ASSESSING THE LIMITS OF EU TRANSFERS: WHY EU FUNDS DON'T FIX ROMANIA'S BUDGET DEFICIT

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Abstract
This paper investigates the relationship between European Union (EU) funds and Romania's general government budget deficit over the period 2009–2023. Using annual budget execution data and macroeconomic indicators such as real GDP growth and inflation, we employ a series of linear regression models to explore whether EU funding inflows have a measurable impact on fiscal balance. While initial results indicated a marginal association when controlling only for COVID-19 crisis years, the inclusion of GDP growth and inflation in the final model reduced the statistical significance of EU funds. The findings suggest that Romania's budget deficit is more closely associated with domestic economic performance—particularly real GDP growth—and with exogenous shocks such as the 2020 pandemic, rather than with the direct volume of EU financial inflows. The results imply that EU funds, although substantial in scale, cannot be used as a justification for fiscal imbalances. Policy implications stress the need for better integration of EU support into long-term fiscal strategy rather than treating it as an automatic stabilizer.

Keywords*: European Union Funds; Budget Deficit; Fiscal Policy; Economic Growth; Regression Analysis; Public Finance;*

1.Introduction

The European Union's Cohesion Policy is a primary mechanism aimed at fostering economic growth, promoting development, achieving convergence, and reducing territorial disparities among its Member States. The main instrument for implementing this policy is the European Structural and Investment Funds (ESIF), which provide significant financial support to Member States through structural instruments. For many EU members, these funds represent a substantial source of financial investment, accounting for up to 70% of total investment (Sousa et al, 2021).

Romania became a member of the European Union in 2007. Since its accession, a considerable volume of EU funds has been made available to various beneficiaries within the country, including rural municipalities (Martin et al, 2023). The study of the impacts of ESIF on economic growth and development has garnered increasing attention, with a notable concentration of research focusing on Central and Eastern European (CEE) countries, especially Romania. Research themes related to EU funds include their impact on regional development and socio-economic growth, the functioning of EU cohesion policy, smart specialisation platforms, institutional capacity to absorb funds, and rural and sustainable development (Sousa et al, 2021).

Within this context, the purpose of this study is to analyze the relationship between the European Union funds received by Romania and the national budget deficit. The analysis covers the period from 2009 to 2023, incorporating data that may extend to 2024.

Understanding the impact of EU funds on national fiscal balances, specifically the budget deficit, is crucial, particularly given the significant amounts transferred and the ongoing debate in the literature regarding the overall effectiveness of Structural and Cohesion Funds. While some studies suggest positive effects, others identify conditional positive effects or even negative effects (Bostan et al, 2022). Fiscal policy, which includes government expenditures potentially influenced by EU funding, plays an important role in shaping the investment environment. This study contributes to the understanding of the fiscal implications of EU funds absorption in Romania.

2. Theoretical Framework and Literature Review

Fiscal policy is a fundamental tool used by governments to influence economic performance, primarily through adjustments to public revenues and expenditures (Dobrota 2024). For member states of the European Union, particularly those with emerging economies like Romania, understanding the interplay between national fiscal management and significant external financial flows, such as those from the EU, is crucial (Surubaru 2020). The general government budget deficit, representing the difference between total government revenue and total government expenditure (Law no. 500/2002), is a key indicator of fiscal health and sustainability (Dobrota 2024).

The European Structural and Investment Funds (ESIF) represent the main instrument of European Cohesion Policy, aimed at sustaining territorial development and reducing regional disparities within the EU (Sousa 2021). These funds constitute substantial financial resources allocated to member states, with a significant portion directed towards Central and Eastern European (CEE) countries, including Romania, which have been net beneficiaries of EU funding since accession (Sousa 2021); Surubaru 2020; Batory 2020. Romania, for example, was allocated almost €23 billion in ESI Funds for the 2014–2020 period (Batory 2020).

