THE COMPARATIVE ANALYSIS OF ROMANIA'S BUDGET DEFICIT COMPARED TO THE EUROPEAN UNION MEMBER STATES

*Rodica Gherghina, Ioana Duca, Mirela Anca Postole**

Abstract

*In their research, the authors started from the premise that, in an emerging economy, it is important that the fiscal, budget and monetary policy measures should keep the long-term indebtedness level constant, so that the amount of public debt should increase at the same rate as the nominal GDP. In this context, the monetary policy must have as main objective to control inflation, because the inflation rate directly influences the long-term nominal GDP growth rate. Yet, this monetary policy direction must be supervised permanently, because a high long-term inflation rate leads to an increase in the nominal GDP, contributing to the increase in the nominal interest rate. Besides, the monetary policy combined with the fiscal-budgetary policy must aim at covering the budget deficits and at decreasing the public debt. In our opinion, chronic budget deficits and a high public debt level have a negative impact on economic growth. Consequently, the two budget indicators must be analysed in correlation with the GDP. We consider that both Romania as a European Union member state, and the other member states must permanently revise, through specific procedures, the budget deficit level in relation to the GDP and the indebtedness level.**

Keywords: budget deficit, public debt, inflation rate, nominal GDP

JEL Classification: H6, H62, H63, H68

Introduction

The problems related to budgetary equilibrium are closely related to the budgetary policy and to the fiscal policy. The fiscal-budgetary policy role consists in accepting the budgetary disequilibrium or not. The monetary policy combined with the fiscal-budgetary policy must aim at covering the budget deficits and at decreasing the public debt.

At the monetary policy level, the main influence has been represented by the level of financing the budget deficit and refinancing the public debt; the budget deficit is financed from domestic and external sources. The strategy to finance the budget deficit and to refinance the public debt will be based on taking out loans on the domestic market and on issuing state bonds. In Romania, loans taken out in order to finance and refinance budget deficits have been used to a very large extent to

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cover certain consumption expenditures and to a very little extent for economic and social development needs. This proves that, during the transition period, the Romanian society broke one of the axioms of any society which aims at progress, by consuming more than it produced.

Theoretical perspectives on the budget deficit. The evolution of the budget deficit in Romania

The state's economic role has been estimated in various economic theories, classical, liberal, neoclassical ones, the economic doctrine regarding the state's intervention in the economy undergoing permanent changes.

After the Great Depression (1929-1933), but especially after World War II, a new concept was created, namely the welfare state: [Dobrotă, (1999)] „the state whose main function is to correct the negative effects of the market". The doctrine regarding the welfare state was a combination of the market economy and the socialist economy and it was most widely spread in the United States of America and Europe. After World War II until the early 1970s, market economies, driven by the expansionist fiscal and monetary policies, recorded a considerable economic growth. After the 1970s, both in Western European countries and in the United States of America increases in public expenditures were recorded, especially at social level.

In our opinion, the indifference to the constant growth in public expenditure led to the emergence of budgetary disequilibriums and consequently to a change in public debt. Among the first causes for the emergence of budget deficits there are: the continuously increasing expenditures on maintaining governmental bodies; the continuous increase in the expenditures on reimbursing the public debt (a part of it usually being generated precisely by financing the previous years' budget deficits); the huge increase in inflation; large, unproductive expenditures, etc.

Consequently, the monetary policy combined with the fiscal-budgetary policy must aim at covering the budget deficits and at decreasing the public debt. Besides, the developed countries' experience proves the need to use a mixed, balanced policy: [Manolescu, (1997)]. For example, the United States of America, in the interval 1979-1985, adopted an imbalanced combination between the fiscal-budgetary policy and the monetary one (firstly, a restrictive monetary policy, then an expansionist fiscal-budgetary policy – decreases in taxes that caused a high budget deficit which led to loans).

In the specialised literature, several authors [Dornbusch and Fischer, (1990)], emphasised the possibility that the ones in charge of public policies resort to financing the budget deficit by several means, namely:
- by reducing the budget expenditures;
- by increasing fiscal revenues;
- by issuing money;
- by resorting to domestic and external loans, generating public debt.

Yet, each means of financing the deficit is controversial. There is no better or worse method, for each of them there are for and against arguments according to the economic, political and social context in which it is applied.

