THE FISCAL AND FINANCIAL CONTROL REFORM IN ROMANIA AND TURKEY: A COMPARATIVE STUDY[1]

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Abstract

After Romania became a member of the European Union in 2007, acquis communautaire became part of the Romanian national legislation and although Turkey is not a member of the EU, the accession process as a candidate country covers many sectors, such as: taxation, statistic, environment, financial control, etc. Since 2007 Romania recorded a strong economic growth, making best use of EU structural funds to enhance investment, innovation, and employment. Turkey is a candidate country and a strategic partner for the European Union with a dynamic economy. Turkey applied to join the European Economic Community in 1987 and it was declared eligible to join the EU in 1997. Finally, the accession negotiations were opened with Turkey in October 2005 and in the last years many reforms have been implemented.

The aim of this paper is to present a comparative study between fiscal and financial control reform in Romania and Turkey, the evolution of fiscal and financial reforms in Romania, and the major problems seen in the public fiscal system in Turkey.

Keywords: *financial reform, financial control, budget deficit*

JEL Classification: G_{17}, H_{83}, H_{62}

1. Introduction

This paper seeks to present an analysis of the fiscal and financial control reform in two different countries, Romania and Turkey, the interaction between European reforms and the consequences of the international economic crisis.

In the last 25 years there have been many fiscal, administrative and social reforms in the East European countries. Between 1990 and 2000, Romania has

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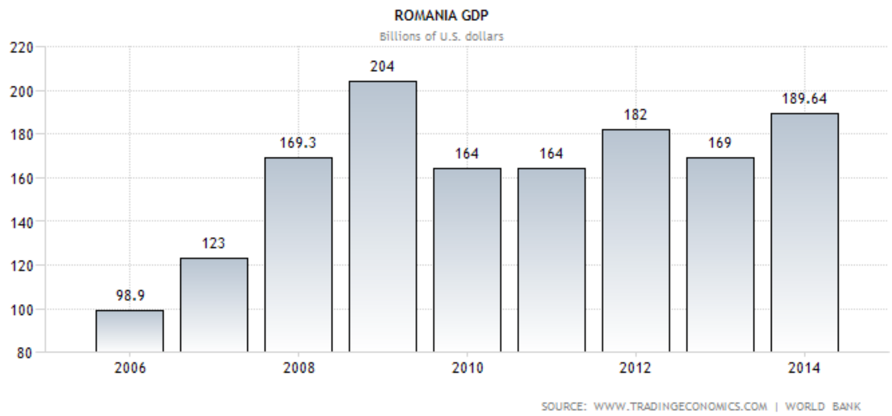
been characterized by significant transformational political and economic reforms. A new Constitution was adopted in December 1991, which set the groundwork for a democratic politic system and for economic development. At the end of 2002, Romania was invited to become a NATO member, at the beginning of 2007 Romania became a member of the European Union and the economic reforms were accelerated. Before the crisis, Romania recorded high GDP growth rates, annual real GDP growth averaged 6.5 % in 2001-2008, mainly due to strong domestic demand (Country Report Romania 2015).

After a big contraction during the crisis, the economic growth recovered quickly, reached 2.9% in 2014 and is expected to continue its positive evolution.

Fig. no. 1. *The evolution of GDP in Romania 2006-2014*



Source: http://www.tradingeconomics.com/romania/gdp

In the Turkish public system we could observe a weak fiscal discipline until the 2000s. The public management was irregular, far from transparency, there was no control of public spending, the deficit was financed by public loans, there are no limits of public deficit etc. (Yükseler, 2010, p. 2).

Until the 2000s, the major problems seen in the public fiscal system in Turkey are:

- high level of budget deficit and inflation rate,
- surplus of domestic and external debt,
- the deficit of the social security budget,
- state enterprises give recorded loss every year and this loss was covered from the general budget,
- financial problems of the local budgets,
- growing bureaucracy,
- wasting of public resources, etc.

During the 1990s, there are some economic developments, such as: Turkey's membership in the Customs Union and the acceptance as potential candidate for European Union (EU), after 1999, when the new coalition government won the elections. By December 1999 a new Agreement was signed with IMF for a stabilization program. On 17 August 1999 the Marmara Earthquake had a significant influence on the deterioration of the public financial structure.

Literature review

The paper has based its conclusions on the following papers and researches:

Radulescu (2011), in her book *The Fiscal Reforms and Flat Tax in Europe and CEE Countries*, presented the fiscal reforms and flat tax reform experiences of the EU Member States which implemented the flat tax and the impact of these reforms for fiscal policy making. (Radulescu, M., 2011) Romania adopted the fiscal tax reform, introduced by the Government at the beginning of 2005, and this modification brought Romania among the most competitive investment destinations in the region. Starting with 2005, following a successful model already introduced by other countries in the region, corporate and individual incomes are levied with a single tax rate of 16%. Even today, the Romanian single tax rate is competitive compared to the other countries' levels of taxation. She thinks that the causes of high budget and current account deficits in the CEE region are explained by excessive expenses generated by a lax monetary or fiscal policy.