The academic literature has extensively explored the impact of EU Cohesion Policy and ESIF on economic growth, regional development, and convergence in EU member states (Sousa 2021); Batory 2020; Surubaru 2020; Bostan et al. 2022. Studies utilizing bibliometric analysis, such as that by Sousa (2021), confirm the significant and growing academic interest in the effects of ESIF, highlighting key research themes like competitiveness, innovation, sustainable development, and the economic impact of global crises (Sousa 2021). These studies often focus on CEE countries, including Romania, due to the concentration of empirical applications in these regions (Sousa 2021).

Research specifically concerning Romania has frequently addressed the absorption capacity of EU funds and the associated challenges (Marcu et al. 2020); Lucian 2014; Bostan et al. 2022; Surubaru 2020; Marin et al. 2023. Administrative capacity, institutional frameworks, strategic planning, and coordination between national and local institutions have been identified as critical factors influencing absorption rates (Marcu et al. 2020); Marin et al. 2023; Bostan et al. 2022. While Romania has shown progress in absorption capacity over time, deficiencies remain (Marcu et al. 2020). Spatial analyses reveal significant differences in EU fund absorption across Romania's regions and rural municipalities, influenced by factors like fiscal capacity, population dynamics, and prior funding experience (Marin et al. 2023).

The economic impact of EU funds in Romania and other CEE countries has yielded mixed results in the literature, with some studies finding positive effects on GDP growth and convergence while others are more cautious or identify conditional effects (Surubaru 2020); Bostan et al. 2022. Policy models often forecast positive GDP contributions, whereas independent academic assessments may provide lower estimates (Surubaru 2020). Furthermore, studies suggest that EU funds may have served as a buffer against the effects of economic crises (Surubaru 2020). EU funds also play a role in financing specific sectors like Research and Development, although convergence with EU targets in this area remains a challenge for countries like Romania (Dul'ová Spišáková et al. 2021).

From a fiscal perspective, EU funds enter the national budget primarily as revenue but also often require national co-financing, representing an expenditure (Surubaru 2020); Bostan et al. 2022. They are intended to finance specific investments (Bostan et al. 2022), which can theoretically stimulate broader economic activity (Dobrota 2024); Bostan et al. 2022. However, the direct, year-to-year relationship between these fund inflows and the overall general government budget deficit in Romania is a complex dynamic, potentially mediated by various factors. While the literature examines EU fund absorption and economic growth impacts, a focused analysis on how

the volume of EU fund inflows directly influences the annual budget deficit, especially when controlling for significant macroeconomic variables such as Real GDP Growth and inflation, and exogenous shocks like the 2020 pandemic, appears to be a less explored area. Understanding this specific relationship is vital for informing fiscal strategy and ensuring that EU support is integrated into long-term planning rather than being perceived as an automatic stabilizer for fiscal imbalances.

3. Data and Methodology

3.1 Data Sources and Variables

This study investigates the relationship between European Union (EU) funds received by Romania and the national budget deficit, controlling for key macroeconomic factors. The analysis covers the period 2009 to 2023, for which consistent annual data was available.

The primary data for EU funds and budget deficit (components: Total Revenue and Total Expenditure) were extracted from the official Romanian Consolidated General Budget execution reports, as compiled from publicly available records of the Ministry of Finance. Real Gross Domestic Product (GDP) growth rates and Consumer Price Index (CPI) inflation rates were sourced from the World Bank's datasets.

The following key variables were constructed and utilized, with all monetary values expressed as a percentage of the nominal GDP for the respective year:

- Deficit (% GDP): The consolidated general government budget deficit, calculated as Total Revenue (% GDP) minus Total Expenditure (% GDP). A negative value indicates a deficit.
- EU Funds (% GDP): Total EU funds received by Romania, as itemized under relevant revenue lines in the consolidated budget reports. This includes standard EU payments, pre-financing, funds from specific operational programs, amounts related to the 2014-2020 Multiannual Financial Framework (MFF), and revenues from the Recovery and Resilience Facility (RRF/PNRR) where explicitly listed.
- GDP Growth (%): The annual real Gross Domestic Product growth rate for Romania.[i]
- Inflation (%): The annual average Consumer Price Index (CPI) inflation rate for Romania.

