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ROMANIA'S AUSTERITY POLICIES IN THE EUROPEAN CONTEXT

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ABSTRACT

The economic recession starting in 2007 with the collapse of the US Bank Lehman Brothers triggered waves of economic shock across the world. Various states were hit more or less hard through different mechanisms and reacted with different intensities to adjust to the crisis situation. In this article, I employ a comparative methodology to assess the austerity policies undertook by Romania during the Great recession period as regards the policies adopted at the level of other EU member states. Thus, I aim to offer an initial evaluation of the degree of similarity of Romania's recession policy responses to that of some other EU member states, and the degree to which Romania can be labeled as an outlier. The comparative analysis tests the explanatory power of three different theoretical approaches on the causal factors explaining variation in policy responses: power resources theories, functionalist approaches and blame-avoidance.

KEYWORDS

- *economic crisis*
- *Romania*
- *austerity*

1. Introduction

In 2007 Romania became member of the EU after a long and strenuous process of accession negotiations. Once with the start of the negotiation for accession in December 1999 Romanian experienced a period of continuous economic growth and improving living standards. Given the guarantees presented by the future statute as an EU member, speculative and non-speculative FDI flows increased and accelerated the economic growth significantly. Apparently, the start of the economic crisis found Romania in a strong position to withstand economic hardship. In 2008 the forecasted GDP growth reached a peak of 7.8%. While the deficit increased to 6% of GDP, Romania's external debt decreased to 14% by 2008[1], one of the lowest levels in the region[2]. Yet, in the following years, Romania implemented some of

[1] The total government debt in RON and foreign currency decreased to 19.54% of GDP
[2] The country rating as at BB+

the most aggressive austerity measures, which significantly affected the wealth of its population and finally led to political turbulence that toppled the Cabinet that implemented these measures. By comparing the characteristics of the Romanian policy response to the economic crisis to those in the other EU member states, this article aims to untangle the causal factors that influenced the evolutions in Romania. The analysis evaluates the explanatory power of various theories that attempt to dissect that causal streams that led to variation in policies of fiscal adjustment.

The article is organized as it follows: in the second section, I present the theoretical models employed by various authors to explain the comparative evolutions in the context of the post 2008 recession. I discuss the Power Resource Theories, the Varieties of Capitalism and the functionalist approaches to the structural factors confining the government's room for maneuver and their application within the post 2008 crisis situation by Lierse[3]. Fourth, I also analyze the blame–avoidance theory advanced by Jensen and Mortensen in 2013[4]. In the third section, I comparatively assess the characteristics of the austerity packages implemented in the EU member states on three dimensions: welfare cuts, investment policies, and fiscal reforms. In the forth section I analyze into more detail the characteristics of the austerity measures in Romania. In the last section, I evaluate the explanatory power of each of these theories, and the degree to which they can help one understand the features of the Romanian austerity measures compared to other EU member states.

2. Theoretical approaches

In this section I define the theoretical framework that will be employed for the comparative analysis of the three dimensions of the austerity packages enacted in Romania and the rest of the EU member states. Each approach has some strength regarding their core independent variables, while they overlook some other important explanatory factors. The Power Resource Theory (PRT) starts with the assumption that the power, intensity and form of the organization reflecting class alignment organizations. Authors like Esping-Anderson and Korpi[5], Huber and Stephens[6], Castels and Obinger[7] focus on various policy and macroeconomic outcomes resulting from left-wing v. right-wing governments. These authors found systematic evidence that left-wing governments actively promote policies favoring consumption and redistribution toward the lower end of income scale. Instead, right-wing governments favor investment and promote measures that decrease the

[3] H Lierse, 'Partisanship and Taxation: An exploratory study of crisis responses', *TransState Working Papers*, no. 159, 2012, Accessed at: http://econstor.eu/bitstream/10419/54988/1/684352990.pdf

[4] C Jensen, & PB Mortensen, 'Blame avoidance, Partisanship, and Government Responses to Fiscal austerity', *Comparative Political Studies*, print June 11, 2013, doi:10.1177/0010414013488536

[5] G Esping-Andersen, & W Korpi, 'Social Policy as Class Politics in Post-War Capitalism: Scandinavia, Austria, and Germany', in Goldthorpe, J. (ed). *Order and Conflict in Contemporary Capitalism: Studies in the Political Economy of Western European Nations*, Oxford: Clarendon Press, 1984.

[6] E Huber, & JD Stephens, *Development and Crisis of the Welfare State: Parties and Policies in Global Markets*, University of Chicago Press, 2001.

