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DIRECT AND INDIRECT TAXATION AND ITS ROLE IN REDUCING THE BUDGET DEFICIT. CASE STUDY

Alina MARCUTA, Cristiana TINDECHE, Cosmina SMEDESCU, Dragos SMEDESCU, Liviu MARCUTA

University of Agronomic Sciences and Veterinary Medicine Bucharest of Bucharest, 59 Marasti Boulevard, District 1, 011464, Bucharest, Romania, Phone: +40213182564, Fax:+40213182888, Emails: alinamarcuta@yahoo.com; tindeche_cristina@yahoo.com; smedescu.cosmina@managusamv.ro, dragos.smedescu@managusamv.ro; liviumarcuta@yahoo.com;

Corresponding author: liviumarcuta@yahoo.com

Abstract

Fiscal policy represents a problem of security and solidarity at the level of each individual state, but also at the community or world level, because ensuring tax revenues can contribute to ensuring economic, social and environmental stability, but at the same time it also contributes to economic development both current, as well as future generations. This can be achieved by improving some important sectors of activity, such as education or health. Each individual state establishes a certain fiscal policy, adapted to its own needs, in which the ratio between direct taxation and indirect taxation, the manner of their application can ensure sufficient fiscal revenues to cover both public expenses, but also allow the achievement of investments. The purpose of this paper is to analyze the two taxation systems, both at the level of Romania and at the level of other EU countries, with the aim of making comparisons and finding solutions regarding the way to improve the fiscal policy in Romania. The research methodology assumed both the analysis of the specialized literature regarding the characteristics of fiscal policies and their role in ensuring economic development, as well as the consultation of internal and international databases from which fiscal information was collected regarding direct taxes and indirect taxes. The data collected and systematized were subjected to an analysis with the help of some statistical indicators. The interpretation of the results allowed us to formulate conclusions that highlighted the fact that although Romania registers a GDP/inhabitant that places it very close to the average of EU countries (72%), in terms of the contribution of tax revenues in the formation of GDP, there is an imbalance, as a result of the weight of 26.3%. This imbalance is due to several factors, among which we were able to identify: low level of collection of fees and taxes to the state budget, granting exemptions from paying taxes or applying preferential fiscal regimes, permanent changes to the Fiscal Code, etc., aspect that, in addition to excessive financing of consumption, contributed to the appearance of the budget deficit.

Key words: *fiscal harmonization, direct taxes, indirect taxes, budget deficit, fiscal policy*

INTRODUCTION

At the level of the European Union, fiscal harmonization is an important objective that contributes to ensuring financial stability both at the community level and at the national level, being provided for in the European treaties and directives through which an alignment of policies was pursued both in terms of direct taxation, as well as indirect taxation. However, the different objectives pursued by each individual member state, the national peculiarities of fiscal policies, have meant that they cannot be applied in full, but efforts continue at the community level. On the other hand, at the level of the union, one of the common objectives was the economic and monetary assurance and consolidation, which is why, the main objective of the European states is to ensure the fiscal resources necessary to cover public expenses, eliminate or reduce budget deficits, which means that taxation is used as a financial, economic and social lever. Romania is also in this situation, which still does not manage to cover the budget deficit that perpetuates itself from one year to the next, thus making impossible a sustainable economic development based on investments and economic growth.

Moreover, in the last decades the world economy and its financial system faced numerous problems (economic crises, the Covid-19 pandemic, the war in Ukraine, etc.) which led to major changes in standards, paradigms, rules, which were influenced in their turn of globalization, digitization, etc. and which required finding solutions to mitigate the consequences of these events with economic, social and environmental impact [10]. This, however, cannot be achieved without building a consolidated strategic cooperation, within which each individual state has its own role [16].

The main tax categories are represented by: capital tax, labor tax, consumption tax, property tax and environmental tax. The way in which these taxes participate directly or indirectly in achieving tax revenues depends on the policy of each state, its level of development and financial stability. Moreover, the fiscal pressure is given by the ratio established between fiscal revenues and GDP [1].

