3.3.3 Romania

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Introduction

Romania is a medium-sized country in the North-Eastern part of the Balkan Peninsula. It's Central and North-Eastern parts belong to East-Central Europe (Transylvania in the Carpathian Basin). The country faces the Black Sea in the East with the important harbour city Constanta. The area of Romania is 230.080 square kilometres and contains very colourful terrains. The Carpathian Mountains occupy the central part of the country with various natural resources (wood, natural oil, salt, gold and iron ore and coal). The mountains are surrounded by fertile arable land producing various types of crops. The largest river is the Danube, the main European sweet water shipping line connecting the Black Sea region with heartland Europe (Germany). Total population of the country was 19.530.631 inhabitants in 2018, down from the pre-transition period high of over 23 million. Part of the decline in population was natural shrinkage (mortality rates exceeding birth rates), but the bulk of the population loss was due to significant outmigration. This is estimated to some 2.5-3 million people taking job and living opportunities mainly in Western Europe. The consistence of age cohorts reflects mostly the aging process, albeit it does not seem to have worsened by migration. Children below 15 consisted 18% of the population, citizens over the pension age (65 years) 15.6%. The share of urban population is fairly low only 53.94% (2017).

1. Political context and quality of institutions

Historically, the Romanian economy has evolved in three different entities. Moldova and Walachia were provinces under Turkish rule with partial internal autonomy until 1877. Modern Romania was established after the 1877 Turkish-Russian war that ended the rule of Turkey over the two provinces that merged and established a joint kingdom. The newly established state gained new territories after World War I, when its size was more than doubled with the annexation of Bessarabia in the East (today's Republic of Moldova), Transylvania and Eastern Hungary in the West. These newly acquired territories had historically different development patterns being parts of the other two main Central European empires (Russia and Austria-Hungary). Thus, current day Romania also shows significant ethnic, cultural and also material development differences and diversity in its different regions. Despite of vigorous social mobility in the country the overall relative development level did not change much in the years of communist rule either. Romania tried to maintain some distance from superpower Soviet Union. This was most obvious in politics, especially under the rule of Nicolae Ceausescu, but also in the economy. Romania did not participate in the close cooperation network of the communist bloc. High degree of self-reliance was however a dead end street already in the years of communism. Hence, Romanian economic and social development lagged behind even its communist counterparts.

Romania's transition to a free-market economy began with its new constitution in 1991. The country became a member of NATO in 2004. EU membership negotiations were finished after long delays due to the high level of corruption and slow progress of liberalisation and privatisation of the economy and the country became member in 2007 (Appel and Orenstein, 2018). The road of transition has been rather turbulent in Romania. The inception of the Romanian Republic was bloody and hard-won: some 2000 people were killed in the late 1989 "revolution" and the consequent street fighting. The Romanian dictator and his wife were caught in flight and executed by revolutionary officers of the army on 25 December. Violence continued also in the successive years. Heated political debates emerged partly because of the leading role of former communist party leaders in the political landscape of the transition process. For example, Ion Iliescu, the first President of modern Romania (1990-1996; 2000-2004) used to be a member of the Central Committee of the Romanian Communist Party before the systemic change. He had decisive influence on politics not only in his social democratic party but also in general in the early stage of Romanian development. His political heritage remained rather strong also after his death.