To account for significant economic shocks that demonstrated exceptional impacts on the fiscal balance, the following dummy variables were created and tested:

- D2009, D2010: Initially considered to capture the effects of the Global Financial Crisis and subsequent recession.
- D2020, D2021: Set to 1 for the years 2020 and 2021 respectively, and 0 otherwise, to capture the unique impact of the COVID-19 pandemic and the initial rebound phase. The final model specification retained D2020 and D2021.

The final dataset used for the presented regression analysis consists of 15 annual observations from 2009 to 2023.

3.2 Methodology: Model Specification and Estimation

To assess the relationship between EU funds and the budget deficit, this study employs Ordinary Least Squares (OLS) regression analysis. The model specification was developed iteratively[ii].

Initially, a simple bivariate model was estimated:

(Model 1)

$$Deficit\_t = \beta_0 + \beta_1 * EU\_Funds\_t + \varepsilon\_t$$

Recognizing the potential influence of major economic crises, dummy variables for crisis years were introduced. A model incorporating dummies for 2020 and 2021 was specified as:

(Model 2)

$$Deficit\_t = \beta_0 + \beta_1 * EU\_Funds\_t + \beta_2 * D2020\_t + \beta_3 * D2021\_t + \varepsilon\_t$$

To further refine the analysis and control for fundamental macroeconomic drivers of the budget deficit, Real GDP Growth (%) and Inflation (%) were added as control variables. This led to the final preferred model specification:

(Model 3 - Final)

$$Deficit\,t = \beta_0 + \beta_1 * EU\_Funds\_t + \beta_2 * GDP\_Growth\_t + \beta_3 * Inflation\_t + \beta_4 * D2020\_t + \beta_5 * D2021\_t + \varepsilon\_t$$

Where:

- Deficit_t is the Deficit (% GDP) in year t.
- EU_Funds_t is EU Funds (% GDP) in year t.
- GDP_Growth_t is Real GDP Growth (%) in year t.
- Inflation_t is Inflation (%) in year t.
- D2020_t, D2021_t are the dummy variables for the respective years.
- β_0 is the intercept.
- β_1 to β_5 are the coefficients to be estimated.
- ε_t is the error term.

The significance of the estimated coefficients was assessed using p-values, with a conventional threshold of $p < 0.05$. The overall goodness-of-fit was evaluated using R-squared (R^2) and Adjusted R-squared statistics.

This study adopts an exploratory approach. While the inclusion of GDP growth and inflation represents an improvement over simpler models, several limitations are acknowledged. The relatively small sample size (15 annual observations) limits the complexity of the model and the precision of estimates. The potential for omitted variable bias remains, as other fiscal policy variables (e.g., lagged spending, revenue, debt) and structural factors were not included in this parsimonious specification. Furthermore, formal tests for endogeneity and time-series properties (stationarity, autocorrelation) were not conducted within the scope of this analysis. Therefore, the results should be interpreted as indicative of associations within this specific model and dataset, rather than definitive causal claims.

4.Results

The primary dependent variable in this study, the consolidated general government Deficit (% of GDP), exhibited considerable volatility over the 2009-2023 period, as shown in Figure 1.

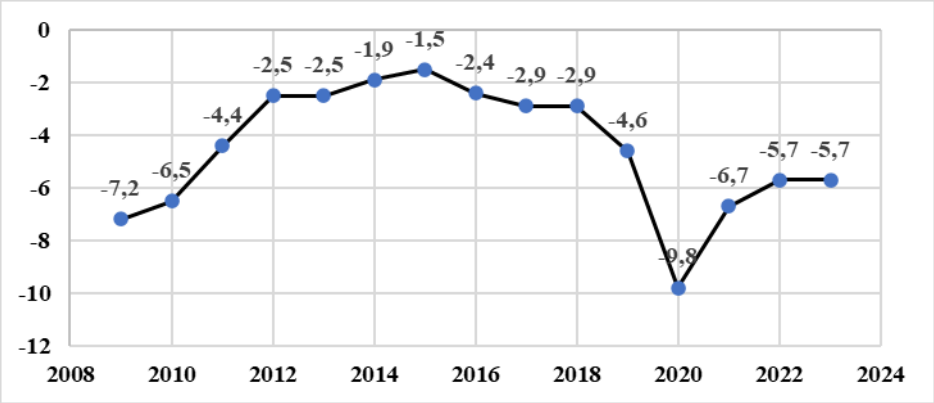

Figure 1: Evolution of Romania's Consolidated General Government Deficit (% of GDP), 2009-2023[iii]

