

Limitations on government debt and deficits. Romanian aspects

Most of the regulations concerning the limitation of budgetary deficit and of public debt are relatively new in the Romanian legal system, being adopted progressively from 2010 as part of a more general legislative attempt to restore sustainability of public finances. A common feature of these rules is that most of them were included in the legislation further to the agreement concluded by the Romanian Government with international financing institutions that, since 2009, granted loans¹ in order to prevent the negative effects of the global financial crisis on Romanian public budgets, as part of the main conditionality attached to this loan.

Below is a brief overview of the legal structure of such limitations.

1. The budgetary process

1.1. Budget drafting

According to article 138 of the Romanian Constitution, the national public budget comprises the state budget, the state social security budget and the local budgets. At central level Government elaborates each year two public budgets, which are adopted through separate laws by Parliament: the state budget and the state social security budget. The procedure for adopting them is similar: drafts prepared by the Ministry of Public Finances are further endorsed by Government and submitted for approval to Parliament within a certain time framework, which includes intermediary steps as described below.

The steps of the budget drafting process at central level and related powers are regulated by both the Law on public finances (no. 500/2002, as further amended) and the Law on fiscal and budgetary responsibility (no. 69/2010, as further amended). Consequently, the legal regime of the preparatory activities for central budgets is to be constructed by reference to both laws, combining the specific norms that are addressing this issue in each of them.

As a first step of the budget drafting process, the Ministry of Public Finances prepares together with the National Commission of Prognosis the macroeconomic and budgetary projections necessary as a basis for the structure of the budget. These projections are aligned with those prepared by the European Commission and discussed at European level during each European Semester (as an *ex ante* cooperation process for drafting national budgets). Any deviation in the national projections from those of the European Commission is to be emphasized and motivated by the Ministry of Public Finances. These macroeconomic and budgetary projections are the basis on which the Ministry of Public Finances further defines the budgetary framework on medium term along the lines of the EU budgetary framework, having as explicit objectives (as provided by article 30¹ of the Law on public finances, introduced by an amendment in October 2013) to strengthen the budgetary discipline and to ensure compliance with the obligations assumed under the Treaty on the Functioning of the European Union and other EU-related treaties for avoiding excessive deficits.

Within the limits of the budgetary framework, the Ministry of Public Finances further prepares and submits to the Government ***the fiscal-budgetary strategy*** by 31st July each year. This strategy restates the macro-economic indicators to be considered for drafting the budgets as well as the projections for the next three years, together with a declaration concerning the compliance with or, as the case may be, any deviations from the most recent forecasts of the European Commission.

The fiscal and budgetary strategy has to be submitted by Government to Parliament by the 15th of August each year, together with the draft law for the approval of the main targets as provided in the strategy. Once approved by Parliament, the fiscal and budgetary strategy and

¹ The total financing package made available to Romania in 2009 amounted to 20 bln. Euro, with 12,95 bln. loan provided by the IMF, a 5 bln. loan granted by the EU, 1 bln. loan by IBRD, 0.5 bln. by EBRD and 0.5 bln. by European Investment Bank (EIB);

the law approving the main indicators of the strategy are the basis for the budget drafting process, which coordinated by the Ministry of Public Finances. Based on these documents, the Ministry of Public Finances drafts the methodology for budget preparation.

For further preparing the draft state budget, the latest by the 1st of August the Ministry of Public Finance starts by sending this methodology and a budget framework to the principal managers of public funds² with indications as to the limits of expenditures to be observed when drafting their own budgets. Based on such indications on budget drafting (methodology) principal managers of public funds further send subsequent guidance concerning budget drafting to managers of public funds subordinated to them (secondary managers of public funds), who in their turn send similar indications to tertiary managers of public funds.