One of the simple "definitions" of the budget deficit shows that it appears as a negative balance of the analysed budget, between the revenues and the expenditures incurred at the level of a financial exercise. According to certain authors, [Easterly, (1989)] the budget deficit may be covered by resorting to loans from international financial institutions, commercial banks, economic agents or even the population. It is well known that chronic budget deficits and a high public debt level have a negative impact on economic growth, [Traclet, (2004)]. For this reason, the increase in budget deficits and public debt in industrialised countries in the 1980s and 1990s occurred simultaneously with the increase in the real interest rates, which attracted the increase in the costs regarding the public debt service and the decrease in productive investments, [Traclet (2004)].

Numerous authors: [Nunes-Correia and Stemitsiotis, (1993)]; [Fillion, (1996)]; [Laubach, (2003)] in their studies based on empirical analyses, demonstrated the effects of the interest rate on the size of the budget deficit and the public debt. Another author, [Dahan, (1998)], studies the impact of the monetary policy on the budget deficit. His research emphasises various influence channels through which the monetary policy can change the size of the budget deficit.

These influence channels are based on a series of factors which depend on the level of prices, public expenditures, fiscal revenues, public debt, issuing money, interest rate etc. But, in each and every state, according to the economic situation, the public decision-makers are the one taking decisions related to what must be done about the budget deficit policy. In the specialised literature as well as in the practice of international financial institutions such as the World Bank and the International Monetary Fund several indicators are used to measure the budget deficit or the budget balance, [Jacobs, (2002)]. The most widely used indicator is the conventional budget balance, which represents all the resources used by the government during one fiscal year, resources used in financing the part of the expenditures not covered by the revenues: [Blejer and Cheasty, (1993)]; [Jacobs, (2002)].

The World Bank defines the conventional balance as the difference between expenditures (e.g., salary expenditures, expenditures on goods and services, capital expenditures, expenditures on the public debt interests, transfer and subsidies) and the following revenues (taxes, grants from financial institutions, revenues from the sale of certain assets, the state capital enterprises' own revenues).

The authors, [Diamond and Schiller,(1993)] specified that the budget balance is equal to the following fiscal balance:

Fiscal balance = [(revenues + grants) – (expenditures on goods and services + transfers) – (loans – refinancing)]

Therefore, the conventional budget balance or conventional deficit is the

difference between the overall revenues and the overall expenditures, difference which will have to be financed by resorting to public loans. Yet, we must specify that these overall expenditures must include the expenditures on the interests related to the public debt but not the instalments to be reimbursed for the public debt. Besides, the public financial disequilibrium is measured on the basis of several types of budget balances or budget deficits, the conventional balance being the starting point in calculating them.

In Romania, the Ministry of Public Finance and the National Bank of Romania annually calculate and report the following budget deficits:

• the consolidated general budget deficit/surplus or the conventional deficit/surplus;

• the primary deficit/surplus;

• the structural deficit/surplus;

• the current account deficit/surplus;

• the operational deficit/surplus.

The consolidated general budget deficit (the conventional deficit) largely expresses the financial disequilibrium between the public sector resources and needs. It is calculated as a difference between the consolidated general budget revenues and the expenditures associated with this budget.

In table 1 and figure 1 the evolution and level of the general consolidated budget deficit in the interval 1993-2008 are presented.

Table no.1 The consolidated general budget deficit level (% GDP), in the interval 1993-2008

Reference years	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Consolidated general budget deficit (% GDP)	-0.4	-2.2	-3.4	-4.8	-5.2	-5.4	-3.6	-4.0	-3.2	-2.6	-2.2	-1.1	-1.2	-2.2	-2.5	-5.4

Source: IMF (May, 2006) Country Report No. 6/169; Eurostat (2008) EU Economic Data pocketbook, Quarterly 1, p.76-77.

