DIRECT TAXATION TRENDS IN EUROPEAN UNION AND ROMANIA, THE INFLUENCE OF DIRECT TAXATION ON BUDGET DEFICIT

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ABSTRACT
The purpose of this paper is to present the direct taxation system and its development in the European Union and Romania. In the first part, we presented theoretical issues related to European tax policy and tables that include EU Member States tax revenues as per 2004 - 2013 period average and charts based on these data. In the second part we built an econometric model based on a simple linear regression, the dependent variable is the budget deficit and the direct tax revenues expressed as a percentage of GDP as independent variable.

Keywords: direct taxation, fiscal policies, budget deficit

JEL Classification: H20, H30, H62

1. INTRODUCTION

There are a lot of definitions in the literature reffering to the tax, each of them refers to certain components of taxation. We believe that the definition of Larousse Dictionary exhaustive "taxation is the tax collection system, a set of laws and the means to apply it."

Taxation in any country operates as a tax system, which comprises three components:

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- legal component - contains rules and other technical elements (Fiscal Code of Fiscal Procedure Code, State budget law, Public finance law and so on) ;
- procedural component (tax mechanism), which provides procedures for administering the budget income tax according to the Fiscal Procedure Code and the annual budget laws;
- institutional component (tax system) represented by the set of state institutions in the field, directly involved in the regulation and enforcement of tax revenues colect to the budget at central and local level (Ministry of Public Finance, through the National Agency for Fiscal Administration - ANAF).

Taxation influences each of our lives. It shapes the relationship between citizens, businesses and state and has an impact on politics, economics and society. In EU, many policy makers, academics and citizens are interested in learning more about how the tax revenues of Member States' tax systems compare with each other.

Taxation is divided into two components, direct and indirect taxes, the proportion of them in total tax revenues has a considerable importance reffering to the distribution of incomes and in terms of economic growth.

However, price stability is the primary goal for many central banks in the developed or developing countries. Modern economic theory says that monetary policy can contribute the most to increase welfare by ensuring predictability of the economic environment, price stability and the creation of a stable financial system. To achieve these objectives, central banks use inflation targeting as a strategy framework whereby the central bank strives to achieve its primary objective of price stability through an inflation target.

Taxation is one of the most important components that must be considered when we are talking about complementary factors involved in maintaining price stability. Even if it comes from indirect taxation, which could directly influence the welfare or on indirect taxation, which indirectly affects the money spent on different types of goods or efforts that central banks need to cover economic shocks, price stability is influenced by these fiscal policies.

2. FISCAL TRENDS IN THE EUROPEAN UNION

Taxation is an essential component of socio-economic life of a nation, and how it is achieved by fiscal policy of the state concerned. In other words, taxation policy is characterized by the ways in which the state sets its tax policies related to social and economic life, both to meet the necessary funds to finance its activities and to regulate market imbalances.

Differentiation of fiscal policies from one country to another determine manifestation of international tax competition, or in other words, a strategically tax context, within broader lack of cooperation between jurisdictions (countries or regions tax belonging to a federation) in which each side sets tax system based on fees charged by others.

In other words, taxation competition in the EU is a fact, 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 fiscal 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.

In figure no.1, based on information from Eurostat databases, we performed a comparison of direct tax revenue as a percentage of GDP as average for the period 2004 to 2013 for each EU Member State. It is noted that there are substantial differences between incomes from direct taxes recorded by the Member States, each state has the possibility of establishing its own fiscal policies, observing higher revenues from direct taxes in the Western Europe Member compared to Eastern European states, the highest level being recorded by Denmark and lowest in Bulgaria and Romania.