Based on such guidance, which may be amended in course of the process, the budget proposals are collected in a bottom-up process, from tertiary to secondary managers of public funds, with proposals made within the previously communicated limits. Within such process, each principal manager of public funds submits a budget proposal for the domain it administers, which is further transmitted to the Ministry of Public Finance by 1st of September. This deadline may be extended up to 15th of September, in case the Ministry of Public Finances requires adjustments to the drafts budgets proposed by the principal managers of public funds for ensuring compliance with the fiscal–budgetary strategy.

The final draft budget is prepared by the Ministry of Public Finance, who also makes any adjustments it deems necessary for complying with the pre-determined macro-economic indicators used as a general reference for the budget structure as well as with the approved fiscal-budgetary strategy. The arbitration of any dissent in this matter amongst the various ministries or between any of them and the Ministry of Public Finance belongs to the prime-minister.

Each year, by the end of September, the Ministry of Public Finances submits to Government the draft budgets as annexes to each of the draft laws for preliminary analysis. Based on the third quarter forecasts announced by the National Prognosis Commission, the Ministry of Public Finances shall adjust draft budgets and will submit their final form to the Government by the 1st of November each year.

Government has to endorse budgets before the 15th of November, which is the deadline provided by the Law on public finances for the submission to Parliament of the draft budgets and draft laws.

1.2 Procedure for budget approval

Within the budget approval procedure, Parliament passes two separate laws – a law approving the annual state budget (together with its budget annexes) and a law approving the annual public social security budget (with annexes). These laws, especially the one approving the state budget, may include, in addition to a statement of the principal categories of revenues and expenditure provided by the budget it approves, provisions establishing specific rules of limited application. For example, such laws may include interdictions to undertake specific

² Generally, managers of public funds are the managers of public entities having legal personality. Amongst their attributions as managers, they are entrusted by the Law on public finances (no. 500/2002, as further amended) with the management of public funds of the respective public entity. The manager of public funds is responsible for the drafting and execution of the budget of that entity, except for those attributions related to payment which are expressly entrusted to the public accountant (as an expression of the principle of separation of powers between managers of public funds and public accountants). Depending on the hierarchic administrative level of a certain public entity, the law stipulates three categories of managers of public funds: principal, secondary and tertiary. Principal managers of public funds are those whose entities are not hierarchically subordinated, such as ministries or other managers of autonomous central institutions. Secondary managers are leading entities that are subordinated but also have other entities subordinated to them and tertiary managers are those who are managers of public entities placed on the last hierarchic administrative level, having no other entity subordinated to them.

expenditure from public funds or even special fiscal norms (deductions, restrictions on deductions etc.).

Laws approving the state budget and the social security budget are passed in a joint session of both Houses of Parliament (Chamber of Deputies and Senate).

Normally, if submitted by Government in due time (i.e. before the 15th of November), laws on budgets should be approved the latest by 15th December, save for the years when parliamentary elections are organized in the last three months of the year, when the budgets prepared by the Ministry of Public Finance have to be submitted to the new government within 15 days from the new government's investiture. In this case, within 20 days from its investiture the new government has to submit the draft budgets to Parliament, but in any case this has to take place before the end of December.

In all cases, if budgets are not approved by Parliament by the 15th December, Government may request that an emergency legislative procedure is used (art. 17 para 2 of the Law on public finances). However, the emergency legislative procedure does not truly speed up the process; it only means that debates and vote on a specific draft law in each House of Parliament are dealt with in a limited amount of time, but it does not alleviate or eliminate any of the stages of the regular legislative procedure.

The Law on public finances sets as a general deadline for the approval of the budgets by Parliament the date falling three days before the end of December or at latest the 31st of December in the years when parliamentary elections are organized, but also stipulates rules for the case when the budgets are not approved by such dates.

According to the general principle provided by article 37 of the Law on public finances, if the budget is not approved by January the 1st, Government (for the state budget) and each public legal person (for all the other public budgets) shall perform according to the existing budget (approved for the previous year), subject to a monthly expenditure limit of either 1/12 of the previous year budget or 1/12 of the draft budget for that year (under approval), whichever is lower.

