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ECONOMIC MEASURES DESIGNED BY INTERNATIONAL FINANCIAL INSTITUTION IN ORDER TO MACROSTABILIZE AND TO AUGUMENT ECONOMIC RECOVERY PROCESS

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Abstract:
The recent economic crisis has affected the world economy in general, but the contagion degree for each member economy was different, depending on the specific economic situation existing at the crisis debut. Some European economies were very seriously affected, especially those who have expressed a number of internal and external imbalances in the pre-crisis period, and who did not take countermeasures. The economic crisis and the recession that followed were felt strong also in the USA, but the flexibility of the US economy and the measures taken since the onset of the crisis allowed a faster recovery than in European vulnerable economies. The accommodative US monetary policy permitted to avert liquidity crises and to clean the bank balance sheets, which was also a premise of resuming lending in order to get out of the recession. In this article we conducted an extensive analysis of management measures adopted in different states which are carrying out programs with IFIs, taking into account both short-term effects and implications of these economic policy measures in the medium and long term horizon.

Key words: *economic crisis, macro stabilization policies, IFI's agreement;*

JEL classification: E 60, E 61, G28;

1. OVERVIEW

The economic crisis that started in 2008 affected most world economies. In many cases they were forced to seek financial support from international financial institutions (IFI) like the International Monetary Fund (IMF), European Commission (EC), European Central Bank (ECB) and the World Bank (WB) in order to ensure macroeconomic stability,to regain access on international financial markets and to restor investor confidence in the economic prospects of these economies. A number of countries, especially in Europe, are still in the financing agreements with international financial institutions, since the economic problems there economies are facing persists, although the situation in the last five years significantly improved. The paper provides an analysis of financial assistance programs concluded by international financial institutions, the causes of these programs and the types of measures and their effectiveness in eliminating internal and external imbalances that these states have faced.

The literature has been enriched with many papers that analyzed funding and the effectiveness of economic policy in these programs. However, it is worth noting that international financial institutions do not provide estimates of the effectiveness of these measures, for example in the form of indicators that provide a ranking of Member States in terms of success and recommended reforms implemented by these states.

An important study on the success of EU and IMF financial assistance programs during the crisis was developed by Jean Pisani-Ferry, André Sapir and Guntram Wolfe and published in 2013 [1]. The review examines EU and IMF assistance programs (EC and ECB) taking into account three

euro area Member States, namely Greece, Ireland and Portugal. The authors concluded that, from an institutional perspective, the cooperation between the EC and the IMF was inevitable, given the lack of experience of EU in funding crises and also a lack of confidence in the Union in their own institutions. Despite the differences in organization and approach between the two institutions, the cooperative process worked. The topics on which there were the most serious disagreements were related to the restructuring of Greek debt and to the acceptance of losses by holders of bonds (senior) issued by Irish banks. Regarding the success of these programs, the authors concluded that the results were mixed. An obvious success has been made in reducing current account deficits in the three countries, even if the reduction occurred predominantly on the basis of reduced imports due to the collapse in domestic demand, in which case the success may be questionable.

Compared to other European countries which have signed one or two financing agreements, Romania has signed three agreements, the last to be finalized in 2015 [2-4, 6]. In 2013, even before the signing of the third agreement, the European Commission has prepared an analysis of the first two funding programs concluded with Romania in 2009-2013, 'Overall assessment of the two balance-of-payments assistance Program for Romania , 2009-2013 '[3]. The purpose of the two programs funded by 5 and 1.4 billion euros, was to provide financial support for financial and economic crisis and to create prerequisites for a sustainable and inclusive growth by promoting structural reforms in order to substantiate this economic growth. The role of the first program, with a value much higher than the value of the second and third one, was to ensure macroeconomic stability in terms of the balance of payments, public finance, inflation and financial stability.

Once that macroeconomic stability was ensured, the second program focused on structural reforms, particularly in transport and energy to ensure a raise in potential GDP**. Other areas of interest important reform measures were those of health, fiscal governance and state enterprises, employment and business . The evaluation findings show that in general, most of the benchmarks contained in the two funding programs have been met.

International financial institutions such as the IMF and WB have clear mandates to support Member States in case of economic difficulties. Thanks to a long period of operation and intervention in crises , these institutions have developed appropriate tools and specialized personnel. Despite having responsibilities in supporting Member States under the Treaties in force, at the onset of the economic crisis, the European institutions experience was almost inexistent, not having a practice in the design and monitoring of economic programs for overcoming economic imbalances. In the near future, the EU has enriched the tools to prevent macroeconomic imbalances and to promote economic governance by adopting new regulations in the economic packages.

