SUSTAINABILITY OF FISCAL POLICY. CASE OF ROMANIA*

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Abstract: The Sustainability of fiscal policy is one of the key concerns of each state, especially in periods of macroeconomic imbalance. This study aims to explore the concept of sustainability of Romanian's fiscal policy. The analysis starts from the definition of sustainability of fiscal policy and its assessment methods. The work is based on the idea that a sustainable fiscal policy ensure sufficient financial resources for long-term to reduce public debt to GDP weighting and provide permits for growth. Are also considered the circumstantial influences that affecting the decisions of a fiscal nature.

JEL classification: H62, H63, O47

Key words: sustainability, fiscal policy, public debt, structural deficit, out-put gap.

INTRODUCTION

An economic crisis, besides the undesirable effects has the advantage of vulnerabilities reveal an economic system. In this situation, fiscal policies pursued by the states are important vectors designed to ensure economic recovery and also to determine the growth recovery process. These directions are followed in the growth and development strategies adopted at national level in many countries, as well as those adopted by international bodies.

That the development strategy for a country to be viable long-term protection and support should enable disadvantaged social groups, to fund education programs and health-social side, the administration must have solid political support as - political side and there must be funding for public spending programs necessary to fulfilment of economic objectives, social and eco-effectively in a financial and fiscal side.

In general terms, sustainability can be defined by the quality of economic activity to take place without exhausting the available resources without destroying the environment, so without compromising the ability to meet the needs of future generations. In macroeconomic plan is used the term sustainable development concept first launched in the ONU Conference on Environment in Stockholm in 1972 and which involves compatibility of four systems: economic, human, environmental and technological[1]. From fiscal perspective, the policy sustainability implemented by

*Acknowledgement: This work was partially supported by the strategic grant POSDRU/88/1.5/S/49516, Project ID 49516 (2009), co-financed by the European Social Fund – Investing in People, within the Sectoral Operational Programme Human Resources Development 2007 – 2013.

[1] Gheorge Pîrvu - Macroeconomie, Universitaria Publishing, Craiova 2004, pp. 125

government refers to the mix of measures that meet current financing needs of the state without compromising future funding sources. The concept of sustainability refers to the future implications of current fiscal policies, namely the opportunity that governments maintain current policies without jeopardizing the achievement of a sustained rhythm of economic growth.

If a particular fiscal policy proves to be unsustainable, should be done some changes to this policy to ensure the consistency with future budgetary needs. In the sphere of income, the state budget can be balanced in two ways: taxation and public debt. Theoretically, any value of the budget deficit is possible if the government can grow without limits the public debt, which is impossible.

To maintain a certain level of public debt can proceed to increase taxes, but this involves legislative[2] changes, takes time and generate additional income for public budgets takes place only if the level of taxation is relatively low. Otherwise, should be taken measures to reduce costs to income levels or relocation of funds in projects with higher economic and social rewarding. In present conditions must show that the space for handle in which the fiscal policy has to work towards stabilization in response to economic crisis, stimulating aggregate demand, is strictly limited to the budget deficit and public debt levels recorded at the beginning of economic crisis. In other words, the manner in which fiscal policy has been paid in the past for stabilizing load affects the way that makes this possible now and in the future. As the situation in terms of taxation is heavier, for more authorities will difficult to react appropriately in the face of asymmetric shocks.

On the other way, it is obvious that on long term is necessary a constant rate between public debt and GDP as a condition of fiscal sustainability of any as a condition of any approach to the concept of fiscal sustainability should take into account three indicators: budget deficit, growth rate and public debt. In this context we find that the large budget deficits in the period before the fiscal crisis limited in counteracting the effects of the crisis.

