FINANCING THE BUDGET DEFICIT OF ROMANIA IN 2017

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Abstract: *The recent economic crisis has revealed the failure of some cognitive and operational models to relaunch the economic activity. The most persuasive example is the thesis that price stability is equivalent to financial stability, with the full use of resources. Nowadays, we hear more and more often of the idea that the budget deficit becomes a means of relaunching the economic activity, given the fact that it does not already have an inflationary character. It is possible to act upon the demand for public goods and services through the use of short-term funds, thus achieving a flexible budget policy. Within this framework, public spending can be resized in relation to the size of these funds. If no changes are made to tax regulation, fiscal revenues may constitute conjunctural adjustment tools. The idea that budget deficit would be a particularly important economic problem is partly true, because it must, nevertheless, exist. Through it, the redistribution of income between generations, the fiscal relaxation in the case of the variation of the income subject to taxation etc. are ensured.*

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JEL Classification*: H62.*

1. Introduction

In the current period, the idea that the budget deficit becomes a means of relaunching the economic activity, given the fact that it is not already inflationary, is becoming increasingly popular (Cioponea, 2007). It is possible to act on the demand for public goods and services through the use of short-term funds, thus achieving a flexible budget policy, whereby public spending can be resized in relation to the size of these funds. In the absence of changes in tax regulation, tax revenues may be instruments of short-term regulation.

In this respect, a process of crucial importance is the efficiency of public spending. The desired objectives can be achieved more efficiently, sometimes faster and with lower costs, without reducing the quantity or quality of the services provided. It is enough to eliminate the excessive staff in the central and local government to see a decrease in the cost of providing certain public services (Kolodko, 2015).

Moreover, it is considered that the government is the only economic actor that can maintain the level of demand in the economy, spending more than it wins, by registering a budget deficit (Chang, 2014).

In turn, the economic crisis of recent years has revealed the failure of cognitive and operational models. Some authors consider that the most telling example is the thesis that price stability equates to financial stability, with full use of resources (Dăianu, 2015).

The idea that the budget deficits would be a particularly important problem for the economy is partly true, as it must to appear, through the provision of redistribution of income between generations, tax relief in the case of variation in taxable income etc.

2. Romania's Budgetary Deficit in 2017

2.1. Economic Situation and Synthetic Budget Indicators

In 2017, Romania recorded an economic growth of 5.2%, being the seventh consecutive year of positive developments (1.1% in 2011, 0.6% in 2012, 3.5% in 2013, 3.1% in 2014, 3.9% in 2015 and 4.8% in 2016), which places us among the first countries, from this point of view, in the EU28. The following aspects contributed to this growth: internal demand, in the conditions of an improved balance between final consumption and gross investment (gross fixed capital formation); the growth rate of gross fixed capital formation, which was projected at 7.2%; expenditure on final consumption of the population, which was projected to have an annual dynamics of 7.2% (MPF, 2017).

The economic growth was driven by a positive contribution of the internal demand, both for consumption and investment, of 7.7 percent, given that the net export had a negative contribution of -0.8 percent.

The data show that 2017 was a very good year in terms of investment. Net investment in the national economy (which represent a part of the gross fixed capital formation because they are only the ones made by the budget sector and the commercial companies) increased by 6.4% in 2017 compared to 2016. In 2016, net investment decreased by 3.3%. Thus, in 2017, gross investment in the economy (gross fixed capital formation) increased by 4.7% compared to 2016, when they decreased by 2%.

Inflation recorded a modest annual growth of 1.34% in 2017, while annual inflation at the end of the year stood at 3.32%. In the first part of the year, the favorable inflation evolution was influenced by the VAT rate cut from 20% to 19%, starting with the 1st of January, then by the removal of the euro-excise for fuel and by the decrease of the specific taxes in electricity distribution. The sharp rise in inflation at the end of 2017 was mainly due to price increases in the second part of the year, being based on external causes such as the oil barrel price rise on international markets, the rising of the prices for some food supplies (eggs and butter) or the depreciation of the national currency in relation to the European one. To these causes, the excise-advance measure on fuels is added in two stages, on September 15 and October 1, 2017, as well as the increase of electricity tariffs in July, September and October.

For the year 2017, the general public administration deficit was calculated on the basis of the data provided by the public institutions and on the basis of the temporary ones of the state-owned companies classified in public administration. According to ESA 2010, the resulting deficit (semifinal data) was 2.9% of GDP.

