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Business and Economics Research Journal
Volume 6 Number 2 2015
pp. 39-58
ISSN: 1309-2448
www.berjournal.com

Fight Against Tax Competition in the EU and the Effects of Tax Policies Implemented in the EU During the 2008 Global Financial Crisis on Tax Competition

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Abstract: *Globalized economy has brought about many economic and political problems in both national and international fields. One of the most significant results of globalization is that it has removed boundaries and reduced time and space related costs preventing international capital from moving towards areas where it can increase its value. This change, which is positive considering revaluation and profit increase in global capital, has caused normlessness and led to a process blocking international competition, which may most of the time result in national and international economic crises. Countries have, thus, started to introduce tax policies that would attract global capital. This problem has conceptually been handled in fiscal literature as international tax competition. Recently its harmful aspects have also been included in the discussions. In this context, national authorities as well as international institutions such as European Union and OECD have been working on projects to prevent harmful tax competition. Yet, globalization and financialization of economy have made countries more dependent on international capital. It is conflicting that countries are making new regulations to prevent harmful tax competitions while they are also creating an environment where they can promote global capital to avoid possible financial crises. This conflict was clearly observed in European Union during the 2008 global crisis. This study reveals the conflict between tax policies applied by EU to overcome the 2008 global financial crisis and the works intended for preventing harmful tax competition in EU.*

Keywords: Tax competition, tax harmonization, financial crisis, European Union tax policy.

JEL Classification: H2, G01, F65, H29, H30

1. Introduction

Globalization has affected all domains of economic and social life. Globalization, on the one hand, involves the new world order. It, on the other hand, covers new economic approaches and new regulation methods used by states. Globalization has helped to improve production mechanisms where extended capital can be reproduced. It has also expanded financial areas (banks, financial intermediaries, credits, etc.,) and encouraged consumption. Capital movements have become more rapid and international with globalization. Yet, they have caused important problems in national decision-making mechanisms and economies. One of these problems is that countries have started to take international capital movements into consideration rather than national requirements while they are deciding on their tax policies. In other words, the influence of national policies has been limited in taxation. Another problem is that as the factor mobility has increased, each country has attempted to create tax structures to attract production factors, which has resulted in harmful tax competition. Tax competition is simply governments' imposing low tax rates in order to

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attract international capital and trade to their own country (Genschel and Schwarz, 2011; Wilson, 1999; Öz, 2005; Saraç, 2006). It is thought that competitive tax cutting will have a two-stage effect on tax system: First, some countries will decrease their tax rates or change their tax systems to offer lower effective tax rates. Second, other countries will cut their taxes in response to the foreseen or existing losses resulting from this competition (Genschel, 2002: 247). This process, known as race to bottom on tax competition, causes a considerable decrease in tax rates, and taxes on capital may, therefore, become unsustainable (Saraç, 2006: 141). Promoting capital movements, competitive tax policies may turn out to be effective tools for capital owners to gain unearned income. Harmful tax competition can, thereby, transfer tax bases in other countries to the target country by introducing special taxes as levied on cross-border investment (2006: 141). The worst effect of harmful tax competition is fiscal degradation (Giray, 2005: 11). Tax base reduction resulting from fiscal degradation is compensated with an increase in taxes on fixed factors. This eventually causes an unjust distribution of tax burden.

It is claimed that tax competition is beneficial in some situations (Saraç, 2006; Teather, 2005). For instance, it is stated that tax competition increases national income, employment, foreign trade and export while it decreases the need for public borrowing and improves income distribution against tax injustice in developing countries (Teather, 2005: 143-144).Today, global tax competition is called harmful because of its negative effects and there are projects to tackle harmful tax competition. The works conducted by OECD and EU have a distinct place amongst such projects.

Another important effect of globalization is that it removes the obstacles to capital. Globalized capital has contributed to the expansion of financial field, development of banking sector and improvement of borrowing and credit systems. Markets have become vulnerable to crises as capital moves towards areas where it is irregularly re-evaluated and as financial markets have become dependent on risk speculation and expectations. The process resulting in 2008 global financial crisis was, in fact, triggered by this transformation. The financial crisis, which broke out in the US mortgage housing sector, spread to financial markets, banking sector and real economy In addition to the shrinkage in world trade, this depreciation in the US financial market adversely affected European financial markets and neighboring countries it had been interacting with. Both the tools of monetary policies and the tools of fiscal policies were used to overcome the global crisis. Taxes are leading fiscal policy instruments. EU countries tried to finance their increasing budget deficits through tax policies while they also tried to offer opportunities such as low tax rates and tax cutting to attract global capital. The aim of introducing such policies was to prevent the exit of global capital and compensate for the depreciation.

This study reveals how EU affected the global crisis process through its tax policies intended for overcoming the crisis while it was also trying to prevent the harmful effects of tax competition and pioneering such studies at global level. In this context, the first part of the study focuses on globalization and tax competition theory. The second part handles the EU projects aimed at removing the harmful effects of tax competition. The final part covers the impact of the global crisis on EU and the tax policies applied by EU to overcome the crisis with a special focus on tax competition.

