

STRUCTURAL FUNDS AS THE SOLUTION A TO THE PRESENT CRISIS: ROMANIA – A CASE STUDY



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Abstract

Numerous economists believe that structural funds provided by the European Union can be the means by which the economy can recover from the present crisis. Popular belief seems to also support this thesis. However, we consider that only economic reasoning can validate such a conclusion and that rational analysis is needed in this sense. By using the monetary theory of the trade cycle, we argue that economic crises consist in misallocations of scarce capital goods, which are triggered by artificial bank credit expansion. Although the EU structural funds represent a way through which additional capital can be attracted into a certain country, there is no a priori reason for which to assume that these new investments can neutralize the effects of the boom-bust cycle. Moreover, a fairly strong case can be made that structural instruments cause supplementary misallocations of factors of production, aggravating and prolonging the present economic downturn. The essence of our argument lies in the fact that European funding will probably be used to supply investment projects which do not respond to the most urgent needs of the consumers. It is only real capital accumulation that can foster economic growth—the much needed remedy for the current economic situation. By using empirical data available from official sources, we will illustrate these theoretical results on the Romanian economy.

Keywords: capital goods, structural funds, structure of production, natural rate of interest, economic crises.

JEL Category: D50, D90, E43, F15, I38

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INTRODUCTION

By taking into account both its amplitude and its intensity, the present economic crisis represents a challenge for national policymakers worldwide. Numerous voices seem to consider that structural funds, provided by the EU, can be a possible solution to jumpstart the economy (European Commission, 2009; Jiletcovici, 2010, p.214-223; Smail, 2010, p. 27-34). We will endeavour to analyse this problem from an economic point of view. Whether the dynamics of business fluctuations can be countered by the redistribution effects of European funding programs is a question that only economic analysis can attempt to answer. A number of steps must be fulfilled before any proper answer can be given. First of all, one must explain economic cycles and their causes. Second, one must have a thorough understanding regarding structural funds, taking into consideration their declared purpose, the criteria on which they are allocated, and the effects that they have on the (real) national economy. The final step that we will attempt is to see whether the economic effects of resource redistribution (which structural funds always imply) can counteract the economic effects created by the boom-bust cycle.

The market is known for the fact that it represents the most efficient way of allocating resources. The job of entrepreneurs is to allocate scarce factors of production to the most urgent needs of the consumers (Mises, 1998). In doing this they rely on market prices, which are necessary in order to calculate the profitability of any investment projects. However, once the possibility of attracting structural funds appears, the allocation of resources is modified. Given the fact that an economic bust necessarily implies a misallocation of scarce factors of production, we will endeavour to determine whether European funds can ameliorate the current situation, worsen it, or have no effect whatsoever.

Our research is primarily qualitative in nature, based on a priori reasoning and verbal logic. However, in order to illustrate some of our points, we will use concrete examples from the

Romanian economy. The empirical data was mainly collected from official sources like the National Institute of Statistics, the National Bank of Romania, the World Bank and the International Monetary Fund.

LITERATURE REVIEW ON ECONOMIC CRISES AND STRUCTURAL FUNDS

Historically, numerous researchers have struggled to explain the major economic phenomena which we know today as business cycles. Any student who would attempt to study the relevant economic literature in this specific area would be bewildered by the multitude of existing theories.

Taking into account the theories supported by various schools of thought, economic crises have different explanations. For example, Schumpeter (1934; 1939) believed that crises are caused by external elements, such as technological innovation. Thus, when a wave of innovation appears, it causes a rise in the levels of profits, investments, and employment opportunities, which can be interpreted as the economic boom. However, as the new entrants on the market adopt and adapt the innovative technologies, profits are gradually diminished. As the market becomes saturated, the competition for credit increases, and technological advance is reduced. In other words, recession sets in, being considered a necessary cost that must be paid for economic progress, until a new wave of innovations appears. Another popular theory regarding economic fluctuations is the one put forward by Jevons (1909), who considered that economic crises are triggered by natural phenomena. In his view, expectations are altered by agricultural fluctuations caused by the weather. These, in turn, alter investment decisions and the business cycle appears. Thus, when weather conditions are favourable, there is a sectorial boom in agriculture, which generates increases and eventual booms in other sectors. The reverse is also true. Due to bad meteorological conditions, the recession felt in agriculture can cause similar situations in other sectors.

