THE BUDGET DEFICIT OF ROMANIA IN 2016. FINANCING AND PERSPECTIVES

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Abstract: *Studies regarding the determination of the budget deficit, the ways of financing it and the assessing of the debt level are specific to different economies, due to the existing disparities in terms of the adopted development models and the issues of financial, social and administrative nature found and implemented through governance programs. These differences raise a number of issues that involve a rigorous approach to the potentially unfavorable outcome of a budget deficit and the public debt establishment beyond a non-inflationary level of funding. In our country, taking into account the fact that the economic activity unfolds in a complex and often unstable context, and due to the preoccupation to establish the place of the budget deficit, a special role is assigned to the calculation of the weight of the public financial deficit within the expenditures and revenues of the general consolidated budget and the permanent concern for its diminution.*

Keywords: *deficit, budget, public administration, economic crisis, financing, investments*.
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. The budget deficit in Romania in 2016

2.1. Economic situation and synthetic budget indicators

Recently, it has been noted that both the euro area and the EU member states the perspective of the public finances have improved due to the strengthening of the economy and flexible monetary policy, and unemployment is gradually decreasing as the economic recovery.

In 2016, Romania recorded an economic growth of 4.8%, being the sixth consecutive year of positive developments (1.1% in 2011, 0.6% in 2012, 3.5% in 2013, 3.1% % in 2014 and 3.9% in 2015), which places us among the top three performers in the EU28. The main factor of this increase was the final consumption as a result of the private growth of 7.4%, in the conditions of improving the purchasing power of the population. On the other hand, government consumption increased by 4.5% (MPF, Budget execution report 2016).

The exports of goods and services increased by 8.3%, while imports of goods and services grew by 9.8%, with net external demand contributing negatively (0.7%), mainly because the increase of domestic demand could not be fully covered by domestic production.

In 2016, compared with 2015, consumer prices declined for the second consecutive year, both as an annual average (-1.55%) and at the year-end (-0.54%). These price reductions were based on the reduction of the VAT rate from 24% to 20% for the rest of the product categories, which entered into force on 1 January 2016.

Romania's structural deficit increased to 2.4% of GDP in 2016, in line with the increase in the general government deficit. The GDP gap versus potential was still negative, down with 0.8 percentage points versus 2015, which led to a cyclical component of the budget deficit of 0.3% of GDP.

Figure no. 1. The structural deficit in Romania (% in GDP)

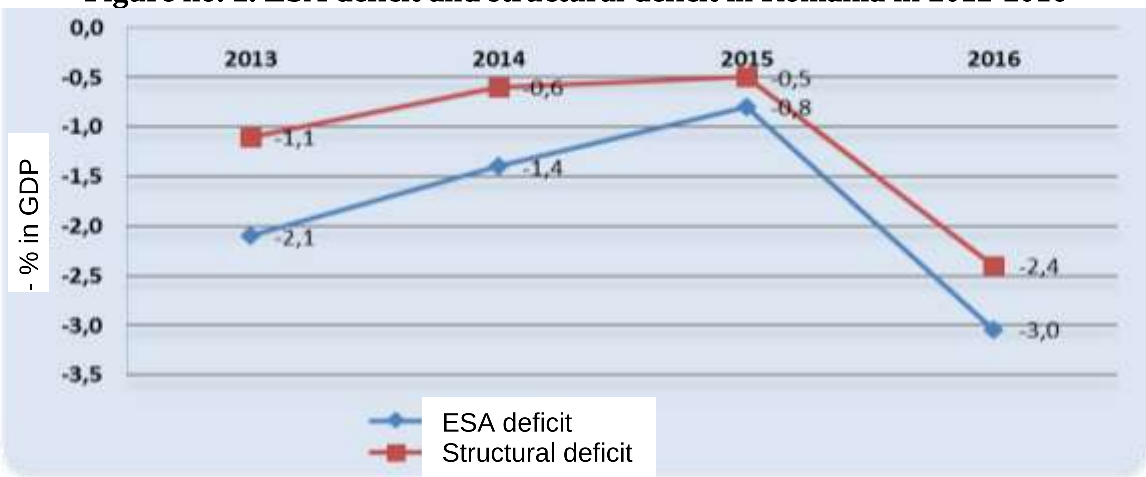
	2013	2014	2015	2016
The structural deficit	**-1.1**	**-0.6**	**-0.5**	**-2.4**

Source: Ministry of Public Finance, *Report on Final Budget Execution for 2016*, www.mfinante.gov.ro

Although the structural deficit is periodically reviewed, including for the values of previous years, it can be appreciated that Romania has been among the deepest reductions in this deficit after the emergence of European regulations in this area.

