

# TAXATION IS FOR POOR PEOPLE OR FOR RICH?

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**Abstract:** Based on some national and international studies and researches, this article aims to demonstrate that the level of social polarisation in Romania is a result of political will. Focusing on the study of the domestic tax policy, the authors asks a few questions, the answer of which may lead to identifying the causes of the social discrepancies accumulated.

**JEL classification:** H12, H21, H26

**Key words:** *fiscality; public choice; economic polarisation; social polarisation*

## 1. INTRODUCTION

The extended global recession is a significant and real risk factor. Seen retrospectively, it may be observed that the great economic crises in the more or less recent history have degenerated, causing severe social convulsions. However, it appears that by forgetting history, we are doomed to repeat its mistakes. How else could the continuous trend of polarising the human society be explained<sup>1</sup> (fewer rich people, but whom have immeasurable resources and increasingly more poor people whom share smaller and smaller resources), while knowing very well that only those human societies where there is a reinforced average class can generate a sustainable development.

As a society is more polarised, the less visible, more widespread and deeper is poverty. Social polarisation is strongly determined by the economic polarisation, caused by the unbalanced access to the economic/material resources in a particular society. From a certain point of view, economic polarisation reflects the social inequality, the distance separating the various social groups from each other.

A recent study [1] (June 2012) of the BNS (National Trade Union Bloc – *Blocul Național Sindical*) creates a cold and suggestive image of the social polarisation in Romania. According to this, the richest 20% of Romanians earn seven times more than the 20% of the poorest, while the UE average says that the richest 20% earn five times more than the poorest 20%. In Romania, 8.89 million people are at risk of poverty or social exclusion, meaning 41-46%<sup>2</sup> of the population, compared to the UE average of 23%. Romania has also registered the steepest decline of the population's property in the world (the value of the financial and immovable assets held by the population, of which the debts have been subsidised from), according to a report of Credit Suisse [2]. Between July 2011 – June 2012, the wealth of Romanians dropped by 36%, while globally, the wealth of the population dropped by 5.2%).

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<sup>1</sup> Concept taken from physics, which defines the tendency of create some separations between various individuals/social groups in a given society.

<sup>2</sup> 41% - under the conditions of relating to the official numbers used for 2002 (21,680,974), 46 % - under the conditions of the population revealed by the census of 2011 (19,042,936).

Economic polarisation leads to social polarisation, characterised by discrimination, marginalisation, (residential, occupational, etc.) segregation, isolation – to the perpetuation of poverty. Lowering the level/degree of polarisation of the poor – reach can be especially done by policies to reduce the inequality of incomes, by creating opportunities among the disadvantaged groups and by promoting some policies of equality of chances (equal opportunities).

Part of Romania’s objectives assumed for the Europe 2020 Strategy [3], drawn since 2010 are is: a rate of employment of the population aged between 20-64 - 70%, the research and development investments related to GDP - 2%, decrease by 580,000 of the number of people at risk of poverty and social exclusion.

**Table no. 1** Values of the objectives of Romania and UE 27 for the Europe 2020 Strategy

Objectives of UE 27	RO Final value
Rate of employment of population aged between 20-64 - 75%	70%
Research and development investments – 3% of GDP	2%
Promoting the social inclusion, particularly by decrease in poverty – decrease by at least 20 millions of the number of people at risk of poverty and social exclusion	580,000 people

Taking into account the current trend of the evolution of these indicators, Romania’s objectives become a utopia.

## 2. ABOUT FISCAL POLICY

Polarisation is both a consequence of the incompliance with the principle of social equity and the unfortunate result of the public policies promoted.

The picture of the social structure shows that a reform is needed, which cannot be done just with administrative means. A set of measures is needed, especially of economic kind, which would reconfigure the social structure.

Therefore, these reforms also aim a properly targeted tax policy. But does the current tax policy ensure the achievement of these targets?

The fight against tax evasion is high on the political (declarative, fictive) agenda, but low in the public reality. The circle is vicious. A cause and an effect of social polarisation is the underground economy, the weak or non-taxed economy. There are numerous estimates concerning the underground economy. The amounts flowing in one direction (from the poor to the rich) are impressive and growing. However, the underground economy cannot increase without being supported, protected, cautioned.

This conclusion puts the performance of various public institutions in an unfavourable light, especially as we benefit from very few quality services from the state. The resultless non-involvement or fake involvement of state’s institutions can mean a masked support provided to evasion, underground economy, social polarisation. This must not be proven, it becomes an axiom. We experience the façade involvement every day, but it also appears from studies and statistics.