Probably the most widespread theory is the one coined by Keynes (1936), who chose the term “animal spirits” to emphasize the importance of the emotions and mind-set of the masses. According to him, in the boom period, investments are made in unstable conditions, prompted by unrealistic expectations. Thus, economic agents will become optimistic during the boom period, and then they will be disappointed when the profits do not rise to their expectations. In other words, we are confronted with a case of “over-optimism” during boom periods, and with “over-pessimism” during recessions. Other explanations of economic fluctuations revolve around the idea of bad economic management, with authors such as Rothbard (2009). They claim that the government’s management of the credit expansion, combined with the support granted to failed enterprises or directed towards maintaining wages above the market value, generates and prolongs economic crises.

However we consider that, in order to be valid, a cycle theory must be perfectly integrated with general economic theory. As Böhm-Bawerk (apud Mises, 2006b, p. 191), a great forgotten economist, usually affirmed: “*A theory of the trade cycle, if it is not to be mere botching, can only be written as the last chapter or the last chapter but one of a treatise dealing with all economic problems*”. The theory to which we are pointing out is none other than the Circulation Credit Theory of the Trade Cycle, also known as the Monetary Theory of the Trade Cycle (Mises, 2006b). This theoretical framework is by no means new, its defining principles being established as early as the age of Lord Overstone¹, although in a somewhat rudimentary and incomplete fashion. Of course, in this article we are interested in the modern form which the Circulation Credit Theory took at the hands of more recent economists (Strigl 1934; Mises, 1998; Mises, 2006b; Hayek, 2008). More and more voices today point out to the fact that trade cycles are triggered by the inflationary money policies that have been

¹ Samuel Jones-Loyd, or Baron Overstone was a leading figure of the British Currency School. He is well-known for his participation in the renowned controversy between the Currency School and the Banking School. See Viner (1965).

pursued by major nations in the last years (De Soto, 2006; Woods, 2009). The only coherent explanation regarding the current economic environment lies in the fact that the banking system, expanding credit way beyond the limit of capital accumulation, caused modifications in the structure of prices which, in turn, determined an expansion in industrial branches which otherwise would not have been considered profitable. Capital goods were in this way misallocated, squandering scarce factors of production².

Alternatively, the literature on structural funds, offers a large amount of different views and opinions. The conclusions reached by studies referring to the efficiency of structural funds can be divided into three main categories. First of all we have studies that identified *a positive effect on regional development and economic growth*. For example, Cappelen et al. (2003, p. 621-644) reached such a conclusion through an econometric analysis using the dispersion of GDP per capita in the EU between 1980 and 1997, as well as the regional standard deviation for Europe as a whole and for specific regions. The second category is represented by studies that correlate the positive effect with institutional and other types of conditions that should exist at regional and local level. Such a study was elaborated by Ederveen et al. (2006, p. 17-42) through the analysis of a panel data set that covers 13 countries, from 1960 to 1995, using three evaluation methods such as model simulation, case studies, econometric evaluation, and the study of macroeconomic trends. A similar conclusion was reached by Bachtler and Gorzelak (2007, p. 309-326). The third category is represented by studies that indicate that there is no correlation or even a negative relation between the rate of absorption of structural funds and regional development (ECORYS, 2006). For example, Basile et al. (2002) based their study on a sample of 119 EU regions, over the 1975 and 1998 period, while

²When we state that resources are wasted we refer to the fact that they were not employed in the production of goods that consumers desire most urgently. If resources are allocated according to hierocratic criteria, we have no way of determining whether such investments were profitable or not (Mises, 1920), except by comparing their results with similar ones which develop on the market.

Boldrin and Canova (2001, p.205-253) concentrated on the study of overall regional macroeconomic data. Of course, what we are interested to see is whether an eventual positive effect generated by the absorption of European funds can compensate for the relative loss of wealth determined by economic crises.

What most authors seem to agree on is that there is a lack of empirical evidence and statistical data to allow a comprehensive econometrical analysis that can clearly assess the efficiency of structural funds. Thus, it is very difficult to statistically quantify the qualitative aspects related to the impact of European funding programs, especially because one would have to gauge the development rates of European regions that would have been in the absence of redistribution (Boldrin and Canova, 2001, p.205-253; Sapir, 2003; Baldwin and Wyplosz, 2004). This is the main reason for which we will employ mainly qualitative analyses, based on general economic principles.

