THE QUANTIFICATION OF THE FISCAL IMPACT OF THE SOCIAL TAXES AND CONTRIBUTIONS LEVIED ON EMPLOYED LABOR ON SMALL AND MEDIUM SIZED ENTERPRISES. IT’S ROLE AS A TOOL OF ECONOMIC COMPETITIVENESS

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ABSTRACT. In the actual world economic framework, in which the financial crisis is running at full steam, and is being felt, not in the least, by the small and medium enterprises, the fiscal impact of the social taxes and contributions levied on employed labour (id est, on employed labour income) is of the outmost importance, for the management of such firms.

In this paper we intend both to quantify the amplitude of this particular impact, through the use of the index known as Implicit Tax Rate on Labour, and to highlight the main measures needed to be adopted, if the management of small and medium enterprises is to diminish the possible or probable negative effects of this type of fiscal impact, impact which is punctuated by the Implicit Tax Rate on Labour index.

For the emphasizing of the main features of the managerial strategy needed to be adopted in this case, we use the strategy of pointing up this particular type of fiscal impact on the small and medium enterprises of Romania, given its quality of being part of the European Union.

Key words: fiscal impact, implicit tax, small and medium enterprises

JEL classification: E24, E62, H32

The role of small and medium enterprises (SME) is extremely important in the economy of every state; this is due to the fact these companies are the engine of the innovative activities carried out, in a system of modern market economy, anyway, in the real economy – to be more exact, the small (and medium sized) businesses are, in such a system, the forefront of technical and economic innovation. It is not, in this sense, without mentioning a market economy is not characterized, if we have in mind the sphere of producers, that is all the producers, only by large market ratios, but, in the era of globalization and virtually free of

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charge telecommunications, by – if not in the most part by – small market ratios, or by residual ‘niches’ of the demand for goods and services.

In this context, it is impossible to ignore the importance of small and medium enterprises’ productivity, in the present economic status-quo, and, consequently, the importance the ‘comparative advantage’ the fiscal system can give, automatically or through the conscious action of the management of those enterprises, to the small and medium enterprises, ‘comparative advantage’ that enhances, or can augment, the efforts made by those small and medium enterprises in their competition struggle.

It is well known the fact excessive fiscal policy represented – and still typifies one of the causes of slowdown of the expansion of this kind of producers, this situation imposing, along the diminishing of the fiscal pressure, a differentiation of taxation using the criteria of economic branch, practice in use, as a matter of fact, in some industrialized states of the European Union, like Belgium.

We can, in this way, express a reasonable opinion about the influence of fiscal pressure on the competitiveness of small and medium enterprises, only if we use a mathematical index – an instrument used for our economic goals, with which we can quantify the quantitative characteristics of fiscal pressure.

Given the fact ITR is the index which embodies the quantification of the tax rate on labour, tax levied on both producer (employer) and consumer (employee), we, though the use of this tool, measure, in fact, the (total) tax on labour put up with, in the real economy, by the above mentioned taxpayers, tax that, moreover, comprises the fiscal influence of the mix of direct taxes and contributions levied on (employed) labour incomes.

The taxes levied on employed labour incomes, that is those levied on the employers of the producers – in our case, of the small and medium enterprises – and those levied on the producers themselves (i.e., small and medium enterprises) encompass all taxes directly linked to salaries, many of those being withheld at source, paid by employers and employees, including, here, the social security contributions. Those taxes, for more precision, comprise the compulsory social contributions paid by employers and the payroll taxes, the compulsory social contributions paid by employees and the (personal) taxes levied on the earned income. The implicit tax rate on labour reflect the taxes and contributions paid/supported by employers and employees in relation to the work taxpayers – we mean here the consumers, not the producers – bring forth for the producers in their quality of employees.

The ITR on labour is a macroeconomic index, derived, structurally, from the data comprised in the national accounts. In some member states of the E.U. the recent fiscal reforms had powerful effects on the taxpayers whose salaries are as large, so to speak, as the minimum wage in the real economy, on the low-qualified workers and on the taxpayers with – among others – the quality of parents, fact which seems to prove

\footnote{In Belgium, the companies that fulfill their operations making good – and daily – use of technological innovation benefit from fiscal measures, or from innovation premiums.}
that these changes only partially reflect the discretionary measures of fiscal policy. According to the ESA95 rules for national accounts, the taxes will be, in normal circumstances, recorded by the fiscal authorities in the very moment of realizing the economic activities – that is, the carrying out of employed labour – for which those taxes are calculated and levied on, rather than according to the moment when the actual payment of taxes takes place. For example, the personal income tax is levied on the incomes accumulated one year before the payment of the due tax is realized.

