Romania's External Debt Sustainability Under Crisis Circumstances

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***Abstract**. Even if one could not say that governments and international organizations took the most appropriate rescue and/or stimulus packages, the worst effects of the financial crisis seem to be overcome. Signs of recovery occurred in the developed countries by the end of 2009, but the question of sustainability is arising. Romania was hit hard by the crisis in 2009, suffering a severe contraction of the economy, estimated at 7.1 percent. The worsening of the external and internal financial framework of Romania and the danger of a currency market crisis urged the need for a financing agreement with IMF. The study shows that, more or less, the parameters adapted for Romania regarding the MLT external debt sustainability entered already the significant risk zone. In the baseline scenario, assuming favourable economic circumstances, an exit of Romania from this risk zone could be possible by 2015. In the alternative scenario, an excessive burden of external debt compared with financing resources needed to comply with the external payments obligations would maintain Romania on the brink of default risk. Supplementary risks associated with unfavourable developments of the external context and also with pressures coming from a non-restructured public debt could make the default situation even unavoidable.*

***Key words**: international financial crisis, global recession, anti-crisis measures, public debt, external debt sustainability, country default risk*

***JEL Classification:** C10, E44, E47, G01, G15, H63, H68.*

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1. Introduction

The turbulences on the international financial markets arising from the US housing market crisis which emerged in July 2007 have turned drastic in the second half of 2008. Despite expectations of an intervention by the Federal Reserves and/or the U.S. government for its rescue, only one week after the nationalization of Fannie Mae and Freddy Mac, two giants of the financial world, in mid-September 2008 the investment bank Lehman Brothers, a reference name on the capital markets, has been left to fall into bankruptcy, which has degenerated into the slump of the stock exchanges capitalization indices all over the world. Investors' confidence in the capability of markets to automatically adjust its dysfunctions has drastically fallen and the risk of unemployment and poverty as consequences of the global crisis could severely damage the political and social framework, particularly in the less developed countries.

The processes of globalization and liberalization of trade and free capital movement have proved to be factors, although we cannot say that they have caused, yet they at least favoured the uncontrolled spread of financial derivatives, including bad mortgage-backed securities, which became "toxic" assets. In the absence of adequate financial transactions control and supervision of global risk monitoring and warning, the protection systems at national level have failed one after the other, posing low resistance to the crisis power expansion and contamination. The secondary capital markets and their indexes of market capitalization, respectively, have suffered a fall-down to 20 percent in only a few weeks (end of September and the first half of October 2008).

It is worth mentioning that, during the years leading up to the crisis, the monetary axis of the planet dangerously slipped from the West to the East, under the pressures of global financial imbalances deepening due to the accumulation, on one hand, of huge international reserves in Asia (mainly China and Japan) and, on the other hand, of huge debt in the USA which generated uncontrolled capital flow movements.

To address the adverse effects of the financial crisis it is absolutely necessary to identify the causes that have generated it and to implement policies and resources coherently connected on short, medium and long terms, at the local, regional, national and international level. The crisis that the world is going through reveals the combination of traditional causes of the economic and financial crisis in general, with other non-traditional, specific ones.

Among the main traditional reasons of the economic and financial crisis one finds: the credit boom on excessively large scale; the sharp rise in asset prices,

particularly in the housing market; lending over the exposure limits to economic agents or persons less solvent or even non-solvent (the sub-prime mortgage debtors); the failure in market discipline; the distortion of risk information and asset pricing.

Regarding the non-traditional reasons, especially the ones related to the financial crisis, we can mention, first of all, the extent and depth of the sub-prime crisis concerning: the uncontrolled growth of a *sui generis* origin-and-distribute model; an inordinate appetite for profit that has fuelled the growth in demand for high risk assets; the *ex ante* ignorance and *ex post* uncertainty regarding the risk associated with stock market values, based on mortgages, derivative financial products and credit-default swaps transactions; the lack of an appropriate corporate governance and the excessive incentives for the financial institutions' managers.

In our opinion, the root cause of the international financial crisis lies in exacerbating the role of financial instruments, of the nominal (monetary) economy compared to the real economy, in terms of ensuring the prerequisites for a sustainable development. This exacerbation was based on the speculative component of the free market economy model, beyond its admissible and controllable limits.

In order to restore the world financial stability and to avoid the collapse of global economy, a number of leading banks and financial institutions in difficulty have been saved, at least temporarily, by state intervention in the USA, the UK, Germany, France, Belgium, the Netherlands and other countries, through bailout rescue packages amounting to almost USD 5,000 billion. These huge public costs suggested the need for a systemic plan in order to strengthen financial institutions, taking into account the fact that certain actions fragmentized at national level may prove ineffective. Thus, a more intensive cooperation of the stakeholders in the stabilization and consolidation of financial markets seem appropriate, particularly for the implementation of reforms on regulation and supervision of financial markets. Any postponement of the implementation of reforms in this area may prove counterproductive in the medium and long run.

The turbulences in international financial markets and their negative effects triggered a contraction of the world economy in 2009, estimated at 0.6 percent (IMF, 2010), sharper in the USA (2.4 percent), Euro area (4.1 percent) and Japan (5.2 percent). Influent international institutions or organizations (including UN, World Bank, IMF, EU, etc.), during various high level meetings of the Member States have discussed and agreed on a series of measures for

counteracting the effects of the crisis and restoring the confidence in financial markets. Although we cannot say that there is a miracle solution ("one-size-fits-all"), some of the experts have envisaged the consistent, clear and coordinated approach to the issues of security bank liabilities, separation of bad assets and recapitalization of the institutions concerned. The idea of systemic plans for safeguarding the financial markets by increasing the prudence, the supervision and the institutional regulation is more and more accredited. From this viewpoint emerges clearly the role of public-private partnerships in the financial sector, reducing the rate of exclusiveness of regulation solely by the market forces.

To understand and motivate better possible solutions we must classify the effects of the crisis according to their action on short-and long term, respectively, this issue depending on the duration of the crisis, on one hand, and its economic and social consequences, on the other hand. In analyzing the effects of the crisis in the context of coherent anti-crisis programs and measures we must take into account not only their negative side but also the opportunities created by the process of "creative destruction" that must be highlighted.

Putting in place emergency measures such as the limitation of borrowing through specific means is mostly meant to overcome the financial crisis on short term. In turn, the implementation of structural reforms within the global financial system on long term aims at preventing the recurrence of such crisis phenomena in the future, and requires special measures. A better regulatory and monitoring framework should be designed to help the speeding-up of financial innovation for the benefit of everybody and not for speculative purposes, by favouring a social minority.

On the agenda of the governments, as challenges for debates and exchange of experience, pointing to a long-run horizon are, to varying degrees, financial issues related to competition, incentives for prudent behaviour, consumers' protection, the improvement of financial education and of corporate governance.

At global level, on the occasion of the high level Summit of G-20 (Washington, November 2008), the Member Countries committed to an Action Plan which was reviewed at G-20 London Summit in April 2009. The Action Plan set recommendations in order to strengthen transparency and accountability, enhance sound regulation, promote integrity in financial markets, reinforce international cooperation and reform international financial institutions.

During the G-20 Summit which was held on 24-25th September in Pittsburgh (USA) the world leaders recognized that the process of world recovery and turnaround was incomplete, in many countries unemployment remaining

unacceptably high and the private demand still weak. As a consequence, they agreed further actions to assure a sound recovery from the global economic and financial crisis, among which: launching a Framework for Strong, Sustainable and Balanced Growth, setting timetables for the reform of the global financial system, mainly by raising capital standards and ending practices that lead to excessive risk-taking, establishing the Financial Stability Board at the G-20 level, in order to coordinate and monitor progress in strengthening financial regulation. European leaders discussed also the idea of an EU institution charged with the coordinated financial supervision of capital markets in Europe (watchdog) getting some politicians express their concern about the functioning of the market economy, in terms of intervention measures and protectionist constraints, including the banking system. The powers of a new European Systemic Risk Board (ESRB) and European System of Financial Supervisors (ESFS) still have to be agreed upon and defined in detail. Despite the unity of action displayed by the European leaders, there is an impression that, in fact, each one is trying to minimize the negative effects on their own account, within their national space.

