Evolution of Taxation in Romania between 2001 – 2010

Pripoaie Silviu[1], Pripoaie Rodica[2]

Abstract: The general characteristic of modern economies is given by the rapid growth of the demand of financial resources as compared to the possibility of acquiring them. In periods of economic *boom*, when State levies allow the procurement of sufficient resources, the way of applying State conjuncture policies and its functions do not cause any debates. However, when the economy is in crisis and as the economic disequilibria carry along social difficulties, the need for financial resources can generate conflicts both between the adepts of different economic doctrines and in other environments as well (population and taxpayers included).

Keywords: taxation; tax pressure; economic policy

JEL Code: H20; H21; H25

1. Tax Pressure - Important Tool in Influencing the Effects of Economic Conjunctures

The obligation to pay taxes appeared along with the emergence of the State and of Law in the human society and the attempt to elude this system was more or less strong according to the increase or decrease of tax burden.

Irrespectively of the terms used: tax burden, tax pressure, fiscal coefficient, compulsory levies rate, etc. the central idea is that of the obligation towards the State and of the diminution / cutting of personal incomes. (Cioponea, 2007, p. 205)

The *tax pressure* indicator (or tax rate) represents the ratio between inland revenues (of the State and of local communities) and GDP or NDP, expressed in

[1] Economist, Dunărea de Jos University Galaţi, Faculty of Economics – Doctoral School, Address: 47 Domnească Street, Galati 800008, Romania, Tel: (+40) 336 13.02.62, Fax: (+40) 236 46.13.53, e-mail: silviupripoaie@yahoo.com.

[2] Associate Professor, PhD, Danubius University of Galati, Faculty of Economic Sciences, Romania, Address: 3 Galati Blvd, Galati, Romania, tel: +40372 361 102, fax: +40372 361 290, Corresponding author e-mail: rodicapripoaie@univ-danubius.ro

percentages. This indicator measures the share of tax in the obtained wealth and thus allows determining the tax burden.

The compulsory levies rate is often emphasised as an indicator measuring the degree of State intervention and is frequently used for international comparisons, especially in order to measure differences between countries, in matter of tax pressure particularly. (Craiu, 2004, p. 123)

The aim of conjuncture policies is to stabilise the economy by means of counter-cyclical methods: expansionist, in periods of recession and restrictive, in periods of expansion. Therefore, the fiscal policy of a State represents an important tool in influencing economic conjunctures, either in modifying the tax rate, or in changing the structure of State expenditures.

The change of the tax rate and / or of the share of budget resources categories in the total State revenue varies with the economic situation: when economy boost is wanted, in case of recession, the tax rate will be low, direct taxes will be less burdening, etc, while in case of economic overheating, contrary measures shall be adopted.

It is known that an increase in indirect taxes causes inflation (a reduced economic growth) and in case of recession, the decision to opt for preponderantly favouring inflation decrease at the risk of disfavouring the rhythm of economic growth is difficult and controversial, the tools of fiscal policy being crucial.

The increase of the role of State in present economies is more and more obviously and thoroughly regulated. State budget - the tool by means of which the State influences the evolution of economy - has become the tool of a new economic policy, that is, budgetary policy. Thus, broadly speaking, budgetary policy includes:

- fiscal policy;
- allocation policy (or budgetary policy, strictly speaking);
- budgetary balance policy (deficit financing and budgetary surplus exploitation).

In the analysis of the impact of State's fiscal policy on the economic growth, an important part is played by the phenomena of underground economy development and of tax evasion stimulation generated by the enforcement of much too high tax rates. Tanzi Vito (Tanzi, 1995, p. 15) analyses the effects of a tax system with arbitrary exceptions and other distorter elements: the degree of corruption increases, production and, consequently, physical capital stock decreases; corruption reduces the rate of economic growth through the distortion caused on resource allocation, destroying the relationship between the social profitability and the financial profitability of an investment. (Obreja Braşoveanu, 2007, p. 117)

