

VALUE ADDED TAX IN THE ECONOMIC CRISIS CONTEXT

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This article tries to present the major aspects concerning the value added tax in the context of economic crisis in European Union countries and Romania. The paper realizes an analysis of the impact of economic crises on VAT in the European space underlining the current situation when the revenues from VAT represent a valuable source of financing the public expenditures. In Romania the economic crises has led to increasing of VAT rate from 19% to 24%. This measure is an important fiscal measure for the state budget and this study tries to reflect the impact of this VAT rate increase on the public revenues and consumption.

Keywords: value added tax, economic crises, tax revenues

Cod JEL: H23, H3, H22, G18.

Introduction

Value added tax is a key element of taxation system for many countries, an important and a reliable source of revenue for their budgets. For European Union countries VAT is assuring a significant part of the tax receipts counting 7% of GDP. Considering the share of VAT receipt in total tax receipts the highest ratio is in Bulgaria 35% and the minimum is in Italy only 13% from the total tax revenues and for EU 27 as average is 17%.

In times of economic crisis, the budget revenues are significantly affected by a sharp decrease. Many factors have an important contribution to this decline like: the tendency of some tax bases to contracts – incomes, profits, consumption; a decline in commodity prices and related revenues, or increasing the tax evasion. In this context for all EU countries a major issues is increasing the budget deficit and impossibility to financing the public expenditures.

The significance of VAT has increased in the financial crisis as governments need to raise more revenue to reduce their national debt, but are reticent to raise direct taxes on labour or capital at a time when employment and investment are needed. Personal income taxes increase is not a solution, especially in the context in which Europe is confronted with aging of the population. However it is necessary to increase social contributions in this regard but this increase will not provide budgetary shortfalls. On the other side increase of corporate taxation is not a good solution for the crisis time because may be a cause for deepening crisis.

One way to improve the situation of public finances and increasing the tax receipts or at least maintaining at the same level like before the economic crises is through increasing the VAT rate. But this measure requires a careful assessment of the possible macroeconomic and microeconomics effects. VAT rate increase is reflected in whole or in part on price of goods and

services. With an unchanged nominal wages, rising prices is clearly diminishing real income of households (reduction in purchasing power), thus affecting consumption.

In the case of VAT, the most of the countries decide to increase rates, but also a high number of measures narrowing the base. Base narrowing was in many cases linked to equity considerations, as some countries reduced the tax burden on food or necessities. Generally, however, the measures increasing the standard VAT rates have had a much larger (positive) budgetary impact than the base narrowing measures; for the cases for which we have information, the ratio is almost 5:1 (Taxation trends in EU, 2010).

The impact of high VAT rates on consumer prices is not necessarily immediately, depending on many factors, including: the market rank for suppliers, the degree of competition, the elasticity of demand. Thus, firms from some industries prefer on the short term, may not fully pass on prices the VAT rate increased; the result is decreasing its profits to avoid reduction in demand, especially when they do not hold a significant position in the market, competition is strong and / or demand is very elastic.

The increase in VAT rate with only a few percentage points is unlikely to register a significant reduction in consumption, but on the other hand can increase VAT receipts for the state budget. Normally, any VAT rate increase can lead through higher prices to increasing inflation, yet inflation is only a temporary shock.

Increase VAT rate may influence the degree of regressive tax against current income households (VAT is a regressive tax against current income; current income decreased its share in the growing income). If, in addition to the standard rate of VAT, a reduced rate of VAT is applied for some consumption goods prevailing in low-income households, an increase for standard VAT rate would reduce the VAT regressivity and an increase for reduced VAT rate would lead to a higher regressivity. However, if there is a single VAT rate, the increase does not change the degree of regressive tax, according to the size and structure of consumption will not change.

A single rate of VAT means that the VAT payments by low-income households will be a higher proportion of their incomes than payments by higher income households. VAT is not regressive if tax payments are expressed as a percentage not of income but consumption. If consumption is used as the denominator, then by definition the impact would be proportional.

The tax burden of a VAT levied at uniform rate would also be largely proportional if the denominator is lifetime income instead of annual or current income because many income recipients are only temporarily in the lower income brackets. However, the main role of value added tax revenue is assuring the tax receipts for the state budget and not to achieve efficient redistribution of income in society; it is the quality of other taxes.

The VAT rate increase would leave a negative impact on the inhabitants purchasing capacity and the economy in general through decreasing of the consumption. But the negative of VAT rate increase will be felt also on the business activities. The increasing of VAT rate means inevitably results in the drop in consumption, and the consumption decline has a significant impact on the economy in general. During the economic crisis conditions it is important to promote the consumption increase.

