
THE IMPORTANCE OF FISCAL AND BUDGETARY RESPONSIBILITY IN ROMANIA AND IN EUROPE

Oana Valentina Cercelaru¹, Dragoș Diamescu² and Otilia Florentina Chiriță³

^{1) 3)} *The Bucharest University of Economic Studies, Romania*

²⁾ *Advanced Studies School from Romanian Academy, Romania*

E-mail: cercelaruoaana@yahoo.com; E-mail: dragosdmisc@gmail.com;

E-mail: chirita.otilia@yahoo.com

Abstract

There has been an increasing interest in the need for a culture of “fiscal and budgetary responsibility” over the last years, especially emphasised by the effects of the world financial and economic crisis. At the European Union level, the intention is to implement a solid and sustainable fiscal and budgetary policy. Given the importance of this topic, the study considered an analysis of the fiscal and budgetary strategy in Romania in the period 2016 - 2018, the public debt and the sustainability of the public debt in Romania, and a case study on the gap between the deficit and the increases of public debt, for the purpose of which data from 39 countries, European Union member states and non-member states, from the period 1970 – 2015, were used.

Keywords: sustainability, fiscal and budgetary strategy, public debt.

JEL classification: G3, G38, H6.

Introduction

Ensuring fiscal and budgetary discipline, and the transparency and sustainability of public finances is one of the main objectives that a European Union member state should respect. In Romania, these provisions were re-analysed in 2015, when the Law of fiscal and budgetary responsibility (LFBR) 69/2010 was republished.

According to Article 4 paragraph (3) of the Law of fiscal and budgetary responsibility 69/2010, republished, “the Government has the obligation to conduct the fiscal and budgetary policy in a prudent way and to administer the budgetary resources and obligations, as well as the fiscal risks in such a way as to ensure the sustainability of the fiscal position in the medium and long term.

In addition, according to the laws in force, the Government shall calculate and manage very carefully the *impact on economic development and on future generations*, this being the equity principle which lays at the basis of a successful fiscal and budgetary policy.

1. Fiscal sustainability

Blanchard et al. (1990) asserted that “Sustainability is basically about good housekeeping”. At the European Union level, there has been an increasing interest in fiscal sustainability over the last years, especially emphasised by the effect of the world financial and economic crisis. At the same time, the need to implement a successful monetary and economic union determined the need to introduce a regulated framework on sustainability (Treaty on Stability, Coordination and Governance in the Economic and Monetary Union).

At present, we can see an alarming distance between the monetary union, for which implementation efforts are made, and the fiscal provisions. On this line, we can see that the European Union is trying with different regulations, treaties and reports to implement also a fiscal union: the implementation of the new Customs Code, which tries to harmonise the legislation referring to free zones, bonded warehouses, temporary admission and final use etc., the additional facilitations (centralised customs for simplified procedures and normal procedures, self-imposition and self-control etc.), conventions for avoiding double imposition on some fees and taxes etc.

The fiscal system and budgetary constraints have significant implication for investments in bank deposits and other forms of savings, given the cyclical changes and future predictions under the influence of certain factors of influence (Tufan, Hamarat, Cristea & Giurcă-Vasilescu, 2007); investments in life insurance, i.e. the savings component (Cristea, Dracea & Tomescu, 2009); or voluntary pension funds’ investments under the influence of public debt (Cristea & Siminica, 2012; Cristea, Siminica & Dracea, 2011).

In January 2016, the European Commission published the “Fiscal Sustainability Report”, which analyses the fiscal sustainability at the European Union level. In the short term, Romania does not show a worrying risk related to its fiscal sustainability. But in the medium term, a gloomy scenario is envisaged, with the public debt reaching over 60% of the GDP in 2026. However the most serious problems are estimated in the long term, the risk being generated especially by “the unfavourable initial budgetary position, compounded by age-related public spending, notably for healthcare and long-term care”. Nevertheless, we cannot say that there is an efficient fiscal sustainability policy in Romania. The frequent changes brought to the fiscal framework lead to some sort of instability that can create serious problems in the future.

Cristea and Dracea (2010) outlined that “the soft budget constraints, still prevalent in many transition countries, have encouraged private sector actors to make counterproductive investments”.