In turn, the budget deficit for 2016 represents -3.0% of GDP, above the average of the budget deficit for the euro area of 1.5% of GDP and for the EU28 of 1.7% of GDP.

Figure no. 2. ESA deficit and structural deficit in Romania in 2012-2016



Source: Ministry of Public Finance, *Report on Final Budget Execution for 2016*, www.mfinante.gov.ro

In our country, the economic developments have ensured the maintenance of macroeconomic balances recovered after the international financial crisis. Of the 16 EU countries identified by the European Commission as having some macroeconomic challenges, Romania is included in the risk category that can be relatively easily managed

(Belgium, the Netherlands, Finland, Sweden and the UK) (NBR, Financial Stability Report 2015).

2.2. Analysis of the state budget revenues and expenditures in 2016

Taking into account the final data, between 1 January and 31 December 2016, the implementation of the general consolidated budget ended with a cash deficit of 18.3 billion lei, respectively 2.4% of GDP, compared to an expected deficit of 20.9 billion lei.

Compared to the previous year, the general government deficit in 2016, on a cash basis, declined as a percentage of GDP by 1.05 percentage points from 1.35% in 2015 to 2.4%.

Figure no. 3. Romania's cash budget deficit

		2015	2016	Differencies 2016-2015
Deficit	**Mil. lei**	**-9630.7**	**-18304.3**	**-8673.5**
	% in GDP	**-1.35**	**-2.40**	**-1.05**

Source: Ministry of Public Finance, *Report on Final Budget Execution for 2016*, www.mfinante.gov.ro

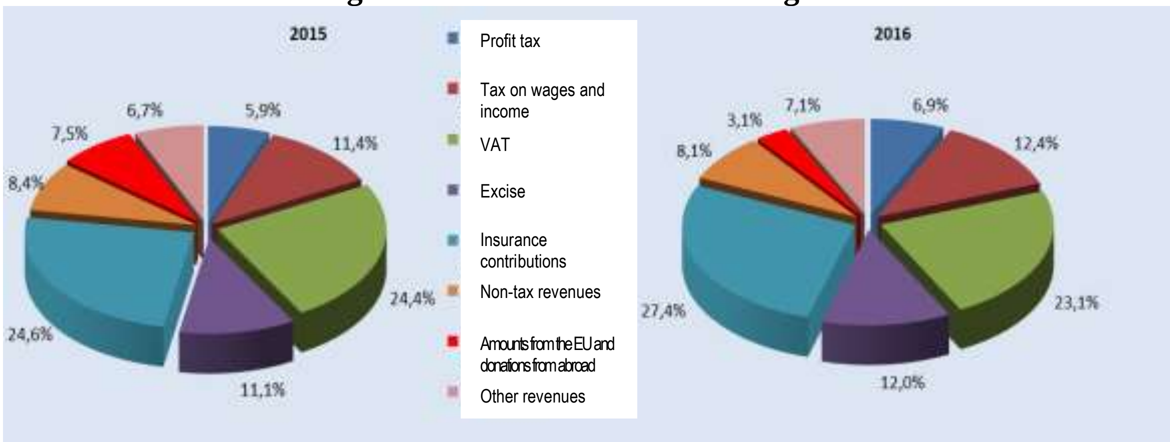
• **The revenues of the consolidated general budget** in the year 2016 totaled 223.9 billion lei, representing 29.4% of GDP and a rate of achievement compared to the 95.1% annual estimates (MPF, Budget Execution Report 2016).