2. Legal limits on the ability of the national government to incur deficits in its annual budget

Following its accession to EU in 2007, Romania has to comply with the general limitation applicable to annual budget deficit (i.e. 3% of the GDP) as provided by the 12th Additional Protocol to the Treaty on the Functioning of the European Union and implemented according to the Stability and Growth Pact. Back in 2012, Romania ratified the Treaty on the Stability, Governance and Cooperation in the Economic and Monetary Union (hereinafter referred to as „TSGC”) and thus assumed the obligation to insert in its national legal system the balanced budget rule and the deriving limits for the structural deficit, as provided by article 3 TSGC. As TSGC entered into force as of January 1, 2013, the regulation at the national level of the balanced budget rule and of the limitations concerning the budget deficit had to be completed by the end of 2013, either at constitutional level or at a level not allowing for derogations made by ordinary laws.

In the last days of 2013 the rules of TSGC concerning budget deficits were adopted as amendments to the Law on fiscal and budgetary responsibility (no. 69/2010). This choice of the Romanian legislator to implement the balanced budget principle in an existing law that has no superior effect to other laws concerning public finances is subject to further scrutiny under article 8 TSGC on compliance with the requirement to have this principle stated at constitutional level or at a similar level (supposedly not allowing for amendments by the budgetary laws).

Although it includes general principles and rules for drafting central budgets and any subsequent amendment to them, the Law on fiscal and budgetary responsibility remains an ordinary law, i.e. it may be revised or repealed by an ordinary or organic law. From a strictly technical perspective, any derogation from the principles and rules it provides may be adopted via a simple budget rectification law.

Within this legal framework, the balanced budget principle and the limits for the structural deficit provided by the TSGC were introduced in the Law on fiscal and budgetary responsibility as rules applicable to the fiscal and budgetary policy of the government. The new provisions introduced in the law are mainly repeating the relevant provisions of the TSGC, generally limiting the annual structural deficit to 0.5% of GDP. If the public debt (calculated according to the EU common methodology) is significantly lower than 60% of GDP and the risks of long term sustainability of public finances are low, the annual structural deficit may increase up to 1% of GDP.

Temporary deviations from any of these limits are allowed in extraordinary circumstances, provided that such deviations do not affect the medium-term sustainability of public finances. The Law on fiscal and budgetary responsibility refers explicitly to the political responsibility³ of the members of the Government which are not complying in performing their duties with the provisions of this law. In addition, failure of expressly nominated categories of civil servants to comply with certain provisions in the Law on fiscal and budgetary responsibility leads to contravention liability and is subject to fines⁴ and recovery of damages incurred by public budgets as a result of such breaches. The compliance is to be assessed by the Court of Accounts within its general powers of control of the use of public funds; its staff is empowered to impose the fines, if the case may be.

In case the limitations and rules provided by the Law on fiscal and budgetary responsibility are not observed by managers of public funds or by the executive management of state-owned companies subjected to this law (i.e. those classified as part of the general government according to Regulation (EU) no. 549/2013 approving the European system of national and regional accounts), Government or, as the case may be, local deliberative authorities may undertake one or more of the following measures: (i) apply a program for reducing expenses of the entity concerned or for its restructuring, (ii) ban the issuance of guarantees or contracting of loans, (iii) ban the increase of expenditure in future budgets.

3. Legal limits on the ability of the government to borrow money or incur debt

According to the same Protocol no. 12 annexed to the Treaty on the Functioning of the European Union, the national public debt, calculated according to the common methodology applicable at the EU level, cannot be higher than 60% of GDP.

No rule relating to the limitation of public debt is provided by the Constitution, but the Law on fiscal-budgetary responsibility, further to its modification in December 2013, restates this debt brake of 60% of GDP and also stipulates a set of remedies to be undertaken by the Government, including the obligation to reduce the debt in average by 5% per year.

The same Law on fiscal and budgetary responsibility stipulates the obligation of Government to adopt each year the fiscal-budgetary strategy and to submit it to Parliament together with a law approving certain limits provided by such strategy. This law has to be approved by Parliament. Once approved, the fiscal and budgetary strategy and especially the limits approved by law are mandatory in the preparation of central budgets.