THE CRISIS EXPLAINED

When discussing economic fluctuations, in order to analyse recession periods, the most widely used indicator is real GDP growth. A country is considered to be in recession after two consecutive semesters in which a negative real GDP growth rate is registered, while two consecutive semesters of positive real GDP growth signal the end of the recessionary period. However, the use of this indicator and of these established periods seems arbitrary and can have serious shortcomings. GDP is calculated as the market value of all *final* goods and services produced or provided within a country at a given moment in time. It does not include the value of intermediary goods, i.e. gross savings/investments, which represent a great part of a country's wealth (De Soto, 2010)³. Furthermore, a country's GDP does not reflect

³ To be more specific, we could use F.W. Taussig's wording and state that *intermediate products* represent a country's *inchoate* wealth, i.e. economic goods that will only fully mature in the future.

the evolution of non-monetary and black markets, which also have an impact on the welfare of the people. This means that even though a country might be deemed as having exited the recession, the positive effects might not be felt by the population.

Thus, in order to fully understand business fluctuations, one needs to be familiar with macroeconomic capital theory. This branch of political economy has a long tradition in economic thought, having its origin in the works of two great economists, namely Carl Menger (2007) and Eugen von Böhm-Bawerk (1930). The former was responsible for introducing the concept of economic goods based on subjective value, while the latter explained the phenomenon of interest as determined by people's time preference. Böhm-Bawerk (1930) also developed one of the first and most comprehensive capital theories from a macroeconomic point of view. However, it was up to his disciples (Strigl, 1934; Mises, 1953; Hayek, 2008) to correlate his works on capital with business fluctuations. We will briefly explain this particular cycle theory, which we consider correct from an economy point of view.

One of the main economic propositions which is linked in economic thought to Böhm-Bawerk's name (1930, p. 301) is that longer production processes are necessarily more productive than shorter ones. Of course, this is a *ceteris paribus* assumption which excludes human error and which refers to the fact that acting individuals will choose to pursue a more time consuming method of production only if it offers a superior result. Thus, a general implication stemming from this principle is that the only⁴ way in which a society can increase output--i.e. boost economic growth—is by increasing the “roundaboutness” of its methods of production. The increase in the number of causal stages of production, using more and more complicated and specialised capital goods, leads to an increase in future income. However, there is a limit to any temporal increase in the methods of production, and that is the stock of accumulated capital that is needed to satisfy the desires of

⁴ Apart from technological innovations and a possible increase in the division of labor. However, our thesis is commonly considered valid in general equilibrium, were the latter two factors are excluded.

consumers until the final product is brought to the market. This necessary capital was first denominated by Ricardo as the “*subsistence fund*” (Taussig, 1896). It was also commonly called *wage fund* (Taussig, 1896) or *free capital* (Strigl, 1934), and it represents a stock of finished goods which support consumption until the new products are sold on the market. Thus, a society cannot lengthen its structure of production more than its accumulated capital permits it.

In a market economy, entrepreneurs are the ones responsible for allocating scarce factors of production. They decide what, how, and when to produce (Mises, 1998). But they do not do this unilaterally, i.e. according to their whimsical will. They tailor production according to the preferences of consumers, which are transmitted through prices. Prices transfer relevant information from producers to consumers and are signals upon which entrepreneurs act (Hayek, 1945). This somewhat lengthy introduction was necessary in order to briefly set forth the business cycle theory. As we previously mentioned, it is the entrepreneurs who decide the length of the production processes based on market prices. But this decision, more than any other, is based on a specific market price, and that is the *rate of interest*. If the rate of interest is low enough, additional investment projects (especially capital intensive ones which require a longer time period to mature) become attractive for businessmen. The opposite is also true. If the interest rate on the market is high, this signals entrepreneurs that capital is scarce and that only the most profitable investment projects will be undertaken. The resources saved are simply insufficient to increase the capital structure.

However, this situation is considerably modified in a fractional reserve banking system, given the fact that banks can expand credit beyond the limit set by capital accumulation (De Soto, 2006)⁵. This can only be done if the market interest rate,

⁵ It is a well-known fact that in a fractional reserve banking system, banks can create commercial bank money on top of the money introduced by the central bank (Mankiw, 2008; Wells and Krugman, 2012).

manipulated by the banking system, is lowered below the equilibrium rate of interest (Strigl, 1934; Mises, 2006b)⁶. Whenever this phenomenon occurs, entrepreneurs begin to invest in longer production processes, which now appear to be profitable. However, the available resources which were previously saved are not sufficient in order to complete the new processes. In order to avoid full immobilization of capital, banks will be forced sooner or later to increase the interest rate (Strigl, 1934; Mises, 2006b; Hayek, 2008). Business calculation will reveal at a later date that these investments were erroneous and that they must be liquidated. Bankruptcies and unemployment, probably the most feared economic phenomena, will follow.