2. Tax Competition Theory and Tax Competition within Globalization

The term tax competition was first used in 1950s. Yet, with globalization, its content has changed just as its impact has. The first studies on tax competition in fiscal literature mostly focused on fiscal federalism and public finance (Tiebout, 1956; Oates, 1972). Charles Tiebout's research on the public services of local administrations within federal states can be listed as one of the first studies to be cited from. Charles Tiebout analyzed the competition among federation governments. In his study, Tiebout (1956) reveals how taxation affects people's choice of space. Tiebout suggests a simple model under the name of "a local government model". In this model, it is assumed that consumers are mobile, they are fully aware of the difference between income-expense patterns and behave accordingly and they opt for communities in which they can satisfy themselves in terms of their preferences the most (Tiebout, 1956: 416-419). Tiebout examined the behaviors of both consumers and managers under these assumptions (1956: 416-419). The study assumes that public resources can optimally be distributed through tax competition (1956: 420). According to the study, tax competition will ensure effective distribution of sources in private markets and affect people's residential choice. Tiebout states that people will determine where to live considering the public services and local tax rates (1956: 420). According to Tiebout, local administrations will cut taxes with a view to attract more people. The competition which occurs among local administrations in this way will contribute to the welfare of the whole society. Tiebout concludes that tax competition can contribute to welfare as long as there is an internal market where people are completely mobile and fully aware of income-expense patterns. "Taxcom" model developed by Peter Bich Sorensen is also another contribution to tax competition theory. According to Sorensen, international tax competition is harmful (Sorensen, 2000). Therefore, an acceptable tax rate should be determined at minimum level and coordination in taxation should be ensured (Sorensen, 2000). Sorensen states that tax coordination is essential mainly because international fiscal competition reduces taxes to the levels leading to ineffectiveness. In this case, international competition is being reestablished against the benefits of relatively poorer communities (Sorensen, 2000: 433). According to Sorensen, welfare gains resulting from tax coordination can be explained with a model based on the interaction between national tax policies. In the model, capital is the relatively mobile factor whereas labor is specific to industry. In addition, a homogenous product subject to international trade and full knowledge based on full competition and symmetry are valid. Taxcom model was created to emphasize the effects of regional tax coordination. In Taxcom model, balance is reached when the profits of all firms and the benefits of all consumers are maximized. In this equilibrium condition, taxation is based on sources and because capital is fully mobile within the region, income rates after taxes are balanced within the region (Sorensen, 2000: 440-442). The main criticisms about the model can be listed as follows: The taxes on interests and profits are not separated. The criteria according to which low tax rates are to be determined are unclear. How all countries can come to terms is a question mark. It is not certain whether or not the states can optimally use the possible increase in its tax revenue. Effectiveness and benefit are two different terms. Welfare might be interpreted differently by different countries. Another important study on tax competition theory is the model developed by Zodrow and Mieszkowski. The model seeks to answer the question how tax policies affect capital distribution. This model suggests that countries tend to levy low taxes in order to attract mobile capital and as a result of this, there occurs loss in tax revenue, which would finally lead to problems in the supply of public services (Zodrow, 2003: 654).

The literature mainly focuses on the harmful effects of tax competition. However, there are also studies showing that tax competition has led to positive results in neighboring countries (Teather, 2005; Goodspeed, 1998). In fact, it is not easy to determine whether tax competition has more positive or more negative results. There are many reasons why there is no clear perception of the effects of tax competition: Tax systems are complex and closed. It is difficult to identify the benefits in public expenditures in return for taxes. Rather than tax policies, governmental practices are predominant (Goodspeed, 1998: 583). Yet, it is clear that globalization has deeply affected tax systems. For example, the taxes on income and property have been affecting regional mobility more than ever (Owens, 1993: 22).

Today, as a result of globalization, capital has become more mobile boosting international competition and multi-national companies have become stronger and more influential. The results of globalization can concretely be observed in every single domain of economic and social life. As Owens put is, "*Today's world is a small place*" (Owens, 1993: 21). In economic field, free capital movements and free trade have broken the boundaries of time and space. For example, a commodity produced in a given place in the world can be obtained from another vendor in another place just with a computer click. Enterprises prefer to operate in areas where they can have a competitive advantage and make a higher profit due to cheap labor force, tax incentives and cuts to operating in only one country. International economy policies have become more and more important in all economies whether small or big. Globalization creates new opportunities for national economies, but they also lead to the risk of crisis. With globalization, national economies are strictly restricted by the decisions made out of their borders (Owens, 1993: 22-23).

Another important field affected by globalization is nation state. Nations are articulated to this transformation in economic, political and legal fields or they are forced to comply with the new order. This shows that international policy is the dominant paradigm in all domains (Saraç, 2006: 69). Economic and political fields have become dependent on each other and integration is on the rise, which both weaken the political decision making mechanisms. From this perspective, globalization has brought about risks for national economies. Particularly developing and under-developed economies are restricted by international decisions. The restriction is obvious particularly in economic fields like interests and taxes (Owens, 1993). Another dimension of the transformation in nation state structuring is that welfare state understanding is being replaced by competitive state understanding (Saraç, 2006: 17). This shift means shrinkage of public sector. Thus, within the framework of neo-classical economics, state's field of activity has been narrowed with stability and structural adjustment programs. As a consequence, now the state's role is to introduce incentive policies and tax regulations to shape the competition environment rather than direct intervention in the market. With globalization, capital owners have started to seek for higher rates of returns on their incomes in international markets (Swank and Steinmo, 2002: 645). It has now become inevitable for countries to consider the local framework which would affect commercial activities vis-à-vis capital movements. They also have to take into consideration the investment decisions and policies of international market players and mobile institutions in a competitive area where capital movement is intense. In this way, the relation between governments and mobile capital has turned into a "Prisoner's Dilemma" (2002: 645). It is observed that optimal tax rates on capital gains are approaching almost "zero" in taxation models in economies open to mobile capital and taxes are shifting to less mobile areas such as labor and land (Razin and Sadka: 1991).

On the other hand, taxes are an important source of public financing. Tax cuts or exceptions which would orient capital movements are influential generally in corporate taxes and capital gains taxes. The tax loss occurring in this scenario is compensated in two ways. First, taxes on labor force, which is less mobile, are increased. Second, indirect tax (special consumption tax, value added tax) rates are increased. This causes a socially unjust distribution of tax burden and increases the indebtedness of household. There will also be problems in social security (Avi-Yonah, S. Reuven, 2000: 1573). This negative outlook, which is the result of financialization, leads to speculative movements disturbing financial markets. In such an environment, any shock would suffice to trigger a financial crisis.

3. EU Work to Prevent Tax Competition

It is hard to make a quantitative analysis of the income loss that countries incur because of the harmful aspects of tax competition. Yet, given the efforts of countries as well as international organizations such as EU and OECD to prevent the harmful effects of tax competition, it can be said that the income loss related to harmful tax competition is considerable. The projects intended for preventing tax competition can be examined in two groups, which are one-sided projects and international projects (Öz, 2005: 77-119). One-sided projects cover decreasing tax rates within national borders, removing tax exemptions and exceptions, expanding tax base, introducing regulations like transfer pricing and controlled foreign corporations. The international projects cover the activities carried out by OECD and EU (Öz, 2005: 92).

The first stage of OECD's projects to prevent and counteract harmful tax competition started with the approval of the report (1998) titled "Harmful Tax Competition an Emerging Global Issue". The report categorizes the works to be done by member states in five groups: (1) identifying the list of tax havens, (2) examining harmful preferential tax regimes in member states, (3) including non-member countries in the project, (4) creating a forum on harmful tax practices (5) making recommendations concerning tax treaties and domestic legislations (OECD, 1998:9). The report offers a framework to define the concepts of harmful tax competition and tax haven. According to the report, not imposing taxes or levying only nominal taxes, not sharing information adequately, not having transparency and lack of considerable activities are some of the factors that can be stated to describe a tax haven[1] (OECD, 1998: 23).