VAT in European Union countries

Since 2009, under conditions of economic crisis, many European Union member states have resorted to increasing the standard VAT rate.

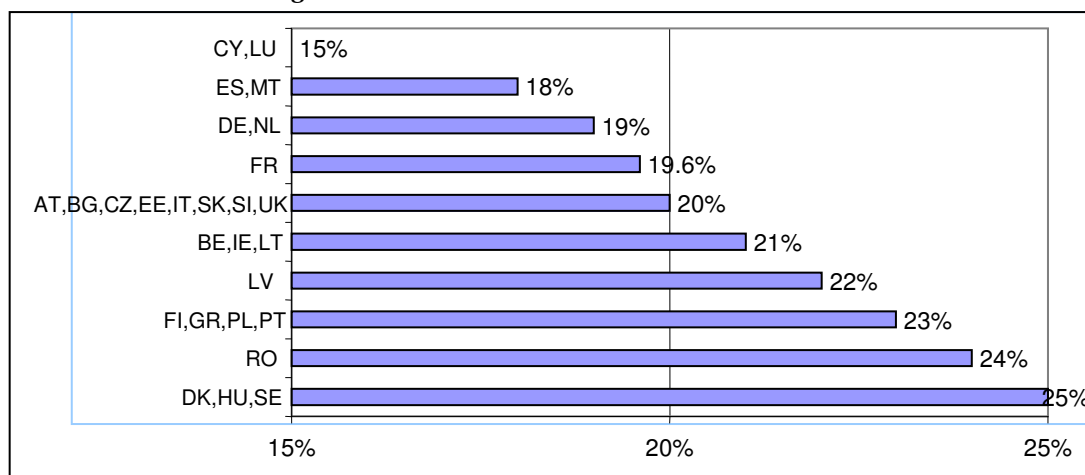
Table 1. VAT rates increases in EU countries

Country	Standard VAT rate increase	Old standard VAT rate	New standard VAT rate	Δ of rate
Czech Republic	01.01.2010	19%	20%	1%
Estonia	01.07.2009	18%	20%	2
Greece	15.03.2010	19%	21%	2
	01.07.2010	21%	23%	2
Spain	01.07.2010	16%	18%	2
Latvia	01.01.2009	18%	21%	3
	01.01.2011	21%	22%	1
Lithuania	01.01.2009	18%	19%	1
	01.09.2009	19%	21%	2
Hungary	01.07.2009	20%	25%	5
Poland	01.01.2011	22%	23%	1
Portugal	01.07.2010	20%	21%	1
	01.01.2011	21%	23%	2
Romania	01.07.2010	19%	24%	5
Slovakia	01.01.2011	19%	20%	1
Finland	01.07.2010	22%	23%	1
UK	01.01.2010	15%	17,5%	2,5
	04.01.2011	17,5%	20%	2,5

Source: European Commission

Currently, the standard rates of VAT charged by the EU Member States are between 15% (Cyprus and Luxembourg) and 25% (Denmark, Sweden and Hungary), with an average of 20.7%. It is standard practice ten different levels, being the dominant share of 20% share. It complies with the minimum of 15% imposed by the European Commission but not required and a maximum limit not achieved a significant near standard VAT rates applied by all Member States.

Figure 1. VAT standard rates in EU countries



Source: European Commission

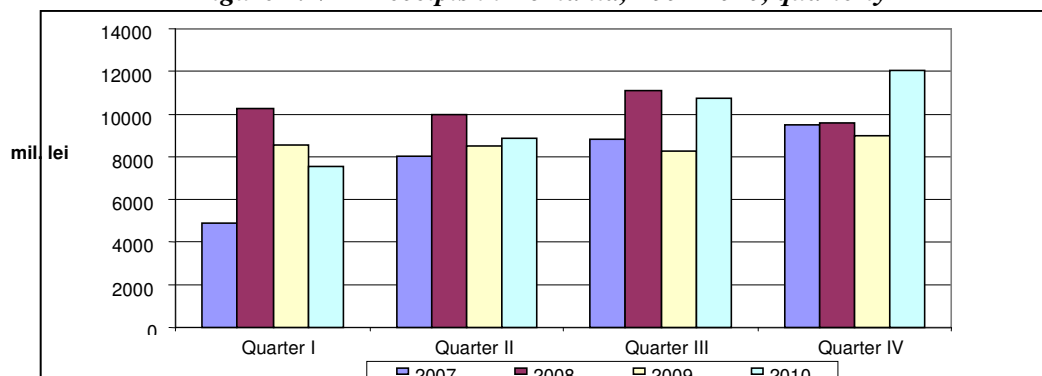
Although differences between the standard rates of VAT applied by some Member States are quite high (ranging up to 10 percentage points), there is some convergence of these shares, so 11

of the 27 countries using the standard rate between 19% and 20%. For instance, France has a VAT standard rate of 19.6% and two reduced rates. A reduced rate of 5.5% is applied to the absolutely necessary products and on the restaurant services and the reduced rate 2.1% for newspapers, plays and approved medicines (Sabau-Popa & all, 2010).