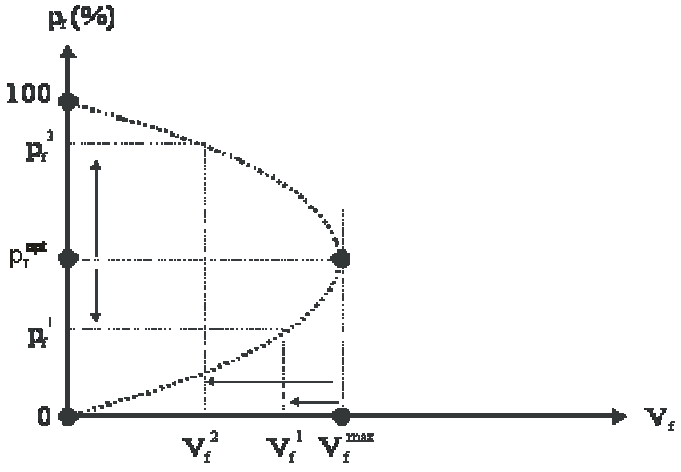
The existence of a developing underground economy determines the erosion of the tax basis increase, which leads to a decrease of inland revenues and to the State's deprivation of a part of its incomes, giving rise to budget disequilibria or to the accentuation of the already existing ones.

The erosion of the tax basis and, consequently, the diminution of budget returns imply the restriction of the State's manipulation possibilities in the economic, social, etc. field.

In this field, the most eloquent analysis is provided by ***Laffer curve*** and by the theory ***"too much tax, no tax"*** which aim at explaining the relationship between the tax rate and the level of tax incomes. Thus, the more a tax is based on a high tax rate, the more the State's inland revenues increase but, over a certain tax threshold, earnings start to decrease.

"Laffer" curve reflects the results of a growth of compulsory levies at a macroeconomic level: it deters the will to work and to save money. This because the increase of the tax rate, from a certain point up, limits the incitation of economic agents, deters investments, narrows taxation bases; also, a tax rate beyond a certain limit may carry along tax evasion actions, such as the orientation towards activities which benefit from tax advantages, fiscal frauds, diminution of NDP and decrease of inland revenues. The volume of revenue may increase even through the reduction of the tax rate, applied however to a greater amount of taxable income. (Pestieau, 1989, p. 46)

According to Lafer's theory, tax level is closely related to the size of underground economy. An exaggerated tax on income will determine a migration of the activities from the sector of real economy to that of underground economy.



P_f – tax pressure rate

$\mathbf{V_f}$ – tax incomes

2. Ways of determining the level of tax pressure

The determination of tax burden is susceptible of several acceptations:

- the officially communicated rate of tax pressure;
- the rate of tax pressure, broadly speaking;
- the rate of tax pressure, strictly speaking;
- the rate of tax pressure at the level of the economic operator;
- the rate of individual tax pressure.

The rate of tax pressure officially communicated by the Statistic Annual drawn up by the National Institute of Statistics is calculated as follows:

$$R = \frac{VF}{PIB} \bullet 100 \text{, where}$$

R – the rate of tax pressure,

VF – tax incomes,

PIB – the volume of gross domestic product

If tax incomes are deemed to be made of taxes, duties and contributions, *the rate of tax pressure, broadly speaking,* is calculated as follows:

$$R = \frac{I + T + C}{PIB} \bullet 100 \text{, where}$$

I – the volume of collected taxes,

T – the total sum of collected duties,

C – State social security contributions;

***The rate of tax pressure, strictly speaking*, can also be calculated by excluding State social security contributions from the numerator:**

$$R = \frac{I + T}{PIB} \bullet 100$$

In the analysis of tax pressure, as generating factor of underground economy, apart from the rate of tax pressure, officially communicated by the

Statistic Annual drawn up by the National Institute of Statistics, *the recalculated rate of tax pressure* can also be determined:

$$R_{rec} = \frac{VF}{PIBrec} \bullet 100, \text{ where}$$

PIBrec = PIBoficial – the value of hidden economic activity

From the standpoint of economic operators, taxes paid to the State are seen as elements of tax pressure, the greater their share in the obtained added value, the higher the tax pressure.

$$r_f = \frac{If}{VAf} \bullet 100, \text{ where}$$

r_f – the rate of tax pressure at the level of the economic operator,

I_f – the total sum of paid taxes (tax on profit / income, social security contribution, tax on land, tax on buildings, etc.),

VA_f – the added value obtained by the economic operator

We may consider that a high level of paid taxes leads to an increase of the tax pressure at the level of the economic operator.

