PUBLIC EXPENDITURES FOR DEVELOPMENT - THEIR ROLE IN OVERCOMING THE ECONOMIC CRISIS AND ALIGNMENT OF ROMANIA TO EUROPEAN UNION REQUIREMENTS

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Abstract:

This paper analyses the role of public capital expenditure in Romania. There were identified two important roles of public expenditures for development in Romania, currently: levers for overcoming the economic crisis, and a means to align Romania to European Union requirements stipulated in the revised Lisbon Strategy. The analysis concluded that these expenses, although with a relative value twice the EU average, experienced a strong downward trend with the economic crisis, so as they have not contributed to economic recovery. Regarding the second role, matching the EU requirements in development, has not been reached. This is demonstrated by the Lisbon index, according to which in 2008 Romania ranked 25th place, while in 2010 situated Romania only on position 26.

Keyworks: *public expenditure, public debt, economic crisis, capital expenditures*

1. Introduction

Investment has a crucial role in socio-economic development of any country, helping to increase technical and economic efficiency of capital, create jobs, to ensure national competitiveness. Investments give rise to a series of chain effects, drive effects, which causes: promoting technical progress, increasing production, improving quality of goods / services, increase economic efficiency. This role is amplified in the current period investment, the economic crisis.

Only through sustained and correlated investment, which starts from public sector, jobs can be created to integrate young people into work, or retain the current in order to reduce unemployment; investments can strengthen research, education, innovation and competitiveness in business, investments can only boost the economy so as to generate sustainable growth, a priority objective for both overcoming the economic crisis, but also to align with EU requirements expressed in the Strategy Lisbon.

From the foregoing it is apparent that the decisive role of budgetary expenditures for development of Romania in the country's economic recovery as a first step but at the same time having as background the objectives of the European Union.

2. Analysis of public expenditure for development financing in Romania

State investment expenditures have a key role especially in the current economic conjuncture, because when public investments are made rationally they stimulate economic growth, creates new jobs, develops certain regions of the country thereby reducing the economic and social disparities that exists between developing regions of Romania.

The objective of the decision-makers at the central level, of the public administrators, should not be increased public investment spending, but must consider the effects that are desired to be obtained, and this is often overlooked. The emphasis in the allocation of public funds for development should not target only the input elements, but especially those of output, outcome and relationship between these indicators. Otherwise, things will happen just like the current situation in Romania: the share of investment expenditure in total public expenditure is almost double the EU average, but the results of these investments are not seen. In a simple analysis of official statistics, Romania is the first in the public financing of development projects, but if you would review the effectiveness of these investments rank would reverse. While it have spent considerable sums on infrastructure, especially highway construction, the results are completely unsatisfactory, building only 303 km of highway so far, which makes one km of motorway in Romania to be more expensive than any developed countries of Europe.

In this section it will be analyzed the situation of Romanian capital expenditures financing, by source of financing.

Table 1: The level of public capital expenditures in Romania during 2006-2010

	2006		2007		2008		2009		2010	
Indicators	**mil lei**	**% GDP**	**mil lei**	**% GDP**	**mil lei**	**% GDP**	**mil lei**	**% GDP**	**mil lei**	**% GDP**
Public capital expenditures - general consolidated budget	12 717	3.8	14 410.4	3.7	23 203.4	4.5	23 175.3	4.6	19 368.9	3.8

- from local budgets mil lei	3 620.4	6 943.3	13 107.6	11 427.5	10 287.9
- from state budget mil lei	5865.2	4164.9	5642.9	3171	3012.4
Share of capital expenditures in local budgets in total capital expenditure %	28.48	48.18	56.48	49.3	53.11
Share of state budget capital expenditures in total capital expenditures %	46.12	28.9	24.31	13.68	15.55
Dynamics of total capital expenditure %	-	113.32	161.01	99.87	83.44

Source: Public Finance Ministry statistics and own computation

In 2006 and 2007 capital expenditure stood at around 3.8 - 3.7% of GDP, and in 2008-2009 increased by about one percentage point to 4.5 - 4.6% of GDP. The situation is not favorable for 2010, the share of capital expenditure in GDP was less than 4%, contrary to the stimulation of investments for economic revival.

