EFECTS OF THE EUROPEAN UNION FISCAL GOVERNANCE PACT ON ROMANIA

Lect. Roxana Ispas Ph. D
University of Craiova
Faculty of Economics and Business Administration
Craiova, Romania

Abstract: This paper aims to emphasize the implications that the signing of the European Fiscal Pact will have on Romania. At the same time are also taken into account the estimates of the European commission concerning GDP and the negotiation of the structural deficit level. The advantages and the disadvantages that influence Romania's economy and some measures for increasing the incomes are also shown from the economical point of view. The fiscal governance pact of the European Union may have a positive effect on Romania, imposing a better fiscal discipline and financial stability. The fiscal governance pact is essential in strengthening the discipline in public finances but will create problems in the authorities' capacity of stimulating the economy due to the budgetary constraints that it will bring.

JEL classification: G30, G35

Key words: fiscal pact, European Union, stability, advantages, member states

1. INTRODUCTION

A number of 25 states of the European Union (EU), including Romania, but without Great Britain and the Czech Republic, have signed the European fiscal pact, which stipulates mainly the fiscal regulations for the balance of the budgets with the coordination of the economic policy at a European level.

Great Britain has decided not to adopt the pact because it has not obtained a series of concessions for the financial sector.

Moreover, the Czech Republic has announced that it would not sign the fiscal pact because it does not consider that this significantly improves compared with the existing regulations. The Czech Republic does not exclude the possibility to join later.

The European fiscal pact shall imply a commitment from the part of the participant states for a solid fiscal governance, the introduction of some provisions to balance the budget in the Constitution, the consolidation of the regulations on the excessive deficit procedure through the automation of the sanctions and the transmission of the budget drafts to the European Commission for verifications. This is the first step towards the fiscal unit. The agreement has been supported by the European Central Bank, which has insisted that the governments from the Euro zone should order their internal policies.

The Netherlands, one of the most vocal and strong supporters of the fiscal austerity, has managed however to comply with the pact for almost one month. With a budget deficit of 5.8% it has exceeded the deficit limit set at 3%.The budget deficit of the Netherlands for 2012 and 2013 shall probably be of 4.6%, facing the same problems as Italy or Spain.

In a similar way, the economy of Spain reduced during the last trimester of 2011 for the first time in two years and it may enter a long recession. The Spanish budget ended in 2011 with 8.5% from GDP.

Spain has to find deficit reduction measures with 0.5%, having to impose austerity measures in order to save 16 billion EUR - when the economy of the country shall drop this year with 0.9% because of a stagnation of exports caused by the financial crisis from the Euro zone.

France has reduced with half the increase forecast for 2012 to 0.5%. The International Monetary Fund has sent a warning to Paris, requesting that in 2013, the public deficit should reach 3.9% from GDP.

Because the negotiations regarding the restructuring of the Greece's debts have not been finished yet, it does not receive a second financial portion of 130 billion EUR, and, without the loan, it has become insolvent in March 2012, when it had to compensate the high value of the due liabilities.

Portugal shall need a new loan in order to avoid insolvency.

The countries from the Mediterranean area have had very strong public sectors and have to restructure. Major problems occur in Greece, Italy and Portugal. The restructuring shall take many years from now on, probably at least 3 - 4 years, in order to see positive effects in the economy of these countries.

Many economists consider the fiscal pact only a gesture to calm the discontent of the German voters on the repeated external financial aids and for the restoration of the market reliability.

In May 2012, Germany sent a series of conditions to France, through which they excluded the possibility of the renegotiation of the European Fiscal Pact and any initiative of increasing the deficits. The renegotiation of the Pact is not possible because it has been signed by 25 of the 27 EU member states and has as purpose the consolidation of discipline in the field of public finances. Germany does not want an increase of deficits, but an economic growth through structural reforms.

Romania has offered, following the negotiations carried out, the participation of the Euro zone non-member states to the common meeting that all the signatory states have, under certain conditions.

