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TAXATION INFLUENCE ON ECONOMIC STABILITY IN ROMANIA AND EUROPEAN UNION

Methodological article

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Abstract

The aim of the paper is the taxation system in Romania and European Union. The first part is concentrated on the theoretical and general aspects regarding the European fiscal policies with a focus on the conditions that member states should respect. Our research continues with the comparison between the share of indirect taxes and direct taxes at the EU level. We discovered that there are some fiscal connections between countries with similar economies. At the end, we emphasized the conclusions obtained with our article.

Introduction

Economic stability encourages economic growth that brings prosperity and employment, represents one of the main objectives in the management of Economic and Monetary Union and The Euro Zone.

The fiscal system is one of the most important elements of the international economic relations established between the States. In a simplistic approach, the fiscal system expresses in terms of the whole of the import duties and taxes from a member. Beyond the main objective on the cover of public expenditure, which is generated by the public needs, the fiscal system must be regarded as a main tool in the creation of favorable economic growth and sustainable development.

The European Union and the Euro Zone have extended gradually, the progress of macroeconomic harmonization being obvious in the last decade. The significant differences between monetary and the fiscal policy of European states are remarkable: while the European Central Bank carrying out monetary policy common to the Member States of the euro area as they waited for the other states to adjust their policies in accordance with the convergence criteria supported by the treaties to Maastricht, fiscal policies are still under the supervision of national authorities. (P. Rozmahel, L. IsseverGrochova, M. Litzman, ”The effect of asymmentries in fiscal policy conducts on business cycle correlation in EU”, *Europe Working Papers Series from Austrian Institute of Economic Research, article with no. 62*, 2014)

At European Union level, fiscal policy is oriented toward the operation without difficulty of the single market, each country is free to adopt its own fiscal policy, more or less developed in close connection with the degree of economic development, social and military markets.

1. Economic stability

Under Economic and Monetary Union (EMU), EU Member States closely coordinate their economic policies with the overall objective of maintaining economic stability. At the same time, the European Central Bank (ECB) conducts an independent monetary policy with the objective of maintaining low inflation in the euro area (below but close to 2%). Economic stability and low inflation create the necessary conditions for sustainable long-term growth, which benefits the euro-area Member States and their citizens.

In the same time, Member States need to maintain their government and debt deficits under specified limits (3% and 60% of GDP), in accordance with the Treaty and the rules set out in the Stability and Growth Pact. Established limits are one of the convergence criteria a country must achieve before it qualifies to adopt the euro. The goal is to ensure sound and sustainable public finances in the Member States of the EU and the euro area.

Sound public finance means that Member States do not generate excessive debts that will burden future generations of taxpayers. In theory, governments could borrow heavily in order to invest and boost economic growth, but this represents a short-term measure as debt repayments would harm economic growth in the future.

The obligation to sound and sustainable public finances is a promise to ensuring economic growth and employment over the longer term. It also helps to ensure that today's and tomorrow's citizen’s benefits are fair – for example, through adequate healthcare provision and pensions.

As with consumers and companies, governments and their citizens, benefit greatly proceeds from economic stability. Low inflation, well-managed euro area makes government borrowing less expensive. This means that interest repayments on national debt, which can be substantial, are minimized. Hereby, large amounts of money picked-up from taxpayers, previously used to repay the interest, will be used for other purposes depending on national priorities; for example, for tax cuts, new public infrastructure, or welfare systems. In addition, economic stability allows governments to plan more certainty national finances, expenditure and revenues.

Economic stability also makes the euro area more resistant to external economic 'shocks', such as sudden economic changes that may arise outside the euro area and disrupt national economies, such as worldwide oil price rises or turbulence on global currency markets. The size and strength of the euro area make it able to absorb such external shocks without job losses and lower growth. (http://ec.europa.eu/economy_finance/euro/why/stability_growth/index_en.htm)

2. Economic stability and growth

The SGP (Stability and Growth Pact) represent a set of rules which ensure that European Union countries will have a healthy public finances and fiscal policies will be coordinated.

