AN EMPIRICAL ANALYSIS OF THE POTENTIAL EFFECTS INDUCED BY THE IMPLEMENTATION OF THE MEDIUM-TERM BUDGETARY OBJECTIVE IN THE COUNTRIES OF THE EUROPEAN UNION

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***Abstract**: In this paper, an analysis will be carried out, which aims to identify potential effects induced by the implementation of the mechanism on the medium-term budgetary objective on the evolution of public finances in Member States that record public debts of over 90% of gross domestic product, but also on Romania. The indicators whose developments will be presented and analyzed are: economic growth; the level of the public debt, the budget deficit (conventional) and the structural balance. The research method used in the paper emphasizes the empirical analysis, by identifying and presenting the possible effects induced by the implementation of the medium-term budgetary objective mechanism on some fiscal-budgetary indicators. The obtained results can be constituted in arguments of efficiency or ineffectiveness of the mechanism of the medium- term budgetary objective.*

***Keywords**: budget deficit, budgetary objective, public debt.*
***JEL classification**: E61, H62, H69.*

1. The state of the art research

There are a number of studies and researches in the economic literature that address the Stability and Growth Pact (SGP) in terms of procedures and mechanisms, increasing efficiency and successive revisions. Also, after 2012-2013, studies have appeared that analyze, and evaluate the implementation of the Treaty of Stability, Coordination and Governance in the Economic and Monetary Union (TSCG), and its effectiveness.

The medium-term budgetary objective (MTO) has become a subject of analysis, both for economists and researchers, and especially for bodies with economic responsibilities and public finances in the institutional structure of the European Union (EU). Thus appeared a series of papers / publications, respectively a code of conduct with specifications on the implementation of the provisions of the SGP, the series of reports on the aging of the population; reports on the sustainability of public finances; series of guidelines on the implementation of the SGP.

In our approach, we do not intend to limit the empirical analysis regarding the fiscal-budgetary consolidation adjustments, generated by the implementation of the MTO only in a few EU countries, according to the title of the paper, but we will try to analyze, observe and record results recorded at the level of the two entities. institutional (EU and EA – Euro Area). We considered it useful to introduce in the analysis of some states with a higher level of public debt, in order to observe potential effects induced by the implementation of the medium-term budgetary objective (these could be more obvious in these states) and to formulate conclusions closer to economic reality. and public finances in the EU.

2. The medium-term budgetary objective - role and significance

The MTO is the central element of the preventive arm of the SGP and has its formal support in Regulation (EC) 1466/97, which stipulates that each Member State should have differentiated medium-term objectives for the budgetary position, which may deviate from the requirement close to balance or in surplus, if it provides a safety margin against the conventional budget balance of -3% of gross domestic product (GDP). This ensures some budgetary flexibility, taking into account the needs of public investment, certain structural reforms and exceptional situations of the Member States.

The purpose of this preventive mechanism is threefold, respectively: maintaining a safety margin in terms of compliance with the conventional deficit limit of -3% of the GDP reference value; ensuring continuous and relatively rapid progress in establishing and orientating fiscal-budgetary policies on sustainable trajectories and prudent levels of total public debt; the permission of some fiscal-budgetary leeway with availability, in particular, for public investment needs.

From this point of view, first of all, the MTO offers a margin of safety against the possibility that, given the unexpected worsening of economic conditions, the budget deficit will rise sharply and exceed 3% of GDP. This safety margin is based on the minimum reference value for the MTO, calculated using budget sensitivity and output gap. Thus, a state with a fiscal-budgetary position that is more sensitive to cyclical fluctuations should commit to a more demanding MTO level and, therefore, to a tighter target, in the medium term, for the structural budget deficit. While a state with a less fiscal-budgetary stance sensitive to cyclical fluctuations - as a result of institutional arrangements for the operation of automatic stabilizers - should engage in a less demanding MTO level and therefore in a less stringent medium-term target for the structural budget deficit. A similar commitment is to be expected from a state with high production fluctuations, as an unexpected drop in economic activity will affect the budget deficit (and vice versa).

Second, the MTO aims to ensure progress towards the sustainability of public finances, defined by taking into account both the current stock of government debt (so-called explicit liabilities) and future debt (so-called default liabilities), associated with the possibility of the expected deterioration of the fiscal-budgetary balances as a result of the increase of the public expenditures on social insurances, induced by the demographic trends (ie the cost of population aging).

In terms of public debt sustainability, the MTO aims to converge its high levels against the nominal criterion of 60% of GDP. Thus, a state whose debt-to-GDP ratio is above this threshold should pursue a more demanding level of MTO. While a state whose public debt / GDP ratio is below this threshold, it should pursue a level of less demanding MTO. States with high debt and low economic growth would then seek to achieve a stronger fiscal stance leading to an increase in government debt below nominal GDP growth, eventually converging to the benchmark.

