Budget Deficit - An Overview

Costinela Forțea
Ioana Lăzărescu
Viorica Ioan
"Dunărea de Jos" University of Galati,
Faculty of Economics and Business Administration, Romania
costinela.fortea@yahoo.com
ioana.lupasc22@yahoo.com
ioan_viorica@yahoo.co.uk

Abstract

Currently, knowledge and concern for reducing the budget deficit are still of great importance, especially as Romania is facing great difficulties in economic developments. This paper aims to provide an overview of the budget deficit in the European Union and in Romania. At the same time, this paper makes a brief assessment of the situation in which our country is in this period.

Key words: public budget, budget deficit, incomes, economic activity
J.E.L. classification: H60, H61, H62, H30

1. Introduction

The economic approach of the budget concept emphasizes macroeconomic correlations and the link with the level and evolution of gross domestic product. In modern theory, the budget is considered an essential variable in determining the gross domestic product and the level of resource use.

Fiscal governance capacity is high when it ensures the provision of a sufficient volume of revenue from the budget to avoid public debt problems and to finance public goods that are essential for social and economic development.

2. Literature review

Economist Paul Krugman referred to the budget deficit as one of the greatest inventions in finance, being an important basis for future development. Robert Eisner, a Keynesian economist, said that the budget deficit is like a sin, often perceived as morally wrong and extremely difficult to avoid.

The size of the public budget deficit is greatly influenced by the phases of the economic cycle.

In the conditions in which the revenues of the state budget are exceeded by the expenditures of the budget, to balance the budget, public debt is increased (Călinică R.M., 2019).

Meanwhile, the perspective on these issues has changed, and in the modern school conception it is wrong to look only at the budget deficit effects, this being only a piece of a larger, more comprehensive picture of how the government chooses to raise and spend funds. Mankiw (2008, p. 536) considers that the single concern about the budget deficit is dangerous because it diverts attention from various other policies that redistribute revenue between generations.

Mankiw (2008, p. 537) expresses an interesting opinion on the budget deficit and debt, as critics of the budget deficit argue that government debt cannot continue to grow indefinitely, but in fact it can, due to the population increase and the technological process, causes an increase in the economy over time. As a result, the state's ability to pay interest on government debt also increases.

Liebermann and Hall (2010, p. 736) share the same opinion, namely what worries a lot of people about the increase of public debt is the feeling that one day we will have to pay it all. But even if we can choose to pay it all at once, we do not have to. Never. In their view there is nothing wrong for it to grow every year.

Economic theory shows that if the government tries to balance its budget in a period of recession, it will have to increase taxes or reduce its spending, but such a policy will tend to reduce demand exactly when it is needed, be stimulated thereby improving the magnitude of economic fluctuations (Mankiw, 2008, p. 535). Stiglitz (2006, p.128) has a similar view, considering that states should not counteract the increase in the deficit by increasing the level of taxes and duties.

Other authors address the problem of budget deficit in terms of getting closer to the poverty line and the trap of the dependence of national economies on transactions with neighboring countries, quantifying disadvantaged economic flows through the waste of public reserves on imports of high added value goods and services that weaken national economies and grow the degree of poverty (Menuet, Minea and Villieu, 2018).

The balance between public revenues and expenditures reflected in GDP is the source of sustainable economic growth, given that any debt has associated additional costs that once matured reveal the economic growth (Del Negro, Giannoni and Schorfheide, 2015; Westerhout and Beetsma, 2019).

Legally, the state budget is a law, a normative act with a predictive and obligatory character, which authorizes and provides for the state's revenues and expenses, for a period of one year. The state budget reflects the financial, economic and social policy options of the state, regarding a duration of one year (Oprișan O., 2019).

The main theories on the budget deficit are Ricardo's Theory on the budget deficit, The neoclassical Theory of the budget deficit and Keynes's Theory on the budget deficit.

