

Guest article:

Romania: Ten Years of EU Membership

Gábor Hunya¹

Abstract²: *By joining the European Union as of 1st of January 2007, Romania made use of a window of opportunity which may not have been open later. In the ten years that followed, advantages and challenges of the membership have in part been overshadowed by the impact of the global financial crisis. The country went through a boom-bust-boom economic cycle. The swing from overheating to depression and back again to overheating has been amplified by pro-cyclical economic policy. Romania has been a selective policy taker in the EU often delaying fiscal and legal actions resulting in lost benefits. By reviewing the current political uncertainties in Europe, the conclusion emerges that more effective governance and more active foreign policy is necessary under the current Europe-wide orientation loss. The country may need to develop a mobilising strategy and policy beyond the direct benefits provided by the EU, one that also contributes to the success of the European integration.*

Keywords: *EU integration, economic development of Romania, macro-economic policy, EU membership*

JEL classification: *F05, E06, O52*

A story of mixed success

Ten years after its accession to the EU, Romanians keep showing a high rate of confidence in the European Union (68% tend to trust).³ They see the benefits of EU membership primarily in the freedom to travel and work abroad. ‘Enthusiasm’ was especially upbeat in the first two years of membership when more than 600,000 people left the country; another almost 300,000 emigrated in the following seven years (net migration balance according Eurostat). The number of those working or studying abroad temporarily is estimated at an additional 2.5 million.

Despite large emigration, Romania’s economic growth has been remarkable: the volume of GDP grew by 30% between 2005 and 2015 in real terms, which is the third highest rate

¹ **Gábor Hunya** is senior economist at the Vienna Institute for International Economic Studies, wiiw. His main fields of research include foreign direct investments and the Romanian economy. E-mail: hunya@wiiw.ac.at.

² An earlier version of this article appeared in the wiiw Monthly Report No. 1/2017.

³ Standard Eurobarometer 83, Spring 2015.

among the Central and East European EU members (EU-CEE) after Poland and Slovakia.⁴ Reflecting the effects of migration, price level and economic growth, per capita GDP at purchasing power parity (PPP) rose from 34% to 57% of the EU28 average in the same period. This fast pace of catching-up is especially remarkable compared with the previous ten years when the development gap hardly narrowed (32% in 1995 and 34% in 2005).

Closing the development gap between Romania and the EU cannot take place overnight, however, nor in a decade or two. In the EU-wide ranking, Romania has overtaken only Bulgaria, making it the second least developed Member State. Although we lack calculations of the contribution of EU membership to the improved macroeconomic performance, it is most likely that the accession has improved the legal stability, FDI inflow and financial transfers from Brussels have decisively contributed to Romania's economic growth. When going into detail, however, one discovers several shortcomings in the economic policy, doing business conditions and the rule of law. Many of these have to do with the premature EU accession and the slowdown of the pace of reforms in the post-accession period. Romania's institutions and administration are still not functioning well enough, therefore there is enough room for the country to fully benefit from EU membership.

Premature EU accession

The negotiations between 2000 and 2004 were spent with the transposition of the community rules and standards into the Romanian legal system and there was neither time nor capacity for their proper internalisation and implementation. In the 2006 monitoring report, the European Commission (EC) stated that 'the country made sufficient progress and would not put at risk the EU's core policies and its regulatory framework'.⁵ This positive view reflected the interest of the EC being in an enlargement-friendly mood similar to the EU member states which were ratifying Romania's accession treaty. When the European Court of Auditors (ECA) opposed the accession of Romania and Bulgaria on the grounds that EU money would not be spent efficiently, it was seen inopportune to change the process of accession.⁶ It was left to the new member states to step up reforms in their own interest.

The concern that Romania needed more time to prepare for accession, so that EU transfers could be absorbed in a more efficient way, has proved to be correct. Lack of institutional capacity and wide-spread corruption has hindered the country to fully benefit from EU funds. Out of the EUR 15.5 billion allocated to Romania under the EU cohesion policy in 2007–2013 (supplemented by EUR 3.4 billion national co-funding), only 75% could be spent by April 2016.⁷ The total sum used in Romania amounted to 1.5% of the cumulative GDP over

⁴ We do not stick to the 2007-2016 period in this analysis as most of the processes related to EU accession started earlier when the decision about membership was made, and also because no final data for 2016 are available at the time of writing. Data are from Eurostat.