THE CONCEPT OF FISCAL SUSTAINABILITY

The concept of fiscal sustainability is quite disputed, referring to the implications it will have in future the fiscal policies currently adopted. The first study[3] defines the concept of sustainability through future implications of current fiscal policies or the government the opportunity to promote current policies without affecting budgetary solvency (solvency of the public sector) which is related to the condition that the present value of future primary surpluses be equal current value of public debt. As such, the long-term public debt should be null. In small accept this means that the public debt cancellation is required at some future time the primary balance to become positive. In larger accept can set a target level for the size of public debt to be achieved over a certain time horizon, this is the case today when the European Union imposes a limit of 3% budget deficit limit of annual and public debt GDP of 60%.

[2] Tatiana Moşteanu (coordinator) – Buget şi trezorerie publică, Ediţia a III-a revizuită, University Publishing, Bucureşti 2008, pp. 41

[3] Moisă Altăr (coordinator) - Finanţe publice: introducerea unui cadru fiscal-bugetar pe termen mediu, European Institute from Romania, Bucureşti 2010, pp. 34-35

Another opinion[4] is that the sustainability of fiscal policy is often confused with the financial solvency of the government because in practice it is tested if both income and costs budget will continue to respect future trends in the past, which is not a problem of solvency. Solvency is defined by condition that the present value of future primary surpluses, which refers to revenues minus interest expenses paid on public debt, to be bigger than or equal to the current level of debt. So it is considered that the sustainability refers to the simultaneous fulfillment of solvency and liquidity, in terms of relative economic stability, and the liquidity represents the ability to pay in established time.

Public debt trajectory is determined by the macroeconomic context and the difference between nominal / real interest rate and nominal/real GDP growth rate, GDP debt decreasing by simply growth of the denominator ratio debt / GDP. If any fiscal policy proves to be unsustainable, this policy changes must be made to ensure connection with existing budget constraint on deficits.

The main problem is to determine the factors that limits the amount of public debt. Traditionally, budget balance must be equal every year but after introducing the idea of Keynes in fiscal policy changes annual vision in view of the business cycle: the budget balance should be equal at the level cycle. But this balance doesn't appear in most cases. Deficits have been accepted in times of recession, but surpluses during the large expansion are not large enough to achieve balance, a phenomenon that leads to considerable growth of the public debt.

Consolidated budget deficit taken as a single indicator is not a right indicator for evaluation of fiscal policy. It reflects the influence of both factors, permanent and the circumstantial factors, which can hardly be referred to without a careful analysis. The permanent factors which influence the budget deficit refers to stable items of income and public spending. Revenue streams and stable expenses are those that can be obtained under normal conditions in the absence of external shocks, when the economy reaches its optimal functioning, induced by a low and stable inflation .Tax revenues tend to decline in periods of recession and grow rapidly during periods of economic expansion. Regarding costs, there is an opposite behavior, for example, spending on unemployment benefits and early retirement tend to rise in times of recession because the job losses and decline in periods of sustained economic growth , when demand for power work is increasing.

The difficulty of differentiation between permanent and temporary influences on the budget insufficient or excessive action can generate the levers of fiscal policy, with implications that expansionary or contraction of the economic cycle at inappropriate times. In addition, a small deficit or even a budget surplus can hide the existence of large imbalances in the extent to which the position is just the result of favorable circumstances, in this case of high income obtained on the background of the economic overheating. Determining the structural balance (called cyclically adjusted balance) allows separation of the temporary and permanent influences of the budget deficit over the medium term orientation and evaluation of fiscal policy.

[4] Laura Obreja Braşoveanu - Impactul politicii fiscale asupra creşterii economice, ASE Publishing, Bucureşti 2007, pp. 130