Paradoxically, despite the insignificant proportion of toxic assets in their banking system, the emerging countries of Central and Eastern Europe, escaped from an experimental system of command economy and going through a transition to a market economy, have also been exposed to the effects of the crisis, mainly due to their excessive openness to the foreign capital, including the financial one, sometimes of pure speculative nature.

The effects of the crisis on emerging European countries in 2009 have been multiplied by their super-positioning to the persistent inflationary pressures caused by the rise of energy, raw materials and agricultural products global prices during 2007 until the second half of 2008. Moreover, in this context, a flight of foreign capital has been noticed, some of these countries facing a sharp depreciation of their currencies and the decline of investors' appetite, which resulted in increasing external financial imbalances.

2. Theoretical considerations and international practice in analyzing debt sustainability

In the economic literature, but also in the international practice there is some consensus on the idea that, in developing countries, depending on the efficiency of external loans/credits, reasonable levels of external indebtedness may help the economic growth by accumulation of capital and by productivity growth. On the other hand, the over-indebtedness, that is a high level of external debt on

medium and long term, potentially unsustainable, can be a brake on technological progress of that country, having adverse effects on growth, the transmission channel being visible upon the public investment and the physical capital accumulation. An excessive burden of the external debt is acting in a vicious circle, i.e. the higher the degree of indebtedness, the more complicated the process of economy financing becomes, including supplementary costs of debt refinancing, which finally could even lead to halting the economic growth of that country and to slip into default.

Some studies have estimated that, for countries with an average degree of indebtedness, doubling the debt is reducing the annual growth by 1 percentage point on long term (C. Pattillo and others, 2004).

The analysis of non-linearity in the relationship external debt-economic growth has pointed out that, at low levels of the debt/GDP ratio, there is a positive influence on growth but at high levels of this ratio a negative impact has been revealed. The analysis of the data for a group of countries during 1968-1998, showed that the average impact of debt on GDP per capita growth becomes negative at levels of 160-170 percent of debt to exports ratio and of 35-40 percent of debt to GDP ratio. According to other studies (B. Clements and others, 2003), the negative marginal effects on growth start to occur at even lower levels of public and publicly guaranteed external debt, i.e. at 20-25 percent of GDP.

The over-dimensioning of debt is producing "overhang effects" on economic growth by discouraging investment (as level and structure) due to a possible threat of increasing taxes in the future, under the constraints of debt repayment obligations, which would affect the ex-ante efficiency parameters related to those investments (see Hennessy, 2004). The same effects can affect the macroeconomic stability because of the currency depreciation, of the fiscal deficit increase, of inflation and of uncertainties induced by the high level of indebtedness (Arnone M. and others, 2005).

Stopping or slowing debt growth as a form of external debt relief should be taken into consideration by the decision makers for the next years. This approach is totally in contrast with non-altruistic politicians and groups of interest concerned rather with their narrow and short-term objectives than with improving well-being. The politicians are inclined to finance their short-term particular interest of re-election by booming the consumption or meeting the pressure of short-term requirements of the economy salvation.

The 200-year-old concept in economics of "Ricardian equivalence"[1] supported by a reduced but outstanding number of economists holds under certain conditions:

- the presence of the so-called altruist intergenerational decision makers who consider that a debt redistributes resources from future to current generation;
- the intergenerational transfer have not to be detrimental to future generation ;
- the existence of perfect capital markets which is not the case in our times of rapid changes;
- the presence of non-distortionary (lump sum) taxation (a distortionary taxation reduces incentives to invest or work, the level of distortions growing with the higher tax increase).

When most debt is denominated in foreign currency, higher levels of debt are generating constraints on the conduct of an independent monetary policy. The public debt management has to design policies aiming at reducing vulnerability of volatile capital markets, costly debt and financial crisis.

Although rising indebtedness is directly linked to the increase of default risk, recent studies show that the debt level is not the crucial factor of sovereign debt risk (Manasse, Roubini, Schimmelphenning, 2003). The quality of national economy, of political and institutional bodies and of the government is among the most important debt factors.

High debt levels are not associated with robust long-term growth when high-return investment projects are not guaranteed. The complex interaction between economic growth and foreign debt has to be evaluated through the potential rate of investment returns. A higher investment return will generate a country's better off and the necessary means to repay the debt obligations.

The defining elements of a sovereign debt crisis scenario – manifested as the situation of non-payment of due amounts at a given maturity – are the downgrading of the country rating, the currency crisis, the calling for loans from the IMF, and foreign capital flight. Typically, this crisis is followed (sometimes preceded) by restructuring or rescheduling the external debt. The problems of external payment overheating are affecting also the private sector, limiting its access to the capital markets and raising the borrowing costs. On the other hand, none of the pressures related to external payments could be without impact on economic growth on different time horizons.

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[1] According to Ricardo, a government's debt-financed tax cut is leading to higher taxes in the future, meaning only a postponement and not a reduction in the overall tax volume.

After 1990, when many emerging countries received access to international capital markets, the risk that a sovereign debt crisis of a particular country causes chain reactions has increased considerably, as it happened in the case of the Asian financial crisis in 1997-1998, when the effect of payment difficulties arising in Thailand have spread almost in the entire region. Wrongful government actions have reputational effects on confidence, affecting not only the sovereign debt, but also the international trade and investments, an entry into payment crisis inducing catastrophic effects on that country, as shown in the model of Cole and Kehoe (1998).

So, the main issue to prevent and avoid a payment crisis situation at sovereign level is to accurately assess **the risk of default**, respectively the external debt sustainability. By sustainability, in this case, is understood the external financial situation of a country where foreign exchange resources are beyond the external debt service payment obligations. The longer the time horizon of the evaluation that corresponds better to the purpose of analysis is, the more difficult it becomes, due to the multiplication factors of uncertainty.

Under the common framework of the IMF and World Bank methodology (IMF, 2008), the debt sustainability analysis, applicable to the public and highly indebted countries, is built on 3 pillars:

I. **Analysis of debt dynamics and prospects of debt service in the context of a baseline scenario**, the alternative scenarios and stress tests standardized. Alternative scenarios have in view the assessment of a country's vulnerabilities to deviations from the baseline scenario and to various plausible shocks. Methodologically, the external debt covers only the long term, is defined on the basis of residence and may include the domestic debt denominated in foreign currency (especially in the case of countries where its level is very high).

II. **Debt sustainability assessment** based on debt service in relation to measuring the ability to pay. Debt stock indicators provide a measure of the total future debt burden, estimated by measuring its present value at a certain discount rate and the ability to pay is measured by GDP, exports of goods and services and/or budget revenues. Debt service indicators (at present value, discounted at a constant rate) relative to exports, respectively budget revenues, are reflecting the burden of future payment obligations of a country, highlighting the risks of insolvency on the long run and providing an indication of the likelihood of locating in time the liquidity problems. The perspective considered takes into account the debt maturity, which is of 10-20 years.

