

## EVALUATION OF THE CONDUCT OF FISCAL-BUDGETARY POLICY IN ROMANIA, IN THE PERIOD 2008 – 2023

**Scientific Researcher III, Ionel LEONIDA**

“Victor Slăvescu” Centre for Financial and Monetary Research, Romania

E-mail: [ionel.leonida@icfm.ro](mailto:ionel.leonida@icfm.ro)

**Scientific Researcher, Cosmin – Octavian CEPOI**

“Victor Slăvescu” Centre for Financial and Monetary Research, Romania

E-mail: [cepoi.cosmin.ccfm@gmail.com](mailto:cepoi.cosmin.ccfm@gmail.com)

**Abstract:** *In the proposed paper, we analyze the conduct of the fiscal-budgetary policy in Romania, in the period 2008-2023, based on the cyclically adjusted budget balance indicator, respectively its variations from one year to the next, in relation to the state of the economic cycle, analyzed on the basis of the output indicator gap. Through this synchronized analysis we can evaluate the conduct of the fiscal-budgetary policy in relation to theoretical benchmarks regarding its action in different phases of the economic cycle. The usefulness of the analysis is relevant from the perspective of the effective actions of the fiscal-budgetary policy on the fluctuations of the economic cycle, either in the sense of tempering them, respectively an anti-cyclical character, or of amplifying them, respectively a pro-cyclical character. The conduct of the fiscal-budgetary policy in relation to the economic state, becomes an increasingly important element, in the context of the increase in the frequency of shocks on the economy, in the adequacy and design of fiscal-budgetary strategies in the short and medium term, but also in the context of the European fiscal framework (discipline and fiscal consolidation), so as to ensure macroeconomic stability.*

**Keywords:** *fiscal-budgetary policy, cyclically adjusted budget balance, actual balance, fiscal impulse, fiscal position.*

**JEL classification:** *E61, H20, H62.*

### 1. Context

The effective budget balance (Sbe) is an imperfect indicator for evaluating public finances and fiscal policies, as it is influenced by government decisions, transitory factors and/or outside the direct control of fiscal authorities. Predominant among these factors are fluctuations in economic activity, respectively their influence on the effective budget balance.

An effective budget balance can be misleading at certain times, through the extraordinary expansion of revenues, and, especially later, through permanent and (perhaps) unnecessary expenditure commitments, generating major imbalances in the following fiscal years.

An important landmark of recent economic history, in this sense, is the financial and economic crisis from 2008 to 2010, generated by such a fluctuating situation (real estate boom).

To facilitate the analysis of fiscal-budgetary policies, Sbe must be corrected by removing these cyclical influences, thus resulting in the cyclically adjusted budget balance (Sbc) or structural balance.

In other words, the SBC seeks to determine what the actual budget balance is if the economy is operating on its "normal" growth trajectory, for example, characterized by roughly constant growth over the medium term.

Sbc has a central role in the Stability and Growth Pact (PSC), respectively in the evaluation and planning of budget policies in the European Union (EU), which have as their objectives fiscal discipline and consolidation. The following can also be identified through Sbc:

- the type of implemented fiscal-budgetary policy, respectively restrictive or expansionist, by measuring the impact of implemented fiscal-budgetary measures (fiscal impulse);

- the type of fiscal policy that works in an economy (procyclical, anticyclical), from the perspective of the function of stabilizing the economic cycle (fiscal position).

## 2. Mode of determination – derived indicators

According to the previous statements, for the determination of the cyclically adjusted budget balance, one starts from the actual budget balance, from which the cyclical components and the elements that usually happen only once in a budget year, respectively:

$$Sbc = Sbe - \text{cyclic components} - \text{one-off elements}$$

The fiscal-budgetary components subject to cyclical adjustment are most frequently identified in four large categories of income and one category of expenses with high sensitivity to fluctuations of the economic cycle: direct taxes on households, direct taxes on companies, indirect taxes, contributions to social security and expenses related to unemployment. This last category does not only consist of unemployment benefits in the strict sense, but also includes all other social transfers, which are considered to depend on unemployment (eg early retirement).

An appropriate macroeconomic basis is identified for each of the selected budget items. In principle, both direct household taxes and social security contributions are related to private sector employee compensation, indirect taxes to private consumption, direct corporate taxes to gross operating surplus, and unemployment expenditures to the number of unemployed. Elasticities are generally determined relative to these bases.

Based on the cyclically adjusted budget balance, derived indicators such as the fiscal impulse and the fiscal position can be determined.

