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# Income Tax Strategy in the Main European Countries

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## Abstract

*The taxation system of a country, in addition to the fact that it represents the main financial resource of the budget, offers the most important lever in economic policy. The standardisation of the European tax, in addition to its favorable effects, will block its manifestation as a national economic lever.*

**Key words:** *taxation, revenue budget, taxes direct and indirect taxes*

**JEL Classification:** *E62*

## Introduction

Revenues following the application of the tax system in a country are the main source of funding for the state budget. At the same time, the role of economic leverage of taxes and tax rates should not be minimized. Putting together the two attributes, as well as the effective coordination of their application determines what S. Paul Samuelson wrote in *L'Economique*, in 1972, namely that the fiscal policy goals are: to help alleviate the economic cycle oscillations and to encourage maintenance of a modern economy ensuring a high degree of labor employment.

In an economy where we have a predominantly private ownership, the role of tax rates and taxes is that of economic stabilizers. They are systemic components together with the financial policy instruments (monetary and credit). 'Tackling socio-economic macro-stabilization imposes taking into account its constituents, taking into account firstly the premises creating a stable economic system, which positively influences the quality of human life'<sup>1</sup>. This is necessary because within society there are opposing forces generating dispersed imbalances, both temporally and spatially.

One must not lose sight of the fundamental role of the state to provide maximum welfare conditions to the community members that are in conformity with the historical period of economic opportunities. Unfortunately, no type of socio-economic organization has found a way to do this in a fair manner for all its members. Maybe it is not possible because the term 'fair' is a very relative one, as it involves social, economic, cultural conditions regarding when and where the rules of this monumental 'game' called social life are implemented.

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<sup>1</sup> Puiu, A., *Strategiile bancare – una din cauzele crizei actuale a economiei românești*, Editura Independența Economică, orașul, 2001, pag. 8-9.

It is believed that the democratic system is the top model of economic and social organization of this historical period. Perhaps as it is a democratic model it is characterized by an extraordinary flexibility and implicit diversity. Are there any attempts to standardize the supranational level of this model, and if so, does not mankind depart from pure democracy? But what is 'pure democracy'? As for interventions in market of ruling forces, any rule imposed by outside actors directly involved in the action, leads to the removal of pure competition.

A very old dispute relates to the proportion to determine direct taxes compared to indirect ones as a source of income to the budget. Basically the dispute is between social equity issue that involves direct tax revenue collection and budgetary efficiency of some indirect taxes. This is more intense in the case of the global financial crisis triggered in recent years because it primarily affects the categories of persons with low income. Indirect taxes also affect the financial resources of those who have wealth but also of remarkable people living at subsistence level, to the extent to which both categories act for purchasing goods and services. Meeting the reduction of social inequities, governments or legislative bodies in some countries have often decided to reduce indirect taxes on certain products considered necessary to the subsistence level or have a major role in ensuring the integrity and health of communities.

Even if more equitable according to a social conception, direct taxes come in contrast with the liberal vision as additional resources available to pay the tax are gained due to the tax payers' superior qualities or to their ability take advantage of different situations as compared to other members of society. Liberal economic concept, while not excluding direct taxes, stands for their limitation. People who have skills and competencies that allow them to accumulate resources for which they would have to pay these direct taxes should be encouraged to continue to exercise their skills and qualities, as they are 'the engines of the society'. These people are those who, willingly or forced, have to introduce the resources of the economic cycle; they are a means of access to resources for other members of the community.

In conclusion, the state must regulate the level, structure and budget of revenue so as to ensure a high level of budgetary resources, but not 'to choke' on domestic economic agents. Results of tax increase over certain limits may be manifested by negative reaction to taxpayers who may choose, with the necessary risks, escapist activities or a fiscal strike (if well organized) or relocation of the capital.

Under economic crisis conditions with direct implications on the entire system of interest, the state has new and multiple roles particularly in the redistribution of gross domestic product, it mainly determines the lack of liquidities for investment. Prior to the current world crisis, the global financial institutions were those who claimed through its levers, at modest prices, the necessary economic investment borrowing. It turned out that the private financial system may not have a comprehensive view of all the economic mechanism, directing resources in many cases to a limited number of fields (firstly see the civil engineering sector development) depending on the momentary interests of different power structures. The gap created between the sectors of national economies has led to the phenomenon of financial recession, as a temporary solution for the adjustment of the development in economic activity. Under these circumstances, state intervention is crucial because it must support the financing of economic development projects, but this time by applying projects resulted from designed national strategies and correlated with union or global level. Thus, the adjustment of economic development will be directed by the state through its financial leverage and tax. Therefore, tactics and strategies of fiscal policies are becoming increasingly important in the current context, which means that there must be a way to determine the nature, size and structure of taxes.

