DIMENSIONS OF THE ROMANIA'S BUDGET DEFICIT IN 2020. FINANCING AND PERSPECTIVES

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Abstract: *The evolution of the Romanian economy in 2020 was marked by the emergence of the COVID-19 pandemic and the adoption of measures to restrict mobility, needed to prevent the disease spread. The health crisis management obviously required significant financial resources, in addition to the significant pre-crisis debt stock. On the other hand, measures adopted to support the economy, along with the gradual easing of restrictions over certain periods, have had the effect of improving investors and consumers perception. However, in order to maintain easy and cheaper access to the external financing market, it is crucial for Romania to engage in fiscal reforms that will improve the predictability of the fiscal framework, revenues collection capacity and will adjust budget expenditures according to the revenues evolution. Improving the governance of public investments, focusing mainly on strategic areas, as well as using European funds to a greater extent are the elements that can lead our country's economy to a new growth model, while reducing the pressure on budgetary resources.*

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JEL Classification: *H62.*

1. Introduction

The level of systemic risks to financial stability in Romania in 2020 remained significant, analogous to international dynamics, given that the outlook for future economic activity continued to be marked by uncertainty, mainly fueled by the multitude of effects associated with the COVID-19 pandemic period.

This crisis has shown, more than ever, the need for a change in the structure of economies, with a focus on environmental protection, implementation and support of technological innovations in the digital field, activities of increasing inclusion and of reducing inequality. Moreover, the crisis has involved significant efforts to ensure the sustainability of accumulated debt, especially in the public and private sectors.

Nowadays, the idea that the budgetary deficit becomes a means of relaunching economic activity (given that it is not already inflationary) is being issued more and more often (Cioponea, 2007). It is possible to act on the demand for public goods and services by using conjunctural action funds, thus achieving a flexible budgetary policy, within which public expenditures can be resized in relation to the size of these funds. If no changes are made to the regulation of taxes, tax revenues may be a tool for short-term adjustment.

In this regard, a process of crucial importance is to make public spending efficient. The desired goals can be achieved more efficiently, sometimes faster and at lower cost, without reducing the quantity or quality of the provided services (Kolodko, 2015). Moreover, the Government is considered to be the only economic actor that can maintain the level of demand in the economy, spending more than it earns, i.e. registering a budgetary deficit (Chang, 2014).

2. Romania's budget deficit in 2020

2.1. Economic situation and synthetic budgetary indicators

For the year 2020, an economic growth of 4.1% was forecast in Romania, and this growth took into account the contribution of the following factors:

- domestic demand seen as an engine of economic growth (+ 4.7%);
- the growth rate of gross fixed capital formation forecast at 6.8%;
- the final consumption expenditures of the population forecast as having a real annual dynamics of 4.9% (MPF, Budgetary Execution Report 2020).

The evolution of the economy has been affected by the onset of the health crisis since the second half of March 2020, statistics show a decrease in gross domestic product by 3.9% in 2020 compared to 2019 based on the activity shrinking in most sectors, consequence of the administrative measures adopted by the Government to limit the effects of the SARS-COV2 pandemic.

Compared to the estimated economic growth in the construction of the budget for the financial year 2020, there was a decrease in gross value added in industry, services and agriculture and a positive development in construction. However, the contraction of the Romanian economy in 2020 was below both the EU 27 average (-6.1%) and that of the Eurozone (6%), as a result of a mix of government policies which stimulate public investment and reduce the negative impact on private consumption.

The nominal value of the gross domestic product achieved in 2020 was 1055.5 billion lei compared to 1129.2 billion lei as initially estimated when drafting the state budgetary law, a difference 73.7 billion lei less.

In terms of usage items, domestic demand fell by 2.1% in 2020. Positive developments in government investment and consumption have supported the slowdown in the economic downturn. Investments in infrastructure and those in the residential sector which were made under the conditions of construction works' expansion (+ 15.9%), led to an increase of 6.8% in gross fixed capital formation (with a contribution of 1.5 percentage points). At the same time, the application of the necessary measures in order to limit the spread of the virus has led to an increase in government consumption by 2.0%.

