Government accounts: below the line financing in Romania

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Abstract. *The statistics represent data; the best decisions are based on information. Fiscal Notification reflects data and correlations between the most important indicators of Government Finance Statistics (GFS). The annual budget programs, the international agreements for financial assistance and the empirical evidence show that fiscal policy in Romania has targeted directly the budget balance (B9), acting only "above the line of B9", on the non-financial accounts of Government sector (S13). Using the language of national accounts experts, it is called "B9 of S13 sector" the difference between government revenues and expenditures, the budget balance of the country according to the European System of Accounts (ESA95). One explanation may be that, so far, the European Commission has opened Excessive Deficit Procedure (EDP) only for countries that have exceeded the threshold of 3% GDP for budget deficit, debt levels above 60% of GDP being not a prerequisite for triggering Excessive Debt Procedure. The role of the Government in economy is manifested through fiscal strategy, which should also cover items from "below the line of B9", where are aligned the financial accounts of Government sector and thus, indirectly the public debt could be targeted, as one of the stock indicators composed by the liabilities side items of the financial accounts. The purpose of this paper is not to characterize the fiscal policy, which however has proved to be pro-cyclical during the entire period, but to find alternatives to improve the budgetary system, to take into account the statistics when formulating fiscal strategy, the government finance statistics, but not only the classical and evident indicators on revenues and expenditures, but also that coming from national accounts statistics, specifically the government financial accounts.*

Keywords: *EDP notification; budget deficit; public debt; ESA95; national accounts; Government sector; fiscal strategy.*

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Introduction

Fiscal Notification is the procedure by which all the European Union Member States are obliged to send to Eurostat data and information about the Government deficit and debt based on a common statistical methodology (ESA95), so that the European Commission can monitor compliance with fiscal discipline in EU (article no. 126 of Treaty on the Functioning of the European Union - TFEU), according to the convergence criteria of the Maastricht Treaty, supervising that the results of the budgetary area are within the limits, maximum 3% of GDP for budget deficit and 60% of GDP for public debt (Protocol annexed to the TFEU). Member States have to calculate and to transmit to Eurostat twice a year the tables concerning EDP notification, in March and September, including annual data for the preceding four years and forecast for the current year. Commission publishes data on the Eurostat website, in April and respectively in October, after previously held rounds of clarifications with each Member States so that Eurostat experts can conclude if the data are consistent with ESA95 regulations, otherwise to express their reservation on published data. Commission monitors public finance indicators for each Member States and if the budget deficit exceeds three consecutive years 3% of GDP and the structural deficit on the medium term doesn't frame within the limits imposed by the Stability and Growth Pact, respectively by the Convergence Program for the EU Member States outside the euro zone, then Excessive Deficit Procedure will be triggered for that country.

Targeting the budget deficit was the main objective of fiscal policy in Romania, in both periods, prior to the EU accession and also after 2007. Compliance with the fiscal criterion requested to be met and maintained in order to have fiscal stability before joining the European Monetary Union, has influenced the national authorities to take decisions with immediate impact on public finances, that not always led to the best results on long term for the national economy as a whole. Therefore, the ad-hoc nature of the budgetary measures highlighted more the procyclical character of fiscal policy.

Deficit and debt axiom: 3% of GDP, respectively 60% of GDP

Leading economists and politicians have met together at Maastricht in 1992 and have concluded, considering the need to strengthen fiscal rules and taking into account the statistics and the various economic models, that a country's economy is stable in terms of public finance if the budget deficit does not exceed 3% of GDP and public debt is within 60% of GDP. But rules on determining all values included in the analysis must be harmonized in all countries, in order to reflect comparable realities. ESA95 standard governing elaboration of national accounts statistics, GDP being the most important indicator, it is also behind of government finance statistics and therefore the government deficit and debt follow ESA95 Manual, which has been updated into ESA2010 and included in 2013 in an EU regulation, thus having the force of law and being directly applicable in Member States. ESA2010 will enter into force in September 2014, for all the national accounts statistics reports.

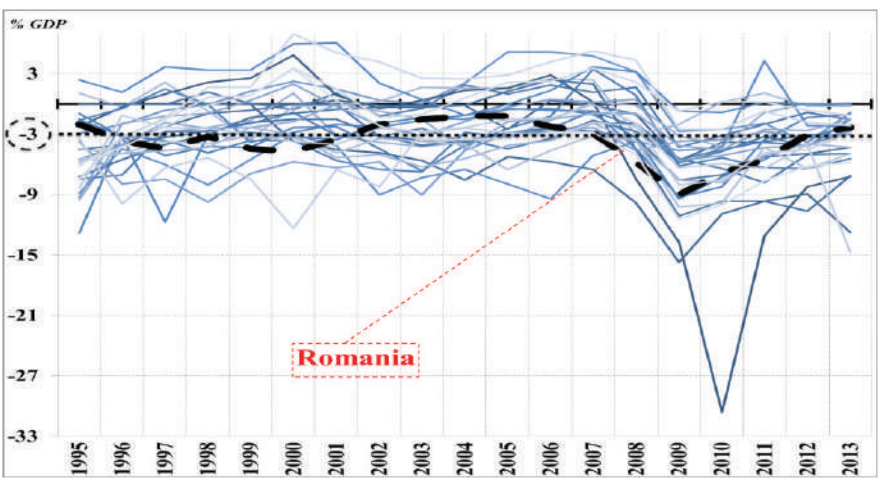


Figure 1. Evolution of budget balance (ESA95) of Romania and the EU Member States