Compared to 2016, the deficit calculated in accordance with the ESA 2010 methodology declined by 0.1 pp in 2017 from 3.0% of GDP in 2016 to 2.9% of GDP in 2017.

The budgetary deficit calculated according to the European methodology was below the reference level of the Stability and Growth Pact, registering a level of 2.9% of GDP in 2017. The budgetary deficit for 2017 was situated above the budgetary deficit average for the euro area of 0.9% of GDP and for EU28 of 1.0% of GDP.

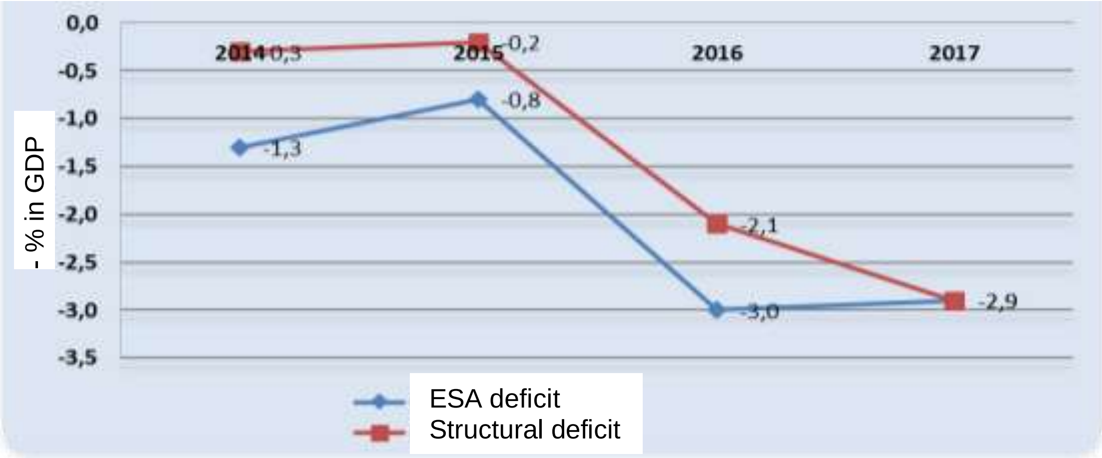
Romania’s structural deficit increased to 2.9% of GDP in 2017, with a general budgetary deficit consolidated in decline compared to the one in 2016, respectively of 2.9% compared to 3.0%. The GDP gap compared to the output gap closed in 2017, from a negative value in 2016, leading to a cyclical component of the 0% of GDP budgetary deficit (Ministry of Public Finance, 2017).

Table no. 1. The Structural Deficit in Romania

	2014	**2015**	**2016**	**2017**
Structural Deficit	-0,3	-0,2	-2,1	-2,9

Source: Ministry of Public Finance, 2017.

Figure no. 1. The ESA Deficit and the Structural Deficit in Romania in 2014-2017



Source: Ministry of Public Finance, 2017.

In the reports issued by the National Bank of Romania no severe systemic risks are identified, but three high systemic risks are presented at a high level: (i) the risk regarding the deterioration of the investors' trust in emerging economies; (ii) the risk associated with the uncertainty regarding economic evolutions in the European Union, in particular those related to the sovereign debt situation in the euro area and to the UK exit from the EU process, and (iii) the risk of non-repayment of loans contracted by the non-government sector. The risk regarding the straining of the macroeconomic balances is assessed as having a moderate intensity and the risk from the real estate market is at a low level (NBR, 2018).

2.2. The Analysis of State Budget Revenues and Expenses in 2017

According to the final data, the execution of the general consolidated budget, during the period January 1 - December 31, 2017, ended with a cash deficit of 24.29 billion lei, respectively 2.83% of GDP, under the fixed target, respectively an estimated annual deficit of 24, 97 billion lei.

Compared to the previous year, the general budgetary deficit consolidated in 2017 increased, on a cash basis, as a percentage of GDP, by 0.43 percentage points from 2.40% in 2016 to 2.83%.