According to the Romanian Executive Power, the Pact stipulates the obligation to maintain a structural deficit that cannot exceed the national objective on a long term, set forth for each member state, with an inferior limit of 0.5% from GDP according to the market prices.If the level of the public debt is significantly under 60% from GDP and there are not risks regarding the long-term sustainability of the public finances, the structural deficit may reach at almost 1% from GDP. The maximum cyclic budget deficit plus the structural one must comply with the limit of 3% from GDP. The new pact must be adopted through the Constitution, and this must take place until the end of 2013.

If deviations are recorded at these levels, a correction mechanism shall automatically be launched, having to be introduced in the national legislation of each member state, in the same manner as the so-called "golden rule", on the limitation of structural deficit. If a member state does not translate these two provisions in the national legislation, the European Union Court of Justice may be notified in this matter.

The failure to comply with the decision of the court may lead to a financial sanction of maximum 0.1% from the respective country's GDP.

If regarding the level of the public debt, Romania ranks on a comfortable level, under 60% with a structural deficit of 0.5% from GDP, when the budget deficit target for 2012 is 1.9%, this seems more difficult to fulfil.

However, it is necessary to make the distinction between the two terms, "structural deficit" and "budget deficit". The budget deficit means one thing, remaining unchanged in the limit of 3% from GDP, and another thing is the structural deficit. The structural deficit and the cyclic deficit form **the budget deficit**. **The structural deficit** reflects the inability of the state to collect incomes and to spend the money available efficiently. On the other hand, the cyclic deficit is influenced by a certain evolution of economy, as it is now, during the crisis, when the smaller incomes are paid to the state, because many are bankrupt or pay less, because they have smaller incomes. Then the incomes of the state suffer a reduction.

The emphasis of the EU on the structural deficit reflects the emphasis of the member states on the solution of some structural problems and that are related to the public sector, so that the state should use efficiently the expenses, as well as the public services, and the private sector should not be "restricted".

Moreover, Romania may benefit from a more extended manoeuvre margin regarding the structural deficit, because of the reduced level of the public debt.

On the other hand, the amendment of the Constitution is not possible in Romania on a short term (during an elective year). The introduction of the budget deficit in the Constitution represents the treatment of the effect, the deficit as a share of GDP, not of the cause, which is the share of the expenses from GDP.

The adoption of the fiscal pact provisions means a certain limitation of the national sovereignty, but one that is not imposed, but self-assumed.

Although the media's attention is focused on the structural deficit, a more structured approach should start from the potential level of GDP. Although it is less difficult to understand, this constitutes the starting point for the classification of the European requirements on the deficit, implicitly for the budget elaboration, for the expenses that shall be made for the population.

According to the estimations of the European Commission and of the National Institute of Statistics, at the moment, the potential Gross Domestic Product, a key indicator for the determination of the structural deficit, has decreased significantly compared to the values from the second part of the last decade.

The potential GDP is the highest GDP that may be obtained without generating macroeconomic unbalances, the most visible effects being the inflationist pressures and the potential accumulations of deficits, if an austere, anti-cyclic fiscal policy is not implemented.

During the period 2004-2007, Romania, on the grounds of the reduction of the potential GDP, (the reduction of the economic increase), was found in a full process of consolidation of the disinflation process, reducing the increase of the prices to values comparable to the usual ones in Europe. If in 2004, an increase of 6% was sustainable, in 2007, the sustainability level decreased to 4%, and in 2012, to almost 2%.

The exceptional economic growth from 2008 meant an overloading of the economy, which increased within the given circumstances over the real capacity given by the total productivity of the production factors, people and capital.

From almost 6% in 2004 and 4% in the year of the adherence, 2007, the economic growth, and implicitly the potential GDP, reduced gradually to a level of only 2% in 2012. The reduction was determined mainly by the capital segment and, to a lesser extent, by the total productivity of the production factors.

We have to mention, however, that the values presented have considered the very low level of absorption of European funds, actually recorded in Romania.

A simulation (see Table) on the potential increase of the absorption degree shows that we could return to significantly higher values of the potential GDP, which would create much better perspectives, in terms of growth and favourable management of the structural deficit limit imposed by the Stability Pact.