In terms of the sustainability of default liabilities, the MTO aims to partially overburden the increase in social security spending, induced by demographic trends. Such an anticipated burden requires a state to improve its budget balances and increase its current savings (thus reducing the pace of debt accumulation or even increasing the value of some assets), so as to provide additional financial resources in the future (in the form a lower burden of public debt or even a larger stock of assets) to better cope with the increase in age-related spending, where appropriate. According to this situation, the MTO level is expected to be more demanding for a state that is facing a high cost of population aging or is willing to pre-charge a higher proportion of that cost. At the same time, the level of the MTO is expected to be less demanding for a state that faces a lower cost of population aging or is willing to preload a smaller proportion of that cost.

Third, the MTO allows a margin of maneuver for a state that chooses to undertake public investment, as a means of supporting aggregate demand or promoting economic growth. The beneficiaries of this situation are, in particular, countries with low public debt, through a less demanding MTO level, so that its budget can supplement investment expenditures, under certain conditions.

As noted, budgetary targets are differentiated for each Member State, depending on the state of the economy and the budgetary position of each and their perspective, as well as the potential risk to the sustainability of public finances in the context of future demographic changes.

3. Developments in the economic situation and public finances in the European Union and the Euro Area

The analysis aims to identify the potential effects induced by the implementation of the MTO on the two institutional entities - EU and EA, on some Member States that register public debts of over 90% of GDP and on Romania.

The indicators whose developments will be presented and analyzed are the level of public debt expressed as a share in GDP, the budget deficit (conventional) and the structural balance.

According to the evolution from figure no. 1, the inclusion of the additional effort to reduce public debt in the methodology for implementing the criteria for determining the MTO, seems to ensure relatively rapid progress towards convergence with the institutional level.

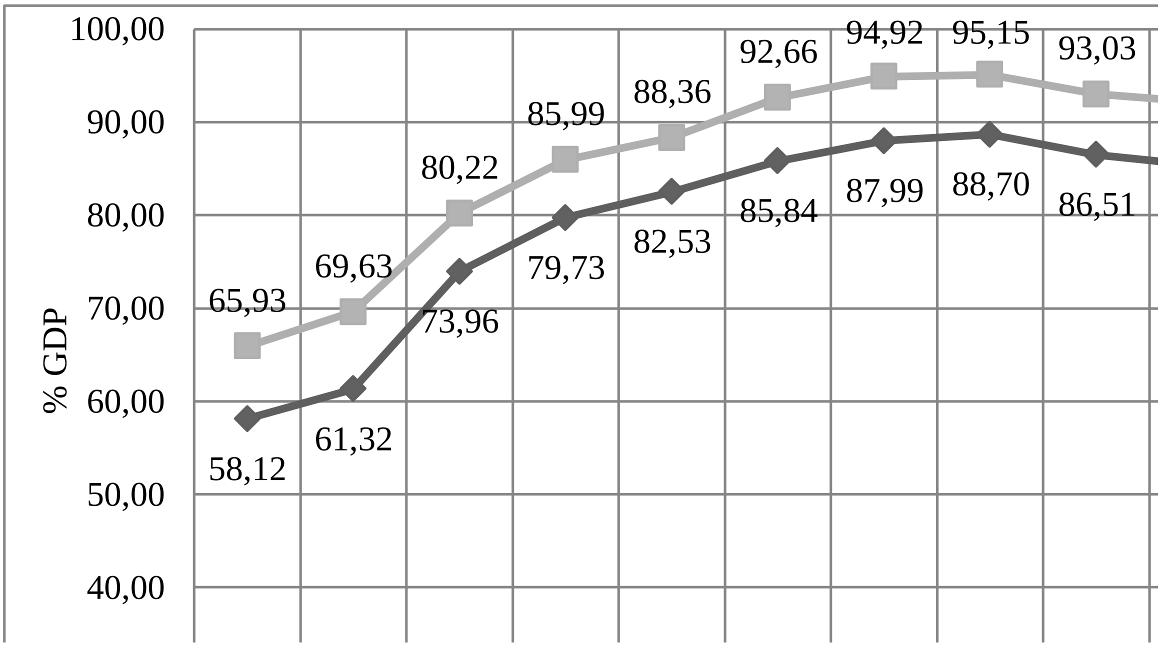

Figure no. 1. The share of public debt in GDP - EU and EA average, 2007-2018

Source: AMECO data, processed by the author

The evolution of budget deficits (conventional deficit and structural deficit), presented in figure no. 2, shows favorable developments, in particular, with regard to the conventional deficit, which is in the range of 3% of GDP, starting in 2014 in the EU (and a year earlier in the EA), until now, and the trend is slight increase in deficits in the coming years.