## Budgetary Revenue Analysis of the Main European Countries

The present paper will draw a contrastive analysis, based on statistical data of the macro-economic indicators, between the fiscal policy of Romania and other European states, both before and after joining the European Union. At the same time, it will focus on the impact of the world financial crisis on the Romanian fiscal policy, as well as in other European countries.

If before the integration in the European Union, Romania had to comply with signed bilateral agreements relating to taxes imposed on the international trade, since joining the EU it has been required to accept a convergence of the nature and extent of several taxes. Tax harmonization is the way the EU manages to implement macroeconomic policies and visions. However, because of the impact taxes have on prices, tax harmonization is essential to the Community market as its main goals are<sup>2</sup>:

- preventing distortion of competition in the Single Market;
- eliminating the legal ambiguities in the field of direct taxes;
- preventing the negative effects of tax evasion.

The power structures of the European Union, given the extent and implications of these objectives - complex, immediate and relevant for all economic actors - have required all states involved following two principles<sup>3</sup>:

- *the principle of accepting national fiscal policies* since they do not have a discriminatory character and they are not contrary to the objectives and policies of the European Union;
- *the principle of subsidiarity* which states that fiscal policy is established by the member countries if cannot be demonstrated that the underlying skills development policy can be better achieved at EU level.

The harmonization phenomenon applies, for the time being, more in the case of indirect taxes which are connected to products, than in the case of the direct ones, whose subjects are people or legal persons who are usually residents of the state.

Given these issues an appreciable difference between the number, structure and value of various categories of taxes in EU countries can be noticed. Although each state is trying to adjust fiscal policy to national economic model some major trends in the European Union countries may be noticed, based on comparative analysis of absolute values and especially of relative ones.

In order to gather the most relevant information, in the case of Romania's budgetary revenue analysis it was chosen a period that includes the years before and after its joining the EU membership. We have tried to capture the tax policies of the European countries selected for the analysis before and in the beginning of the financial crisis. As regards 2009 achievements, we analyzed the government forecast and decisions of fiscal policy made so far.

The following EU countries were chosen for the study: Romania, Bulgaria, Germany, France, Hungary, and Poland. The criteria for choosing these countries were:

1. Romania represents the main objective of the analysis;
2. as the cumulative values of the adimensional indicators at the level of the EU represent reference points, countries such as France and Germany were chosen, as being among the most developed countries;

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<sup>2</sup> Tomi, A.R., Armonizarea fiscală în domeniul accizelor – proces necesar și continuu, *Impozite și taxe*, nr. 10/octombrie 2008.

<sup>3</sup> Idem

3. Bulgaria, Czech Republic, Hungary and Poland are countries with the same characteristics as Romania, i.e. they are part of the Eastern Europe with the same economic history (former CAER members), they have almost the same amounts as far as the GDP is concerned and, last, but not least they have common objectives.

The correlation analysis between the evolution of the fiscal revenues and GDP was based on Table 1.

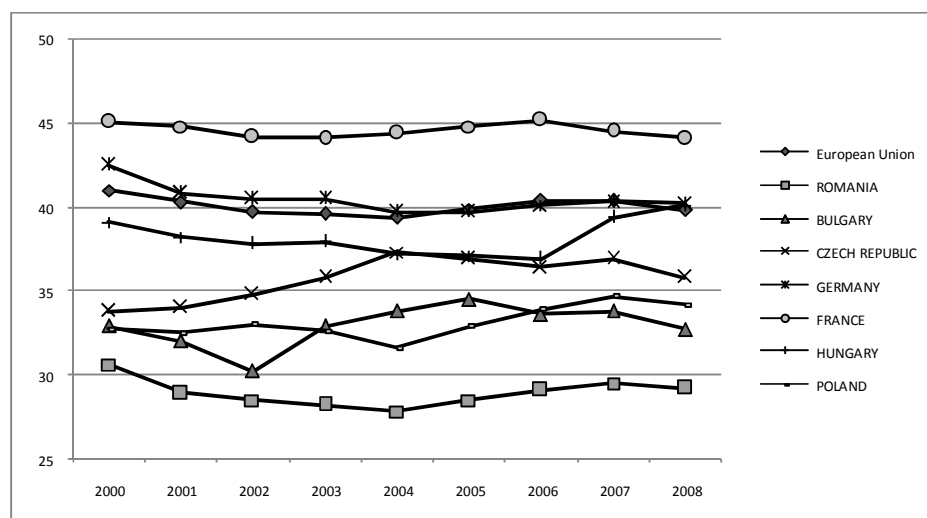
**Table 1.** The evolution of share of fiscal revenues to the consolidated budget, in the GDP of some member states of the European Union during 2000 - 2008