Results of the research of Acatrinei, Gorun and Marcu (2013, pp. 137) ” The findings will also help us derive conclusions about investors’ keenness to move capital to the Eastern Europe or whether the Romanian capital market is decoupled from the European capital markets.” However, other economic implications are possible in several branches of the economy: mass distribution- explained by the fact that „modern distribution had a real success nowadays, perceived mainly by the fortune that the founders of the modern supermarkets managed to gain” (Stancu and Meghisan, 2012, pp.503) and mass consumption- with a distinction that „must be drawn between the post-purchase feelings and the post-usage feelings” (Girboveanu et al., 2008, pp. 901). The globalization „seems to monopolize the food that we are consuming” (Meghisan F., Meghisan G.-M., 2012, pp. 398) and the services we are taking- e.g. telecommunications services, with a strategy of growth based on „the protection of the current market share and the maintenance of the incomes at the current levels” (Meghisan., 2012, pp.148).

2. The fiscal and budgetary strategy in Romania

For the period 2016 - 2018, the objectives set by Romania within its Fiscal and Budgetary Strategy are to increase the confidence of investors in the Romanian economy, to “create a predictable fiscal policy, fiscal simplification”, to continue the reform of public investment, to diversify and develop tools for the management of public debt, to stimulate consumption – at the same time, to ensure social protection for the categories of population with a low income.

The draft budget for 2016 and the perspective 2017 - 2018 is based on a new vision, a strong commitment in favour of change which should stimulate growth, the removal of disparities and social tensions, the creation of new jobs for ensuring *sustainable development*”, according to the Fiscal and Budgetary Strategy 2016 - 2018.

In the area of the tax on profit, both at national and European level, there is a fight against “financial engineering” used to avoid paying the tax, through the implementation of measures that prevent “the transfer of profits and the erosion of the tax basis”.

With the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union and the Convergence Programme, Romania assumes a structural deficit of 1% of the GDP.

In order to encourage growth and the development of efficient management of financial resources, a *Strategic Plan of the Public Finances Ministry* was established, with the following priorities: “simplification of fiscal matters and creation of predictability in a stimulating fiscal framework for the development of the private and public economic environment; improving the management of governmental public debt”.

In order to be able to analyse the fiscal and budgetary responsibility and the Fiscal and Budgetary Strategy 2016 – 2018, it is necessary to study the public debt, one of the important elements at the basis of the Law 69/2010 and of the regularly established strategies.

According to the Maastricht Treaty, the ratio of the governmental public debt and the Gross Domestic Product must not exceed 60% in order to be under the alert threshold. Nevertheless, the existence of an increase rhythm of the governmental public debt which is superior to the growth rhythm of the economy shows signs of worry, as in this situation the risk of solvability increases.

Considering the current situation, the governmental public debt will increase being determined by the need to finance the budgetary deficit and some particular elements which according to the European Union methodology are not components of the public debt (loans from the available of the State Treasury).

In order to keep the governmental public debt at a sustainable level it is absolutely necessary to respect a fiscal consolidation policy and to keep the budgetary deficit as low as possible.

Marcu and Meghişan (2011, pp. 218) asserted that “The process of managing public debt portfolio is a priority for every government in order to reduce medium and long term exposure to risks. The main objective in process of public debt management is represented by providing for the governmental financing needs in terms of minimizing long term costs and limiting the risks involved.”

3. Results of the Research

In order to carry out this analysis, first a database was developed. Consequently, the following indicators were extracted: the budgetary deficit in relation to GDP, the public

debt in relation to GDP, the actual annual growth, the annual inflation rate, the annual average interest for government securities with 10 year maturity. These indicators were extracted for 39 countries, EU member states and non-member states, and the source is the OECD statistical database. The data were extracted for the period 1970 - 2015. It must be mentioned that the panel set obtained in this way is not a balanced one, as not all statistical data are available for all economies in the period indicated above.

We use a series of descriptive statistics for the data set that was developed. Now, it is also a good time to clarify the abbreviations that will be used hereafter. So, they are: *location - country, loc* – country numerical index, *time – year of observation, gdebt* – governmental debt in relation to GDP, *def* - budgetary deficit in relation to GDP, *gpdg* – actual annual growth, *infl* – annual inflation rate, *ir* – interest for government securities, *target* – the target/optimal level of budgetary deficit, *gap* - difference between the target and the observed deficit.

