

## AN EXPLORATORY ANALYSIS OF SOME POTENTIAL FISCAL- BUDGETARY VULNERABILITIES IN ROMANIA

**Scientific Researcher III, Phd. Ionel LEONIDA**

“Victor Slăvescu” Centre for Financial and Monetary Research

E-mail: [leonidaionel@yahoo.com](mailto:leonidaionel@yahoo.com)

**Scientific Researcher, Phd. Cosmin – Octavian CEPOI**

“Victor Slăvescu” Centre for Financial and Monetary Research

E-mail: [cepoi.cosmin.ccfm@gmail.com](mailto:cepoi.cosmin.ccfm@gmail.com)

**Abstract:** *The severe deterioration of public finances during the COVID-19 pandemic and its consequences brought aspects of a fiscal-budgetary nature into the debates, fiscal policy, through its instruments, being considered the main anchor through which the government can stimulate or inhibit the economy in a moment of crisis, but also afterwards. The proposed work is part of this direction of continuing the debates and analyses, aiming exploratory at the possibility of identifying some vulnerabilities or emphasizing some existing ones from the previous period, based on an analysis framework that aims at three important aspects: the evolution of the budget deficit; the evolution of public debt and their positioning in relation to economic dynamics. The result can be a source of information, of possible development and refinement, to the extent that it will signal the existence of significant fiscal-budgetary vulnerabilities in the short and medium term at the level of Romania.*

**Keywords:** *fiscal-budgetary policy, revenues, expenses, deficit, public debt, vulnerability.*

**JEL Classification:** *E61, H20, H50.*

### 1. Introduction

The financial and economic crisis of 2008-2010 produced a sudden and severe deterioration of public finances worldwide, amid the implementation of fiscal-budgetary measures to combat and limit its spread, to support the economic environment, but also due to the fact that the size tax bases was significantly reduced, which led to a decrease in collected revenues. In this context of reduced revenues and increased expenses, the budget deficit increased to historical values, and to ensure the necessary financial resources, loans were resorted to, which led to a rapid increase in the level of public debt.

In this light of the increasing frequency of crises and their diversity, of the severe impact on public finances at a general level, but also at the level of each country, there is an increasing need for analysis of fiscal-budgetary vulnerability, meaning that in this paper we outline an analysis framework on the current state of public finances, with extension in pre and post pandemic, in Romania.

Thus, in this introductory section, we present the framework regarding the concept of fiscal-budgetary vulnerability and aspects related to it, as well as the indicators on which we intend to focus the analysis.

Regarding the concept of fiscal-budgetary vulnerability, it can be characterized by a situation where a government is exposed to the unfavorable possibility of not being able to meet its aggregate fiscal policy objectives. This situation of vulnerability does not explicitly refer to a momentary situation in which the fiscal-budgetary policy may not be adequate to the present economic-social state, but refers to the unfavorable quality and the reduced capacity for recovery of the fiscal-budgetary policy in a time frame that includes the initial, present state and, above all, its short- and medium-term prospects and consequences on the economic and social environment. From this perspective, fiscal-budgetary vulnerability is not a state that is felt immediately, but a discrete state, which can "hide" in apparently stable fiscal-budgetary situations, in two forms: i) underlying, non-transparent and unidentifiable deficiencies in the analyzes and the present fiscal-budgetary results, but with incidences on

the future ability to fulfill the aggregated objectives in its charge; ii) these underlying, non-transparent and unidentifiable deficiencies in current fiscal-budgetary analyzes and results may limit a government's capacity to intervene and respond to short- and medium-term fiscal-budgetary challenges and consolidation needs in response to a shock external, of the nature of crises (economic, social, sanitary, conflicts, etc.).