Regarding the structural deficit, as a target for the MTO, it is, formally, in the range of 0.5% - 1%, and the evolution is more favorable in the EA, being within the range in the period 2014 - 2018 and unfavorable at EU level, where it fails to enter this range for the entire period presented.

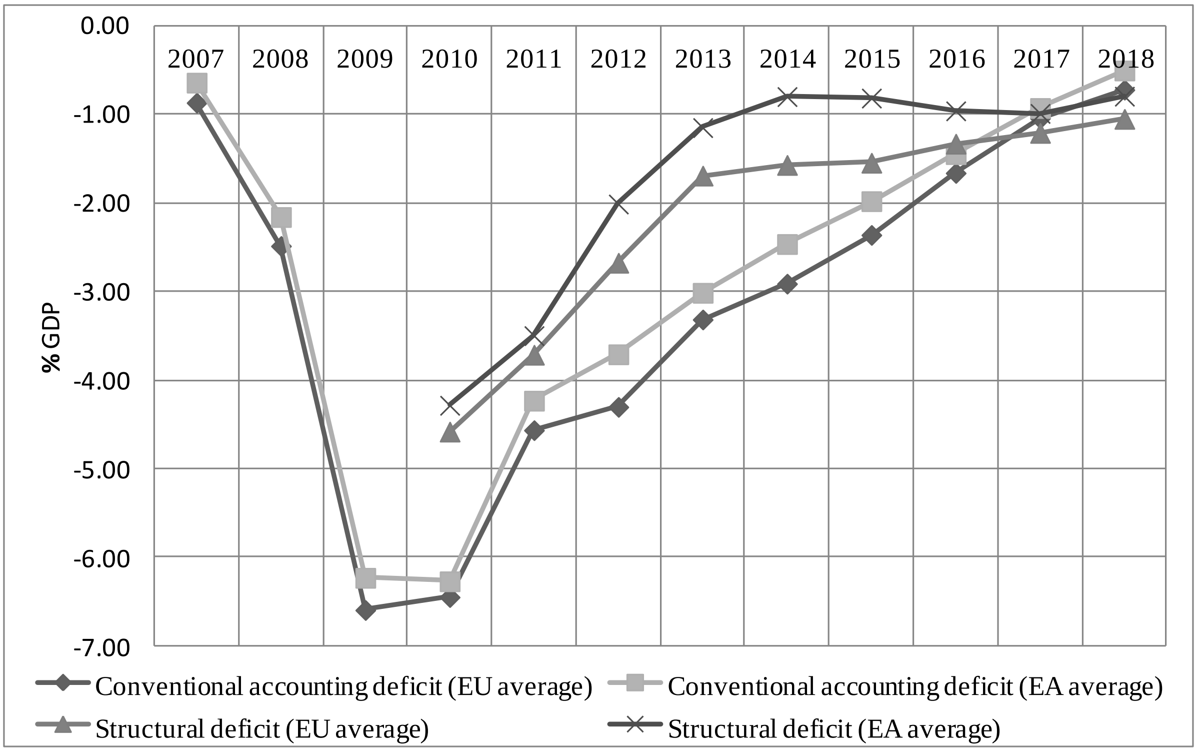

Figure no. 2. The evolution of the conventional deficit and the structural deficit in the EU and EA, 2007 - 2018

Source: AMECO data, processed by the author

It follows that the implementation of the MTO and the printed flexibility of the SGP, through its successive changes, have led, at least overall at the level of the two institutional entities, to finding a certain balance between monitoring and implementing fiscal policies oriented towards economic growth, in particular by reforms and investments.

It is estimated that the use of this flexibility has led to a 0.8% increase in EU, GDP over the last four years and has contributed to the creation of around 1.5 million jobs.

4. Evolution of the economic situation and public finances in EA countries that recorded a high level of public debt in GDP in 2014

Next we will analyze the results recorded in the Member States with the highest levels of indebtedness (over 90% of GDP in 2014), these being: Ireland, Belgium, France, Portugal, Italy, Spain and Cyprus, all members of the SE.

Each of these countries had to take certain measures to strengthen fiscal and budgetary path and enter the path of adjustment towards the MTO. The progresses registered in relation to the cumulated requirements in the period 2014 - 2017 are included in figure no. 3.