[7] FG Castels, & H Obinger, 'Social expenditure and the politics of redistribution', *Journal of European Social Policy*, vol. 17, no. 3, 2007, pp. 206–222.

redistributive role of the states in economy. According to Steinmo and Tolbert[8], the evolution of tax policies in democratic states is strongly influenced by changes in voters' attitudes toward taxation. The most straightforward way to operationalize these attitudes is to proxy leftist party control of governments for pro-taxation attitudes. The most important implicit argument that can be extracted is that right-wing governments are much more apt to enact policies falling under the category of tax competition. Based on the power resource theory, one can expect that the perceptions on the priorities regarding reforms under conditions of economic crisis will be different along the left-right continuum (Allan and Scruggs[9]; Amable et al[10]). While right-wing politicians would favor more abrupt welfare state retrenchment, left wing politicians will militate for milder reforms, whose impact will be distributed over a longer time span. Also, those authors focusing on the strategies generated by the aim to limit the negative consequences of welfare state retrenchment have identified various strategies used in different countries (see Pierson[11]).

The functionalist approach on policy reforms emphasizes the structural factors that confine government's choice at any given moment. Authors like Garrett and Mitchell[12], Swank and Steinmo[13], Swank[14], stress that the increased global integration through capital liberalization or trade openness increase the interdependencies among states and generate capital competition and a shift of the tax burden toward consumption taxes. Garrett and Lange[15] and Rodrik[16] postulate that the increased exit options for capital decrease state's capacity to impose redistributive policies, situation that leads to a shift toward consumption taxes. Thus, during recession times, irrespective of their policy aspiration, the capacity of governments to enact tax measures aimed at taxing capital is limited.

One approach that tried to explain the conditions under which despite the structural pressures created by recession some states may choose not to enact widespread adjustment measures was developed by Katzenstein[17]. He argues that while capital mobility may exert downward pressure on tax rates, another major

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[8] Sven, S, & CJ Tolbert, 'Do institutions really matter? Taxation in Industrialized Democracies', Comparative Political Studies, vol 31, no. 2 1998, (April), p. 167.

[9] JP Allan, & L Scruggs, Political partisanship and welfare state reform in advanced industrial societies, *American Journal of Political Science*, vol. 48, no. 3, 2004, pp. 496-512.

[10] B Amable, D Gatti, & J Schumacher, 'Welfare-state retrenchment: The partisan effect revisited', *Oxford Review of Economic Policy*, vol. 22, 2006, pp. 426-444.

[11] P Pierson, 'The New Politics of the Welfare State', *World Politics*, vol. 48, no. 1, 1996, pp. 143-79.

[12] G Garrett, & D Mitchell, 'Globalization, government spending and taxation in the OECD', *European Journal of Political Research*, vol. 39, 2001, pp. 145-177.

[13] D Swank, & S Steinmo, 'The New Political Economy of Taxation in Advanced Capitalist Democracies', *American Journal of Political Science*, vol. 46, no. 3, July 2002, pp. 642-655.

[14] D Swank, 'Tax Policy in an Era of Internationalization: Explaining the Spread of Neoliberalism', *International Organization*, vol. 60, 2006, pp. 847-882.

[15] G Garrett, & P Lange, 'Political Responses to Interdependence: What's "Left" for the Left?', *International Organization*, vol. 45, no. 4, 1991, pp. 539-564.

[16] D Rodrik, *Has Globalisation gone too far?*, Washington DC, Institute for International Economics, 1997.

[17] P Katzenstein, *Small States in World Markets. Industrial Policy in Europe*, Ithaca: Cornell University Press, 1985.

component of globalization, namely trade openness, has a positive result on tax/GDP ratio. Moreover, the author stresses that the compensatory policies are typical in small, open European economies, countries that developed complex policy instruments to reduce the risk caused by international exposure. In his influential Small States in World Markets, Peter Katzenstein examines the economic and social development success of small European capitalist states and gives an explanation for the relationship between their size and the economic strategies they pursued. Katzenstein groups the type of responses to economic crisis in three categories: the liberal approach – of those countries relying on market solutions, and, in the extreme, to protectionist measures; the statist approach – of large capitalist countries like Japan that impose wide-ranging systemic protectionist measures; the small democratic corporatist countries that depend on the world market and cannot purse systemic protectionist measures. This group tends to combine their trade openness with an array of economic and social policies designed to temper the negative effects of cause by economic adjustments. According to Katzenstein, these countries' strategy can be described as a preference "for a reactive and flexible policy of industrial adjustment"[18]. Nevertheless, pursuing such strategies while maintaining democratic institutions can be done only as viable mixtures of sustainable bargains among politicians, the stakeholders and bureaucrats on some core issues could be developed. Overall, within Katzenstein interpretation, although small states depend on the external influence, they cannot be labeled as passive recipients of this influence, but as actors that developed proactive adaptive responses to external challenges. All in all, according to Lierse[19] the empirical evidence regarding the exact direction of tax shifts is still inconclusive as "often the effects are small and dependent on the specification of the mode." Also, its worth stressing that some of the most important factors that deter the overall tax decrease regard budget rigidities and the long-term fixed costs of servicing the public debt.

