

THE ANALYSIS OF EVOLUTION AND FINANCING POLICIES OF THE BUDGET DEFICIT IN ROMANIA, IN THE PERIOD 2007 – 2012

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Abstract:

The budgetary deficit issue is a topic of wide interest since the 80s, when the United States faced with the largest budgetary imbalances after World War II. The approached theme coexist naturally with many pro or against mainstreams of a negative budget balance. The essential purposes taken into account in writing this study are illustrated by analyzing both revenue and expenditure of the general government in Romania during 2007 - 2012 and the consolidated budget deficit analysis, the causes of the budget deficit, and the ways of its funding for the period 2007-2012.

Key words: budgetary deficit, financing of the budget deficit, budgetary revenues, budget expenditure

JEL clasification: H61, H62, H63

1. INTRODUCTION

The proceedings related to the budget deficit always preoccupied many specialists, academics and members of government. The representatives of classical current and even those of the post-kenesian current consider the process of prosecuting the financial impact of the budget on the economy by achieving its balance, respective bigger revenues than expenses or, at worst, equal with them.

The budget deficit has become a phenomenon characteristic of the contemporary world. A major chronic budget deficit may lead to an increased inflation, a currency crisis, some foreign debt repayment difficulties and other undesirable phenomena which adversely affects macroeconomic stability and economic progress respectively.

The essential goals envisaged in the development of this study were not focused on highlighting the budgetary impact mainly on the economy deficits but they considered defining and highlighting the causes of the budget deficit; exploring the ways to finance the budget deficit; presenting the methods of financing the budget deficit in Romania during 2007-2012. The objectives, issues and theoretical treatment of the theoretical aspects referring to the budget deficit, but also the study of its evolution and financing have determined the logical structure of this paper.

2. CAUSES OF THE BUDGETARY DEFICIT

The budgetary deficit has nowadays become a common phenomenon in many countries, closely related to the development of the public expenses. In Romania, the budget deficit has been,

in the recent years, one of the most difficult problems faced by economic policy. In the current economic activity, when the need for financial resources is greater than the available funds, the setting up of the budgets at all levels is one of the primary issues, particularly in observing the principle of the budgetary balance. In most of the cases, the budget balance is not achieved automatically by covering budget expenses by budget revenues. In this case it can be said that the budget is developed by *deficit financing*.

If the state budget is reported to an economy that ensures the full use of the labor, we can speak of a cyclically adjusted budget, which represents the surplus or deficit that would exist if the economy ensures the full use of the labor, which would be possible if the achieved national income equals to the potential national income [5].

The existence of the budget deficit has several causes, such as:

- The decrease in the production of goods and services in the economy;
- The increase of spending in order to achieve certain social programs;
- The increase of the activity of the invisible sector of the economy;
- The increase of the marginal costs of social production;
- The excess money issue that is not accompanied by economic growth.

The budget deficit can occur both in economically developed countries and countries with economies in developing or in transition, and the causes can be generated from its own economy or the international situation. Specifically, among these *causes* [1] are:

- The fluctuations of Gross Domestic Product, which is one of the internal causes that lead to the emergence or increase of the budget deficit, by slowing the growth of government revenue;
- The degree of redistribution of Gross Domestic Product can lead to imbalances between the revenues and the expenses, while components on unemployment benefits and social assistance are constantly growing;
- The increase of the public spending weapons was often one of the causes that led to overcoming public revenues by public spending;
- The international cyclical phenomena transmit their influence through the exchange rate and interest rate.

3. OPTIONS FOR FINANCING THE BUDGET DEFICIT

Bernheim și Inman [2] reveal that the issue of the budget deficits and public debt can be analyzed in terms of three schools of thought. Thus, according to the neoclassical paradigm, the budget deficits lead to the long-term increase in consumption and where the economy operates under conditions of full employment of labor, the consumption growth will reduce the savings. In order to balance the financial markets, it will be necessary to increase the interest rate, which will have the effect of reducing the rate of capital accumulation in the private sector.

From the point of view of the Keynesian paradigm, most of the people consume most disposable income and a temporary reduction in the tax rate will have immediate and significant positive effects on aggregate demand. If the economy does not operate in conditions of full employment of labor, this will lead to an increase in national income.