The fiscal impulse indicator expresses the discretionary character of the fiscal policy and the way in which it contributes to stimulating or inhibiting the national economy. The fiscal impulse can be measured as the difference in the cyclically adjusted budget balance of the consolidated budget, for two consecutive years or at two different times. A positive fiscal impulse reflects an expansionary fiscal policy, while a negative fiscal impulse suggests the promotion of a restrictive fiscal policy.

$$\text{Fiscal impulse} = Sbc_1 - Sbc_0$$

The fiscal position indicator shows the budget balance gap, calculated by the difference between the actual budget balance and the cyclically adjusted budget balance, i.e. the current position of the conventional accounting budget balance of the general consolidated budget, compared to the potential benchmark. In the economic analysis, the indicator represents useful information for evaluating the structural sustainability of the consolidated general budget balance.

The fiscal position indicates the type of fiscal policy that works in an economy, from the perspective of the stabilization function of the economic cycle. A positive value of the fiscal position indicator indicates a procyclical fiscal policy, while a negative value indicates an anticyclical fiscal policy.

$$\text{Tax position} = Sbe_1 - Sbc_1$$

### 3. The evolution and analysis of the budget balance indicators and derivatives

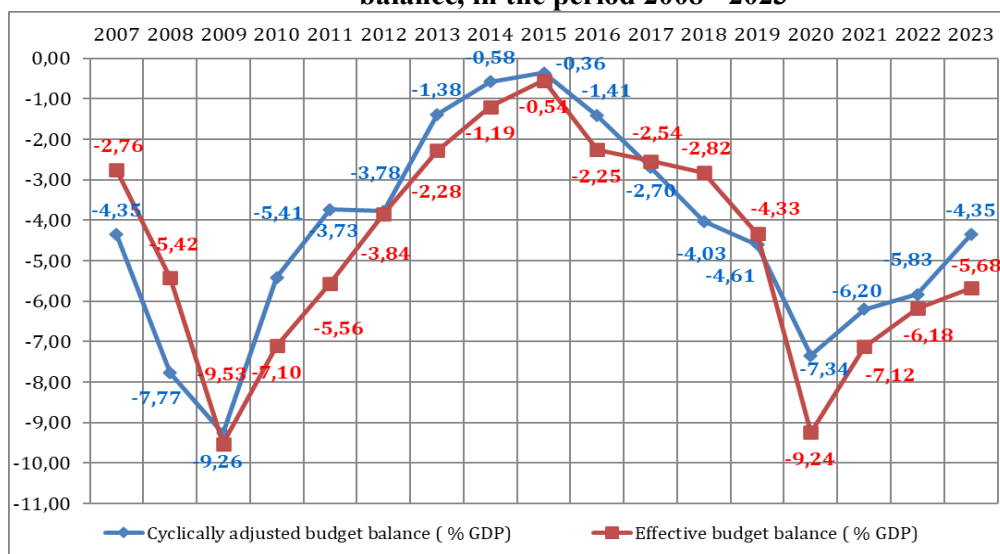
The assumption by Romania of the Treaty on Stability, Coordination and Governance (TSCG), in 2012, meant a commitment to comply with a fiscal-budgetary framework based on a series of rules, having as its main objective a level of the cyclically adjusted budget balance of -1% of GDP. The TSCG provisions were taken over in the national legislation in 2013, so the medium-term fiscal-budgetary projections were conditioned by the new rule, starting in 2015. This constraint mechanism did not work in practice, and after the 2013-2015 period, in which the cyclically adjusted budget balance has been below the mentioned limit since 2016 and until now there has been a wide deviation from the rule regarding the maximum level of -1%.

The fiscal-budgetary consolidation process, initiated in 2009-2010, had a fast and efficient course, leading to the achievement of the medium-term budgetary objective in the period 2014-2015, and in the following period measures were required to maintain and continue it. After this period of positive adjustment, starting in 2016, the cyclically adjusted budget balance went out of the target of the medium-term budget objective, due to the implementation of fiscal relaxation measures and an increase in administrative budget expenses, measures that negatively affected the two balances budgeting (cyclically and effectively adjusted, as seen in figure 1).

In the years 2017, 2018 and 2019, the fiscal-budgetary policies assumed the implementation of some measures to increase budget expenditures (salary in the public sector and the public pension system), as well as those of fiscal relaxation (reduction of the tax rate on the income of natural persons, starting from 1 January 2018, the reduction of the VAT rate from 1 January 2017), which led to the deterioration of the cyclically adjusted balance, reaching in 2019 approx. 5% of GDP.

In 2020, the impact of the outbreak and manifestation of the COVID-19 pandemic on the normal flows of the economy, at national, European and global level, and the implementation of discretionary measures to mitigate the economic and social effects of the pandemic, both at national and community level, have structurally imbalanced the economy and, implicitly, the nature and flows of budget revenues and expenditures.

