

## THE FINANCIAL AND BUDGETARY DISCIPLINE IN ROMANIA – THE ARREARS OF THE LOCAL PUBLIC AUTHORITIES

Popeangă Vasile Nicolae, PhD lecturer at  
„Constantin Brâncuși” University of Targu-Jiu, România,  
alyn77ro@yahoo.com

### Summary

*Treaty on European Union requires the Member States to consider the economic policies as a matter of common interest and to have fiscal policy guided by the need to ensure sound public finances. Global economic and financial crises have exposed the weaknesses of the economic and fiscal governance in the economic and monetary union. Reactions of European decision-making structures are not immediate. The vast majority of Member States have joined and strengthened their adherence to such solutions. Romania's macroeconomic policies are therefore part of the European common objectives, actions and decisions of public internal actors being conducted in a well-defined and regulated frame. We used analytical research method and I caught the status quo in the study, and governmental policy decisions necessary.*

**Keywords:** financial and budgetary discipline, the Stability and Growth pact, medium-term budgetary objective, arrears

### Introduction

Semantic, according to Romanian language explanatory dictionary, discipline means "the totality of conduct binding rules that ensure normal relations between the members of a community".

Extrapolating, we can say that at the macroeconomic level, the financial and budgetary discipline is the body of rules, principles and legal standards relating incidents that must be met by all subjects involved in financial processes in order to ensure sound management of public finances.

### The new European paradigm in financial and budgetary discipline

Nowadays, amid the global economic crisis, budgetary and financial governance has become a pillar of sustainable economic and social development of mankind, as an integrated system. Thus, both states and supranational bodies have imposed new rules on public finances, adapted to the new realities revealed by the crisis and to combat its effects, but also to prevent future similar situations. In addition, public entities were required by context (in some cases for the first time) to design and implement sanctioning mechanisms (corrective) tough and reliable for those who deviate from common financial rules [1].

In the European Union (in principle the subjects of the regulations are represented by the member states of EMU but also, by signing TSCG, by the states outside the Euro-zone, the scope of the measures is quite widespread in the EU) budgetary policy coordination and surveillance through the 'Stability and Growth Pact'(SGP), an instrument with two components - one preventive, another corrective. After the outbreak and generalization of the crisis, the vulnerabilities and weaknesses in the European financial governance were highlighted as a reform and a strengthening of the pact was imposed, based on three lines of action:

- ↳ amelioration, improvement of legal regulations (provisions) which it contained;
- ↳ strengthening its applied side by including items, tools that make it more effective enforcement;
- ↳ supplementing/adding new regulatory provisions (especially related to national fiscal systems).

Deterrence pact was and is operationalized through common provisions on the "strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies"[2].

Thus, the national government's decision is subject to the general interest of the Union, and the economic, fiscal and employment benefits are produced by Member States on the basis of the guidelines which are addressed to them before taking key decisions on the national budget for the coming years, whereas the progress is monitored by the European Commission. Where a Member State fails to implement the guidance received, the possibilities for action are the following:

- ⇒ it may receive new recommendations to take specific measures;
- ⇒ it may receive a warning;

⇒ certain measures may be implemented (Recommendation, revised recommendation, decision, etc.), procedure which is monitored and may include carrying out surveillance missions.

Each Member State has a medium-term budgetary objective, which may deviate from the requirement of close to balance or in surplus, providing a margin of safety in terms of the 3% of GDP budget deficit. This ensures sustainability of public finances or a rapid progress towards sustainability while allowing room for budgetary maneuver, considering in particular the need for public investment. It is reviewed every three years or in case of a structural reform with a major impact on public finances.

Compliance with the medium-term budgetary objective shall be included in the national medium-term budgetary frameworks [3].