Although there are many methodologies for determining the structural balance, such as Hodrick -Prescott filter and the production functions method [5], all of this involves essentially quantification excess / deficit of demand in the economy (the output gap) and determination of income and expenditure budget sensitivity across from it, these elements allow the party determination from the observed budget balance which is attributed to the existence of economic conditions of relatively favorable or unfavorable, that calculation of the so-called cyclic components. In this context we can place the authors analyze Aura Gabriela Socolo and Dorin Măntescu defining the concept of output gap as "a measure of the cyclical position of a country, the percentage difference between actual GDP and potential GDP[6]. It also looks like a negative gap means an economy underperformed, which operates under a positive potential and a gap is the result of excess aggregate demand, which can induce inflationary pressures. The right estimation of it is very important, a level indicator or worse than the actual application can lead to inappropriate economic policies. However, we believe that the structural deficit is not a perfect measure for sustainability assessment of the fiscal position, with the increasing social costs or expenses of the substations that are appropriate demographic developments in the coming decades. Gheorghe Matei[7] believes that the current stage of economic development and social subordination stated economic strategy towards the need to ensure the welfare problem. Also the polarization of society into rich and poor is a specific phenomenon and current society between the two extreme groups of socially there is a wide range of groups classified as those in good condition or those with few opportunities. The author emphasizes the need for social policies materialized in special programs provide economic and financial measures and instruments aimed at maintaining and increasing living standards, to improve quality of life. In the same time the author believes that the social policy is a consequence and a premise of economic growth.

THE SUSTAINABILITY OF FISCAL POLICY IN TERMS OF PUBLIC DEBT

If we analyze the case of Romania in the last decade we observe that our country has relatively a low share of public debt in GDP, if we consider the maximum weight of 60% which requires the Maastricht Treaty. So at the end of 2006,the public debt represents 18,4% of GDP, while at the end of 2010 on the background of deepening international financial crisis, in Romania the level of this indicator was 37.9% of GDP, according to the Ministry of Finance[8], with perspective growth for 2011 as in October reached 38.6% level of GDP.

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[5] A. Andrei, Gh. Oprescu, M. Roman, R. M. Păun - Consideraţii privind estimarea PIB potenţial în România, paper published in the International Conference on Finance and economic stability of the financial crisis context, Bucureşti 2009, pp. 247-254

[6] A. G. Socol, D. Măntescu - Remodelarea politicii fiscale româneşti în contextul crizei economice, Theoretical and Applied Economics Magazine, Vol. XVIII(2011), No. 1 (554), pp. 112-121

[7] Gheorge Matei - Protecţia social în România, Didactic and Pedagogic Publishing, R.A. Bucureşti, 2007, pp.13-14

[8] Ministry of Public Finance - Raport privind administrarea datoriei publice guvernamentale în conformitate cu strategia de administrare a datoriei publice guvernamentale 2008-2010, Bucureşti 2010, pp. 14, available online at http://discutii.mfinante.ro/static/10/Mfp/buletin/executii/Rap_dat_pub_guv_31dec2010.pdf

According to IMF analysis[9], Romania experienced an economic boom during 2003-2008, which led to overheating and unsustainable imbalances. GDP growth was placed over 6% per year during 2003-2008, foreign direct investment and capital inflows contributed to a significant increase in consumption and investment. Strong growth in exports to EU countries reflected a process of integration of increasingly large Western European economies. The demand growth was even faster, resulting in current account deficits becoming larger, which peaked at 14% of GDP in 2007.The overheating economy and rapid capital reinforcements have complicated monetary policy, which has attracted NBR's ability to achieve the inflation target despite higher interest rates and reserve requirements. Fiscal policy has played a strong pro-cyclical role, say IMF officials, the budget deficit increased from 1% of GDP in 2005 to almost 5% of GDP by 2008 but with a sharp decline from 7,4% in 2009 and a slight increase from 6,51 in 2010.

