

COUNTRY RISK FROM ROMANIA AND BULGARIA AFTER UE INTEGRATION

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ABSTRACT: Country risk is a relatively new concept in economical reasoning, that has entered in researchers attention only in 70es. The assessment of country risk by the international financial institutions, has extended in the same time with the increasing of external activities of private commercial banks in course of development.

KEYWORDS: country risk, economic growth, banking system, budget deficit

Most of the human actions present a certain dose of uncertainty and risk, due to the man, and also because of environmental elements.

Country risk is a relatively new concept in economical reasoning, that has entered in researchers attention only in 70es. The assessment of country risk by the international financial institutions, has extended in the same time with the increasing of external activities of private commercial banks in course of development.

The assessment of country risk has as an aim pointing out the difficulties that can occur in paying the bonds by a certain country that comes with its external affairs. Until the 70es, losses because of country risk factors had been neglected, reason for which private banks granted loans way to much over the prudence limit, especially to rich natural resources countries from Latin America. As a consequence, debt crisis from 80es has unbalanced the entire international financial system, causing great losses to external creditors. Then it became obvious that ignoring country risk is a source of uncertainty and risk that can lead to eliminating firms from the market. The only way to reduce the ambiguity is to know very well the economical, political and social external conditions, exactly what is wanted to know with evaluating the country risk.

In the next tab we have a presentation of the assessment of country risk, elaborated with Euromoney method, for Romania and Bulgaria. It contains the period between 1993 – 2005, and the changes in two respectively five years.

Assessment of country risk for Romania and Bulgaria. between 1993 – 2005

Country	1993-2005 (%)	1993-2005 (%)	1995-2000 (%)	2000-2005 (% modified)
BULGARIA	28,65%	8,59%	0,47%	17,92%
ROMANIA	-5,33%	14,68%	-42,50%	43,58%

Romania joined the EU on 01.01.2007, but this accession was coupled with strict supervision in numerous areas. The EU will continue to monitor Romania's progress in meeting these requirements and may invoke so-called safeguard clauses up to three years after accession. The accession treaty provides for safeguard clauses in the areas of economic integration and common market as well as justice and home affairs. Possible sanctions in this respect are export barriers for foodstuffs and a reduction in EU structural and agricultural funds. In addition, transition periods have been established for the free movement of Romanian workers. The Commission may also introduce measures to ensure the correct administration of EU policies. This concerns the areas of food safety, air traffic safety, agricultural subsidies, the judicial system and the fight against corruption.

Economic growth in 2006 was driven primarily by domestic demand, which was supported by higher wages, an increase in private credits and a loosening of fiscal policies. Growth is forecast to slow somewhat in 2007 due to lower real wage increases, a more restrictive fiscal policy and declining foreign demand.

Economic success has led to a weakening in the balance of foreign trade, but the negative effects of this development were moderated by strong confidence resulting from EU accession and a high pace of investment activity. However, the exchange rate risk may increase over the medium-term if the budget deficit and current account deficit rise and income from privatizations declines at the same time.

The textile industry has become one of the most important sectors of the economy, employing more than 20% of the workforce. In addition, the role of Romania as a location for automotive component suppliers is growing. Strong development is expected in the foodstuff production and processing sector as well as waste disposal, technology and energy.

Despite this overall impressive economic performance, there is considerable need for reforms in many areas. Excessive red tape, persistent legal uncertainty, a deficient infrastructure, widespread corruption and the fact that 35% of the total workforce is employed in the agricultural sector reduce Romania's attractiveness to foreign investors. FDI reached a record level of EUR 8 billion in 2006, but a decline is forecasted for 2007.

Economic relations with Austria are considered excellent, with more than 3,500 Austrian investments registered in Romania since 1990. Goods with a value of more than EUR 1.8 billion were exported to Romania in 2006, which represents an increase of 30% compared to 2005. Exports from Romania to Austria amounted to EUR 800 million in 2006. This makes Romania a very important trading partner for Austria, more important than some EU countries and equal to Russia.

Selected Indicators 2003 to 2008 for Romania

Key Data	2003	2004	2005	2006	2007	2008 (f)
GDP (real in %)	5.2	8.4	4.1	7.1	6.3	5.5
Consumer prices (%)	15.3	11.9	9.0	6.5	5.3	4.5
Gross fixed capital formation (real in %)	9.1	10.8	13.0	12.5	13.0	13.4
Unemployment (%)	7.2	6.3	5.9	6.1	6.3	5.2
Budget deficit (in % of GDP)	-2.2	-1.1	-0.8	-0.9	-3.1	-2.4
Merchandise imports (million EUR)	22,200	30,200	37,300	52,000	60,000	55,400
Merchandise exports (million EUR)	17,600	23,500	27,700	36,600	40,800	36,000
Current account (million EUR)	-3,100	-5,700	-7,800	-13,800	-18,200	-13,200
FDI (inflow, net in million EUR)	2,000	5,100	5,200	8,700	5,600	5,500
Gross foreign debt (in % of GDP)	39.6	41.0	37.4	48.1	54.2	n.a.

