

The Use of Fiscal Policy at the National Level

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Abstract: The purpose of this article is to present the evolution of the index of efficiency of direct and indirect taxes recorded in Romania in 2011 as well as to compare the effectiveness of fiscal policy situation of our country to the countries of Central and Eastern Europe.

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JEL codes: E62; G20.

1. Introduction

Considering the economic crisis of recent years, Romania has felt the need of using fiscal policy as a tool of macroeconomic stabilization but this was not possible due to the unfavorable position it had². During expansion, fiscal policy was also expansionary implemented and it led to rising public debt and budget deficit. Because a wrong fiscal policy applied in the past, room for maneuver has been reduced considerably³. Another problem was the population's lack of confidence in the tax system in Romania because of the frequent legislative changes and unclear areas. Also, there were shortcomings in identifying the most effective tool that fiscal policy could call in the given macroeconomic situation.

Application of pro-cyclical fiscal policies affect macroeconomic stability of the economy, so effective and countercyclical policies should be applied. For this, we have analyzed the current level of effectiveness of fiscal policy and identify key factors that have a negative influence on the efficiency index of taxation.

² Burghilea, C. (2011) "Economic Crisis perspective between current and forecast", Theoretical and Applied Economics, Vol. XVIII, No. 8, pp. 137-147.

³ Gheorghiu, A., Gheorghiu, A., Spânulescu, I., (2009) "Target market risk evaluation", Proceedings of the International Conference on Econophysics, New Economics & Complexity - ENEC-2009, Editura Victor, București, ISSN 2065-2550, p.113.

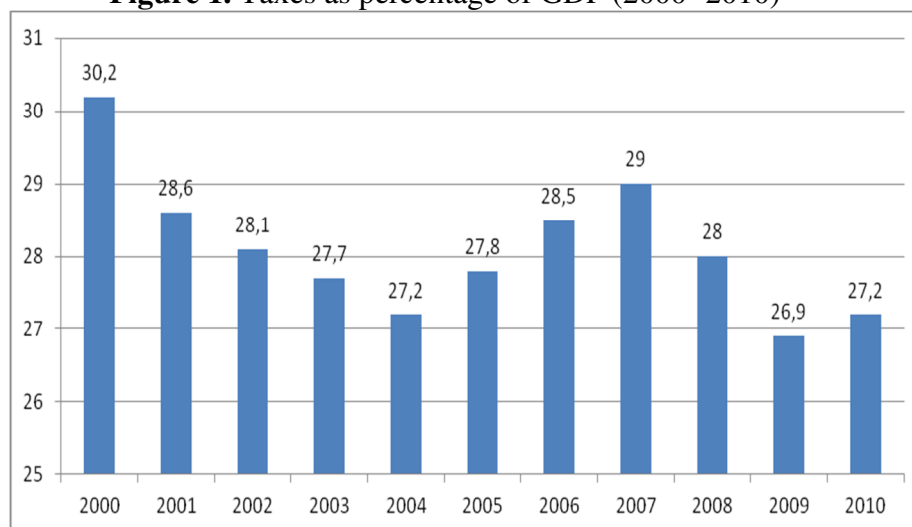
2. Macroeconomic stability

Fiscal policy is considered to be effective if applied instruments will lead to sustainable potential GDP growth. For this, we need to achieve productive public expenditure (education, public investment, R & D) and taxation to apply mainly on capital.⁴

For an expansionary fiscal policy measure to be effective, IT must be adopted immediately after the economy decrease occurred, to be representative as a percentage of GDP, to not lead to lower sustainability of the fiscal system, to be credible and to focus on support of consumption.

If we look at the tax system at EU level we can begin with the revenues from taxes in 2010 that were 27.2% of GDP, while the EU average (27) was 35.6%. Only Lithuania had a share of income from taxes in GDP lower by 27.1%.

Figure 1. Taxes as percentage of GDP (2000- 2010)