III. **Recommendations on the borrowing strategy** in order to limit the risk of payment problems; the risk is rated according to how present and future indicators of external debt are related to the thresholds of the base scenario, the alternative scenarios, and stress tests, hence:

- **Low risk**: all the indicators are well below the thresholds. If one indicator is above a certain threshold it should be checked if it is a matter of sustainability;
- **Moderate risk**: when the base scenario indicates the exceeding of thresholds and the alternative scenarios or stress tests show a significant increase in the level of debt service indicators on the projected period;
- **High risk**: base scenario indicates the exceeding of thresholds of debt and/or debt service, and alternative scenarios or stress tests also show an exacerbation of level indicators;
- **Statement of payment problems**: debt and debt service ratio are significantly above the thresholds; the existence of payments delays suggests that the country is in default, except when there are reasons, other than the burden of debt service, for which payments are not made.

Starting from the fact that sustainable levels of external debt are influenced by the quality of policies and institutions, to assess their performance the World Bank calculates the CPIA (Country Policy and Institutional Assessment) Index by 3 categories of countries (with strong, medium and weak policy), the final classification into various categories of risk depending also on the score obtained by this index.

According to some opinions (D. Gray and others, 2008), the traditional analysis of external debt sustainability presents a number of weaknesses due to the fact that a growth in the debt/GDP ratio does not necessarily mean an unsustainable debt dynamics. Moreover, the stabilization of the debt/GDP ratio is not sufficient if, for example, the level at which it stabilizes is too high (possibly unsustainable). Some studies have shown that the threshold of sustainability of external debt for the emerging countries ranges from 15-20 percent to 50-60 percent of GDP, whereas for the developed countries it can rise up to 350 percent of GDP, with an average of 85 percent (Reinhart and others, 2003).

The traditional approach does not take into account the level and the changes in public sector assets and liabilities that affect the sustainability of debt and does not consider also the international reserves level. In defining the macroeconomic parameters that determine the debt sustainability, it does not take into account the

volatile nature of markets, and it is based on assumptions regarding the evolution of economic growth, the real interest rates and the exchange rates. The markets' volatility may increase both on account of political shocks and the exogenous shocks, and a higher volatility in emerging countries compared with the advanced countries may be due to their limited ability to increase taxes and to their uncertain tax base. As Catao and Kapur (2006) pointed out, the external volatility of international trade has also a significant impact on the likelihood of payments' default.

The experiences of many countries concerning the external debt sustainability suggests that, for monitoring the vulnerability to insolvency, currency and liquidity risks, analysing the debt structure depending on interest rates and currency composition is extremely important. It was noted that, for example, economies that have a higher share of debt with variable interest rate in the total debt are more vulnerable to sudden increases in interest rates. In recent years, fluctuations in exchange rates, especially of the U.S. dollar (in the sense of its depreciation) have created relevance problems concerning the level of the overall external debt denominated in a particular currency. Consequently, it considers that information on the composition by currency and interest rates is absolutely necessary for a correct assessment of debt sustainability, through an appropriate currency conversion and by calculating a weighted average of interest due on that debt, respectively.

An appropriate public debt management requires consistent management of risks associated with debt portfolio, that is refinancing risk (the inability to refinance debt or excessive increase its costs), currency risk (increase in foreign debt due to currency depreciation), interest rate risk (rise in interest on domestic or international capital markets), credit risk (bankruptcy of counterparts), the payment risk (errors in the payment system), operational risk (error of debt management system or human error, lack of appropriate procedures, lack of staff) and legislative risk (interpretation of the law).

3. Romania's vulnerabilities under the global crisis impact. Was the IMF financial assistance unavoidable?

The global crisis has severely affected the real economy, in 2009 the gross domestic product of Romania falling by 7.1 percent compared with 2008. The exports fell by almost 14 percent and the imports by 32 percent. The manufacturing sector, whose main branches are under the majority control of foreign capital and subsidiaries of multinational corporations, being more exposed to international markets, witnessed a 6.5 percent contraction.

Constructions and retail trade registered also a sharp decline (more than 15 percent and respectively 10 percent) in comparison with their "boom" in previous periods. The financial sector recorded a significant fall (more than 5 percent). Even if bankruptcies of banks did not occur, the lending activity entered a deadlock.

The financial framework of Romania, both internal and external, deteriorates under the pressure of the state budget widening due to diminishing revenues and rising public sector expenditure and of the decline of foreign exchange incomes due to the falling exports.

The biggest challenge for the prospects of Romania's development is related, in our view, to the sustainability of the external financial situation revealed by the evolution of external debt both on short-, medium and long term (see Table 1).

Under the circumstances of falling contribution of the autonomous flows (foreign direct investments) for covering the current account deficit and the increase of compensatory flows (external loans), the medium and long-term external debt of Romania has risen more than three times over the last six years, exceeding EUR 51.7 billion at the end of 2008. The short-term external debt has increased even faster, almost seven times in six years, mainly due to the boom in imports and consumption credits. But an excessive rise of the short-term external debt puts great pressure on the currency market, risking a crash of the national currency in 2009.

Table 1

The short, medium and long term external debt of Romania in the period 2003-2009

- EUR billion -

External debt	2003	2004	2005	2006	2007	2008	2009
TOTAL	18.4	21.5	30.9	41.2	58.3	72.4	80.1
- short term	2.7	3.2	6.3	12.6	19.8	20.6	14.6
- medium and long term	15.7	18.3	24.6	28.6	38.5	51.8	65.5

Source: National Bank of Romania, Interactive Databank.

On the other hand, the accumulation of a large foreign debt in the medium and long run, accompanied by high levels of annual services, weakened the international position of Romania, undermining its sustainable development. The medium and long-term external debt of Romania continued to grow in 2009,

mainly due to the loan from IMF and other international organizations, reaching EUR 65.5 billion at the end of December.

To deal with the financial difficulties in 2009, increased by the consequences of the global crisis, Romania has concluded a financing agreement for a two-year loan of EUR 20 billion with IMF, EU, EBRD and World Bank, under the conditions of reducing the budget deficit and freezing wages in the public sector. Regarded as a "safety belt", the loan was intended to support the budget deficit and economic activity, to maintain the euro-lei exchange rates at sustainable levels for the economy and population and to boost the recovery of lending activity. The financial assistance and the economic policies are supposed to cope with liquidity pressures ou the short run, to improve competitiveness and to redress the macroeconomic and financial balances.

The real causes of the accelerated increase in Romania's external financing requirements are related to growing vulnerabilities of the financial situation which resulted from deepening macroeconomic imbalances, particularly the savings-investments balance, from pressures on the external balance of payments emerged in recent years due to the deterioration of the current account and to the widening of trade deficit. The excessive increase in domestic private credit for consumption has fuelled the massive increase in imports, mainly in 2007 and 2008. At the same time, reducing the relative contribution of foreign direct investment to financing the current account deficit has lead to increases ou short- and medium-long term of the external debt, mostly in the private sector (including banks).

The deterioration of the current account during the last years is also explained by transfers the slowing of current from the Romanians working abroad and the increase in the income balance deficit, especially due to growing profits repatriation and/or reinvested by the foreign companies and also to increased interests related to the external debt. All these were accompanied by a modest rate of EU funds absorption in the first years of accession (about 10 percent), as despite its low level of development Romania being a net contributor to the EU budget.

The gross financing requirements for 2009 estimated by the IMF and the National Bank of Romania, for EUR 44 billion, from which a financial gap of around EUR 12 billion should be covered by an external loan, was not adequately sustained in our view, at least according to published sometimes contradictory or confusing information.

For example, the estimation of foreign direct investments, i.e. EUR 3.5 billion in 2009, has proved to be under-sized, compared with the previous year (EUR 9 billion) and also with the real amount of FDI registered at the end of 2009 (EUR 4.9 billion).

In our opinion, under the circumstances of many uncertainties in the international environment, which could have assumed also the rebound of the world economy as of 2010, a financing agreement over a shorter period would have been more appropriate. In case the pessimistic assumptions about the Romanian economy would have been confirmed, an extension of this agreement could have been negotiated. However, a much more advantageous financing solution for Romania, as an EU member state, would have been the qualification for obtaining a credit line for 6 months or one year from FCL ("Flexible Credit Line"), a funding modality initiated by the IMF in the month of March 2009 for replacing SLF ("Short Term Liquidity Facility"). It is worth mentioning that, this new credit line is released for the prevention of crises in countries with very strong fundamentals, policies, and track records of policy implementation, which is not totally the case of Romania.

