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Effects of the economic crisis in Romania

Abstract

In Romania, the economic crisis started at the end of 2008, deeply affecting the living standards of the population. From the beginning, a significant number of people lost their jobs, while income levels recorded a significant decrease. The consequence was that expenditure on consumption fell, precipitating a further decline in production and investment. The reduction of exports led to a significant diminution of production volumes, and in 2009 compared to 2008 there was a significant decrease in the volume of exports. The external balance of payments was retained by a greater reduction in imports, which negatively affected economic growth. Domestically, the balance was deeply upset; and public expenditure significantly outweighed income. Public debt increased, with the government having to take out massive loans. In 2009, Romania entered into a loan agreement with the IMF to sustain expenditure, under conditions of a short-run reduction in budget income. This article presents specific aspects of the economic crisis in Romania and analyses the consequences of the economic and political measures applied by the public authorities.

Keywords: *economic growth, economic crisis, public debt, loan agreement*

Economic outlook

Looking ahead, the economic signals are encouraging; both European Commission and IMF forecasts reveal a consolidation of economic recovery for eastern and central European member countries in 2011. The lowest annual growth rate is, however, expected to be found in Romania, i.e. about 1.5 %. According to expectations, domestic demand will have an important contribution to make to economic growth although, in some countries, exports will remain the engine of economic activity. However, there are risks in these perspectives.

The greatest risk is the maintenance of unemployment at a high level, although it has gradually been reduced, starting from the first half of 2010. The high level of unemployment can affect private consumption over a long period. Also, there will be only a modest increase in domestic demand if debt reduction in the private sector is continued. Further uncertainties are generated by perspectives on external demand, where a reduction can determine the rate of decrease in the dynamic rate of exports and in capital flows from the region.

These uncertainties are more significant in the case of Romania. Measures for reducing the budget deficit and reforming the public sector have contributed to a decrease in domestic demand on top of the reduction caused by the general effects of the crisis.

Three important elements have contributed to this situation: the macroeconomic imbalances accumulated in the period before the crisis began; low levels of competitiveness on the world market; and the reduction of foreign capital inflows.

The imbalances from the period preceding the crisis refer mainly to the increase in wages and pensions over and above the productivity gains. The adjustments to wages have partially contributed to the difference in price competitiveness compared to other countries. However, domestic consumption was affected; the increasing perspective as regards this indicator being limited.

At the same time, an increase in competitiveness was partially attained by a significant nominal depreciation in the national currency.

The reduction in capital inflows was due to decreases in the incomes of those who are working in other countries (over three million Romanian people are working abroad) but, in particular, it was due to a decrease in foreign direct investments. For Romania, the low level of attraction of European grants contributed to this development.

Table 1 – GDP projections for 2011 (percentage annual variations)

	European Commission	International Monetary Fund
Bulgaria	2.6	2.0
Czech Republic	2.3	2.2
Estonia	4.4	3.5
Hungary	2.8	2.0
Latvia	3.3	3.3
Lithuania	2.8	3.1
Poland	3.9	3.7
Romania	1.5	1.5

Source: ECB (2010) Monthly Bulletin December

Historical trends

Positive perspectives, where they exist, are based on the trends in general economic activity during the last few years, especially after the crisis began.

In the 2000-2008 period, Romanian GDP recorded a continual increase. The average growth rate during 2003-2008 was about 6.5 %, while sustainable growth was possible due to the massive foreign capital inflows in this period (Isărescu, 2009).

The main source of foreign capital inflows in Romania from 2003 to 2008 was represented by EU countries. Compared to other countries from eastern and central Europe, which benefited from significant foreign investments during the 1990s, Romania had a late start, being 'discovered' by foreign investors only in recent years and particularly after accession to the European Union in January 2007. In 2008, the net inflow of direct investments stood at €9 496m (Romanian National Bank report on FDI).

This is one of the main reasons why, during 2003-2008, GDP per head expressed in terms of purchasing power parity (PPP) grew rapidly in Romania, by about 74 %, while, in the other countries of the region, the increases in the same indicator were much lower – about 40 % in Poland, 34 % in Czech Republic and 20 % in Hungary (Romanian National Bank Annual Report, 2008). In 2008, the level of GDP per capita (in PPP) in Romania reached €11 300, approximately 43.5 % of the EU average, compared to 40.7 % in the previous year.

