THE EXCESSIVE DEFICIT, A TOOL TO IMPROVE THE ECONOMIC GOVERNANCE IN THE EU MEMBER STATES

Elena Doina, Dascălu[1]
Bogdan Narcis, Fîrțescu[2]

Abstract:
This research approach presents the viewpoint on the issue of the excessive deficit within the European context, and highlights the situation in Romania. The starting point was the evolution of economic and budgetary governance policy within the European Union. Consequently, we focused on the study of budgetary policies among the Member States, whose role is to ensure a solid system of public finances in the framework of the smooth functioning of the Economic and Monetary Union (the Maastricht Treaty). The question we attempted to answer in this research was: "Has the application of the economic and monetary union principles ensured the stability of the Member States' public finances and avoided the excessive deficit?". In this context, we started from the following assumptions: "Are the data that the public accounting provides reliable, so that the information included in the public finance statistics can be considered trustworthy?"; "Does the public accounting reform in the Member States ensure the transparency and comparability of the information?";"Have the reforms concerning the strengthening of the financial discipline improved the excessive deficit procedure?".

Keywords: *excessive deficit, accrual accounting, cash accounting, public finance*

JEL Classification: *M41*

1.Introduction

Within the current European context, the issue of the excessive deficit requires the implementation of structural reforms in the Member States. The structural reforms recommended by the Council of Europe (for example, public expenditure reform) are not binding nor enforceable for these states, therefore they need to score progress in relation to the budgetary discipline. Besides, if the excessive deficit is not corrected within the set deadline dates, sanctions may be imposed, in the form of a fine which can be up to 0.5% of GDP.

The European regulations adopted in the field of economic governance and budgetary policy are: The Maastricht Treaty, The Stability and Growth Pact (SGP), the SGP reform, the economic governance package, the Budgetary Pact, and Budgetary surveillance and monitoring regulations. The latter is only applicable to the Euro area Member States. Since 2011, new regulations have been adopted in the field of economic governance and budgetary policy. Thus, the economic governance package is based on the European Semester for economic policy coordination, and it contains the detailed requirements and demands of stability and convergence programmers, the requirements regarding budgetary frameworks of the Member States, the procedure and sanctions regarding macroeconomic imbalances, the operationalization of the debt criterion. The budgetary pact stipulates that the structural deficit cannot exceed the overall objective in the medium term and, if deviations occur, a national mechanism for correction will automatically trigger. The compliance with this regulation and its monitoring is carried out by the national fiscal councils. The budgetary surveillance and monitoring regulations package establishes a strict monitoring of the Member States which are subject to an excessive deficit procedure through regular reporting on the budget execution throughout

1 Professor, Ph.D., Vicepresident of Romanian Court of Accounts, doina.dascalu@rcc.ro
2Associate Professor, Ph.D., Alexandru Ioan Cuza University of Iaşi, Faculty of Economics and Business Administration, Romania, firtescu@uaic.ro

the year, as well as a mechanism of early warning regarding the risk of failure to correct the excessive deficit by the deadline dates set during the launched proceedings.

”The Five Presidents' Report” concerning the completion of the economic and monetary union (developed by Jean-Claude Juncker, Donald Tusk, Jeroen Dijsselbloem, Mario Draghi and Martin Schulz, 22nd of June 2015) led to the adoption by the European Commission of measures needed to improve the economic governance (21 of October 2015) by establishing national competitiveness councils and a European fiscal council having an advisory role.

In this context, a Member State, as a part of the application process of the excessive deficit, has 4 main obligations: to report statistical data to Eurostat, to correct the excessive deficit by the set deadline, to state the budgetary effort required by the recommendation, and report on the taken action.

To ensure the comparability of the data provided by the Member States, it is necessary to comply with the accounting rules which are in accordance with the European System of Accounts (ESA 95/ESA 2010). Feeds must be registered under the accrual principle when an economic value is created, transformed, exchanged, transferred or extinguished, or when debts or obligations arrise, are transformed, or canceled. (ESA 95, section 1.57)

2. Research methodology

The epistemological positioning acted as the starting point of the research theme, „The excessive deficit - a tool to improve the economic governance in the EU Member States”, portraying reality through two contemporary epistemological paradigms, i.e. positivism and constructivism. Positive spirit implies the rigour of inductive reasoning, thus ensuring the transition from facts to hypotheses. Constructive thinking is, necessarily, the construction of the subject, following the interaction with the object under study. (Niculescu, Vasile, 2011, page 57, page 75).