In nuce, the business cycle theory states that an artificial increase in credit accommodated through a lowering of the market rate of interest below the natural rate of interest⁷ will generate an economic period characterised by the illusion of prosperity, in which scarce factors of production are invested in suboptimal projects. This is known in popular language as the ‘boom period’. Whenever banks, persuaded by the scarcity of capital, are forced to increase the rate of interest the ‘bust phase’ of the business cycle steps in. Investment projects, scrutinized according to the new data on the market, reveal themselves to be ‘malinvestments’ and must be liquidated. Now that we have explained the cause of economic crises, we can analyse the effect of structural funds on the economy, and see whether they can be used to counteract the negative aspects associated with economic depressions.

⁶ We know that the market process tends to equalize the supply of credit with the demand for credit. The interest rate would rise to such an extent that all the available capital on the market would be distributed to the most efficient investment projects. Thus, the only way in which additional credit could be injected is at a lower interest rate.

⁷ The natural interest rate is the rate achieved in final equilibrium.

STRUCTURAL FUNDS AND THEIR IMPACT ON ECONOMIC GROWTH

The foundation for the Cohesion Policy and its corresponding structural funds lies in the theoretical approach regarding agglomeration forces, which states that entrepreneurs will tend to concentrate their productive facilities in regions that are close to large markets, their suppliers, and where they register high returns to scale (Baldwin and Wyplosz, 2004). In other words, in their attempt to benefit from reduced transportation costs, businesses tend to form clusters. Given the fact that this is a phenomenon which occurs as a consequence of the decision entrepreneurs take with regard to the location of their production facilities, one can easily conclude that such a formation of clusters is a consequence of the free market.

This tendency, however, leaves poorer regions at a disadvantage, as it is stated in the Delors Report (1989, p. 18): *“Transport costs and economies of scale would tend to favour a shift in economic activity away from less developed regions, especially if they were at the periphery of the Community, to the highly developed areas at its centre. The economic and monetary union would have to encourage and guide structural adjustment which would help poorer regions to catch up with the wealthier ones”*. What the authors of the Delors Report probably mean by this is that the European Union should take on a more active role in redistributive policies at a supranational level, with the sole intent of modifying the decisions taken by entrepreneurs with regard to the location of their businesses. More precisely, they are advocating for the offering of large financing to poorer regions, so that this would make them seem more attractive for businesses. The question, however, is a bit more complicated: do such large monetary transfers stimulate economic growth, be it at regional or national level, or do they represent another case of resource misallocation?

At a theoretical level, this issue can be looked upon from more than one perspective. According to some authors (Martin, 1997; ECORYS, 2006), investments made in large infrastructure projects could stimulate economic growth by increasing consumption on one

side, and by attracting other types of economic activities and thus increasing trade on the other. However, two questions that one should always keep in mind when analysing these investments are: 1) where do the funds come from, and 2) how are the projects decided upon and implemented?

The answer to the first question related to structural funds is that the money comes from the EU budget, which is mainly financed by the contributions of the member states⁸. Furthermore, an important aspect is the fact that member states pay these contributions from the state budget, which means that they are ultimately paid by European taxpayers. The entire redistribution process inherently involves a bureaucratic system, which can be affected by corruption. In this case it is highly probable that the redistributive process may end up being more expensive and wasteful of taxpayers' money than simply offering an equivalent national subsidy. In order to see if a country can use structural funds for economic recovery, one must first see whether that country is a net contributor or a net beneficiary. Upon a closer inspection, this issue is more complex than expected. The term "European funds" encompasses five types of funds meant to help implement the Europe 2020 Strategy, respectively: the European Regional Development Fund (ERDF), the European Social Fund (ESF), the Cohesion Fund (CF), the European Agricultural Fund for Rural Development (EAFRD), and the European Maritime and Fisheries Fund (EMFF). Out of these, the ERDF and ESF form the Structural Funds. As it can easily be observed, these funds cover a wide variety of financing areas, with possibilities ranging from rural development to social infrastructure and SME support.

