

# THEORETICAL AND PRACTICAL APPROACHES TO FISCAL CONSOLIDATION - THE EXPERIENCE OF ROMANIA

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## Abstract

Fiscal consolidation is a traditional concern, we can say at the European institutional level, ratified and gradually taken over by the member countries, implemented through the Stability and Growth Pact, and enshrined in the Treaty of Maastricht, which is part of the permanent bailouts of national governments of the national and anchor budgeting of the European Union's fiscal policy. The importance of fiscal consolidation was strengthened with the manifestation of the effects of the financial and economic crisis started in 2008, through the strengthening and monitoring of fiscal discipline, being regulated by the European fiscal framework, to which Romania has also joined. The proposed approach on the issue of fiscal consolidation aims in the first part to present some theoretical and scientific fundamentals of this concept, and in the second part, the progress registered in Romania based on a set of specific indicators will be presented and evaluated. From a methodological point of view, the conceptual, logical, analytical and deductive approach will prevail. The results obtained can be a benchmark for assessing progress on fiscal consolidation and fiscal status at national level.

**Keywords:** fiscal consolidation, fiscal stance, fiscal framework, fiscal rules

**JEL Classification:** E61, E62, H62

## 1. Introduction

Concerns about the limitation of public budget balances and debt ratios of member countries at European level, justified by the need to monitor national fiscal policies to achieve and maintain

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quantitative and institutional coordination, have intensified at Community level, have materialized in providing the fiscal framework with more complex mechanisms of monitoring, constraint, control and sanctions.

Alongside the concerns and institutional developments in the field of community tax, the concerns in the sphere of knowledge and scientific exploration of this field, specialized literature, have also intensified, offering studies oriented on several directions.

The literature offers studies with general approaches to fiscal consolidation that address specific issues (Agnello, Caporale, and Sousa, 2016; Alesina, Favero, and Francesco, 2015), but also the concern to highlight local, regional and community experiences prior to the financial and economic crisis (Afonso, 2010; Afonso, Nickel and Rother, 2005) that may be useful to substantiate current decisions and also to design fiscal-budgetary strategies. It also seeks, from the point of view of completeness and effectiveness, the tools used in the fiscal consolidation process (OECD, 2010).

At national level, the issue of fiscal consolidation is indirectly addressed by addressing related issues such as the lack of fiscal discipline (Dumitru and Stanca, 2010), frequent adjustments to the tax strategy, the manifestation and role of automatic fiscal stabilizers (Dinga, 2009), and from the perspective of fiscal governance.

The diversity of approaches and the abundance of work dealing directly or indirectly with the theme of fiscal consolidation confirms that it is a topic of interest for both the research environment and the institutional environment, and the authorities responsible for implementing fiscal policy and, implicitly, fiscal consolidation. This effervescence manifested around fiscal consolidation creates prerequisites for the appropriateness / adjustment of factors and instruments for substantiation and rationality of government institutional interventions through fiscal policy.

With these references provided by the literature, the present paper seeks, in the first part, to point out some conceptual and theoretical aspects of fiscal consolidation, and in the second part, the results recorded in Romania in the fiscal consolidation process, through in terms of conceptual and theoretical aspects, government interventions and a set of nominal and real convergence criteria of a fiscal and budgetary nature.

## **2. Theoretical approach to fiscal consolidation**

In the process of governance of a country or community, of guiding the economy and of ensuring the sustainability of public finances, fiscal policy has a determining role given by its policy of adjustment. This character is generated by the traditional functions of the fiscal system: the financing function; the adjustment-stabilizing function of the economy, and the resource allocation function. Starting from these theoretical milestones on the role of taxation in the economy and society, we will theoretically tackle fiscal consolidation.

Fiscal consolidation occurs and manifests in particular through the capacity of the fiscal system, due to the existence of instruments / levers / means to stimulate or inhibit economic activity through the implementation of fiscal policy measures to mitigate economic cyclicity, governmental objectives of a quantitative nature, mainly but also qualitative, and / or economic constraints resulting from the ratification of Community / international treaties / agreements.

This process therefore seeks to achieve a quantitative goal based on intermediate objectives implemented through fiscal measures aimed at adjusting the size of tax revenues, budget expenditures (to narrow the gap between them) and, on this basis of reducing the size of government loans over a period of time.

Fiscal consolidation is currently considered a fiscal state to which it is aiming, and the achievement of this state is achieved on the basis of a desirable process that indirectly seeks to achieve economic convergence but, in particular, fiscal convergence within The European Union.