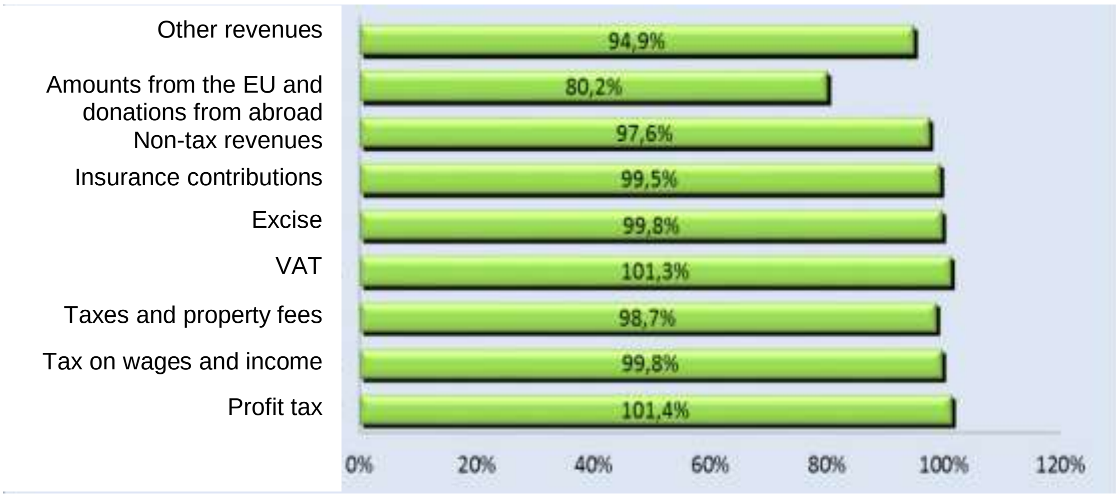
Table no. 2. Romania's cash budgetary deficit

		2016	2017	Differencies 2017 - 2016
Deficit	mil. lei	-18.304,3	-24.294,7	-5.990,4
	- % in GDP	-2,40	-2,83	-0,43

Source: Ministry of Public Finance, 2017.

- **The revenues of the general consolidated budget**, in the year 2017, amounted to 251.9 billion lei, representing 29.3% of GDP and an achievement degree compared to the 98.0% annual estimates (Ministry of Public Finance, 2017).

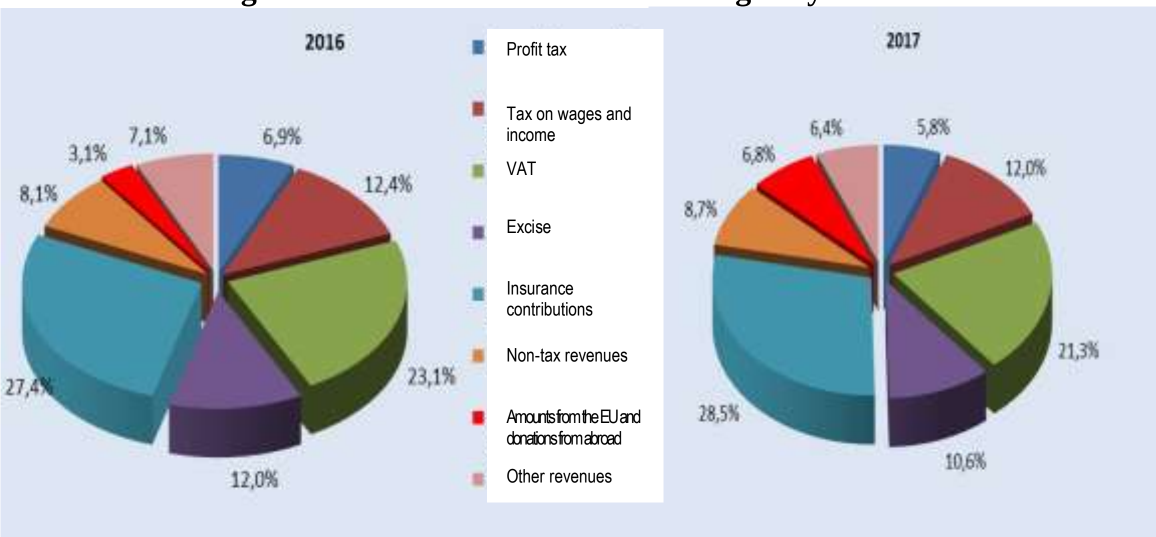
Figure no. 2. The Consolidated General Budget Revenues' Degree of Realisation in 2017



Source: Ministry of Public Finance, 2017.

The budget revenues were influenced by both the economic developments and the adopted tax policy decisions such as: raising the minimum wage, reducing the standard VAT rate, increasing the salaries for some categories of employees in the budgetary sector, increasing the retirement point, increasing of the non-taxable monthly limit on pension earnings from 1,000 lei to 2,000 lei and the retired people exemption from the payment of social health insurance contributions, as well as the modification of the excise quantum.