Regarding private consumption, the restrictions imposed on the population in the context of the pandemic crisis had the effect of reducing it by 5.2% compared to 2019, contributing by 3.2 percentage points to the decrease of the real rate of gross domestic product. Net exports (-1.6 percentage points) also had a negative contribution to the decrease in GDP in 2020, as a consequence of the 9.7% reduction in exports of goods and services, higher than the contraction of imports of goods and services (-5.1%) (MPF, Budget Execution Report, 2020).

In 2020, inflation has been on a downward trajectory since the beginning of the year, reaching a low of 2.06% in December, 1.5 percentage points lower than in January, when it reached the maximum of 3.60%. The reduction in the inflation rate was due to a contraction in domestic demand, the effects of which were partially offset by a depreciation of the national currency against the euro, averaging 1.9%.

The slowdown in the annual inflation rate in the latter part of 2020 was due to the lowering of vegetable and fruit prices amid rising supply, but also due to a base effect on some food items. The evolution was partially reduced by the increases recorded in December for fuel and cigarettes.

On average, inflation recorded a moderate level of 2.63% in 2020, with above-average increases in food prices (4.80%) and service tariffs (3.10%), while prices for non-food goods increased by only 1.01%.

Compared to 2019, the deficit which is calculated according to the ESA 2010 methodology in 2020 increased by 4.8 percentage points, from 4.4% of GDP in 2019 to 9.2% of GDP in 2020.

Romania's structural deficit stood at -7.5% of potential GDP in 2020. The cyclical component of the consolidated general budgetary deficit was -1.7% of potential GDP, significantly mitigating the deepening of the structural deficit, given the deterioration of the ESA deficit as a result of the COVID-19 pandemic (MPF, Raport privind execuţia bugetară, 2020).

Figure no. 1

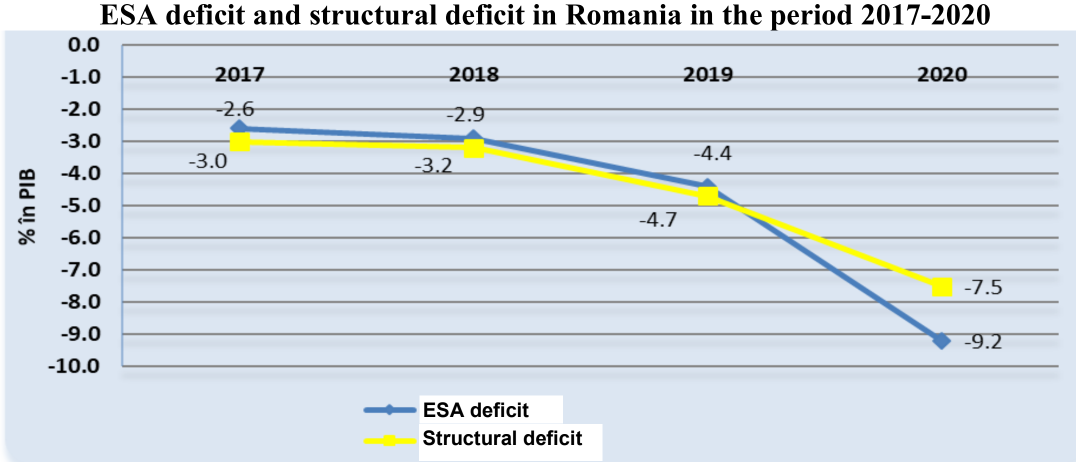
Structural deficit in Romania

	2017	2018	2019	2020
Structural deficit	-3,0	-3,2	-4,7	-7,5

Source: Ministry of Public Finances, *Raport privind execuţia bugetară finală pe anul 2020*, www.mfinante.gov.ro

Figure no. 2

ESA deficit and structural deficit in Romania in the period 2017-2020



Source: Ministry of Public Finances, *Raport privind execuţia bugetară finală pe anul 2020*, www.mfinante.gov.ro

The National Bank has identified only one severe systemic risk in 2020, namely tensions in domestic macroeconomic equilibria, also as a result of the COVID-19 pandemic. The following two risks to financial stability were assessed at a high level: (i) the persistence of uncertainty about the return to global economic activity in the context of the COVID-19 pandemic; and (ii) the risk of non-repayment of non-government loans. The last risk factor, in the moderate category, is the access to finance of the real economy.