Nica et al. (2014) presented in their research "The Role of Internal Control and Financial Audit in Implementing European Financed Projects from European Social Fund Category" the role and importance of the internal control and financial audit in implementing European financed projects from Community funds. They presented the types of internal control, internal control system, audit procedures, actual facts control elements, finalizing an audit mission, audit beneficiary, the work of an independent financial auditor, and actual facts report.

2. **Fiscal and financial reforms in Romania and Turkey**

Many fiscal reforms have taken place in the European area in the last decades, and some of them are still continuing to be implemented in the European countries (Radulescu, 2011). Some countries, including those in Eastern Europe, have adopted some version of a flat tax in an attempt to boost economic growth. Among the new EU Member States, Estonia was the first one to adopt a flat income tax reform in 1994, then some other European countries adopted this fiscal reform, Slovakia imposed in 2004 a flat tax of 19%, and Romania adopted in 2004 the flat tax of 16% (Radulescu, 2011). It was a good decision of the government and strong fiscal reform with benefits for the state budget and the economic development because a country's tax system affects its government revenues. Also, the VAT rate adopted at that moment was 19% in order to encourage the investments and the economic transactions.

Reform of tax administrations at the organizational level continues to feature strongly in Member States' strategies (EU Tax Reform Report 2014) (Tax Reforms in EU Member States 2014). Romania has restructured its national agency for fiscal administration, setting up a new anti-fraud department. Regarding personal income tax, we noticed that the tax incentive for collective savings for housing was abolished in 2013 and related to corporate income tax, we noticed that the additional tax deduction for expenses relating to qualifying research and development was increased from 20% to 50%, with effect from February 2013. In global crisis, the government of Romania was forced to increase the VAT rate from 19% to 24% to shrink the deficit this way budgetary (Stroe, 2011). Recently, the VAT rate was reduced to 9% for bread, flour and related products, with effect from September 2013. One of the weaknesses of fiscal and financial reform in Romania is the frequent changes of the fiscal legislation and the difficulties for the investors to plan the budgets and the development projects.

According to the EU country report *Romania 2015*, under successive assistance programs key macroeconomic imbalances in Romania concerning the current account and fiscal policy have been considerably reduced and financial sector stability has been maintained. “Although measures to increase the efficiency of the tax administration are being implemented, value added tax compliance is among the lowest in the EU and undeclared work weighs on budget revenues. Frequent changes to the tax system contribute to instability in the business environment.” (Country Report Romania 2015)

In Turkey there have been some measures in the financial reform after 2000. The absence of fiscal discipline, high public debt, large public spending, and high levels of inflation, during 2000-2001 crisis in Turkey, reveal the importance of fiscal reform. Between Turkey and IMF a stand-by agreement was signed 19 times so far. The last 19th stand-by agreement with IMF ended in May 2008. After this date no other stand-by arrangement has been concluded. Turkey started to implement fiscal rules with a virtually stand-by agreement (Saygılıoğlu, Erduran, 2011, p. 2). “Fiscal rules are imposed on financial variables legal limitations or imposed on fiscal policies permanent limitations” (Kopits and Symansky, 1998), pp. 1-5). The IMF agreements have become the main axis of fiscal policies in Turkey. The most important target was reducing the burden of public debt and budget deficit, avoiding big public spending, and increasing the public revenues. After 2000-2001 crises due to the Transition to Strong Economy Program, legal regulation has been made in four main areas (Işık, Sakal, Meriç, 2010, p. 16):

- restructuring of the financial sector,
- ensuring the government transparency and strengthening of public financing,
- increasing competition and the effectiveness of the economy,
- strengthening the social solidarity

Thus, implementing a strong monetary policy, and opening the inflation target, budget discipline and structural reforms, inflation rate has dropped to single digits since 2004 (Işık, Sakal, Meriç, 2010, p. 17). In the context of strong fiscal policy, increasing revenues, the new public spending policy, and improvements in public financial structure have been observed.

The Public Finance Management and Control Law no. 5018 adopted in 2003 implemented specific rules for public financial management and for the public finance, in order to ensure transparency and accountability in the public system.

According to the Law no. 5018 in public financial management, extra budgetary funds were transferred into the general budget, internal audit was implemented, public institutions were divided according to a new classification under the Analytic Budget Classification, a medium-term expenditure strategy was adopted and the relations between the development plans and budgets were improved, strategic plan was implemented in all public entities, and more regular and detailed financial statistics were prepared for the public management (Yereli, 2010).

A new Law on Regulating Public Finance and Debt Management was introduced in 2002 in order to cut the growing public debt. With this law, Treasury can loan until budget deficit. After 2001 crisis in Turkey, with the Law of Central Bank Amending, Central Bank cannot finance other public institutions and Treasury (Meriç, Bülbül, 2013, p. 300).

In addition, according to the Municipality Law no. 5393, the external debt of local budget can be accepted in order to promote investment, but legal limitations have been introduced.