In the context of the Ricardian paradigm, the policies of financing the budget deficit will lead to an indifferent attitude of the individuals vis-a-vis the alternative chosen by policy-makers. This is because, in the opinion of this paradigm, the consumption is a function that depends on the amount of resources in all generations, so that, if budget deficit would require a tax rate increase, it would not affect resources for all generations. The author believes that neither of these quotations can be entirely applied in reality, but the neoclassical perspective is one that provides the most relevant results on the incidence of public deficits and their methods of financing on the economy.

The option to finance the budget deficit must be based on maximizing the total social utility [8]. Once public goods offered are characterized by public financial resources of any kind, whether ordinary or extraordinary, must generate social utility that will justify and motivate socially

promoted government budget deficit. In other words, the government must achieve an optimal combination of ordinary revenue and borrowed resources, so their usefulness is optimal.

In order to be able to finance the budget deficit, equivalent to the covering of the negative budget balance, states may choose, in modern society, either for the redistribution of the available resources of the economy through monetary relations and characteristic financial flows of the domestic credit, and sometimes the external credit, or for the forced monetary creation or issue of new currency[8]. Thus, we define two categories of budget deficit financing policies: monetary financing policies of the budget deficit and non-monetary policy of deficit financing.

The non-monetary financing of the budget deficit represents the financing policy through which the state authorities take credits from the holders of temporarily available cash resources, either as internal loans or as external ones. This type of financing the deficits represents the key part of the monetary and financial policies of macroeconomic adjustment by Keynesian inspiration. State loans have always been contested because of the effects they have on other economic variables. In this respect, it is often invoked the *crowding out effect* [7]. This effect refers to the consequences of practicing deficit (budgetary expenditure growth) on investment demand. The latter tends to transfer from the private plan to the public plan. In other words, the budget deficit by borrowing occurs only by substitution among the components of aggregate demand, not its growth. Another appeal of this type of deficit financing is the idea that the loans would not be something else than deferred taxes and the present value of future tax burdens [4].

The financing of the budget deficit by issuing money represents an issue much debated in the academia, because such a policy leads in most of the cases to an increase of inflation. However there have been numerous cases where governments have decided that the budget deficit should be done by issuing currency because they considered other alternatives as non-viable (Germany, 1921-1923) [6]. Such a method used to finance the budget deficit becomes often more effective for the government than for the others. Monetary expansion through coinage is very easy. Money from coinage can generate a governmental profit by the central bank operations of lending in order to cover the state budget deficit [3].

Although the financing of the budget deficit by direct monetary issuing or other seigniorage revenues has been used in many cases, is not a recommended policy due to the associated negative consequences.

The financing of the deficit through tax increases will lead to a decline in national economies, to a growth of the rate exchange and thus to a reduction of the investments; maintain the budget deficit at the same level through tax cuts and public spending will lead to a decrease in consumption and investments.

4. THE ANALYSIS OF THE CONSOLIDATED BUDGET DEFICIT OF ROMANIA IN THE PERIOD 2007-2012

The approaches regarding the budget deficits, the means of financing and especially the dimension of the public debt take a number of specific shades in the case of the different economies. The concrete economic, financial, social, administrative conditions raise a number of issues that require a very serious approach to the potentially unfavorable of the dimension of the budget deficits and public debt over the real possibilities of non-inflationary financing.

In Romania, in particularly complex framework in which the economic activity takes place, in an attempt to highlight the place it holds budget deficit, an important role is assigned to determining the share of public financial deficit in the case of the consolidated government expenditure and revenue.

In order to emphasize this point I considered necessary to accomplish a summary of the general consolidated government expenditure and revenue of Romania. With the evolution of the information sources regarding the evolution of the incomes, expenses and general consolidated government balance, published on the website of the Ministry of Finance, I have made their centralization during 2007-2012 as can be seen in the table below.

