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A Comparative Analysis of the Greek and Romanian Public Finances: 2000-2008

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Abstract

In this paper we analyze the situation of the Public Finances for Greece and Romania for the 2000-2008 period, attempting to identify the fundamental factors that lead to the poor situation of the two countries in the current period.
Currently, Greece and Romania are facing difficult financial situations, confronted with record levels of public debt and deficits, being forced to close urgent financial agreements with the European Commission and IMF to avoid financial collapse.
In the study we analyze the main parameters of the government finances of Greece and Romania and compare them with the average levels of the European Union.
Keywords: *public finances, public debt, public financial deficit, macroeconomic situation, evolution of GDP*
JEL Classification: *H6 - National Budget, Deficit, and Debt; H7 - State and Local Government; Intergovernmental Relations; H72 - State and Local Budget and Expenditures*

1. Introduction

Under normal conditions, a healthy macroeconomic evolution usually leads to good perspectives even for the public finances of any given country. Romania and Greece apparently registered good economic evolutions for the 2000-2008 period. However, the 2008-2010 financial crisis lead to an almost unprecedented deterioration of the public finances' situation in the two countries, revealing high budgetary deficits, increasing public debt and fears of bankruptcy. In our paperwork we will address mainly the situation of the public debt and deficit in Greece and Romania, analyzing in the same time other important features of the public finance situation, such as the level and structure of the public financial revenues and expenses.

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We have chosen to compare the two countries as they have a certain number of elements in common as well as different features due to the conditions of historic evolution.

The issue of budgetary deficits has become a topic of large interest, not only for the public authorities but also for the academic community, starting with the 1980's high budgetary imbalances, encountered especially in the United States, but also in some European countries. The debates around the optimal size of the budgetary deficit, to its effects or the factors that determine the size of the deficits have generated several theoretical approaches, pro or against having a negative budgetary balance.

In section two we approach the concepts of public debts and deficits and take a brief review of the related literature. In section 3 we realize a brief analysis of the European economic context in the last 4 years. In section 4 we analyze the situation of the public finances in Greece for the 2000-2008 period, whereas in section 5 we do the same for Romania. In section 6 we present our conclusions of the analysis.

2. Literature overview

Adolf Wagner (1835-1917) was among the first to signalize the tendency for fast growing of the public sector (he formulated the Law of increased state spending), due to the overall progress of the society, but at the time his warnings were not considered of immediate importance. The 1930's economic crisis' experience has determined a change in the view upon the economic equilibrium and especially upon the consequences of significant economic imbalances.

After the Second World War, authors such as Strayer (1949), Ram (1986), Barro, (1989), Barro and Sala-i-Martin (1995), Rodrik (1998) outlined the accelerated growth in size of the public sector thru the level of public expenses and tried to identify and explain the causes of this dynamics.

The continuing high budgetary deficits registered between 1980 and 2000 represented an alarm signal as to the possible implications of the negative balances of the different national economies.

Slowly but steadily the perspective of the minimalist state was replaced by the welfare state and the necessity of its intervention in the improvement of the negative effects of the market externalities and of the defective allocation of the financial resources in the economy. One characteristic of the welfare state, as it was stressed by Tanzi and Schuknecht (1997), is concerning the significant budgetary deficits and the high stock of the public debt.

In the same time, Sloman and Wride (2008) stated that a balanced budget may not always be the best strategy, whereas Alesina and Perotti (1996) outlined that implementing such laws to enforce setting a balanced national budget are neither sufficient nor necessary to ensure fiscal discipline.

Moreover, Alesina and Perotti consider that, on one hand, setting a balanced budget does not represent a solution when adopting anti-cyclical policies that involve using financial stimuli and on the other hand, the budgetary deficit allows the public authorities to promote policies for reducing the costs of taxation.

As a result, the budgetary imbalances that involve negative balances are no longer considered a failure of the public policies and the budgetary deficits can represent in many situations an instrument of ensuring a better allocation of the resources in the economy. However, we must not forget that the tolerant approach of the budgetary deficits does not imply the discretionary accumulation of deficits but rather maintaining them within certain limits considered sustainable.

In our opinion, what really matters is the usefulness and efficiency of spending the public financial resources that lead to the creation of budgetary deficits. If a certain country invests in education, research, infrastructure, in the health system, resulting in temporary budgetary deficits the situation can be acceptable if the respective policies are well founded and the overall result creates better conditions for human and economic development. Nevertheless, when the countries spend money on social protection and social assistance they have to be careful not to go over their real possibilities of offering such services and to avoid compromising the level of competitiveness of the national products and services by the mean of higher taxes needed for funding.

