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SUSTAINABILITY OF TAX SYSTEM IN ROMANIA

Case study

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Fiscal Policy
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Tax Revenues

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C10, C80, E62, H70

Abstract

In the context of globalization, sustainable development is the key to the development of contemporary society and future generations. Sustainability has become a key point for the debates in the political, economic, and academic environment. Therefore, today we have reached the point when we speak of a country or company sustainability, of environmental or agricultural sustainability, while speaking, at the same time, of fiscal policy sustainability.
The purpose of this paper is to analyze the Romanian fiscal policy sustainability in terms of tax revenues. The methodology used in this research is bibliographical analysis of specialist literature and statistical analysis of data. Bibliographical analysis was used to define operating concepts: fiscal sustainability and tax revenues. Statistical analysis was used to analyze the evolution of tax revenues in Romania between2005and2013, as well as the share of tax revenues in the general consolidated budget of Romania. Statistical data were processed using Microsoft Excel and presented as evolution diagrams.
The novelty and originality of the present work consist in the bibliographical study on Romanian fiscal policy sustainability, the statistical study on the evolution of tax revenues in Romania between 2005and2013, and the analysis of fiscal policy sustainability in Romania in terms of tax revenues.

Introduction

Sustainability has nowadays become a broad concept relevant to every aspect of human life. It occurs at the junction of three core components that have been called the “pillars” of sustainable development: society, environment and economy (Zaman &Goschin, 2010).

Sustainability requires a strong partnership between society, environment and economy. This partnership involves satisfying the needs of the present without compromising the ability of future generations to meet their own needs (Brundtland Report, 1987).

In the context of fiscal sustainability, sustainable development means actually paying the current debts and drawing tax policies able to generate benefits not only in the short term, but also in the medium and long term. Fiscal sustainability is an important quality for any state. This concept refers to the impact that fiscal policy promoted by the government has on the society in the medium and long term. Specialist literature reveals various definitions of the concept of fiscal sustainability because sustainability depends on the admissibility of future government actions, such as raising taxes in order to build budget revenue and employingbudgetary expenditures. Sustainability is a critical point to be considered for policy makers because ignoring it can lead to economic and political collapse in case the government faces a debt that cannot be repaid.

The European Union (EU) fiscal policy over the last year has focused on the need and urgency of pulling the economy out of recession. The integrated discretionary measures and tax incentives have allowed for paying off economic downturn and contributed to the improvement seen during the last period. However, this also led to diminishing the financial reserves instate accounts, which in turn, over lapped to demographic developments projected in response to population aging, caused the long-term sustainability of public finances to become a major challenge and a necessity for the future.

This paper aims at providing an analysis of fiscal sustainability in Romania in terms of tax revenues for the period 2005 to 2013. The paper is structured as follows: Introduction in the research topic (1) Bibliographic study of the concept of fiscal sustainability (2) The evolution of tax revenues in Romania in the period 2005 to 2013, their share in GDP and budget deficit; (3) Research methodology, results and discussion; Conclusions.

The analysis subsumes a number of assumptions upon which the present research is based:

(H1) The share of tax revenues in Romania in GDP is well below the EU average;

(H2) The sustainability of Romanian tax system was affected by the economic crisis;

(H3) The Romanian tax system shows relative stability;

(H4) Romania must implement fiscal policies that lead to increasing tax revenue share in GDP.

1. Literature overview

1.1. Fiscal Sustainability

Fiscal sustainability is a present-day problem, anurgentone, that needs immediate solutions, as population aging and the increase of budgetary expenditures in order to support its needs, as well as previous financial commitments will raise the tax burden on future generations (Schick, 2005).

Fiscal sustainability is not a stationary process but a dynamic one, which even though variable, is still permanently balanced. By sustainability we mean the very characteristic of a process (phenomenon, system) to maintain the desirable path, within a given or acceptable “lane”, for an indefinite period of time and on a global level of accessibility (Dinga, 2001).

Government has the obligation to prudently conduct its budgetary/fiscal policy and to manage budgetary resources and obligations, as well as fiscal risks, in such manner asto ensure the sustainability of fiscal position in the medium and long term. Sustainability of public finances requires that, in the medium and long term, the Government should be able to manage risks or contingencies without being compelled to make significant adjustments to expenses, income or budget deficit susceptible to cause economic or social destabilizing effects (Law 69/2010).