With regard to the general objectives of the fiscal-budgetary policy, it is well known that they subscribe to the functions of financing public goods and services, of intervention and adjustment of the economy, respectively of maintaining a certain social equity through income redistribution. But, beyond these general and generic objectives, the fiscal-budgetary policy develops a series of other objectives depending on the economic level of the incidence of its measures and actions, namely:

- at the macroeconomic level - the objectives and concerns mainly concern the income-expenditure balance and the adjustment of its results - the budget deficit and the public debt;
- at the sectoral level - intermediate between macro and micro - the pursued objectives concern the tax bases, the structure and contribution of certain tax revenue categories, the structure and orientation of expenses, multiplier effects, etc.;
- at the microeconomic level – the objectives aim at the efficiency of expenses and fiscal-budgetary programs (facilities, subsidies, equity).

Manifestation of fiscal-budgetary vulnerabilities is possible and can be analyzed at any of the three levels, but in this paper we track and analyze potential fiscal-budgetary vulnerabilities at the macroeconomic level, for the following reasons:

- the macro (fiscal-budgetary) level indicators - the budget deficit and the public debt - are the most important for the assessment of the fiscal-budgetary state, the evolution and evaluation of the consolidation process and fiscal-budgetary sustainability, which include elements from the subsidiary and temporal levels , especially from the past and present;
- in the strategy and management of fiscal-budgetary policies, elements/measures must also be followed/implemented to ensure a certain flexibility of them in relation to the economic environment, both through fiscal-budgetary recovery devices and automatic adjustment of the effects of economic cycles, as well as through discretionary measures implemented additionally for recovery or through which it is possible to respond in an adequate and timely manner to the need to adjust internal and external macroeconomic imbalances;
- the ability of the government to obtain revenues in a manner that ensures equity, maintaining reasonable and stable tax rates, as well as supporting the economy through public investment projects with multiplier effects.

The mentioned considerations/objectives can turn into fiscal-budgetary vulnerabilities in the situation where the possible inability to meet any or all of these objectives is manifested, which are not independent of each other, but chained / interconnected, and the causality of a vulnerability can arise from both meanings. Thus, a hypothetical situation, which penetrates all three objectives, can refer to the existence of the budget deficit whose financing through the creation of money can generate inflation, and by contracting loans the sustainability of the public debt is endangered, in perspective, following the possibility of a fiscal policy -restrictive budgets, with increases in some tax rates or the reduction of some categories of government expenditure, especially in the sphere of those with multiplier effects (investments). Such interactions also occur between the fiscal-budgetary objectives from the levels stated above, the causality also being in both directions, the weak points in a certain

level being able to manifest negatively on the other levels. Potential weaknesses in the rationale and design of fiscal revenue strategies and government spending programs can create vulnerabilities that can spill over into fiscal objectives. Also, a poor design and implementation of fiscal instruments to ensure a certain fiscal equity can have negative effects in the fight against poverty, which can lead to additional expenses of a social nature to reduce poverty, a vulnerability that can be transferred to the macro level.

The analytical framework pursued in the elaboration of the work has as its starting point an analysis and a discussion of the current fiscal-budgetary state, respectively of the indicators of revenues, expenses, budget deficit and public debt, in the sense of their fulfillment as general macroeconomic and fiscal-budgetary objectives. The current fiscal-budgetary situation is useful in the analysis because it encompasses and describes the previous fiscal-budgetary policy, with the possibility of identifying some of its weak points, potentially generating vulnerabilities. The next step is to develop and expose a short-term perspective on fiscal vulnerabilities.

Considering the character and nature of the vulnerability, in general, but of the fiscal-budgetary one, in particular, i.e. the manifestation in perspective of a possible unfavorable situation in terms of reaching or fulfilling some fiscal-budgetary policy objectives, the interpretation of the evaluation results from this the work must be done with caution, with balance and in the context of its descriptive nature.