Thus, since the economic crisis started, international financial institutions were more or less prepared to meet the needs of Member States in terms of financial resources, intervention instruments, as well as experience in economic development programs. At the onset of the crisis, the IMF was the only institution that possesses the kind of economic programs, legislation, professional experience and financial resources needed for the formulation, negotiation and implementation of these programs. However, to assist countries with sound macroeconomic policies, but indirectly affected by contagion, the IMF has developed two new financial instruments, respectively the Flexible Credit Line (2009) and the Precautionary Liquidity Line (2011). At the same time the IMF has increased the capital available to support Member States through economic programs with funding from 250-1000 billion. This operation started in 2009 through loans from member states less affected by the economic crisis.

European Commission and the ECB were less prepared to support member countries, because they had the tools and financial resources, but no professional experience. In case of the European Union, the only financial instrument (type of economic program) was available for non euro area countries which were facing balance of payments difficulties. With this type of program (balance of payments assistance), the European Union through the European Commission could give countries outside the euro area financial resources from the EC loans on international financial markets. Until the onset of the economic crisis the European Union never used this tool. The same situation was also in the case of ECB, which did not have a clear mandate to support Member States

in the euro area and beyond. However, both the EC and the ECB have developed legal framework, logistic and financial support to help Member States facing great economic problems. The ECB played an active role, as partner, in the euro-area countries while in non-euro states this institution had an observer role. ECB role under these programs was to provide liquidity to banks which were in difficulty.

World Bank was part of the economic program especially with the IMF in emerging countries. Experience and financial resources of the first previous mentioned institution aimed primarily structural adjustment and modernization in different areas - such as education, transport, environment, governance of public institutions, agriculture, etc - specific especially in emerging economies. In Europe, the World Bank has been a partner in economic programs with the IMF and EC only in Hungary and Romania and Latvia.

2. INVENTORY OF MEASURES TAKEN IN ROMANIA

External financing agreements signed by Romania with IMF aimed to limit spread of the financial crisis effects in Romania through the transmission channel of external financing and promoting economic package of measures to limit the negative effects on the Romanian economy and ensuring the necessary conditions to resume economic growth .

The first economic program with funding from IFIs aimed at restoring macroeconomic stability which was severely affected during the boom economic registered in the 2003 – 2008 period, and which led to overheating and unsustainable imbalances. GDP growth averaged over 6½% per year in 2003-2008 (showed by Figure no.1) fueled by foreign direct investment and capital inflows (in part by foreign bank branches in Romania). Robust increase exports to the EU countries reflected a process of integration increasingly higher in Western European economies. Domestic demand growth was even faster, generating current account deficits increasingly larger, which culminated in 2007, reaching 14% of GDP. The overheating economy and the rapid capital inflows complicated a lot the Monetary policy of the country, which drew after itself the National Bank of Romania inability to achieve the inflation target despite rising interest rates and reserve requirements [5].

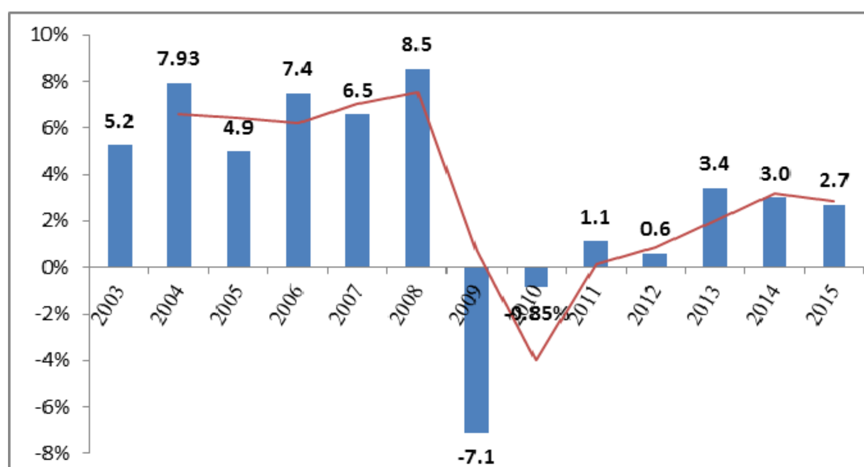

Figure no.1 Real Growth Evolution between 2003 - 2015
Source: Own calculation based on Eurostat data

Real Exchange Rate (RRES) has appreciated by approx. 50% during the interval 2004 - 2007, the value being determined by massive capital input and by the economic convergence expectations due to the EU aderathion.