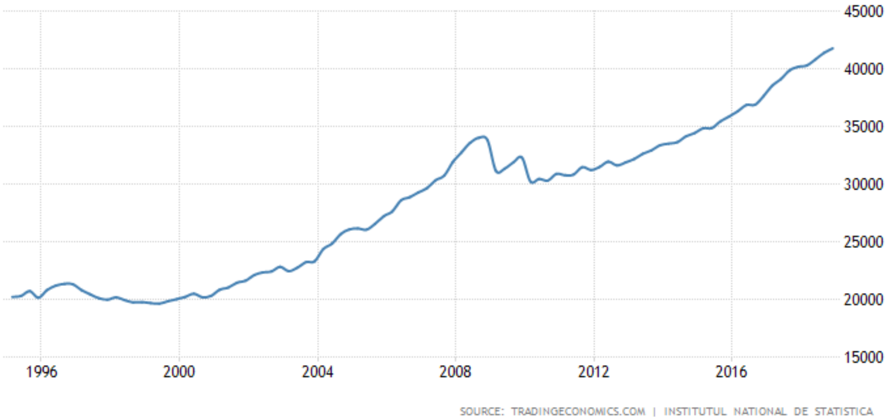
Despite of the violent, revolutionary overturn of the communist regime in 1989 incumbent politicians could maintain leading positions in Romanian politics. This was also reflected in the very cautious introduction of reform measures and the postponement of privatisation process (Appel and Orenstein 2018). Surviving paternalism served as continuous hotbed of corruption (Hellman *et al.* 2000; Innes 2013). Socially important big business remained intact despite of lack of competitiveness. Politicians soon used dependent company communities for their political support even in form of organised violent counter-demonstrations against their political opposition. The state captured business, Romanian transition was earmarked by strong politicians and weak business sphere (Schoenman 2014). Since the economy became a prey of polity, economic development was rather slow during the 1990s. The development was reinforced by international institutions and the European Union, but the Romanian governments tried to avoid or water down the impacts of newly established market institutions (Simmelfenning and Sedelmeier 2005; Racovita 2011; Appel and Orenstein 2018).

Consequently, the World Bank (2018) governance indicators show permanently low indices for Romania. The measure voice and accountability measure (the public perception of freedom in various areas) was relatively highest ranked around 60. This level is in fact not better than the regional modus. Moreover, it did not change much over the 1996-2017 period. The measure of political stability and absence of violence was fluctuating despite of the fact that the very frightening events of the 1990s (e.g. visits of militant Jiu-Valley miners to the anti-government demonstrations in 1991) were not repeated in the 2000s. This measure evolved below 50% level low. Government effectiveness was ranked even lower between 40 and 50%, with a small peak in 2014. Interestingly, EU accession made no change in this measure either. Regulatory quality was perhaps highest among the indicators, and steadily improving after 2000, reaching a plateau around 65% in 2011. The rule of law measure also climbed from below 50% to around 60%, especially in the years after the EU accession (2007) showing the beneficial effects of acquis application. Control of corruption has always been the most serious problem in Romanian economic policy. The strikingly low value of 30% in 1998 improved steadily parallel with the establishment of various anti-corruption offices (on demand of the European Union). However, the relatively stable position on 50% by far does not mean that the control would be effective. But as repeated political scandals show many corrupt cases are discovered and there has been some institutional and social control over the problem (especially in DNA anti-corruption office). Yet, sentences against affected politicians were usually very meager.

