

THE IMPACT OF ROMANIA'S ACCESSION ON ECONOMIC GROWTH

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Abstract

The EU integration is a complex process that involves a series of coherent actions taken by the New Member States which must give priority to both nominal and real convergence in order to eventually succeed to adopt the single currency. Romania has made a significant progress, but the vulnerability of the economy was quite high when the spread of the economic-financial crisis occurred, since the economic development has not reached a sustainable level and it has been based on ineffective principles (too much consumption and indebtedness). The forecasts concerning the integration showed the growth would continue for 3-4 years, but it was proved to be inappropriate, because Romania, along with some of the new members have considerably suffered from external negative phenomena triggered by the global crisis.

Key words: economic growth, convergence, European Union, gross domestic product, foreign direct investments, productivity

JEL Classification: F43, F15, E21

1. Introduction

Romania has developed commercial relations with Europe, long before the start of accession negotiations. This paper deals with economic developments between 1990-2012. The first part briefly captures the measures taken by Romania in the 70s to take advantage of the best possible exports to countries in Europe. In the next part of the article is presented the economy of Romania before accession and the efforts made by this country to meet the requirements for growth and development. This paper also shows some of the effects (positive and negative) resulting from integration, but also their limitation due to the crisis.

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2. Romania's way into EU

The economic integration, defined as "the elimination of the economic borders between two or more states" in order to enable the actual or potential mobility of goods, services, productive factors, communication flows" is a challenge for all countries that joined the European Union. The central and Eastern European states have removed these barriers since the early '90s, even though the European agreements concerning market liberalization were made much later. The trade between the E.U and these countries has increased significantly long before the final stage of the accession process. The goal of the ambitious project for the EU enlargement is a united, free and prosperous Europe. Experts believe that the opportunity of this process exceeds the potential obstacles and the involved costs.

According to H. Grabble, joining the Central and the Eastern European countries is based on a mix of political, economic and security motivations². The new Member States have considered that enacting the EU membership is a way to regain the European identity, and their accession to the EU represents "a central strategy to meet the need of inclusion."

Romania's interest for the development of foreign trade originated long before the '90s. In the period 1972-1973 there were signed agreements with the EEC on tax exemptions (partial or total) for Romanian exports of food (pork, poultry, eggs, cheese). Moreover, there were made agreements on the access to this market of textiles, steel and other industrial products. It is noteworthy that in 1980, Romania is the first country in Central and Eastern Europe to recognize the EEC as an entity by signing the Agreement on the founding of the Joint Commission Romania-EEC. In 1989, the negotiations regarding The Agreement on trade, commercial and economic cooperation with our country were suspended, but since 1991, Romania has been subject to the same treatment that was applied to the developing countries.³

2.1. The evolution of the Romanian economy before joining the EU

The trade relations with the EU states have improved considerably in the period 1980-1990 (about 40% of exports and over 25% of imports).

All the above mentioned issues, aspects are the basis of what was to follow.

The transition from a centralized market economy to a functional one triggered major changes both at the economic and social level. The economic indicators fluctuated due to the influence of internal factors (the privatization and restructuring process, the inappropriate monetary and fiscal policy) and external factors (the requirements of IMF). In the period 1990-1992 the real growth rate of GDP decreased, and the agricultural and industrial production has considerably diminished. In the following years (1993-1996) there were made efforts to stabilize the economy and to reduce the rate of inflation. The effects were not long lasting because the fragility of the economies in transition was felt again in 1997. The real GDP growth rate was on a downward spiral and the price levels increased

² Grabble, H. - *Profiting from EU enlargement*, CER, London, 2011 (pp.7)

³ Fota, Constantin – *Integrarea României în Uniunea Europeană- "ante" și "post" aderare.*, Editura Universitaria, Craiova, 2008, pp.31-32

dramatically. As a consequence, the inflation rate reached 154.8%, compared with 38.8% in 1996.

In the period 2000-2006, the inflation rate decreased (from 45.7% to 6.56%), the interest rate diminished (from 35% in 2001 to approx. 8.5% in 2006), and also the budget deficit decreased (from 22.5% of GDP to 12.5% of GDP), the capital movement was gradually liberalized, it was established an economic framework for the business development, and the household income increased. Thus, on the 1st of January 2007, Romania (along with Bulgaria) became members of the European Union.

