THE IMPORTANCE OF FOREIGN FINANCING AND THE ABSORPTION OF EUROPEAN FUNDS TO COVER THE BUDGET DEFICIT IN ROMANIA

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Abstract:

The budget deficit that is reflected as a percentage of the Gross Domestic Product (GDP) that is calculated as the difference between a state's expenditures and revenues is covered by various financial sources. But in this health crisis, the contraction of the budget deficit depends largely on the return of the national economy to normal. In order to recover the economy affected by the pandemic, it is necessary to encourage foreign investment and especially the absorption of European funds.

Controlling the budget deficit depends on public sources of funding, which during the pandemic were directed to the payment of salaries, pensions and facilities provided to vital sectors of the national economy.

In the first phase of the analysis of the use of money from European funds, in the severely economic sectors affected by the health crisis, cannot change the fate of a budget deficit because these sources appear on both sides of a budget, both in terms of revenues and expenditures. But now, at the end of 2020 and the beginning of 2021, in the midst of pandemic, we must insist on this issue because the statement is only partially justified. The issue of the use of European funds must not only be nuanced, but especially in the current circumstances, of the "European Recovery and Resilience Plan" emergence, analysis of the situation of public budgets it changes radically. According to statistical data, Romania's budgetary situation was and is very tense, which is also reflected by Romania's singular placement in the excessive deficit procedure (EDP) of the European Commission (EC) at the beginning of the year. Macroeconomic imbalances - the current account deficit (4.6% of GDP) and the relatively large structural budget deficit (over 4% of GDP) and the persistence of high budgetary pressures to increase permanent spending call for immediate macroeconomic correction to maintain access to market financing and to maintain the country rating.

Keywords: pandemic, public budget, European fund, budget deficit.
Classification JEL: **:** E42, E50, F30

1. INTRODUCTION

Being a macroeconomic indicator, the budget deficit that reflects the spending of public money would not be a problem if it were reflected in the vital investments of the national economy. But during the pandemic, the budget deficit increased as a result of unforeseen economic activity. The deficit is therefore reflected as a percentage in the Gross Domestic Product, the size of which also depends on its correction. "The main macroeconomic aggregate, the Gross Domestic Product represents the synthetic expression of the results of the economic activity produced inside the economic territory in a time interval, regardless of the contribution that domestic or foreign subjects had to the development of the country's economic activities" [1].

In addition to other public policies, it is necessary to urgently absorb European funds and at the same time encourage foreign direct investment to bring the economy back on an upward trend. These measures can contribute to the development of enterprises that pay taxes and fees to the state and implicitly to the increase of state revenues and to the creation of reliable sources to cover the budget deficit created.

At the same time, the impact of foreign direct investment on the competitiveness of Romanian exports remains one of the most complex issues, whose in-depth analysis requires both the correct measurement of the influence of their volume, structure and dynamics, and the profitability and distribution of reinvested and repatriated profits of foreign firm , as well as transfer pricing issues.

Among the ways to budget deficit contraction, can be taken into account:

- reduction of budget expenditures

- increase in tax revenues
- increasing the money supply through monetary policies
- contracting internal and external loans, generating public debt
- attracting European funds and encouraging foreign investment

Each of the ways of financing the budget deficit is controversial and in particular the attraction of European funds must be correlated with the measures established by the "European Recovery and Resilience Plan".

The correction of the budget deficit in Romania comes against the background of the economic downturn not only in our country but in the whole European area.

In the midst of the economic crisis generated by the pandemic and in line with the economic, social and financial policy objectives of this period, the economic approach to the concept of budgethighlights macroeconomic correlations and, in particular, the link with the level and evolution of gross domestic product.

Using the method of empirical research by observing the evolution of the gross domestic product, it is found that it expresses the economic relations in monetary form that arise in the process of its formation and distribution.

The economic downturn in Europe and other parts of the world at this time of year, compared to the same period in 2019, speaks for itself of the shock of COVID-19: a 15% decline in GDP in the euro area of 14, 1% in the EU as a whole, 31.7% in the US. It must be emphasized that the epidemic cycle conditions the speed of return, that there may be local "closures"; the war with COVID-19 is not over, he is one of attrition. It should also be noted that the savings do not have a similar degree of robustness, shock absorption.