The rapid increase of credit that fueled the boom led to a large exposure of Romania to the global financial temporary obstacles and to the exchange rate volatility. External loans of the banking system led to an increase of domestic credit, which reached an average of 50% per year

over the past four years until 2007. The companies' access to foreign loans also contributed to the boom, increasing from a net 4% of GDP in 2005 to almost 11% in 2007.

Moreover, over half the domestic private loans were in foreign currencies, much of them belonging to people or companies exposed at risk, which generated a significant indirect exposure of the banks to currency risks (Figure no. 2). The maturity structure of external debt also deteriorated in those years, the coverage of short-term external debt to gross international reserves decreasing to about 75% in February 2009 from over 170% in 2003.

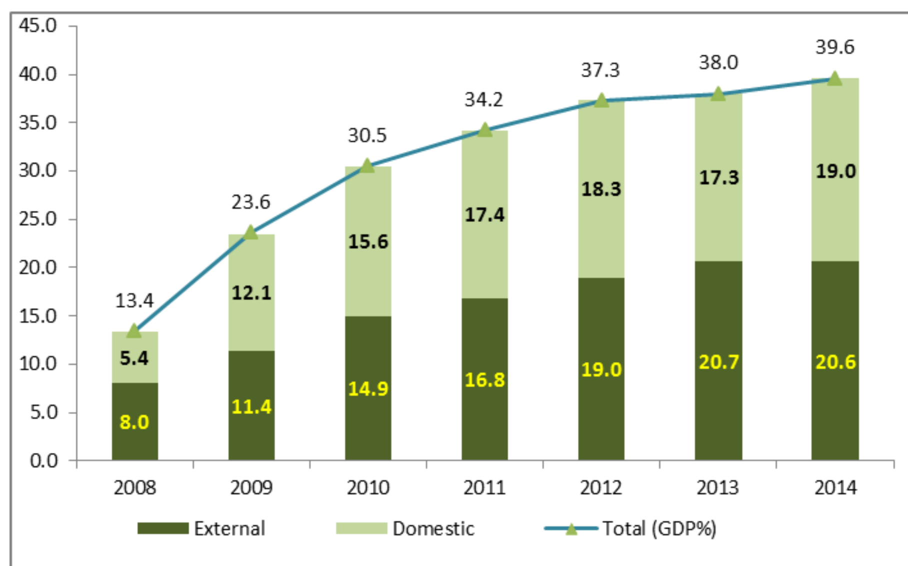

Figure no. 2 Romania – Public Debt as GDP percentage, 2008-2014
Source: Self Calculation based on MPF data

The second grant agreement signed by Romania focused on stimulating growth potential through structural reforms. Structural deficiencies in key economic areas slowed economic growth. Improving the eficiency in public sector should have the effect of reducing bureaucratic barriers and increase the absorption of EU structural funds, boosting in the same time the capital expenditure for improving national infrastructure.

The new program also aimed at reaching reforms in the transport and energy sectors, including reforms in terms of pricing mechanisms, better regulation and restructuring and privatization of state enterprises in the transport and energy sectors. Precautionary assistance from the International Monetary Fund and the EU was a reinsurance to private markets and an opportunity to mitigate future shocks in the event of their occurance.

Target for fiscal balance at the end of December 2011 was met by a substantial margin, reflecting bigger tax revenue than anticipated. Fiscal policy has played a strong pro cyclical role, the budget deficit rising from under 1% of GDP in 2005 to almost 5% of GDP in 2008. Difficult fiscal measures adopted in 2010, supplemented by the prudent policies on spending, make Cash fiscal deficit target of 3.0% in 2012 to be achievable (See Figure no.3).

However, to ensure sustained deficit reduction was essential to continue efforts to improve tax collection, to reduce expenditure pressures (especially in the health sector), and to reduce the arrears [8]. Under sustained efforts to improve tax administration, the government approved a decision on indirect methods of control, as a prior action for the new joint agreement (with IMF and EC) [7].

