Tax Competition and Harmonisation in the Central Europe in the European Union Pre-Accession Period

GDN Project RRCIV-015

Non-Technical Summary

We hereby present two non-technical summaries/ abstracts, one in relation to tax competition and one in relation to tax harmonization.

Tax and Labor Cost Competition in Central Europe in European Union Pre –Accession Period

The paper deals with tax and labor cost competitiveness of four Central Europe countries from the investor’s point of view. The paper contains a synthetic index which shows financial benefits for the investor from moving manufacturing from one of the 14 European Union countries to Poland, Slovakia, Czech Republic and Hungary Central Europe which could be achieved in the pre - accession period (1998-2004). The results of the research show that those benefits are significantly growing. The model assumes that financial benefits from moving production come from differences in labor hourly rates and from the share of labor in the product in capital origin country. They also depend on the corporate income tax rates of the capital location country and capital origin country and on profit rates in both countries. Under accepted assumptions the most important mechanism for yielding financial benefits for investors is built of labor cost competitiveness factors: the share of labor in created gross added value and differences in hourly labor costs. Opposite to common thinking, corporate tax rates differences between countries alone are not critically important in creating benefits from moving manufacturing from one country to another. The sensitivity analysis reveals that corporate tax rate of investment destination country is much more important for investors than tax rate in investment origin country. This reduces tax policy alternatives for countries with high labor costs in Europe. The paper contains interesting arguments for investment agencies in Central Europe countries who are welcome to cite research results. The paper contains also strong arguments for those politicians from European Union countries who intend to change over socialized economic models of their countries. Corporate income tax manipulations in such countries are nearly worthless and without deep structural changes they would not change significantly economic benefits from manufacturing delocalization.

Impact of Tax Harmonization with EU on Economies of Central European Countries during the Pre-Accession Period

The paper refers to the issue of harmonization of indirect taxes which took place in four Central Europe countries in the pre-accession period to the European Union. In this period Central Europe countries had to increase indirect taxes on fuels, tobacco products and energy due to requirements of European Union. Harmonization significantly increased prices of harmonized products and inflation in general what was a rationale for the hypothesis on the negative impact of harmonization on main economic aggregates like GDP, consumption, gross capital formation, exports and positive impact on imports. To estimate the impact of harmonization on prices, a concept of Net Harmonization Indices (NHI) was set up. The indices were tested through incorporation to demand equations (transformed income balance identities) and verified by autoregressive ones. The procedure confirmed mostly negative impact of tax harmonization on main macroeconomic aggregates in Poland, Slovakia, Czech Republic and Hungary. It also showed that harmonization friendly policy may result in more negative effects for the country using such a policy. The project results create an interesting illustrative picture for policy makers, researchers and tax specialists on how to shape tax harmonization policy with the EU in order not to suffer from harmonization costs.