Nowadays, most economists believe that the deficit should be addressed as part of the countercyclical fiscal policy, but that it should not be a structural or a permanent deficit.

3. Research methodology

The research methodology is largely based on statistical data made public by Eurostat and the Organization for Economic Co-operation and Development (OECD). The purpose of this paper is to provide insight regarding the budget deficit in the European Union and in Romania. Therefore, this work is a combination of a meta-study approach and descriptive statistics.

4. Findings

4.1. The budget deficit at the European Union level

The budget deficit problem concerns not only political but also economic issues, such as the equitable redistribution of social goods and the distribution of resources between generations. It is not admissible. It is not permissible for a generation to take on excessive risks caused by previous generations. However, the equity of the budget deficit distribution between generations depends on the fiscal system and the state expenditure system.

There are four convergence criteria according to the Treaty of the European Union Functioning, art. 140, paragraph 1 (Treaty of the European Union Functioning, available at https://eur-lex.europa.eu/legal-content/ro/TXT/?uri=CELEX:12012E/TXT):

- achieving a high degree of price stability, it results from an inflation rate close to the rate of up to three Member States with the best results in terms of price stability;
- the soundness of public finances, it results from a budgetary situation that does not have an excessive public deficit;
- compliance with the normal fluctuation limits provided for by the exchange rate mechanism of the European Monetary System for at least two years without devaluing the currency in relation to euro;

- the sustainable nature of the convergence achieved by the Member State subject to a derogation and its participation in the exchange rate mechanism, which is reflected in the level of long-term interest rates.

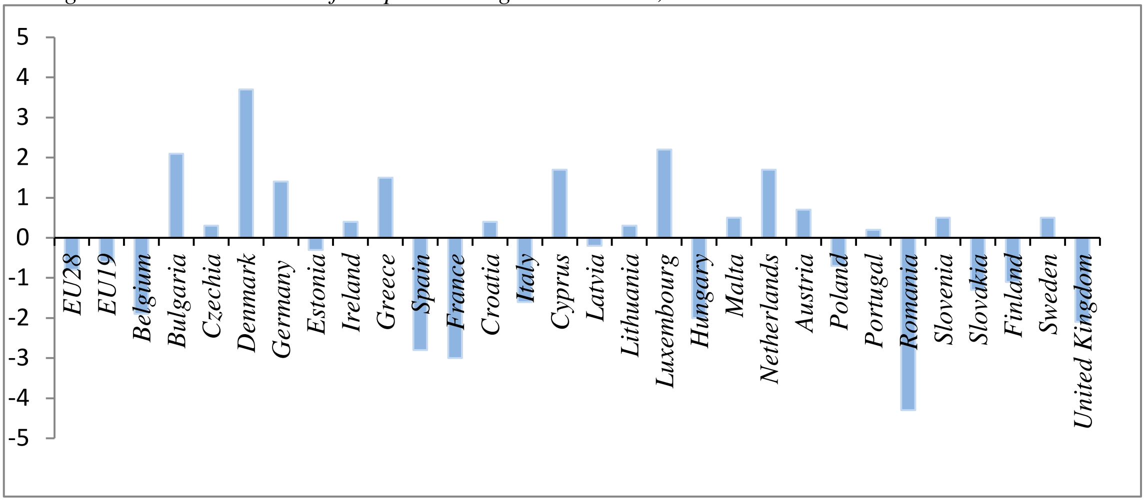
Table no. 1. The balance of the public budget at EU level, period 2009-2019 (% of GDP)

