Adjustment of macroeconomic imbalances

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Abstract

The global financial and economic crisis was the factor that triggered the adjustment of macroeconomic imbalances accumulated in Romania. The current account deficit and budget deficit were two major structural imbalances that have created a high vulnerability for the economy and explained the extent of economic contraction in Romania during the economic crisis. This article identifies the main causes that lead to the need for fiscal adjustment both in the EU and in Romania, as well as main effects of adjustments in respect of their experience in recent years. The article deals with this topic, because the current topical debate in the field of fiscal adjustments implemented both in the EU and our country, and their need for economic activity aimed at economic recovery.

Keywords: economic growth, sustainability, financial crisis, fiscal policy.

JEL Classification: F43; Q56; E62.

1. Sustainable growth

The current crisis has widened further increase government debt in advanced economies at levels that have not been seen since the end of World War II. In advanced G-20 economies, the growth rate of debt to GDP will reach 118% in 2014 from a level of 78% as it was in 2007. By 2014, it may be eight advanced economies whose growth rate debt to GDP ratio to be somewhere more than 100%.

While this increase in debt is due to the current recession, it is also a continuation of the trend that started many years ago. With only a few exceptions, all OECD governments have deepened indebtedness over the period 1980-2007. In this respect, increasing government debt associated with the current crisis is a wake-up call for governments to improve fiscal discipline and long-term approach to sustainability issues that were debated and largely ignored since the late 80s. Temporary improvement of public finances in the 90s, which in some cases has led to a scenario too optimistic about the adjustment, was first behind the relaxation of fiscal discipline in the years that followed. Inability of governments to accumulate enough surpluses during the period of growth has created a trend that has increased the debt. Of course, because the recession has had an impact far greater than expected, made things go worse.

Finally, if we add to this overview and that future liabilities faced by governments are large, there is no doubt about the need for fiscal adjustment in the near future for most economies. The question that arises is how large should, from the effects of macroeconomic and institutional framework that will ensure the success of adjustments.

The baseline scenario is the effort required to stabilize debt at current levels. Another is to bring the debt level at which it was before the crisis. The second scenario, more ambitious, is using a target of 60% (gross public debt in GDP). Why 60%? This level is arbitrary but it is far from average in advanced economies before the crisis, and at the same time is the reference from Economic and Monetary Union.

Fiscal consolidation to be achieved in the coming years depends largely on the following two scenarios[1]:

- √ If you want to maintain the level of debt in GDP from 2010, the government must bring the primary balance from a deficit of 1%;
- √ If we want to reduce the debt to GDP ratio to pre-crisis levels until 2030, the primary structural balance should move from the current (- 4%) to a surplus of about 4% by 2020. This represent for advanced economies, an average adjustment of 8 percentage points of GDP over the next 10 years. This effort ensures that the debt to GDP ratio converges to 60% in 2030.

Both scenarios require adjustments in the structural budget balance (between 7 and 40 percent of GDP) over a short period. Some of these adjustments will take place normally while measures constructed stimulus packages are removed temporarily. While this will only help in the short term, their effect is short compared to what is needed.

2. Economic consolidation

With the growth that returned in 2010 and stabilized in 2011 and 2012, consolidation is now required in both the EU and the euro area. Economic analysis shows changes planned deficits and structural deficits 2010-2014 period that otherwise referred to as the SCP (Stability and Convergence Programme). They show that, overall, both the EU and the euro area are designed to improve their fiscal positions each year between 2010 and 2014.

In the EU, provided that the general government deficit to decline to 6.3% of GDP in 2010 to 4.6% in 2011, 3.4% in 2012, 2.3% in 2013 and 1.4% in 2014. Meanwhile, figures for the euro area of 6.0%, 4.3%, 3.1%, 2.1% and 1.3%. Also in structural terms, deficits are projected to decrease faster in 2011-2012 than in 2013-2014[2].