The desideratum of the fiscal consolidation process is, beyond the quantitative dimension of fiscal revenues and budget expenditures, the establishment of a (qualitative) discipline climate in the fiscal-budgetary process, starting from a good substantiation of the measures to be implemented, a good predicting anticipated results and avoiding frequent changes to tax rules embedded in specific codes. Fiscal discipline implies the transparency and even the public debate in the academic and university environments of the programs of measures promoted by the authorities and their passage through the institutional "filters" for the assessment of their consistency and convergence with the purpose of the fiscal consolidation, for the evaluation of the time horizon will be

implemented and will generate the anticipated effects for the possibility of implementing / designing signaling mechanisms and combating the potential fiscal and budgetary vulnerabilities generated by them.

An important aspect of the fiscal consolidation process is related to the administrative and institutional side, and the capacity to provide a favourable framework for fiscal consolidation by positively influencing behaviour in the economic sphere but also in the social sphere. An administrative and institutional apparatus with little capacity to create and support an optimal fiscal consolidation framework will alter the continuity and effectiveness of this process.

The impact of political decisions may also alter the process of fiscal consolidation, in the sense that they are not substantiated, but are geared to the political objectives / orientations of the governing party or to conjunctural issues (social, electoral, etc.). Such behaviours are present in most European countries, whereby mechanisms for limiting the impact of political decisions on the fiscal consolidation process have been introduced through the reform of the European fiscal framework. Generally speaking, these mechanisms aim at multi-annual planning of program-based budget expenditures, adoption of the fiscal responsibility law, additional constraints on budget deficit and public debt limits, and the creation of independent fiscal institutions at national level to monitor the fiscal and budgetary process, with an advisory role.

Summing up the issues outlined, we appreciate fiscal consolidation as a process of fiscal policy recovery by actions / measures aimed, in particular, at limiting the budget deficit, as well as acquiring good fiscal-budgetary discipline.

The assessment of the fiscal consolidation process is done by reporting the quantitative results, in terms of the budget balance, to the quantitative institutional set-up at the European level, implemented through the Stability and Growth Pact (SGP) and enshrined in the Maastricht Treaty (MT).

The general guideline for reaching this criterion is governed by the European fiscal framework, taken at national level, which aims at establishing fiscal policy co-ordinates applied by member countries in a given discipline and constraint on fiscal policies, expressed as fiscal indicators Budgeting.

Historically, the relative limitation and quantitative compliance of MT criteria, of a fiscal nature (the conventional budget deficit

account for at most 3% of GDP and the public debt to account for a maximum of 60% of GDP), proved to be insufficient to achieve the objective of tax discipline. On this background, there have been successive legal reforms of the fiscal framework that generally aimed to improve its effectiveness in consolidating fiscal positions through several objectives such as providing stronger economic bases to support the fiscal framework, increasing public debt, strengthening the mechanisms for implementing the fiscal framework and implementing more tax-friendly regulation.

This general tax framework is not a sure guarantee for completing the fiscal consolidation process, but is the starting point for each individual member state's "customization of the fiscal stance", its specificities, its history and economic present.

### **3. Practical aspects of fiscal consolidation - the experience of Romania**

The monitoring and evaluation of the fiscal consolidation process is mainly based on the criterion of the balance of the conventional budget of the general consolidated budget, in terms of GDP.

Also, a number of other indicators derived from the operations between the conventional accountant and the structural balance can contribute to the consistency of the tax consolidation process. In this context, our analysis aims to include in the assessment a structural balance, fiscal position and fiscal impulse. Beyond the consistency or inconsistency of the fiscal consolidation process, these derived indicators can provide useful insight into the nature of fiscal consolidation measures, and in particular the fiscal nature of policy in general.

The conventional balance sheet budget balance indicator shows the general government deficit / surplus, based on the actual consolidated nominal consolidated general government data, excluding any revenue and / or expense categories.

The evolution of this indicator from the accession of Romania to the EU and until 2017, presented in figure 1, recorded a oscillating evolution following a cyclical trajectory. In the period 2008 - 2012, against the background of the reduced effectiveness of the fiscal framework implemented through the SGP, but also of the negative

manifestation of the effects of the economic and financial crisis, the limit set in the TM was marked by this indicator.

The effects of legislative changes taken over at national level and the prudence of tax authorities (post-crisis) have generated relatively immediate effects of adjusting the conventional balance, which is within the limits of MT, starting in 2013, which remains at the end of 2017.

A useful concept to support the nominal convergence criteria of a fiscal nature is the cyclically adjusted budget balance by which, from the conventional accounting budget balance, the economic activity fluctuations reflected in the variation of the revenues and the budgetary expenditures are eliminated. In practice and macroeconomic language, the name of structural balance is more commonly used, being associated with the structure of tax structures and budget expenditures.