Apart from the tax pressure measured at the national level and at the level of the economic agent, the individual tax pressure can also be quantified, psychologically felt and measuring the threshold of tax tolerance. This is calculated as the ratio between the total tax levies born by the taxpayer - natural person and the sum of gross incomes obtained by him / her (incomes before taxation). (Cioponea, 2007, p. 210)

$$r_i = \frac{PFi}{VBi} \bullet 100, \text{ where}$$

r_i – the rate of individual tax pressure,

PF_i – total tax levies paid by the individual,

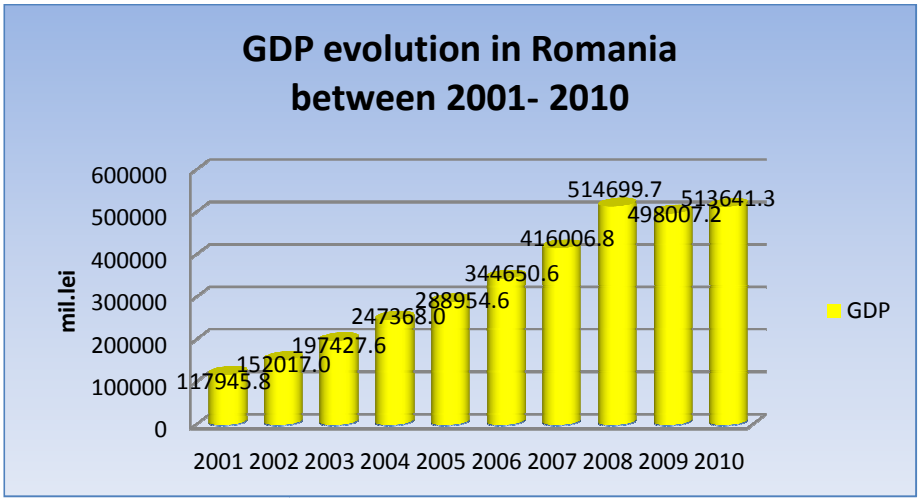
VB_i – gross incomes earned by the individual

The accurate determination of tax pressure at this level is very difficult because of certain randomly elements: diversity of levies, the occult character of including taxes in prices, the value of public services the individual benefits from, etc.

Irrespective of the level on which tax pressure is determined, the value of this indicator is influenced by a multitude of economic, social, psychological, doctrinarian, etc. factors.

3. The Evolution of GDP between 2001 and 2010

According to the data provided by the National Institute of Statistics, the level of the yearly GDP for the period 2001 - 2010 had the following evolution:



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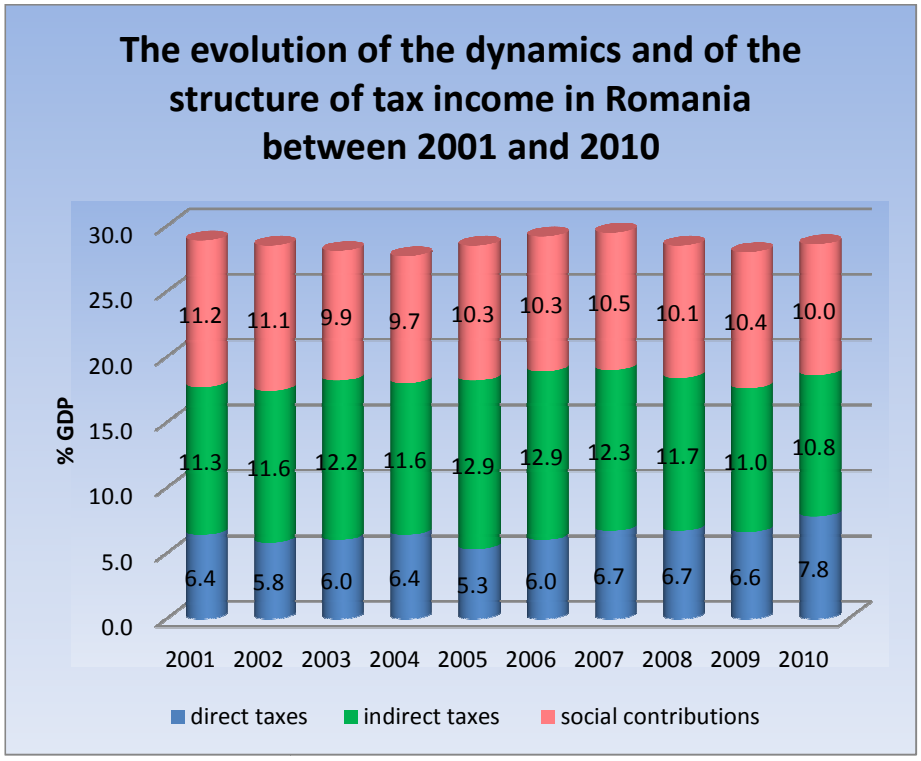
4. The Evolution of Tax Incomes between 2001 and 2010

In August 2010, Tax Council[1] published the study "The Position of Public Finances in Romania - International Comparisons", paper which emphasised the dynamics and structure of budget incomes, budget expenditures, budget deficit, public debt, etc. between 2001 and 2010.

The calculation methodology for the main categories of public resources and budget expenditures was ESA95 Methodology (European System of Accounts), methodology which ensures the perfecting and updating of financial position models in view of sending the data required by financial reporting as per the requirements of the European Institute of Statistics (EUROSTAT). ESA95 standard differs from the cash methodology by the registration of incomes and costs in an "accrual" system (based on commitments and not on actual payments, as in the cash system) and the treatment of EU funds (EU is considered a separate sector in the ESA95 system).

[1] *Consiliul Fiscal – Poziţia finanţelor publice în Romania/Tax Council - Public finance position in Romania*, 2010



From the data provided above[1], on the structure of financial resources, we can draw the following conclusions:

- in the indirect taxes chapter (VAT, excise duties, customs duties), the data show that their level recorded a decrease in 2010 (10,0%) as compared to 2009 (10,4%), with a very low degree of collection;
- although excise duties increased, the level of the revenue collected from excise duties decreased;

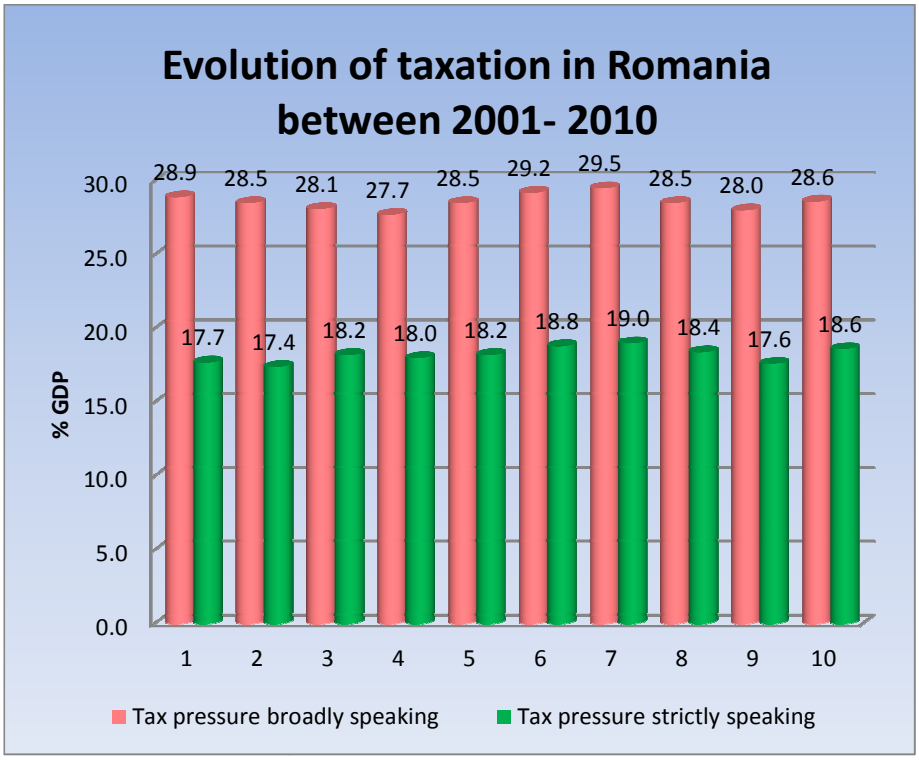
[1] Consiliul Fiscal – *Poziţia finanţelor publice în Romania/ Tax Council - Public finance position in Romania* 2010

