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To Link this Article: <http://dx.doi.org/10.6007/IJARAFMS/v5-i2/1614>

DOI:10.6007/IJARAFMS /v5-i2/1614

Received: 13 April 2015, **Revised:** 14 May 2015, **Accepted:** 29 May 2015

Published Online: 18 June 2015

In-Text Citation: (Solomon & Capusneanu, 2015)

To Cite this Article: Solomon, A.-G., & Capusneanu, S. (2015). Analysis of Budgetary and Fiscal Convergence Scenarios for Romania and Bulgaria in the Period 2007-2016. *International Journal of Academic Research in Accounting Finance and Management Sciences*, 5(2), 126–134.

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Vol. 5, No. 2, 2015, Pg. 126 - 134

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Analysis of Budgetary and Fiscal Convergence Scenarios for Romania and Bulgaria in the Period 2007-2016

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Abstract

The topic reflects an analysis of Economic and Monetary Union convergence in tax-budgetary system of Romania and Bulgaria. The importance of this theme is underlined by the objective on the integration of the two European Union member states in the Eurozone. In this context, attention was focused on the aspects of the state of completion of budgetary and fiscal convergence. In its realization it is required a strictly coordination of macroeconomic policies, emphasizing structural reforms and ensuring a stable economic environment. Therefore, the main elements used in the analysis of convergence scenarios are budgetary position of Romania and Bulgaria, the evolution of the annual plan for revenue collection and compliance with targets set in the plan year in government spending.

Keywords: Fiscal Convergence, Budget Revenues, Budget Expenditures, Budget Deficit, Public Debt

Introduction

Fiscal convergence has been approached in the literature, especially in the light of the achievement of fiscal policy coordination and the financial stability in the member states. Subsequently, fiscal convergence study was developed. It is focused on the level of tax burden. In this sense cross analysis was used (by calculating beta convergence and sigma) or one based on time series. The proposed models have emphasized the importance of fiscal convergence on reducing and/or correction of primary deficits, synchronization of business cycles and fiscal policy response to potential shocks.

Developing ways of estimating fiscal convergence by including the level of taxation, charging mix of elements or tax harmonization, were led to formulation of the following values: fiscal convergence can not be considered a characteristic of the Eurozone, but it can discuss about near targets set out in the Maastricht Treaty in terms of debt and deficit; in 2011, the absolute convergence is observed only in Germany and the UK, two of the EU countries that have committed to the process of tax harmonization. In Romania, entry on the convergence path implied, initially, "*continued reforms and reduce regional economic*

disparities"¹, without affecting the macroeconomic balance, and continued with intensified efforts to "sustainable economic development while promoting policies to achieve convergence and public finance fiscal sustainability"². Almost symmetrical Bulgaria's convergence program includes measures for sustainable economic growth, while ensuring the stability of the macroeconomic environment. To this end, the government targets maintaining sustainable public finances and public debt in line with the nominal convergence criteria laid down in the Maastricht Treaty.

Methodology of Research

This article aims to explore the analysis of the budgetary-fiscal convergence scenarios for Romania and Bulgaria for the period 2007-2016. In our analysis we used internal and external documentation based on Romanian Government Convergence Programme 2006-2009, 2009-2012 and some estimation for 2012-2016. Also in the analysis made we widely used the documentation of the Romanian Academy in Bucharest and Agency for Economic Analysis and Forecasting in Bulgaria and data sources found on the internet, which covers budget-fiscal documents of Romania and Bulgaria.

Analysis of Budgetary and Fiscal Convergence for Romania

To conduct the Europe 2020 Strategy, at the EU has been created the European Semester. It constitutes an important initiative designed to strengthen economic policy coordination and strengthen budgetary surveillance. In this context, at the member states level it became mandatory designing convergence programs under which the European Commission can assess (through benchmarking) initiatives on sustainable economic development. However, economic instability and financial market tensions installed once with the economic-financial crisis have led to increased measures on strengthening fiscal-budgetary discipline. So, in December 2012 by signing the fiscal Treaty, member states agree on balanced budget compliance, including implementation in national law of automatic correction mechanism. A second measure provided in the Treaty strengthens the excessive deficit procedure. This uptight climate being felt in the national economy.