Source: Eurostat database

In the period 2008-2011, Figure 1 shows that in Romania the budget deficit exceeded the threshold, because the European Commission opened the excessive deficit procedure (EDP) for the country. EDP is triggered if the budget deficit is three consecutive years more than 3% of GDP and suppose a fine to be paid to the EU budget, amounting up to 0.2% of GDP of the country if in a set period, the public finances doesn't meet again the Maastricht criteria and also could be reason for exclusion from the EU. In 2013 the European Commission has decided to close EDP for Romania, being confident that the deficit will not surpass 3% of GDP in the coming years. In April 2011, Eurostat express reservation on the Romanian data, because of uncertainty regarding the correct reclassification of companies from non-financial corporations sector (S11) into the Government sector (S13) after applying 50% criterion (more than 50% of expenditures of the company are financed by government) for the period included in the notification, between 2007 and 2011. But, fortunately, in April 2012, the specific reservations on the quality of the Romanian fiscal notification were withdrawn, after several technical, methodological, dialogue and upstream visits of the Eurostat experts, which involved all institutions responsible for compiling EDP Notification, National Institute of Statistics (NIS), National Bank of Romania (NBR), Ministry of Public Finances (MoF), as well as some companies, ministries and agencies, as primary data sources for EDP Notification.

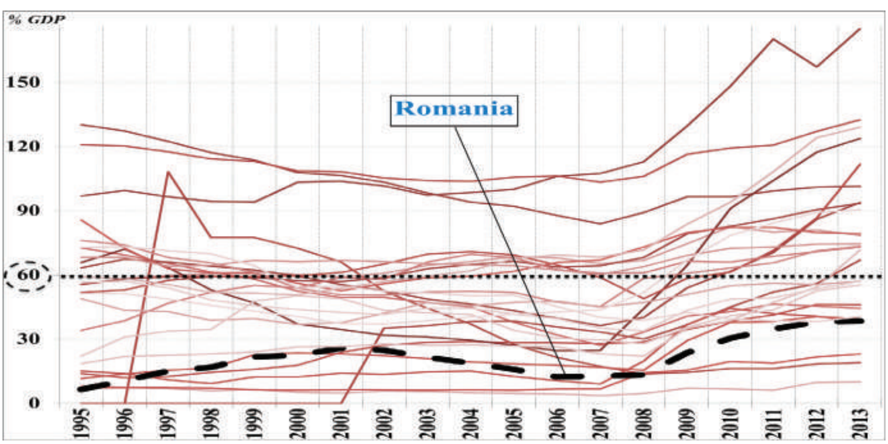


Figure 2. Evolution of public debt (ESA95) of Romania and EU Member States

Source: Eurostat database

The Figure 2 illustrates that in Romania, the public debt has recorded levels well below the nominal convergence criteria, but once the financial crisis has started, the public debt has begun to accumulate pro-cyclical fiscal policy outcomes, reaching the level of 38,4% of GDP at the end of 2013, two times higher than the outstanding level of the end of 2008, when the crisis began. However, noticeable is that the annual increase of public debt is reducing dynamics every year, as percentage of GDP, recording the peak of 10.2% in 2009 and the lowest increase in 2013, year coming only with an additional of 0.4% for public debt level.

Theoretical equivalences and practical discrepancies

ESA95 manual defines general government sector (S13), as part of the national economy. Annual national accounts are transmitted to the Eurostat once a year, in September, with the EDP Notification. Quarterly accounts of the national economy, both non-financial and financial accounts, have begun to be reported since September 2013 and are transmitted at a distance of a quarter (t+1). Specific to national accounts is the fact that all historical data have to be updated if occurre changes in terms of procedures, reclassifications, new information, in order to have comparability over the period.

The time series used in analysis covers the period 1995-2013. As a EU Member State, Romania has to report fiscal data according to ESA95 starting with 1995, compiling the standardized tables of EDP notification, the sequences of non-financial accounts of general government sector and its subsectors and also the related financial accounts, the last category being excepted from reporting for years 1995-1997. All these data are public and could be found on dedicated category web page of national responsible institutions and also on the site of Eurostat, the Statistical Institute of the European Commission, which provides access to all member states government finance statistics, as well as on the ECB database.

Government revenues and expenditures are transposed into budgetary resources and uses in order to determine B9, the net lending/net borrowing of general government, as is shown in Figure 3 ("B9 above the line") and are also reflected in the mirror, based on the double entry principle, on the financial accounts, which demonstrate the ways in which B9 was invested/ financed, the difference of net flows of assets and liabilities representing "B9 below the line", summary called "B9F" in Figure 4.