According to European applications, we find the involvement of the state through specific instruments, on the one hand to regulate or stabilize the economy and on the other hand to stimulate economic expansion or to restructure (modernize) the economy. In the first case, the state is acting to counter the economic crisis caused by the pandemic. To this end, it shall use specific instruments with the meaning of incentives or, where appropriate, financial facilities, in order to reduce as far as possible the amplitude of economic fluctuations. In the second case, the activity of the state is oriented through financial instruments towards stimulating investments, as a premise for increasing the volume of production, relaunching the economy or combating the downward trends of the economy. And, for this purpose, are taken into account the amounts of money received for the reziliation of the "European Recovery and Resilience Plan" .

In the conditions of financial crisis, from this year, the state intervention for satisfying the collective needs of the society, in terms of financial relations, develops a new type of processes and economic relations of redistribution of the gross domestic product.

On the occasion of the first budget rectification for 2020, there was an abrupt increase in Romania's financing needs from about 8.6% of GDP in 2019 to levels between 11% and 14.3% amid the abrupt deepening of the budget deficit.

In essence, the phenomenon of public finances expresses the economic processes of prelevation by public authorities, a part of income or assets of individuals or entities in their territory and the use of financial funds thus formed to meet the common needs of society. In the same sense, private entities with private capital that are stimulated by European funds or government funds by the state contribute to the formation of gross domestic product.

In this context, the Keynesian doctrine attributes to the deficit of the public (state) budget the quality of “starter” of the economic activity.

The regulatory impact of public finances, based on the interaction of material processes with financial ones, is reflected in economic and financial variables whose dimensions condition the achievement of objectives, and the main tools used for this purpose are taxes, public spending, public budget.

In the midst of a pandemic, this finding allows, given the relationship between public finances and public budgets, the assignment of a similar function (reglation-stabilization) to public budgets. The manifestation of this function of the public budget is based on the acceptance of the budget deficit and its financing from extraordinary resources, in the phases of the economic decline. It is now becoming a factor in economic recovery and growth. And, the importance and usefulness of this function of public budgets are highlighted and supported by the theories and models of economic growth affirmed or built in the context of interventionist economic doctrines aimed at budgetary policy.

The function of reglating (stabilizing) the economy has a specific conceptual support, based on the Keynesian doctrine, which supports the influence by the state, if necessary, of various economic and social activities with the help of economic and financial levers, among which an important role belongs to the public budget. .

Development and promotion of budgetary policies for purposes such as economic stabilization, economic growth or restructuring, modernization and adaptation of the economy to market requirements are based on the acceptance of the budget deficit financed, in principle, from internal or external sources.

For this year coverage of financing necessary is ensured to a large extent, but its coverage in the medium term could be much more problematic. It is hard to believe that financial markets will tolerate high levels of the budget deficit for a long time to come, even if fiscal rules in the EU remain suspended in 2021.

The ability to finance the budget deficit and refinance the public debt that is maturing is a very heavy constraint that affects the fiscal-budgetary policy.

2. The impact of European funds and foreign investment on the contraction of the budget deficit

Starting with 2021, against the background of economic recovery, a big macroeconomic problem of Romania is the correction of the budget deficit, of the macroeconomic imbalance, given that it is true that international markets will not accept large budget deficits for years, especially countries that want to enter the euro area.

The correction of the budget deficit requires a multi-year program, in line with the EC's request, to bring the deficit close to 3% of GDP, through the expected sources of funding.

In this sense, an important role in balancing the deficit can be played by European funds, which can facilitate correction, support aggregate demand through additional government spending of 2-2.5% of annual GDP (net of contribution to the EU budget), and can develop domestic production.

In this sense, European money would help to finance the balance of payments, and important European funds would strongly support the activity of private companies, directly and indirectly. The absorption of European funds needs to be as high as possible in the years immediately following when the macroeconomic correction needs to be made in line with the European recovery and rezilience plan.

At the same time, Romania must increase the level of tax revenue collection, a chapter in which it has much to recover, including the collection of VAT. According to the Government's latest forecast, Romania will have a budget deficit of 8.6% of GDP in 2020. And the contraction of GDP was revised by the National Forecast Commission to 3.8%, close to statistical data that reflect a decline of -4.4 of GDP, which places Romania among the countries severely affected by the pandemic.