⁸ According to official documents (European Commission, 2012, http://ec.europa.eu/budget/explained/budg_system/financing/fin_en.cfm) the EU budget comprises four revenue sources: traditional own resources (mainly import duties), VAT based own resources, GNI based own resources (meaning the contributions of the member states—this is currently the largest revenue source), and other revenue sources (such as interest on deposits, payments from non-EU organizations, etc.).

If a country pays more than it receives from the EU, the answer is clear. However, from a political point of view things are not as straightforward as they seem at a first glance. Throughout the history of the Cohesion Policy, states have used their access to structural funds as a bargaining chip in negotiations related to other types of funding that are more accessible, such as those from the Common Agricultural Policy. So even though a member state might not attract financing through Structural Funds larger than its contribution to the EU budget, this might be compensated by other types of benefits.

The second question is less complex: these projects are usually elaborated in accordance with national development strategies, and have to comply with the rules, regulations, and objectives set at EU level. In other words, this type of funding comes with strings attached—only certain types of investments are taken into consideration and the projects are usually written and implemented by public authorities⁹. Thus, the quantity of resources attracted in the implementation of these projects is decided by bureaucrats, not by entrepreneurs in accordance with consumer preferences. In other words, their impact on economic growth might not be the one that the European officials are expecting, since we are talking about a suboptimal allocation of resources through large projects which are not market-oriented. Economists (Krugman and Obstfeld, 2006) consider that the only way to foster growth is through trade (a principle on which, at least theoretically, the EU was founded). Thus, individual initiatives and businesses should take precedence, and resources should be allocated through the mechanism of the market. This would result in an optimal allocation, which would, in turn, foster economic growth. From this point of view, structural funds distort the market by reallocating resources towards projects that will not satisfy the most urgent needs of consumers.

⁹ There are exceptions, but they usually refer to small projects. All large infrastructure projects, such as road works, the development of waste management, or water supply systems are implemented by local, regional, or national authorities.

However, empirical studies have been written over the years, often reaching conclusions that are complete opposites of each other. They only serve to prove that the available statistical data is not sufficient to create a comprehensive econometrical model that would include all the variables related to economic growth and development¹⁰. For example, Cappelen et al. (2003, p. 621-644) offered empirical evidence that supports the idea that the financing offered through structural funds had a significant positive effect on economic growth at regional levels, especially after 1989. In other words, after the 1988 Cohesion Policy reform, when larger budgetary allocations were established in order to boost the economic growth of less developed regions, there were signs that the economy benefited from these large monetary inflows. Alternatively, Rodriguez-Pose and Fratesi (as cited in Bachtler and Gorzelak, 2007, p.309-326) reached the conclusion that the only structural funds that have a positive effect are those directed towards projects for education and human resources. They consider that in the long run, poorly made investments made possible with the aid of structural funds can affect the competitiveness of the receiving regions. However, some economists (Krugman, 1994, p. 28-44) have contested the concept of competitiveness, and until further data becomes available, we are relatively unsure whether competitiveness refers to economic efficiency or not.

Furthermore, a report written for the European Commission by ECORYS (2006) identified certain negative economic effects, as well as the fact that EU funds contribute only marginally to the reduction in inequalities between the income levels of different regions. A similar conclusion was presented by Boldrin and Canova (2001, p.205-253), who stated that structural funds and the Cohesion Policy had, at best, a minimum impact on inequality levels, and no impact on economic growth rates. Midelfart-Knarvik and Overman (2002, p.321-359) reached the conclusion that Structural Funds have indeed influenced the localization

¹⁰ For an extended explanation on the difference between economic growth and development (i.e. the so-called "process of civilization") see Pătruți and Topan (2012, pp. 45-56).

process of R&D industries. They agree on the fact that structural funds distort the allocation of resources stating that: “*The direct impact of SF expenditure are counter to economic determinants, thereby possibly impeding an efficient allocation of resources. EU expenditures appear to be more distortionary than state aid*”. Furthermore, they draw attention upon the high probability that this distortion of the R&D localisation process might have affected the comparative advantage of less developed regions.