European Union's regulations concerning tax competition date back to the Treaty of Rome at its foundation phase (Saraç, 2006:208). When EU was still at the establishment phase, the main principles of taxation were determined with the Treaty of Rome, which came into force on 01.01.1958 (Öz, 2005: 116). The purpose of the Treaty of Rome was to remove tax practices ruining competition and lay the foundations of a common taxation system among member countries (Saraç, 2006: 208). In this process, member states started to act in harmony to adopt principles like the removal of customs duties, acceptance of a common customs tariff, ban on discriminatory taxation, prevention of double taxation and tax harmonization. (Öz, 2005: 116-117). With globalization, capital mobility among member states has increased since 1980s in particular. Yet, the Treaty of Rome had not introduced any

[1] *Based on these criteria, OECD identified 47 countries as tax havens. By 2005, 33 countries in the list committed themselves to the cooperation with OECD while 5 of them refused cooperation. OECD now has three lists, which are white, grey and black. The white list covers the countries that have agreed to apply the standards. The grey list covers the countries that promised to apply the standards. The black list covers the countries that have made no commitment. By May 18, 2012, Nauru was in the grey list within tax havens and Guatemala was put in the grey list within fiscal/financial centers (Gravelle, 2013: 3-4).*

preventive measures in this field, which caused EU to search for new openings. In this direction, a committee composed of independent experts was appointed under the chairmanship of Onno Ruding, the Ministry of Finance from the Netherlands (Saraç, 2006: 210).

3.1. Ruding Report

A committee of independent experts was appointed under the chairmanship of Onno Ruding by European Commission in 1990. The committee prepared a report covering some detections and recommendations as respects harmful tax competition. It took two years to issue the report and the committee sought an answer to the question whether or not differences in corporate taxes among member states would cause ineffectiveness in terms of investment and competition (Ulutaş, 2004). To do this, the committee examined the differences in corporate tax rates, base and practices and applied extensive surveys in companies. Based on the results of this research, they concluded that differences in taxation among member countries affect the evaluation of capital and course of investment (Ulutaş, 2004). In this framework, in addition to other suggestions, the report recommends that the practices that would prevent investment among member states are ended and a minimum rate of 30% is determined in corporate taxes to prevent harmful tax competition (Methibay, 1996: 111).

3.2. Monti Memorandum

Mario Monti, a European Commissioner introduced a new protocol offering a global tax strategy in order to contribute to the completion of EU's single market in 1996. He issued a report and published a memorandum regarding harmful tax competition and its limitations (Bratton and McCahery, 2001: 684). The report puts emphasis on the important problems encountered by EU. The focus is on growth, employment, stabilization of fiscal systems and creation of single market. In this scope, there is a common agreement on relieving the tax burden on labor in order to promote employment. The commission underlined that member states are free to reduce taxes on labor and financing tools according to the principle of *subsidiarity*[2]. It is stated in the report that a schedule must be set to shift to a new and common VAT system and a commission should be appointed to create a simpler and more effective VAT system. The Commission believes that tax competition will lead to beneficial results in an objective zone to create jobs and build wealth in the long run (Commission Of The European Communities Report, 1996: 4-12).

3.3. Code of Conduct

One of the most important projects of EU intended to prevent tax competition is the "code of conduct" for business taxation adopted by the Council on December 1, 1997. The package was based on the works of the tax study group chaired by Mario Monti, the former EC Commissioner for the Single Market. This study handles three main contents of EU policies: stabilization of tax revenues in member countries, proper functioning of the single market and an increase in employment (Bozkurt, 2006: 104).

The package offers three measures: business taxation legislation, which is not binding; a draft directive on the taxation of savings and a draft directive on the taxation of cross-border interests and royalty payments (Avi-Yonah, S. Reuven, 2000: 1652).

[2] *The principle of subsidiarity in EU requires the Union not to be involved in the areas out of its exclusive competence as long as the action taken at national, regional or local level is effective enough*

- ***Business Taxation Legislation***

The legislation is, in some aspects, the most interesting one of all the three proposals. The legislation has a considerable effect on the actions of member states and the related work of OECD. The legislation is a political commitment, which is not legally binding, but it is supported by all member countries even on paper. The legislation handles business tax precautions that significantly influence or might influence the place of commercial activities within the community. It covers all tax precautions including zero taxation and considerably low effective tax levels generally applied in member countries. Such precautions are considered to be potentially harmful:

“In determining whether they are in fact harmful, several other factors are considered, including: (1) whether the tax measures apply only to nonresidents; (2) whether the measures are "ring-fenced," or segregated from the domestic market to prevent erosion of the domestic tax base; (3) whether advantages are granted without any real economic activity or substantial economic presence in the member state;(4) whether the state follows the OECD transfer pricing guidelines (to prevent artificial allocation of profits to the activity benefiting from the measure); (5) whether the measure lacks transparency (for example, if it is granted by covert administrative action)” (Avi-Yonah, S. Reuven, 2000: 1653).

The legislation offers two initiatives. One of them is that member states do not take tax precautions found to be harmful and they remove existing harmful practices (2-5 years). The second initiative is that member countries inform each other on preferential tax regimes (exchange of information) and a member state can demand to discuss about or comment on the tax precautions of another member state (Avi-Yonah, S. Reuven, 2000: 1653).

- **Taxation of Savings**

The Commission submitted a draft directive to the Council in May 1998. The draft offers a coexistence model based on two options. Each member state will either be involved in the information exchange or charge withholding tax on the interests paid to the residents of another member state by its own institutions. If a member state chooses information exchange, it agrees to automatically or annually give information about the interests payments made by the payment institutions within its borders to the individual beneficiaries residing in all other member countries. If it chooses the withholding tax option, it agrees to collect 20% withholding tax from all similar payments unless it documents that it has been informed by the tax office in its own country about the interest to be charged. Withholding tax is collected from the beneficiary in return for his/her tax debt in his/her country of residence (Avi-Yonah, S. Reuven, 2000: 1654-1655).

