

## **THE VULNERABILITIES OF ROMANIAN ECONOMY REVEALED BY THE 2016 COUNTRY REPORT**

**Camelia Băltărețu**

**Scientific Researcher, "Victor Slăvescu" Centre for Financial and Monetary  
Research**

*Abstract: European Union has been confronted in the last ten years with persistent macroeconomic imbalances that has been reflected in large and lasting external deficits and surpluses. These deficits and surpluses accentuated the negative effects of the financial crisis started in 2008. The implementation of the monetary policy measures has been obstructed both by these major imbalances and by the constant losses of competitiveness and of accumulation of indebt. As an answer to this challenge, the European Union institutions adopted, at December 13th, 2011, the so-called "Six Pack" European Union laws, having the goal to strengthen the fiscal and macroeconomic surveillance in European Union countries and in the euro zone, introducing a procedure concerning the macroeconomic imbalances (MIP). The surveillance of the imbalances in the MIP framework is a part of the European Semester, which represents the instrument of economic governance in the European Union. The country report contains the in-depth review from the MIP. For Romania, the country report for 2016, evaluates the Romanian economy in the light of the annual analysis of growth, elaborated by European Commission for 2016. This paper emphasizes the vulnerabilities which influences the Romanian economy, as revealed by the in-depth review of the Romania country report for 2016.*

*Key words: European Semester, country report, macroeconomic imbalances, procedure*

### **Introduction**

The European Union has been confronted in the last ten years with persistent macroeconomic imbalances, reflected in large and lasting external deficits and surpluses, which accentuated the negative effects of the financial crisis that has been started in 2008. The application of the common monetary policy measures has been therefore hampered, the macroeconomic challenges for the member countries continued and contributed – by the contagion phenomena – to the Euro zone threats.

As a response to this challenge, the European Union institutions adopted, on December 13th, 2011, the so-called "sixpack" European union laws, in order to secure the macroeconomic and fiscal surveillance in the Euro zone and in the European Union countries. This law pack introduced a procedure for the surveillance of the macroeconomic imbalances in the member countries, *the Macroeconomic Imbalances Procedure* (MIP), in order to early identify and correct the macroeconomic imbalances, especially those that contaminate other member countries. The imbalances surveillance within MIP is a part of the European Semester – the instrument of economic governance in the European Union, which establishes the general economic and social priorities, offering next year policy orientations for the member countries.

The starting point of the annual cycle of the Macroeconomic Imbalances Procedure is represented by the Alert Mechanism Report, which aims to identify and correct the imbalances that block the efficient functioning of the economies of the member countries and the overall European Union economy, and that can endanger the correct functioning of the monetary and economic union.

The dashboard that represents a basis for the Alert Mechanism Report contains 14 fundamental indicators with guidance thresholds, and another larger set of auxiliary indicators, in order to detect, for the member countries, the potential economic imbalances that need policy measures.

Initially, ten indicators have been chosen as relevant, but the latest years evolutions imposes the addition of 4 more relevant indicators, the first one being the growth rate of the indebt in the financial sector, to better reflect the link between the real economy and the financial sector. Starting with 2015, there have been included in the dashboard three indicators for the labor force employment, as an actual result of the Commission commitment to consolidate the analysis of the macroeconomic imbalances: the labor force participation rate, the long term unemployment, and the young people unemployment. The relevance is given both by the long lasting negative evolutions regarding the labor force employment, and by the social aspects which can unfavorably impact on the potential growth of the GDP, leading to greater macroeconomic imbalances.

The publication of the 2016 Alert Mechanism Report, on November 26<sup>th</sup>, 2015, initiated the 5<sup>th</sup> annual round of the MIP. The Report identifies the member countries that should make supplementary, more profound balances in order to evaluate if they are affected by imbalances that need policy measures.

The Commission recommendations for the 2016 concern the same - like in 2015 - three fundamental pillars for the European Union economic and social policy:

- the encouragement of the EU member countries (including Romania) to participate at the Europe investment plan, by activating the necessary public and private investments;
- the continuation of the structural reforms supposed to modernize the economies of the member countries, in order to correct the imbalances, to increase the productivity and to reach a higher level of convergence;
- the elaboration of a responsible budget policy, focused on the achievement of the requirements of the Stability and Growth Pact.