Year **Area/Country**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
EU28	-4.6	-4.3	-3.3	-2.9	-2.4	-1.7	-1	-0.7	-0,8
Belgium	-4.3	-4.3	-3.1	-3.1	-2.4	-2.4	-0.7	-0.7	-1.9
Bulgaria	-2	-0.3	-0.4	-5.4	-1.7	0.1	1.1	1.8	2.1
Czechia	-2.7	-3.9	-1.2	-2.1	-0.6	0.7	1.6	1.1	0.3
Denmark	-2.1	-3.5	-1.2	1.1	-1.2	0.2	1.7	0.8	3.7
Germany	-0.9	0	0	0.6	0.9	1.2	1.2	1.9	1.4
Estonia	1.1	-0.3	0.2	0.7	0.1	-0.5	-0.8	-0.6	-0.3
Ireland	-12.8	-8.1	-6.2	-3.6	-1.9	-0.7	-0.3	0.1	0.4
Greece	-10.3	-8.9	-13.2	-3.6	-5.6	0.5	0.7	1	1.5
Spain	-9.7	-10.7	-7	-5.9	-5.2	-4.3	-3	-2.5	-2.8
France	-5.2	-5	-4.1	-3.9	-3.6	-3.5	-2.8	-2.5	-3
Croatia	-7.9	-5.4	-5.3	-5.3	-3.3	-1.1	0.8	0.3	0.4
Italy	-3.6	-2.9	-2.9	-3	-2.6	-2.4	-2.4	-2.2	-1.6
Cyprus	-5.7	-5.6	-5.8	-8.7	-1	0.1	1.7	-4.4	1.7
Latvia	-4.2	-1.2	-1.2	-1.4	-1.4	0.1	-0.5	-0.7	-0.2
Lithuania	-9	-3.1	-2.6	-0.6	-0.3	0.2	0.5	0.6	0.3
Luxembourg	0.5	0.3	1	1.3	1.4	1.8	1.4	2.7	2.2
Hungary	-5.2	-2.3	-2.5	-2.8	-2	-1.8	-2.4	-2.3	-2
Malta	-2.4	-3.5	-2.4	-1.7	-1	0.9	3.4	1.9	0.5
Netherland	-4.4	-3.9	-2.9	-2.2	-2	0	1.3	1.5	1.7
Austria	-2.6	-2.2	-2	-2.7	-1	-1.5	-0.7	0.2	0.7
Poland	-4.9	-3.7	-4.2	-3.6	-2.6	-2.4	-1.5	-0.2	-0.7
Portugal	-7.7	-6.2	-5.1	-7.4	-4.4	-1.9	-3	-0.4	0.2
Romania	-5.4	-3.7	-2.1	-1.2	-0.6	-2.6	-2.6	-3	-4.3
Slovenia	-6.6	-4	-14.6	-5.5	-2.8	-1.9	0	0.8	0.5
Slovakia	-4.5	-4.4	-2.9	-3.1	-2.7	-2.5	-1	-1.1	-1.3
Finland	-1	-2.2	-2.5	-3	-2.4	-1.7	-0.7	-0.8	-1.1
Sweden	-0.2	-1	-1.4	-1.5	0	1	1.4	0.8	0.5
United Kingdom	-7.5	-8.2	-5.5	-5.6	-4.6	-3.4	-2.4	-2.3	-2.1

Source: Made by the authors, according to Eurostat data

The evolution of the public budget balance at the level of the European Union, in 2019, is highlighted graphically.

Figure no.1. The balance of the public budget at EU level, in 2019



Source: Made by the authors, according to Eurostat data

According to *Figure 1*, the share of public deficit in GDP in the EU28 decreased from -1% in 2017 to -0.6% in 2018. In 2018, 13 countries in the European Union recorded a public surplus: Luxembourg (2,4%), Bulgaria and Malta (both 2%), Germany (1.7%), the Netherlands (1.5%), Greece (1.1%), the Czech Republic and Sweden (both 0.9%) , Lithuania and Slovenia (both 0.7%), Denmark (0.5%), Croatia (0.2%) and Austria (0.1%). 12 Member States of the European Union, recorded in 2018 deficits below 3.0% of GDP, namely Belgium, Estonia, Spain, France, Italy, Latvia, Hungary, Poland, Portugal, Slovakia, Finland and the United Kingdom. Two Member States had deficits greater than or equal to 3% of GDP: Cyprus (-4.8%) and Romania (-3.0%).

