

PUBLIC PENSIONS POLICIES IN THE CONTEXT OF BUDGETARY DEFICITS

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Abstract

Fiscal policy, social security expenditures and budgetary deficits represent the framework for future public policies for all the governments within the European Union. Also demographic changes determine governments to find the right solutions in order to provide the sustainability of social public expenditures. We consider that the main aims of future policies should be creating better job opportunities and working conditions for the growing number of older people in Europe. It is very important to help older people play an active role in society. The literature usually focuses on elements which underline the effects of macroeconomic parameters on the size of public pension expenditure. However, demographic effects are also important elements which affect the sustainability of social security expenditures. The European governments seem to be extremely preoccupied by the sustainability of the pension and social insurance systems, especially in the context of the economic crisis and in the context of the aging process, and try to determine the best solutions both for the public pension systems and the privately managed pension systems. Within this paper we highlight the main challenges of future fiscal policies and explain the position of Romania by considering fiscal revenues, public expenditures and the fiscal constraints Romania is facing..

Key-words: *demography, pensions, public expenditures, sustainability, governments*

JEL classification: *H00, H55*

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1. Introduction

The reform of the pension system can be politically, ideologically, economically and socially influenced, but this thing can not be realized in a short period of time, because it assumes the adoption of long-time horizon measures and the assesment of their effects. Nowadays, there is encouraged the organization and application of a multi-pillar pension system which guarantees sufficient public funds, as well as private pension funds. It is remarkable the fact that Romania has not registered in the last years major deficits of the public pension system, but it looks like on the long term the deficits are harder and harder to be managed and to be financed. A fair valuation, but simple in the same time of the sustainability of the public pension system in the current financial and economic Romanian context can be made through the analysis of the pension expenditures and of the incomes obtained from the employee's and employer's contribution. For the future, if the value of ratio between incomes and expenditures is a positive one, we can consider that, on the medium and long term, the sustainability is ensured; if the value of the ratio is forecasted to be a negative one, therefore we have a deficit of the incomes and an increase in the level of expenditures, it is necessary to be found solutions of financing the system..

The main factors that influence the sustainability of the pension systems are the following ones:

- The demographic component that includes the number of contributors and beneficiaries, but also the prognoses related to their evolution in time;
- Average salary;
- Rate of contribution to the pension funds;
- Economic growth in absolute values.

The European states prove to be extremely preoccupied by the sustainability of the pension and social insurance systems, especially in the context of the economic crisis and in the context of the generalized aging, and proceed at strengthening the public pension systems with privately managed pension systems. The experts state that public pension systems (1st Pillar) from all the European countries can not resist anylonger to demographic pressures after 2030, being necessary the introduction as quick as possible of private pensions.

In the majority of the European countries the pension system has been reformed in order for the population to have incomes with a larger coverage and with an adequate level of pensions. As far as concerns the number of persons ensured through different pension systems, there are many differences between the member states and between the type of pension systems chosen by the population (mandatory pensions, optional or occupational pensions). As an example, the share of population ensured by the mandatory pensions reaches approximately 25 % in Italy (where labour black market reaches worrying levels) and 100 % in Sweden, with an average value situated between 50 % and 70 %, at the level of the other member states of European Union. In the same time, the optional pensions have a relatively limited importance, representing an option just for a small part of the employed population, although in a few states their level is significant (45 % in Czech Republic and a little lower in Germany, Great Britain, Ireland).

Although Romania has registered a transition to the private pension system, public pension system remains the basis for ensuring the incomes of the current pensioners. In the present, the Romanian public pension system requires annual subventions from the state budget for ensuring a level of the current pensions, sufficient to ensure a decent lifestyle for the pensioners.

Like Panzaru [5] points out, “the socio-demographic and economic processes that characterize the period of the last two decades in Romania [...] and that will exacerbate in the future are transforming the issue of social protection for the elderly and particularly the problem of more effective administration of pension systems in one of the largest social vulnerabilities”.

Public finance sustainability holds a privileged role in the assurance of a good functioning of the Economic and Monetary Union (EMU). The Stability and Growth Pact (SGP) establishes the regulatory framework for the coordination of national fiscal policies within the EMU. Therefore, ensuring the financial discipline represents a mandatory condition for reaching a medium term price stability and sustainable economic growth.

In the context of giving up at the exchange rate as a monetary policy instrument, the importance of fiscal policy is a growing and fundamental one, through the automatic stabilizers and discretionary fiscal policy, in the sense of alleviating economic volatility generated by the asymmetrical shocks that can affect the EMU countries.