The third theoretical approach is Jensen and Mortensen's[20] argument based in Pierson's[21] theory of double motivation: policy and re-elections motives - leading politicians pursuing various policies. According to this view, whenever economic hardship prompts politicians to enact measures leading to welfare state retrenchment they will be motivated both by ideological motives and by their desire to minimize the negative electoral impact these measures would have on them. To understand adequately the interaction of these potentially conflicting policy aims, one has to look at their dynamic interaction along two key dimensions: the ideological predominance of the government and the number of veto points[22]. These authors advance the hypothesis that the more veto points are present, the wider the distribution of blame for retrenchment reforms is. Instead, when the

18 Katzenstein, op. cit., p. 24.

19 Lierse, op. cit., p. 5.

20 Jensen and Mortensen's, op. cit.

21 P Pierson, *Dismantling the Welfare State. Reagan, Thatcher, and the Politics of Retrenchment*, Cambridge: Cambridge University Press, 1994, p 17.

22 Jensen and Mortensen's, op. cit. A veto player is a person or institution that can prevent a change from taking place

number of veto player is decreased, most blame for unpopular measures will go to these few veto players. Thus, actors that will have strong incentives to avoid being blamed for the economic hardship caused by retrenchment measures. The combination of the causal direction on these two dimensions leads to the predictions systematized in table 1. First, in countries with few veto players and left-wing government in power, one can expect to encounter higher prevalence of policies designed to protect the core constituencies of the left-wing government, and thus one can expect that social protection measures would be expanded. In addition, for the combination of right-wing governments in countries with few veto players, one can predict modest welfare state retrenchment measures given that voters of right-wing parties are less likely to be affected by these measures.

Instead, when several veto players are present, and thus, the blame for unpopular measures can be diffused, Jensen and Mortensen's[23] model predicts that power sharing will increase the likelihood of adopting retrenchment measures, irrespective of the type of government. Thus, the pressure caused by decreasing revenues given the economic downturn would prompt left-wing movements to enact modest retrenchment measures.

Table 1. The direction of reform given the number of veto points and the predominant ideology of the parties in government (from Jensen and Mortensen's 2013)

		Government party	
		Left-wing	Right-wing
Veto points	**Many**	Modest retrenchment	Radical retrenchment
	Few	Expansion	Stability

Overall, the three different theoretical perspectives offer clear hypotheses that can be tested through the analysis of the policy efforts undertook after the start of the economic crisis. As the first part of this comparative assessment, in the following section I will present some of the most relevant features of the policy reforms undertook as a response to the economic crisis. These policy responses will be analyzed through their implications on the explanatory power of each of the three theories discussed in this section.

3. Analyzing the EU member states governments' responses to the economic crisis

Given that different countries had different structural weaknesses, the economic crisis affected the EU member states differently on different dimensions and prompted more or less immediate adaptation measures. While in 2009 many EU countries introduced tax relief measures to stimulate economic recovery, by

[23] Ibid.

the end of 2010 this trend has been reversed. Starting with the spring of 2010, as news from Greece confirmed the discrepancy between its official statistics and the real situation, interest rates abruptly increases for all EU countries whose state of public finances was questionable. The potential Europe-wide banking sector collapse prompted the intervention of governments and subsequently led to the creation of the European Financial Stability Facility[24].

The aggressive measures undertook by many EU member states to mitigate the effects of the economic crisis – especially to help the banking sector – led to an increase of the average debt from 59% in 2007 to 80% in 2010[25]. As capital markets reacted to the increasing risk of long-term unsustainability of public debt, interest rates on government bonds soared for many countries. Forced to regain their credibility on the financial markets, governments across the EU introduced various tax increases aimed to help the process of fiscal consolidation, measures that nevertheless were quite diverse.

Theodoropoulou and Watt[26] evaluate the characteristics of the austerity packages adopted in the EU countries for 2011 and 2012. The packages forecasted a 0.9% of GDP/year discretionary retrenchment, with a total value of 501 billion Euros for the five years after 2010. As expected, those countries that requested external funds from the IMF and the EU - Hungary, Latvia, Greece, Ireland, or those that were close to have to – Spain and Portugal – implemented the most abrupt adjustment measures[27]. Greece increased the top PIT rate by 5%, the VAT by 4% and imposed a one-time extra levy on business. Hungary also increased the VAT rate and the CIT tax. Instead, countries with better position managed to enact measures that would help economic recovery, like modifying the depreciation and exemption rules[28]. Further, countries that appealed to the IMF implemented austerity packages that placed most of the adjustments in the first year (frontloading). While indirect taxes represented the predilection area for tax increases, expenditures reductions were operated mainly in the area of social protection and public administration, reforms that overall had a consistent regressive effect on income distribution[29].

All in all, with a few exceptions (Greece and Cyprus in 2011), most austerity measures enacted expenditures reductions rather on tax raises. The countries where this distribution was the most skewed in towards spending cuts (above 70%) are Denmark, France, Hungary, Ireland, Luxembourg, and UK[30]. The UK went so far

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[24] In October 2010, Ireland was the first country to benefit from this mechanism. Among the states most affected by the crisis, Portugal, Spain, Ireland, and UK announced harsh austerity packages in their effort to reestablish investors' confidence in their capacity to repay their debt.