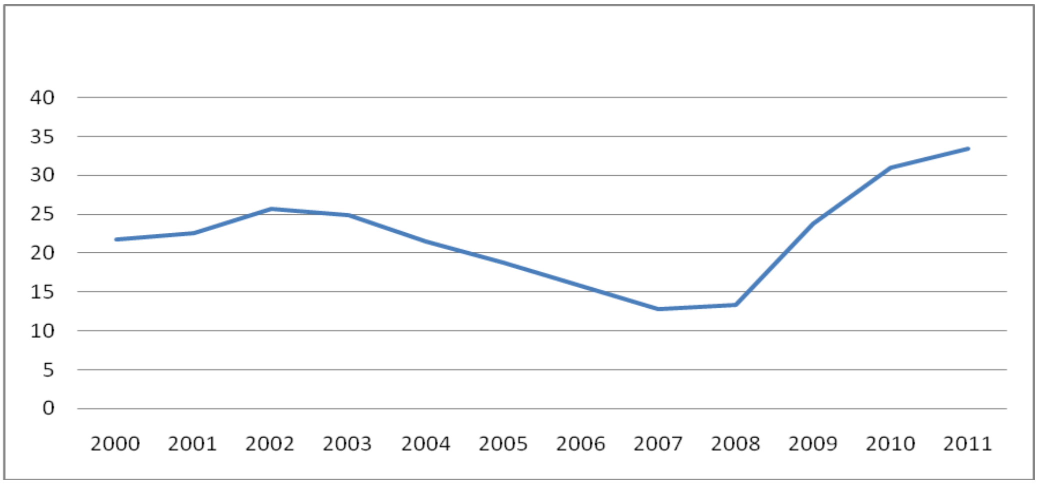
Recent analysis conducted by the IMF[10] about the evolution of public debt in Romania for 2011 forecast that was required to pay 9.2% of GDP in mature debt account. At this percentage will be added another 4.4% of GDP, the IMF estimated percentage of the budget deficit reaching a total borrowing requirement of 13.6% of GDP. This percentage is higher than that estimated one for 2012, the year in which the IMF expects a budget deficit only of 2.8%, part of the deficit target practice required by the European Union, but the payment of public debt will reach maturity will be about 0.1% from GDP higher. According to the state budget approved for 2012[11], the budget deficit is provided in the amount of 17.163,2 millions lei. This amount is reported to the GDP forecast for 2012 published by the National Commission of Prognosis [12] in value of 597.586 millions lei, then increase to 2.96%.

[9] International Monetary Fund - Solicitare de acord stand-by, întocmit de Departamentul European, 24 aprilie 2009, available online at http://www.fmi.ro/img/File/Staff%20report%20aprilie%202009_modificat-fara%20track%20changes-new.pdf

[10] International Monetary Fund - Fiscal Monitor September 2011: Adressing Fiscal Challenges to Reduce Economic Risks, available online at http://www.imf.org/external/pubs/ft/fm/2011/02/pdf/fm1102.pdf, pp. 20, 31

[11] Law no. 293/2011 concerning the state budget for year 2012, published in the M. Of. No. 914/22.12.2011

[12] National Commission for Prognosis - Prognoza pe termen mediu 2011-2015 - varianta de toamnă 2011, available online at http://www.cnp.ro/user/repository/prognoza_2011-2015_varianta_de_toamna_2011.pdf



Source: Ministry of Public Finance, http://www.mfinante.ro

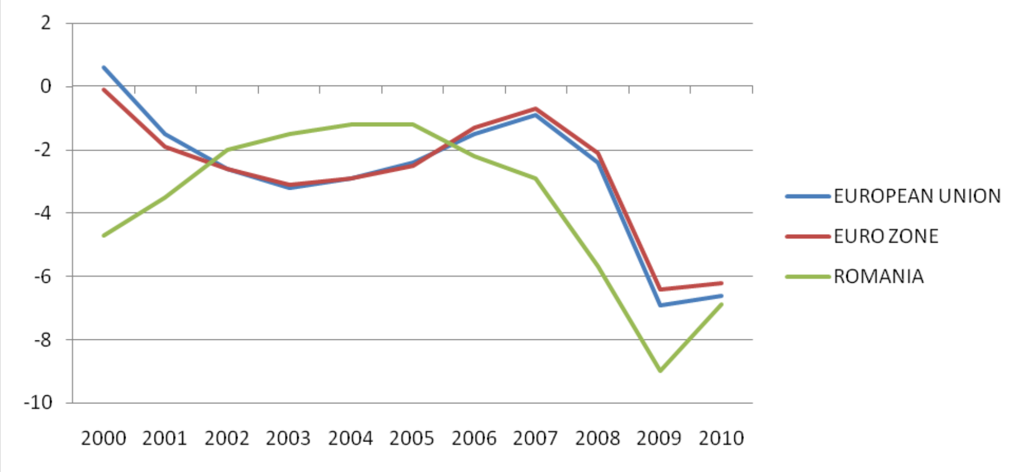
Figure no. 1 Evolution of public debt in GDP of Romania