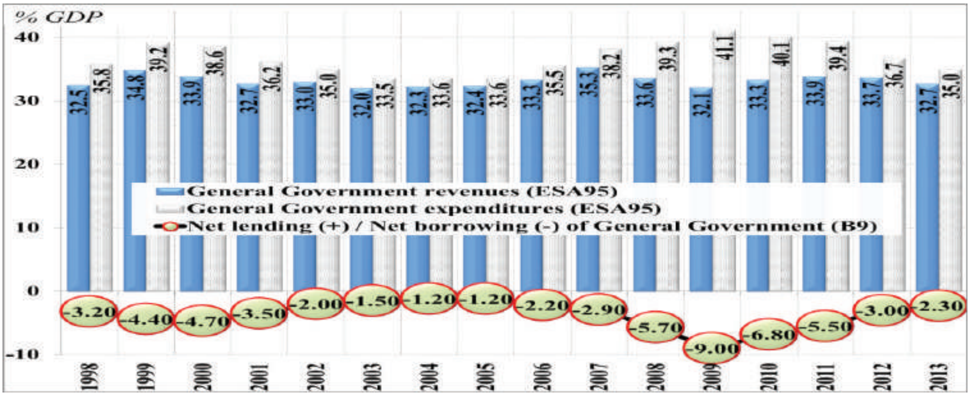


Figure 3. Revenues, expenditures and deficit B9 of General Government in Romania (ESA95)

Source: Eurostat database

If budgetary revenues have been relatively constant as a percentage of GDP in the period 1998-2013, recording levels between 32-35% of GDP, budgetary expenditures has been fluctuated from 35% to 41% of GDP and as direct consequence have increased the budget deficit. Fiscal policy has been built on spending programs based on optimistic forecast of tax collections to the state budget without taking into account the status of the economic cycle. The fiscal policy has proved to be pro-cyclical almost in all the last sixteen years, in time of growth the tax rates have been reduced (the introduction of flat tax in 2005) and in time of recession the expenditures have been cut and the tax rates have been increased (the increase of value added tax from 19% to 24%). Anyway, it is important that, in about three years of budgetary adjustments (2009 – 2012) after the crisis has started (end – 2008) and the deficit surpassed the European target, the budget balance come back below 3% of GDP, this Maastricht convergence criteria being again fulfilled.

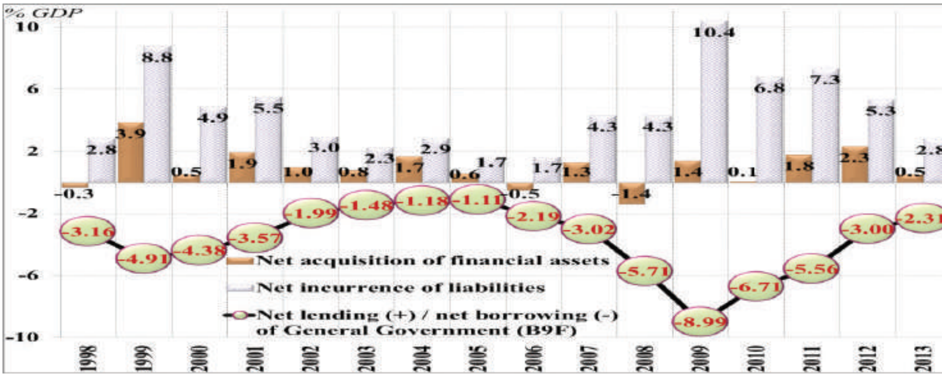


Figure 4. Transactions with assets, liabilities and B9F of General Government in Romania (ESA95) *Source: NBR, General Government Financial Accounts tables*

B9F is simply represented in Figure 4 as the difference between the net acquisition of financial assets and net incurrence of liabilities. What is clear is that the values of B9F in Figure 4 are very close to those of B9 in Figure 3. In theory, B9 equals B9F, but in practice discrepancies arise. The fiscal notification tables request this information to be compiled for each subsector of general government. It is tolerated and accepted the existence of a certain level of discrepancy, considered as being normal and varying from a country to another, depending on GDP level, complexity and size of transactions. Sometimes their absence raises doubts on quality data. The reasons of discrepancies come mainly from data sources and also from time of recording of transactions, non-financial accounts and financial accounts being developed using different financial statements.

It is evident therefore, that B9 differs from B9F at second decimal, as percentage of GDP. In practice, when considerable differences have occurred, Eurostat has requested to investigate causes and sometimes to recalculate B9, the balance of non-financial accounts flows being monitored through EDP. In Romania, the NIS is the institution responsible for the transmission of fiscal notification to Eurostat, the tables being compiled by NIS together with MoF, NBR and the National Prognosis Commission, each having well-defined roles in the protocol of cooperation signed by these institutions. The non-financial accounts are elaborated by NIS, the financial accounts by NBR and because MoF is coordinating fiscal policy and annual state budgets, the ministry is also responsible for determination of cash budget balance, starting point for EDP Notification indicators and in addition, it provides advice and most of the primary data, because of the role stipulated by law of collection of the financial statements of the entities from the economy.