Also, each Member State shall regularly submit a stability program or a convergence program, which includes information on:

- medium-term budgetary objective and direction of fiscal and budgetary action to achieve it;
- public obligations undertaken with potentially large impacts on public accounts (such as those relating to pensions, government guarantees etc.);
- consistency of programs with the broad economic policy guidelines and the national reform program;
- forecasts of macroeconomic and macroeconomic indicators that are relevant for the programs (capital public expenditure, nominal and real growth in gross domestic product, employment, inflation, etc.);
- a quantitative assessment of the budgetary and other economic policy measures that are being implemented or proposed to achieve the program objectives, including a cost-benefit analysis of major structural reforms which have direct long-term positive budgetary effects by raising potential sustainable growth included;
- analysis to achieve finality, i.e. main economic impact on the budget and public debt;
- in situations where slippage occurs (deviations) from the default paths for medium-term budgetary objective, their causes.

The stability program is most likely based on macro-budget scenario or on a more prudent scenario while convergence program is most likely based on macro-fiscal scenario or on a more prudent scenario.

The national macroeconomic forecasts underlying the programs are compared to the European Commission forecasts and, where appropriate, to those of other independent bodies and significant spreads between macro-fiscal scenario and macro-fiscal scenario chosen by the Member State and the Commission forecasts are described and motivated.

The national medium-term budgetary objective contained in the stability or convergence programs, in the framework of multilateral surveillance, is the subject of evaluation and review of the relevant EU structures, and comparing the results of this work which is reached by following a well-defined procedures, benchmarking indicators, with stages to achieve the objective, with exemptions, exceptions and limitations clearly stated, if there is a significant deviation, the corrective measures are taken against the Member State concerned.

The remedy (sanctioning) function of the "Stability and Growth Pact" (SGP) is applied by the European legal standards on "speeding up and clarifying the implementation of the excessive deficit procedure"[4].

The compliance with the two basic criteria of European fiscal policy, namely the budget deficit (3% of GDP) and the public debt (60% of GDP), gives the securing of the financial and budgetary discipline in the economic area. In order to prevent and correct excessive government deficits, a corrective mechanism was designed and applied increasingly over time.

An analysis of the conceptualization made by the European structures on the concept of excessive deficit allows us to structure it on three levels:

- ▶ exceptional excessive deficit - generated independently of the action taken by the Member State which binds to extraordinary, random phenomena (disasters, crises, etc.);
- ▶ temporary excessive deficit - which disappears after exceptional phenomenon where it originates;
- ▶ excessive structural deficit - caused solely by financial and budgetary discipline of the Member State.

The steps of establishing the excessive deficit are well stated by the European procedure and the institution that decides on the actual existence of it is the EU Council, that instantly make recommendations to the Member State concerned, giving it a maximum of six months (three months for severe cases) to take effective measures to correct the deficiency (usually the year that follows its accomplishment). In a certain period of time, the Member State concerned shall report to the Council and Commission the decisions taken in response to the recommendation. Under special circumstances, the Member State may be issued a revised recommendation. If the above do not achieve their goal, the next procedural step is to call on the Member State to which it answers through an explanation and justification report and then revised notice.

If the Member State fails to respond the successive steps mentioned and does not take any measures to correct the excessive deficit, by decision issued within time, the Council imposed sanctions and then even harsher penalties.

Basically, the penalty takes the form of a fine. In addition, the Board may impose other sanctioning measures:

- ⇒ “require the Member State to publish certain information, before issuing bonds and securities;
- ⇒ invite the European Investment Bank to reconsider its lending policy towards the Member State concerned;
- ⇒ require the Member State concerned to make (to the Union) an interest-bearing deposit of an appropriate size, until the date on which the Council considers that the excessive deficit has been corrected”[5].

The fine has a double component:

- fixed value equal to 0.2% of GDP;
- variable value [6].

After applying the fine until repealing the decision on the existence of an excessive deficit, Member State shall be evaluated annually to check if it complied with the summons and in the case of negative conclusions, an additional fine is imposed, determined by the algorithm of the variable of the first fines.