Source: Data from the official Romanian Consolidated General Budget execution reports (Romanian Ministry of Finance)

The visual representation in Figure 1 highlights several distinct phases. The aftermath of the global financial crisis saw large deficits (-7.2% in 2009, -6.5% in 2010), followed by a period of improvement culminating in a deficit of -1.5% in 2015. The deficit then widened in the pre-

pandemic years, with a sharp deterioration to -9.8% in 2020 due to the COVID-19 crisis. The subsequent years, 2022 and 2023, show the deficit stabilizing at -5.7%. Understanding the drivers behind these fluctuations is a key objective of the regression analysis that follows.

4.1 Model Development and Selection

The investigation into the relationship between EU Funds (% GDP) and the Deficit (% GDP) proceeded through several model specifications.

- Model 1 (Bivariate): A simple regression of Deficit on EU Funds yielded a statistically insignificant coefficient for EU Funds ($\beta \approx 0.58$, $p \approx 0.33$) and a very low explanatory power ($R^2 \approx 0.07$). This suggested that EU funds alone are a poor predictor of the deficit.
- Model 2 (EU Funds + Crisis Dummies 2020 & 2021): Introducing dummy variables for the COVID-19 pandemic years (D2020 and D2021) significantly improved the model's fit (Adjusted $R^2 \approx 0.56$). The coefficient for EU Funds diminished in magnitude ($\beta \approx -0.03$) and its p-value increased significantly ($p \approx 0.0$). The D2020 dummy was highly significant, highlighting the exceptional deepening of the deficit in that year.
- Model 3 (Final - EU Funds + GDP Growth + Inflation + Crisis Dummies 2020 & 2021): This model, representing our preferred specification for this exploratory analysis, incorporates key macroeconomic controls. The results are presented in Table 1.

Table no. 1. Regression Results for Deficit (% GDP) - Final Model (2009-2023)

	Coefficients	Standard Error	t Stat	P-value	Lower 95%	Upper 95%
Intercept	-3.48	0.64	-5.39	0.00	-4.94	-2.02
EU Funds (% GDP)	0.30	0.45	0.68	0.51	-0.71	1.31
GDP Growth (%)	0.19	0.11	1.69	0.13	-0.07	0.45
Inflation (%)	-0.33	0.10	-3.30	0.01	-0.56	-0.10
D2020	-5.71	1.69	-3.37	0.01	-9.54	-1.88
D2021	-3.56	1.19	-2.99	0.02	-6.25	-0.87

Regression Statistics	
Multiple R	0.932207357
R Square	0.869010556
Adjusted R Square	0.796238642
Standard Error	1.081771965
Observations	15

Source: Author's own calculations

4.2 Interpretation of Final Model Results (Model 3)

The final model (Table 1) provides the following insights:

- Intercept: The statistically significant intercept of -3.477 suggests that, in the absence of EU funds, GDP growth, inflation, and the specific shocks of 2020-2021, Romania would have an estimated baseline budget deficit of approximately 3.48% of GDP.
- EU Funds (% GDP): The coefficient for EU Funds is +0.302. This implies that a one percentage point increase in EU funds as a share of GDP is associated with a 0.302 percentage point reduction in the budget deficit (i.e., the deficit becomes less negative). However, this effect is not statistically significant ($p = 0.515$), indicating that within this model, a clear, independent impact of EU funds on the aggregate deficit level cannot be reliably discerned from random variation.
- GDP Growth (%): The coefficient for real GDP growth is +0.191. This suggests that a one percentage point increase in GDP growth is associated with a 0.191 percentage point reduction in the budget deficit. This relationship aligns with economic theory, as higher growth typically boosts revenues and

reduces certain expenditures. While the direction is intuitive, the effect is not statistically significant at the conventional 5% level (p = 0.126), though it approaches marginal significance[iv].