**Figure no.1 The consolidated general budget deficit evolution (% GDP),
in the interval 1993-2008**
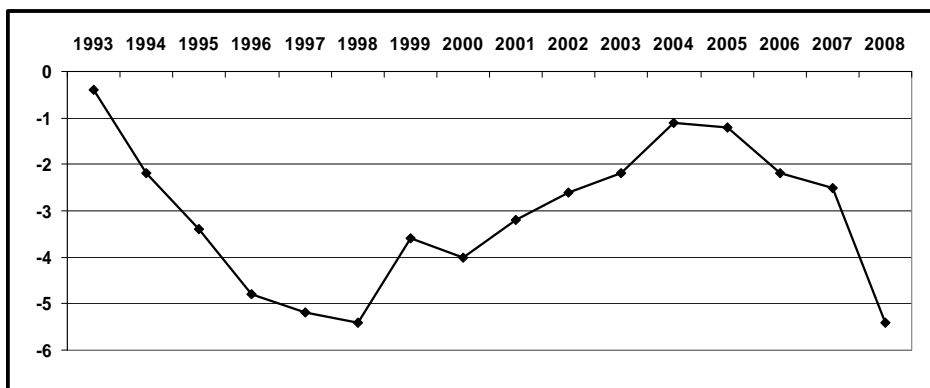
Source: IMF (May, 2006) Country Report No. 6/169; Eurostat (2008) EU Economic Data pocketbook, Quarterly 1, p.76-77.

From the analysis of the consolidated general budget deficit level we notice that the main purpose of the economic policies mix was to keep it under control. Thus, until 2000, Romania underwent a vast reformation process, from a centralised economy to a market economy, yet, the budget deficit level was not very high compared to other European countries. After 2000, the deficit gradually decreased, in the context of a NBR monetary policy whose main objective was to lower the inflation year by year, also influencing the decrease in the deficit. Besides, the budget deficit criterion to maintain it below the level of 3% of the GDP has been observed in our country since 2002. The exception in our analysis is the year 2008, when the deficit reached 5.4% of the GDP, increasing mainly in the 3d and especially 4th quarter due to the expansionist fiscal-budgetary policies.

The primary deficit/surplus is the difference between the consolidated general budget deficit and the expenditures on the interests related to the public debt. It is an indicator used in analysing the fiscal and budgetary policies sustainability. The primary deficit/surplus level and evolution are presented in table 2 and figure 2.

**Table no. 2 The primary budget deficit level (% GDP),
in the interval 1993-2008**

Reference years	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Primary deficit/surplus (% GDP)	0.5	-0.8	-2.0	-3.1	-1.4	0.7	1.7	0.8	0.6	0.4	-0.2	0.1	0	-1.4	-1.8	-4.7

Source: Calculated on the basis of the data from the International Monetary Fund (1993-2004) and Eurostat (2005-2008)

**Figure 2: The primary deficit/surplus evolution (% GDP),
in the interval 1993-2008**
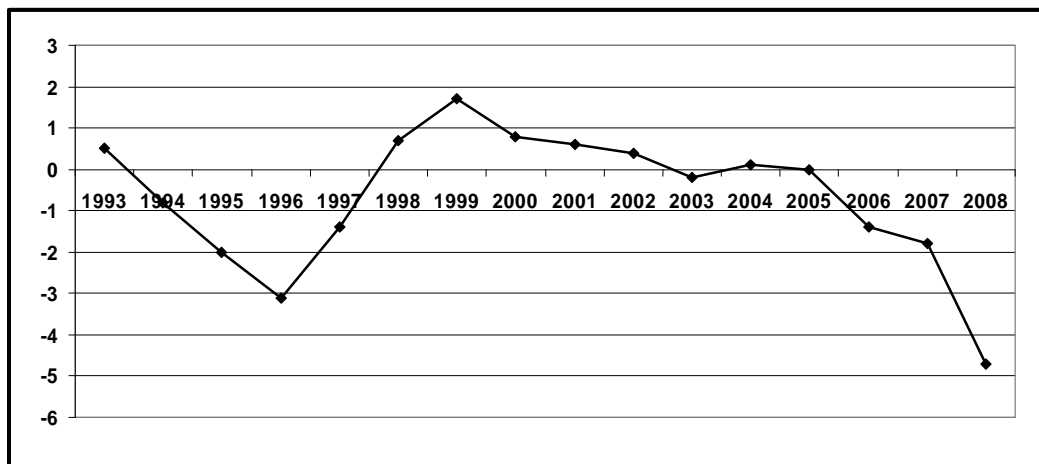
Source: Elaborated on the basis of the data from the International Monetary
Fund (1993-2004) and Eurostat (2005-2008)

We notice that the primary balance recorded a surplus in 1993, and also in the interval 1998-2002, respectively in 2004, due to the high ratios of expenditures on the interests associated with the public debt to the GDP. By comparing the evolution of the two budget deficits – the conventional and the primary one (figure 3) we notice that in the interval in which the primary balance recorded a high deficit and the conventional balance also recorded a deficit. Besides, when the primary balance recorded a surplus, we notice that the conventional deficit increased.