The budget deficit was maintained in the 2003-2008 period at a strict limit of 3 %, which was required to be respected from the perspective of introducing the euro. There was an exception to the rule in 2008, when the budget deficit increased to 5.7 %, although GDP recorded an increase of 7.3 %. Public debt was 20 % of GDP, significantly below the level of 60 % recommended by the EU.

Inflation witnessed a declining trend, falling from 15.5 % in 2003 to 4.8 % in 2007, before then increasing to 7.9 % in 2008. Similarly, the unemployment rate decreased continually from 7.4 % in 2003 to 3.9 % in 2007 before then increasing to 4.4 % in 2008.

The high level of foreign capital inflows, with investment funds not being the result of internal activity and saving, had important consequences for the economic and social development of Romania: the appreciation of the national currency; a rapid increase in asset prices; a reduction in the cost of credit and an increase in the indebted population; and the dependency of the banking sector on foreign capital – but, most crucially, the delaying of structural reforms and the loss of external competitiveness.

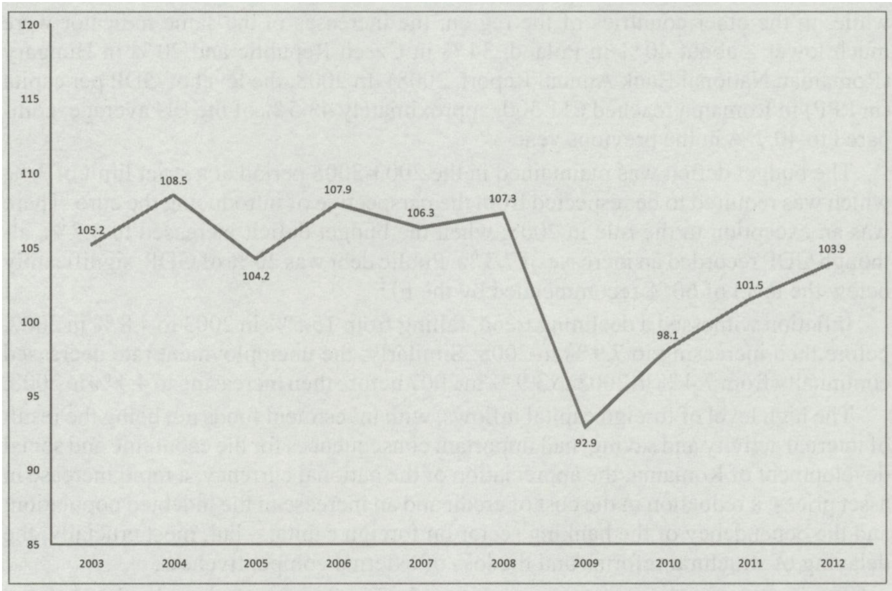
The increase in currency reserves achieved through their purchase by the National Bank, and the increase in the minimum mandatory reserve level, did not limit, other than slightly, these external capital inflows. The other lever – the taxation of foreign capital inflows – was used marginally.

Table 2 – Aspects of national finances (% of GDP), 2003-2012

	Public debt	**Budgetary deficit**
2003	26.0	-1.5
2004	22.5	-1.2
2005	20.4	-1.2
2006	18.7	-2.2
2007	19.9	-2.6
2008	20.1	-5.7
2009	27.5	-7.4
2010	31.7	-6.5
2011	33.0	-4.5
2012	31.9	-3.4

Source: National Forecasting Commission

Figure 1 – Gross domestic production variation in Romania, 2003-2012 (%)



Economic crisis

The economic crisis which began at the end of 2008 found Romania unprepared. The economy of Romania was based on massive foreign inflows, on the presumption that this situation would continue to last forever; there was just about full employment, unemployment being at its natural limit; the population was more indebted than current income should have allowed; the public sector was unrestructured and inefficient; a sustainable development strategy was lacking; and the environment of economic affairs was dominated by group and clientelist interests.

This crisis was really the first with which Romania has been confronted. The other recession periods were due to the transition from the planned economy to a market-based one. Initially, however, the crisis was mostly ignored by the Romanian authorities.

The prime minister at that time, Călin Popescu Tăriceanu, explained it thus:

> Imagine that the global economy is the Titanic, which had hit the iceberg, with some of those downstairs on the lower floors in water over their heads while upstairs, on the second and third floors, the music was playing, like in the film. Those for whom the music is playing are here in Romania; they did not hear that the Titanic had hit an iceberg. This is the way in which we find ourselves. (Popescu Tăriceanu, 2008)

Financial stability was maintained at the beginning, but the markets for main export products rapidly grew to be restricted. In December 2008 compared to the October of the same year, exports dropped from €3 245bn to €2 550bn, i.e. by more than 40 %. Industrial production decreased in December 2008 by 19.2 % on the previous month.

