

## BUDGETARY RISKS IN 2014 AND SOME ASPECTS OF SOCIAL AND ECONOMIC INEQUALITY

Iosif Moldovan, Assoc. Prof., PhD, "Lucian Blaga" University of Sibiu

*Abstract: The construction project of the Romanian State budget for 2014 was based on the forecast of macroeconomic indicators by taking into consideration some economic and institutional milestones in order to ensure macroeconomic equilibrium, to strengthen the fiscal-budgetary responsibility and financial discipline, in accordance with the requirements of strengthening sustainable public finances and developing sustainable economic growth, under the tax Treaty. In the budget documents, the social and economic inequality in Romania which tends to acutiseze, is not treated distinctly but traditionally only by fixing targets achieved for keeping under control the number of registered unemployed (It is expected that the unemployment rate will fall to 4.4% at the end of the year 2017 compared to 4.9% in 2013 ) and by allocating more significant amounts to social assistance, being disregarded when considering other possibilities such as those offered by progressive taxation of income.*

*Keywords social and economic inequality, macroeconomic equilibrium, tax politics, budgetary discipline, profit taxation.*

### 1. Budgetary framework approach

The State budget for 2014<sup>1</sup> is based on budgetary policy influenced by developments in economic indicators domestically and international and by the and improvement of fiscal policy at EU level, who are considering the requirements imposed by the tax Treaty.<sup>2</sup>

For the use of balanced public funds and to reduce pressure on the budget a number of commitments were delayed until 2015 : the granting of vouchers meal vouchers, gift and holiday for staff of institutions and public authorities, with the exception of institutions financed entirely from their own incomes.

There were also covered measures<sup>3</sup> which relate to the strengthening of budgetary discipline through empowerment of authorizing officers to reduce budget deficit and to reduce arrears registered on behalf of State-controlled enterprises.

Other measures concern improving budgetary planning prioritizing significant public investment projects<sup>4</sup>, actions started since the year 2012 as a requirement of the World Bank and the Global Fund International, as well as measures aimed at increasing the access of EU funds.

Also through the various measures taken in the field of taxation it's keeping track of creating the space needed to decrease taxation demanded by the business environment and sustaining economic growth versus economic development.

### 2. Risks relating to the development of economy in 2014

---

<sup>1</sup>The Romanian Government, MPF, the macroeconomic situation report on 2014 and its perspective for the years 2014-2017

<sup>2</sup>Tax treaty, which came into force on 1 January 2011, sets out the application of penalties in case of non-compliance with the criterion of public debt and budget deficit criteria

<sup>3</sup>O.U.G. nr. 88/2013adopting fiscal-budgetary measures for the fulfilment of commitments agreed with international bodies as well as for the modification and completion of some legal acts published in the Official Gazette, part I, no. 593, of 20 September 2013.

<sup>4</sup>The Ministry of public finance has been set up, with the delay, the unit of assessment of Public Investments, prioritizing, evaluating, and managing new public investment projects; and in the budget for 2014 have been 104 significant public investments which satisfy the conditions of the analysis under O.U.G. 88/2013

In 2014 on the evolution of the economy and public finances some risks persist, although, lately, in Romania the process of fiscal consolidation and structural reforms carried out in response to the financial agreements with international financial bodies have been improved.

Thus, the deficit in terms of ESA came down in 2012 and 2013 below the level of 3% of GDP, enforced by the excessive Deficit Procedure and Romania's public debt is below the ceiling of 60 percent of GDP stipulated in the Maastricht Treaty.

A touch of confidence comes from the record of an unforecasted economic growth in the year 2013 the GDP by 3.5% even if it was against the background of low consumption and investment.

The risks that will be subject to developments in the economy and the public finances in the year 2014, through the budgetary pressures in the short term or medium are internal and external difficulties:

**Internally**, domestically, the risks can be caused by:

- Not collecting the forecasted budgetary revenues;

Incomes at lower levels than projected already has precedent in the second part of the year 2013, caused by losses in the banking sector, the low collection of VAT in respect of imports but mainly by the slowness of the restructuring of tax administration<sup>5</sup>.(1). Because of not collecting the estimated revenues they had to take measures to reduce spending on public investment and the change by growing 0.2 percent of GDP budget deficit.