Regarding the structure of the consolidated budget in 2008-2010 we observe an increase in the share of expenditure on lower revenues. The level of the budget deficit in Romania has increased significantly in 2008-2010 from 5.4% of GDP in 2008, 7.3% of GDP in 2009 , readjust to the 6.5% in 2010. Among the causes that gave rise to this, lists: decrease of industrial production, oversized expenses in carrying out programs of investment, increase tax evasion, reducing revenues due to economic crisis, institutional factors such as legislative changes and bureaucracy, lack of political consensus.

Financing agreements concluded by the FMI and European Union forced the Romanian government to take measures for fiscal consolidation .These measures have helped to reduce the deficit and also to reduce the risk of accelerated growth since the public debt that had covered large deficits in previous years installments of public debt and refinanced at maturity. For 2012, Romania should close the excessive deficit procedure in which is from 2009, bringing the indicator below 3% of GDP.

The deadline for correcting the excessive deficit involves, according the calculations of European Commission[13], the average adjustment effort of the structural deficit of 1.75 percentage points of GDP in the next two years. The reduction of structural deficit is necessary to avoid increasing public debt, public expenditure and interest to overburden monetary policy. This will be a test for coherent mix of future policy. It will be valid if scheduled reductions of the structural deficit will be made without compromising economic growth. A endangering growth in this way does not remain without consequences in terms of inflation and financial stability.

[13] European Commission - In the EDP Commission presents reports for Lithuania, Malta, Poland and Romania, Brussels May 13, 2009



Source: Eurostat, http://epp.eurostat.ec.europa.eu

Figure no. 2 Evolution of budget deficit (% of GDP)

As we shown above circumstantial factors will be also present this time. If in crisis years the structural budget deficit was higher than cyclically adjusted deficit because the output gap was negative for the next decade the output gap will be positive. IMF estimates, starting from the constant situation in 2010, that the next decade will require some fiscal adjustment, which will require an increase in budget revenues by approximately 4.3% of GDP for public debt in GDP will not grow.

As Alberto Alesina[14] said in the sphere of fiscal policy sustainability on long term come in adverse impact of demographic aging. Considering the cost of population aging, a structural deficit even lower in the present can hide major long-term vulnerabilities. Implications for countries with high structural deficits are obvious, in conditions that in the EU level updated average cost for aging population between 2010-2060 is estimated at about 4% of GDP. Jacques Attali thinks that in the absence of sufficient demographic dynamism, can't ensure the replacement of generations, especially in Spain, Portugal, Italy, Greece and Germany (..) which will result in a depreciation of public service quality, transport and education, health and social security[15].

The analysis made by Gabriela Molanescu and Mirela Ionela Aceleanu[16] for Romania show that the social security budget since 2006 recorded large deficits in 2009 reaching the highest value about 1.5 billion euro, annual expenditure for pensions, which was the largest category of subsistence costs budget, its share in GDP to 8%, with a tendency to increase in coming years.

