

THE OBSTACLES TO SOCIAL- ECONOMIC CHANGE IN POST- COMMUNIST ROMANIA

NAGY EGON

“Babeş-Bolyai” University, Faculty of Geography, Clinicilor 5-7, 400006 Cluj-Napoca, Romania,
Email: enagy@geografie.ubbcluj.ro

ABSTRACT - The aim of this paper is to study the macroeconomic phase which characterizes present-day Romania, 15 years after the regime- change, embedded into that regional context which Romania is part of. The regional importance of this paper is that Romania is the biggest state of the southeastern region as far as territory and population are concerned. For this reason the country’s economic development cannot be indifferent to the neighbouring states, as it can have positive or negative social effects on them. The Romanian society was passing through a slowly and difficult process of democratization and economic liberalization during the nineties and the turn of the millenium, which was a similar way to the other post-socialist East European countries. The NATO membership of Romania and the imminent EU membership in 2007 are important stimuli to make further progresses on the way to functional capitalism and welfare. As an express of the efficient economy policy at the end of the social-democratic administration the economical growth of Romania rose to the incredible rate of 8.1%, while the budget deficit was only 1.3%. In the autumn of 2004 was elected a right, liberal coalition-government, which began his activity with a radical fiscal reform introducing a unique rate of taxes (16%). In this circumstances the possibility of the avalanche of the FDIs is a real expectance, but Romania still have to fulfill some other requirements, such as the reducing of the almost generalized corruption and to maintain the balance of the budget according to the agreement with the IMF, in order to became a major economic competitor of the Central-Eastern European region.

Key words: social-economic change, macroeconomics, economic development, Romania

During the political regime change after 1989, a unique historical process occurred. There was no a precise “recipe” for this process and several economic shocks followed. The radical change of the whole social-economic system was very painful because the former communist states were used to a foreseeable/predictable plan- system and now they had to put up with the unpredictable factors. They had to learn how to counteract the side-effects of these factors and to adjust fast to these extremely new circumstances.

In this adjustment race post-communist Romania started from a very disadvantageous position because it had had the most severe neo-Stalinist dictatorship among all the satellite states in Eastern Europe. Centralized control was extreme. This paternalist state-model kept the submissive population very far from independent initiative and democracy. This is why the regeneration of civil society and the revival of the entrepreneurial spirit can be expected only decades after 1989.

The aim of this paper is to study Romania’s present-day macroeconomic phase in a regional context and 15 years after the regime change. The regional importance of this paper is that Romania is the biggest country of Southeastern Europe as far as territory and population are concerned. That is why the country’s economic development is important for its neighbouring states. It can have positive or negative social effects on them.

According to some economic analysts, during the ‘90s, after the socialist centrally planned economy collapsed, the former communist states underwent an economic decline that surpassed the shock caused by the Great Crisis in the early ‘30s. The general crisis increased both social and territorial disparities. The latter were clearly noticeable if one compared different types of settlements. The capital city and a few regional centers or municipalities emerged as centres of development, unlike their rural surroundings.

The incredible decrease of the main macroeconomic indicators led to an important decrease of the standards of living and increased social and territorial disparities. The economic data on these aspects are evident (table 1). They also point to the close relation between the inflation rate and the public budget deficit at the turn of the first two governmental cycles (1990-1993). This is because in Romania, as in other countries of the region, putting the money-press to work often solved the budgetary deficits (The National Bank of Romania had a so-called quasi fiscal policy).

Table 1. Macroeconomic indicators of Romanian economy in the last one and a half decade (%).

Years	Industrial production	Budget balance	Unemployment	Inflation
1990	-19,0	1,0	1,3	5,1
1991	-22,8	3,3	3,1	170,2
1992	-12,9	-4,6	8,2	210,4
1993	1,3	-0,4	10,1	256,1
1994	3,3	-1,9	10,9	136,8
1995	9,5	-4,1	9,5	32,2
1996	-3,2	-5,8	6,5	56,9
1997	-5,9	-3,6	8,9	151,5
1998	-3,3	-2,9	10,4	40,7
1999	-9,0	-4,5	11,5	56,1
2000	8,2	-3,5	10,5	45,7
2001	6,5	-3,0	8,8	34,1
2002	6,0	-2,7	8,1	22,5
2003	4,5	-2,6	7,2	15,3
2004	4,6	-1,5	6,2	9,3

Source: www.insse.ro

The inflation rate was extremely high in Romania as compared to the other countries of the former communist block (113.8% was the average between 1990-1998). With the exception of the states of the former USSR and the belligerent former Yugoslavian countries in Southern Europe, this rate was a record in the region. The increasing inflation rate was facilitated by artificially solving the budgetary deficit and also by a series of so-called “cost- push” factors. The increase in costs and the falls in income can be explained by the unbalanced foreign trade, the loss of export markets, and the necessity to import energy sources from Russia at world trade prices.