The causes listed above may take effect during the budget year 2014, with the banking sector not going back on credit policy, with all the measures undertaken by National Bank and by not finishing the restructuring process of the tax administration.

In this respect the Government's commitment is appreciated that countering these risks, that the 10% reserve of the budget will not be taken into account only at the second correction of the budget in 2014.<sup>6</sup>

- Budgetary pressures generated by the political background of "motivation" of the 2014 elections to the European Parliament and of the President of Romania

- The results to be obtained from agriculture, after a very good 2013 crop year, the sector remains dependent on climate conditions, the low level of technical equipment and the defective management practice.

- The credit policy of the bank sector, even if the monetary policy rate has been reduced, is excessive-prudential and for the achievement of growth in 2014 it calls for a significant expansion of crediting economic agents and population showing caution in hiring and dismissing of loans for consumption or development.

- Not managing tax risks, in the context of reforming process of the public finance management influenced negative by the political restructures, with negative consequences in increasing budgetary revenue collection and in combating tax evasion, frequent changes of tax laws, the lack of transparency in the elaboration of normative acts in the field of taxation, and so on

- Not accessing EU funds at the level of allocation and the risk of automatic disengagement, as a result of not correcting irregularities in the system that led to the financial correction in 2012 generated mainly by matters relating to public acquisitions.

Even if the evaluation of the risk of automatic disengagement (the  $n+2/n+3$  rule), for the programming period 2007-2013<sup>7</sup>, through the application of the  $n + 3$  rule of disengagement of commitments for the years 2011 and 2012 for România and Slovacia, It

<sup>5</sup> See "România: Memorandum de politici economice și financiare, nov. 2013, pct.3, 4"

<sup>6</sup>Same as 7

<sup>7</sup>in accordance with the provisions of art. 93-94 of Regulation (EC) 1083/2006, as amended and supplemented, and in relation to the provisions of the draft amending Regulation (EC) 1083/2006.

follows that, assuming that these forecasts will be fulfilled, at the end of 2013, there will be significant amounts disengaged (after the rule  $n + 2/n + 3$  of 2.670.2 mil. Euro, and after  $n + 3$  Rule 137, 44mil)

- The evolution of state guarantees for loans granted to companies and payments that will be made by the MPF as a guarantor on behalf of guarantees issued for government programs (estimates for payments to be made from the State budget in the securities account are under 0.1% of GDP in the period 2014-2017)<sup>8</sup>.

- The evolution of government debt, that remains high but acceptable as share in GDP being made so that it will be 40.4% in 2014 and will fall in the year 2017 at 39.2%, compared to the debt level estimated for the end of 2013, at 39.5 percent.

- Risks arising from the reduction of taxpayers that are active on the labor market because of aging population and the migration of young labor force, compared with the percentage of those who benefit from pension rights and other social aid.

- The commitment of reducing labor taxation, under the terms of the the total tax burden calculated as share in the labor cost of the tax on the salary and social contributions is the highest in EU.<sup>9</sup>

- The risk of maintaining the low rate of growth in the construction industry and in 2014, which went down in 2013 by 1.6 percent and contribute only 7.9% in GDP, compared with 2008 when record 11% of GDP and generating a growth of 7.3%<sup>10</sup>

- The large number of companies in insolvency, in the period 2009-2013, there were about 120,000, of which about 100,000<sup>11</sup> have entered bankruptcy even if at the beginning of 2014 the number has decreased by 6% and it shows signs of the revival of economic activities.

**Externally**, the risk analysis shall take into account the fact that European<sup>12</sup> economy forecasts are based on the assumption of implementing rigorous budgetary policy measures, agreed by the EU and the Member States, in order to improve the trust climate and financial conditions and can be generated by:

- The non confirmation of the European Commissions<sup>13</sup> forecasts, the EU's economic comeback that began in the second quarter of 2013 will go on into 2014, in conditions of reduced demand in the EU, the main commercial partner of Romania, will affect the growth of gross domestic product.

- The fragility of the financial markets and the reactivation of some negative perceptions in regarding the application of rigorous economic policies as a result of a continuation of the slow pace of reforms in 2014, that explains, in part, due to the fact that some Member States have already achieved medium-term objectives in terms of structural budget balances<sup>14</sup>

- Geopolitical tensions that could lead to an increase in higher energy prices.