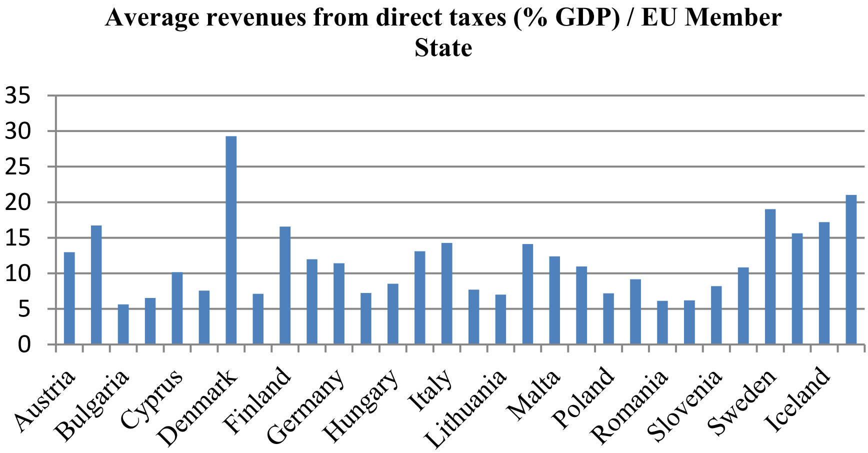

Figure 1: Average income from direct taxes in the EU (% GDP) / Member State; Source: own representation, using Eurostat data

However, in recent years, from the first quarter of 2009, revenues from direct taxes as a percentage of GDP fell in the European Union. In the chart below one can see that by 2008 there are no big changes, but in 2009 when the crisis began in the most countries, collected revenues decresed. What we represented on the chart is an average, but the most affected were the Central and Eastern European countries where tax revenues are based on indirect taxes, especially VAT.

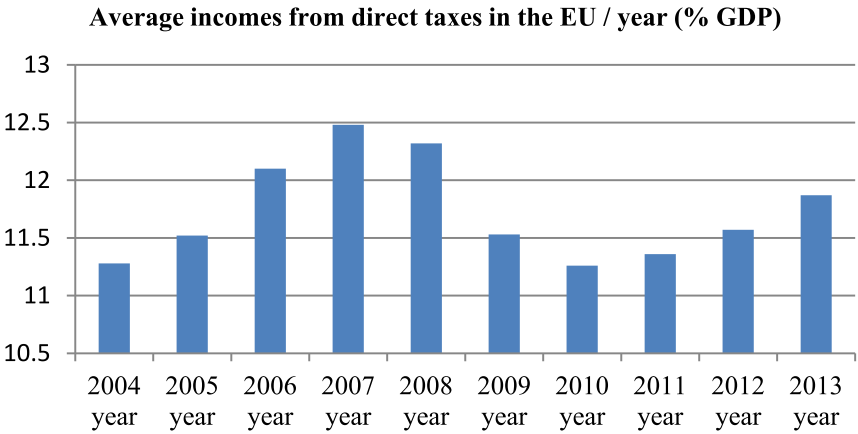

Figure 2: Average incomes from direct taxes in the EU (% GDP) / year; Source: own representation, using Eurostat data

Although efforts to harmonize economic and political systems, economic globalization and the increasing mobility of capital has created the conditions for tax competition between Member States. At the same time, the economic integration processes led in the Union to specific problems of each Member State, including taxation issues, which can effect on other Member States, by producing distortions in the single market level.

Belonging to the single European market requires unquestionably practices harmonization in several areas of interest, among which is the taxation. In general, tax harmonization is induced by the necesity of national tax systems do not affect the four freedoms written into the Treaty on the establishment of the European Community: free movement of goods, people and inventory, freedom to provide services.

Some experts when discuss about tax harmonization, most often about indirect taxes, but some aspects can be said of direct taxation. Where indirect taxation often influence the free movement of goods and services that require a high degree of harmonization, it does not happen the same with direct taxation. For a high degree of harmonization it is not necessary to harmonize direct taxation, which is strictly enforced within each Member State of the

European Union. Therefore, most of the rules on direct taxation must be attributed entirely by each state because they are an attribute of their sovereignty.

In terms of direct taxation harmonization at EU level led to the following goal: creating a common system of taxation applicable to suppliers, transfers of assets and stocks, transfer of shares between companies belonging to different Member States; creating a common taxation system of profits between branches and the mother company; a common taxation system applicable to interest payments and equities among affiliated persons. The first directive in direct taxation was "Directive 90/434 / EEC reffering to a common taxation system applicable to mergers, cessions and changes in the shareholder among companies belonging to different EU Member States ".

