

# THE THEORY OF FISCAL OPTIMIZATION. AN ANALYSIS OF FISCALITY IN EUROPEAN UNION MEMBER STATES

**Popa Ionela**

*Universitatea 'Constantin Brancoveanu', Pitesti, Facultatea de Management Marketing in Afaceri Economice, Rm. Valcea , Str. Tudor Vladimirescu, 248A, Baile Govora, Valcea, popainela80@yahoo.com, 0723089561*

**Codreanu Diana**

*Universitatea 'Constantin Brancoveanu', Pitesti, Facultatea de Management Marketing in Afaceri Economice, Rm. Valcea, Str. Mihai Eminescu nr. 47, Bl. C13, Sc. A, Ap. 16, Rm. Valcea, Valcea, codreanudia@yahoo.com, 0743167718*

**Marin Camelia**

*Universitatea 'Constantin Brancoveanu', Pitesti, Facultatea de Management Marketing in Afaceri Economice, Rm. Valcea , B-dul Pandurilor, nr. 13, Bl. A8/1, Râmnicu Vâlcea, jud. Vâlcea, cameliamarin81@yahoo.com, Tel. 0723867749*

*Taking account of the lack in revenues' popularity that is permanent and general within the entire economy, it is legitimate and extremely important to identify the best way to set up revenues in order to reach maximum acceptance of payers.*

*Starting from the theory of "fiscal optimization", the article aims at analyzing the degree to which European Union member states' fiscal systems comply with the "optimization" from two perspectives: those of payers – by means of specific indices: fiscal rate, fiscal pressure, fiscality relative degree – and those of the authorities that have duties in the fiscal field – emphasizing the amount of fiscal charges in this respect.*

*Key words: fiscal optimization, fiscal revenues, fiscal pressure*

## 1. The theory of fiscal optimization

The theory of fiscal optimization as a coherent scientific approach is new, but some of its elements have been analyzed for a long time. Even in the 18<sup>th</sup> century, Adam Smith asserted the idea that a tax may be rated as good if it obeys four rules<sup>154</sup>:

- Economy- assuming that taxes do not require a costly cashing procedure and they do not discourage business either;
- Facility – all taxes must be collected by a procedure convenient to tax payers;
- Certainty – meaning that the payment time, payment ways and the amounts owed by tax payers as taxes must be certain, not random;
- Equity – all taxes must be perceived as "correct".

Starting from the essence of Adam Smith's explanations, the English professor Stephen C. R. Munday, (Headmaster Of Sixth Form, Saffron Walden County High School) said that "all the discussions about ideal fiscality admit the fact that there are three requirements that must always be taken into account":

1. The need for certainty, irrespective of how it is defined;
2. The need to minimize the administrative costs that fiscality involves;
3. The need to minimize the demobilizing effects of taxes<sup>155</sup>.

The issue of fiscal optimization is not easy as its requirements contradict one another, which makes it difficult to compose them and to set up a single "objective function" of theirs.

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<sup>154</sup> Florescu Dumitru, Coman, Bălașa – "Fiscality in Romania – Regulation, Doctrine, Jurisprudence", Publ. All Beck, 2005, page 77

<sup>155</sup> Stephen C.R. Munday- "Avantgarde Ideas in Economy", Publ. Codecs, Bucarest, 1999, page 183

Taking account of the lack in revenues' popularity that is permanent and general within the entire economy, it is legitimate and extremely important to identify the best way to set up revenues in order to reach maximum acceptance of tax payers. Legitimacy can be emphasized both from the perspective of fiscal authority that wants best taxes at least to prove the fiscal system's administration capacity and from the perspective of tax payers that are mostly pleased by "average" rather than extremes.

## 2. The evolution of fiscal revenues in Romania

The argument of the economic calculations used by the fiscal policy is given by the arbitrary feature. What are the reasons for which the government suggested the shift from progressive quotas on income installments to the unique quota of 16%? Why 16%? The natural question refers to the way income quotas are set up; to the way of emphasizing the best tax that helps the economy flourish and go for the better. Yet, in practice, the reason of any fiscal system is not and cannot be objective. It is neither ensuring the "good running" of the economy, nor reducing the taxes' collection costs, as fiscal authorities often show. The fiscal regime is more often subject to discretionary budget needs and political interests, in a world where most specialists keep talking about "fiscal optimization" like an illusion.

During the debates upon the nature of fiscal regime, specialists have precisely left aside the essential element: the general fiscal burden. The real issue does not relate to the progressive or proportional taxing method, but to the general level of taxing. This is an issue that primarily relates to ethics and secondly to efficiency.

