

## ROMANIA'S ECONOMY AFTER THE EUROPEAN UNION ACCESSION

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**Abstract:** *If, during the communism, Romania had an unusual position at the European level, after 1989 it had a different path, in comparison with other former communist states: the country had the harshest difficulties finding its European path, then it had the most important economic growth rate; in the same time, it has been the candidate state facing many economic and social issues, which have worsened during the crisis. In this paper, the authors present the evolution of the Romanian economy, by analyzing representative economic indicators, the dynamics of the national economy, after its accession to the European Union (EU). It is obvious that the country's evolution has been influenced by the decisions taken and implemented during the pre-accession period. At first sight, it is very difficult to economically separate the two periods of time. However, one can notice that, after the beginning of negotiations (February 2000), Romania's economic policies have been implemented in a more sustained rhythm, due to the surveillance coming from the European authorities. After seven years of economic growth, which contributed to a partial catching-up with the European average, Romania became member of the EU, having a precarious economic and social situation. Under those circumstances, it would have been normal to continue to implement economic reform policies. Unfortunately, the determination of national authorities has sharply diminished after 2007. The first years of Romania's membership have been characterized by important rates of economic growth, due, among other factors, to favourable international circumstances. This contributed to an increased trust on the part of Romania's population and government in the national economy (even too optimistic). This, together with the fact that Romania had an unhealthy economic growth, contributed, after the outbreak of the crisis, to some powerful shocks for the population and for the economy as a whole (a sudden and rapid economic fall, wage cuts unwitnessed in other European economies, increase of expenditures taxes). The Romanian authorities had to make external loans (from the International Monetary Fund, the EU and the World Bank). In spite of those measures, the Romanian economy did not straighten out. Due to reasons less linked to the economy, those funds did not reach the intended purpose. On the contrary, the Romanian economic and social environment had severely worsened. In the meanwhile, as the EU was facing its own issues, it had adopted firm measures to deal with it. Romania had to accept those measures (for instance, the Fiscal Treaty).*

**Key words:** Romania's economy, European Union, economic growth, economic crisis.

**JEL classification:** F43, N14, O11, O52

## 1. Introduction

The 1989 Revolution brought for Romania, as well as for the other Central and Eastern European countries, an important change in conceiving and acting in the economy, and in the society, generally. One can say that this has been *a changing process without solid theoretical bases, except for some inspirational ideas in different government programs* (Marin, Socol, Niculescu 2005: 4). One can appreciate this has been *a revolution without an ideological program*.

After Romania had been invited to start the accession negotiations (during the European Council hold in December 1999, in Helsinki), the European Union has urged the national authorities to accelerate the social and economic reform measures.

The relations between Romania and the EU have been quite difficult during the pre-accession period. The European officials knew that, where the Romanian strictness was well beyond the European strictness, there was a very large possibility for compromises. One can say that, at first sight, the EU has been very vigilant regarding our country's transformation during the pre-accession period (and even before, starting with the year 1997). Our accession date has been delayed, in comparison with other states, because the developing gaps were too large; in 1999, a medium term strategy has been adopted, allowing the EU and the international financial organization to guide the Romanian economy, still under the state control, and to build a free market (Părean 2013: 539). For the national economy, this period of time can be characterized by a sustained economic growth, allowing the catching-up in comparison with the EU average (a complex analysis has been done by Virginia Câmpeanu and it is presented in Mureșan 2008: 419-448). This catching-up process continued in the years 2007 and 2008, and it has been the best reflected in the evolution of the Gross Domestic Product/inhabitant (Murgescu 2010: 476).

## 2. Economic Growth after EU Accession

The catching-up process is, indeed, obvious, but, in spite of that, in the moment of our accession to the EU, Romania had an economic development level slightly superior to a third of the European average, and approximately 30% of its population lives in a subsistence agriculture (Cerna 2011: 2).

After a period of sustained economic growth, one can identify the following economic risks. In 2007, the accession moment, among the 15 EU poorest economic regions, six were in Romania. The poorest EU region is the North-Est Region, in Romania; in fact, the only Romania region not included in the category "very poor" is Bucuresti-Illfov, having a GDP/capita of 74% in comparison with the EU average (Rădulescu 2008).

The reform programs implemented after 1989 cannot be characterized by consistency, the adopted measures produced just partially the anticipated effect, which entailed negative effects on the social level, deteriorating the population's living standard. The Romania's difficult situation is reflected by the existence of some major economic and social risks (Părean 2009: 200), like: the part of the external debt in the GDP – medium risk; the excessive growth of loans granted by the banking system – medium risk; the low level of GDP/capita – major risk; the labour productivity – major risk; the increase of the deficit of the current account, especially due to the trade deficit – major risk; other social risks: demographic decrease – major risk; resources allocated for the health insurance programs – major risk; pensions of

retired people, in the state system – major risk; governmental resources allocated for education, health, infrastructure and research and development – major risk.

