THE INVESTMENT ACTIVITY AND THE FINANCING PROBLEMS DURING THE CRISIS IN ROMANIA

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Abstract : This article treats the correlation between the investment projects and financing difficulties in a vicious circle during the crisis. First of all, Romania, as the whole world, should reconsider the planning problems, taking into consideration two problems: from one point of view, the nowadays economic and social difficulties; from another point of view, the negotiation between the economic boom and the financial imbalances. Secondly, the investment decisions should be close connected to possibilities financing. This paper has underlined that Romania is an emergent economy and it must elaborate strategically plans, on the large scale and on the long time, but, all participants – government, local administrations, large and small enterprises, and individuals have to head skills to estimate the financing resources. Thirdly, one lesson from the financial crisis is a Nobel winners´ vision – E. Ostrom and O. Williamson - about our overconfidence in institutions that are important to the functioning of the economy and about the economic governance. Accepting the idea of an L-shaped recovery, during a long time, in this paper we consider that there are necessary small steps, but based on a performing management coordinated to the national and even international level, in function of the government financing possibilities for communities and individuals. The research is based on the statistical analysis and on the lessons of the financial crisis to prove the valid explanations and measures to support the real economy. Recently, European Union (EU) has underlined the numerous recovery measures to support the real economy during the economic crisis.

JEL Classification: E22, E44, E60, F01, F36, G30, G31, G32, H80, O10, O52.

1. Introduction

Generally, the investments activities are into the chain investment projects-financing - economic growth and this chain is in a virtuous circle during the economic growth. The virtuous circle shows that money will generate the investments projects,

and, finally, the economic growth, and this growth generates funds for new investments.

But, the economic and financial crisis generates a vicious circle and the dilemma: first of all, will be the money less or will be the investment projects inefficiently?

The correlation between the investment activity and economic growth in Romania is strongly affected by the financial crisis. Moreover, because of globalization, the present day financial crisis widens and complicates this vicious circle.

Serious measures of the policy lessons from the crisis for mature markets are similarly applicable to emerging market authorities.

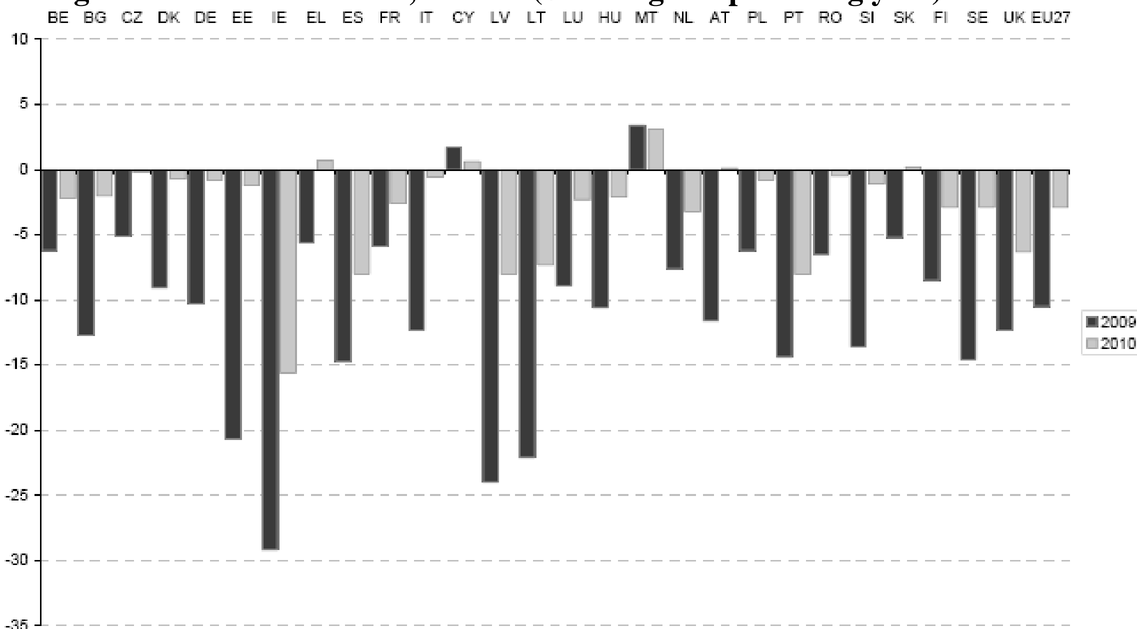
But, the emergent economies, as Romanian economy, have many difficulties and imbalances and they are more exposed to the crisis.