As obviously, Figure 4 illustrates financial transactions in assets and liabilities of S13 sector, flows between institutional units inside sector are consolidated; the data includes relationships with other sectors of the national economy and rest of the world. The figure shows that the total amount of asset transactions has recorded very low levels as a percentage of GDP, generally positive, except years 1998, 2006 and 2008, taking values between 0-2% of GDP. Fluctuating in the same trend as the budget deficit B9, the total amount of liabilities transactions has recorded levels between 1.7-10.4% of GDP in the period under review. At first sight, therefore, it can be said that B9F sit on liabilities, Figure 4 is a chart so simple but saying a lot!

Fiscal Policy is targeting budgetary flows … on debt

EDP notification is the radiography of Government sector, which captures financial flows contributing to the change in public debt. Analysts could read the figures of this blueprint from two perspectives:

a) National Competent Authorities explain public debt stock starting from the government flows, the most important and the one that contributes the most to changes of the public debt, being the budget balance. The classic formula governing elaboration of national accounts: "closing stock = opening stock + transactions + reevaluation + other changes in volume" can be applied also to calculate the stock of public debt. Figure 5 and Figure 6 show the direct and high influence that Romania's budget deficit has on change in government consolidated gross debt.

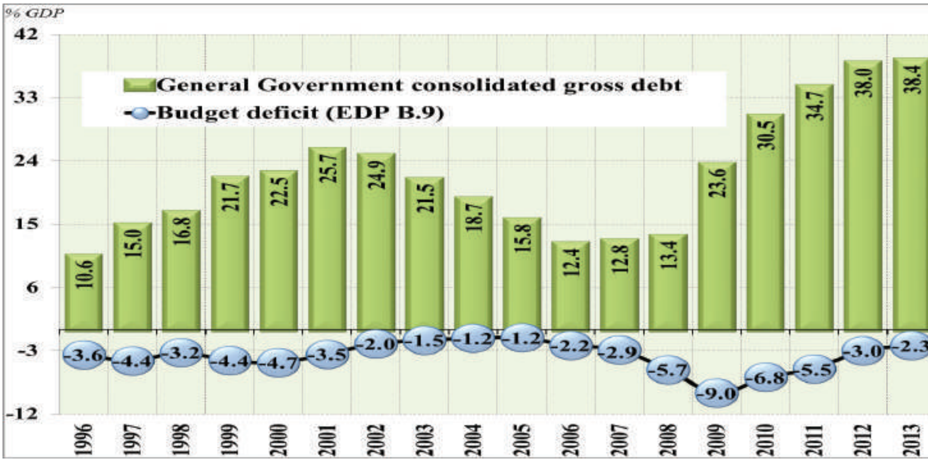


Figure 5. Evolution of budget deficit and of public debt (ESA95) in Romania

Source: Eurostat database

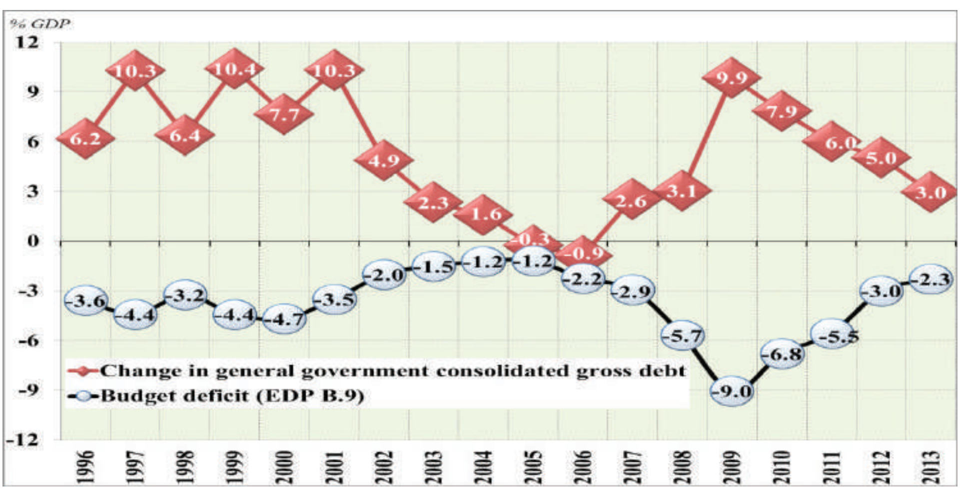


Figure 6. Evolution of budget deficit and change in Maastricht debt (ESA95) in Romania

Source: Eurostat database

Figure 6 shows the almost perfect symmetry between budget deficit and change in public debt in Romania, highlighting that the budget deficit is a result of pro-cyclical fiscal policy and an explanation for change in debt.

Eurostat, based on Table 3A of April 2014 EDP Notification, developed an analysis called "Stock -flow adjustment (SFA) for the Member States, the Euro area and the UE28 for the period 2010-2013". EDP Table 3A, namely "Provision of the data which explain the contributions of the deficit/surplus and the other relevant factors to the variation in the debt level (general government)", is part of a set of harmonized tables reported for EDP purpose by all member states. These flows are in deep monitored also during the upstream dialog visits by Eurostat, which are data quality check visits, organized by Eurostat in order to verify consistency of notified data. The authorities are tempted to hide behind these elements, flows that actually should enter into the calculation of the deficit and/or the debt. Sometimes, it is required the reclassification of certain transactions that should have an impact on the budget deficit/surplus. Thus, this analysis highlights the main factors that contribute to changes in public debt other than the budget deficit/surplus and assess the overall trend.