Going on the assumption of a reasonable increase, it could go up to 3.5%. There are possible the next situations:

If we do not manage to increase the European funds and we continue with 2% GDP potential, a 3% economical increase, would impose a spending limit, to obtain a necessary budgetary surplus for the objective of 0.5% structural deficit.

a) If we do not manage to draw European funds in a significantly increased proportion, then a 3.5% economical increase with 3.5% GDP would allow us a 0.5% deficit equal to our structural deficit objective.

The council tax draws the attention that Romania has one of the smallest GDP share of the budget revenues. These were only 32.5% of GDP in 2011,with 12.1 percentage points, under the European average, also the number of the financial administration is comparable to the one in Poland, a country with two times higher population. The lever of the income tax reported to GDP (taxes and social contributions), in Romania was 27.2% in 2022, 12.4percentage points less than the average 27 EU (39.6%). The income taxes share in GDP was significantly lower than in Slovenia(37.8), Hungary(36%), Poland(32.1%) and Slovakia (28.5%), as shown in Council Tax report for 2011.

The tax revenue structure in Romania shows a high share of the receipts from the indirect taxes (46.32% from the total of the tax revenue, compared to 33.08%, the EU average 27), while the revenue from the social contributions was 32.35% (35.1% EU 27), and the one of the direct taxes was only 21.32% (31.81 EU 27).

Table no. 1

Degree of absorption	GDP Potential
40%	3.1%
60%	3.6%
80%	4.0%
100%	4.4%

Comparing to 2010, the indirect taxes share has increased with almost three percentage points, because of the TVA standard rate increasing and the excise, re decreasing in GDP than the reduction of the final tax revenue in gross domestic product. Under these conditions, we can see the indirect taxes as the most important component of the budgetary revenues tax consolidation. Romanian tax system is characterised by a poor collecting, with an ineffective administration and an excessive bureaucracy, a relatively low tax base, with many exceptions statutory deductions and a high level tax evasion.

As an example of the poor tax collection, Romania has collected 8.4 %from GDP, VAT income, in 2011, the same as Estonia, while the VAT legal share in

Romania is higher than the Estonian one (24% and 20%).In addition, Bulgaria, with an economic structure, like the one in Romania, with a lower VAT legal share (20%), has collected even more VAT in 2011,8.6% GDP. Regarding the social security, paid by the employees and the employers, budgetary revenues collected in 2011,was 8.3% from GDP, much lower than in Czech Republic (13.1% from GDP), and Hungary (12.3%from GDP),although the contributions rates were relatively similar.

In Council Tax's view, needs a radical reform of the tax collecting system, to ensure the significant increase of the revenues collected and the decrease of the administrative costs.

The Council believes that the reform needs to focus on: increasing levels of voluntary compliance of the contributors, especially by simplifying the tax code, and the tax procedure code, and, using a comprehensive program of government spending full transparency; increase efficiency and reduce collection costs, especially by strengthening tax administration number, computerization, statement and electronic payment aggressive promotion, increasing the quality of collecting staff and reducing corruption; indirect stimulation of a more sustainable economic conception, increasing the tax collecting level, suitable for a better accommodation of potential adjustments in Tax System, pointing in the direction of work stimulation (especially by decreasing the contribution to social insurance, being at a high level at the moment),and increasing internet savings for decreasing the dependence on foreign capital flows in, for financing of investments, as the report shows.

The Tax Council is an independent authority established in the Budget and Fiscal Law, which intents to support the Government's activity in the process of developing and conducting fiscal policy and budget and to promote transparency and sustainability of public finances.

The Fiscal Council has among its attributions the publication of an annual report that analyses the unfolding of the fiscal-budgetary policy from the previous year compared to the one approved by the fiscal-budgetary strategy and the annual budget, it evaluates the macroeconomic and budgetary trends comprised in the fiscal-budgetary strategy and in the annual budget, as well as the objectives, the targets and the indicators set forth through the fiscal-budgetary strategy and the annual budget.

The leaders of 23 states have set forth a new inter-governmental agreement, meant to start up a new fiscal pact. Broadly, this means a higher fiscal discipline and a careful control of the national budgets. Great Britain has opposed to this agreement again.