**Figure 3: The evolution of Romania's consolidated general budget deficit
and primary deficit/surplus in the interval 1993-2008**
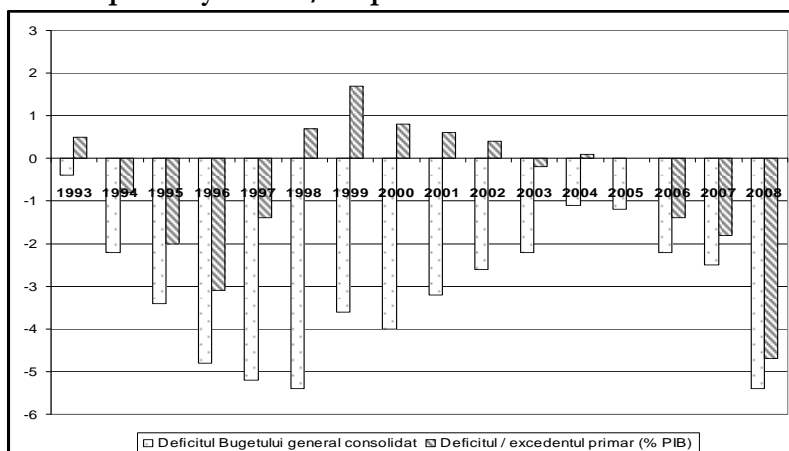
Source: Elaborated on the basis of the data from the IMF and Eurostat (1993-2008)

The structural deficit/surplus – excludes from the conventional deficits the receipts from privatisation, which are considered sources of financing not of revenue. The structural deficit size and structure are established by the National Bank of Romania, which makes them public. There is an indicator used in the fiscal adjustment processes and in numerous studies regarding the fiscal and budgetary policies sustainability.

The current account deficit/surplus: [Jacobs, (2002)] is calculated as the difference between current budget revenues and current budget expenditures. It measures the government's savings level. The operational deficit/surplus: [Jacobs, (2002)] is calculated as a difference between the conventional balance and the inflationist component of the expenditures on interests (or it can also be defined as the primary deficit plus the real interest paid for the domestic public debt). It is an indicator which reflects the impact of the fiscal policy in the intervals with high inflation.

In order to finance these deficits, according to the data [IMF, (2006)] domestic resources were used frequently during this interval and external ones were used less. For this reason, the decision-makers, in order to finance the constantly growing budget deficits, must choose between increasing fiscal revenues (by increasing existing taxes or introducing new taxes) and taking out loans. In most cases the second solution is selected, for the following reasons:

• increasing taxes is an unpopular measure, because it immediately affects the population's standard of living, with immediate political consequences;

• state loans provide a faster means to find financial resources than indirect taxes;

• if the loan is taken out from the Central Bank, the interval for obtaining the money resources is the shortest, compared to issuing bonds to natural and legal persons.

Yet, today's reality clearly proves that loans are a more costly means of finding the financial resources necessary to the state than taxes; the interests and the other advantages granted to the state's creditors inevitably increase public expenditures.

Romania's budget deficit versus the budget deficit of the European Union member states

In their research, the authors made a comparative analysis of Romania's consolidated general budget deficit level as a GDP ratio, in the interval 1998-2008 and that of other European Union member states. Besides, in table 3 and figures 4 and 5 we notice its evolution, identifying fluctuations from one year to another. Yet, the comparisons will not be limited only to the "classic" European Union members states, because there is also a significant evolution in the consolidated general budget deficit level in the Euro zone and in the states that joined the Union after 2004.