5. The Evolution of Taxation in Romania Between 2001 and 2010

Given the data provided by the National Institute of Statistics and by the Tax Council, we proceeded to the calculation of the level of tax pressure for the period 2001 - 2010, the data obtained being centralised in the table below:

Year	GDP (mil. Lei)	Tax incomes % GDP	Direct taxes % GDP	Indirect taxes % GDP	Social contributions % GDP	Tax pressure broadly speaking	Tax pressure strictly speaking
2001	117945,8	28,9	6,4	11,3	11,2	28,9	17,7
2002	152017,0	28,5	5,8	11,6	11,1	28,5	17,4
2003	197427,6	28,1	6,0	12,2	9,9	28,1	18,2
2004	247368,0	27,7	6,4	11,6	9,7	27,7	18,0
2005	288954,6	28,5	5,3	12,9	10,3	28,5	18,2
2006	344650,6	29,1	6,0	12,9	10,3	29,2	18,8
2007	416006,8	29,5	6,7	12,3	10,5	29,5	19,0
2008	514699,7	28,5	6,7	11,7	10,1	28,5	18,4
2009	498007,2	28,0	6,6	11,0	10,4	28,0	17,6
2010	513641,3	28,6	7,8	10,8	10,0	28,6	18,6

According to the data provided by the previous table, the level of the taxation in Romania between 2001 – 2010, had the following evolution:



6. Conclusions

➢ the data represent ***the official level*** of tax pressure, because the data provided by the two institutions and the results obtained from research must be recalculated and correlated with a series of economic, social, psychological, doctrinarian factors, the quantification of which can not be accurately determined;

➢ the most common factors emphasised in specialised literature are: the level of economic development, the amount of public debt, the level of underground economy, governmental policy by establishing the priority of certain public expenditures, the efficiency of financial resource usage, the degree of voluntary conformation to tax payment, etc

➢ although the officially declared level of tax pressure, broadly speaking, ranges between 27.7% and 30.6% and the one of tax pressure, strictly speaking ranges between 17.4% and 19.2%, we may appreciate that is much higher. In order to achieve an as accurate analysis as possible, we must study the following:

- the level of real economy, meaning that it must be calculated after the deduction of the official GDP of the percentages representing hidden economy, given that these incomes are characterised by tax avoidance,

- the existence of a significant amount of activities exempt from certain categories of taxes - the favourable tax regime applicable to free zones, duty-frees, disfavoured areas, etc,

- parafiscality, respectively the existence of an impressive number of taxes and duties which are not to be found in the State budget but in the budgets of certain agencies;

➢ the analysis of the level and of the structure of tax pressure must be correlated with the **intensity of tax regulations**, that is, with the large number of normative documents, frequent amendments, bureaucratic formulations, legal overlapping, etc. The most eloquent example is that of Law no. 571/ 2003 on the Tax Code which between December 2003 and August 2010 was modified by no less than 75 amending documents and Decision no. 92 / 2003 on the Fiscal Procedure Code was amended 15 times during the same period.

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