The efficiency of tax cashing depends on several factors among which, especially in our country, the most important are: legislation stability, issuing regulatory acts and their clear implementation norms that should not produce misunderstandings; the reduction of government expenses that are unproductive and non-economic; discouraging tax evasion and removing underground economy; a quicker compliance of the fiscal legislation within the European Union.

Analyzing the effects of the 16% quota in Romania in order to identify the relationship between that fiscal step and the government's practical ability to set up the level of the 'best' taxing rate, one can notice that the goal has been accomplished at least from the perspective of fiscal authority.

### *Evolution of fiscal revenues in Romania during 2000-2008\**

*Table 1:*

<b>Years</b>	<b>Fiscal revenues (million Lei, current prices)</b>
2000	<b>23504,8</b>
2001	<b>32669,9</b>
2002	<b>41816,6</b>
2003	<b>53248,2</b>
2004	<b>66678,3</b>
2005	<b>78281,4</b>
2006	<b>96773,9</b>
2007	<b>115208,8</b>
2008	<b>23274,4</b>

Source: Made by the author with data from [www.mefromania.ro](http://www.mefromania.ro)

\* - The data for the year 2008 include the fiscal revenues achieved during January-February.

It can be noticed that even if on 1<sup>st</sup> January the single quota –16%- started being applied for most incomes of individuals and businesses, a quota that replaced the progressive taxing (the quotas between 18% and 40% applied in income installments), of individuals' incomes and the 25% quota of businesses' incomes, the fiscal cashing went up from 66,678,3 mil. Lei in 2004 to 78,281.4 mil. Lei in 2005.

In an interview about the single tax in Romania in the "Capital" newspaper, Arthur Laffer, the author of the famous curve that bears his name, the advocate of the theory saying that small taxes stimulate productivity

and economy, stated: “The single quota is going to solve many corruption matters because, if it is applied on a large basis, it can lead to the existence of few incentives to break the law. Yet, at the same time, a fiscal amnesty is necessary, which is very difficult. How can you solve all the crimes of the previous fiscal regime when you replace a corrupted system by a mere one? You must start from nothing, but it is very hard”. And he also asserted about the fiscal optimization: “The idea is to collect taxes in the least harmful way and spend them in the most profitable way (...); the most important lesson is not to pay people who do not work and not to tax those who do”<sup>156</sup>.

### 3. The evolution of fiscal pressure in Romania

As far as tax payers are concerned, fiscality level/or the rate of fiscal pressure emphasizes the ratio between the total of all fees, taxes, social dues and other fiscal duties charged centrally or locally and an aggregated economic index (G.D.P., G.N.P., national revenue). Both at economic level and at social, economic and financial levels, the issue to size the share of G.D.P. taken by the state is highly important.

Fiscality rate set up as the ratio between the set of fiscal revenues (taxes and social duties) and the gross domestic product<sup>157</sup>:

$$R_f = \frac{V_f}{PIB} * 100$$

provides a picture of the fiscal pressure exerted by the system of fees, taxes and duties upon tax payers, as well as the picture of the political conception regarding the set up of public expenses’ financing sources.

The analysis of the fiscal pressure evolution in Romania should start from the emphasis of fiscal revenues as well as from the level of G.D.P. accomplished in our country.

#### *Fiscal pressure evolution in Romania during 1991- 2008*

*Table 2*

Name of indices	Cashing - billion Lei, current prices (ROL)								
	1991	1992	1993	1994	1995	1996	1997	1998	1999
Revenues-total	-	-	6700	15537	22642	31597	72385	111000	173634
1.Current revenues	-	-	6652	15476	22580	31443	71802	110867	173337
<b>- fiscal revenues</b>	-	-	<b>6269</b>	<b>14042</b>	<b>20804</b>	<b>29257</b>	<b>67000</b>	<b>103992</b>	<b>164026</b>
- non-fiscal revenues	--	-	383	1434	1776	2186	4802	6875	93113
2. Revenues from capital	-	-	48	61	62	154	584	133	297
<b>G.D.P.*</b>	<b>2203,9</b>	<b>6029,2</b>	<b>20035,7</b>	<b>49773,2</b>	<b>72135,5</b>	<b>108919,6</b>	<b>252925,7</b>	<b>371193,8</b> <b>373798,2</b>	<b>545730,2</b>
General rate of fiscality (%) (Fiscal revenues including social duties/ GDP x 100)	33,2	33,5	31,3	28,2	28,8	26,9	26,5	28,2	30,1