3. Accounting reform in public sector

From the EU perspective, the public sector accounting standards (IPSAS) are not transparent and are not comparable, consequently it is necessary to harmonize the accrual accounting. The European statistics on public finances are issued according to ESA 95 / ESA 2010, are interpreted and further adjusted by Eurostat and include data on economic activities of public administration, including public revenue and expenditure, deficit, operations in assets and liabilities, other economic streams and balances.

Since 2015 with a view to achieving the strategic objectives of improving the public financial management it has been necessary to increase the putting in force of IPSAS based on the accrual accounting. Thus, in 2015 the following standards have been revised:

- in January 2015 IPSAS 33 "*First time adoption of the accrual accounting*" and IPSAS 34-38 "*Interest in Other Entities*" were revised and they replace IPSAS 6-8;
- in March 2015 the standard concerning *Reporting information on service performance* was revised (Ernst@Young, mai 2016, Brussels Workshop).

In EU Member States there are different accounting approaches depending on each country’s specific circumstances, therefore, to implement the IPSAS standards in the public sector it is necessary to harmonize the accounting treatments to ensure comparability and drafting, putting in force and implementing the EPSAS standards.

Eurostat has undertaken a research on the potential impact of the implementation of accrual accounting and the appropriate framework of IPSAS standards stating that EPSAS implementation costs are estimated between 1.2 billion Euro and 6.9 billion Euro. The participants in this research believe that financial statements prepared on the accrual accounting basis have greater credibility to stakeholders, i.e. investors, citizens and fund donors. (Ernst@Young, December 2015, page 9).

The European Commission's priorities for the period 2015 - 2016 have been: the establishment of the EPSAS working group and of the EPSAS cell for the first time implementation of the standards (Cell on First Time Implementation), the development of the EPSAS and the broadening of the scope of activities to stakeholders (authorities, auditors, academic environment). In mid-2016 the EPSAS working group has completed the Guide "First Time Implementation" (Ernst@Young, May 2016, Brussels Workshop)

The synopsis of the situation is presented in the figure below:

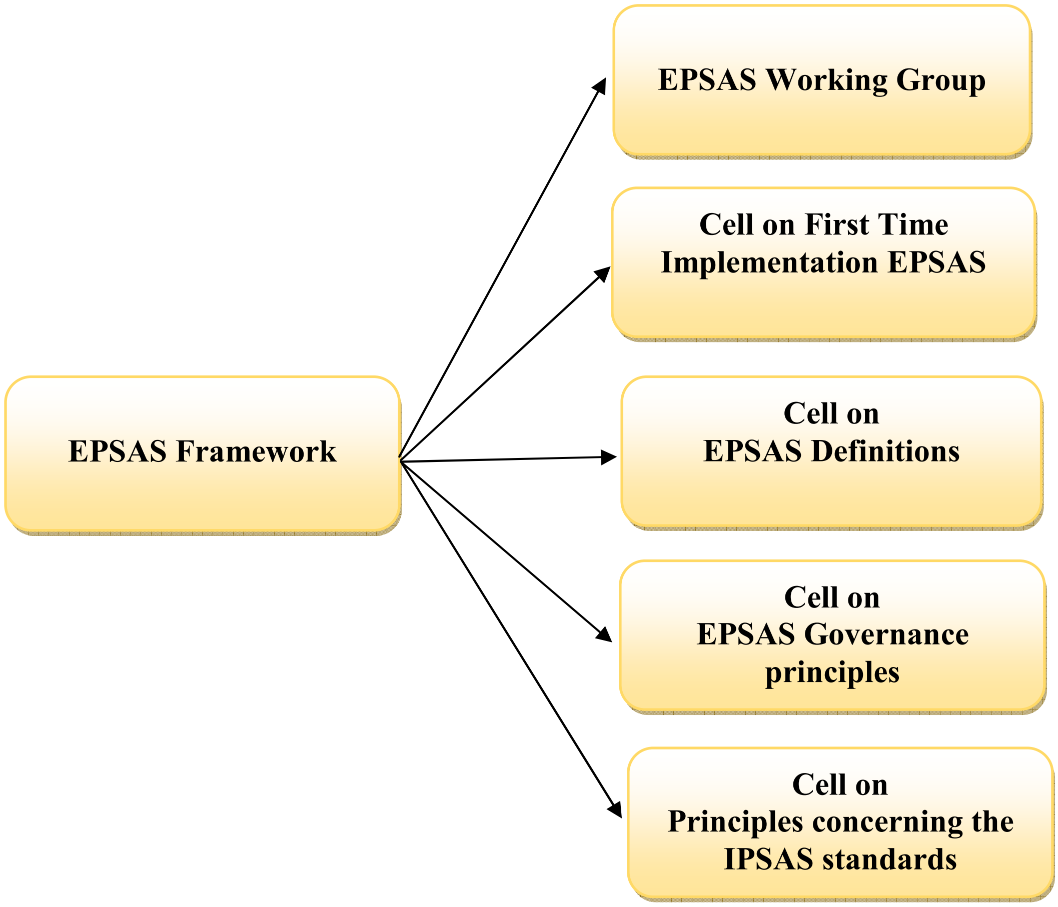

Figure no.1 EPSAS Framework
Source: adapted from Makaronidis

The EPSAS standards should be developed such as to reduce the differences to the ESA (the European System of Accounts) in order to achieve an integrated system which can be applied at microeconomic and macroeconomic levels. The European system of national and regional accounts (ESA 95 / ESA 2010) is the EU's accounting framework, internationally compatible and used for systematic and detailed description of the economies of the regions and of the Member States. The system was updated in September 2014 by switching to ESA 2010 which reflects the developments on measuring the modern economies, the progress in the methodological research and the users' needs. ESA is a system updated with the accounting rules and the classifications that are being used within the comparable UN system and has specific features, in accordance with the EU needs.

4. Public finance statistics data quality

As aforementioned, the quality of the data provided by the Member States to Eurostat through national statistics institutes and national central banks (case of Belgium) is crucial in assessing the situation of each of the Member States and deciding on the matter of an excessive deficit procedure initiation.

The analysis and assessment of the information provided is based on areas specified in the excessive deficit procedure, among which: the delimitation of the public administration sector, the classification of specific operations in the public administration, the record keeping of the operations in accordance with the accruals accounting principle.

Over the past years, the legal framework governing the quality of statistical data in the public finance sector has undergone several changes in order to improve:

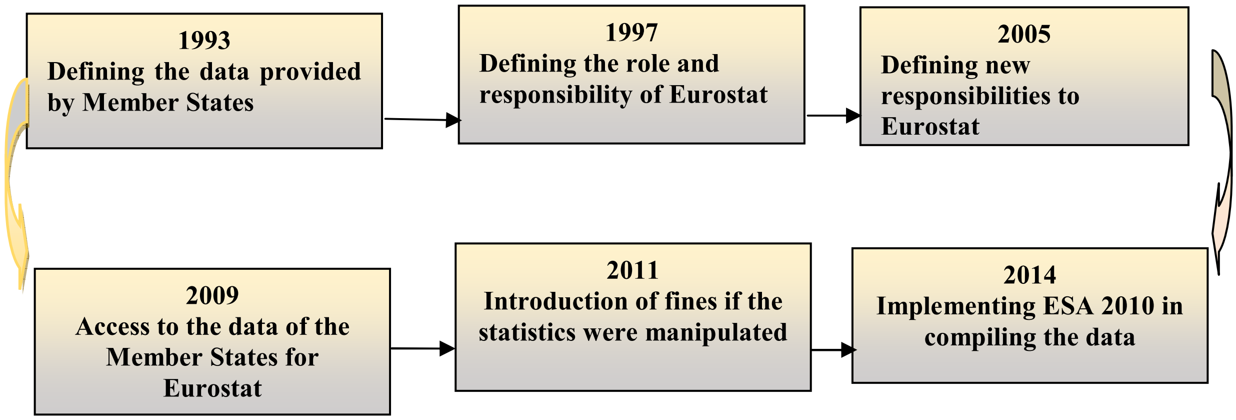

Figure no.2 The evolution of the legal framework of public finance statistics
Source: own information processing

In ECA special Report No.10 of 2016, it is stated that the data provided by the Member States are not always complete, both in case of binding data and data submitted voluntarily. This statement is grounded by the fact that Eurostat has not carried out a detailed analysis of the data contained in the correlation tables displaying the link between the ESA classifications and the public accounts, and also has not submitted feedback on the quality of the information included in these reports.