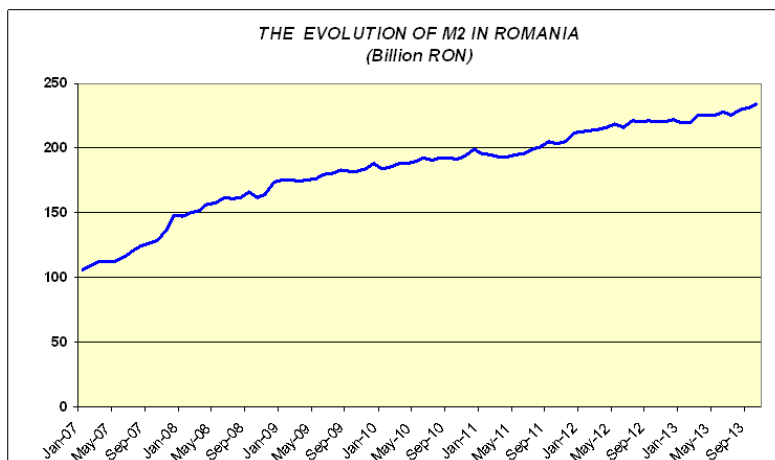
ANALYSING THE ROMANIAN ECONOMY: CAN STRUCTURAL FUNDS BE A REMEDY FOR THE PRESENT CRISIS?

As we have seen above, the literature on structural funds does not offer a straightforward answer regarding the nature of their economic impact. As economists, we are more concerned with efficiency than political goals. The available statistical data is at best insufficient, and at worst incapable of serving as a basis for answering our main research question. This is why we consider that qualitative analysis is the optimal tool to reach our goal, i.e. to see whether attracting European funds can solve the problems caused by business fluctuations. We have chosen Romania as an example for this case study, since it is one of the newest member states of the EU, and has benefited from an entire programming period from Structural Funds. This somewhat implies that the impact of these funds on the Romanian economy should be easier to observe than in the case of older member states.

We have described above economic cycles as phenomena determined by artificial credit expansion. In Romania, the empirical evidence speaks for itself. It is easy to observe from Figure 1 below that there was a continual increase in the money supply¹¹ since Romania’s accession to the EU. M2 increased from somewhere around 100 billion RON in 2007 to approximately 232 billion RON

¹¹ M2 is usually referred to as the *intermediary money mass*, as it is mainly composed of base currency, demand deposits, and small time deposits (BNR, 2014 - <http://www.bnro.ro/Indicatori-de-politica-monetara-1744.aspx>).

at the end of 2013. In seven years' time Romania's money supply more than doubled. It is clear that such an evolution cannot be without consequences for the business sector.

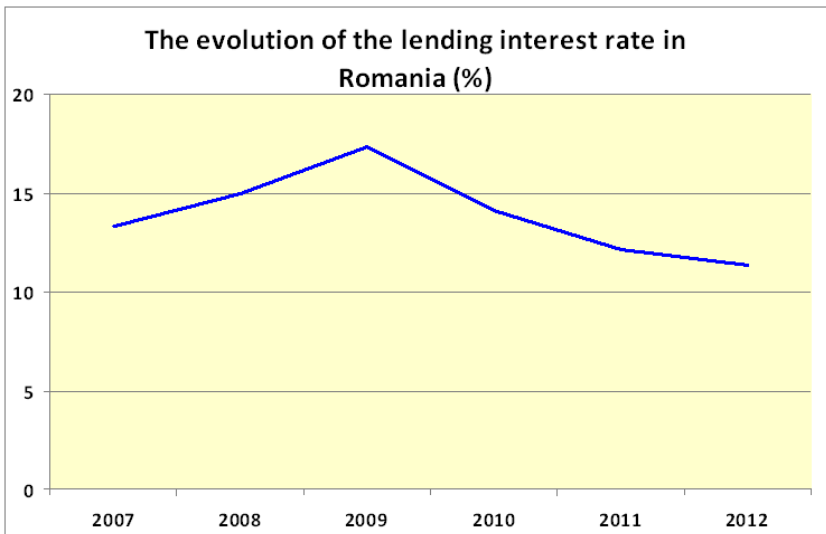
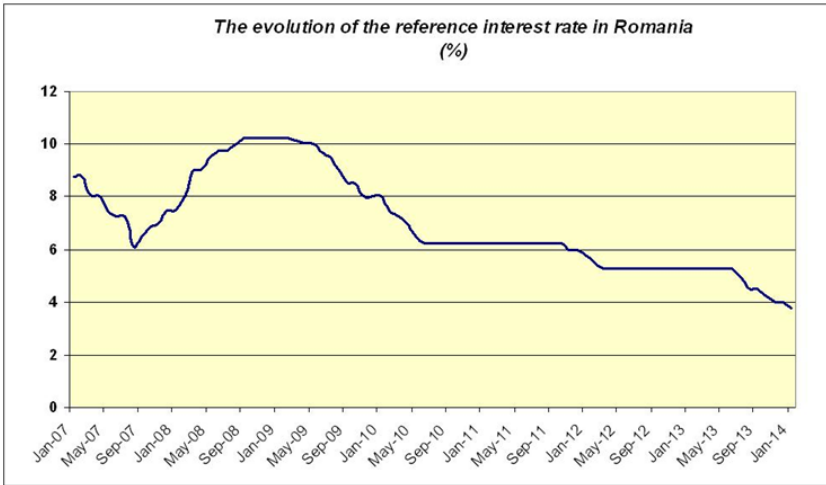