2. Analysis of challenges regarding future fiscal policies

The Stability and Growth Pact establishes as medium term objective for the budgetary positions from the Euro zone countries, to be as close as possible to the equilibrium point or even in surplus, situation that allows them to manage normal cyclical fluctuations without overpassing the critical value of 3 % in GDP for the effective budget deficit. As well, reaching the medium term objective should ensure the rapid evolution towards a sustainable situation, generating in the same time enough fiscal space for some discretionary fiscal policy measures, like for example, increasing infrastructure investments.

In order to consolidate the surveillance of budgetary positions and to strengthen the economic policies, 25 countries member of the European Union have signed in March 2012 the Treaty regarding stability, coordination and governance within EMU. The most important part, the Fiscal Treaty, aims at the consolidation of the fiscal discipline at the European level through the introduction of some automatic penalties that are applied, and a more rigorous surveillance of member states. In a nutshell, the new treaty includes the requirement that national budgets are balanced, or even with a surplus, requirement that is fulfilled if the annual structural deficit does not overpass 0,5 % from GDP. The member states have the obligation of introducing this „norm regarding the balanced budget” in their national legislation systems, preferable on a constitutional level, the deadline for fulfillment of this requirement being of maximum one year from the year of introduction of the Treaty. If a member state has its public debt a lot under 60 % of GDP and the risks regarding the public finance sustainability are low, it can have a structural deficit of more than 0,5 % of GDP, but not more than 1 % of GDP. The failure in achieving this requirement concerning the structural balance will engage an automatic correction mechanisms, established by each member state on the basis of the principles imposed by European Commission.

In the case of Romania, it can be proved both theoretically and empirically, the fact that on the medium and long term (on the duration of a full economic cycle), the average effective deficit equals the average structural deficit, and the average cyclical deficit is 0. Through assuming a maximum structural deficit of 0,7 % of GDP, Romania assumes the obligation of maintaining an effective budget deficit, as average on a full economic cycle (and as an average on the long term), of maximum 0,7 % of GDP, which means, considering the historical standard value (3,8 % of GDP being the average structural deficit in the period 1999-2011) a much lower budget deficit and a more reduced „manouver” space.

These targets are as difficult to achieve if we are to consider the fact that Romania’s budget revenues are one of the lowest in GDP (fiscal and nonfiscal revenues), these representing in 2011 only 32,5 % of GDP, with 12,1 % lower than the European average. The level of fiscal revenues (taxes and social contributions) cumulated in Romania in 2011 only 27,2 % in GDP, 12,4 % lower than the European average (39,6 %). The share of fiscal revenues in GDP is significantly lower than in Slovenia (37,8 %), Hungary (36 %), Poland (32,1 %) and Slovakia (28,5 %).

The structure of fiscal revenues in Romania highlight a relatively large share of indirect taxes, 46,32 % of total fiscal revenues in comparison with 33,08 % the EU-27 average, the share of social contribution is of 32,35 % (35,1 %

in EU-27), while the direct taxes is of only 21,32 % (31,81 % in EU-27). In comparison with 2010, the share of indirect taxes has increased with almost 3 %, due to the increase of the VAT and of the accizes, while social contributions and direct taxes have diminished their relative importance, in the context of a decrease of their share in GDP, larger than the one registered by the share of total fiscal revenues in GDP. Having in consideration all these, we can state that the indirect taxes have represented the main component of fiscal consolidation in the last years. As a practical prove of the reduced tax collection, Romania collected VAT of 8,4 % in GDP in 2011, similar to Estonia, while our VAT is larger than the one of Estonia (24 % in comparison with 20 %). Moreover, Bulgaria, with a similar economic structure, and a lower VAT (20 %) collected in 2011 even more from the VAT (8,6 % in GDP) than Romania did.

As far as concerns the contributions to the social protection system, paid by both employers and employees, the budget revenues cumulated in 2011 were of 8,3 % of GDP, a lot smaller than in Czech Republic (13,1 % of GDP) and Hungary (12,3% of GDP), although they have similar contribution levels, Slovenia (13,6%), Estonia (11,4% of GDP), Lithuania (9,5%), Poland (9,1%) and Latvia (8,6%), where the statutory contribution rates are even lower than in Romania.

The structure of public expenditures in Romania is characterized by the prevailance of salaries and social security (pensions, social benefits). After a relatively stable evolution of these as share in total budgetary revenues before 2007, they have grown strongly in 2008-2009, a lot over the EU-27 average, having a considerable adjustment in 2010-2011. Nowadays, the allocations from budgetary resources for salaries and social security are similar with the European averages.

All the matters invoked above could be highlited by analysing figures no. 1 to no. 3, offered by the 2012 report of the fiscal committee.

