Romanian Public Expenditures Policy during the Economic Crisis

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1. Introduction

Since budgetary policy remains one of the main components of economic policy, by pursuing its cyclical objectives, but also by its multiple links with the other economic policies, whom it provides a financial support, we will present a few studies which show the relationship between using certain types of expenditures and their contribution to economic growth. During the current global crisis, the Keynesian economic policy, based on monetary and fiscal policies has been implemented by many governments with a high share in the global economy. According to Keynes (1970), in periods of economic decline it is useful to employ higher public spending, given the multiplier effect that public final consumption and investment demand entails. Public expenditure multiplier expresses the income and production growth resulting from an increase in total public expenditure without adjusting tax amount, which conducts to an increase or to a budget deficit, financed via borrowing (Frois, 1994, p.345).

There are many studies which confirm the positive relationship between public capital and economic growth. Discussions on the effects of infrastructure has increased especially after 1989, with the assumption made by Aschauer (2000), that the decline in productivity of public services is crucial to explain general decline in growth. The study conducted by Alonso-Carrera (2009, p. 571) identified the positive spillover effects of public capital for almost all regions of Spain, with differences in per capita production in various regions. In turn, Toshiki (2009, p. 253) showed that public investments enhance economic growth, because it stimulates demand for intermediate goods, and also increasing profits for the sector companies. Therefore, this increase raises the interest market rate and thus leads to economic growth.

Some studies had controversial results concerning public investments contribution to enhancing economic growth. Typical is the study by Gregoriou and Ghosh (2009) for 15 industrialized countries. For Brazil and Thailand, public capital expenditure had a significant negative effect, while current expenditure has a significant positive role on economic growth; on the other hand, for countries like Sudan and Zimbabwe none of the two types of expenditure has a substantial impact on growth. Also, Deliktas et al. (2009, p. 376), on the case of Turkey, emphasizes positive and negative long-term effects of public capital installed outside of regions over others on private capital and employment. Thus, in the Marmara region, which represents 60% of private manufactured in Turkey and that attracts most public investment, around 30%, the effects are positive, while in the south-east Anatolia, the effects are negative. These cases are explained by the mobility of production factors, from the less developed to developed ones. Moreover, the employment rate is 9.7% to -5.5% in the Marmara and South-eastern Anatolia. Also, social protection can be seen as a necessary investment that fosters productivity through consumption smoothing, and if governed appropriately, can behave as a productive factor by bringing more people back within the economic mainstream who would otherwise be marginalized (Dewan, 2009, p. 9). Gerson (1998) shows after combining the economic with the functional expenditures classification, that investment in certain areas, in particular transportation and communication, appears to be more systematically matched with higher growth.

In other studies, using a functional classification, the types of public expenditures that have been found to raise growth are education, R&D and public infrastructure spending, while others also include spending on health, public order and safety, and environment protection.

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There are also studies on automatic stabilizers in times of recession, which focuses on social benefits, such as unemployment insurance. For example, the study conducted in Canada, by Stokes (1995), demonstrated the stabilizing impact of unemployment insurance program on GDP, as it increased employment during the 1981-1982 and 1990-1991 recessions and reduced it during the boom of the second half of the 1980’s. These countercyclical effects also contributed to a rise in participation rates, thereby reducing the stabilizing impact on the unemployment rate. Sargent (2005, p.1) argues that unemployment insurance is not just a way of ameliorating the impact of a recession on the unemployed. It also has a potential role in making the recession itself less severe through its traditional automatic stabilizer role.

Also, study conducted by Dolls et al. (2009) shows that unemployment insurance is an automatic stabilizer in times of economic crisis, absorbing with about 32% the European economic decline, whereas the value of the economic stabilizer for the US is about 19 per cent. From the studies presented we can say that implementing the public expenditures policy can contribute to economic growth and in this context of the economic crisis it can be used for the economic recovery.

2. Aspects of Romanian public expenditures policy in the context of the economic crisis

In the context of the economic and financial crisis, there was a need for Romanian government programs in order to boost competitiveness, to support certain sectors in danger of collapsing and helping those who have been hurt by the economic downturn.

Graph 1- Evolution of public expenditures as a % of GDP, in Romania during 2006-2009

Source: According to data from the Ministry of Public Finance

Public spending evolution relative to GDP has been a positive one over the last 4 years, as presented in Graph 1, due to an upward trend of public expenditures, which increased with 71.38% in 2009, compared with 2006.