Eisner (1984, 1989 and 1994) claimed that before we proceed to analyzing the budgetary imbalances and investigating their impact upon the economy and their determining factors, it is very important to define in a correct manner the measure based on which we express the size of the budgetary deficits and it is used for the analysis. For example, the very existence of substantial budgetary deficits does not imply by itself a very unfavorable situation for that country. Boskin (1987) exemplifies this aspect with the case of Japan, which in the middle of 1980's was confronted with high deficits, but in fact its net investing position was positive (favorable). Later on, Auerbach, Gokhale and Kotlikoff (1994) were reiterating the position of Eisner to outline that the *budgetary deficit* was not a very well defined concept in the economic literature, being more likely a number whose value depends on the way in which certain budgetary operations are registered. Moreover, the three authors considered that the budgetary deficit represents a measure of limited usefulness in what concerns the assessment of the fiscal and budgetary policies, as those policies are very dynamic and cannot be analyzed based on short term measures (as it results from the size of budgetary deficits). On the other side, any given size of the budgetary deficits cannot express the burden induced by the public policies upon the future generation.

All these considerations raise the question of a correct interpretation of the information relayed by the measures that quantify the size of the budgetary imbalances. In this sense, Jacobs (2002) identified several ways of quantifying the size of the budgetary imbalance, each having its significance and utility. This is why, when for example, one claims that the budgetary deficit is too high or too low, or when it is considered the cause of such phenomena as inflation or the crowding-out, it is crucial to know how the size of the respective budgetary balance was quantified (Sloman, J. and Wride, A, 2009; Rosen and Gayer, 2008).

In the current context, of EU membership, the Growth and stability Pact, adopted in 1997, imposes clear limits for the debt and deficit components, respectively maximum 3% budgetary deficit and maximum 60% debt ratio in the GDP.

Among the most utilized measures to describe the type and size of the public budget imbalances we can mention: the conventional balance, the primary balance, the operational balance, the structural balance, current balance, internal balance and the external balance. The use of these measures depends accordingly to the nature and information necessary for the analysis.

Rosen and Gayer (2008) consider that the public deficits can be financed by the mean of following instruments: a) financing by increasing taxes; b) financing by reducing budgetary expenditures; c) financing by monetary emission; d) financing by public debt. In case of Romania, the financing of the budgetary deficit was made largely by issuing state bonds and public loans. Only very recently the authorities decided to undertake measures to reduce the public expenditures, deciding to reduce by 25% the compensation of the employees from the public sector and by 15% the public pensions. This was done with the declared intention of avoiding an increase in the taxation levels (in effect an increase of VAT from 19% to 25% and an increase in the single taxation rate from 16% to 20%) in order to observe the planned budgetary deficit of 7% from the GDP and to create the conditions for getting out of the recession.

Even if the degree of public indebtedness is still reduced in case of Romania, compared to the situation of other emergent economies, the main problem was that it was created paying salaries and pensions and does not originate from making public investments to stimulate the economic rebound.

3. The latest European evolutions

Romania and Greece registered good economic evolutions in the 2000-2008 period. The two countries shared similar development conditions even in the past periods, for example in 1938 they had similar levels of GDP/capita, of 94$ in Romania, respectively 76$ in Greece (Di Vittorio, 2006). Nevertheless the two countries were among the hardest hit countries by the global economic crisis that started in 2008.

But if we take a closer look to the overall EU economic and financial situation we will find that other southern or Mediterranean countries are also facing very difficult situations, such as Portugal, Spain and Italy. This entitled some analysts to speak about the creation of clusters of economic patterns, with the Northern countries (Denmark, Sweden, Germany, The Netherlands) on the one side and the Southern Mediterranean countries (Spain, Greece, Cyprus, Portugal and Italy) on the other side. Between those, we have the mix represented by the France, Belgium, the UK and the separate block of the East European countries.

In table no. 1 below we present a synthetic situation of the public debt and deficits for the last 4 years for the Eurozone, all the European Union, Greece and Romania.

We can see that both Romania and Greece were performing worse than the other EU countries. In what concerns the economy, we can appreciate that for the period, both Romania and Greece registered better evolutions than the overall EU or the Eurozone countries. The Romanian economy grew by about 50% (expressed in Euros), even if it decreased by 7.2% in 2009. The Greek economy grew by 12.84% during the same period, and the decrease was almost negligible for 2009. The EU economy grew by only 1% in the same period as a result of a fairly dramatic decrease of 5.57% in 2009. The situation with the budgetary deficit evolution for Romania and Greece is totally opposite compared to the economic evolution. The Romanian and Greece’s budgetary deficits were constantly higher compared to the overall EU or to the Eurozone for the entire period. Also, Greece’s debt holds a higher share into GDP compared to EU or Eurozone. Romania’s debt is lower, standing at 23.7% from the GDP in 2009 (and at even lowers levels in the previous years). We will try to find out if these evolutions mean that the economy and the public finances are totally different things.