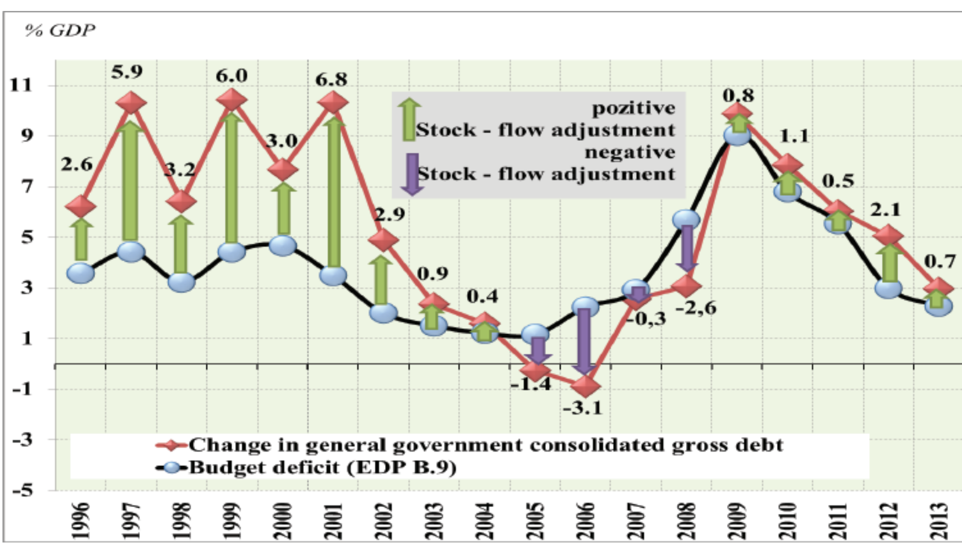


Figure 7. Evolution of stock-flow adjustment in Romania

Source: Eurostat database

Buti, Martins and Turrini (2006) in the research concerning relationship between "budgetary rules" of Economic and Monetary Union (EMU) and the "political incentive for manipulating fiscal variables" demonstrate that "during the run-up and in the early years of EMU", "Governments used a number of operations to conceal the true size of their deficits and put in place financial operations to stem the increase in the public debt". The conclusion shows that "increased weight to the deficit criterion in the EU surveillance resulted into lower Maastricht deficits but also into a higher incidence of stock-flow adjustments potentially connected with accounting tricks to keep Maastricht deficits low" and that "such incentives were reinforced in electoral periods" (Buti et al., 2006, p. 1038).

Certain studies demonstrate how some countries use the accounting rules and instruments in order to hide real level of deficit and debt: Hagen and Wolff (2004) measure the creative accounting by the stock–flow adjustments.

In Romania, the low level of SFA shows that no evidence of hiding real fiscal indicators is. The total effect of SFA is very small (0.7% of GDP in 2013), but it should be investigated, because it may be the effect of compensations resulting from totalized values of individual factors Figure 7 reveals that, in the period 2005-2008, the stock-flow adjustments were negative, the budget deficit has surpassed the change in debt, on one side mainly due to the fact that the stock of debt must be recorded at nominal value and that period has been characterized by depreciation of foreign currency debt/ appreciation of national currency and, on the other hand due to the increase in net incurrence of other liabilities (trade credit and advances and other accounts payable), most result of entry and of no use of the EU funds before and after joining the EU, both liabilities items not included in the Maastricht debt. Figure 8 presents the transaction with financial assets, on the left side and the transactions with liabilities instruments on the right side, item not included in the Maastricht debt.

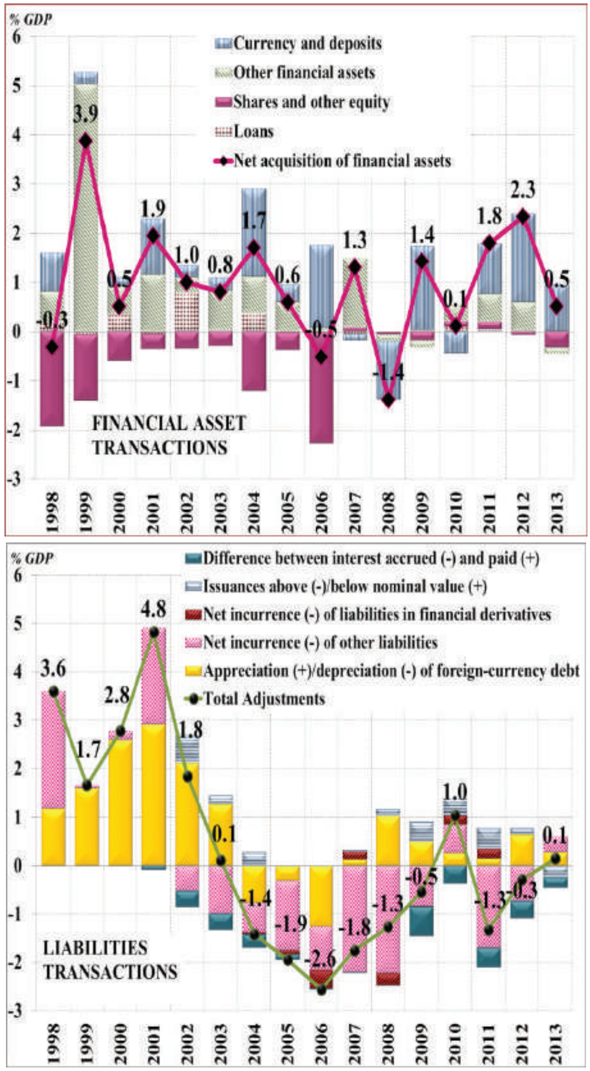


Figure 8. Evolution of transactions with financial assets and liabilities (ESA95) in Romania