- Inflation (%): The coefficient for inflation is -0.334 and is statistically significant (p = 0.009). This indicates that a one percentage point increase in the inflation rate is associated with a 0.334 percentage point worsening (deepening) of the budget deficit. This suggests that, during the analyzed period, inflationary pressures may have contributed to larger fiscal imbalances.
- Crisis Dummies (D2020 and D2021): Both dummy variables are statistically significant[v].
  - The D2020 coefficient of -5.711 (p = 0.008) indicates that the budget deficit in 2020 was approximately 5.71 percentage points deeper than would have been predicted by the levels of EU funds, GDP growth, and inflation in that year, reflecting the severe fiscal impact of the COVID-19 pandemic.
  - The D2021 coefficient of -3.560 (p = 0.015) suggests that the deficit in 2021 also remained significantly deeper (by about 3.56 percentage points) than expected based on the model's core economic variables, indicating persistent fiscal challenges or policy choices during the early recovery phase.

These results underscore that major economic crises have had substantial, distinct negative impacts on Romania's fiscal balance, beyond what could be explained by concurrent EU funds, GDP growth, or inflation levels alone.

5. Discussion and Interpretation

The empirical analysis presented in this study sought to understand the key drivers of Romania's budget deficit between 2009 and 2023, with a particular focus on the role of EU funds. The final regression model, which controlled for real GDP growth, inflation, and the exceptional circumstances of the COVID-19 pandemic years (2020 and 2021), yielded several noteworthy insights.

A central finding is the lack of a statistically significant independent effect of EU funds (as a % of GDP) on the overall budget deficit in the specified model. While the coefficient suggested a tendency for EU funds to improve the fiscal balance (reduce the deficit), this association was not robust enough to be distinguished from chance. This does not imply that EU funds have no economic value or impact; rather, it suggests that their direct, isolable effect on the aggregate year-to-year budget deficit figure, when considered alongside major macroeconomic drivers and shocks, is not statistically prominent in this analysis. The impact of EU funds might be more nuanced, potentially influencing the composition of public spending (e.g., towards investment), substituting for national funding in certain areas, or having longer-term effects on growth potential that are not captured by this short-run model.

Conversely, inflation emerged as a statistically significant factor associated with a worsening of the budget deficit. A one percentage point increase in inflation was linked to an approximate 0.33 percentage point increase in the deficit. This could reflect various mechanisms, such as public expenditures (particularly those indexed or related to rising input costs) increasing more rapidly than revenues during inflationary periods, or inflation being symptomatic of broader economic instability that also pressures public finances.

Real GDP growth showed an economically intuitive association with an improved fiscal balance (a higher growth rate linked to a smaller deficit). Although this relationship did not achieve statistical significance at the strict 5% level in the final model (p=0.126), its direction is consistent with established economic principles where economic expansion typically enhances government revenues and reduces demand for certain social expenditures. The borderline significance warrants caution but does not entirely dismiss the role of growth. It's possible that the strong effects of the crisis dummies or the limited sample size may have influenced the precision of this estimate.

The significant impact of the dummy variables for 2020 and 2021 underscores the profound fiscal disruption caused by the COVID-19 pandemic. Even after accounting for concurrent levels of EU funds, GDP growth, and inflation, the deficits in these years were substantially deeper than

what the model would otherwise predict. This highlights the unprecedented nature of the shock and the scale of fiscal responses implemented.

The overall model demonstrated strong explanatory power, with an Adjusted R-squared of approximately 79.6%, indicating that the included variables collectively account for a large portion of the annual fluctuations in Romania's budget deficit.

Limitations and Avenues for Future Research:

It is important to acknowledge the limitations of this study. The relatively short time series (15 annual observations) restricts the complexity of the econometric models that can be robustly estimated and may impact the statistical power to detect more subtle effects. The parsimonious nature of the final model means that other potentially relevant variables (e.g., lagged fiscal aggregates like government debt or spending, explicit measures of fiscal policy changes, or more detailed breakdowns of EU fund types) were not included, potentially leading to omitted variable bias. Furthermore, this analysis did not formally address potential endogeneity issues or employ advanced time-series techniques that could account for properties like non-stationarity or cointegration.