Table nr.1 The main indicators of the general synthetic consolidated government budget in the period 2007-2012

	INDICATORS	YEAR 2007	YEAR 2008	YEAR 2009	YEAR 2010	YEAR 2011	YEAR 2012
1.	Budgetary incomes - Value thousand lei - % GDP	127.108,2 32,5%	164.466,8 32%	156.624,9 31%	168.598,5 33%	181.566,9 33,1%	193.148,2 33%
2.	Budgetary expenses - Value thousand lei - % GDP	136.556,5 34,9	189.121,7 36,9%	193.025,4 38,2%	201.903 39,5%	205.403,6 37,5	207.922,1 35,5%
3.	Budgetary deficit - Value thousand lei - % GDP	-9.448,4 -2,4%	-24.654,9 -4,8%	-36.400,6 -7,2%	-33.305,2 -6,5%	-23.836,7 -4,3%	-14.773,9 -2,5%
4.	GDP (thousand lei)	390.800	503.958,7	505.503	511.581	547.829	585.200

Source: Carried on by the author based on data provided by the Ministry of Public Finance

The year 2007 was a crucial year for Romania and a turning point in the evolution of the Romanian economy, when our country was faced with the greatest opportunities in recent history, with the integration into the European Union. The effects of the integration are clearly visible since 2008, when gross domestic product increased considerably continuing its upward trend. A negative evolution is found in the budget deficit, it doubled in 2008 compared with 2007. This increase was largely due to the increased interest expense on loans contracted by the Romanian state. Deficit gradually began to show a downward trend beginning with 2010, reaching in 2012 (-2.5% of GDP) around the value of 2007 (-2.4% of GDP), its evolution is presented in Chart no. 1

Romania had to adjust their macroeconomic policies to the new context created by the international financial crisis began in 2007, to correct its imbalances, to prevent them in the future and ensure a long-term sustainable development. To achieve these plans was needed to find solutions to some challenges:

- reducing the budget deficit at a time when the global economy is in recession;
- promoting the structural reform measures in a time when social difficulties are increased also by the national and international economic context [9].

In 2010 the most important fomentation for the monetary policy was represented by a setting up of the inflation expectations and ensuring a sustainable disinflation simultaneously with setting up the confidence and creating the conditions for sustainable recovery criteria and recovery business lending.

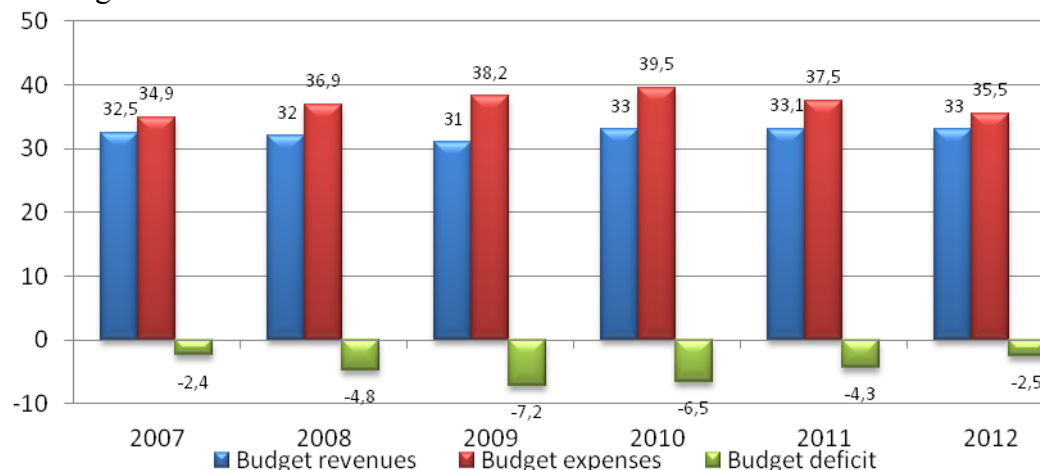


Chart no. 1 The evolution of the budgetary indices and the budget deficit in the period 2007-2012 (% of GDP)

This challenge is intensified by the fact that such a configuration of the monetary policy is strictly related to a continued compliance with the objectives assumed under the multilateral external financing arrangement concluded with the European Union, International Monetary Fund and other international financial institutions, such as to ensure the systematization and stability of the economic policy mix implemented by the authorities [10].

The budgetary revenues for 2011 were 181,566.9 millions, with a 37.5% share of Gross Domestic Product, up to 0.2 percentage points compared to 2010, due to the growth of 1.5% recorded in 2011, as well as the measures to improve the funding process. Due to the uncertain international context, the economic recovery was still fragile, requiring a continuation of the fiscal consolidation so that their effect since 2012 should allow achieving a budget deficit of 3% of Gross Domestic Product, in accordance with the Maastricht convergence criteria. Since 2011, most of the budget revenues will be included on an upward absolute value trend, an important aspect illustrated in the year 2012, because they increased by 2518.9 million compared to the previous year, while the share of Gross Domestic Product will have a constant coevolution.