If we keep in mind the fact fiscal pressure, in general, is quantified through the intermediation of an index itself computed using, among other components, the tax on labour, and the impact of fiscal pressure on SME competitiveness is a considerable one, it becomes clear taxing labour influences, directly, the power of such a firm of sustaining the competition struggle.

Given the importance of income taxation for SME competitiveness, our paper relies on the study of the effects of labour taxation on the financial and economic performances of those companies.

In order to understand better the global implications of the concept of fiscal pressure, we can use order taxes, according to the ‘object’ the taxes are levied on, into three main categories: consumption taxes, taxes on labour and taxes on capital.

The aggregate taxable bases corresponding to the quantification of the fiscal pressure tolerated by SME are constructed starting from the data comprised in the national accounts, in order, to be (more) explicit, to determine ITR on consumption, labour and capital. ITR is, thus, an index that measures the average of the effective fiscal pressure levied on different categories of incomes or economic activities; it, however, does not measure the final incidence of taxes, given the economic reality taxes can be displaced from one activity to another due to (microeconomic) producers’ psychology.

Previous approaches, relying exclusively on aggregate data from the national accounts, estimated the total personal income tax, in what labour or capital incomes were concerned, using the ratio of (aggregate) labour or capital income to the (aggregate) total income of the taxpayer. These approaches inferred the effective average ratios of personal income tax were of the same value, considering different sources of taxable income and different types of taxpayers, statement unsoundly enough for us to say more about it here.

In order to have a realistic image of the fiscal pressure generated by labour incomes taxation, including the SME case, we consider it is necessary to use the ITR index. This is the fact, as we will demonstrate, and for more than one reason.

One of the reasons is the characteristic of ITR to facilitate the building up of a study of the dynamics of the levels fiscal pressure reaches in time – and, by this, the identification of the production factor, or of the income source mainly taxed, in a given period of time –, and in a given group of states, so that it will be feasible, and reasonably accurate, to make an inter-state fiscal comparison.
Another reason for which we, and nor only we chose to put this mathematical tool to good use – we, in this very paper –, in order to reach the goals mentioned above, is the possibility it gives us to obtain a near complete picture of the phenomena we are analyzing therein: with the help of ITR index it becomes visible the entire field of financial and economic influences which leave their mark on taxation (on labour taxation, in this case).

It must be underlined that, for sure, a taxation trend cannot be fully explained just by using ITR. But, for the goals of this paper we need a little less than that, and, precisely, the piece of knowledge the ITR index is, more surely, able to supply us with: this is the clarification of the shape of such a trend, clarification that no longer seems improbable to occur once we state the formula with which ITR on labour is computed, which is what can be seen below:

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\text{ITR on labour} = \frac{\text{direct taxes (if any, indirect taxes too) and compulsory actual social contributions paid by employers and employees, on employed labour income}}{\text{Compensation of employees + Wage bill and payroll taxes}}
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The main methodological difficulty which must be confronted in order to calculate the ITR on labour is the fact the personal income tax is levied on multiple sources of incomes (employed labour, self-employed labour, and income in the form of pensions received and in the form of social benefits payments). Dividing the tax according to the personal income tax (PIT) concept, into different types of taxable (personal) income has the aim of realistically calculate the average personal tax rates (in the sense they cannot be conceived as being equal to one another, given the different sources from which taxable incomes are obtained and the different types of taxpayers that are not producers); therefore, the tax is quantified as a weighted average of the taxable incomes obtained from different sources (wages, copyright, etc.).

The quantified ITR can be seen as a synthetic measure that approximates the average level of the effective fiscal pressure levied on the labour incomes generated in the real economy. In this sense, it must be underlined the calculus of ITR may, can be said, hide important variations of the effective tax rates – concerning different activities of the company, or different families, or different wage levels. For example, cuts in social contributions on the part of taxpayers whose salaries are around the level of the minimum wage, or on the part of low-qualified workers may have a small impact on the global ITR and yet be effective in raising take-home pay for the taxpayers involved.