In order to test the connection between the theoretical level of the budgetary deficit and the observed deficit, a panel linear regression, with fixed effects, will run over the developed set of data (table no. 1). Therefore, the following equation will be estimated:

$$def_{it} = \alpha + \beta * target_{it} + \epsilon \tag{1}$$

where:

def_{it} – is the observed budgetary deficit

α - is the constant term

β - is the parameter vector

$target_{it}$ – is the optimal value for the budgetary deficit

ϵ - is the estimation error

Table no. 1: Panel linear regression

Dependent Variable: DEF				
Method: Panel Least Squares				
Date: 09/17/16 Time: 16:48				
Sample (adjusted): 1995 2015				
Cross-sections included: 31				
Total panel (unbalanced) observations: 538				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-2.106062	0.134949	-15.60638	0.0000
TARGET	-27.65840	3.802557	-7.273630	0.0000
Effects Specification				
Cross-section fixed (dummy variables)				
R-squared	0.583626	Mean dependent var	-2.293793	
Adjusted R-squared	0.558117	S.D. dependent var	4.621832	
S.E. of regression	3.072331	Akaike info criterion	5.140387	
Sum squared resid	4776.244	Schwarz criterion	5.395427	
Log likelihood	-1350.764	F-statistic	22.87912	
Durbin-Watson stat	0.769795	Prob(F-statistic)	0.000000	

Source: OECD statistical data, author's own calculations

The estimation gave the results above. The independent variable is statistically significant with a threshold of 99%. At the same time, R^2 is 58%, which, for panel regressions, shows a very good explanation of dependent variables in relation with the regressors (figure no. 1). Another way to test the correlation could have been to calculate this indicator based on co-variation. Nevertheless, this aspect would not have taken into account the panel structure of the data set. At the same time, it is somehow counterintuitive to think that the government authority will have the level of budgetary deficit in line with its optimal value. Therefore, a lag based approach would be more appropriate, thinking that there will always be a gap between what is desired and what is real

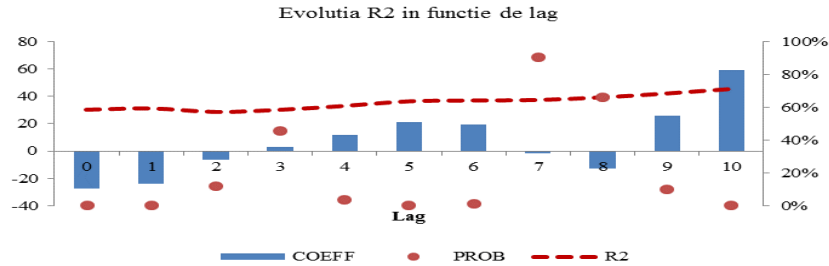


Figure no. 1: Evolution of R^2 in relation to lag
 Source: OECD statistical data, author's own calculations

Therefore, 10 additional regressions were run, with each one increasing the lag of the optimal deficit by a year. So, in the figure above, we can see 3 key values: the coefficient, the probability associated with the t test, and square r. It can be noticed that as the lag increases, the R^2 increases too. But this aspect should not be interpreted as such because the application of lags reduces the observation sample, with positive effects on errors. After the 6th lag, the number of observations decreases under 350, and the solidness of the model can be questioned. However, the lags 4, 5 and 6 are interesting. They all pass the significance test and R^2 reaches its maximum in lag 5. The positive sign of the coefficient shows a correlation on the same line between the dependent variable and the independent one. All these aspects are in line with the economic rationale and expectations. As the government terms of office are of 4, 5 years and the objectives are assumed for similar periods, we can expect that the deficit optimum to be reached towards the end of term. Considering what has been presented so far, we can conclude that this optimal deficit, determined by a simple determinist formula has solid roots in practice.

The next phase attempted to emphasise the impact of the gap between the observed deficit and the optimal one. For this purpose, a first step was to develop a gap variable, defined as difference between the optimal deficit and the observed one. Considering that in the set of data, the deficit will appear with -, and the surplus with +, this gap can be interpreted as follows: the bigger its value, the further from the “target” value the budgetary policy is. In order to observe a relationship between the public debt and the budgetary deficit, the first step was to transform the share of the public debt in the GDP. Historically, this indicator had an increasing trend for all economies. Therefore, in order to avoid problems connected with non-stationary and, at the same time, to amplify the periods when the public debt “is out of control” the series was put to a Hodrick-Prescott filter, keeping only the cyclical component (deviation from trend).

In figure no. 2 we can see the GDEBT variable (public debt in relation to GDP), out of which the trend components and its deviation from the trend were extracted.