⁵ Communication from the Commission – Monitoring report on the state of preparedness for EU membership of Bulgaria and Romania, Brussels, 26.9.2006, COM(2006) 549 final.

⁶ <http://www.euractiv.com/section/enlargement/news/auditors-romania-and-bulgaria-were-not-ready-for-accession/>.

⁷ Applica, Ismeri Europa and Cambridge Economic Associates, 'Country report Romania – Work Package 1 Ex post evaluation of Cohesion Policy programmes 2007–2013, focusing on the European Regional Development Fund (ERDF) and the Cohesion Fund (CF)', September 2016.

seven years, one of the lowest shares among the new EU members. There have been some remarkable results nevertheless, including the expansion of water and sewage infrastructure and the modernisation of public heating systems, while the large amount of funds spent on road construction resulted only in a fragmented motorway network. (In the 2014–2020 period the allocated funds are two times higher comparing to the previous one.)

Boom and bust economic cycle overshadowed the benefits of EU membership

An overarching account of Romania's economic development since 2007 is primarily the story of managing the impact of the global financial crisis amid recurring political strains and only to a lesser extent an impact assessment of EU membership itself. The Romanian economy underwent a full-fledged boom-bust-boom cycle in the past ten years (Figure 1). Rapid capital inflows and pro-cyclical fiscal spending resulted in consumption booms both in 2006–2008 and in 2015–2016. Increasing instability in the first boom period triggered high inflation and currency devaluation, making the country highly vulnerable to the global financial crisis. That growth trajectory proved unsustainable thus GDP contracted in 2009 and 2010, then stagnated in 2011 and 2012.

The modest but balanced post-crisis recovery of 2013–2014 was followed by an expansionary fiscal policy in 2015 leading to rapid GDP growth especially in 2016. The difference between the two boom periods is that this time inflation was negative due to the VAT cuts and low international commodity prices, while the external balance was in much better shape than in the earlier period. In other words, capital inflows have become more cautious and do not finance excessive current account deficits. As a result, the rate of economic growth in 2015–2016 has been only about half of what it used to be in 2006–2008.

A more detailed analysis reveals that the economic policy aggravated the impact of the global financial crisis, and the stabilisation steps were taken too late and too harsh⁸. In 2008 Romania was heading towards unsustainable current account deficits – already before the financial crisis. Also, fiscal deficits were on the increase on account of high public sector wage increases that the liberal government handed out to win the 2008 elections. It failed to win despite a rise of fiscal expenditures on wages by 87% in nominal terms over two years. In 2009, fiscal deficits expanded to 7.5% of GDP, also on account of recession. The government had no credible economic policy of its own; none of the three governments in office during 2009–2010 had been able to come up with a fiscal programme that could be trusted and implemented. The authorities shifted the bulk of the uneasy task of economic policy-making to the IMF. In order to forestall a further deterioration of the situation, the government called the EC-IMF-WB troika for help. On 4th of May 2009, the Executive Board of the IMF approved a '24-month Stand-By Arrangement for Romania to support an economic program to cushion the effects of the sharp drop in capital inflows while addressing the country's external and fiscal imbalances and strengthening the financial sector'⁹. The programme combined short-term budget cuts with longer-term fiscal policy reforms as a condition for loans worth EUR