Fiscal sustainability is more than designing in the future; it is about urgently changing the fiscal policies, and about the need for new budgetary tools able to assess governments’fiscal position, because conventional instruments do not ensure the fiscal sustainability required by the Stability and Growth Pact of EU (European Commission, 2004).

According to EU Stability and Growth Pact, in order to ensure the sustainability of a tax system it is necessary to create a budget in the medium and long term (3 to 5 years) and a range of sustainable fiscal policy. The specialist literature highlights the need for such tools, considering that states have debts in the medium and long term which, although not included in annual budgets and balance sheets, will still put a burden on future generations when they become due. The concept of fiscal sustainability emphasizes that responsible governments should not put pressure on future generations by implementing in the present moment certain fiscal policies.

According to the European Commission, the fiscal sustainability of a state subsumes four dimensions that work as a tandem inside a responsible and fiscally sustainable state (European Commission, 2004):

1. Solvency (government's ability to pay financial obligations);
2. Increase (the existence of a fiscal policy able to support sustainable economic growth);
3. Stability (governments' ability to meet their future obligations while maintaining the current tax level);
4. Fairness (governments' ability to pay current obligations in the present, without transferring the burden on future generations).

In terms of solvency, the fiscal sustainability of a state is ensured when the present value of future budget surpluses will exceed the present value of future budget deficits (Anderson and Sheppard, 2009).

In terms of tax revenues, expenditures and public debt, a tax system is considered sustainable if it shows a steady rate of public debt in GDP over at least 75 years, with revenues and expenditures showing parallel progress (Appendix, 2010).

Fiscal sustainability of an economic system can be ensured by a boost inthe growth of foreign trade (Albu, Iordan, Lupu, Chilian&Diaconescu, 2012), througheconomic competitiveness (Pelinescu, Iordan&Chilian, 2012) and by ensuring public debt sustainability (Albu&Pelinescu, 2003).

2. Sustainability of Romaniantax system in terms of tax revenues

In Romania, the fiscal policy is considered as part of national macroeconomic policies. Thus, in order to increase the income –deeply affected by the 2008 crisis – and achieve a balance between public revenue and public expenditures in relation to socio-economic objectives able to ensure the sustainability of the tax system, measures have been taken for developing tax policy by drawing the Fiscal strategy during 2011 to 2013 (Lobont, 2013).

The literature reveals that sustainability of Romanian tax system is affected on one hand by the economic crisis and the extent of corruption (Lobont, 2013b) and on the other hand by the election periods (Moldovan, Hatmanu, Lobont, 2014). These indicators cause disturbances in the parallel progress of revenues and expenditures as well as direct implications for the sustainability of Romanian tax system.

Sustainability of a tax system is ensured primarily by the level of budgetary revenues. Budgetary revenues include tax revenues, non-tax revenues, grants, income from capital, donations and money from the EU.

Over the years, the share of budgetary revenues in Romania recorded low values, well below the EU average, as can be seen in Table 1.

The largest share in the budgetary revenues is represented by tax revenues (income tax, payroll, capital income and gains, taxes on goods and services insurance contributions). Fiscal revenues in Romania experienced a sinuous evolution over the period considered in this analysis (2005 to 2013), as can be seen in Figure 1.They have shown a spectacular growth between 2005 and 2008, especially in the last two years (2007 and 2008), following the integration of Romania in the EU. Romania's integration in the EU resulted in it being subject to EU laws in terms of stability and economic growth.

The year 2009, an election year and also the first one of the economic crisis, has brought certain changes – a sudden drop – in the level of tax revenues, while since 2010 the volume of tax revenues in Romania has shown slight increases.

The share of tax revenues in GDP during 2005 to 2013 shows a sinuous evolution – increasing and decreasing repeatedly –suggesting the instability of Romanian tax system, it being easily influenced by external factors such as economic crisis and election periods (Figure 2). The first three years(2005, 2006 and 2007)show a 0.5 percent growth (%) from one year to another. The named years precede the economic crisis and the years of parliamentary (2008)as well as presidential and Euro-parliamentary (2009) elections in Romania, when the share of tax revenues in GDP decreases dramatically, to reach 17.5 percent (%) in 2009. Beginning with 2010, the share of tax revenues in GDP enters a growing process.

From the point of view of this analysis, the sustainability of a tax system is ensured when the following conditions are met:

1. Fiscal Sustainability = Budgetary Revenues-Budgetary Expenses = Budget Surplus (a point when expenses are completely covered from budgetary revenues with a subsequentin come surplus).
2. Fiscal Sustainability = Budgetary Revenues-Budgetary Expenses = Budget deficit under three percent (%) of GDP (compliance to fiscal sustainability requirements imposed by the Maastricht Treaty).