- **Taxation of interests and royalty**

Taxation of interests and royalty is the least controversial topic of the package. According to the draft directive, the withholding tax on interests and royalty among associated companies defined with the 25% possession threshold should be abolished within EU. Yet, tax cut is not applicable if the corporate tax is lower than the generally applicable rate or lower than the benefits obtained from preferential decrease in the tax base (Avi-Yonah, S. Reuven, 2000: 1665-1656) in the residential country.

3.4 Tax Harmonization Works to Prevent Tax Competition

Since the Treaty of Rome, tax harmonization has remained on top of the agenda for European integration. Tax harmonization is important to EU. The reason is that free movement of production factors in addition to goods and services makes the differences between domestic tax systems more distinctive (Saraç, 2006: 213). In this sense, it can be said that tax harmonization is a series of legal and administrative measures in taxation taken by member states in order to eliminate the elements that would prevent the creation and functioning of the single market in Europe (Yıldız, 2006: 555). The Union regards tax harmonization as a concept involving the harmonization of tax bases and tax rates as well as the definition of tax, (Yıldız, 2006: 555). However, the economic and financial indicators of member states are not equivalent to their volumes. Therefore, there is, by nature, an asymmetry in information. The existence of such asymmetry strengthens the claims that harmonization efforts would fail (Saraç, 2006). As a matter of fact, European Commission made the following statement in its communication titled "*Tax Policy in The European Union-Priorities for the Years Ahead*" on May 23, 2001;

> "*The commission reiterated its belief that there is no need for an across the board harmonization of Member States' tax systems. Provided that they respect EU rules, Member States are free to choose the tax systems that they consider most appropriate and according to their preferences*"

From this angle, it can be said that the EU's harmonization works mainly target to harmonize tax regulations that would prevent economic integration. To ensure free movement of production factors in the union, tax rates that ruin competition and shape capital movements must be abolished. Differences in tax structures must be eliminated. The commercial relation within the Union must be based on competition and equality (Saraç, 2006:11). EU's tax harmonization works are categorized in two groups: indirect taxes like value added tax, excise duties and direct taxes like personal income tax and corporate income tax. Among indirect taxes, particularly VAT is highlighted whereas among direct taxes, corporate tax is highlighted. Though many directives regarding tax harmonization have been published, it can be said that the EU has not made a big progress in tax harmonization so far (Saraç, 2006: 216; Yıldız, 2006: 560-565).

4. Tax Competition and Tax Policies Applied in EU during Global Financial Crisis

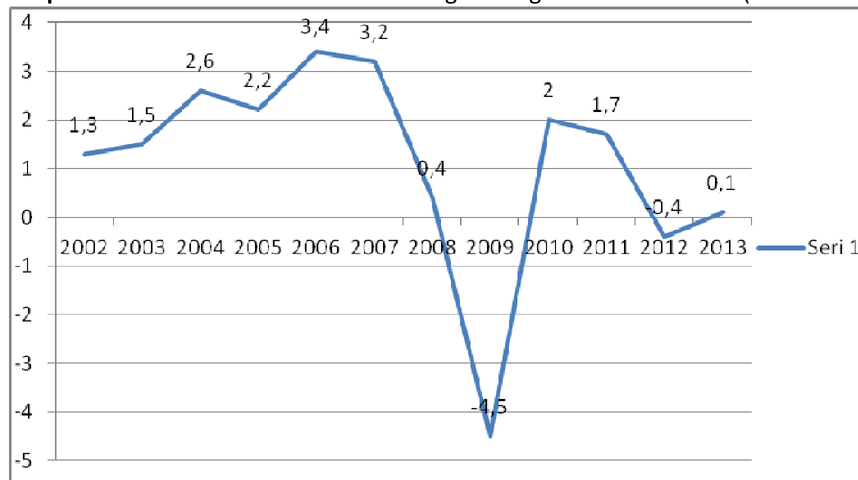
4.1. The Impacts of Global Crisis on EU Economy

Towards the end of 2007, the upheavals that broke out in the US housing credits and credit markets turned into a global crisis. The crisis which affected mainly the USA and EU countries caused big collapses in the field of finance. The process which evolved from a liquidity crisis into a debt crisis caused an unclear and insecure environment in the inter-bank zone. As a result of this, many investment banks went bankrupt and governments tried to bail out many others (Hodson and Quaglia 2009; Schelkle, 2012; Hope, 2011)[3]. The global financial crisis eventually affected real sector and spread to developed countries as well as neighboring countries trading with them. As the unemployment increased and public expenditures in fields like education and health were decreased, a great majority of the

[3] *At that time, many bank rescue packages were offered in the US and Europe. The bailout of Bear Sterns in the US and Northern Rock in the spring of 2008 was followed by the nationalization of the fund administration of the insurance/investment companies called Freddie Mac and Fannie Mae.*

society were also affected by the global crisis. The global crisis affected mainly US economy and European and other economies. Although it developed in a 4-year period, the dynamics triggering the crisis cover a much longer process (Eroğlu, 2011: 390). The situation of the world economy in the pre-crisis period gives important clues. While there was constantly a current account deficit in the US economy, there was a surplus in the economies of neighboring countries, petroleum exporting countries and China (IMF, World Economic Outlook, 2010). In that situation, the survival of US economy seemed possible with the surplus of the neighboring countries' economies. One of the biggest indications of the crisis was that the increase in the savings gap of US economy became unsustainable. The resource transfer to the USA from the world economy, the deficit in the balance of international trade and the financial bubble in the USA all constituted the preconditions of the 2008 global financial crisis. The articulation of financial markets at international level, creation of new derivatives market, development of banking industry, unlawful movement of financial capital are the reasons for the entire process (Lucarelli, 2004; Prakash, 2001; Burkett, 1987). In brief, global economy has been enshrouded in uncertainty resulting from confusion, lack of financial transparency and unlawfulness caused by financial liberalization after 1980. It can be argued that the global crisis, the implications of which are still valid, is a result of this uncertainty.

