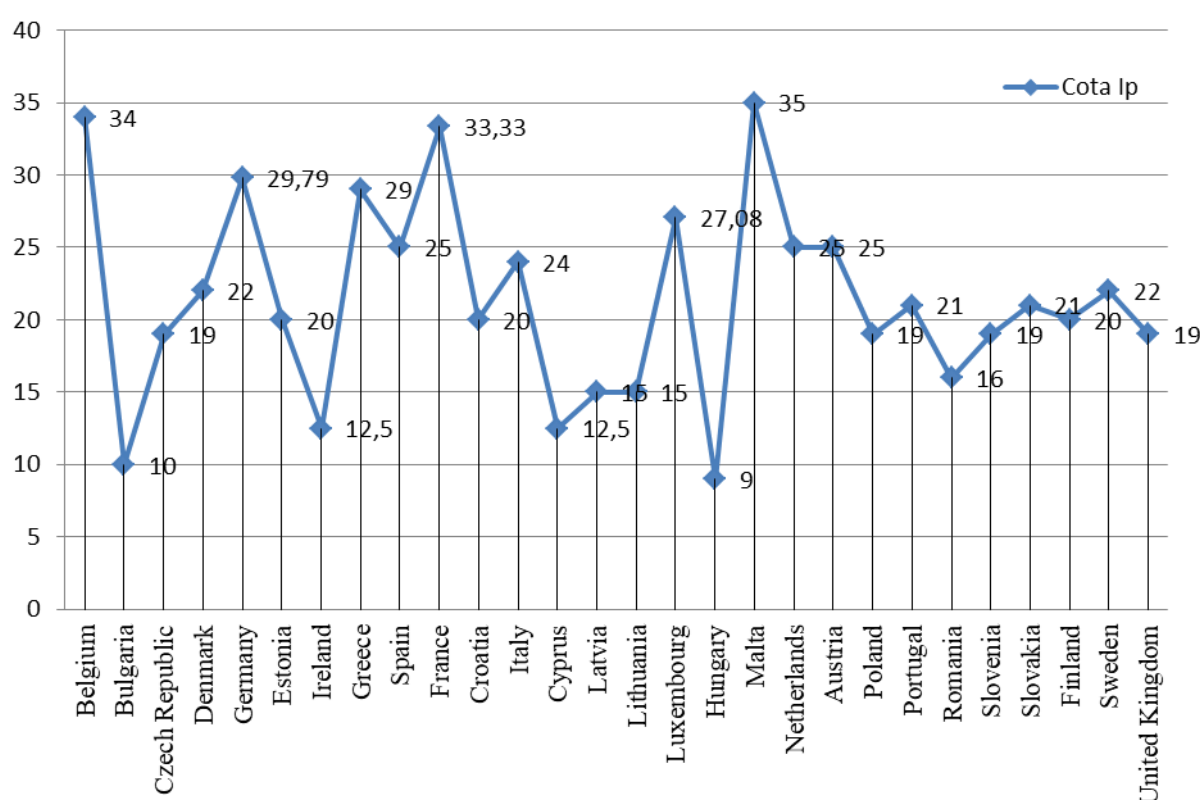
In the field of direct taxation, most direct tax arrangements refer to bilateral tax treatments involving EU Member States and third countries and covering the scope of taxation of income streams between states.

The main objectives pursued by the tax policy within the European Union in the field of direct taxation relate to the prevention of tax evasion and the elimination of double taxation.

As far as corporate income tax is concerned, the Code of Conduct for Business Taxation is not a legislative instrument, but a political commitment by the Member States of the European Union to reduce unfair competition.

The reduced tax rates used for company taxation and personal income applied to the Member States of the European Union lead to the situation where the revenues received from such taxes are reduced as a share of the total tax revenues.

