BUDGET DEFICIT PERSPECTIVES IN ROMANIA

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Abstract: Although Romania engaged itself through the Convergence Program to reduce its budget deficit to less than 1% of GDP by the year 2011, the recent evolution of the public revenues and expenditures contradict this hypothesis. Compared to our country, the public finance in the European Union member states will improve significantly, as the result of fiscal revenue increase.

Key words: budget deficit, the Pact of Stability and Growth, durable convergence

Introduction

Achieving the public financial balance according to the modern directions allows budget deficit and other state debts. They are assumed by the public authorities through special norms and financed from the loans contracted by the public administration authorities, the external non-repayable funds, and other funds the state may obtain (for example amounts from privatization, state assets valuation, financial placements of public deposits).

The idea of constant budget balance achievement has both supporters and opponents. A low budget deficit may produce unfavourable effects on reducing the gaps between the emergent and developed countries, because developing some sectors as infrastructure, health or education requires high budget expenditures. Therefore the expenditures are the major element the finance procedures should adapt to. Due to the permanent increase of the public needs, the financial effort to satisfy them is increasingly higher. Therefore the public expenditures are increasing on long-term, and the public revenues adapt to this. The budget deficit maintained within certain limits represents the rule of budget planning, a rule enforced by the low financial resources compared to the fund needs, and by the governmental policy view that may consider the public unbalance as an instrument of conjectural economic policy.

Budget deficit theories

The classic theories of budget deficit demonstrates its negative impact on economy (by reducing the national revenue) and living standard of the next generations that have to stand a higher fiscal pressure to pay the public debt. Engaging to budget expenditures higher than the current revenues is an imprudent policy with multiple effects. The increase of internal public debt as the effect of budget deficit financing from public loans may cause the bank interest increase with negative effects on investment credit demands and inflation.

Traditionalists argue that a reduction in the budget deficit will significantly help the economy in the long run. This theory is based on the following logic. When the government runs a budget deficit, it is spending more than it is taking in. In this way, national savings decreases. When national savings decreases, investment-the primary store of national savings-also decreases. Lower investment leads to lower long-term economic growth. Similarly, lower investment is accompanied by higher domestic interest rates, which decreases net exports. Based on this logic, a budget deficit is a drain on the long-term economy.

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The present economic theory suggests that the reasonable public loans in a developing country do not alter the economic growth. If the lent resources are used in productive purposes, the repayment of the accumulated debts should be painless. In case of some high public debts there is risk regarding the country's repayment incapacity that might discourage investments and trouble the economic growth. The theory of excessive indebt was defined by Jeffrey Sachs who suggested that the payment owned to the creditors acts like a discouraging tax for production and that there is an indebt threshold beyond which any debt marginal increase generates a significant reduction of investments, a fact that reduces the future repayment capacity.

The mere existence of a budget deficit, meaning a higher amount of monetary resources in economy, generates inflation. If the budget deficit is covered by monetary issue, the impact on inflation will be even stronger. As the main objective of any central bank is to limit inflation, the monetary authorities will take measures to increase the reference interest that may attract speculative capitals, contributing to the national currency strengthen and consequently discouraging exports. Therefore another consequence of the budget deficit is the occurrence of current account deficit.

The modern theories of budget deficit consider that this unbalance does not have only inevitable negative effects. According to the "Ponzi gamble" theory, a less prosperous future is only a possible consequence of a period with high budget deficits. If the economic growth rate is higher that the debt rate, the budget deficits will be covered by the future economic growth from the general resources. This approach of the budget deficit means to study the average interest rate for the public debt and to compare it with the average economic growth rate. The rational game Ponzi in which repayments and debts are always replaced by a new debt was presented in the studies of Minsky (1982) and Kindleberger (1978). Applying the Ponzi game, the government may increase the living standard because each generation benefits by transfers and no generation pays additional taxes for them. But this point of view cannot be accepted because the budget deficit, even if it does not always lead to fiscal pressure increase, will determine lower investments as the savings will be mainly placed in governmental titles.

The Pact of Stability and Growth

The Pact of Stability and Growth is an agreement between the EU member states through which they adhere to a special fiscal and budgetary discipline, as part of their medium-term economic objectives. The member states in the Euro zone engage to achieve balanced or even surplus national budgets on medium-term. Adopted by the European Council in Amsterdam, June 1997, the Pact has two key aspects:

- a preventive alarm system to identify and correct the budget skid before it exceeds the 3% threshold of GNP was settled in the Treaty for the budget deficits;
- a set of rules to discourage the pressures on the member states, so that they avoid the excessive deficits and take rapid measures to correct them if they occur. The sanctions are applicable only to the states in the Euro zone and value between 0.2% and 0.5% of GNP, according to the degree the reference value of 3% is exceeded. These sanctions carry no interest at first, but if the situation is not corrected in 2 year time, they will turn into penalties.

If the above mentioned budgetary objectives are achieved, the quality of public finance will improve and the member states may release the budgetary resources to encourage innovation, investment, education and new jobs. The evolution of the main financial indicators in the EU countries shows their continuous progress in correcting the excessive deficits.