Figure no. 3. The Structure of the Budgetary Revenues



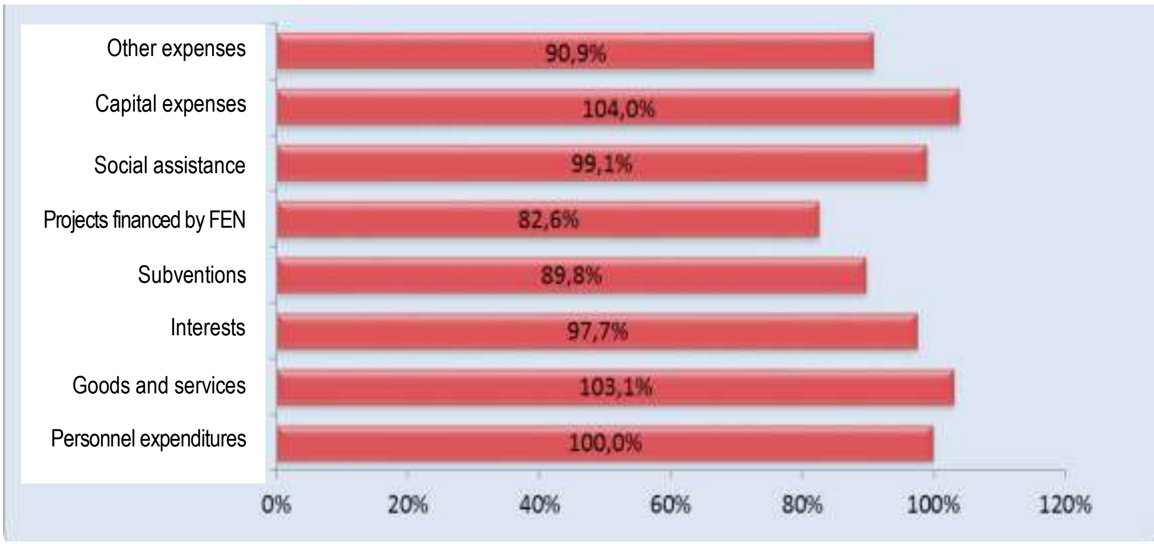
Source: Ministry of Public Finance, 2017.

Compared to the previous year, the consolidated general budget revenue in the year 2017 increased by 12.5% and as a percentage in GDP they decreased by 0.1 percentage points from 29.4% in 2016 to 29.3% in 2017.

The sums received from the European Union in the payments made account (including donations) in the year 2017 amounted to 17.2 billion Lei, 247.6% above the level recorded in 2016. Also, as a ratio in GDP, they registered a growth of 1.1 percentage points from 0.9% in 2016 to 2.0% in 2017.

- **The expenses of the general consolidated budget** amounted to 276.2 billion Lei in 2017, which represents 32.2% of GDP and a degree of achievement compared to the projected level of 98.0% (Ministry of Public Finance, 2017).

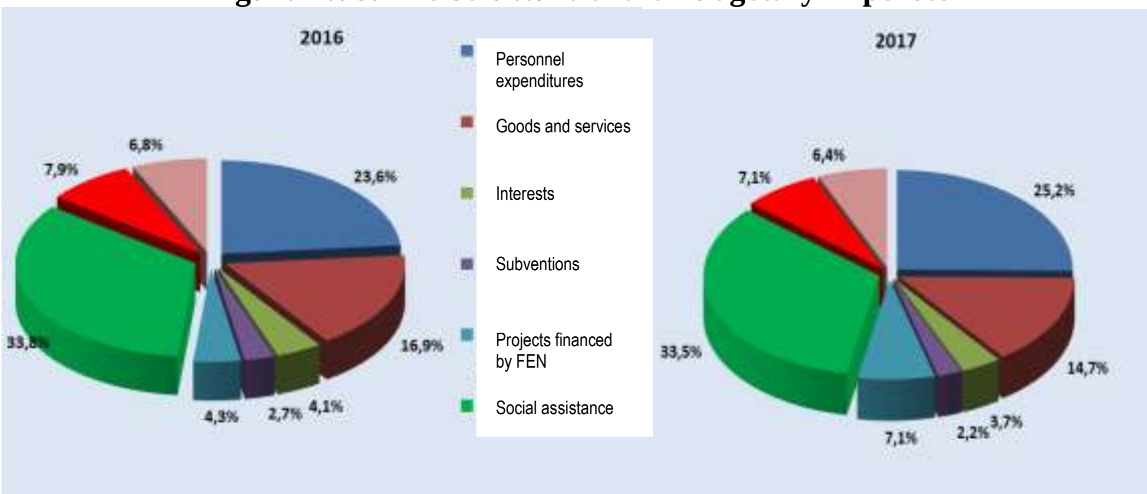
Figure no. 4. The Consolidated General Budget Revenues' Degree of Realisation in 2017



Source: Ministry of Public Finance, 2017.