The aims of some SGP’s rules are to prevent fiscal policies go to potentially problematic directions and to correct excessive budget deficits or public debt burdens.

The rules of the SGP’s ‘preventive arm’ bind European Union governments to their commitments towards sound fiscal policies and coordination by setting each one a budgetary target is known as Medium-Term Budgetary Objective (MTO).

Member States who intend to witch to euro as their currency, they need to reach their MTOs in ‘Stability Programmes, such other EU Member States do so in Convergence Programmes. All these criteria are assessed by the European Commission

and EU governments during the European Semester.
The Excessive Deficit Procedure (EDP) correct the excessive budget deficits or excessive public debt levels in order to control excessive deficits and reducing excessive debts.
The EU Treaty defines an excessive budget deficit as is greater than 3% of GDP and public debt is considered excessive if it exceeds 60 % of GDP without diminishing at an adequate rate (defined as a decrease of the excess debt by 5% per year on average over three years).
Countries that fail to respect the SGP's preventive or corrective rules may ultimately face sanctions.
For Member States sharing the euro currency, this could take the form of warnings and ultimately financial sanctions including fines of up to:

- 0.2 % of GDP, if they fail to submit by either the preventive or the corrective rules, or
- 0.5 % of GDP, if they repeatedly fail to submit by the corrective rules. In addition, all Member States (except the United Kingdom), could see a suspension of commitments or payments from the EU's Structural and investment funds (e.g. the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund).

It can be seen that things are generally moving in the right direction. Efforts are being made tore design tax systems in a way that supports jobs and growth, and that – crucially – ensures fairness. For example, it can be seen a trend towards targeted measures to protect vulnerable groups. There has been a new and very visible focus on tackling tax evasion, so that honest citizens don't pay for the tricks of the dishonest. And, many Member States have also focused their tax reforms on boosting competitiveness, for example, by reducing corporate tax rates or using tax measures to encourage research, investment and entrepreneurship. All of this is encouraging, and shows the recognized value of the partnership approach offered through the European Semester. However, this certainly does not mean that the job is done. Tax reform is not an overnight process. It requires consistency, dedication and continuous review.
Main trends in taxation come from the difficult fiscal positions of many Member States led to an overall increase of the tax burden. Given the continued need for the fiscal consolidation, the overall tax burden kept growing in many Member States (revenues from direct and indirect taxes as well as social security contributions). Following the outburst of the crisis, tax revenues were at their lowest in 2009-2010. Since then, the tax burden has grown due to fiscal consolidation measures. Between 2010 and 2013 revenues from both direct and indirect taxes have increased. As a share of GDP the increase has been limited: revenues from direct taxes have increased by less than 1 percentage point of GDP and those from indirect taxes of about half percentage point of GDP.

3. The taxation system in the European Union

Along the time the taxation system has undergone important legislative interventions and it was placed in each Member State under different forms to bring the hall-mark on the Economic and Social space.
An important objective of the European fiscal policies shall be represented by the limitation of the budget deficit to 3 percent of the GDP, this condition being imposed by the Treaty of Maastricht (1992). The general purpose of such limitation is to keep the balanced budgets at the level of the business cycle. Thus, the increase of the public expenditure may not be financed by the public debt, but just by increasing the revenues of public incomes.(www.imf.org)
The fact that they have accepted in principle the objectives of the European Union fiscal policy, the authorities of the Member States have been reluctant in respect of fiscal harmonization. This is due to the fact that the fiscal policy is regarded as a component of the national sovereignty and the tax systems of the Member States differ substantially due to differences between the structures of economic and social conditions of each other and conceptual differences on the role of taxation in general and of a given tax in particular. (Mitrica E., „Politica fiscala a Romaniei in perspective aderarii la Uniunea Europeana" pg. 111-114)
At the same time, it has been demonstrated that there is a negative relationship between fiscal irregularity, measured in the difference between the budget deficit registered by each member and the limit imposed by the fiscal criteria of the European Union and the economic development of a country looked at from the perspective of the business environment.
So that the countries which comply with the fiscal European criteria or at least approach to these, they have a business environment more stable and an economic growth larger and healthier in comparison with the countries with a budget deficit and is from fiscal point of view away from the limits laid down in the EU. Also, in a broad sense, this difference shall be applied between the countries that have adopted the single currency (euro) and those who still use their own national currency. (Rozmahel P., Grochova I.L., Litzman M., „The effect of asymmetries in fiscal policy conducts of business cycle correlation in the EU", *Europe Working Papers Series from Austrian Institute of Economic Research, article with no. 62*, 2014)
In order to comply with the Directives of the European Union, but also to apply an optimal taxation theory, Member States have adopted