External private credit lines were severely reduced, the income sent home by Romanians working abroad significantly decreased and the aversion of foreign investors to face risk increased. In the last quarter of 2008, GDP recorded a decline of 3.8 %.

All these internal and external factors contributed to a significant decrease in GDP in 2009, to the tune of 7.1 % following an increase of 7.3 % in 2008; as well as deep damage to the budget deficit, which stood at 7.4 % of GDP compared to 5.7 % of GDP in the previous year; the impairment of the national currency; and the substantial diminution of the current account deficit, at 4.5 % of GDP from 11.8 % of GDP in 2008 (Romanian National Bank Annual Report, 2009).

The final consumption of households decreased in 2009 by 9.2 %, a trend which was continued into 2010, with a fall of a further 3.3 %. Real earnings decreased in 2009 by 5.3 % and in 2010 the decrease was 3.7 %. The inflation rate increased in 2010, to 8.2 %, while unemployment reached 7.3 %.

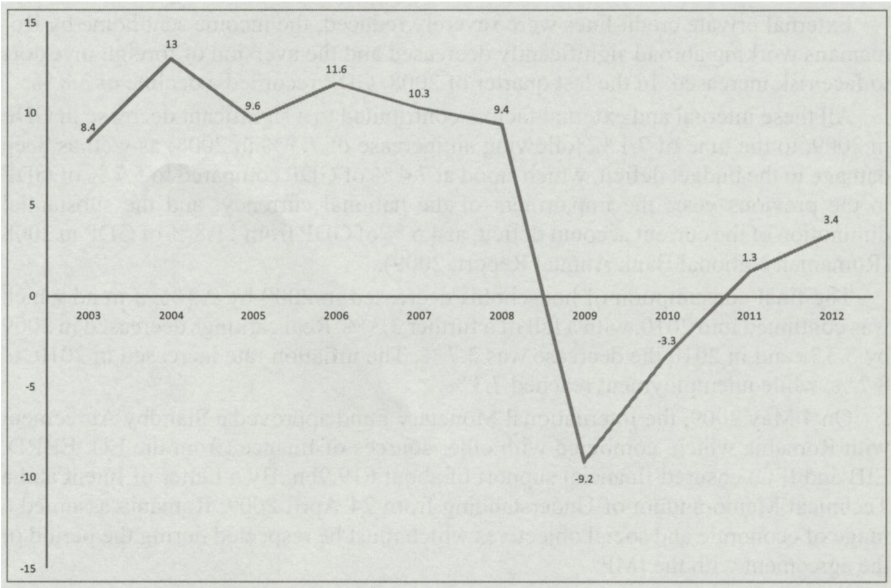
On 4 May 2009, the International Monetary Fund approved a Standby Agreement with Romania which, combined with other sources of finance (from the EU, EBRD, EIB and IFC) ensured financial support of about €19.9bn. By a Letter of Intent and a Technical Memorandum of Understanding from 24 April 2009, Romania assumed a range of economic and social objectives which must be respected during the period of the agreement with the IMF.

Table 3 – Economic indicators, 2003-2012 (prior year = 100)

	Inflation rate	Unemployment rate
2003	15.5	7.4
2004	11.9	6.3
2005	9.0	5.9
2006	6.5	5.2
2007	4.8	3.9
2008	7.9	4.4
2009	5.6	6.3
2010	8.2	7.3
2011	5.3	7.9
2012	3.5	7.6

Source: National Forecasting Commission

Figure 2 – Final consumption expenditure of households (%)



Maintaining the gaps

Dynamic analysis emphasises the changes produced in a particular time interval concerning countries' level of development and their positions relative to each other. In the last ten years, many nations have recorded important progress. However, there have been few changes concerning the relative position between developed and less developed countries: the world has been continuously changing but nothing, or almost nothing, has changed concerning the distribution of wealth on a global level.

Such a conclusion can be proved by analysing the changes recorded in the last ten years at the regional or global level. The percentage growth in GDP in the most powerful economies of Europe is relatively lower than the increases in GDP in eastern European countries. Apparently, the less developed countries have recovered some of the gap compared to developed countries. In reality, however, western European countries have maintained their dominant positions. In the last ten years change has not happened; no country has left the group of developed countries and not one country has entered this group.

