

BUDGET DEFICITS AND THEIR ECONOMICAL AND SOCIAL IMPACT IN ROMANIA AND THE EUROPEAN UNION

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Abstract

Budget deficits present a complex issue with significant economic and social repercussions. This paper analyzes the evolution of budget deficits in Romania and the European Union (EU), comparing them with other major global economies, and examines public debt levels, the current economic and social impacts of budget deficits, and their consequences on economic growth, employment, social cohesion, and macroeconomic stability. It identifies indicators that can provide insights into how budget deficits may affect investor confidence and, consequently, lead to a decline in foreign investments, which has major implications for the economy.

Keywords: budget deficit, public debt, economic impact, social impact.

JEL Classification: E620, H6, H63, H74

1. Introduction

The budget deficit is a major concern in contemporary economic policy, with extensive implications for fiscal sustainability and social welfare. In the context of globalization and economic integration, budget deficits have become a central issue for EU member states, including Romania, a country with a transitioning economy. This paper aims to deeply analyze the impact of budget deficits on the economy and society, focusing on relevant case studies and empirical data to highlight the evolution and consequences of this phenomenon. This work contributes to a deeper understanding of the impact of budget deficits, providing a solid foundation for the future development of economic and social policy in Romania and within the EU.

The budget deficit has emerged as a central issue in contemporary economic policy, profoundly influencing fiscal sustainability and social welfare. Within the context of globalization and economic integration, the management of budget deficits has become a critical concern for member states

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of the European Union (EU), including Romania, which is navigating a transitional economy. This article aims to provide an in-depth analysis of the economic and social impacts of budget deficits, drawing on relevant case studies and empirical data to elucidate the evolution and consequences of this phenomenon.

The study begins by exploring the theoretical underpinnings of budget deficits and their multifaceted effects on national economies. It examines how deficits can affect economic growth, public investment, and fiscal stability, and considers the short-term and long-term implications for consumption, national savings, and investment. Furthermore, the article investigates the neutrality of budget deficits in the long run, particularly when financed by public debt, and the subsequent impact on economic activity, tax revenues, and public expenditure.

In analyzing the evolution of budget deficits, this paper compares Romania's fiscal performance with that of other EU member states and major global economies. It highlights the challenges and trends observed during periods of economic crisis, such as the 2008 financial crisis and the COVID-19 pandemic, and their effects on national budgets. By comparing Romania's fiscal policies and outcomes with those of countries experiencing both higher and lower deficits, the study provides a comprehensive overview of the fiscal landscape.

Additionally, the article addresses the social repercussions of budget deficits, examining their impact on employment, income distribution, and social cohesion. It considers how fiscal austerity measures, increased taxation, and reduced public spending can exacerbate economic inequalities and affect vulnerable populations. The role of investor confidence, credit ratings, and government bond yields is also discussed to understand how budget deficits influence foreign investment and economic stability.

Through a thorough analysis of budget deficits in Romania and the EU, this paper aims to contribute to the broader understanding of fiscal policy's role in achieving sustainable economic growth and social equity. The findings offer valuable insights for policymakers, public authorities, and stakeholders involved in economic and social governance, providing a foundation for developing future fiscal strategies that balance economic development with social welfare within an integrated and competitive European framework.

2. Analysis of Budget Deficits and Their Economic and Social Impact

Budget deficits are imbalances with significant implications for national economies, and their effects on economic growth and public investments vary depending on their size and management. This section analyzes the impact of the budget deficit using specific data and figures for the Romanian and EU economies. Many analysts believe that budget deficits negatively impact economic growth and development, as demonstrated by the evolution of key

macroeconomic variables over various periods and countries. In the short term, budget deficits can reduce consumption due to decreased national savings, leading to higher interest rates and lower investments, subsequently affecting consumption again.

Several opinions exist in the literature regarding the impact of budget deficits on economic activity. In the short term, the effects on consumption are considered, while in the long term, the focus is on national savings, investments, and labor demand. Additionally, the neutrality of the budget deficit in the long term is debated, particularly when it is financed by increasing public debt, suggesting that budget deficits result from decreased economic activity, reducing the tax base and budget revenues. High budget deficits also reduce state investment expenditures, impacting job changes and budgetary expenditures in social or employment areas. Subsequent measures to finance the budget deficit, such as reducing budgetary expenditures, increasing taxation, or raising public debt, exacerbate the negative impact on the labor market in both the short and long term.