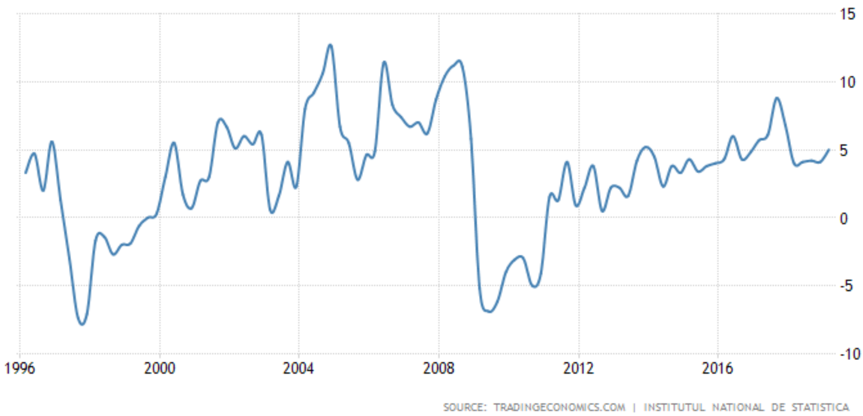
2. General economic outlook

Romania underwent a rather long and difficult transition process, which was also reflected in the macroeconomic performance of the country. Economic growth was rather sluggish during the 1990s reflecting the lack of competitiveness of most segments of the economy (including unproductive agriculture and weak manufacturing industry). Liberalisation, lack of capital investments and modernisation brought deep transformational recession to the country during the first phase of the transition process with 25% GDP decline between 1990 and 1992 (EBRD 2000). During the 2000s, the Romanian economy performed much better and reached very high growth rates (6.9% in 2007; 9.3% in 2008). The 2008/9 crisis hit also the Romanian economy rather badly (over 10% decline in two years), but the economy recovered after that and grew at accelerating speed again (7.0% in 2017). The quick economic growth of the country is very remarkable especially in regional comparison: highest in most years. Three main factors can be observed in the background. FDI penetrated the country and successfully modernised a few strategic industries (automotive, electronics, personal services). The country became a net recipient of EU transfers that also stimulated economic growth. Thirdly, the country has successfully restored macroeconomic stability after the rather troubled years in the 1990s (Pop-Eleches 2009). The annual average growth was 5.9%. Consequently, Romania successfully increased its per capita GDP development level from 39% of EU average in 2006 to 63% in 2017. The very impressive improvement might deliver the necessary material resources for the overall modernisation of the country's main infrastructure systems (linear infrastructures, health, education). Due to the inherited relatively low level of development these systems still show the signs of underdevelopment.

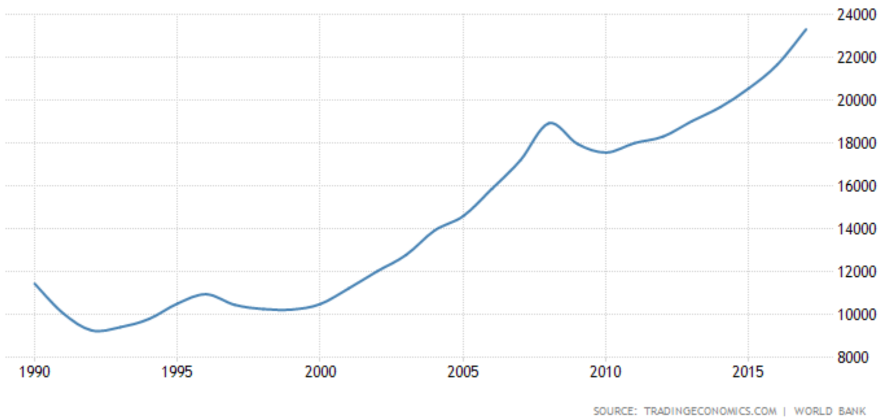
GDP at constant prices (million RON).



GDP growth rates (1996-2018)



Per capita GDP (USD, PPP constant prices)



Historically Romania has been a mostly agrarian land with a few important industrial centres that based their activity mainly in natural resource based industries (oil extraction and refinery in Ploesti, iron ore mining and metallurgy in Hunedoara, etc.). This profile changed only slowly during the years of socialist industrialisation, since Romania did not take part in the complex industrialisation programs of the Soviet Bloc. Important engineering industry centres were added in Brasov, Pitesti and Galati already in the interwar period (with strong military equipment profiles). This tradition is reflected in the slow changes of the transition period. Agriculture still employed 23 % of the labour force in 2018. Industry's share was also relatively large (29.9%). The services sector on the other hand remained at the relatively low 47% level. Unfortunately, agriculture is not modern, this is also reflected in the high share of agrarian population. Low levels of productivity in the sector yield low income, hence the mostly agrarian regions suffer of deep poverty. The overall level of per capita GDP increased due to significant economic growth in the 2000s and peaked with 63% of the EU average in 2017. The relatively larger size of the Romanian economy, as well as the still modest FDI penetration produce lower levels of openness of the country. Exports reached 41.2% of the GDP, meanwhile imports accounted to 42.1%. Excess import means a moderate deficit in Romanian trade balance.

The Romanian economy fought with serious macroeconomic imbalances in the first phase of the transition process like many other EEC countries. Macroeconomic stabilisation was not an easy job, due to several social and political factors. On the one hand, the high influence of organised labour always threatened governments with open political pressure especially when austerity measures were to be introduced. But they were also successfully manipulated to block government policies in other domains as well. On the other hand, the high social cost of systemic corruption could not be eliminated in the country despite all efforts and pressure from especially the European Union. Weak tax collection, expensive functioning of institutions, and widespread bribing has always limited the budgetary reserves of the governments. Moreover favouritism in public spending also deteriorated the efficiency of the usage of the centralised part of the GDP (Kaufman and Vicente 2011). All this resulted in relatively expensive and fairly low quality of social services. This also increased the danger of emerging macroeconomic imbalances. The problem of budget deficit has always been a key macroeconomic problem of the country. The level of deficits ranged from 3-11% per year in 2006-2013. Latest figures are more promising. Starting with year 2013, the Romanian budget deficit did not exceed the 3% Maastricht criteria level (2.9% in 2017). The accumulated state debt was only 35.1%, well below the Maastricht conditions.