As it can be seen from Table no. 1 and Chart no. 1 the budgetary synthetic indicators, namely budget income and expenditure had an upward trend, both as nominal value and relative value (percentage of Gross Domestic Product). In contrast, the budget deficit was a slight trend (negative aspect), but is followed by a decrease in the budget from one year to another. If we refer to Gross Domestic Product, we can say that it has evolved in the direction of growth on the entire analyzed period, which is 2007-2012, the highest value of which is reached in 2012 with 585.200 millions.

The Government consolidated budget revenues are observed through a diversified and complex structure, the most prominent being tax revenues and revenues from social insurance contributions and health insurance contributions, these two categories of income being the most important source of formation of general government revenues.

According to Chart no. 2, the revenues had the largest share in both Gross Domestic Product and budget revenues, they were revenues from social insurance contributions and health contributions, with a rate of over 9% of Gross Domestic Product and share of income total budget of between 26.75% and 30.56%. Since tax revenues, the largest share in both Gross Domestic Product and total budgetary revenues is VAT 8.7% (2011) and 26.39% achieved in 2011, this being the main fiscal income and tax. Overall, other tax revenues (income taxes, payroll taxes and property taxes, excise duties) had a share of Gross Domestic Product below the level of 8.7 percentage points over the years submitted for analysis.

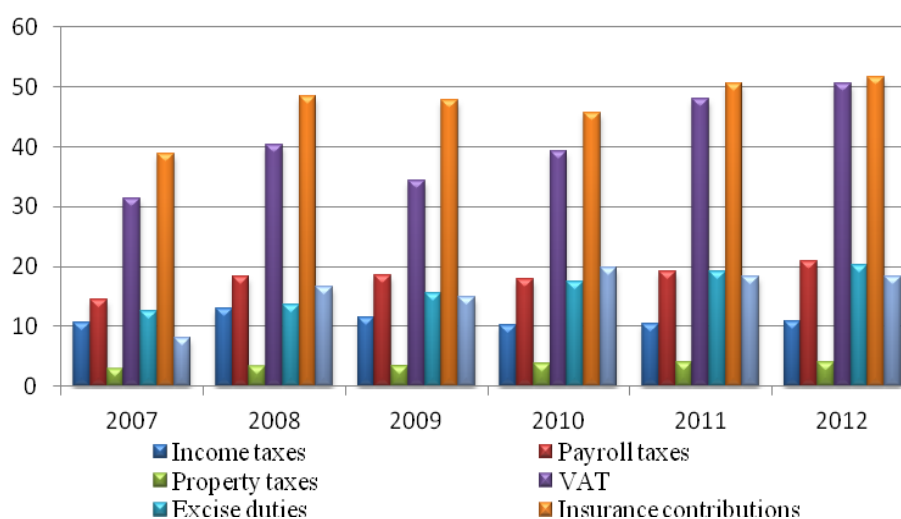


Chart no. 2 The evolution of the main budget revenues in 2007-2012 (billions lei).

The main reason that led to increased tax revenues from VAT in 2010-2011 was the single VAT rate change in July 2010 to increase its share from 19% to 24%, an aspect available nowadays.

Running in the period 1 January 2007-31 December 2007, the consolidated revenues amounted to 32.5% of Gross Domestic Product and the nominal value registered an amount of 127,128.2 millions.

In 2008, due to colonial policy and macroeconomic nuanced imbalances, which made their mark with a current account deficit and high inflation, total revenues for the year analyzed represented 32 percentage points of Gross Domestic Product, and as nominal value represents 164,466.8 millions, which led to a growth of 0.5% compared to the previous year.

The budget revenues for 2009 (31% Gross Domestic Product) decreased compared with 2008 (32% Gross Domestic Product), this being due in particular to the reduction the receipts from income taxes (11551.4 million in 2009 compared to 13045.9 million lei in 2008), as well as those from VAT (34322.4 million lei in 2009 to 40375.1 million lei in 2008).