On analyzing Figure 3, we can see that Romania's fiscal deficit for the period under review follows the sinuous trend of the share of tax revenues in GDP. The economic crisis has had the greatest impact on the evolution of Romania's fiscal deficit in 2008, 2009, 2010 and 2011, with the deficit recorded values well below three percent.

Economic and budgetary policy applied in Romania over the years before the economic crisis led to internal and external imbalances that need to be corrected in the next period. A sustainable achievement of lower budget deficits requires considerable adjustments to budgetary process as well as reforms to revenue and expenditure policy.

The analysis of the three indicators – tax revenue volume, the share of tax revenues in GDP and fiscal deficit – reveals 2010to be the year that reorients the indicator track after the drastic declines of economic crisis years. This year corresponds to the implementation in Romania of Fiscal-Budgetary Responsibility Law, the Law 69/2010.
Fiscal-budgetary responsibility principles include: (1) maintaining a prudent level of public debt so as to maintain fiscal sustainability; (2) providing a balanced general consolidated budget over the economic cycle; (3) developing a prudent management of assets, liabilities and fiscal risks related to public sector in order to avoid burdening future generations; (4) ensuring predictability of tax; and (5) maintaining an appropriate level of tax reserves for debt service.

3. Methodology, Results and Discussions

The methodology used in the study on fiscal sustainability in Romania during 2005 to 2013 consists in bibliographic research and statistical research. Bibliographical research means studying the concept of fiscal sustainability, filtering most popular definitions, developing a critical analysis of definitions and presenting one's personal views on the concept of fiscal sustainability. With the aim of comparing the statistical data and complying with the principle of methodconsistency, the period considered for analysis begins with 2005. This is the year when the passage was made from the four-stage-progressive tax system, with tax rates between 18 and 40%, to16% single tax share. The data-string end year considered in the present analysis is 2013, it being the last year for which data related to Romania's consolidated budget is provided; 2014 is in progress.
There are multiple limitations to the present research. First, the shortness of period subject to analysis; the criterion considered in the analysis is the tax revenue share in GDP and the fiscal deficit. Future extended research will be performed considering a longer period of time, so that analysis can be structured according to applied tax rates; more indicators will be considered in the future studies (the structure of budgetary revenues, the structure of budgetary expenditures, the influence of population aging on budgetary expenditures and thus on fiscal sustainability, the evolution of GDP, the evolution of budget deficit).
Following the analysis of Romanian tax system sustainability over the period 2005 to 2013 in terms of tax revenues, we can highlight a number of results that reinforce the initial assumptions.
(H1) The share of GDP of tax revenues in Romania are well below the EU average, being lower by almost 10 percentage points. This low share of tax revenues in GDP is caused by the low rate of employment. In order to solve this problem, Romania should take steps meant to increase employment, as stipulated in the EU Development Strategy, Europe 2020 Strategy. This strategy aims to create a smart, sustainable and inclusive economy.
(H2) The economic and financial crisis has had serious implications for the economic development of EU countries and consequently for Romania. Fiscal sustainability of EU states has been severely affected by the economic crisis, through the increase of expenditure share in GDP and the diminishing of budgetary revenue share, which generated large budget deficits.
(H3) The Romanian tax system shows relative stability, being slightly affected by the economic crisis, but also by the periods when elections are conducted. The most eloquent year is2009, this having been both an election year and a year affected by the economic crisis, with the lowest budget deficit ever recorded – 7.2%.
(H4) Romania must implement fiscal policies leading to increased tax revenues in GDP. Increase of tax revenues in GDP can be achieved by lowering the unemployment rate, increasing the active population range, lowering the underground economy, fighting tax evasion etc.

Conclusions

Fiscal sustainability is a development track that should be considered by all governments, in developed countries but especially in developing or under developed ones.
Fiscal sustainability is closely related to the level of tax revenues in GDP, as they are the main revenue constituent.
Romania is a country with an average level of risk for fiscal sustainability and it should follow some important steps towards perfecting its fiscal sustainability:

- Reducing corruption and underground economy;
- Increasing the share of tax revenues in GDP by increasing tax collection, not by introducing new taxes;
- Reducing the budget deficit;
- Stimulating investments and economic growth;
- Creating new jobs and reducing unemployment.