Of course, there are variations in the time profile. For some countries, such as Belgium, Denmark, Luxembourg and Estonia, the adjustment is slower, meaning that both the general government deficit and the structural deficit is projected to be higher during the second part of the program (2013 - 2014) than it was in the first half (2011-2012).

While the first half of the program, countries such as Lithuania, Poland, Italy, Estonia, Belgium, Germany, Sweden and Bulgaria are designed to strengthen their efforts to be higher in 2012 than in 2011. A back-loaded adjustment in 2012 - compared to 2011 - is also designed

[1] Fatas, A., *The Economics of Achieving Fiscal Sustainability*, Academic Consultants Meeting on Fiscal Sustainability Board of Governors, Federal Reserve, April 9, 2010, page 1

[2] Public Finances in EMU, European Union, 2011

for more extreme of Slovenia, where the deficit is projected to stabilize in 2011, and Hungary, where the budget deficit is estimated to grow in 2011.

Overall, the euro area is primarily due to the strengthening basic expenses. While revenue ratio increased by 0.5 percentage points of GDP between 2010 and 2014, the share of expenditure was set to shrink by 3.6 pp of GDP. A similar pattern exists in the EU, due to report earnings growth of 0.5 pp of GDP and expenditure report due to contraction of 3.9 pp of GDP.

In the cases of France and Belgium to some extent, be noted that the consolidation effort is largely based on the increase of income, despite the fact that these countries have among the highest tax burden in the EU. In contrast, despite a low starting tax ratio is projected to decline significantly in 2014, in countries such as Hungary, Latvia, Slovakia, Estonia and to a certain extent, Slovenia and Lithuania (for some these countries, however, reduce the tax ratio is mainly due to slower absorption of EU funds. How EU structural funds have a neutral effect on the deficit, this is reflected by a decrease in expense report) adding to reduce expenditure will be needed to close the deficit.

The table below (see table no. 1) the differences between planned and actual data on costs and revenues as seen in the past, as envisaged in the SGP. Table calculates averages between 1999 and 2007, shows the results of 2010 and then the forecasts for 2011-2014. Given the years shown in the table, it should be noted that past results do not refer to episodes of consolidation, but the years before the onset of the crisis. Presented are un-weighted averages, so they are media program. The figures in the table below are the percentage increase in nominal values.

Table no. 1.

Real fiscal adjustment vs. planned fiscal adjustment - EU-27 (un-weighted averages)						
	1999-2007 Planned Real	2010 Planned Real	2011 Planned	2012 Planned	2013 Planned	2014 Planned
Incomes	6,6% 7,7%	3,0% 3,2%	6,5%	4,5%	3,9%	3,9%
Expenses	5,5% 7,1%	2,4% 1,3%	2,6%	2,3%	1,9%	2,1%
Governmental equilibrium	0,3 pp 0,2 pp	0,2 pp 0,9 pp	2,3 pp	0,7 pp	0,8 pp	0,7 pp

Source: www.ec.europa.eu

According to the data shown in the table above, during 1999-2007, became stronger revenues than planned, and the results in terms of costs are real. While the programs were planned spending growth of 5.5%, real growth has averaged 7.1%. Taken together, this meant that the public balance was improved by less than planned. In 2010, expenditure restraint was successful. While spending was planned to increase by 2.4%, they increased only at a rate less than 1.3% of the stress of debt on the market, in this respect, some countries have implement new measures to strengthen. Revenue growth was stronger than was originally planned, which meant an improvement in the government balance which was stronger than was planned. The table shows also plans PSC (Planned fiscal policy), 2011-2014. Commission forecasts for 2011 and 2012 are generally in line on the expenditure side, while they are lower on the revenue side.

For the euro area government debt have gone from a level of 85.4% in 2010, before reaching a peak of 87.0% and later to return to the level of 85.1% by 2014 . For the EU-27, the debt starts at 80.0% of GDP, before reaching a peak of 82.5% and then a return to 79.9% of GDP. In both cases, the maximum was reached in 2012.

Medium term implication is that as long as consolidation measures are not reversed beyond 2014, the debt should be on a downward path.