<sup>8</sup>The Romanian Government, MPF, the macroeconomic situation report on 2014 and its perspective for the years 2014-2017

<sup>9</sup>This was in the year 2012 by 44.5%, 0.3 percentage points less than that in 2011 and 3.5 percentage points below the level of 2001. Employers' social contributions, in 2012, accounted for 21.9 percent, 0.5 percentage points below the level in 2011 and 8.9 percentage points below the ratio recorded in 2001. The Romanian Government, MPF, the macroeconomic situation report on 2014 and its perspective for the years 2014-2017

<sup>10</sup><http://www.zf.ro/zf-27.03.2014>

<sup>11</sup>The printed edition of Ziarul financiar 27.03.2014

<sup>12</sup>European Economic Forecast, Autumn 2013.

<sup>13</sup>In perspective, economic growth will accelerate gradually over the forecasted period, reaching 1.4% in the EU and the euro area by 1.1 percent and 1.9 percent, respectively, reaching 1.7% in 2015. See The Romanian Government, MPF, the macroeconomic situation report on 2014 and its perspective for the years 2014-2017

<sup>14</sup>European Commission press release, 5 May. 2013

- The risks arising from the integrity of the euro seen as being linked to the sovereign debt crisis, which currently have decreased
- The evolution of the business environment and consumer confidence even if the implementation of the single financial supervisory mechanism is considered a major breakthrough for carrying out banking Union
- Uncertainties arising from fiscal policies and the development of the U.S.
- The effects of economic expansion policy of Russia and developed Asian States

### 3. Economic and Social Inequality

The effects of the international financial and economic crisis followed by recession has focused concerned States and funding agencies on the need to resume economic growth, even if it is necessary but not sufficient for economic development, thus neglecting aspects relating to economic and social inequality across states.

The aspects mentioned, retain the attention of a study by the International Monetary Fund experts<sup>15</sup> showing that inequality affects economic growth and taxation of wealthy individuals in order to help the poor is good for economy.

Thus, the IMF experts, recognized as a favorite institution to enforce economic austerity measures, warns that countries with a high degree of inequality growth rates are lower than the States where incomes are more evenly distributed . In addition, they argue that inequality volatilizes economic growth and can even create conditions for it's slump. The study authors argue that: „It would be a mistake to focus solely on economic growth and believe that inequalities will resolve on its own ”.

The study's conclusion, controversial but correct, in our opinion is that income redistribution, primarily through taxation, does not have a significant impact on economic growth provided that the intervention should not be excessive and the redistribution of income through taxation has a positive impact on the reduction of inequality and the overall effect on the economy is boosting economic growth.

Even though this study seemingly contradicts the recommendations made by the IMF in crisis States<sup>16</sup> to focus on reducing taxation and Government spending, and less on social inequalities, it's worth accepting the new approach, motivated by the fact that economic and social inequalities are more obvious than in most countries of the world and implicit in Romania and requires problem solving measures.

Other addressing inequality event is the World Economic Forum in Davos<sup>17</sup> held on 22-25 January 2014, where among the topics discussed social inclusion was found.

The subject is topical , given that the international crisis has had a particularly brutal impact on young people, and it appears necessary to improve health systems as a way of promoting economic growth and a more equitable distribution of income in society, specifying that a small group of people take advantage of the growth of most states ' economies.

The merit Board identifies in the final report<sup>18</sup> among global risks the uneven distribution of income as one of the greatest dangers to the global economy. Also the Report notes that increasing wage differences and social anxieties are among the most important threats in 2014,. Social inequality was accentuated since the 1980s, Currently, the wealthiest

<sup>15</sup>prepared by Jonathan Ostry, head of the Research Department at the IMF, and others, published on,2014 26.02, www.capital.ro, accessed 27 February 2014.

<sup>16</sup>18 months ago, the IMF has released another controversial study according to which the reduction of expenditure in the public sector has a more negative effect than was believed until now.

<sup>17</sup><http://www.zf.ro>, accessed 21.01.2014.

<sup>18</sup>Global Risks 2014 Ninth Edition - World Economic Forum , [www3.weforum.org](http://www3.weforum.org).

85 people in the world have a fortune greater than the poorest 3.5 billion, representing half of the world's population.

In the same sense opinions and messages converge<sup>19</sup> in the sense that they argue that the capitalist economic model cannot survive if the income and wealth are concentrated in too few at the expense of the many.