In fact, in our view, the logic of the agreement with the IMF was based on monetary coordinates designed inside the NBR perimeter. Starting with the top priority of Romania's accession to the Euro Area in 2014 and thus of its entry into the ERM II (Exchange Rate Mechanism) in 2012, the strict conformity to convergence criteria (in particular those on inflation, nominal interest rates on long term and exchange rate) has become the fundamental objective in the medium and long run.

The threat of a possible collapse of the national currency in the first quarter of 2009, due to internal and external pressures accumulation doubled by the lack of immediate liquidity of assets in which the international reserves of Romania have been invested and also by the reduction of the minimum reserve requirements on foreign currency liabilities of the commercial banks could have triggered an uncontrolled inflation, missing the objective of joining the Euro area.

The inconsistency of tax and fiscal policies of the government, mainly the excessive budget expenditures in 2008, has worried the monetary authorities of Romania, but also the European Commission. Under these circumstances, the central bank has been forced to resort to international arbitration for imposing the national fiscal discipline under a multilateral financing agreement: IMF, EU, EBRD and World Bank.

The Stand-By Arrangement with the IMF provides a number of advantages for Romania, implementing the necessary fiscal and monetary policies, including the

fiscal discipline, ensuring the macroeconomic stability in the context of conditionality and performance criteria, improving the perception of foreign investors, stabilizing the foreign exchange market, ameliorating the predictability, sustainability and coherence of economic policies, supporting the banking sector and its strengthening, including the recovery of the lending activity, both for businesses and population.

Beyond these advantages, there are also several risks arising from the agreement with the IMF, such as creating a negative image regarding the financial situation of Romania, which would make a "bailout" necessary, limiting the government room of manoeuvre in implementing various economic policies, including the predictable reduction in the budget allocation in accordance with national priorities, such as infrastructure development, export promotion and environment protection. The loan of about EUR 20 billion will push the external debt towards excessive levels, with annual services potentially unsustainable ou the medium and long run. The social effects generated by the loss of jobs, accompanied by the non-indexation of wages and pensions, can have adverse economic costs that are difficult to estimate. Any non-conformation of Romania to the conditions and performance criteria specified in the agreement, which involves postponements or, worse, cancellation of the next instalments, could lead to adverse effects on the economy, as well as on the prospects of sustainable development.

A weak point of the procedures backing the agreement with the IMF was the lack of an alternative, for example compared with a loan from another country and/or with a launch of Romanian government bonds on national and international capital markets, considered too restrictive *a priori*. In this context, the comparative terms of loans could have been made known, so that one can be sure that the most advantageous borrowing alternative has been chosen. In this way, speculations around the conditionalities imposed by IMF and the confidentiality of certain clauses of the agreement could have been avoided, especially under the circumstances of increasing the financial system transparency, considered as a primary remedy for its recovery.

According to the first review the Stand-By Arrangement, the report of IMF staff team, following discussions with the Romanian authorities ended in mid-August 2009, underlined the contraction of economic activities, sharper than projected, due to the combination of an unfavourable external environment and faster retrenchment of domestic demand during the first half of 2009. The IMF experts brought many significant corrections to the macroeconomic framework projected 6 months earlier, confirming our doubts previously mentioned regarding their

adequacy. For instance, the new figure for the gross financing requirements stood for EUR 41.5 billion (instead of EUR 44 billion) for 2009, respectively EUR 2.5 billion less, following the corrections of current account deficit (down from EUR 9 billion to EUR 6.5 billion).

The total financing resources were revised from EUR 32.2 billion up to EUR 34.5 billion, mainly due to the corrections of net foreign direct investments estimation from EUR 3.5 billion to EUR 5 billion. The most significant change suffered the estimates for the increase of gross international reserves - rather an adjustment parameter - respectively from 0 to EUR 4.5 billion, which made the external financial gap (EUR 11.5 billion instead of EUR 11.8 billion) to remain almost the same, justifying in this way the amount of loan from the IMF and other international organizations.

4. The assessment of Romania's public and MLT external debt sustainability

For Romania, the issue of appropriate management of debt, both internal and external, has become of acute importance in recent years, which witnessed a sharp growth in indebtedness, on one hand, on account of considerable budget deficits accumulation and on the other hand, due to the direct effects of the global crisis, which reduced foreign exchange earnings from exports and caused a decrease in FDI inflows, making the financing of the economy difficult and imposing a massive sovereign borrowing.

First, we will examine the evolution of the public debt main indicators, trying to assess sustainability. According to a report of the Ministry of Finance, in the period 2000-2009, the total public debt (government and local authorities, internal and external, including state guarantees) rose more than three times in real terms, reaching, according to our estimates, about 30 percent of GDP at the end of 2009 (see Table 2).

Even if this parameter is below the limit set by the Maastricht Treaty (i.e. 60 percent of GDP), the fact that in just 4 years this share has almost doubled in the case of Romania, is a warning signal to the authorities, considering also an unfavourable internal economic context, which would rather suggest a further increase in the sovereign debt. It is worth mentioning that another indicator of public debt is deteriorating, the ratio of the debt to the exports of goods and services exceeding 100 percent in 2009 and falling already, according to international standards, in the area of a moderate risk of sustainability problems.

Table 2

Indicators of Romania's public debt sustainability in the period 2001-2009

Indicators/ Years	2001	2002	2003	2004	2005	2006	2007	2008	2009
Public debt (as percentage)									
- in GDP	28.7	28.9	26.0	22.5	20.5	18.4	20.3	21.8	30.1
- in Exports of G&S*	80.0	73.1	68.7	64.2	60.6	59.6	61.9	64.9	102.5

*For 2009, own estimation.

Source: For 2001-2008, *Public Debt Report* (in Romanian Language: *Raport privind datoria publică)*, Ministry of Finance, June 2009; for 2009, data from *Public Debt Bulletin*, Ministry of Finance, December 2009.

As we previously mentioned, in order to relieve the public debt sustainability, of crucial importance proves to be the examination of the debt portfolio structure, from data on Romania resulting that **the main tendencies reflect a deterioration of its prospects**. Thus, in terms of currency composition, it is noteworthy that, since 2007, when the public debt denominated in lei, with a total share of 53.2 percent, has exceeded for the first time the public debt denominated in foreign currencies, especially on account of increased needs for budget deficit financing, which happened also in 2008 and 2009. Although, in principle, this could be interpreted as a positive trend due to containing the currency risk, paradoxically, the financing costs in national currency were extremely high, especially due to rising inflation expectations. The government bonds were issued with a 10 percent annual interest, this high level being fuelled also by the volatility of international capital markets.

On the other hand, changes in the structure of public debt by type of financial instruments reveals the effects of the Ministry's of Finance application of a strategy aimed at **extending the issue of government bonds and of their maturity** (in 10, 12 and even 15 years), which intends also to relax the timetable for repayment. In the structure of debt by type of interest rate, there was a **downward trend of the share of debt with fixed interest rate** (to about 30 percent in 2009) and the corresponding increase in the share of debt with **variable interest rate**, which may affect in the future the public debt sustainability, especially in the case of an unfavourable evolution of financing costs.

If we analyze the evolution of debt structure by categories of creditors, it is worth mentioning that the main and growing share (reaching over 80 percent in 2009) is held by private banks and other private creditors, this tendency being sustained also by the structural changes in public debt by type of financial instruments which have been previously mentioned. As some studies point out (Flassbeck and Panizza, 2008), this category of creditors present also the highest risk in terms of long-term sustainability of debt, i.e. the likelihood of payment problems occurrence at Sovereign level.