Source: Eurostat database

Table 1. Contributions of the deficit and the other relevant factors to the variation in the debt level

% of GDP	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Net acquisition of financial assets (1)	**-0.3**	**3.9**	**0.5**	**1.9**	**1.0**	**0.8**	**1.7**	**0.6**	**-0.5**	**1.3**	**-1.4**	**1.4**	**0.1**	**1.8**	**2.3**	**0.5**
Currency and deposits	0.8	0.2	0.2	1.1	0.3	0.3	1.8	0.4	1.7	-0.1	-1.2	1.7	-0.4	1.0	1.8	0.9
Loans	0.2	-0.1	0.3	-0.1	0.8	0.0	0.4	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0
Shares and other equity	-1.9	-1.3	-0.6	-0.3	-0.3	-0.3	-1.2	-0.3	-2.3	0.1	-0.1	-0.2	0.1	0.2	-0.1	-0.3
Other financial assets	0.6	5.0	0.6	1.2	0.3	0.8	0.8	0.6	0.1	1.4	-0.1	-0.1	0.3	0.6	0.6	-0.1
Adjustments (2)	**3.6**	**1.7**	**2.8**	**4.8**	**1.8**	**0.1**	**-1.4**	**-1.9**	**-2.6**	**-1.8**	**-1.3**	**-0.5**	**1.0**	**-1.3**	**-0.3**	**0.1**
Net incurrence (-) of liabilities in financial derivatives	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.1	-0.4	0.2	-0.2	0.0	0.2	0.2	0.0	0.0
Net incurrence (-) of other liabilities	2.4	0.1	0.2	2.0	-0.5	-1.0	-0.6	-1.4	-0.9	-2.2	-2.2	-0.8	0.6	-1.7	-0.7	0.3
Issuances above (-)/below nominal value (+)	0.0	0.0	0.0	0.0	0.6	0.2	0.3	0.0	0.0	0.0	0.1	0.4	0.4	0.5	0.2	-0.3
Difference between interest accrued (-) and paid (+)	0.0	0.0	0.0	-0.1	-0.3	-0.3	-0.3	-0.1	0.0	0.0	0.0	-0.6	-0.4	-0.4	-0.4	-0.2
Appreciation (+)/depreciation (-) of foreign-currency debt	1.2	1.6	2.6	2.9	2.1	1.3	-0.8	-0.3	-1.3	0.1	1.0	0.5	0.3	0.1	0.6	0.3
Statistical discrepancies (3)	-0.1	0.5	-0.3	0.1	0.0	-0.1	0.1	-0.1	0.0	0.1	0.0	0.0	-0.1	0.0	0.0	0.0
SFA (1+2+3)	**3.2**	**6.0**	**3.0**	**6.8**	**2.9**	**0.9**	**0.4**	**-1.4**	**-3.1**	**-0.3**	**-2.6**	**0.8**	**1.1**	**0.5**	**2.1**	**0.7**
Net borrowing(+)/lending(-) of general government (-B9)	**3.2**	**4.4**	**4.7**	**3.5**	**2.0**	**1.5**	**1.2**	**1.2**	**2.2**	**2.9**	**5.7**	**9.0**	**6.8**	**5.5**	**3.0**	**2.3**
Change in general government consolidated gross debt (-B9 + SFA)	**6.4**	**10.4**	**7.7**	**10.3**	**4.9**	**2.3**	**1.6**	**-0.3**	**-0.9**	**2.6**	**3.1**	**9.9**	**7.9**	**6.0**	**5.0**	**3.0**

In the Table 1 it is obvious that the budget deficit (B9) is the element contributing the most to the change in debt (77% in 2013).

b) The EU Member States notify the Eurostat the budget balance as output of fiscal policy of the Government, highlighting transactions on assets and liabilities with financial instruments by which the deficit was funded or the surplus has been invested, thus the budget balance being justified by the changes in government financial accounts.

