Academic Journal of Economic Studies
Vol. 1, No.4, December 2015, pp. 20–36
ISSN 2393-4913, ISSN On-line 2457-5836

Romania's Macroeconomic Steering in 2015 - between Enthusiasm and Recession Risk

Cristian - Marian Barbu[1], Sorinel Căpuşneanu[2]

[1] Department of Management-Marketing, "Artifex" University, Bucharest, Romania, e-mail: doctrine.economice@gmail.com
[2]Department of Accounting and Auditing, "Dimitrie Cantemir" Christian University, Bucharest, Romania, e-mail: sorinelcapusneanu@gmail.com

Abstract *This article reveals that, despite having a solid macro-economic state and a significant economic growth as starting points, those who conceive the fiscal-budgetary macroeconomic policies in Romania apply more enthusiasm than principles of responsibility, prudence and sustainability. While economic growth in Romania is over 3% of the GDP, public debt of a little over 40% of the GDP, budget revenues with 7.8% bigger than during the first 9 months of the previous year, and budgetary surplus of almost 1% of the GDP after the first 8 months, the 2016 budget prospects look good. Well, they are actually not. If the Government implements the budgetary expenditure announced, the budget deficit may explode which may lead, in 2018, to exceeding the maximal critical threshold of public debt, and in this case, according to the Romanian National Bank, the recession risk will be over 50%.*

Key words Macroeconomic policy, public debt, budget deficit, accountability, prudence, recession risk

JEL Codes: E60

1. Introduction

Romania is currently enjoying a good macroeconomic state, and a solid economic growth. Unbalances caused by the strongly pro-cyclic fiscal-budgetary policies, like in the years before the economic crisis, have been corrected. That is why Romania should continue along the path of responsible policies, which requires prudence in fiscal-budgetary policies, in order to strengthen macroeconomic balance and the long-term economic growth potential. Thus, the fiscal-budgetary framework is deviated because of the political decision. We lack basic coordination between the priorities of the fiscal policy, on the one hand, and budgetary policy, on the other hand. Fiscal policy diminishes taxes, while budgetary policy increases taxes. With low taxes and high expenses, as the law of harmonized wages looks like, we have an explosive harmful combination, especially at the stage of economic expansion. Hence, excessive deficits and public debt expansion.
The enforcement of the new Fiscal Code, adopted by the Law no 227/2015 on the approval of the Fiscal Code, published in the Official Gazette no 688 of September

10, 2015, gives way to tax cuts that have been well received by the business milieu: health contribution cuts of 5%, VAT cut for food items from 24% to 9%, to be put in practice starting with 1 January 2016. For the first time in 25 years, following the reorganization of ANAF (National Agency for Fiscal Administration) and the creation of the Anti-Fraud Directorate, fiscal receipts have become the rule, and revenues from VAT increased with 20% in the first six months in 2015. The VAT cut was desirable, not necessary. The problem is to implement it together with the other measures, at the same time. At times, this all-inclusive approach paradoxically annihilates its own success chances. On the other hand, we must emphasize that the reduced VAT for food is a good measure, also from the point of view of fiscal fraud. However, we have to wait in order to assess, comprehensively, all economic effects and budgetary implications.

Budget revenues increased from 141 billion lei (31.75 billion euro) for the first nine months in 2012 to 169 billion lei (38 billion euro) for the first nine months in 2015, 20%, over the GDP growth rate for the same period of time, 18%. The government kept the budgetary deficit under control by diminishing investments, from 11.9 billion lei (2.6 billion euro) for the first nine months in 2012 to 7.6 billion lei (1.7 billion euro) in the first nine months in 2015.

To note that the target meant to discipline the fiscal-budgetary policies does not refer to the actual deficit of the governmental budget, but to the so-called „structural deficit". This is the „control leverage" that ensures fiscal discipline and renders impossible the pro-cyclic fiscal policies, by correcting the actual deficit with a cyclic component. The purpose is to slow down the pro-cyclic policies, resulting into higher structural deficits during expansion, which strongly eroded the sustainability of public finance and imposed huge costs for budgetary adjustments and post-crisis economic recovery. If we take into account the fiscal code implication for 2016 and we look at the structural deficit, Romania significantly deviates from the Medium Term Objective (MTO) target, and such prospects, rather profitable, will render even more difficult the effort for fiscal consolidation.

2. Literature review

As regards Romania's budgetary-fiscal policy, an extremely interesting opinion is found in the book of Liviu Voinea which has two main theses substantiated with discernment and based on reports and relevant studies: the internal nature of the crisis in Romania in 2009 and myths directing the going of Romanian economy (Voinea, 2009). These two theses go together, and their deployment follows two directions announced in the subtitle: crisis and anti-crisis. He places the origin of the economic difficulties of Romania in the perimeter of a wrong economic policy mix. A mix which, in his opinion, has stimulated consumption at the wrong time and stressed imbalances.