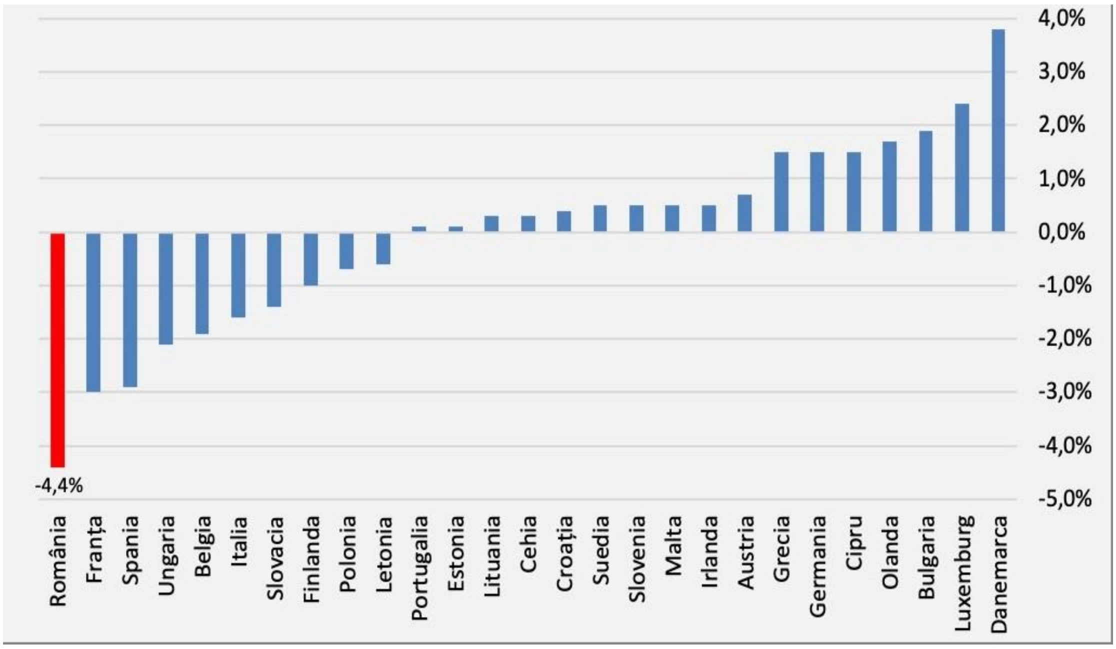

Figure no.1 Pre-crisis public finances, EU 27 (budget deficit% in GDP, 2019)
Source: Eurostat

A larger budget imbalance is possible amid a worsening state of the public budget, public finances, if the pension point is increased by 40%, which would lead to an increase in the budget deficit in 2021 to over 11% of GDP, which could severely affects the economy, hampering economic recovery in 2021.

The European Commission has favorably corrected the level of Romania's economic contraction in 2020 to -5%, in the autumn forecast, from -6% in spring.

But mainly due to the increase in pensions and other social allocations, the European Commission's forecasts for the budget deficit have been severely tightened, to -9.1%.