5. Excessive deficit - case study

In the Euro zone (countries which have adopted the Euro), the government deficit decreased from 6.3% of GDP (GDP) in 2009 to 2.1% of GDP in 2015, and the forecast for the period 2016 - 2017 is of 1.9% of GDP in 2016 and 1.6% of GDP in 2017. In addition to that, the public debt was expected to record a significant drop from 94.4% in 2014 to 91.1% in 2017. Currently, only 6 states are in the excessive deficit situation, namely: France, Spain, Portugal, Britain, Croatia and Greece. (European Commission, Stability and Growth Pact: Fiscal Proposals for Spain and Portugal, 2016)

At the present time, the excessive deficit procedure has been applied in almost all Member States, except for Estonia and Sweden. Hence, 92.85% of Member States were or are in the course of an excessive deficit procedure, which means that rules on the budgetary discipline have not been respected, therefore structural reforms are needed in the framework of the global financial and economic crisis.

The synopsis of the situation of the countries which were or are in the course of an excessive deficit procedure is presented in the figure below:

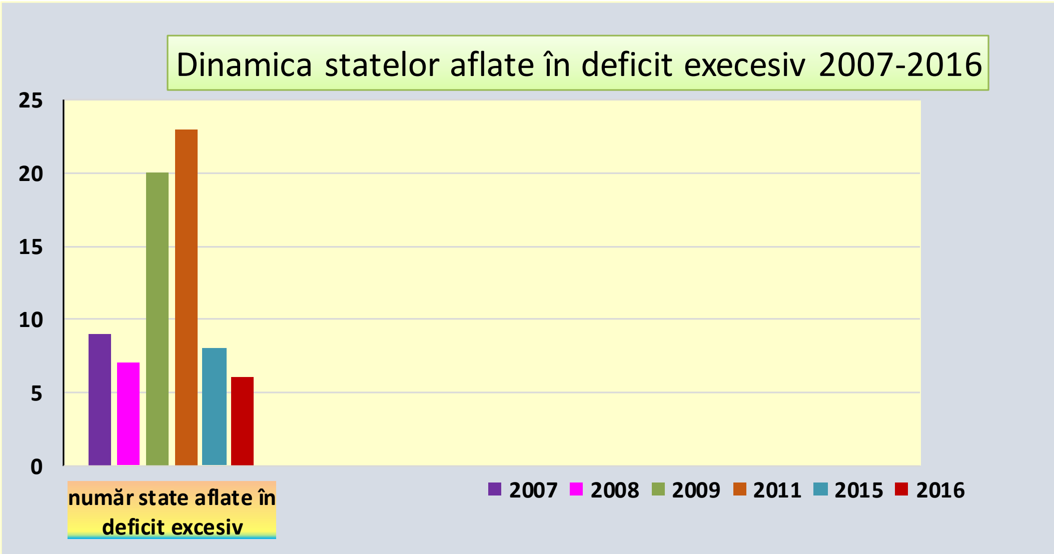

Figure no.3 The dynamics of states in excessive deficit procedure
Source: own information processing

The result of applying the excessive deficit procedure should have impact on the deficit and public debtand it should also lead to the strengthening of budgetary discipline, but the excessive deficit procedure has not proven fully effective as a correction mechanism. However, France continues to be in excessive deficit procedure after three extensions of time, and Cyprus has accepted a financial assistance program. (ECA, 2016, page 67).

If position ourselves in 2008, which is a reference year because it marked the beginning of the financial and economic crisis, we find that the public debt to GDP increased on average by over 24% in 2012 in the EU Member States. The factors of the public debt dynamics are the primary balance, the snowball effect and stock flow adjustment. The primary balance is the budget balance minus the expense of the public debt interest, and it is considered also an indicator of financial discipline. The snowball effect is the effect of the accumulation of public debt and is calculated as the difference between the public debt interest and the nominal growth rate of GDP. If the interest rate is higher than the nominal growth rate of GDP, the snowball effect will cause an increase of the public debt rate to GDP. As a result, the growth of the public debt rate to GDP should be compensated by the primary balance. (ECA, 2016, pages 69-70).