The amount of the two potential fines for a Member State that does not comply with financial and budgetary discipline in Europe may not exceed 0.5% of GDP for each hand.

### **Arrears of local governments in Romania - concepts, diagnosis, action**

As a member state of the European Union which signed TSCG, working under the excessive deficit procedure, Romania was and is required to adhere to such targets and to develop public policies subordinated to the need for sound management of public finances (e.g. medium-term budgetary objective implies reaching a deficit of 0.7% of GDP in structural terms).

Knowing that a key component of the national financial system is the local finance, our country has adopted and is still adopting decisions with profound implications for financial and budgetary policy of local authorities, undertaken in order to achieve that assumed objective.

Such decisions were those concerning the management of arrears with effects on financial and budgetary autonomy of local communities, being adopted in recent years by the central government decision maker [7].

It must be said that, in our opinion, Romanian government accountability in this area was not necessarily given by understanding the new economic realities and financial crisis, but rather by the pressure of the European treaties and agreements with European and international bodies. Moreover, Directive 2011/85/EU stipulates in its preamble, the need to impose financial discipline on local government also stating that “a significant number of Member States have experienced a sizeable fiscal decentralization with delegation of budgetary powers to sub-national governments. The role of sub-national governments in the enforcement of the SGP has grown considerably, particular attention should be paid to ensuring that all general government properly fall under the requirements and procedures established by national budgetary frameworks”. Meanwhile, the European Council Decision of the 12th of May 2011 granting preventive financial medium-term assistance from EU to Romania, in Article 3, paragraph 3, letter b), provides ‘obligation to achieve progressively more stringent benchmarks of reducing central and local government payment arrears.

After the Romanian language explanatory dictionary definition, arrears are “Financial debts unpaid at the time required”. Romanian legislator defines arrears as “overdue payments older than 90 days, calculated from the due date” [8]. Basically, arrears are therefore monetary obligations that the legal entity have against the third party as a result of non-payment period agreed between the parties.

In recent years, local public finances in Romania stood by registration and progressive accumulation of financial debts unpaid at the time required, the phenomenon of local government arrears becoming a generalized one. Our analysis led us to identify four main reasons for the emergence and perpetuation of “slippage”:

- legal noncompliance made by the central public authorities to provide special purpose transfers to local budgets to finance multiannual projects of economic and social community development;
- development of legal and budgetary commitments within the approved budget, but grounding loans based on their oversized, “fictitious” income;
- implementation of the local public expenditure without the real existence of revenues needed, i.e. the commitment of expenditure over the approved budget;

➤ imposing and assumption of financial obligations by local authorities as a result of decisions taken by the judiciary, whose financial impact transcends the budgetary capacity of those public (decisions related to payroll, compensation for property rights etc.).

If the first and last questions are independent of the local stakeholders, the other two are related to a financial mismanagement of the chief accountant, even because of ill-will and failure incidents in the legal norm.

In Romania, on the basis of their generating fact, arrears of local authorities can be structured into the following categories:

- ▣ arrears resulting from commercial relations (operations);
- ▣ arrears resulting from labor relations (rights);
- ▣ arrears resulting from financial ratios (operations);
- ▣ arrears based on other types of ratios.

Note that local trade arrears, i.e. those obligations which the local contracting authority has to third parties as a result of public procurement procedures, give rise to at least two types of effects of microeconomic location:

→ immediately generating □ a disinvestment of the legitimate subject who hold claims against the local authority determining, in the first phase, increasing its cost of the capital needed to continue operations through the use of loans and finally the bankruptcy of the firm;

→ generating the increased public financial local effort due to the penalties and default interest, plus the principal flow of the community against the third party.

Both effects, initially with local impact, induce macroeconomic influences as well, the final result being the increase of the general consolidated budget deficit and thus missing the potential medium-term budgetary objective.