Also in the Financial Stability Report (2015) National Bank of Romania notes that while the domestic macroeconomic environment has improved due to favorable developments in 2014 (economic growth, structural deficit of 1 percent of GDP, purchasing power of the population has increased, the interest rate of monetary policy has reached an historic low, the current account deficit has increased of around 1 percent of GDP, due to higher export competitiveness, the cost of financing public debt continued to decline), the internal macroeconomic policies mix must remain prudent, to promote healthy economic growth, accompanied by a deficit budget within the limits of the medium term objective of fiscal-budgetary policy.

Another paper argues that over-expansionary monetary policy and lack of effective macro-prudential oversight, which allowed an extension of prolonged consumer spending financed by debt and lack of political action in a timely and decisively to correct internal and external imbalances; they contributed substantially to the buildup of financial excesses that led to the financial crisis and Great Recession of 2007-2008 (Catte *et al*., 2011). On the other hand, it suggested that only a much broader set of interdependent macroeconomic factors (and financial) it could generated a crisis of this magnitude (Visco, 2009).

3. Methodology of research

In order to conduct this study, we have complied with some guidelines regarding the methodology of scientific research. Thus, the principle of unity between theoretical and empirical aspects, the principle of unity between informative judgment and evaluative judgment (all researchers should involve morally to support general values), as well as the principle of unity between quantitative and qualitative, used in order to render efficient the results of the research. This mixed methodology is typical of social sciences. In order to fulfil our goal, we have used fundamental research methods consisting in reading of the specialized literature in this field and some statistics, articles and studies covering this topic.

In order to establish and analyse the situation and the performances of the macroeconomic policy in Romania, we have used the data provided by national statistics (from Ministry of Public Finance, National Bank of Romania, National Institute of Statistics) and by various national and international publications that we assessed and interpreted. Our methods have been: analysis, synthesis, comparison, deduction and induction.

4. Synthetic analysis of the budgetary revenues and expenditure in 2014

In 2014 the state collected almost 214 billion lei (48 billion euro) that means 2,400 euro, on the average, per capita (including revenues from EU funds, and money reimbursed by the European Commission) of the resident population (according to the INS - National Institute of Statistics data for 2014). Most significant revenue sources are taxes, fees, excises and social contributions. Fiscal revenues (VAT, excise, tax on income, tax on profit etc.) means 58.4% out of the total public revenue last year, social and health contributions were 26.9%, and non-fiscal revenues (fines and royalties) 8%.

Most significant expenses are those with social assistance (majority, in the public pension system) – 31.5% out of the total (16.1 billion euro), public employees' salaries 22% out of the total (11.3 billion euro), goods and services 17.5% out of the total (8.9 billion euro – including fuel for the cars of the public institutions and the medicine) as well capital-related expenditures, 7.6% out of the total (3.4 billion euro – expenditure incurred with investments made with public money, without including the EU funds).

While in the case of the VAT, excises and tax on revenue, the destination of the money is "general", in the sense that they are not collected for a certain kind of expenditure, the case of the contributions is different (social insurance goes to pensions, health insurance goes to the Health authority etc.). There are cases where the state collects a certain tax for a reason that turns out to be, partially or fully, false, for expenses that are not transparent, and the state cannot prove the "path of the money" from the taxpayer's pocket to the state's account that collects.

Here are 5 kinds of taxes, collected at national level for a certain purpose, and the way in which they can be found in expenditure, as amounts or transparency of the public money:

- Super-excise – admitted as a mistake of the government. Introduced by the Government on 1 April 2014, the super-excise on fuel (additional excise of 7 eurocents for fuels) was supposed to bring additional revenue to the public budget that the politicians should have re-orient to investments in infrastructure, at national level (through the Romanian National Company of Motorways and National Roads - CNADNR), and local level. Originally, additional revenues of half billion euro were estimated, which later on turned out to be 350 million euro. In 2014, central and local authorities in Romania had expenses for investments (capital expenses from public money, without taking into account the EU funds) with 700 million lei less than in 2013 and with 883 million lei under the planned level, in the 2014 budget, the effect of the super-excise was zero in infrastructure, as the money was oriented to other kinds of expenses. This was confirmed in May 2015, by the very Prime Minister of Romania, who created this super-excise: "It has not been a good project, as we haven't managed to de-block the procedures and to effectively invest the money. It helped have a fiscal space. To initiate a procedure, you must show that you have the money, otherwise the European Commission and the IMF will say: cut, you cannot give CNADNR so much".