Source: Data from the National Bank of Romania, authors' illustration

Figure 1: The evolution of M2 in Romania, between January 2007 and September 2013

Now, inflation by itself cannot generate business cycles. The main problem is that because of low interest rates resources are caught up in suboptimal investment projects. Economic cycle theory (Strigl, 1934; Mises, 1998; De Soto, 2006; Hayek, 2008) informs us that an artificially lowering of the interest rate sets in motion the boom phase, while an increase in the interest rate (generated by a shortage of real capital) signals the beginning of the economic bust. Figure 2 shows two key indicators for the Romanian economy: the reference interest rate and respectively the lending interest rate¹².

¹² The lending interest rate represents the rate at which private banks generally offer short and medium-term credits (The World Bank, 2014, <http://data.worldbank.org/indicator/FR.INR.LEND>).



Source: Data from the National Bank of Romania and The World Bank, authors' illustration.

Figure 2: Interest rates evolution in Romania, 2007 to 2013

It is extremely interesting to study these two trendlines. With the help of Figure 2, we can see that from the second half of 2007 until 2009, the central bank was forced by inflationary pressures to limit credit expansion by increasing the reference rate of interest. The private banking sector responded to this stimulus, increasing credit interest rates from 2007 until 2009. The numbers are not so impressive until we compare them to Romania's economic growth over the same period. If we consult Table 1, we can clearly observe that 2009 and 2010 were the two years which were hardest hit by the economic downturn. The increase in the rate of interest reveals the fact that resources were badly allocated (on account of the inflationary boom), and the economy decreased at a rate of 6.6 and respectively 1.1 percent annually.

Table 1: GDP growth rates in Romania, 2007 to 2013

<i>Year</i>	<i>GDP based on PPP (billions USD)</i>	<i>GDP Growth (percentage)</i>
2007	246.750	+6.3
2008	270.056	+7.3
2009	254.240	-6.6
2010	254.361	-1.1
2011	264.953	+2.2
2012	271.441	+0.7
2013 (IMF estimate)	280.658	+2

Source: Data from the International Monetary Fund, author's illustration

Given the fact that capital goods are mostly non-specific, to use Friedrich von Wieser's terminology (Hayek, 2008), once invested in a definite project they cannot be reconverted without cost. Thus, the main problem which an economic crisis raises is that factors of production are misallocated¹³. The question we are

¹³ This also means that they cannot be easily put to other uses.

putting forward is whether structural funds can compensate for this misallocation. Before answering this, one must fully understand the nature of the European funding programmes. Structural funds are redistributive instruments, i.e. resources are taken away from donor countries and handed over to recipient countries. Thus, structural funds can benefit only the countries on the receiving end. It is true that if a nation receives European funds, the situation is similar to receiving a capital infusion from abroad. At least theoretically, it can now import factors of production which can cover for the national factors which were caught up in suboptimal investments because of the economic crises.

If we want to apply our analysis to Romania's case, we have to enquire first of all whether it is a net receiver or a net contributor to the EU. If the payments towards the EU exceeded the sums received in the course of the implementation of the European funding programs, it is clear that there can be no hope to jumpstart the Romanian economy based on structural funds. Unfortunately, the empirical data are far from being well organised and transparent. According to a declaration from the Romanian Ministry of European Funds (Ministry of European Funds, 2013), the absorption rate of structural funds had reached 33.47 percent, while the total payments from the EU, through structural funds (and the Cohesion Fund), were around 5.09 billion euro. Summing up the data available from the European Commission with regard to the Financial Programming and Budget, we reached the conclusion that, up to 2012, Romania's contribution to the EU budget was around 6.65 billion euro. Thus, based on our calculations up to 2012 Romania was a net contributor country with regard to structural funds¹⁴.