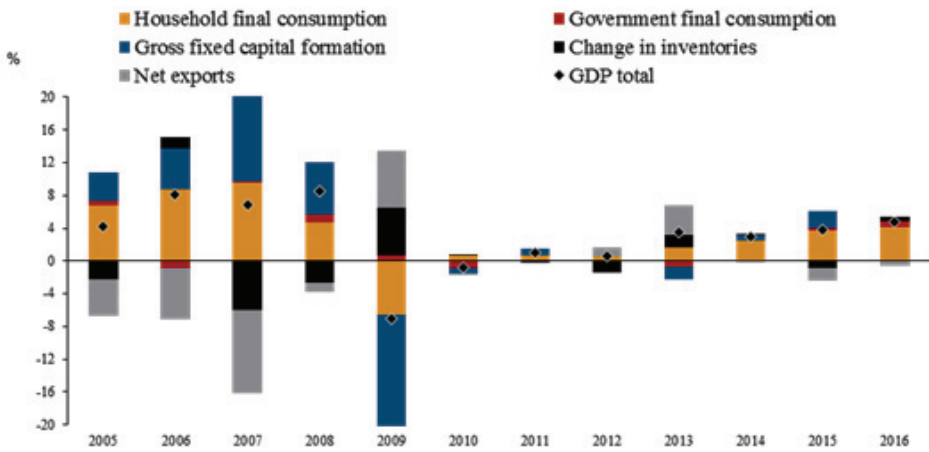
⁸ The author's detailed analysis of Romania's economic development of the past decade can be found in the forecast reports of wiiw published on a semiannual basis. <http://wiiw.ac.at/wiiw-forecast-reports-ps-50.html>.

⁹ <http://www.imf.org/external/np/sec/pr/2009/pr09148.htm>.

20 billion. As a result, the country entered a downward spiral of economic contraction and fiscal austerity. Expenditure cuts were enforced as of July 2010 in the form of public sector wages slashed by 25%. Additional fiscal revenues were accrued by the increase of the VAT rate from 19% to 24% and by broadening the scope of social security contributions. Fiscal stability was achieved, but the economy stagnated for another two years. Based on ex-post calculations, less fiscal restriction would have caused less recession and achieve the same stability at a higher GDP level.

Figure 1

Romania: Contribution to real GDP growth



Source: wiiw Annual Database incorporating national and Eurostat statistics, 2016 wiiw forecast, author's calculations.

Romania emerged from the financial crisis with an export-led economic growth in 2013. The fiscal stance was kept restrictive and household consumption recovered only modestly. Abundant liquidity on capital markets and increasing trust brought down the cost of market financing. This happened although many of the structural reforms stipulated by the IMF accord remained pending. Fiscal arrears could be reduced, but the privatisation and restructuring of loss-making state-owned enterprises made little progress. Still, based on the improved financial situation, further fiscal austerity did not seem justified in the following years. Nevertheless, the Medium-Term Objective (MTO), an obligation under the preventive arm of the EU Stability and Growth Pact and the new IMF precautionary stand-by agreement, prescribed to bring down the structural budget deficit to 1% of GDP in 2015. The socialist-led government broke the commitment in order to increase both wages and investments which proved successful in the given circumstances. But the major aim of the 2016 tax reform implemented ahead of the December elections was mainly political – to bring back

the VAT rate to the June 2010 level and increase public sector wages by at least as much as they had been cut in the austerity period. Fiscal policy swung back to expansion by which the ten-year cycle was completed. The political benefit could be reaped this time, bringing back a socialist-led coalition after a year spent under a caretaker government. A rare window of opportunity for improving institutional efficiency and structural change has opened up based on the achieved economic stability and parliamentary majority.

Romania's economic growth of 4.8% in 2016 was one of the highest in Europe. Soaring household consumption was the main component of growth and government consumption also contributed positively, while fixed investments and the foreign balance were on the negative side. As to 2017, the government took measures to speed up economic growth by further generous incomes policy measures. It is not all that clear why consumption needs further stimulation as its growth has been robust enough. Expanding fiscal deficits at a time of high economic growth is a pro-cyclical policy which proved disastrous ten years before. Overshooting in the austerity period is now matched by an overshooting in growth stimulation. The response of the economy to fiscal stimulation has at least not been all that harmful yet as demand increased more for than for imported consumer goods. The domestic production of goods and services absorbed most of the surge in household demand thus the trade balance did not deteriorate to a large extent.

The longer-term prospects of the Romanian economy will be sobering if investments do not recover. The government's 2017 budget law is based on the ambitious assumption of 5.2% GDP growth driven by both consumption and investments. This assumption may be based on the desire of keeping the fiscal deficit below the 3% of GDP. Demand stimulation will not be enough to reach that economic growth rate; an investment miracle must take place. Not only EU funds need to be absorbed at a faster pace but also the private sector needs to expand and modernise capacities. But what if growth will not achieve the forecasted level, which is very much likely? The government may find itself in the unfavourable situation with a deficit above 3% of GDP as it will not be able to generate the expected revenues. In this case, it will have to cut expenditures which have been tied by wage commitments. It will be public investments that will again fall victim to the necessary austerity.