Economic stability versus financial stability is one new vision post-financial crisis. European Union has underlined the numerous recovery measures in order to support the real economy. In addition, there is a Nobel winners´ vision – E.Ostrom and O. Williamson - about our overconfidence in institutions that are important to the functioning of the economy and about the economic governance.

2. The impact of the crisis on investment activity in European Union

The crisis has hit investment severely. The EU Commission's Spring 2009 forecast [6] points to a contraction of 10.5% in 2009 in the EU, following a flat growth in 2008; investment growth is also forecast to remain negative in 2010 (-2.9%).

Figure 1: Total investment, volume (% change on preceding year)



Source: **Commission's Spring 2009 Economic Forecast.**

The fall is particularly acute in equipment investment (-16.4% in 2009 and -3.6% in 2010 in the euro area), though growth in construction investment will also

remain in the red (with an expected contraction of 6.5% in 2009 and of 2.5% in 2010). As a result, the current fall in total investment growth is more severe than in previous downturns.

Specifically, investment in equipment has been hit by weakening demand, reduced availability of funding and waning confidence. In turn, investment in construction is negatively affected by the large downturn in the housing market, particularly in Member States. All in all, the expected slump would have been higher had it not been for public investment stimulus measures. Indeed, public investment in the EU is forecast to reach 2.8% of GDP in 2009.

Short-term prospects are not particularly promising. Survey results show that managers expect weak demand for some time, which could translate into further reduced investment. Although some confidence indicators have improved recently, they still point to continued weakness in economic activity. On the financing side, the EU banking system remains under considerable stress, as shown, inter alia, in the high spreads on credit default swaps and in banks' tighter credit standards. Furthermore, private consumption is forecast to remain weak, due to losses in financial and housing wealth. These are likely to boost savings over next year despite lower price pressures and interest rates. According to the accelerator theory, depressed private consumption should translate into weak investment prospects. Finally, throughout 2009 construction investment will, in all likelihood, be dragged down by the ongoing correction in the housing markets of several Member States.

The financial crisis translated into a severe contraction of credit and loans to companies and households. The main drivers were the negative economic outlook, but also the impact of banks' ability to obtain financing in the market. At the same time, the slump in business and consumer confidence contributed to decreasing the demand for credit and loans. The tightening of credit standards for loans to enterprises in the euro area increased significantly in the third quarter of 2008 (by 22 percentage points from the previous quarter to 65%).

While large enterprises were more affected by the net tightening of credit standards, the situation worsened for SMEs during the last quarter of 2008, so that the net tightening of credit standards was comparable for both large enterprises and SMEs. The main driving factor behind the changes in credit standards, for both large enterprises and SMEs, are expectations regarding general economic activity and the industry- or firm-specific outlook. At the same time, banks' cost of funds and balance sheet constraints played a somewhat more important role in the net tightening for large firms than for SMEs as the current slowdown in syndicated lending and a subdued credit risk transfer market have increased the cost of allocating capital to larger loans.

3. Policy lessons from the crisis for mature markets refer to financial stability

The concept of financial stability has gained new importance, considering the geometric growth in the size of financial transactions, and the ever increasing costs of financial crises.

The reasons behind the problems within the financial systems of advanced countries were: (i) the significant liquidity surplus in the context of low interest rates which promoted higher risk taking for larger yields, (ii) the development of financial innovations, without adequately understanding the risks assumed and without implementing adequate risk management methods, and (iii) the transparency of

placements in innovative products, as well as the related regulatory framework were insufficient.

The Financial Stability Forum (FSF), consistent with the statement by the Basel Committee on Banking Supervision, notes that recent market reactions regarding capital levels have been highly procyclical [9]. Members agreed with the Basel Committee's decision not to increase global minimum capital requirements during this period of economic and financial stress. As the Basel Committee has previously noted, capital buffers above the regulatory minimum are designed to absorb losses and support continued lending to the economy [1].

Central banks responded in a timely manner [2]. First of all, the immediate measures consisted in the followings: the emergency provision of liquidities, the resort to new financing facilities beyond those provided via current monetary policy operations and, in some cases, the cut (aggressive, in the case of FED) of monetary policy rates.

