

# THE EVOLUTION OF FISCAL INDICATORS IN THE LAST YEARS IN ROMANIA

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*Tax revenues are an important part of budget revenues, and their structure represent the mirror of government's fiscal policy. Also their level and structure reflects the evolution of the economy in general. The evolution of tax revenues has been influenced by the financial crisis of this period. The tax revenue structure in Romania is characterized by relatively high share of indirect taxes revenues in comparison with another European Union states, where the share of revenues from direct, indirect taxes and social contribution is relatively close.*

*Government expenditure is vital for the economy especially if they are focused on productive areas. They are the engine of economic developments and plays an important role in raising the standard of living of population in a state. In the last years, the growth rate of public expenditure was higher than the trend of tax revenues increase. Sizing revenue and public expenditure is essential for achieving the budget balance target and to meet the criterion stipulated in the Stability and Growth Pact. According to the Pact, the budget deficit may not exceed 3% of GDP. This development asymmetric led to increased deficits in the last years.*

*The high level of structural deficit has canceled an initiative to tax relaxation in this recession period. The need for fiscal consolidation has been paramount in the context of chronic deficit and difficulties faced in financing it. The opportune solution to finance the high public deficit and to achieve the objective of financial stability of the economy was contracting of public debt from International Monetary Fund. Other measures to reduce the deficit were the reduction of public expenditure and increasing tax revenues.*

*We propose in this paper to analyze the evolution of fiscal indicators in comparison with the evolution of macroeconomic indicators to capture the reaction of taxpayers and economic environment at measures adopted.*

*Keywords: fiscal, tax, fiscal revenues, budget, financial crisis*

*Coduri JEL: E60*

## **I. Introduction**

The importance of fiscal policy of a state budget is derived from the impact that it manifests on the main macroeconomic indicators which reflect progress through economic growth. The fiscal –budgetary policy must be linked to macroeconomic policies and support macroeconomic stability objective. The main objectives of fiscal-budgetary policy are to stimulate the economic activity, rising living standards, fiscal consolidation, promotion of countercyclical fiscal policies. The mirror of fiscal-budgetary policy is a state budget, which includes destinations of financial resources and their sources of funding. Some authors considers that budgetary policy represent the concept and actions of government for public revenue and expenditure, the means to raise revenue, the types and size of expenditure which can interfere in the stabilization and economic recovery( Dobrotă N 1999:354). Although the architecture of revenue and expenditure depends

from economic priorities of a state, it must adapt to situations at a time. Through the budgetary policy is reflected the efficiency of public expenditure use and management and the allocation of financial resources. The level and structure of public revenue and expenditure reflects the main trends, directions for action in a state economy. So do not neglect “the important role of policies and budgetary levers in the modern economy”, like it is highlighted by Constantin Tulai professor(Tulai C. 2007:68). Fiscal policy offers the main tools which is used by the government to influence the economy through changes in taxation level or public expenditure adjustment. Fiscal policy plays an important role in mitigating the economic cycle. According to several experts which we subscribe too, the effectiveness of fiscal policy is reflected by its role of stabilizing the economy. Thus, we can say that the optimal tax policy is acting to mitigate the amplitude of business cycle fluctuations, that in periods of recession adopt a lax behavior and in the expansion periods a more restrictive behavior. An important indicator by means of we can estimate if the fiscal policy performs the stabilizing role is the structural deficit. The structural deficit shows how many from the fiscal-budgetary position level reflected through taxes, transfers, expenditure due to economic conditions and how many due to fiscal policy decisions taken. The analysis of this indicator reflects the sustainability of fiscal policy.( Raport anual: Evoluții și perspective macroeconomice și bugetare 2011: 23-24)

By the side of monetary policy, fiscal policy has an important role in the general economic policy objectives. While monetary policy acts on short-term, the effects of fiscal-budgetary policy is outlined in a medium or long time horizon. However the objectives of the two categories of economic policies must be linked.