– Vignette - tax that helped the Romanian National Company of Motorways and National Roads - CNADNR to make a huge profit. Unlike the super-excise on fuel, which is paid to the state budget like other taxes, the vignette is, under the law, revenue of the CNADNR, the public company that is supposed to look after national roads and motorways in Romania. In 2014 CNADNR had revenues of 240 million euro from the vignette and the bridge fee in Feteşti. Out of the total budget of CNADNR, the vignette is 20% of the revenue, the difference is ensured by subsidies from the public budget. The cheapest vignette costs 13.27 lei for a car and it has 7 day validity. The most expensive costs 5,354 lei for the goods vehicles over 12 tons with at least 4 axes and it has 1 year validity.
At the end of 2014 Romania had 683 km motorways, 6.1% more than in 2013, with 39 km, but there are still 15 km of national road (DN 5A Mironeşti-Izvoarele, Giurgiu county, DN 2N Bogza-Mărtineşti, Vrancea county and DN 24C, Botoşani county), for which the vignette is compulsory, which are soil roads, with no road coating.
To note that despite the poor national road infrastructure, in 2014 CNADNR managed the "success" to rank the 11th most profitable companies in Romania, it did not spend about 429 million lei out of the revenue collected (from the vignette and state subsidies), (96 million euro), according to the list made by Ziarul Financiar. CNADNR also managed the success to decrease the number of km opened for traffic, after ordering the demolition of 200 metres on the 3rd segment of Sibiu – Orăştie motorway, at km 60, opened for traffic by the minister of Transport at that time, Ioan Rus, 2 days before the 2nd round of presidential elections, with Victor Ponta, the Prime Minister at that time, present, who later on lost the election in favour of Klaus Iohannis, the current president.
– About 20% of the environmental sticker fee is spent to reimburse the "first registration fee", illegally collected. Introduced by Tăriceanu Government in 2006 and applicable since 2007, the special first registration fee has been object to many changes, and Romania entered into conflict with the European Commission because it enforced it, at a certain moment, only on imported cars. Following the illegal application of this fee, hundreds of thousands of people are not entitled to request reimbursement of a part of the fee paid between 2007 – 2013, depending on the account to which the payment was made, the state budget or the budget of the Environmental Fund Administration (AFM).
The money collected from the current environmental sticker fee is direct revenue to AFM – the Environmental Fund Administration, namely 70% of total revenue. In 2014, about 21% of the value of the environmental sticker fee collected was spent on reimbursing the tax illegally collected by the state that is 150 million lei, out of the total 713 million lei. The reimbursement of the amount illegally collected is the 3rd biggest expense of AFM-the Environmental Fund Administration, after the projects for "protection of water sources, for water supply integrated systems, treatment

plants, and sewage systems", 170 million lei, and "the Wreckage car program", to renew the car fleet, for which AFM spent 141 million lei in 2014, according to the official report of the institution.

– Tax on vice. Introduced in 2006, by Tăriceanu Government, to add extra money to the Health Budget, the tax on vice (20 eurocents per pack of cigarettes and 200 euro per hectolitre of spirit – at the moment when it was implemented) was announced as solution to fund the national program against smoking and alcoholism, as prevention and treatment of smoking-and alcohol-related diseases. During the last years, with few exceptions, transparency regarding how the money collected was spent was almost zero. Among exceptions, the statement made by the officials of the Health Ministry, for Mediafax press agency, according to which the revenue from the tax on vice was 1.3 billion lei (almost 300 million euro) per year; the total revenue from 2007 to 2013 was 7.5 billion lei.

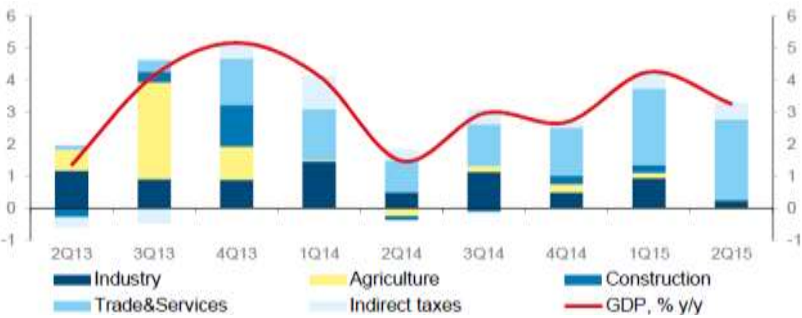
About the destination of this money, the officials of the Health Ministry told Mediafax that "the beneficiaries of the money collected from the tax on vice have been the medical units subordinated to the Health Ministry, and the medical units subordinated to the local public administrations. The money was allocated, among others, for national programs for treatment of communicable and non-communicable diseases (HIV/AIDS, TBC, cardiovascular diseases, oncological, neurological, diabetes, haemophilia, thalassemia, rare diseases). Savings made from the money received from the Health Ministry allowed the procurement of ambulances".

According to the official data of the Health Ministry, the budgets allocated for the national health programs (from vaccines to oncology) are of 4,579,860,000 lei, that is over 1 billion euro. The National Health Insurance Authority - (CNAS) has the biggest budget for national health programs, especially because of the national oncology programs, of 3.75 billion lei, the difference of 830 million lei is the budget allocated to these programs by the Health Ministry.