Table 1- Evolution of public expenditures (selected ones from the economic classification) in Romania during 2006-2009 (millions RON)

<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total expenditures</td>
<td>112,626.3</td>
<td>136,556.5</td>
<td>189,121.7</td>
<td>193,025.4</td>
</tr>
<tr>
<td>1. Current expenditures</td>
<td>99,869.4</td>
<td>122,127.8</td>
<td>166,371.3</td>
<td>173,340.9</td>
</tr>
<tr>
<td>Staff expenditures</td>
<td>21,057.0</td>
<td>25,588.9</td>
<td>43,344.5</td>
<td>46,710.7</td>
</tr>
<tr>
<td>Social assistance transfers</td>
<td>30,901.7</td>
<td>38,326.7</td>
<td>53,591.4</td>
<td>63,962.1</td>
</tr>
<tr>
<td>Interests</td>
<td>2,489.7</td>
<td>2,739.7</td>
<td>3,893.3</td>
<td>6,061.8</td>
</tr>
<tr>
<td>Goods and services</td>
<td>22,744.8</td>
<td>25,835.1</td>
<td>33,225.5</td>
<td>28,835.0</td>
</tr>
<tr>
<td>2. Capital expenditures</td>
<td>12,717.0</td>
<td>14,410.4</td>
<td>23,203.4</td>
<td>23,175.3</td>
</tr>
</tbody>
</table>

Source: According to data from the Ministry of Public Finance

Analyzing the evolution of public expenditures on structure, as presented in Table 1, we can see some of the changes in public expenditures generated by the current economic crisis. In 2009, consolidated budget expenditures amounted for 193.0 billion RON, of which almost 89% (172,340.9 millions RON) represented current spending, an increase with 3.58% compared to 2008 and with 73.56% compared to 2006. As international financial institutions have warned at the end of 2008, Romania spends a lot on unproductive expenditures, such as budgetary employees’ wages and pensions, and this must decline, in favor of investments which foster production, contributing to the country's economic recovery. If we analyze the evolution of current expenditures, the highest percentage was with social assistance transfers, which have doubled in the period considered, reaching 63,962.1 millions RON in 2009, 12.7% of GDP, followed by staff costs, whose evolution was a similar one (46,710.7 millions RON in 2009, 9.2% of GDP). Fairly large share of expenditures on social assistance is justified under the current crisis, given the large increase of the unemployment rate, from 4%, its value in October, 2008, to 7.8%, in December 2009, reaching 7.35% in September, 2010. In this context, additional costs with unemployment benefits and reductions of unemployment insurance revenues were necessary.

As seen in Graph 2, during 2006-2008, when the unemployment rate decreased from 5.4% to 4%, expenditures with unemployment benefits also decreased, with 13.73%. In contrast, in 2009, a year marked by the negative effects of the economic crisis, public expenditures for unemployment insurance doubled compared to 2008. This confirms that the unemployment insurance development is related to business cycle, can act as an automatic stabilizer, which is in fact evidenced by numerous studies.
In what concerns goods and services, we can note from Table 1 that was registered a decrease of 13.21% in 2009 in the interests paid, with 55.69% in 2009 compared to 2008.

Within the target budget deficit of 5.9% of GDP. Also, as resulted from Table 1, this external loan generated an increase in the number of annual early retirements and also the difference between the smallest (350 RON, from October 1, 2010) and largest public pension in Romania (37,000 lei) will be reduced. After implementing the new law on pensions, according to which the retirement age for both women and men will be 65 years, our state pays for these guarantees, between €60,000 and €75,000 on stages of implementing the pension point has become 732.8 RON.

In what concerns the others recommendations, their implementation will be done through the adoption by Parliament of the new pension law, according to which the retirement age for both women and men will be 65 years, the number of annual early retirements and also the difference between the smallest (350 RON, from October 1, 2009) and largest public pension in Romania (37,000 lei) will be reduced. After implementing the new law on pensions, it is forecasted that consolidated public budget expenditures will be reduced with 2761 million RON in 2010 and about 24.119 million RON in 2020. As showed in Table 1, social assistance costs increased by 9.8 billion RON in 2009 compared with the previous year, the budgetary deficit being around €1.74 billion (7.36 billion RON).

The Romanian government priorities were job creation and helping those who have been hurt by the economic downturn. In order to stimulate employment and reduce the unemployment rate, in February 2010, our Government adopted an ordinance of exemption for a period of 6 months payments for social contributions for those employers which employ for at least 1 year unemployed persons, which have been unemployed for at least 3 months. This measure aims at employing almost 500,000 persons, according to an estimation made by the Ministry of Public Finance with the Labor Ministry. According to a Government press release, the total number of employees, as a result of GEO 13/2010, on 30 June was 2,635 and the number of employers who have benefited of GEO 13/2010 was 1,686.

Secondly, another type of current expenditures on which Romania is spending very much is on pensions. Last year, total expenditures on pensions represented 48 billion lei, meaning 9.5% of GDP and 31% of the state revenues. According to Labor Ministry statistics, the total number of pensioners of the state social security system, including paying farmers in 2009 was 5.54 million people, while the total number of contributors to public pension system did not exceed, at that time 5.65 million people, leading to a dependency ratio for the public pension system of 0.98 for retired to 1 taxpayer. In 2009, total annual pension expenditure in Romania was about 39 billion RON, the largest budget expenditure category, its share in gross domestic product being 8%. Thus, the pension fund budgetary deficit was about €1.5 billion (about 2 billion dollars) and was financed from the state budget, while for 2010 the deficit is estimated at €1.7 billion. For 2010 were allocated 39.6 billion RON for pensions, which represent 7.36% of GDP. The public pension system in Romania, as in many other countries, has felt the impact of demographic changes, like population ageing. This is why measures taken now by the Romanian government to reform the actual pension system have to cover long-term objectives. Some recommendations from international financial institutions were: indexing pensions to inflation, increasing the retirement age and equality for men and for women, as well as reducing early retirement.