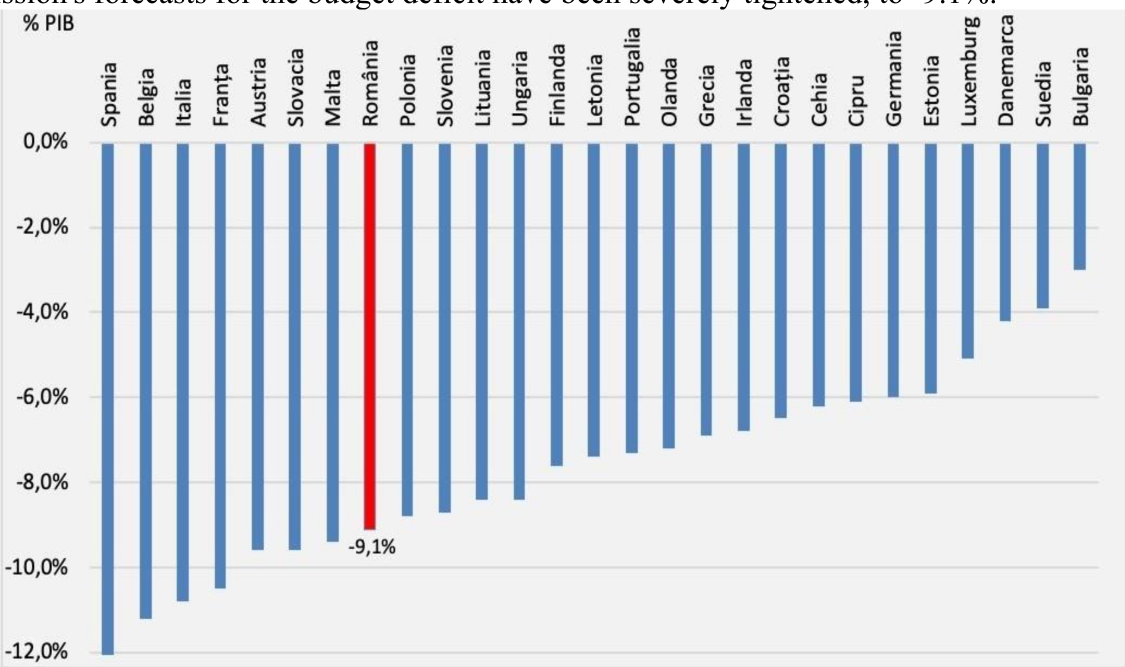

Figure no.2 EU budget deficit 27 (2020) Estimates according to the European Commission's autumn forecast
Source: Eurostat

Therefore, due to the diversification of the attracted financial resources, in addition to the European funds that have an important role in the economic recovery and implicitly in the large contributions to the state budget, foreign direct investments also have an important role.

First, the direct impact of foreign direct investment begins to manifest itself at the microeconomic level, starting from the financial capital provided by the multinational company (through direct participation in capital, through reinvested profits, or through loans granted to local companies) and continuing with the transfer of technology and innovation.

Through foreign investment, creditors interested in immediate profit expose local firms to a set of management, marketing and entrepreneurial skills and abilities that were initially lacking or underdeveloped. At the same time, foreign investments create conditions for the development of human resources, which means not only the increase of salaries or taxes due to the state budget, but also training programs and training, including for new trades and skills.

Also at the macroeconomic level where state taxes and fees are collected, the effects of foreign investments can be seen in increasing the performance of local companies in which multinational companies invest and their degree of market competitiveness, but also in business practices promoted by them, different in a positive sense from the previous ones.

Then, from the microeconomic level, the effects of foreign investments can spread at the sectoral level, by changing the structure of the markets and the degree of concentration in favor of final consumers, but also of suppliers. Finally, at the macroeconomic level, the effects can be observed through higher contributions to the state budget, by contributing to balancing the payments balance, but also by changing the structure of exports and improving the balance of trade.

Foreign direct investment is one of the main sources of development of the national economy which may lead to a contraction of the budget deficit. On the one hand, they are complementary to public investment and those made from private sources, and on the other hand, they stimulate the development of both the enterprises in which they invest and the enterprises in the national economy with which they enter into economic relations.

According to the Organization for Economic Co-operation and Development (OECD) [18], "foreign direct investment can influence the change in the structure of exports and improve the balance of trade, through the main channels of the national economy influenced by the sources attracted because they:

- is an important source of innovative technologies and organizational knowledge of workflows (know-how);
- contributes to the development of enterprises as well as to their restructuring;
- contributes to the development of international trade and integration into the world economy;
- contributes to stimulating and increasing competitiveness;
- creates jobs and contributes to the development of human capital

Figure no.3 Evolution of foreign investments without intergroup loans (billion euros)
Source: www.bnr.ro/Finante-publice-8554.aspx

Foreign direct investment (equity investments and intragroup loans) amounted to 1.7 billion euro in ten months of 2020, compared to 4.7 billion euros in the same period last year. But this seemingly huge drop (minus 63%) comes not only from "equity holdings", but from so-called "intragroup loans" - loans that foreign companies grant to their subsidiaries here.