The main challenge for the next period was the risk of tensions in the internal macroeconomic equilibrium, as a result of the COVID-19 pandemic, which was assessed at a severe level (NBR, Raport stabilitate financiară, june 2021).

2.2. Analysis of state budgetary revenues and expenditures in 2020

According to the final data, the execution of the consolidated general budget, between January 1 and December 31, 2020, ended with a cash deficit of 101.8 billion lei, respectively 9.64% of GDP, above the set target, respectively a foreseen annual deficit of 96.0 billion lei.

Compared to the previous year, the general budget deficit consolidated in 2020, based on cash, increased by 5.06 percentage points from 4.59% of GDP in 2019 to 9.64% of GDP in 2020.

Figure no. 3

Romania's cash budgetary deficit

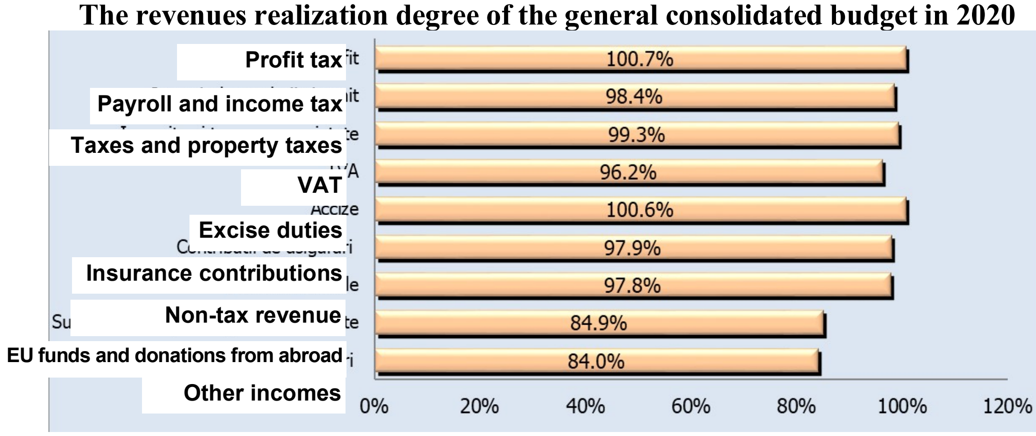
		2019	2020	2020/2019 differences
Budget balance	mil. lei	-48,554.3	-101,798.7	-53,244.4
	% of PIB	-4.59	-9.64	-5.06

Source: Ministry of Public Finances, *Raport privind execuţia bugetară finală pe anul 2020*, www.mfinante.gov.ro

The revenues of the general consolidated budget, in 2020, added up to 322.7 billion lei, representing 30.6% of GDP and a degree of achievement of 95.8% compared to the annual estimates (MPF, Raport privind execuţia bugetară, 2020).

Figure no. 4

The revenues realization degree of the general consolidated budget in 2020



Source: Ministry of Public Finances, *Raport privind execuţia bugetară finală pe anul 2020*, www.mfinante.gov.ro

Revenues from tax revenues were below the value which was scheduled to be achieved in 2020, the degree of achievement being 96.4%. The revenues were influenced by the evolution under the established program of receipts from income tax and salaries (98.4%), taxes and property taxes (99.3%), value added tax (96.2%), other taxes and duties on goods and services (96.0%), taxes on the use of goods, authorization of the use of goods or the carrying out of activities (57.1%), tax on foreign trade and international transactions (99.4%) as well as other taxes and fees (98.0%). Favorable developments were registered in the case of income tax revenues (100.7%), excise duties (100.6%), as well as in the case of other taxes on income, profit and capital gains (100.9%).