Table no. 3 The consolidated general budget deficit (-) / surplus (+) level (% GDP) in the interval 1998-2008, in the EU states and Romania[1]

States / Reference year	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
1	2	3	4	5	6	7	8	9	10	11	12
EU-27	-1.9	-1.0	0.6	-1.4	-2.5	-3.1	-2.8	-2.5	-1.4	-0.9	-2.3
EU-15	-1.8	-0.8	0.8	-1.2	-2.3	-3.0	-2.8	-2.4	-1.3	-0.8	-
EURO AREA[2]	-2.3	-1.4	0.0	-1.8	-2.5	-3.1	-2.9	-2.5	-1.3	-0.6	-2.0
BE	-0.8	-0.5	0.1	0.6	0.0	0.0	0.0	-2.3	0.3	-0.2	-1.2
BG	-	0.2	-0.3	0.4	-1.0	-0.5	1.4	1.8	3.0	0.1	1.8
CZ	-5.0	-3.7	-3.7	-5.7	-6.8	-6.6	-3.0	-3.6	-2.7	-0.7	-2.1
DK	-0.1	1.3	2.2	1.3	0.2	-0.1	1.9	5.2	5.2	4.5	3.4
DE	-2.2	-1.5	1.3	-2.8	-3.7	-4.0	-3.8	-3.3	-1.6	0.2	0.0
EE	-0.7	-3.5	-0.2	-0.1	0.3	1.7	1.6	1.6	2.3	2.6	-2.7
IE	2.4	2.7	4.8	0.9	-0.4	0.4	1.4	1.7	3.0	0.3	-7.2
GR	-2.5	-1.8	-3.7	-4.5	-4.8	-5.6	-7.5	-5.2	-2.9	-3.7	-7.7
ES	-3.2	-1.4	-1.0	-0.6	-0.5	-0.2	-0.3	1.0	2.0	1.9	-4.1
FR	-2.6	-1.8	-1.5	-1.5	-3.1	-4.1	-3.6	-2.9	-2.3	-2.7	-3.4
IT	-2.8	-1.7	-0.8	-3.1	-2.9	-3.5	-3.5	-4.3	-3.3	-1.5	-2.7
CY	-4.1	-4.3	-2.3	-2.2	-4.4	-6.5	-4.1	-2.4	-1.2	3.4	0.9
LV	0.0	-3.9	-2.8	-2.1	-2.3	-1.6	-1.0	-0.4	-0.5	-0.3	-4.1
LT	-3.1	-2.8	-3.2	-3.6	-1.9	-1.3	-1.5	-0.5	-0.4	-1.0	-3.2
LU	3.4	3.4	6.0	6.1	2.1	0.5	-1.1	0.0	1.3	3.7	2.5
HU	-7.8	-5.4	-3.0	-4.0	-8.9	-7.2	-6.4	-7.9	-9.3	-5.0	-3.8
MT	-9.9	-7.7	-6.2	-6.4	-5.5	-9.9	-4.7	-2.9	-2.6	-2.2	-4.7
NL	-0.9	0.4	2.0	-0.2	-2.1	-3.1	-1.7	-0.3	0.5	0.2	0.7
AT	-2.4	-2.3	-1.7	0.0	-0.7	-1.4	-4.4	-1.6	-1.6	-0.6	-0.4
PL	-4.3	-2.3	-3.0	-5.1	-5.0	-6.3	-5.7	-4.1	-3.6	-1.9	-3.6
PT	-3.4	-2.8	-2.9	-4.3	-2.8	-2.9	-3.4	-6.1	-3.9	-2.6	-2.7
RO	-5.4	-3.6	-4.0	-3.2	-2.6	-2.2	-1.1	-1.2	-2.2	-2.5	-5.4
SI	-2.4	-3.0	-3.7	-4.0	-2.5	-2.7	-2.2	-1.4	-1.3	0.0	-1.8
SK	-5.3	-7.4	-12.3	-6.5	-8.2	-2.8	-2.4	-2.8	-3.5	-1.9	-2.3
FI	1.6	1.6	6.9	5.0	4.1	2.6	2.4	2.8	4.0	5.2	4.5
SE	1.1	1.3	3.7	1.6	-1.2	-0.9	0.8	2.3	2.5	3.8	2.5
UK	-0.1	0.9	3.6	0.5	-2.0	-3.3	-3.4	-3.4	-2.7	-2.7	-5.0

Source: Eurostat; EU Economic Data pocketbook, Quarterly 1-2008, p.76-77; The International Monetary Fund.