Of course, all this money received by Romanian companies ensures the realization of ordered products, works and services that after delivery contribute to the contraction of the budget deficit, through the taxes and fees that pay them directly went indirectly to the state budget.
National Bank data show that foreign direct investment amounted to 1.75 billion euros in ten months (compared to 4.67 billion euros in January-October 2019), of which equity investments (including estimated net reinvested profit) amounted to 3.2 billion euros. At the same time, intragroup loans registered a negative net value of 1.5 billion euros. That is, the value of investments was diminished by the negative value of "intragroup loans" - money that had to be returned anyway someday. The positive fact is that, even in this severe crisis, foreign investment has continued to come. At ten months, foreign investment, which means equity investments, was 3.2 billion euros. In the first ten months of 2019, these investments amounted to 4.2 billion euros. It is a decrease of one billion euros, and in percentage this means a decrease of 24%.
At the same time, the current account deficit decreased in the first ten months by 3.7%, to 8.7 billion euros, and foreign direct investment decreased by 60%, to 1.7 billion euros.
At the end of October, Romania had a current account deficit of 8.77 billion euros, down from 9.11 billion euros in January-October 2019, according to BNR data. The decrease of the deficit was determined by the increase of the surplus in the area of services and secondary incomes.
At the same time, international trade declined, with a deficit of 15.1 billion euros, up 995 million euros.
NBR data show that an important impact in reducing the current account deficit was increased by the surplus of the services balance, by 715 million euros, to 7.8 billion euros. The largest share is in the transport sector, which has a surplus of 3.3 billion euros, while tourism remains in deficit, with a minus of 1.2 billion euros.
Instead, the primary income balance increased its deficit by 191 million euros to 3 billion euros, and the secondary income balance registered a higher surplus by 810 million euros, of 1.6 billion euros.
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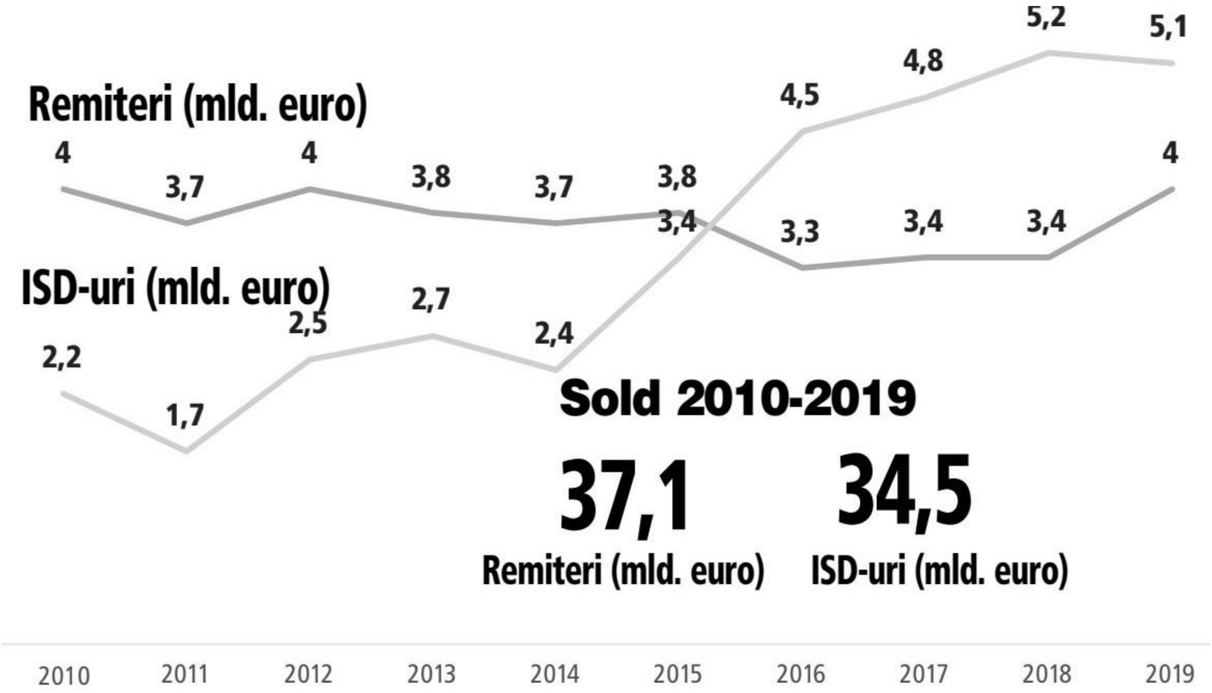