Another document for reflection on inequality is the analysis made by the International Confederation Oxfam<sup>20</sup> which aims to eradicate poverty and global inequality and asked the participants at the World Economic Forum to commit that they will solve the problem of inequality, that they shall refrain from non-payment of taxes and that they will use their wealth to seek favors from politicians.

#### Economic and social inequality in Romania

In Romania, the level of poverty and social exclusion affect in 2012 was about 42% of the population growing from 2011 when this indicator was 40.3%. Thus, Romania was exceeded only by Bulgaria, with 49% and well above the EU average, which is situated at about 25% .<sup>21</sup>

The factors of poverty in Romania are: the population of rural areas, regional disparities , the small towns that are experiencing depopulation and demographic ageing, mono-cities and towns with agricultural industries or those who do not comply with the newly established urban minimal indicators.

Romania has the largest share of the EU population in rural areas (45% of total population) and after the INS data for 2010, the risk of extreme poverty is 4 times higher in rural areas (8.8%), compared to urban areas (2.2%). In terms of regional disparities studies show that regions with the highest rate in the population at risk of poverty and social exclusion are parts of: Northeast-southwest Oltenia, South Muntenia .

Urban areas affected by poverty include small towns which focuses poverty due to poor physical infrastructure (transport, health, education) and who have been affected by industrial restructuring. These cities are vulnerable through the low level of employment and small and unstable incomes.

Differences in wealth, opportunity, education, skills and health care it's characteristic in many areas and it intensified in the last decade. These issues are captured in the second version of the partnership agreement proposed by Romania for the programming period 2014-2020, which notes that these differences are profound with pronounced variations between regions and between urban and rural areas<sup>22</sup>.

Compared with the affairs described above The European Commission has asked Romanian authorities that in the period 2014-2020 to allocate funds and to define clear objectives for poverty combat with the target to the people affected by poverty and toward those affected by social exclusion.

#### **4. The consequences of social and economic inequality**

In the modern states inequality takes three forms: economic, social and political. Economic inequality is determined by the size of property owned and the income of the various categories of individuals, the social one is reflected in social status, and that political is reflected in the way in which rules are complied within a democracy, in what means the

<sup>19</sup>Christine Lagarde, the Director general of the IMF: in an interview with the Financial Times warned that "Business and political leaders at the World Economic Forum should remember that in too many countries the benefits of growth benefit too few people. This is not a recipe for stability and sustainability <http://www.zf.ro>, accessed in 21.01.2014.

<sup>20</sup>an International Confederation of 17 organizations in the network from 94 countries, which belong to a global movement for the construction of a future free from injustice and poverty.

<sup>21</sup>Capital.ro , accessed in 10 Jan 2014.

<sup>22</sup>Partnership agreement proposed by Romania for the programming period 2014-2020, second version <http://www.fonduri-ue.ro/>

accuracy of public decisions, or the degree of influence of their undemocratic means in the electoral process.

Of the three forms of economic inequality, economic inequality influences the other two, and according to some authors it divides the society by class, owners class, for whom propriety is essential and manufactures class for whom income is essential.<sup>23</sup>

The consequences of social and economic inequality in less developed states leads to:

- Migration of population, especially the young to developed states, motivated by the large wage differences with negative effect in decreasing active population as a consequence of increased freedom of movement on the labor market after joining the States of Central and Eastern Europe, least-developed countries, in the European Union.

- Inequitable social mobility generated by the fact that those who come from a favored environment have much higher chances to be thoroughly trained and promoted on the labor market helping to increase social inequality
- Incitement to tax evasion for income from employment, after estimates of the Tax Council , shows that in 2013 in Romania there are about 1.45 million undocumented persons working. The effect of this evasion amounts to more than 4.1 billion Euros per year uncollected to the budget on account of income tax and social contributions for income from undeclared work.<sup>24</sup> Vulnerable areas are: guard services, construction, agriculture, bakery or forestry

The large number of clandestine workers is proved by the fact that at a population of about 20 million, as has Romania, there are recorded only about 5 million employees, which is exceeded by the number of retirees. The methods by which employers avoid the payment of taxes on state wages are : transformation of full-time contracts in part-time, the use of civil contracts or conventions of PFA and so on.

The loss of law recognized rights for employees as: length of service for the determination of pension rights , the right to receive unemployment benefits and the quality of being assured in the health records system.