Figure no. 2 Level of corporate income tax rates in the Member States of the European Union at the level of 2015

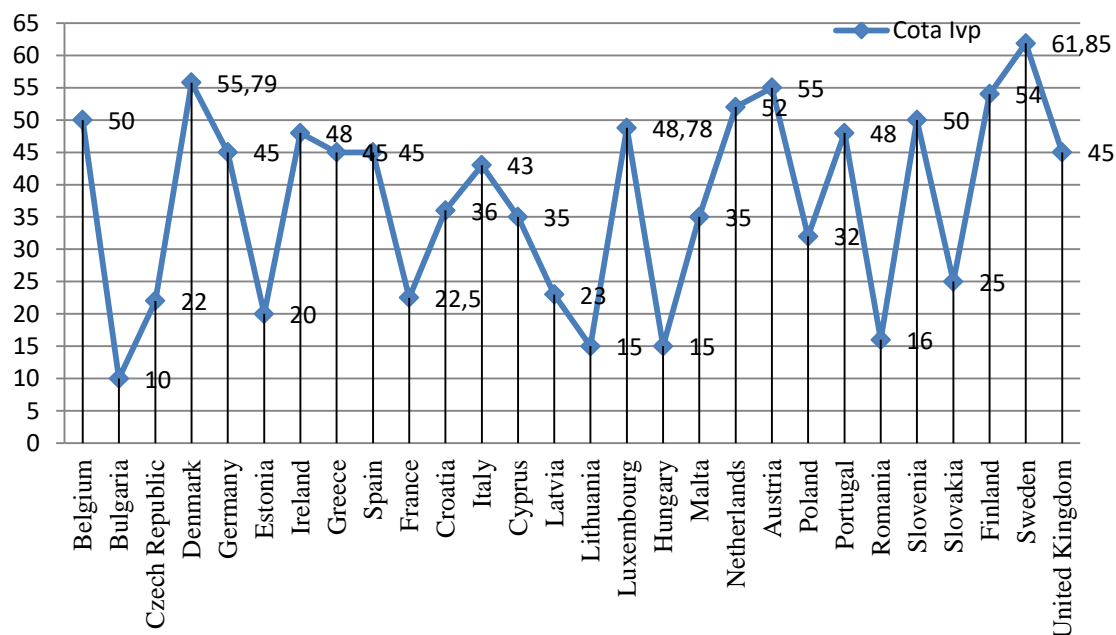


In 2015, the maximum corporate tax rate was 35% in Malta, compared with 9% in Hungary. In the field of corporate taxation, harmonization concerns have been intense in the field of personal income taxation such concerns have been limited to a few measures relating to capital gains in order to avoid double international taxation.

As regards personal income tax, the tax measures adopted within the Member States have been aimed at reducing the tax burden on wage income, a measure of which has the effect of increasing employment.

In the Maastricht Treaty, there is a question of taxing personal income and social benefits by stating that obtaining freedom of movement for labor will cause the abolition of all nationality denunciations within the Member States as regards employment, remuneration and other working conditions (EU Treaty, Art. 48).

Figure no. 3 The level of personal income tax rates in the Member States of the European Union at the level of 2015



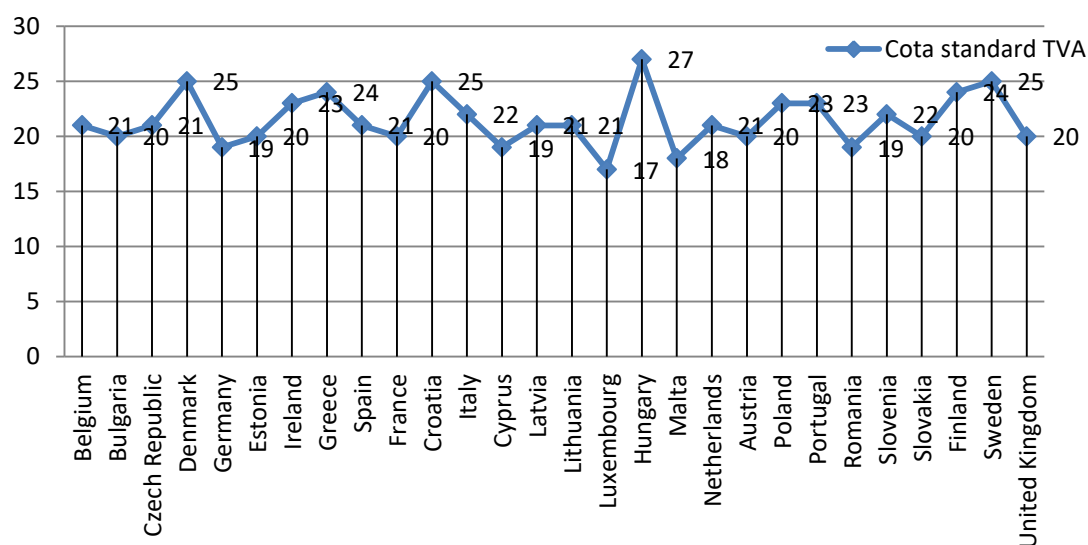
In 2015, the highest rate of personal income tax rate was recorded in Sweden (61.85%). The opposite was Bulgaria with a 10% tax rate of personal income tax.