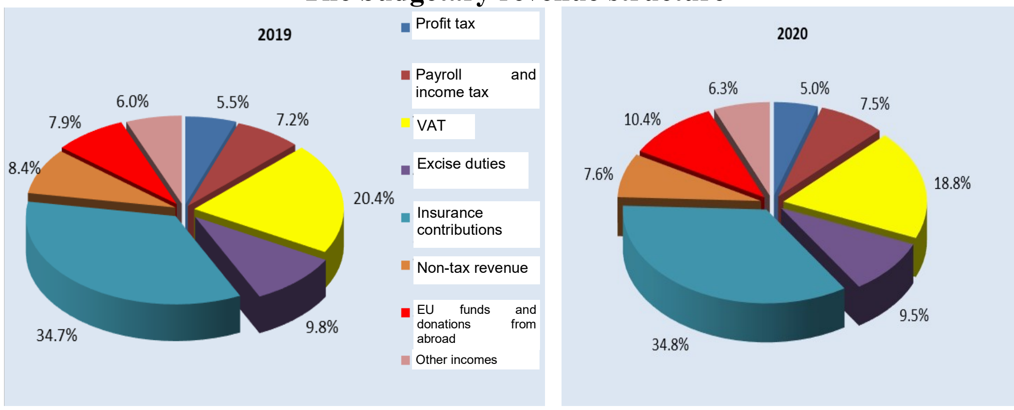
Receipts from insurance contributions were lower than the collection schedule, the degree of achievement being 97.9%. The non-realization of the program was determined by the lower receipts of the annual program in the case of revenues from insurance contributions collected to the state budget (98.4%), to the state social insurance budget (97.6%), to the unemployment insurance budget (96.5%) as well as those from the unique national health insurance fund budget (98.3%).

Revenues from non-tax revenues were lower than the annual program, the degree of achievement being 97.8%.

Receipts from the amount received from the EU and other donors on account of made payments were below the annual program, with a recorded degree of achievement of 84.9%.

Figure no. 5

The budgetary revenue structure



Source: Ministry of Public Finances, *Raport privind execuţia bugetară finală pe anul 2020*, www.mfinante.gov.ro

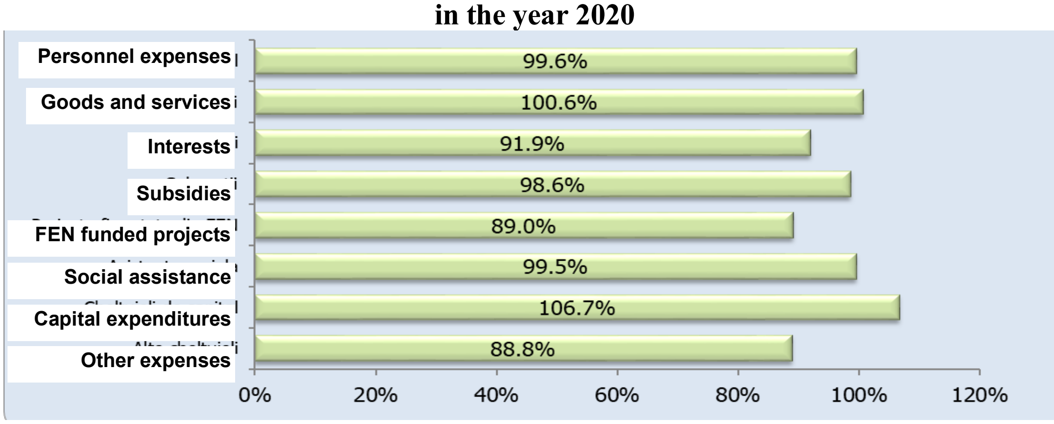
Compared to the previous year, **the revenues of the general consolidated budget in 2020** increased by 0.5% (+1.6 billion lei), and as a percentage in GDP by 0.3 percentage points from 30.3% in 2019 to 30.6% in 2020.

The amounts received from the European Union on account of made payments (including donations) in 2020 amounted to 33.6 billion lei, 32.4% above the level recorded in 2019.

In 2020, the expenditures of the general consolidated budget added up to 424.5 billion lei, which represents 40.2% of GDP and a degree of achievement compared to the projected level of 98.2% (MPF, Raport privind execuţia bugetară, 2020).