³ The political responsibility of members of the government is regulated by the Constitution and by Law no. 115/1999 on ministries' responsibility, as republished and further amended.

⁴ According to article 53 paragraph 2 and article 56 of the Law on fiscal-budgetary responsibility the fines are ranging from 2,000 lei (approx. 440 Euro) to 20,000 lei (approx. 4,400 Euro).

Amongst these limits one refers to the total amount of public guarantees that may be issued by the Ministry of Public Finances and the other refers to the entire public debt, calculated according to the EU common methodology. Whilst the first limit was provided in the initial form of the Law on fiscal and budgetary responsibility (as adopted in 2010), the annual limitation of the public debt to be undertaken in a specific year was only introduced through the amendment of the law in December 2013.

Following this amendment, the Law on fiscal and budgetary responsibility states that the Ministry of Public Finances shall communicate to the European Commission an *ex ante* report on the planned contracting of public debt (article 5⁵).

Since January 1, 2014, the Law on fiscal and budgetary responsibility provides that national public debt - calculated according to the EU methodology - cannot be higher than 60% of GDP at any time. The law also stipulates a mechanism meant to ensure compliance with this limit, including both preventive and corrective measures.

Corrective measures are to be undertaken if the public debt overpasses an alert level of 45% of GDP⁵. If the public debt is higher than 45% of GDP but below 50% of GDP, the Ministry of Public Finances has to submit to the Government a report justifying the increase of public debt and providing for measures for its sustainability. In case of public debt ranging between 50% and 55% of GDP, the Government has to make public and apply as soon as possible a program for reducing the public debt, and such program will necessarily include, among other measures, the freezing of total personnel expenditure of the public administration. If the public debt is higher than 55% of GDP but still under the 60% level, the governmental debt reducing program will have to include, in addition to the measures described above, the freezing of the total social assistance expenditure.

For the implementation of measures included in the governmental program for reducing public debt the Government has to initiate a law that will allow for such implementation the latest during the next semester following the one during which the relevant threshold (50% or 55% of GDP) has been overpassed.

As for the corrective mechanism, it will become applicable if the public debt overpasses the limit of 60% of GDP and will include all measures provided by the preventive mechanism; in addition Government will have to ensure the application of the public debt rate of reduction provided by the Stability and Growth Pact – i.e. public debt will be reduced by an yearly average rate of 5%.

4. Budgets of autonomous public entities. Deficit and debt. Government guarantees for solvency or debt

The budgets of autonomous public entities (agencies) are consolidated with the public budgets only if the criteria provided by EU methodology for statistical classification of certain entities as belonging to the sector of public administration are met⁶. This means that the consolidated national public budget will only include the budgets of those entities controlled by the state which cannot cover at least half of their production costs.

Budgets of autonomous entities controlled by the state (i.e. autonomous regies, national companies) but which are not in situation described above are treated separately, being subject mainly to financial regulations concerning private companies, but also to specific regulations regarding their corporate governance, reporting of financial transactions with public entities

5 As of December 31, 2013, Romania reported a public debt of 40,2% of GDP, calculated according to the Eurostat methodology, <http://discutii.mfinante.ro/static/10/Mfp/buletin/executii/Structuradatpub20002013octro.pdf>

6 Regulation (EU) no. 549/2013 of the European Parliament and of the Council of 21 May 2013 on the European system of national and regional accounts in the European Union, published in OJ L174 as of 26.6.2013.

and control of budget execution⁷. They can incur deficit and debt similar to privately owned companies, without any explicit or implicit state guarantee for their obligations.

The law does not stipulate any general guarantee, but allows for explicit state guarantees to be undertaken in relation to specific obligations of nominated beneficiaries (i.e. state-owned enterprises). There are no special legal provisions related to the enforcement of creditors' rights or to insolvency procedures applicable to state-owned companies that may be interpreted as implicit state guarantees for the obligations of such entities.