Future research could build upon these exploratory findings by:

- Extending the time series as more data becomes available.
- Incorporating a broader set of control variables, particularly those related to fiscal policy stance and public debt dynamics.
- Employing more sophisticated econometric methods to address potential endogeneity and time-series characteristics.
- Disaggregating EU funds by type (e.g., structural funds, agricultural funds, RRF) to assess if different categories have differential impacts on the budget or specific components of public finance.
- Investigating the impact of EU funds on the composition of public expenditure and revenue, rather than solely on the aggregate deficit.

In conclusion, this study provides an initial econometric exploration suggesting that while major economic shocks and, to some extent, inflation significantly influenced Romania's budget deficit, a direct, statistically robust link between the aggregate level of EU funds received and the overall deficit was not established in the parsimonious model employed. GDP growth showed an expected ameliorating effect, though its statistical significance was borderline in the final specification.

6. Conclusions and Policy Recommendations

This study set out to investigate whether the inflow of European Union funds into Romania over the period 2009–2023 had a discernible independent impact on the country's general government budget deficit (as a % of GDP). While exploratory models considering only pandemic-related shocks initially suggested a marginally significant relationship where EU funds might improve the fiscal balance, the final econometric specification—which additionally accounted for crucial macroeconomic drivers such as real GDP growth and inflation—revealed no statistically significant independent effect of aggregate EU funds on the annual deficit level.

Instead, the regression results consistently highlight inflation as a statistically significant factor associated with a worsening of the budget deficit. Furthermore, while the coefficient for real GDP growth indicated an expected ameliorating effect on the deficit, its statistical significance was borderline ($p=0.126$) in the final parsimonious model. Critically, major exogenous shocks, particularly the COVID-19 pandemic (as captured by the D2020 and D2021 dummy variables), demonstrated a profound and statistically significant deepening of the deficit, independent of the other economic variables included.

These findings support the argument that while EU funds are undoubtedly a vital component of public investment and contribute to Romania's development, their year-to-year variation (as a % of GDP) does not appear to function as an automatic stabilizer for the aggregate budget deficit, nor can they be seen as a direct substitute for robust domestic fiscal management when other fundamental economic factors and major crises are taken into account. The volatility

observed in Romania's deficit (Figure 4.1) appears more closely linked to underlying economic performance, inflationary pressures, and extraordinary events.

From a policy perspective, these results underscore the importance of embedding EU transfers within a coherent and sustainable national fiscal strategy. Reliance on EU fund inflows should not detract from the imperative of sound domestic budgetary planning, which includes strengthening tax collection efficiency, optimizing public expenditure, and maintaining prudent macroeconomic management, especially to build resilience against crisis periods. The significant impact of inflation on the deficit also points to the need for policies that manage price stability effectively to support fiscal sustainability.

Future research could expand this analysis by incorporating a more extensive set of fiscal control variables, such as government debt dynamics, the structural budget balance, or specific fiscal policy measures. Employing time-series econometric methods to test for lagged effects and address potential endogeneity would further enhance the robustness of the findings. Additionally, a disaggregated analysis by type of EU funds (e.g., Cohesion Policy, CAP, RRF) or by the sector of expenditure could reveal more nuanced impacts that are not apparent at the aggregate level.

[i] *EU Funds were treated as a unified aggregate in this analysis. No disaggregation by type (e.g., ESI Funds, RRF, CAP) was performed, although future research may explore heterogeneous impacts.*

[ii] *OLS is employed due to its interpretability and suitability for small-sample exploratory models. However, standard errors should be interpreted cautiously due to the limited number of observations (n=15)*

[iii] *In this model, the budget deficit is defined as a negative value. Thus, an increase in the deficit variable (i.e., becoming less negative) reflects an improvement in fiscal balance.*

[iv] *Although the coefficient for GDP growth is not statistically significant at the 5% level (p = 0.126), the direction and magnitude are economically consistent with theory. A larger sample may improve its statistical power*

[v] *The dummy variables isolate residual shocks unexplained by GDP growth, inflation, or EU funds. Their large and significant coefficients imply a structural break in fiscal performance during the COVID-19 pandemic.*

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