The Government consolidated budget revenues showed an increase in 2010, this increase is due mainly to the following receipts: VAT revenues increased by 4.923.6 million compared to the previous year, excise revenues increased due to the increase of excise duty applied from 1st January 2010 as well as the increase in the amount of some products such as tobacco, alcoholic beverages, fuels; non-tax revenues also increased in the year under review, therefore measures to restore budgetary balance such as inclusion in the state budget the amounts of reduction of wages in the public authorities and institutions, wholly or partly financed from its own revenues; transferred to the state budget amounts from their own sources of financing operators owned by the state, following the receipt of dividends from state-owned operators, as well as the payments to the state budget of the central bank 's net profit [9].

The revenues collected at the consolidated budget in 2012 of 193,148.2 million were 15.8% higher as nominal values compared to the corresponding period of the previous year's achievements. Proceeds from the income taxes continued to improve, while proceeds from insurance contributions have had a downward trend, being slightly below the values of the previous year.

The consolidated general government budget expenditures have a more complex structure than government revenues, the most important uses of budgetary revenues as social assistance expenses consisting in covering the social budget expenses, followed by expenses with the personnel of the public sector, the costs of goods and services, capital expenditures, etc.

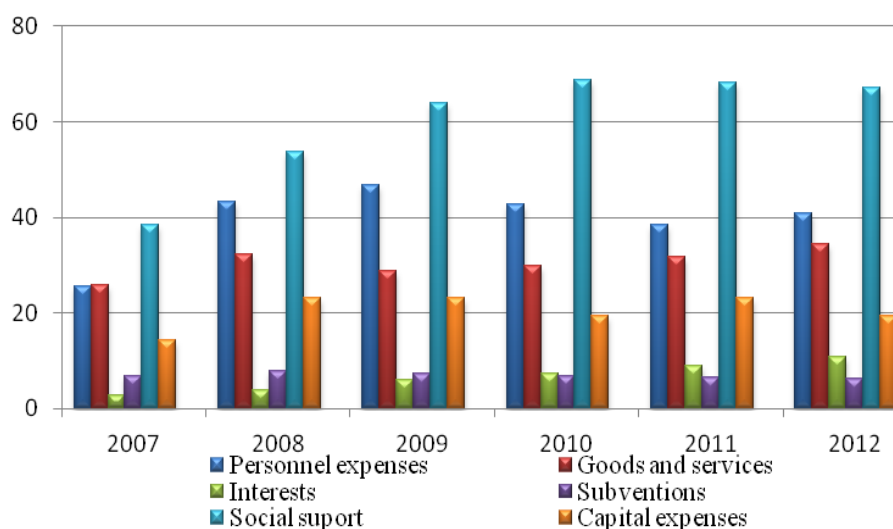


Chart no. 3 The evolution of the main budget expenditure in the period 2007-2012 (billion lei)

As shown in Chart no 3, the expenses that recorded the largest share in both the total budget expenditure and Gross Domestic Product during the period under review in 2007-2012 consisted in an expenditure on social assistance with a share of over 10 percentage points of Gross Domestic Product throughout the period and a share of between 28% and 34% of total revenue.

The expenses regarding social assistance increased in 2012 compared to 2007 to 28721.8 million lei, 57.17% respectively, this being the consequence of an increased pension point in October 2008 granting minimum guaranteed social pension from April 2009.

Staff costs had a constant evolution over the period analyzed, 2007-2012, the highest value being recording in 2009 with 46710.7 million lei. Because of the crisis that has hovered over the economic activity, the government decided to adopt measures to protect low-income social categories, such as giving the minimum pension, indexation of pensions, minimum income increase by 15%, and all these facts have led to increased personnel costs as well as increasing social assistance.

An increasing trend in the period 2007-2012 recorded an interest expense, due to the fact that our country was required to pay interest on previously contracted loans.

5. THE EVOLUTION OF THE GENERAL GOVERNMENT DEFICIT IN THE PERIOD 2007-2012 AND ITS FINANCING METHODS

The general government deficit fluctuated over the analyzed period, which is 2007-2012, the maximum being reached -7.2 % of Gross Domestic Product in 2009, and the minimum level of -2.4% of Gross Domestic Product in 2007. The budget deficit rose from 4.8 % of Gross Domestic Product in 2008 to 8 % (7.2 % according to the methodology cash) at the end of 2009, due mainly to the effects of economic contraction on revenue and expenditures (automatic stabilizers) and the fiscal policy measures taken to support the stabilization and economic recovery. Among other causes that led to the registration of such high deficit values are the following: decreasing economic output, overspending in the development of social programs, increasing the share of the black economy, reduced revenues, institutional factors (procedures and budgetary laws, bureaucracy), political instability and not the least the impact of the global financial crisis installed.

