PUBLIC INVESTMENT CHALLENGES AND REFORMS IN ROMANIA

Daniela PÎRVU[1], Claudia STANCIU-TOLEA[2]

[1]University of Pitesti, ddanapirvu@yahoo.com

[2]University of Pitesti, stanciu@tef.ro

Abstract: *The public investments play an important role in stimulating the economic growth and in reducing the disparities between urban and rural areas or between the regions of a country. The share of public investments in GDP in Romania has decreased significantly in recent years, giving the increase of some categories of public expenses, as well as the decrease of the budget revenues that have generated actions to adjust the state budget, in order to avoid the excessive deficit procedure. This paper analyzes the problem of public investments in Romania correlated with the evolution of the main categories of public expenses.*

Keywords: Economic growth, Public investments, Public expenses.

JEL Classification Codes: E60, H41, H54.

1. INTRODUCTION

The public investments represent the expenses of the public entities (central and local public administration authorities, public institutions, etc.) to accumulate capital by creating, modernizing or replacing the fixed assets in order to obtain economic and social benefits for the entire society or for certain communities. The expenses for public investments may concern the construction of public infrastructure (streets, bridges, railways, etc.), the acquisition of capital goods (medical equipment, computers, etc.), the improvement of the existing capital stock held by the public sector, etc. The fixed capital gross formation is the main component of the public investments.

The expenses for public investments are very important due to their impact on the economic growth. Several authors (Aschauer, 1989; Milbourne et al., 2003; Brückner and Tuladhar, 2010, *Fournier, 2016*) demonstrated that the public investments have a positive and statistically significant impact on the economic growth, since the public capital is complementary to the private capital.

The public investments in transport, communications and education have the greatest impact on the economic growth. Other authors (Gomanee et al., 2003; Mosley et al., 2004) highlighted the negative and statistically significant impact of the public expenses for investments (in particular in the field of education, agriculture, housing and utilities) on poverty. According to the Organization for Economic Cooperation and Development, the public expenses on investments may balance the business cycles and create new jobs.

The public capital provision (especially the public infrastructure) depends on the level of economic development of a country. The expenses for public investments are relatively higher in the intermediate stages of development. On the other hand, as a result of the innovation in the financial field (the emergence of some complex financial instruments to cover the risk), the economic operators in the private sector have started to replace the public initiatives related to risky projects (Turrini, 2004).

The positive relation between GDP and public investments in Romania was demonstrated in a study by Stanciu and Mitu (2017), using a multiple regression model and semester data for the period 2006-2016. After Romania's adherence to the EU, most public investments were supported by the European funds, but during the last financial programming period, there was a low absorption degree of the European funds. In recent years, due to the governors' change of priorities regarding the allocation of public financial resources, the share of public expenses for investments financed from the central budget has decreased significantly.

This paper presents a comparative evolution of the public investments in Romania and in the Member States of the European Union and analyzes one of the main causes of public investment decrease in Romania: the reforms in the field of staff remuneration in the budgetary system and in the field of social protection.

2. THE STATE OF PUBLIC EXPENSES FOR INVESTMENTS IN ROMANIA AND IN THE MEMBER STATES OF THE EUROPEAN UNION

The total investments (private and public) in the Member States of the European Union have decreased in the period after the outbreak of the international financial crisis. Starting with 2014, the total investments as share of GDP recorded an upward trend, but in 2018, this share was 2 % below the period before the crisis (Figure 1).