**Figure 1. Evolution of the effective budget balance and the cyclically adjusted budget balance, in the period 2008 - 2023**



Source: data Fiscal Council Report 2022 (page 47) and MFP, budget execution 2023 <https://mfinante.gov.ro/static/10/Mfp/buletin/executii/bgc31122023.pdf>

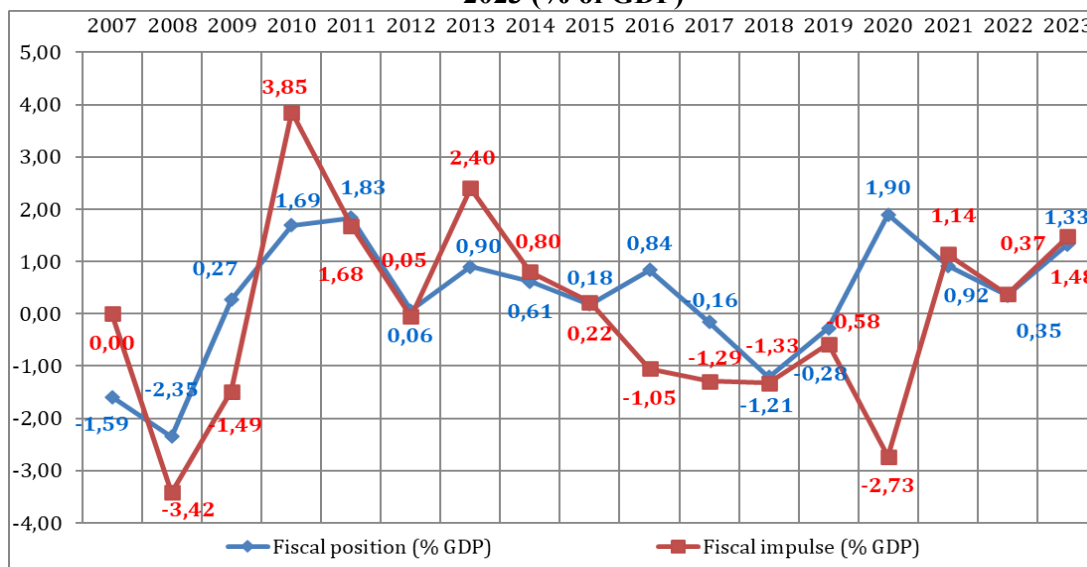
In the years 2021 and 2022, the cyclically adjusted budget balance registers a favorable evolution in relation to the situation in 2020, adjusting gradually, like the actual budget balance, even against the background of some increases in expenditure that occurred in addition to the initial budget projection, manifested in the sphere of defense expenses as a result of the outbreak of the war in Eastern Europe (by 0.5 pp of GDP), respectively the increase in expenses with compensation measures and capping of energy tariffs (electricity and natural gas), as well as fuel (gasoline, diesel), estimated at 2 pp of GDP.

And in 2023, a series of measures that required budget expenditures, implemented in the previous year, were maintained, namely the measures to compensate and cap energy tariffs (electricity and natural gas), as well as in the sphere of defense expenditures, in which there is also a slowdown in trade flows determined by a slowdown in the global economic evolution, with unfavorable effects mainly located at the level of the industrial sector. In these conditions, analyzed in relation to the negative values of the output-gap, which indicate a state of economic recession, the influence on the cyclically adjusted budget balance continues to be negative, and the outlook is not favorable in terms of commitments regarding the increase of pensions and of a year in which several election cycles will take place, situations that will require additional expenses for their organization.

The evolution of the fiscal position, presented in figure 2, in the reference period, in relation to the mentioned indices, it can be seen that in the years and periods 2009-2016 and 2020-2023, a pro-cyclical fiscal policy operated in the Romanian economy, and in the years and periods 2007, 2008 and 2017-2019. an anti-cyclical fiscal policy was promoted and implemented.

The evolution of the fiscal position in the periods 2007-2008 and 2017-2019, reflects the fact that in the pre-crisis periods the fiscal policy acted anti-cyclically, and with the manifestation of the crises the action of the fiscal policy manifested itself pro-cyclically, the situation that signifies the fact that a fiscal policy was needed more active, more appropriate to the respective conjunctures through the implementation of fiscal-budgetary measures, especially the employment of budgetary expenses to support the economy.