In Romania the negative effects of the financial crisis leading to deterioration of the budgetary position, namely the increasing budget deficit - 2.9% of GDP in 2007 to - 8.9% of GDP in 2009 (according to the methodology of the European System of National and Regional Accounts). Tax scenarios on improving fiscal position, included increasing budget revenue collection, reducing current expenditures in the public sector, reviewing the base for social security contributions etc. In this context, it can be concluded that fiscal policy for the period 2009-2012 was built under sustainable fulfillment of the budget convergence nominal criterion; and in this respect budgetary targets assumed were aimed at "*mitigating the cyclical economy, reducing inflationary pressures and limiting external deficits*"³. Contrary to expectations, amid the financial crisis in 2009 Romania recorded a deficit of - 9% of GDP, which It drew triggering the excessive deficit procedure. In these circumstances, according to the Convergence Programme 2009-2012, the national budget-fiscal measures were subordinate objective of fiscal consolidation, and materialized by:

- Creating a pension system sustainable in the long term;
- Ratification of the budget in 2009, due to:

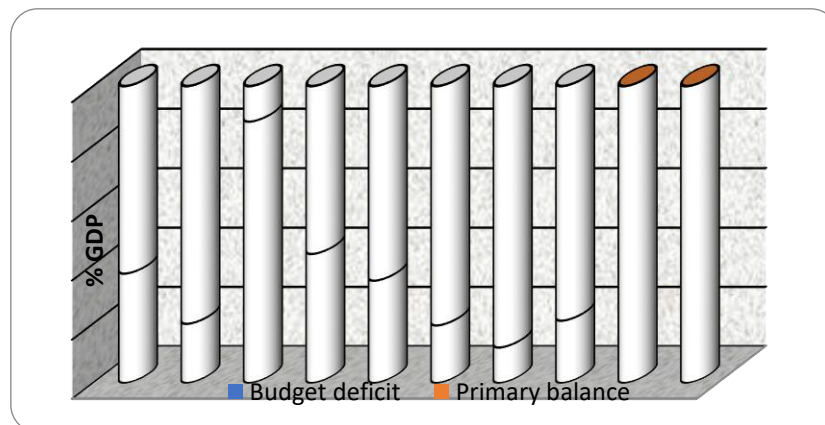
¹ Romanian Government "Convergence Programme 2006-2009", Bucharest, January 2007, p. 7;

² Idem 1;

³ Idem 1

- increase social contributions by 3.3 pp;
- Increase in excise duties on tobacco and alcohol;
- Introducing minimum tax for those categories of economic entities that recorded an income tax lower than the proposed minimum tax;
- Rationalization of the public sector wage bill etc.
- In 2010-2012, average annual consolidation effort of 1.75% to be achieved so budget deficit to remain below 3% of GDP.

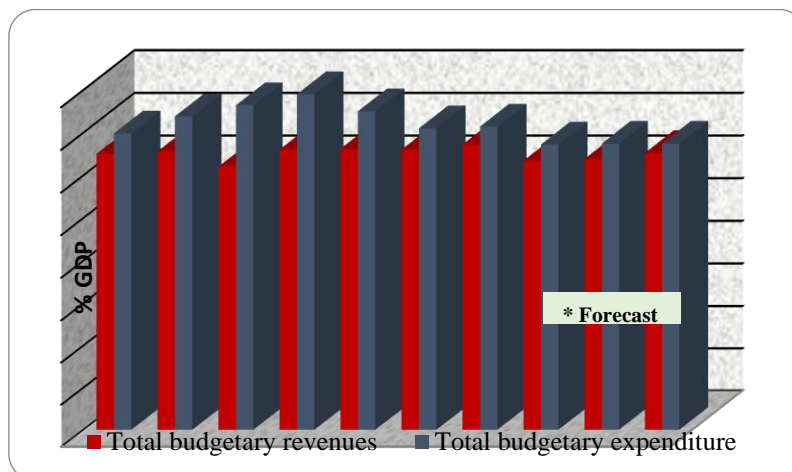
Since 2013, Romania emerges from the excessive deficit procedure, due to financing agreements with the International Monetary Fund and European institutions respectively. However, the fiscal consolidation process was started and supported by structural reforms, management of arrears in the public companies, as well as the public administration sector. For the years 2014-2016, budget-fiscal policy projection is based on the continuation of fiscal consolidation process. Creating a favorable tax environment, representing the essence of a fiscal policy geared towards stimulating economic growth (by attracting investment and increasing consumption). The situation budget deficit and the primary balance, for the period analyzed is illustrated in Figure 1.