As a result of the above measures in the financial reform, Turkey's financial indicators have been significantly improved. Thus, the budget deficits to Gross Domestic Product (GDP) ratio have been reduced:

Table no. 1: **The Budget Deficit to GDP Ratio in Turkey**

Years	**2000**	**2001**	**2002**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
(%)	-7.9	-11.9	-11.5	-5.5	-3.6	-1.4	-2.0	-2.2	-2.5

Source: Undersecretariat of Treasury, Turkey, http://www.hazine.gov.tr/default.aspx?nsw=EilDPQez15w=H7deC+LxBI8=&mid=59&cid=12&nm=167

The share of central government budget expenditures to GDP has declined almost 10 points from 2001 to 2014.

Table no. 2: *GDP Share of Central Government Budget Expenditures*

Years	**2000**	**2001**	**2002**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
(%)	30.8	36.2	34.1	28.2	26.8	24.2	25.1	25.7	25.0

Source: General Directorate of Budget and Fiscal Control, Budget Aggregates and Budget Realizations, http://www.bumko.gov.tr/TR,4534/merkezi-yonetim-butce-gelirleri-2006-2012.html

On the other hand the ratio of central government debt has improved to almost 50%. This rate is around 74% in 2001 and decreased to 34% in 2014.

Table no. 3: **Central Government Debt Stock to GDP ratio**

Years	**2000**	**2001**	**2002**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
(%)	38.2	74.1	69.2	46.3	43.1	39.9	37.6	35.9	34.1

Source: Undersecretariat of Treasury, Treasury Statistical Yearbook, Public Debt Management, http://www.hazine.gov.tr/default.aspx?nsw=EilDPQez15w=H7deC+LxBI8=&mid=249&cid=26&nm=41

3. **Internal control in Romania and Turkey**

According to the Committee of Sponsoring Organizations of the Treadway Commission (COSO), internal control is broadly defined as a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories: Effectiveness and efficiency of operations, Reliability of financial reporting, Compliance with applicable laws and regulations. In the last decades, internal control has become an important instrument to manage the public revenues and public deficits.

In Romania, a new regulation was adopted in 2005 for approving the “Internal Control Code, comprising the internal management/control standards at the public entities” for the development of the managerial control systems. According to the commitments assumed by Romania within the framework of Chapter 28 “Financial control” of the negotiations with the European Union, the Romanian Government adopted on July 2005 a new legislation to reform the internal control. “The *acquis* under this chapter consists mostly of general internationally agreed and EU compliant principles of public internal financial control that need to be transposed into the control and audit systems of the entire public sector. In particular, the *acquis* requires the existence of effective and transparent financial management and control systems; functionally independent internal audit systems; central harmonization units for these two fields, responsible for the co-ordination and harmonization of methodologies; an independent external audit of the public internal financial control systems in the public sector (Supreme Audit Institution); an appropriate financial control mechanism for EU funds; and the administrative capacity to give effective and equivalent protection to EC financial interests.”[2]

In the programs there have been comprised, distinctly, professional training actions, for persons with management positions, as well as for those with execution positions, by training sessions organized by the School of Public Finance and Customs, the National Institute for Administration or by other authorized organizations.

[2] ***Chapter 28: Financial control,*** the commitments assumed by Romania in the negotiations with the European Union.

In Turkey, in the area of public internal financial control (PIFC), the Ministry of Finance issued a circular on alignment with internal control standards and published a public internal control guidebook. The Central Harmonisation Unit for financial management and control has drafted a central harmonization guidebook. “With regard to internal audit, the Ministry of Finance issued a circular on the appointment of internal auditors and internal audit practices. The Internal Audit Coordination Board announced the 2014-16 internal audit strategy document. The appointment of internal auditors at central and local administration is yet to be completed. The revised PIFC policy paper, which will also need to clarify the role of internal auditors and ensure the compatibility of centralized financial inspection with managerial responsibility, needs to be finalized and adopted” (Turkey Progress Report 2014).

The enforcement of internal financial control could help the implementation of fiscal and financial reforms in all countries. In the last few years many positive results have been observed in the dynamic economies.

Conclusion

In this research we presented the analysis of the fiscal and financial control reform in Romania and Turkey. We observed that significant reforms have been adopted in European and non-European countries, most of them accelerated by the economic growth after 2000. A remarkable economic growth was observed in Romania and structural funds significantly contributed to financing important investments in local economy. Despite important reforms, deficiencies in the business environment might threaten future investment in Romania and the development of small and medium enterprises. However, despite the contraction during the crisis, the Romanian economy is recovering quickly and the growth will remain positive in the next years.

We can observe a positive evolution of financial and fiscal reform in Romania, especially after 2005 when new regulation was adopted for approving the Internal Control Code, according to the EU legislation.

In Turkey there have been implemented important fiscal reforms and positive changes in the fiscal structure of Turkey were observed. Public expenditures, public debt and budget deficit as share of GDP decreased, but the international financial crisis had a negative impact on financial indicators of Turkey. The major problems seen in the public fiscal ~~It~~system in Turkey were until 2000s. In that period of time, we could observe the high level of budget deficit and inflation rate, financial problems of the local budgets, growing bureaucracy and wasting of public resources. But, in the last few years new reforms were implemented according to EU regulation and it is expected that in the next few years the Turkish economy will recover completely.

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