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EU Structural Instruments – key component in improving the Romanian macroeconomic stability?

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Abstract

Romania is experiencing a rather paradoxical situation: while its balance of payments reflects a severe need of financing and capitalisation, the first EU *Alert Mechanism Report* demonstrates the vulnerable macroeconomic external position of Romania and the EU allocation for the 2007-2013 programming period potentially provided a significant amount of money for investments, around 29 billion euro through Structural Funds, the level of absorption, after five years since the beginning of the current financial framework, remains extremely low. The paper focuses on the main Romanian macroeconomic imbalances, the current account balance, international investment position and on the most important sources for financing investments and development, the EU financial structural instruments: ERDF and Cohesion Fund.

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1. Introduction

When the financial crisis hit Europe, Romania was one of the most exposed countries from Central and Eastern Europe CEE. Before 2008, the very rapid growth which stimulated the domestic demand was mainly the effect of foreign direct investments and capital inflows facilitated by foreign banks with subsidiaries in Romania. As a result of the reduction of capital inflows and sharp decline in export demand, the previous pace

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of growth has proved unsustainable and a very severe recession hit Romanian economy in the late of 2008 Dragan,G., 2011. In order to avoid a possible banking sector collapses in CEE, the EU, the IMF and other International Financial Institutions EBRD, EIB and the World Bank Group created a new financial facility called *EU Balance of Payment Facility* BOPF. Consequently, Romania, Hungary and Latvia, all of them non-euro EU member-states facing problems resulting from an "*unusual combination of external shocks and domestic policy mistakes*", received a common financial support package of around €50 billion**.** Romania signed its first agreement of multilateral financial assistance in May 2009 for an overall amount of 20 billion euro and an additional one in May 2011, for around 5 billion euro.

The first *Alert Mechanism Report* on macroeconomic imbalances in the EU member states, published by the European Commission in February 2012, demonstrates the vulnerable macroeconomic external position of Romania, which surpasses the indicative threshold in three out of ten indicators, all of them from the area of external imbalances and competitiveness. However, although the FDI inflows in Romania have decreased due to prolonged economic recession of Western Europe, the EU funds allocated to our country for the 2007-2013 financial period should have had a visible impact on the Romanian BoP, offsetting this drop and supporting the external sustainability of the country. Unfortunately, the contracted and payment ratio are still very low in Romania comparing with the CEE average. Romanian's poor absorption of EU funds represents a multifaceted reality, the causes ranging from a weak administrative capacity, managing structures and rules too complicated, inefficient procedures, institutions, etc., to the lack of co-financing, respectively of guaranteeing the national contribution, as a result of an acute shortage of financial resources both for public and private co-financing investments.

2. Macroeconomic imbalances in the Romanian's external position

The European Commission EC - *Alert Mechanism Report* on macroeconomic imbalances in the EU member states, published in February 2012, is based on a scoreboard including indicators and thresholds and represents the first phase of the new EU surveillance procedure and part of the so-called "European Semester". Its main goal is to allow the EC to find out internal and external imbalances of the analyzed countries and, if it is the case, to "propose policy recommendations, either under the preventive or the corrective arm of the procedure" AMR, 2012. The report demonstrates the vulnerable macroeconomic external position of Romania, which surpasses the indicative threshold in three out of ten indicators, all of them from the area of external imbalances and competitiveness, specifically on the current account balance, international investment position and nominal unit labor costs Table 1.

The Report shows that at the EU level, as a result "of a sharper drop in private sector demand and a corresponding contraction in imports", the crisis has determined "a significant reduction in external imbalances" in most of the EU member states, particularly in those EU countries "which entered the recession with large current account deficits", AMR, 2012. Consequently, the high current account deficits decreased in the majority of EU member states. However, there are a number of EU member states, and among them Romania, where the scoreboard indicator on the ***current account balance CAD*** has been surpassed. Nevertheless, even if the AMR threshold of 4%/ +6% for "the 3 year average Current Account Balance" as a % of GDP has been slightly exceeded in Romania, where the average is - 6.6 %, the situation is even worse for countries like Bulgaria -11.1%, Greece -12.1%, Cyprus -12.1% and Portugal -11.2%.

Romania's external deficit the CAD declined from a peak of around 13% in 2007 to an average of around 4% since 2009 and, according to the 2012 European Commission Spring Forecast, it will remain below 5% of GDP in the next period 2012-2013 EC Spring Forecast, 2012. The decrease of CAD over the past three years was mainly the result of a significantly decrease of trade deficit, due to a sharper decline of imports on the back of the domestic demand's turn down.

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