Table no. 1. GDP, Budgetary and Public Debt evolutions in EU 2006-2009

Measures (million Euros/ Lei – for Romania)	2006	2007	2008	2009
Euro area (EA16) - GDP market prices	8 553 600	9 003 902	9 258 895	8 977 933
Government deficit (-)/surplus (+) (% of GDP)	-112 48 -1.3	-55 723 -0.6	-181 176 -2.0	-565 111 -6.3
Government expenditure (% of GDP)	46.7	46.0	46.8	50.7
Government revenue (% of GDP)	45.3	45.0	44.9	44.4
Government debt (% of GDP)	5 842 888 68.3	5 940 433 66.0	6 424 615 69.4	7 062 625 78.7
EU27 - GDP market prices	11687 271	12364 567	12500 094	11804 734
Government deficit (-)/surplus (+) (% of GDP)	-167 687 -1.4	-103 584 -0.8	-285 685 -2.3	-801 866 -6.8
Government expenditure (% of GDP)	46.3	45.7	46.9	50.7
Government revenue (% of GDP)	44.9	44.6	44.6	44.0
Government debt (% of GDP)	7 172 706 61.4	7 265 256 58.8	7 697 027 61.6	8 690 304 73.6
Romania –GDP market prices (million Lei)	344 651	416 007	514 654	491 274
Government deficit (-)/surplus (+) (% of GDP)	-7 474 -2.2	-10 438 -2.5	-27 931 -5.4	-40 791 -8.3
Government expenditure (% of GDP)	35.3	36.0	37.6	40.4
Government revenue (% of GDP)	33.1	33.5	32.1	32.1
Government debt (% of GDP)	42 583 12.4	52 292 12.6	68 532 13.3	116 526 23.7
Greece - GDP market prices (million euros)	210 459	226 437	239 141	237 494
Government deficit (-)/surplus (+) (% of GDP)	-7 496 -3.6	-11 478 -5.1	-18 303 -7.7	-32 342 -13.6
Government expenditure (% of GDP)	43.6	45.0	46.8	50.4
Government revenue (% of GDP)	39.3	39.7	39.1	36.9
Government debt (% of GDP)	205 738 97.8	216 731 95.7	237 252 99.2	273 407 115.1

Source: Eurostat reports

4. The situation of Greece

Greece's GDP rose from 136.28 billion Euros to 239.14 billion Euros from 2000 to 2008, which represents a significant 75.47% increase, at an average annual rate of about 4%, well above the Euro zone pace of 1.9%. In the same period the unemployment rate decreased by 2.9 percentage points, standing at 8.3% in 2007 versus 7.4% in the Euro zone.

Even in previous years, Greece presented the characteristics of a real economic miracle. The term Greek economic miracle has been used to describe the impressive rate of economic and social development in Greece from the early 1950's to the mid 1970's. Between 1950 and 1973, the country had an average rate of economic growth of 7%, the biggest one in Europe. In the 1950's, growth rates often exceeded 10% and in the 1960's the industrial production grew annually by 10% as well, for several years (Maddison, 2007).

4.1. What went wrong?

The main source of Greece's economic expansion over the 2000-2008 period (Athanassiou, 2009) was a rapid increase in domestic demand, with the overall contribution of the external sector being, on average, negative. The increase in domestic demand was supported by an expansionary fiscal policy, reflected in public deficits exceeding the EU's Stability and Growth Pact threshold of 3% of GDP for most of the period, and was boosted further through credit expansion to households and private businesses at average annual rates of 29.6% and 14.8% respectively over the same period. Also, Greece promoted an excessive welfare state model, with 72 billion Euros worth of public employees' salaries and social assistance expenditures in 2009.

One qualitative economic measure, called the Economic Sentiment Indicator, which stood at 99.6 in EU (in March 2010), had a value of only 69.6 in Greece for the same period, reflecting a low morale in face of future economic prospective. In the same time the Long term government bond yields were at 3.90% for overall EU and at 6.24% for Greece.

We consider that the financial problems of Greece come from three sources:

The consistent commercial deficit (negative trade balance), caused mainly by the relatively low exports and the much higher imports. The Greece's commercial deficit evolved from 24 billion Euros in 2000 to around 43 billion Euros in 2008 (a 79.16% increase). But being part of the Eurozone allowed Greece to carry on with the imbalance as it always disposed of hard currency to buy import goods.

In case of Romania this was not possible, as the trade deficit eventually lead to a deterioration of the Leu-Euro exchange rate, the imports became more expensive and the deficit reduced automatically, as was the case in 2009;

The budgetary deficit which grew ever bigger as a result of implementing the European social model, with a significant number of social benefits. As such, in 2008, the amount of social benefits reached 45 billion Euros, representing 19% of the GDP and 39.45% of the total public expenditures. Those levels are around the EU averages, but the situation is obviously different for countries as Denmark, Sweden or Germany, which do not display such high trade deficits and public debt figures and manage to mobilize a much higher share of public revenues.

The constant increase in salaries and other benefits, which grew over the pace of increase in the labor productivity for most of the 2000-2008 period. For the 2002-2007 period the annual labor productivity in Greece was roughly at the EU-27 average level (at 100% in 2002 and 2003, at 103% in 2005 and 2006 and at 105% in 2007). Nevertheless the hourly labor productivity in Greece was at 70% from the EU 27 average levels for the entire period (Eurostat yearbook for 2009).

The compensation of employees from the public sector almost doubled for the same period, from 14.27 billion Euros in 2000 to 27.45 billion Euros in 2008. With a GDP increase for the same period of only 75.47%, the fore-mentioned salary and benefits increases created a liquidity imbalance, which had to be covered by imports and inflation (Eurostat 2009).

4.2. The evolution of public financial revenues in Greece

The public revenues attracted by Greece had a relatively good evolution for the 2000-2008 period, as reflected by table no. 2 below.