After its accession, Romania has been a drab member, having neither personality nor initiatives (Boia 2012: 104).

Another important aspect for the Romanian economy, before and after the accession, is related to the relaunching of the internal production, based on the foreign direct investments. Thus, the labour productivity increased significantly, the gap in comparison with the EU average being partially caught-up. If in the year 2000, Romania's average labour productivity represented 28.8% in comparison with EU 25 labour productivity, by 2006 this indicator has reached 38.8%, and by 2008 it has reached 46.6% (\*\*- *România în cifre* 2009: 79).

EU has brought Romania important benefits: it has forced the institutions' modernization, it has brought foreign direct investments and economic prosperity. But the local capital is still fragile, the resources' allocation is not compatible with the strategy of sustainable development (Romania exported highly qualified labour force), and the market dominant positions have multiplied. Economic disequilibria have increased, in 2008 the deficit of the current account exceeded 12% of the GDP. Even worse, the savings did not sustained high productivity investments. In 2008, the gross investment exceeded 30% of the GDP (Dăianu 2012: 222), but their structure raises important issues (for instance, there aren't important infrastructure projects – highways, railways, harbors, or important land projects).

The first two years after the accession, the macroeconomic indicators showed a good situation, which contributed to the catching-up process towards Western Europe (table 1). In 2008, although GDP increase was significant, one can notice that the economic crisis started to hit the national economy: unemployment, budgetary deficit and external debt have increased, while the labour productivity has decreased.

**Table 1.** The Dynamics of main macroeconomic indicators, for 2007 - 2008

	GDP (% yearly variation)	Annual average inflation rate (%)	Unemployment (%)	Budgetary deficit (% of GDP)	Deficit of payment balance (% of GDP)	External debt (% of GDP)	Labour productivity (2000 = 100)
2007	6,0	4,8	4,1	-2,6	-13,5	47,5	181,4
2008	7,3	7,8	4,4	-4,8	-12,3	49,1	170,5

Source: \*\*\* - *Anuarul Statistic al României*, 2011

The post-accession strategy, adopted by the government at the beginning of 2007, had, as objectives, to create a framework, favorable for infrastructure development (transports, IT, energy, environment), to develop the human capital,, to promote the research and development, to consolidate the market economy mechanisms, etc. (Murgescu 2010: 480); unfortunately, all these objectives were not achieved.

After a sustained economic growth, due to procyclical economic policies, the economic recession could not be avoided. However, one must take into consideration that the catching-up process is a slow one and that a total caught-up rarely takes place. The management of the economic policy doesn't need to be extraordinary, but determined, with serious and capable people, doing their job, taking on obligations and following them through, discretely and responsively

(Părean 2013: 549). The measures they adopt have to avoid social polarization (Derek Aldcroft was severely criticizing the situations where fiscal and redistributive state policies “tend to favor a small minority, to the disadvantage of the big majority of the population [...], while distributing unequally the revenues and the wealth”, and thus the “governance is through and for elitist groups”) (Aldcroft, Sutcliffe 1999: 19). As a matter of fact, since 2007, the International Monetary Fund and the Governor of Romanian National Bank were warning against the risk of the over-heating of the economy (Alonso 2010). The danger was the increased inflation rate and the increased current account deficit (Escritt, Wagstyl 2007). In November 2007, *Standard & Poor* has reduced our country's perspectives from *stable* to *negative* (Gallagher 2010: 271), and in March 2008 *Economist Intelligence Unit* (EIU) has warned that Romania is among Eastern Europe's most vulnerable countries. The privatization process was largely concluded, and the foreign investors were no longer very interested in the Romanian economy; consequently, without foreign investments, it was almost impossible to take under control the current account deficit. The foreign investments did not contribute significantly to the increase of the labour market. In 2007, 49 private companies, with a turnover superior to 1 billion euros, were employing only 3.8% of the labour force (Șerbănescu 2008).

### **3. The Beginning of the Crisis and its Manifestations**

There is an intense debate regarding the causes of the crisis in Romania, after 2008. Some authors consider that, partially, the crisis has been imported, especially through the reduction of the external demand, and because of the reticent attitude of foreign investors while others consider as main cause the unsuitable governmental policies in 2007 and 2008. Other authors (Fota, Băcescu 2009:49-54; Voinea 2009: 63) have shown that, in fact, the causes of the crisis in Romania must be looked for exclusively inside the country, the international events having just contributed to the unleashing of the crisis.