[25] Lierse, op. cit., p. 1.

[26] S Theodoropoulou, & A Watt, *Withdrawal symptoms: an assessment of the austerity packages in Europe*, European Trade Union Institute WP 2011.02, p. 13

[27] ibidem, p. 5

[28] ibidem, p. 5.

[29] The only exceptions to this trend are Luxembourg and France, countries where measures aimed at top PIT earners have had a progressive effect.

[30] S Theodoropoulou, & A Watt, op. cit., p. 18.

as to plan tax cuts for 2012. For example Latvia enacted one of the most aggressive austerity packages. Nevertheless, fiscal retrenchment started in 2008 after it took over the liabilities of one of the largest banks and had to apply for IMF assistance in order to avoid default. Interestingly, during the negotiations, the IMF suggested an increase of the PIT Flat tax form 15% to 19%, measure that was considered unacceptable. Overall, the 18% output reduction in 2008 and 2009 made the Latvian recession one of the most dramatic in the EU[31].

Further, some of the most significant spending cuts were implemented in the areas of education, research and development or public investments[32]. The analysis of the distribution of losses among social categories reveals that some of the persons most affected by these reforms were the pensioners and people approaching the age of retirement. In addition, public sector workers were disproportionately affected in comparison with workers from the private sectors. In some countries, plans to decrease the total number of state employees (Ireland, France, Austria, Spain, and Greece) led to a freeze in employment and in some countries significant layoffs were implemented (Hungary, Ireland, Cyprus, Germany, UK, Latvia, and Spain)[33].

Some authors[34] also argue that given that countries with current account surpluses designed reform packages aimed to further improve their competitiveness, an overall decrease of inequality among the EU countries is highly unlikely. Overall, given the high unemployment rates during the crisis, the regressive nature of the tax, and expenditure reforms, the overall effect of the economic crisis would increase income inequalities at the EU level. Last but not least, based on questionnaires completed by national level experts[35] the authors appraise that while some forms of social dialogue took take place prior to announcement of the austerity packages, in the final outcome, the views of trade unions were largely ignored in most countries.

Another point of view is offered by Lierse[36] who investigates the strategies adopted between 2008 and 2010 by the governments of the EU member states in order to mitigate the effects of the economic crisis in the area of fiscal revenues. Given that analyzing just the changes in the tax rates or the evolution of tax revenues does not offer a direct evaluation of the substantive characteristics of government's policies, this author explores both the direction and amount of tax adjustment.[37] Her aim was to explain to what extent did the left-right distribution of government composition and various structural pressures affected the type of measures undertook in the EU countries? Thus, her main depended variables are

[31] S Theodoropoulou, & A Watt, op. cit., p. 14.
[32] ibidem, p. 19.
[33] ibidem, p. 23
[34] ibidem, p. 6
[35] *Ibid.* According to these authors, most experts were members of the TURI Network of national trade-union research institutes.
[36] Lierse, op. cit.
[37] The tax rate produces effects only in combination with the tax base the policy is applied too and the capacity of the government to collect that revenue.

the number, the direction (tax cuts v. tax increases) and the type of tax reforms. One of the most important predictions derived by Lierse based on the Power Resource Theory is that left-wing governments should promote more interventionist measures, translated into more tax changes focusing on mitigating the negative effects of the crisis. Instead, right-wing governments are expected to enact less tax changes and less abruptly[38]. Her independent variables are operationalized as the government dominance of right v. left[39], the bound rates, and the predicted growth rate.[40]

Her analysis reveals that for the 2008-2010 period both right-wing and left-wing governments opted for more tax cuts, although left-wing governments cut taxes less, and in some areas (SSC, VAT and other consumption taxes), they even chose to apply small increases[41]. Instead, a structural factor clearly associated with tax reforms is the fiscal stress reveled by the interest rates on ten-year government bonds[42]. Instead, countries with the interest rate under the EU average were those that afforded to cut taxes consistently across all types[43]. This author concludes that "high fiscal stress severely restrict governments' capacities to shape political intervention. In fact, there is little proof that social-democratic governments adopt a more redistributive and interventionist approach to taxation than conservatives."[44] Instead, "State activity and adjustment processes increase with bond rates. Moreover, the results also support that tax competition is highest in the fields of corporate and personal income taxes as high rates may lead to a capital flight into low-tax regions or to comparatively costly employment"[45]. It's worth mentioning that the tax shift from business and personal income taxation toward the consumption taxes was also advocated by OECD in the 2010 report[46] on arguments that direct taxation is detrimental to growth.

Instead, Jensen and Mortensen's[47] testing of the blame-avoidance theory using OLS PCSE finds statistical evidence that strongly dominated left-wing cabinets would pursue expansionary welfare measures under the presence of few veto points. As soon as right-wing parties would join the government, this effect would disappear given that they would have a veto power over expansionary measures[48]. Instead, right-wing cabinet dominance with more veto points and economic globalization leads to aggressive welfare retrenchment measures. Also, even if the

[38] Lierse, op. cit., p. 4.