Table no. 2 The evolution of public financial revenues of Greece, 2000-2008

		Year (in million Euros)					% of GDP	
	Measure	2000	2005	2006	2007	2008	2000	2008
	Total revenue	58,538	75,219	83,494	91,495	97,043	43.0	40.6
1	Taxes	32,086	39,736	42,677	46,072	48,039	23.5	20.1
	Indirect taxes	18,502	22,764	25,542	27,764	28,930	13.6	12.1
	Direct taxes	13,158	16,578	16,825	17,970	18,497	9.7	7.7
	Capital taxes	426	394	310	338	612	0.3	0.3
2	Social contributions	16,989	26,104	28,046	31,804	35,201	12.5	14.7
3	Sales	1,703	3,077	3,330	3,344	3,489	1.2	1.5
4	Other current revenue	4,251	3,617	4,576	5,174	6,037	3.1	2.5
5	Capital revenue	3,508	2,685	4,865	5,101	4,277	2.6	1.8

Source: Eurostat, Government Finance Statistics, no. 2/2009

Apparently the evolutions are favorable in terms of absolute and percentage growth, with an increase from 58.5 billion Euros in 2000 to 97.04 billion in 2008, respectively an increase of 65.88%. If we compare this evolution with the increase of the GDP for the period, of 75.47%, we find actually that the weight of public financial revenues into the GDP decreased from 43% to 40.6% in 2008.

If we analyze the structure of the public financial revenues, we can notice that the weight of indirect taxes decreased from 13.6% in 2000 to 12.1% in 2008. This could be a normal favorable evolution if it would be accompanied by an increase in the direct taxes and maybe a decrease in the social contributions. However, the weight of the direct taxes decreased by two percentage points, from 9.7% in 2000 to 7.7% in 2008 and the weight of social contributions increased by 2.2 percentage points, from 12.5% in 2000 to 14.7% in 2008.

The revenues from direct taxes are at a significantly lower level than the average EU-27 level, which is about 13.1% of the GDP for 2008. Also, the revenues from the personal income taxes are lower than the average level for EU-27 (Eurostat 2009). These things could point to a lower economic substance, to lower taxation rates or to higher fiscal evasion.

4,3. The evolution of public expenditures in Greece

For the same period the Greece's public expenditures had the following evolution (see table no. 3 below). The most accelerated evolution for the 2000-2008 interval was registered by the social benefits, which increased by 126.28%, followed by the compensation of the employees, which grew by 92.37%. The weight of social benefits increased from 14.8% to 19.1%, where the share of compensation of the employees grew from 10.5% in 2000 to 11.5% in 2008. During the same period, the capital investments increased by 36% in nominal terms. Nevertheless, their weight into GDP decreased from 3.8% in 2000 to only 3% in 2008.

Compared to the other countries from the Eurozone-16, Greece has registered the following budgetary evolutions for the 2000-2008 period (Eurostat Government Finance Statistics 2/2009):

- Total public revenues increased by 32.59% for the Eurozone and by 65.77% in Greece, revealing a better situation for Greece;
- Total taxes increased by 32.63% in case of Eurozone 16 and by 49.72% in Greece, also a better situation; The taxes and public revenues' increases are nevertheless subject to a debate concerning the quality of fiscal reports supplied by Greek authorities during 2005 – 2009 period (Report on Greek government deficit and debt statistics, European Commission, January 2010);
- Total expenditure increased by 38.26% in case of Eurozone 16 and by 81.65% in Greece, which is definitely a worse situation.

The expenditure elasticity of Greece for the 2000-2008 period can be calculated as follows:

$$Exp_{elasticity} = \frac{\Delta\%Exp}{\Delta\%GDP} = \frac{81.65\%}{75.47\%} = 1.08$$

For the same period, the expenditure elasticity for EU-16 (Eurozone) can be determined as follows:

$$Exp_{elasticity} = \frac{\Delta\%Exp}{\Delta\%GDP} = \frac{38.26\%}{36.66\%} = 1.04$$

Table no. 3 The overall and structural evolution of the public expenses, 2000-2008

		Year (in million Euros)					% of GDP	
	Measure	2000	2005	2006	2007	2008	2000	2008
	Total expenditure	63,627	85,626	90,193	100,458	115,581	46.7	48.3
1.	Intermediate consumption	8,778	10,286	10,372	12,172	11,894	6.4	5.0
2.	Compensation of employees	14,270	22,384	23,457	25,331	27,452	10.5	11.5
3	Interest	10,054	9,007	9,293	9,988	10,980	7.4	4.6
4	Subsidies	192	257	277	286	299	0.1	0.1
5	Social benefits	20,155	31,814	35,240	39,378	45,608	14.8	19.1
6	Other current expenditure	1,389	3,321	3,334	4,373	4,733	1.0	2.0
7	Capital transfers payable	3,604	2,845	1,792	2,176	7,559	2.6	3.2
8	Capital investments	5,185	5,712	6,428	6,754	7,056	3.8	3.0
9	*of which, Gross fixed capital formation*	*4,957*	*5,479*	*6,241*	*6,549*	*6,845*	*3.6*	*2.9*

Source: Eurostat, Government Finance Statistics, no.2/2009

We can notice that the public expenditures had an accelerated evolution in Greece compared to Eurozone 16, related to the GDP evolution.