Source: Adapted from: AMECO, European Commission; the General Consolidated Budget of Romania 2007-2014, PFM

Figure 1. The evolution of budget deficit and the primary balance in 2007-2016

On the side of the primary balance was recorded a deficit more pronounced in 2009 (-6% of GDP) compared to previous years, when this indicator was -4.1% of GDP (in 2008) and -1.7% of GDP (in 2007). These differences were recorded, on the one hand, because of the total public expenditure growth by about 3.3 percentage points in 2007-2009 and maintaining budgetary revenues around 32% of GDP, on the other hand, the increase of expenses related public debt. An improvement of the situation is visible since 2010, when the primary balance deficit is on a downward trajectory, reaching a minimum threshold of 0.3% of GDP for 2013. Progress resulted from: strengthening fiscal discipline and efficiency fiscal consolidation by increasing the budget revenue collection coupled with rationalization of public expenditure. In terms of the annual plan, incomes and expenses of consolidated budget have recorded the following increases (Figure 2).



Source: Adapted after General consolidated budget, PFM

Figure 2. Evolution of budget revenues and budget expenditures in 2007-2016

By analyzing figure 2 we can see that budget revenues remains below the budget expenditures throughout the period analyzed. The minimum level of budget revenues is noted in 2009, being 31% of GDP. Since 2010, the share of revenues in GDP is increasing by 2 percentage points and maintained during budget years for 2011, 2012, and 2013. Thus, budgetary revenues accounted for 2013 is 31.6% of GDP, reaching an achievement of 97.5% compared to the annual estimates. The influence of the main categories of taxes on the total budget revenue can be summarized as: "there have been increases for wage and income tax by 0.4 pp, security contributions 0.4 pp, and on amounts received from EU payments and pre accounts 0.4 percentage points. Budget revenues decreases were noted in the category of tax revenue caused by poor collection of profits tax and VAT.

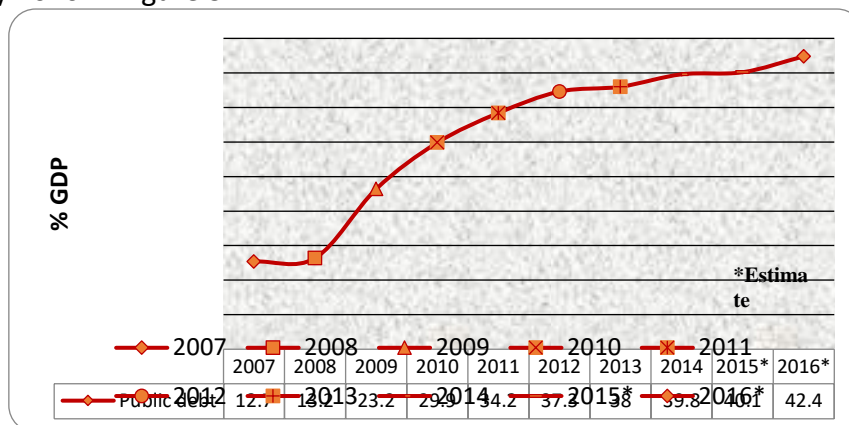
Year 2014 is characterized by the expansion of public investment, eliminating tax on reinvested profit and consumption incentives. This fiscal circumstance afforded to obtain a percentage of 31.7% of GDP of total budget revenue, the tax receipts were up 11.7% compared with previous year, according to the fiscal-budget Strategy for the period 2015 - 2017, and those from VAT accounted for 6.4% of GDP.

Their estimates raise budget revenues increased by 0.2 percentage points in 2015, 0.9 percentage points respectively in 2016 and in nominal amount of 243.3 bln. lei in 2016. On the expenditure side, they oscillated between a minimum of 33.6% of GDP (2014) and a maximum of 39.5% of GDP in 2010. The increasing trend of public expenditure of 2007-2010, can be justified by implementing structural reforms, which referred to particular areas of education, research and transport infrastructure, and public housing.

2 percentage points reduction in public expenditure in 2011 compared to 2010 was largely due to adjustments and equally continuing to maintain budgetary constraints. Important progress has been noted in the staff costs (7% of GDP), the subsidy (1.2% of GDP) and expenditure on goods and services (5.8% of GDP). Amid global economic turmoil, expenditure policy of Romania between years 2012-2014, was "*restrictive, cautious and balanced built on the principle of sound financial management*", which were printed total costs are regressive.

Forecast for the years 2015-2016, shows the continued total public expenditures to a percentage of 33.7% of GDP, which indicates a reduction in the fiscal consolidation efforts. Budgetary scenarios of this period forecast redistribution of budget resources to provide public investment and ensuring a sustainable environment in public spending on wages and

pensions. Analysis of fiscal convergence scenarios emphasizes the link between the budget deficit and public debt; it is known that the budget deficit will influence the level of public debt. Therefore, a major objective of budget policy is to maintain debt within the nominal convergence targets. Entry into recession, scored debt on an upward trend, reaching the highest levels known to Romania. Although kept below the 60% of GDP, public debt has varied in a range between 12.7% (in 2007) and 39.8% of GDP (2014), a situation highlighted ESA methodology 2010 in Figure 3.