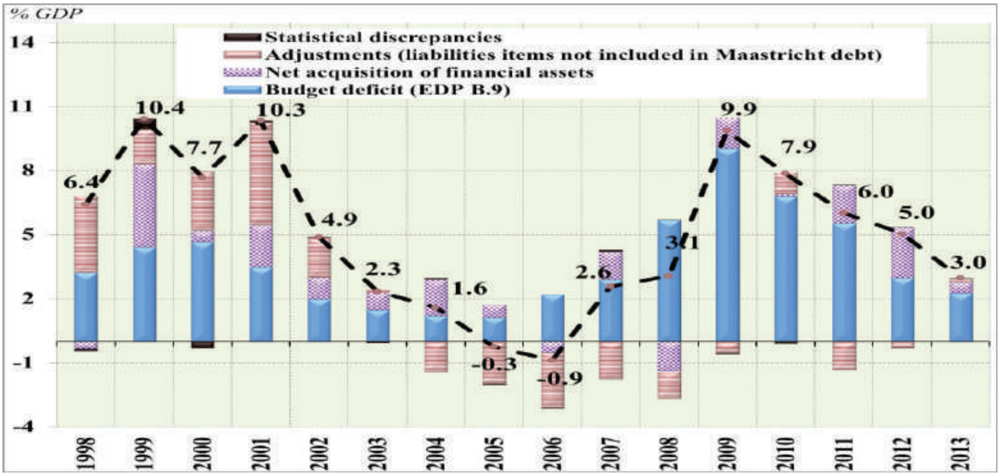


Figure 9. The main factors contributing to change in Maastricht debt in Romania

Source: Eurostat database

Figure 9 shows that in Romania, in addition to budget deficit, change in public debt is influenced also by the net acquisition of financial assets, the effect of other liabilities adjustments and by the discrepancies. According to the Protocol on the excessive deficit procedure annexed to the EC Treaty, Maastricht debt is the consolidated gross debt of the whole general government (central government subsector, local government subsector, social security funds subsector), the outstanding amount at the end of the year at nominal value. According to the EU Regulation no. 479/2009, it includes the following categories: currency and deposits, securities other than shares excluding financial derivatives and loans.

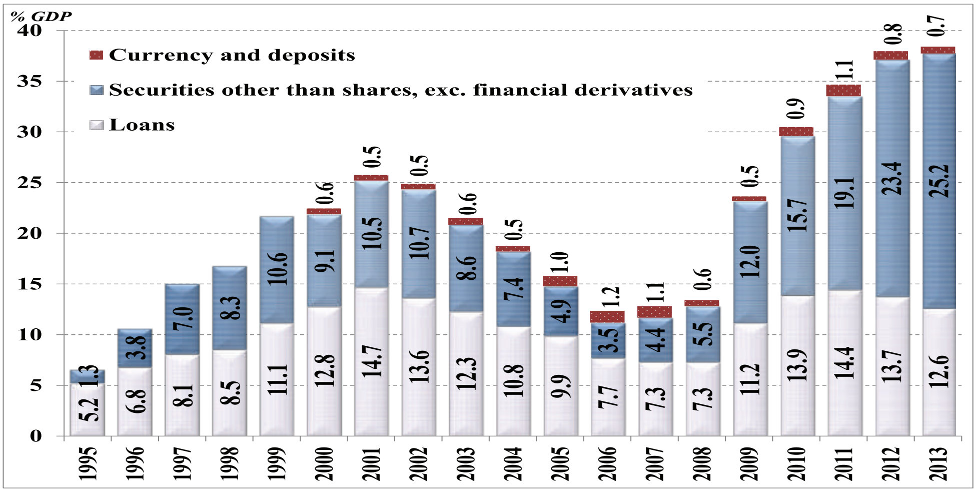


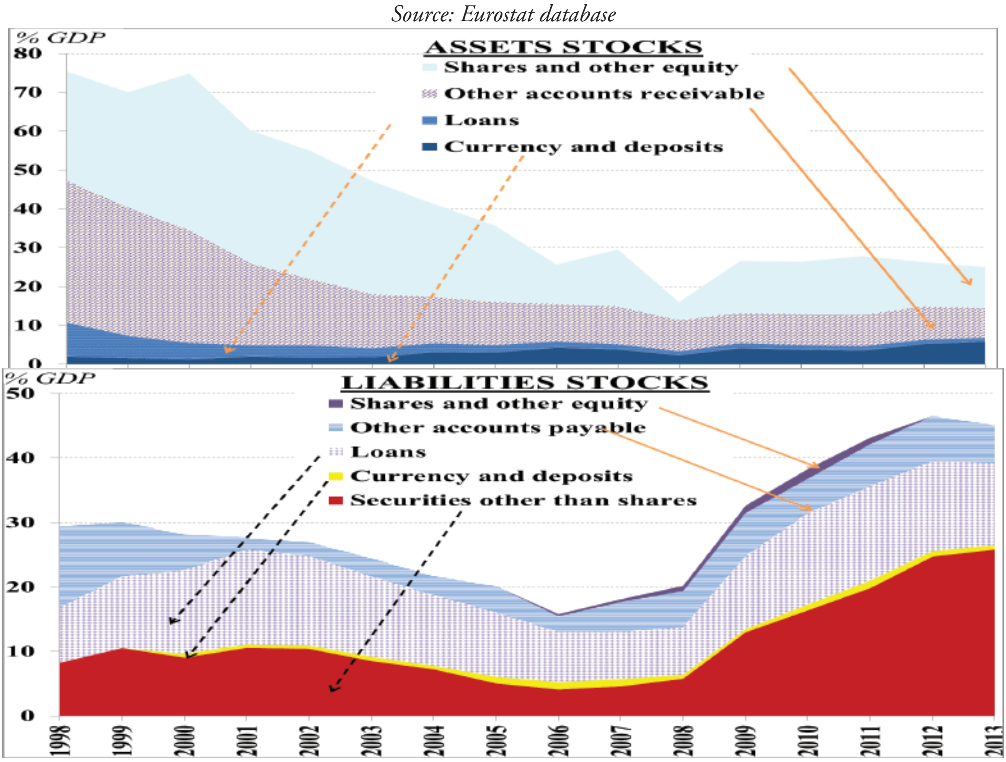
Figure 10. Evolution of budget deficit and public debt (ESA95) in Romania

Source: Eurostat database

The management of government assets and liabilities that are not included in the Maastricht debt is missing (Figure 11).