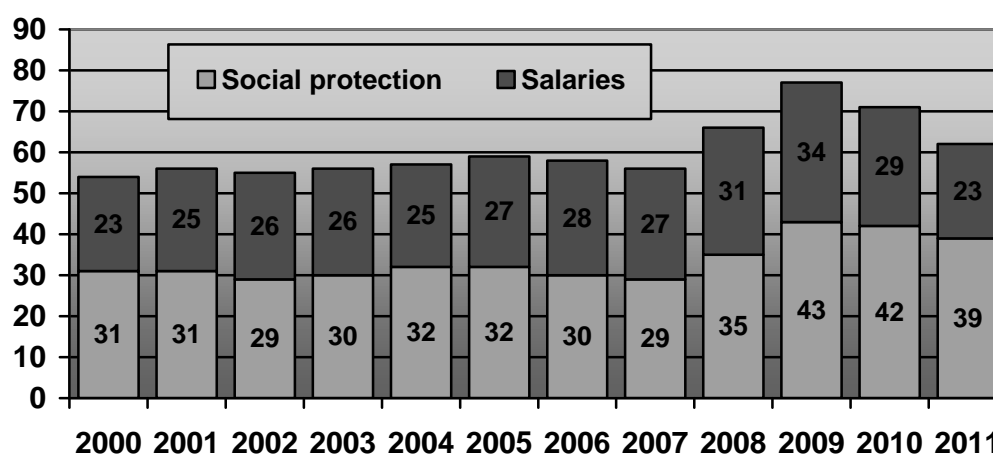


Figure no. 1 – Dynamics of the social protection expenditures and salaries in total budgetary revenues (%)

Source: [3]

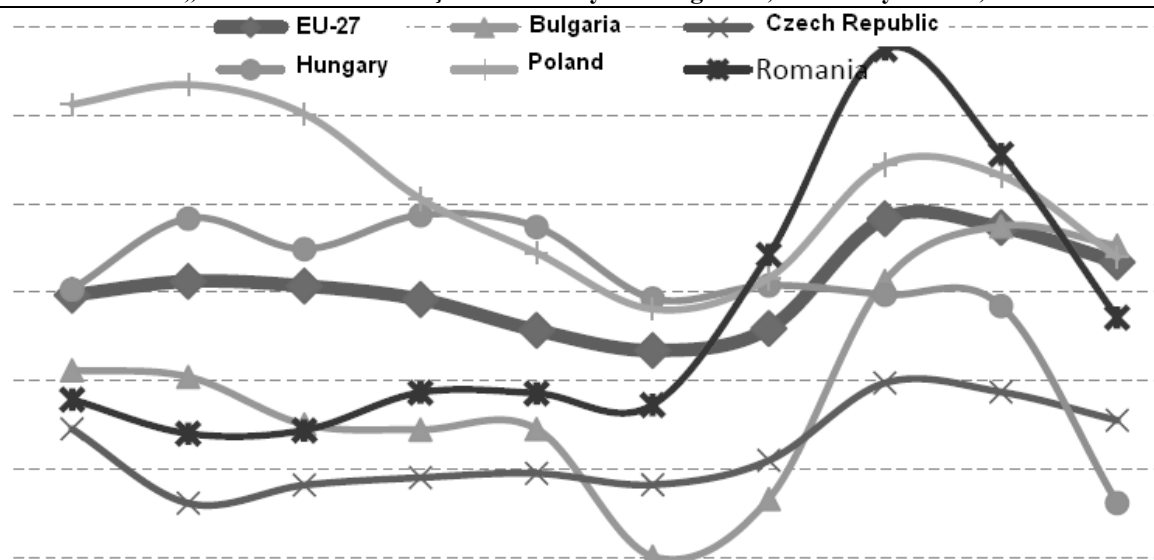


Figure no. 2 – Dynamics of salary expenditures and social protection expenditures. Comparative view EU-27-CEE countries
Source: [3]