The share of wages amounted to 29.9% of the 2017 GDP, a relatively low level. Romania has remained a country of cheap labour force. The more recent increase of the minimum wage started perhaps a longer-term acceleration of real wage increases. This may cause problems if not paralleled by matching increase in labour productivity, because then unit labour costs would increase too. The country would lose its hard-won FDI attraction potential. Low wages prevailed despite of considerably high level of trade union density. In 2014, 35% of the labour force was organised. Also, the collective bargaining share was considerable (36% of all employed in 2012). This is most probably the outcome of the inherited industry structure, the survival of large industrial complexes in major industrial cities. With the high share of agriculture as usual rates of activity remain lower. In Romania the activity rate was 67.3% in 2017, which is higher than in some more traditional rather agrarian countries, but less than other EEC countries' figure. Total unemployment was rather low, 4.2% in 2018, as a result of the impressive economic growth figures of the country in the 2000s. Temporary employment is almost nil, statistically. Most probably, short term employment is not reported at all, due to the weak operation of state control in this area too.

State spending on social protection is relatively low in Romania. The total benefits to GDP ratio is only 10.8% in 2017. Self-reliance is relatively high, but also perhaps the size of available services that the state can afford is relatively low. This may be a reason why many individuals who have both Romanian and Hungarian citizenship choose to participate in the Hungarian social service system (mainly in health care), that puts rather serious burden on the Hungarian system, since these recipients of the services do not contribute to the Hungarian system. The total government expenditure directed to families in percentage of total government is very low: only 5.4% (2017). Pensions' share in GDP was 8.1% in 2015. Total expenditure on health care: 5.0%. Inequality in the society is moderate, only slightly higher than for example in Hungary and lower than in Bulgaria (another country with byzantine heritage). The Gini coefficient was 36.5 (yet, it was 40.4 in 2015), only slightly exceeding the EU28 average (36.0). After correction by social transfers it still remains 33.1, which is a clear evidence of relatively modest efforts of social security systems in Romania.

3. Quality of entrepreneurship

Entrepreneurship in Romania has no long tradition. Political control was especially tight during the communist regimes, citizens were regarded as sole contributors of ambitious government plans. No effective work incentives were used and entrepreneurship flourished only on the black market. Since the transition process did not change much the ruling elite, the old type of state and political control together with flourishing corruption survived. Since the international advising community set modernisation requirements in order to change the Romanian system into a compatible one, market economic institutions were set up. Nevertheless, their functioning has always been marred by the impacts of the "old traditions". This is clearly shown in most evaluations.

The country profile in Global Entrepreneurship Monitor mirrors entrepreneurial behaviour and attitudes. Romania's scores are rather mixed. From the self-perception measures the country scored above the global and regional average in “fear of failure rate” and in “entrepreneurial intentions rate”. This shows strong entrepreneurial attitudes of the Romanian population (see also the high share of agricultural employment which is most importantly self-employed small holders). Entrepreneurial employee activity rate was also very high. However, many entrepreneurs are quasi or forced entrepreneurs, people who have no alternative job opportunities, which is clearly shown by the extremely low motivational index. The GEM spider shows in the case of Romania above average level of commercial and legal infrastructure. However, this is the only good news: in all other aspects the country scores rather badly, usually below rank 3, and mostly below the international average too. Worse grades were achieved in the 2015 ranking in entrepreneurial finance, governmental policies both in support and relevance and in taxes and bureaucracy, as well as in government entrepreneurship programs.

Despite of impressive economic growth figures Romania was only 68th in the 2018 edition of the Global Competitiveness report. Worse performance was achieved in business sophistication pillar (116) and innovation (96). Far below average was the record in pillars institutions, health and primary education, goods market efficiency, labour market efficiency and financial market development. Not surprisingly, the score was improved by pillars market size and macroeconomic environment, and to some extent technological readiness. Individual indicators can reflect more nuanced problem areas and also advantages.