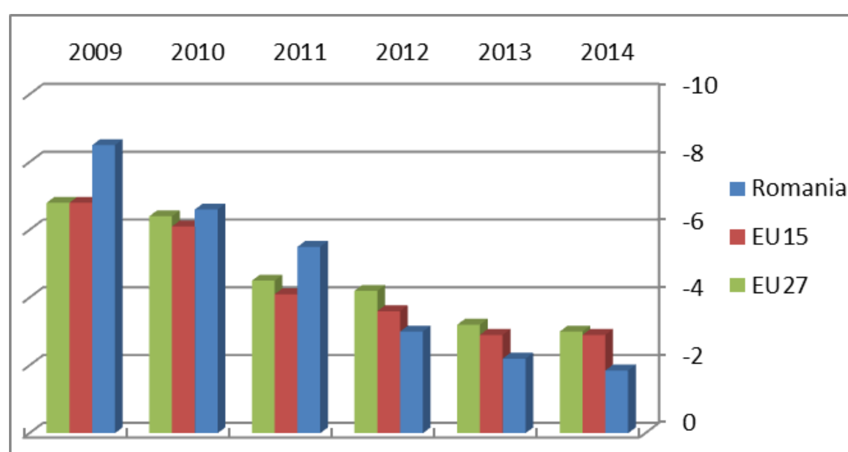

Figure no.3 – GCB Deficit (GDP percentage)
Source: Own Calculation based on AMECO data

The banking system faced well the crisis, being well capitalized and liquid. Nonperforming loans (NPLs) continued to grow, althow at a slower pace , and reached a peak in mid 2011. Banks were still well capitalized, at the end of 2010 recording an average of capital adequacy ratio of 14.7%, all banks hovering above 11% [21]. However , the vigilence was maintained, given the fact that performance varied significantly from bank to bank. In March 2011 , the authorities discussed with the largest foreign banks an extension of the European Bank Coordination Initiative (ICBE), in order to continue the stabilizing effects that this initiative have had.

The third funding program provides a valuable anchor of policies and supports the comprehensive economic program of Romania for the period 2013-2015. The purpose was to maintain sound macroeconomic policies and financial sector stability and also the continuation of structural reforms designed to enhance growth prospects.

In particular, the program seeks :

(i) to protect a healthy public finance system, supported by a stronger institutional fiscal framework;

(ii) to continue monetary and financial sector policies that restore the reserves and protect the economy against external shocks;

(iii) to reduce economic bottlenecks which are impeding the country's growth potential and competitiveness, through structural reforms.

The program aims to maintain investor confidence by ensuring discipline and stability of policy design. This agreement also allows the targeting of measures in order to support domestic demand. Because people, banks and companies continue to lower the debt level, domestic consumption and investment demand remain modest. The program combines long-term institutional responses to short-term measures, targeted, such as the extension of mortgage guarantee scheme, aimed at putting recovery on a firmer basis.

Specifically, measures were related to fiscal consolidation, financial stability and structural reforms in order to facilitate and accelerate economic recovery. Adjustment program demanded that the consolidation proccess to focus mainly on spending cuts, given the pre-crisis fiscal slippages in current spending and financial constraints. The strategy also involved reducing the deficit below 3 % of GDP by the deadline set by the European Council in the context of the excessive deficit procedure***. The European Council initially set 2011 as the deadline for reaching a deficit below 3% of GDP, but in 2010 this deadline was extended until 2012 because of a significant deterioration in economic conditions [9-14].

The category of fiscal consolidation measures includes both measures designed to reduce costs but also to increase revenue. Reducing expenses covered all categories of expenditure, respectively expenditure on wages, goods and services and capital expenditure. The income increase aimed all income categories, but especially tax revenues which are the majority in the budget and are easier to control.

After the timeframe for implementation and action we can distinguish [9-20, 22]:

• short-term measures. In the category of short-term economic measures are the ones that can be implemented immediately and have immediate effects on relevant economic indicator (for example - reducing the budget deficit), such as increasing some taxes (VAT, social security contributions) and reduction of expenses (wages , pension and investment) .

• long-term measures. Long-term measures are involving improvement of strategy in the aimed field and requires a development of the strategy, appropriate legislation, the possibly to set up institutions with clear responsabilities in the frame of the new strategy. In this respect we can mention fiscal consolidation measures by strengthening the fiscal framework and by developing the fiscal budget strategy on the medium term, public pension reform, healthcare reform, governance reform at state enterprises, local public finance reform, public administration reform, etc. Development and implementation of these reforms is a lengthy process, and consequently the results are supposed to be visible at least on a medium timeframe. For example, in case of the reform of public pensions, the results can appear even after a period of 20-50 years, if one of the measures is to increase the period of retirement or relocation scheme of contributions and benefits. Other reforms in the energy, transport, business environment, etc are a plus in the reform field with a direct effect on public finances.