[39] Operationalized through the party positioning in the Party Manifesto Group (Volkens et al. 2011)

[40] This author chose not to control capital account openness given that all countries are members of the EU

[41] Lierse, op. cit., p. 10.

[42] Those countries with interest rate well above the EU average (>7% at an EU average of 5.1%) enacted most of tax increases (although not Corporate Income Taxes), especially in the area of VAT and other consumption taxes.

[43] Lierse, op. cit., p. 12.

[44] ibidem, p. 2.

[45] ibidem, p. 13.

[46] *OECD Tax Policy Reform and Economic Growth*, OECD Publishing, 2010, Available at: http://dx.doi.org/10.1787/9789264091085-en (accessed: January 2011).

[47] Jensen and Mortensen's, op. cit.

48 Jensen, & Mortensen, op. cit., p. 19

government debt is high, in countries where the number of veto points is reduced retrenchment measures are delayed.[49]

Overall, while the conclusions of these authors agree to some extent, they differ in some important points. Even if all authors agree that functional pressures are important[50], their decisiveness differs. Lierse's[51] analysis implies that functional pressures trump the importance of the left v. right dimension, while Jensen and Mortensen stress that this is not the case if another dimension is taken into account – the number of veto players. The detailed empirical mapping of government's response undertaken by Theodoropoulou and Watt[52] reveals that the presence of external conditionality – especially the IMF – forced governments to enact measures that were not in accordance with their ideological stand. Instead, these authors indicate that the focus on expenditure cuts across the EU' expose the extent of neoliberal economic philosophy dominance. Further, given that the condition stipulated by Jensen and Mortensen[53] – the presence of pure left-wing cabinet under conditions of few veto players – did not characterize most EU countries after 2007,this causal situation did not have an important effect on the overall direction of EU reforms.

In the continuation of this comparative assessment, in the following section I will present into more detail the characteristics of the austerity package in Romania, the policy events that led to these outcomes. Further, I will comparatively analyze the features of these reforms in comparison with those from the rest of the EU member states. Throughout this analysis, I will attempt to test the degree to which various theoretical approaches could help one explain the chain of events.

4. Policies of austerity in Romania

To adequately understand the features of Romania's policy responses to the economic crisis, we first need no analyze the peculiarities of its economic and political conditions. In this section I first present the most important factors that affected the structure of incentives of various policy actors, and then investigate into detail the timing and characteristics of the retrenchment policies adopted in Romania. Despite the signals that a worldwide economic crisis is highly probable, the autumn 2008 caught Romanian politicians in the fever of the parliamentary elections, and thus all political parties opted for highly optimistic electoral promises. The 2008 electoral year offered important incentives for politicians to increase significantly the salaries in the public sector, with a vote on doubling payments in the educational sector that occurred in the autumn. Thus, while the full effects of the crisis started to be felt in the last three months of the year, the first acknowledgments of these situations came only in the beginning of 2009. The initial

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49 Jensen, & Mortensen, op cit., p. 20

50 Especially the government bond rates and government debt.

51 Lierse, op. cit.

52 S Theodoropoulou, & A Watt, op. cit.

53 Jensen, & Mortensen, op. cit.

adjustment started in the private sector, with a 315,000 reduction of employees in 2009, mainly in the construction and commerce sectors. As compensation measure, through Law No. 329/2009 Romania aimed to offer incentives for firms to employ persons in exchange of tax exceptions for reinvested profit. Subsequently, through Government Ordinance No. 13/2010 the government offered 6 months social security contribution exemptions for companies employing unemployed persons. Unfortunately, the budget passed in January 2009 was based on outdated data regarding the forecasted economic growth. As the discrepancy between the forecasted revenues and expenditures increased dramatically, between January and August 2009 Romania experienced an abrupt increase for the government bonds long-term interest rate that surged from 7% to a top value of 11.4%.

According to Aligica and Tarko[54], the peculiar characteristic of the economic crisis in Romania was that it came after a three year period (2006-2008) when the government spending increased at a very abrupt pace. Despite the economic growth around 6-7%/year, the budget deficit also soared from 3% to 5.7%, the current account deficit peaked 13.6% of GDP in 2005, and annual inflation grew from 5% to 8%. Thus, given that the budget for 2009 was calculated on a presumed economic growth of at least 3%, the sharp economic contraction of 6.6% led to a budget deficit of 9%. In 2009, the expenditures continued to rise up to 41% of GDP while the total government revenues decreased to just 32%. While the consolidated gross debt as percentage of GDP remained stable over the 2006-2008 period, the widening gap between expenditures and revenues led to an increasing gross debt from 14% in 2008 to 25% in 2009 and 32% in 2010. In addition, from 2004 to 2008 the number of civil servants increased by around 400,000.