A significant increase in overall capital spending took place in 2008, 61% in nominal terms, and those financed from local budgets in 2007 was increased by 91.78% due to the promotion of reform in local government and implementing investment programs financed from structural and cohesion funds and co financed by local budgets. With the economic crisis, it is noted that the volume of public investment has declined. In 2009, consolidated budget expenditures for investment not only increased the pace of previous years, but actually fell by about 1 percentage point compared to the 2008 level, so their percentage of GDP increased cutbacks of GDP.

To provide a clearer picture of the relative level of capital expenditure financing in Romania, we present the situation at EU level in the table below:

Table 2: Public expenditure on capital, expressed as a percentage of GDP in the EU

Country	2009	2005	2000
EU 27 average	**2.9**	**2.3**	**2.3**
Austria	1.1	1.1	1.5
Belgium	1.8	1.8	2.0
Bulgaria	4.8	4.1	3.7

Cyprus	4.1	3.1	2.9
Czech Republic	5.4	4.9	3.5
Danmark	2.0	1.7	1.7
Estonia	5.0	4.0	3.8
Finland	2.8	2.6	2.4
France	3.4	3.3	3.1
Germany	1.7	1.4	1.8
Greece	2.9	2.8	3.6
Hungary	2.7	4.0	3.2
Ireland	4.5	3.5	3.5
Italy	2.4	2.4	2.3
Latvia	3.9	3.3	1.4
Lithuania	3.9	3.5	2.4
Luxembourg	3.6	4.5	3.9
Malta	2.0	4.8	4.0
Netherlands	4.0	3.3	3.1
Poland	5.4	3.5	2.4
Portugal	2.4	2.9	3.8
Romania	**5.4**	**3.9**	**3.9**
Slovakia	2.3	2.2	2.6
Slovenia	4.9	3.2	3.2
Spain	4.4	3.6	3.2
Sweden	3.7	3.0	2.8
United Kingdom	2.7	0.7	1.2

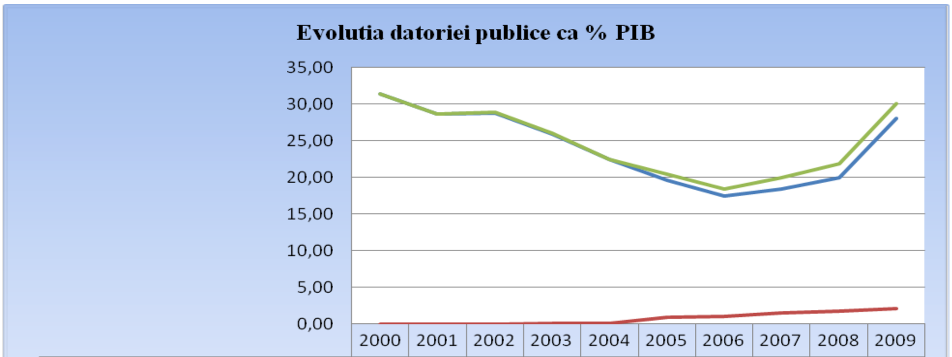
Source**:** data extracted from EUROSTAT

It notes that Romania allocates the highest percentage of GDP for investment, almost double the EU average. This difference has a rational justification arising from Romania's status as the new EU member country in developing and mainly aims to catch up with developed countries of the Union. In this sense it is justified to start a comprehensive investment process, to "provoke" a sustainable economic growth, allowing in the near future, increased attention to the social dimension. But looking at the figures, a paradox arises. In terms of data made public, Romania attaches the highest importance to the investment process of all EU Member States, but the effects where they are? Therefore, the problem is not so allocated amounts, but the effectiveness of their spending, when we refer to the result of state investment. Waste disposal should be considered carefully and prioritize public investments.

In addition to the regular public financial resources, such as taxes, fees, contributions, which are income to the state budget, local budgets, state social insurance budget, etc., are often used to finance investments by the State borrowed financial resources which have an extraordinary character.

On March 31, 2010, Romania registered a total debt of 165,078 million, comprising government and local public debt, direct and guaranteed by state and local governments, arising from internal and external market. The debt related to GDP reaches the level of 30.63%.