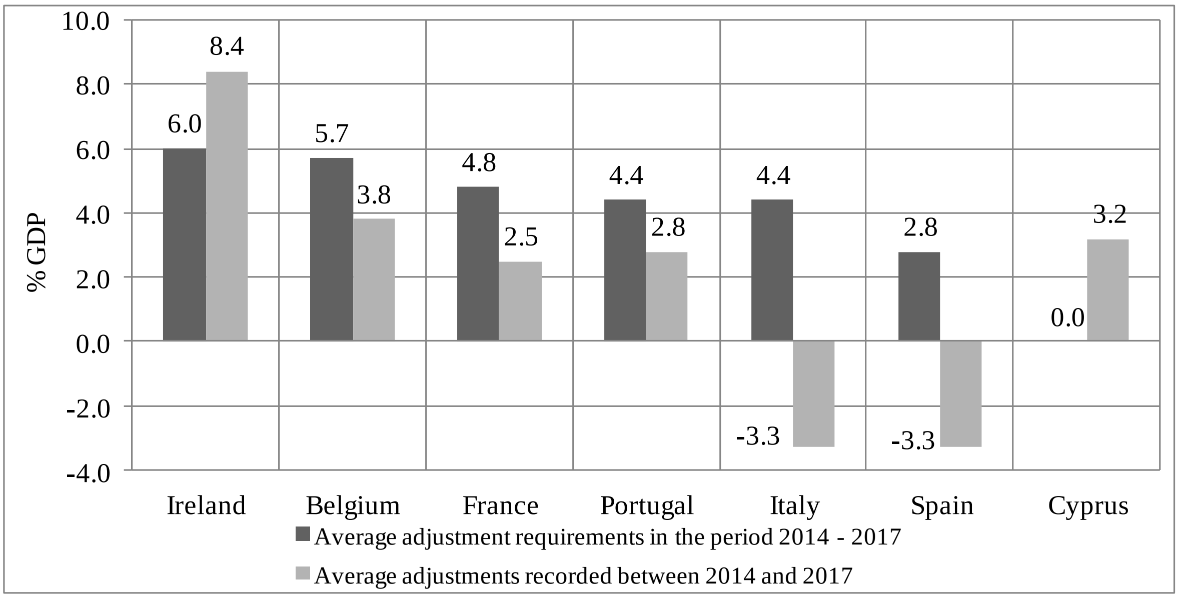

Figure no. 3. Cumulative adjustment requirements and results recorded (by varying the structural balance), in the period 2014-2017

Source: AMECO data on the structural balance and EC requirements, issued following the evaluations, from spring 2015, 2016 and 2017.

Two aspects emerge from this representation:

➢ *a positive one - represented by the cases of Ireland and Cyprus.*

Ireland has far exceeded the requirement in the matrix regarding the improvement of its structural balance, and in 2018 it reached the MTO, registering, as we will see below, rapid progress in reducing public debt. Cyprus has reached its medium-term budgetary target in 2018, and this, combined with the recovery, has shown, as we will see, a downward trajectory of the debt ratio, even if this decline has been slow.

➢ *a negative one - represented by the cases of Italy, Spain and France.*

The adjustments that have taken place in these countries are lower than the matrix requirements and, at this rate, will not facilitate convergence towards the MTO within a reasonable timeframe. Italy (under the preventive component) and Spain (under the corrective component), registered a deterioration of the structural balances and were removed from the MTO (Italy is at 2 pp, and Spain at 3 pp of the MTO). France, which is covered by the corrective component, managed to improve its structural balance to a very small extent during that period. Regarding the progress registered regarding the reduction of the public debt, represented in figure no. 4, they are relatively similar to the results recorded by adjustment to the MTO.

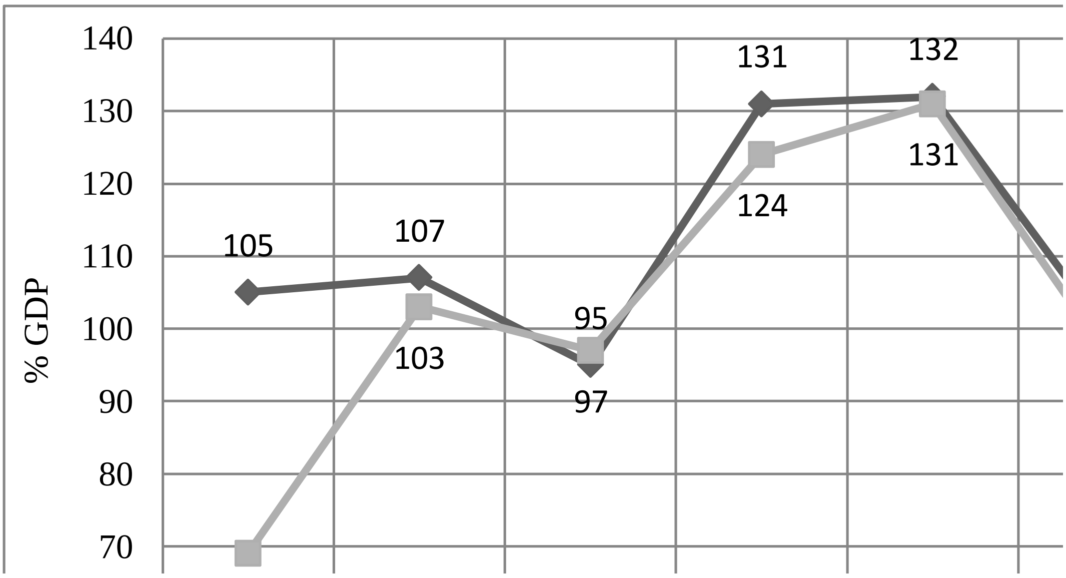

Figure no. 4. The evolution of public debt between 2014 and 2018, in countries of the EU with public debt over 90% of GDP (in 2014)