Source: Author's according to AMECO, European Commission

Figure 3. Dynamic of public debt in 2007-2016

The decrease of gross domestic product, increased leverage developments, evolutions of "domestic and foreign financial markets, marked by the sovereign debt crisis in the EU⁴" are considered the main factors leading to the increase of public debt in the period under review. However, following economic growth and efforts to maintain a low level of budget deficit for the period 2015-2016 was estimated growth of public debt to GDP ratio of about 2 percentage points compared to 2014.

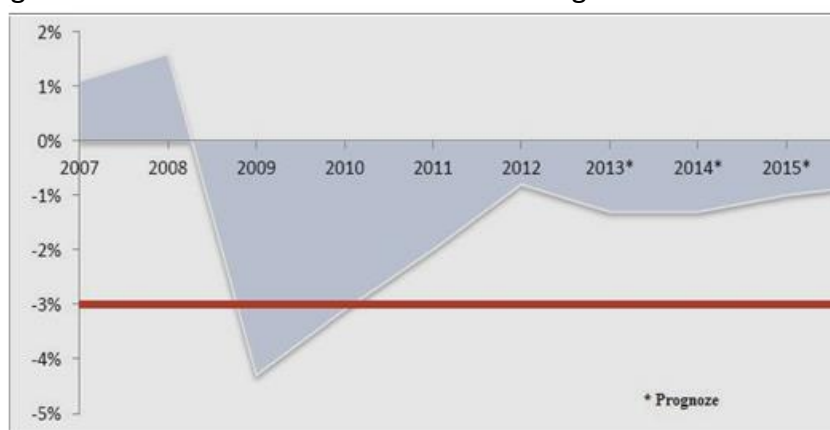
Analysis of Budgetary and Fiscal Convergence for Bulgaria

The case of Republic of Bulgaria is largely symmetrical with that of Romania, the objectives pursued by the government aimed at maintaining macroeconomic stability, financial and tax. In April 2013, Bulgaria announced that the consolidated fiscal program targets a deficit of -1.3% of GDP for 2014, -1% of GDP in 2015⁵ and -0.8% 1 to 2016. Progress towards these figures started in 2009 by implementing a series of fiscal policies that would ensure sustainable fiscal position and limit excessive levels of debt. Basically, for 2007-2009, maintaining high rates of economic growth was the assumption of medium-term macroeconomic scenario. The results of this scenario have incorporated fiscal and budgetary variables, indicating a tendency towards fiscal convergence in the Republic of Bulgaria. In doing so, it was necessary to balance fiscal risks, budgetary constraints and to strengthen the fiscal policy response to potential external and internal shocks and maintaining a high level of current account deficit. An analysis of fiscal convergence scenarios, at that period, indicates orientation of government measures to: reducing public expenditure of Bulgaria and keeping them at a low level; ongoing monitoring of government debt and its inclusion in the acceptable limits of risk, and not least to ensure budgetary balance by stable sources of funding.

⁴ Romanian Government "Convergence Programme 2012-2015", April 2012, p. 31;

⁵ The data provided represents the value of cash deficit

In a period of four years, Bulgaria has managed an improvement in the fiscal position by 3.5 percentage points imposing such restrictions on deficit and debt levels. Government deficit for 2012 was quoted at -0.8% of GDP, which was a positive overshoot targets set in the Convergence Programme of the Republic of Bulgaria for 2012-2015. These fiscal progresses resulted from: recovery of domestic demand, increasing collection, measures to strengthen fiscal discipline and tighter spending in most sectors of the budget. The values recorded in 2012 represented an improvement of 1.2 percentage points relative to GDP over the previous year, derived from successful initiatives that target revenue, while expenditure side was maintained at the level of 2011. The favorable effects on the scope of revenue had the elements propellant consumption growth, accelerate the implementation of projects of Structural and Cohesion Fund of the European Union and control measures of underground economy. Budget's balance in ESA 95 terms is shown in Figure 4.