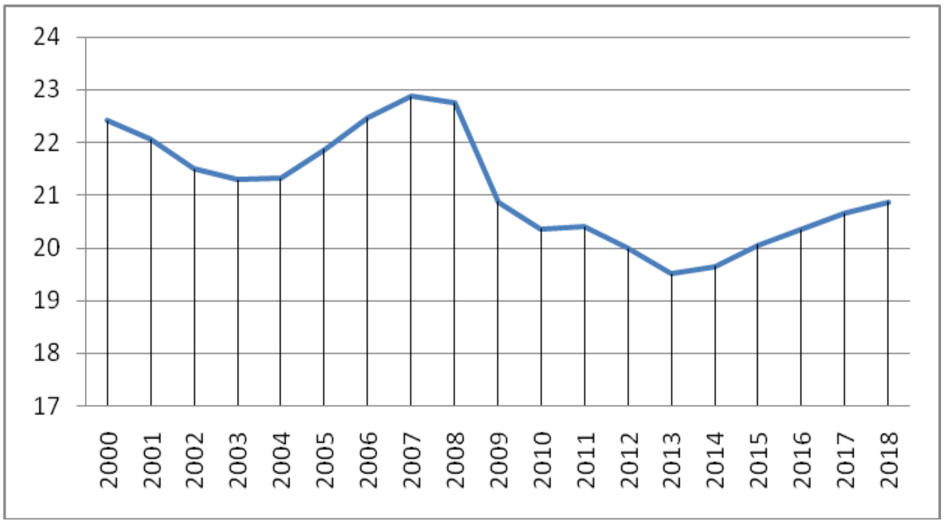

Figure 1. ***Total investments as shares (%) of GDP (EU 28)***
Source: Eurostat

After the outbreak of the international financial crisis, the downward trend of public investments was lower because during the beginning of the economic crisis, many EU Member States used the public investments as a counter-cyclical policy instrument; the government investments as share of GDP recorded the higher value of the period 2000-2018 in 2009 (Figure 2).

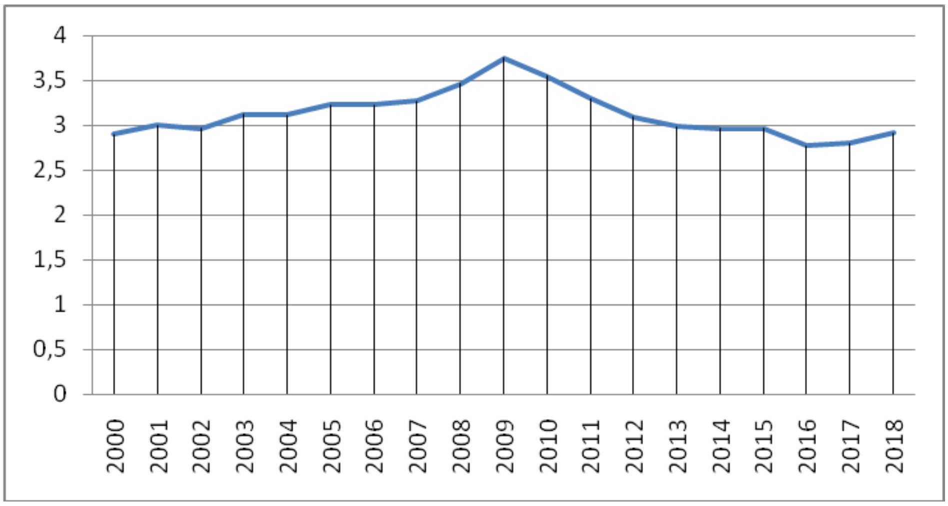

Figure 2. ***Government investments as shares (%) of GDP (EU 28)***
Source: Eurostat

There are significant differences between the Member States of the European Union, from the point of view of government investments as share of GDP, reflecting the differences of their economic policy objectives. Thus, in recent years, in countries like Estonia, Hungary or Sweden, the government investments as shares of GDP have approached or exceeded 5%, while in countries such as Ireland, Spain or Portugal, the government investments as shares of GDP have barely reached about 2%.

As noted in the Country Report of Romania prepared by the European Commission, the total investments benefited by the Romanian economy are relatively high for the year 2019. In the period 2007-2018, the total investments reached an average of 26.7% of GDP, a value well above the EU average (20.3% of GDP). The private investments accounted for about 80% of total value. The public investments registered a high level immediately after joining the EU in 2007 (around 6% of GDP), but they have started to decrease since 2016, lowering below 4% of GDP, due to a slowdown in the absorption of the EU funds. Although the level of private investments in Romania have constantly exceeded that of countries with a similar situation in the region, the public investments have lagged since 2014, with the exception of a slight comeback in 2015 (Figure 3).