Romania is one of the states that uses indirect taxes as the main source of income, that is, that taxes mainly work and consumption, and less capital and property [9, 11].

Ensuring fiscal revenues is necessary to cover public debts and reduce or eliminate budget deficits, which at the community level are imposed by signing the Maastricht Treaty in 1992 and which aim at the sustainability of public debt and the soundness of public finances. The European Union monitors the budget deficit of the EU states, imposing a limit of 3%, a limit that Romania has failed to meet in recent years [8].

In this context, the purpose of the paper was to compare the situation of fiscality in Romania with that of other member states of the European Union, so that finally to formulate recommendations for the ficsal policy could be improved.

MATERIALS AND METHODS

The research methodology involved the creation of an analysis plan that went through the following steps: preparing the plan, collecting information, verifying the collected information, determining the indicators, interpreting the results and formulating conclusions.

Prepare analysis plan was necessary in order to establish the researched elements that will be the basis of achieving the proposed objectives. It also included elements related to the sources used, the indicators used, the way of processing the information and presenting the results.

The sources of information used were represented by the existing specialized literature, as well as by data taken from international and domestic databases.

The verification of the collected data followed, on the one hand, the accuracy of the information, the degree to which it presents the level of the researched phenomenon, but also the way of its production. The logical examination of the links that exist both between the levels of the analyzed indicators, as well as between their values and the characteristics of the analyzed phenomenon from the period 2016-2021.

The data processing methods were comparison, qualitative and quantitative methods

The interpretation of the data allowed the establishment of conclusions that resulted from the processing of the collected and processed data.

RESULTS AND DISCUSSIONS

An important aspect that characterizes Romania's fiscal system is the fact that tax revenues have a low contribution to the formation of the Gross Domestic Product, which represents a vulnerability in the conditions that they cannot cover public expenses. Thus, at the level of 2022, the revenue contribution was 26%, compared to the average contribution registered at the community level, which was 40%. Another serious aspect is that of the public debt, which in 2022 reached almost 51%, thus becoming more and more difficult to refinance, but also accompanied by a structural deficit. The causes of these deficiencies are numerous, but an essential role is played by fiscal policy, the way in which fiscal revenues are established and collected that could contribute to reducing the budget deficit, which became excessive in March 2020 [12, 11].

What is criticized about the fiscal policy in Romania is both the poor collection (in 2022, Romania recorded a VAT non-collection rate of 35%, compared to an average rate of 10% recorded at the community level), as well as the granting of some more fiscal facilities or the application of an unbalanced taxation system in terms of direct and indirect taxes.

An obvious imbalance is registered at the level of Romania between the contribution of tax revenues to the formation of GDP (which is reduced compared to other EU countries, being approximately 26%) and GDP/capita which in 2020 reached 72% of the value recorded at the community level (Figure 1),

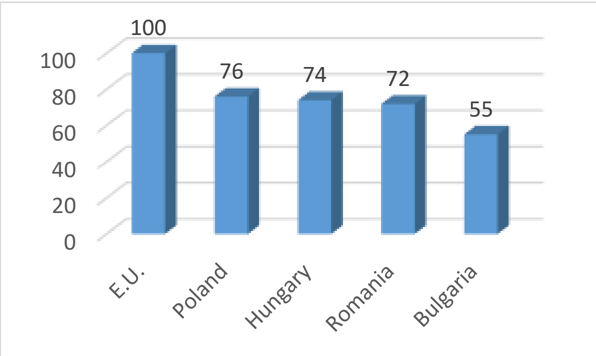

Fig. 1. The share of GDP/capita in Romania compared to the EU average and othe countries (%)
Source: own processing based on Eurostat data base [7].

An analysis of the evolution of direct taxes highlights the fact that the largest share is represented by the income from social contributions related to salary income, which, however, due to the fact that they are deductible from gross income, are correlated with the lower income from the salary tax. These revenues, with a weight of 12%, are below the European average of approximately 15%.