(%)

Years Countries	2000	2001	2002	2003	2004	2005	2006	2007	2008
<b>European Union</b>	41	40.3	39.7	39.6	39.4	39.9	40.4	40.4	39.8
<b>ROMANIA</b>	30.6	28.9	28.5	28.2	27.8	28.5	29.1	29.5	29.2
<b>BULGARIA</b>	32.9	32	30.2	32.9	33.8	34.5	33.6	33.8	32.7
<b>CZECH REPUBLIC</b>	33.8	34	34.8	35.8	37.3	36.9	36.4	36.9	35.8
<b>GERMANY</b>	42.5	40.8	40.5	40.5	39.7	39.7	40.1	40.3	40.2
<b>FRANCE</b>	45.1	44.8	44.2	44.1	44.4	44.8	45.2	44.5	44.1
<b>HUNGARY</b>	39.1	38.2	37.8	37.9	37.2	37.1	36.9	39.4	40.1
<b>POLAND</b>	32.7	32.5	33	32.6	31.6	32.9	33.9	34.7	34.2

Source: Government Finance Statistics - Summary page, <http://epp.eurostat.ec.europa.eu>

Analyzing the data presented in Table 1, from the perspective of 2009, after the financial crisis has marked substantially the economic development of all countries and led to many negative effects, the tax policies of the mentioned period may be considered as not being optimal. In all these countries, during the reported period, the GDP has had an upward trend amid the global economic growth. At that time it was difficult to predict the occurrence of the financial crisis and even more difficult the scale, propagation, effects and even ways of manifestation. Each country is willing to accept upon the approval of the state budget a certain level of economic, social, political etc. risk. In such a context, the economic-financial crisis has found most of the world countries unprepared.



**Fig. 1.** The evolution of fiscal revenues to the budget reported to 100 m.u. GDP, national currency in the member states of the EU during 2000 – 2008

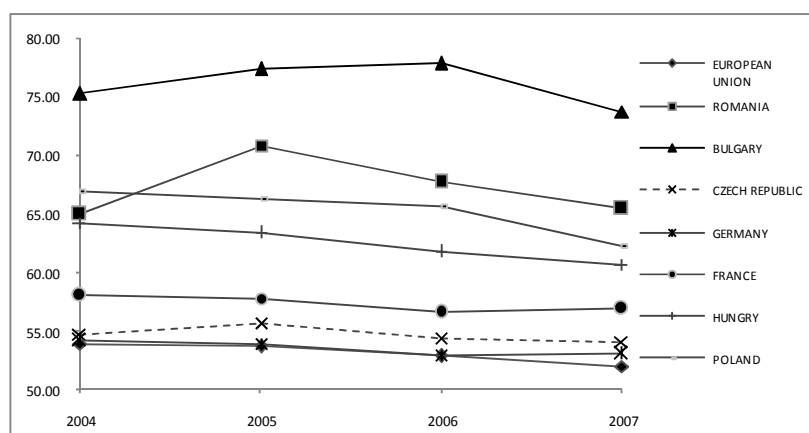
Source: Table 1

It is known that one of the macroeconomic policies that can be tackled is to gather appropriate reserves by the state, retaining from surplus budgets, values (and here is questionable the optimal form to enable the best possible conservation of the value, provided that the state may use financial placement, the growth of the foreign currency or the reserve of precious metals and other investments that may be called for value conservation) for supporting the economy during the crisis. At the same time with the economic growth, some countries, particularly those with an economy sensitive to external economic fluctuations, as well as those with emerging economies, should have increased the tax levies to the budget.