Most of the member states of E.U. compute the labour income tax by multiplying, basically, every payment accounted for an income tax with the ratio of every selected income source to the global income of the taxpayer (e.g. Belgium, Denmark, Germany, France, the Netherlands, Ireland, Luxembourg, Finland and Sweden).
This is done both through macroeconomic simulation models, which are based on samples of all taxpayers, and by using extensive data regarding the return of personal incomes of exhaustive tax return data-sets (e.g. Belgium and Ireland). Estimates obtained at taxpayer level are aggregated in order to obtain estimates on the personal income tax levied on personal labour income. Personal income tax (labour) can be estimated as follows:

$$\text{PIT} \text{ (labour)} = \sum_j \left( \frac{W_j}{Y_j} \right) \times \text{PIT}_j = \sum_j W_j \times \text{PIT}_j$$

Where:

- $W_j$ quantifies the labour income of taxpayer $j$ in a sample of individuals $(j=1,...,n)$ and
- $\text{PIT}_j$ measures the personal income tax payment of taxpayer $j$ (on his total taxable income $Y_j$).

The equation above illustrates the total personal income tax levied on labour income as weighted average of each payment of the personal income tax of each taxpayer, with the weights $w_j=W_j/Y_j$ attached to individuals payments, reflecting distribution of total wages for different categories of taxpayers.

Some Member States, such as Spain, Italy and Greece, use information regarding tax return data, that is aggregated at a number of incomes’ categories or income tax brackets $(j=1...n)$, but in principle perform the same calculations. The next approach aims to obtain comparable effects of the differences in tax treatment and distribution of income sources in the various categories of taxpayers. Other Member States, such as Austria and Portugal, choose a different approach and use information on tax receipts data from the wage withholding tax and statistical information on the final income tax and apply a number of adjustments.

The tax on income from labour of employees – in particular, tax income from wages – is by its very nature designed to estimate exactly how much debt represents final income tax for holders of wage income, but in some cases there are some adjustments for assessing the income tax, because wage tax retained it is not correctly calculated, given the different jobs or pensions the taxpayer has in one year. There are situations in which the net amount of the corrections shall be deduced from the total amount of wage tax recorded and the pay tax of personal income is adjusted accordingly. The personal (adjusted) income tax is rather divided between incomes generated by self-employment activities and income from capital, using aggregate information from various categories of incomes (Austria).

The recent trend the economists concerned with the monitoring aspects of the fiscal pressure reveal – we think only about the fiscal pressure concerning labour – confirms the importance, or in other words the value of Implicit Tax Rate. Let’s say, first, that labour’s taxation – represented by the amount of taxes and social contributions generated by income from labour of employees, mostly withheld at source – represents one of the main sources of income in the European Union, providing, on average, over 50% of total incomes.
A second source of income is represented by consumptions taxes, which amount to 25 to 30% of incomes in most Member States. Taxes on income from capital are less important, providing approximately one-fifth of total fiscal revenues.

It’s not unimportant, in fact, really, is of great importance the fact is also evident from the statistics that, in Member States with a tax-GDP ratio relatively high, a tendency to collect relatively high amount of social contributions and taxes from labour occurs – and vice versa. The proportion of labour taxes and social contributions in total taxes is significantly below the average of the E.U-15 countries with low taxation, such as Ireland and Great Britain, and also Greece and Portugal. It’s noteworthy that recent research illustrates an insignificant decrease of labour taxation, in terms of the tax – GDP ratio (Office for Official Publications of the European Communities).

The implicit tax rate on labour recorded an increase in most Member States, since 1970; from around 1995 there were Member States that adopted measures to decrease the fiscal burden concerning labour incomes, in order to encourage the demand for labour and encourage provision of incentives. Currently, the general trend evidenced in most Member States concerning the increasing of labour taxation has stabilized and even declined slightly – implicit tax rate on labour, in E.U. 25, fell by 0.7 percentage points (in the GDP-weighted average) between 2000 and 2003, but, nowadays, is still relatively high. There are some Member States in which the development of implicit tax rate on labour was influenced by economic growth at the end of 1990 years and slowdown in the years that followed.

In most Member States the implicit tax rate on labour reflects the important role played by wage based contributions in financing the social security system. On average, approximately 65% of the implicit tax rate on labour comes from social contributions paid by employees and employers.