Another direct tax is the profit tax, respectively income or specific tax. The specific tax began to be applied to medium and large HoReCa entities starting in 2017, when the profit tax was eliminated, and from January 1, 2023 it no longer applies. It was found that this taxation system was ridiculous, but it was maintained as a result of the fact that the sector was heavily affected by the Covid-19 pandemic.

The income tax, of 16%, is paid by a relatively small number of economic entities, compared to the number of entities paying income tax, which until 2022 was 1%, respectively 3%. Starting with January 1, 2023, the income tax was restricted to 1%, the condition being that the respective entities have at least one employee. Also, the turnover was reduced up to which the economic entities can remain paying tax on the turnover.

Income from indirect taxes results from VAT, excise duties, customs duties, etc. that is, from consumption taxation.

From the data related to the revenues planned by the Budget Law for the period 2016-2021, we find that a significant increase in 2019 in revenues from turnover, this is due to the significant increase in payers, economic entities classified as micro-enterprises (by approximately 15% in 2019 compared to 2016). If in 2016, the share of micro-enterprises (turnover tax payers) from the total of economic activity tax paying entities was 72%, and 28% were profit tax paying entities, in 2019 their share increased to 87%, against 13% profit tax paying entities.

In order to have a real picture of the contribution of each category of income to the formation of the gross domestic product, the analysis followed the weight of the five categories of income and their evolution in the period 2016-2019 (Table 1).

Table 1. Evolution of revenues planned by the Budget Law (million lei)

Income	2016	2019	2021
Income from corporate tax	14,331,284	15,916,594	17,388,366
Income from turnover tax	553,119	2,644,929	2,668,958
Income from payroll tax	25,871,374	23,560,790	26,166,190
Income from social contributions	38,041,851	71,689, 581	73,504,857
VAT income	52,342,288	69,647,956	69,698,446

Source: Own processing based on teh data from [14, 15].

In this way, we note that the participation of income from the corporate profit tax contributed 1.46 - 1.89% to the formation of

GDP, with a reduction of this contribution in 2021 compared to the previous period. In terms of turnover revenues, they had the largest contribution to GDP formation in 2019 (0.26%). Moreover, there is a reduction in the contribution of all five categories of income in the formation of GDP for the year 2021. However, the largest contributions are the income from labor taxation (social contributions with weights of 5.01% of GDP in 2016, of 6.58% in 2021 and of 7.01 in 2019; but also payroll tax with contributions between 2.30% in 2019 and 3.41% in 2016) and VAT revenues which in 2016 contributed 6.89% to GDP formation, in 2019 with 6.81%, and in 2021 with 6.24 %.

What represents a negative aspect, emphasized before, is Romania's VAT GAP, which is among the largest among the countries of the European Union, and which is due to the reduced collection of revenues to the state budget. Although the VAT rates in Romania (5%, 9% and 19% until 2022) were close to those of the EU states, or above these rates, their contribution to GDP is 3% lower than the EU average (Figure 2).

