Fiscal Policies and Fiscal Pressure in European Union and Romania

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Abstract. *The purpose of this paper is to analyze the link between fiscal policies and the tax burden, the relationship between fiscal policies, budgetary revenues and expenditures, and the proportion of direct tax revenues out of the total budgetary revenues. In the first part of the paper, we introduce the general concepts of fiscal policy, we discuss different national strategies in approaching fiscal policies, we look at the tax competition in the EU, the impact of fiscal policies on the economy in general, the connection between taxation for the budget and budgetary expenditure. The second part highlights the link between fiscal policies and the tax burden as well as some theoretical aspects related to tax affordability according to Laffer curve. A comparison is drawn between tax revenues and expenditures in the EU and Romania, and the share of direct taxation from the total revenues is analyzed. We have also built an econometric model based on a simple linear regression, with the fiscal pressure as a dependent variable and the budgetary expenditure as an independent variable. In the last part, there are the conclusions for this work.*

Key words: *fiscal policy; fiscal pressure; direct taxation; European Union; Romania.*

Introduction

A well-designed tax system is efficient and correct. It can raise revenues to finance public spending, support economic growth, competitiveness and job creation, and allows for the desired social redistribution. An "optimal" structure involves compromises and requires prioritization of objectives according to situations and options specific to Member States.

The difference between the tax policies from one country to another determines the manifestation of tax competition internationally, in other words, a strategic tax context where, within the broader lack of cooperation between states, each side sets the parameters of the tax system depending on the fees charged by others and bearing in mind the need to cover expenses in order to avoid imbalances. Thus, tax competition in the EU is a fact, yet the EU wants more discipline and cooperation among member states and more benefits, giving up as little as possible on their sovereign rights in the field of taxation. However, although the tax context is coordinated by the EU institutions, each tax jurisdiction sets its tax policies in relation to the levels of taxation applied by other countries and to their own needs.

Two of the most urgent demands of European citizens, both individuals and companies are economic stability and social justice. A sustainable economic prosperity cannot be achieved as long as social and market imbalances persist. On the other hand, these imbalances cannot be eliminated without an economic environment that supports jobs, economic growth and investment policies.

Taxation has an essential role in achieving these objectives. Tax policies have been shown to have a major influence on employment decisions, investment levels and the willingness of entrepreneurs to expand. Taxation can also help tackle inequities in society not only by financing decisive spending on social mobility such as education but also by reducing income inequality on the market through a progressive taxation system. Therefore, in Europe, tax systems must be designed to deliver on the dual goals of equity and economic growth. Both are equally important, and their success depends on their intrinsic connection. If one is behind, it influences the other negatively, hinders the general success of the reforms. Tax systems are also required to be stable in order to gain confidence from taxpayers. This is the confidence that their money will be well spent and the confidence that everyone pays their fair share.

The design and reform of tax systems must take place at two levels: European and national. At national level, there is no single approach. Each Member State must find the best approach to meet its own specific needs, challenges and priorities. However, there are certain general principles that apply, whereby each Member State could consider reforming its tax system to make it fairer and more favorable to growth.

The efficiency of a tax system is influenced both by its structure and its implementation. An efficient system is one that provides jobs, investment, innovation and avoids tax-induced distortions. An efficient income-generating system, is one which does not create high costs for taxpayers or tax administration. Tax reforms can increase efficiency by helping create an environment that supports investment and innovation, especially for young, dynamic companies that promote innovation and create jobs. A coherent and coordinated approach to corporate taxation is important to reduce the legal uncertainty and distortion of competition that companies face today.

At EU level, an action is under way to increase the fairness and efficiency of profit tax systems through measures such as the Action Plan for a Fair and Efficient Taxation System in the EU, and the re-launch of the Common Consolidate Corporate Tax Base (CCCTB) - a friendly business system that will deliver the simplicity and security necessary to attract investors and encourage cross-border trade.

At national level, Member States can do more to boost investment through fiscal policy reforms. Designing smarter tax systems that facilitate innovation, entrepreneurship and access to finance would add to the development of the right business environment for investment in the EU. This includes: 1) encouraging alternative sources of funding; 2) designing better tax incentives for entrepreneurship initiative; 3)reducing compliance costs for entrepreneurs, in particular by: a)simplifying and reducing tax liabilities, especially for new entrepreneurs and small businesses; b)broadening the range of electronic services and making them available in one-stop shops; c)raising awareness, informing and training taxpayers to help them comply with tax rules through various channels.