Chart 1: Public debt evolution in Romania, as a % of GDP

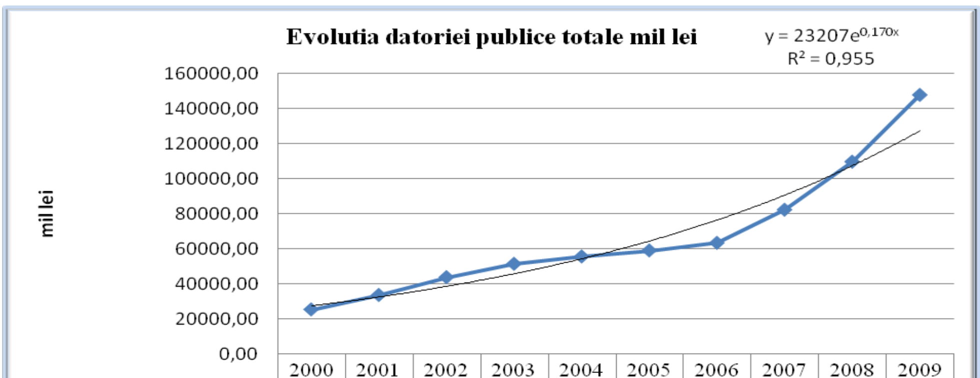


	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Total datorie publica guvernamentala, procent in PIB (%)	31,40	28,70	28,80	25,90	22,40	19,50	17,40	18,40	19,95	28,01
Total datorie publica locala, procent in PIB (%)	0,00	0,04	0,05	0,11	0,16	0,91	1,01	1,50	1,80	2,10
Total datorie publica, procent in PIB (%)	31,40	28,70	28,90	26,00	22,50	20,40	18,40	19,90	21,80	30,10

Source: own calculations

Even if the relative amounts Romania has an acceptable level of public debt, approximately 30% of GDP under the Treaty of Maastricht is acceptable limit of 60% of GDP, in absolute size is an increase of over 80 000 million in three years, from 2006 to 2009, meaning an increase of 233% as can be seen from the chart and table below, has grown exponentially in the last ten years analyzed. It is important to analyze the destination of these loans. Were the borrowed money been used for investment or for financing unproductive expenditures?

Chart 2: Public debt evolution in Romania, in mil lei



	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Total datorie publica	25235,	33506,	43706,	51363,	55550,	59010,	63340,	82324,	109795	148055

Source: own calculations

In order to answer the above question we propose a comparative analysis between the overall capital expenditure of the consolidated state budget over the last five years and the new contracted government loans in those years. The centralization of data is in the table below:

Table 3: The dynamics of overall annual capital expenditure of the consolidated state budget and the new contracted government loans in that year

Indicators	2006	2007	2008	2009	aprilie 2010	2010
Capital expenditures – general consolidated buget MIL LEI	12717.00	14410.40	23203.40	23175.30	4472.10	19368.9
New annual government Loans mil lei	4330.00	14828.80	32551.50	111205.70	17023.00	68092
Dynamics of capital expenses %	-	113.32	161.02	99.88	-	83.57
Dynamics of government loans %	-	342.47	219.52	341.63	-	61.23

Source: data extracted from mfinante.ro and own computation

It can be seen that the optimal ratio occurs in 2006 when public expenditure investments are 12,717 mil lei, while new loans only 4330 mil lei. But even here there is room for interpretation in the sense that the state could borrow additional sums but with the condition to target them for investment, thus accelerating the economic development process. Maintaining a low level of borrowing against investment has a negative impact on future development of the country. Analyzing the correlations between the two indicators there is a phenomenon with serious economic implications, namely a much higher growth of new loans contracted by the state related to annual public investments. In 2007, capital expenditures increased by approximately 13% and loans by 340%; in 2008, new government loans were 40% higher than capital expenditures, government loans contracted in 2009 were 4.8 times higher than capital expenditures. What happened to these loans? Obviously they took the path of current expenditure, deficit financing, that have been used for unproductive purposes, and the effects are already seen as deepening the budget deficit, and to cover likely to be incurred by new loans. Measures to reduce the budget deficit in 2010 are focused on public expenditure, namely the cutting of pensions and salaries, and not to increase state budget revenues by stimulating the private sector by reducing tax evasion. These revenue reductions will create a number of negative chain: will lower consumption, will affect businesses, will affect banks by the outstanding loans, and eventually all state revenues will suffer.