In an agreement published on the European Council webpage, "the decision of the European leaders to overcome the current difficulties" is shown, as well as the fact that these decided "a new fiscal pact and a new significantly more intense coordination of the European policies", on Friday.

A consolidated construction for the monetary unity means:

- the European leaders commit to debate at the level of the Euro zone the reforms in the economic policy, planned by the member states from the Euro zone;

- the Governance of the Euro zone shall be consolidated and they shall regularly organise summits, at least twice a year.

- The excessive deficits from the states of the Euro zone shall be corrected, and the countries that face a financial instability shall receive support and the evaluation of the budget plan drafts.

2. THE PROVISIONS OF THE FISCAL PACT

1. a new fiscal rule shall be imposed:

- the general budget of the governments must be balanced or in surplus
- the rule shall be introduced in the national legal systems
- the member states with an excessive deficit undertake to present to the European Commission a strategy aiming at the remedy of the excessive deficits

The revival of the Euro zone:

- The European Fund of Financial Stability (EFFS) shall receive more funds and shall get actively involved in the finance of the programs in progress
- The Pact on the European Stability Mechanism shall be viable, starting with July 2012
- In March 2012, the total capacity of the Fund as well as of the Mechanism was revaluated
- The European leaders promise that they shall accelerate the capital payments so as to maintain a ratio of at least 15% between the paid capital and the outstanding amount from the MES issues and shall ensure an actual combined credit capacity of 500 billion EUR
- The member states from the Euro zone as well as other member states shall examine and confirm within 10 days the provision of additional resources for the IMF of up to 200 billion EUR (270 billion dollars under the form of bilateral loans, in order to ensure the fact that IMF disposes of proper resources to face the crisis.

The consolidation of the stabilisation instruments means:

- The longer-term reforms must be combined with an immediate action in order to approach the existing tensions on the market.
- The leverage effect of the European Fund of Financial Stability shall be rapidly put in practice, through the means of two concrete options agreed by Euro group.

Romania shall be bound to continue the structural reforms, in order to classify in the structural deficit target of 0.5%. The problem is that a budget may be balanced or unbalanced even with collections of 10-20% from GDP, as the most liberal countries in the world have, and with 40 - 50%, as the majority of the EU states have. Romania finds itself in the middle of this range.

A scenario is "to bring to the surface the underground economy", and as a compensation to reduce the level of taxes on labour and consumption. In this case, the collection stagnates and cannot support the level of expenses.

Another scenario is that all the taxpayers should be bound to contribute to the current levels, thing that so far has proved infeasible and even counter-productive.

3. ROMANIA AND THE FISCAL PACT: THREE RISKCS

1. The limitation to 0.5% of the structural deficit, amount unitary set forth for all the countries of the pact, although their public debt differs considerably, from 6% (Latvia) to 160% (Greece) – Romania being around the threshold of 40% – it cannot achieve the fine-tuning requested by the economic optimisation.

Romania could request a derogation for the extension to 0.7% or even 1% of the structural deficit. Without this concession, the economic growth would be artificially affected, and the potential of development would remain underused. 0.5% would preserve the gaps instead of allowing their recovery.

2. In case of a favourable economic evolution, it would be very difficult to explain to the population why the immediate bonuses cannot be granted and why the consolidation of the results must be accepted before distributing advantages on a long term.

The problem of national sovereignty limited through this super state agreement is already debated. The second step, the intervention one, even at the level of experts, on the budgets presented to Brussels before passing on to the National Parliaments is unavoidable and shall trigger controversies.

3. The calculation manner is very difficult and the unvarying application would lead to important controversies on the compliance with the rule of 0.5% of structural deficit.

Negative effects may be expected on the European cohesion, as well as unbalancing reactions at an institutional level.

Concretely, Hungary is already confused by the sanctions imposed by the European Commission for exceeding the budget deficit. Greece hardly accepts the conditions imposed at the moment. At the same time, it contests the calculations regarding the budget "restructuring" calendar and the feasibility of the reimbursement of the public debt, scheduled on a medium and long term.