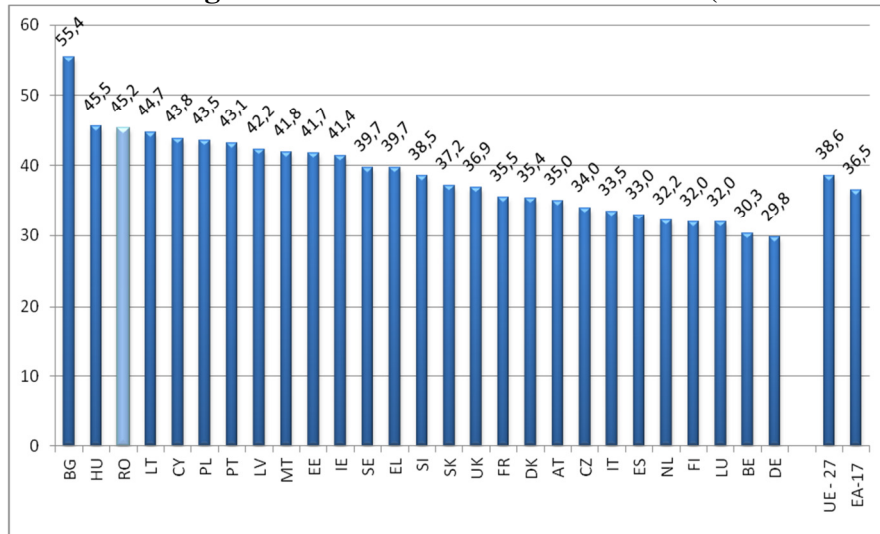


Source: Eurostat

The picture above captures the evolution of the value of taxes in GDP (see Figure 1). It declined considerably from 2000 to 2004 from 30.2% to 27.2%, then began to increase to 29% of GDP in 2007 along with strong growth in GDP. In the next two years the tax rate fell by almost 2 percentage points mainly due to lower revenues from VAT. In 2007, VAT revenues were 8.1% and in 2009 6.6% of GDP. However, in 2010 due to higher excise duties and VAT from 19% to 24%, revenues from indirect taxes have increased and offset the continued decline in direct government revenues and social contributions.

⁴ Mărcuță, L., Mărcuță, A., Tindeche, C., (2013) "Analysis of Romanian GDP during crisis", *20th International Economic Conference - IECS 2013, Post Crisis Economy: Challenges and opportunities*, Sibiu, România

Figure 2. Share of indirect taxes in GDP (UE-27 - 2010)



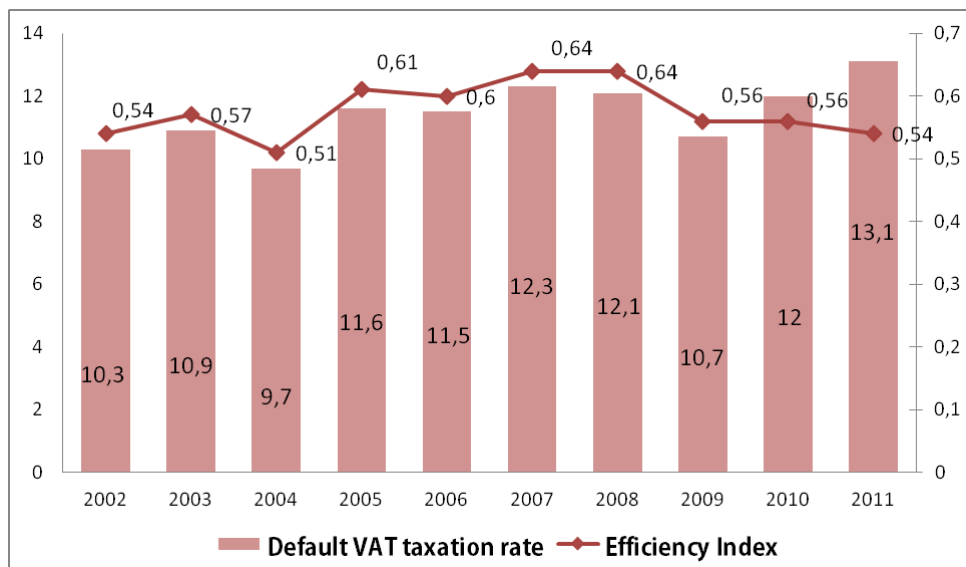
Source: Eurostat

Of total government revenues collected from taxes highest share is 45.2% indirect taxes. Romania is the third country ranked by indirect taxes as a share of total taxes (see Figure 2). The less revenue is collected from direct taxes, only 22.6 % of the total, by 8 percentage points less than the EU average .

According to the Fiscal Council tax collection efficiency is calculated by the ratio of the implicit tax rate and the statutory rate of taxation. The implicit tax rate is equal to the ratio of actual revenues collected from a tax category and the corresponding tax basis of macro .

If we analyze the effectiveness of taxation for VAT in Romania, it is observed that it decreased significantly compared to the period before the economic crisis, but this has not happened only in Romania but also in the new EU member states in Central and Eastern Europe(see Figure 3).

Figure 3. Taxation rate and collection efficiency index related to VAT in Romania



Source: www.consiliulfiscal.ro

In 2011 the revenue collected from VAT were 47.9 billion lei, 6.9 billion lei higher than those in 2010. This increase is attributed to the increase in VAT rate from 19% to 24% from 1 July 2010, increasing household consumption and rising prices.