To counteract the negative effects of this increase, the Romanian government was forced to begin negotiations with the IMF in the winter of 2009 and a deal was reached in March 2009. The two-year stand-by agreement offered a joint IMF-EU-World Bank 12.95 billion Euros loan for Romania. The most important characteristics of this agreement were the commitment to maintain inflation low, and frontloading significant cuts in government spending. Aligica and Tarko[55] argue that some of the negative features of this agreement were: the recentralization of the public sector as a mean to allow the fast implementation of expenditure cuts, and the imposition of across the board cuts. Thus, the absence of any performance related principles for government's cuts blocked any structural reforms in the following years. Some of the most important measures imposed by this agreement were:

- Decreasing wages in the public sector by 25% and the elimination of many extra-benefits;
- Public pensions cuts by 5% - this measure was declared unconstitutional

[54] D Aligică, & V Tarko, 'The Uses of Austerity: Romania. Impressive improvisation on the short run, dark structural clouds on the long run horizon', Presentation, 2012. Accessed at: http://www.slideshare.net/upsidown/the-uses-of-austerity-romania-20072011

[55] Ibid.

by the Constitutional Court and was compensated by a VAT increase from 19% to 24% and the imposition of a tax for the health insurances;

- Decreasing the total number of positions for employees paid by the state by 200,000 during the 2009-2011 period;
- 15% cut in unemployment and child benefits;
- Structural reforms of 141 government agencies;
- Tax increases for owners of more than one house or car;
- Institutional reform to decrease tax evasion;
- Privatization of various state companies like Oltchim, Cupru-Min, Transelectrica, Transgaz, TAROM, and Posta Română;

All in all, these reforms should have led to a total of 700 million Euros savings in 2010 (3% of the total government spending). Given that the Presidential elections were scheduled in December 2009, none of the most unpopular measures were implemented in 2009. After several delays in starting the implementation of these reforms, in May 2010 President Traian Basescu became the main factor pushing for austerity reforms by publicly announcing the need to immediately implement some of the most painful measures of these reforms. In June 2010, the Boc Cabinet ordered a 25% wage cut for employees paid by the state, 15% cut in social security benefits and a VAT increase from 19% to 24%. Through the Strategy on reforming the social benefit sector[56], the government committed to the goal of decreasing the costs of social security from 2.9% to 2% (the EU average is 5%). This aim was to be achieved by increasing the strictness of tests for resources, changing the manner of calculating the level of welfare benefits, and transferring the financial costs to the local authorities (30% central government and 70% the local budgets)[57]. In addition, in 2010 - 60,610 government employees were laid off. The implementation of the cuts led to a decrease of the average salary in the state sector from above 2,200 RON in 2009 to less than 2,000 in 2010 and 1,900 in 2011. Instead, wages in the private sector continued to rise during the entire period, from 1,650 in 2008 to almost 2,200 in 2012. Thus, despite the crisis, the overall wages in the Romanian economy have steadily increased during this period, from almost 1,800 in 2008 to over 2,010 in 2012.

After intense debates, in March 2011 the Parliament approved a new Labor Code that was vocally opposed by unions and the Romanian employers' associations. Among the most relevant changes were the increased flexibility of employing and dismissing employees, the implementation of fixed-term work contracts, and decreasing the immunity of trade union leaders[58]. Further, in the summer of 2010 the Social Dialogue Code changed the criteria imposed on unions for gaining representativeness, imposed new and more difficult conditions for

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[56] Strategia privind reforma în domeniul asistenţei sociale 2011–2013 (National Strategy for reform in the area of social services). Accessed at: http://www.mmuncii.ro/pub/img/site/files/58bd6ffc9844fbc4a8a639672450872b.pdf

[57] V Stoiciu, 'Austerity and Structural Reforms in Romania', *FES Working Paper*, 2012. Accessed at: library.fes.de/pdf-files/id-moe/09310.pdf, p. 3

[58] Ibid.

registering new unions, eliminated the professional trade unions and the national collective agreements[59]. Thus, despite the economic crisis and the high rates of unemployment, the share of social welfare costs remained constantly under 15%, one of the lowest levels in the EU. According to Stoiciu[60], by 2010 the percentage of people at risk of poverty increased to 29.8% for if inactive and 45.4% for the unemployed persons. Also, while in 2009 the level of absolute poverty reached 4.4%, in the absence of social transfers the level would have raised to 36.8% of the population.

In addition to these measures the health system was another sector where significant cuts were aimed. While in 2011, 67 hospitals were closed, in January 2012 a draft bill aiming to reform the health care system caused an increased public outrage. Among the radical measures advanced by this law were the privatization of the emergency system, the transfer of health insurance to private companies, the privatization of hospitals or transformation them into foundations. Within this context, the political debate focused on the fact that the president had no Constitutional attributions regarding economic policies. Also, the coalition that supported the PDL Cabinet achieved 51% of votes through a process of massive migration following the 2009 Presidential elections. These aspects have been the most important points in the political oppositions' effort to voice against the legitimacy of these austerity measures. While the public discontent continued to increase after the start of the austerity measures, protest movements were triggered only by the political conflict around the privatization of the emergency rescue services. The street protests in the winter of 2012 led to the resignation of Prime-Minister Emil Boc.

