Articles

How Romania Can Use Its Tax System for More than Just Raising Revenue and in Fact to Grow Its Economy

Kevin A. DIEHL [1]

Abstract: Tax systems can be more than just the means that governments utilize to fund their budgets. In fact, the Romanian tax system can have provisions for revenue raising, economic growth, social projects, political issues, environmental causes, ease of administration then, and judicially created principles. Whereas the country's recent experience with Government Emergency Ordinance 34/2009 showed that raising taxes during recessions does not usually work, the Romanian government can actually grow its economy just through proper management of tax principles. This paper seeks to present some tax alternatives that exist in other countries that Romania could adopt for this growth. The methodology will be case study primarily of the US tax system by comparison. The results are that other options exist for the Romanian government to use in its tax system directly to grow its economy and, in solving other issues through the tax code, also indirectly grow its economy.

Keywords: Romania; US; tax system; revenue raising; economic growth

1. Introduction

Considering tax policy is an important topic for research with no more recent evidence than Lazar (2014). To begin, politicians have been utilizing tax policy for years for purposes beyond revenue raising (Smith et al., 2014). While Bernardi (2014) does not necessarily agree with regard to Europe from 2000 to 2011, the US experience, by comparison, has at least been far different.

With regard to tax policy then, governments worldwide have many times over the years referenced Keynes in supporting tax policy changes. Keynes first suggested that, during bad economic times, politicians should lower taxes (Klein, 1950). During good economic times, Keynes then believed taxes could be increased (Klein, 1950). In this back and forth way, tax policy could grow economies and limit inflation.

[1] Associate Professor, PhD, Western Illinois University QC, USA. Address: 3300 River Drive, Moline, IL 61265, United States of America. Corresponding author: KA-Diehl@wiu.edu.

In the years since, tax policy has ventured beyond just regulating national economies through tax rate changes. Tax policy has begun to emphasize certain industries for growth. Before beginning inquiries as to how the Romanian government can grow its economy through tax policy, the many uses of tax systems are first explored. Indeed, tax systems have been used for revenue raising, economic growth, social projects, political issues, environmental causes, ease of administration then, and judicially created principles (Smith et al., 2014).

While the US tax system is by far from the most ideal in the world, it does offer the best comparison for Romania. As such, the US tax system is explored in the case study methodology in the following.

2. Revenue Raising

In 1913, the US federal government discovered that customs and tariff charges were insufficient to fund the budget of the economy (Smith et al., 2014). In fact, tariffs could actually diminish the world's economic growth. Thus, the Wilson administration enacted the US federal income tax to help raise revenue to support the government (Smith et al., 2014).

Romania in much the same way has enacted its own system of income and valued-added taxes (VAT). These systems exist to provide funding for the government to operate. For the general person, this category is usually considered to be the only reason for the existence of taxes.

3. Economic Growth

General Keynesian principles on the use of tax rate changes to control the economy have been mentioned. However, more specific uses of tax provisions are possible to enable growth in certain less productive industries.

In the US currently, politicians are extremely reluctant to increase tax rates. Such votes for increases generally are the main reason that they are not re-elected. In fact, largely because of taxes without representation in government, the American Revolutionary War was fought against England.

Because of that history, all tax provisions must generally start in the House of Representatives (Smith et al., 2014). The reason is that these legislators are subject to re-election votes every two years and therein deemed to be more receptive to public input with regard to tax issues. Senators, by contrast, are subject to re-election every six years. The only way tax bills can emerge from the Senate first is by riders (Smith et al., 2014) and generally leads to the tax provisions being passed first through the House of Representatives.

Because of this reluctance to increase tax rates and face losing their jobs, US politicians generally increase tax rates indirectly. For instance, phase outs are introduced for particular tax benefits so that higher income individuals do not receive the full benefit of these tax benefits. In the end then, it effectively increases these higher income individuals' tax rates but does so indirectly.

More to the point, given this general reluctance to play with tax rates, politicians generally emphasize certain industries. They accelerate economic growth by in effect lowering taxes in those areas. For example, during low growth economic times, US politicians tend to enact accelerated depreciation methods. The current system provides modified accelerated cost recovery system (MACRS) deductions, which parallel double-declining balance financial accounting depreciation (IRS Publication 946, 2013).

However, in bad economic times, politicians add Internal Revenue Code (IRC) 179 cost recovery and additional bonus deductions. For instance, in 2013, companies were allowed to write off up to $500,000 of many personally property items (movable property) purchased (IRS Publication 946, 2013). The only limits were that the property was utilized for business use, not then personal use, and the deductions were not greater than business income for the year (IRS Publication 946, 2013). Additional bonus depreciation has ranged from 50 to 100 percent of goods purchased during the recent economic recession (IRS Publication 946, 2013). This fact obviated the necessity even to rely on 179 or MACRS to recover the cost of the goods.

The result is that US companies in effect were paying less for goods used in their operations than the purchase price. With the normal interaction of supply and demand, lowering the price of goods from the equilibrium results in greater demand for the goods and increase sales. Thus, if at the current equilibrium, companies are not operating at full production. The effective lowering of after-tax costs of property eventually results in the new equilibrium price with increased supply and increased purchasing (i.e., demand).

This tax system could work for Romania. If politicians eventually learn that political harm follows directly from increasing tax rates or even decreasing them, they could resort to this US model of indirectly increasing and decreasing taxes. Of more benefit, though, would be learning how to emphasize economic growth, especially during bad economic times, through industry emphases in the tax system.