Figure no. 4. The degree of achievement of the consolidated general government revenues in 2016

Source: Ministry of Public Finance, *Report on Final Budget Execution for 2016*, www.mfinante.gov.ro

The budgetary incomes were influenced by both economic developments and tax policy decisions, such as: raising the minimum wage, widening salaries in the public sector, increasing the retirement point, increasing the contribution rate for privately managed pension funds, such as and the change in the amount of excise duty.

Figure no. 5. The structure of budget revenues



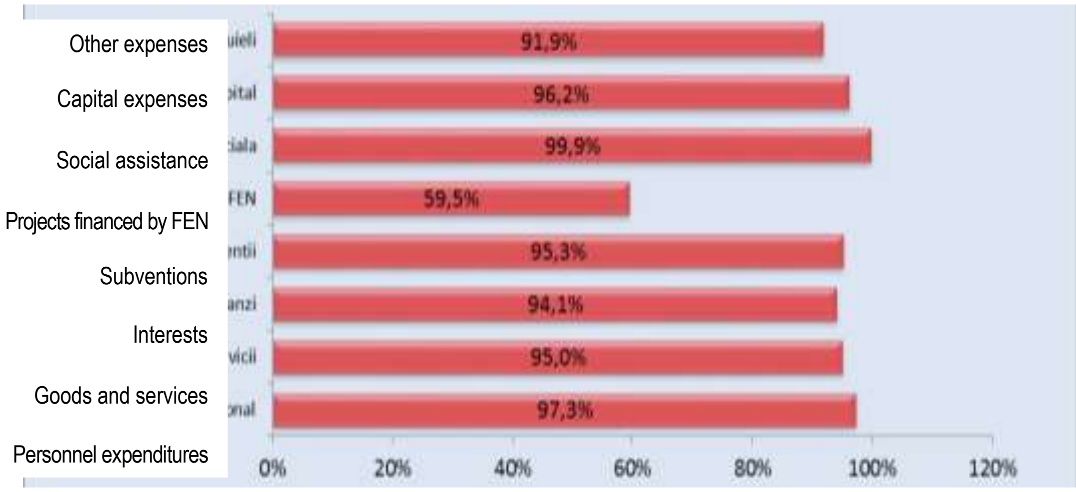
Source: Ministry of Public Finance, *Report on Final Budget Execution for 2016*, www.mfinante.gov.ro

Compared with the previous year, the general consolidated budget revenue in the year 2016 decreased by 4.2% and as a percentage of GDP decreased by 3.5 percentage points from 32.9% in 2015 to 29.4 % in 2016.

Amounts received from the European Union for payments made (including donations) in the year 2016 amounted to 6.9 billion lei, 60.2% below the level recorded in 2015. Also, as a ratio to GDP, they declined by 1.6 percentage points from 2.5% in 2015 to 0.9% in 2016.

- **The expenditures of the consolidated general budget** in the year 2016 amounted to 242.2 billion lei, which represents 31.8% of GDP and a degree of achievement compared to the planned level of 94.5% (MPF, Budget execution report 2016).

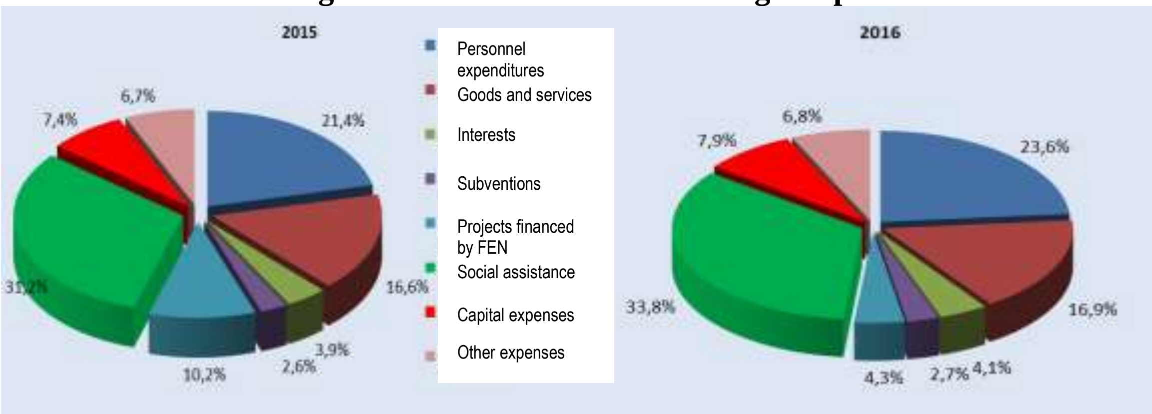
Figure no. 6. The rate of achievement of the general consolidated budget expenditures in 2016