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Appendices

Table No. 1
The evolution of share of total tax revenue from GDP between 2005 and 2012 at EU 28 country and Romania level

Share of total tax revenue from GDP	2005	2006	2007	2008	2009	2010	2011	2012
Romania	28.5	31.8	32.5	32	29.9	33	33.1	33
UE 28 country	47	46.7	46.2	46.6	45.9	46.3	46.8	48

Data source: European Commission

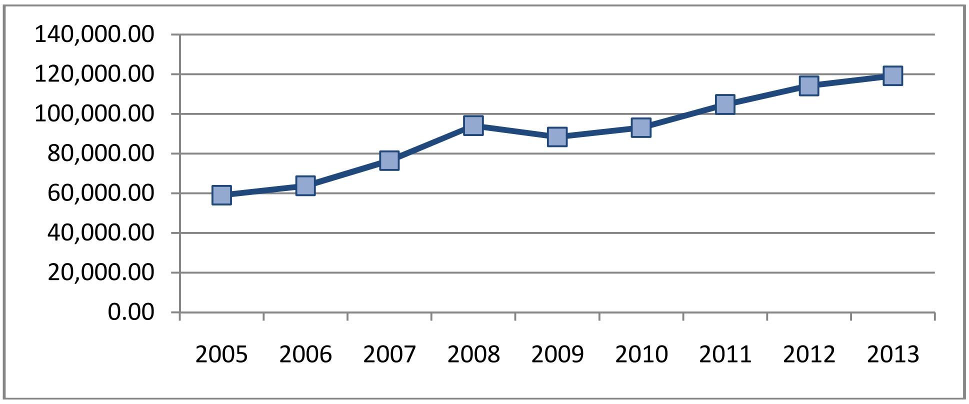

Figure No.1. The evolution of tax revenue in Romania between 2005 and 2013

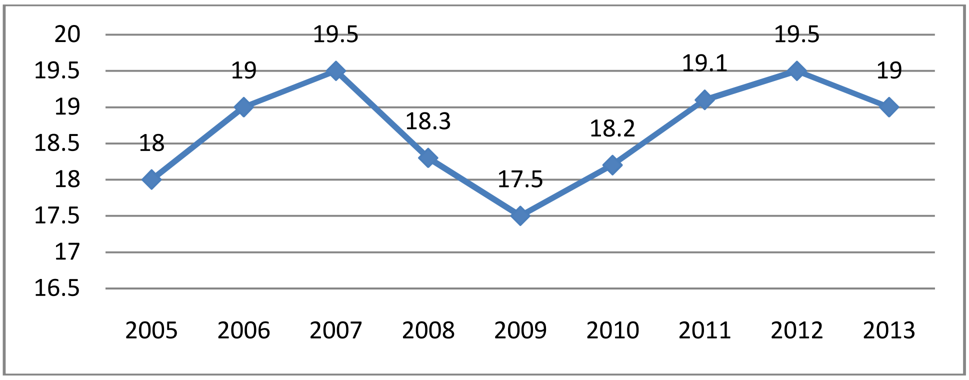

Figure No. 2. The evolution of share of tax revenue from GDP

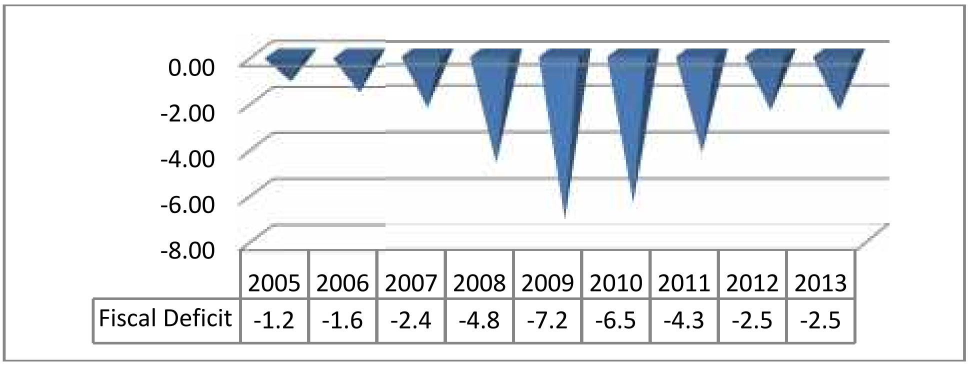

Figure No. 3. Romanian fiscal deficit between 2005 and 2013