

# BUDGET FOR ROMANIA IN 2010 CONSTRAINTS AND CHALLENGES

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## **Abstract**

*Generally speaking, the budget of any state represents the way how that state develops, expressed by the capability to spend for consumption and investments – smaller and higher amounts of money – depending on the income level that the state may circulate, based on the taxes and duties applied onto economy.*

*What happens with Romania in the middle of 2010, when it is facing one of the most menacing situation in terms of the possibility of covering the current budget expenses from the taxes and duties – not to mention the investments? The paper herein will be dealing with this issue and more:*

- *the reasons of this unparallel situation, compared to the other EU countries;*
- *the objectives and prerequisites of the budget building;*
- *the main categories of income and expenses stipulated in the budget;*
- *the critical analysis of the measures set for recovery and proposal for alternative measures, in order to avoid the ‘grecizing’ the country.*

**Key-words:** *state budget, income and budget expenses, budget deficit, taxes and duties, austerity measures, economic and financial crisis*

**JEL Classification:** G18, G30, G32, G38

## **I. The internal and international economic climate**

The internal and international macro-economic environment for building the budget for Romania for 2010 is the most unfavourable one:

### *Externally*

The European Union has gone through (and still is – see Greece, for instance) the most profound, longest and extended economic crisis in its history. As a matter of fact, all its savings have been affected by this crisis; for 2009, the GDP has contracted to circa 2% in France, 4.5-5% in Germany, Italy and Great Britain. For the entire EU economy, this GDP contraction is around 4.1-4.2%.

In the USA, where the current economic and financial crisis started in 2007, the GDP contraction was of circa 2.5% in 2009; for Japan, the GDP reduction was around 5.9%.

For the European Union, a special award should be granted to Poland, whose GDP in 2009 was higher than the 2008 (even the growth rate has slowed down). In Asia, China is a good example to follow, as its GDP has constantly grown, by a 8.7% rate.

The GDP evolution for the last three years, in the world economy and economic areas, is as follows:

	-annual percentage change-		
	2007	2008	2009
• TOTAL GLOBAL ECONOMY	5.1	3.1	-1.2
• EU 27, out of which:	2.9	0.8	-4.1
– the EURO zone	2.8	0.6	-4.0
• GERMANY	2.5	1.3	-5.0
• ITALY	1.6	-1.0	-4.7
• France	2.3	0.4	-2.2
• USA	2.1	0.4	-2.5
• JAPAN	2.3	0.7	-5.9

*Source:* The fall forecast of the European Committee

### **Internally**

For the year of 2009, the GDP contraction in Romania was almost double (7-8%) compared to the EU (4.1%), as a result of a combination between an not favourable external environment and a more rapid reduction of the internal demand.

Even if the budget initially approved for 2009 had a budget deficit of circa 2% of GDP, due to the economic contraction brought about by the world crisis effects and to the lack of real and effective anti-crisis measures, this budget was successively resized by two rectifications during 2009, i.e. to 4.6% and 7.3% out of GDP, respectively. This thing happened in the event when Romania had contracted a record loan from IMF, European Commission and the World Bank, in the amount of 19.95 billion euros.

For the last three years, the main budget indicators are as follows:

	-% out of GDP-		
	2007	2008	2009
• Income	7	8	30.7
• Expenses	5	8	38.0
• Budget deficit	6	8	7.3

*Sources:* MFP Macroeconomic evolutions and trends

Until the end of 2009, Romania has been included into the accepted level of the budget deficit set up by the Maastricht Treaty, i.e. of 3% of GDP the most. The years that followed witnessed a strong decline – at the end of 2009, the deficit level was more than the double approved in the Treaty above.

As far as the real economy, it has registered significant drops, reflected in the size of gross added value for each branch (constructions – 18.9%, services – 5.6%, industry – 4.3%, agriculture – 2%, etc.).

*The evolution of the gross domestic product* for the last three years, in its components, shows as below:

	- % compared to previous year -		
	2007	2008	2009
• The domestic demand, out of which	14.7	7.9	-13.0
– the final individual consumption of population	9.8	8.4	-10.7
– the final collective consumption of the public administration	7.6	3.7	-3.0
– the gross building of the fixed capital	29.0	19.3	-20.0
• Export of goods and services	7.9	19.4	-10.5
• Import of goods and services	27.2	17.5	24.8
• The gross domestic product	6.2	7.1	-7.0

*Source:* MFP Macroeconomic evolutions and trends

Should we only refer to the reduction of the final consumption for 2009 versus 2008, it is worthwhile mentioning that this has been associated mainly with the population (-10.7%) and less with the public administration (-3.0%).

## II. The prerequisites of the budget building

The 2010 budget for Romania has started from the below *premises*:

As far as the *economic growth* is concerned, the following possibility has been visioned: for the first two trimesters in 2010, the real GDP growth be negative but for the entire year, the negative sector will be left behind and switched to a GDP increase, in real terms of 1,3%.