## 5. The possibilities of reducing economic and social inequality

One possibility for reducing social and economic inequality can be reconfigured of taxation, as in the rise of wealth and profit taxation.

This is obvious that the total tax rate on profits of companies from Romania is 42.9% , according to the study findings BM/PwC<sup>25</sup> superior to the 41.1% from EU and it's composed from:

- taxes and contributions on labor, representing 31.5 percentage points of the total.
- taxation of profit, which represents only 10.3 percentage points of tax burden

By comparison, the tax burden in Germany , is distributed differently taking into account that labor-related taxes and contributions generate 21.8 points of the total rate of 49.4% toll, and the profit tax is 23 percentage points.

Studies and economic analyses point out the fact that the overcharge labor is the main reason that employers avoid paying budgetary obligations and incite to tax evasion.

Public policy scenarios in order to reduce social and economic inequality have a high degree of complexity given the diversity of the areas in which the State can prove its effectiveness.

<sup>23</sup>Max Weber's Economy and Society is the greatest sociological treatise ... New Ed edition (December 19, 1978), ISBN-10: 0520035003 [www.amazon.com/Economy](http://www.amazon.com/Economy)

<sup>24</sup><http://www.Zf.ro> accessed in 17.01.2014

<sup>25</sup>Paying Taxes 2014, The global picture A comparison of tax ... PwC [www.pwc.com/gx/en/paying-taxes/assets/pwc-paying-taxes-2014.pdf](http://www.pwc.com/gx/en/paying-taxes/assets/pwc-paying-taxes-2014.pdf) . Contacts. PwC. John Preston. Global Head of External Relations., Regulation and Policy for Tax, accessed in 26.02,2013 <http://www.zf.ro/eveniment/> accessed 27.11.2013

Between them immediate results can give the fiscal- social measures aimed at redistributing income in Romania and requiring you to bear in mind the following:

- a system of progressive taxation of income
- higher taxes on wealth
- minimum wage increase
- additional allowances for children from poor families
- paternal allowance varied according to income
- increasing unemployment help

## Conclusions

Growth indicators need to be analyzed together with those of economic development , under the conditions in which they are more complex , and acute issues relating to gender inequality appear highlighted with more poignancy in times of crisis, but risks persist when economic development is not addressed.

In Romania, the aspects of social and economic inequality are acute and have structural causes that make poverty difficult to combat for social categories affected and diversification of employment and education can lead to poverty reduction through well-grounded public policies.

There are opportunities for reducing inequality of a fiscal nature that can be taken to ease the congestion and the benefits arise both for those on low incomes, but also for those with high incomes .

With regard to taxation, fiscal-budgetary policies for 2014 need to be aimed at keeping under control the budgetary risks mentioned in the paper and to bear in mind:

- the subordination of taxation to basic objective of economic development;
- a qualitatively enhanced fiscal-budgetary vision to stimulate the economic, investment and entrepreneurial initiative;
- efficient spending of public financial resources in order to finance significant public investments
- progressive income taxation;
- correct taxation of property, towards the EU average;
- reducing the taxation of income from work through appropriate capital taxation.

## Bibliography:

- Boulder Fusco, A., Guio, Anne-Catherine, Marlier, E. (2010). *Characterizing the income poor and the materially deprived in European countries*, in Atkinson, Anthony B., Marlier, E.,
- Davis, K., Moore, W.E. (2001). *Some Principles of Stratification*, in Grusky, David B., *Social Stratification: Class, Race, and Gender in Sociological Perspective*, Westview Press,
- Eurostat, „Combating Poverty and Social Exclusion. A Statistical Portrait of the European Union 2010”, European Commission, Luxemburg.
- Guvernul României, MFP, Rport privind situația macroeconomică pe anul 2014 și perspectiva acesteia pe anii 2014-2017;
- Paying Taxes 2014, The global picture A comparison of tax ... PwC [www.pwc.com/gx/en/paying-taxes/assets/pwc-paying-taxes-2014.pdf](http://www.pwc.com/gx/en/paying-taxes/assets/pwc-paying-taxes-2014.pdf) . Contacts. PwC. John Preston. Global Head of External Relations,. Regulation and Policy for Tax, accessed in 26.02,2013 <http://www.zf.ro/eveniment/> accessed in 27.11.2013
-