Graphic 1. Real GDP Grow Rate- Percentage Change on Previous Year (EU-27 Countries)



Source: Eurostat;
http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&plugin=1&language=en&pcode=tec00115
(Access Date: 25 April, 2014)

The crisis adversely affected the real economies of EU countries. There was a GDP regression. The growth rates which had a downtrend as from the last quarter of 2006 continued to decrease until 2010. As it can be seen in the graph, the percentage change in growth was -4,5% in EU(27) when the global financial crisis broke out. The change in growth rate was fluctuating until 2014. The effects of the crisis on EU can be observed in public finance and social sphere. In fact, the unemployment rate in EU had shown a tendency to decrease in the period before the financial crisis. Together with the crisis, the unemployment rate started to increase[4]. Increase in interests, liquidity problems and the unclear and insecure environment caused by the crisis all caused a regression in production and

[4]*The increasing unemployment rate in the young population is particularly attention-grabbing. In 2008, the unemployment rate under 25s in EU (27) was %15,8. In 2013, this rate reached 23,2% (Eurostat). Similarly, more than 25% of EU population is at risk of poverty and women having a%2 higher risk than men. Having a job is not considered to be a guarantee against poverty. 9% of the employed are under the poverty threshold. This constitutes one third of the employed population. This outlook shows that the crisis has had considerable social implications in EU.*

consumption augmenting unemployment rates. Public finance also had a negative outlook for EU. The rescue packages and economic revival packages intended to tackle the crisis increased public expenditures. In response, there was shrinkage in consumption and particularly housing-construction sectors. As a result of this, there was a decrease in tax collection. This all led to budget deficit. At that time (2009-2010), budget deficit /GDP was -6%. There is a similar tendency in public indebtedness. With the crisis, net public debt/GDP was 74%. One of the fields affected by the shrinkage in production and consumption is current deficit. The global crisis increased the current account deficit in EU. An examination of EU member states reveals that the countries with the biggest public deficit in 2013 were respectively: Slovenia (-14,7), Greece (-12,7), Ireland and Spain (-7,1). The countries with the highest unemployment rate as of 2013 were respectively: Greece (27,3), Spain (26,4) and Portugal (16,4). The EU countries that were affected by the global crisis the most were Greece, Spain and Portugal.

Table 1. Euro Area (27): Macroeconomic Changes during the Financial Crisis Process

Years	***Gross Domestic Product Percent Change***	***Unemployment Rate****	***General Government Net Debt/ GDP***	***Current Account Balance/ GDP***	***General Government deficit-surplus /GDP****
2003	0.718	9,1	54.953	0.518	-3,2
2004	2.204	9,2	55.380	1.243	-2,9
2005	1.707	9,0	55.692	0.496	-2,5
2006	3.250	8,2	54.307	0.501	-1,5
2007	2.999	7,2	52.077	0.375	-0,9
2008	0.376	7,0	54.088	-0.709	-2,4
2009	-4.404	9,0	62.351	0.246	-6,9
2010	1.965	9,6	65.617	0.591	-6,5
2011	1.549	9,6	68.225	0.707	-4,4
2012	-0.641	10,4	72.239	1.861	-3,9
2013	-0.437	10,8	74.867	2.326	-3,3

Source: IMF, Outlook Database 2013
http://www.imf.org/external/pubs/ft/weo/2013/02/weodata/weorept.aspx?pr.x=62&pr.y=12&sy=2003&ey=2013&scsm=1&ssd=1&sort=country&ds=.&br=1&c=163&s=NGDP_RPCH%2CLUR%2CGGXWDN_NGDP%2CBCA_NGDPD&grp=1&a=1
***Eurostat**,http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&init=1&language=en&pcode=tec00127&plugin=1
http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&init=1&language=en&pcode=tsdec450&plugin=1

4.2. Tax Policies Applied by EU in the Global Crisis

Contrary to the classic view, after the 2008 global crisis, it has been reiterated that markets will not be able to recover on their own and there is a need for state intervention. The USA and many EU countries presented rescue packages of billion dollars and prepared fiscal programs covering public expenditures and tax policies to overcome the crisis. Because the crisis affected both financial and real sectors, the policies introduced to fight against the financial crisis are the tools of monetary and fiscal policies. The crisis affected foreign trade, credit markets, employment and social fields such education and health in EU. The uncertainty that enshrouded markets together with the crisis increased banks' liquidity needs and there were more demands for guarantee from governments. On the other hand, governments widely accepted the tax policies composed of tax incentives and cuts in order to make up for the decrease in capital profits.

Central banks initially reacted against the crisis in two ways. The first is to meet the liquidity and the second is to decrease tax rates. On 9th- 14th August 2007, the Federal Reserve, "The ECB and the Bank of Japan coordinated their efforts to respectively inject USD 64 Bio, EUR 229 BİO, and JPY 1 trillion to provide banks with liquidities" (Hemmelgarn and Nicodeme, 2010: 18). In the period concerned, European Central Bank systematically decreased interest rates[5] (European Commission, 2009: 57).

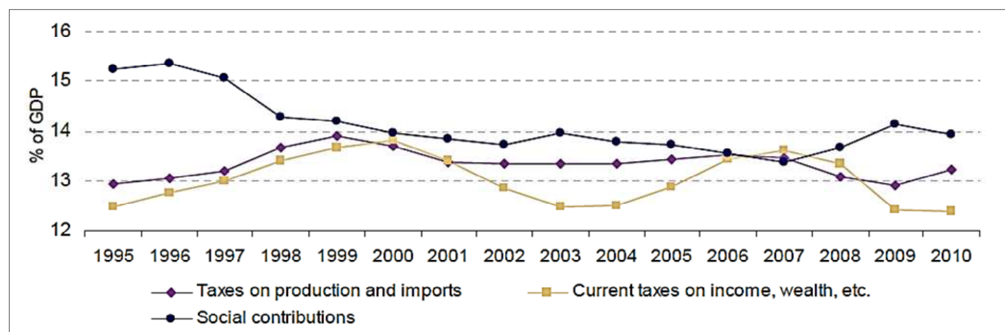
The tax measures taken within the scope of fiscal stimulus packages are among the leading fiscal policies. Due to the shrinkage in the production and consumption of member countries on global scale, there have been significant decreases in tax incomes. On the other hand, fiscal stimulus packages have increased public expenditures leading a rise in budget deficits (Brondolo, 2009: 9). During financial crises, high unemployment and low profitability cause a decrease in tax base bringing about troubles in public finance. In most countries, tax revenues drop as a result of crises. An important reason for this drop is the mobility of capital (Hudson and Chowdhury, 2010).

