

Rethinking fiscal policy in Romania. Lessons for emerging countries

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Abstract—This paper study the way in which the Romanian authorities have reacted during the crisis and the lessons to be learnt subsequently to the encounter with this crisis. We consider the arguments for the necessity to re-think the modality to re-think and interpret the Romanian fiscal policy, under the terms of the future adhesion to the Euro Zone. We estimates the structural budget deficit, considering this indicator as one of the most relevant for assessing the performance of the fiscal management, and also the extent to which the Romanian fiscal policy is prepared to act as a sole instrument which can stabilize the national economy after entering the Euro Zone. Finally, the work mentions a series of conclusions and recommendations regarding the methodological re-construction of the assessment for the fiscal policy's efficiency and the lessons for emerging countries.

Key words: *fiscal adjustment; austerity; recession; economic crisis; fiscal policy*

I. INTRODUCTION

Romania economy encounters a series of overlaid crises – the external crisis over the domestic economic crisis, the political crisis and the social crisis, as well as the confidence crisis. The current economic crisis brings up again the necessity to use the fiscal policy in order to adjust the macroeconomic unbalances. If, subsequent to the Great Depression, the Keynesian policies focused on using the fiscal policy as the main instrument for macroeconomic stabilization, a balance between the importance given to the fiscal and the monetary instruments was settled during the '70-'80's. During the last decades, the monetary policy has been preferred by the macroeconomic policies' decision makers within the shock absorption process.

During the period of the current crisis, the fiscal policy should have been the most important instrument used by the authorities in order to stabilize the economy. However, in Romania, the margin of maneuver has been severely limited due to the perpetuation of the past deficits. Under the terms in which, during the economic expansion period, Romania accumulated huge budget deficits, the result has been that we are the only ones who are permanently "pro-cyclic". Also, during the expansion periods, when we should have

accumulated, we did not do it, and during the recession periods, when we should have increased the expenses, we have cut them. While other countries afforded to grant fiscal stimuli because they were starting from previous low deficits, we were forced to make a large fiscal adjustment.

II. THE ROLE OF FISCAL POLICY IN ECONOMIC CRISIS

The inefficiency of the fiscal policy from the past may currently affect us to a huge extent. However, in order to understand this thing, we should re-think the modality in which we assess the fiscal policy's efficiency. If the central banks have learnt their lesson and if they are making the transition from the price stability as a sole objective (which, by the way, reached its limits, a great financial crisis arising in an oasis of price stability) towards a mix between price stability and financial stability in a slow but certain manner, we think that it is the time for the analysis made to the fiscal policy to be re-assessed.

We should pass from the exclusive analysis of the current budget balance to the structural budget balance. We all have been spectators for Greece (and also for Romania), when it was obvious that, in the process of assessing the fiscal policy, the current budget deficit indicator has had an extremely limited usefulness (it is very easy to fulfill the budget deficit target on paper, thus delaying the making of some consistent payments for a subsequent period, increasing the half-wits, etc).

The contagion of the global financial crisis has laid over the cumulative causation effect – the negative effects of the external crisis being emphasized by the already existing domestic unbalances, especially in the developing economies. Last but not least, the herd effect has acted – the investors have withdrawn their speculative capitals from the emergent countries during a short period of time.

When entering the crisis, Romania has had an unfavourable macroeconomic situation. Besides Latvia, Romania has been strongly dependant on the foreign capital inflows, both in the public sector and also in the private sector. The issue of the high twin deficits (real budget deficit of 5.4% of the GDP and current account deficit of 13% of

the GDP in 2008) resulted in a margin of maneuver which is too low to financially support the proper fiscal stimuli.

Romania has had an improper management of the macroeconomic policies. The pro-cyclic fiscal policies resulted in creating a fiscal space during the recession gap periods and in its running short during the expansion gap periods (Table I). Romania has made large fiscal adjustments when the economy used to function below its potential, opposite to the postulates of the macroeconomic theory, which recommends fiscal consolidation processes during the expansion periods.

The external financing, which has fed the economic growth recorded during the period 2006-2008, was more and more expensive and less and less, thus resulting in the decrease of granting loans towards the real economy. In the case of the economies with flexible exchange rate, the capital outputs are accompanied by the decrease of the globally available financial resources, thus resulting in the national currency depreciation. Romania has faced an absence of new capital entries rather than their getting away to a large extent.

All these determined recession, lower revenues to the national budget, the increase of the cost with the external financing, high unemployment and social exclusion. Moreover, the public debt recorded a high increase, thus generating a potential high risk for the future.

TABLE I. THE EVOLUTION OF THE OUTPUT-GAP AND OF THE STRUCTURAL BUDGET BALANCE

Year	Output-gap	Structural budget balance
2000	-2.22	-2.64
2001	-0.60	-2.55
2002	-0.48	-1.76
2003	-0.97	-1.15
2004	1.04	-0.43
2005	-1.09	0.62
2006	0.81	-2.11
2007	2.17	-3.73
2008	6.20	-7.71
2009	-2.95	-6.84
2010	-3.46	-4.40
2011	-3.92	-1.90
2012	-2.13	-1.30
2013	-0.10	-1.40
2014	2.35	-1.80

Source: International Monetary Fund, 2010

Actually, we may speak about the burdening of the future generations so that the global economy could survive at present. However, the actual crisis has resulted in another crisis, which is deeper – the confidence crisis. A pessimism state has been established in the global economy, and it has resulted in the decrease of the long-term consumer goods and of the companies' investments.

