THE INTRODUCTION OF GLOBAL INCOME TAX SHOULD BRING ADDITIONAL REVENUE TO THE STATE

Abstract

This paper is an exclusive interview with Mr. Valentin Lazea, state secretary – Department for Economic Analysis and Financial System Informatisation. The paper is a translation of the interview that was published in issue nr. 9 (1997) of Financial Bulletin (previous name of Financial Studies).

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FINANCIAL BULLETIN: At the beginning of the year, in just two days, the national currency devalued by almost 100% in relation with the US Dollar. The National Bank had to intervene in a strong manner in order to stop the decline of the leu. Economic theory shows, however, that the financial-monetary policy measures yield results only on the short-term, 9-12 months. Do you think that the measures taken within the real economy for privatization, reorganisation, revival of the export sufficiently support the financial-monetary policy of the government?

VALENTIN LAZEA: I must begin by saying that the my answers to your questions represent my personal opinions, as specialist and that they must not be interpreted as official positions of the Ministry of Finance, or of the party that I represent, PSDR. Regarding the actions taken within the real economy to support the monetary and financial policies, we may say that, despite some hesitations, more has been accomplished in the last 10 months than in the 7 previous years. The most spectacular result was scored in agriculture where, at least in 1995-1996, was a hindrance to the reform. The fact that the idea of not crediting the agriculture with fresh money injected by National

Bank into the system was accepted, represents, in itself, a true revolution. Also, the shutdown of 20 bankrupt animal production units, despite the populist wave of protests, proved to be a success, largely closing up this “black hole” which was draining the state funds.

Although they are less clear, the measures for reorganising the industry are also noteworthy. The shutdown of the fifteen unprofitable units has to be finalised despite some diversionist actions that claim either the existence of court orders that contest General Assembly decisions, or the uniqueness of the heat sources of some localities which would be left out cold as those units are closed down. The Government cannot afford to go back on the issue of these 15 enterprises because its image would be seriously affected. We must also note the success of shutting down a large number of mines and the sacking of more than 60 thousands miners, representatives of a sector that produced much negative added value (it was decreasing the gross domestic product instead of increasing it). Even though undecided and hesitant, the measure of letting seven refineries of the existing nine at the will of the market also is a brave measure that has to be taken to its very end. Some of them will probably not hold and will close down. The Government will have to have the strength not to jump to their aid, otherwise it will do exactly as the Văcăroiu government did: each time the reform turned painful, it backed off. It is not without importance that the lack of credibility manifested within the international financial media regarding our country originates in this ambivalent attitude which our leaders had until 1996; the following months will test this government too.

FINANCIAL BULLETIN: Is the current taxation system a stimulant for work, saving and investments, therefore for long-term economic growth?

VALENTIN LAZEA: My position regarding taxation is very clear, even though it is not very often met within the public debates: Romania has the most liberal taxation policy in Eastern and Central Europe (actually in all Europe) and the possibilities to stimulate the economy further in this direction are exhausted. With consolidated budget revenues amounting to less than 27% of the GDP we cannot ensure the efficient functioning of a modern state. Those who are condemning the current taxation system in Romania probably don’t know what they are saying. Let’s exemplify:

The VAT rate is 18% in Romania (with many reductions to 9% and with many exemptions), while the standard rate is 22% in Poland and the Czech Republic and 25% in Hungary and the Slovak Republic.

The profit tax rate is 38% in Romania compared to 40% in Poland and Slovak Republic, 29% in the Czech Republic and 18% in Hungary.

The tax rates for social insurances are between 30-40% in Romania for the employers and 4% for the employees, while in Hungary the corresponding figures are 47% and 11%, in the Czech Republic they are 35.25% and 13.15%, in Poland 40% and 0% and in the Slovak Republic they are 38% and 12%, respectively.

It is true, however, that Romania has a very high marginal rate of wage taxation (60% of the income exceeding a certain level), but this affects a very small number of employees (under 5% of the total workforce); this marginal level will most certainly be removed in the future, maintaining the highest taxation rate at 40%.