However, in order to thoroughly refute an argument, one must choose to use its most "powerful" form. Let us presume that Romania *would be* a net recipient of structural funds. Could these

¹⁴ If we take into consideration the payments made to the agricultural sector, which have no relevance in terms of economic development, the situation might change.

additional resources help the economy recover from the present crisis? Such an enquiry can only be answered on a theoretical level. In our opinion, it all comes down to efficiency. Will the attracted European funds be invested in efficient, market-oriented projects, or will they be dedicated to misguided undertakings selected on bureaucratic criteria? It is a well-known fact that bureaucracies are inherently inefficient (Mises, 2006a) and that European funding programmes are bureaucratic in nature. Their main goals are not economic and we have no reason to assume that the surplus capital they attract into a certain country will be allocated in an optimal way, as compared to consumer desires. Thus, even though structural funds can theoretically bring additional factors of production into the country, they will probably be used in a manner that will not boost national productivity.

But this does not mean that European funding programs will have no effect whatsoever on national economic recovery. On the contrary, it is possible that a large quantity of funds will aggravate the economic crisis. We have argued that business fluctuations cause misallocation of resources, which are caught in suboptimal investment projects. But structural funds specifically target suboptimal investment projects, i.e. projects which in the absence of special aid programs would have never been undertaken (Sapir, 2003). If the factors of production necessary in order to undertake these projects would all be imported, the country's future prosperity would possibly not be affected. But other national factors of production are always attracted and caught up in these suboptimal investments. The most basic example is labour. National labour is always necessary in order to implement projects financed through structural funds. Numerous skilled workers are attracted from efficient market-oriented sectors and relocated towards sectors financed by structural funds. National productivity will thus decline¹⁵ and resources will be allocated according to non-economic (bureaucratic) criteria.

¹⁵ We refer here to a decrease in relative terms, and not in absolute terms.

The situation regarding capital goods is in no way different. Will the tools and equipment bought with the aid of European funds be allocated towards the people that need them most urgently and have the skills to use them? It is highly unlikely to be the case here. Once profit and loss accounting is no longer the yardstick for buying and employing capital goods, efficiency is taken out of the picture. There are numerous cases presented in the mass-media which illustrate the lack of efficiency of some major projects that were funded in Romania through structural funds. A simple Google search can render several examples¹⁶, but such an endeavour would be unnecessary. We consider that the issue we have stressed is relatively clear: structural funds cause a redistribution of resources that is not oriented towards satisfying the most urgent needs of consumers.

CONCLUSION

After briefly explaining the causes of the current economic crisis, we endeavoured to show whether structural funds can be a solution to “jumpstart” the economy and provide healthy economic growth. In doing so, we’ve used Romania’s example as empirical support.

If economic fluctuations are caused by monetary expansions which lead to resource misallocations, the only way in which redistributive instruments can have a positive effect on national development is by attracting capital from abroad. However, even if a certain state is a net recipient of European funds, the investment projects which they will pay for will be chosen

¹⁶ The examples range from a football field built on the slope of a hill, in the Bihor county (Petrovici, 2012, <http://www.evz.ro/detalii/stiri/exclusiv-povestea-reala-a-celui-mai-celebru-teren-de-fotbal-din-romania-un-caz-ca-la-rad-1015291.html>), to a homeless centre that has no beneficiaries, in the Suceava county (Zară, 2013, http://adevarul.ro/locale/suceava/fonduri-europene-1_52427f61c7b855ff56c1b870/index.html).

according to bureaucratic criteria, and not according to profit and loss calculations. Because political goals will substitute efficiency as the main criteria for investment, resources will be allocated in a suboptimal fashion. Moreover, we have strong reasons to believe that structural funds cause additional capital misallocation, by attracting and blocking national factors of production in inefficient business projects, thus decreasing national productivity. If this is the case, European funding programs can slow down recovery by prolonging the period in which capital is tied up in suboptimal investments.

Our analysis concerning the Romanian economy leads us towards a conclusion that some would consider discouraging. Since Romania's accession to the EU, it has been a donor country rather than a net receiver. On a real basis, resources were attracted from the national economy towards Brussels and redistributed. However, even if Romania would be a net receiver of structural funds, there are strong theoretical arguments which show that the capital attracted from abroad will be caught up in inefficient and unwisely chosen investment projects. It is our belief that only local capital accumulation can lead to healthy economic growth in the future.

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