<sup>156</sup> Arthur Laffer: "Fiscal amnesty is a necessary step", Capital, 18 May 2005

<sup>157</sup> Florescu Dumitru, Coman, Bălașa – “Fiscality in Romania – Regulation, Doctrine, Jurisprudence”, Publ. All Beck, 2005, page 74

Partial rate of fiscality (%) (Fiscal revenues/ GDP x 100)	28,2	22,1	20,6	19	20,7	19,4	19,6	20,0	19,5
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Name of indices	Încasări realizate- milioane lei, prețuri curente (RON)								
	2000	2001	2002	2003	2004	2005	2006	2007	2008 **
Revenues-total	-	-	-	-	-	-	106975,3	127108,2	27394,5
1. Current revenues	-	-	-	-	-	-	104004,0	123298,9	25451,4
<b>- fiscal revenues</b>	<b>3504,8</b>	<b>32669,9</b>	<b>41816,6</b>	<b>53248,2</b>	<b>66678,3</b>	<b>78281,4</b>	<b>96773,9</b>	<b>115208,8</b>	<b>23274,4</b>
- non-fiscal revenues	-	-	-	-	-	-	7230,1	8090,1	2177,0
2. Revenues from capital	-	-	-	-	-	-	2971,3	3809,2	1943,1
<b>G.D.P.*</b>	<b>30377,3</b>	<b>116768,7</b>	<b>151475,1</b>	<b>197564,8</b>	<b>246468,8</b>	<b>288047,8</b>	<b>335900,0</b>	<b>390800,0</b>	<b>440000,0</b>
General rate of fiscality (%) (Fiscal revenues including social duties/ GDP x 100)	29,3	28,3	27,6	28,0	27,9	27,3	28,8	31,5	-
Partial rate of fiscality (%) (Fiscal revenues/ GDP x 100)	18,6	17,5	17	18,2	18,5	18	19,0	19,5	-

Source: Made by the author with data taken from the 2005 Statistical Yearbook of Romania, [www.fmi.ro](http://www.fmi.ro), [www.mfinante.ro](http://www.mfinante.ro)

- Data missing

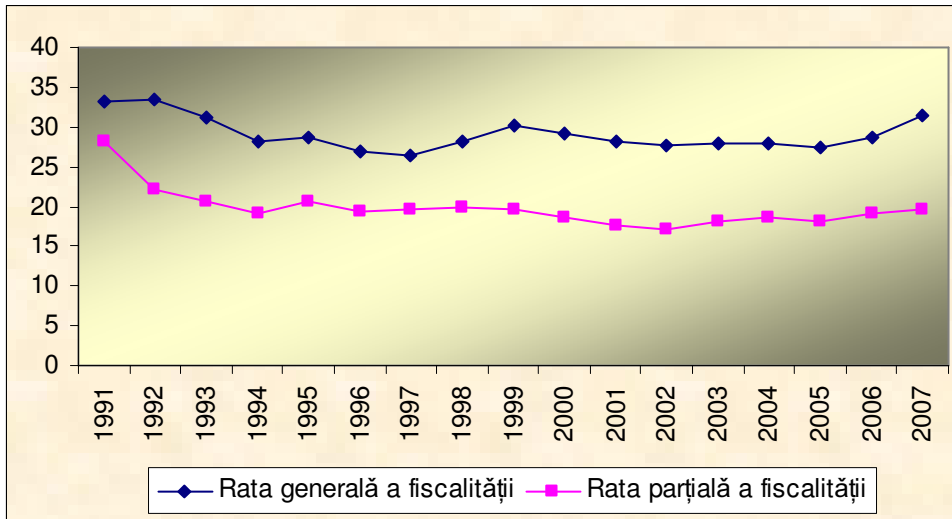
\* - The national accounts of Romania have been made up ever since 1989, based on the methodology of the European System of Integrated Economic Accounts 1979 (SEC 1979). In 1998, they started using the new European Account System 1995 (SEC 1995) and in 1998 there was the connection between the two versions of the European Account System.

\*\* - The data shown in the table for the year 2008 emphasize the total of general, public, enhanced revenues cashed between 1 January and 29 February this year.

The overall analysis of the fiscality rate evolution in our country since 1991 up to the present provides an overlook of the fiscal pressure exerted by the tax and income system upon tax payers as well as a picture of the political conception regarding the setting up of public expenses' financing sources. I have highlighted the values of fiscality rate with its two aspects: the general rate set up from the perspective of fiscal revenues' share, including insurance dues in total G.D.P., respectively the partial fiscality rate set up only from fiscal revenues.