– TV tax, the main revenue source of a bankrupt institution. Last year, in 2014, the Romanian Television (TVR) collected 72.5 million euro from the TV tax, which is 4 lei for physical persons and up to 50 lei for legal persons having their registered office in Romania, that is an average per year of 12.7 euro from each of the 5,651,095 payers in 2014 (according to the TVR report, made public), out of which 5,327,861 are physical persons. Legal persons operating in the tourism sector pay 7.7 lei per room. For total revenue of 124 million euro, the TV tax is 58.5% of the revenue of the Romanian television. The difference was ensured mainly from state budget subsidies, plus revenue from advertising of approx. 6.4 million euro. To collect this tax, TVR paid in 2014 commissions of 5 million euro, 7% per year on the average. In 2014 TVR had 18.5 million euro loss and reported 160 million euro debts. Out of the 625 million lei total expenses, TVR budget in 2014 included the following: expenses for services performed by other entities - 242 million lei (especially payments to Radiocom – the company that ensures national broadcasting for TVR programs - 142 million lei) and staff -153 million lei. TVR programs in 2014 cost 105 million lei (according to the TVR activity report – page 154), including : sports contests – 53.5 million lei (especially as a result of the Football Championship broadcasting from Brazil – in 2013, expenses were only 15.3 million lei), production – 25 million lei, news and talk shows - 16.3 million lei and procurement (e.g. films) – 10.7 million lei.

5. Macroeconomic state at mid-2015

As expected, the annual economic growth calmed down during the 2nd quarter in 2015 (+3.3%), due to significant deceleration of the added value growth in industry. Per quarter, the economy almost stagnated between April-June (+0.1%), being affected by the negative impact of net exports and stocks slide. Given that the GDP data, seasonally adjusted, has high volatility, and requires significant reviewing from one quarter to another, we shall limit ourselves only to making comments on the annual evolution of the GDP components.
Regarding resources, the "industrial production" was a major slowing down factor in the 2nd quarter in 2015, its annual growth was only 0.8%. While the new foreign orders speeded up the annual growth between April-June, the domestic orders had a negative annual trend generated especially by the significant slide of sustainable consumption and capital commodities in April-June. The slowing down of the capital commodities production was curbed as a result of the modest recovery of the foreign demand. Romania is still in the previous paradigm: export of capital commodities (70% of exports are done by companies with FDI), in parallel with import of machinery and equipment needed to increase its production capacity.



Source: INS and BNR data processing

Figure 1. GDP formation (resources)

Although ”agriculture” affected the economic advance in the 2nd quarter, it was not much of surprise, given the volatile and difficult-to-foresee behaviour. After positive surprise between January-March, ”agriculture” ended the 2nd quarter with 2% annual slide. ”Constructions” slowed down their annual growth pace (+1.5%), due to loss of speed of the residential segment. ”Commerce and services” were the only factor that improved performance in the 2nd quarter, ”IT&C” accelerated its annual dynamics to +15%. If it hadn’t been for the good results of the sectors ”IT&C” and ”real estate”, the overall trend in ”commerce and services” would not have reached the level of the previous quarter, because some categories decelerated (such as ”financial intermediation”, ”administrative and support services”, ”recreational services” and ”other services of household repairing”).

Private consumption continued its ascending trend in the 2nd quarter (+5.3%), as suggested, as least partially, by the speeding up of the three month mobile average of retail sales, especially as a result of significant contribution of food sales. We believe that the salary increase was practically the main element of the good performance in the food sales, as prices started decreasing in June when the Government cut the VAT to 9% for all food items.

The gross fixed capital formation slightly decreased in the 2nd quarter, although the equipment represented a higher percentage in the total investments, as against the previous quarter. Exports slowed down per year quicker than imports (+4.2%) due to the unexpected decrease of the export of services. The increase of private consumption and the significant growth of investments may have fuelled imports, thus explaining the less significant slowing down of imports compared to exports. In the balance, net exports reduced the annual economic growth with 1.5 p.p. in the 2nd quarter, slightly higher than in January-March 2015.

For the moment, the prospect of economic growth for 2015 is 3.6%, although we should not exclude a stronger dynamics of private consumption. The reduced VAT that entered into force in June 2015 may give additional boost to consumption until the end of the year. However, this ascending trend may be slowed down by postponed consumption in non-food items, as the recently amended Fiscal Code stipulates further VAT reduction for the other element of the consumer basket (besides food) from 24% to 20%, starting with January 2016. Regarding the quality of agriculture, everything seems to indicate reduced crops this year, as large areas have been affected by serious draught.

Regarding investments, the trend was ascending for the first 6 months, but it is still too early to say if it is a consolidated trend, given the decrease in the previous two years. The expectations for exports of commodities for the 3rd quarter are higher, according to the data presented by the European Commission, and if they are accurate, they may diminish, to a certain extent, the negative contribution generated by imports.

Despite exceptional performance in exports, industrial production increased with only 0.5% in July as against the previous month. A simultaneous interpretation of the data regarding exports and industrial production is not relevant in most cases due to the gap between the two indicators. If it hadn't been for the monthly advantage of the energy production in July (7%) – the heat has led to high electricity consumption – industrial production would have become negative, as the extraction sector diminished with 5.7%, and the processing sector increased with only 1.4% as against the previous month.

The durable goods and capital commodities had among the highest dynamics during the first 7 months this year, sustaining the annual growth of the processing sector (+3.6%). Industrial production increased with 3.4% annual rate and 3.2% in the first seven months as against the seven months of 2014. Monthly exports reached a historical maximal value in July (5 billion euro), being supported by the EU component which also reported the highest rate (3.6 billion euro). Exports of cars and equipment significantly contributed to the growth reported for January-July. Exports per year exceeded the threshold of 54 billion euro with a high rate in July (54.2 billion euro).