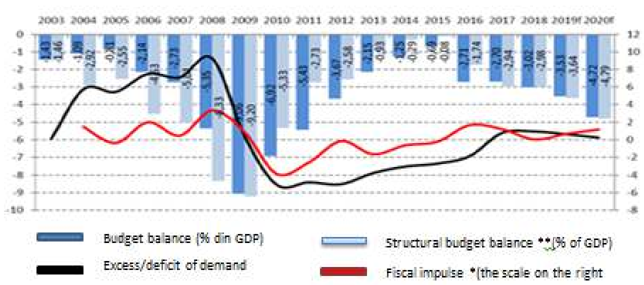
4.2. The budget deficit in Romania

In Romania, economic activity continued its upward trend in 2018, but the growth rate slowed compared to 2017. This economic growth was accompanied by significant fluctuations in inflation and a significant deepening of the current account deficit.

Fiscal-budgetary policy in 2018 continued to deviate from the medium-term objective, the budget deficit expressed as a share in GDP according to the European System of National and Regional Accounts 2010 (ESA 2010) being slightly above the initial target level, but very close to the 3% threshold, while deficit targets expressed in nominal terms, both according to cash standards and according to ESA 2010 have been exceeded. In 2018 the structural deficit deepened compared to the previous year, respectively to 2.98% of GDP compared to 2.94% of GDP in the previous year.

Despite the marked structural budget balance that better reflects the tax position of an economy presents several disadvantages, most notably related to uncertainty in its estimation. Thus, the value of the structural balance is dependent on the level of the output gap, which in turn is dependent on potential GDP, an unobservable size which is often subject to significant revisions.

Figure no.2. Structural deficit, fiscal momentum and excess demand

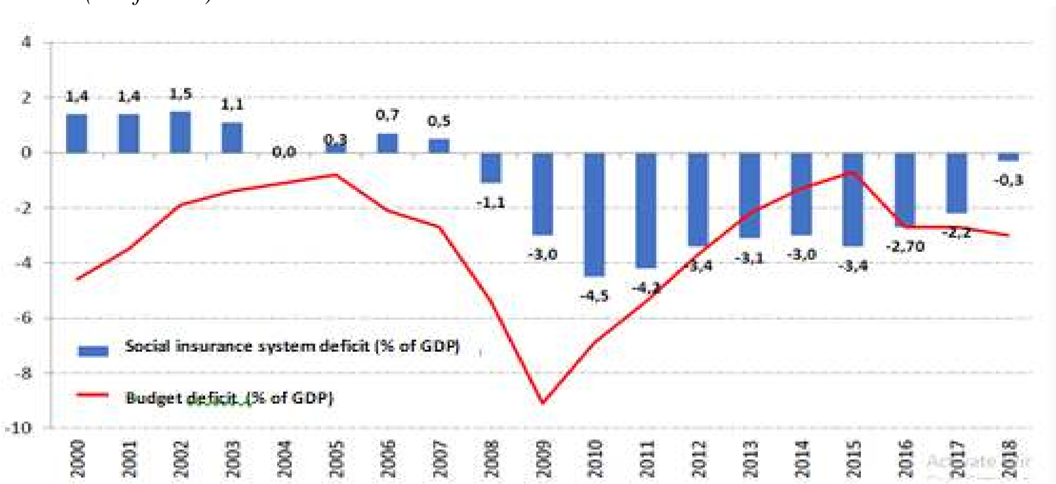


Source: Annual Report of the Fiscal Council in Romania 2018

Tax collection efficiency index decreased for direct taxes paid by the population has stagnated for VAT but recorded positive developments for direct taxes paid by businesses. The results obtained were partially affected by the incidence of discretionary fiscal policy measures.