3. BUDGET DEFICIT

Over time, the tax system has undergone significant legislative intervention and takes different forms in the economic and social system of each Member State. An important objective of European fiscal policy is a limit on the budget deficit to 3 percent of GDP, this condition being imposed by the Maastricht Treaty (1992). The general purpose of this limitation is to maintain balanced budgets. Thus, increasing public expenditure can not be financed by debt, but only by increasing revenues.

The fact that Member States agreed, in principle, fiscal policy objectives of the European Union, Member States were reluctant regarding tax harmonization. This is because fiscal policy is regarded as a component of national sovereignty and tax systems of the Member States differs substantially due to differences in the economic and social structures of states.

Since 2008 economic crisis is felt in our country. In these conditions, Romania had to take a number of fiscal measures aimed at reducing the budget deficit. These measures were aimed on the one hand to increase taxation, reduce tax evasion and improve revenue collection system and on the other reduce spending.

The economic crisis has severely affected economic activity in Romania, reflected in lower collection from companies. If in 2008 the volume of corporate tax revenues accounted for 2.5% of GDP in 2011 was only 1.9%. Reduced economic activity and rising unemployment affected revenue collection from individuals, from 3.7% in 2009 to 3.5% of GDP in 2011. In 2012 it was decided to increase the taxable income, e.g. taxation the rent collected by the owner from renting tourism rooms located in private homes, with an accommodation capacity of between 1 and 5 rooms including; taxpayers with income from independent activities that recorded in the previous fiscal year in gross income higher than the RON equivalent of EUR 100,000 annual income tax will result in a real system.

As well for the companies income taxation base was extended, e.g. the introduction of new tax rules for taxpayers applying International Financial Reporting Standards; deduction limited to 50% of fuel costs for road motor vehicles which are intended solely for passenger transport.

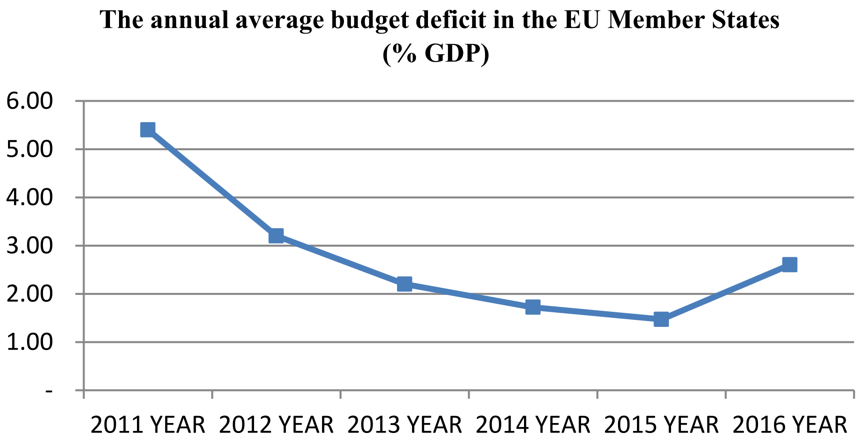

Figure 3: The budget deficit (% GDP) averaged in the Member States;
Source: own representation, using Eurostat data

In figure no.3 we made a graph representation of the budget deficit as a percentage of GDP in the European Union for the period 2011 to 2016, where we see a decrease in its percentage to a percentage exceeding 5% in 2011 to a threshold between 1% and 2% in 2015 and an upward trend in 2016, a trend near the threshold of 3%.

Using EViews program, we built an econometric model, we performed simulations of 1% increase budget revenues and 1% increase budget expenditures to see the impact on the budget deficit, the results can be seen in the graphs and figures lower.

For our analysis we have used the annual time series of 28 EU member states where the dependent variable was the government deficit as percentage of GDP and the explanatory variables were government revenues (% of GDP) and government expenditures (% of GDP), data that were collected from Eurostat official site for the period 2011-2014.