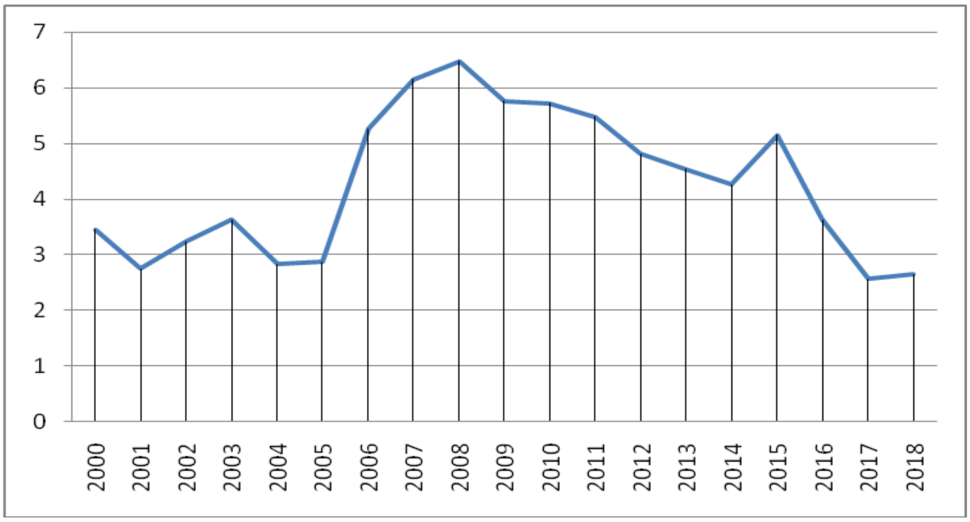

Figure 3. ***Government investments as shares (%) of GDP in Romania***
Source: Eurostat

The year 2017 marked the lowest level of public investments in the history of Romania, even though both the business environment and the population indicated the need to make investments in the field of health and education, transport and energy infrastructure, waste and wastewater management infrastructure.

The EU funds represent a large part of public investments in Romania. Since 2014, the capital transfers from the EU have represented, every year, a quarter of the public investment expenses and 1% of GDP (European Commission, 2019).

3. ANALYZING PUBLIC INVESTMENTS BY THE MAIN CATEGORIES OF PUBLIC EXPENSES

The main categories of public expenses financed from the state budget recorded an upward trend with different rhythms, in the period 2006-2017. Staff and social assistance expenses increased more than twice, while the expenses for goods, services and capital remained almost at the same level, even though these categories of expenses decreased after the financial crisis. The reduction of capital expenses was significant, reaching in 2012 more than half of the level recorded in 2006 (Figure 4).

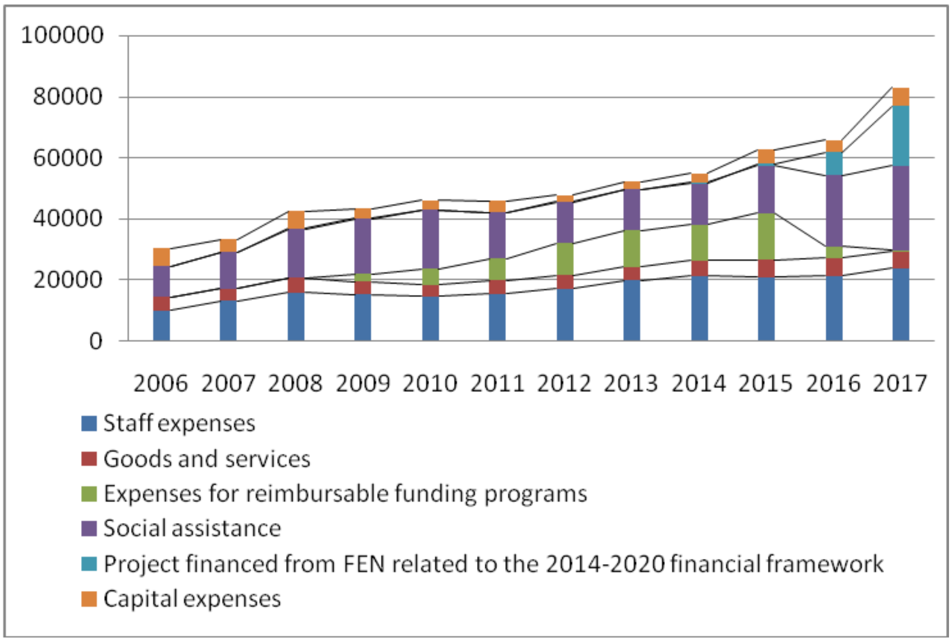

Figure 4. ***The evolution of the main categories of public expenses financed from the state budget***
Source: Tempo-on-line

The public expenses allocated for projects financed from non-reimbursable external funds registered in the state budget, represented about 10-15% of total expenses during the peak periods of implementing the programs related to the financial framework 2007-2013, respectively 2014-2020.