Based on the economic analysis of the dashboard from MIP, the Commission reveals that there is a necessity for supplementary, more profound balances, because imbalances have been identified in the previous round for the majority of countries: Belgium, Bulgaria, Germany, France, Croatia, Italy, Hungary, Ireland, Netherlands, Portugal, Romania, Spain, Slovenia, Finland, Sweden and the United Kingdom. For the first time, there will be established, as well, detailed balances for Estonia and Austria. For the member countries that benefit of a financial support (Greece and Cyprus), the surveillance of the imbalances and the monitoring of the corrective measures take place in the framework of the corresponding support programs. For Czech Republic, Denmark, Latvia, Lithuania, Luxemburg, Malta, Poland, and Slovakia, there is no need for a detailed balance for the time being and the continuation of the surveillance within MIP it is no more justified. However, there is a need for a careful surveillance and a continuous policy coordination, in order to evaluate if there are excessive imbalances, if the imbalances persist or increase, if they correct, in such a way that the member countries can identify the emergent risks and to propose policies that will lead to the economic growth and to the increasing of the employment.

### **The Country Report Romania for 2016**

The Alert Mechanism Report for 2016 identifies Romania as a country that needs a detailed balance. Therefore, the country report includes the detailed balance from the Macroeconomic Imbalances Procedure; it contains the annual analysis concerning the social and economic challenges for the European Union member countries. For Romania, the Country Report for 2016, published in February 26<sup>th</sup>, 2016, evaluates the economy of Romania in the light of the annual analysis of growth, made by the European Commission. The survey recommends three priorities for the EU's economic and social policy 2016: re-launching investment, pursuing structural reforms to modernise Member States' economies and responsible fiscal policies.

This report is structured in three sections: 1.Scene setter: Economic situation and outlook 2.Imbalances, risks, and adjustment issues and 3.Additional structural issues. The second section of the country report contains the detailed balance from the Macroeconomic Imbalances Procedure, focusing on risks and vulnerabilities shown in the Alert Mechanism Report for 2016.The issues analyzed in this section are : the determinants of recent improvements in the current account deficit and net international investment position; the structure of its external financing; the effects of rising labor costs, improved international competitiveness in terms of Romania; the solidity of the financial sector and the potential impact of the emergent national laws on the financial stability; the implications of the ongoing fiscal loosening on Romania's growth trajectory and on debt sustainability; the real estate market with credit developments; measures regarding the offer, considering both public investment (particularly infrastructure ) and investment barriers. Summary of the conclusions of the in-depth review is described in the evaluation matrix of the MIP which ends this section, focusing on imbalances and adjustment issues relevant for the MIP.

**The vulnerabilities of the Romanian economy revealed by the country report**

The key findings of the in-depth review covered in the country report and the challenges of the Romanian economy, are found in Table 1:

**Table 1: Country Report Romania 2016 - findings / challenges**

Main findings	Specific challenges
Economic growth in the last 3 years has been significant, among the highest in the European Union, due to strong exports (abundant harvests, massive industrial production in the years 2013-2014) and the gradual recovery of domestic demand since 2014. It estimated that real GDP grew by 36% in 2015 due to increased consumption and investment recovery; is expected to boost the growth rate above potential GDP in 2016 (4.2% - in response to tax incentives), following that in 2017 to moderate this growth (3.7%).	The real challenge for the government in terms of economic growth would ensure its sustainability and a balanced growth .