The amount of the local government arrears in our country, expressed in million lei - current prices, on structural categories, between 2011 - February 2013 is as follows:

Table 1

Indicator \ Period of time		December 2011	December 2012	January 2013	February 2013
<b>Arrears from commercial operations</b>		741	828,6	1.169,4	1.186,1
<b>Arrears from salary rights</b>		3,7	1,7	1,4	1,2
<b>Arrears from financial operations</b>	<b>Grants</b>	5,7	7,2	7,5	4,6
	<b>Outstanding interest</b>	1,5	2,1	1,9	2,8
<b>Other arrears</b>		1	0,6	0,6	0,8
<b>TOTAL</b>		<b>752,9</b>	<b>840,2</b>	<b>1.180,8</b>	<b>1.195,5</b>

Source: Data from Ministry of Finance

In the period covered by statistical data presented, the estimated volume of gross domestic product (GDP) in millions of current prices and the weight of the total amount of arrears of local government in GDP it's shown in the following table:

Table 2

Indicator \ Year		2011	2012	2013
<b>Gross domestic product (GDP)</b>		547.829	585.200	623.300
<b>Share arrears local GDP (%)</b>		0,14	0,14	0,19

Source: Data from Ministry of Finance and own calculations

A simple analysis allows us to formulate some conclusive statements:

◆ Arrears resulting from commercial operations has the largest specific weight in total, representing 98.42% in December 2011, 98.62% in December 2012, 99.03% in January 2013 and 99.21% in February 2013;

◆ Dynamic trends in the various categories of local arrears have specific features. Thus, while some elements of structure always showed decreases (wage arrears), other developments mark the oscillating periods of alternating growth and decline, and the most important category, the commercial arrears, only have a positive dynamic with a gain throughout the range (December 2011 - February 2013) + 445,100,000 lei;

◆ The most significant increase in the absolute size of local arrears trade takes place between December 2012 and January 2013, when its volume increases by 340.8 million lei, registering a growth rate of 29.14%;

◇ If the years 2011 and 2012 the share of total local arrears in GDP remains relatively constant, at the beginning of 2013 we see an increase of 0.05% of it.

In such a situation, the central governmental factor was forced to react and, after the global model of the disciplinary necessity, to impose new rules for the local management arrears, rules that are both designed to address the phenomenon now, and to avoid its recurrence in the future. Such new benchmarks are set and read as follows:

⇒ "For budgeting ...authorizing officers and deliberative authorities are obliged to provide separate budget for extinguishing outstanding loans at the end of the year preceding that for which the budget is drawn up".

This rule was introduced by section 11 of art. I of Emergency Ordinance no. 63/2010; it was implemented on January 1st 2011 and it was a first measure aimed at settling the arrears of the local authorities.

⇒ In case the degree of achievement of their programs in budget revenues ... in last 2 years is less than 97% each year, authorizing officers based revenues for the current year up to the achievements of the previous year". The provision was inserted by section 11 of art. I of Emergency Ordinance no. 63/2010 and it applied starting with the 1st of January 2011. Application of such rules has resulted in quite widespread practice of authorizing officers of the local budget, namely that of oversize revenues which were scheduled and approved in the budget. The logic of this practice was simple: the higher the provisions in the income were, the bigger the amount of the budget appropriations approved in the budget year was; consequently they could achieve greater legal and budgetary commitments, even if their foundations were fictitious. We appreciate that the practice was encouraged by the lack of sanctioning measures for such "tricks".

⇒ "in budgets, authorizing officers are required ....to ensure outstanding payment and the outstanding results during the year. Authorizing officers may make new legal commitments, within approved budgetary provisions only after the settlement payments at the end of the previous year or the arrears of execution that year, except those from the denial amounts due under contracts financed projects implemented by national programs".