Current situation of VAT in Romania

In Romania, VAT receipts recorded in the last quarter of 2008 were only 0.6% higher in nominal terms than revenue in the fourth quarter of 2007, the conditions under which started to manifest in our country financial and economic crisis. It should be noted that although in the last quarter of 2008 saw a economic growth of 2.9%, final consumption fell in real terms than that registered in the fourth quarter of 2007 by 2.8%, while final household decreased by 4.7%, due to reduction in sales volume of retail goods and services rendered (Institutul Național de Statistică, 2009).

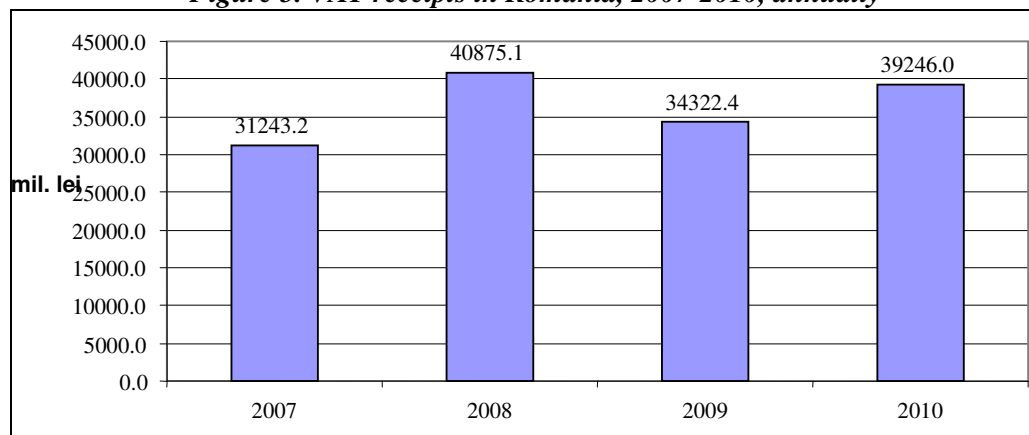
Figure 2. VAT receipts in Romania, 2007-2010, quarterly



Source: own calculation based on Finance Minister Data

Value added tax collected in 2008 was 30.8% higher in nominal terms, than that received in 2007, provided that, in real terms, household final consumption increased by 9.2% , Consumption increased by 8% and gross domestic product grew by 7.1%.

Figure 3. VAT receipts in Romania, 2007-2010, annually

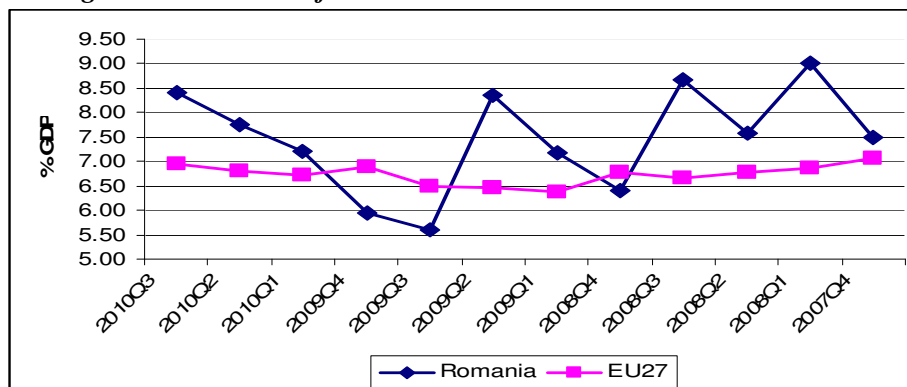


Source: own calculation based on Finance Minister Data

In 2009, there was a significant decrease in revenues from value added tax compared to 2008. They have decreased by 16% in nominal terms, due to real decrease of final consumption of

households with 10.8% and total final consumption decrease with 8.2% and 7.1% of gross domestic product (Institutul Național de Statistică, 2009). VAT receipts recorded in 2010 exceeded 14.3% in nominal terms comparative with 2009, while the standard rate of VAT was increased in July 2010 by 5 percentage points amid economic downturn mitigation (in terms real gross domestic product fell by 1.3%, consumption fell by 2.1% and household final consumption decreased by 1.6%) (Institutul Național de Statistică, 2009). Value added tax collected in 2010 was lower, in nominal terms, than that received in 2008 by 4%.