<p>The vulnerabilities associated to the external position have been reduced in a context of strong economic growth. The net international investment position significant negative has improved since 2012 and it expects to maintain this trend, but it remains sensitive to macroeconomic shocks.</p> <p>The main drivers of this improvement were a strong growth of the nominal GDP and a reduction in current account deficits. Although the net international investment position has a large negative value, specific to the economies that are in a phase of catching, such as Romania, trajectory is descended.</p>	<p>Although it found to reduce those vulnerabilities, the net international investment position remains sensitive to macroeconomic shock; recent trends but also the expectations from the European Commission, according to a simulation of unfavorable macroeconomic developments shows that the main risks affecting the net international investment position arise from shocks to inflation and growth.</p> <p>From the point of view of competitiveness although cost competitiveness was restored after 2010, however the pressures may reappear if the current acceleration of wage growth is sustained and exceeding gains in productivity.</p> <p>In terms of competitiveness not based on the costs, may be strengthening this competitiveness challenge in terms of the transition to an economy with a higher added value.</p>
<p>Although conditions in the labor market were favorable and the labor market was stable, with an estimated gradual improvement of it, despite the increase in employment, particularly in sectors with high added value, yet still problems of a structural nature they were in 2015: the employment rate has improved but is still below the EU average; vulnerable groups have limited access to the labor market; lack of coordination between measures nationally funded and financed by the European Social Fund lead to competing</p>	<p>The government will have to focus on strengthening labor market on the following measures: labor market integration of young people, especially young undocumented and long-term unemployed; stimulating internal and external mobility, focusing on highly skilled workers; implementation of the national strategy to reduce early school leaving; increasing the supply and quality of</p>

<p>systems; early school leaving rate is high; preventive and remedial programs are limited; the percentage of young people who are not in employment, education or training are above the EU average; active employment measures are not sufficiently varied to meet specific needs of various groups of the labor market; the adequacy of unemployment benefits is low and further degrade; labor market and social challenges are interconnected and there is big gap between rural and urban areas.</p>	<p>early childhood care and education; elaborating by the Ministry of Labor of an integrated catalog of services funded both by the European Social Fund and the national budget; developing a strategy for social dialogue; accelerating the implementation of dual education .</p>
<p>After the unfavorable developments in 2014, banking sector profitability was restored in 2015 and were consolidated prudential banking indicators, but recent legislative developments could exert pressure on the banking sector and financial stability. Despite capital reserves and liquidity encouraging overall banking sector continues to be exposed to internal sources of vulnerability.</p> <p>Over the last two years have been legislative initiatives that have been discussed, not yet finalized , implementation of laws already in force or of bills can put pressure on the banking sector : for the moment , the current version of the law on commissioning payment and the impact of certain decisions of courts applying the law on unfair terms. Another negative impact on banks might have the provisions on legislative initiatives on the conversion of foreign currency loans</p>	<p>The banking sector remains so vulnerable to some initiatives national legislative: implementing the law on unfair contract terms ('unfair terms') and the law on giving in payment, applying it retroactively, pose a serious challenge to the stability of the banking sector, with implications for the entire economy (the current version of the law on payment commissioning may have um negative impact on domestic demand and consumer confidence and investor).</p>

in local currency loans.	
<p>Strong economic growth in 2015 was enhanced by tax cuts and wage increases in the public sector and ad hoc decisions taken and approved outside the budget process, without providing for their funding under national law.</p> <p>From January 2016 came into effect new measures that will continue expansionary fiscal year 2017. Thus public finance deficit is expected to increase more than three times as percentage of GDP in just two years, leading to compromise of budgetary consolidation, gradually realized in last years.</p> <p>Lack of vision on medium and poor implementation of fiscal rules are the main factors behind the pro-cyclicality.</p>	<p>An expansionary fiscal policy in an environment of strong growth is a cause for concern.</p> <p>Adopting an expansionary fiscal policy in an environment of strong growth, which stimulates primarily the internal consumption without first taking further measures which aimed the offer could stimulates new internal and external imbalances.</p>
<p>Poverty and social exclusion is among the highest in the European Union, especially among children and the Roma. Social transfers have limited impact on poverty reduction; provision of social services is insufficient; lack of a coherent adjustment mechanism; activation and labor market integration of social assistance beneficiaries were limited. Although progress has been made, the results remain unsatisfactory.</p>	<p>Effectiveness of social protection and health system continues to be a serious challenge.</p>
<p>Effectiveness and efficiency of public administration are limited; the ability of public institutions to develop and implement policies in a strategic and coordinated way is strongly influenced by both the unstable</p>	<p>Accelerating reform of public administration; reorganization of public procurement so as to increase transparency and efficiency; development of e-government to improve the</p>

organizational structure, weak administrative capacity and inconsistent policies in terms of human and financial resources and the politicization and lack of accountability of civil servants. Add to this the complexity of administrative procedures, the volatility of fiscal policies and the widespread use of emergency ordinances government, which creates uncertainty and hampers the investment decisions.	efficiency of public administration; supporting interoperability at national and better providing digital services representing several priorities on public administration.
---	--