As explained in Figure 1, Poland, Bulgaria, Germany have shown a trend of increasing tax revenue ratio with GDP. But there were also countries where the low share of tax revenues in GDP and the budget can be noticed: Romania, France, Hungary and even the average of the 27 countries forming the EU. The difference between the fiscal policies of the two groups of countries concerns their attitude towards various aspects of the fiscal strategy which affects this indicator. Thus, if some countries have tried to attract investors and encourage business, growth in living standards, others had objectives such as setting the economic growth, supporting increased public spending, creation of reserves, etc.

In a mature economy, the state can leave a higher amount of the GDP to economic operators, in order to override their decision on the use of money, i.e. their reintroduction in the national economic cycle. When considered that the investors' attitude is not healthy for the national economy on the long term, the state can take over a greater amount of the GDP for redistribution, provided its use in public procurement, especially in strategic projects.

One can suppose that some countries have benefited from economic growth to develop the public sector, while others have encouraged the accumulation of resources in sectors in which the primary distribution of GDP takes place. In the years preceding the financial and economic crisis tax deductions increase was possible, with the risk of economic slowdown, but with the purpose of creating reserves to enable further mitigation of economic and financial crisis. Because economic growth was relatively low (below 5% in European countries), and the fiscal policies of these countries could not predict the extent of the financial crisis, in most countries there are no state financial resources to reduce the effects of this macroeconomic imbalance.



**Fig. 2.** The share of indirect taxes in the total amount of fiscal revenues of the state budget in the member states of the EU during 2004-2007

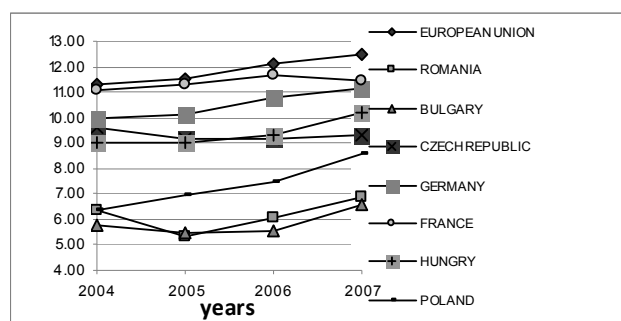
Source: Government Finance Statistics - Summary page, <http://epp.eurostat.ec.europa.eu>

Tax funding structure of state budgets of EU countries chosen for analysis and presented in Figure no. 3 is based on the indirect taxes, these having a share of more than 50%. It can be noticed that countries like Bulgaria and Romania call for such funding in a higher proportion than the average of other European countries. The explanation may consist in several issues that

can be observed, as characterizing the level of economic and social development of these countries. However, there are side effects of the shift towards a higher share of indirect taxes in the budgetary tax revenues, namely ‘direct implications on inflation, so great that, they abolished the positive contributions of labor productivity growth and the rise in unemployment’<sup>4</sup>.

Thus, factors that influenced the guidance in these countries mainly to indirect taxes may be listed: poor management of databases that emphasize the income and property of individuals and businesses at domestic level, the difficulty of direct tax collection, many problems of legal titles for a substantial number of taxpayers. Moreover, high levels of consumption of goods linked to a weak contribution to offer domestic economic institutions have encouraged these institutions to use the nature of economic leverage of these taxes.

The orientation towards indirect taxes of tax systems in developed countries is considered a modern trend, in line with the development of these countries, especially with the standard of living achieved by their population. As Romania is in a period of deep transformations, a very turbulent period of its existence, it is difficult to establish common ground on economic characteristics with countries that have not gone through centralized economy and are now EU members. It is therefore difficult to argue which economic model applies better to the economic organization of the country. What can be said that represents a relative consensus of economists and politicians from Romania refers to objectives to be achieved, but the good way forward is difficult to establish. In this respect there are voices that claim to shift a larger share of direct taxes as ‘indirect taxes share increase in the structure of Romania’s state budget revenues does not reflect trends in a modern developed economy, on the contrary, it reveals the contradictions generated by transition and IMF policies in the direct confrontation area between wages and prices in the consumption space’<sup>5</sup>. To identify the arguments of the decisions on the volume and structure of taxes and to analyze the effects of those decisions we shall continue to explore the correlation between the volume of gross domestic product and the level of taxes on their two components: direct and indirect ones. In this respect, the comparative figures values of direct taxes to gross domestic product per 100 currency units were plotted (counted amounts expressed in national currencies of those countries). The macroeconomic indicators of the same European countries in the previous analysis were taken into account.