The expenditure elasticity can also be calculated against the evolution of public revenues. The calculus for the 2000-2008 reveals the following:

$$Exp_{elasticity} = \frac{\Delta\%Exp}{\Delta\%Pubrev} = \frac{81.65\%}{65.77\%} = 1.24 \ for\ Greece$$

$$Exp_{elasticity} = \frac{\Delta\%Exp}{\Delta\%Pubrev} = \frac{38.26\%}{32.59\%} = 1.17 \ for\ Eurozone\ 16$$

We can also notice that the expenditures increased at a higher pace in Greece compared to the Eurozone 16. These evolutions show that the budgetary evolutions of Greece are unsustainable and they actually contributed to the budgetary deficits and to the increasing public debt of Greece.

One very important feature is the high weight of the social benefits and of compensation of employees, which amounted to 30.6% of the GDP or 73 billion Euros in 2008. In the same year, Sweden registered even higher values for those measures, 34% of GDP. The difference is represented by the weight of the public revenues in the GDP. Sweden had public revenues amounting to 55.6% of GDP, where Greece had a weight of public revenues of only 40%. Romania’s public salaries and social benefits amounted to 21.4% of GDP in 2008, where the weight of public revenues in the GDP reached 32.8% for the same 2008 (Eurostat Government Finance Statistics, 2/2009).

5. The situation of Romania

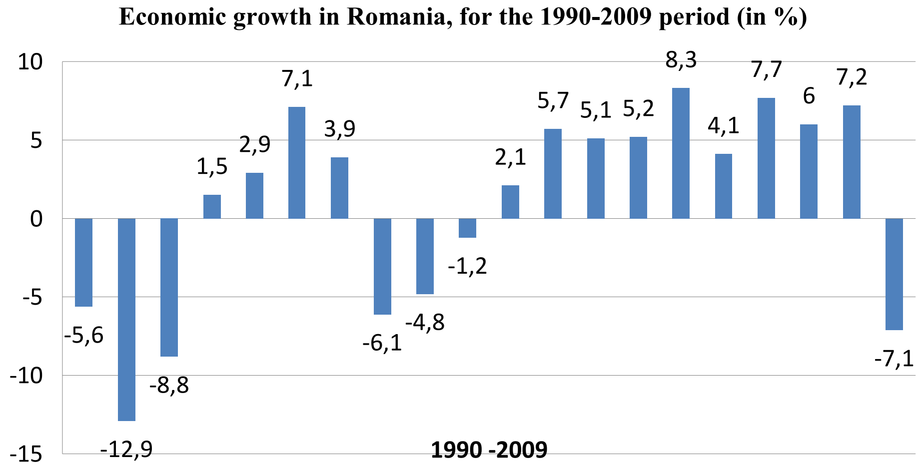
5.1. Economic overview

Before World War II, Romania was Europe's second-largest food producer (Di Vittorio, 2006). In 1938, the national income per capita reached $94, bigger than other present-day developed European countries such as Greece ($76) or Portugal ($81) (Di Vittorio, 2006). In the first 25 years of socialist command economy Romania registered also high economic growth rates, but unfortunately after 1973 the growth was almost halted (0.06% between 1973 and 1990) and it was based on using cheap energy sources from the CAER system (Maddison, 2007). The Romanian economy has a lot to recover and catch up in comparison to the Western developed economies, especially in the fields of competitiveness and of securing quality infrastructure and consumer goods to its people.

After 1990 the economic evolution of Romania was very sinuous, with alternating periods of positive and negative economic growth (see graph 1 below).

As we can notice from the graph, the period 1990-2003 was only used for restructuring (the growth was zero for the period), in order to make the pass from the communist to a modern economy, able to compete in the market context.

Graph no. 1. The evolution of economic growth in Romania, 1990 to 2009



Source: The Romanian National Statistics Institute

However, starting with 2000 we can notice a period of 9 consecutive years of economic growth, which ended abruptly in 2009, with a 7.1% negative growth.

This happened because the growth was based on expanding consumption, fueled by the relaxed credit policies of the banks, by the important amounts of currency send home by the Romanians working in Western Europe and the ever larger imports of goods and products to compensate for the lack of domestic production.

In the same time, the governmental budgetary and public policies were not coherent and/or oriented toward sustainable growth, without too much concern as to the efficiency and effectiveness of public activities and expenditures. The unemployment issue was "solved" in the 1990's by retiring a big number of employees which were hit by the restructuring of the economy (such as today we have 5.5 million pensioners at 4.3 million employees – Romanian National Statistics Institute). In the 2000's the unemployment problem was solved hiring a big number of people in the public sector, whose number increased dramatically in the last three years (some 1,362,463 people working in the public sector now).