In the context of Romania integration into the European Union, another concern is adapting the fiscal-budgetary policies to EU requirements. Optimum sizing of public revenue and expenditure is essential to achieve budget balance and to respect the objective criteria laid down in the Maastricht Treaty. According to the Treaty, the budget deficit must not exceed 3% of GDP.

The current financial crisis has exposed some weakness of fiscal budgetary policy direction of Romania that pro-cyclical. Thus, in the context of excessive growth in the budget deficit in Romania is necessary a budgetary and fiscal consolidation. A growth model based on debt and increase investment in housing and consumer sector, high budget deficits have required fiscal consolidation efforts.

## **II. The evolution of main fiscal indicators in period 2000-2010**

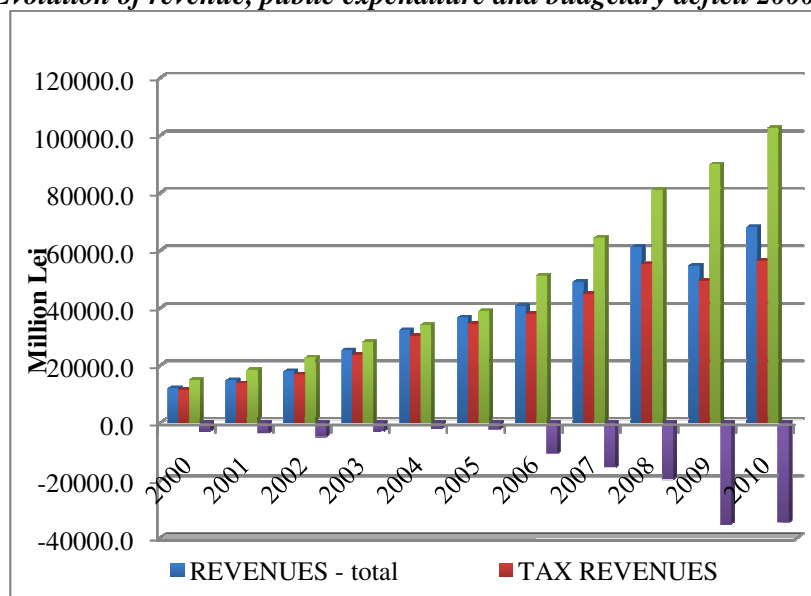
Procyclical nature of fiscal and budgetary policies of economic growth before the financial crisis, canceled fiscal space to stimulate the economy during the recession claiming the need to reduce high budget deficit during the crisis and maintaining pro-cyclical fiscal and budgetary policies. Although Romania is the country with the highest GDP growth in Europe but in the short term this situation marks a number of uncertainties about the outcome of the deep financial crisis(Raport privind situația macroeconomică pentru anul 2009 și proiecția acesteia pe anii 2010-2012: 8).

Analyzing the revenue and expenditure in the period 2000-2010, we notice a trend of growth, but it is noticeable that since 2006 public expenditure growth has outmatched the strong growth trend of public revenues. The share of public revenues in GDP in the period 2008-2010 is situated between 32.2% and 32.7%, while the share of expenditure in GDP have been growing larger, ranging between 37-39, 5%( Ministry of Finance - *Raportul la proiectul Legii bugetului de stat pentru anul 2011 și orizontul 2012-2012:9*).

This development resulted in an exaggerate increase in the budget deficit. Unlike other European Union countries (Ireland, Belgium), where the excessive budget deficits growth is due by measures adopted by national governments to support the banking system, in Romania the budgetary deficit is determined by two main factors: the dramatic loss of budget revenues caused by the GDP collapse and the structural deficit accumulated by Romanian before the starting of

financial crisis. If in the period 2001-2007, the budget deficit was fitted within the limits set by the Maastricht Treaty, since 2008 the share of budget deficit to GDP has significantly increase about 5.7% from GDP, exceeding far the permitted threshold of 3 % of GDP. Fiscal adjustment measures aimed primarily efforts to increase tax revenue by increasing the VAT rate with 5%. On the expenditure side, efforts were directed towards a reduction in salaries of public sector, complemented by reducing the number of employees, a decrease of 15% of most social benefits and reduce spending on goods and services by 10%.