The current role of EU institutions is, among others, to safeguard the Romanian government from falling into fiscal overspending which would harm the country as well as the international partners. The 3% of GDP fiscal deficit rule has its own fallacies but it cannot be considered out of place in times of high economic growth. It is actually a maturity test of an EU member state to control the political cycle of economic policy. The European Commission may find it necessary to impose an excessive deficit procedure to bring back the government to a balanced economic policy path.

Structural change generated by FDI

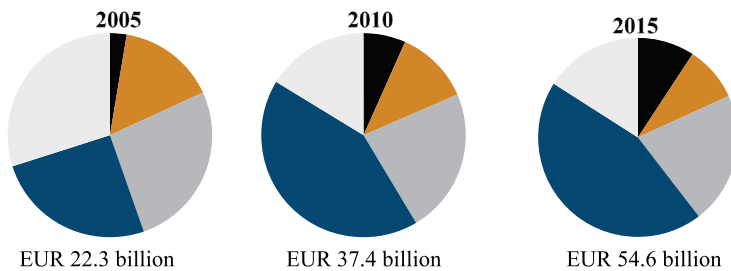
Meanwhile the real economy underwent remarkable structural changes away from agriculture and light industry to more sophisticated manufacturing and services. Improved competitiveness of the Romanian economy is expressed in expanding export volumes of both goods and services and the growing export shares of machinery and transport equipment

(Figure 2). This is to a large extent due to the activity of foreign investors that came to the country after the announcement of EU accession. FDI stocks per GDP increased from 27% in 2005 to 40% in 2015, and Romania climbed from the penultimate to the seventh place among the EU-CEE countries.

Figure 2

Romanian goods exports by SITC commodity groups, fob

- 0 Food and live animals; 1 Beverages and tobacco; 4 Animal and vegetable oils, fats and waxes
- 2 Crude materials, inedible, except fuels; 3 Mineral fuels, lubricants and related materials
- 5 Chemicals and related products, n.e.s.; 6 Manufactured goods classified chiefly by material
- 7 Machinery and transport equipment
- 8 Miscellaneous manufactured articles; 9 Commodities not classified elsewhere in the SITC



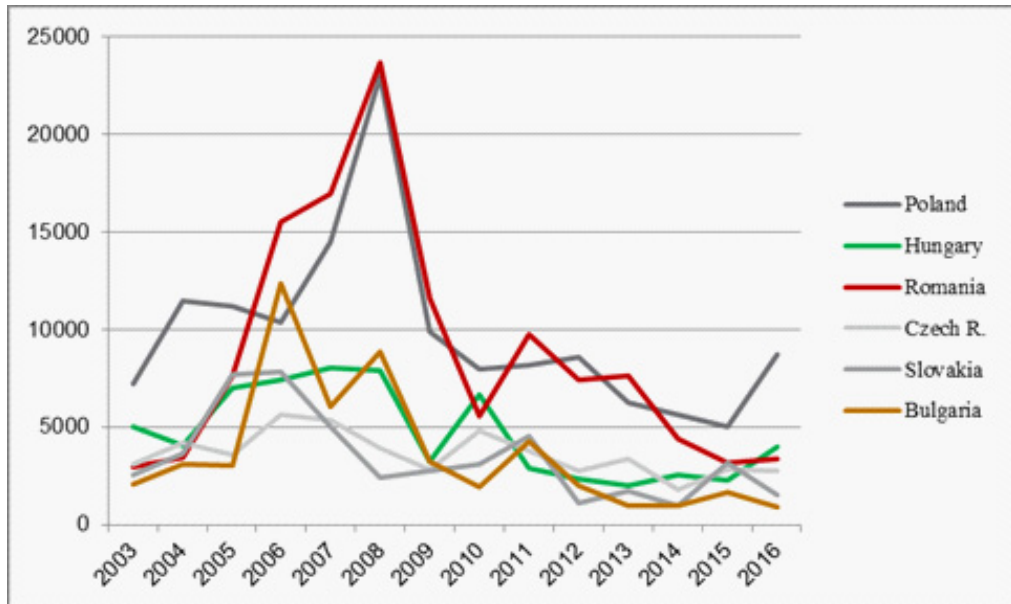
Source: wiiw Annual Database incorporating national and Eurostat statistics.