When the tax composition of EU before the financial crisis is examined, the effect of crisis on tax policies can be more clearly seen. The majority of tax revenues (more than %90) in EU come from three sources: indirect taxes (VAT, taxes on consumption, production and imports, excise duties), direct taxes (current taxes on income and wealth, capital taxes) a social security contributions (SSCs) (European Commission Report, 2010: 17). The ratio of tax burden to GDP in EU is (measured by total taxes-including social security contributions) higher than international standards. In fact, this ratio has been 39,3% since 2008. The tax burden in EU is higher than the average of the USA, Japan and OECD (including 19 EU countries) (European Commission Report, 2010a: 17). Tax levels change from one country to another within the union. We can put the Nordic countries such as Denmark, Finland, and Sweden and some EU Member States under the category of high-tax countries. A group of five EU Member countries (Belgium, Austria, Italy, France, and Hungary) had high tax ratios accounting for more than 40 % of GDP in 2008, followed by Germany and the Netherlands with 39.3% and 39.1% of GDP respectively. Except for Cyprus, geographically more peripheral countries, especially those in Eastern Europe, are more likely to show lower tax ratios (Euro Commission Reports, 2010: 13). Since 1999, tax ratios (overall tax-to GDP ratio) have

[5] *"October 2008. European Central Bank (ECB) cuts its interest rate on its main refinancing operations (Refi) by 50 basis points (bp.) to 3¾ % in a coordinated move with other central banks. November 2008; ECB cuts Refi by 50 bp. to 3¼ %. December 2008; ECB cuts Refi by 75 bp. to2½ %. January 2009; ECB cuts Refi by 50 bp. to 2%. March 2009; ECB cuts Refi by 50 bp to 1%" (European Commission, 2009: 57).*

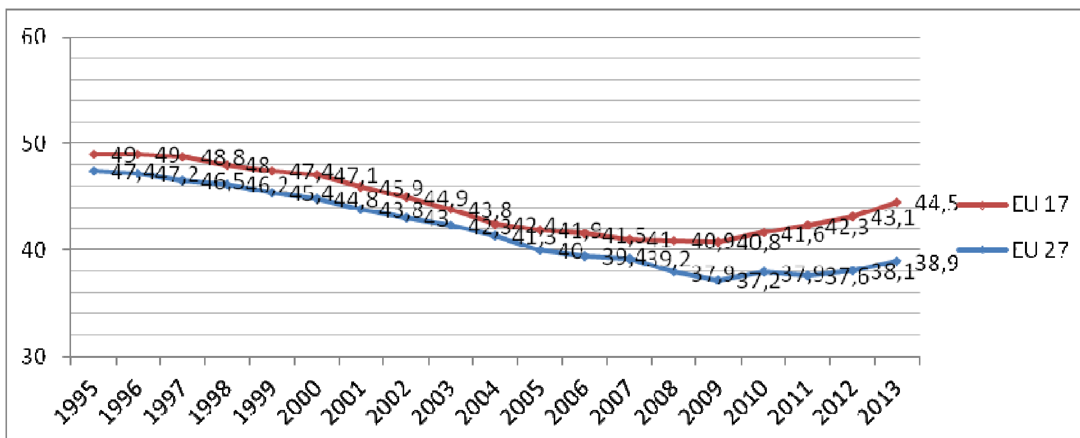
generally had a tendency to drop. This trend continued until 2004. After 2004, tax ratios started to increase (to finance the increasing budget deficit). However, when the crisis broke out, there was a sudden decrease in tax ratios (from 39,3% to 38,4%). This trend continued in 2010, too. In 2011, however, tax ratios started to increase. Tax revenues started to increase as from 2010 and they came back to the level before the crisis in 2011 (European Commission Report, 2013: 21).

Graphic 2. Evolution of the Main Components of Tax Revenue in the EU-27 in Percentage of GDP, 1995-2010



Source: Laura WAHRIG, Eurostat Statistics in Focus 2/2012, p.3.

Graphic 3. Top Personal Income Rates 1995-2013 (EU 27-EU 17)



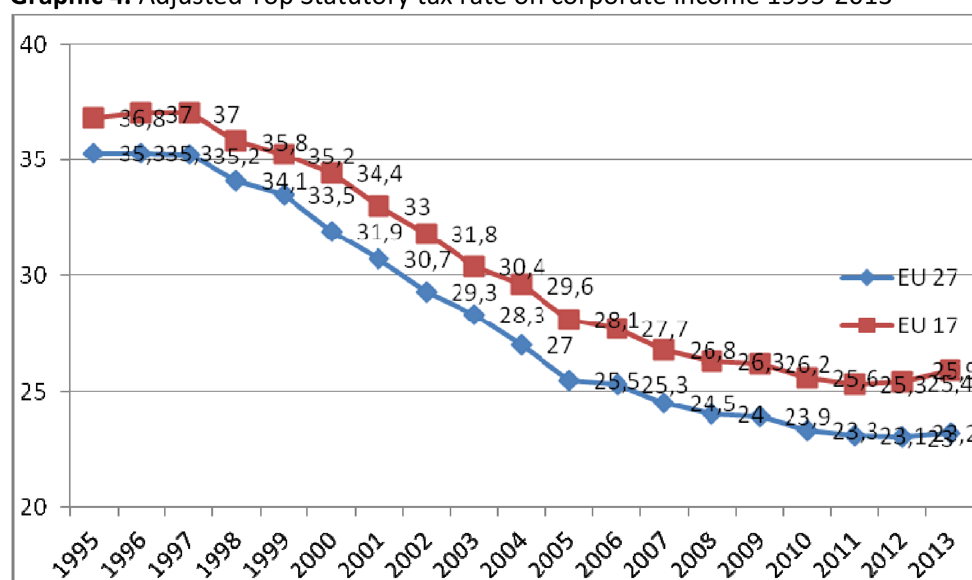
Source: European Commission Report, 2013.

As it can be seen in the graph above, income ratios have been constantly decreasing in the EU since 1995. It was in 2010 when they started to rise. It can be said that one reason for this is the increase in budget deficit. There was an increase in budget deficit because there was a desire to remove the erosion in public income resulting from the crisis. Fiscal revival packages increased public expenditures and pressured budget, which caused governments to need public income. Thus, income tax ratios increased until 2013.