We must mention that the value λ used for this exercise was the standard of 6.25 (Ravn & Uhlig 2002), specific to annual frequency series. Therefore, the series was transformed at panel level, the observation data were restricted between 1996 and 2015, and the countries with less than 10 observations were eliminated.

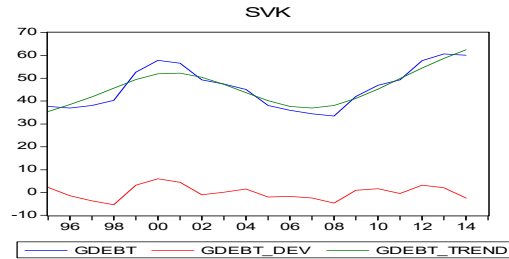


Figure no. 2: GDEBT variable

Source: OECD statistical data, author's own calculations

These eliminations were made in order to consolidate the structure of the panel with a view to maximise statistical accuracy. The deviation of the public debt from the trend was explained separately, in relation to various variables derived from the gap between the optimal deficit and the actual deficit. Annual increases were tried, deviation from the trend, averages for 2, 3, 4, 5 years. The result below is the one related to the regression with the highest R^2 (table no. 2).

Table no 2: Linear regression – restricted observations between 1996 and 2015

Dependent Variable: GDEBT_DEV				
Method: Panel Least Squares				
Date: 09/18/16 Time: 00:48				
Sample (adjusted): 1996 2015				
Cross-sections included: 30				
Total panel (unbalanced) observations: 498				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-1.104522	0.209166	-5.280609	0.0000
GAP_AVG2	0.484613	0.056720	8.543939	0.0000
Effects Specification				
Cross-section fixed (dummy variables)				
R-squared	0.137945	Mean dependent var	0.012250	
Adjusted R-squared	0.082567	S.D. dependent var	3.804530	
S.E. of regression	3.644083	Akaike info criterion	5.484314	
Sum squared resid	6201.451	Schwarz criterion	5.746419	
Log likelihood	-1334.594	F-statistic	2.490965	
Durbin-Watson stat	1.836628	Prob(F-statistic)	0.000032	

Source: OECD statistical data, author's own calculations

The coefficient is statistically significant, and R^2 has a decent value for a panel data set. The positive sign of the coefficient shows a direct relation between the deficit gap and abrupt increases in the public debt. In other words, if the government authority does not succeed in stabilising the budgetary deficit, then we can expect eruptions of the public debt.

Conclusions

The importance of fiscal and budgetary discipline, of transparency and sustainability of public finances is emphasised especially by the effects of the world financial and economic crisis. At present, there is an alarming distance between the monetary union, for which implementation efforts are made, and the fiscal provisions.

The objectives set by Romania within its Fiscal and Budgetary Strategy 2016 - 2018 are to increase the confidence of investors in the economy and for that purpose to “create a predictable fiscal policy, fiscal simplification”, trying to attain with the actions and measures adopted the objectives set at the European Union level on the stability of public finances and the increase of financial stability.

For a more thorough study, we attempted to develop an indicator for the degree of fiscal sustainability or vulnerability starting from the dynamic equation of the public debt presented by Stoian (2013). To carry out this analysis, a database was developed for 39 countries, EU member states and non-members, the source being the OECD statistical database. Therefore, the following indicators were extracted: the budgetary deficit in relation to GDP, the public debt in relation to GDP, the actual annual growth, the annual inflation rate, the annual average interest for government securities with 10 year maturity.

Therefore, in the first phase, the purpose was to test the connection between the theoretical level of the budgetary deficit and the observed deficit by running a panel linear regression, with fixed effects. A lag based approach was also envisaged, thinking there will always be a gap between what is desired and what is real. Therefore, 10 additional regressions were run, with each one increasing the lag of the optimal deficit by a year, seeing how as the lag increases so R^2 does. But this aspect should not be interpreted as such because the application of lags reduces the observation sample, with positive effects on errors.

Considering what has been presented so far, we can conclude that this optimal deficit, determined by a simple determinist formula has solid roots in practice, as the government terms of office are of 4, 5 years and the objectives are assumed for similar periods, we can expect that the deficit optimum to be reached towards the end of term. The next phase aimed to emphasise the impact of the gap between the observed deficit and the optimal one. Considering the analysis that has been carried out, we can see a direct relationship between the deficit gap and abrupt increases of the public debt. In other words, if the government authority does not succeed in stabilising the budgetary deficit, then we can expect eruptions of the public debt.

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