The OeNB's 80th East Jour Fixe: Bulgaria and Romania – 10 years after EU accession[1]

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Combining two focal points of interest for the Oesterreichische Nationalbank (OeNB) – EU integration and Central, Eastern and Southeastern Europe (CESEE) – the 80th East Jour Fixe reviewed economic and institutional developments in Bulgaria and Romania over the first decade following the two countries' accession in 2007. The event took place at the OeNB on March 31, 2017.

In her introductory statement, *Helene Schuberth,* Head of the OeNB's Foreign Research Division, highlighted some features of the transition process and pointed out that the boom and bust cycle in CESEE in a way has overshadowed the benefits of Bulgaria's and Romania's EU membership. Both countries joined the EU at the height of a boom period, which came to an end shortly after EU accession, when Lehman Brothers collapsed in September 2008. While Bulgaria and Romania have shared some challenges arising inter alia from excessive capital inflows, their macroeconomic policy frameworks have been quite different.

In the first session, central bank representatives gave their view on macroeconomic developments. *Florian Neagu,* Deputy Director of the Financial Stability Department at the National Bank of Romania, emphasized that EU accession had been a very positive event for Romania. Yet, he pointed out that economic developments have been highly uneven across Romania's regions and that the economy has not shifted to more innovative sectors with higher value added. With regard to capital inflows and foreign currency lending, Neagu elaborated on Romania's experiences with loan-to-value and debt service-to-income ratios. In his opinion, the central bank has reached its three goals – price stability, financial stability and exchange rate stability – although big challenges occurred after EU accession. Then, *Zornitsa Vladova,* Head of Financial and Monetary Research Division at the Bulgarian National Bank, gave a presentation on her country. She portrayed the currency board, the central bank's countercyclical policies (including countercyclical capital requirements and restrictions on credit growth) and a strict fiscal policy as the main pillars of Bulgaria's policy framework. According to Vladova, the most important EU accession effects have emanated from strong capital inflows and EU funds. Overall, real convergence has made progress, but has slowed considerably from 2009. With regard to the financial sector, Vladova illustrated that banks have managed to substitute parent bank funding with domestic deposits since 2008. Moreover, nonperforming loans rose markedly in the aftermath of the global financial crisis, but started to fall in 2013.

The discussion that followed centered on macroprudential measures, the role of foreign banks, credit growth as well as the costs and benefits of specific monetary policy regimes. One of the points raised was that subsidiaries of foreign banks (which were characterized as being small within the banking group, but systemically important for the host country) may have been restricted by the economic situation and regulatory requirements in their parents' home countries in the last few years. With regard to the fixed exchange rate under the currency board

[1] *The presentations and the workshop program are available at: https://www.oenb.at/en/Monetary-Policy/Research/workshops.html.*

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regime, it was highlighted that balance sheet effects had been avoided in Bulgaria, while the exchange rate was not available as an adjustment tool.

As chair of the second session, *Peter Backé,* Deputy Head of the OeNB's Foreign Research Division, then welcomed two speakers from the European Commission. *Mariana Hristcheva,* Head of Unit of Evaluation and European Semester, discussed the implementation of European structural and investment funds. Hristcheva presented a comprehensive compilation of facts and figures on the allocation, volumes and economic impact of EU funds in Bulgaria and Romania. In both countries, the bulk of European regional development and cohesion funds went to environmental and infrastructure (in particular road) projects under the 2007–2013 EU budgetary framework. EU fund absorption picked up slowly in the first two years of the programming period in both countries, but then started to rise faster in Bulgaria than in Romania. Hristcheva also elaborated on the features of the European structural and investment funds under the 2014–2020 programming period and inter alia pointed to the application of ex-ante conditionality. Subsequently, *William Sleath,* Director in the Secretariat General at the European Commission, gave a presentation on progress on judicial reform and the fight against corruption and organized crime in the framework of the Cooperation and Verification Mechanism (CVM). He made clear that the rule of law is one of the EU's fundamental pillars and highlighted the high economic costs of corruption as well as the benefits of having an effective judicial system and a predictable legal environment. The CVM has served as a tool to keep up the reform momentum after EU accession with the aim of bringing the two countries reasonably close to EU standards. Sleath explained that progress has been uneven and further steps are needed for concluding the CVM. The discussion that followed focused on the low rate of absorption in the current funding cycle up to now, the possible impact of Brexit on the EU budget as well as the risk of backtracking on reforms.

The third session was chaired by *Julia Wörz,* Head of the Central, Eastern and Southeastern European Analysis Unit at the OeNB's Foreign Research Division. In the first presentation of the session, *Gabor Hunya,* senior economist at The Vienna Institute for International Economic Studies (wiiw), showed that the inward FDI stock as a percentage of GDP is higher in Bulgaria than in Romania, which is partly related to the size of the economies. However, it turns out that the economic importance of FDI in Romania is higher than in Bulgaria, as a larger part of FDI has been directed to the manufacturing sector in the former country, whereas a substantial part has gone into the real estate sector in the latter. After both countries had seen substantial FDI inflows before the global financial crisis, no upward trend could be observed in the last few years, particularly with regard to greenfield investments. The export structure reflects the FDI structure: In Romania, machinery and vehicles have gained a prominent role, while Bulgaria's exports have remained dominated by food, fuel and chemicals. The final presentation was delivered by *Anna Ilyina,* Head of Poland Baltics Division at the IMF's European Department. She focused on emigration and its economic impact in CESEE. She highlighted that emigration reduces labor supply in addition to the effects of adverse demographic trends. Ilyina discussed push and pull factors for emigration and highlighted that emigration from CESEE shows evidence of brain drain. While inflowing remittances tend to promote investment, financial deepening and consumption, they seem to be associated with lower labor force participation in recipient countries (lower incentives to work). While it is obvious that a smaller labor force reduces nominal GDP in net sending countries, Ilyina also stipulated that emigration has a negative impact on GDP per capita. Yet, she also emphasized that migration has a positive economic impact on the EU as a whole. Ilyina finished her presentation by raising a range of policy options for CESEE countries to retain and attract workers and to better utilize remittances and the remaining work force.

Points raised in the discussion that ensued included the appropriateness of focusing on GDP, as also the income of emigrants could or should be taken into account. Yet, liabilities (government debt, pension liabilities) have to be seen against the background of the country's economic strength. Furthermore, the different implications of structural emigration (one-way flow from CESEE) versus cyclical reallocation of labor were discussed. As regards policy options available for net receiving countries it was seen as a paradox that mitigating measures are being discussed in those countries that economically benefit from migration flows within the EU.

Wrapping up the event, *Marion Mühlberger,* senior economist at Deutsche Bank (Risk Research), concluded that the resilience of the two economies has been tested and confirmed by the crisis and that rebalancing has been achieved. Moreover, the short term economic outlook appears encouraging. For the medium term, however, one has to take into account that human capital will remain a constraint on growth, in contrast to other emerging market regions. Yet, in comparison to other emerging economies, Bulgaria and Romania enjoy the advantage of having EU membership as an institutional selling point vis-à-vis foreign investors. Both countries face the challenge of evading the middle income trap, and convergence will very likely continue at a more moderate pace than before the crisis.