**Table no. 2** The evolution of controls concerning the controlling the undeclared labour

Indicator	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
No. of controls	44269	69889	78322	80289	78529	74109	100200	90677	99698	101407	109349	99600
Number of employers who use undeclared work	4193	9014	3713	4095	3442	3525	7840	7701	7963	8500	9263	9731
No. people found working illegally	19228	33519	11651	13031	10446	8492	16571	16059	16162	17464	17755	29095
Value of sanctions applied (thousands lei)	1890	6008.6	6318	762	6946.8	7980.9	25561.9	24217.5	22736.3	22480.3	50614.5	105373.7

Source: [www.gov.ro](http://www.gov.ro)

How to explain that although the number of controls concerning the untaxed (undeclared) labour, as well as the number and value of fines have increased, it has not been succeeded to obtain a regression of the phenomenon? Moreover, both the number of those using the untaxed labour, and of those accepting to work without benefiting from the social protection advantages provided by the labour contract are increasing.

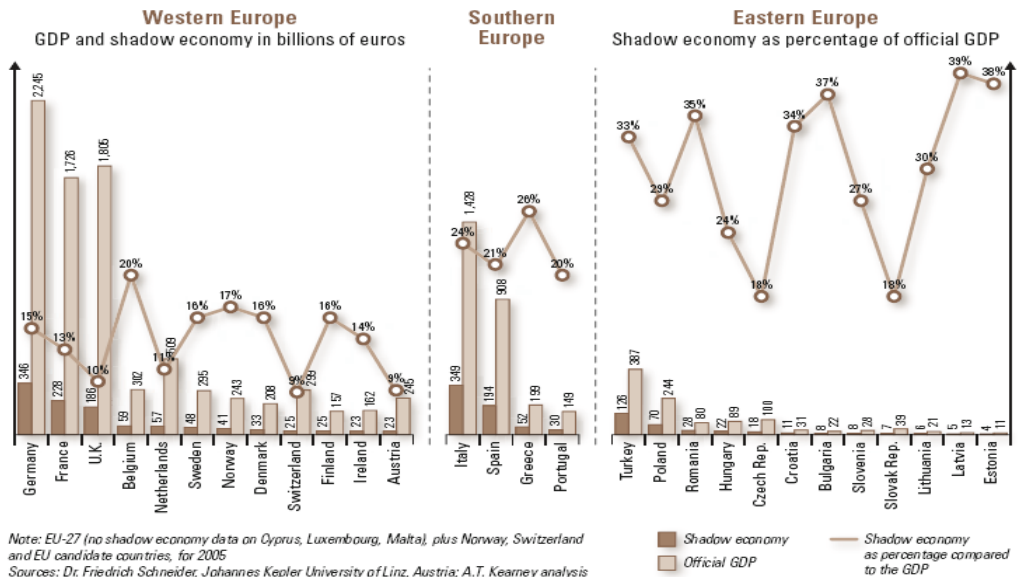
According to the National Institute of Statistics (INS – *Institutul Național de Statistică*), the share of underground economy in GDP is constant, standing around 20%.

**Table no. 3** Underground economy stated as share in GDP (1998 – 2010)

Perioada	Pondere în PIB (%)
1998	23.5
1999	20.0
2000	18.1
2001	17.9
2002	17.6
2003	15.4
2004	14.5
2005	16.6
2006	16.6
2007	20.0
2008	19.6
2009	20.1
2010	20.3