Retail sales seemed to have found annual balance around 6%. The fact that non-food sales had a weak increase in July prevented retail sale to increase quickly per month (+1%). Fuel sales exceeded expectations, with a monthly increase of 4%, and their prices significantly decreased in July. Food sales slowed down in July (+0.3% per month), after a hike in June. The annual dynamics of sale speeded up to 8.5% in July and 5.5% in the first seven months.

Trust in consumption improved in August, and the annual growth trend consolidated. It can signal a continuation of positive contributions of the private consumption.

Although they had a monthly dynamics that was diminished as against June, constructions had an overall monthly increase of 1.4% in July, which pushed the annual growth to over 15%. The non-residential and engineering segments increased with equal percentages in July (+1.1% monthly), but the residential segment exceeded all expectations with a monthly increase of 17%. Cumulated for the first 6 months, the main growth factors were the residential and non-residential segment, while the dynamics of the constructions-engineering was more diminished.

The expectations regarding employment during the next three months (September-November) significantly increased in August, as services, commerce and constructions reported significant increases. At the other ends, the expectations regarding employment in industry, which continued to slide in August for the 3rd consecutive time. The number of new jobs increased with 147,000 in the first seven months, while unemployment rate, while the unemployment rate that is seasonally adjusted was 6.8%, after the National Institute of Statistics reviewed downwards the data for January-June. The first five sectors with the highest job dynamics have

been ”IT services”, ”electronics and optical equipment production”, paper production”, ”car industry” and ”hotels and restaurants”. In terms of contribution to new jobs, the leading sectors have been: ”car industry”, ”hotels and restaurants”, ”IT and support services”, ”commerce” and ”constructions”. They generated, on the average, over 53% of the new jobs created in the first seven months.
The annual inflation rate decreased to -1.9% in August, from -1.7% in July. Food became cheaper with 0.8% per month following the cuts in vegetable, fruit and dairy prices. Non-food items also had cheaper prices in August as against July (-0.5%), after significant cut of fuel price, but also cuts in medicine prices. Services prices had a flat monthly trend because the cut in phone services fees was balanced by increases in sewage services and town cleaning services.

Table 1. Evolution of macroeconomic indicators

	2010	2011	2012	2013	2014	2015 f.
Gross domestic product, % y/y real	- 1.1	2.3	0.6	3.5	2.8	3.6
Private consumption, % y/y real	0.2	1.4	1.5	- 2.4	3.7	4.5
Investments, % y/y real	- 1.8	7.7	3.8	- 5.4	- 3.5	7.4
Current account, % of GDP	- 4.6	- 4.6	- 4.5	- 0.8	- 0.5	- 0.8
Foreign direct investments, % of GDP	1.8	1.4	1.6	1.9	1.6	1.8
Inflation, % y/y average	6.1	5.8	3.3	4.0	1.1	- 0.5
Budget deficit, % of GDP (ESA)	- 6.7	- 5.5	- 2.9	- 2.2	-1.9	- 1.6
EURRON (average)	4.21	4.24	4.46	4.42	4.44	4.45

f = forecasted

Source: INS, BNR and MF data processing

A detailed analysis of inflation in August shows that offer shocks such as VAT cut in food in June and cut in fuel price mainly explain the annual negative inflation. In addition, the Government’s decision to cut medicine prices in summer and the seasonal effect of a richer supply in fruit and vegetables favoured inflation below zero in August. For the moment, we estimate an annual inflation rate of -0.2% in December 2015 and 0.7% in December 2016. Inflation could be negative until May 2016, after the VAT cut for food to 9%, starting with June 2015, and the standard VAT rate of 20% starting with January 2016. The annual inflation rate could reach the level aimed at by the Central Bank only at the beginning of 2017. Inflation in August turned out to be neutral for the monetary policy, and the monetary policy interest is estimated to stay unchanged at 1.75% until the end of the year. It is unlikely that that Central Bank may respond with a relaxation of the monetary policy to this temporary decline of inflation caused by offer shocks. Salary increases planned for 2016 are another reason to justify a cautious monetary policy. An interest rate increase should not be excluded for 2016 to balance the stimulus that the fiscal policy will give to the aggregated demand, at a moment when consumption is on the rise anyway.