structures of the taxation systems in correlation with the fiscal and monetary objectives laid down.
In Figure no. 1 is the structure of the tax system in the European states, taking into account the importance of indirect taxes to the achievement of budgetary revenues in each of the Member States(% of GDP).

Conclusions

After the analysis carried out a first conclusion is detached relating to the structure of the tax system. Although the purpose of setting up the European Union was to form an economic and political partnership between Member States from the fiscal point of view, it can be clearly distinguished three categories of countries: countries that rely the budgetary revenues on the collection of indirect taxes, located in the east and south-eastern Europe, countries situated in Central Europe whose budgetary revenue shall consist mainly of direct taxes and last but not the least Western and north-western countries, based on the revenue from the social insurance.
We have also noticed the fact that the states that base their resources on indirect taxes are more unstable from the point of view of the revenue volatility within the period of crisis in comparison with the other Member States.

Reference list

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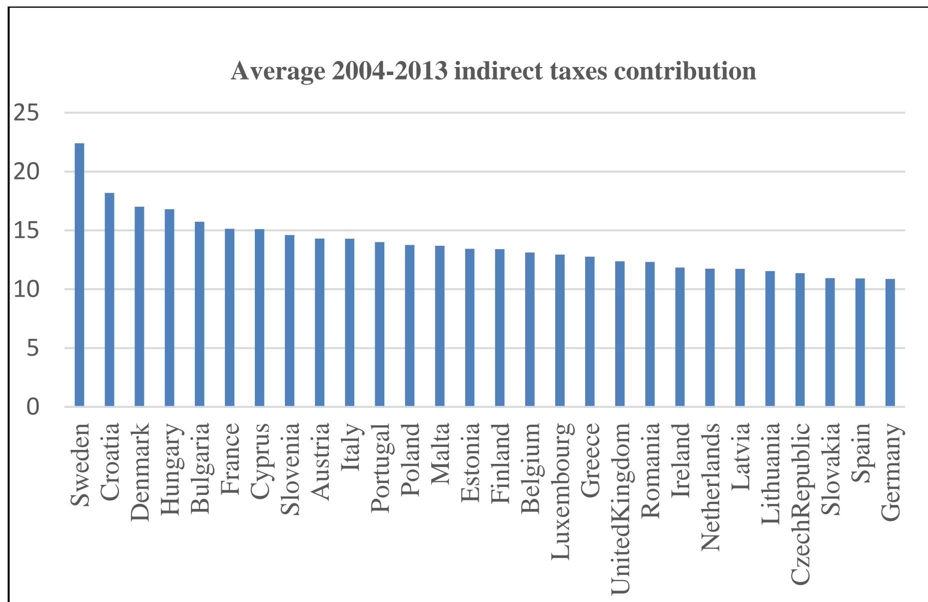
Appendices

Figure 1: The average of the share of indirect taxes in total taxes in the E.U., period 2004 – 2013



Source: Own representation, Eurostat data(online data code: gov_10a_taxag)

Top positions in the period between 2004-2013, are occupied by Sweden (22,4%), Croatia (18,19%), Denmark (17,01%), Hungary (16,8%), Bulgaria (15,73%), followed by France and Cyprus (15,14%, respectively 15,11%), Romania register a percentage of 12,32%. Also, all these countries have adopted the systems of tax with standard rates, all leading to a strong reduction of direct taxes compared with the indirect ones.