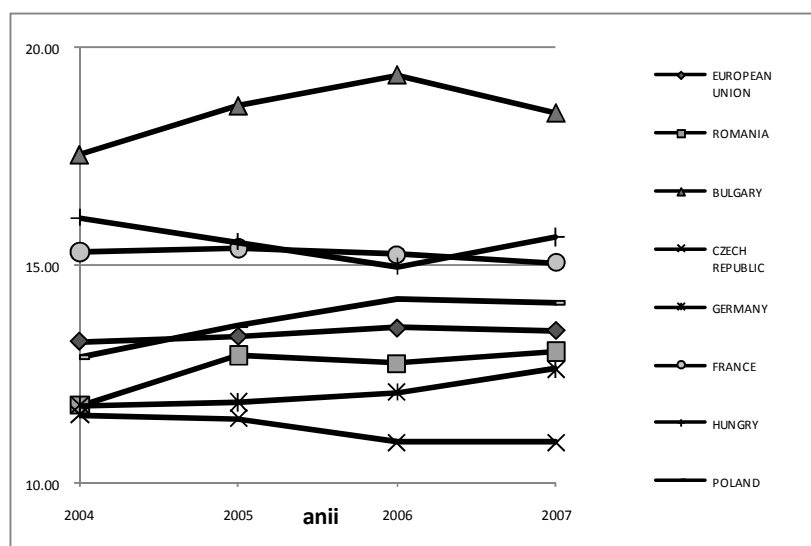
**Fig. 3.** The level of direct taxes at 100 m.u. of GDP in the member states of the EU during 2004-2007  
Source: Government Finance Statistics - Summary page, <http://epp.eurostat.ec.europa.eu>

Done, I., *Probleme și provocări economice ale tranziției*, Editura Expert, București, 2009, pag. 158.

<sup>5</sup> Idem, pag. 159

In the case of Community countries, through direct taxes on average approximately 12% of gross domestic product of EU countries is redistributed. As seen from the structure analysis of tax revenues to budgets of the studied EU countries with underdeveloped economy, a smaller part of GDP is redistributed through direct taxes. For example, Romania and Bulgaria redistribute only half of what is happening in the European Union combined. This comes to reduce the budget revenues of these countries whose fiscal policy may be accepted only if justified by the desire to form a core business, of strong economic agents in financial terms, possibly contributing significantly and perhaps even crucially to the economic progress of the respective countries.

Indirect taxes collected to 100 units of national currency have had an evolution during the four years analyzed represented in Figure 4.



**Fig. 4.** The level of indirect taxes to 100 m.u. in the GDP of E.U. countries during 2004-2007

Source: Government Finance Statistics - Summary page, <http://epp.eurostat.ec.europa.eu>

The graph shows that the highest level of indirect taxes collected at 100 m.u. national currency are recorded in Bulgaria, compensating low direct taxes. However, the relatively low level of GDP in Bulgaria compared with other countries should be taken into account (Table 1) which has led to more consistent support from the state budget.

**Table 2.** The GDP of analyzed E.U. countries

- millions euro (at 1.1.1999) -

	2004	2005	2006	2007
EU (27 countries)	10602783.3	11063085.7	11676756.6	12352993.6
Bulgaria	19875.4	21882.3	25238.2	28898.6
Czech Republic	88262.0	100190.1	113458.5	127142.9
Germany	2210900.0	2243200.0	2321500.0	2422900.0
France	1660175.0	1726053.0	1807462.0	1892132.0
Hungary	82235.4	88681.2	90007.0	101130.6
Poland	204236.5	244420.1	272088.9	310612.9
Romania	61063.9	79801.9	97751.0	123846.8

Source: Government Finance Statistics - Summary page, <http://epp.eurostat.ec.europa.eu>

In this context, it is noted that in this case Romania records an average level of income coming from indirect taxes to the state budget. The two sources of income, correlated in Romania can lead to the conclusion of a reduced funding from fiscal sources of the budget. This may be explained by the population and economic agents' opposition to increased taxation, financial and particularly fiscal indiscipline, but also by a state budget without excessive demands on reallocation of resources in the economy. As reflected in the work of other prominent economists it can be stated that [...] in Romania, taxation issues must comply with the correlations which have been found to be expressive for the evolution of knowledge and economic practice.<sup>6</sup>

As a result of the comparative analysis of graphs 2 and 3 it can be observed that countries with economies under major transformations such as those located in Eastern Europe, but also some countries like France have chosen to fund the state budget mainly from tax revenues coming from indirect taxes.