The cross-border nature of tax evasion, evasion and the integration of Member States' economies requires a coordinated approach, not only through European initiatives, but also through the coordination of national policies. Regardless of the progress made so far, it remains important to continue efforts against those who cheat the system. Member States must combat tax evasion, using a multi-channel coordinated approach. A multi-channel approach means the use of computer applications and, in the prevention action, to make the tax authorities more modern and computerized to prevent and combat fraud and evasion; better communication and educational measures to promote a culture of transparency and compliance with tax obligations.

Taxation also plays a role in reducing inequalities and promoting social justice. The crisis has shown that our tax systems can be powerful instruments to reduce market inequalities, especially in some Member States. In the current context of the rising income tax inequality, it remains important to take into consideration the social impact of tax systems to achieve a fair balance between efficiency and equity.

Fiscal policies

Tax policy is the use of government spending and the taxation is one of the revenue collections tools. If the government decides on the goods and services it purchases, it influences the taxes it collects, all being found in the tax policy of that state. The main economic impact of any change in the state budget is felt by certain groups, a reduction in taxes for families with children, for example, increases the available income.

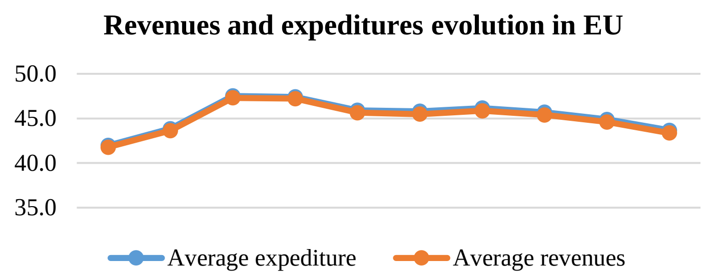

Figure 1. *Revenues and expenditures evolution in EU – 2008 – 2017*
Source: own representation, using Eurostat data

The immediate effect of fiscal policy is to change the aggregate demand for goods and services. A fiscal expansion, for example, increases aggregate demand through one of the two channels. First, if the government increases its purchases, but keeps the taxes steadily, the demand grows directly. Second, if the government reduces taxes or increases payments by transfer, it increases households' disposable income, and they will spend more on consumption. This increase in consumption will turn into increase aggregate demand. Tax policy also changes the structure of aggregate demand. When the government has a deficit, it covers part of its expenses by issuing bonds. Keeping other things steady, an increase in taxation will raise interest rates and "drive away" some private investment.

In an open economy, fiscal policy also affects the exchange rate and trade balance. In the event of an increase in taxation, raising interest rates due to government borrowing attracts foreign capital.

Two fiscal rules mentioned in the Treaty of Maastricht, which must be observed by all Member States in the European Union, are general: the government deficit, which should be maximum 3% of GDP, and public debt, to a maximum level of 60% of the GDP. It is very important to follow the rules, in order to have a stable economic situation, which is favorable to withstanding various financial shocks.

Fiscal pressure

Fiscal pressure expresses the intensity of collected revenues from natural or legal persons through taxation.

In determining the tax burden, the states use the fiscal policy objectives as guidelines, which define the main directions of economic and social influence. The effects of tax burden are both economic and social.

The economic effects occur whenever the aggregate demand changes at the level of society or at the level of the individual. At the aggregate level, increasing the burden leads to reduced global demand by taking a greater share of nominal income to the state. Overall demand for goods for private consumption is to some extent offset by increased consumption of public goods.

Economic effects occur not only globally but also in the composition of aggregate demand. Thus, depending on the type of tax, higher income is typically taxed more heavily than smaller ones. On the other hand, low-income taxpayers receive more budgetary resources than those with high incomes, which have the effect of changing consumer behavior, accumulation and investment in society.

The social effects are manifested by decreased purchasing power at the real income level. However, this effect is contradictory since those with lower incomes are compensated through social protection policy, provided through the state budget.