Thus, reality proved to be harsher – the economic contraction for the first semester will be worse; therefore, the IMF mission in May this year gave a negative forecast for the Romanian economy and admitted that the +1,3% forecast was 'too optimistic', and a zero 2010 growth in Romania would be a happy outcome.

Romania has delayed the adjusting of the macroeconomic policies to the new environment created by the international economic and financial crisis, and as a consequence, the macroeconomic imbalance has continued or become worse at mid 2010.

➤ *The annual inflation* has registered a sinuous and contradicting evolution during the last three years, which manifested as sudden changes of the trend, as such:

	2007				2008				- % / year - 2009*			
	Trim. I	Trim. II	Trim. III	Trim. IV	Trim. I	Trim. II	Trim. III	Trim. IV	Trim. I	Trim. II	Trim. III	Trim. IV
Real inflation	3.66	3.80	6.03	6.57	8.63	8.61	7.70	6.60	5.65	4.83	4.14	4.21
Inflation target		4.00				3.80				3.50		

*Source:* The National Institute of Statistics and RNB. The annual average inflation for the 2009 was of circa 5.6 %.

The inflationist pressure at this time has been very well mirrored in the non-alimentary products (excise increase for the tobacco-based products), the increase of services fees, as well as the unfavourable evolution of the exchange rate for the national currency compared to foreign currencies (the depreciation of the national currency versus EUR and USD).

The inflation could have been worse if the increase in prices had not been slowed down by the price evolution of the alimentary products, which was 4 % below the total annual rate of the prices.

A notice should be made about the RNB policy to reduce inflation – it had no results for the period of time under discussion – as all the targets have been missed: in 2007, the target was 4%, the effective inflation was 6.57%; in 2008, the target was 3.8%, the effective inflation – 6.60%; in 2009, target 3,50%, the effective inflation 5.6%. At the end of the first trimester in 2010, the registered inflation was 4.20%, while the annual RNB target forecast for 2010 was 3.5%.

➤ The maintenance of the *flat income tax* for the income of the legal and natural persons at 16 % is another alternative taken into account while setting the budget for 2010. From this point of view, one can notice the non-uniform policy of the European states.

Below is a list of the UE states that operate a flat income tax for the income of legal and natural persons:

	- % -	
	Natural persons	Legal persons
Bulgaria	10	10
Czech Republic	15	20
Estonia	21	21
Slovakia	19	19
Romania	16	16

For other countries, the income tax follows a system of progressive taxing, as it follows;

	Natural persons	Legal persons
Germany	15-45	30-33
England	10-40	30
France	0-40	33.3

From the direct income taxing, Romania places on the 25<sup>th</sup> as far as the taxing on natural persons income is concerned and on the 23<sup>rd</sup> for the legal ones.

After the first trimester of 2010, specialists in economy are talking about going up to 20% for the legal persons and progressive taxing for the natural ones.

Another prerequisite considered for the 2010 budget was *the maintenance of the VAT at 19%*, which would bring income to the state budget an amount representing 6.6% of GDP.

As for as the VAT is concerned, the European practices vary a lot, but they still converge to using two levels of VAT, standard and lower ones, operational for a range of goods of a social importance. Thus,

	Standard	Lower
Netherlands	19	6
Greece	19	4.5-9
Czech Republic	19	9
Slovakia	19	10
Hungary	25	5
Bulgaria	20	7

Source: MEP The fiscal policy

The major challenges that the Romanian economy is facing in the middle of 2010, due to the delay in the economic recovery and also to the difficulty in collecting the income already estimated by the adopted budget, are bringing pressure on the Government for increasing the VAT to circa 24%.

*The implementation of this measure, as well as the accrual of the income tax for the natural and legal persons during the crisis might have dramatic effects, on both the economic and social areas.*

➤ *Employment (unemployment).* The unemployment rate registered at the end of 2009 was of circa 8% of the active population, almost double than the level for the previous year (circa 4.4%), when the number of unemployed people officially registered exceeding 700,000.

Should we add to this number another 200,000 in technological unemployment or with their unemployment benefits cut off (and still out of job),

the real unemployment rate rises up to 10% of the active population, and their number is circa 1 mil. And this number is not final, taking into consideration that a large group of Romanians have decided to leave the country and find employment abroad (mainly Italy and Spain).

➤ *The minimum wage* has increased by 2.13 times during the last electoral cycle, from 718 lei in 2004, to 1742 lei in 2008 and cca. 1845 in 2009.

The increase of the minimum wage, largely in the budgetary sector, seems to be unstoppable, unless radical measures are being taken (see the sacrifice curves) – similar to the ones recently made public, due to the pressure from the international financial organisms, which forecast a decrease by circa 25% of the wage income in the central and local administration, starting with June 1, 2010.

### III. The income and budget expenses for 2010

In accordance with the Act concerning the state budget for 2010, its main components have been set up:

- Income: 66.654,3 mil. lei
- Expenses: 101.678,4 mil. lei
- Budget deficit: 35.024,1 mil. lei

The deficit in the state budget represents 5.9% of GDP, when all the state-financed investments amount up to 4% of GDP, i.e. the budget is not balanced on either the income or current expenses.