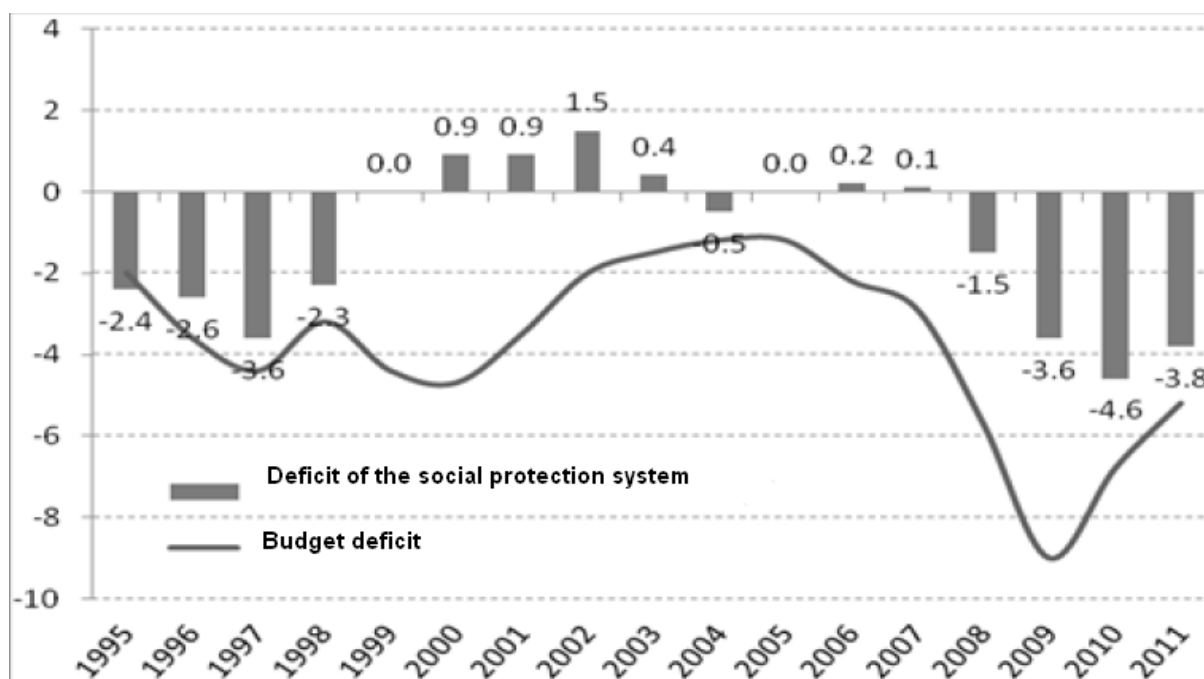


Figure no. 3 – Social protection budget deficit and total budget deficit in Romania (% of GDP)
Source: [3]

In the Fiscal Committee opinion [3], Romania needs a profound reform of the tax collection system that can ensure the accomplishment of the two essential objectives – the significant growth of the collected revenues and the decrease of the associated administrative costs. In the opinion of Fiscal Committee, this reform must focus mainly on the following components:

- The increase of the voluntary fiscal conformism of the contributors, especially through the simplification of the Fiscal Code and of the fiscal procedure code and through a wide programme that aims of making more transparent the public expenditures;
- The increase of the efficiency and the reduction of the costs for tax collection, especially through the consolidation of the number of fiscal administrations, informatization of the system and aggressive marketing policy in what concerns the electronic payments and electronic declarations;

- The increase of the professional quality of the hired staff employed in the collection of taxes and the reduction of corruption, especially through adequate training programmes, the introduction of an ethical code and of a very clear performance and rewarding measuring system, respectively of penalization of bad performance/corruption within the personnel.;
- Indirect fostering of a more sustainable economic growth model, through the increase of the tax collection that allows for certain adjustments in the tax system, meant to stimulate labour (especially through the reduction of contributions for the social security system, which are very high nowadays) and the growth of internal saving for reducing the dependency of the foreign inflows for financing the investments.

The projections related to the pension system sustainability in the macroeconomic context are usually made either on longer periods of time (50-60 years), either on medium term (20-30 years), but their evolution can be influenced also by the political changes or by the economic policy, by the technological progress, migration etc. In present time, the number of contributors and pensioners is dependent of the „demographic evolution” and the „economic growth”. The aging of population, due to increased longevity, is outlined by a continuous decreasing fertility rate

3. Conclusions

From the point of view of the medium and long term sustainability, it is important in the next years that the potential growth of salaries expenditures in the public sector to be correlated with the economic activity dynamics and especially with productivity growth. As far as concerns the social security expenditures, (especially pension expenditures), the financial status of social security system is very poor, this fact demanding an increased attention to this kind of expenditures in the next years. In this sense, it is mandatory a medium and long term strategy.

In the absence of concrete and well-oriented measures, the social security system will face major problems. Even on European Union level, almost all the countries confront themselves with the problem of sustainability of their pension systems and consequently, they conceive and implement specific reforms meant to harmonize these systems. Within this framework, the retirement age has been increased, the anticipated pension requests have been reduced, in the same time with supporting private pension incomes. It is pretty clear that the transition from PAYG system to a multipillar system is limiting pressure on the budget deficit. The budgetary policy on medium and long term is very important and should be stable; a viable pension reform project should consider a large period of time, to cover also the period of transition between the two pension system models.

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