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# The New Role of Growth Financing

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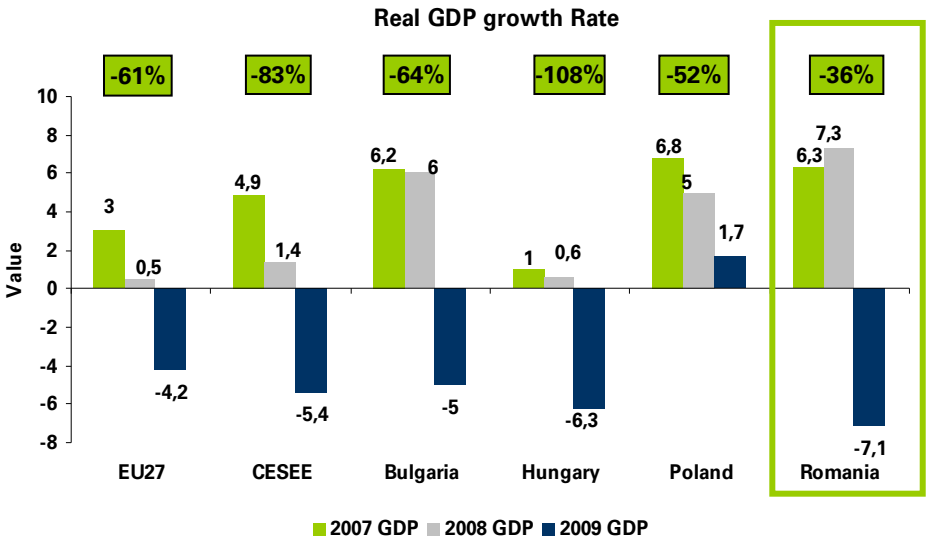
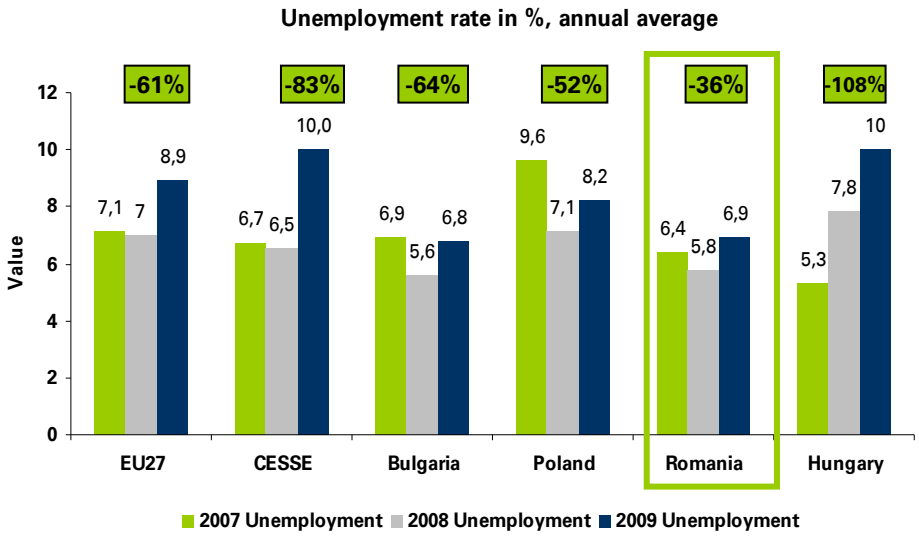
# FDI in CESEE – recent arrivals

- CESEE countries started to be FDI recipients after communist regime collapse
- Larger populations in CESEE tend to attract more FDI, having a broader area to develop
- Countries in CESEE have fewer restrictions on foreign equity ownership than those in the CIS
- FDI inflows led to an increase in economic growth