These increases in pension costs are determined first by the aging population and active population reduction. The authors estimated that in the year 2050, to 100 active citizens 149 will be inactive, and the population over 65 years will exceed 5

[14] Alesina, Alberto - The Political Economy of the Budget Surplus in the United States, The Journal of Economic Perspectives 14, no. 3 (2000): 3-19, on line at http://search.proquest.com/docview/212079888?accountid=15533

[15] Jacques Attali - Scurtă istorie a viitorului, Polirom Publishing, Iaşi 2007, pp. 91-92

[16] G. Molanescu, M. I. Aceleanu - Consecinţele deficitului bugetar în România în contextul crizei actuale. Implicaţii asupra pieţei muncii, Theoretical and Applied Economics Magazine, vol. XVIII(2011), No2(555), pp 58-74

million, as compared to 3 million as is currently, effects on long-term will be labor shortages and insufficient economic resources necessary to support elderly people.

Despite increasing public debt, consider that Romania has achieved sustained economic growth, because the loans used to cover deficits contracts especially not for economic development itself. Because a good part of contracted loans were carrying of variables interest, as their rate increases, the amounts due by Romania with this title were also increasing. To pay the debs and due rates, Romania was forced to contract new loans. So, a significant part of public debt is a direct result of current refinance of the public debt from previous years.

To the growth of public debt contributed also the committed mistakes in guiding economic policy and foreign financial. In some cases it's about the utilization of borrowed resources to finance unproductive or important objects of budget deficits and achieve goals with a low economic efficiency and that exogenous factors have played a crucial role in Romanian increasing debt and the international context provide a favorable action of exogenous factors and print the borrowing problem of the public administration a pronounced political character.

SUSTAINABILITY OF FISCAL POLICY IN TERMS OF GROWTH IN LIVING STANDARDS

When we talk about policy coherence, we should consider a target against which to evaluate. In our specific case, the major objective is the sustainable convergence to EU average living standards. The analysis of living through the GDP / resident will lead us to conclusion that the level of living has increased in periods in which policies were rather consistent. For example, to analyze the comparison of living standards growth and structural budget deficits on economic growth during 2000-2008.

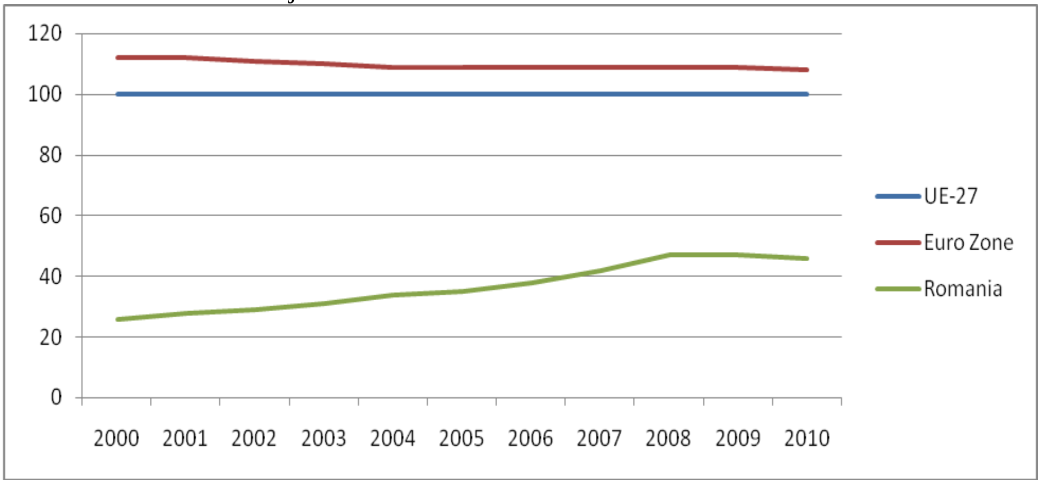
Between 2000 and 2003 GDP / resident compared to EU-27 increased from 26% to 31% which means an average advance of 1.67% per year, according to Eurostat[17] statistics. This growth was achieved simultaneously with a reduction in the structural budget deficit from 1.6% of GDP in 2000 to 1.2% of GDP in 2003.Based on these data we conclude that it was a healthy growth in 2006, GDP / capita reaching to 38% of the EU-27.Structural deficit in the same period increased on average by almost one percentage point per year, reaching 4.1% of GDP in 2006. In these circumstances, we believe that between 2004 and 2006 growth in living standards was accompanied by accumulation of structural problems in public sector. Inconsistency is followed by lower living standards and the need for coherent policies to improve living standards.