Unfortunately, Romania has had very many indicators with ranking below 100. This means that the problem pillars all need massive improvements. Pillar 1 is about institutions. The transition period and the EU accession process was thwarted by continuous problems with political as well as low level (bureaucratic) corruption. There has been a widespread consensus among political forces about the treatment of political power as a prey. Despite of continuous efforts at tightening control over corruption virtually all political parties defended the affected politicians and maintained systemic corruption intact. The political consequence of this policy was frequent political crises and also low level of public trust in politicians (113), due to frequent favouritism in decisions of government officials (116), low efficiency of government spending (115), and the burden of government regulation (124) or transparency of government policy making (113). Due to the lack of judicial independence efficiency of the legal framework in settling disputes was the worst measure of all (131). Similar aggregation of bad scores is observed in labour market efficiency pillar. These measures show the reasons of high outmigration from Romania. Pillars financial market development and business sophistication also received repeatedly bad grading. For example, availability of financial services was 121, venture capital availability 126, local supplier quantity 122. All these indicators show serious institutional and cultural weaknesses of the Romanian economy that could be improved on the long run through steady deliberate government efforts to cure the roots of the problems. Unfortunately however, most indicators of the public administration and structural policies of the government show the opposite, a deliberate maintenance of the current situation.

The Heritage Foundation's research on business freedom ranks Romania 42nd on the list, which is ahead of many countries from the CEE region. The score was 68.6 in 2019. Judicial effectiveness and investment freedom deteriorated (e.g. the president of the anticorruption office DNA was successfully forced to resign), but there were improvements in the area of property rights, tax burden and government spending. Romania's score matches the regional average and is above the world average. Despite of the relatively advantageous ranking and score, the explanations in the text call the attention to some of the same unsolved problems (mainly corruption) that have plagued Romania transition for the past 30 years. More recently also some relaxation on tight fiscal policies were introduced putting macroeconomic stability at risk once again. Also, courts are still subject to political influence and suffer from a lack of expertise. On the other hand, efforts to fight both petty and high level corruption have become more credible. Yet, judicial corruption still remained a problem.

4. Modernisation based on FDI

Romania has delayed privatisation rather long and did not provide strong incentives for foreign investments either. Thus, the 1990s passed by with virtually no important FDI inflows (except Hungarian petty entrepreneurs' small scale investments, and a few larger Hungarian firms presence). The investment climate changed in the 2000s, but it has never been as supportive as in Hungary. Privatisation also proceeded and some of the Romanian flagship companies were sold to foreign firms (Petrom to Austrian OMV in 2004, Dacia, the Romanian car manufacturer to Renault in 1999). Also some new greenfield investments took place. Nevertheless, in terms of total FDI stock Romania still lags behind the Visegrad countries. According to UNCTAD (2018) database the total inward FDI stock was a mere 6.9 billion USD in 2000. It increased to 68.7 billion USD in 2010, and 88.2 billion USD in 2017. This was approximately 50% of the Romanian GDP. Romania could enjoy significant investor interest in this late phase of the transition process because of the country's relatively big size (market seeking motive of investments) and also the inexpensive labour force. This later factor is however not always decisive. What really matters is unit labour cost: labour charges should be adjusted by productivity level. Labour productivity has been lower in Romania than in Visegrad countries, hence, access to cheap labour motivated investments in only a few specific labour intensive sectors (leather, shoe, and textile). Unfortunately, also some Romanian investments suffered from the 2008 crisis. The then still relatively new (2008) Cluj facility of Nokia was closed down in 2011 (parallel with the closure of the company's cellular production facility in Hungary).

The penetration of multinational business in Romania has been similar to the Visegrad countries, however it has not been so widespread due to the time delay of the process and the relatively few privatisation opportunities. The market share of foreign owned banks was large already in 2010 (84%). On the list of the 500 largest business ventures in ECE we can find 46 situated in Romania (a fair number but smaller than what could be expected given the size of the country). Out of this number the majority was foreign owned (37 entities). There were still 5 state-owned firms, only two owned by local individuals, and two in the possession of investors of other ECE countries.