In 2008, according to the Government report published in early 2010, we can notice the following:

The weight of the underground economy increased from 14.5% in 2004 to over 21% in 2008;

The gross value added in nominal terms from the underground economy tripled in the 2005-2008 period;

The unregistered workers were making up the most of the underground economy. In the first 9 month in 2008 the unregistered work represented 50.8% from the underground economy;

The VAT evasion has reached 24 billion Lei (6 billion Euros) in 2008, as compared to 7.4 billion Lei in 2004;

The fiscalization of the economy is reduced and there are still activities that are ran outside the organized markets, in the population households or underground. The high economic growth from 2005-2008 was accompanied by an increase in the underground economy, as well as by the expansion of the tax evasion.

According to the last bulletin published by the National Bank of Romania the labor productivity in the industrial sector increased by 27% in January 2010 compared to January 2009. However, for the 2005-2008 period the correlation between labor productivity and salary was not favorable in Romania, as the compensation of employees and the social benefits doubled in size that period (nominal values), where the GDP only increased by 62.25% in nominal values (National Bank of Romania, 2010/3). As in the case of Greece the liquidity imbalance was solved by higher imports and inflation. The positive things which were brought about by the 2008-2009 crisis were the forced reduction in the trade and current account deficits, the initiatives for fiscal consolidation carried by the Romanian government and the efforts for achieving sustainable and equitable public sector compensation system and pension system.

For example, the trade deficit registered a 58.6% reduction in 2009 compared to the level from 2008, based on the abrupt decrease in the imports level, even if the exports decreased too. A good evolution is represented by the increase in the weight of the exports of machinery and transport means by 6.6 percentage points (to 42.8% of total exports).

The current account deficit also reduced by 68.7%, reaching 5 billion Euros in 2009 compared to 2008. It was financed in a 96.9% share by direct foreign investments (Bulletin of National Bank of Romania, 2010/3).

5.2. The fulfillment of the Maastricht criteria

Proposed by Germany in 1995, and adopted in 1997, the controversial Stability and Growth Pact (SGP) was designed to set the guidelines for union-wide regulation for fiscal policy, to safeguard sound public finances, maintain an overall climate of stability and financial prudence as a premise of stable, long-term economic growth in the Euro-area. This international institution is a rule-based framework for the coordination of national fiscal policies in order to achieve economic homogeneity amongst the EMU member countries before the introduction of the single currency, and budgetary discipline after the currency has been introduced.

The first step in introducing supranational fiscal rules were the Maastricht fiscal criteria for joining EMU (entered into force in 1993). Besides the monetary criteria set in the Maastricht Treaty (requirements for a high level of price stability, convergence of long-term nominal interest rates and normal fluctuation margins for the exchange rate), the member countries must comply with the fiscal criteria: all EU member states must seek to ensure a medium term budgetary position close to balance or surplus.

The second step was the adoption of the SGP that complements and tightens the fiscal provisions set in the Maastricht Treaty. The Pact is built on two key aspects: preventive elements for identifying and correcting slippages, and a dissuasive set of rules, to put pressure on Member States to avoid excessive deficits and to take measures to correct them quickly should they occur.

With the EU accession the member states have given up the control over their currency and inflation, therefore the monetary criteria are no longer in national competence, but mainly in the responsibility of the European Central Bank (ECB). The power to adjust the structure and level of taxation is the last tool which remained at the EU Member State’s disposal to stimulate or regulate their economy, and this emphasizes the importance of the fiscal criteria.

Romania, as a member state of the European Union is liable for the adoption of the common European currency, the Euro. For this reason Romania must fulfill the Maastricht criteria. The present state of fulfillment of the Maastricht criteria for Romania is shown in table 4 below:

Table no. 4 Observance of Maastricht criteria by Romania

Country	Convergence criteria					Target date	
	Inflation rate	Government finances		ERM membership	Interest rate	Set by the country	Recommended by the EU
		Annual **govern. deficit** to **GDP**	Gross **govern. debt** to **GDP**				
Reference value, 2007	Max. 3.0%	Max. 3%	Max. 60%	Min. 2 yrs	Max. 6.4%	-	-
Romania, 2007	6.7%	2.3%	19.9%	-	4%	2010-2014	-
Romania 2008	7.9%	5.4%	21.7%	-	9,5%	2015	-
Romania 2009	4.74%	7.2%	30.14%	-	9%	2015	-

Sources: The NBR and Romanian Ministry of Finance reports

We can easily notice that Romania has registered an unfavorable evolution for most of the measures involved by the adoption of Euro in 2008 and 2009. If in 2007 the main issue was the inflation rate, for 2008 and 2009 the inflation remained a concern, while the budgetary deficit and the interest rate added up to the problems which could prevent Romania to adopt the European currency in 2015. As a result Romania became subject to the excessive deficit procedure of the EU Commission. Taking into account the 2010 evolutions we can appreciate that the budgetary deficit will remain the most important problem to be addressed in the time left until the adoption of Euro in Romania. The fiscal consolidation plan taken up by the Romanian government should contribute to the solution of the deficit problem.

The inflation criterion has become somewhat irrelevant in the context of the current economic crisis since many EU countries registered deflation in 2009.

5.3. The evolution of Public revenues in Romania

In the table no. 5 below we have represented the evolution of public revenues in Romania for the 2000-2008 period, expressed as percentage of the GDP.