## **2. Fiscal-budgetary situations potentially generating vulnerabilities**

Usually, a fiscal-budgetary analysis has as its main point of departure the budget, both the previous one and the current one, respectively its underlying assumptions, more concretely, how realistic they are (see the current situation of the budget in Romania, with the erroneous estimation of some revenues and the need to implement some austerity measures on the budget expenditure side). An unrealistically based budget distorts its result, namely the budget deficit, and can create false premises for the next budget course (vulnerabilities, spending commitments, etc.). In this context, the budget becomes, generically, the main source generating fiscal vulnerabilities, which is true, but quite generally, which is why we will also present other fiscal-budget situations potentially generating vulnerabilities, respectively:

- the availability and transparency of statistical data, their knowledge by government authorities, especially regarding the level of gross debt, about its structure (maturity, fixed vs. variable interest, rates and currency composition), are important elements in identifying the risk short-term fiscal;
- the interpretation of fiscal balances can be a source of vulnerability, deriving from the scale and complexity of fiscal-budgetary activities, the structure of revenues and expenses, but above all, the cyclical nature of some of them;
- the composition of expenses is important in assessing vulnerability. An increased weight of administrative expenses in total expenses, limits fiscal-budgetary flexibility in the need to reduce their level, in crisis situations;
- the structure of tax revenues is also important. A good fiscal structure is one in which revenues come from a series of broad-based taxes, ideally, large macroeconomic aggregates (wages, profit and consumption), a situation that will favor a balanced and flexible fiscal system, which is desired from the point of view of facilitating countercyclical fiscal policy through the operation of automatic stabilizers. A revenue structure dominated by one or two taxes with narrow tax bases is a source of

vulnerability, both by increasing a government's exposure to unexpected fiscal developments and by limiting its ability to respond when needed.

Therefore, there are a number of fiscal-budgetary sources and postures that can lead to fiscal-budgetary vulnerabilities.

### **3. The current fiscal-budgetary situation**

The current fiscal-budgetary situation, which also includes historical aspects of the fiscal process and the economic environment in general, can represent a source of vulnerability to the extent that the macro objectives described above are not met. Thus, if the current fiscal position is characterized by large deficits and debts, inability to respond to macroeconomic imbalances (for example, because automatic stabilizers are small and discretionary fiscal policies take time to formulate and implement), and/or high tax rates, then the presumption is created for fiscal-budget vulnerabilities in the short and medium term.

Annex 1 presents data on the evolution of some general indicators, but also on the structure, through which we capture the current fiscal-budgetary state, with an attempt to summarize the situations and situations described previously, potentially generating vulnerabilities, in the period 2007 - 2022.

Total incomes, but also in their structure, record decreases in their share in GDP in 2022, compared to 2007. Thus, at the level of total incomes, there is a decrease in their share in GDP of 1.3 pp, the most important source of the decrease being generated by fiscal revenues from direct taxation, which will be at a lower level in 2022, by 2.1 pp of GDP, compared to 2007, but also against the background of the decrease in the same sense, of other categories of fiscal revenues, including the level of social contributions. Non-tax revenues represent the only revenue category that recorded a higher share in GDP, in 2022, compared to 2007, by +0.7 pp.

Within the analyzed period, the evolution of the share of total revenues and their structure, shows cyclical evolutions, with decreases in the crisis periods (2008 – 2009 and 2020, especially regarding the revenues from direct taxation) and with increases in the post-crisis periods.

Contrary to the general and accentuated trend of reduction of total revenues and in their structure, the share of total expenses registers higher increases in most chapters of their structure. Thus, total expenses have a higher weight in GDP in 2022, compared to 2007, of 1.7 pp. In their structure, the current (administrative) expenses of the state represent the main source of increase in total expenses, they are 4.9 pp higher in 2022, compared to 2007. At the same time, investment expenses (those expenses with a direct impact on the economy, but also on tax revenues through the tax multiplier effects they generate) have decreased by approx. 1 pp in 2022, compared to 2007.

Within the analyzed period, total expenses and their structure increased during the crisis periods (2009-2010 and 2020-2021) and gradually moderated in the post-crisis periods.

A first interpretation of the current fiscal-budgetary situation, based on the income and expenditure situation, suggests a state of imbalance, a state that tends to deteriorate compared to 2007 and which represents a major factor of fiscal vulnerability, especially in the occurrence of an economic, social, health, energy or regional security crisis.