In conclusion, it can be said that in recent years **there has been a rapid deterioration of the public debt sustainability parameters in Romania, including of the loan portfolio structure**. The main factor determining the increase of domestic debt was the budget deficit accumulation, and, respectively, the foreign debt rise, due to borrowing from international organizations (IMF, EU, World Bank). It is worth mentioning that the external credit was partially used to finance the deficit budget, but also in order to support the currency market and the national currency exchange rate. If the measures agreed in the Stand-by Agreement will produce the desired results, turning back under control the consolidated budget deficit, we consider that there are not major risks ou the medium run about Romania's public debt sustainability.

In other countries the government anti-crisis programs (including measures to increase public investments, tax relief, financial packages supporting companies and/or financial and banking institutions with liquidity problems, etc.) significantly affected the fiscal framework (in the EU countries for 2009, estimating a budget deficit of about 7 percent of GDP), which allowed, to a large extent, the absorption of the global crisis effects and the economic recovery of these countries starting in late 2009. But the costs of these programs have a deep impact on the public debt, which, for example, in EU countries has increased, as a proportion of GDP, from 61.5 percent in 2008 to 73 percent in 2009, and in 2010 it is estimated to approach even to 80 percent. The case of Greece, which accumulated almost EUR 300 billion public debt (117 percent of GDP) at the end of 2009, became dramatic during the first months of 2010, without the financial assistance from EU and IMF, risking an exit from Eurozone and even a sovereign debt default.

It should be noted that in Romania not the financing of anti-crisis measures - in fact, almost nonexistent - has caused the fiscal deficit widening, but rather the covering of the financing needs of an oversized public sector and of supporting the social security budget. Moreover, the poor management of the public finance has led to partially blocking the economy through the creation of arrears, that is payment delays to the companies, which generated a chain reaction.

Thus, we consider that delays in economic recovery of Romania could lead, while maintaining the current pace of the public debt deterioration, to exceeding

the critical threshold of 60 percent of GDP in only 4-5 years, i.e. just around the period in which Romania is preparing to join the Euro Area.

In terms of country risk analysis, the debt sustainability assessment should be consistent with that of total foreign debt, which, in the case of Romania, experienced a dramatic evolution over the past decade. According to its structural configuration, the Romanian economy's development is dependent on imports, implying the deterioration in the trade and current account balances, as the economic growth rate is higher.

Under these circumstances, as we have mentioned before, the external debt on medium and long term increased from a level below EUR 10 billion in 2000 to EUR 65 billion at the end of 2009. At the same time, the short-term external debt increased from a level below EUR 2 billion in 2000 to over 20 billion EUR in 2008, followed by a decline to about EUR 15 billion at the end of 2009.

In this study we are focusing ou the long-term sustainability of the external financial framework, which does not mean that the short-term external debt sustainability is less important. Our main reasons are that, on one hand, methodologically, one could not analyse the merger of medium and long-term debt with the short-term debt, because of their different nature, and, on the other hand, if a short-term external balance could be, more or less, easily adjusted, on long term this correction becomes much more difficult, which is requiring another approach.

Starting from the fact that the short-term external debt is predominantly related to the trade receivables, with limited influence on the overall long-term financial situation of a country, bearing however in mind that Romania has felt acutely the short-term debt pressures on the currency market in the spring of 2009 - which partially motivated the IMF financial assistance - we will continue our analysis focusing on MLT external debt, seeking an assessment of its sustainability.

As it can be noticed in the data presented in Tables 3 and 4, **the main parameters for assessing the sustainability of the MLT external debt recorded an unfavourable trend in the period 2000-2009**, being at present at the limit or beyond the threshold of sustainability.

The thresholds proposed by us are indicative, their setting having in view the vulnerabilities of Romania in conditions of crisis, considering only partially the international standards (mainly, of the rating agencies). Also, we specify that they represent rather a zone delimitation (in the sense of warning levels under the circumstances of maximum caution) than a qualification assessment scale.

The MLT external debt to GDP ratio increased from 23.9 percent to 37.6 percent in 2008, making a sharper leap in 2009 when this ratio reached 54.9 percent, it is true, under the circumstances of a GDP contraction by more than 7 percent this last year.

Table 3

Indicators of external financial framework of Romania in the period 2000-2009

Indicators/Years	2000	2004	2005	2006	2007	2008	2009
MLT External Debt (EUR bn)	9.6	18.3	24.6	28.6	38.5	51.8	65.5
MLT External Debt Service (EUR bn)	2.2	3.8	4.8	6.1	7.5	12.1	11.4
Gross Domestic Product* (EUR bn)	40.2	60.7	79.7	97.8	123.6	136.8	117.0
GDP real growth (percent)	2.1	8.4	4.1	7.9	6.2	7.1	-7.1
Exports of Goods &Services (EUR bn)	13.2	21.8	26.4	31.4	36.5	42.4	36.0
Forex Earnings (EUR bn)	14.7	25.5	31.7	38.7	46.1	53.4	43.8
Forex Reserves (EUR bn)	5.2	13.1	18.3	22.9	27.2	28.3	30.9

* For 2009, estimation of the National Commission for Prognosis.

Source: National Bank of Romania, National Commission for Prognosis.

Table 4

Indicators of Romania's MLT external debt sustainability in the period 2000-2009

- percent -

Indicators/Years	2000	2006	2007	2008	2009	Threshold
External Debt /GDP	23.9	29.2	31.1	37.9	56.0	50.0
External Debt/Exports G&S	72.7	91.2	105.5	122.2	181.9	150.0
External Debt/ Forex Earnings	65.3	73.9	83.5	97.0	149.5	100.0
Forex Reserves/External Debt	54.2	80.0	70.6	54.6	47.2	50.0*
External Debt Service/Forex Earnings	15.0	15.8	16.3	22.7	26.0	20.0
External Debt Service /Exports G&S	16.7	19.4	20.5	28.5	31.7	30.0
External Debt Service /Forex Reserves	42.3	26.6	27.6	42.8	36.9	40.0
Forex Reserves/GDP	12.9	23.4	22.0	20.7	26.4	25.0*

*Minimum threshold

Source: Calculations based on Table 3 data.

Compared with the foreign exchange earnings, in our opinion the most important indicator as a sustainability prerequisite, the ratio of MLT external debt rose above the threshold of 100 percent in 2009 and compared with the exports of goods and services the ratio stood well above the threshold of 150 percent. In

this context, it should be noted that the export sector in Romania was one of the most affected by the global crisis in 2009, which had a direct impact on the decrease in foreign exchange earnings for this year.

Even the proportion of international foreign exchange reserves in GDP increased from 12.9 percent to over 25 percent in the period under review, but compared with the external debt, they fell for the first time below 50 percent in 2009.

Regarding the international reserves it should be noted, however, that their lack of immediate liquidity, in the case of Romania, implies a certain deficit of their relevance in the analysis of external debt sustainability. These reserves are largely invested in government bonds issued by developed countries (including the Treasury of the USA), with an uncertain market value under the circumstances of international financial crisis and the volatility of capital markets.

The ratio of the external debt service to the foreign exchange earnings reached 26 percent in 2009 (compared with 15 percent in 2000) and in relation to exports of goods and services it increased continuously during the considered period, reaching more than 31 percent in 2009. It is also noteworthy that the external debt per capita increased from only EUR 427 in 2000 to more than EUR 3000 in 2009, which represents already a significant debt burden upon the population of Romania and its future generations.

Table 5

Average annual growth rate of some indicators of MTL External Debt Sustainability

- percent -

Average annual growth	2001-2008	2001-2009
MLT External Debt	23.4	23.8
GDP real growth	6.2	4.6
Exports of Goods & Services	15.7	11.8
Forex Earnings	17.5	12.9

Source: Calculations based on Table 3 data.