Secondly, the monetary and fiscal policies that have been adopted worldwide have provided substantial macroeconomic stimulus and have been complemented by wide-ranging measures to stabilize financial systems.

Some recently announced responses are still in early stages of implementation. Members of the FSF reaffirmed the commitment of their governments to support systemically important institutions. They discussed the steps that are underway to restore stability to financial systems and promote credit extension, with a particular focus on measures to recapitalize financial institutions and strengthen balance sheets. The FSF will continue to monitor the impact of these measures both within and across jurisdictions and seek opportunities to promote the consistency of these actions.

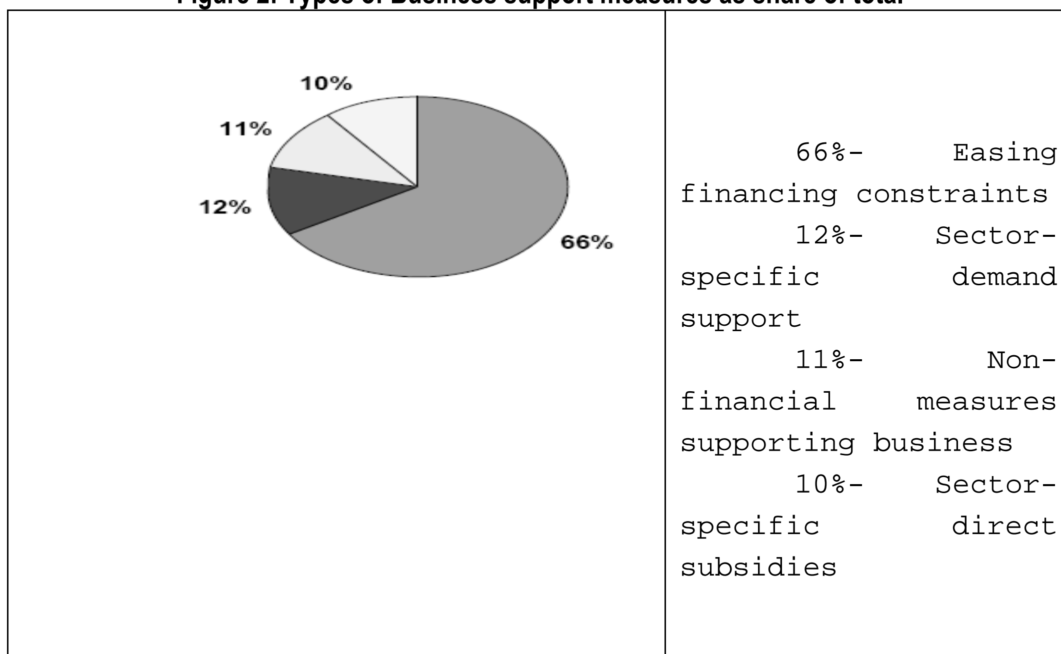
4. The European Economic Recovery Plan to support real economy

For Romania, are very important the EU measures. The European Economic Recovery Plan (EERP) has recognised the need for public intervention to support of businesses during the crisis for several reasons.[7]

To begin with, beyond the measures to restore the normal functioning of credit markets, which remain distressed, additional government intervention can help ease the specific financing constraints facing companies. Also government may have a role in providing or supporting specific credit services (e.g. export credit insurance) which markets are temporarily unable to provide, at least at economically viable conditions and prices.

Among the measures classified as supporting real economy, and first of all, industrial sectors, business and companies, two thirds aim at easing financing constraints for business .

Figure 2: Types of Business support measures as share of total



Source: European Commission, The EU's response to support the real economy, 2009.

These comprise the extension both in terms of volumes and conditions of credit guarantees, including export credit, particularly for SMEs and the increase in the capital of public development banks to bring this about; easing conditions for access to and repayment of loans; temporary tax reductions and exemptions; and changes in depreciation rules favoring SMEs.

Sectoral measures (both demand support measures and direct subsidies) account for almost one quarter of total number, but are concentrated in a number of Member States with industries that are particularly hard-hit by the crisis.