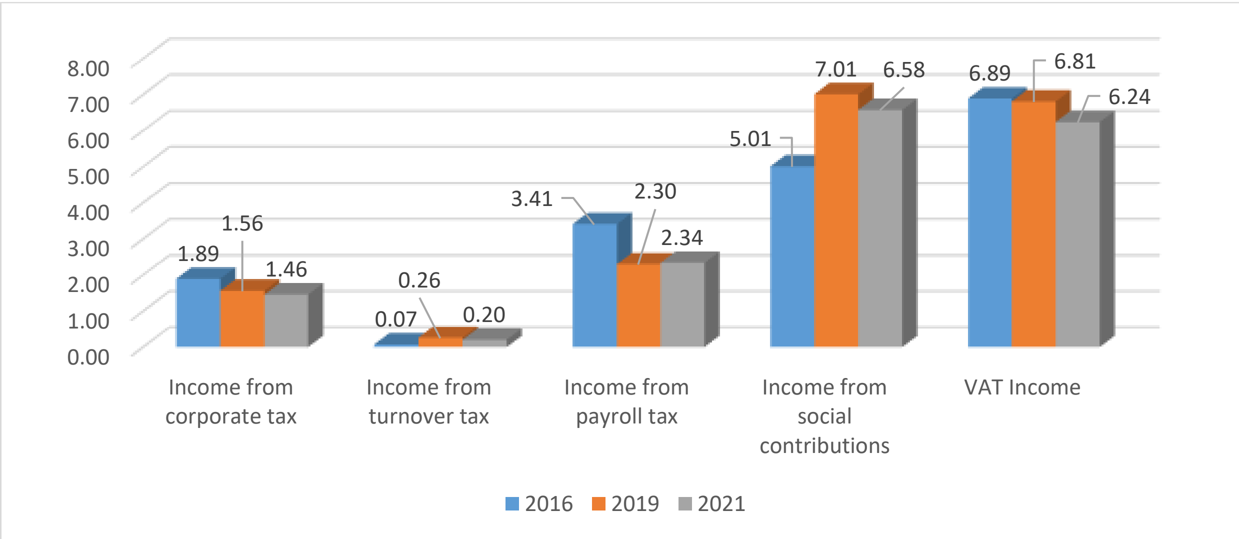

Fig. 2. Share of income from taxes and fees in GDP (%)
Source: own processing based on the data from [7].

The data for 2020 highlight the fact that compared to other European Union states, Romania participates with the lowest contribution of taxes to GDP formation (26.3%), compared to an average of 40.2% in the European Union or compared to 36.3% in Hungary and 35.7% in Poland. Bulgaria, for its part, contributes 30.6% to GDP from fees and taxes.

Another aspect that must be emphasized is the fact that, if at the level of the European Union the contribution of direct and indirect taxes is almost equal (13.0% direct taxes and 13.6% indirect taxes in 2016), both in Romania and in the other states in the analyzed sample there is a high share of indirect taxes in GDP (Figure 3).

But Romania has the lowest share of these contributions, indirect taxes participating with 6.4% in GDP formation, (compared to 7.1% in Poland, 7.3% in Hungary or 5.8% in Bulgaria) and 11.4% contribution from indirect taxes (compared to 18.2% in Hungary, 15.6% in Bulgaria or 13.6% in Poland) as it is show in Figure 3.

The same balance regarding teh direct and indirecct taxes in the EU is maintained in the next period (13.2% direct taxes and 13.7% indirect taxes in 2019; and 13.3% direct taxes and 13.4% indiresct taxes in 2020).

As we easily notice, in the EU, the share of direct taxes increased in the total GDP increased in the period 2016-2020, the smae trend was registered in Poland and Bulgaria.

Romania was the only country were the share of dircet taxes declined. If in 2016, the income from direct taxes contributed by 6.4% to GDO, in 2020, the share was only 4.7% (Figure 4).