From the point of view of the achievement degree of the annual program, the main categories of budgetary expenses registered the following evolutions: 100% staff expenses, 103.1% goods and services expenses, 97.7% interest expenses, 89,8% subvention expenses, social assistance expenses 99.1%, capital expenses 104%.

Figure no. 5. The Structure of the Budgetary Expenses



Source: Ministry of Public Finance, 2017.

Compared to the previous year, the consolidated general budget expenses increased by 14% and as a percentage of GDP by 0.4 percentage points from 31.8%, as it was in 2016, to 32.2% in 2017.

2.3. Sources of Financing the Budgetary Deficit in 2017

According to the EU methodology, the governmental debt was at 35.0% of GDP on 31 December 2017, decreasing from 37.4% of GDP as it was at the end of 2016, below the level of 40% of GDP set by Law no. 5/2017 to approve the levels of some indicators specified in the fiscal-budgetary framework for 2017. Out of the governmental debt, on the 31st of December 2017, internal debt represented 18.0% of GDP and external debt represented 17.0% of GDP.

In 2017, financing the budgetary deficit was mainly accomplished through internal sources through issues of state titles launched on the internal market and in addition from external sources. The sources needed to refinance the governmental public debt were provided by the markets on which these debts were issued and by the financial backup currency available to the MPF, which at the end of 2017 covered 3.8 months of the necessary gross financing.

The debt instruments used in 2017 to finance the budgetary deficit and to refinance public debt were (Ministry of Public Finance, Budget Implementation Report 2017):

- The state title issues denominated in lei, on the internal market, amounting to 39.8 billion Lei. Thus, treasury certificates with a due date of up to 1 year in the amount of 10.9 billion Lei and state obligations of the type benchmark 28.9 billion Lei, according to the announced calendar.
- State title issues denominated in euro on the internal market, amounting for EUR 340 million.
- Issues of Euro-obligation launched on the foreign capital markets. In 2017, MFP attracted EUR 2.75 billion from foreign markets. Thus, on the 19th of April 2017, MFP attracted EUR 1.75 billion through a Euro-obligation issue in euro in two tranches, of which EUR 1 billion through a new issue of a 10-year maturity, a 2,375% coupon and 750 EUR million by reopening the issue launched in October 2015, with the initial maturity of 20 years, a 3.875% coupon. On the 10th of October 2017, the 10-year maturity euro-obligation issue launched in April 2017 with a coupon of 2,375% was reopened for EUR 1 billion.

3. Perspectives on the State Budget Deficit

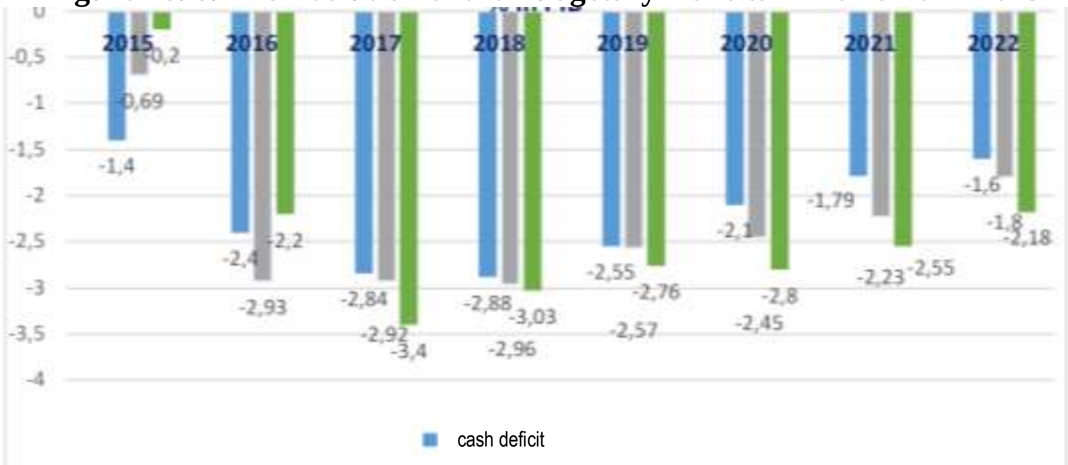
If we address to the EU member states, the economic recovery has manifested itself in all Member States, but it has been slow, being supported by factors such as the falling in the oil prices, flexible monetary policy and the relatively low external value of the euro. It is estimated that the economic growth pace in Europe will remain moderate, the factors favoring the growth being the decrease of unemployment and the increase of private consumption, but, in contrast, there are some obstacles or even the loosening of other favorable factors is anticipated.