The analysis of the indicators in terms of the average annual growth rate during 2001-2008 and 2001-2009 respectively, revealed that **the degradation of the MLT external debt sustainability** parameters has been caused by exceeding the external debt rate (23 percent annually), compared with the GDP real growth rate, by about 17-18 percentage points, and the export of goods and services and forex earnings, by about 8-10 percentage points respectively (see Table 5).

The comparison between the two periods of analysis has revealed that, although the year 2009 did not change the trends, it produced a shock upon the data series, especially concerning exports and forex earnings, with a differential of about 4 percentage points between the two average annual growth rates.

The external debt of Romania was by far the indicator that has registered the highest growth rate during 2001-2009, compared with other outcome indicators such as GDP, exports and foreign exchange earnings. The ratio between the average growth rate of external debt and the average growth rate of GDP, exports and forex earnings was much higher during 2005-2009 than during 2001-2004, which reveal an unfavourable trend taking into account also the circumstances of international crisis (see Table 6). If this trend is going further there can be growing difficulties and pressures generated by Romania's external debt repayment upon economic growth, investments and welfare.

Table 6

The ratio between the average annual growth rate of MLT external debt and those of GDP, exports of G&S and forex earnings of Romania in 2001-2009

Indicators	2001-2009	2001-2004	2005-2009
MLT external debt /GDP	5.17	2.87	8.35
MLT external debt /Exports of G&S	2.02	1.31	2.75
MLT external debt /Forex earnings	1.84	1.18	2.54

Source: Calculation based on Table 3 data.

Such gaps on the horizon of one decade reveals that the external financing attracted on medium and long term has not generated major technological changes to ensure sound economic structures and sound growth, these vulnerabilities of Romania becoming obvious in 2009 by the lack of resistance to the global crisis impact. In this context, it should be noted that the main component of MLT external debt was the private sector, whose share in total debt increased from about one third in 2000 to over two thirds in 2008. In 2009, under the circumstances of the foreign debt increase mainly due to the IMF loan (EUR 6.6 billion), plus the increase of non-resident deposits to over EUR 7 billion, this share has declined somewhat below 60 percent.

Therefore, in the case of Romania, the accumulation of external debt mostly by the private sector has failed, at least for now, to generate effects ensuring a sustainable economic growth. Perhaps, this was due to the fact that, to a significant extent, the investments in this sector had a speculative component,

focusing on real estate, the secondary capital market, the banking sector, including non-resident deposits searching for the valorization of the interest rate differential on the primary capital market.

In assessing debt sustainability, several methodological issues have to be considered, including the ones that show an undervaluation of the debt size comparing with the official data. The world economy globalization, which favored the liberalization and acceleration of goods and capital international flows, has been accompanied by the creation of significant statistical discrepancies, including external debt figures. In fact, **Romania's foreign debt is greater than it appears in the records of the National Bank of Romania (NBR)**, one of the explanations relying on the financing of Romanian companies (many with foreign capital majority) directly from foreign banks located abroad, which are beyond the international financial flows registered by the NBR. Although some of this financing are short-term loans (up to one year), others, more difficult to assess - but anyway amounting to several billion of euros annually - have a maturity of more than one year, belonging then to Romania's total foreign debt.

Moreover, as specified in NBR statistics, the MLT external debt represents its stock in a given moment, not including all payments related to the debt repayments (interests, fees, penalties, etc.). Under the circumstances of missing information on foreign debt repayment schedule, if we add also the cross-border loans directly to Romanian companies that we have been mentioned before, it becomes obvious that, in reality, the payments related to the external debt are significantly higher than results from the official data. As a consequence, Romania's international financial position appears to be extremely fragile, remaining vulnerable to a rapid deterioration of the sustainability parameters because of possible future shocks, the sovereign risk topping rather the speculative area, as anyway our country is qualified by the major rating agencies.

5. Scenarios of Romania's external debt sustainability on time horizon 2010-2016

Further, we are submitting two possible scenarios of Romania's external debt sustainability on the time horizon 2010-2016, by comparson with the foreign exchange earnings, which are the main resource of fuelling the external payments due. Both scenarios were constructed based on the data series for the period 2000-2009, the projection for the period 2010-2016 being made by the regression functions of polynomial type, which responded most adequately to the correlation requirements with the real data series.

The baseline scenario assumes a limitation on the increase in the external debt stock over a threshold of EUR 70 billion in 2010, followed by a slight decrease in successive years, to the extent of achieving a positive annual balance of payments versus new loans (hypothesis close to the IMF's vision on the future development of Romania's external financial framework until 2014, as well as on the financial gap covering). For the indicator forex earnings we used, as a benchmark, the forecast of BoP current account balance prepared by the National Commission for Prognosis (see NCP, 2009).

The equations in the case of Baseline Scenario are:

The MLT external debt: $y = -0.28x^2 + 9.1583x - 10.259$ (1)

$R^2 = 0.879$

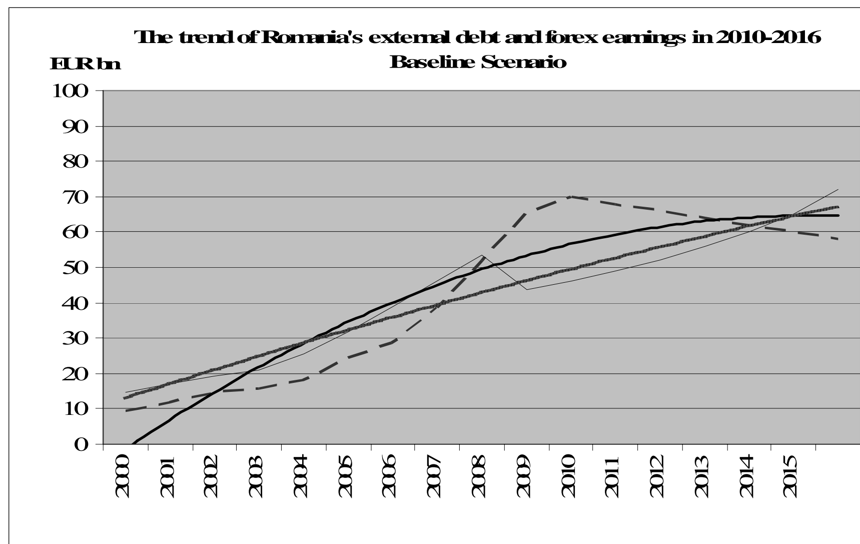
The forex earnings: $y = 0.0417x^2 + 4.1411x + 8.9544$ (2)

$R^2 = 0.9452$

where: y represents the MLT external debt in the relation (1) and respectively the forex earnings in the relation (2);

x represents the time (years 1,2…16);

R represents the squared correlation coefficient.



------------External debt data series —— —— —— External debt regression
_______ Forex earnings data series ========== Forex earnings regression

Figure 1

As one could observe in Figure 1, in 2009 the external debt still exceeded the foreign earnings in absolute values, Romania entering the significant risk zone in terms of external financial framework sustainability.

Assuming a desirable implementation of appropriate economic, fiscal and monetary policies, supported by restoring the confidence in business environment, including substantial investment inflows, able to help boosting the economic growth in a manner that would limit the MLT external debt, in 2015 Romania could register an exceeding of its foreign debt level by that of its foreign earnings, as an essential prerequisite for ensuring the external payments sustainability. To the extent to which the other indicators recover up to sustainable levels, one may hope that Romania is getting out of the significant risk of external payment problems, especially on the time horizon of Euro Zone accession.

The alternative scenario assumes an increase in the MLT external debt on time horizon 2010-2016 at an annual growth rate of around 6.0 percent (2 percentage points over the average GDP growth rate expected for this period).

