

## INFLUENCE OF EXCISE AND VAT UPON PRICE COMPETITION

Merce Cristian \* Roman Lucian \*\* Ladar Călin \*\*\*

- \* University of Agricultural Sciences and Veterinary Medicine, Calea Mănăștur 3-5, 400372 Cluj-Napoca, Romania, e-mail: [cristiancmerce@yahoo.com](mailto:cristiancmerce@yahoo.com);  
\*\* University of Oradea, Faculty of Environmental Protection, 26 Gen. Magheru St., 410048 Oradea, Romania, e-mail: [lucianroman54@yahoo.com](mailto:lucianroman54@yahoo.com);  
\*\*\* University of Oradea, Faculty of Environmental Protection, 26 Gen. Magheru St., 410048 Oradea, Romania, e-mail: [ladarcalin@yahoo.com](mailto:ladarcalin@yahoo.com);

### **Abstract**

The article establishes the idea that the type of price competition is the kind of competition in which one of the competitors is trying to attract the customers of the other competitor, by charging a lower price. Excise and VAT affect differently the price competition. Excise mitigates price competition while VAT maintains the competitive conditions. Excise being a tax applied to quantity, is equally applied to both competitors and makes as the price reduction practiced by one of the competitors to be mitigated as price reduction rate. VAT being proportional with the price does not affect the rate of price reduction and maintains the competitive conditions. Typically, the state practices a combination of two types of indirect taxes causing, in terms of the state the achievement of a balance connected to two objectives: secure revenues for the budget and a stimulating competitive market. The excise ensure secure revenue to the budget and VAT ensures the maintenance of the competitive conditions in the market.

**Key words:** duty, VAT, price competition.

### **INTRODUCTION**

Price competition leads to the increase of demand while increasing the supply of goods. The price decrease leads to an increase in the required amount and for a beneficiary it leads to lower costs due to some average fixed costs (unit), therefore the firms will increase their production. As it is known, the price competition has a disinflation or even deflation effect.

The only problem that arises and is specific to agriculture and not only refers to that part on which it is usually found, that is the demand curve, the pair quantity - price falls in the less elastic or even inelastic area.

For this reason, the decrease in price will lead to a drop in revenue, which is not desirable. Lower income for producers also means lower VAT for the budget. On the other hand, the lack of price competition means higher prices, higher incomes to the state budget, but not necessarily higher revenues for the producer. Price increase by increasing excise leads to the decrease of the traded amount and to the increase of the average fixed costs (per unit). In this context, firms must reduce their production because they face a lower demand.

## **MATERIAL AND METHOD**

Competition is a complex process within which the traders are confronted with the market and therefore competition may take actual different forms and can be viewed and analyzed from different points of view (Cocioc P, et al, 2000, Ch. 11.2 ).

Price competition is a competitive subspecies, namely that type of competition which consists in practicing a lower price than the competition, when there is a homogeneous product. The views expressed in this article are the result of inventory, analysis and selection of opinions expressed by various experts on competition in general, and on price competition in particular.

The price competition model is described by the author in the literature ( Merce C. C, 2006). This model is different from the classical model in which the "market" sets the price and equilibrium quantity (Ghişoiu Magdalena et al, 2000). Comparative analysis of the two models naturally triggers the question: If the price is not determined by the buyers and sellers, then by whom? By the "market"?

There are different ways of determining the price on the free market, either by the sellers, or by buyers or by both sellers and buyers.

The main used method is the comparative analysis on pricing and costs as well as their role in stimulating competition as a source of economic prosperity.

## **RESULTS AND DISCUSSIONS**

The recent measure of decreasing VAT in agriculture will lead to a decrease in price competition, and will be beneficial for the small producers, producers for whom the competition of large producers is devastating.

The large farmers benefit from average low costs (unit) due to the used varieties, pesticides, fertilizers and advanced machinery etc. In other words, large firms have a competitive advantage due to the advanced technologies. When these large companies are in competition with small firms, it is clear that many of the small companies will go bankrupt. In both cases it is worth studying what effect has the duty and VAT on competition. Competition is desirable in the economy and in fact the ideal model is a competitive economy. In economics, however, the most common are situations where there is a certain level of competition between firms and a level of collusion. The tax system that used both excise and VAT is a tax system on tax. What's worse, though, is that the excise falsifies the price competition and creates a quasi-monopoly situation. The article exemplifies

a situation in which there is only excise duty, only VAT or excise duty and VAT.

Using only VAT, although it involves certain risks for the state budget is where the price competition is favored in the highest degree.

Using only the excise duty that is without risk to the state budget, favors the monopolistic arrangements in the highest degree.

The question arising from this "study case" is whether the state should aim in its policy to increase competition among producers - sellers or an increase of revenues to the state budget.

The excise duty is a tax per product amount and is not related to price. Therefore, the use of excise ensures a secure income to the state budget unlike VAT which is a tax applied in percentages to the cost and therefore it is influenced by the seller by altering the price.