Regarding indirect taxes, the European Union seeks to ensure the neutrality of consumer taxes (value added tax and excise duties).

Since the internal market has become a reality, differences in VAT rates across Member States can distort economic activity.

Even though a Community regime applicable to indirect taxes has emerged through successive Community rules, however, in the case of the standard rate of value added tax as the main indirect tax at the level of the Member States of the European Union, there are significant differences in tax rates. This can also be seen in figure no. 3.

Figure no. 4 Standard VAT rate applied in the Member States of the European Union at the level of the year 2017



Although a Community regime applicable to indirect taxes has emerged through successive Community regulations, however, in the case of the standard VAT rate, there are significant differences in tax rates as the main indirect tax at the level of the Member States of the European Union (figure no. 4).

3. Conclusions

Tax competition is desirable for several reasons. Most importantly, it facilitates economic growth by encouraging legislators to adopt rational fiscal policies and promote responsible fiscal policies. Lower tax rates reduce state pressure on business and create an environment more conducive to entrepreneurship and growth.

Tax competition is even more fierce nowadays because it is easier for taxpayers to move their resources to less taxed areas.

The benefits of tax competition can be appreciated by illustrating the changes in fiscal policy that have swept the world over the past 30 years. Obviously, tax competition should not be perceived as the only factor that has led to the following tax changes. In some situations it can even be rude. But in each case, tax competition has encouraged the shift to fiscal policies that generate growth and more opportunities.

Tax competition exists both between different European tax systems and between countries belonging to the same tax models. It is most pronounced amongst the Eastern model states and less among the northern model states. It also manifests itself more strongly between the eastern and the continental models. Instead, the Nordic system is the most resilient to tax competition (which may be said to be somewhat "frozen") due to the existence of dual taxation, as well as the fact that countries are geographically more isolated and do not interact with the rest of Europe.

Fiscal competition can induce the risk of depreciating the tax base of EU Member States. Impairment of tax bases is detrimental because it makes the functioning of the Economic and Monetary Union more difficult and undermines national fiscal sovereignty. Tax competition translates into losses from the calculation base and disrupts the implementation of economic and monetary union. Tracking the erosion of tax bases makes it more difficult to implement budget policies.

In the absence of harmonization of direct taxation, EU Member States preserve their entire sovereignty in this area. All states practice competition that involves attracting jobs and businesses in a country through the tax benefits of this. But this practice can be doomed to failure because of over-reliance in over-reliance, no country has any advantage compared to the others and all of them are losing ground. Multiplying tax benefits to attract the economic activities of another is detrimental to all EU Member States: taxable bases are diminishing and companies are moving in search of the highest tax incentives; but when facilities are the only reason for choosing, the investment is not sustainable. If taxing more favorably than abroad leads to activities and thus increases the rate of tax calculation, it allows for a further reduction in rates, while owing to the loss of activities abroad, these rates are increased, or public expenditures are limited, some of which are at least favorable to the development of activities.

Possible negative or positive effects attributable to tax competition at EU level are supported by states differently, as each is focusing on divergent interests. On the one hand, economically developed countries and the ability to resist market failures are against fiscal competition, while less developed countries are not fully willing to give up their full right to collect taxes and taxes in the way they dictate the interests of their own fiscal policy, as it remains among the few instruments of action at the disposal of national governments to fill the shortcomings created in the economy by possible crises and shocks propagated in the market.

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