In the case of local budgets, the evolution of staff expenses was similar to that observed for the state budget. The increase of social assistance expenses was more significant, 4 times higher in the year 2017 compared to the year 2006. Capital expenses and goods and services expenses have recorded an upward trend, since the local public authorities have increased and strengthened their role of providing some public services (Figure 5).

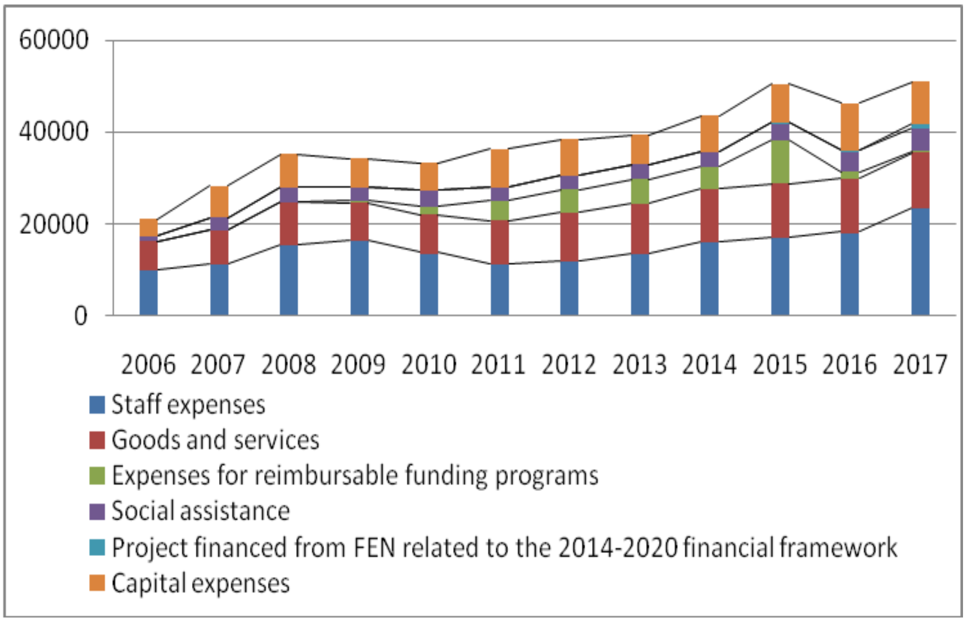

Figure 5. ***The evolution of the main categories of public expenses financed from the local budgets***
Source: Tempo-on-line

The public expenses allocated for projects financed from non-reimbursable external funds, registered in the local budgets, represented about 15% of total expenses in 2015, but they have contributed less to the public investments in the following period.

The staff and social assistance expenses in the general consolidated budget increased by 200% in the period 2006-2017, being more accentuated in 2008 and 2017 compared to 2008, respectively 2017 (Figure 6).

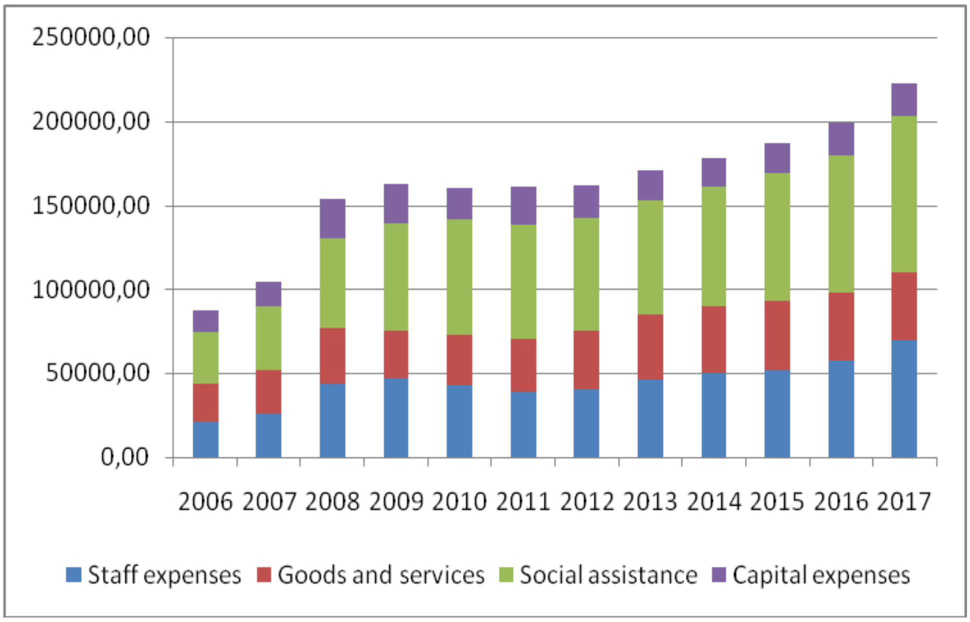

Figure 6. ***The evolution of the main categories of public expenses in the general consolidated budget***
Source: Ministry of Public Finance - budget executions