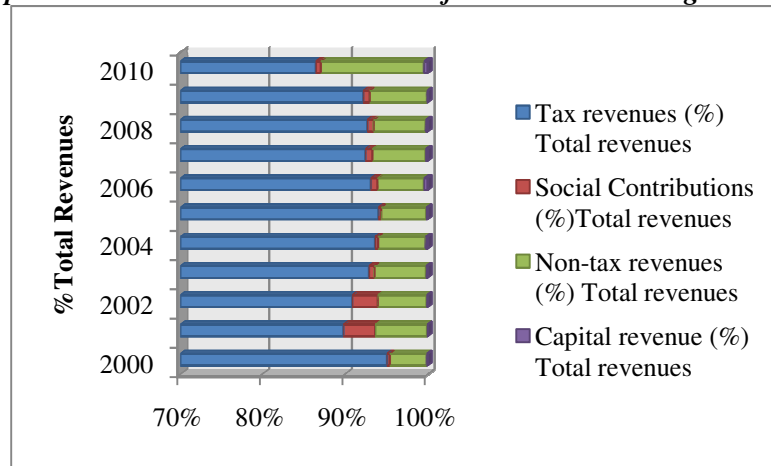
**Graphic 1. Evolution of revenue, public expenditure and budgetary deficit 2000-2010**



Source: Ministry of Finance- [www.mfinante.ro](http://www.mfinante.ro)

By the side of public revenues, Romania is the state with the lowest share of budgetary revenues in GDP (32.4% of GDP in 2009), in comparison with other European Union countries, with about 11% lower than the EU average. Also the share of tax revenue to GDP is below the EU average. Analyzing chart below we notice a downward trend in the share of fiscal revenues in total government revenue, emphasizing in the period 2009-2010. This evolution is certainly due to the economic slowdown and GDP downward during 2008-2009 period. Reducing the share of tax revenues in total revenues during 2009-2010 budget is offset by an increase of share of non-tax revenue in the total income.

**Graphic 2. Trend in share tax revenue of total income during 2000-2010**

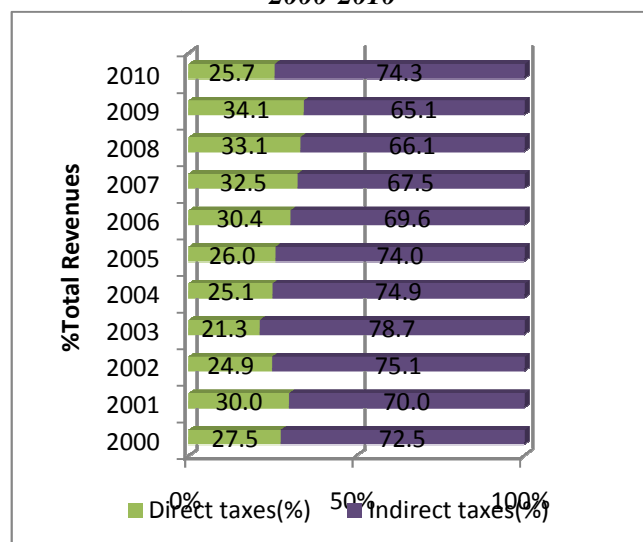


Source: Ministry of Finance- [www.mfinante.ro](http://www.mfinante.ro)

The tax revenue structure in Romania is characterized by relatively high share of indirect taxes revenues in comparison with another European Union states, where the share of revenues from direct, indirect taxes and social contribution is relatively close. Although the share of revenues from direct taxes fluctuate between 20% and 30% of fiscal revenue in the reviewed period, it is lower in comparison with the share of tax revenues from indirect taxes ranging between 65% and 80%. Analyzing strictly period 2007-2009, we can observe that the revenue from indirect taxes knows slightly downward trend from 67.5% in 2007 to 65.1% in 2009. The orientation of revenue from indirect taxes change in 2010, when an increase of almost 10 percent record compared with 2009.