In the past 20 years, two periods in financial and economic developments of the Romanian state can be distinguished, that is: the period of the '90s, when the Romanian state was based on resources and infrastructure created by 1990 and the second period between 2000 and 2010, during which, the orientation was to attract financial and material foreign resources to modernize the economy.

If during the first period the state's financial resources were based mainly on the exploitation under various forms of what had been achieved in the Romanian economy by 1990, during the second period state revenues were obtained mainly from taking advantage of foreign investment under the form of production capacities.

At the end of the second period, as resulting from the analysis, the state budget revenues show signs of involution primarily because of the spreading of the economic crisis. Romanian crisis was felt first by the withdrawal of foreign investors, especially small investors and portfolio investors. It was the main input signal of the Romanian economy facing the crisis. This was reflected in the budget tax revenues which began to decline.

There are two major trends for the state to cope with the crisis: first, to increase tax revenues by increasing tax rates (because Romania has many new taxes), relying on the capacity of traders and individuals to comply with them, but especially on their accumulation from the previous period, or, second, to keep within acceptable limits the tax levels and use other sources of borrowing.

## Conclusions

The treaty of establishing the European Economic Community contains the general framework on fiscal policies in the European Union, stating that:

No member state shall impose, directly or indirectly, on the products of another member state, internal taxes higher than those applied to similar products from domestic production.

In addition, no member state should tax the products of another member state so as to provide a third member state protection of its products.

In case of exports to another member state, the refund of paid taxes within the country will not exceed their volume.

For other taxes different from turnover taxes, excise and other indirect taxes, refunds relating to exports to another member state cannot be guaranteed, and taxes on imports cannot be applied

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<sup>6</sup> Done, I., *Probleme și provocări economice ale tranziției*, Editura Expert, București, 2009, pag.156



without being approved for a limited period of time by the Council, following the Commission's proposal.

The Council will adopt proposals from the Commission on the harmonization of legislation on indirect taxes, unanimously, after consulting the Economic and Social Committee<sup>7</sup>.

However, the facing of the crisis by the European economy caused intense political and economic turmoil both among member states, and especially at the European Council level. Not only are there some changes currently proposed such as:

- countries using the euro as their currency should have a unique tax measure to discourage speculators to use tax differences to gain from moving investments on different markets, which creates financial instability;
- the national budgets of member countries should be submitted first to the European court for expert analysis and then approved and implemented in those countries,

but there is also an issue of great importance on giving up the unique European currency, or even excluding some countries from the Union.

Traders taking advantage of different tax rates in the European Union countries led to the emergence of the concept of 'transfer pricing'. 'Basically it comes to exports of half-finished or finished products manufactured by subsidiaries of foreign companies in Romania at low prices which are then exported at higher prices after a brief processing and packaging with the brand that remains'<sup>8</sup>.

In this context, the struggle to maintain national interests overriding the values of correlations and the values of indicators lacking contextual motivation can become a major objective for some countries and for Romania as well, a country with an economic history different from developed countries of the Union.

In the context of the presented facts, we believe that the national interest is that Romania remains an attractive country from the tax point of view, in the European Union, but it should ensure sufficient resources in the budget to provide decent social protection, public services of appropriate quality and last, but not least an effective tool for the guidance and control of economic development trends.

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<sup>7</sup> \*\*\* Treaty of Establishing the European Economic Community, signed in 1957 – the General Framework of Fiscal policies in the European Union, articles 90-93, used in The Treaty of the Establishing the European Union in 1992, as well as by the Treaty of Lisbon, which is to come into force in 2010.

<sup>8</sup> Z a m a n , G., V a s i l e , V., "Aspecte ale eficienței macroeconomice a investițiilor străine directe în România", în *România în U.E., Potențialul de convergență*, Editura Ager, București, 2006, pag. 80.

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## Strategia veniturilor fiscale în principalele țări europene

### **Rezumat**

*Sistemul fiscal al unei țări, pe lângă faptul că reprezintă principala resursă financiară a bugetului, oferă și cea mai importantă pârghie de politică economică. Uniformizarea cotelor fiscale la nivel european, pe lângă efectele favorabile, va bloca tocmai atributul de pârghie economică națională.*