2.2. Post-accession period

The steps taken by Romania to integrate in the European structures and bodies faced a number of changes that have reformed the entire economy. The concerns related to sustainable development and progress are subject to community principles that have a great importance. These include: environmental protection, nuclear security, crime combat, food standards. Without neglecting their importance we would like to mention that the analysis herein focuses on the economic aspects.

Being part of the Single Market, our country benefits from free movement of goods, services, capital and persons. As expected, becoming a EU member our country fostered significant inflows of foreign funds. In the first half of 2007, the currency was appreciated. The second half brought a new challenge for the Romanian economy. Food prices increased as a result of the dry agricultural year, of an inadequate wage policy and credit expansion. Still, our country managed to maintain the average inflation rate at a lower level than the inflation rate from the previous year. The 4.9% value exceeded the 1.8% percentage established by the EU, but it is worth noting that Romania had far better values than other EU new member countries (Lithuania 5.8%, Estonia 6.7%, Bulgaria 7.6%, Hungary 7.9%, Latvia 10.1%). Even if the results were favorable on this indicator over the past decade, there was a vulnerability of the entire economic sector as a result of measures taken in terms of reaching productivity growth by increasing wages and excessively financing loans. Regarding the public finance criterion Romania had a positive development, public debt was much lower than 60% of GDP (about 13% of GDP) while the budget deficit, although higher than in 2006, did not exceed 3% of GDP (around 2.9% of GDP). The influence of the accession process had a great impact not only on the nominal indicators but also on the real ones. The GDP increased by 2007 to about 5.6% annually, and when joining the EU the GDP per capita was only 40% of the EU-27. This negative aspect was taken in consideration, but there was a priority in the sense that the focus was on sustainable development, not on its speed. This indicator was influenced by investments (positively) and exports (negatively). It was necessary to enforce a policy in the coming years to limit consumption and to promote the exports by not stimulating the imports.

In 2008, Romania passed a period with both benefits and costs of capital liberalization. The first semester of this year was favorable, the GDP increased, but the global economic crisis affected the economic growth and the foreign investor confidence diminished. The budget deficit exceeded the reference value, reaching 5.7% of GDP, due to the higher pension percentage (from 32 to 45 percent of the

average salary) and the Romanian state had to pay damages for refugees in Basarabia, Bucovina and the Quadrilateral areas. The economy of all countries was affected that year. The reference value of the inflation rate in the EU-27 reached 4% and thus Romania witnessed the first change of the inflation rate. The average value of this indicator for 2008 was about 8%. This change was due to the tensions caused by the oil prices, the price of food and the imports of raw materials. The negative consequences continued in terms of differences in productivity growth (below 10%) and salaries (over 20%). Thus, the Romanian products were expensive and the vast European market competitiveness decreased significantly.

The global financial and economic crisis had tremendous effects on the Romanian economy in 2009. The Romanian exports decreased. Foreign investors showed a greater aversion to risk and preferred to retreat to their home markets and also they chose not to invest in other countries in such a period of uncertainty that even the developed countries faced. The investments diminished by over 25%, the exports decreased by 5.5% and the private consumption by 9%, all these affected the evolution of real GDP, which decreased by 6.6%. The decrease of the domestic demand, due to the population's lower incomes had a positive impact on the dynamics of imports (-20%). The budget deficit continued to grow throughout the year reaching 9% of GDP. An increase of the budget deficit was reported in the entire European Union. The public debt remained below the reference value, but its alarming increase by more than 10% in just one year brought additional concerns to the Romanian state. A favorable evolution was registered by the inflation rate - 5.59%, which was below the previous year, due to the volume of the food supply, the lower gas prices, the adjustment of costs to the labor force.

The economic decline continued in 2010, the GDP decreased again this year, but only by 1.1%, which is much lower than in 2009. Moreover, the model of economic growth was changed. If until 2010 it had excessively been based on consumption, exports began to have a significant role from then on. Their increase by 28% was due to the external demand, to the exploitation of new growing export markets and due to the efforts to increase competitiveness. Romania's exports in this period were based on machinery, electrical equipment and transport means. Thus, imports of raw materials increased. Under these circumstances the budget deficit narrowed to 6.8% of GDP, but it still continued to increase the public debt by 30.5% of GDP (+ approx. 7 percentage points compared with the previous year). In the first semester of 2010 the national currency was appreciated because of the improved perception on the Romanian economy, but in the next semester the trend of the exchange rate changed due to the sovereign debt crisis Greece was facing at that time, investors fearing that such a critical situations may occur in other states. The average inflation rate increased slightly by 6.09% due to the higher VAT rate. The degree of openness of the Romanian economy, improved slightly but it was still far inferior to other new member states (Poland, Hungary).