(f) forecast

n.a. not available

Sources: *WIIW, CBR, CNS RO, Bank Austria Creditanstalt Konzernvolkswirtschaft, Coface S.A*

During the third quarter of 2006, GDP growth rose by a real 6.7% over the comparable prior year period. This represented the strongest quarterly development since the start of transition as well as a slight increase over the real growth of 6.6% recorded for the previous quarter. The structure of GDP components on the demand side point to a slight improvement in the pattern of growth, whereby the gap between positive effects of domestic demand and the negative effects of net exports declined moderately compared with both 2005 and the first half of 2006. Consumer spending increased by a strong 7.4%, as individuals grew more confident in their capacity to earn and spend more.

The high pace of economic expansion will continue in 2007, supported by favorable external conditions and solid growth in domestic demand. Although only a marginal decline in inflation is expected, private consumption should remain resilient. Forecasts also indicate a positive short- to medium-term outlook for investments. Accession to the EU has highlighted Bulgaria's advantages as a low-cost location for businesses and this, in turn, has created additional stimulus for the inflow of foreign capital. In addition, the more than four-fold increase in the potential volume of EU grants will contribute to GDP growth over the short run.

After years of self-imposed constraints (to keep the large current account deficit in check), access to the structural and cohesion funds is likely to spur capital expenditure in the public sector during 2007. During debates over the new federal budget, the Minister of Finance underscored the plans of the ruling coalition to press ahead with the implementation of several large infrastructure projects. The new budget reflects an increase of 22% in spending over the base year to a level of EUR 1.3 billion (or 5.3% of projected GDP).

The seasonal decline in inflationary pressure during the summer came to an end in September. Inflation accelerated during the last three months of the year to a level of 6.5% in December and 7.3% on average for the whole of 2006. The general increase in the price level resulted primarily from a sharp rise in food prices.

The most recent statistics provide a mixed picture of external economic performance. The current account deficit – which is viewed as the major weak point in the economy – increased from 9.4% in 2005 to 12.9% of GDP during the period from January to November. However, the foreign trade deficit has remained essentially unchanged at roughly 20% of GDP for more than a year. Merchandise exports were 27.4% higher in year-on-year comparison at the end of November, and thereby exceeded the 24.2% increase in imports.

Selected Indicators 2003 to 2008 for Bulgaria

Key Data	2003	2004	2005	2006	2007	2008 (f)
GDP (real in %)	4.5	5.7	5.5	5.8	6.0	6.3
Consumer prices (%)	2.3	6.1	5.0	7.6	6.8	4.7
Gross fixed capital formation (real in %)	13.9	13.5	19.0	21.0	16.5	12.0
Unemployment (%)	12.7	13.0	12.0	10.0	9.2	8.5
Budget deficit (in % of GDP)	-0.4	1.5	2.3	3.0	1.0	1.5
Merchandise imports (million EUR)	8,900	11,000	13,800	17,400	21,400	25,000
Merchandise exports (million EUR)	6,700	8,000	9,500	11,300	13,400	15,000
Current account (million EUR)	-1,600 -	-1,600	-2,400	-3,100	-3,900	-3,400
FDI (inflow, net in million EUR)	1,800	1,600	2,300	3,800	3,900	3,200

Gross foreign debt (in % of GDP)	67.2	70.2	63.4	66.4	62.6	83.5
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(f) forecast

Sources: *Bank Austria Creditanstalt Economics Department, BNB, NSI, Coface S.A*

GPD growth accelerated during 2006 and is expected to peak in 2007. EU accession has underscored the positive attitude of international investors and will keep foreign direct investment above 10% of GDP for the fifth year in succession. The pace of economic development will also be supported by an increase in capital expenditure by the public sector and strong growth in private consumption. However, opportunities for reducing the current account deficit will be limited because rising fuel prices and higher demand for investments will absorb the positive effects of the steady increase in exports. The strengthening of the country's competitive ability remains a key priority of economic policy, but will require the continuation of structural reforms. The government agenda for 2007 will be focused on preventing the activation of safeguard clauses and ensuring the maximum possible utilization of EU grants.

In 2006 Coface Romania has made public Romania's rating emitted by Coface Group. Romania has been included for the first time in the A category of country risk, being assessed with the A4 mark. Coface emits ratings for 151 countries, analyses 44 million companies from all around the globe and it's a global leader in export loan insurance, and has a quotation of 25%.

If in 2005 Bulgaria had been evaluated by Coface with B+ while our country had B, Romania ascended another level in the hierarchy, to A4, instead Bulgaria maintained its rating. The rating is reflected also in indicators like life standards purchasing power, that in Romania are better comparing with other countries in course of development. For example, according Coface analysis, in Romania exist 69 computers per 1000 inhabitants, while in other countries in course of development is 37 (the regional average is 84 computers per 1000 inhabitants).

The main consequence of A4 country rating for Romania is that it will enhance the access on international markets and the credit limits of Romanian companies for commercial credits, from their external partners, other international creditors or from financial risk insurance companies. This will lead to an increase of commercial relations volume especially in EU countries and enhancement of Romanian business environment credibility on international scale.

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