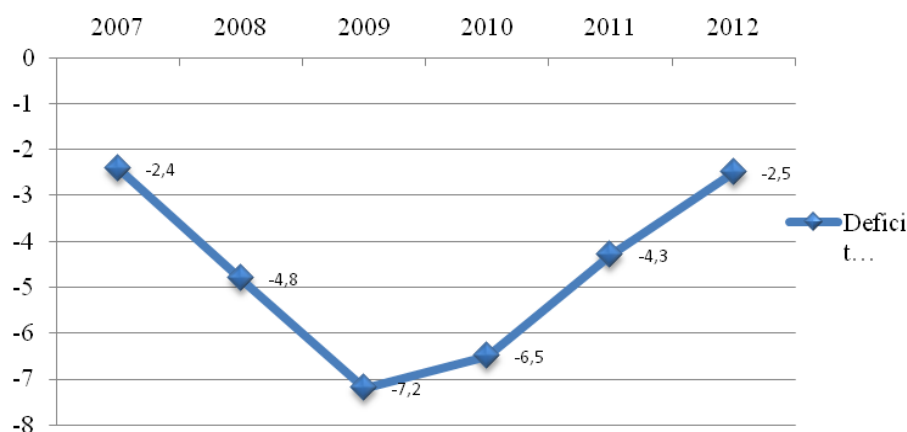


Chart no. 4 The evolution of the budget deficit in 2007-2012 (%Gross Domestic Product)

One of the objectives in the 2009-2012 Convergence Programme was also the sustainable reduction of the budget deficit and reach the level of 3% of Gross Domestic Product by 2012 (2.5% Gross Domestic Product). Given the convergence criteria that need to be met (deficit <3%), the impact of the financial crisis has made each year from 2007 to 2010 these criteria will be reviewed and according to the forecast closer to the reality of their achievement in about the impact of unexpected economic circumstances.

The General government deficit financing in Romania, in the period 2007-2012 was conducted both through internal funding sources, mainly from 2007-2009, and from 2010 budget deficit was made through external sources, accounting more than 50%. In addition to these two categories of funding sources related deficits lowest percentage returns to the amounts recovered by the Authority for State Assets Recovery (AVAS) in bad loans, with a share of less than 10 percentage points in the sources.

Table no. 2 The financing of the budget deficit in the period 2007-2012 (- percentage)

Financing method	YEAR 2007	YEAR 2008	YEAR 2009	YEAR 2010	YEAR 2011	YEAR 2012
Total percentag	100%	100%	100%	100%	100%	100%
Internal financing	80,9%	89,2%	58,8%	41,6%	45,0%	34,3%
External financing	10,0%	9,3%	37,9%	57,2%	53,3%	65,7%
Other sources (AVAS recoveries)	9,1%	1,5%	3,3%	1,2%	1,7%	0,02%

The last part of the year 2007 ended with a deficit of - 9448.4 million, and its share in Gross Domestic Product was -2.4%. Analyzing the process of funding in 2007, it is clear that this was done mainly from internal sources, and additionally from external sources. In this respect, the intention was to launch new bonds on international capital markets. Option Bond foreign capital markets is to:

- need to cover non-inflationary budget deficit;
- avoid the eviction of the private investment.