4. THREE ADVANTAGES

1. The prevention of the policy deviances, of granting some elective benefits with an unbalancing effect on a long term, through the means of the structural deficit. The best example in this matter is the decision to increase the pensions based on the presumed economic growth, which, in reality, has not taken place.

The pension point value was increased in advance (!!) to 697.50 RON in October 2008, following the overoptimistic forecast of GDP increase with 6.5% in 2009. In reality, GDP decreased that year with over 7%, but, the pension point value had been increased to 718.40 RON in April and 732.80 RON in October.

2. The implicit obligation of any lawgiver to grant benefits to prove sustainability over time of the granted benefits. The practice has shown that, once given, the benefits cannot be withdrawn, even if the decision factors undertake the responsibility in this matter.

Again, we have to mention the reduction of the pension point value. This would have been logical, even in 2010, after the economic decrease recorded for the second consecutive year and after the reduction of the salaries in the budget sector. Although logical, it was not legal, according to the Constitutional Court.

3. The macroeconomic stability allows a rapid development, the better use of the available resources, for investments with a subsequent favourable effect and not for consumption. Everything is that the rule of 0.5% or the result obtained should be accepted as a value in itself, through the solid ensured frame of economic activity.

The increase of the VAT from 19% to 24%, measure taken by necessity to balance the budget, has affected the business environment and has stimulated the risk taking for the fiscal fraud. The competition has moved from technology and productivity to ability and accountancy.

5. Conclusions

The new fiscal pact has been very much debated lately, this being drawn up by initiators as a decisive solution to the euro zone issues. At a conceptual level, the new pact does not bring very many new elements, instead it introduces an automatic mechanism of correction and penalty in case deviances are recorded. The limits of 3% from gdp for the budget deficit and 60% from gdp in case of the public debt have always existed, being set up through the pact of maastricht in 1992. The stability and increase pact (1997) set forth that the structural position on a medium term of the budget should be close to balance or in surplus. The fiscal structure introduces the target of structural budget deficit of maximum 0.5% from gdp.

Undoubtedly, an important step forward is taken through the adoption of this fiscal pact, by introducing an automatic correction mechanism of the fiscal deviations, thus contributing to the increased discipline of the fiscal policies and to their better coordination. However, may this new fiscal pact be considered as being sufficient for the assurance of a good operation of the monetary union (euro zone)? The answer is probably no. The historical experience shows that the monetary unions must be accompanied by fiscal unions in order to succeed. The euro zone does not have a fiscal union yet, the member states having sovereignty over the leading of the fiscal policy. The common budget of the european union is only slightly over 1% from gdp, which is a very low level. Moreover, there are no fiscal transfers between the eu states when the asymmetrical shocks occur and the mobility and the flexibility of the labour force in europe are relatively low.

References

1. Avram C. D., Avram V. — Some Considerations on the Global Financial Crisis and its Impact on the Banking System in Romania", Annals of the University of Craiova, 2010
2. Ispas R. — The Role of International Taxation in the Drawing-up of the Fiscal Strategy, KBO, Sibiu, Conference Proceedings 2, 2010
3. Ispas R.; Simion D. — The Financial Management of the Small and Medium Sized Companies in Romania, Annals of the University of Craiova, 2010, Economic Sciences Series
4. Mitu N. E. — Brief foray into taxation ethics, Finance - Challenges of the Future, University of Craiova, Faculty of Economics and Business Administration, vol. 1(9), 2009
5. Moşteanu N.R. — Public Finances, Univeritară Publishing House, Bucharest, 2011
6. Talpoş I., Avram A. — Considerations Regarding the Mix of Anticrisis Fiscal Policies in Romania,Theoretical and Applied Economics, Volume XVIII No. 1(554), 2011
7. Ţâţu, L. — Taxation from Law to Practice, All Publishing House, Bucharest, 2010
8. Văcărel, I. (coord.) — Public Finances, Didactic and Pedagogic Publishing House, 6th Edition, Bucharest, 2009
9. * * * — http://www.mfinante.ro
   http://anaf.ro
   http://www.fin.gc.ca
   http://www.lagomedia.net