The world economic crisis hit Romania in the second half of 2008 (officially, the crisis started on October the 1<sup>st</sup>, 2008). From that moment, the combination between the external deficit, the budgetary deficit and the reduction of financial flows led to important economic disequilibria, at the national level. Partially, the crisis had been imported (the reduction of external demand, the reticent attitude of foreign investors), but a big contribution can be given to internal side-slips.

Unfortunately, in Romania, in the last decade, the government has implemented mainly procyclical policies. During periods of economic growth (in 2005), one has adopted the flat rate tax, encouraging the business sector, while in 2009, during economic recession, the government introduced the minimum tax for the business sector. This led to the closure or suspension of an important number of small and medium sized enterprises (table 2).

**Table 2.** The dynamics of the business sector after the crisis beginning, in Romania

Indicator \ Years	2009	2010	2011
Number of closed enterprises	57041	49092	13290 (sem I)
Number of suspended enterprises	127129	139139	22062 (sem I)

Source: [www.onrc.ro](http://www.onrc.ro), accessed on December the 15<sup>th</sup>, 2012

Certainly, those measures are justified, but we can say that in Romania, only short-term objectives have been followed, while medium- and long-term objectives have been neglected, although these objectives should have been decisive for the economic policy. In 2005, Romania had the historic chance to partially catch-up the gap in relation to the EU average, and the perspective of EU accession has encouraged stimulation actions for the business sector. After the crisis, through the economic measures taken, the government wanted to equilibrate the national budget, and the minimum tax system was intended to clean the Romanian business environment. But this measure reduced even more the economic recovery potential, having negative impact upon the Romanian economy and society.

The difficult economic and social situation in Romania, after 2009, is presented in table 3. The first two years reflect the massive effect of the crisis. We can see that after years of strong economic growth, a strong recession followed. The value of loans has constantly increased, but in the same time, the arrears in repayment have increased as well. As for the public debt, Romania still has one of the most reduced public debts in Europe. However, we can notice that the tendency indicates an increase of the public debt.

The decrease of the unemployment is, on the one hand, encouraging. But, on the other hand, this reduction was possible because many people have left the labour market (through retirement, for instance). And this led to another difficult issue: the considerable increased numbers of pensioners, deterioration of the ratio between active persons and dependent persons, generating a structural deficit of social insurances budget.

**Table 3.** The evolution of some indicators for the economic situation of Romania during the crisis (2008 - 2012)

Indicator \ Years	2009	2010	2011	2012
Economic growth rate – real GDP(%)	-7,1	1,3	2,2	0,3
Inflation rate (%)	5,6	6,1	5,79	4,9
Public debt	147,3	194,5	223,3	241
Governmental public debt (billion RON)	136,5	182,5	210,4	227,2
Public debt as percentage of GDP (%)	29,4	37,2	38,6	40,2%*
Value of loans (billion RON)	198,9	207,9	225,16	?
Value of arrears in repayment (billion RON)	5,9	13,9	21,32	24, 72 (1 <sup>st</sup> semester)
Unemployed people (thousands of persons)	731	714	460	493,8
Unemployment rate (%)	7,8	6,97	5,12	5,59

\* estimated

Source: [www.bnr.ro](http://www.bnr.ro), [www.insse.ro](http://www.insse.ro), [www.mfinante.ro](http://www.mfinante.ro), [www.onrc.ro](http://www.onrc.ro), accessed on February the 15<sup>th</sup>, 2012

The inflation rate has increased in the first two years (2009 and 2010), but then a disinflationary trend has followed. However, the target, in terms of inflation rate, has not been reached: until the end of 2012, the annual inflation rate had been of 4.95%, higher with 0.95% than the target for 2012 (Raport asupra inflației 2013:8).

After having officially acknowledged the crisis, the national authorities adopted a program to fight against its undesirable effects. *Action Plan for Economic Growth and Jobs* has been adopted by the end of 2008 (November) and had many stipulations. Three measures referred to a fiscal relaxation, one measure to job creation, seven measures were aimed to stimulate the aggregate demand (by increasing the government expenditures with goods and services) and the aggregate supply (by stimulating the private investments), others were administrative measures, for a better coordination of activities within the economy, regarding a better absorption rate of structural funds, or regarding the insurance in the economy of necessary capital flows by the private banks.

On March the 29<sup>th</sup> 2009, Romania signed a borrowing and assistance agreement with international financial organizations. The borrowed amount of money was of 19.5 billion Euros, following the agreement with IMF, European Commission, European Bank for Reconstruction and Development, and World Bank. Romania used 11.8 billion euros in 2009, 7.1 billion euros in 2010 and 1.05 billion euros in 2011.