A result of the excessive tax burden is the phenomenon of "tax resistance", which is manifested by the following risks:
- Tax abstinence, which consists in omitting to fulfill certain operations in order to avoid taxes on them. It is a type of passive resistance by a person actively seeking to limit or reduce the activity in order not to attach in a certain level of taxation; or the consumer does not consume products on which several taxes (import, excise) are levied.

- The risk of tax evasion and fraud. In this sense, two processes are becoming dangerously widespread: the shadow economy and international evasion (relocation of production of certain companies to countries with more favorable tax legislation);
- The risk of inflation through taxation because tax increases tend to influence the process of establishing prices and wages, generating inflation;
- The risk of reducing the international competitiveness of domestic products and diminishing the capacity of investment and modernization.

Measurement of the tax burden. Currently, many countries measure the tax burden using the net tax burden calculation method, which allows obtaining of a fiscal image from the accounting viewpoint. The tax burden rate is an indicator of the share that the trader withdraws from the budget, instead of allowing it to be reinvested in the economy. This indicator has a double sense: • Tax pressure, narrowly - is the ratio between the total amount of taxes and taxes collected to GDP; • Tax pressure, broadly - is the ratio between the total amount of taxes and the social contributions to GDP.

Using this indicator in a global assessment of taxation is reasonable, however, it represents only one side of this phenomenon. The second side of the phenomenon is indicative of the satisfaction of public needs by spending. Approaching only the tax burden rate in our analysis would create the impression that a high rate of tax burden shows a weak economy and vice versa. Fiscal practice uses different ways of calculating the tax burden, including:

I. General Fiscal Pressure

$$FP = \frac{\sum_{j=1}^{n} Ij(SF)}{GDP} x100\%$$

II. Strict fiscal pressure

$$FP = \frac{\sum_{j=1}^{n} Ij}{GDP} x100\%$$

Where,
FP = Fiscal pressure
$\sum_{j=1}^{n} Ij(SF)$ = Total taxes including social funds
$\sum_{j=1}^{n} Ij$ = Total taxes without social funds

By definition, taxation is represented, as M. Laure (1956) said in *"Traite de politique fiscal"*, by the levies imposed on inhabitants of a country by a public authority which provides protection and services. Obviously, there is a definition of taxes. Some authors, starting from defining taxes as a form of income tax bite on the wealth of individuals and businesses by the state, which is meant to cover public expenditure, see tax as a link between the State and natural or legal persons. Trying a systemic approach of relational taxation, some authors define the tax system as "all fees established by the state, which bestow upon it an overwhelming part of the budget revenues, each tax with a specific input and a regulating authority in the economy" or a "set of concepts, principles, methods, processes on a variety of elements (quotations, subscription tax, tax issues), which has arising from design, regulation, settlement and the collection of taxes, and are managed under the tax laws in order to achieve objectives of the system.

Society cannot exist without charge, to be established by the Constitution and, on the other hand, demonstrated by historical reality. Fiscal pressure is generally given by the contributions calculated by dividing total value of compulsory levies (taxes, fees, social security contributions) in a certain period, usually a year, the size of gross domestic product achieved during the same period of 365 days.

The threshold tax borne by taxpayers was raised continuously by academics and practice tends to exceed the figures every time. The idea that "a large tax kills tax" was maintained by many economists. Thus, Waline and Laferriere (1952) said that "high taxes cause, if impracticable, a reduction in tax matter, either by limiting consumption that is not essential, or by concealment or evasion". The specific issue of tax burden generated a series of tests by American academics and others meant to rethink the issue of the optimal tax. Thus, Arthur Laffer (1974) transposed graphically an idea expressed by Adam Smith in 1776, according to which too high tax rates destroy the tax base. Laffer believes that there is a threshold of maximum tax burden beyond which any increase generates a reduction of the capacity of taxation since too high fiscal pressure will inhibit investments, saving, production and job creation. Arthur Laffer illustrated the relationship between the tax rate and the income taxes in the form of a graph called the "Laffer Curve".

A significant reduction in direct taxes and a mitigation of their progressiveness are also desirable for the simple reason that it is the people with high incomes who invest and save more. Tax reductions must be accompanied by a reduction in public spending, in order to generate the resources needed to relaunch production.