There is a similar tendency in corporate tax ratios, too. Corporate tax is one of the most emphasized taxes within the framework of international tax competition and EU's tax harmonization works. Given the tax burden in EU, it can be said that corporate tax ratios in EU are high. It should be noted that corporate tax ratios affect the investment decisions of capital. As mentioned earlier, decreasing corporate tax ratios with the purpose of attracting

capital could have harmful effects. The graph above shows that these ratios have been constantly decreasing since 1995. The decrease in corporate tax is more evident during the crisis. Tax ratios are decreased mainly because of the negative effect of the crisis on real sector. Shrinkage of global trade, increase in household debt, decrease in consumption and depreciation in financial markets all affect the profitability rates of mobile and fixed capital. During the crisis, there were many considerable capital outflows from the financial markets in Euro AREA. In 2007, the proportion of capital injection to GDP was 40%, but there was a rapid drop under the influence of the crisis and this proportion regressed to 3% in 2009. This significant decrease had negative effects on both financial markets and the balance of payments (Lane, 2013: 28). Big amounts of capital outflows adversely affected markets leading to a decrease in investments. Insufficient liquidity, unsafe and risky environment and capital outflows caused depreciation almost stopping productions. Therefore, it can be said that the decrease in corporate taxes was intended for partially compensating the capital depreciation.

Graphic 4. Adjusted Top Statutory tax rate on corporate income 1995-2013



(EU 27- EU 17)
Source: European Commission Report, 2013.

Table 2 provides a more detailed analysis of the change in tax ratios during the crisis in EU countries. At it can be seen, EU countries mostly decreased their tax ratios in the course of the crisis. It can be seen that especially England, Ireland and Greece increased income tax ratios. In 2010-2011, these countries were followed by Spain, France, Portugal and Latvia. All these countries are similar in that they had the biggest public deficit among EU member states. In 2009, the top ranking countries in the list of public deficit were respectively England -11,4%, Ireland -13,7%, Greece -10,9%, Portugal -10,2% and Spain -11.1%[6]. There is a similar tendency in corporate taxes, as well. Most countries excluding Italy, Lithuania, Portugal, Greece, Luxembourg and Romania decreased their corporate taxes. However, the situation is different in VAT and SCT. Many countries increased these taxes. Thus, it can be inferred that governments wanted to make up for the loss in public income resulting from shrinkage of consumption in this way.

[6] *http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&init=1&language=en&pcode=tec00127&plugin=1*

Graph 4 provides the public income and expenditure in EU during the crisis. The gap between public income and public expenditures grew more when the crisis started to impact EU. The gap reached the highest level in 2009. Since 2010, public expenditures have been decreased and public incomes have been increased. Thus, the gap is being closed.

Table 2. Tax Trends in EU during the Financial Crisis (2008-2011)

		2008-2009*		**2010-2011****	
		Statutory Rates	**Base or Special Regimes**	**Statutory Rates**	**Base or Special Regimes**
Personal Income Tax	**Increase**	UNITED KINGDOM, IRELAND, GREECE	**IRELAND, CZECH REPUBLIC, ESTONIA**	GREECE, SPAIN, FRANCE, IRELAND, LATVIA, LUXEMBOURG, PORTUGAL, UNITED KINGDOM	**AUSTRIA, CZECH REPUBLIC, DENMARK, ESTONIA, SPAIN, FRANCE, IRELAND, LATVIA, PORTUGAL, ROMANIA, SLOVAKIA, UNITED KINGDOM**
	Decrease	GERMANY, AUSTRIA, DENMARK, FINLAND, FRANCE, NETHERLANDS, SWEDEN, LATVIA, LITHUANIA, LUXEMBOURG, HUNGARY, MALTA, POLOND, PORTUGAL, SLOVAKIA, SLOVENIA	**GERMANY, AUSTRIA, BULGARIA, SPAIN, SWEDEN, ITALY, PORTUGAL, SLOVAKIA, ROMANIA, BELGIUM**	**GERMANY, DENMARK, FINLAND, HUNGARY, NETHERLANDS**	**AUSTRIA, BULGARIA, GERMANY, FINLAND, ITALY, LITHUANIA, SWEDEN**
Corporate Income Tax	**Increase**	**ITALY, LITHUANIA**	-	**GREECE, PORTUGAL**	**LUXEMBOURG ROMANIA**
	Decrease	**SWEDEN, LUXEMBOURG, PORTEKİZ, GREECE**	**GERMANY, AUSTRIA, BULGARIA, FRANCE, NETHERLANDS, SPAIN, ITALY, LITHUANIA, POLONYA, PORTUGAL, SLOVAKIA, SLOVENIA**	**CZECH REPUBLIC, GREECE, HUNGARY, LITHUANIA, NETHERLANDS, UNITED KINGDOM**	**AUSTRIA, BELGIUM, GERMANY, SPAIN, LITHUANIA, NETHERLANDS**
Social Security Contributions	**Increase**	**IRELAND, ENGLAND, ROMANIA, LITHUANIA**	-	**IRELAND, LATVIA**	**BULGARIA, CZECH REPUBLIC, IRELAND, LITHUANIA, PORTUGAL, ROMANIA, SLOVAKIA**

	Decrease	CZECH, FINLAND, NETHERLANDS, HUNGARY, SWEDEN, SLOVAKIA	-	BULGARIA, HUNGARY	
Value Added Tax	Increase	HUNGARY, IRELAND, LATVIA LITHUANIA	-	CZECH REPUBLIC, GREECE, SPAIN, FINLAND, HUNGARY, LATVIA, POLAND, PORTUGAL, ROMANIA, SLOVAKIA, UNITED KINGDOM	BULGARIA, CYPRUS, GREECE, SPAIN, FRANCE, PORTUGAL, LATVIA
	Decrease	ENGLAND	-	IRELAND	BELGIUM,, GERMANY, HUNGARY, LITHUANIA, NETHERLANDS, POLAND
Excise Duties	Increase	-	-	AUSTRIA, BULGARIA, CYPRUS, CZECH REPUBLIC, GERMNAY, DENMARK, ESTONIA, GREECE, SPAIN, FINLAND, FRANCE, IRELAND, HUNGARY, LATVIA, MALTA, NETHERLANDS, POLAND, ROMANIA, SLOVENIA, SLOVAKIA, UNITED KINGDOM	DENMARK, IRELAND, ITALY, LATVIA
	Decrease	-	-	AUSTRIA, BULGARIA, SLOVAKIA	BELGIUM, NETHERLANDS
Taxation Property	Increase	-	LATVIA	CZECH REPUBLIC, GERMANY, GREECE, FRANCE, LATVIA, PORTUGAL	LATVIA
	Decrease	SPAIN, ITALY, LUXEMBOURG, PORTUGAL, GREECE			

Source:*Hemmelgarn and Nicodeme, 2010:19, **European Commission Report, 2011: 32.