In 2011, Romania continued the macro-stability economic policies, which aimed to reduce the inflation and the budget deficit and to provide sustainable economic growth. The inflation at the end of 2011 had low values (3.14%), and the average was below the previous year (5.79% versus 6.09%). The improving perceptions

concerning the market risks reduced the interest rate on a long-term. Moreover, a reduced value was reached as compared to the reference value. It was also registered a progress on fiscal consolidation. The budget deficit was reduced to 5.5% of GDP and even if public debt increased by 3 percentage points (these changes appeared on the one hand because of deficit financing and on the other hand because of the cash reserves established by treasury) had much better values as compared to values registered in 2008-2010. Thus, the economic openness improved. Exports and imports were on an upward trend, and net exports had positive results. Unfortunately FDI continued to decrease (-15%). The dynamics of GDP mirrored a positive growth (+2.2%), as a result of the favorable developments in industry, agriculture and construction, and also as a result of the increased domestic supply. The negative dynamics of real income, the high indebtedness of the population, the consumer uncertainty about the economic environment, along with reluctance of lending and a slightly negative value of net exports, made the GDP growth be limited. During 2011, the Romanian government took steps to increase the absorption of EU funds, but this level remained and still remains low (5.5% of the allocation for the period 2007-2013), although the absorption is higher than in 2010.

It was registered a slight revival of the Romanian economy in 2012, but this was not sufficient, because our country missed a number of targets set by European authorities that made agreements concerning the mentioned targets with the international lenders. The year was marked by two main aspects: political instability and the recession of the euro zone. The unemployment rate registered in December was among the lowest in the EU, but it still remained at a high level. The annual inflation rate was 3.3%. The price of food and nutrition products increased considerably mainly due to the fruits and vegetables sector was severely affected by drought. The budget deficit is another missed target of Romania. Poor income and the blockage of EU funds led to a value of 2.5% of GDP in December, 0.3 percentage points more than the one set between the national authorities, the IMF, the European Commission and the World Bank. Positive signals were registered in the foreign direct investment sector, which in the first eight months of 2012 increased by 55% as compared with the same period of the previous year.

Obviously, 2013 will encompass a new period of challenges. Romania's economy is largely influenced by the external environment. If the euro area and the Member States will be able to get rid of the recession, there may be registered an economic growth in the sense that Romanian exports to the EU countries will increase. This year, efforts and steps must be made to build trust with the foreign business environment in order to attract foreign investors and European funds.