The second interpretation of the current fiscal-budgetary state results from the evolution of the two fiscal-budgetary indicators in relation to the state of the economy. Thus, the imprint of the two major crises that affected the economy can be faithfully observed in the evolution of the two indicators, the incomes being affected, and the expenses requested to boost the economy, the social environment in order to mitigate the effects and overcome the

state of economic recession. The period after the economic and financial crisis (2013-2016) generated a consolidation of public finances, both on the basis of economic recovery and on the basis of the constraints implemented at the European level to restore public finances, but the subsequent management of the fiscal space thus created was unfavorable (the administrative expenses of the state increased) and vulnerabilities appeared in the following years, especially on the budget deficit, which led to the opening of the excessive deficit procedure on Romania by the European Commission, a situation suspended as a result of the outbreak of the COVID pandemic in February 2020.

The observed imbalance was recorded annually in the size of the conventional accounting budget balance, deteriorating by -3 pp, in 2022, compared to 2007. The primary conventional budget balance indicates that the size of interest expenses related to public debt service increased from 0.7 pp, in 2007, to 2 pp in 2022.

A relevant indicator in the analysis and evaluation of the fiscal-budgetary policy, in addition to the ones mentioned, but with direct influence on it, is the public debt. It progressively incorporates the annual fiscal-budgetary results and reflects the institutional capacity of fiscal-budgetary management. The evolution of this indicator during the analyzed period indicates an increase of more than 27 pp, in 2022, compared to 2007, respectively from 20% to 47% of GDP, an aspect that clearly shows a weak fiscal performance, especially in the sphere of revenue formation and an excessive expenditure policy, a conjunctural institutional management, which did not seek to implement a balanced conduct, a sustainable path, to the fiscal-budgetary policy. The alternatives of revising some tax rates, consolidating the tax bases, or improving collection, were neglected, for electoral reasons and priorities, resorting exclusively to the contracting of loans, an aspect that transfers to future generations a fiscal burden- difficult budget.

The third interpretation of the current fiscal-budgetary situation is the fact that the deficiencies in the budget process are found cumulatively in the size of the current public debt, this representing a vulnerability factor on the future fiscal-budgetary policy, the current size of interest expenses being 2% of GDP .

Fiscal consolidation resumes with difficulty, being positive signals in 2022, deficits entering a reduction process compared to 2020 and 2021, and the evolution of the weight of the total public debt recorded a reduction of over 1 pp of GDP. However, the fiscal burden is much heavier today, in relation to the period after the economic crisis of 2008, i.e. if the deficit can be adjusted in the next one / two years, the debt burden is much increased, this being, in fact, the "real cost" of the effects the two major crises that humanity and, implicitly, Romania has gone through, but also the effect of a fiscal-budgetary policy unable, in the current state, to generate and collect revenues at the level of some countries in the region with a similar fiscal regime (e.g. Bulgaria).

#### **4. Final findings and comments**

The objective pursued in the paper aimed at identifying those characteristics of the Romanian fiscal-budgetary system that tend to compromise the ability to fulfill fiscal objectives (traditional or those newly emerging from the evolution of society, the globalization process, etc.), These characteristics offer the possibility of better management of the potential vulnerabilities arising from them, so as to limit the exposure to possible negative results by improving the ability of the fiscal-budgetary system to respond to its general objectives, but also to unanticipated economic and social developments.

The main unfavorable characteristic of the budgetary fiscal system seems to be the fact that it has accumulated a certain exhaustion in most of its structures, an aspect indicated

by the fact that Romania frequently ranks last at the EU level in terms of the level of income generated by certain tax bases, of certain quotas of taxation, of the degree of collection, etc., a situation that manifested itself regardless of the economic state (stability, crisis).