The purpose of the econometric analysis is to analyze the relationship between macroeconomic determinant - government deficit and government revenue (% of GDP) and government expenditure (% of GDP) for the 28 EU Member States by analyzing Panel. We conducted a pooled OLS model using annual data for 2011-2014, in order to determine the impact of fiscal policy on government deficit.

As descriptive statistics, from the summary statistics of the data we observe that the mean of the government deficit is -3,54% of GDP, the mean of the government expenditures is 46,45% of GDP and the mean of the government revenues is 42,72% of GDP.

	Mean	Median	Minimum	Maximum
Gov_def	-3.5420	-3.1000	-15.000	7.7000
Gov_exp	46.456	45.900	34.100	60.800
Gov_rev	42.721	42.600	32.100	58.400

Figure 4: The results obtained by simple linear regression;
Source: own representation, using Eurostat data and Eviews

Model 1: Pooled OLS, using 112 observations
Included 28 cross-sectional units
Time-series length = 4
Dependent variable: Gov_def
Robust (HAC) standard errors

	Coefficient	*Std. Error*	*t-ratio*	*p-value*	
const	0.0237652	0.377625	0.0629	0.94993	
Gov_exp	-0.923801	0.0584628	-15.8015	<0.00001	***
Gov_rev	0.921117	0.0633014	14.5513	<0.00001	***

Mean dependent var	-3.541964	S.D. dependent var	3.269092
Sum squared resid	306.8151	S.E. of regression	1.677742
R-squared	0.741358	Adjusted R-squared	0.736612
F(2, 109)	156.2158	P-value(F)	9.82e-33
Log-likelihood	-215.3549	Akaike criterion	436.7098
Schwarz criterion	444.8653	Hannan-Quinn	440.0188
rho	-0.010105	Durbin-Watson	1.035519

Figure 5: Results obtained by simple linear regression;
Source: own representation, using Eurostat data and Eviews

We observe that the explanatory variables have a statistically significant impact on the dependent variable – government deficit for the 28 EU member states in the period 2011-2014 at a 1% significance level.
The econometric model tells us that when the government expenditures (% of GDP) increase with 1%, the government deficit (% of GDP) decreases with 0,92% while when the government revenues (% of GDP) increase with 1%, the government deficit (% of GDP) increases with 0,92%.

3. CONCLUSIONS

Considering all mentioned above, we conclude that direct taxes have different evolution in the EU, each country establishes direct taxation policies, which comply with European Union rules. We have seen that the revenue from direct taxes decreased during the crisis, starting with 2008, 2009, and in 2010 recorded an upward trend. Also, we have seen that the Member States of the European Union, revenues from direct taxation are at a higher level in

Western European countries, the highest being recorded in Denmark with a level of 29.29% of GDP while countries in eastern Europe recorded low levels, Bulgaria and Romania 5.63% 6.14% levels as average over 2004 – 2013, from here we deduce that the countries of eastern Europe provide their budget revenues in the mostly from indirect taxes.

On tax harmonization, we can mention that harmonization is needed especially at indirect taxation level so as not to hinder affect the free movement of goods, services, people and stocks. Thus it can be seen that harmonization does not largely affect fiscal policy on direct taxation.

We olso noticed that the budget deficit must meet a certain level agreed and accepted at EU level to ensure that there are no gaps in national economies, which may have a negative impact on the entire economic system of the European Union, an important objective on European fiscal policy is a limit on the budget deficit to 3% of GDP, this condition being imposed by the Maastricht Treaty (1992).

At the same time, we could see, studying the econometric model developed by simulating an increase in budget revenues by 1%, generated an increase in the budget deficit in the European Union 0.92%, while an increase in spending by 1% led to a decrease in the budget deficit to 0.92%.

Such an increase in budget revenues by increasing taxation does not lead to a decrease in the national budget deficit, on the contrary, it may lead to an increase in the budget deficit can be explained by the way, an increase in taxation generates a decrease in consumption and the decrease of budgetary revenues which generates an increase in the budget deficit.

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