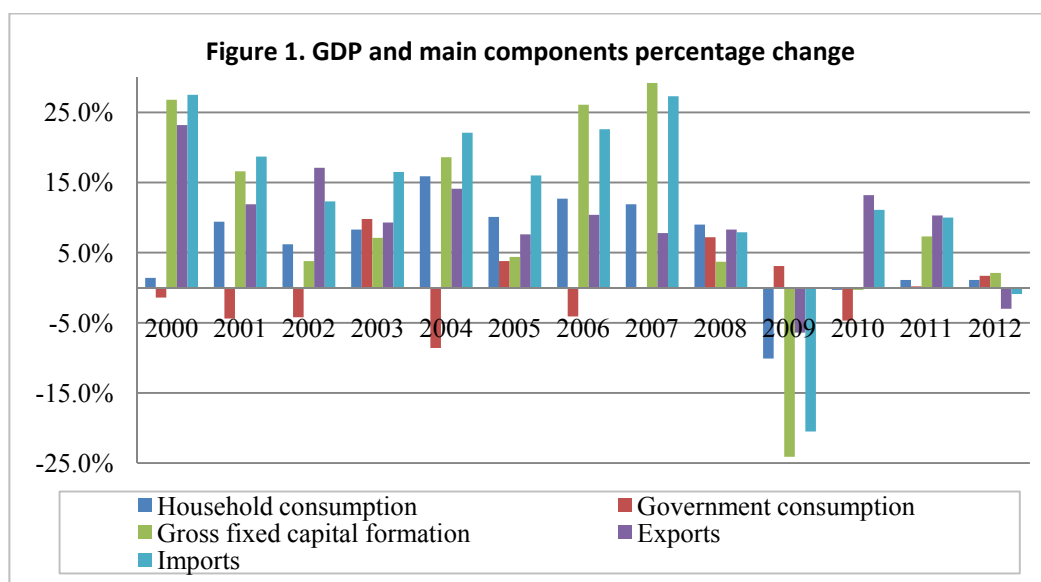
2.3. The effects of integration

Any new Member State has the goal of adopting the single currency, but to achieve this goal, it has to meet certain requirements, which concern the nominal and the real aspects of the economy. In the Treaty of Maastricht there were settled the nominal convergence requirements the new members have to meet in order to integrate in the European Monetary Union. All these requirements are not sufficient and a new member state must also consider the real aspects of the economy (GDP,

income, productivity), the latter ones providing the sustainability for the development process and for the economic growth. Thus, it appears that beyond accession, the new member states, along with Romania will have to strive to continue the process of alignment with the EU requirements and to improve all the sectors of their economy.

In the first years after accession (2007 and 2008) it was registered a positive development of the Romanian economy, which enjoyed a high degree of integration regarding the goods and services market, the labor and capital market. Thus, the standard of living and the capital accumulation increased.

As shown in Figure 1, the economic expansion was mainly due to the household consumption, especially due to the credit expansion and the increasing purchasing power. All these causes determined the increase of imports by 27.3% in the first year of integration compared to the previous year. This trend changed in the late decade of 2008.



Source: Eurostat

With a greater economic openness and the increased investor confidence, gross fixed capital formation reached the highest values in 2007. The investments made in the pre-accession increased the productivity and improved the competitiveness of the Romanian products by implementing modern technologies and by increasing the labor force formation. All these, along with the markets liberalization led to the increased trade between Romania and the European Union member countries. Also, as shown in Figure 1, the exports registered a continuous growth until 2009.

The economic crisis has severely affected the Romanian economy. One can see the economic decline in 2009 (as it is showed on Table 1). Of all the components of GDP, the one that increased is the government consumption. This happened due to the electoral pressures exerted during this period. The most significant decrease and decline was registered in the investments sector. As described above, Romania does not provide

to investors, to equity holders (both national and international ones) a healthy economic environment. In comparison with the first year after accession the economic decline was obvious again and the market risks were higher and higher. Local businesses substantially reduced the financial capacity to invest and foreign investors withdrew from the Romanian market or headed to other states where incomes were lower, but those economies were able to cope with the worldwide recession.

Tabel 1. - Romania's Macroeconomics Indicators

Indicator		2000	2006	2007	2008	2009	2010	2011	2012
Real GDP growth rate	%	-0,4	7,9	6,3	7,3	-6,6	-1,1	2,2	0,7
Primary Sector ⁴	% of GDP	12,0	8,9	6,5	7,5	7,9	8,8	-	-
Secondary Sector ⁵	% of GDP	34,4	36,2	37,8	37,7	37,9	38,8	-	-
Tertiary Sector ⁶	% of GDP	53,6	54,9	55,7	54,8	54,2	52,4	-	-
GDP / capita	euros	2.700	4.000	4.200	4.600	4.300	4.200	4.300	-
Labour productivity per person employed	% of EU average	23,7	39,7	43,4	49,2	49,4	48,5	49,2	-
Real desposable income	% of EU average	26,2	34,2	37,3	44,4	40,8	39,3	38	-
Business Investments ⁷	% of GDP	18,8	23,7	25,6	30,2	31,9	24,0	24,6	-
FDI growth rate	%	-	0,6	-0,2	0,3	-0,6	-0,4	-0,2	-
Saving Rate	% of GDP	12	12	12	16	19	19	21	21
Investment Rate	% of GDP	19	27	32	30	25	26	27	27
FDI	% of World FDI	-	0,8	0,5	0,8	0,4	0,3	-	-

*Source: *Eurostat, BNR, INS*

⁴ The Primary sector includes the production of raw material and basic foods. Activities associated with this sector include agriculture, forest, farming, fishing, mining. The productivity is low and it depends on the mother nature, and the demand is inelastic.

⁵ The Secondary Sector includes manufacturing, processing, and construction. Activities associated with this sector include automobile production, textile production, energy utilities, engineering, constructions. The productivity is higher than the primary; the demand is elastic.

⁶ The Tertiary Sector provides services to population and to business. Activities associated with this sector include retail, transportation and distribution, entertainment, restaurants, tourism, insurance, banking, healthcare, law. The productivity is highest.