Nevertheless, a balanced relationship between the foreign and the domestic sector has been maintained at least at the macro-economic level. The share of majority foreign owned companies is less than 50% of the output and about one quarter of the employment is in the business sector (financial sector excluded - Eurostat FATS). This is lower than in the highly foreign dependent economies such as Slovakia or Hungary, but higher than in Poland. Strengthening local SMEs, but especially the medium-size segment may be necessary in order to keep up the balance.

Most of the larger FDI projects especially in the manufacturing industry were implemented before the global financial crisis (Figure 3). In the post-crisis years, FDI inflow has not recovered to its pre-crisis level of 7% of GDP; it has stagnated at 2% of GDP in recent years. This is actually in line with the European trend of sluggish investment activity. Also the announced greenfield projects of recent years are smaller in value, and focus on the services sectors (www.fdimarkets.com). As a result, Romania has emerged as an important hub in terms of ICT offshoring which has important positive impacts on the services balance of the current account. Economic openness in terms of free movement and goods and capital has been a major achievement of EU membership.

Figure 3

Investment capital pledged in announced greenfield FDI projects, 2003-2016, EUR million



Remark: partly estimated

Source: fDi Markets database: fdimarkets.com

Fierce fight against corruption with mixed results

There have been numerous further changes in Romania that can be attributed to EU membership, including political and legal conditions based on democratic values and the rule of law. The adaptation of liberal democratic political and legal rules and values had been thrust upon Romania in the accession process leaving internalisation and implementation for the own efforts of the new member state but under continuous guidance and assessment.

Continuous EU pressure, learning by doing as well as a generation change improved the administrative capacity over time. To safeguard the reform process after accession, the EC imposed continuous monitoring on areas not meeting the required standards such as the reform of the judicial system, elimination of corruption and the struggle against organised crime. Despite progress, the Cooperation and Verification Mechanism (CVM) is still in place. The recent CVM Report¹⁰ finds several issues pending including transparency and professionalism of public institutions.

¹⁰ Report from the Commission to the European Parliament and the Council – On Progress in Romania under the Cooperation and Verification Mechanism, Brussels, 27.1.2016, COM(2016) 41 final.

The fight against corruption received much lip-service around the EU accession date, but policies and attitudes hardly changed for years. The turning point was marked when former Prime Minister Adrian Năstase, was sentenced to prison for corruption in 2012. The next decisive step was taken in 2013, the upgrading of the activity of the National Anticorruption Directorate (DNA), founded in 2003. Since then, this institution has been actively investigating and prosecuting corruption-related offences such as bribery, graft, patronage and embezzlement. In 2015, the DNA finalised investigations concerning over 1,250 private and legal persons, including five ministers, 16 members of the chamber of deputies and five senators.¹¹ In addition, Prime Minister Victor Ponta was indicted on charges of forgery and money-laundering which indirectly led to his resignation in November 2015.¹² In 2016 the DNA's activity took on a more nation-wide character, expanding to the regional administration.

The anti-corruption fight remains incomplete as long as transparency and coordination of legislation and jurisdiction is not fully provided. Under the current fuzzy system it is hardly possible for decision-makers to act in full accordance with the law and public interest which has a paralysing effect. In practice these problems could be fixed by coordinated efforts with the support of the CVM. More attention is necessary as the current government does not have the fight against corruption on its agenda¹³ and curtailing the power of the DNA is on the agenda.

In a wider sense, there is a conflict between the traditional political establishment and a new generation of persons, movements and institutions representing 'European', democratic values. The political establishment of almost all parties is widely inflected by clientelism. The promoters of liberal democracy grow in number and become more organised as being shown by the demonstrations early-February 2017.

Putting unconditional trust into the DNA is disputable. The positive results have been overshadowed by transparency of how the target persons of investigations are selected¹⁴ and how far the whole process can extend¹⁵. The anti-corruption prosecutors are not faultless and often act arbitrary especially in cases of influence peddling or embezzlement.¹⁶ Publicity is used for deterrence without presuming innocence. Leaders in public administration may have the widespread impression that they can be any time prosecuted for any decision they have taken, therefore public procurement, and public investment activity in general, have slowed down. The task for the future is not only to implement law but also to improve and

¹¹ <http://www.pna.ro/results.xhtml>.