Structural problems have worsened in 2007-2008, when GDP / capita in Romania increased to 47% of the EU-27, an average of 5 percentage points per year, but in the context of severe damage to the structural budget deficit of 8.5 percent of GDP in 2008.

Let examine now in parallel, as we did above, the recession and fiscal adjustment measures and to analyze the implications for living standards and the structural deficit. Only in 2009 GDP / capita expressed as a percentage of average EU-27 remained constant, however structural deficit was reduced with only 0.4 percentage points from 8.2% of GDP in 2008 to 7.8% of GDP .In other words, the recession led to

[17] Eurostat - GDP per capita in purchasing power standard, available online at http://epp.eurostat.ec.europa.eu/portal/page/portal/eurostat/home/

lower GDP / capita compared to EU-27 average, but the structural deficit remains large, without the same line adjustment.



Source: Eurostat, http://epp.eurostat.ec.europa.eu

Figure no. 3 Evolution of GDP / capita expressed in purchasing power standard

Reported to the evolution of GDP / capita in the euro zone, Romania had a favorable evolution during the crisis but the gap is still very high. If in 2000 this indicator stood at 112% of the EU in the Euro Area and only 26% for Romania, in 2010 was a decrease from 108% in the euro area increased to 46% for Romania. This evolution can be attributed to economic development efforts made by Romania in the last decade.

However this rate of growth is unsustainable because the overuse of resources can't be maintained for long term. Increasing domestic demand based on credit and not on raising productivity has shown the limits. Even if economic growth will register positive values in coming years, the convergence by the developed economics of Europe will be made during a period of time. Globalization has made possible this favorable evolution but also the globalization made vulnerable the emerging economies, making them dependent on external financing. Although there are prerequisites for economic growth above 3% average annual this growth it must consider a restructured economy. Romania's economy which relied on agriculture and construction sectors proved that is vulnerable. The growth rate of GDP / capita left the false impression that a policy of fiscal relaxation is always timely. Fiscal adjustments occur sooner or later and improve living standards can be stopped suddenly by economic shocks such as financial crises, crises of raw materials or energy.

CONCLUSIONS

The eruption of the crisis has changed the balance of risks from external vulnerability to greater concerns about fiscal sustainability. The main challenge in the medium is to be able to ensure fiscal sustainability without threatening economic growth of the prospects .The question is if the policy mix applied in the period 2009-2022 is consistent and compatible with the new challenge, are effective restrictive measures of wages in the budget and the increase in VAT to reduce the difference. In the medium term, it is meant to lead to resumption of sustainable growth in living standards but everything depends on the government capacity to manage public funds. But in short term, low living standards is inevitable. Would be desirable to decrease the standard of living will not generate a new bout of populism. Political discourse can remove lot of the economic fundamentals that should stay at the basis of any macroeconomic decision. The problem is that, in the case, were are not allowed increases in public debt or budget deficits to stimulate economic recovery, the only options are to reduce spending or increase taxes, measures that reduce the economic growth. These applied measures in the low point of economic cycle represent pro-cyclical measures involving money out of circulation just when they are needed and have the effect of short-term to increase the unemployment. Therefore have to consider the gap that manifests in getting the effects behind reform decisions. Reforms must be implemented gradually, not by massive cost cuts because the lower income and consumption lead to the economic slowdown, decreasing GDP and budget revenues, increasing more economic deficits.

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13.	International Monetary Fund	http://www.imf.org/external/index.htm
14.	National Commission for Prognosis	http://www.cnp.ro/
15.	Ministry of Public Finance	http://www.mfinante.ro/acasa.html?method=inceput&pagina=acasa