Another important source of financing for development spending in Romania and one way out of the critical economic situation is most effectively use of the available structural funds for Romania during 2007-2013 period. In 2007-2013 period, Romania will benefit from EU funds totaling 27.465 billion euros, of which 19.21 billion are allocated from the Structural and Cohesion Funds; 8.022 billion euros from the European Agricultural Fund for Rural Development and 0, 233 billion euros from European Fishery Fund. To these, are added 6 billion euros to ensure national co-financing. But, as can be seen from the table below, the rate of absorption of these funds is very low for Romania.

Absorption rate and contraction rate can be calculated in several ways, and in the table below are presented three ways: in relation to the entire budget available for 2007-2013 period, reported only on EU financial allocation for 2007-2013, reported on EU financial allocation for 2007-2009 period. Government's version determine the absorption rate and contraction rate reported on EU financial allocation for 2007-2009 period, but only for Structural and Cohesion Funds, that does not take into account the amounts allocated from the European Agricultural Fund for Rural Development and from European Fishery Fund. In this case the absorption rate is 10.4% and the rate of contraction is almost 65%, this variant being the most optimistic calculation.

I consider that it should be taken into account also the funds allocated by the EU through European Agricultural Fund for Rural Development and from European Fishery Fund because they have an importance for the development of Romania, specifically on agriculture and rural infrastructure, the fisheries and aquaculture. So, in this case, the degree of contraction is 38.44% and 4.21% is the absorption rate, otherwise very low level, the lowest among EU countries. For example, the contraction rate is 102% in Estonia, in Lithuania 95%, Hungary 90%, Bulgaria 53%, Poland 53%, 59% in Czech. The rate of absorption of EU funds in Estonia is 27%, Slovenia 41%, Lithuania 39%, Hungary 23%, 18% in Czech Republic, Poland 16%, 9% in Bulgaria. It can be found significant differences between Romania and these countries.

Tabel 4: Absorbtion of EU grants in Romania in 2007-2009

Operational Programs	EU alocations 2007-2013 mil	Total available buget 2007-2013 mil eur	The value of contracted projects 2007-2009 mil eur	The value of payments 2007-2009 mil eur	Contracted ratio * %	Absorbtion ratio* %	Contracted ratio ** %	Absorbtion ratio ** %	EU alocations 2007-2009 mil	Contracted ratio*** %	Absorbtion ratio *** %

	eur								eur		
National Development Plan	19212	23251	3663	587	15.75	2.52	19.07	3.06	5642	64.92	10.40
Development of administrative capacity	208	246	41	1	16.67	0.41	19.71	0.48	89	46.07	1.12
Environment	4512	5611	1037	182	18.48	3.24	22.98	4.03	1318	78.68	13.81
Economic Competitiveness	2554	3011	542	120	18.00	3.99	21.22	4.70	656	82.62	18.29
Human Resource Development	3476	4089	643	67	15.73	1.64	18.50	1.93	996	64.56	6.73
Transport	4566	5698	206	31	3.62	0.54	4.51	0.68	1352	15.24	2.29
Regional Development	3726	4384	1166	185	26.60	4.22	31.29	4.97	1175	99.23	15.74
Technical Assistance	170	213	28	1	13.15	0.47	16.47	0.59	56	50.00	1.79

Rural Development Policy	8022	9971	1695	0	17.00	0.00	21.13	0.00	2589	65.47	0.00
Operational Fisheries Programme	231	308	0	0	0.00	0.00	0.00	0.00	67	0.00	0.00
TOTAL	27465	33530	5358	587	15.98	1.75	19.51	2.14	13940	38.44	4.21

***- calculated by reference to the available budget 2007-2013 (which contains EU contribution and national contribution)**

****- calculated by reference to EU financial allocation 2007-2013 (FEDR, FSE, FC, FEADR, FEP)**

*****- calculated by reference to EU financial allocation 2007-2009 (FEDR, FSE, FC, FEADR, FEP)**

Source: own computation

The economic crisis continues to make its presence felt in Romania. Romania, as well as most EU countries have experienced a significant reduction in foreign investment since the beginning of the recession. In Romania, it takes a substantial improvement in the use of funds allocated to infrastructure projects. Many investors have repeatedly stressed that the poor infrastructure in Romania is a serious impediment to investment; transport within the country is inefficient and dangerous. In these circumstances, it is essential for Romania to take advantage of significant amounts made available by the European Union by funds allocated for 2007-2013 (see KMPG declaration).