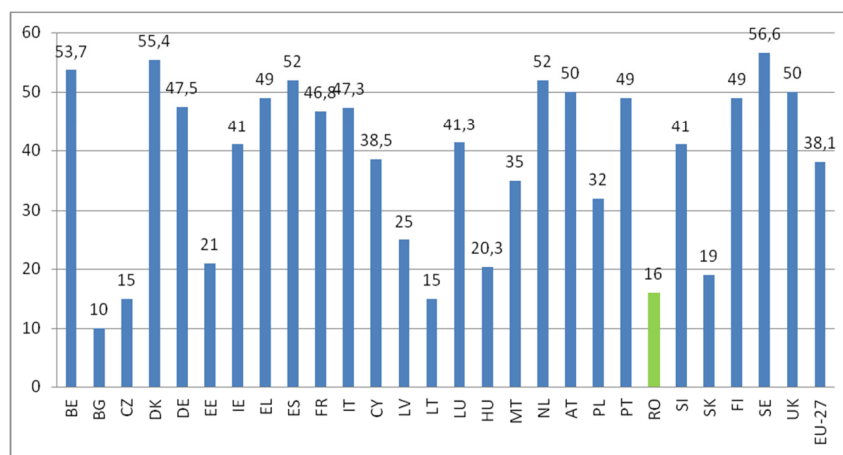
Analysis made at the end of 2011 on value added tax shows a small loss of efficiency compared to 2010 (54% in 2011 compared to 56% in 2010), this loss of efficiency coming from increased macroeconomic base considered.

Another factor that contributed to lower efficiency, "in the context of a shock of favorable supply in agriculture, self-consumption component as well as the peasant marketers, which are not likely to generate tax revenue."⁵ This component has affected efficiency so much that, after calculations, it was concluded that if this element would not change, efficiency would have not decreased. It can be said that revenues have changed in the same direction and about the same size as the basis macroeconomic being adjusted to mitigate the impact of the VAT increase from 16 % to 24 % in 2010.

Comparing the efficiency of VAT collection in Romania to the EU countries shows that the 54% is far below the level of 82 % in Estonia, 72 % in Slovenia and 71% in Bulgaria. In terms of share of GDP, revenue collected from VAT was 8.1% .

Increased excise duty on diesel, gasoline, cigarettes and other products and the introduction of new excise resulted in a 10% nominal increase of government revenue from excise duties, they recorded a value of 19.1 billion lei at the end of 2011 (see Figure 4).

Figure 4. Personal income tax 2012, UE - 27

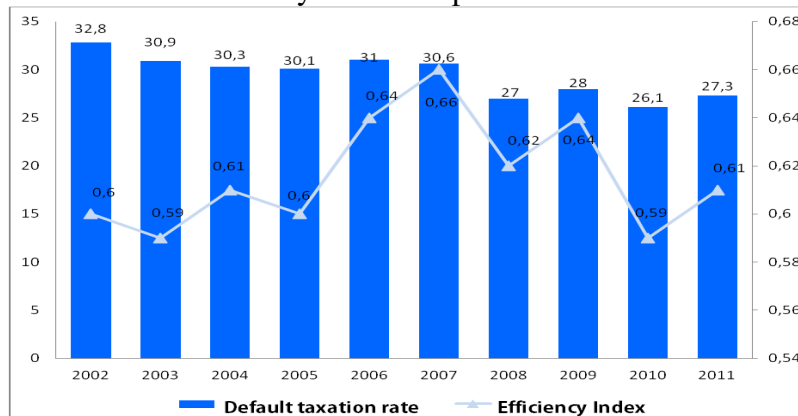


Source: Eurostat

Since 2005 the flat taxation system was implemented, which replaced a progressive tax between 18% and 40%. Tax rate of 16% is among the lowest in the EU-27, only Bulgaria (10%), the Czech Republic and Lithuania (13%) standing before Romania; this represents an advantage for attracting foreign direct investment.

In early 2011 the flat tax was removed. However both the efficiency and the tax rate decreased continuously between 2008-2011 (see Figure 5).