**Figure 2. Evolution of the fiscal position and the fiscal impulse, in the period 2007 – 2023 (% of GDP)**



Source: processed data from figure 1

Analyzed in relation to the state of the economic cycle, fiscal policy (through the lens of the evolution of the fiscal position indicator), had a predominantly procyclical behavior, sometimes inappropriate to the state of the economic cycle.

The evolution of the fiscal impulse, represented in figure 2, during the reference period, indicates that the fiscal policy showed oscillating tendencies of expansion and restrictiveness, respectively a significant reduction during the manifestation of crises and a significant abrupt increase post-crisis, reflecting the necessary fiscal policy actions implemented in those economic moments. Referring to the two moments of crisis and the evolution of the fiscal impulse, as an element of evaluating the character of the fiscal-budgetary policy, it is observed that in the crisis years (2008 and 2020) it recorded the highest negative values of the analyzed period, signaling a severe restrictiveness of the fiscal policy, and in the following years the fiscal policy relaxed, gradually becoming expansionist.

In order to highlight and more accurately capture the character of the fiscal-budgetary policy promoted in the period 2007-2023, based on the values of the fiscal position and fiscal impulse indicators, a tabular presentation of them was made, highlighting the characteristics of the fiscal policy and the state of the economic cycle (notations: R = restrictive fiscal policy; E = expansionary fiscal policy; A = countercyclical fiscal policy).

**Table no. 1. The characteristics of the fiscal policy in the period 2007 – 2023**

An	Fiscal position	Fiscal impulse	Output gap ul <sup>1</sup>	Characteristics	Action on the economic cycle <sup>2</sup>
2007	-1,59	-	Expansion	-	-
2008	-2,35	-3,42		A + R	Procyclic
2009	0,27	-1,49	Recession	P + R	Anti cyclical
2010	1,69	3,85		P + E	Procyclic
2011	1,83	1,68		P + E	Procyclic
2012	0,06	-0,05		P + R	Anti cyclical
2013	0,90	2,40		P + E	Procyclic
2014	0,61	0,80		P + E	Procyclic
2015	0,18	0,22		P + E	Procyclic
2016	0,84	-1,05		P + R	Anti cyclical
2017	-0,16	-1,29	Expansion	A + R	Procyclic
2018	-1,21	-1,33		A + R	Procyclic
2019	-0,28	-0,58		A + R	Procyclic
2020	1,90	-2,73	Recession	P + R	Anti cyclical
2021	0,92	1,14		P + E	Procyclic
2022	0,35	0,37		P + E	Procyclic
2023	1,33	1,48		P + E	Procyclic

Source: Data from Figures 1 and 2

From the evolution of the cyclically adjusted budget balance, the fiscal impulse and the fiscal position, in relation to the state of the economic cycle, it follows that in the period 2007-2023, Romania mainly practiced a pro-cyclical fiscal-budgetary policy (with the exception of the years 2009, 2012, 2016 and 2020).

<sup>1</sup> It refers to the state of the economic cycle determined by actual GDP – potential GDP / potential GDP, \* 100, resulting in the Output gap, which is interpreted according to the resulting value, thus a negative value signifies a state of recession, and a positive one a state of expansion (see figure no. 1.1.14).

<sup>2</sup> Expansionary fiscal policy vs economic expansion / restrictive fiscal policy vs economic recession = procyclical. Expansionary fiscal policy vs economic recession / restrictive fiscal policy vs economic expansion = anti cyclical.

The discretionary fiscal policy of intense but counterproductive stimulation of the economy during periods of pre-crisis expansion (2007-2008 and 2017-2019), respectively of braking during the period when the economy operated below potential (2009 - 2016 and 2020-2023), contributed to amplifying the fluctuations of the economic cycle through its pronounced procyclical character, the automatic, beneficial and stabilizing action of the automatic stabilizers, thus being cancelled.

#### 4. Results

The analysis of the two budget balances reveals the fact that the fiscal-budgetary policy, after a period of instability (2007-2012), characterized by their excessive negative values, entered a consolidation process, starting from 2013, and recorded significant progress in terms of their reduction, but also in line with its function of macroeconomic adjustment, until 2016. Starting from 2017, the budget balances have permanently deteriorated, the situation becoming more pronounced in 2020, both due to the inertia of the measures increase of the mentioned expenses, as well as of fiscal relaxation measures.

During 2021, uncertainty prevailed regarding the evolution of the pandemic, so that the measures were adapted to the specific situation of the country and, by extending the states of alert, some temporary actions acquired the character of continuity. At the same time, it again entered a path of fiscal consolidation, the cyclically adjusted budget balance, registering a favorable evolution in relation to the situation in 2020, adjusting by approx. 0.5pp, as well as the effective balance which registered a positive adjustment of approx. 2pp, against the background of the gradual resumption of economic and commercial flows, but also of accommodating the conduct of some economic activities to the conditions imposed by the restrictions of the COVID-19 pandemic.