Source: INS

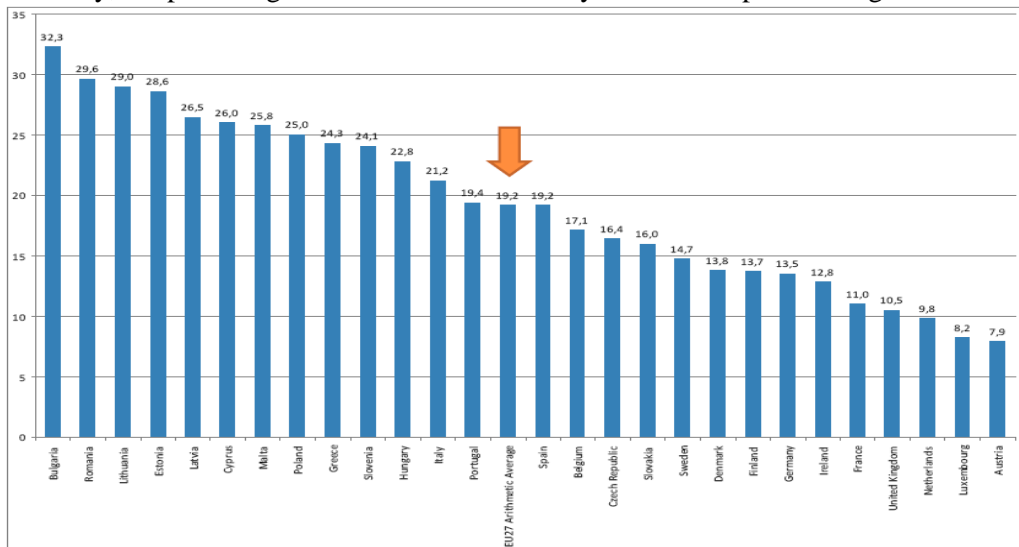
Other statistics of the same phenomenon are much more worrying. Thus, in 2005, Romania was on the 4<sup>th</sup> place in the European Union after the share of the underground economy, representing above a third (35.4%) of the GDP, according to a study published by the consultancy company AT Kearney [4].



Source: [www.atkearney.com](http://www.atkearney.com)

Figure no. 1 The shadow economy in relation to total GDP

A report of the European Commission [5] estimates that the share of Romanian underground economy has reached in 2011 almost a third of the national gross domestic product (29.6%), being exceeded only by that of Bulgaria. Romania registers a grey economy, the percentage size of which exceeds by far the European average.

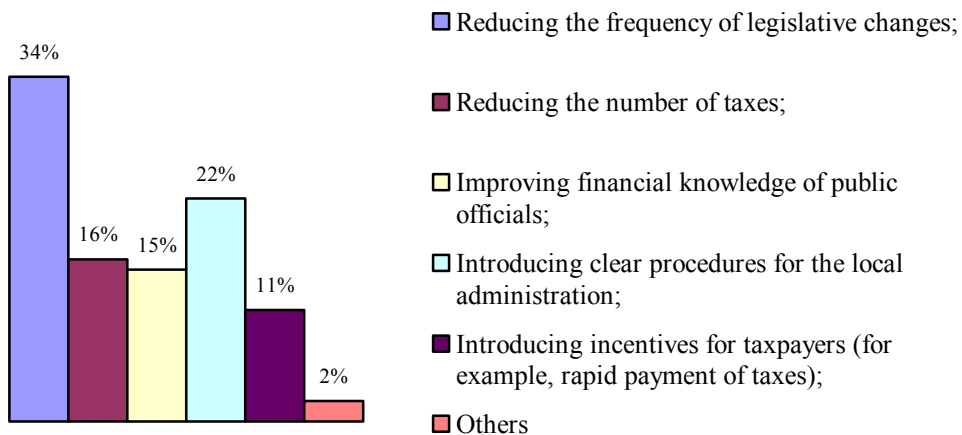


Source: Schneider, F. (2011) [http://ec.europa.eu/europe2020/pdf/themes/06\\_shadow\\_economy.pdf](http://ec.europa.eu/europe2020/pdf/themes/06_shadow_economy.pdf)

Figure no. 2 Estimate of the size of the shadow economy in 2011 (% of GDP)

What is the secret of the fact that during such a long period of time, when almost all domestic political forces have governed, the underground economy constantly has very high levels, standing among the first most negative European places?

In a Deloitte study [6] in 2010, the requirement of the business environment was outlined, that the authorities would pursue a medium and long term fiscal strategy and would focus its efforts in order to reduce the frequency of legislative changes. Thus, approximately 34% of the participants to that study sustained that the premise for a tax environment favourable for the development of business is the stability of legislation. Only in this way the business environment can establish and follow a coherent strategy and a sustainable budget. 22% of the participants at the study have also shown their will to introduce certain clear procedures into the tax administration.



Source: [www.deloitte.com](http://www.deloitte.com)

**Figure no. 3** Expectations of the business environment concerning the Romanian tax system

However, if the business environment deems this requirement important, what is the explanation that over 20 laws have been issued since 2010 until now, to amend the Tax Code?