Figure no. 6

The degree of realization of the general consolidated budget expenditures in the year 2020

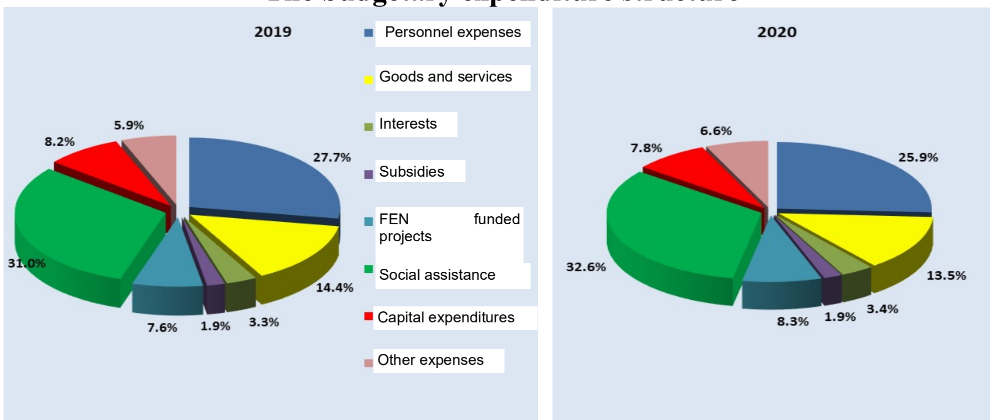


Source: Ministry of Public Finances, *Raport privind execuţia bugetară finală pe anul 2020*, www.mfinante.gov.ro

From the point of view of the annual program degree of realization, the main categories of budgetary expenditures registered the following evolutions: personnel expenditures 99.6%, expenditures on goods and services 100.5%, interest expenditures 91.9%, expenditures on subsidies 98.6%, expenditure on projects financed from non-reimbursable external funds 89%, expenditure on social assistance 99.5%, capital expenditure 106.7%.

Figure no. 7

The budgetary expenditure structure



Source: Ministry of Public Finances, *Raport privind execuţia bugetară finală pe anul 2020*, www.mfinante.gov.ro

Compared to the previous year, the general consolidated budget expenditures increased by 14.8%, and as a percentage in GDP by 5.3 percentage points from 34.9%, as they were in 2019, to 40.2% in year 2020.

2.3. Sources of financing the budgetary deficit in 2020

At the end of 2020, the government debt according to the EU methodology accounted for 47.3% of GDP compared to the level of 35.3% of GDP, as recorded at the end of 2019, exceeding the ceiling of 47.0% of GDP set by the Emergency Government Ordinance no. 201/2020 on the rectification of the state budget for 2020, as a result of the public debt contraction with the purpose of covering the financing needs of the budgetary deficit (9.7% of GDP), with the role of consolidating the financial reserve in foreign currency at the disposal of the State Treasury, and of insuring partial refinancing of the financing needs in 2021. On the 31st of December 2020, domestic debt accounted for 23.2% of GDP and external debt for 24.1% of GDP (MPF, Budget Execution Report, 2020).

In 2020, due to the significant challenges imposed by the COVID-19 pandemic context and the urgency of implementing measures that required budgetary efforts to combat the social and economic effects caused by the COVID-19 crisis, government funding needs increased (they were determined by the level of the general consolidated budgetary deficit and the volume of public debt refinancing), mainly due to the increase of the budgetary deficit as a result of the three budget corrections, from 3.6% of GDP the initial target approved by the State Budget Law no. 5/2020, at 9.7% of GDP, level recorded in execution.

The financing of the budgetary deficit for 2020 was done in a balanced way from internal and external sources. The sources necessary for the refinancing of the government public debt were ensured from the markets on which these debts were issued and from the financial reserve in foreign currency at the disposal of the Ministry of Finance.

In the context of the gross financing need increase up to 149.0 billion lei (14.1% of GDP) from 86.9 billion lei (7.7% of GDP), as a result of the budgetary deficit increase due to the COVID-19 pandemic, but also for the consolidation of the foreign exchange reserve at the disposal of the State Treasury, the financing of the budgetary deficit and the refinancing of the government public debt was ensured from the following sources:

- on the internal market: state titles for the population under the two programs Tezaur and Fidelis; titles issued on the interbank market (discounted treasury certificates and benchmark bond issues);
- from the external market, through issues of Eurobonds.