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[1] The European Union Countries: Belgium (BE), Bulgaria (BG), The Czech Rep. (CZ), Denmark (DK), Germany (DE), Estonia (EE), Ireland (IE), Greece (GR), Spain (ES), France (FR), Italy (IT), Cyprus (CY), Latvia (LV), Lithuania (LT), Luxembourg (LU), Hungary (HU), Malta (MT), The Netherlands (NL), Austria (AT), Poland (PL), Portugal (PT), Romania (RO), Slovenia (SI), Slovakia (SK), Finland (FI), Sweden (SE), The United Kingdom (UK).

[2] The Euro-zone includes 16 countries, beginning with 1 January 2009, due to Slovakia. The data include the Euro-zone 15 countries at the level of 2008, namely: Belgium, Germany, Ireland, Greece, Spain, France, Italy, Cyprus, Luxembourg, Malta, The Netherlands, Austria, Portugal, Slovenia, Finland.
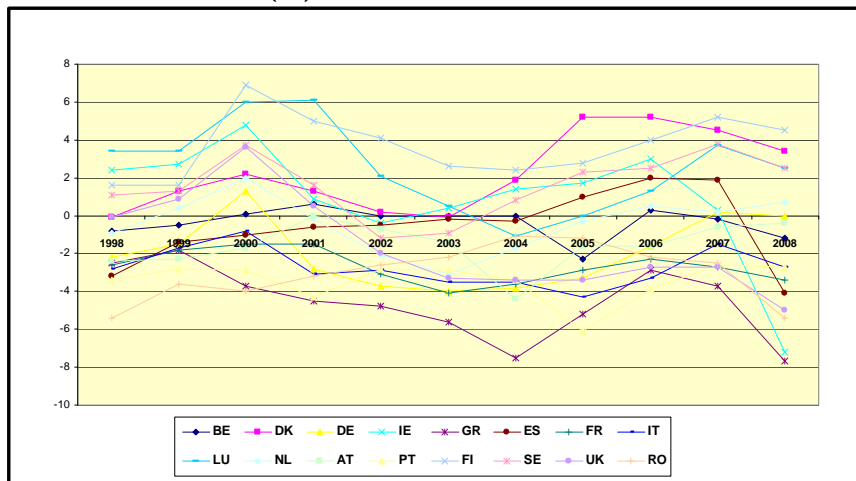
Figure 4: The consolidated general budget deficit evolution (% GDP) in the UE and Romania, in the interval 1998-2008
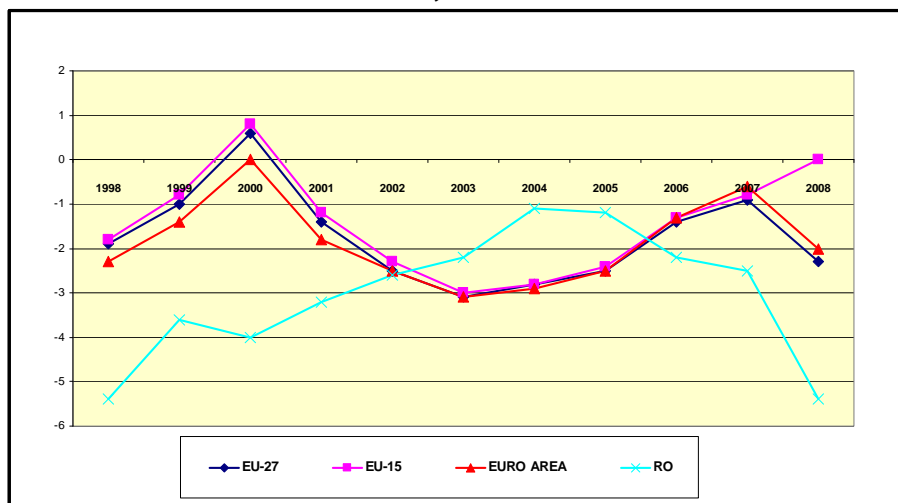
Source: Eurostat; EU Economic Data pocketbook, Quarterly 1-2008, p.76-77; The International Monetary Fund.