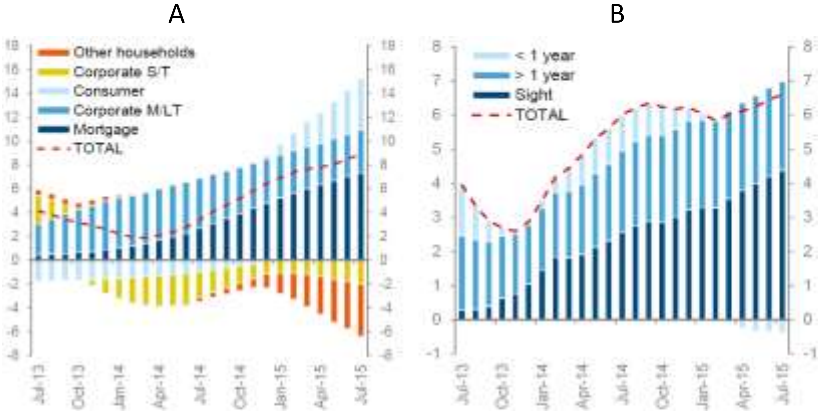
Budgetary revenue increased in July with almost 4.8 billion lei as against June, helped by advance payments of tax on profit and by unexpected rise of non-fiscal revenue, most probably from fee and penalties, following the checks done by the Fiscal Administration (ANAF). In the first seven months, budgetary revenue increased with 10 billion lei, most contributions came from VAT, and non-fiscal revenue came from money reimbursed by the European Union and from the tax on salary as a result of successive increase of the minimal salary.

Overall public investments increased in July following a recovery of the projects co-financed through non-reimbursable EU funds (+33.5%). Capital expenses funded from local sources seem to have been forgotten by authorities, a proof is their decline with 15% per year in July, hence the solid budgetary surplus for the first seven months. The expenses with staff and social expenses increased with 5% and 6%, respectively, between January–July, and there was an obvious trend for the Government to increase social expenses.

The budgetary deficit this year is estimated to be about 1.6% of the GDP, but the deficit may jump to 3% of the GDP in 2016, due to the significant fiscal relaxation and salary increases prepared by the Government for 2016, an election year.

Loans in foreign currencies decreased to 51.7%, in July 2015, from 52.8% in June 2015, which proves that local banks no longer encourage foreign currency loans. Consumption loans and mortgage loans have been the main categories given to the population, while corporate loans were given for medium- and long term. A new round of conversion from foreign currency into lei may have taken place for households, as consumption loan and mortgage loans in other currencies than lei decreased again in June as against May. The increase in June of the loans in lei given to the population could have been supported by the decline of loans in other currencies than lei. In general, non-Governmental loans decreased with 1.1% per month in July and 0.8% per year.

It becomes more and more obvious that the 1-year maturity loans have been affected by the significant decrease of the interest rates. Demand deposits have become the most important factor to support the annual increase of the population's deposits in lei in the last 12 months. A positive aspect is that people seem more willing to make deposits in the national currency with 1-year maturity, while deposits with maturity date of less than 1 year have become a slowing-down factor for the annual increase of deposits, starting with April. Although at a lesser extent, this is valid also for fixed deposits in foreign currency and some banks give interest rates that are slightly higher than for deposits with more than 1-year maturity. The population's deposits increased with 5.9% per year in July, driven by both leu and foreign currency. The companies' deposits slowed down in July (+8.4%) due to the decline of the deposits in lei.



** Annual trend*
Source: Central bank data processing

Figure 2. A) Contributors to RON loan growth* and B) Contributors to RON household' deposits*

We can therefore say that the investors' risk appetite will be the main element to influence the turnover of local bonds (average turnover slightly increased to 2.3%, in August, from 2.2% in July, and the average maturity term increased to 3.5 years from 2.9 years in the previous month). Turnovers could gradually increase in 2016, due to possible increases of the monetary and fiscal policy interest in relation to the Fiscal Code, budgetary execution and local and parliamentarian elections.

6. A plausible scenario - Romania on the verge of recession in 2016, year of elections

In 1 month only, the Government made additional expenses of 760 million euro (3.4 billion lei) after increasing the salaries in the health sector (25%, starting with 1 October 2015, for about 200,000 people – 1.7 billion lei per year) and educational sector (15% starting with 1 December 2015, about 300,000 people – 1.7 billion lei per year), that is 0.4% of the GDP. Furthermore, the Romanian Parliament has just approved on 11 November 2015 an increase of 10% to other wages paid from the state budget as of December 1, 2015, the additional burden gross on the budget only these three measures was estimated at 1.1% of GDP in 2016.

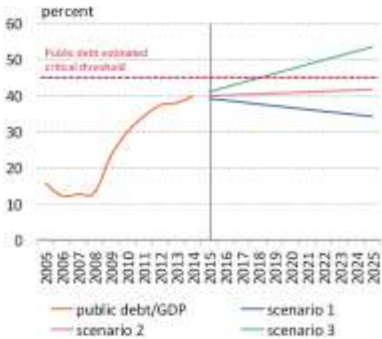
The new Fiscal Code enters into force on 1 January 2016, and its impact may affect about 2.2% of the GDP, as Romania took the responsibility, in front of the European Commission, to comply with a budgetary deficit of about 1.2% of the GDP, with a margin of temporary aid (as public debt is below 60% of the GDP) of 0.5%. That is not all. The mysterious law of public sector salaries, whose presentation, assumed by the Government, has been postponed, could bring an additional budgetary deficit of about 2% of the GDP. Initially, it was about a salary convergence of 60% in 2016, which would correspond to 15.5 billion lei plus in expenditure, that is 2% more of the GDP. It is a big impact, non-sustainable, which will lead to the violation of the commitments undertaken in the Growth and Stability Pact - MTO.