The equations in the case of the Alternative Scenario are:

The MLT external debt: $y = 0.0677x^2 + 5.1824x – 2.3324$ (3)

$R^2 = 0.9718$

The forex earnings: $y = -0.1037x^2 + 4.9027x + 7.3074$ (4)

$R^2 = 0.9415$

As we could see in Figure 2, in the case where, for various reasons, a correction of the MLT external debt trend does not happen and if the forex earnings would enter a path less favorable than the forecast, Romania's external payment sustainability would remain in the significant risk zone, i.e. payment problems and slippage into a financial crisis. This probability could be higher in the case of unfavorable external circumstances, and if pressures of the domestic debt accumulation unadjusted in time are added, this slippage would be even inevitable.

Thinking that most of the external debt belongs to the private sector and this is relieving the government and the central bank decision makers of any obligation in the appropriate management of sovereign debt risk would be a fatal error for Romania. Due to ST and MLT external debt inter-connections (which became obvious during the spring of 2009, when the government had to borrow from international organizations in order to cover a huge demand, mostly private, on the

foreign exchange market managed by the central bank) and to financial links between private and public sectors (bailouts of strategic private companies by the government, arrears in public works payments, accumulation of nonperforming loans in retail/corporate lending) huge debt services without foreseeable own sources of gap financing, if the economy is not recovering as expected, create a heavy perspective of debt rollovers under more and more unfavourable conditions and implicitly on Romania’s external debt sustainability.

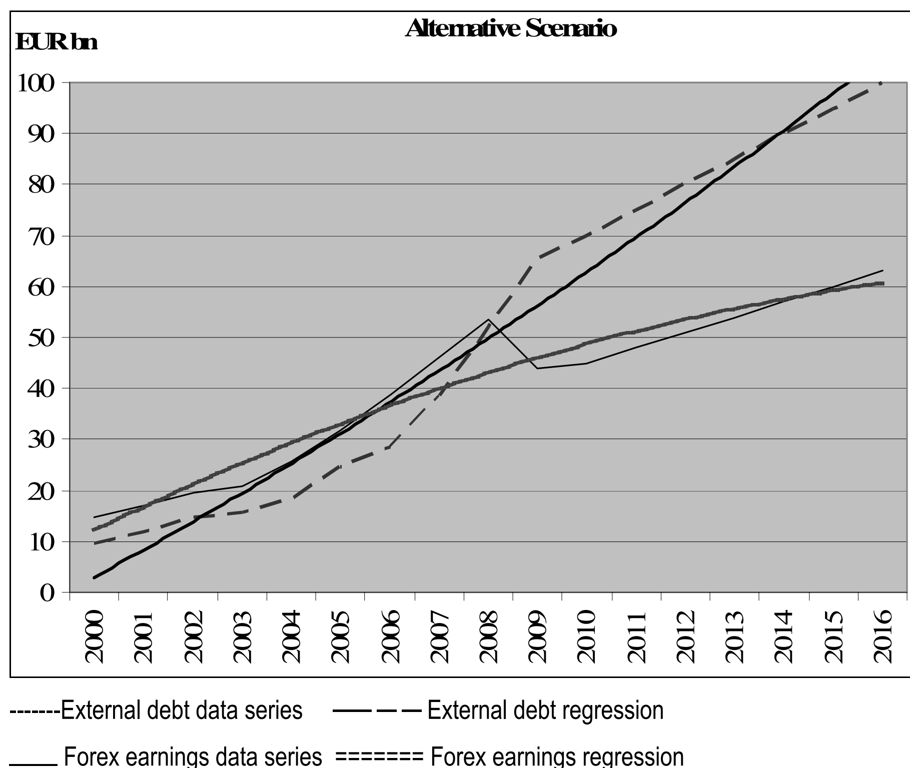


Figure 2 - The trend of Romania’s external debt and forex earnings in 2010-2016

6. The absorption of EU structural funds, a pillar of debt sustainability?

The structural funds (including cohesion funds) allocated to Romania from the EU budget for the scheduled period 2007-2013 are amounting to EUR 19.2

billion, plus national co-financing (state budget, local budgets and private sector), amounting to around EUR 9 billion. The EU structural funds are implemented through five Sectoral Operational Programs (i.e. SOP, for: Transportation: EUR 4.5 billion; Human Resources Development: EUR 3.4 billion; Increasing Economic Competitiveness: EUR 2.5 billion; Administrative Capacity Development: EUR 208 million; Environment: EUR 4.5 billion), Regional Operational Program (ROP, amounting to EUR 3.7 billion) and Operational Program for Technical Assistance (amounting to EUR 170 million).

Out of the total structural and cohesion funds allocated to Romania for the period 2007-2009, Romania's allocation amounted to EUR 5.64 billion (representing about 24.14 billion lei). According to the official data of the Authority for Coordination of Structural Instruments (see Table 7), by the end of December 2009, payments made to beneficiaries (reimbursements) amounted to 2.5 billion lei (around EUR 600 million), which means an EU fund absorption rate of 10.3 percent, that is a very low level.

Table 7

Structural fund absorption rate in Romania at the end of December 2009

Operational Program	EU Allocations 2007-2009 (Lei mil.)	Reimbursed EU Contribution (Lei mil.)	Absorption Rate (percent)	Number of projects*		
				Submitted	Rejected	Approved
Regional	5029.4	790.0	15.3	3110	916	715
Environment	5511.9	777.7	14.0	141	48	64
Transportation	5595.1	134.5	2.4	41	6	20
Increasing Economic Competitiveness	3124.7	513.7	16.4	5386	2069	1264
Human Resources	4260.4	286.2	6.5	5250	3329	1691
Development Administrative Capacity	381.5	6.1	1.6	931	152	111
Development Technical Assistance	241.1	3.0	1.2	31	8	23
TOTAL	24144.1	2511.3	10.3	14890	6528	3888

*The difference between the projects submitted and rejected/approved is represented by the projects under assessment.

Source: Press release regarding the *Situation on 31st December 2009 of projects submitted and approved, of contracts signed and payments reimbursed to beneficiaries,* ACIS, January 19, 2010.

It should be noted that in nearly 3 years, when Romania has contributed with more than EUR 3 billion to the Community budget, our country has managed to absorb only EUR 0.6 billion from EU structural funds, the status of net contributor (at a very unfavourable rate, i.e. of 6/1) is paradoxical for a country that has to close a significant development gap, whose time horizon seems to be removed.

Within the operational programs' structure, while SOP Increasing Economic Competitiveness has registered an absorption rate of more than 16 percent, in the case of SOP Human Resources Development the absorption rate was only about 6.5 percent. The SOP Transportation, which in terms of funds allocated is the most important, was not able to absorb more than 2.4 percent. Out of the 14,890 total projects submitted only 3,888 were approved, i.e. only 1 out of 4, which is far from the expectations. Out of the 7 operational programs, the OP Regional, SOP Increasing Economic Competitiveness and SOP Human Resources Development concentrate about 94 percent of total approved projects, while compared to submitted projects for these programs the ratio is still 1/4.

The causes of this situation are multiple, starting from the endemic inability of potential beneficiaries to develop viable projects, the excessive bureaucracy of management authorities, the great zeal in following the procedures, the long time and delays throughout evaluation-approval-signing financing contract-tendering-reimbursement-implementation, the lack of performance criteria for consulting firms, the deficiencies in contractual relations between different institutions at the central and local level, between them and the consulting firms, and the project beneficiaries, etc.