Below is an analysis of the evolution of budget deficits in major global countries to observe global connections and trends.

Table 1.1. Evolution of Budget Deficits in Major Global Countries (% of GDP)

Country	2006	2007	2008	2009	2011	2013	2015	2017	2019	2020	2021	2022
France	-2.4	-2.6	-3.3	-7.2	-5.2	-4.1	-3.6	-3.0	-3.1	-9.0	-6.5	-4.9
Germany	-1.7	0.3	-0.1	-3.2	-0.9	0.0	1.0	1.3	1.5	-4.3	-3.7	-2.6
Italy	-3.6	-1.3	-2.6	-5.1	-3.6	-2.9	-2.6	-2.4	-1.5	-9.7	-9.0	-8.0
Japan	-3.0	-2.9	-4.1	-9.7	-9.0	-7.6	-3.7	-3.1	-3.0	-9.1	-6.2	-7.8
Russia	7.8	5.6	4.5	-5.9	1.4	-1.2	-3.4	-1.5	1.9	-4.0	0.8	-2.2
UK	-2.8	-2.6	-5.1	-10.0	-7.5	-5.5	-4.5	-2.4	-2.2	-13.0	-8.3	-6.3
USA	-2.0	-2.9	-6.6	-13.2	-9.7	-4.5	-3.5	-4.8	-5.7	-14.0	-11.6	-5.5

Source: IMF, <https://www.imf.org/external/data>,

From the table above, it is evident that budget deficits tend to increase during economic crises when national economies shrink, and governments try to offset declining consumer spending with increased public expenditure to support the economy. The United States had the largest budget deficits during the analyzed crises, with values of -13.2% in 2009 and -14% in 2020. The UK followed with -10% and -13%, respectively. Germany had the smallest budget deficits, with -3.2% in 2009 and -4.3% in 2020, managing budget surpluses between 2013 and 2019, a rarity among the analyzed countries. Russia also shows a different trend post-2014, recording budget surpluses in some years.

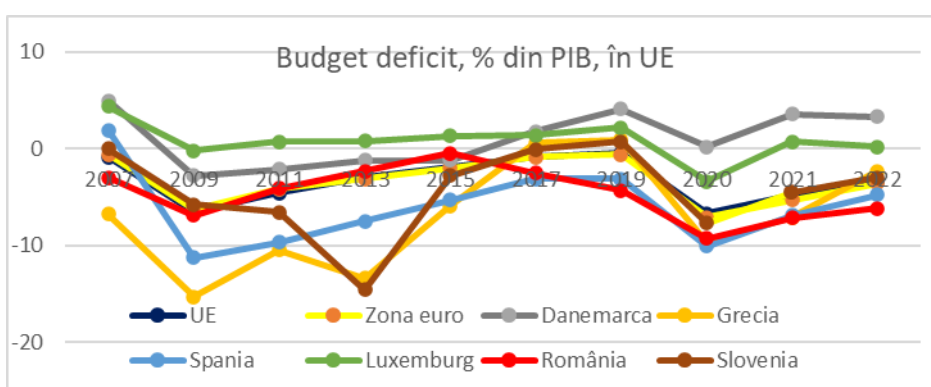
Romania will be analyzed in comparison with the EU and Eurozone averages and countries with the largest and smallest budget deficits in the Union during the period 2007-2022.

Table 1.2 Evolution of Budget Deficits in the EU and Romania (2007-2022, % of GDP)

Time	2007	2009	2011	2013	2015	2017	2019	2020	2021	2022
EU-27	-0.9	-6.6	-4.6	-3.0	-1.9	-0.8	-0.5	-6.7	-4.8	-3.4
Eurozone-19	-0.6	-6.3	-4.2	-3.1	-2.0	-0.9	-0.6	-7.1	-5.3	-3.6
Denmark	5.0	-2.8	-2.1	-1.2	-1.2	1.8	4.1	0.2	3.6	3.3
Greece	-6.8	-15.3	-10.5	-13.4	-5.9	0.6	0.9	-9.7	-7.1	-2.3
Spain	1.9	-11.3	-9.7	-7.5	-5.3	-3.1	-3.1	-10.1	-6.9	-4.8
Luxembourg	4.4	-0.2	0.7	0.8	1.3	1.4	2.2	-3.4	0.7	0.2
Romania	-3.0	-6.9	-4.1	-2.3	-0.5	-2.5	-4.3	-9.3	-7.2	-6.2
Slovenia	0.0	-5.8	-6.6	-14.6	-2.8	-0.1	0.7	-7.7	-4.6	-3.0