The fiscal pressures in the E.U. Member States and in Romania to rigorously analyze fiscal pressure in EU Member States must move away from the mere observation of the inflationary disparities between European countries and the consistency of their budgetary policies towards the analysis of the connection between tax reduction, the economic growth and the stability of the pact, irrespective of its constraints.

All countries are trying to create a competitive business environment, as demonstrated by the reduction in total corporate taxes, the average of which fell from 47.3% in 2009 to 43.4% in 2016. In the EU countries, the average tax burden has resumed its upward trend in 2007, reaching a record high in 2009, following a short-term decline between 2013 and 2016. Between 2007 and 2009, the tax burden has increased in all E.U. countries. In essence, in the framework of the Stability Pact, which requires a reduction in structural budget deficits, only Norway and Sweden are able to guarantee the necessary economic incentive.

In Romania, the tax burden is neither statistically nor fiscally tracked by the Ministry of Finance. When calculating the fiscal pressure, some experts take into consideration the tax burden on the consolidated state budget. In Romania, the tax burden became topical only after 1989, with the first signs that the Romanian economy will turn into a market economy, and therefore the detailed modernization of the tax system was necessary, a process which continues after 18 years of transition.

An analysis of the tax burden in our country after joining the EU should take into account features such as:
- the insufficient development of the economy, which cannot cope with the European competition;
- the difference between the individual income in Romania and the Community;
- the promotion of fiscal policies whose only goal is to collect revenue;
- the underground economy, the taxation of which would fill the budget gaps which are currently filled exclusively by increasing the tax burden.

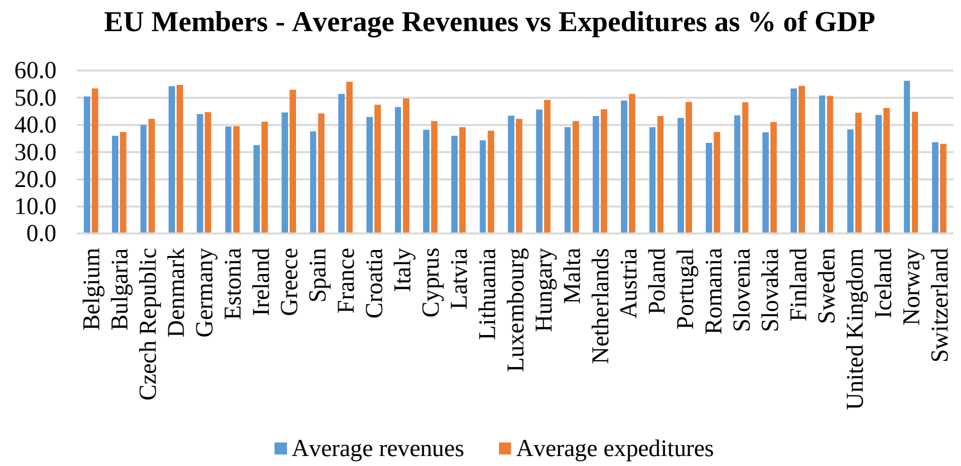

Figure 2. *Average revenues vs. Expenditures (% GDP)*
Source: own representation, using Eurostat data

At the macroeconomic level, the consolidated income tax in the period 1990-2007 represented around 30% of the GDP, while the non-consolidated revenues amounted to an average of 3%. The total tax burden is supported by direct taxes which, together with the three major groups of compulsory contributions and the local taxes had a share in total budget revenues of 57.7% in 2007, and by indirect taxes, which amount to 42.3%. As far as direct taxation is concerned, the social security contributions accounted for approximately 37.18%, followed by the taxes on income and wages, with 17.66%, while the VAT provided 54.18% of the indirect taxes, the rest being customs duties and other indirect taxes. If we only took into account the taxes on income, these would be only 19% of total revenue for the year 2007, well below the EU average.

At the microeconomic level too, the tax burden affects the fiscal policy, the strategy and the decision-making process. At the level of business, taxation is an important element, influencing the management decisions and the strategic development. A fair approach to fiscal pressures implies the analysis of the development, financing and production functions of companies.