Source: AMECO data, processed by the author

Thus, Ireland and Cyprus have made significant progress, a reduction of 36 pp in the case of Ireland from 2014 to 2018, and 9 pp in the case of Cyprus in the same period. Portugal (7 pp), Spain (3 pp) and Belgium (4 pp) also recorded slower reductions over the same period. There is a lack of progress in the cases of France (-2 pp) and Italy (1 pp), compared to the same time frame.

Regarding the progress registered on the line of budget deficit reduction (conventional), all the analyzed states register progress in the mentioned time period (see the evolution presented in fig. no. 5).

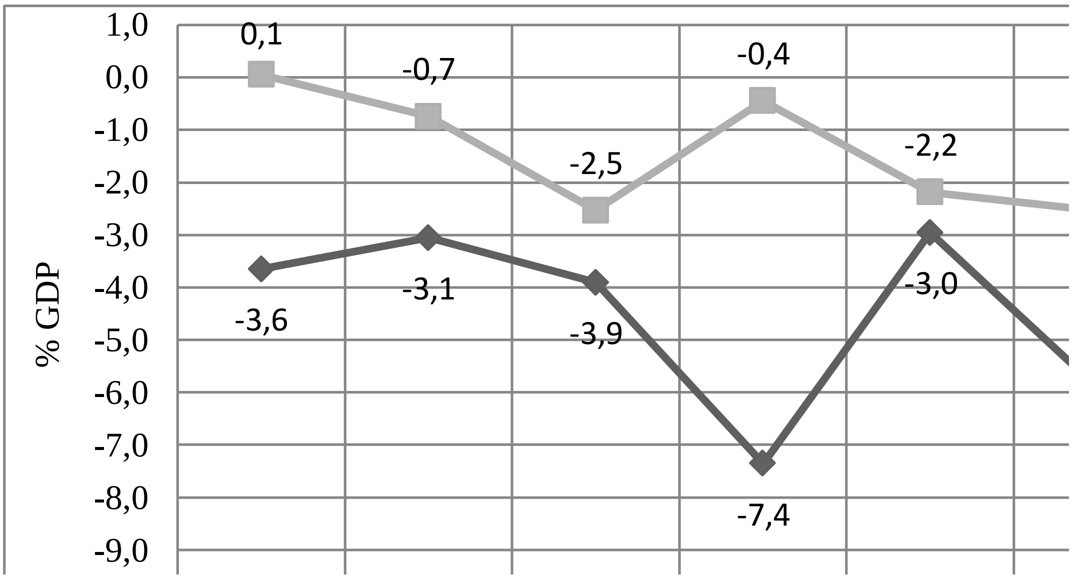

Figure no. 5. The evolution of the conventional budget deficit, between 2014 and 2018, in EU countries with public debt over 90% of GDP (in 2014)

Source: AMECO data, processed by the author

Significant reductions are recorded in Ireland (3.5 pp), Belgium (2.4 pp), Portugal (7 pp), Spain (3.4 pp) and Cyprus (4.3 pp), but this country remains below the TM level (-3% of GDP), with a deficit value of 4.4% of GDP.

France and Italy are making slower progress of 1.4 pp and 0.8 pp, respectively, but that is helping them to reach TM limits.

Regarding the progress made in the line of reduction of structural deficits, Ireland, Belgium, France and Portugal are making some progress, while Italy and Spain are deepening their structural deficits, while Cyprus is registering structural surplus, reducing it from 4.8 % in 2014, to 1.9% in 2018. (see the evolution presented in fig. no. 6).