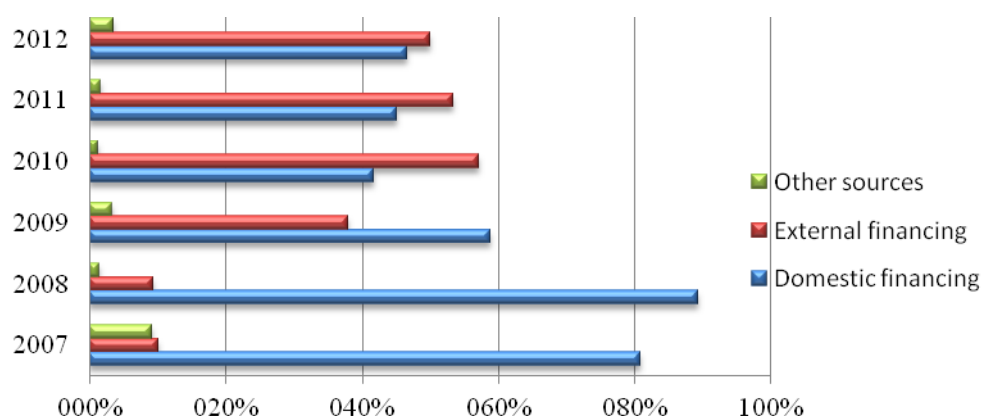


Chart no. 5 The evolution of deficit financing in the period 2007-2012

Budget deficit in 2008 and government debt refinancing was accomplished by [13]: issue Treasury bills and bonds domestic benchmark value of 12.5 billion lei; Eurobond issuance in international capital markets, amounting to 750 million euro; drawdown of loans to finance projects contracted with international financial institutions; temporary loans Current Account in the State Treasury in the amount of 12.3 billion lei; loans from local authorities in EUR 3 billion lei; amounts recovered by AVAS bad bank assets.

At the end of 2009, the budget deficit financing in the amount of -36,400.6 million was made essentially from domestic sources, followed by external ones. Internal financing has been realized by issuing treasury bills with maturities of medium and long term, then by contracted loans to local authorities and other sources like the use of revenues from privatization. As external

funding sources, there were taken into account external loans, and loans from international financial institutions, and by issuing Eurobonds issue [13].

The general government deficit financing in 2010-2011, representing - 6.5% of Gross Domestic Product, respectively - 4.3% Gross Domestic Product, mainly made from balanced sources (45% of Gross Domestic Product in 2011 and 41.6% of Gross Domestic Product in 2010) and external (53.3% of Gross Domestic Product in 2011 and 57.2% of Gross Domestic Product in 2010), by issuing domestic bonds and foreign withdrawals from existing loans to finance projects, issues of Eurobonds on foreign markets capital under the 2011-2013 medium-term (Medium term Notes Programme), withdrawals from the external envelope signed with the IMF, EC and IBRD loans of local authorities and amounts recovered by the Authority for State Assets Recovery of bad bank assets [11].

The financing of the budget deficit (cash terms) in 2012 to secure a larger share of domestic sources (34.3%) compared with external sources (65.7) by: issue bonds in domestic and foreign, draw on existing loans to finance projects, loans of local authorities and receipts from privatization mechanism used by the National Development Fund [12].

6. CONCLUSIONS

The modern trends of the budget balance policy have together the basic idea of accepting deficits within sustainable limits. Deficits faced by our country since 2008 have had significant repercussions on the population, but also in terms of the economy as a whole. Funding for this imbalance was achieved by loans from international organizations and the establishment of the Romanian government austerity measures to reduce spending.

The Romanian case regarding funding policies is one of the most diversified deficits. In the early years of transition to market economy, Romania has addressed both policy of deficit financing.

In Romania, the financial crisis has contributed to the economic decline, with maximum impact in 2009. The evolution deficit in recent years has been one of increasing, reaching -7.2% of GDP in 2009, with direct impact on increase public debt to 23.7% in 2009, compared to rates below 15% in previous years.

The compliance of the Romanian state with the nominal convergence criteria was only possible due to the criterion of maintaining debt below the 60% of Gross Domestic Product. Instead, the criterion of maintaining the budget deficit below 3% of Gross Domestic Product needed multiple revisions, as this indicator always take values above the limit set by the Maastricht Treaty.

Projection of fiscal policy in 2013-2015 shows that continued virtually balanced behavior started in the second half of 2012, fiscal consolidation and sustainable in this context, the economic recovery. In the fiscal strategy for the period 2013-2015 were provided levels of the budget deficits -2.1% in 2013, -1.8% respectively for the years 2014 and 2015.

Reducing the budget deficit is not an end in itself but a means to stimulate economic activity, the fact that the state has so less need for deficit financing, allowing the banks to increase lending to private sector firms.

In the short term, the Government's priority was and still remains one related to economic recovery, creating jobs and ensuring the sustainability of public finances.

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