The external financing process in 2020 was aimed to ensuring Romania's constant presence on foreign capital markets at advantageous cost conditions, diversifying the investor base as well as consolidating the financial reserve in foreign currency at the disposal of the State Treasury.

3. State budget deficit forecasts in 2021

The year 2020 was marked by the crisis generated by the COVID-19 pandemic, the largest unprecedented lockdown in modern history, with severe and very specific implications on almost all economic and social levels.

During the crisis, fiscal rules were suspended, but it must be borne in mind that economic laws react to imbalances, economic vulnerabilities and unsustainable issues that they sanction and require their correction.

Romania had the largest current account deficit in the region before the outbreak of the pandemic and the largest budgetary deficit, which, along with other unfavorable developments, leads to additional pressures on economic balances. Romania's budgetary deficit has a structural nature (induced by reductions in taxes and an increase in permanent expenditures), less generated by the pandemic. High deficits become difficult to manage in times of crisis due to the increased risk aversion of external investors on which their financing depends.

The low level of tax revenue compared to other European countries, as well as the rigid structure of the national budget marked by the high share of expenditure on salaries and pensions, combined with the effect of the epidemiological crisis create short-term financing needs and reduce the maneuvering space for the fiscal policy decisions.

For 2021, the Government has set a number of major objectives for fiscal and budgetary policies (MPF, Strategia fiscal-bugetară pentru 2021-2023):

- to mobilize the financial resources that the state needs for financing and to direct them in a targeted and efficient way according to priorities;

- to support a favorable and predictable business environment, for economic recovery and sustainable economic growth;

- to contribute to the recovery of the economic contraction from 2020 and to ensure the stability of the Romanian economy, by mitigating the unfavorable impact that may occur in the evolution of economic cycles.

Given the Government's obligation to prudently conduct the fiscal-budgetary policy to which will ensure the sustainability of the fiscal position in the medium and long term, the need to maintain budgetary balances by adopting measures which limit the increase in permanent budgetary expenditure and the need to comply with the European Commission's as part of the excessive deficit procedure launched for Romania, the following measures were mainly taken into account when estimating the expenditures:

- financing social protection measures in the context of the pandemic caused by the SARS-CoV-2 coronavirus;
- new measures:
  - maintaining in 2021 the gross amount of salaries at the level granted for December 2020;
  - in 2021 maintaining the amount of the increments at the level of the amount granted for December 2020 maximum;
  - maintaining in 2021 the amount of the food allowance at the level set for 2020;
  - non-giving of prizes and holiday allowance provided by the Framework Law no. 153/2017;
  - compensation of overtime for budgetary staff only with appropriate free time;

- extending the use of holiday vouchers issued in 2019 and 2020 until the end of 2021 and suspending the issuance of holiday vouchers for 2021 by public authorities and institutions.

Under these conditions, the projected budgetary revenues for 2021 represent 32.67% of GDP, 31.40% of GDP in 2022, and in 2023 will represent 30.96% of GDP, an evolution determined by the evolution of macroeconomic indicators on the reference horizon as well as the adopted measures / provisions, and the projected budgetary expenditures for 2021 represent 39.84% of GDP, reaching 35.33% in 2023, decreasing on the reference horizon as a share in GDP.

4. Conclusions

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

Given the current conditions, when Romania is trying 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 fiscal levers in accordance with the requirements of the European Union, taking into account other macroeconomic policies that may be adopted to overcome the current economic situation. Thus, the theory is established that, in times of crisis, it is preferable to ensure an increase in budgetary expenditures, with the goal of contributing to the recovery of economic activity, the effects being reflected in increasing employment and reducing unemployment.

The model of economic growth must be re-analyzed, taking into account the experience of the past years in which the economic growth in our country was based on consumption, a situation that did not allow sustainable economic development. For this reason, a different approach based on investment in high value-added sectors is needed.

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