Its phased calculation methodology, starting from the estimation of the actual GDP between GDP and the potential GDP, continuing with the estimation of the cyclical component based on the output gap and the deficit sensitivity and, finally, with the actual estimation of the structural component by removing the conventional balance accounting for the cyclical component, is useful for accurately assessing the budgetary and revenue targets, for a more specific assessment of the fiscal policy (expansionist or contractionist) and for providing information on the degree of economic stability.

Following the evolution of the structural balance over the whole period presented in figure 1, it is observed that it followed a cyclical trajectory, respectively the increase in the period 2006 - 2009, reduction in the period 2010-2015 and growth, starting with 2016.

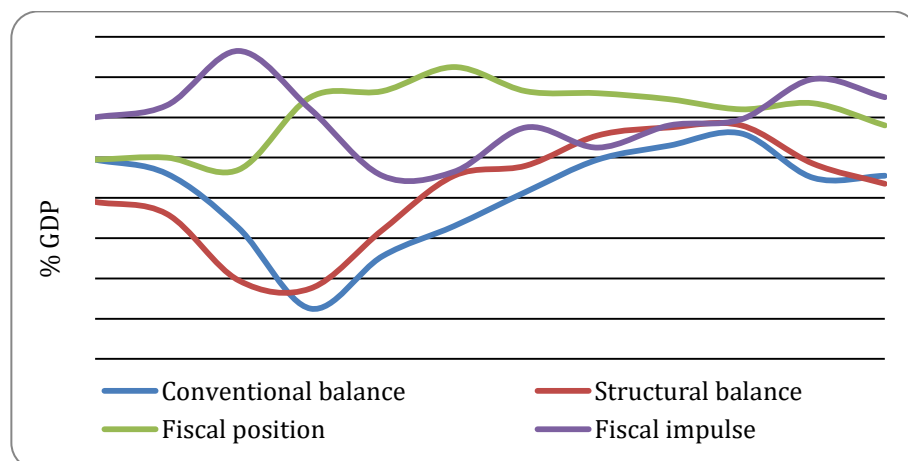
Between 2011 and 2015, a period corresponding to the expansion of the economic cycle, as well as the consolidation of the structural balance, there were changes in the European fiscal framework, changes taking over Romania. Their implementation has created a mechanism for pursuing the consolidation, supervision and coordination of fiscal policy with a view to enhancing fiscal discipline.

The lack of these normative, even coercive, mechanisms regarding the structural balance in the first part of the analysed period led to a certain relaxation of the tax authorities regarding its evolution, but with their taking over in particular the requirement of a level of the structural balance and its convergence with the MTO, the level of the

structural balance has become a priority for the tax authorities. Against this background, it is noted that, from 2013 onwards, the structural balance reached the MTO target (-1%) faster than the target planning, which was maintained in 2014 and 2015. Moreover, synchronization is observed regarding the observance of the 3% of GDP limit of the conventional balance (the effect of the structural balance of "safety" on the limit of the conventional balance). This trend was supported by the economic growth recorded in that period (around 3% in 2014 and 4% in 2015), the increase in the level of tax revenue collection and the reduction of public investment expenditure, in particular in 2013 and 2014.

Since 2016, the structural balance has come out of the MTO target, in the light of the above-mentioned economic growth, expectations of the expansion of tax bases and potential tax multiplier effects, government authorities have implemented fiscal relaxation measures (reducing the share of CSS, the share of VAT) and the increase in budget expenditures (increase in wages in the public domain), measures that negatively affected the two budget balances (structural and conventional accounting).

**Figure 1**  
**The evolution of the structural balance, the conventional balance, the fiscal position and the fiscal impulse (% of GDP) during 2006-2017**



Source: Processed by the author based on the data in Appendix.

The fiscal position is an indicator showing the gap between the structural balance and the conventional balance, ie the current positioning of the conventional book balance against the potential benchmark. The usefulness of the information provided by this indicator refers to the type of fiscal policy that operates in an economy, from the point of view of the stabilization function of the economy. A positive value of the fiscal position indicator indicates a pro-cyclical fiscal policy, while a negative figure indicates an anti-cyclical fiscal policy.

Following the evolution of the fiscal position, during the reference period, presented in figure 1, it is noted that in the Romanian economy between 2009 and 2016 there was a procyclical fiscal policy, and in the period between 2006 and 2008 and in 2017 an anti-cyclical policy functioned. The pro-cyclical fiscal policy was more pronounced, according to the evolution of the fiscal position, between 2009 and 2013, after which, due to the constraints of the fiscal framework, the pro-cyclicality of the fiscal policy was moderate.