Under these conditions, no well-intended person may say that fiscality is excessive in Romania.

FINANCIAL BULLETIN: The intention to introduce a system of global taxation of the incomes as of January 1st, 1998, besides the huge costs it will involve, will it not increase tax evasion, since the state doesn't have enough means to check the correctitude of the fiscal statements?

VALENTIN LAZEA: In my opinion, the introduction of the global income tax should bring additional revenue to the state budget, not decrease the existing revenues. Otherwise it would be foolish to spend a lot of money with training the staff, advertising and purchase of computers (long-term debt of the state) if the revenue to the budget would decrease.

Two preconditions are required for this increase of the budget revenues:

- The bulk of incomes (from wages, dividends and interests) should be taxed at the source, which would make the attempt to falsify the incomes less effective.
- The taxation rate for the global incomes should not be too different from the current rate used for the tax on wages. In other word, besides discarding the 60% marginal rate, the other changes should be purely "cosmetic".

If these two preconditions are observed, there is no reason for the revenue to the state budget to decrease. True, there will be many undeclared sources of income (those are not taxed presently either, as a matter of fact), so that ultimately the measure should be beneficial for the budget.

The more sophisticated sources of income (capital gain, use of in kind goods, etc.) are more difficult to evaluate and control at this moment. They require specific procedures that can only be integrated in time.

FINANCIAL BULLETIN: The Government planned rather small rates of economic growth for the next three years, 1-2% each year, lower than the average rate of growth stated by the programs of the other governments from Central and Eastern Europe (4.5% per year). How will the budget be able to support important sectors such as health care, education or national defence, whose funds are scarce currently?

VALENTIN LAZEA: Your question has two different aspects. On the one hand, the rate of growth will depend, in our country, on the rapidity and depth of the reorganisation. If privatization will be largely concluded by 1999 and the large state monopolies and autonomous units will be broken down, way may witness, starting that year, annual growth rates in excess of 5%.

However, until these measures from the real economy are finalised, the monetary-financial restart could be hasty, repeating the error made in 1995-1996, when money was pumped into an economy that was insufficiently reorganised.

The second aspect of your question concerned the support from the budget of the sectors which, by definition, represent “public goods”: health care, education, national defence.

I absolutely agree that these sectors should consume most of the budget funds. In this respect, I don’t agree with the exaggerated allocation, in 1997, of the funds with social destination (the human capital would have been much better stimulated if part of that money would have been directed to schools and hospitals than to the families with many children), as I also cannot agree with the stronger accent, in the 1998 budget, on economic expenditure.

Two things are needed to ensure proper funds for the health system, education and national defence: ending the process of tax reduction (see the answer to the second question) and making a hierarchy of the budget priorities within the Government.

FINANCIAL BULLETIN: For the first time after 1989, the small and medium enterprises started to massively “produce” unemployment. What does the Ministry of Finance intend to do to improve the economic and social environment in which the small and medium entrepreneurs conduct their activities?

VALENTIN LAZEA: The subject of the small and medium enterprises is a common subject lately. The Ministry of Finance should provide an equal treatment with the other tax payers. By this, I understand a correct, nonpartisan attitude of the fiscal inspectors, who should objectively control those enterprises.

It would be completely unrealistic to demand fiscal facilities for enterprises that represent over 75% of the total number of companies. Anyhow, wherefrom this idea that the small and medium enterprises should be unconditionally supported? Firstly, most of them operate in the field of services (not of direct production) and have a very low export activity; and the export is the drive for relaunching the Romanian economy. Secondly, it is not even true that most of them would have gone bankrupt if restrictive financial-monetary policies are implemented. As far as I know, in the first half of 1997, the average number of newly established companies balanced the average number of discontinued companies.

Of course, considering the many similarities of mentality, tradition etc. it is possible that in Romania “hold” the Italian pattern of the multitude of small, family companies as fabric of the national economy. However, stimulating them excessively, while endangering the budget equilibria, seems a luxury that Romania cannot afford.