In *Figure no.3* the evolution of the social insurance budgets balance (pensions, unemployment and health) is analyzed, in the period 2000-2007 social insurance budgets were characterized by a relatively balanced balance even in surplus, and after 2008 they passed on deficit, representing an important component of deficit total, respectively between 64% and 81% in the period 2010-2017. In 2018, the deficit of social insurance systems decreased considerably, reaching 10% of the total budget deficit.

Figure no.3. Social security budget deficit (pensions, unemployment and health) and total budget deficit - ESA 2010 (% of GDP)



Source: Annual Report of the Fiscal Council in Romania 2018

Table no.2. Incomes, expenses and deficit of the general consolidated budget, 2017-2019

Year	UM	Incomes	Expenses	Deficit
2017	Mil.lei	254,717	278,817	-24,100
2018	Mil. lei	287,528	314,487	-26,960
2019	Bil. lei	342,675	370,924	-28,249

Source: Made by the authors, according to the Ministry of Public Finance

Table no.3. Quarterly distribution of incomes, expenditures and deficit of the general consolidated budget for 2020

Period	UM	Incomes	Expenses	Deficit
Trim. I	Mil.lei	72,711	99,284	-26,572
Trim.II	Mil. lei	81,150	112,895	-31,745
Trim III	Mil. lei	87,966	99,357	-11,390
Trim. IV	Mil. lei	99,272	102,065	-2,793

Source: Made by the authors, according to the Ministry of Public Finance

In *Table no.2* we presented the revenues, expenditures and the deficit of the general consolidated budget, in the period 2017-2019. Regarding the incomes, there was an evolution as follows: they increased by 12.88% in 2018 compared to 2017, they increased by 19.17 % in 2019 compared to 2018. Expenses increased by 12.79% in 2018 compared to 2017, and in 2019 increased by 17.94% compared to 2018. The deficit in 2017-2019 recorded the values: -24,100 in 2017, -26,960 in 2018, -28,249 in 2019.

In *Table no.3* we presented the quarterly distribution of incomes, expenses and deficit of the general consolidated budget for 2020. In Quarter. IV there is a significant increase of incomes by 12.85% compared to Quarter. III, and the expenditure increased by 2.72% in Quarter. IV compared to Quarter. III.

4.3. The economic, financial and budgetary impact generated by the COVID-19 effects on Romania

Romania's economy will be strongly affected by restrictive measures in the context of pandemic coronavirus (European Semester- 2020 Country Report Romania 2020).

According *European Economic Forecast Spring 2020,* at the onset of the COVID-19 crisis Romania's economy was growing at an annual rate of around 4%, mainly driven by private consumption. However, signs of macro-economic imbalances had already emerged, notably in the form of high and growing current account and fiscal deficits.

The Romanian economy evolution is similar to that at European level against the background of negative developments as a result of the measures that had to be implemented in the context of the pandemic coronavirus, restrictive measures that led to the closure of European economies.

The pandemic shock is unparalleled in contemporary history and poses a huge challenge to governments and medical systems to save lives. This requires an exemplary mobilization of resources with a large impact on economic policies, on public budgets. The current crisis is multiple, its components interfering: a health component caused by the pandemic, a social one and an economic crisis that manifests itself, both on the demand and supply side, which also has a reliable aspect. We can identify at least four main mechanisms for transmitting the effects of the economic crisis (Fiscal Council opinion on the draft rectification of the consolidated general budget for 2020, available at http://www.consiliulfiscal.ro/Opinie%20Rectificare%20I%202020.pdf): the imposition of measures related to the exceptional situation leads to an internal shock on aggregate demand but also to a shock on aggregate supply, a transmission of negative trade dynamics / shocks, and the world economy in general, on national economies, and in some countries , there could be an increase in shocks in the relationship between the real economy and the financial sector.