Figure no.4 The evolution of remittances and foreign direct investments in the last decade
NOTE: FDI also includes intra-group loans, along with capital contributions and reinvested earnings.
Source: www.bnr.ro

For comparison, foreign direct investments (which also include intragroup loans, ie loans granted by parent companies to subsidiary companies in Romania, but which are not equity investments) were, at eight months of the year, 1, 4 billion Euros. Decreasing by 67% compared to the same period of 2019 (4.3 billion euros). Excluding intragroup loans, foreign investment (equity and reinvested earnings) amounted to one billion euros, less than half of remittances.

The current account deficit of the balance of payments was, between January and August 2020, of 5.8 billion euros, compared to 7 billion euros, an amount recorded in the same period of the previous year (minus 17%). Of course, the reduction in international trade, amid the pandemic, had an impact on this result, even in the situation where the trade deficit increased, instead of decreasing, as was believed in the spring.

But the almost 2.3 billion euros sent home by Romanians abroad have contributed to maintaining a stable leu / euro exchange rate. The leu depreciated against the euro by only 2% from January to the end of October.

For the comparison regarding the significance of remittances, between January and September 2020, Romania received from the EU, structural funds of 1.7 billion euros. All funds, including those for agricultural subsidies, amounted to 4.9 billion euros and, decreasing Romania's contribution by 1.5 billion euros in the mentioned period, results in a positive balance of 3 billion euros. Therefore, the money sent home by Romanians abroad is close to the level of net funds received from the EU. It can be said that, since Romania's accession to the EU, on January 1, 2007, Romanians who had the freedom to travel and work abroad have sent home 56.8 billion euros.

The net amounts received by Romania from the EU (amounts received minus Romania's contribution to the community budget) were 39.6 billion euros, according to data from the Ministry of Finance and the NBR.

According to the records, the National Bank keeps the statistics on remittances, ie since January 2005, Romanians abroad have sent home 69 billion euros. In 2005, Romania's total GDP was 79 billion euros, ie only 10 billion euros below the amounts that Romanians abroad have sent home in the last 15 years.

But due to the pandemic, between January and August 2020, Romanians working abroad sent 2.28 billion euros to those at home, according to data from the National Bank of Romania. It is a decrease of 13% compared to the first eight months of 2019 (2.62 billion euros), but it is a modest decrease, if we consider that, during this period, Europe and the world have gone through a shock that generations of today they did not know him.

3. CONCLUSIONS

The magnitude and complexity of the COVID-19 pandemic exceed the individual response capacity of countries, requiring international cooperation, both in the health field (to identify the best solutions for treatment, prevention and diagnosis) and economically (especially to maintain international trade) and financial (including finding solutions to support access to finance for emerging and in developing markets). The measures that have been taken so far in response to the outbreak of the pandemic have been of unprecedented magnitude, consisting of fiscal, monetary and prudential interventions.

The contraction in GDP, which is revised for 2020 to 3.8%, is in the immediate vicinity of the lower threshold of the baseline scenario expected to be credible in the external lending market. The battle for the absorption of European funds in 2021 is crucial for economic stability and GDP contraction.

A massive absorption of European resources from the multiannual financial framework and the "European Recovery and Resilience Plan" will reduce the need for financing in the financial markets and support domestic aggregate demand and supply, thus allowing a smoother macroeconomic correction path.

It can be appreciated that the interval of 4-6% for the contraction of GDP in 2020 remains valid.

The existence of this large structural deficit of the public budget (over 4% of GDP) which was accentuated in the conditions of the pandemic by increasing expenditures and reducing budget revenues. This deficit calls for a correction in the next 3-4 years, a budgetary consolidation, with a significant impact on the economy.

As a result of the alarming decline in budget revenues, the second budget adjustment on the revenue side is a strong downward revision, in line with the deterioration of the macroeconomic framework taken into account in substantiating the budget construction..

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