Source: Ministry of Public Finance, *Report on Final Budget Execution for 2016*, www.mfinante.gov.ro

From the point of view of the annual program achievement, the main categories of budget expenditures registered the following evolutions: 97.3% personnel expenses, 95.0% expenditures on goods and services, 94.1% interest expenses, subsidies 95.3%, social assistance expenses 99.9%, capital expenditures 96.2%.

Figure no. 7. The structure of budget expenditures



Source: Ministry of Public Finance, *Report on Final Budget Execution for 2016*, www.mfinante.gov.ro

Compared to the same period of the previous year, general government expenditures declined by 0.5% and as a percentage of GDP by 2.4 percentage points from 34.2% in 2015 to 31.8 % in 2016.

2.3. The financing of the budget deficit in 2016

According to EU methodology, government debt stood at 37.6% of GDP on 31 December 2016, down from 38.0% of GDP as at the end of 2015, below the limit of 41% of GDP set by Law no. 338/2015 for the approval of the limits of some indicators specified in the fiscal-budgetary framework for 2016.

From government debt, on 31 December 2016, domestic debt accounted for 19.4 percent of GDP, and external debt was 18.2 percent of GDP.

In 2016, the budget deficit financing was mainly driven by domestic sources through issues of government securities on the domestic market and in addition from external sources. The sources needed to refinance government debt were provided by the markets on which these debts were issued and by the foreign currency reserve available to the MFP, which at the end of 2016 covered 4.8 months of gross financing, including holdings in foreign currency from the privatization proceeds.

The debt instruments used to finance the budget deficit and debt refinancing in 2016 were (MFF, Budget Implementation Report 2016):

- government securities denominated in lei, on the domestic market, amounting to 45.4 billion lei. Thus, treasury certificates with maturity of up to 1 year amounting to 13.7 billion lei and benchmark government bonds worth 31.7 billion lei were issued, according to the announced calendar;
- government securities denominated in euro, on the domestic market, amounting to EUR 775 million;
- eurobond issues launched in foreign capital markets. In 2016, the MFP drew from the foreign markets a volume of 3.25 billion euros through three programs under the MTN Program;
- issue of government securities exclusively for individuals, FIDELIS. This issue had a significant success, attracting a volume of 735.26 million lei, compared to the initially announced volume of 100 million lei;
- entries of external credits to finance projects amounting to approximately EUR 59 million related to the loans contracted from international financial institutions.

3. The perspectives on the state budget deficit

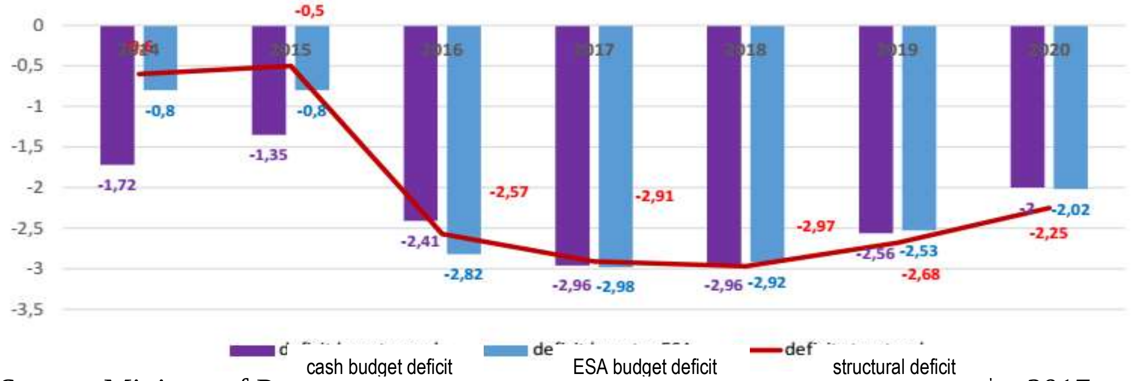
If we relate to EU member states, economic recovery has manifested itself in all member states, but it has been slow, supported by factors such as falling of the oil prices, flexible monetary policy and the relatively low external value of the euro. It is estimated that the pace of economic growth in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