Romania, as an EU Member State, was in the excessive deficit situation between 2009 and 2013 based on the decisions by the Council to open the excessive deficit procedure (in July 2009) and to repeal the excessive deficit procedure (in June 2013). At present, in Romania there isn't an ongoing excessive deficit procedure, because the country stands alongside the other 21 Member States which meet the preventive part of the proper functioning of economic and monetary union mechanism (budget deficit ≤ 3% of GDP and public debt ≤ 60% of GDP).

The government debt to GDP in the period 2012 - 2014 in Romania is presented in the table below:

Table no. 1. „2012-2014 Public Debt Situation in Romania”

No.	Indicators	Financial year - million Euro -			Chain index		Fixed index
		2012	2013	2014	$I_{2013/2012}$	$I_{2014/2013}$	$I_{2014/2012}$
1.	Public debt	54,382.20	59,569.30	65,946.50	9.53%	10.70%	21.26%
2.	GDP	133,905.29	144,286.03	150,860.61	7.75%	4.55%	12.66%
3.	The public debt ratio to GDP (%)	40.61%	41.28%	43.71%	1.64%	5.88%	7.63%

Source: information processing after the Court of Accounts Report

By analysing the public debt ratio to GDP in the period 2012 - 2014, we find that the growing trend of the public debt was higher than the GDP growth: I_{DP} = 21.26% > = I_{PIB} 12.66%. The situation is not favourable even if the level in the period under review is below the alert threshold of 60% which is provided in the Maastricht Treaty.

The Fiscal Council in Romania in the 2014 report estimated that the impact of state companies on the budget deficit calculated based on the European System of Accounts (ESA 2010) is an additional pressure on the budget deficit targets under the Maastricht Treaty. Thus, the reasons underlying this statement are that the impact is materialized by issuing state guarantees and, especially by re-classifying a number of state companies in public administration. Following the analysis by the Fiscal Council, it was concluded that, subsequent to the re-classification of several state-owned enterprises (according to the Eurostat methodology on accrual accounting ESA 2010) in the central administration sector, the general consolidated deficit was positively influenced (ESA 2010) within 2011 - 2014, with the exception of year 2012. At the same time following the re-classification of state enterprises in the local administration sector, the general consolidated deficit was negatively affected within 2011 - 2014, with the exception of year 2011. (The 2014 Report of the Fiscal Council in Romania, page 118)

The situation is presented in the table below:

Table no.2. „The contribution of the companies in the public administration to the budget deficit”

No.	Company	The contribution of the companies in the public administration to the consolidated budget deficit (mil. lei)			
		2011	2012	2013	2014
1.	Total number of companies in the public administration				
	– total amount	1,236.80	-382.70	2,475.30	3,198.20
	% - as share in total	96.82%	-67.92%	111.25%	100.61%
2.	Total number of companies in the local public administration				
	– total amount	40.60	-180.70	-250.40	-19.60
	% - as share in total	3.18%	-32.08%	-11.25%	-0.61%
3.	Total number of companies in the local and central public administration				
	– total amount	1,277.40	-563.40	2,224.90	3,178.60
	% - as share total	100.00%	-100.00%	100.00%	100.00%
4.	(%) in PIB	0.23%	-0.09%	0.35%	0.48%

Source: adapted after The 2014 Report of the Fiscal Council in Romania

In order to ensure the sustainability of the public debt of our country, action must be taken to reduce the budget deficit by: adopting fiscal consolidation measures, ensuring economic growth, increasing public debt at lower rate than the GDP growth, ensuring the growth of goods and services export at a higher rate than the increase of the external public debt, so that the people's indebtness level is reduced. All these are included in the governamental public debt management strategy 2015 - 2017.