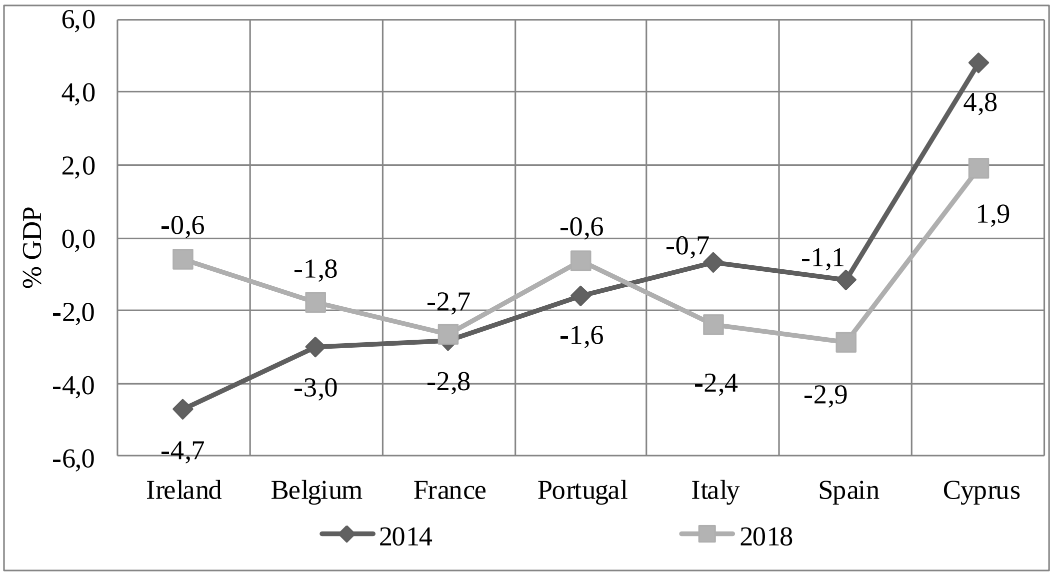

Figure no. 6. The evolution of the structural deficit, between 2014 and 2018, in EU countries with public debt over 90% of GDP (in 2014)

Source: AMECO data, processed by the author

I draw attention to the situations in Ireland, Italy and Spain. In the case of Ireland, the adjustment rate is noticeable, from -4.7% in 2014 to -0.6% in 2018. In the cases of Italy and Spain, the deterioration of the structural deficit is observed by more than 1.7 pp, in both cases during the analyzed period.

Regarding the progress registered on the line of economic growth, all the analyzed states register progress in the mentioned time period (see the evolution presented in fig. No. 7).

During this period, four states register an economic growth of over 3 pp, from 2014 to 2018, respectively: Ireland; Portugal; Spain and Cyprus, stating that three of them (Portugal, Spain and Cyprus) recorded negative economic growth in 2014, of -0.8%, the first two, and -1.7%, in the latter case. This positive development has contributed to a massive adjustment of the conventional budget deficits in these states.

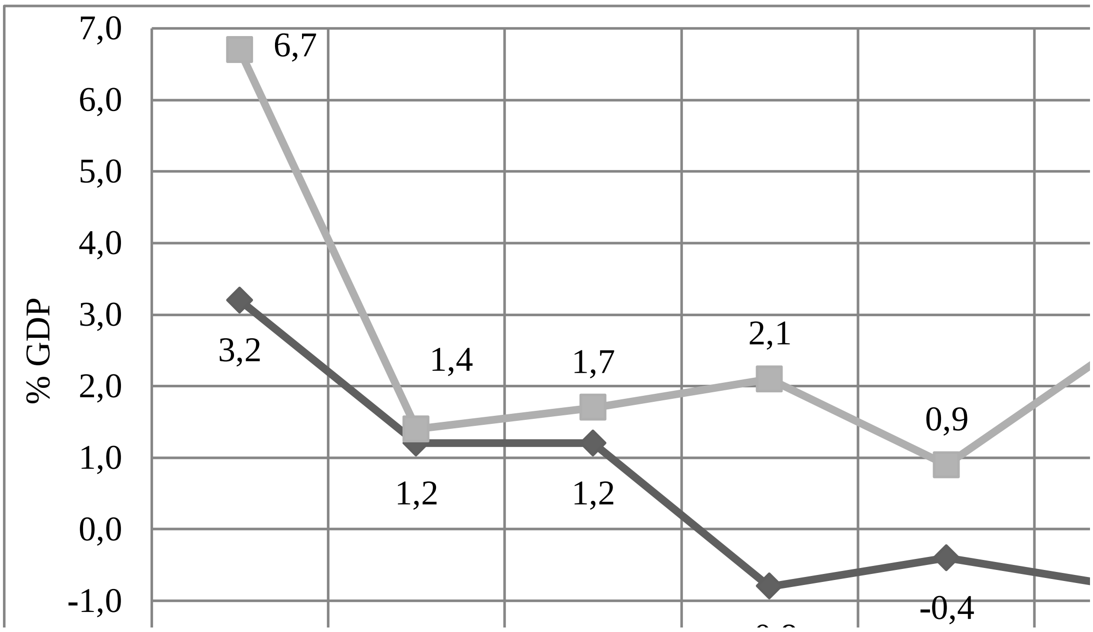

Figure no. 7. The evolution of the economic growth rate, between 2014 and 2018, in EU countries with public debt over 90% of GDP (in 2014)

Source: AMECO data, processed by the author

In the other states analyzed, there is slow progress in terms of economic growth between 2014 and 2018, respectively 0.2 pp in the case of Belgium, 0.5 pp in the case of France and 1.3 pp in the case of Italy, a situation that partly explains the slow progress made by these countries in the area of fiscal consolidation.