The detailed presentation of the policy measures undertaken in Romania underlines some peculiar features of the events in Romania: first, they were significantly influenced by the elections calendar, a situation that prevented any agreement among various political forces for almost one and a half years. Second, this one and a half year delay widened the scale of adjustment the external institutions asked from the Romanian authorities in order to offer a loan. Third, the second Boc Cabinet was consistent in its option for austerity measures that would have a regressive character. Thus, while no comprehensive quantitative evaluation of these measures exists at this moment, the Romanian austerity package appears to be one of the most steep and regressive among the EU member states.

5. Implications

Based on the detailed analysis in the previous presented, in this section I comparatively assess the features of the Romanian austerity policies in comparison with those from other EU member states. To start with, as in the case of most other EU members, the economic crisis came after a period of accelerated growth, period

[59] Ibid. It is worth mentioning that the initial draft of this law was proposed by the American Chamber of Commerce and the Council of Foreign Investors and later embraced by the Boc Cabinet.

[60] Stoiciu, op. cit., p. 6.

that nevertheless did not lead to an abrupt increase of its debt as % of GDP. Unlike many West-European states, Romania did not face a significant threat of banking sector collapse, especially given the fact that most banks were subsidiaries of foreign banks and given that their exposure to risky credits was limited. Despite this, the widening gap between revenues and incomes that appeared in the beginning of 2009, combined with the lack of interest from the political parties and the President to publicly acknowledge the scale of the problem, led to a deterioration of investors' confidence in Romania's capacity to service its debt.

Also, the beginning of discussions about austerity measures was faster than in other West-European countries. Even if the measures were delayed after the 2009 presidential elections, they were still implemented before most other EU states. After Romania dropped out of the Stand-by agreement with the IMF in 2005, the beginning of the negotiations for a new agreement offered to the Romanian authorities a source of external credibility and increased their legitimacy for imposing austerity measures. The scale of the problem can be understood considering that even under the conditions of harsh austerity expenditure reductions, the government debt increased from 19.54% in 2009 to 34.93% in 2010.[61] Thus, while Romania did not have to bail out it banking sector, the deficit issue became highly problematic since it could have led to a rapid deterioration of the state of public finance.

While countries that also took loans from the IMF like Greece, Latvia and Hungary opted for a combined package of tax hikes and expenditure cuts, the initial austerity package in Romania contained no increase of any major tax. Instead, the austerity measures forecasted abrupt cuts of state employees' wages (25%) and public pensions (15%). Only after the Constitutional Court declared the pension cuts unconstitutional the government opted for a VAT raise from 19% to 24%. An effective pension reduction was nevertheless obtained by imposing a 5% contribution to social health insurances for the pension income above 740 RON. In addition, considering that most of these measures were implemented in 2010, the Romanian austerity measures were among the most frontloaded. As with most other EU countries, the areas of education, research and public investments were significantly affected by expenditure cuts. The divergent evolution of wages in the public and the private sectors in Romania led to a skewed effect of adjustment on the workers from the public sector. Nevertheless, throughout the austerity period, the total expenditures of the public institutions did not actually decrease but increased given the implementation of some reorganization measures and the obligation of the state to pay for some wage increases obtained through court of law decisions.[62]

While at this moment no comprehensive evaluation of the social effect of the austerity package exists, most of these measures had a regressive nature,

[61] Data from the Ministry of Public Finance.

[62] http://www.gov.ro/informare-a-ministerului-finantelor-publice-referitoare-la-cheltuielile-de-personal-cuprinse-in-proiectul-bugetului-general-consolidat-pentru-anul__l1a107557.html

including the only significant tax increase, the VAT. Also, as in most other EU member states, the social dialog produced no relevant effect on the nature of the austerity measures[63]. Additionally, the Cabinet chose to dismantle the Council for Social Dialogue in 2010 and to change the Labor Code as to create one of the most flexible labor markets for employees of the private sector.

Further, unlike other countries where the political coalitions in power justified the austerity measures as a means to restore the country's financial viability, the Romanian President and some members of the Boc Cabinet actively advocated the austerity as a tool to enact a much-needed reform of the state apparatus and to dismantle inefficient welfare policies. According to Stoiciu[64], the government employed two types of arguments as a means to legitimate its actions. The technical justification referred to the requirements imposed by the EU and the IMF and the need to modernize some sectors affected by the crisis. For example, while the Romanian labor market was not evaluated as too rigid, the Boc Cabinet insisted on deregulation of this area. The ideological arguments appealed to the widespread frustration and lack of trust in the state institutions and proposed to reform the system as to limit benefits for people on welfare, to dismiss as many lazy and corrupt officials as possible and to reform the obese state. [65]