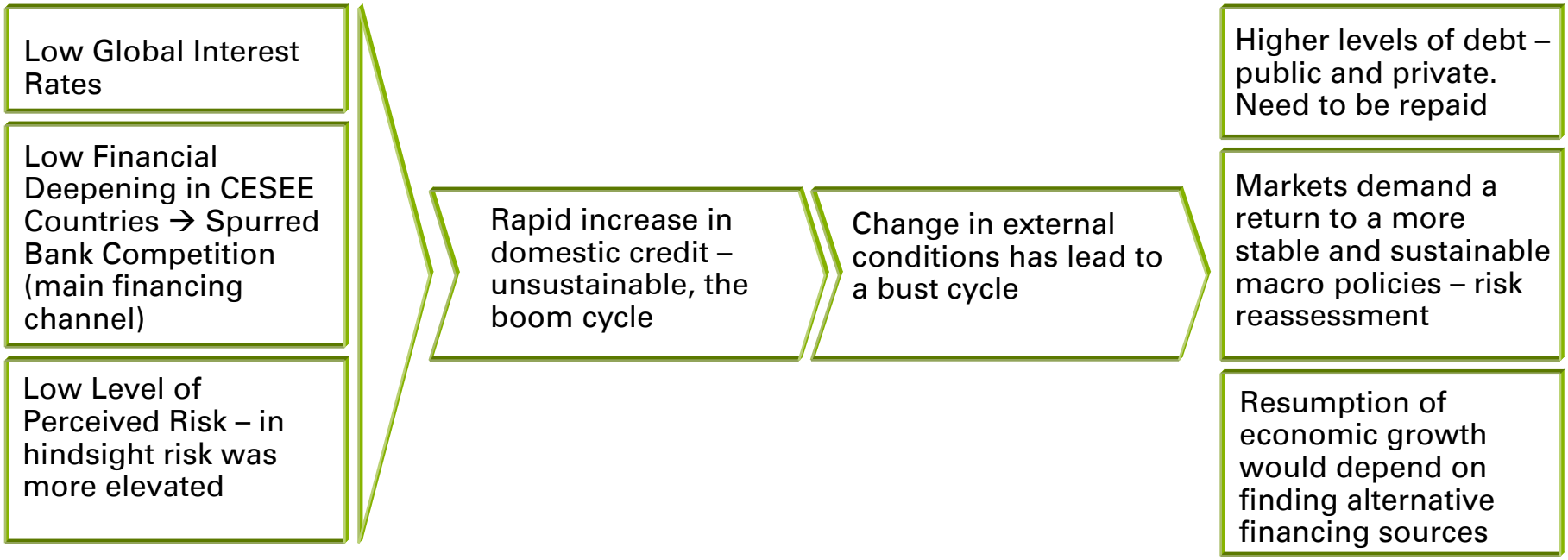



FDI inward flows evolution 2007-2009 (in %)

Source: UNCTAD FDI statistics database and Eurostat

# The Old Story of Boom and Bust Applies to CESEE



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# Measures Aiming at Bridging Financing Gap in CESEE

- Macro imbalances and/or policy weaknesses – magnified the effects of financial crisis – it was an urgent need to secure funding
- Borrowing becoming more difficult for CESEE, risk premia increasing
- FDI – an engine of growth in CESEE - dried up

- EU's medium-term assistance facility activated for the first time in 15 years with its ceiling increased fourfold to EUR 50 bn
- International support programmes (EU, IMF, WB, etc) launched for Hungary, Latvia, Romania, Ukraine, Serbia
- Vienna Initiative – parent banks pledging to maintain their exposure to CESEE countries, roll over loans and recapitalize their affiliates