Financial indicators (as a percentage of GDP)

Year	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
Euro area						
Government deficit/surplus	-2,5	-3,1	-2,8	-2,5	-1,5	-0,5
Government expenditure	47,7	48,1	47,5	47,4	47,2	46,4
Government revenue	45,1	45,0	44,6	45,0	45,6	45,9
Government dept	68,2	69,1	69,6	70,3	68,6	66,5
EU25/EU27*						
Government deficit/surplus	-3,1	-3,1	-2,8	-2,4	-1,6	-1

Government expenditure	46,9	47,3	46,8	46,8	46,6	45,9
Government revenue	44,5	44,3	44,0	44,4	45,0	44,9
Government dept	60,4	61,8	62,1	62,7	61,4	58,3

Source: Eurostat, Euro-indicators, 142/22 october 2007, 139/23 october 2006

European Commission, Economic forecast Autumn 2007

*from 2003

In 2006 the largest government deficits in percentage of GDP were recorded by Hungary (-9.2%), Italy (-4.4%), Portugal (-3.9%), Poland (-3.8%), and Slovakia (-3.7%). Ten Member States registered a government surplus in 2006: Denmark (+4.6%), Finland (+3.8%), Estonia (+3.6%), Bulgaria (+3.2%), Ireland (+2.9%), Sweden (+2.5%), Spain (+1.8%), Luxembourg (+0.7%), Netherlands (+0.6%) and Belgium (+0.4%).

Compared to the situation before the Pact conclusion, the number of countries with excessive budget deficits is decreasing. In 2006, the budgetary situation improved significantly: the average deficit in the EU reduced from 2.4% in 2005 to 1.7% (and from 2.5% to 1.6% in the Euro zone), and the debt decreased in both the EU and the Euro zone for the first time after 2002. The EU member states' medium-term objective is to achieve a balanced budget ("zero deficit"), a deficit less than 1% or a budget surplus. In some countries, the surplus revenues from taxation are partially used to finance the expenditure increase, so that the European Committee is concerned with the fact that the member states do not consolidate their public finances rapidly enough, in spite of the favourable economic settings. Therefore the European Committee presented at 13th June 2007 a series of proposals to improve efficiency of the preventive component of the Pact of Stability and Growth:

- extending the field of application for the fiscal supervision in the EU. The advantages of a solid fiscal policy may be better understood if the fiscal supervision falls into a larger economic perspective, for example paying more attention to the internal and external unbalances that might jeopardize the economic and fiscal stability.
- strengthening the responsibility for the budgetary objectives established by the stability and convergence programs. There is high possibility to strengthen the connections between the national objectives and the objectives presented by the EU; for example, the national parliaments and other administrative sectors should involve more in program planning and monitoring.
- strengthening the reliability and credibility of the budgetary objectives on medium-term. The recurrent deviations from the plans risk, if repeating, to injure their credibility. Providing more information on how the budgetary objectives will be achieved according to the expenditure tendencies would facilitate the evaluation of the national fiscal policies.
- achieving a viable budgetary situation on medium-term. This means a better monitoring of the budgetary plan application, as well as a deeper understanding of the budgetary situations that may provide a higher absorption of the population ageing impact.

A slight deterioration is expected in 2008, as the draft budgets for 2008 do not envisage any further fiscal consolidation. Based on the usual no-policy-change assumption, the deficit is expected to broadly stabilise in 2009.

Expectations concerning total expenditure and revenue, general government, in EU Members

Country	Total expenditure, general government (as a percentage of GDP) 2008	Total revenue, general government (as a percentage of GDP) 2008	Net lending (+) or net borrowing (-), general government (as a percentage of GDP) 2008	Total expenditure, general government (as a percentage of GDP) 2009	Total revenue, general government (as a percentage of GDP) 2009	Net lending (+) or net borrowing (-), general government (as a percentage of GDP) 2009
Belgium	48.2	47.8	-0.4	48.0	47.6	-0.4
Germany	43.3	43.2	-0.1	42.8	43.0	0.2

Ireland	36.6	36.3	-0.2	36.8	36.2	-0.6
Greece	41.8	39.9	-1.8	41.9	40.0	-1.8
Spain	38.7	40.0	1.2	39.4	39.9	0.6
France	52.8	50.2	-2.6	52.7	50.0	-2.7
Italy	48.6	46.3	-2.3	48.4	46.1	-2.3
Cyprus	45.5	44.8	-0.8	45.4	44.8	-0.6
Luxembourg	37.2	38.3	1.0	36.6	38.0	1.4
Malta	42.6	41.1	-1.6	41.8	40.8	-1.0
Netherlands	47.4	47.9	0.5	46.9	48.1	1.3
Austria	48.0	47.3	-0.7	47.8	47.4	-0.4
Portugal	45.4	42.8	-2.6	45.2	42.8	-2.4
Slovenia	43.2	42.1	-1.0	42.2	41.4	-0.8
Finland	47.6	51.8	4.2	47.4	51.4	4.0
Bulgaria	36.3	39.4	3.1	36.3	39.4	3.1
Czech Republic	43.0	40.2	-2.8	42.9	40.2	-2.7
Denmark	51.4	54.5	3.0	51.2	53.6	2.5
Estonia	35.7	37.7	1.9	36.5	37.5	1.0
Latvia	37.6	38.4	0.8	37.0	37.5	0.5
Lithuania	35.6	34.1	-1.4	34.6	33.8	-0.8
Hungary	48.9	44.7	-4.2	48.7	44.9	-3.8
Poland	42.3	39.0	-3.2	41.8	38.8	-3.1
Romania	39.0	35.8	-3.2	40.9	37.0	-3.9
Slovakia	48.2	32.8	-2.3	48.0	32.2	-2.4
Sweden	43.3	55.8	2.8	42.8	55.6	3.0
United Kingdom	36.6	41.0	-3.0	36.8	41.3	-2.8