During the period 2006-2017, the public investments had a divergent evolution from the one of the public expenses for staff and social assistance, except for the period 2006-2008 and the years 2011 and 2015, when the public investments had an evolution similar to the one of the mentioned expenses (either increasing or decreasing). The public investments have registered a significant decrease since 2016, decreasing by 21% in 2017 compared to 2016, given that the public expenses for staff have increased by 22% and those for social assistance by 13 % (Figure 7).

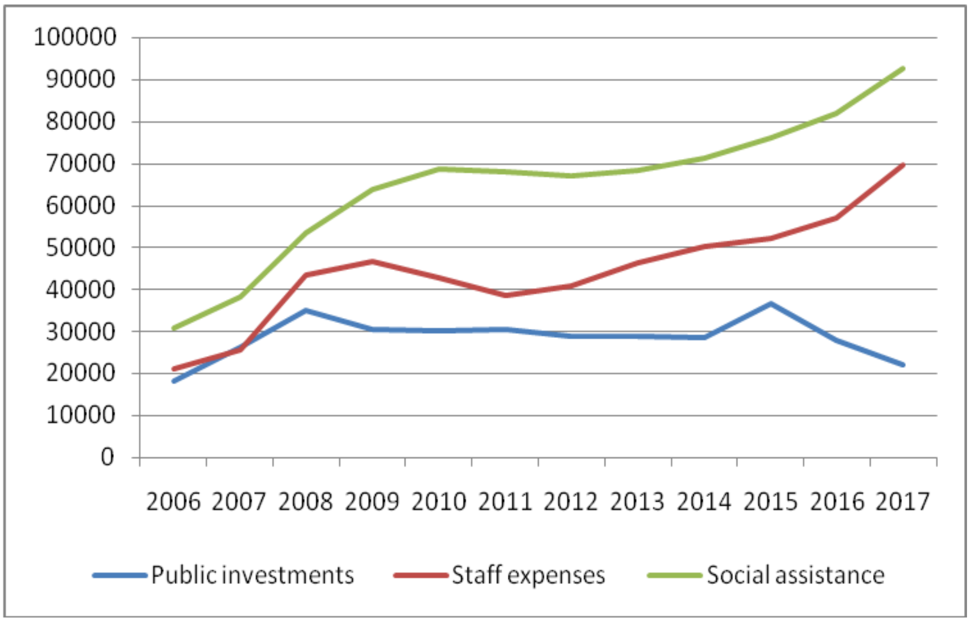

Figure 7. ***The evolution of public investments versus staff expenses and social assistance expenses***
Source: Ministry of Public Finance - budget executions; Eurostat

The periods with divergent evolution of investment expenses compared to the two categories of expenses analyzed were marked by "reforms" in the field of human resources from the public sector and social assistance. For example, in 2008, the staff expenses showed a nominal increase of 35.4% compared to 2007, reaching a level of 9.1% of GDP and a percentage of 24% of total public expenses (Romanian Government, 2009). Starting with 2016, the public staff expenses have increased considerably as the effect of a new salary law. The governors' intention was to increase the employment attractiveness of certain areas of the public sector that were facing either personnel shortages (e.g. healthcare) or inefficiency in activity (e.g. public administration). On the other hand, the need to increase the welfare of pensioners and socially disadvantaged categories has motivated the decision to significantly increase pensions and social assistance benefits in recent years.

4. CONCLUSIONS

Due to the uncontrolled growth of some public expenses, the public investments in Romania have decreased significantly in the last years. The level of public investments, as share of GDP, was below the average level registered in the Member States of the European Union, in 2018.

The analysis of public expenses for investments compared to the public expenses for staff and social assistance showed their divergent evolution in certain periods. Thus, the periods in which the provisions of the legal regulations by which the pensions, social assistance benefits and salaries of the public system employees were implemented, marked significant involutions of the public investments.

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