The economic potential of eastern Europe countries remains inferior to that of western countries (and, again, not one single country changed the group to which it had belonged ten years previously), although it could be argued that the period under analysis is too short to allow significant changes concerning the level of income per capita.

Analysing aspects of economic growth in depth, it can be established that, concerning GDP per capita, the gap to developed countries has actually increased in the last ten years; in only a few cases have the gaps reduced. The same situation is found if the analysis is extended to take into account the last twenty or thirty years.

The economic capacity of western European countries is greater than that of eastern Europe; Romania has a level of GDP per capita which is four times lower than that of Germany, France, Italy, etc.

The incomes available to developed countries allow them to have a different approach to economic crisis. Empirical evidence shows that developed countries have found it easier to deal with the negative effects of the crisis and have rapidly overcome the phase of recession.

In addition to the gaps between developed and developing countries, a more important gap is appearing within countries from eastern Europe: i.e. the gap between people with high and low levels of income.

Table 4 – GDP at current market prices (€, 1 000 million)

	1998	2008	%
Germany	1 952	2 496	27.8
UK	1 300	1 816	39.7
France	1 315	1 950	48.2
Italy	1 087	1 572	44.6
Spain	537	1 095	103.9
Czech Republic	55	149	168.2
Poland	153	362	136.0
Hungary	42	106	152.4
Romania	37	137	266.0
Latvia	6	23	284.3

Source: National Forecasting Commission

Factors in economic growth

The effects of the economic crisis in Romania have been extensive and lasting. Are these trends the result of the lastingly poor economic traditions of Romania?

It remains true that the Romanian economy is lying in last place in the EU concerning objective results, productivity, innovative capacity, investment capacity and technological and organisational capacity. Does this flow from a historical point of view that Romania was always in this situation and will never overcome it?

In the short-term, the trends in general economic activity are determined by incidental or local factors as well as by the concrete conditions in which economic activity takes place (via rules, institutions, politics, etc.).

However, in the long-term, the trends in economic status cannot be other than those which result from the historical trend. Is the historical trend a factor in economic growth? In other words, in the long-term, we have the place we deserve, i.e. the last one, taking account of the recorded historical trend.

Evolutionary macro-economics, which is based on the idea that the main determinant of economic growth is a lengthy process, currently generates a powerful return in terms of economic debate (Foster, 2010). One of the greatest challenges facing economists is the need to offer a theory of economic growth which corresponds to the historical data. Historians reveal that economic growth is the result of the process of innovation, entrepreneurship, technological and organisational innovation, education, training and experience.

Conclusions

The opportunities offered by global competition are not in use in Romania. Some aspects of the closed economy are still present. Participation in the international exchange of goods, technologies and services is still at a low level. In addition, at the theoretical level, an approach to thinking which is based on the way of a planned economy still remains in place.

Co-operation, collaboration, development of new common projects and interest promotion at the global level must be the essence of political economics in the following period. In this sense, the promotion of co-operation in the field of education represents a major objective for the reform of the Romanian educational system.

There are some aspects of under-development which are interesting. For example, looking for places full of history and mystery, Prince Charles bought a castle in Viscri in Transylvania, a region of Romania. The London *Evening Standard* of 6 October 2006, described the village of Viscri thus:

> The dusty, rutted track that leads to the remote village of Viscri in deepest Transylvania is an obstacle course of knee-deep pot-holes. Visiting Viscri, in central Romania, is like journeying into the past — to a medieval landscape and existence that has been bypassed by all things modern. In this pre-industrial land of myth and legend, of vampires and the blood-sucking Count Dracula, the Prince is said to have found *a personal serenity*.

Without doubt, some aspects of life nowadays are related to medieval times. The traditions, customs, way of life, beliefs, superstitions, etc. are, in some places of Romania, similar to medieval ones. But some aspects of modern day life can also be found among them: education; communications; and even some elements of infrastructure.

This mix between old and modern can represent a trump card, as well as a point of interest and a point of co-operation. Poverty and a return to the past cannot be acceptable from a social point of view; macroeconomic policies should have, as a major objective, the raising of the living standards of the population. Even if, through economic growth and development, some aspects of the traditional Romanian way of life are lost forever, this is the only path to be followed.

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