5. The evolution of the medium-term budgetary objective and its implications on public finances in Romania

Romania, having the status of a member state, has the obligation to comply with the reference values for the conventional budget deficit and public debt, according to the SGP. In addition to the two commitments, Romania also adhered to the Fiscal Compact (2012), which implies commitments regarding the assumption and observance of the medium-term budgetary objective.

In this situation, Romania currently has a commitment to comply with the MTO of -1% of GDP, assimilated to a structural balance, due to the fact that the ratio between public debt and GDP is below 60%, and the risks (at when calculating this level of MTO) on the long-term sustainability of public finances were low.

The effective analysis of the MTO compliance will be performed by subordinating the minimum limits of the structural deficit to the medium-term budgetary objective, in Romania, in the period 2007 - 2018, according to the evolution of this indicator from figure no. 8.

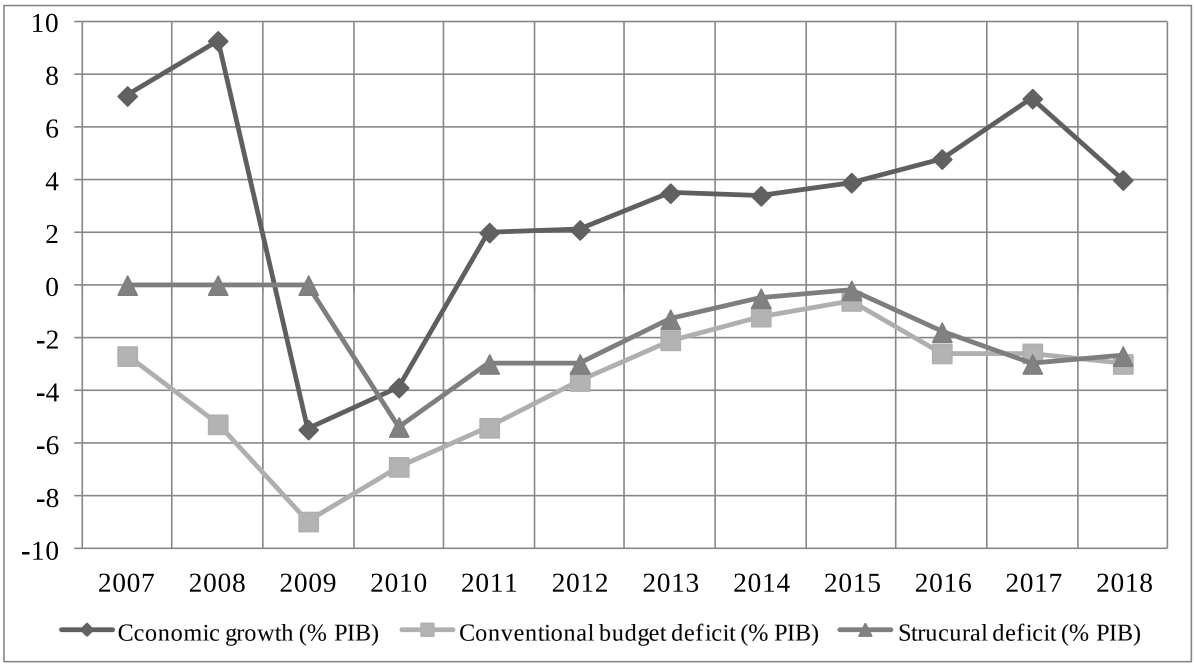

Figure no. 8. The evolution of the conventional deficit, of the structural deficit and of the economic growth in Romania, in the period 2007 - 2018

Source: AMECO data, processed by the author

The lack of normative constraints on the structural balance, in the first part of the analyzed period, led to a certain relaxation of the fiscal authorities regarding its evolution. With the implementation of European rules, taken over by national governments, on the requirement of a level of structural balance and its convergence with the MTO, and adjustment of prevention and corrective mechanisms, the level of structural balance has become a priority for tax authorities.

Against this background, it is noted that since 2013, the structural balance has reached the MTO target (-1%) faster than planned, a target within which it was maintained in 2014 and 2015. Moreover, there is synchronization in terms of concerns the observance of the limit of the conventional accounting balance of 3% of GDP (manifesting the effect of the structural balance of "safety" on the limit of the conventional accounting balance). Since 2016, the structural balance has been out of the MTO's target, amid anticipations of economic growth, the expansion of tax bases and potential effects of fiscal multiplication, government authorities have implemented measures to ease fiscal easing and increase budget spending, measures that negatively affected the two budget balances (structural and conventional accounting). On the other hand, the evolution of public debt in Romania, with increases of 3 - 4 pp of GDP, in the period 2012 - 2016, seems to support the consolidation of budget deficits in the same period (see figure no. 9).