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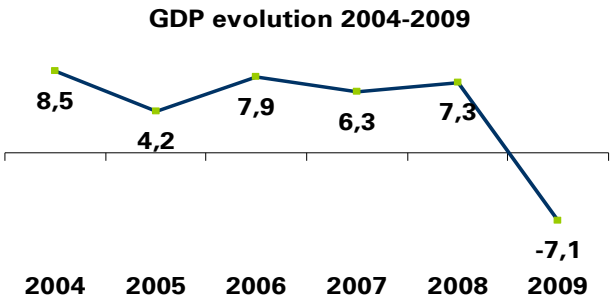
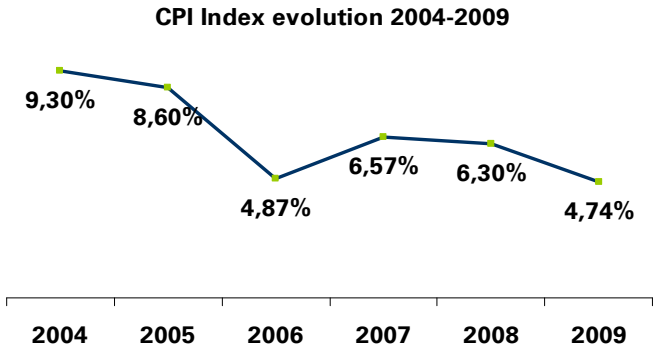
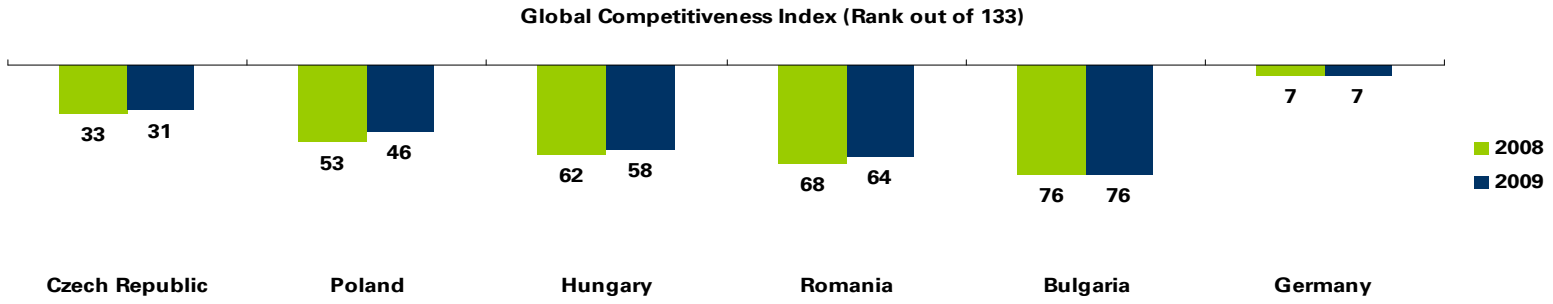
# Case Study – Romania. Lessons learnt




- Unsustainable pre-crisis economic growth concealed imbalances
- Price controls still in place
- Competitiveness in several sectors lower compared to average EU
- Legislation instability - a major cause of uncertainty for investments
- High level of foreign denominated loans make the private sector vulnerable to FX movements
- Ratio of bank loans to deposits greater than one -> increasing reliance on foreign financing
- Adoption of clear measures in various areas are critical for restoring sustainable growth




*1 is the highest rank

# Case Study – Romania. Way forward

- Stabilizing the macroeconomic environment – resolving macro imbalances (budget deficit, public debt growth, unemployment rate, inflation)
- Switch from consumption driven growth to investment and capital-enhancing productivity growth

- Targeting tax policies for growth – reduce labour taxes; maintain a low level of capital tax
- Transforming the public sector – increase public sector efficiency
- Reforming the legal system – adjust labour legislation to reduce hiring and firing costs
- Building the infrastructure for a modern economy – promote co-financing projects

- Leveraging EU funding authorities with concentrated expertise and good management
- Supporting further investments, both FDI and domestic - develop capital markets as alternative fund raising for the private sector
- Supporting SME business development
- Implementing better public governance

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# Financing alternatives for CESEE

- Need to diversify away from bank financing and increase capital markets financing. Most banks are still saddled with non-performing loans and the quality of some assets is doubtful → would result in more cautious lending
- Stimulate FDI through economic re-launch
  - Boost competitiveness and domestic consumption
- Develop capital markets and private equities - to reduce financing dependence on banking, through:
  - Good governance
  - Clean and transparent economic policies
  - Public sector institutions credibility
- Stimulate banks to take more risk to finance companies, especially SME, through:
  - Extending the range and quality of collateral through guarantees
  - Credit risk insurance schemes
- Make full use of available EU structural funds



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