The conditions imposed to Romania referred to deficit control actions. The restrictive financial policy led to a spectacular cut of current account deficit (from 16157 million Euros in 2008 to 5054 million euros in 2009, especially due to a reduction of imports, by more than 12.3 billion euros) (Murgescu 2010: 478).

In 2009, the most important relaunch measure was the Program "The First House", having a very important budget for the first stage (approximately 1 billion euros for 2009). Although this program had several stages, it did not stimulate the construction sectors, people preferring to buy apartments already built, instead of new apartments.

In 2009, the difficulties of the Romanian authorities were obvious. During the last two months of the year, the employees in the budgetary system had an unpaid vacation of 5 days, or had to work without being paid (a form of partial unemployment). But the toughest measures had been taken in 2010, when the wages of the employees in the budgetary system had been cut by 25%, and the value-added tax increased by 5% (from 19% to 24%)

At the beginning of 2012, Romania signed the Fiscal Discipline Treaty, taking on the obligation of increasing the budgetary discipline. This Treaty aims to solve the issues of the Euro zone. In the same time, we must take into consideration the fact that our country's situation depends on a positive solution for the Euro zone. This is not a fiscal integration, so we can say that the monetary union is not a complete one without a common treasury. According to the Fiscal Treaty, the structural deficit must be of maximum 0.5% of GDP. In Romania, this deficit was superior to 3% of GDP, and in 2008 it has been of 8%. In order to reach the target, a fiscal and structural correction of 3% of GDP is needed, which is considerable, especially taking into consideration that our fiscal revenues represent 28-29% of GDP (Dăianu 2012: 211). Of course, the immediate effects are negative, but positive effects are expected on medium- and long-term. One can also consider that implementing such an agreement represents a high limitation of the capacity of the fiscal policy to stimulate the activity of economic agents. A structural deficit of 0.5% of GDP means that the actual deficit should be close to zero, on the long-run. Given the fact that, in Romania, the interest rates of the public debt represent 1.7%-1.8% of the GDP, this means that the budget, before the payment of the interest rates for the public debt, must register a surplus.

#### **4. Conclusion**

After 1989, Romania has been long looking for its own path, more than other former communist countries. After the accession negotiations began, Romania had many benefits. Between 2000 and 2008, it had the biggest economic growth rate in Europe: this period of time has been the only one, in over 200 years, when Romania partially caught-up its development gaps, in comparison with the European average. This is an important thing to be mentioned, given the major differences between our national economy and the economies of other West European countries. Even more, the West European structures had a major and positive impact upon the Romanian economy and society.

In Romania, the way of thinking and acting has been seriously influenced by the communist inheritance. Unfortunately, Romania had a certain reserve in immediately and accordingly implementing the necessary economic measures, which would have contributed to a healthy and performing economy. This seems to be a paradox, especially taking into consideration the optimism and confidence of the population in the Western structures. It is obvious that there is a huge difference between people's desires and politicians' desires. As a matter of fact, just as Lucian Boia notices, the Romanian politician is also a business person. Thus, in implementing the economic measures and European directives there was not much of an enthusiasm, and in the

moment of EU accession, Romania seemed to be a country with a less successful economic reform, partially due to the fact that the European authorities did not pay too much attention to the way of implementing the reforms (in that sense, Tom Gallagher noticed that the Romanian authorities managed to “balkanize” the Westerns).

If, during the accession negotiations, there was a sustained rhythm of implementing the economic reforms, after the accession this rhythm became much more relaxed. After 2007, our country's economy continued to have high economic growth rates, but mainly due to the fact that Romania was now part of a select economic group, allowing us to have a low country risk and to attract foreign investors. Also, the lack of authentic reforms lowered the price of certain economic resources, thus keeping the country attractive. After accession, the economic reforms have almost stopped. Consequently, after 2008, in a crisis context, most economic indicators for Romania have worsened, and the financial situation has considerably deteriorated. The increase of budgetary deficit was the expression of a reduced economic activity, but also of unwise economic policies from previous period of time. The result was the unpopular measures taken in 2010, in order to rebalance the national budget. Unfortunately, those decisions had an adverse effect, by strongly disequilibrating the households' budgets. Those measures were intended for a short period of time (6 months), in order to take the necessary measures to stimulate the economic activities. But the measures failed. And the evolution of the external environment did not help Romania.

The social negative evolution is the direct effect of a reduced GDP, of a reduced power purchase of households, and an indirect effect of revenues redistribution methods aimed to favor limited interest groups, to the disadvantage of a vast majority of the population.

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