The tax burden coming from indirect taxes varies between Member States, ranging from less than 15% of GDP in Romania and Ireland (near 12%), Latvia (11.73 %), Lithuania (11.54 %) and Slovakia (10.94%) to more than 16 % of GDP in Sweden (22.4%), Denmark (17.01%). Consumption taxes were the largest source of tax revenue in Bulgaria (56%), Sweden (52%), Croatia (50%), Cyprus(48%) and Romania (45%). These countries registered the highest shares of taxation from indirect taxes and the lowest were in Belgium and Germany (29%) and Finland (31%).

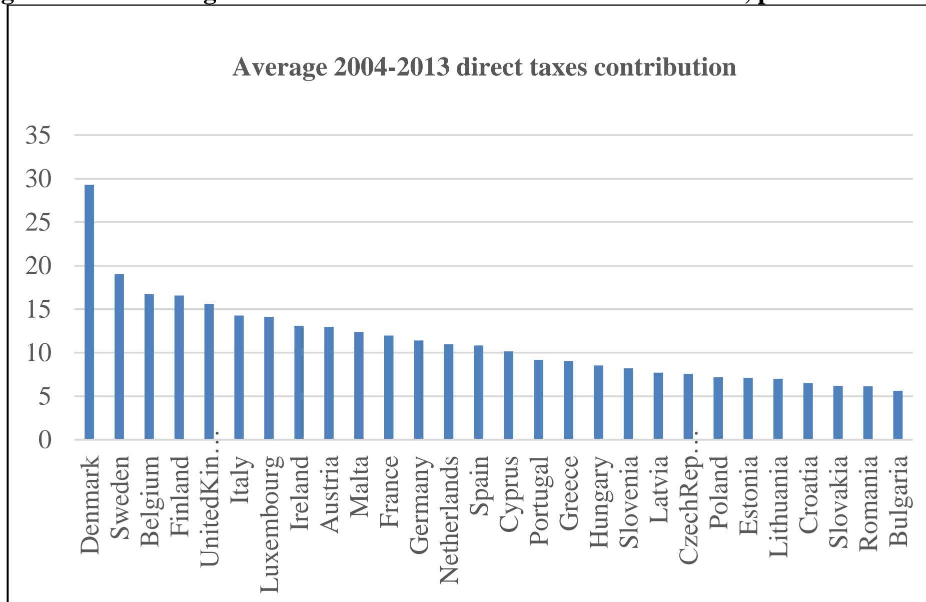
Table 1: Total receipts from taxes & compulsory social contribution 2013 Share of Direct Taxes in Total receipts (EU Report, "Taxation trends in the European Union", 2015)

Member states	Total receipts from taxes & compulsory social contribution 2013 (% of GDP)	Indirect taxes	Direct taxes	Share of Indirect Taxes in Total receipts	Share of Direct Taxes in Total receipts
Denmark	47.6	17.01	29.29	36%	62%
United Kingdom	33.7	12.37	15.62	37%	46%
Ireland	28.8	11.84	13.1	41%	45%
Sweden	42.8	22.4	19.02	52%	44%
Finland	43.9	13.4	16.58	31%	38%
Malta	32.8	13.69	12.38	42%	38%
Belgium	45.2	13.12	16.73	29%	37%
Luxembourg	39.4	12.95	14.11	33%	36%
Spain	32.4	10.91	10.84	34%	33%
Italy	43.1	14.29	14.27	33%	33%
Cyprus	31.6	15.11	10.16	48%	32%
Austria	42.7	14.31	12.97	34%	30%
Germany	38.1	10.88	11.41	29%	30%
Netherlands	37.2	11.75	10.96	32%	29%
Latvia	27.9	11.73	7.7	42%	28%
Portugal	34.3	14	9.18	41%	27%
France	45.3	15.14	11.98	33%	26%
Greece	34.3	12.7625	9.05	37%	26%
Lithuania	26.9	11.54	7	43%	26%
Poland	31.8	13.76	7.18	43%	23%
Romania	27.4	12.32	6.14	45%	22%
Estonia	31.8	13.43	7.12	42%	22%
Hungary	38.4	16.8	8.53	44%	22%
Slovenia	37	14.6	8.2	39%	22%
Czech Republic	34.8	11.36	7.58	33%	22%
Slovakia	30.2	10.94	6.2	36%	21%
Bulgaria	28.1	15.73	5.63	56%	20%
Croatia	36.5	18.19	6.53	50%	18%