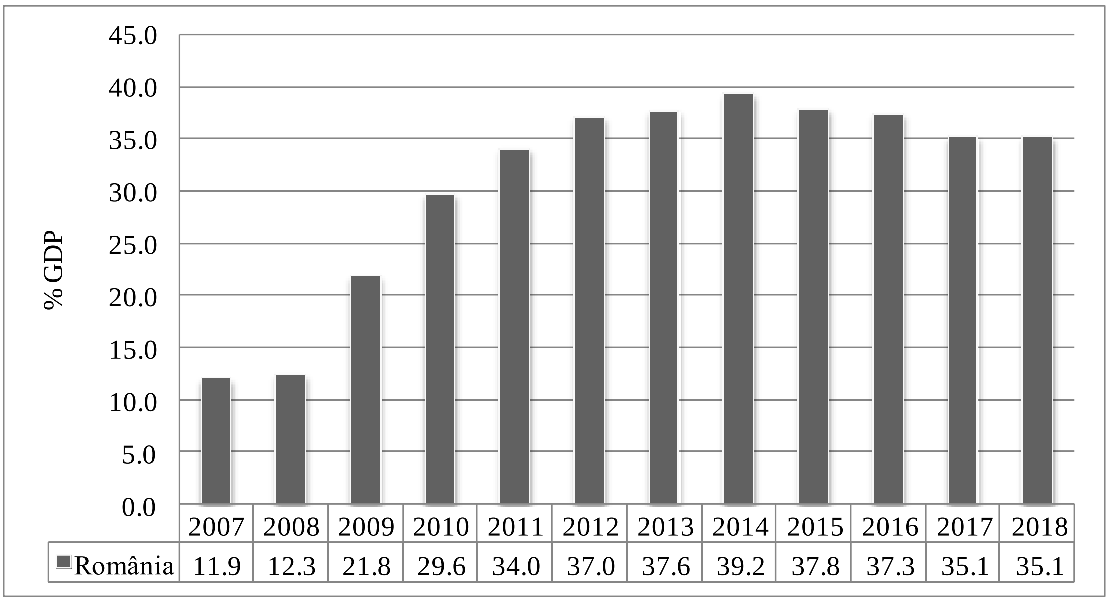

Figure no. 9. The evolution of public debt (% of GDP) in Romania, in the period 2007 - 2018

Source: AMECO data, processed by the author

Continuing the reasoning of the "reverse synchronization" between the level of public debt and budget deficits, relative to GDP in Romania, it is found that in 2017-2018, the level of public debt decreased by 2 pp, and budget deficits increased during this period.

From the perspective of non-compliance with the MTO, Romania received from the EC a warning regarding the existence of a significant deviation from the MTO, starting with 2016, transposed in a recommendation to adopt some measures, in particular, regarding the maximum nominal advance of 3.3% of government expenditures in 2017, compared to 2016, and of 4.3% in 2018, compared to 2017. The implementation of these measures ensures successive annual structural adjustments of 0.5% of GDP and, implicitly, the approximation of OTM.

The EC recommendations have not been implemented, and in 2018 it issued another warning to Romania regarding the existence of a significant deviation from the adjustment path to the MTO, warning translated into a decision of the EU Council regarding the lack of effective measures for to correct the significant deviation from the MTO. It was also noted that the medium-term fiscal plans are not correlated with the budgetary ones and with the national economic perspectives, and the recommendations of the Fiscal Council are not sufficiently taken into account.

The evolution of the structural balance of the last three years and the non-implementation of effective measures to correct the significant deviations from the MTO, brings Romania closer to the possibility of opening the excessive deficit procedure.

6. Conclusions

The objective of the paper was to identify possible impacts of the application of the MTO on the fiscal consolidation process. Concrete progress has been made at EU and EA level, validated by the positive development of public debt and budget deficits.

In countries with a debt level of over 90% of GDP, with the exception of Ireland and Cyprus, which have made spectacular progress, several large euro area countries (Spain, France and Italy) are far from their long-term budgetary targets. environment, and the structural deficit has worsened considerably, the same phenomenon being observed in an intensified form also in the case of the conventional budget deficit.

In contrast to the positive developments registered at the level of the two institutional entities (EU and EA), Romania, although it has an economic growth above their average, does not manage to stabilize the budget deficits, being in the situation of receiving repeated warnings regarding the existence of a significant deviation from on the adjustment path towards the MTO, a warning translated into an EU Council decision on the lack of implementation of effective measures to correct the significant deviation from the MTO.

The general finding is that progress towards the MTO was further increased immediately after the financial crisis and the implementation of the amendments to the SGP (2011), the TSGC and the Fiscal Compact (2013), until 2014, 2015, after which it decreased even more indebted countries. it is not on a trajectory that ensures that the goal is achieved within a reasonable amount of time.

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