This development is due to austerity measures adopted by the Romanian government among indirect taxes in response to IMF conditions, namely increase in VAT rate from 19% to 24%, gradually increasing excise.

**Graphic 3. The share of direct tax and indirect tax revenue to the formation of tax revenues 2000-2010**

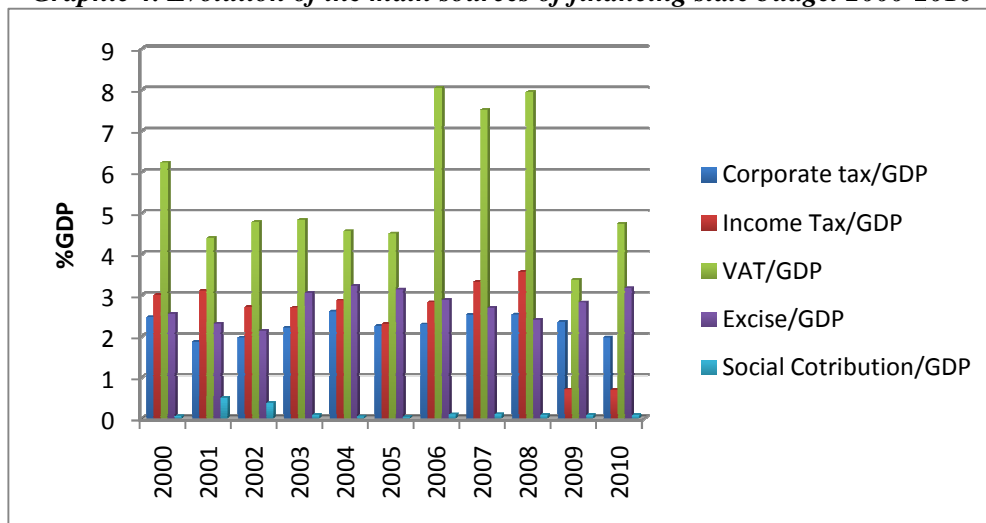


Source: Ministry of Finance- [www.mfinante.ro](http://www.mfinante.ro)

Analyzing the main categories of sources of revenue: income tax, VAT, excise duties and social contributions can be seen that the largest share is held by value added tax, culminating in 2006 recorded values (8.05% of GDP), 2007 (7.5% of GDP) and 2008 (7.9% of GDP). There then follows a collapse in 2008-2009 of VAT receipts. Then follows a collapse in 2008-2009 of VAT receipts. Since 2010, the revenues from VAT has resumed the ascendant trend as a result to measures taken by the government: the increase in VAT from 19% to 24% by OUG 58/2010 to achieve a balance between revenues and expenditures, where the income were strongly affected by the financial crisis. Government has taken this measure to increase the VAT rate to achieve the objectives of fiscal policy commitments agreed in the bilateral funding agreements concluded with the International Monetary Fund, the World Bank and European Commission. In comparison with the revenues from value added tax, excise revenues are not aware such asymmetric developments in the analyzed period. A slight decrease in revenue from excise duty in 2008 with slight recovery observed in 2009. The slight increase in excise revenue due to the increase of excise duty applied on 1 January 2010 for cigarettes, electricity, heat and gas, to achieve the minimum level required by Community legislation, the increase of the average rate RON / EURO considered at the computation of excise for 2010 and increase the amount of duty on some products. In order to study the impact of fiscal changes on the macroeconomic indicators we can say that measures to increase the rate of VAT and excise duty levels had a negative direct effect of inflation growth in Romania. As regards direct taxes there are high differences among the income taxes, a decrease of approximately 3% of GDP in 2009 compared with 2008. Since may 2008, receipts from corporate income tax recorded a slight decrease. Decreasing receipt from direct taxes is determined mainly by decline of household income and the level of profits as a result of financial crisis. Measures taken by the Romanian government in order to income tax to restore the balance between revenues and public spending was temporary introduction of the minimum tax in April 2009. From the analysis of changes in tax receipts we can observe that the measure do not provided higher receipts from this source, the effect was rather gap mitigation. Social benefits also know a slightly downward trend. The share of social contributions to GDP is steadily falling since 2006. This development is the result of gradually implementation of pension pillar II, which involves targeting gradual shares of social security contribution rate by a private pension fund to invest. Gradually implementation of the pension pillar II is achieved by increasing the share of social contributions redirected from 2.5% to 3% in 2010. In order to restore balance in the public pension system have been adopted reforming measures which include: raising the standard retirement age, increasing the number of those taxpayers with income from professional services, managers, discouraging the number of early retirement, early partial and unfair disability retirement, the expansion base for social contributions.