The average annual growth rate of potential GDP estimated by the European Commission for the period 2017-2018 is 3.7%, while for the same period, at national level, an average annual growth rate of 4.9% is projected (MPF, Macroeconomic Situation Report 2017).

Compared to other European countries, Romania is, however, among the least indebted. The EU average is 87% of GDP, according to Eurostat, the European countries with the largest debts now being Greece, Italy and Portugal.

It is also worth mentioning that the European Commission estimates those in the Autumn Forecast 2016, where economic growth for 2017 and 2018 does not take into account the impact of measures in the Governance Program, being below the macroeconomic framework taken into account in the budget for 2017. The private consumption would remain the main source of growth until 2018, sustained by the projected increase in employment rates (continuing the current trend) and wages (in a slight upward trend).

Figure no. 8. The evolution of budget deficits in Romania during 2014-2020



Source: Ministry of Public Finance, *Report on the macroeconomic situation for 2017 and its projection for the years 2018-2020*, www.mfinante.gov.ro

Romania has made good progress in meeting the medium-term budgetary objective defined in terms of structural deficit in 2014-2015, which reached 0.6% of GDP and 0.5% of GDP respectively GDP, which is in line with the provisions of the Treaty on Stability, Coordination and Governance within the Economic and Monetary Union.

On the other hand, it is noted that the structural balance deviates from 1% of GDP from the Medium-Term Budget Objective (MTO), starting from 2016. The main reason for this evolution is the fiscal relaxation started in 2015-2016 , determined by the new tax code, salary increases and social security rights and continued by the recently adopted measures such as the abolition of contributions for pensioners, the non-taxation of pensions under 2,000 lei, the law on the elimination of 102 taxes, decisions which have effects since 2017.

In the context of those previously presented, in structural terms, a deviation is estimated on the reference horizon of MTO set for Romania, 1% of GDP, the structural deficit for 2017 being estimated at 2.91% of GDP, and in the year 2018 to 2.97% of GDP, with a downward trajectory starting in 2019 and 2020 respectively.

Given this risk, the deviation from the MTO would occur under conditions of maintaining a sustained level of government debt below 40% of GDP over the entire planning horizon, the ultimate goal of European rules on budget deficit being assured.

If the beginning of 2019 it would recover from the deviation of the MTO, this could generate sufficient fiscal environment for some budgetary policy measures, such as increasing public investment in infrastructure.

This deflection recovery at the end of the forecasting horizon is also necessary in view of the fact that a deterioration in the structural position of public finances would result in a potential market reaction, with consequences on the increase in the cost of financing the budget deficit.

4. Conclusions

The main effects of public spending can be equated to „crowding out", which in this case refers to the deflection of market resources from those sectors that the market sees as profitable to the areas considered as being interesting by the state. Also, a hidden cost of budget deficit and public debt influencing the country rating, a major 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 it is desired to identify and encourage those branches and sub-branches of the national economy that can be developed in the world economy, it is necessary to use tax levers in concordance with the requirements of the European Union and taking into account the other macroeconomic policies that can be adopted to overcome the current economic situation. Thus, the theory that, during the crisis period, it is preferable to ensure an increase in budget expenditures, with the objective of contributing to the revival of economic activity, the effects being reflected in the increase of the employment and the reduction of the unemployment.

The economic growth model needs to be reassessed, taking into account the experience of the past years when the economic growth in our country was based on consumption, a situation that did not allow sustainable economic development. For this reason, another investment-oriented approach is needed in sectors with high added value.

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