European funds are one of Romania's economic development opportunity, in a context where their use would mean an annual influx of capital that is, as a share, about 4% of gross domestic product. Moreover, once the fund-raising post-accession, Romania could become a favorite target for investors. Structural Funds should therefore be viewed as an opportunity to attract capital for new start-up investment, development and support existing ones and not as a social aid from the European Union. Member States which were able to allocate the structural funds to the investment sector are those with the highest absorption rate and at the same time, enjoy the highest added value and the highest sustainability of the results produced.

3. The role of public expenditure on development in Romania to matching the european development objectives

We will analyze how Romania managed to align the requirements of the European Union's development through Lisbon Index- a measuring instrument of the performance of EU member countries in achieving the Lisbon Strategy. However, this analysis will help to determine the level of efficiency in spending public money to finance public investment in Romania.

In order to better monitoring of the achievement of the revised Lisbon Strategy, the World Economic Forum in 2008 constructed a composite index, called Lisbon Index. WEF divided Lisbon Strategy into 8 areas, and take one indicator associated with each field representative, and a number of sub-indicators. These indicators are aggregated to form index of Lisbon, being associated to the same important coefficients. The indicators chosen to compose the Lisbon index are:

1. The level of Information Society;
2. Dimension of innovation, research, development;
3. Liberalisation (related to the harmonization of competition rules, state aid, the single market);
4. Transport infrastructure, utilities and telecommunications;
5. Financial Services;
6. Enterprise;
7. Social inclusion;
8. Sustainable development.

The table below is presented Index Lisbon as the WEF methodology, in each EU member country, and rank the country out of 27 Member States:

Table 5: Lisbon Index in European Union countries

Country	Rank 2010	Rank 2008	Scor 2008	Rank 2006	Country	Rank 2010	Rank 2008	Scor 2008	Rank 2006
Sweden	1	1	5.71	3	**Czech Rep.**	15	16	4.53	14
Danmark	3	2	5.64	1	**Spain**	18	17	4.52	15
Finland	2	3	5.64	2	**Malta**	17	18	4.43	19
Netherlands	4	4	5.44	4	**Lithuania**	20	19	4.39	20
Austria	7	5	5.34	7	**Slovakia**	19	20	4.34	18
Germany	6	6	5.34	5	**Latvia**	22	21	4.25	22
Luxembourg	5	7	5.22	8	**Hungary**	21	22	4.18	17
France	8	8	5.12	9	**Greece**	23	23	4.1	23

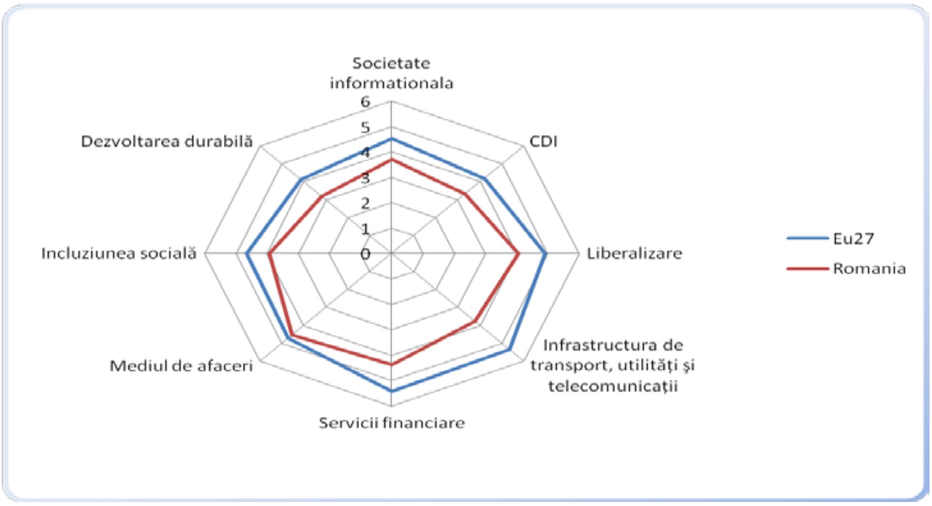
United Kingdom	9	9	5.12	6	**Italy**	25	24	4.05	24
Belgium	10	10	5.11	10	**Romania**	26	25	3.84	26
Ireland	11	11	5.03	11	**Poland**	24	26	3.76	25
Estonia	12	12	5.02	12	**Bulgaria**	27	27	3.68	27
Cyprus	13	13	4.68	21	**EU27 average**			**4.73**	
Portugal	16	14	4.61	13					
Slovenia	14	15	4.58	16					