The large number of taxes and the high tax rates inhibit the investors' interest in activities that generate profit and further investments. Given the economic situation of Romania, a low level of taxation would be beneficial, as this could attract capital from countries with high levels of taxation. Through low taxes we could try to stimulate economic growth, the demand for goods and services and the most important activity, investment. A high tax in a weak economy like the one of Romania may have only negative medium and long-term consequences, reducing the demand for commodities and the interest in saving and investment, which ultimately impairs the economic dynamism of the country. Even if the percentage of fiscal pressure in Romania is close to or even lower than that of other European countries, in fact, the real fiscal burden on each taxpayer is much bigger because of the low incomes. In such a situation, it is obvious that the temptation to bypass the legal framework for reporting all income correctly determined in terms of taxation is growing.

In 2008, according to the estimates by the Council for SMEs, the actual number of taxes and special taxes amounted to 540 (one third of which could be removed as they are not justified), while the number presented by the Ministry of Finance in August 2008 was 115. A coherent system of taxes with a positive outcome both for the state and taxpayers should be developed both qualitatively and quantitatively. Beside the large number of taxes owed by physical entities and legal entities from Romania, they are forced to spend also a lot of time in order to pay them with a relatively high frequency (usually monthly) and in quite inadequate conditions (queues formed because of the small number of counters, rudimentary technique). However, the same study by the World Bank has shown the amount of time Romanian taxpayers spend, on average, making payments to the state, an amount considered moderate as compared to the European average and very small if we look at counterparts such as Bulgaria or the Czech Republic.

The most important taxes paid by individuals are value added tax (VAT), excise duties (tobacco, alcohol, fuel, coffee), income tax, contributions to social budgets on properties (real estate, automotive), and various other payments for services. In Romania, during 1990-2008, the tax burden pressed, especially on individuals, both by high labor taxation, and by increasing indirect tax revenues, thus leading to a significant reduction in the degree of tax compliance for this category of taxpayers. An analysis of international practices and trends in fiscal policy allows us to draw some conclusions on the complex issues of tax burden:

- Through an analysis of the level and structure of taxation, we found that its level varies in relation to the tasks of the State, especially at the level of social protection.
- After the tax reforms carried out in the European countries in the 1990s, a process of reducing marginal tax rates began in most countries, on finding that their values highly distort the economic activity and encourage tax evasion. The idea is gaining ground that taxes could be used as economic and social tools neutralize tax evasion.
- After the accession of new countries to the E.U., there will be an alignment of the level of taxation and redistribution of values in countries with lower taxes.
- The Romanian fiscal system has reached its maturity, as other tax systems in the E.U. have, but several changes are needed in order to harmonize it with the E.U. legislation and to remove some of its shortcomings.
- The fiscal pressure and the level of taxation in Romania is only apparently low; in fact, because of the low GDP, the uneven distribution of taxation and the large number of taxes, for many of the taxpayers, the system is very oppressive.
- We need a fairer redistribution of taxation through better tax collection and through lower levels of taxation, in order to support investment, to stimulate economic development and to increase per capita income and the general welfare.
- Also, we should reassess the level and forms of social protection in Romania and labor taxation, since conducting a globalizing social protection system has a negative impact on the economic development. The fiscal reforms in Romania should not stop at the current achievements; on the contrary, the national tax system needs to be restructured, both in its quality and quantity.

We wanted to see the correlation between budget revenues and tax burden in the European Union, so we have created an econometric model, developed in EViews software application, based on a simple linear regression the following formula:

$$P = a + c * PD,$$

where P - the average total tax revenues and social contributions as a share of GDP, PD - budget expenditures and c - constant.

Regarding the period, I chose 10 years, from 2007 to 2016, in order to see if two variables are correlated in a range that includes an expansive economic situation, a time of crisis and a period of recovery.

The data used are the percentage of budgetary revenues in GDP and the tax pressure dependent variable and expenditure, as well as a share of GDP as the independent variable. We can see from the analysis that there is a direct linear relationship, which means that we have budget expenditures that affect the tax burden.