Another derived indicator is the fiscal impulse that shows the discretionary nature of fiscal policy and how it contributes to stimulating or inhibiting the economy. The fiscal impulse can be measured as a difference in the structural balance for two consecutive years or at two different times. A positive fiscal impulse indicates an expansionary fiscal policy, while a negative fiscal impulse suggests promoting a restrictive fiscal policy.

Following the evolution of the fiscal impulse in the reference period, presented in figure 1, it is observed that the fiscal policy has manifested oscillating tendencies of expansion and restrictiveness. The fiscal policy stance given by the information provided by the fiscal impulse indicator indicates that fiscal policy, in terms of stimulating / inhibiting economic processes, has been restrictive in the period of the economic and financial crisis (2007-2011) and expansionary since 2012.

The graphical representation of the four indicators in figure 1, which we consider to be a "scoreboard" of the progress made in the fiscal consolidation process, reveals at the same time that the fiscal-budgetary policy after a period of instability (2007-2012), characterized by excessive deficits, pro-cyclicality and restrictiveness, has generated a consolidation process from 2013 until 2016, with significant progress on budget balances, both the conventional and the structural balances were within the limits, but also in line with its



adjustment function macroeconomic, showing both anticyclical and expansionist tendencies. At the same time, the end of 2017 signals the tendency to deviate fiscal and budgetary indicators, especially balances, from the agreed targets.

#### **4. Conclusions**

In view of its purpose, fiscal consolidation aims at maintaining the conventional budget balance within predefined limits, both during economic and recession periods, in order to reduce government debt in the medium term and to establish a climate of fiscal discipline medium and long term.

The analysis revealed a general lack of stability in the evolution of the main indicator of the assessment of the fiscal consolidation process - the conventional budget balance - but also in the evolution of those derived from it, which means that there are certain vulnerabilities in the fiscal consolidation process.

A possible vulnerability arises from the composition of the measures implemented in the fiscal consolidation process, in which discretionary decisions are prevalent, less the elements of automatic fiscal stabilization.

The discretionary decisions, which have wide impact and effects, relatively immediate, but are generally weakly oriented and oriented, in particular, towards the increase of wage and social expenses, to the detriment of the investment ones, which, by their multiplier effect, will generate the expansion / consolidation of tax bases. Automatic stabilization elements integrated into the system of levy and public spending can generate slower action without creating vulnerabilities-generating shocks.

Another source of vulnerability is the relatively negligible, at the level of the tax-budgetary authorities, of the signals given both by the autochthonous independent tax organization and by the European bodies regarding a certain inconsistency of the governmental actions in the field of fiscal policy, in particular, with fiscal consolidation objectives (budget balances, relatively inadequate fiscal measures, etc.)

The progress obtained by Romania in the fiscal consolidation process is relatively inconsistent and lacking continuity and sustainability, and it is necessary to implement measures to strengthen fiscal discipline, to empower tax authorities in allocating

public resources, to education, to investment projects with multiplying effects tax and corruption mitigation in the sphere of public funds.

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## APPENDIX

**Table 1**  
**The evolution of the conventional budget balance, the structural balance, the fiscal position and the fiscal impulse in Romania, between 2006 and 2017 (% of GDP)**

Year	Conventional balance	Structural balance	Fiscal position	Fiscal impulse
2006	-2,1	-4,2	-2,1	
2007	-2,8	-4,8	-2	0,6
2008	-5,5	-8,1	-2,6	3,3
2009	-9,5	-8,5	1	0,4
2010	-6,9	-5,6	1,3	-2,9
2011	-5,4	-2,9	2,5	-2,7
2012	-3,7	-2,4	1,3	-0,5
2013	-2,1	-0,9	1,2	-1,5
2014	-1,4	-0,5	0,9	-0,4
2015	-0,8	-0,4	0,4	-0,1
2016	-3	-2,3	0,7	1,9
2017	-2,9	-3,3	-0,4	1

Source: -conventional balance:

[http://ec.europa.eu/economy\\_finance/ameco/user/serie/SelectSerie.cfm](http://ec.europa.eu/economy_finance/ameco/user/serie/SelectSerie.cfm)

- structural balance

[http://ec.europa.eu/economy\\_finance/ameco/user/serie/ResultSerie.cfm](http://ec.europa.eu/economy_finance/ameco/user/serie/ResultSerie.cfm). (2010-2017) and the Fiscal Council for the period 2006-2009

- fiscal position and fiscal impulse, calculations of the author, according to the methodology described in the paper.