During the year of crisis 2009, when the absorption of structural funds was supposed to be the priority no. 1, as included in the new government program, the absorption rate remained as low. Although an inter-ministry committee for the management of EU funds was set up in the beginning of 2009 under the Prime Minister's coordination, with a weekly periodicity of meetings, in time, they became more rarely, until their complete disappearance during the summer. We can say that government authorities, including the line ministries with responsibilities in managing the structural funds did not meet their commitments and obligations, the weak measures taken or declared failing to attract and absorb these funds.

Furthermore, instead of having the structural funds support the development projects that contribute to mitigating the effects of economic crisis, it was their low absorption rate that blocked the development of many projects, due to the financial deterioration of eligible parameters of economic agents. Also, the

insufficient co-financing from the state budget (central and/or local) was caused by growing deficits. The large uncertainty degree of obtaining project pre-financing from the banking system, which restricted credit conditions and increased its costs, changing the *ex ante* financial parameter projects (calculated in lei) by sharp domestic currency depreciation, led to the increased costs of implementation. All these were overlapped by the political crisis triggered in the autumn of 2009, which caused an institutional deadlock at the central and local government levels, including the Managing Authorities of European Funds.

We believe that, in the years 2010-2013, the absorption of EU structural funds, including the recovery of allocations from previous years, is one of the pillars of the strategy to exit from the crisis. Regardless of the government political colour, the Romanian authorities have to make this key priority operational by decisive actions in order to remove blocking factors, many of which are mentioned above. As far as our country succeeds to attract structural funds, in addition to project implementation effects on the real economy, they may contribute also to the recovery of Romania's external balance, directly by reducing the financial gap, but also indirectly by increasing the financial resources (of state and private sector), implicitly to the payment of outstanding debt.

Under the circumstances of public deficit worsening and of budgetary constraints following the global crisis impact, both at EU and national levels, a review of operational programs is expected, which could add supplementary difficulties in increasing the structural fund absorption rate in the case of Romania.

7. Concluding remarks on the current economic crisis and the prospects of Romania

The conditionalities of the external sustainability trend under the baseline scenario and the avoidance of threats induced by materializing the alternative scenario are multiple, involving an adjustment of the economy not only by eliminating the weaknesses demonstrated by the inability to absorb the global crisis effects, but especially those that have remained for long. In our opinion, Romania would have entered anyway a financial crisis, given the rapid widening of external imbalances as a result of the accumulation of trade and current account deficits, simultaneously with the increasing needs to cover the financing gap through compensatory flows (foreign loans), as an effect of reducing the autonomous flows (FDI), to the extent of the depletion of privatize assets. Paradoxically, the fall of the economy in 2009 under the global crisis effects has caused a sudden and abrupt adjustment of the current account deficit (fully

covered by foreign investments in 2009, even if it was reduced by almost half compared with the previous year), and rushed the call to the IMF financial assistance in order to avoid Romania's entry into a currency market crisis, which would have degenerated into a resuscitation of inflation and undermining the timetable for joining the Euro Area.

As mentioned above, these threats had existed before the surge of the global crisis, which only accelerated and accentuated the effects suffered by Romania, transformed into a real economic and financial shock: reducing the industrial production, construction sector and exports, paralysing the primary capital market and high volatility on secondary capital market, freezing the real estate market, reducing the household consumption and rising the unemployment, etc. One of the few anchors that saved Romania from a financial wreck was the exchange rate, supported, as mentioned before, by the IMF loan.

If the maintenance of the exchange rate is sustainable in the medium and long run there still is a big dilemma regarding the Romanian economy. Through monetary and financial instruments, as we saw in the previous national and international experiences, without substantial support in the real economy, we can have delusions of short-term macro-stabilization and major disappointments in the medium and long run.

Even if the delimitation of the causes that generated the economy's sharp decline (i.e. specific to Romania/of foreign origin) became impossible, their overlapping being in fact frequent and extensive, it is obvious that, despite some performance criteria and indicative targets set by the agreement with the IMF, the hesitations and the lack of prompt and appropriate reactions of the authorities to the challenges of the global crisis is the main factor in prolonging the serious situation of Romania and the uncertainties that hang over the immediate future.

The immobility of the Romanian economy management seems more obvious if we consider that, at global and European levels, countries have adopted anti-crisis programs and measures, which essentially consisted of:

- Stimulating the domestic demand;
- Supporting the public investments;
- Temporary introduction of financial incentives by fiscal relaxing on the entire capital-salary-consumption axis, sometimes accompanied by postponement or tax exemption;

- Implementation of monetary incentives, primarily by reducing the benchmark interest rates by central banks;
- Harmonization of monetary policies for the purposes of the interest rate differential shrinkage, reducing the speculative cross-border capital flows;
- Financial state intervention for temporary acquisition of unconventional non-performing assets;
- Massive injection of public capital to save important financial and banking institutions;
- Protection of public deposits;
- Additional social assistance programs for poor and unemployed people;
- Voluntary restraint of government bond sales;
- Better regulation and supervision of the financial system through new capital adequacy standards, particularly for financial institutions with international ramifications.

Finding that the economies of these countries have responded positively to these measures, in the late 2009 being recorded clear signals of recovery, the discussions between the G20 world leaders, were focusing on the most appropriate "exit policy", i.e. the timing and procedures for withdrawing programs that support their economies, specific to crisis conditions (IMF, November 2009). Thus, there is a consensus on the fact that the "exit policy" should be correlated with the improvement of production in all these countries, without which adverse effects may occur, and that the coordination of these policies does not necessarily mean synchronizing. It was recommended that financial assistance should be withdrawn if and when economic fundamentals are restored, financial markets are stabilized, market mechanisms resume the functioning and market competition - somehow disturbed by the public interventions in financial and banking institutions - is restored.

Besides taking into consideration these remedies, which have already had a positive impact on other countries, given its features, Romania, which has to go through two stages in order to turn back on the economic growth path (recovery + rebound), respectively the nominal and real convergence with EU countries, must undertake actions as mentioned below:

The Real Economy:

- Setting a significant financial package to support economic sectors in decline and the development of public works projects;

- Supporting the exports, as the main factor of foreign earnings growth, through appropriate trade, financial and banking tools;
- Implementing appropriate measures of institutional structural reform, including the resizing of the public sector;
- Internal and external steps to restore confidence in business climate and to reopen the appetite of foreign investors;
- Providing non-fiscal stimulus for targeting investments in priority sectors;
- Restoring conditions of fair competition in the market of goods and services.
- Increasing the absorption rate of EU structural funds.

The Fiscal Policy:

- Fiscal consolidation, as top priority action;
- Adequate timing and steps to bring the public debt to lower levels;
- Fiscal adjustment by strengthening the primary balance.

The Monetary Policy:

- Setting up a neutral authority for the supervision of primary capital market;
- Reducing the benchmark interest rate of the central bank;
- Reducing reserve requirements for commercial banks liabilities;
- Maintaining the exchange rate stability;
- Reforming the forex reserves management.

The Financial and Banking System:

- Resuming the lending activity for business financing by the commercial banks;
- Sustaining the absorption of EU structural funds (project co-financing, pre-financing);
- Measures to increase the quality of banking assets aimed at reducing the NPL ratio;
- Supporting the process of recapitalization of banks with state capital;
- Unblocking the payment system and reducing the arrears.

Any positive results of these measures depend on the internal effort in order to achieve a sustainable economic growth but also on the external context restoring - i.e. the sustainability of the global economic recovery, returning to the normal functioning of international capital markets - on the international oil and natural gas quotations and on the price of raw materials.

Romania has a relatively high degree of international openness of the economy, which has to be accompanied by the efforts to sustain increasing production and underdeveloped domestic market. For this reason, a program to end the crisis effects on Romania and to re-launch the sustainable growth should be aimed at short and medium-term measures that contribute to strengthening the national sector of the Romanian economy by effectively using the opportunities arising from the global crisis itself through required restructuring that, until now, has induced but disadvantages.

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