Indexing pensions to inflation, with 3% on April and with 2% from October 2009 was a social measure adopted by the Romanian Government to better protect pensioners in the short term by maintaining their purchasing power, but at the same time, it is a measure which contributes to long-term fiscal sustainability of the pension system. Currently, pensioners receive 45% of the average wage, but according to Labor Ministry data, the average wage in Romania in 2010 was 1,700 lei. As a result of this measure, the value of the pension point has become 732.8 RON.

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In what concerns goods and services, we can note from Table 1 that was registered a decrease of 13.21% in 2009 compared to 2008, following the recovery measures approved by the Ordinance Emergency 34/2009. In times of economic recession it is important to focus on productive expenditures, such as investments. From Table 1 results that our Government spent a large amount on current spending while capital expenditures decreased with 13.3% compared to 2008, accounting 23,175.3 millions RON, respectively 4.9% of GDP, although in the 2009 budget as for 2010, capital expenditures were projected at 7% of GDP. For 2010, there is a need for investments projects in order to stimulate the recovery and our hope is that their percentage of GDP will increase. The Romanian Government important projects are: “First House”, Romanian village revival program-10 houses for specialists, “Rabla” and the public-private partnership to build Comarnic-Brașov highway. This year, through the “First House 2” program, the ceiling for government housing guarantees increased to €75,000, aiming at a multiplier effect in the economy, at increasing employment and bringing as many business resources in a period marked by economic difficulty. It should be noted that our state pays for these guarantees, between €60,000 and €75,000 on stages of implementing the

Graph 2 - Evolution of unemployment insurance budget expenditures in Romania during 2006-2009 (millions RON)
construction. Till November 2010, under the „First House” program, the total amount of government guarantees granted were about 1,069.8 mil euro. In the case of “Rabla” program, money is taken from the Environment Fund, which collects money from taxpayers who pay the tax pollution. In what concerns the public-private partnership Comarnic-Brașov, it is known and stated by the Minister of Transport, that the project would have never been built with money from the state budget, because it would have increased the budgetary deficit.

In 2009, when the negative effects of the economic crisis deepen, our state supported businesses affected by the crisis, granting state aids schemes, approved by the European Commission since May, 2009, to potential beneficiaries from all sectors. State aid plays an increasing role in supporting the economic recovery and enabling the clause stipulated in Art. B7 (3) (b) of the EC Treaty, for a temporary period, was justified in this period of financial crisis. Also, in order to support production, were extended government guarantees by increasing with 900 million RON the share capital of the House of Savings Bank. Public expenditures were in the form of grant, interest subsidy and state guarantees, in order to help companies affected by the crisis and reduce the unemployment rate. From the above analysis we can see that there is a need for further investments in Romania, in order to stop extending this crisis and also are needed reductions of unproductive expenditures. Only by making productive public expenditures, in investments, we can see that multiplier effect of public spending.

3. Conclusions

The current economic and financial crisis has shown the recrudescence of the Keynesian paradigm, in which the government intervention should be seen as a way to stimulate consumption, global demand and thus the economic recovery. Thus, the governments tried, through budgetary fiscal stimulus and monetary policy to alleviate the economic downturn. According to Keynes, in periods of economic decline it is recommended to employ higher public spending, given the multiplier effect that public final consumption and investment demand entails. After analyzing the evolution of Romanian public expenditures between 2006 and 2009, according to the economic classification, was noticed that higher spending was directed to unproductive areas, which do not bring added value in the economy, while capital spending declined. Payments for salaries of government employees and pensions have consumed all Government resources, both internal and external, in detriment of investments, although the stand-by arrangement contracted by the Romanian government with financial international institutions aimed at allocating more than €10 billion on infrastructure projects. Also, there is presented the changes in public expenditures (increases of social assistance spending and interests, decreases of goods and services) as a result of the measures implemented by the Romanian government in the context of the crisis, in order to support job creation, helping those who have been hurt by the economic downturn, to support investments, businesses, labor market, boost demand. Thus, there are necessary reductions of unproductive expenditures, such as staff costs and increases of intellectual and economic investments in strategic areas, which can represent an exit from the economic crisis. Public capital expenditure is a key driver of growth, contributing to poverty alleviation, improving living standards and business productivity, households and government services. Fiscal-budgetary policy, as well as the monetary and currency policy, aimed to stabilize the economy and to initiate a rapid recovery, which also must be based on sustainable growth.

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