Booming economy produced very significant increases in labour productivity in the 2010s. The 2010 level was exceeded by 42.7% in 2018, the highest level increase among the EU member states. This development in fact gave an opportunity to take measures to increase real wages even if during the preceding period labour productivity actually declined by 7%, thus the increment was lower if treated on longer time horizon. Labour attractiveness of the country was regarded insufficient by the Global Competitiveness Report. But it can potentially improve if economic development continues, labour shortage intensify in the country, and real wages are pushed up. However, if high level outmigration (some 3- 3.5

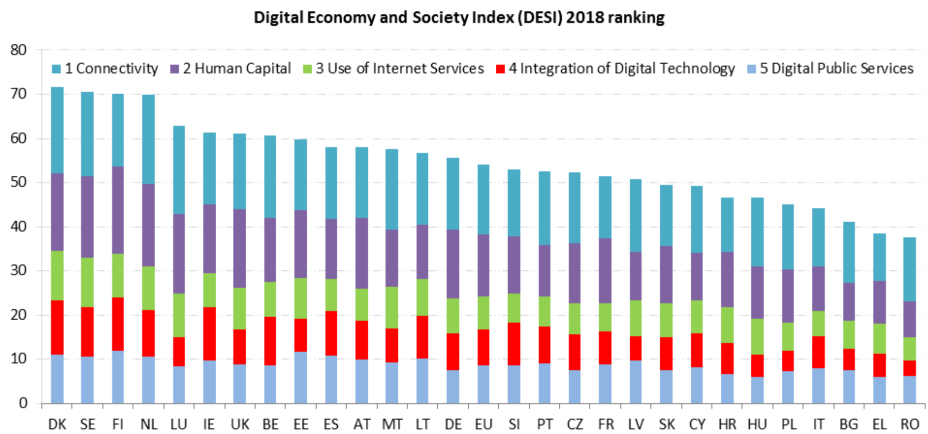
million people) had other reasons than insufficient employment opportunities and migrants turn out to be refugees, than real wage increases would seriously deteriorate the country’s very fragile international competitiveness position with FDIs just having started to explore the country.

5. Knowledge sector

As seen also in many other already mentioned indicators the knowledge sector does not belong to the country’s strengths. Inherited low level of development of institutions plagued the performance of the education and innovation system. Especially bad was the situation under the communist regime of Nicolae Ceausescu, who exercised strong political pressure on the system instead of providing it the necessary level of self-governance. The situation improved substantially in the Romanian transition process, but especially after the EU accession. Yet, the low profile heritage is still depressing the sector which is reflected in the performance measures.

R&D expenditure was a mere 0.48% of the Romanian GDP in 2016. This reflects huge hiatus both in public and private spending. Although the high-tech export seems relatively considerable, this is due to the export-oriented activity of a handful of multinational companies. Moreover, their effective activity in Romania is most probably not especially knowledge demanding but rather some simple labour intensive transformation or assembly phases of the production in the GVCs. Just as R&D public spending on education is also fairly low with 9.08% of the GDP (2015). The higher education rate was 28.6 % below the 30-40 % rate of most developed countries of the European Union.

The economic structure of the country with high share of agriculture and heavy industry does not seem advantageous for science and technology development and innovation (STI). This is reflected by the poor performance measures of the country in the European Innovation Scoreboard. Unfortunately, the country could not improve its ranking and still takes the last position of the 28 member countries, moreover, its gap is widening. Meanwhile in 2010 the country stood at 47% level of the EU-average in the synthetic STI measure (Summary Innovation Index), this position sunk to 33% level by the year 2017. Situation improved only in broadband penetration and slightly in medium and high-tech product exports (this later was due to new export capacities of multinational firms in car and electronics industry). The country's position is extraordinarily bad and deteriorating in human resources (down from 41% of the EU-average in 2010 to 22.5% in 2017), finance and support measure (from 48% to 22%), firm investments (from 65% to 13%).