With a small debt, as percentage of the GDP, Romania could theoretically afford to borrow the money it needs. While other countries can sustain public debt that supersedes the annual value of their economies, Romania cannot. In 2014 Romania paid, only for the interests of the public debts, 2.3 billion euro, that is 1.5% of the GDP, comparable with the budgets of some "small ministries".

Ionuț Dumitru, president of the Fiscal Council, a neutral, technocrat body, set up upon the IMF's request to monitor the fiscal activity of the Romanian Governments, told Gândul newspaper, that "during economic growth, public debt should be consolidated to be prepared for the next recession. This is economy, operates in cycles. Let us not forget that, at the beginning of the 2009 recession, Romania had a public debt of 13% of the GDP. Now it is 40% of the GDP and going to the critical threshold, and the Romanian National Bank has drawn attention on it. According to the current data, we could increase public debt to 45-46% of the GDP. The next recession may find Romania with a public debt of 50% of the GDP. Let us not forget that the 2009 recession was so tough precisely because we did not have manoeuvring space".

Since the beginning of 2009 until the beginning of 2015 public debt increased from 69.02 billion lei, which is 13.2% of the GDP, to 259.6 billion lei, that is 38.8% of the GDP. The 160 billion lei increase in the public debt during the last 6 years means more than Romania's GDP in 2002, of 152 billion lei. Obviously, in official reports and strategies, on the website of the Ministry of Finance, and official public documents, totally assumed by the Government, the budgetary deficit target for 2016 is around 1% of the GDP, not 5.6% of the GDP (1% plus current engagements, the impact of the new Fiscal Code and the potential impact of the new law of public salaries, of 4.6% of the GDP), which actually what might be, as a result of the decisions taken or announced by the Government for 2016.

The only thing the Government should do, helped by the Parliament, is not to spend more public money that it collects, and to keep the budgetary deficit at a level see as maximal by experts, under the threshold of 3% of the GDP.
On October 6, 2015, when they presented the report on financial stability, the Romanian National Bank officials showed what they considered to be the maximal threshold of public debt in the GDP, which, if crossed, ensures Romania a 50% chance to enter recession again. The threshold is 45% of the GDP, not far from the current state of the public debt. The Romanian National Bank claims that (pages 56 - 57 in the 2015/ Financial Stability Report - 2015) "the current level of public debt is not sustainable, but came close to the critical level, and crossing this level may lead negative effects on economic growth (recession potential of over 50%) and on taking further loans under appropriate terms", while "keeping the deficit within limits established by MTO would allow increase of the nominal public debt without increasing the public debt as percentage of the GDP". The warning of the Central Bank also says: "even with favourable conditions of keeping the current costs of the public debt and the economic growth at the potential GDP level, a budgetary deficit of about 3% of the GDP would cause the exceeding of the critical threshold of the public debt for the next three years" (figure 3).
In the Romanian political milieu, there have been debates for years regarding the need to spend less than we produce, to ensure quicker development, and to overcome the difference in living standards compared to the average living standard in the UE, the main indicator we take into account. Ionuţ Dumitru, president of the Fiscal Council, says that "we can have high deficits with two conditions: to be able to finance them, and to cause them for investments, not for higher social costs. Investments can guarantee economic consolidation and healthy development in the future". Regarding the opinions according to which the lack of a significant budgetary deficit restricts economic growth, Ionuț Dumitru sternly says that „the Government has proved that this is a false idea: in the first 6 months this year, economy grew with 3.8% of the GDP, while at the end of the 1st semester, the budget did not have a high deficit, but a surplus of 0.6% of the GDP".
At the same time, during the first eight months this year, when the budgetary surplus was 6.46 billion lei (almost 1% of the GDP), the state spent on the interests of the public debt with 26% more than on investments (capital expenditure) made by the state, without taking into account the EU funds, that is 7.5 billion lei as against 5.9 billion lei.



	Scenario 1 (decreasing public debt)	Scenario 2 (stabilising public debt)	Scenario 3 (rising public debt)
Interest rate on public debt (%)	4.05[1]	4.05	4.05
Primary government budget balance (% of GDP)	+0.30[2]	-0.40	-1.50
Growth rate of real GDP (%)	2.80[3]	2.80	2.80

Notes:
1) Public debt interest payments as a ratio to average government debt in 2014.
2) The primary government budget balance of 0.3 percent of GDP corresponds to a structural deficit of around 1 percent of GDP (MTO – Medium - Term Budgetary Objective) in 2014.
3) 2.8 percent is the real growth rate in 2014.