Moreover, the financial relations between the state (public budgets) and the state-owned companies are monitored and any measure that may be undertaken by the state, directly or indirectly, by implying public funds and meant to provide financial support to such state-owned enterprises have to comply with the state aid regulations.

5. Local government deficits and debt

In principle, local collectivities, named "administrative-territorial units" (communes, cities and counties) enjoy decisional and financial autonomy, and each such unit has its own budget, prepared by the local executive authorities and approved by the deliberative bodies (local councils).

A separate law on local public finances (no. 273/2006, as further amended) regulates the budgetary procedure and the principles and rules for drafting, approval, execution and control of the local budgets.

Unlike the central budgets, local budgets are structured with a functioning (current expenses) section and a development (investment) section, running separate sub-budgets.

The Law on local public finances provides expressly for the balanced budget principle and does not allow deficits of local budgets upon their approval. In addition, local debt may be undertaken only for the financing of local investments or for the refinancing of local debt, but not for covering the local budget deficit.

The undertaking of local debt by local authorities is governed by the same Law on local public finances, which sets several barriers.

The first obstacle is the limited purpose of local debt, i.e. public investments and refinancing of existing debt. Second, the law requires that financial pre-conditions are met before starting the debt approval procedure: no deficit of the functioning section of the local budget as of the end of the previous year and no unpaid obligations as of the end of the previous year. It is admitted that the second condition is still met if the outstanding debt (as of December 31 of the preceding year) is paid before approval of the undertaking of local debt by the central Commission for Authorization of Local Loans. In addition to these conditions that are specific for the undertaking of local debt, the law stipulates a general restriction to enter any new contract if arrears are registered, except for debt to be used for payment of existing arrears.

The amount of local debt outstanding at a certain moment is subject to a general limitation of 30% of the average annual own incomes of the respective local budget, calculated by the taking into consideration the last three years. The own incomes considered for the calculation of this limit are those characterized by a certain stability⁸ and include local taxes, income for own assets, the income tax quota distributed monthly from the state budget, but do not include

⁷ Further to specific requirements of the international financial institutions providing loan finance to the Romanian Government, a regulation on the corporate governance of public undertakings (Emergency Government Ordinance no. 109/2011, as further amended) was enacted. The financial relations between the public sector and the public undertakings are regulated by the Competition Council Regulation dated 21 May 2004 concerning the transparency of the financial relations between public authorities and public undertakings as well as the financial transparency within certain undertakings, transposing into Romanian law Directive 80/723 (the Transparency Directive). Public undertakings having the state or a local community as a majority shareholder or those benefitting from public guarantees or acting as concessionaires of public property assets or receiving public funds in any form are subject to the control of the Court of Accounts.

revenues from sale of assets or any distribution or transfer from the state budget (except for the redistributed income tax quota).

However, these financial pre-conditions to debt undertaking and limitation of outstanding debt are not applicable to loans contracted by local authorities for ensuring the co-financing of investments financed from EU funds (non-reimbursable). Also, the financial pre-conditions (ensuring the stability of the local budget) are not applicable in case of loans contracted by the local authorities subject to financial crisis or insolvency procedures for the refinancing of existing debt according to the resolution plan approved within the procedure.

In addition to this general limitation, to be calculated by the local authorities when intending to undertake local debt, special nominal limits for the overall local debt that may be undertaken during one year and that may be required to be disbursed in the same year are set by the special law approving the targets of the fiscal-budgetary strategy. Both limits are provided as nominal amounts valid for all debt undertaken and, respectively, disbursed by or to all local authorities using debt instruments during the reference year.

Compliance with these limits is verified first by local authorities before going through the stages of the procedure for approving the undertaking of local debt obligations. Another check is provided by a governmental Commission for Authorization of Local Loans, which has to approve the debt before the underlying contracts are signed.

8 S. Gherghina, *Drept financiar public. Datoria publica, op.cit.*, pp. 152-158.