Sector-specific demand support is provided through temporary tax breaks, permanent changes, and other financial incentives for purchases of sector-specific products in support of environmental and innovation policy objectives; easing regulatory requirements and financing conditions for homeowners and first-time buyers; sectoral liberalization measures; and the handout of coupons for the consumption of certain goods and services. *Sector-specific supply measures (including direct subsidies)* provide direct financial support, such as tax reductions and direct state aid payments as well as measures aiming at complementing the deterioration of financial conditions (guarantees and loans with subsidized interest rates) .

Non-financial business support (e.g. regulatory reforms) relate mainly to the reduction in administrative burdens for businesses, in particular SMEs, but also to the provision of advice services to business in export activities and trade fair participation.

5. The Romanian economic boom and the financial imbalances

Over the past five years from 2003 to 2008, the Romanian economy has characterized as an economic boom, but, the economic boom led to overheating and unsustainable imbalances. Economic activity turned down sharply in late 2008 and has

fallen further in early 2009, but inflation remains relatively high. Inflation has eased somewhat from its 9.1 percent peak in July 2008, but remains near 7 percent.

Table 1. Main macroeconomic indicators for Romania before and during the crisis

Macroeconomic indicators	2008	June 2008	June 2009
Gross domestic product (GDP)* - % change	+ 7.1	+ 9.3	- 8.8
Industrial output - % change	+ 2.7	+ 6.7	- 8.7
Registered unemployment rate -%	4.4	3.7	6.0
Consumer prices HICP- %	7.9	8.7	5.9
Interest rates of credit institutions:			
-on loans -%	15.07	14.40	17.46
-on time deposits - %	9.55	9.16	12.64
Consolidated general government deficit (-) Lei mill.	-24 654.9	-5 191.1	-14 383.1
Total Domestic credit -lei mill.	215 260.9	189 246.2	234 796.5
-of which non-government credit - %	92.0	94.2	84.4

*Nominal GDP (current prices) in 2008 is esteemed at 503 958.7 lei mill.(Approximately €145 bill.)
Source: National Bank of Romania, Monthly Bulletin, June 2009, p.16-18.

Gross Domestic Product (GDP) growth averaged over 6.5 percent per year. Addend, one robust export growth to European Union countries reflected a process of increasing economic integration with western European economies. The foreign direct investment and capital inflows (in part through subsidiaries of foreign banks in

Romania) helped finance high consumption and investment growth. In addition, the domestic demand growth was even faster, generating increasing current account deficits that reached 14 percent of GDP by 2007.

The banking system's external borrowing drove rapid domestic credit growth, averaging 50 percent per year over the past four years. Banks' net foreign liabilities increased from -2 percent of GDP in 2003 to +19 percent in 2008. Corporate access to foreign credit also contributed to the boom, rising from a net of 4 percent of GDP in 2005 to nearly 11 percent in 2007. In addition, over half of the domestic private credit is in foreign currency, much of it is to unhedged households or corporations, creating substantial indirect foreign exchange risk exposure for banks even though banks' balance sheets themselves have little currency mismatch. The maturity structure of external debt also deteriorated in recent years, with the coverage of gross international reserves to short- term external debt declining to about 75 percent in February 2009 from over 170 percent in 2003.

Real GDP growth slowed from an average of 9 percent (quarter-on-quarter, annualized) during the first three quarters of 2008 to a 13 percent decline in the fourth quarter — one of the sharpest turnarounds among emerging markets. The decline was spearheaded by a drop in domestic demand. For the first quarter of 2009, early indicators (confidence, industrial production, retail sales, tax revenues) all point to a continued sharp drop in GDP. Export growth has also turned sharply negative, but imports have dropped even more steeply, beginning a rapid correction in the current account deficit, which halved during January-February 2009 compared to the same period last year.

The loose fiscal and incomes policies also contributed to the overheating of the economy and to its current vulnerabilities. Excessive spending growth, especially on wages and pensions, was the main culprit and helped fuel domestic demand growth. It may be said, that the bonuses in Romania are the public sector wages.

Table 2 Romanian Nominal wages- Annual percentages change -%

Years	Nominal wages	Public sector wages	Private sector wages
2005	17.0	25.9	14.7
2006	18.9	27.3	16.5
2007	22.6	18.5	23.2
2008	23.6	31.0	21.2
2009 projected	5.9	5.1	6.2

Source: International Monetary Fund, *Romania: Request for Stand-By Arrangement*, June 2009, IMF Country Report No. 09/183.