Figure 4. VAT as % of GDP in Romania and EU in economic crises



Source: Based on Eurostat data

Concerning the evolution of VAT as % of GDP in Romania and EU 27 in the economic crises time we can see that for EU there is a constantly evolution with slight fluctuations between 6 and 7 % of GDP. The increasing of VAT rate in Romania has a significant impact on the tax receipts because there is a continuously increase of the share of VAT receipts in GDP for 2010. Following this trend we can say that the rate increase was felt in the budget favorably even if the purchasing power of consumers has been affected.

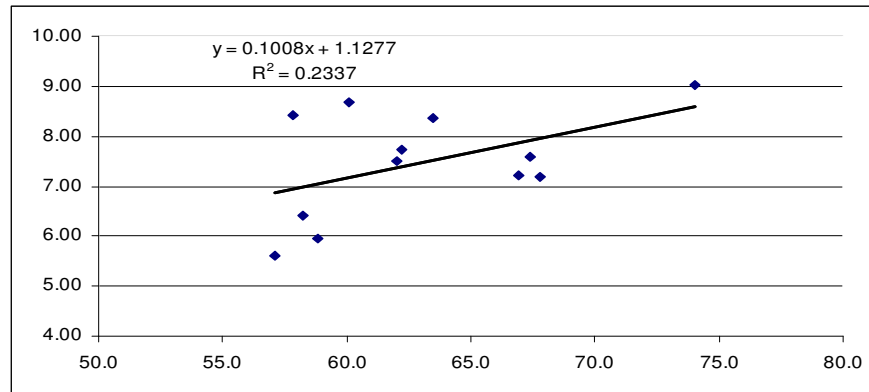
Table 1. Evolution of households' expenditures and VAT as % in GDP

VAT % GDP	Q4	Q3	Q2	Q1
2010		8.42	7.74	7.22
2009	5.96	5.6	8.36	7.19
2008	6.41	8.68	7.59	9.01
Final consumption expenditure of households % GDP	Q4	Q3	Q2	Q1
2010		57.8	62.2	66.9
2009	58.8	57.1	63.5	67.8
2008	58.2	60.1	67.4	74

Source: Source: Based on Eurostat data

Following the correlation between consumption and the VAT for the economic crises there is a direct correlation, if the consumption increase with 10% than the VAT receipt increase with 1%. The VAT receipts are correlated with consumption –in this case only household consumption with 23%.

Figure 5. Correlation between consumption and the VAT for Romania



Source: own calculations based on Eurostat data

Conclusions

In conditions of economic crisis the government may use the VAT to increase the tax receipts but not without macroeconomic consequences. With the emphasis on taxation is increasingly putting more on indirect taxes, value added tax can be considered a tax of the future, being by far the most important and largest indirect tax harmonization success tax.

Annex 1 VAT in Romania, 2007-2010, millions lei

	2007	2008	2009	2010
January	1.803,8	4.671,2	4.295,4	3.188,0
February	1.323,3	2.543,0	2.371,6	2.214,3
March	1.747,4	3.050,0	1.868,5	2.154,6
April	2.586,8	3.236,2	3.045,7	2.953,4
May	2.725,9	3.486,9	2.741,2	2.692,1
June	2.702,0	3.240,6	2.736,8	3.231,0
Julie	2.894,8	4.083,6	2.748,9	3.220,4
August	2.813,1	3.510,2	2.476,1	3.637,1
September	3.137,2	3.485,0	3.040,7	3.890,0
October	3.187,6	3.747,3	3.162,8	4.233,9
November	2.770,6	3.066,3	2.693,2	3.896,9
December	3.550,7	2.754,8	3.141,5	3.934,3
1st Quarter	4.874,5	10.264,2	8.535,5	7.556,9
2nd Quarter	8.014,7	9.963,7	8.523,7	8.876,5
3rd Quarter	8.845,1	11.078,8	8.265,7	10.747,5
4th Quarter	9.508,9	9.568,4	8.997,5	12.065,1
Total	31.243,2	40.875,1	34322,4	39246,0

Source: Finance Minister

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