Source: European Commission, Economic forecast Autumn 2007

In the Euro area is expected the further improvement in most countries about continuous deficit reduction. Outside the euro area, the budgetary outlook improves substantially in the Czech Republic (with the deficit now expected to fall below the 3% of GDP reference value in 2008, after the strong deterioration in 2007), Hungary (forecast to reach a deficit of 3.8% of GDP in 2009, compared to 6.4% in 2007) and Slovakia (expected to reduce the deficit in the two subsequent years). For several other countries outside the euro area the outlook also improves, for instance in Bulgaria, Latvia and Sweden. The deficit is projected to widen significantly in Romania (with a deficit above 3% in 2008 and forecast to reach almost 4% of GDP in 2009), while the surplus in Denmark and Estonia declines rapidly over the forecast horizon.

Budget Deficit Perspectives in Romania

Since 2005, the governors have been concerned with the following actions regarding the change of the budget main characteristics:

- promoting a challenging fiscal policy;
- reducing the budget duties by reducing the social insurance contributions;
- directing the funds carefully to the priority policies: education, health, social insurance, transport, infrastructure, regional development, agriculture, research-innovation, national defence.

Through the Convergence Program 2006-2009, the public authorities in Romania made a commitment to support the budget deficit reduction by improving revenue administration and increasing the efficiency of budget expenditures. In consequence, the revenues will show an increasing tendency as a result of the implementation of some measures regarding collecting and administration improvement, taxation extend to field such as real estate market, agriculture, environment and enterprises with state capital's majority. According to the budget projection for 2007, it was meant to reach 1.9% of GDP in 2009 and 0.9% of GDP in 2011.

Given the increase of budget expenditures at a rate higher than the revenue increase and in spite of a significant economic growth, Romania has faced the budget deficit increase lately.

The budget deficit evolution in Romania

Year	2004	2005	2006	2007	2008
General consolidated budget deficit (% of GDP)	-1.22	-0.81	-2.3	-2.4	-2.8

Source: The Ministry of Public Finance

The Government's and the European Committee's standpoints toward this evolution are different. According to the Romanian officials' opinions, a responsible budget deficit reported by the European Committee would mean to fall within the Maastricht criteria, in other words we should not exceed the 3 percents. Maintaining a low budget deficit is a good macroeconomic policy, but it does not support development and gap reduction. For the developed countries, members of the European Union, the restriction 3% of GDP is normal, because it means rigour and sustainable development. But for the lagging countries, the effort of limiting the budget deficit may lower the economic growth. The standpoint of the National Bank of Romania regarding the budgetary policy is more prudent. The recommendations of the National Bank of Romania refer to the quality improvements of the budget expenditure structure and avoidance of their increase in certain periods, in order to limit the budget deficit.

Referring to the objective assumed by the Romanian government through the Convergence Program 2006-2009 (a deficit lower than 1% by 2011) the European Committee estimates that there are small chances to attain it. According to the European Committee's forecast, Romania's budget deficit will reach 3.2% in 2008 and 3.9% in 2009, and our country risks the European funds freeze if it keeps breaking the EU regulations. The estimates of the Committee are based on the pension expenditure rise and the revenue decrease from the social pension contributions, once they reduce with 2% in 2008 and 2.5% in 2009 (to finance the second pillar of the private pensions). The costs of the pension reform, once their private administration is introduced, are estimated at 0.25 of GDP in 2008 and 0.3% of GDP in 2009; they were included in the EC forecasted deficits. The forecast also reflects the Government intention to reduce the insurance contributions with 6% in three stages during the next year, a lowering that will have total impact starting with 2009.

Considering the European Committee's evaluation and the need to provide a sustainable convergence, the following recommendations were made:

- reducing the risk of an excessive deficit by establishing more ambitious budget targets in the future;
- improving public expenditure planning and performing;
- limiting the public expenditure increase;
- strengthening the fiscal discipline;
- continuing the structural reforms;
- adopting policies to eliminate inflationist pressures.

Under the European Committee's pressures, the Romanian government performed the first budget correction, reducing the public expenditures with 1.1 billion Euro. This measure is estimated to reduce the budget deficit estimated for 2008 with about 0.5%.

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