Source: Eurostat, <https://ec.europa.eu/eurostat/databrowser>,

Graph 1.1 Evolution of Budget Deficits in the EU and Romania (2007-2022, % of GDP)



Source: Eurostat, <https://ec.europa.eu/eurostat/databrowser>,

Analyzing the graphical evolution of budget deficits in the EU and Eurozone, it is clear that they are almost similar. Romania's path is not far off, except that it records a higher deficit from 2018-2019 and achieves the second largest budget deficit in the Union in 2020, after Spain, with only the UK recording more, but it had just exited the EU. The EU average recorded the highest deficit in 2020, at 6.7% of GDP, caused mainly by the COVID-19 crisis, very close to the deficit recorded following the 2008 global economic crisis when the EU average was 6.6% of GDP.

In recent years, Romania's budget deficit trend reflects a worrying tendency, directly impacting economic growth and public investment capacity. Official data from the Ministry of Finance and Eurostat show that in 2022, Romania recorded the largest deficit in the EU at 6.2% of GDP, with a 2021 deficit of 7.2% of GDP, down from 9.3% in 2020.

Increasing the budget deficit in the EU can negatively affect economic growth through its impact on fiscal stability and investor confidence. Countries

with large budget deficits may be less capable of financing necessary public investments to stimulate economic growth and respond to social needs and may face difficulties fulfilling financial commitments for joint European projects and accessing EU funds (according to European Commission data).

This significant increase in the budget deficit can negatively influence economic growth through several mechanisms:

1. Higher Financing Costs: A high budget deficit may force the government to borrow substantial amounts from the financial market. Increased demand for government bonds can raise financing costs, making it harder for the private sector to access capital and diverting financial resources to interest payments instead of productive investments.

2. Capital Expenditure Restriction: To reduce the budget deficit, the government may need to adopt fiscal austerity measures, including cutting capital expenditures. This can negatively affect infrastructure development, education, health, or research and development investments, all essential for long-term economic growth.

3. Impact on Investor Confidence: A high budget deficit can affect investor confidence in a country's fiscal stability. Domestic and foreign investors may become more reluctant to invest in an economy with fiscal sustainability risks, reducing the investment flows needed for economic growth and job creation.

The economic crisis of 2008 triggered a significant increase in public debt globally. Below is an analysis of the evolution of public debts in major global economies.

Table 1.3 Evolution of Public Debts (2007-2021, % of GDP)

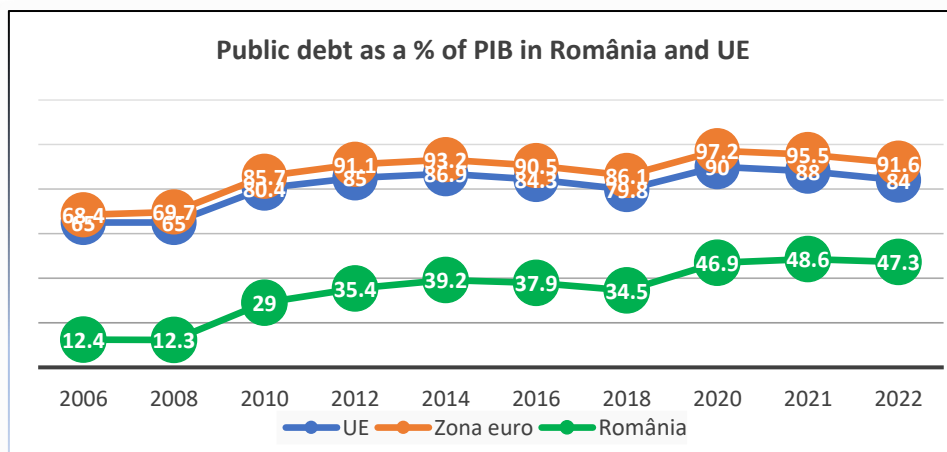
Country	2007	2008	2009	2011	2013	2015	2017	2019	2020	2021
France	51.19	55.25	67.05	69.64	74.75	76.61	79.55	80.87	92.98	91.76
Germany	39.52	40.05	44.41	50.00	49.54	45.34	41.32	37.42	44.43	46.27
Italy	97.82	100.42	109.80	113.19	126.34	130.03	129.56	129.94	150.85	146.55
Japan	135.45	143.28	158.07	177.91	189.14	189.86	193.93	199.79	221.43	221.32
Russia	6.75	6.09	7.78	8.89	11.06	14.15	13.49	13.16	18.54	
UK	41.98	49.78	63.71	80.14	83.85	86.06	85.05	83.89	102.63	102.97
USA	45.17	53.41	64.97	78.53	85.14	86.91	88.98	93.11	119.37	115.28