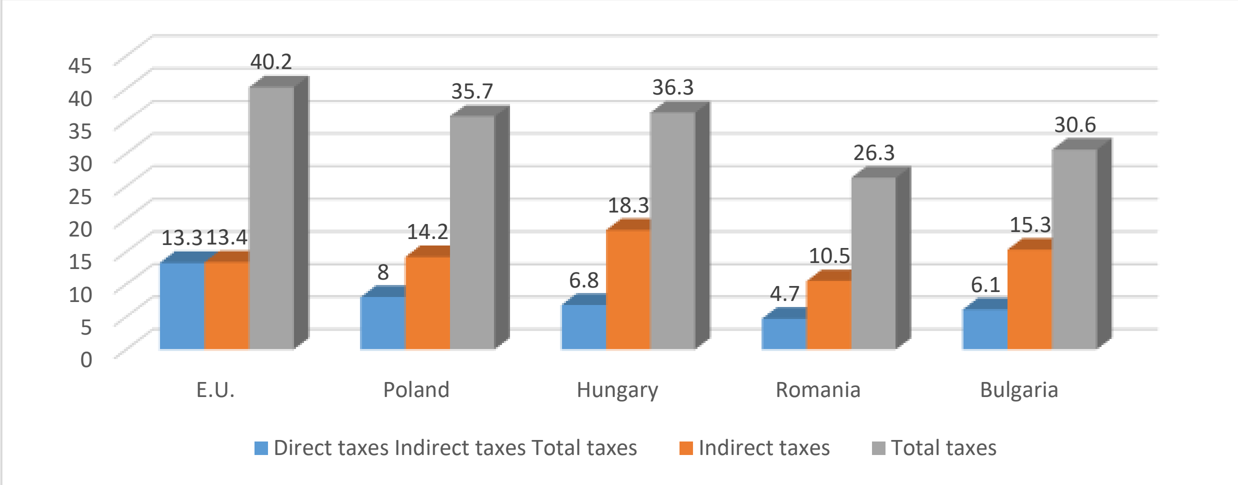

Fig. 3. The share of taxes in total GDP (%) in 2020
Source: own processing based on teh data from [4, 2, 3, 5, 6].

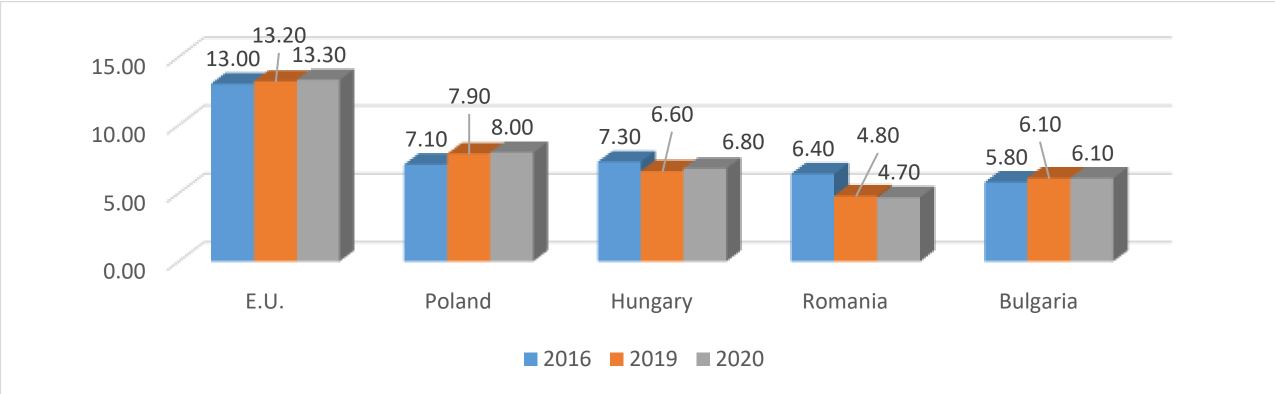

Fig. 4. Share of direct taxes in GDP in the period 2016-2020 (%)
Source: own processing based on the data from [4, 2, 3, 5, 6].

Concerning the contributions given by indirect taxes to GDP, we found out that Hungary, Poland and Bulgaria are situtaed over the EU average. But Romania continued to remain below this level with contributions to GDP of 10.5% in 2016, de 10.7% in 2019 si de 11.4% in 2020 (Figure 5).