All countries, except Finland, Latvia and Luxembourg are designed to achieve a maximum level of debt in 2014, and later to have been a reduction in debt. However, for some countries, such as Greece, Ireland, Portugal, Britain and Spain because of rising debt levels too high during the crisis, will be harder to achieve their reduction by 2014, and for reach the lower level before the crisis will have to pass several years before this to be done.

3. National macroeconomic imbalances

Global financial and economic crisis was the factor that triggered the adjustment of macroeconomic imbalances accumulated in Romania by the end of 2008. The current account deficit and budget deficit were two major structural imbalances that have created a high vulnerability for the economy and explaining the extent of economic contraction in Romania during 2009-2010.

In Romania, in the pre-crisis fiscal policy was pro-cyclical one, characterized by a dominance of short-term political considerations, without paying much attention to the consequences on the sustainability of public finances in the medium and long term.

To restore the sustainability of public finances is needed fiscal consolidation effort, coupled with deep structural reforms to create conditions conducive to sustainable economic growth. Restructuring public expenditure and fiscal space for investment issue should be a major goal of government policy. Although in 2009-2010 have made great strides to correct fiscal policy unsustainable pre-crisis, further efforts are needed to strengthen structural reforms necessary to restore sustainable public finances and resume growth.

Budget and fiscal responsibility law approved in March 2010 aims to strengthen fiscal discipline and must contribute to improving the medium-term budgetary programming. It introduces a number of fiscal rules should lead to prioritizing spending and a prudent fiscal policy in times of economic upswing, which preserves the necessary fiscal space to stimulate the economy in periods of recession. Budget revisions are limited to two during the year and introduced reporting requirements that will increase the transparency of fiscal policy.

The year 2010 was difficult in terms of budget and fiscal adjustment, the Romanian economy registered a growth of 2.5% in 2011, one percentage point higher than forecast, mainly due to favorable supply shock in agriculture . On the other hand, the outlook for 2012 showed a weaker economic advance than originally estimated, the main reason being the worsening external economic environment, directly affecting exports through trade channel and indirectly domestic demand channel capital flows.

Provide initial budget deficit reduction to 4.4% of GDP according to the methodology cash and 5%, according to ESA95. Budget execution has recorded a budget deficit of 4.12% of GDP in cash-based, end-2011 target for being taken with a comfortable margin of about 0.3% of GDP. Concerning general government deficit under ESA 95 statistical treatment clarify state obligations to pay certain categories of employees in the public sector occur after final court ruling involving exceeding the ceiling of 5% of GDP by 0.2 points percentage[3].

Currently renegotiation attempts by the new government with the IMF and EU budget deficit target. Even if the upward revision of the deficit target, there are risks in terms of its reach, given the downward revision of projected growth.

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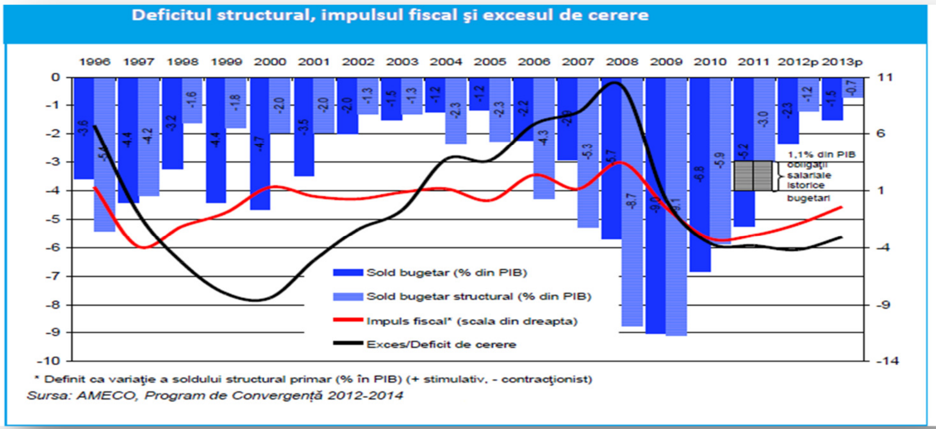
[3] Romanian Fiscal Council, *2011 Yearly Report – Macroeconomic and budgetary evolutions and perspectives*, 2012, available online at www.consiliulfiscal.ro