High levels of budget deficits exert pressure on funding possibilities in the context of access to resources in foreign markets is becoming increasingly problematic - especially emerging economies. According to the Fiscal Council estimates, Romania's financing needs increase from about 8.6% of GDP in 2019, to levels between 11% and 14.3% of GDP depending on the scenarios considered in 2020, respectively between 119, 5 billion lei and 144.3 billion lei. Although fiscal rules have been temporarily suspended in the EU, covering such financing needs poses great challenges for Romania, arising from the limited debt absorption capacity of the internal market, uncertainties about the availability of financing on foreign markets.

5. Conclusions

The budget deficit has now become a common phenomenon in many countries against the background of the amplification of public expenditures.

In the current conditions of economic activity, in which the need for financial resources is greater than the existing funds, the elaboration of budgets at any level is one of the primary problems, especially as regards the principle of budgetary balance. In most cases, the budget balance is not automatically achieved by covering budget expenditures with budget revenues. In this case it can be said that the budget is elaborated with a financing deficit.

6. References

- Baumol, W.J. şi Blinder, A.S., 2009. *Economics. Principles and Policy*, ediţia a 11-a, South-Western: Cengage Learning.
- Călinică R.M., 2019. Analysis of the Dynamics and Structure of Romanian Public Debt in the Period 2007-2017. *International Conference "Risk in Contemporary Economy"*, pp.547-552.
- Del Negro, M., Giannoni, M. P. and Schorfheide, F., 2015. Inflation in the Great Recession and New Keynesian Models, *American Economic Journal: Macroeconomics*, 7(1), pp. 168–196. doi: 10.1257/mac.20140097
- European Economic *Forecast Spring 2020*. available at https://ec.europa.eu/info/sites/info/files/economy-finance/ip125_en.pdf
- European Semester- *Country Report Romania 2020*, available at https://ec.europa.eu/info/publications/2020-european-semester-country-reports_en

- Eurostat https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Government_finance_statistics/ro
- Iacob D., 2017. The Significance of Economic Resource Deficit. Journey to Praxeology, *Annals of “Dunarea de Jos” University of Galati Fascicle I. Economics and Applied Informatics* Years XXIII – no3/2017, pag. 219-225
- Kim, J.M., 2005. *From Line-item to Program Budgeting. Global Lessons and the Korean Case*, Korea Institute of Public Finance/ The World Bank, *available at* http://www1.worldbank.org/publicsector/pe/bookprogrambudget.pdf
- Lieberman, M. şi Hall, R.E., 2010. *Principles & Applications of Economics*, 5th Edition. South-Western: Cengage Learning.
- Mankiw, N.G., 2008. *Principles of Macroeconomics*, 5th Edition. South-Western: Cengage Learning.
- Menuet, M., Minea, A. and Villieu, P., 2018, Deficit, monetization, and economic growth: a case for multiplicity and indeterminacy, *Economic Theory*, 65(4), pp. 819–853.
- Ministry of Public Finnance http://www.mfinante.gov.ro/pagina.html?pagina=buletin&categoriebunuri=executie-bugetara,rapoartetrimestriale,rapoarte-semestriale,rapoarte-anuale,arieratele-bugetului-general-consolidat
- OCDE, https://www.oecd.org/
- Oprişan O., 2019. Romania's Budget Deficit Between 2017-2018, *“Ovidius” University Annals, Economic Sciences Series* Volume XIX, Issue 2 /2019
- Annual Report of Fiscal Council of Romania for 2018, http://www.consiliulfiscal.ro/raport2018final.pdf
- Stiglitz, J.E., Ocampo, J.A., Spiegel, S., Ffrench-Davis, R. şi Nayyar, D., 2006. *Stability with Growth. Macroeconomics, Liberalization and Development,* New York: Oxford University Press.
- Tomić Zoran, 2015. Analysis of the Impact of Public Education Expenditure on Economic Growth of European Union and BRICS, *Economic Analysis* 48, nr. 1–2 (2015): 19–38.