⁷ The indicator gives the share of GDP that is used for gross investment. It is defined as gross fixed capital formation (GFCF) expressed as a percentage of GDP for business.

The developments registered in the period 2010-2012 emphasized the high vulnerability of the Romanian economy due to external influences, and it also appeared and manifested as a result of the high interdependence of its relations with the external environment. As it can be seen in Table 1, even if the GDP continued to decline in 2010, the decline was not so significant because the exports registered a 10% increase. GDP per capita at PPP almost get doubled during 2000-2012, but compared to UE27, it can't exceed 20%.

Labour productivity per person employed has improved significantly. They reached values twice larger, and Romania had the highest growth in the region (from a level of 23.7% of the EU27 average in 2000 to 49.2% in 2011). Determinants consist of increasing workforce skills, the availability of equipment and attracted new technologies in the production process.

Real disposable income is reduced comparing with other new members. Despite its growth efforts to improve the standard of living of the population, at the end of 2011 the Romanians had disposable income of only 40% of the EU27 average (the lowest value, except Bulgaria), by 6 percentage points below 2008 (Table 1). Reducing these revenues may be caused by the need of governments to adopt a policy of increasing the amounts collected to the state budget by raising taxes for income in the period after 2009. Romania can improve the standard of living of the population by rising income per capita as a result of increasing labor productivity and this can cause long-term reduction in population that migrates to other states.

Structure of Romanian economy differs from that of the EU27, which is why structural divergence index is very high. During 2006-2008 it tends to be reduced to 33% but it returns a little over 40% after 2009. The divergence starts mainly due to the high share of primary sector in GDP. In the European Union it is 1-2%, but in Romania last few years was about 8%. After 1990 its share still decreased but we cannot say that it has reached levels comparable to other Member States. Structural gap is due to the services which have a contribution to GDP of about 50%, while the EU27 average is somewhere over 70%.

The Percentage of business investments in GDP increases continuously between 2001 and 2008 (from 15.83% to 24.43%) in the coming years diminishing up to 13.34% (in 2011); but, during the entire period continued to be higher than average value of EU27. This shows that the private sector has a high growth potential, but to continue, Romania needs to develop its capacity to absorb EU funds. The possibility of such funding allows reconstruction, strengthening and eliminating disparities in relation to the other Member States but European funds becomes difficult in condition of co-participation.

Romania's economy has developed mainly on the basis of funds raised from outside because the savings rate was quite low, especially until 2007. The key to future growth is the foreign direct investment (FDI), which is still from the pre-accession an engine of development and progress. Their volume has increased rapidly since foreign investors have exploited market opportunities (greenfield investments, mergers, acquisitions). FDI flows reached maximum values in the year

2008 (8491 million - about 0.8% of global FDI), but the spread of the crisis led to a decline of over 50% in 2009 and continued to decline until 1484 million in 2011 (0.3% of global FDI). FDI flows are needed, they increase productivity, competitiveness, skill levels of employees. If the external situation improves and the Romanian authorities will continue structural reforms and adopt appropriate policies, foreign investor confidence can be regained. It is a reality that Romania needs major investments that only domestic savings can not support.

3. Conclusions

There were advantages once with the EU expansion, both for old and new members, being a process that still reinforces peace and stability in the region. Romania, along with other New Member States felt the allocation and accumulation impact. Since the signing of the first trade agreements between Romania and EU, the trade volume increased almost 3 times. The liberalization had also a positive and a negative feedback. The uniformity of incomes was a slower process, since it involved a longer period, and labor force could migrate to markets with higher marginal incomes, thus enhancing the already existing gaps between center and periphery (a situation faced by Romania after accession). Today, another effect is the possibility of the domestic producers to enter new markets, but also the possibility of the foreign producers to enter the domestic market, but still problems arise in the sense that the Romanian businesses are not capable of producing competitive goods and services concerning both price and quality; moreover, the domestic companies have to cope with the increased, even fierce competition, if not, they are going to be eliminated. The EU membership generally builds trust with investors which as noticed at the beginning of the accession negotiations were highly interested in Romania. A larger volume of investments has definitely a great impact on productivity growth, employment and a better technological transfer. The accession to this group which has economic and political power brought benefits, but as you can see the initial enthusiasm diminished after accession. The convergence process must be continued but it requires substantial efforts, mainly due to the global economic environment - global crisis.

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