This characteristic is accentuated by the fact that in the analyzed period in the structure of budget expenditures, a broad dynamic of the state's administrative expenditures and an excessive limitation of those for investments can be distinguished, these representing the main factor of inducing multiplier effects in the economy and, subsequently, on tax revenues, by expanding some tax bases.

This state of exhaustion of the fiscal-budgetary system, generated by insufficient revenues and excessive administrative expenses, affected its potential to adapt to the requirements of each stage of national, European and international economic and social evolution. The needs of public funds were covered by borrowing and accumulating public debt at an alarming rate.

From this perspective, the main vulnerability to the fiscal-budgetary policy emerges, namely the excessive indebtedness and the cost of servicing the public debt, located at very high levels in relation to their history at the national level, and their multiplier effect is not found in the economy and society, a fact that will complicate the fiscal burden in the future, practically transferring the affordability of public debt costs to future generations, without significant accumulations in terms of economic desolation, fiscal culturalization, etc.

The Romanian fiscal system is characterized by short-term actions, excessive relaxation, reduced collection, pressures on the deficit and debt, in general a fiscal system insufficiently adequate to the economic situation and not calibrated to achieve strategic objectives of revitalizing fiscal revenues in the short and medium term.

## References

1. Baldacci, E., McHugh, J., & Petrova, I., 2011. *Measuring fiscal vulnerability and fiscal stress: A proposed set of indicators*. IMF Working Paper.
2. Baldacci, E., Petrova, I.K., Belhocine, N., Dobrescu, G., & Mazraani, S., 2011. *Assessing fiscal stress*. IMF Working Paper.
3. Bartolini, L., & Cottarelli, C., 1994. *Government Ponzi games and the sustainability of public deficits under uncertainty*. *Ricerche Economiche*, 48.
4. Schaechter, A., Alper, C.E., Arbatli, E., Caceres, C., Callegari, G., Gerard, M., Jonas, J., Kinda, T., Shabunina, A., & Weber, A., 2014. *A toolkit to assess fiscal vulnerabilities and risks in advanced economies*. *Applied Economics*, 46.
5. Stoian, A., 2011. *Fiscal vulnerability vs fiscal sustainability: theoretical background*. *Theoretical and Applied Economics*, Asociația Generală a Economistilor din România - AGER, 5(558)(su), pp.541-547.
6. \*\*\* <https://mfinante.gov.ro/domenii/bugetul-de-stat/informatii-executie-bugetara>
7. \*\*\* <https://ec.europa.eu/eurostat/data/database>