The final conclusion of a study of GEA (Group of Applied Economics) [7], which appeared in September 2008, was that the effect of the flat tax was that the social polarisation deepened between those with high incomes and those with low incomes. The statistics of the study shows us how the “welfare” has been distributed after applying the flat tax: 53% of the employees (2.5 mil. people) have additionally received less than 1 Euro per month; 32% have received 5 Euros per month and only 3% of the employees (around 160,000) have received over 220 Euro a month. Under these conditions, 4 mil. people (85% of the total) have received only 18% of the amount remained at their disposal by introducing the flat tax, while 15% of the employees have received over 82% of the 700 millions remained at their disposal. From here also the polarising effect of introducing this tax measure. The flat tax polarises the incomes of citizens, leads to the increase of social inequality.

The flat tax is a tax policy which does not use the European countries with a developed economy where there is a well reinforced average social class. This policy has been promoted by Russia and Slovakia, but the latter ultimately gave it up, appearing in return other European countries which apply it.

Why is such a taxation system kept? Why is the 16% level further kept, which does not provide anymore for a long time the competitive advantage created by its introduction?

Quite a lot of specialists observe the incapacity of state's institutions to efficiently collect the taxes, duties and contributions. A calculation based on the data provided by Eurostat for 2010 regarding the profit tax; the income taxes and social contributions, shows that Romania, with a percentage of 27.9% is far under the European average of 39.9% (EU 27):

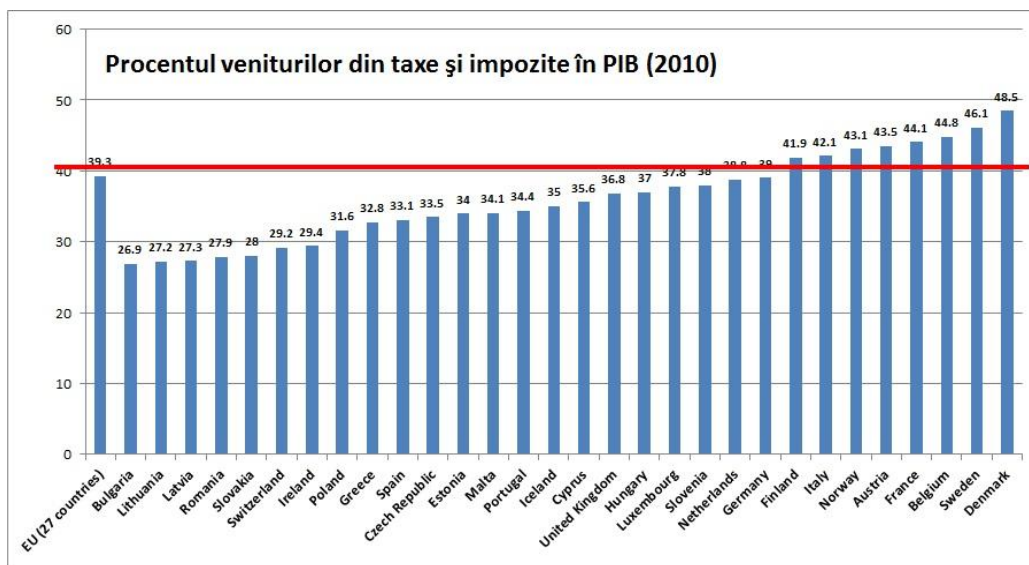


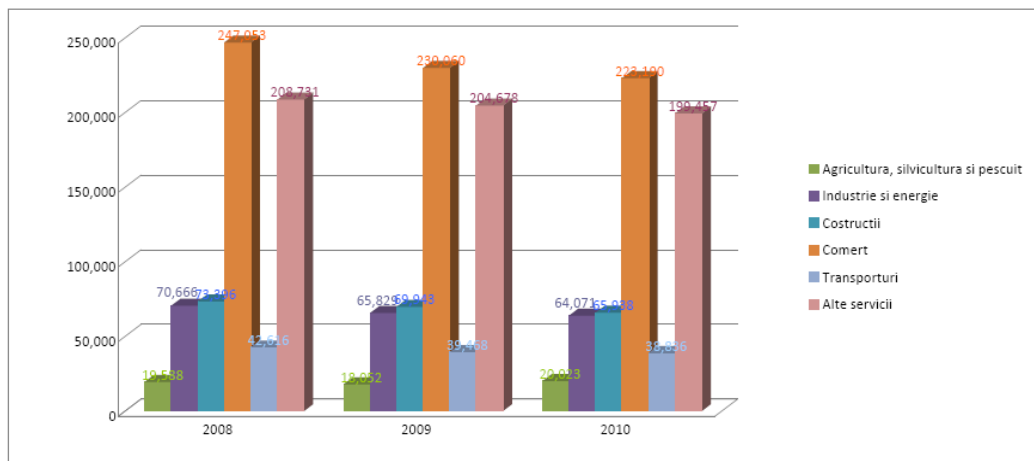
Figure no. 4 Percentage of taxes in GDP (2010)