Sursa : *The Lisbon Review 2008-Measuring Europe's Progress in Reform* , World Economic Forum 2008, pag.7, de Jennifer Blanke and Thierry Geiger**.**

The Lisbon Review 2010. Towards a More Competitive Europe?, World Economic Forum 2010, pag.7, by Jennifer Blanke and Stephen Kinnock.

As to the results of this research, Romania occupies position 26 in 2010, as in 2006. So, although Romania has allocated twice the European average in relative terms of capital expenditures, results of the last five years are not significant.

Chart 3 : Comparison between Romanian Lisbon Index indicators and the average level of the EU 27



In Romania, of all eight indicators, the best value is recorded by the enterprises indicator, probably due to simplify the arrangements for opening a business. The largest gap is recorded by Romania in infrastructure, achieving a score of 3.74, significantly below the average of 5.32, and far behind Germany, which is considered a leader in this field with a score of 6.47, 73% higher than the score of Romania . Significant negative differences are seen in terms of quality financial services and sustainable development. In 2010, Romania still have to recover a significant gap from the EU 27 average, is 20% below the EU average. This difference is emphasized if we compare with the financial allocations used by Romania in this direction.

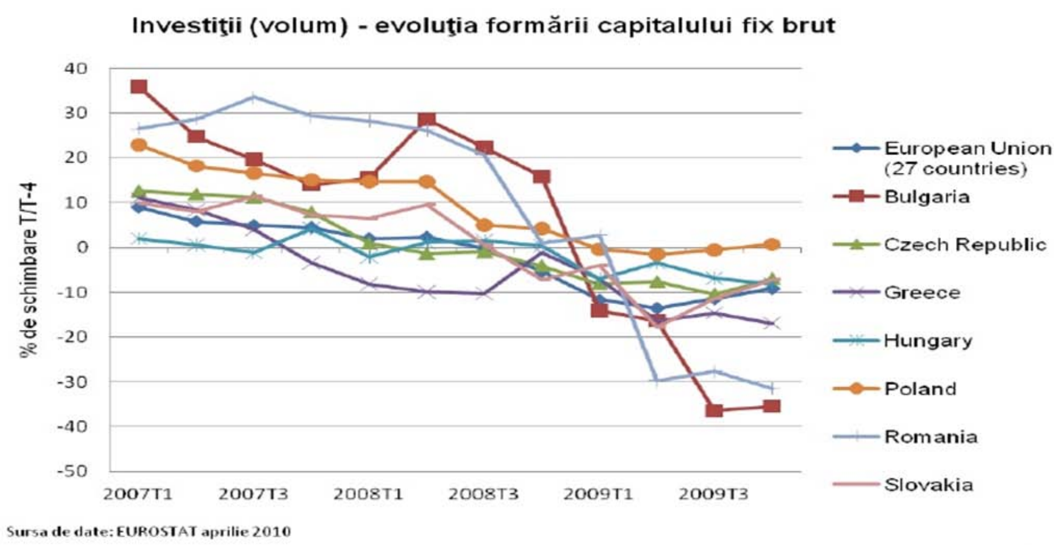
4. The role of public expenditure on development in Romania in overcoming the economic crisis

