

The impact of Fiscal Stability Pact on Fiscal consolidation in Romania

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Abstract

In 2012 many states are facing a crisis of public debt and high deficits and challenges resumption of economic growth. In Europe, efforts are made to achieve and maintain the deficit targets set by international organizations. In 2011, most EU Member States received recommendations from the ECOFIN to take action and cut the deficit below 3% by the deadlines set for each country, starting in 2011 and ending in 2015.

Keywords: Fiscal Stability Pact, fiscal deficit, fiscal harmonization, the Community acquis

Introduction

The tax reform in Romania has been a lengthy and complex process which involved carrying out multiple targets to reduce imbalances in the national economy.

The tax system was influenced primarily by the transition from a planned economy to a market economy. This action required significant financial and material resources. In the recent years, the challenge that Romania had to bear was to adapt to the membership of the European Union namely compliance with strict rules imposed on the tax system. The entire Romanian society had to go through many transformations in the desire of socio-economic development especially due to the demands of citizens to be European citizens with the same rights and principles applied in the Member States and a decent standard of living.

Material and Methods

This study presents the evolution and involution of the State Budget of Romania as a result of the integration of this country into the European Union.

In the proposed research, the most useful and popular method used is the comparative data analysis which is performed both, in theory and in practice.

When we performed this comparative analysis we used the data source from the account of the state budget for 2006-2010. Based on these documents we performed several tables aimed towards facilitating the analysis and comparison of data and the extraction of conclusions that reflect the influence of integration into the European Union on the state budget and also the process of social-economic development in Romania.

Literature review

In taxation, Romania faced many difficulties regarding the implementation of the *acquis*, transposition of directives and regulations imposed by the European Union, as it said in this context provided from the work of I. Condor, in which the tax file is undoubtedly one of the most difficult issues in the negotiation of harmonizing Romanian legislation in the European Union¹.

Acquis is defined by T. G. Savu as "the communitarian *acquis*" which means all the legal rules governing the European Union institutions work, actions and policies, which are:

- the content, principles and political objectives contained in the original Treaties of the European Communities and in the future (the Single European Act, the Maastricht Treaty and the Treaty of Amsterdam);
- legislation adopted by the EU institutions for the implementation of treaties (regulations, directives, decisions, opinions and recommendations);
- Court of Justice of the European Communities;
- declarations and resolutions adopted by the European Union;

¹ Condor, I., Tax reform, harmonized with EU requirements, *Economic Truth*, no. 47 (555), 2002, page 17

- joint actions, joint positions, conventions signed, resolutions, statements and other documents adopted within the Common Foreign and Security Policy and Cooperation in Justice and Home Affairs;

- international agreements to which the Community is a party, while the EU still lacks legal personality and those concluded between Member States of the European Union with regard to its work².

Tax reform in Romania is the result of changes in the Romanian economy, changes that caused an adaptation of the tax system to create mechanisms and tools to ensure the financial resources of the state constitution and framework by which they are managed and used to achieve savings as effective. Objectives of maintaining growth and thus tax reform were to:

- Support the convergence process of the Romanian economy in the European economy;
- Promotion of harmonized taxation of market mechanisms;
- Accelerating the process of fiscal decentralization in the collection and allocation of public resources;
- Thorough reform of tax administration in order to improve the collection of tax liabilities;
- Require all categories of taxpayers and all forms of income;
- Increased capacity to absorb structural funds post-accession;
- Reduction in administration costs of taxes;
- Increase transparency of public expenditure;
- Establishing government deficit at a level correlated with the requirements of international organizations;
- Further harmonization of fiscal and budgetary legislation with EU.

These objectives have been captured in the book of C. Tulai (2005), "Comparative Taxation and tax harmonization."

Results and discussion

"Stability and Growth Pact (SGP) is a regulatory framework for the coordination of national fiscal policies in the Economic and Monetary Union (EMU). The pact was designed to ensure the stability of public finances, an important requirement for the proper functioning

² Savu, T.G., Company and the acquis communautaire, Tribune Publishing House, Bucharest, 2001, page 22

of EMU. This pact includes a preventive component and a corrective component³.

Under the provisions of the preventive arm Member States must submit annual stability programs (convergence) showing how they intend to achieve or ensure stable fiscal position over an medium term, taking into account the immediate impact that aging will have on the budget. These programs are assessed by the Commission and the Council shall advise each. The preventive includes two policy instruments that can be used to avoid "excessive" deficits. Based on a proposal from the Commission, the Council may bring proceedings early warning to prevent an excessive deficit. Through early warning system, the Commission may recommend a Member State to comply with the Stability and Growth Pact requirements.

Corrective arm of the Pact governs the excessive deficit procedure (EDP). This is triggered when the deficit exceeds 3% of GDP threshold of the Treaty. If it is concluded that the deficit is excessive under the Treaty, the Council issued recommendations to the Member States concerned to correct the excessive deficit and set a deadline for this. Failure leads to triggering the next steps in the procedure, including the possibility of sanctioning the euro area in Member States.

The document whose final form was agreed at the informal European Council on 30 January 2012, establishes the structural deficit threshold limit of 0.5%. If public debt is significantly below 60% of GDP and there is no risk of long-term sustainability of public finances, the structural deficit may reach 1% of GDP. Budget deficit plus the maximum cyclic structure will fall within 3% of GDP. Great Britain and the Czech Republic have signed the treaty.