The neoliberal ideology was significantly present in the justification employed by the Boc Cabinet and especially the President. Given the dominance of the right-wing Liberal-Democratic Party, the Power Resource Theory appears to explain the direction of reforms in Romania. Nevertheless, it is worth mentioning that the coalition in power managed to obtain a slim majority in the Parliament after an intensive political migration of parliamentarians to the social democrats. The smaller left-wing party, the National Union for Romania's Progress[66] could have easily veto the highly controversial austerity reforms or to condition that the impact of the reforms be felt less on the lower end of the income scale. Instead, the enactment of radical retrenchment under the conditions of right-wing party with several veto points can explain the intensity of these reforms. On one hand, the presence of a three-party coalition with a left-wing party, the implication of the President and the capacity of the Constitutional Court and ordinary courts to censor some measures increased significantly the number of relevant veto points. Further, the implication of the IMF, the European Commission and the World Bank in drafting the agreement for the external loan Romania obtained further allowed a wider distribution of blame for the retrenchment reforms. On the other hand, the trigger of the harshest wave of reforms in May 2010 depended on the direct involvement and support of the most visible figure of the coalition in power: President Traian Basescu. As expected, in the months following these reforms the level of public trust in him decreased significantly (from above 50% to fewer than

[63] S Theodoropoulou, & A Watt, op. cit.
[64] Stoiciu, op. cit., p. 4.
[65] Expressions used by the President Traian Basescu
[66] Uniunea Nationala pentru Progresul României (UNPR) is a center left party according to its political program acced at http://www.unpr.eu/description.php/Ideologie/16/

20%) for the next years. All in all, the political and economic situation of Romania and the characteristics of the policy sequence that led to the policy outcomes make the Romanian case a peculiar one. Using the theoretical instruments presented in the second section and the comparative data from the third section, in the next section I draw some preliminary conclusions regarding the explanatory power of each of the different theories under discussion.

6. Conclusions

Within this final section I investigate the strength and limitations of each of the three theories when they are applied to the case of Romania. Overall, the post-2007 economic recession affected Romania's economy significantly and accentuated the public deficit problem to a point that could have led to a significant deterioration in a short period. While Romania had the advantage of a low level of public debt, the foreign loan it took from the International Monetary Fund, the World Bank and the European Commission could only delay the necessity of a painful adjustment. The presence of two consecutive election years – in 2008, the parliamentary elections and in 2009, the presidential elections – delayed any significant adjustment measure by at least one and a half years. Since the looming painful austerity measures have not been discussed in either the parliamentary or the presidential elections, no clear popular mandate regarding these reforms resulted from these elections. After May 2010, Romania enacted one of the most aggressive and regressive fiscal retrenchment programs. While the scale of this retrenchment can be partially explained through the conditionality from foreign lenders, the regressive nature of all measures is a function of the ideological choice of the core artisans of this austerity package. Nevertheless, since the majority that enacted these reforms was crafted by President Traian Basescu through political migration and did not result from elections, the chain of events in Romania does not offer the strengths to the Power Resource Theory (PRT).

Instead, these events could offer more weight to the functionalist approach. Despite the inconclusive result of the parliamentary elections, and the delay caused by the presidential elections, the Romanian government had to implement the package of austerity policies given the structural constrains faced by Romania. While the coalition of the two biggest parties in the Parliament after the 2008 parliamentary elections could have led to a wide-ranging pact as those described by Katzenstein, the pressure created by the looming presidential elections, as well as the lack of trust among the two parties blocked any potential agreement on implementing a set of balanced austerity policies. Nevertheless, while the scale of retrenchment increased given the delay of these measures, the distribution of austerity measures across various categories and the timing of the implementation were placed within the choice of the Cabinet. The fact that the choices were consistently regressive and focused on state employees and beneficiaries of various welfare policies cannot be explained without weighting in the ideological factor. Thus, the functionalist approach on the structural threats faced by Romania could explain the sense of urgency for enacting and frontloading some of the harshest austerity measures. While most of these reforms were delayed for one year given the presidential elections, in 2010 the reshuffled Cabinet[67] enacted the harshest austerity measures, reforms that in combination with a continued economic recession led to significant social suffering. Instead, the highly regressive nature of most of the austerity measures was significantly influenced not by structural factors but by ideological reasons. For example, the need to keep Romania attractive for FDI was used as an argument to maintain the low Corporate Income Tax and the Personal Income Tax.

The presence of a heterogeneous coalition in power, the implication of the President and the power of the Constitutional Court increased the number of potential veto players who could affect the possibility of implementing the austerity measures. While this situation gives weight to Jensen and Mortensen's argument regarding the conditions under which radical retrenchment is more probable, two limitations apply. First, the coalition in power comprised one left-wing party (UNPR) that could have easily derailed the reforms at any moment. Second, given the specific conditions of Romania, the decision to implement these reforms was attributed to a limited number of players – President Traian Basescu, the Prime-Minister supported by him and the main political party in the coalition – the Liberal Democratic Party. Further, the communication strategy used during the period of austerity placed the source of this decision on the President. Thus, no significant blame-avoidance strategy could be identified in the case of Romania.

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[67] After winning the Presidential elections, Traian Basescu managed to forge a parliamentary coalition that would support a reshuffled Boc cabinet.

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