Dependent Variable: T
Method: Least Squares
Date: 03/30/18 Time: 22:33
Sample: 2006 2016
Included observations: 11

Variable	Coefficient	Std. Error	t-Statistic	Prob.
E	-0.494717	0.112381	-4.402126	0.0017
C	23.19987	2.324291	9.981482	0.0000

R-squared	0.682861	Mean dependent var	12.97273
Adjusted R-squared	0.647623	S.D. dependent var	0.392660
S.E. of regression	0.233088	Akaike info criterion	0.088166
Sum squared resid	0.488971	Schwarz criterion	0.160510
Log likelihood	1.515088	F-statistic	19.37871
Durbin-Watson stat	0.833252	Prob(F-statistic)	0.001715

Figure 3. *Results obtained by simple linear regression*
Source: own representation, using Eurostat data and EViews

It can be seen that the estimation of R-squared and also adjusted R-square values are high, 68% and 65%, which means that there is a correlation between the two indicators. The financial model shows that the fiscal pressure is dependent on the budget expenditure. Also, the Durbin Watson test confirms this, with a value of 0.83. The value of the sample (F-statistic) obtained is very low, less than 1%, so the coefficients are null (if we consider a significant level tested at less than 1%) without reference to the constant coefficient, which confirms once more that between the fiscal revenues and debt there is a direct linear relationship.

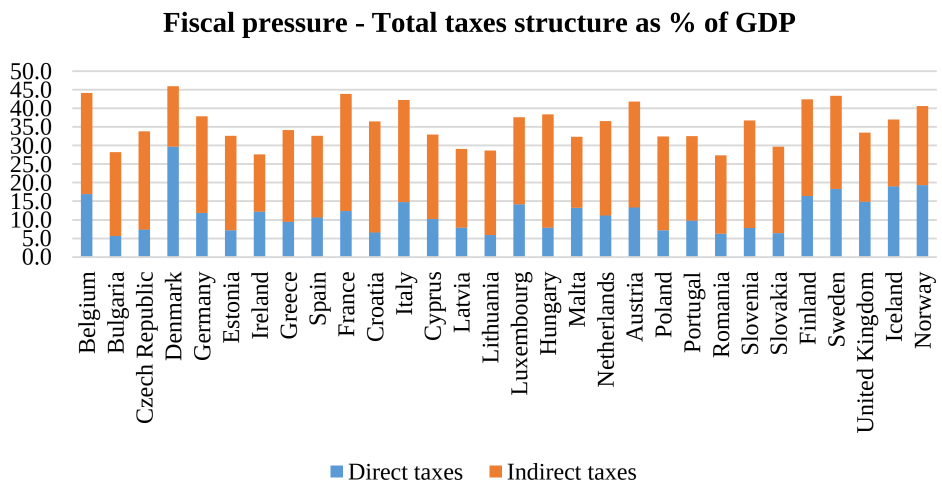

Figure 4. *Fiscal pressure - Total taxes structure as % of GDP*
Source: own representation, using Eurostat data

To avoid discouraging investment, taxes should be simple, stable and neutral towards different forms of investment and / or financing; tax administration must be efficient. Many factors influence the investment decisions of companies. Taxation is such a factor as it increases the cost of capital of companies and create high compliance costs when tax systems are complex and unpredictable. Taxation is therefore an important element of a business environment that works well. Efficient management and tax efficiency, legal certainty, stability, predictability and simplicity of fiscal rules matter for the decisions of investors. The distortions in the tax system may affect access to finance and discourage capital investment. A well-designed tax system could contribute to improved living standards by providing incentives for smart and healthy investment.

Conclusions

The analysis carried out in this paper has shown that fiscal policies can contribute to the significant development of government strategies, that there is a correlation between tax policy and tax burden, and that there is competition in the E.U. states in terms of the level of taxation.

Through fiscal policies, tax rates and the number of taxes should be set at a level that has to be competitive in the E.U. Member States context, while covering the budgetary expenditure without creating imbalances in the economy.

In the last chapter we developed an econometric model, we used data derived from Eurostat for a period of 10 years, from 2007 to 2016, and using dependent variable both as the percentage of budgetary revenues in GDP and the tax pressure and independent variable as expenditures found that there is a correlation between the total budget revenues and the tax burden, and concluded once more that the tax burden is closely linked to the state's tax policies.

Using the EViews application, it shows up that the fiscal pressure is dependent on the budget expenditure, budget expenditure affecting tax burden. The variables used in this model are dependent variable both as the percentage of budgetary revenues in GDP and the tax pressure on one hand and independent variable as expenditures on the other hand.

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