According to the Treaty, if there is a deviation from these levels it will automatically trigger a correction mechanism to be introduced into national law, as so-called "golden rule", to limit the structural deficit. If a Member State does not implement these two provisions, the national law may be brought before the Court of Justice of the European Union. Failure to comply with this court decision may result in a financial penalty of up to 0.1% of the GDP of that country.

"The European fiscal pact requires a commitment from the participating States to a: sound fiscal governance, introducing provisions for balancing the budget in the Constitution, strengthening

³ www.ec.europa.eu

rules on excessive deficit procedure through automation sanctions and the European Commission budget submissions for review"⁴.

Romania signed the Treaty of fiscal governance on 28 February 2012, in Bucharest.

The chances of implementation of fiscal governances depended on finding ways to increase revenues and expenditures rationalization and to avoid an excessive deficit. In this sense, a retrospective analysis of budget execution and recorded deficit is indispensable.

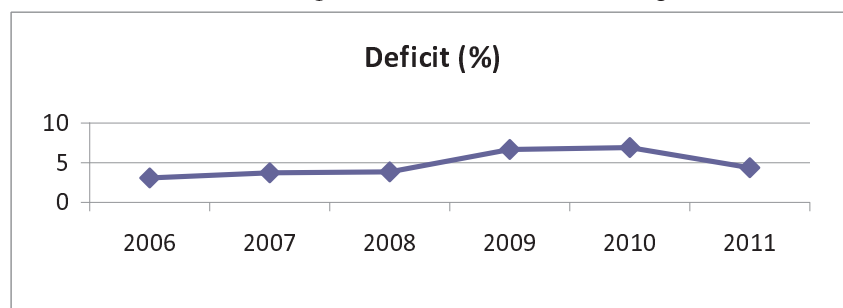
For Romania, the budget deficit in 2010 was -6.9% of GDP, in 2011 was -4.35% of GDP, according to data issued by the Ministry of Finance. Tax reforms implemented in 2011 in the most EU Member States focused on increasing revenues, while they are accompanied by efforts to strengthen spending.

Table 1. Romania's budget deficit between 2006 and 2011

	2006	2007	2008	2009	2010	2011
	(million lei)					
EXCEDENT(+), DEFICIT (-)	-10537,5	-15388,9	-19735,4	-33416,9	-36081,3	-25167,1
GDP	344650,6	416006,8	514700	501139,4	522561,1	578551,9
Deficit (%)	-3,06	-3,7	-3,83	-6,67	-6,9	-4,35

Source: National Institute of Statistics

Chart 1. Romania's budget deficit evolution in the period 2006-2011



Source: made by author based on data from Table 1

⁴http://www.adevarul.ro/international/Liderii-UE-semnat-stabilitate-fiscal_0_656334474.html

The chart above is a tendency to increase Romania's budget deficit with EU integration. The sharpest increase occurs in 2009-2010 when it comes to values close to 7%, followed later by a decline around 4% in 2011.

In the data from Table nr. 2, we can see that in 2006, when Romania was not yet an EU member State, the budget received a total revenue of 40,698.1 million lei, minus expenses amounted to 51,235,600,000 lei. As can be seen in Table no. 1, at the end of 2010, Romania registered a deficit of 36,081,300,000 lei.

Table 2. The income statement in Romania between 2006 and 2010

(million lei)	2006	2007	2008	2009	2010
Total income	40698,1	48984,6	61151	56434,8	66546,5
Total expenditures	51235,6	64373,5	80886,4	89851,7	102627,8

Source: National Institute of Statistics (<http://www.insse.ro>)

The year 2007 draws a series of events seemingly favorable but don't show the amazing expected outcome of entrepreneurs and economists in Romania. This opinion is observed in Table 1 as a considerable increase over the previous year budget deficit of EU integration.

Conclusion

The general trend in the EU is to reduce the level of direct taxation and moving the tax burden towards indirect taxes. In the years 2010-2011, this trend is less clear, most states maintaining constant tax rates. So, pace of tax rates decreased to pre-crisis when countries were in a stronger competition on providing an attractive investment environment, purely fiscal. However, countries such as the Czech Republic, Hungary, Lithuania, Great Britain, Greece had reduced their tax rates. Czech reduced tax rate in 2010 from 20% to 19%, Greece has decided to reduce the standard rate of corporation tax from 25% to 24% in 2010 and 20% in 2011 and Great Britain decided to reduce the standard rate of corporation tax in 2011 from 28% to 27% and to reduce the tax rate from 21% to 20%. Countries like Lithuania, the Netherlands, Germany took measures as restricting the tax base.

In case of the income tax and the social contributions, Romania remained with a flat income tax (16%) and the introduction of social

security regulations to the Tax Code in 2011 and of the taxation on income residents beginning from the 1st January 2012. In the tax administration there had been done some unification statements, single statement on social contributions and cancellation penalties and delay penalties for unpaid tax in 2011, under certain conditions.

Following the signing of the EU accession treaty, Romania had to respect and implement several provisions that would affect the state budget and the local budgets. At 1st January 2007, following the application of the right to free movement of goods, persons and services and the abolition of customs duties for all members of the European community, in terms of foregone import and export within the EU, were adopted the concepts of intra-Community acquisition or delivery. In other words, since 2007, Romania lost revenues to the State budget revenues assigned duties to the detriment of the EU's own resources or so-called financial aid U.E.

Therefore, from a financial standpoint, at least initially, the impact of EU integration was negative for the Romanian national budget.

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