The rapid increase in borrowing that fueled the boom left Romania highly exposed to global financial difficulties and to exchange rate volatility.

Romania is one of the most exposed countries to the crisis, based on the combination of high current-account deficits and a substantial build-up of foreign liabilities by the private sector.

As financial markets have deteriorated, deficit financing was increasingly concentrated at very short maturities, exposing the government to roll-over and funding risks in an environment of intensifying deleveraging. As financial markets have deteriorated, deficit financing was increasingly concentrated at very short maturities, exposing the government to roll-over and funding risks in an environment of intensifying deleveraging. The asset and financial markets have been severely affected by the economic downturn and the effects of the global crisis.

The interbank market was disrupted in October 2008 by liquidity problems at a commercial bank, with rates spiking to very high levels and remaining relatively high on lingering concerns about counterparty risk, high risk aversion, and market segmentation due to an uneven distribution of assets (T-bills) eligible for discount with the NBR. Balance of payment pressures drove a 15 percent depreciation of the leu against the Euro from October 2008, putting pressures on household, corporate and bank balance sheets. Despite the depreciation, financial conditions tightened significantly on increased sovereign credit default swap premium and monetary policy tightening. Romania's international credit rating was cut in late 2008 (to below investment grade in the case of Fitch) by a larger margin than those of other countries in the region, reflecting market concerns about the sustainability of Romania's large current account deficit, uncertainties surrounding the outlook for fiscal and incomes policies, and the financial health of banks with subsidiaries or branches in Romania.

This has translated into significantly higher external borrowing costs for Romanian banks and corporates.

The Bucharest stock market, like markets elsewhere, has been hard hit, losing 65 percent of its value since the peak in August 2008. The exchange rate has weakened significantly since the onset of the downturn, starting to reverse the appreciation accumulated in recent years.

Because of the global credit crunch, Romania suddenly began to experience problems attracting capital from abroad. In same time, the domestic financial resources have strongly decreasing.

The Romanian economic activity turned down sharply in late 2008 and has fallen further in early 2009.

6. The financial problems put presures on the Romanian real economy

The great problem is that the Romanian economic boom led to overheating and unsustainable imbalances.

The main macroeconomic indicators for Romania register a negative trend in the period 2007-2010.

Table 3. Main macroeconomic indicators for Romania in 2007-2010 period

	2007	2008	2009-projected	2010 projected
GDP growth (%, yoy)	6.2	7.1	-4.0	0.0
Inflation (%, yoy)	4.9	7.9	5.8	3.5
Unemployment (%)	6.4	5.8	8.0	7.7
Public budget balance (% of GDP)	-2.5	-5.4	-5.1	-5.6
Current account balance (% of GDP)	-13.5	-12.3	-7.4	-6.1

Source: European Commission, Economic Forecast Spring 2009, European Economy, 3/2009.

The investment activity has deteriorated and the Gross Fixed Capital Formation has fallen further in early 2009 .

Table 4. Indices of gross domestic product, by category of uses in Romania -%

Years 1st quarter	Gross domestic product	Gross fixed capital formation	Export of goods and services	Import of goods and services	Investments total
2007	106.1	123.5	116.6	129.1	122.8
2008	108.2	133.2	125.3	135.1	134.3
2009	93.8	99.7	80.4	68.6	99.7

Source: National Institute of Statistics, Romania, *Monthly Statistical Bulletin,* 6/2009.

In April 2009, Romania has accepted an unprecedented financial support from the International Monetary Fund (IMF) and from the European Union – around €20 billion.

Generally speaking, the management consist on seven functions: planning, organizing, leading, co-ordinating, controlling, staffing, motivating. The financial crisis

put pressures on the every management functions, but it has underlined that the investment decisions should be close connected to financing.

European Union – EU and International Monetary Found –IMF have instituted a new vision, especially, about the planning and controlling.

There are the following objectives to: (i) strengthen fiscal policy further to reduce the government's financing needs and improve long-term fiscal sustainability; (ii) maintain adequate capitalization of banks and liquidity in domestic financial markets; (iii) sustainable reduction of inflation; and (iv) secure adequate external financing and improve confidence.

First of all, there is a new management of the structural funds in European Union

After jointed in 2007, European Union has imposed to Romania two practices very complex and very important for the management functions [12].