This provision was stipulated by paragraph 2 of art. I of Emergency Ordinance no. 47/2012. It has a fair character, exempting the constraints of those officers who recorded arrears by the fault of the central authorities (which have not provided resources that are hired for local projects), but also a character on penalties, limiting the range and the opportunity to gain new obligations by officers who have been foreclosed arrears because of their own financial mismanagement. For the latter, the legislature provided, however, an exception, allowing the emergence of new legal commitments for projects / programs funded by external grants. We consider this provision as wise and effective because beyond the need to punish, if only the budget and financial plan, inefficient and / or illegal practices, obtaining external financial resources is a goal in itself for local communities which should not be affected by public decisions.

⇒ "Authorizing officers of the local budgets of units / territorial-administrative subdivisions and public institutions of local subordination, which records arrears on January 31st , 2013, are required to reduce their volume by at least 85% until March 31st , 2013".

This normative assessment is provided by Emergency Ordinance no. 3/2013 and became an emergency as a result of finding an extremely worrying situation for the medium-term budgetary objective, or local increase in arrears at the end of February 2013 compared to January 2013.

⇒ "Territorial-administrative subdivisions may request from the Ministry of Public Finance no later than March 29th, 2013, borrowing privatization of payments recorded in the General Account of the Treasury, with a maximum repayment term of 5 years the amount of 500,000 thousand lei". Note that the interest rate is 5.25%. Emergency Ordinance no. 12/2013 contains this provision and supports local government for which shares and their respective amounts deducted as transfers from the central level are not sufficient arrears in the payment schedule.

## Conclusion

Imposing financial and budgetary discipline locally in Romania is a necessity, not an optional feature. The central government is in a delicate position for at least two reasons: 1).is the generator of local arrears by lack of funding for local projects approved as national programs and 2).there is somewhat limited room for maneuver, taking into account the European principles governing local finances. Obviously there were reactions to the restrictive measures imposed by central government. In our opinion, however, the arguments revealed by some representatives of local power, namely the call to the requirements of the principle of autonomy, used to challenge the central level intervention in their own budgetary policy, although partly valid, they are outside the economic and financial crisis, which requires, as I mentioned, behaviors and decisions perhaps for the first time, perhaps atypical, maybe as limit legal norms, but subordinated to a supreme goal, both national and European: sound public finances.

## Bibliography

- [1] See, for example, in the European Union "Treaty on stability, coordination and governance in the Economic and Monetary Union (TSCG)" signed on March 2, 2012 from 25 Member States, became operational in early 2013 and includes a budget pact (Title III) whose main objective is to ensure sound public finances in the Member States and the Union as a whole;
- [2] See in this regard: Regulation (EC) no. 1466/97, Regulation (EC) no. 1055/2005 and Regulation (EU). 1175/2011;
- [3] Directive 2011/85 / EU on requirements for budgetary frameworks of Member States considers the medium-term budgetary "a specific set of national budgetary procedures that extend the horizon of budgetary policy beyond the annual budgetary calendar and include the defining policy priorities and medium-term budgetary objectives"
- [4] See in this regard: Regulation (EC) no. 1467/97, Regulation (EC) no. 1056/2005 and Regulation (EU). 1177/2011
- [5] Treaty on the Functioning of the European Union, art. 126, para. 11
- [6] The variable component amounts to one tenth of the absolute value of the difference between the balance - as a percentage of GDP - in the previous year, be the benchmark for budget balance or budget balance as a percentage of GDP (where failure budgetary discipline includes the debt criterion) which ought to be made in the same year, according to the order received by the Member State;
- [7] See in this regard: Emergency Ordinance no. 63/2010 amending and supplementing Law no. 273/2006 on local public finances and to establish financial measures Emergency Ordinance no. 47/2012 amending and supplementing certain laws and regulations of fiscal and budgetary measures, the Emergency Ordinance no. 3/2013 regarding certain measures to reduce arrears in the economy, other financial measures and amendment of legislation, the Emergency Ordinance no. 12/2013 to regulate certain financial-fiscal measures and extension of deadlines;
- [8] Law no. 273/2006 on local public finances amended by Emergency Ordinance no. 47/2012