The decline in tax ratios became more pronounced in 2009 under the impact of the crisis. This was due to two factors. Firstly, many countries adopted significant fiscal stimulus packages under the European Economic Recovery Plan, in the form of both expenditure increases and tax cuts to support household's purchasing power and relieve enterprises. The revenue-based stimulus measures were around ¾% of GDP in 2009 and 2010. Secondly, the declining tax ratio mirrors a more than proportional fall in certain tax categories, particularly in property taxes, in response to the sharp drop in economic activity, thereby reversing the windfall revenues collected during the preceding boom years (European Commission Reports, 2010: 16).

4.3. Evaluation of Tax Competition in the Post-Crisis EU

Concerning the battle against tax competition, the stage the EU has reached needs discussion. The most debatable issue in tax competition theory is whether or not tax competition is beneficial. A closer look into the tax competition policies during the financial crisis in EU shows that tax competition is beneficial for countries in the short term because it alleviates the impacts of the crisis, but it may be harmful in the long term because it impoverishes capital movements and prevents common policies. EU assumes that tax competition is harmful and leads the initiatives intended to prevent it; however, to what extent it does prevent tax competition within itself needs to be discussed. The most important indicator regarding this is the difference in countries' corporate tax rates. On the other hand, EU member states decreased their corporate tax ratios during the crisis and get involved in the competition, which adversely affected the work about tax competition. Since companies shifted to countries with an attractive tax regime during the crisis, it became inevitable for countries to make policies in this direction.

Despite the works to fight against tax competition, it is seen that most of the EU member states have adopted competitive policies. Effective tax ratios are an important factor affecting the investment and settlement decision of multi-national enterprises (Giray, 2005: 94). An examination of effective tax rates in non-financial sectors in EU countries shows that the rates have decreased in each and every country and countries all have different rates (European Commission Report 2013: 262). Competitive structure of capitalist economy forces countries to compete to be stronger in political and economic fields. Competition is an intrinsic part of capitalist economy. Given the dominant paradigm, EU shows conflicting behaviors by introducing regulations to prevent tax competition. EU justifies this conflict with the assumption that capital can move more effectively and productively with the prevention of tax competition. However, the competing interests of global capital and nation states show that effectiveness and productivity are relative. The ultimate goal of global capital is to increase profitability. Yet, states sometimes have to introduce regulations like income distribution and social security which would ensure social justice so as to guarantee the sustainability of the system. It seems conflicting that liberals, who object to state intervention at institutional level, find it necessary during the crisis. This was, in fact, the case in global financial crisis. However, liberals can be said to be consistent with their ultimate goal.

An analysis of EU's tax structure during the global financial crisis reveals that the fiscal burden on capital is decreasing, but the fiscal burden on consumption and labor force is increasing. This means that the tax burden on more mobile capital is decreased and the cost of this (in terms of budget deficit) is paid by labor, which is less mobile.

The tax policies applied by EU during the crisis negatively affected tax competition and EU's work to prevent tax competition were interrupted. Countries acted individually depending on how much they were affected by the crisis instead of acting according to common policies. This causes the questioning of the course of tax harmonization and coordination works.

5. Conclusion

Tax has been a critically important notion for centuries. Taxation became an international issue with the emergence of nation states and development of international market relations. Together with globalization, the political and economic relations between

countries increased and in this process, one of the major factors affecting their relations was the taxation structure they each had. For example, while foreign investors are determining which country to move their capital to, they consider labor force cost and capital gains. If the target country has high taxes on labor force or if the taxes on capital are high, investors will prefer another country. In such a situation, countries tend to cut taxes or introduce tax incentives in order to attract capital. As a result of this, part of tax income will be eroded. Capital will be distributed ineffectively and international competition will adversely be affected. On the other hand, tax revenues are important to countries. The most important income source in public finance is taxes. Any decrease in tax revenues put public finance in difficulty. Such a result leads states to apply two strategies: To borrow and to increase tax sources. Over the years, corporate tax rates have decreased while the proportion of total tax income to GDP has increased. This shows that the tax burden on other tax sources increased. Finally, both strategies turn out to be ineffective and lead to income injustice.

Countries' attempts to offer attractive fiscal opportunities to investors in an environment where capital movement has been liberalized eventually interrupt global competition and cause ineffective distribution of sources (capital) and unequal development of countries. On the other hand, this leads to positive results for some countries, especially the ones that do not have qualified labor force or lack the technology or industry to compete in international platforms and the countries where service sector is developed.

It should also be noted that low tax ratios are not the only determining factor in the decision-making of investors. Some other factors like the development of financial markets with globalization, diversification of fiscal tools and instruments, taxation of savings and interests, flexibility of tax legislation and operation costs should also be taken into consideration.

Tax competition is more intense during crises. Taxes are the primary fiscal policy tools used in the battle against crises. As in 2008 global crisis, governments increase public expenditures to overcome liquidity problem and cut taxes to increase consumption or promote investment. Considering the financial aspect of crises today and such free capital movements, it can be stated that any change in tax ratios might significantly affect the preferences of capital. As a matter of fact, the financial capital escaped from the financial centers, where the global financial crisis was intense and moved to countries where it felt safer because of attractive interest and tax policies.

In this respect, one of the results of this study is that EU countries had a negative influence on tax competition by decreasing or increasing tax ratios to tackle the global financial crisis. The most important reason why tax ratios are decreased and special tax regimes are applied is to prevent the outflow of financial capital and fixed capital investments. Another reason is to provide financial guarantee for the financial capital affected by the crisis, though partially. Together with the financial crisis (2007-2009), there were considerable capital outflows from the Euro zone. There has been capital injection under the influence of financial policies since 2010, though not so much.

Another conclusion of this study is that tax harmonization and coordination works intended to overcome tax competition were interrupted by the financial crisis. This shows that tax coordination and harmonization works in EU do not work if member countries prioritize their national economic benefits. The idea of creating common policies in a field like taxation, which is of great importance from an economic and political perspective, has been rocked to its foundations.

The financial crisis has one more proved the importance of public fiscal policies. Although member countries can apply common fiscal policies for a single market, national fiscal policies come to the forefront whenever there is a crisis. The main reason for this is that member states have different economic and political structures and they are differently affected by the global crisis. This difference affects countries' performance in tax harmonization to fight against tax competition. In conclusion, it is evident that some factors like the rapid development in communication and technologies within EU, development of e-trade market, increased international competition and deepening political and economic crises will lead to new quests in taxation and fight against tax competition.

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