Fiscal consolidation is difficult, but positive signals are maintained in 2022 and 2023 as well, with budget balances continuing on the path of reduction compared to 2020 and 2021, respectively the cyclically adjusted budget balance was -4.3% of GDP and the effective balance was -5.7 % of GDP in 2023, decreasing, but still above the institutional limits (-1% for the cyclically adjusted budget balance and -3% for the actual balance).

The evaluation of the conduct of the fiscal-budgetary policy, evaluated on the basis of the presented budget balance indicators and those derived from them, indicates that certain particular characteristics are recorded, respectively:

- the evolution of the fiscal position from the periods 2007-2008 and 2017-2019, reflects the fact that in the pre-crisis periods it acted anti-cyclically, and with the manifestation of the crises the action of the fiscal policy manifested itself pro-cyclically, the situation that signifies the fact that a more fiscal policy was needed active, more appropriate to the respective contexts through the implementation of fiscal-budgetary measures. Analyzed in relation to the state of the economic cycle, the fiscal policy had a predominantly procyclical behavior, sometimes inappropriate to the state of the economic cycle;
- referring to the two moments of crisis and the evolution of the fiscal impulse, as an element of evaluating the character of the fiscal-budgetary policy, it is observed that in the crisis years (2008 and 2020) it recorded the highest negative values in the period analyzed, signaling a severe restrictiveness of the fiscal policy, and in the following years, the fiscal policy relaxed, gradually becoming expansionist;
- starting from 2021 and continuing with 2022, the fiscal consolidation process has resumed, but the task is much heavier, i.e. if the deficit can be adjusted in the next two/three years, the debt burden is greatly increased, this being, in fact, "the cost real" of the effects of the two major crises that humanity and, implicitly, Romania went through,

but also the effect of a fiscal-budgetary policy unable, in the current state, to generate and collect revenues at the level of some countries in the region with a similar fiscal regime (Bulgaria).

From the evolution of the cyclically adjusted budget balance, the fiscal impulse and the fiscal position, in relation to the state of the economic cycle, it follows that in the period 2007-2023, Romania mainly practiced a pro-cyclical fiscal-budgetary policy (with the exception of the years 2009, 2012, 2016 and 2020).

The discretionary fiscal policy of intense but counterproductive stimulation of the economy during periods of precrisis expansion (2007-2008 and 2017-2019), respectively of braking during the period when the economy operated below potential (2009 - 2016 and 2020-2023), contributed to amplifying the fluctuations of the economic cycle through its pronounced procyclical character, the automatic, beneficial and stabilizing action of the automatic stabilizers, thus being cancelled.

### References:

1. Anton, S.G. and Puiu, C., 2014. The IMF Approach Towards the Structural Deficit, *Journal of Public Administration, Finance and Law*. [pdf] Available at: <[https://jopafl.com/uploads/special-issue-1-2014/THE\\_IMF\\_APPROACH\\_TOWARDS\\_THE\\_STRUCTURAL\\_DEFICIT.pdf](https://jopafl.com/uploads/special-issue-1-2014/THE_IMF_APPROACH_TOWARDS_THE_STRUCTURAL_DEFICIT.pdf)> [Accessed 12 March 2024].
2. Bouthevillain, C. et al., 2001. Cyclically adjusted budget balances: an alternative approach (including annexes), ECB WP no. 77. [pdf] Available at: <<http://www.ecb.int/pub/pdf/scpwps/ecbwp077.pdf>> [Accessed 12 March 2024].
3. Bornhorst, F.G. Dobrescu, A., Fedelino, J., Gottschal, and Nakata, T., 2011. *When and How to Adjust Beyond the Business Cycle? A Guide to Structural Fiscal Balances*. IMF Technical Notes and Manuals 11/02, International Fund, Washington, D.C.
4. Dobre, A.S., 2015. *Classic and Modern Theories Regarding Budget Balance*. [pdf] Available at: <<http://dx.doi.org/10.2139/ssrn.2671267>> [Accessed 12 March 2024].
5. Mankiw, G., 2016. *Macroeconomics*, 9th edition. New York: Worth Publishers.
6. Mourre, G., Astarita, C. and Princen, S., 2014. *Adjusting the Budget Balance for the Business Cycle: the EU Methodology*. European Commission Economic Papers 536.
7. <https://mfinante.gov.ro/domenii/bugetul-de-stat/informatii-executie-bugetara>
8. <https://ec.europa.eu/eurostat/data/database>