*Evolution of fiscal pressure in Romania during 1991- 2007*

**Graph 1**



Source: Made by the author with data from table 1.

One can notice that general fiscality rate during the analyzed period changed within slight limits and recorded extreme values in 1996 – 26.5%, respectively in 1992 – 33.5%. The overall index trend is about 2% decreasing during the analyzed period.

The partial fiscality degree had a more pronounced evolution, almost 9% decreasing during the analyzed period.

The relative fiscality degree essentially rendered by the sum of main fees and taxes charged on companies and individuals is shown below:

**Relative fiscality degree in Romania during 2004-2008**

**Table 3:**

Main taxes	2004	2005	2006	2007	2008
- profit tax	25%	16%	16%	16%	16%
- income tax	40%	16%	16%	16%	16%
- V.A.T.	19%	19%	19%	19%	19%
- social duties	49%	49%	47,5%	45,5%	39,5%*
<b>TOTAL</b>	<b>133%</b>	<b>100%</b>	<b>98,5%</b>	<b>96,5%</b>	<b>90,5%*</b>

Source: Made by the author with data from [www.cdep.ro](http://www.cdep.ro), *The Bill of Social State Insurance Budget for 2004- 2008*,

-\* - They foresee a change in 2008 according to the provisions of the Law of Social State Insurance Budget no.387/2007 (M. Of. no. 901 of 31 December 2007) and the Law of State Budget for 2008 no.388/2007 (M. Of. no. 902 and 902 bis of 31 December 2007) aiming at the reduction of 6% as compared to the level of quotas in 2007; the total reductions for employers is 4.5%, and for employees, the social insurance duties are going to decrease by 1.5% in July 2008, so that: 0.5% for unemployment insurances and 1% for health insurances.

As well as fiscality degree, the relative degree of Romanian fiscality has never been and is not among the highest, and its reduction during only one year (2005, the year that witnessed the shift from progressive percentage taxing to proportional quotas) by over 30% is something that rarely occurs in an economy.

**4. Conclusion**

In a comparative analysis of the public revenue share of GDP in all the European Union member states, one can get a confirmation of the moderate level of fiscality in Romania:

**Public financial resources of EU countries (share of GDP and per capita) during 2000-2006**

**Table 4:**

	Public resources-share of GDP							Public resources/capita in Euros						
	2000	2001	2002	2003	2004	2005	2006	2000	2001	2002	2003	2004	2005	2006
EU-27	...	...	44.4	44.4	44.2	44.7	45.2	...	...	9,054	9,161	9,520	9,980	10,605
EU-25	45.8	45.1	44.5	44.5	44.2	44.8	45.3	9,208	9,411	9,588	9,700	10,070	10,538	11,182
BE	49.1	49.6	49.8	51.1	49.1	49.9	49.1	12,072	12,496	12,900	13,534	13,655	14,211	14,623
BG	...	...	39.6	40.3	42.0	41.6	40.3	...	...	839	917	1,075	1,179	1,317
CZ	38.1	38.7	39.5	40.7	42.2	41.3	40.7	2,281	2,617	3,101	3,230	3,649	4,051	4,518
DK	56.5	56.0	55.4	55.6	57.3	57.8	56.2	18,374	18,737	19,052	19,429	20,789	22,205	22,756
DE	46.4	44.7	44.4	44.5	43.3	43.5	43.8	11,650	11,482	11,548	11,657	11,614	11,848	12,350
EE	36.2	35.0	36.0	36.4	35.9	35.4	36.6	1,611	1,772	2,052	2,337	2,534	2,941	3,602
IE	36.3	34.3	33.2	33.8	35.2	35.4	37.1	9,987	10,398	11,014	11,820	12,886	13,785	15,246
EL	43.0	40.6	40.0	39.3	38.2	38.0	39.5	5,428	5,463	5,738	6,104	6,388	6,804	7,610
ES	38.1	38.0	38.4	38.2	38.5	39.4	40.4	5,987	6,348	6,780	7,115	7,590	8,256	8,992
FR	50.2	50.0	49.5	49.2	49.6	50.7	50.8	11,901	12,239	12,434	12,656	13,177	13,858	14,408
IT	45.3	44.9	44.4	44.8	44.2	44.0	45.6	9,479	9,843	10,055	10,380	10,566	10,677	11,435
CY	34.7	35.9	35.9	38.6	38.8	41.2	42.7	5,035	5,532	5,637	6,281	6,660	7,419	8,049
LV	34.6	32.5	33.4	33.2	34.7	35.2	37.0	1,238	1,286	1,414	1,423	1,679	1,993	2,613
LT	35.9	33.2	32.9	32.0	31.8	33.1	33.4	1,267	1,294	1,425	1,523	1,679	2,006	2,338
LU	43.6	44.2	43.6	42.4	41.3	41.7	39.7	21,855	22,616	23,459	24,130	24,761	26,897	28,421
HU	43.6	43.2	42.4	41.9	42.4	42.1	42.6	2,220	2,522	2,948	3,091	3,457	3,714	3,806
MT	34.8	36.6	37.7	37.9	41.0	42.0	41.6	3,769	4,007	4,274	4,208	4,576	4,929	5,148
NL	46.1	45.1	44.2	43.9	44.3	44.9	46.7	12,113	12,586	12,738	12,920	13,377	14,002	15,257
AT	49.8	50.7	50.0	49.3	48.9	48.2	47.8	13,073	13,615	13,662	13,738	14,136	14,372	14,893
PL	38.1	38.6	39.2	38.4	36.9	39.0	40.1	1,847	2,145	2,150	1,926	1,975	2,499	2,855
PT	40.3	40.1	41.4	42.5	43.1	41.7	42.5	4,803	5,037	5,404	5,647	5,919	5,877	6,225
<b>RO</b>	<b>43.8</b>	<b>36.7</b>	<b>37.6</b>	<b>32.1</b>	<b>31.2</b>	<b>32.2</b>	<b>33.2</b>	<b>788</b>	<b>736</b>	<b>835</b>	<b>776</b>	<b>875</b>	<b>1,185</b>	<b>1,492</b>
SI	43.6	44.1	44.6	44.4	44.2	44.5	44.1	4,634	4,969	5,395	5,635	5,921	6,285	6,682
SK	38.3	37.8	36.6	37.7	35.6	35.6	33.9	1,569	1,656	1,772	2,051	2,241	2,519	2,767
FI	55.2	52.7	52.9	52.4	52.3	53.0	52.5	14,119	14,212	14,636	14,668	15,237	15,888	16,670
SE	60.9	58.3	56.6	57.2	57.5	58.7	57.9	18,026	16,218	16,417	17,205	17,974	18,714	19,511
UK	41.2	41.5	39.9	39.5	40.0	41.2	41.9	11,005	11,332	11,279	10,729	11,656	12,336	13,229
IS	43.6	41.9	41.7	42.8	44.2	47.6	45.9	14,596	12,982	13,740	14,373	16,113	21,039	19,981
NO	57.7	57.4	56.3	55.5	56.6	57.4	58.7	23,447	24,299	25,297	24,198	25,661	30,127	33,665

Source: Eurostat, *Economie et finance, Statistique des administrations publiques*

The above table shows the size of the public administration sector in each European Union member state.

Our country has the lowest income tax in all the European Union. Almost the same can be said about profit taxes that are among the lowest in the European community. It is for these reasons that the tax revenues'

share of GDP is small. Practically, in 2005, Romania recorded the lowest level of revenues from taxes and fees as compared with the countries in the European Union.

According to a survey made up by Eurostat<sup>158</sup>, the European Statistics Department, Romania had in 2007 the lowest income tax of all the 27 European Union member states, which is 16%. At the opposite side there are Denmark and Sweden that have an income tax of 59%, respectively, 56.60%. As far as the European average income tax is concerned, it is 38.68%, whereas the average in the Eurozone is 45%.

Romania relatively has the same level of profit taxes, too, that is still 16%, but it is not the lowest. The lowest profit taxes are in Bulgaria, Cyprus, each having 10%, Ireland (12.5%) and Latvia (15%). Romania ranks fifth, after those countries. In the other part of the chart, having the highest profit taxes, there are Denmark (38.7%), Italy (37,3%) and Malta (35%).

Yet, a relative fiscal approach does not have a practical relevance without the connection with its real approach. The 33% rate in 2006 in Romania and 56% in Denmark or Sweden (within the same periods) are not comparable because their basis is different: Romania's GDP in 2006 at purchase parity was 192.96 billion Euros that is equal to 8,900 Euros/inhabitant. The figures rank Romania the 26<sup>th</sup> (last but one) among the European Union member states that had an average GDP/capita at purchase parity of 23,600 Euros. Hence, the conclusion that both the fiscal supporting power and the real effects of promoting a certain fiscal rate are higher in those countries than in Romania<sup>159</sup>.

As a conclusion, fiscality, although never to be popular, is objectively necessary ; the issue is to design a fiscal system to diminish social losses and achieve equity goals that are socially accepted at a given time.

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