Figure 11. Evolution of stocks of financial assets and liabilities (ESA95) in Romania

Source: Eurostat database



The assets stocks of share and other equity are decreasing rapidly between 2004 and 2008, because of the privatization of public companies, structural operations that do not increase the net worth of Government because all receipts financed the budget deficit in that period.

The policymakers have to analyze and to take active action on asset stocks of shares and other equity, of other accounts receivable or of currency and deposits (F5, F7 or F2 – ESA95 codes) and also they have to take into account the liabilities stocks of shares and other equity and of other account payable (F5 and F7 – ESA95 codes). The best solution when all options have already been exhausted is to find niches that even if at first view do not seem so important, through targeted strategies on medium and long term, they can drive to benefits.

Considering the IMF staff discussion note on definition of public sector debt taking into consideration 61 countries around the world, the gross debt is "headline indicator for risk-based assessments of the fiscal position", but also "net debt is important to any comprehensive analysis of a country's debt, debt sustainability and fiscal risks. Net debt is calculated as gross debt minus the financial assets corresponding to debt instruments". It could be seen as a new trend, "while much of the policy debate centers on government liabilities, some countries have begun to publish and focus policy analysis on net debt" (Dippelsman, Dziobek & Gutiérrez Mangas, 2012, pp. 3-4, 7-8). In Romania, the financial assets (F2 - currency and deposits and F4 - loans) related to debt instruments, as we see from Figure 11a, maintain relatively the same level during the analyzed period, respectively 10% of GDP, the decrease of loans being compensated by the increase of currency and deposits.

We conclude from both approaches that behind fiscal notification are the national accounts, as statistical standard and also as used, extracted and compared figures.

Conclusions and implications

The management of all financial assets and liabilities is essential; attention must focus not only on the liabilities items included in public debt but also on other financial accounts. To define the strategy is needed, using models which change the routine and which do not look only at revenues and expenditures, to come up with innovative mechanisms if the classical does not proved any more effectiveness. Diversifying the existing framework, but using existing resources, use of the EU funds mainly can implement the management of financial assets and liabilities and determining fiscal targets based on analysis of all economic sectors. S13 sector itself would consolidate its position by any step taken for development of the other sectors, which in return are paying taxes. The management of the financial assets and liabilities means to develop strategies for existing stocks so that, with the lowest risk, considering that government sector are in the middle, whose role is not the same as for a company, maximization of profit, but the redistribution of revenues and a decent living for citizens so that to lead to value added into the economy and positive net wealth.

In formulating the fiscal policy, analysis of budgetary indicators should be linked to national accounts statistics, especially to government finance statistics and to all government accounts. Special attention should be given to stock indicator “net wealth”, which is equal to the stock of nonfinancial asset plus net financial worth, calculated as difference between stocks of financial assets and liabilities (GFSM2001, IMF). By analogy with the fact that the budget balance is the main element defining the fiscal policy, calculated as difference between revenues and expenditures or in terms of national accounts standards as difference between financial assets and liabilities transactions of government sector, any budgetary decision requiring the determination of the impact on the budget deficit, the policymakers should give equal importance to managing stocks of assets and liabilities, whether they are financial or non-financial. Government sector net worth is as important as the budget balance in order to accomplish both objectives of fiscal strategy, the stability of public finances and economic growth. Last year, the Ministry of Public Finance has created a new department responsible for management of nonfinancial acquisitions, which has begun activity with prioritization of public investment and inventory of state-owned fixed capital, being very important to update their book values to the market value.

Regional financial companies having role of development agencies could be a solution for managing the financial assets and not only. These financial institutions can play the role of a bank or of an intermediary institution dealing with EU funds projects or also the role of direct business partner, according to the European regulations on state aid! This is an idea to increase the stocks of shares and other equity and to use EU Fund in efficient manner involving the private companies.

The Government's role in the economy could be met with efficiency and effectiveness through fiscal strategy, targeting directly government financial accounts counterparties, each balance of the national economy sectors, as classified by ESA95 manual into the nonfinancial corporation sector – B9 of S11, the financial corporation sector – B9 of S12, the households sectors – B9 of S14, the nonprofit institutions serving households – B9 of S15. But which is the optimum level for each B9 of each sector? Perhaps at European level, it should be defined another axiom of B9 for each sector of the economy and also an EDP notification for each sector. Then, the fiscal strategy will target national macroeconomic policies coordinated at European level.

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