⁵ www.consiliulfiscal.ro - „Raport anual pe anul 2011. Evoluții și perspective macroeconomice și bugetare”

Figure 5. Rate and efficiency rate of corporate income tax in Romania

Source: www.consiliulfiscal.ro

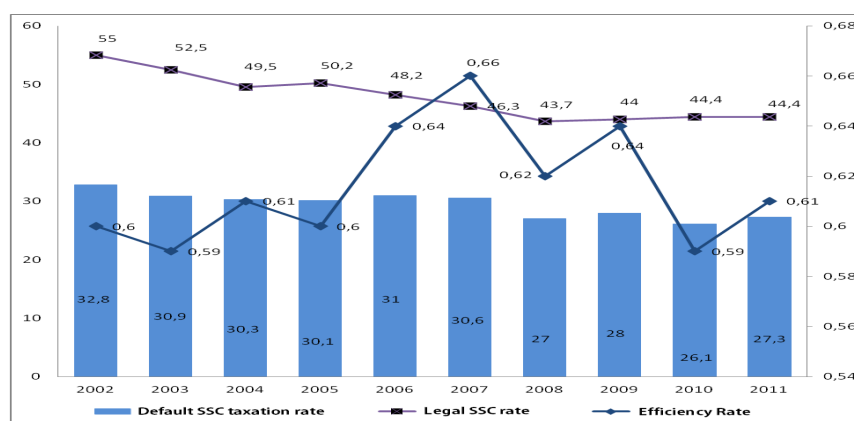
Between Central and Eastern Europe countries, in terms of tax efficiency Romania ranks fifth with 22 % and a default taxation rate of 3.6%.

Revenues from taxes on income and wages rose more than expected. This reflects the average salary increase of 4.9% and also the improvement of the situation on the labor market.

Increasing default taxation rate from 12.3 % to 12.6 % was caused by the impact of the recalculation of pensions of retired military personnel and retired from work classes I and II.

Romania ranks 3rd place in the EU with a degree of tax efficiency of 79%, recording a default taxation rate of 12.6 %, this being calculated as the ratio between the total direct taxes paid by the entire population and gross wages taken from the national accounts.

Income from social contributions rose to 50.6 billion in 2011, leading to increased default taxation rate and efficiency index rising from 0.56 to 0.61. This increase was due to expansion of the tax base and the introduction of social security contributions for military personnel. But there were also negative influences due to redirection of 0.5 percentage points of the total employee pension contributions to the second pillar of the pension system (see Figure. 6).

Figure 6. Default taxation rate of social security contributions in Romania

Source: www.consiliulfiscal.ro

Compared with other countries in the region, Romania ranks last in terms of collection efficiency of social contributions, despite improvements since 2011 . As the share of social contributions is the third largest in the region, only in Slovakia and the Czech Republic it being higher, however implicit tax rate is the 3rd from last, among the lowest rates.

Net budgetary expenditures increased in 2011 by 0.3% over the previous year, registering a level of 202.9 bn; growth was so low due to lower wage bill by 10.1 % since 2010 and also due to the reduction of subsidies by 17%. There were increases in projects financed by post-accession external funds (increased by EUR 3.4 billion) and capital expenditures increased in 2011 by 3.3 billion lei compared to 2010, as well as expenditures for goods and services 2.1 billion lei.

Evolution of the general consolidated budget expenditures shows a concentration in the last quarter. Specifically, total spending in the fourth quarter 2011 totaling 59 billion, higher by 24 % from the previous quarter and 1.5 % higher than the fourth quarter of 2010. More than half of the increase in spending in the fourth quarter of 2011 was due to capital expenditures, which increased by 148 % over the third quarter.⁶

3. Conclusions

Fiscal policy is only considered a good tool for economic stabilization in the case of a fixed exchange rate regime, because the Central Bank intervention counteracts the crowding out of net exports. There is also the possibility that fiscal policy does not lead to higher prices for exports because appreciation may reduce inflation. So, expansionary fiscal policy can also be effective for an open economy with a flexible exchange rate regime .

In formulating and imposing fiscal package not only their composition and size should be taken into account, but it has to be calculated whether it is more effective: change of taxes or change of expenditures.

Even though Romania has a tax system based on a flat rate of 16% , among the lowest in the EU -27 , the overall rate of taxation is 44.2 % due to other taxes. Compared to other countries in Central and Eastern Europe the value added tax is high enough, and the increase in 2010 from 19% to 24 % was significant. The 5 percent have decreased the efficiency index of the collection of VAT and this was due to increased tax evasion.

When we get rid of taxes is a useful indicator to analyze the impact of taxes each year. The calculations include all fees beared by an employer, so looking at the results from each year can identify how much change it affects citizens concerning the taxes they have to pay from that year on.

One thing is clear, the efficiency of the tax system in Romania has to be improved even though in recent years there have been some steps by introducing the online declarations of taxes. One of the problems is the large number of taxes that should decrease, and this will lead to decreasing the time spent by taxpayers at counters and hence lower state bureaucracy.

In conclusion, the fundamental principles that must be met by the tax system to achieve sustainable economic growth are: efficiency, certainty of taxation, stability and predictability, and the national tax system should be based on these.

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