Romania has one of the lowest percentages of GDP in tax revenue (taxes and social contributions) of the EU countries, accounting in 2011 only 27.2% of GDP by 12.4 percentage points of GDP lower than the European average. Thus, in 2011, the effectiveness of charging for value added tax and social contribution - calculated as the ratio of implicit tax rates and legal - is among the lowest in the Eastern European countries in the sample, 54% in If VAT from Estonia (82%) and Bulgaria (71%), and 61% for social contribution[4].

In the period of rapid growth before the financial crisis in Romania was positive fiscal impulse, he contributed to overheating and widened thus accumulated imbalances in the economy (see fig. 1). Romania had an inadequate management of macroeconomic policies. Pro-cyclicality of fiscal policy during the pre-crisis economic upswing has exhausted the fiscal space necessary to stimulate the economy during the recession that followed, the need to reduce the budget deficit during the crisis (primarily due to funding constraints) leading, inevitably keep cyclicality of fiscal policy. Thus, automatic action, beneficial and stabilizing cyclical deficit (automatic stabilizers) was canceled pro-cyclical discretionary policy.

Fig. no. 1

Budget deficit, fiscal impulse and excess demand



Source: www.ameco.ro

Romania has made large fiscal adjustments when the economy operated below potential, contrary macroeconomic theory postulates that recommended fiscal consolidation processes during expansion (see Table 2).

Table no. 2.

Output-gap evolution and structural budget balance

Year	Output-gap	Year	Structural budget balance
2000	-2,22	2000	-2,64
2001	-0,60	2001	-2,55
2002	-0,48	2002	-1,76
2003	-0,97	2003	-1,15

4 Romanian Fiscal Council, *2011 Yearly Report* – Macroeconomic and budgetary evolutions and perspectives, 2012, available online at www.consiliulfiscal.ro

2004	1,04	2004	-0,43
2005	-1,09	2005	0,62
2006	0,81	2006	-2,11
2007	2,17	2007	-3,73
2008	6,20	2008	-7,71
2009	-2,95	2009	-6,84
2010	-3,46	2010	-4,40
2011	-3,92	2011	-1,90
2012	-2,13	2012	-1,30
2013	-0,10	2013	-1,40
2014	2,35	2014	-1,80

Source: www.mf.ro

In 2009-2011, the structural budget deficit fell from 9.1% of GDP to 3.0%; the rate of adjustment of about 2 percentage points per year is very fast. At the same time, bear in mind that the starting level was high, that required rapid adoption of decisive measures to ensure the sustainability of fiscal policy.

All this has caused the need for large fiscal adjustments, which had started in 2009. Although the degree of freedom provided macroeconomic policy makers in Romania was reduced fiscal adjustment should be carefully considered rational and orderly communicated necessarily smart to be understood by the public.

4. Conclusions

To restore macroeconomic sustainability was and remains necessary fiscal consolidation effort, coupled with deep structural reforms to create conditions conducive to sustainable economic growth. Restructuring public expenditure and release of fiscal space for investment represent one major goal of government policy. Although in 2009-2010 have made great strides to correct fiscal policy - budgetary unsustainable pre-crisis, further efforts are needed to consolidate the reforms.

Fiscal adjustments, including large, reducing the budget deficit can be successful in reducing debt in GDP without causing a recession. It turned out that fiscal adjustments based on expenditure cuts are the most effective and the best chance of success.

To take our country has shown that it is necessary to create a fiscal space during expansion, so its use will help us in recession.

To immunize the economy against future shocks, Romania should promote a policy of sustainable growth by structural reforms in education, infrastructure development, health, and stimulating entrepreneurial spirit through massive investments in research and development, innovation and human capital.

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