Source: IMF, <https://www.imf.org/external/data>,

Public debts have increased significantly in these countries, with Japan leading at 221% of GDP, followed by Italy. The USA nearly tripled its public debt from 45% in 2007 to over 115% in 2021, similar to the UK. Germany managed to keep its debt percentage relatively stable, with only a 15% increase over the last 15 years. Russia, while maintaining lower GDP values at 18.5%, also tripled its public debt in the past 15 years.

In EU countries, public debts have substantially increased, with the EU average rising by about 50% over 15 years, reaching 91.6% in the Eurozone and 84% in the EU. Although Romania's public debt remains below the EU average, it has quadrupled from 12.4% to 47.3%, representing one of the highest increases alongside Estonia and Latvia.

Graph 1.2 Evolution of Public Debts in the EU and Romania (% of GDP)



Source: Eurostat, <https://ec.europa.eu/eurostat/databrowser>,

Measuring the impact on investor confidence in the context of a high budget deficit can be challenging due to multiple variables and the subjective perception of financial markets. However, several indicators can provide insights into how budget deficits may affect investor confidence:

- **Credit Rating Scores:** Credit rating agencies like Standard & Poor's, Moody's, or Fitch evaluate sovereign credit risk, including the budget deficit level and fiscal sustainability. A downgrade may indicate a negative perception of a country's ability to honor its debts and maintain fiscal stability.

- **Government Bond Yields:** Government bond yields reflect the cost investors are willing to pay to purchase government debt. Rising yields can indicate increased risk perception associated with investments in government debt, which may be influenced by the budget deficit level.

- **Foreign Capital Flows:** A decrease in foreign capital flows can reflect reduced investor confidence in a country's fiscal and economic stability.

- **Domestic Financial Market Volatility:** Excessive volatility in domestic capital markets can reflect investor uncertainty about a country's economic and fiscal outlook. Increased volatility may suggest concerns about fiscal sustainability and can affect access to capital for local businesses and investments in development projects.

Budget deficits also have social impacts, affecting employment and income distribution, with implications for social cohesion and living standards. Budget deficits can lead to different effects on the labor market:

- **Increased Unemployment:** If the government decides to cut spending to control the budget deficit, this can lead to layoffs in the public sector and reduce aggregate demand, affecting the private sector as well. Simultaneously, increasing taxes to cover the deficit can discourage investments and consumption, leading to reduced employment.

- **Economic Stimulus Programs:** In some circumstances, budget deficits can be used to finance economic stimulus programs, which can create jobs and reduce unemployment. This is often a strategy used during economic recessions and represents a positive effect of deficits.

Budget deficits can affect income distribution through regressive fiscal policies. When indirect taxes (VAT, excise taxes) are increased to reduce the deficit, this can disproportionately impact lower-income individuals, exacerbating economic inequalities. Budgetary expenditure cuts can affect social programs (e.g., social assistance, education, health), essential for vulnerable populations, leading to increased inequalities and a deterioration in the quality of life for low-income individuals. If the deficit is financed through external or internal borrowing, the debt burden may lead to future reductions in social transfers or subsidies, negatively impacting income distribution.

Budget deficits and associated measures for their reduction can impact social cohesion:

- They can generate dissatisfaction and social tensions, especially if the population perceives these measures as unfair or ineffective. Austerity measures and the perception of an unfair distribution of fiscal burdens can exacerbate polarization among different socio-economic groups, weakening social cohesion.

- Financing deficits through money printing or borrowing can lead to inflation, as observed in recent years in Romania, eroding citizens' purchasing power. High deficits can also lead to higher interest rates, negatively affecting investments and consumption.

Conclusions

The social impact of budget deficits largely depends on how these deficits are managed and the economic and fiscal policies adopted to control them. A balanced and well-thought-out approach can mitigate negative effects and promote sustainable and equitable economic growth. Budget deficits are not just an economic issue but also a social one, with varied and interconnected impacts within the European and Romanian context. For Romania, prudent management of the budget deficit is crucial for ensuring sustainable economic growth and improved social cohesion. Fiscal policies and reform measures must consider the complexity of this phenomenon and strive to balance economic

and social development needs within an integrated and competitive European framework.