¹² See for details <https://www.theguardian.com/world/2015/nov/04/woman-leading-war-on-corruption-romania>.

¹³ <http://gov.ro/en/objectives/programme-for-government>

¹⁴ <http://globalriskinsights.com/2016/07/romania-anti-corruption-fight-sends-mixed-messages/>.

¹⁵ The political scientist Alina Mungiu-Pippidi, president of the Romanian Academic Society, hailed the DNA for prosecuting the corrupt political class what she called the trans-party mafia; <http://www.bbc.com/news/blogs-eu-31537338>.

The historian Stefano Bottoni warned that Romania may become similar to Italy in the early 1990s, when the anti-mafia fight wiped out the former political class, destabilised the party system and gave rise to the rule of Berlusconi. Bottoni concludes that corruption and economic interests ruling in politics has not changed in its intensity but in its form; <http://www.miscareaderezistenta.ro/actualitate/36389-dna-critici-kovesi-bottoni>.

¹⁶ <https://www.theguardian.com/world/2017/jan/10/romania-corruption-fight-is-a-smokescreen-to-weaken-its-democracy>

harmonise the legislative framework itself. Avoiding false accusations of corruption is just as important as fighting it. The Justice Services Improvement Project of the World Bank supported by EUR 60 million funding approved on 31 January 2017 may be of some help.¹⁷

A road ahead under growing uncertainty

Global and European economic and political uncertainty has increased over the past year. The Economic Policy Uncertainty Index¹⁸ provides one indicator of this apparently sudden and dramatic increase in uncertainty: it has surged high, with particular spikes in June-July (Brexit referendum) November (Trump election) 2016 as well as the rising EU-scepticism. Especially the economic, political, military and cultural role of the US means that it is a matter of concern for everyone, including the EU-CEE countries.

The perception of insecurity had already been on the rise on account of Russia's annexation of Crimea and its involvement in the conflict in Eastern Ukraine, as well as the impact of the migration crisis in 2015. The continuation of the EU and NATO in their current form and the maintenance of the post-war economic and security architecture are being openly questioned. Romania's interest seems to be challenged in both of these aspects.

A US paradigm shift from globalization toward protectionism, and an isolationist security policy may disrupt the international order. Many EU-CEE countries have extremely open economies, thus leaving them particularly vulnerable to a downturn in global trade volumes. A rise in global protectionism would harm also the Romanian economy. Mr Trump's apparent antagonism towards Germany and European integration is of particular importance. German, French etc. industry has long supply chains stretching deep into the CEE region. By its exports and FDI structure, Romania is plugged into the European supply chains in the automotive and related industrial sectors while it is exactly this industry which is in the focus of Mr Trump's protectionist intentions. Romania would suffer if German exports were curtailed by the imposition of tariffs (20% of Romanian exports go to Germany).

Brexit negotiations can also have important implications for the EU budget and on migration flows in and out of CEE countries. Questions are related to fiscal transfers less developed member states and the free movement of labour. Romania is strongly affected in both. As a newcomer, it could not benefit from the 2007-2013 financing period in full and would need the transfers of the 2014-2020 period to catch up with basic infrastructure. Due to delays already obvious, drawing on the funds will cumulate in the years after 2020 when the whole financing scheme is getting increasingly fragile. By the exit of Britain, one of the main net payers will leave the EU budget reducing the available funds for cohesion policy.¹⁹ The country's net financial position to the EU budget amounts to 0.4% of its GNI which could drop to a half, had Norway's contribution be the pattern of the new British-EU relations. This would leave about 10% less to be distributed than envisaged.

¹⁷ <http://projects.worldbank.org/P160751?lang=en>

¹⁸ www.policyuncertainty.com

¹⁹ Richter, S. (2016), 'Brexit, the EU budget and the EU-CEE countries', In: Labour Shortages Driving Economic Growth?, wiiw Forecast Report, No. Autumn 2016, Vienna, November 2016, pp. 29-34.