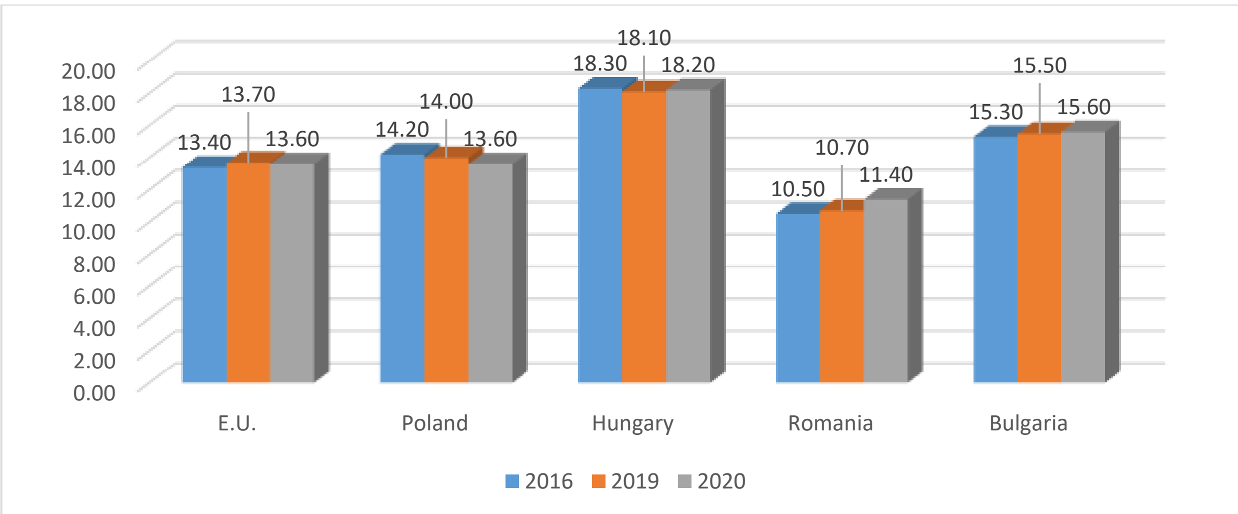

Fig. 5. Share of indirect taxes in GDP in the period 2016-2020 (%)
Source: own processing based on the data from [4, 2, 3, 5, 6].

Although social contributions in Romania have the highest weight among all fiscal revenues that contribute to the formation of GDP, they are both below the European Union average, but also below the values of other EU countries. We find that in 2016 the country that had a contribution higher than the EU average it was Hungary, and in 2019 and 2020 Poland. Bulgaria with figures of 7.7% of GDP in 2016, 8.8% in 2019 and 9.2% in 2020 is below the values of the other countries in the analyzed sample.

Although in Romania the value of social contributions in GDP is not at all small, there is also a problem related to "black" or "gray" work, which means that part of the contributions are not withheld and paid, which then contributes to the registration of tax revenues low (Figure 6).

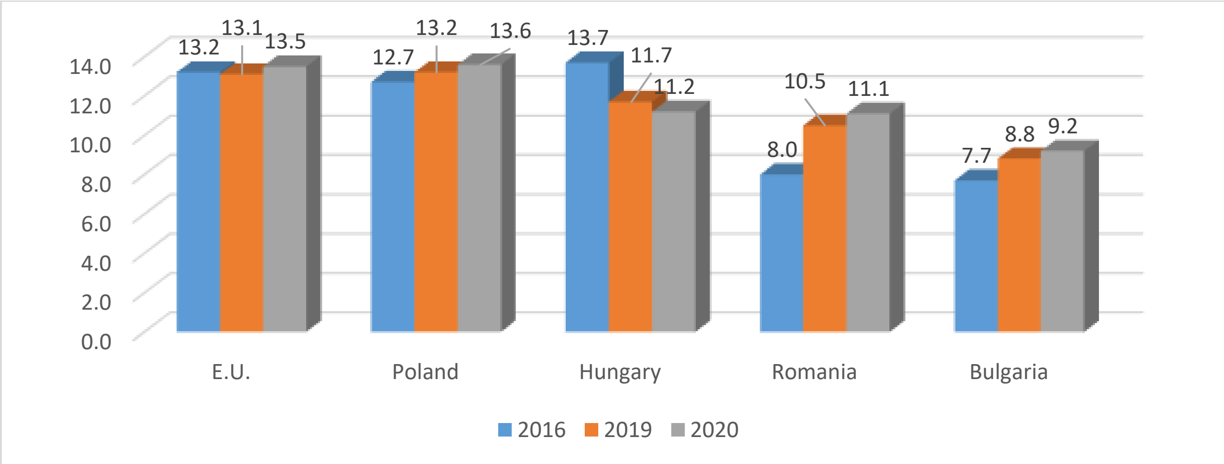

Fig. 6. Share of social contributions in GDP during 2016-2020 (%)
Source: own processing based on the data from [4, 2, 3, 5, 6].