The digital economy as part of STI world is not yet highly developed in Romania. In 2018, the country was on last position among the 28 European Union member countries. The good news is that the country could improve its performance over the past year, so the gap did not widen. The most important problem is that digitalisation of the economy and digital skills in the population is low. This hinders progress in most other dimensions as well. Broadband connectivity is on the other hand relatively high: 44% of the homes subscribe to ultrafast broadband. ICT contributes 6-7% to Romania's GDP and the digital sector is growing with two major hubs in Bucharest and Cluj-Napoca. All this achievements were at least partially due to the 2015 Romanian Digital Agenda 2020. But despite of the technical opportunities the degree of ICT affectedness is still below other countries' levels, in terms of internet usage, basic digital skills or the supply of ICT specialists. Because of inadequate human background various types of internet uses are also underdeveloped except video calls and social networks. These services are widespread cheap communication devices between dissidents and relatives left back in Romania. Digital public services is another very weak point of the Romanian digital economy and society system.

6. Public opinion attitude towards transformations

The byzantine heritage of Romania has influenced economic and social development also most recently, during the EU-accession process and with full membership. High level of corruption both in politics and in bureaucracy plagued the economy with little social control. This led to continuous poverty in most backward regions and a fairly ineffective use of the country's endowments. The EU accession process enforced the establishment and strengthening of some liberal structures in Romania. However, these efforts brought only very limited results when implemented by the "one step forward two steps back" approach of the Romanian governments that made all efforts to reduce outside or internal social control over their policies and practices. Therefore, a long term progress and catching up of the country requires the steady presence of (not very effective) Europeanisation anchors. Europeanisation has always been supported by the urban population and regarded as the main driver of gaining stronger control over inherited and transformed paternalistic linkages in polity and economy. Election campaigns always featured anti-corruption slogans, but most governments were then flawed in corruption scandals.

The most important field of debate has always been systemic (elite) corruption (Racovita 2011). Under pressure of the European Union Romania established not less than 6 anti-corruption authorities. Their activity area and licenses largely overlapped, and their control was rather chaotic. Their licenses were frequently changed. As a consequence, no effective control over corruption was carried out for many years. The European Union even froze negotiations about the last chapters of membership negotiations until results were delivered by the country in anti-corruption fight. During the mid-2000s this was done by the Anti-Corruption Office (DNA) and Romania was admitted to become EU member. Yet, the problem of corruption was not solved at all. On the contrary, the government forced President of DNA to resign. Continuous conflicts between Romania and the EU over issues of corruption are demonstrated by the fact that the recently dismissed DNA president became the strongest candidate for the President's post in the newly established

European Persecution Office. The task of the office would be among others to detect fraudulent usage of the EU funds in the member states.

While Romanian governments were not really interested in fundamentally changing the political and societal profile of the country, and successfully paralysed the effective functioning of institutions of the competition state, large part of the population desired getting rid of the traditional byzantine heritage. This is clearly expressed by mass demonstrations against corruption and some government measures recalling past routines. Also, opinion surveys show a surprisingly large support of western values. The ruling elite's clever policies could however dampen social pressures. Concerning opinion poll results we see for example that the social support and appreciation of the European Union is very strong in the country. According to the last survey (Eurobarometer 88) 76% of the citizens was dissatisfied with the economic situation of the country. Consequently trust in the government was very low (21% of the citizens). In contrast, 51% of the Romanians trusted the European Union. The most important problems for the Romanians were inflation and the cost of living, economic situation in general, and the low level of health and social security services. Support for the EU declined somewhat from the pre-accession peaks (e.g. 74% appreciation rate in 2004, then highest among the surveyed countries: Eurobarometer 62). There were high social expectations towards EU membership concerning solving important problems in various areas (foreign affairs, crime, economic problems, environmental protection, health and education, etc.). Unfortunately, these expectations were not fulfilled.

Conclusions

Romania is a country with great economic potential, but the usage of the opportunities is rather weak due to several historic, cultural and most recent political problems. The inherited weaknesses of social and economic institution systems could not be significantly improved up till the late 2000s. After 2010 however, we see a strong economic revival, partly based on the increasing role of FDI that can create the necessary conditions for the improvement of the underdeveloped infrastructure items. Unfortunately, systemic corruption still plagues all spheres of the economy and society that makes every reform step most difficult. Romanian governments do not rush to support effective market economic institutions that could potentially deprive them from their easy rents. Growing foreign owned sector can substantially improve the country's macroeconomic performance and thus create more stable environment. The modernisation process of the country and the expansion of its economy would badly need more efficient use of the resources. This is a task that cannot be solved without curbing historically embedded corruption and paternalism.

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