We notice that Romania recorded a higher budget deficit than the average of the European Union member states in the interval 1998-2002, and in the interval 2006-2008, as a result of the increase in expenditures on maintaining the government apparatus; of the constant increase in expenditures on reimbursing the public debt; of the increase in inflation and the increase in unproductive expenditures. But between 2002 and 2006, the budget deficit in our country recorded lower values than the budget deficit recorded at European Union level. Regarding the budget deficit evolution at European Union level, the authors noticed insignificant differences in the average of the 27 member states and the states making up the Euro-zone, so that the convergence criterion related to the 3% deficit of the GDP was observed. Moreover, we notice that in 2000 at European Union level a budget surplus was actually recorded.
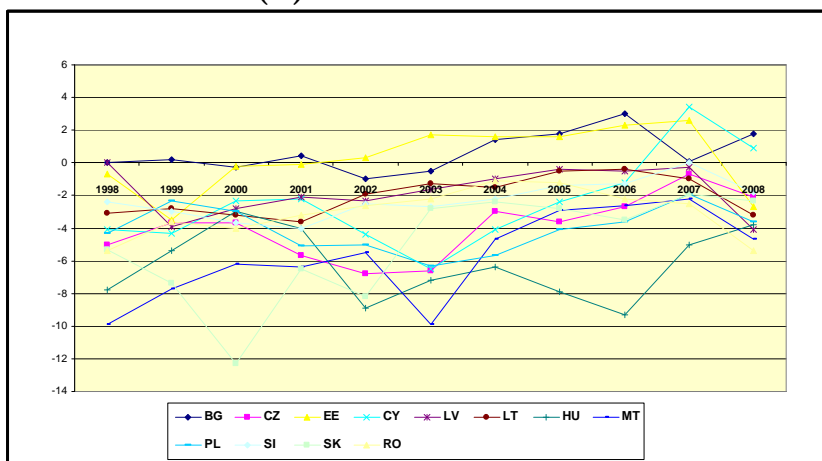
Figure 5: The consolidated general budget deficit evolution (% GDP) in the EU countries (15) and Romania, in the interval 1998-2008.

Source: Eurostat; EU Economic Data pocketbook, Quarterly 1-2008, p.76-77; The International Monetary Fund.

In figure 5 we notice that Romania records a lower budget deficit in certain years compared to certain European Union states such as Italy, Greece, Portugal, but a larger one compared to Belgium, Denmark, Luxembourg and the Netherlands. At the level of the 15 European Union countries, the 3% limit set by the Maastricht Treaty regarding the ratio of the budget deficit to the GDP was not observed. Several states even recorded budget surpluses.

Figure 6: The consolidated general budget deficit evolution (% GDP) in the EU countries (11) and Romania in the interval 1998-2008

Source: Eurostat; EU Economic Data pocketbook, Quarterly 1-2008, p.76-77; The International Monetary Fund.

In figure 6 we notice that Romania's consolidated general budget deficit, calculated as a ratio to the GDP, is much lower than it is in the other 10 "new" European Union states which joined the EU after 2004. After the analyses and comparisons performed regarding the evolution of the budget deficit in Romania and in other European Union member states, we notice the states' permanent concern with maintaining the budget deficit level according to the Maastricht Treaty requirements of February 1992 and to the Stability and Economic Growth Pact ratified in 1997.

These agreements contain a protocol titled "The Excessive Deficit Procedure" through which the member states must permanently revise, through specific procedures, the budget deficit level according to the GDP and the indebtedness level.

Conclusions

In our opinion, the monetary policy combined with the fiscal-budgetary policy must aim at covering budget deficits and at decreasing the public debt. In an emerging economy it is important that the fiscal, budget and monetary measures should keep the long-term indebtedness level constant, so that the amount of public debt should increase at the same rate as the nominal GDP. The authors of the research emphasise that the monetary policy must control the inflation, because the inflation rate directly influences the long-term nominal GDP growth rate. We consider that we must envisage an inflation rate that influences a higher nominal GDP growth rate than the interest nominal rate.

Consequently, the monetary policy direction must be supervised permanently, because a high long-term inflation rate leads to an increase in the nominal GDP, thus influencing the increase in the nominal interest rate. Therefore, the budget deficit is influenced by the inflation rate and the interest rate, but on the long term, for a financial stability at state level, two aspects must be monitored related to: the real loan cost and the economy growth rate.

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