Increasing the budget deficit can reduce the government's investment capacity and negatively affect its ability to respond to current and future economic and social challenges. Therefore, coherent and sustainable fiscal-budgetary policies are essential to promote stable economic development and maximize the benefits of public investments for all citizens.

Managing the budget deficit remains a major challenge for many EU member states, and lessons learned from other countries' experiences can provide important guidelines for effective fiscal-budgetary policies. Policies that promote gradual fiscal consolidation, improve fiscal-budgetary transparency, and stimulate productive investments are crucial for ensuring long-term economic growth and financial stability within the EU.

Economic Impact

1. Growth and Investment: The analysis reveals that budget deficits have a significant impact on economic growth and public investment. High deficits often lead to increased borrowing costs, reducing the government's capacity to finance infrastructure and other critical investments. This, in turn, hampers long-term economic growth and development.

2. Inflation and Interest Rates: Persistent budget deficits can lead to higher inflation and interest rates. As governments borrow more to finance their deficits, they increase demand in the financial markets, which can push up interest rates. Higher interest rates make borrowing more expensive for businesses and consumers, potentially stifling economic activity.

3. Fiscal Sustainability: The long-term sustainability of fiscal policies is jeopardized by high budget deficits. Continuous borrowing increases the national debt, making it more challenging to manage in the future. This can lead to a vicious cycle where increasing debt levels require more borrowing just to service existing obligations.

Social Impact

1. Employment: Budget deficits can have mixed effects on employment. While government spending can stimulate job creation in the short term, especially during economic downturns, long-term deficits may necessitate austerity measures. These measures often include cuts to public sector jobs and social programs, increasing unemployment and reducing social support systems.

2. Income Distribution: The study shows that budget deficits can exacerbate income inequality. When governments raise indirect taxes (such as VAT and excise duties) to finance deficits, the burden disproportionately falls on lower-income households. Additionally, cuts in social spending adversely affect those who rely most on public services, widening the gap between rich and poor.

3. Social Cohesion: Persistent budget deficits and the measures taken to address them can undermine social cohesion. Austerity measures, perceived as unfair, can lead to social unrest and increased polarization within society. Ensuring fair and equitable fiscal policies is crucial for maintaining social harmony.

Investor Confidence

1. Credit Ratings and Bond Yields: High budget deficits negatively impact a country's credit rating, reflecting perceived risks of fiscal instability. Lower credit ratings can lead to higher bond yields as investors demand greater returns for increased risk. This further raises the cost of borrowing for governments and can deter foreign investment.

2. Foreign Investment: The analysis indicates that high budget deficits can deter foreign investment. Investors seek stable and predictable economic environments, and high deficits signal potential future instability. This can result in reduced capital inflows, affecting economic growth and development.

Policy Recommendations

1. Fiscal Consolidation: It is essential for countries, including Romania, to adopt gradual and sustainable fiscal consolidation strategies. This involves carefully balancing spending cuts and revenue increases to reduce deficits without stifling economic growth or exacerbating social inequalities.

2. Transparent and Accountable Governance: Improving fiscal transparency and accountability is critical. Governments should ensure that budgetary processes are open and that fiscal policies are clearly communicated to build investor and public trust.

3. Strategic Public Investment: Prioritizing strategic public investments that yield long-term economic benefits, such as in infrastructure, education, and healthcare, can help stimulate growth and improve social outcomes. These investments should be designed to maximize economic returns and social welfare.

4. Social Protection Measures: Implementing social protection measures to mitigate the adverse effects of fiscal consolidation on vulnerable populations is crucial. Policies should aim to protect the most disadvantaged groups from the brunt of austerity measures and ensure that economic growth is inclusive.

5. Debt Management: Effective debt management strategies are necessary to ensure that public debt remains at sustainable levels. This includes setting clear targets for debt reduction, improving debt servicing mechanisms, and exploring options for restructuring or refinancing existing debt where feasible.

Future Research Directions

Further research is needed to explore the nuanced impacts of budget deficits on different economic sectors and social groups. Comparative studies between countries with varying fiscal policies can provide deeper insights into best practices and successful strategies for managing budget deficits.

Additionally, the role of international financial institutions and their policies on national budget deficits warrants closer examination to understand the broader global economic context.

By adopting these recommendations and focusing on sustainable fiscal management, countries can better navigate the challenges posed by budget deficits, promoting stable economic growth and enhancing social well-being in the long term.

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