From the analysis of the other categories of taxes represented by consumption tax, labor tax, capital tax, environmental tax and property tax, we find that in Romania the largest share in GDP, but also the closest value to the average of the Union European is owned by the consumption tax and the labor tax, this together with the social contributions being taxes withheld from the employee and paid by the employer, as a result of the fiscal changes of 2017. At the same time, but in terms of consumption tax and labor taxation, they have the closest value to the European Union average. In addition to these taxes, social contributions are also withheld from the employee, but are paid by the employer, this being established following the fiscal changes of 2017. Another observation related to the Romanian taxation system is that the property tax it is a relatively low one compared to the weight it registers at the level of the European Union. Its share is between 23-35% of it. A tax that comes close to that of the European Union is, however, the environmental tax, which, due to the legislation adopted and which has weights between 1.9-2.5% of GDP (Table 2).

Table 2. Evolution of revenues planned by the Budget Law (million lei)

Tax category	2016		2019		2020	
	E.U.	Romania	E.U.	Romania	E.U.	Romania
Consumption tax	11.1	10.1	11.1	10.2	10.8	10.0
Labor tax	20.5	10.0	20.7	12.0	13.0	21.5
Capital tax	8.1	5.1	8.1	3.9	7.9	3.3
Environmental tax	2.5	2.4	2.4	2.1	2.2	1.9
Property tax	2.3	0.8	2.2	0.7	2.3	0.6

Source: own processing based on the data from [4, 2, 3, 5, 6].

The environmental tax refers to different categories of taxes applied to energy, transport (with the exception of fuel tax) and pollution taxes. Energy taxes being close to the community ones, they can no longer be increased. As far as taxes on pollution and mineral resources are concerned, they are almost non-existent in Romania. Their application, as in the other EU states, could contribute to supplementing the revenues collected to the state budget.

CONCLUSIONS

What we find based on the analyzed data is that in Romania the level of tax revenues is low as a result of their taxation system. Thus, consumption is under-taxed compared to EU countries. Even if the stimulation of consumption is what leads to an increase in GDP, this is due to the increase in imports, which have the effect of creating a current account deficit. In 2021, this deficit reached 7% of GDP, far outside the European regulations.

What is found from the analysis of the Romanian tax system is the fact that both capital and property are undertaxed in Romania, with much lower weights compared to the EU countries.

The causes that contribute to this deficit in the registration of fiscal revenues are represented by the low level of collection of taxes and fees (as is the case with VAT), the fact that there are numerous exemptions and exemptions applied to different categories of payers or the application of preferential taxation regimes in certain sectors of activity (IT, construction, etc.) that lead to the reduction of the taxable base. Nor is the fact that digitalization is not yet implemented at the level of the other EU states an aspect to be neglected.

All these aspects contribute to the increase of the budget deficit which has become recurrent and which requires refinancing which must cover the consumption needs without allowing the realization of the much needed investments in infrastructure, health or education.

Romania's taxation system, based on indirect taxation, could contribute to the reduction of the budget deficit to a much greater extent than the application of direct taxation, but it must be accompanied by an increase in the level of collection and a reduction in tax evasion. In this way, direct taxation could be used for the purpose of attracting capital, by investors, thus using the model applied by Hungary, Poland or the Czech Republic.

The reduction of the budget deficit can only be achieved through a consolidation of the public budget which, however, will last for a few years, so that the economy can respond to the measures taken by the new Fiscal Code applied from January 1, 2023 and by which a sustainable correction of budget imbalance.

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