In a recent study developed by the Government, "*Ex-ante analysis of the appropriateness of introducing measures to promote investment*", states that "*the immediate challenge is to overcome the crisis, but the biggest challenge is to avoid the reflex to return to the situation before crisis*". Even before the crisis, there were many areas where Europe has not moved fast enough compared with the rest of the world (Ministerului Economiei, Comerţului şi Mediului de Afaceri, 2010). But reality is not so simple, even in theory or in practice. Not only in Romania but global voices were raised for and against public investment incentives during the crisis, identifying antithetical recovery measures adopted by Europe and the U.S. These polemics are not recent, but it has as pawns: John Maynard Keynes, artisan public investment in times of crisis to stimulate consumption and Austrian Friedrich von Hayek, market liberalization lawyer. Joseph Stiglitz, Nobel economics laureate said: "*Europe will go to disaster if you insist on austerity measures* ". U.S. calls for public spending stimulus. Now, while the U.S. reported an economic growth of 5.9% of GDP, compared to 2009, European countries will face a period with "painful" cuts - in the words of David Cameron, and for a "long term" - in the words of Angela Merkel.

One thing is sure, in the current period should be taken special measures to stimulate private investment, but already we are entering a vicious circle. Private investment will not get big without ensuring a stable legal framework and stimulating, without the existence of necessary infrastructure. All these conditions will be provided through state intervention, with the leverage public investment. Public capital expenditure should have as priorities: investment in transport infrastructure, agriculture, environment; ensuring the co financing of the projects financed by structural and cohesion funds; state aid for investment projects; public-private partnerships.

However, it can be seen from the chart below, that the investment has been a downward trend with the start of the crisis, both at European and national levels.

Chart 4: The volume of investments - Gross fixed capital formation evolution



Source: Ministerului Economiei, Comerţului şi Mediului de Afaceri, (2010) - *Analiza ex-ante a oportunităţii introducerii unor măsuri de promovare a investiţiilor.Studiu pilot, studio cantitativ şi calitativ.*

Although the global economic crisis has produced declining investments in most European countries, it is noteworthy that the pace of decline is steeper for Bulgaria and Romania.

The two countries had the highest rate of growth of investment in the first quarter of 2007 compared to same period last year, ending 2009 with the lowest values of the same indicator (negative values of approximately the same magnitude as those at the beginning analyzed).

From this perspective, we note the two countries' high vulnerability to international economic changes, particularly in terms of investments and economic competitiveness. It follows that the introduction of measures to promote investment is not only appropriate for the Romanian business environment, but also necessary (Ministerului Economiei, Comerţului şi Mediului de Afaceri, 2010).

5. Conclusions

The purpose of this study was to analyze public expenditure for development in Romania, from the perspective of funding sources, their role, and how this role was fulfilled. Regarding sources of funding, they may be ordinary resources of the state, extraordinary resources, from loans, but also from the EU structural and cohesion funds. It was noted that the relative level of capital expenditure in Romania is the highest in the EU 27 is double the European average as a percentage of GDP. However progress in the development of the country are below the EU average, Romania in 2008, occupying the 25th position in the EU member countries rank on the degree of compliance with development requirements of the Lisbon Strategy. And in a paradox highlighted in 2010, according to the same survey conducted by WEF, Romania dropped one position, peaking at 26 in the conditions under which public funding for development was above the EU average. So the priority problem is not lack of funds, but the effectiveness of their use.

Related loans in Romania, they have increased exponentially since the second half of 2007, and since 2008 new contracted loans have exceeded the annual total public capital expenditure, which meant that borrowed funds originated in unproductive consumption. Investment, considered to be a lever for economic crisis, experienced a sudden drop in Romania with the crisis. However, the country still lacks the resources to stimulate investment, and these resources come from post-accession EU funds, but their absorption rate is the lowest in the Union, as we demonstrated in this paper.

So, as a synthesis, albeit at a first analysis of capital spending in Romania their situation looks favorable, specific to developing countries, a deeper analysis demonstrates their ineffectiveness because their desire has not been reached even in overcoming economic crisis or aligning the country to the EU requirements stated in the Lisbon Strategy.

6. Aknowledgement

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