The new E.U. Member States do not register significant differences in the taxation of labour, compared with the old Member States. European Commission Reports on “The structure of taxation in the E.U.”, which are based on ESA79 national accounts system, denote a common tendency to increase the fiscal burden related to labour incomes in the 15 EU Member States, since the early 1970s; this overall growth was closely linked to the expanding public sector share in the economy, mainly due to expenditure on social security needs from children and elderly (especially for pensions, health care and other social benefits). Growth in the first half of the 1990s was associated with the increase in social contributions attached to the recession at the beginning of the decade. Moreover, the fiscal pressure increase was associated with budget deficits in the run-up to EMU.

It’s noted that Implicit Tax Rate is an effective tool for investigating the impact of fiscal pressure related to labour (in its quality of production factor), for SMEs (more revealing are the effects of labour taxation in the case of employees, but, and just because of this, on the SME in its quality as producer), at least due to the following facts:
1. SMEs pay, at least in Romania, but actually in Romania as in other EU countries, the income tax – in this case, for all incomes, generated by whatever source\(^6\);

2. Implicit Tax Rate allows a study on the dynamics of fiscal pressure levels over time – because of this, among others, we can identify the most taxed income source in a given period;

3. Total tax, levied on income from labour, as it is calculated by ITR, it is quantified as a weighted average of the taxable income derived from different sources (wages, copyrights, etc.);

4. The majority of EU Member States – including Romania – calculate the tax on labour incomes by multiplying, basically, every payment accounted for an income tax with the ratio of every selected income source to the global income of the taxpayer.

But, let’s outline the existing link between advantages – existing as such even for the management of a SME – generated by the use of ITR index and the advantages needed in order to increase the competitive features of such a company.

It is common knowledge that marginal tax rates affect not only labour-supply decisions, but also decisions related to the start in or to the expansion of a business activity. In our case, the small and medium enterprises are subject, in the European Union, and in Romania too, to what may be labelled as personal tax rates (in fact, taxes laid upon the revenues of the firm), and not to corporate tax rates. As a result, a decline in personal tax rates, as a general case, or, in our case, in the tax rates the small and medium enterprises are subject to have an effect on the risk/reward ratio for potential investors. Moreover, it is proved progressive marginal tax rates makes any entry into self-employment a difficult task (Lipsey & Chrystal, 1999). For this, ITR is more than a tool to rely on, for being able to announce the management whenever investment, or the expansion of activity, is a reliable alternative.

The management of any small or medium enterprise must pay attention not only to these matters, but also to another, id est to investment decisions (once the existence of a small or medium enterprise is real and stable): if tax rates affect the supply management, any modification of the tax rate will, inevitably, induce an oscillation in the trajectory of aggregate supply (Schiller, 2003). In this respect, the ITR is very important, because, whether the sector of small and medium enterprises in an important one, in a given economy, the expansion of production, started out due to the fact ITR, among, of course, other mathematical instruments, gives the signal to invest more, or to expand even further, will have positive and sensible results in the entire economy as a whole.

Firstly, as we have said, the ITR is able to give a signal to the management to produce more – or, to expand the production capacity; secondly, the small – or medium sized – firm will, therefore, use more resources, found in the real economy itself.

\(^6\) They trade inclusively on the unique quota system.
The small and medium enterprises are able, as any other company, to produce more/to expand the production capacity if they can hire more workers; these workers, once hired, will reduce the number of unemployed workers in the real economy, and, on the other side, the newly generated production will, *caeteris paribus*, lower the pressure of inflation. To put it shortly, if the economic sector of small and medium enterprises goes well, the real economy will prosper.

We must mention that ITR is a very powerful tool from another point of view too: due to its structural ‘power’ of underlying the *source* of incomes mostly – in a given period of time – *taxed*, this index will help the small and medium enterprises to compete with other companies in the sense it will tell the management whether the *form* of a given governmental act of diminishing some tax on another will truly help the company in its quest of – at least as an intermediary goal – winning the commercial battle with the other firms from the market.

This is because not every tax (rate) cut is as good, as helpful, to be precise, for the firm as another can prove to be; for example, a tax rebate is, at least is *more probably* effective for consumers, rather than for producers, and, certainly, has no effect whatsoever on the marginal tax rate – and will *not* encourage the small and medium enterprises to work/produce/expand more (Schiller, 2003).

As a possible conclusion, ITR is a very important mathematical – and, in this way, economic – index in order to help the management of small and medium enterprises in taking the *economic* and *fiscal* decisions necessary when these companies compete – that is, permanently – with the other firms in the real economy.

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This will undoubtedly strengthen only the demand side, and not the supply one.