**Annex 1. Data on the current fiscal-budgetary state of Romania (period 2007 – 2022, shares in GDP)**

| Indicator                |                                | 2007        | 2008        | 2009        | 2010        | 2011        | 2012        | 2013        | 2014        | 2015        | 2016        | 2017        | 2018        | 2019        | 2020        | 2021        | 2022        | Dif.<br>2007<br>–<br>2022<br>pp |
|--------------------------|--------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|---------------------------------|
| <b>Revenues</b>          | <b>total</b>                   | <b>34.8</b> | <b>32.3</b> | <b>30.4</b> | <b>32.4</b> | <b>32.5</b> | <b>32.3</b> | <b>33.7</b> | <b>34.2</b> | <b>35.5</b> | <b>32.5</b> | <b>31.1</b> | <b>31.7</b> | <b>31.6</b> | <b>32.3</b> | <b>32.7</b> | <b>33.5</b> | <b>+1.3</b>                     |
|                          | direct                         | 6.7         | 6.8         | 6.3         | 5.7         | 5.5         | 5.6         | 5.6         | 5.5         | 6.0         | 5.9         | 5.6         | 4.4         | 4.3         | 4.1         | 4.4         | 4.6         | +2.1                            |
|                          | indirect                       | 11.8        | 11.7        | 10.3        | 11.6        | 12.7        | 13.0        | 12.6        | 11.9        | 12.7        | 11.1        | 10.2        | 9.9         | 9.9         | 9.5         | 10.5        | 10.9        | +0.9                            |
|                          | social security contributions  | 9.9         | 10.1        | 9.5         | 8.9         | 9.2         | 8.8         | 8.7         | 8.5         | 8.2         | 8.1         | 8.5         | 10.3        | 10.7        | 10.6        | 10.7        | 9.8         | +0.1                            |
|                          | non-tax                        | 2.1         | 3.4         | 2.9         | 3.9         | 3.3         | 3.1         | 2.7         | 2.5         | 2.8         | 2.4         | 2.6         | 2.9         | 2.6         | 2.3         | 2.2         | 2.8         | -0.7                            |
| <b>Expenses</b>          | <b>total</b>                   | <b>37.5</b> | <b>37.7</b> | <b>39.9</b> | <b>39.5</b> | <b>38.1</b> | <b>36.2</b> | <b>36.0</b> | <b>35.4</b> | <b>36.0</b> | <b>35.0</b> | <b>33.6</b> | <b>34.5</b> | <b>36.0</b> | <b>41.5</b> | <b>39.4</b> | <b>39.2</b> | <b>-1.7</b>                     |
|                          | stream                         | 31,3        | 32,4        | 34,1        | 35,8        | 33,4        | 32,3        | 31,8        | 31,2        | 32,2        | 29,4        | 30,6        | 31,6        | 33,0        | 37,8        | 35,9        | 36,2        | -4.9                            |
|                          | of capital                     | 3,7         | 4,5         | 4,6         | 3,7         | 4,2         | 3,3         | 2,9         | 2,5         | 2,6         | 2,5         | 2,3         | 2,5         | 2,9         | 3,2         | 2,8         | 2,8         | +0.9                            |
|                          | other                          | 2,5         | 0,8         | 1,2         | 0,0         | 0,5         | 0,6         | 1,3         | 1,7         | 1,2         | 3,1         | 0,7         | 0,4         | 0,1         | 0,5         | 0,7         | 0,2         | +2.3                            |
| <b>Budget balance</b>    | <b>conventional accountant</b> | <b>-2.7</b> | <b>-5.4</b> | <b>-9.5</b> | <b>-7,1</b> | <b>-5.6</b> | <b>-3.9</b> | <b>-2.3</b> | <b>-1.2</b> | <b>-0.5</b> | <b>-2.5</b> | <b>-2.5</b> | <b>-2,8</b> | <b>-4.4</b> | <b>-9.2</b> | <b>-6.7</b> | <b>-5.7</b> | <b>-3.0</b>                     |
|                          | conventional primary           | -2,0        | -4,7        | -7,7        | -5,4        | -3,8        | -1,9        | -0,4        | 0,4         | 0,9         | -1,2        | -1,3        | -1,6        | -3,3        | -8,4        | -5,5        | -3,7        | +1.7                            |
|                          | structural                     | -5.0        | -8.3        | -9.2        | -5.5        | -3.7        | -3.7        | -1.3        | -0.7        | -0.3        | -1.4        | -2.7        | -3.1        | -4.7        | -7.5        | -6.0        | -6.3        | -1.3                            |
| <b>Total public debt</b> | share in GDP                   | <b>19,8</b> | <b>21,3</b> | <b>23,6</b> | <b>30,5</b> | <b>34,7</b> | <b>38,1</b> | <b>38</b>   | <b>39,8</b> | <b>37,8</b> | <b>37,4</b> | <b>35,1</b> | <b>34,7</b> | <b>35,3</b> | <b>47,3</b> | <b>48,9</b> | <b>47,2</b> | <b>-27.4</b>                    |
|                          | annual growth rate             | 29,9        | 33,4        | 34,2        | 6,8         | 21,4        | 15,1        | 8,7         | 9,8         | 2,7         | 6,1         | 5,5         | 9,7         | 13,1        | 33,4        | 15,5        | 15,5        | -                               |

Source: budget executions of the consolidated general budget, available at <https://mfinante.gov.ro/domenii/bugetul-de-stat/informatii-executie-bugetara> and eurostat data