*Source:* European Commission, European Semester Documents 2015, 2016

### **Conclusions**

In February 2015 the Commission concluded that Romania was experiencing macroeconomic imbalances, which require policy action and monitoring particularly. The 2016 Alert Mechanism Report, which initiated the 5th annual round of the Macroeconomic Imbalances Procedure, identified Romania as a country that needs an in-depth review. The risks arising from these macroeconomic imbalances come from: the relatively large negative net international investment position (NIIP), a weak medium-term export capacity and while financial sector stability was preserved, external and internal vulnerabilities of the banking sector remained.

Therefore, on February 26, 2016, the annual Country Report for Romania was issued, containing an evaluation of the economy of Romania in the light of the annual analysis of growth. The analysis made by the European Commission recommends that it should consider three priorities for the economic and social policy of the European Union in 2016: the restart of the investments, the persistence in the structural reforms, in order to modernize the economies of the member countries, and the using of responsible budgetary policies.

The analysis presented in the Country Report for Romania 2016 leads to a number of conclusions:

- negative net international investment position continues to be a source of macroeconomic vulnerability; net debt related to foreign investment contributes around -39% of GDP to the net international investment position;
- expansionary fiscal policy in an environment of strong growth is a cause for concern; adoption of an expansionary fiscal policy in an environment of strong

growth, which stimulates primarily the internal consumption without first taking further measures which aimed the offer could stimulates new internal and external imbalances;

- liquidity of the banking sector has improved due to deleveraging; despite capital reserves and liquidity encouraging overall banking sector continues to be exposed to internal sources of vulnerability; it remains vulnerable to some initiatives national legislative: in particular the law on debt discharge, in its current form, poses a serious challenge to the stability of the banking sector, with implications on the whole economy; it could impact negatively domestic demand as well as consumer and investor confidence;
- other sources of vulnerabilities are the implementation of the law on abusive clauses and legislative initiatives on the conversion of foreign currency loans into local currency loans.
- the solid economic growth determined the increase of the macroeconomic resistance; the current account debts, previously unsustainable, have been corrected and it is estimated that it will remain under control, at a level under 3% of the GDP until 2017;
- although the stability of the financial sector has been ensured by the regulation authorities by decisive measures, with the European Commission support, however, some legislation initiatives can become a threat in this respect;
- the difficulties in implementing the structural funds programmes hamper public investment so that basic transport and other infrastructure remain underdeveloped, generating a bottleneck to growth in Romania;
- in the same time, Romania achieved limited progress concerning the implementation of the 2015 specific recommendations for each country.

- **Bibliography**

- ✓ REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN CENTRAL BANK AND THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE Alert Mechanism Report 2016, EUROPEAN COMMISSION, COM(2015) 691 final, November, 2015;

- ✓ REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN CENTRAL BANK AND THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE Alert Mechanism Report 2015, EUROPEAN COMMISSION, COM(2014) 904 final, November, 2014;
- ✓ Macroeconomic Imbalances, Main Findings of the In-Depth Reviews 2015, European Economy- Occasional Papers 228, June, 2015;
- ✓ Country Report Romania 2016, EUROPEAN COMMISSION, SWD(2016) 91 final, February, 2016;
- ✓ COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN CENTRAL BANK AND THE EUROGROUP 2016 European Semester: Assessment of progress on structural reforms, prevention and correction of macroeconomic imbalances, and results of in-depth reviews under Regulation (EU) No 1176/2011, COM(2016) 95 final, Strasbourg, March, 2016;
- ✓ Country Report Romania 2015, EUROPEAN COMMISSION, SWD(2015) 42 final, February, 2015;
- ✓ COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN CENTRAL BANK AND THE EUROGROUP, EUROPEAN COMMISSION, COM(2015) 85 final, Brussels, February, 2015.