Considering the evolution of the economic growth potential for the period 2019-2021, it is estimated that the Romanian economy will continue the sustained growth, and a growth of 5.4% annually of the internal gross product being possible, in average (Ministry of Public Finance, 2019b).

The budgetary planning for the years 2019 -2021 was based on the fiscal relaxation measures started in the period 2015-2016 in order to stimulate the economic growth (the new fiscal code and salary increases and some social assistance rights) and they were continued by the normative acts adopted in the year 2017 which regulated measures in the field of salaries of the staff in the budgetary sector, the legislation in the field of social rights, the legislation in the retirement field, with additional impact on staff and social assistance expenses implemented in 2018, but the fiscal budgetary measures also taken during the year 2018, which will influence the macroeconomic framework and the budgetary indicators on the horizon 2019-2021.

Under these circumstances, the budget revenues projected for 2019 represent 33.51% of GDP, 32.23% in 2020, and in the year 2021 it will represent 31.97% of GDP, a development determined by the macroeconomic indicators on the reference horizon, as well as the normative acts adopted so far, and the budget expenses projected for 2019 represent 36.28% of GDP, reaching 33.98% in 2021, decreasing in the reference horizon as a share of GDP.

Figure no. 6. The Evolution of the Budgetary Deficits in Romania in 2015-2022



Source: Ministry of Public Finance, 2019a.

The budgetary planning for 2019 and the estimations for 2020-2021 set the ESA budgetary deficit in 2019 at 2.78% of GDP, an adjustment of 0.18 percentage points as compared to 2018, which will continue on the 2020-2021 horizon, reaching 2.45% of GDP in 2021, respectively an adjustment of 0.33 percentage points compared to 2019 (MPF, *The Fiscal-budgetary strategy for 2019-2021*).

On the 2019-2021 horizon, the budgetary deficit policy continues to directly support the economic growth, staying within the margin allowed by the Stability and Growth Pact, respectively an ESA budgetary deficit of 3% of GDP.

In structural terms, it is estimated that the significant deviation registered in Romania in 2016 from the OTM set for Romania (1% of GDP) will be adjusted starting with 2021.

The deflection from OTM would occur under conditions of maintaining, over the entire planning horizon, a sustainable public debt level below 40% of GDP, with Romania registering, in 2017, a percentage of the public debt of 35.2%, decreasing compared to 2016 with 2.1 percentage points.

The moderate growth perspective of the governmental debt on medium-term and the perspective of maintaining it at a relatively stable and sustainable level is due to sustained economic growth and to some calculated budgetary deficits according to the EU methodology of up to 3.0% of GDP over the period 2019-2021.

The estimation of the structural budget balance, despite the fact that it reflects the fiscal position of an economy better, presents an uncertainty associated with its projection. Thus, the value of the structural balance is dependent on the output gap level, which is dependent on the potential GDP, an unobservable size that is often subject to more or less significant revisions depending on the revision of the statistical data and the methodology used.

4. Conclusions

The main effects of public expenses can be assimilated to the "crowding out" effect, which, in this case, refers to the diversion of the market resources phenomenon from those sectors that the market sees as profitable to areas considered by the state to be of interest. Also, a hidden cost of the budgetary deficit and public debt is represented by their influence on country rating, an indicative indicator for investors looking for business opportunities.

Taking into account the current conditions, when Romania tries to define its role and place in the world, when the identification and encouragement of those branches and sub-branches of the national economy that can be developed within the world economy is desired, it is necessary to use fiscal levers in concordance with the requirements of the European Union and the other macroeconomic policies that can be adopted to overcome the current economic situation should be taken into account. Thus, there is famous theory stating that, during the crisis period, it is preferable to ensure an increase in the budgetary expenses, with the fixed objective of contributing to the revival of economic activity, the effects being reflected in the increase of the workforce and the reduction of the unemployment.

The economic growth model needs to be reviewed in the light of the experience of the past years in which the economic growth in our country was based on consumption, a situation that did not allow a sustainable economic development. For this reason, another orientation based on investment in the sectors with high added value is needed.

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