III. THE FISCAL ADJUSTMENT IN ROMANIA

The freedom degrees provided to the macroeconomic policy decision makers from Romania have been low. The monetary policy has not had a too large margin of maneuver under the terms of the existing inflationary shocks, such as the currency depreciation or the increase of the VAT. Under these terms, the fiscal policy would have represented a more

efficient anti-cyclic policy, but its implementation has had certain constraints. The first one is related to the low intervention margin for re-launching the economy, especially due to the expansionary fiscal policy promoted during the expansion years, which have generated the decrease of the budget deficit and of the public debt. The second constraint refers to the automatic increase of the budget deficit, caused by the economic down fall, requiring a fiscal stimulus which is as important as its implementation is made later. The third constraint is related to the Ricardian equivalence, to the economic agents' lack of confidence in the sustainability and in the efficiency of the promoted expansionary fiscal measures. Last but not least, the identification of the most efficient fiscal stimuli is an important constraint, under the terms in which the human beings tend to increase the saving rate during the economic recession periods.

The necessity to make fiscal adjustments was imperative. Romania has concluded an agreement of multilateral financing with IMF, EC and WB, the advantage of this option has been the benefit of external credibility (which has decreased the country risk from 800 to 400 interest points for Romania) and the disadvantage has been the deepening of the economic recession. The main target of the adjustment program has been to obtain an actual budget deficit of 6.8% of the GDP in 2010, 4.4% of the GDP in 2011 and 3% of the GDP in 2012, this condition being in compliance with the nominal convergence criteria provided for entering the Euro Zone (Table II).

However, Romania finds itself into vicious circles out of which it is difficult to get. The low budget revenues give the impression of enormous expenses for normal rights: entire wages, entire pensions, entire scholarships, family allowances, etc. We do not have too high budget revenues because those who should pay fees and taxes – the private companies – record a free falling.

TABLE II. LARGE FISCAL ADJUSTMENTS IN EU – FUTURE EXPERIENCES

Countries	Cyclically adjusted primary budget balance for 2008 (% of the GDP)	Cyclically adjusted budget balance for 2011 (% of the GDP)	Cyclically adjusted primary budget balance, per year (% of the GDP)
Estonia	-3.9	-0.5	1.1
Greece	-5.0	-2.4	0.9
Hungary	-0.9	+1.1	0.7
The Czech republic	-3.4	-2.6	0.3
Latvia	-5.8	-5.4	0.1
Romania	-7.71	-1.9	1.9

Source: International Monetary Fund, 2010

We do not have high budget revenues because the reforms in the pension system, in health, education, infrastructure, etc are slow. We do not have budget revenues because there are not strong programs which help in creating jobs.

Programs which help in attracting the 1.5 million illegal workers and the 2 million workers in agriculture caught in

statistics as active population, but who do not pay for social contributions.

And the most important thing, we do not have budget revenues because the tax evasion is endemic. Facing the dilemma related to deficits-economic recovery, Romania proposed itself to implement an austerity budget program in order to provide the sustainability of the public finances. Romania has the most ambitious program for the fiscal correction in EU, as it makes a comparative analysis between the experiences of the EU countries acquired during the last 30 years regarding the large fiscal adjustments (corrections).

The forecasts for the cyclically adjusted primary budget balance for the next years confirm the toughness of Romania's austerity program. From the European Commission's spring economic forecast, we have selected the countries which have a low sustainability of the public finances (a high structural deficit) and which have the experience of the austerity packs. As they do not have sufficient fiscal space, the measures for the economic re-launching are rather pale.

However, it is obvious that two scenarios may happen:

1. The austerity program will be successful. We will have a better position on a medium term from a macroeconomic point of view, only if the program is accompanied by strong measures for increasing the budget revenues and by well elaborated structural reforms.
2. The program will not be successful. The speed of the fiscal correction is too high. The measures are too tough for the Romanian business environment and for the Romanian citizens. The social risk gets deeply increased and we pass from a shock therapy to a gradual one. We extend the fiscal adjustment (consolidation) on a medium term, as we can see from the experience of the last 30 years in EU.

IV. CONCLUSIONS

There are several lessons which we should learn from this crisis.

The first lesson refers to the fact that we should have good policies in good times. This is the only way to provide macroeconomic stability. The moderate increase will be accompanied by moderate recessions. The creation of a fiscal space should be made during expansion periods and its use will help us during recession periods.

The second lesson is related to an efficient monetary policy being added with macro-prudential policies, by means of financial regulating instruments.

The third lesson is that we should immunize our economies against the future shocks. We can make this by promoting pro sustainable growth policies – structural reforms in education, health, development of infrastructure and also decrease of labor taxes, stimulation of entrepreneurial spirit and of massive investments in research, development, innovation and human capital.

Moreover, we believe in the necessity to apply equitable adjustment programs. The reforms should be made by people for people. First of all, we focus on decreasing evasion, on

decreasing the waste of the public money, on removing the fiscal privileges and I consider that the last stage should consist of huge cuts from wages, pensions and social security benefits. We believe that the best active social security measure remains to create jobs.

Therefore, it is necessary to make a deep re-assessment of the fiscal policy in Romania, especially subsequently to the adhesion to the Euro Zone – an objective we have assumed - this is the only available macroeconomic instrument for the macroeconomic stabilization.

ACKNOWLEDGMENT

This paper represents a partial dissemination of the exploratory research projects IDEAS, *Substantiating and Implementing an Econometric Model of Growth in the Efficiency of the Fiscal Policy with reference to Romania's Adhesion to the Eurozone*, research contract no. 1766/2008, PNCD II, Program Ideas/ Exploring Research Projects program, 3 years, 3 stages, Project Manager Socol Cristian.

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