3. THE IMPACT AND THE EFFICIENCY OF ECONOMIC MEASURES DESIGNED BY THE FINANCIAL ASSISTANCE PROGRAMS

Romania had the most drastic fiscal adjustment during programs in comparison with similar countries in the region. The structural deficit improved by 5.5 percentage points of GDP in 2009-2011. Romania had also the weakest starting position, with a unsustainable structural deficit of 9.5 % of GDP in 2009, highly generated by a pro-cyclical fiscal policy during the years of growth from 2004 to 2008. Despite drastic fiscal adjustment measures which had negative effects on domestic demand Romania returned to economic growth since 2011, after a significant decline in real GDP to almost minus 7 % [15-21]. The resumption of economic growth process is accompanied by increasing levels of confidence in the economy, expressed by economic sentiment indicator.

The success of financing is directly reflected in the reduction of the perceived risk by markets toward Romanian economy. The CDS spreads (the cost of insurance in case of bankruptcy, practical the bankruptcy likelihood of a country) followed a similar trend and fell below 200 basis points in mid- June 2013, from a peak of about 800 basis points in March 2009. (note that the market believes that the risks of failure are higher in Hungary than in Romania, so that the cost of insurance in case of bankruptcy in the first mentioned country is at about 300 basis points, which is almost double than in Romania). The interests on government loans followed a downward trend since 2011 and dropped to a historical low in the spring of 2013 (Figure no.4).

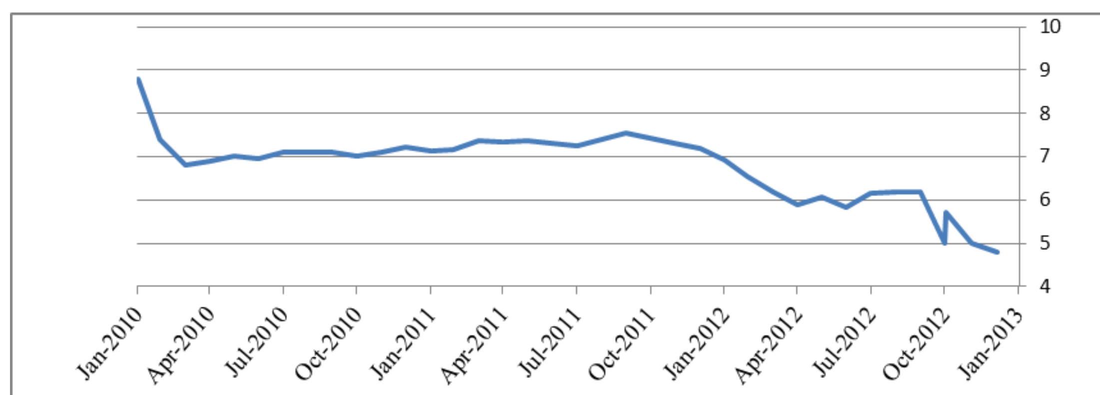

Figure no. 4 Government bond yields-as weighted average of 3, 5, 10, 12 and 15 year bonds

Source: OWN Calculation based on MFP data

Generally, programs have attained their recovery macroeconomic stability objectives, restoring market access to finance sovereign debt and maintaining financial stability.

4.CONCLUSION

The three programs signed by Romania with IFI had some slippages and unconvinients but also had the effect of restoring macroeconomic balance and economic recovery, so that in 2014 Romania recorded the highest GDP growth rates in the EU. Although some economic measures have had negative effects on household income (wage cuts, reduction of employment in the state sector, increasing inflation due to the VAT increase), the Romanian economy is back in the area of sustainable economic growth with sound macroeconomic fundamentals. Macroeconomic adjustment that occurred in the last 4 years in Romania and the return indicates positive growth due to the economic reforms implemented during the three IFI's financing economic programs.

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** The third program aims to protect and deepen the initial reforms, and expanding particularly in modernizing public administration.

*** According to the Stability and Growth Pact of the EU, European Union Member States should maintain the general government deficit below 3 percent of GDP. Exceeding this limit attracts a specific procedure (excessive deficit procedure) to return the budget deficit below 3 percent of GDP.

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