As a matter of fact, almost 2/3 of the budget represents staff-related expenses (27.6% of the total of budget expenses) and pensions (35%); thus, there are not enough resources for maintenance and operation and zero resources for investments (the ones mentioned will be exclusively covered from the deficit).

Conforming to the Act above, Romania has assumed the following *objectives and challenges*:

➤ *the reduction of the budget deficit* during a time when the global economy is in recession (from 7.3% of GDP in 2009, to 5.9% of GDP in 2010);

➤ *the promotion of structural reforms*, at a time when the social problems are higher due to the national and international economic environment.

For the first half of 2010, these objectives were not implemented for real, the structural reforms were late to show up, the budget instrument was not restricted and, thus, generated huge expenses; the lack of economic recovery, correlated with difficulties in collecting the forecast income led to the impossibility to bear such expenses, and therefore jeopardized the inclusion into the approved budget (6.8% versus 5.9%) and threatened to push the country into an economic and social regression like the one in Greece.

Under such circumstances, Romania only had two alternatives:

a) *the fiscality rise* by increasing:

- Flat tax, from 16 % to 20%;
- VAT, from 19 % to 24%.

b) the adoption of several *radical measures*, meant to drastically reduce the expenses, such as:

- the lowering of wages for the people employed in the central and local administration, starting with June 1 r.y, by 25%;
- the lowering of pensions by 15%, as of the same date;
- the cutback in the unemployment benefits, by 15%;
- the extreme decrement of the subventions;
- the fusion of all those 16 social assistance programmes into a single one, coherent and efficient.

The main items of income and expenses of the state budget, approved for 2010, are as below:

BUDGET	2008	2009	-mil. lei- 2010	% 2010/2009
<b>I. TOTAL INCOME</b> , out of which:	<b>61,150,392</b>	<b>56,401,227</b>	<b>66,654,311</b>	<b>18,18</b>
• tax on profit	13,039,901	11,325,500	11,561,500	+2,08
– economic agents	12,338,636	10,657,500	10,289,000	-3,62
– banks	701,265	650,000	1,272,500	95,77
• tax on the micro-companies income	369,633	406,200	444,000	9,31
• tax on pensions	351,161	507,700	1,200,000	136,36
• tax on rents	356,336	315,300	356,336	13,01
• tax on gambling	82,226	89,100	82,226	-7,71
• wage taxes	15,581	34,033	10,000	-70,62
• VAT	40,873,555	35,405,000	35,548,800	0,41
• excises	12,382,507	13,319,200	16,886,300	26,78
• tax on foreign commerce and international transactions	962,334	540,000	710,500	31,57
• tax on dividends	882,345	350,000	1,200,000	242,86
• contributions from insurance paid be:	454,222	463,000	471,400	1,31
– employers	291,912	270,000	271,400	0,52
– insured	162,310	193,000	200,000	3,63
<b>II. TOTAL EXPENSES</b> , out of which:	<b>80,741,254</b>	<b>92,737,132</b>	<b>101,678,400</b>	<b>9,62</b>
• personel expenses	15,791,230	15,309,554	16,899,800	10,39
• capital expenses	5,641,265	3,307,711	2,948,966	-10,68
• interests	2,087,686	5,096,075	7,758,202	52,24
• extracting industry, of processing and constructions	455,409	381,811	391,928	2,65
• agriculture and forestry	6,305,360	6,722,041	5,879,271	-12,54
• transports	7,823,742	9,997,415	9,720,240	-2,77
• communications	18,562	143,362	267,883	86,86
• funds for awards	714,370	498,483	521,416	4,60
• leave benefits	540,226	228,515	303,150	32,66
• research	1,963,259	1,392,782	1,396,104	0,24
• education	7,367,864	5,417,792	4,931,502	-8,89
• insurance and social protection	18,500,305	20,604,700	21,366,632	3,70

Source: The Act of state budget for 2010

To avoid a new convulsion of the economic and financial crisis and to prevent the economic downturn, more **clear-cut measures of production increase** come along the old ones:

- Distributing money for investments, even during the present austerity conditions, for full employment and multiplication in economy;
- The acceleration of the process for accessing the European funds – a special opportunity for Romania, which is about to be (partially) missed;
- The support of the agriculture development projects (mainly ecological), tourism and small and medium enterprises;
- The protection of the economic interests of population and assurance of social security – especially for people with low and very low income;
- The priority payment of the state administration debts to the economic agents (due invoices, received but not paid works, etc.);
- The extension of the due date for payments coming from the economic agents that have been affected by the economic and financial crisis;
- The balancing of VAT to be paid with the income;

As for the stimulation of the SMEs sector development, few things have been done. The European Commission acknowledges the fundamental role of the SMEs for the states economy, as they represent the largest echelon, with an essential part to play to come out of the crisis and help the economy recover. This is the reason why a great attention needs to be paid to. In our country, the **SMEs generate most of the GDP (circa 70%)** and also employment places.

Within the recovery measures for the Romanian economy, the authorities need to consider the active stimulation of export. For this stage, the economic recovery may only be successful if based on the economic engine of exports.

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