As the ECA noted in its assessment concerning the effectiveness of the excessive deficit procedure so far, the procedure has taken into account mostly the public deficit criterion. The debt criterion has been operational since 2012 and will be applied by all Member States no earlier than 2020. This is due to the fact that the governments do not exert the same level of control over the public debt ratio in the GDP as over the budgetary deficit. The arguments supporting this statement concern the financial transactions, particularly the stock-flow adjustments, which have a significant impact on public debt in a budgetary exercise. If we take into account that budget years depend on each other, we are aware that inconsistencies may result between the deficit based targets and the public debt based targets.

6. Conclusions

In the European context of the improvement of the economic governance framework, the European Commission has granted the Member States access to information, data, and tools necessary to calculate the relevant indicators which are used in the budgetary surveillance process (since the first quarter of 2014). The Commission has also granted access to information on the return of the key individual fiscal measures, discretionary for the Member States under excessive deficit procedure with an ”ascending” approach. (The ECA, 2016, page 132).

Given the fact that currently only 6 countries (Croatia, France, Greece, Portugal, Spain, and the UK) out of the 23 Member States under this procedure in November 2011 are using the excessive deficit procedure, we can state that claiming that structural reforms have been implemented while the micro and macro environment has undergone change. Consequently, the excessive deficit procedure has been improved though reforms aiming at strengthening the financial discipline.

Thus, since the "economic governance package" reform in 2011, the debt criterion implying an average annual reduction of 0.2% of the difference between the actual debt level and the reference value of 60% at a time, for 3 years, has been made operational. Basically, the 23 Member States undergoing the excessive deficit procedure in 2011 fall under this reform.

The research carried out emphasized a particularly important issue, namely the data quality of public finance statistics depends on the quality of information provided by the system of public accounting in the Member States. The public sector accounting systems in the Member States are currently undergoing a process of harmonization and improvement: at microeconomic level, we can talk about financial reports based on IPSAS standards, developed on the basis of IFRS and EPSAS standards under development on IPAPS basis, while at macroeconomic level we can talk about statistical reports, namely government finance statistics – GFS, national system of accounts – NSA and the European system of accounts - ESA.

Our conclusion concerning the question of our scientific approach is that the stability of the public finance has been and still is vulnerable and that is why most of the Member States were, until now, subject to the excessive deficit procedure.

The limits of our scientific approach are set by the current state of information available from public accounting and public finance statistics, by the changing conditions of the economic environment, and by economic crisis cases which the Member States experience.

Bibliography

1. Ernst@Young, *IPSAS Outlook, D*ecember 2015.

2. Ernst@Young, Workshop "*The reform of public sector accounting*", 13 May 2016, Brussels, Belgium, 2016.

3. European Commission, „*Stability and Growth Pact: fiscal proposals for Spain and Portugal*", Brussels, 2016.

4. European Court of Auditors, Special Report no.10 "*Further improvements are needed to ensure an effective implementation of the excessive deficit procedure*", Luxembourg, 2016.

5. European Union, Regulation no. 549/2013 of the European Parliament and Council of 21 May 2013 on the European *System of National and Regional Accounts in the European Union*, Official Journal I174 of 26 June 2013.

6. European Union, *The Maastricht Treaty*, Official Journal C191 of 29 July 1992.

7. Government Emergency Ordinance no. 64/2007 *on public debt*, Official Gazette, Part I, no. 439 of 29 June 2007.

8. Law 69/2010 *on fiscal responsibility*, Official Gazette, Part I, no.252 of 20 April, 2010.

9. Makaronidis A., " *IPSAS - current status and latest developments*" - EY- Workshop "*The reform of public sector accounting*", 13 May 2016, Brussels, Belgium.

10. Ministry of Public Finance of Romania, *Public debt management strategy 2012-2014*, Bucharest, 2012.

11. Ministry of Public Finance of Romania, *Public debt management strategy 2015-2017*, Bucharest, 2015.

12.Niculescu Maria, Vasile Nicolae, *Epistemology, interdisciplinary perspective*, Bibliotheca Publishing House, Târgovişte, 2011.

13.Niculescu Maria, *Economic Diagnosis*, vol. 1, Economica Publishing House, Bucharest, 2005.

14. Romania Court of Accounts, Performance audit report "*Evaluation of public debt management* ", Bucharest, 2015.

15. The Fiscal Council of Romania, *Report for 2014 on the implementation of the fiscal and budgetary policy*, Bucharest, 2015.

16.www.curteadeconturi.ro

17.www.eca.europa.eu