Source: Adapted from "Convergence Programme" (2013 - 2016)
Ministry of Finance, Republic of Bulgaria, April 2013

Figure 4. Evolution of balance budgetary for period 2007-2016

Conservation of the main level taxes in 2012 ensured a predictable economic environment and favourable to entrepreneurship and investment initiatives, and facilitated recovery of domestic demand. The taken austerity measures have maintained government spending at a similar level to that in 2011 they recorded a level of 35.7% of GDP compared with the previous level of 35.6% of GDP. Interest expenditure increased by 0.2 percentage points as a result of a new issue of Eurobonds placed in July 2012. It was also a reduction in public sector salaries by 0.3%, thanks to measures to limit personal remuneration reforms in the pension system. It notes the adoption in January 2013 the Public Finance Law, which transposes the precautions of European Directive 2011/85/EU on the budgetary framework for Member States as part of the Stability and Growth Pact. The 2013 fiscal framework targeted a general deficit of 1.3% of GDP. The expenditure side was influenced upwards of co-financing of operational programs of the EU and social policy issues as indexing pensions and raising the minimum wage⁶.

The main features of the fiscal policy on income side for 2013 are:

- freezing of direct taxes, including VAT;
- increased excise rates for a number of products⁷;

⁶ Convergence Programme (2013 - 2016), Ministry of Finance, Republic of Bulgaria, April 2013

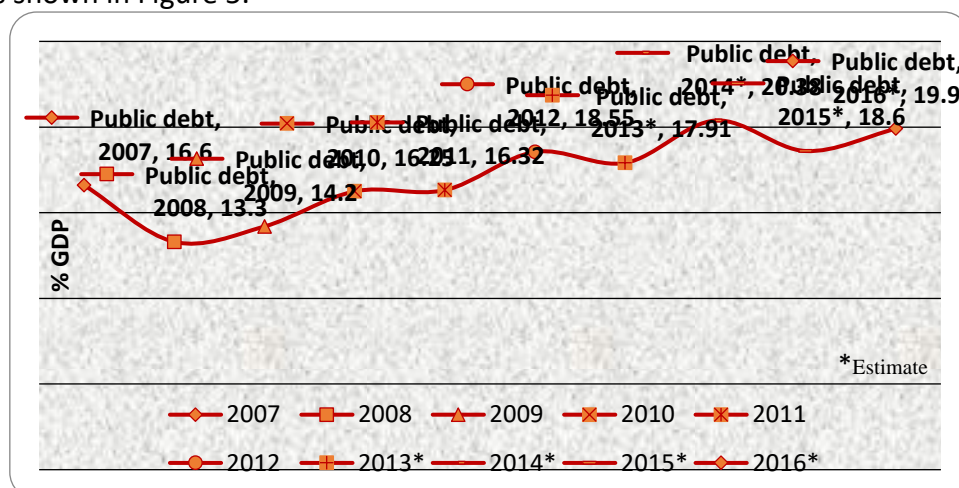
⁷ According to the Accession Treaty

- Increase by 20 percentage points of contributions to public pension funds for the military, Interior Ministry employees and staff in prisons;
- freezing social security contributions for all categories of employees;
- maintaining social security contributions;
- facilitating corporate income tax administration.

The priorities for the expenditure side of 2013 were:

- policies for promoting economic growth;
- facilitating the implementation of programs and projects co-financed by European Union funds;
- investments in public infrastructure;
- fighting poverty;
- encouraging social inclusion;
- protecting vulnerable groups and improving quality and access to public services.

One of the key priorities of the expenditure side is the investment in public transport infrastructure and environmental services, where there was an increase of 2.2% over the previous year. Another priority initiative has been engaging in measures to accelerate the absorption of EU funds. The maximum amount of new debt that can be issued in the year 2013 is 1022 billion euro. The maximum level of new government guarantees that may be granted in the year 2013 reached 0.1 billion euros. The evolution of total government debt ESA 95 is shown in Figure 5.



Source: Adapted from AMECO, European Commission "Convergence Programme" (2013 - 2016)

Ministry of Finance, Republic of Bulgaria, April 2013

Figure 5. Government debt for period 2007-2016

Conclusions

The results of empirical study confirm the fulfillment of fiscal-budget objectives on medium-term and economic performance growth necessary to meet the commitment to adopt the euro. Analysis of convergence scenarios for Romania and Bulgaria, emphasizes the tendency of fiscal convergence in both countries. As a result of the austerity measures implemented, we can say that: both for Romania and the Republic of Bulgaria two indicators showed mixed developments in 2007-2016. For Romania, remarkable progress has been achieved in terms of correcting macroeconomic imbalances and improving the efficiency of the policy mix, which contributes to financial stability. In the case of Bulgaria, fiscal convergence scenarios are "shady" gloomy outlook for economic growth for 2014-2016. Thus,

the envisaged measures aim to balance the budget by reducing the risks assimilated and within the restrictions imposed on tax rules within the European Union.

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