The direct conclusion emerges from the Report of the World Bank – Doing Business 2011 [8]: the Romanian system of taxes and duties is characterised by a weak collection, inefficient management, excessive bureaucracy, a relatively low taxing basis with many exceptions and legal deductions and a high tax evasion.

Knowing these inconveniences, what is it that prevents governments to adopt measures to make the tax collection more efficient?

In Romania, the number of small and medium-sized enterprises continues to decrease. This is a factor of unemployment and poverty increase, taking into account that the main social class affected by this phenomenon is the average and poor one.

Business sector	Year		
	2008	2009	2010
Agriculture, Forestry and Fishing	19,588	18,052	20,023
Industry and Energy	70,666	65,829	64,071
Constructions	73,396	69,943	65,938
Commerce	247,053	230,060	223,190
Transports	42,616	39,468	38,836
Other services	208,731	204,678	199,454
<b>TOTAL SMEs</b>	<b>662,050</b>	<b>628,030</b>	<b>611,515</b>
<b>NATIONAL TOTAL</b>	<b>663,333</b>	<b>629,095</b>	<b>612,435</b>



Source:

<http://www.busnetsupport.ro/intranetNEWS/infoFILES/infoNEWS/File/ZONA%201%20SUD-MUNTENIA.pdf>

**Figure no. 5** The evolution of the number of SME's in the main sectors of the national economy between 2008 – 2010

Between 2008 – 2010, the most affected economic branches were constructions, with a drop by over 10%, the trade by almost 10%, industry and energy by 9% and transports by almost 9%. The only field of activity which registered an increase of the number of enterprises was agriculture, by 2.2% (one possible explanation being the climatic conditions which made 2010 be a good agricultural year).

Under these conditions, the tax policy may become an economic leverage that may encourage the small entrepreneur to develop. However, the lack of any tax facilities for the small entrepreneurs or for the starting businesses can show us there is no interest for the development of SME's and hence for the occurrence of a strong social middle class.

How can a business appear or develop in a climate where it is taxed even since on very first day of its existence?

### 3. CONCLUSIONS

The possible answers to the questions so far can provide a picture of the Romanian taxation state and also the possible ways to follow.

One of the big mistakes of the different current decision makers is that in order to drop the taxes and duties, it is expected to improve the economic results. In reality, the measures to decrease and simplify the taxation should be implemented currently so that the economy would generate better results in the future.

In order to create an asymmetry in the decision of economic agents inclined towards evasion, the fines, penalties and delay penalties should be increased. Their increase makes the difference between normal taxation, ideally decreased, the cost related to evasion and penalty to reverse the current asymmetry in decision, in favour of the just determination and payment of taxes and duties of each taxpayer's responsibility. Currently, the asymmetry operates reversely, in the direction where after including the penalty cost (weighted with the probability to be caught), the economic agent makes a significant benefit to the official taxation.

Besides reducing the taxation and significantly increasing the penalties, enhancing the probabilities that the penalty would materialise is also important. This probability to identify and penalise the evasion is proportional to the motivation of the segments in the state apparatus with responsibilities in this field.

To the extent where the civil servants in various fields involved in reducing the evasion receive a significant incentive, proportionate to the amount identified, it can be a matter of an increase of the probability to decrease this phenomenon and reversal in the decision of economic agents. Under the conditions of some modest salary payments, the large evasions cannot be identified and followed plausibly. For example, it is difficult to imagine that a control team of 2 servants whose cumulative annual incomes most of the time do not exceed 15,000 Euros would incriminate an evasion deed of 100 million Euros.

Reversing the asymmetry in the decision of economic actors, necessary for a sustainable economic growth and a drained economy may be done only by the simultaneous actions into the three directions and not just with threats and rigid measures.

Besides the tax and economic measures justly and inspirationally applied, reducing the social polarisation gap also involves political will inclined towards the overall welfare rather than the particular, group welfare.

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