First, Romania must elaborate strategically plans, on the large scale and on the long time.

Secondly, all participants – government, local administrations, big and small enterprises, and individuals must estimated financing resources.

Practically, there is a really and long chain of the every investment project, and all the management functions must be used during this chain.

Allocation is based on the good studies about feasibility and financing resources. Accession permits to begin the investments activities. Absorption proves the quality of the projects and management, and finally, all the disbursements are accepted.

One single error on every part of this chain will be stopped the investment.

Figure 3. The chain of the European structural funds financing and the Romanian performances in 2007-2009 September periods

Allocation 240% for total projects value of total approved EU fund (lei 23.8 bil)		Accession 62% approved projects value of total EU allocation		Absorptio n 20% value of accession

Source: www.fonduri-ue.ro.

Secondly, there are the lessons of the International Monetary Found.

In 2009, the IMF-supported program for Romania combines strong policy measures with sizable financial support [10].

Key to restoring confidence is a reversal of the sharp increase in public spending, which caused a large deficit to accumulate even during a period of strong economic growth. Short-term budget cuts will be combined with fiscal policy reforms to place the public finances on a more sustainable path.

The effects of the fiscal adjustment and budget reforms will be cushioned by boosting social safety net spending and safeguarding capital spending.

Banking sector measures will also be implemented to ensure that banks remain sufficiently strong to weather the economic downturn.

7. The Controversies of the crisis solutions and new economic and social visions

In the last ten years, it saw a dramatic shift in influence away from entrepreneurship in the real economy to speculation and gambling in the financial sector. This causes serious problems at once for the real economy, and later on for the social economy as well.

Many economists show that the current IMF approach asking for pro-cyclical policies in crisis countries is inadequate. Practically, the IMF assistance – at times combined with swap agreements or direct financial assistance from the EU or, recently, even the United States – has helped to ease the immediate pressure on the currencies and banking systems of the troubled countries.[4]

The United Nations Conference on Trade and Development (UNCTAD) has long argued that multilateral coordination is the only viable solution.[5]. The idea of a cooperative global financial and monetary system would be to ensure, on a multilateral basis, the same rules of the game for all parties, just as multilateral trade rules apply to all trading partners.

The fiscal and monetary policies put in place to address the crisis worldwide are unprecedented in both scale and scope.

A new vision is about economic versus financial stability and price-level targeting versus inflation targeting.

The one lesson from the financial crisis is that all the actors have overconfidence in institutions that are important to the functioning of the economy.[3]

The research of the winners of the Nobel price in 2009 – E. Ostrom and o. Williamson- reveal how critically important it is to understand these so-called non-market institutions such as companies, governments, regulators and courts.

Concretely, Ostrom showed how common resources — forests, fisheries, oilfields, grazing lands and irrigation systems — can be managed successfully by the people who use them, rather than by governments or private companies.

Williamson is focused on how companies and markets differ in resolving conflicts. He found that companies are typically better able than markets to resolve conflicts when competition is limited, the citation said.

One new point for consideration that has emerged from this crisis relates equally to ethical, social and political aspects. [5]

8. Conclusions

The correlation between the real economy and the financial area is translated in the correlation investment projects and financing problems and it is in a vicious circle during the crisis. Moreover, because of globalization, the present day financial crisis widens and complicates this vicious circle.

Many of the policy lessons from the crisis for mature markets are similarly applicable to emerging market authorities like Romania’s economy in different areas such as crisis management, central bank liquidity operations, capital adequacy, supervision of liquidity management, deposit insurance, and the clarity of authorities’ roles and responsibilities.

UNCTAD has long argued that multilateral coordination is only viable solution.

A new economic philosophy is about the economic stability versus the financial stability, but the financial crisis put pressures on the every management functions. It has underlined that the investment decisions should be close connected to financing.

European Union – EU and International Monetary Found –IMF have instituted a new vision, especially, about the planning and controlling.

For Romania, the great problem is that the Romanian economic boom led to overheating and unsustainable imbalances.

The important idea is that EU and IMF-supported program for Romania combines strong policy measures with sizable financial support, and social protection.

Romania is in a contradictory position because, on one hand, it has an emergent economy, vulnerable to crisis, but, on the other hand, it can absorb the new practices, overtaking the old stages.

A coherent policy mix is essential for a smooth restoration of macroeconomic equilibrium.

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