Although it seems that the application of a tax to tax is not correct, this type of taxing allows a tax mix that can achieve a desirable balance between two objectives in the economy. One of these goals is to encourage the price competition, competition that leads to the lowest prices possible. A second objective is to bring revenue as safe as possible to the budget. The usage of excise guarantees secure income to the state budget while a VAT, high enough, ensures a desirable level of competition in the economy. Eventually it seems that the tax on tax practiced in many countries is a satisfactory compromise for the two objectives. In order to increase the level of competition, it can be practiced a higher level of VAT on luxury goods. In agriculture, in addition to VAT as a quasi-universal tax, there is also the excise duty on inputs such as diesel, or excise duty on final products, such as wine or brandy.

The excise duty on diesel is transmitted as a cost to the final good, a situation that makes it appear as a double taxation. The excise duty on alcohol products is combined with VAT when the alcoholic products go on sale, making it appear again the tax on tax situation.

In addition to the overall level of taxation in agriculture, level of taxation that can be a lever for the development of agriculture, the state can intervene by the mix of taxes (excise, VAT) to achieve macroeconomic objectives.

By decreasing the excise and increasing VAT, the state encourages the price competition which in turn leads to an increase in demand for agricultural products but lose safe income to budget. It is about a policy of economic expansion. By increasing the excise and decreasing VAT, the state provides secure income to the budget but the demand for agricultural products decreases. It is about a policy of economic contraction. The effects of the stated assumptions are shown in the following three scenarios:

**a. Scenario one**

- producer's initial price is 100 euro / kg.
- Excise is 300 lei / kg and 25% VAT.
- The selling price is  $P_v = 100 + 300 + 100 = 500$ .
- Reduction of the price to 80 lei / kg at the producer, makes the excise 300 lei / kg, and VAT is 95 lei / kg.
- retail price is;  $P_v = 80 + 300 + 95 = 475$ .
- Relative decline in the price of production is:  $RPP = (80-100) / 100 * 100 = 20\%$ .
- Low relative selling price is:  $RPV = (475-500) / 500 * 100 = -5\%$

**b. Scenario two**

- producer's initial price is 100 USD / kg, the excise duty is 400 euro / kg.
- The selling price is  $P_v = 100 + 400 = 500$  USD / kg
- A reduction in the price to 80 lei / kg makes the final sales price to be:  $P_v = 80 + 400 = 480$  USD / kg.
- Relative decline in the price of production is:  $RPP = (80-100) / 100 * 100 = 20\%$ .
- Low relative selling price is:  $RPV = (480-500) / 500 * 100 = -4\%$

**c. Scenario three**

- producer's initial price is 100 USD / kg, 400% VAT, so VAT is 400.
- The selling price is  $P_v = 100 + 400 = 500$  USD / kg.
- A reduction in the price to 80 lei / kg makes VAT equal to 320 lei / kg and selling price  $P_v = 80 + 320 = 400$  USD / kg.
- Low relative price of production is:  $RPP = (80-100) / 100 * 100 = 20\%$ .
- Low relative selling price is:  $RPV = (400-500) / 500 * 100 = 20\%$ .

The decrease of production, respectively selling costs, by adopting one or other of the presented scenarios, is suggestively illustrated by the graphic (figure no. 1).

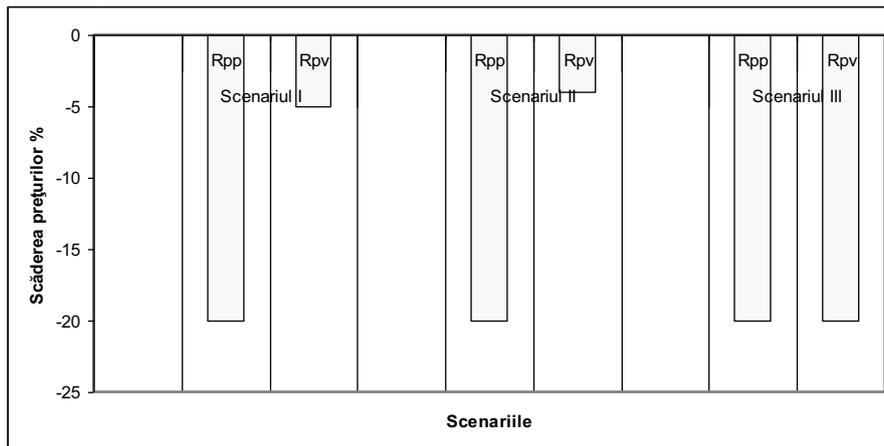


Fig.1 Decrease of production and respectively sales costs, within the three scenarios

## **CONCLUSIONS**

The excise duty and VAT are indirect taxes that provide revenue to the state budget. Their influence on price competition is different. Of the three scenarios, scenario three provides the greatest price competition, and the second scenario protects the least price competition, but ensures the utmost budgetary revenues. Scenario one reflects a mix of indirect taxes (excise and VAT) and provides a balance between the two objectives pursued by the state: secure revenues at the budget and protection of a certain level of market competition. Price competition favors the consumers who purchase the product at a lower price, a visible effect in the case of scenario three.

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