Source: MPF, NBR calculations: Financial Stability Report – 2015, p.167, http://www.bnr.ro/PublicationDocuments.aspx?icid=6877

Figure 3. Public debt sustainability

In the official report at the end of her visit in Romania, in October 2015, Andrea Schaechter, head of IMF mission, despite cautious praising, drew attention on the danger of exceeding a budgetary deficit of 3% of the GDP in 2017 and on the need of concrete reforms regarding the public companies. "Among the main policies that should be a priority: fiscal discipline in order to consolidate public finance, and renewal of the momentum for structural reforms – especially in public companies - to sustain the level of trust and to improve the long-term growth potential", say the IMF officials. "For 2016 and 2017, the adopted policies and the policies to be adopted – combination of massive cuts in taxes with salary increases - will push the fiscal deficit to almost 3% of the GDP in 2016, and over this level in 2017 if no compensating measures are identified or if it does not happen again that the capital expenditure is not fully spent", said the head of the IMF office in Bucharest.
Given Romania's apparently good state (public debt under 40% of the GDP, economic growth over 3% of the GDP, budgetary deficit assumed for 2015 of under 1.9% of the GDP), a new agreement with the IMF looks like not necessary. While most economists and political leaders claim that a new agreement may bring more credibility for Romania on foreign markets (therefore lower loan interest rates), the strongest reason is not for politicians but for the population, as the new agreement

"may force, to a certain extent, the politicians to avoid deviations and implement healthy, sustainable public policies", says Ionuț Dumitru, president of the Fiscal Council.

7. Conclusions

To have a sustainable, healthy fiscal relaxation, we need revisit the budgetary construction beforehand, to define clear priorities for the budgetary policies. The absence of such exercise, the budget will continue to waste the public money, and the fiscal-budgetary framework will suffer from lack of coherence. We need prudence, responsibility in approaching the long term public finance.

The current budgetary surplus is temporary, under the circumstances, while tax cuts should be permanent. Hence, reserves, in the current budgetary logic, regarding the sustainability of the fiscal package. Not to ignore, at the same time, the recent errors of fiscal policy, that make difficult the fiscal relaxation's finding its place in MTO. For instance, the newly adopted Fiscal Code does not stipulate the remedy for recent fiscal errors, such as elimination of taxes implemented one year ago, for instance the tax on special constructions („tax on the pillar") and the additional excise of 7 eurocents on fuel. As proved by the 2014 budgetary execution, the two taxes turned out to be not necessary, since the actual budgetary deficit was only 1.5% of the GDP in ESA terms, which is much below the budgeted deficit of 2.2% of the GDP. 2014 has reached MTO, but unintentionally and unexpectedly, since Romania had no budgetary commitment in this respect for 2014.

If the budgetary policy, the public expenditure policy, is imprudent, the risk of excessive deficit may appear a situation that we just left behind two years ago. In this context, as the Fiscal Council mentions, Romania's macroeconomic state may be exposed to certain risks and vulnerabilities such as: the lack of basic correlation between fiscal priorities and policies, on the one hand, and budgetary priorities and policies, on the other hand. For instance, the fiscal policy takes taxes downwards, while the budgetary policies takes expenditure upwards, if we invoke for instance the budgetary expenditure rise already announced; the return to a pro-cyclic fiscal-budgetary policy at an inappropriate moment, by promoting an economic model based on stimulating consumption, to the detriment of investments. Regarding investments, the budgetary execution for the 1st semester provides most relevant data; recent performance in collecting revenue should be consolidated as well, confirmed in time, in order to sustain such a fiscal relaxation package.

It is obvious that Romania needs fiscal relaxation but the way to do it is of major importance, as well as the appropriate stages for the measures to cut taxes, that should not cause vulnerability to the fiscal-budgetary framework.

References

Barbu, C.M. (2010). Economie. Microeconomie-Macroeconomie, Universitară Publishing House, Bucharest;

Barbu, C.M. (2009). Politici Economice, Milena Press Publishing House, Bucharest;

Catte, P., Cova, P., Pagano, P. & Visco, I. (2011). The role of macroeconomic policies in the global crisis, Journal of Policy Modeling, Volume 33, Issue 6, November-December 2011, Pages 787–803;

Rosca, C. (2015). Campionii economiei: 20 de companii sunt „responsabile“ pentru aproape 20% din profitul total din businessul românesc, Ziarul Financiar, August 29 -http://www.zf.ro/companii/energie/campionii-economiei-20-de-companii-sunt-responsabile-pentru-aproape-20-din-profitul-total-din-businessul-romanesc-14691326;

Visco, I. (2010). Global imbalances, the financial crisis and the international monetary system., World Economics, Vol. 11: 69-82;

Visco, I. (2009). The global crisis: the role of policies and the international monetary system, in G20 Workshop on the Global Economy, Macroeconomic causes of the crisis: Key lessons: 60-80, www.g20.org/Documents/g20_workshop_causes_of_the_crisis.pdf;

Voinea, L. (2009). Sfârşitul economiei iluziei. Criză şi anticriză: o abordare heterodoxă, Publica Publishing House, Bucharest;

∗∗∗ Ministry of Public Finance - http://www.mfinante.gov.ro;

∗∗∗ National Bank of Romania - http://www.bnr.ro/Home.aspx;

∗∗∗ National Bank of Romania - *Financial Stability Report – 2015*, http://www.bnr.ro/PublicationDocuments.aspx?icid=6877;

∗∗∗ National Institute of Statistics - http://www.insse.ro/cms/en; http://www.insse.ro/cms/en/content/statistical-bulletins.