Source: Eurostat (online data code: gov_10a_taxag)

In Figure no. 2, are plotted the average of the shares of direct taxes in total taxes for the year 2012. It is visible that the largest shares of direct taxes are recorded in Denmark (29,29%), Sweden (19,02%), Belgium (16,73%), followed by Finland (16,6%), and United Kingdom (15,62%).
This can be explained by the numerous foreign investments attracted by such states in the last decade, by the size of these countries resident's income: in 2013, Denmark has placed 1st place and Ireland 3rd in the top of the countries with the highest income from Europe, but also by the size of the fiscal pressure (Denmark registers the highest fiscal pressure in the European Union).(L. Abrudan, "Comparațiaunorsistemefiscale din vestulEuropeiprinprismaimpozitelordirectemajore", Pg 418-420)

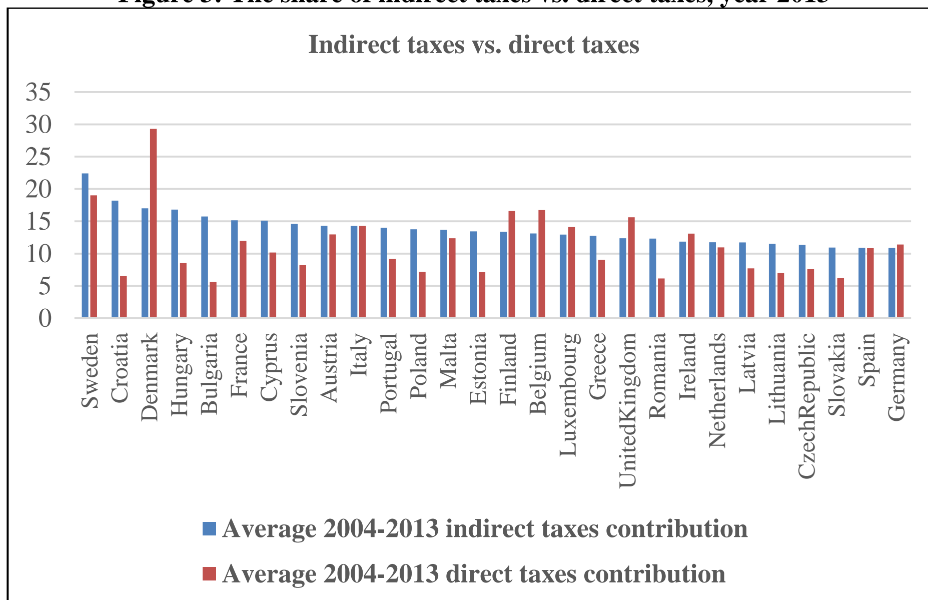
Figure 2: The average share of direct taxes in total taxes in the E.U., period 2004 - 2013



Source: Own representation, Eurostat data (online data code: gov_10a_taxag)

When it is about direct taxes contribution as the average for the years 2004 - 2014, the difference is higher 23.6 %. The structure of total receipts made off direct and indirect taxes shows deeper differences between older and latest states. On the one hand, in older states the share of direct taxes is almost equal to indirect taxes, on the other hand, in latest states, the share of direct taxation is smaller in total receipts from taxes. For 2013, the smalest shares of direct taxation are registered in Romania (5.9%), Bulgaria (5.3 %) and Lithuania (5%). These countries have addopted a flat rate of direct taxes with consequences on more pronounced reduction of direct taxation share than indirect taxation.

Figure 3: The share of indirect taxes vs. direct taxes, year 2013



Source: Own representation, Eurostat data (online data code: gov_10a_taxag)