Brexit disregarded, Western Europe's commitment to the process of transition and catching up of the new members will not be as strong as it used to be. It is not only the talk about 'two-speed' Europe which is more or less a fact by now as not all member states participate in euro and Schengen. Poland and Hungary in particular have governments opposing deeper integration and care mainly for financial benefits. Such countries will have to decide how much of free riding they really want to enjoy within the EU. If they want less EU and the multi-speed EU is their logical answer, then transfers and single market may have to be traded for nationalist policies.

A rise in the number and support of anti-EU and anti-euro parties has been apparent in many EU member states. The polarisation of mainstream parties and business people keeping the faith in the EU on the one hand and nationalist parties and protectionist tendencies on the other is based mainly on sentiments. The attractiveness of the latter goes against experience: the post-2008 recovery has been based on the growing access to the EU markets, and also the financial system proved resilient.

Romania can either join the more and more EU-sceptic V4 group or remain a strong supporter of deeper integration. In the first case it may have strong alliance in the neighbourhood which loosens its EU ties. In the second case, it needs to work to tighten alliance with Germany. Breaking the fiscal convergence rule is not a good starting position for such an endeavour.

Romania should be more active in developing EU integration

Romania's role has not been destructive in the EU; the country has denied policy coordination with the Visegrad countries and does not support the nationalist line of Hungary and Poland. But even if not outspokenly, Romania's policy has never gone beyond nationalist self-interest. Even the undercurrent of EU-scepticism comes to the surface time to time in the form of demonstration of national pride and refusal of international control mechanisms. It would be in Romania's interest to become active in shaping the European agenda if it wants to enjoy the benefits of the cohesion policy beyond 2020. The country may need to develop a mobilising strategy and policy beyond the direct benefits provided by the EU, one that also contributes to the success of the European integration in a wider sense. Going beyond the position of a policy-taker is especially necessary under the current lack of orientation in the EU as a whole.

REFERENCES:

Official documents:

- Communication from the Commission – Monitoring report on the state of preparedness for EU membership of Bulgaria and Romania, Brussels, 26.9.2006, COM (2006) 549 final;
- Report from the Commission to the European Parliament and the Council – On Progress in Romania under the Cooperation and Verification Mechanism, Brussels, 27.1.2016, COM (2016) 41 final;
- Standard Eurobarometer 83, Spring 2015.

Reports:

- Applica, Iseri Europa and Cambridge Economic Associates, 'Country report Romania – Work Package 1 Ex post evaluation of Cohesion Policy programmes 2007–2013, focusing on the European Regional Development Fund (ERDF) and the Cohesion Fund (CF)', September 2016;
- Richter, S. (2016), 'Brexit, the EU budget and the EU-CEE countries', In: Labour Shortages Driving Economic Growth? wiiw Forecast Report, No. Autumn 2016, Vienna, November 2016, pp. 29-34.

Online references:

- Bringing in the scalps: the woman leading Romania's war on corruption, <https://www.theguardian.com/world/2015/nov/04/woman-leading-war-on-corruption-romania>;
- Istorice italian, atac la Kovesi: "DNA slăbește sistemul imunitar al societății", <http://www.miscareaderezistenta.ro/actualitate/36389-dna-critici-kovesi-bottoni>;
- Our results, <http://www.pna.ro/results.xhtml>;
- Press Release: IMF Executive Board Approves €12.9 Billion Stand-By Arrangement for Romania, <http://www.imf.org/external/np/sec/pr/2009/pr09148.htm>;
- Romania and Bulgaria were not ready for accession, EU auditors confess, <http://www.euractiv.com/section/enlargement/news/auditors-romania-and-bulgaria-were-not-ready-for-accession/>;
- Romania anti-sleaze drive reaches elite, <http://www.bbc.com/news/blogs-eu-31537338>;
- Romania's anti-corruption fight sends mixed messages, <http://globalriskinsights.com/2016/07/romania-anti-corruption-fight-sends-mixed-messages/>;
- www.policyuncertainty.com;
- <https://www.theguardian.com/world/2017/jan/10/romania-corruption-fight-is-a-smokescreen-to-weaken-its-democracy>;
- <http://gov.ro/en/objectives/programme-for-government>.