Overall we conclude that the financial crisis effects have been evident since the end of 2008, resulted in a strong decline are the main sources of financing state budget.

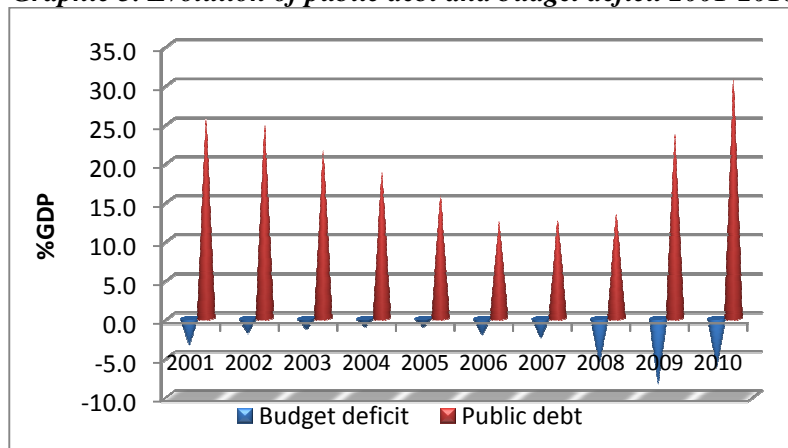
**Graphic 4. Evolution of the main sources of financing state budget 2000-2010**



Source: Ministry of Finance- [www.mfinante.ro](http://www.mfinante.ro)

In terms of economic contraction and the budget deficit financing needs in 2008 (5.7% of GDP), Romania's public debt increased. The optimal solution for financing, the high deficit and debt refinancing, respectively to achieve the objective of financial stability of the economy was contracting of public debt from the International Monetary Fund (Mara Eugenia Ramona, Inceu Adrian, Cuceu Ionuț, Achim Monica Violeta 2005: 5). Increasing public debt growth is due mainly by the increasing of government debt, local debt remained constant. The structure of government debt shows that public debt contracted directly by the state is about 90% of the total public debt and debt guaranteed by the state government is about 10% of the total. (privind situația macroeconomică pentru anul 2009 și proiecția acesteia pe anii 2010-2012: 30). Analyzing the public debt by the currencies in 2010, we can observe the most important component is the Euro (44.1%), followed by national currency (43.5%), while other currencies have only 12.4% of total debt government. High share of debt in euros due to the hiring of loans in euro, both domestic and foreign. Romania's public debt has increased significantly in the last two years, reaching the 2010 level of 30.8% of GDP, which is well below the ceiling imposed by the Maastricht Treaty of 60% of GDP.

**Graphic 5. Evolution of public debt and budget deficit 2001-2010**



Source: Eurostat

### III. Conclusions

Through the financing agreements concluded with the IMF and the European Commission, the Romanian government has assumed an adjustment program to reduce the general government deficit at 4.4% of GDP for 2011 of 3% in 2012, and most adjustment measures are already in force. This further implies keeping under control public spending and the elimination of discretionary fiscal policy measures affecting the revenues.

In conclusion we can say that Romania's fiscal policy should remain a conservative, restrictive towards the goal of fiscal consolidation.

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