4. Social Projects

The US tax system emphasizes an important social issue, lessening the demand on the government budget to solve social causes. Tax deductions are permitted for donations of cash or property to qualifying IRC 501(c) (3) charities or to government entities (IRS, Publication 526, 2013). In that way then, the US government empowers individuals to choose to what social purposes their wealth is sent instead of having the government fulfill this purpose for them.

To encourage businesses to donate to charities or government entities as well, contributions of inventory for the care of certain groups of individuals result in increased deductibility. Normally, corporations could deduct only the basis of property as it is donated to such social purposes. However, the government permits an increased deduction of the lesser of basis plus 50 percent of the appreciation in the property or, in the alternative then, twice the basis (Smith et al., 2014).

By doing so then, the government incentivizes individuals and businesses to help solve societal issues. It does so in the way of permitting individuals to feel in control of where their money for societal issues is being diverted. Simultaneously, the government reduces its budgetary revenue raising objectives with private citizens helping to contribute toward the resolution of these issues.

5. Political Issues

For many years then, the US federal government made welfare payments to low income individuals. However, certain political groups raised concerns about the incentive to work if such payments were made. Thus, the US government eradicated these direct payments and replaced them with tax code provisions. Specifically, the government legislated to have earned income tax credits available for working individuals who were below poverty levels even in spite of working

(IRS, Publication 596, 2013). Credits are dollar-for-dollar reductions of tax liability (IRS, Publication 596, 2013). For individuals who owe no taxes, these dollar-for-dollar reductions for earned income credits are refundable (IRS, Publication 596, 2013). In essence, they become refunds but in the end are virtually the same as direct welfare payments (IRS, Publication 596, 2013). In doing so then, Congress incentivized low income individuals to find work to qualify for these additional government benefits.

6. Environmental Causes

US tax provisions in this area emerge from fringe benefits and wind generation credits. Fringe benefits are categories of provisions that employers provide to employees. The employers get tax deductions for these provisions, and the employees do not have to include the benefits received in their incomes subject to taxation (IRS, Publication 15-B, 2013). The fringe benefit here is in the area of qualified transportation (IRS, Publication 15-B, 2013). Employers can provide money to employees to encourage them to ride to work together or for riding bicycles to work (IRS, Publication 15-B, 2013). The employers get deductions for these payments (IRS, Publication 15-B, 2013). The employees do not have to include the benefits received in their income (Smith *et al.*, 2014).

US businesses are encouraged to develop wind energy with specific credits available for such projects (General Electric, 2014). General Electric has emerged with some of the lowest effective tax rates in the US over the years largely because of these specific credits and their reliance on developing this energy source (General Electric, 2014).

7. Ease of Administration then

As judicially created principles are not under the control of governments, the final topic discussed is in the category of provisions enacted to ease administration of the tax system. For example, the US tax system permits only 50 percent of meals and entertainment expenses incurred in the business use of interacting with clients to be deductible (IRS, Publication 463, 2013). The other 50 percent not deductible is permanently disallowed (IRS, Publication 463, 2013). With this provision then, the US government simplifies an incredibly difficult area to audit.

Also, the US tax code permits the standard deduction instead of itemizing expenses (IRS, Publication 501, 2013). The standard deduction is an amount high enough to encourage most individuals to utilize that lump sum amount instead of computing all the various qualifying deductions that they could otherwise use as an itemized deduction (IRS, Publication 501, 2013).

8. Conclusions

Just as other countries' governments can learn much from the Romanian government's remarkable steps forward toward becoming the leading economy in Eastern Europe, the Romanian government can learn some things with regard to tax policy from others. The US tax system is by far from the best in the world. However, it provides an important case study from which Romanian politicians can learn much. The most important point is that tax systems can be used for more than just revenue raising. Romania can utilize its tax system to grow its economy.

For instance, to increase international investment, Romania could become the next France. This country in Western Europe is unique in that it does not tax worldwide income for companies incorporated there. Thus, many US companies seek to merge or in some way incorporate there to avert some level of high US tax on worldwide income. Romania could become the France of Eastern Europe in that way.

However, Romania should adopt many of the cost recovery methods in the US, IRC 179, additional bonus, and MACRS, especially during bad economic times. These provisions have been tested over the course of time to stimulate economic growth through changing the current supply and demand equilibrium.

While social issues do not seem to be economically related, they can be to the extent they occupy some of the government's budget. If private individuals could solve those issues without government intervention, in effect, the government would not require so much revenue. As such, tax rates could be decreased. This action has shown over time to be helpful in promoting economic growth.

Even for political issues, if government subsidies to individuals and businesses require more and more revenue, then political issues can be solved in other ways through the tax code. The US example proves this case. Being environmentally efficient also leads to economic efficiencies in the long run.

Finally, easing the administration of tax collection saves money from auditing returns that can be used for economic growth if so desired.

Thus, tax systems can in fact be utilized for more than just raising revenue but also to regulate the economy, improve social issues, attack political objectives in more politically acceptable ways, serve the environment, and provide easier administration of tax collections. In the end then, all those other rationales for tax provisions can lead to economic growth. With these lessons learned, the Romanian government can continue to be the leading light for the countries of Eastern Europe if not for the entire rest of the world.

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