Table no. 5. The evolution of public financial revenues of Romania, 2000-2008 (mil. Lei)

		Year (in million Lei)					% of GDP	
	Measure	2000	2005	2006	2007	2008	2000	2008
	Total revenue	27,374	93,325	114,126	139,428	165,422	33.8	32.8
1	Taxes	15,490	52,625	64,877	79,258	94,865	19.1	18.8
	Indirect taxes	9,841	37,249	44,154	51,371	60,292	12.2	12.0
	Direct taxes	5,649	15,376	20,723	27,887	34,574	7.0	6.9
	Capital taxes	-	-	-	-	-	-	-
2	Social contributions	9,254	29,650	35,604	43,639	51,988	11.4	10.3
3	Sales	1,222	5,030	6,521	8,593	9,795	1.5	1.9
4	Other current revenue	1,317	5,081	6,525	7,395	8,163	1.6	1.6
5	Capital revenue	91	940	598	543	611	0.1	0.1

Source: The Eurostat reports, 2/2009

From analyzing the table no. 5 we can notice several important features such as:

Even if the total revenues increased significantly, both in nominal and in real terms in 2008 compared to 2000, their share into GDP has decreased by 1 percentage point, revealing the incapacity of the Government to attract more public revenues;

The weight of total public financial revenues into GDP is well below the EU average of around 40%. Someone could deduct that the taxation is at very acceptable levels in Romania, close to the ones of fiscal heavens. That could be the case if the fiscal evasion would not throw the weight of the taxation upon the *good taxpayers*, whilst the others enjoy a real fiscal heaven climate. On the other hand, such a low level of public revenues impairs the appropriate functioning of the state services and institutions, especially in the health, education and infrastructure sectors and contributes to the consolidation of budgetary deficits;

The weight of indirect taxes continues to be the bulk of public revenues, which expresses an emerging economy, with insufficient production apparatus and with relatively low personal income of the population. This situation causes problems related to the fiscal equity aspects, especially due to the incidence of excise taxes.

5.4. The evolution of public expenses in Romania

The evolution of the public expenditures in Romania for the 2000-2008 period is presented in table no. 6.

Table no. 6. The evolution of the public expenses, 2000-2008 (million Lei)

		Year (in million Lei)					% of GDP	
	Measure	2000	2005	2006	2007	2008	2000	2008
	Total expenditure	31,154	96,669	121,600	149,894	193,363	38.5	38.4
1.	Intermediate consumption	7,643	20,271	21,974	25,864	33,699	9.4	6.7
2.	Compensation of employees	6,381	25,265	31,458	38,638	51,447	7.9	10.2
3	Interest	3,193	3,167	2,826	3,142	3,825	3.9	0.8
4	Subsidies	1,450	4,283	6,114	5,748	5,765	1.8	1.1
5	Social benefits	8,537	27,765	32,956	40,716	56,381	10.5	11.2
6	Other current expenditure	345	1,891	3,342	7,322	6,939	0.4	1.4
7	Capital transfers payable	426	2,804	5,290	4,879	6,716	0.5	1.3
8	Capital investments	3,180	11,223	17,642	23,586	28,592	3.9	5.7
9	*of which, Gross fixed capital formation*	*2,791*	*11,168*	*17,674*	*23,582*	*28,452*	*3.4*	*5.6*

Source: Eurostat, Government Finance Statistics, no.2/2009

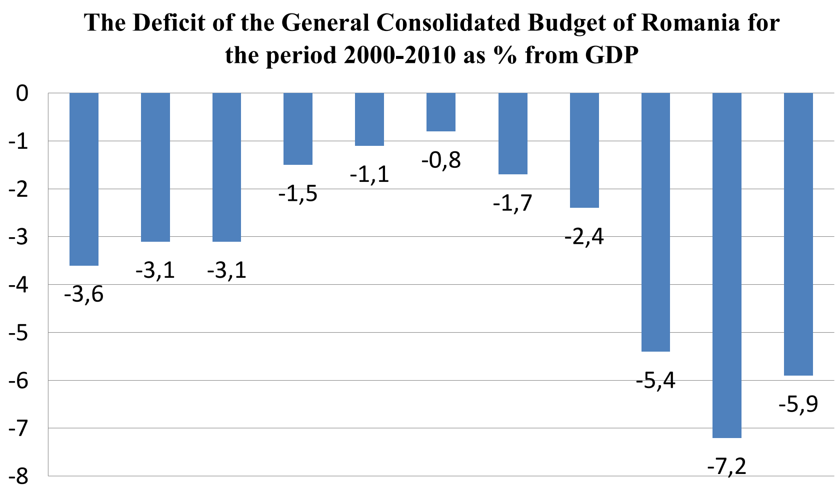
Analyzing the evolution of the public expenditures for the 2000-2008 period we can make the following comments:

The public expenditures increased significantly in absolute measures, but their share into GDP remained pretty much the same in 2008 as in 2000;
The share of the compensation of employees into GDP increased by 2.3 percentage points in 2008 compared to 2000, and having a spectacular evolution in nominal and real terms;
The social benefits also increased dramatically both in nominal and in real terms and their weight into GDP increased by 0.6 percentage points;
For the same period the GDP increased less in nominal and real terms, resulting an imbalance between the increase of public salaries and social benefits and the GDP growth;
The weight of public investments into GDP also increased from 3.9% in 2000 to 5.7% in 2008, but they are still insufficient, given the perpetuated lack of quality infrastructure in transportation, health and education areas.
As a result of the combined evolution of public expenditures and revenues we will get the following picture of the budgetary deficit in Romania for the 2000-2009 period (see table no.7 and the graph no. 2 below)

Table no. 7. The evolution of the budgetary deficit of Romania, 2000-2009 (Million Lei)

Measures	Deficit	GDP	Deficit as % of GDP
2000	2882	70654	3.60
2001	3580	116768	3.10
2002	4761	151475	3.10
2003	2900	197600	1.50
2004	2723	246372	1.10
2005	3058	287186	0.80
2006	2957	342418	1.70
2007	6537	404700	2.4
2008	11863	503900	5.4
2009	35173	486525	7.20

Graph no. 2. The evolution of the consolidated budget deficit in Romania 2000-2010[*]



*

- for 2010 we have estimates from the Agreement with the IMF

We can notice that the deficit of the general consolidated budget of Romania has a sort of W shape evolution with a steady decrease from 2000 to 2006, in correlation with the requirements of joining the EU, but starting with 2007 the deficit increased to plunge to 7.2% in 2009, due to the effects of the global economic crisis. For 2010 the Romanian government has foreseen a 5.9% deficit, according to the financial aid packing concluded with the IMF.

The data shows us that the deficit was kept under controllable limits until 2008, when unexpectedly, in a year with an impressive economic growth, of 7.2%, the government forgot the good practices and spent much more money than it should have at a time when the global recession was presenting ever more clearly its signs. Instead of making reserves to be used for stimulating the economy in 2009, the Romanian government spent money in the eve of parliamentary elections and thus creating a good terrain for the full manifestation of the economic crisis.

Among the factors that influenced the negative evolution of the budgetary deficit we can enumerate:

The poor public policies, especially the financial policies that did not succeed to make the best of the 9 years period of economic growth. For most of the 2000-2009 period the public financial policies were pro-cyclical, at best. That means the public expenses increased in time of favorable economic conditions, whereas the public financial revenues did not increase sufficiently in the same period of growth;

The structural imbalances of the Romanian economic framework, with a high number of public sector employees, displaying an especially rapid increase in the 2007-2009 period, a high number of senior retired persons and an insufficient production apparatus, which in turn creates the need for extended imports;

The hesitancy of the Romanian governments to promote structural reforms due to the lack of parliamentary majority. The lack of parliamentary majorities lead to creation of political coalitions that did not have the strength to promote structural reforms as the electoral interests prevailed all through this period. The state is still wasting precious public resources granting all kind of subsidies (heating subsidies, transport subsidies and other types of aids) to all kind of people, no matter the level of personal income levels and with no foreseeable perspectives for sustainability.

6. Conclusions

Even if Romania and Greece are part of the European Union, which promotes a strong set of social policies, somewhere along the way the governments of the two countries seemed to forget that we are nevertheless operating in a very competitive global market economy where everybody has to take care of oneself and that the basic economic principles cannot be ignored. The social policies (conceived by the highly developed northern countries), promoted sometimes for electoral reasons were proven unsustainable, given the current stage of economic and industrial development of Romania and Greece. The public sectors of the two countries turned into the Leviathan mentioned by Buchanan (1975) that wants to attract more and more public financial resources and creates a web of beneficiaries and providers of public services (both individuals and institutions) that need each other in order to survive.

Especially in case of Romania and Greece, that do not seem to succeed covering all their consuming needs from their internal production, the public finance policies should have acted as a compensator for the expansion of internal consumption fueled by credit or external capital inflows and act anti-cyclically. Instead the governments of the two countries only managed to increase the public expenditures to reflect a presumed situation of welfare, instead of being preoccupied of attracting more public revenues to ensure covering of the deficits and funds for public investments in time of economic downturns.

In 2008, Romania had a somewhat better position compared to Greece in what concerns the foreign trade position and the amount of public debt. Romania's exports were of 33.58 billion Euros, almost twice compared to the 17.20 billion Euros exports of Greece. Also, the trade deficit was of only 22.66 billion Euros in Romania compared to the 43.13 billion Euros in Greece. The share of exports in GDP (for 2008) was of 24.26% for Romania and 7.19% for Greece.

In the same time, the minimum wage increased in Greece from 526 Euros in 2000 to 681 Euros in 2008, respectively an increase of 29.46%. This may not look like very much, but actually it can have a significant impact upon the level and structure of the new productive investments.

In its turn, Greece has a lot of comparative advantages: the tourism, the quality of infrastructure, a stronger banking sector and not wasting 45 years with communist experiences.

Greece and Romania are facing difficult times and they will have to take unpopular measures attempting to adjust the budgetary deficits and to deal with the increasing public debts. The problem is that they will have to take those measures while trying to resuscitate their crisis affected economies. As Nobel winner economist Stieglitz stressed very recently the European Union needs show solidarity in order to continue as a union.

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