There also appeared an increased societal necessity to consume, which also influenced prices. This further increased the demand for imports and the external imbalance as Romanian industry had a very unhealthy structure with over-production of investment goods instead of good quality consumer goods. There also existed the so-called ‘free-theft’, a phenomenon whose intensity increased after ’89 but which was not characteristic only of Romania. If we exaggerate a little, we can say that it was a characteristic of the entire former communist block before and after the regime change. I’d like also to refer to J. Sgard (see Bal, A. 1997), the economist who considers that in economy there is a positive correlation between the inflation rate and the intensity of nibbling public assets, which is sometimes organized or even happens at state-level.

Because of the high inflation rate economic processes became unpredictable and scared off foreign investors. Risks were high and reimbursement and profit rates couldn’t be calculated. The political instability in Romania and in the Balkans contributed to this situation. The economic legislation was not favorable either for foreign investments, which have a key-role in maintaining the external balance. Instead of improving, the general image of the country became even worse after 1989 and this *psychological* factor also had an important role in economy. Although the inner convertibility took place quite early (1991), block-privatization was delayed. Instead, the inefficient coupon-based system was preferred in order to allow workers to have their share. The public utilities systems, which attracted the foreign investors’ attention, were declared strategic branches. Thus privatization became impossible and the inexistent profits of privatization could not be redirected towards economy. Because of this lack of “fresh” functional capital it wasn’t possible to transfer the western type management, technology, and innovation (the know-how). Besides, although the law allowed the appearance of private property, the constitution didn’t stipulate its inviolability and created an uncertain milieu for investors. It was only in 2003 when the Constitution changed that private property received complete legal protection. This might be the reason why today (2004) the Romanian foreign investment stock is only \$ 13 billion, though the dimension of the market, the cheap and relatively well trained labour force, and Romania’s mediating role for other market regions represent serious advantages. In this context Professor Kopátsy Sándor’s remark that foreign investors are not only interested in cheap labour force, but also in the economic atmosphere, in reliability, investment culture, and market potential is very true. The economic atmosphere is very well characterized by the data on corruption. It is needless to comment: this is a field, which has little improved lately. Corruption is also a permanent

discussion matter with the EU (especially the high level, perhaps governmental corruption). And this can seriously endanger Romania's accession to the EU, which is scheduled for 2007. If Romania does not fulfil this or any other condition, her becoming a fully recognized EU member may be delayed for one year.

The economic production decrease at the beginning of the '90s can be explained by the decline of the so-called peripheral branches. Among these are some branches of light industry and those branches traditionally not considered heavy industry, unlike power production, crude oil refining, coal mining, and some engineering branches (Pasti V. – Miroiu M. – Codiță C., 1997). The absence of reform, of structural changes, and privatization in these strategically important branches led to the increase of the deficit. The state, the worst owner, could, by no means, make profitable these branches where there had been very few lay-offs. Subsidies and the huge salaries transformed these industrial giants into "black holes." The National Railway Company can be included in these groups as it attracted and used up all financial sources. On the other hand, for those people who managed to keep their jobs, these structures became islands of relative welfare or existential security in a quickly impoverishing society. In order to illustrate the losses produced by some of these structures, it's enough to take into consideration the fact that the industrial plant at Galați or some unprofitable oil refineries 'produced' 20% of the total budget deficit.

In the first transitional years Romanian economy had to face another peculiarity of Eastern European economic transition, namely stagflation, a period of little economic growth but rapidly increasing inflation. Romanian governments could not take the social risks of the shock therapy, there were such attempts, but these were short-lived, and soon failed (the "stop-go" economic growth). Because reforms were delayed after the first decrease phase during the mid transition period (1993-1996, the second governmental cycle), there appeared an increase of industrial production and the unemployment rate started to decrease. All these were supported by some important governmental subsidies. At the same time the inflation rate started decreasing though it still remained high. The general improvement tendency was negatively compensated by the growth of external debts, as the absence of structural reforms could not allow sustainable growth. Marketing industrial goods was a problem because of their poor quality caused by backward technology and low productivity. Under such circumstances, the Romanian economy produced "for stock" in this period. The delay of privatisation led to rapid losses especially in the peripheral branches of industry not supported by subsidies. These state-owned companies, which did not receive subsidies, were selected according to economic criteria and soon became unproductive. In this period there appeared delays in payment, companies fell into arrears with their employees' salaries and the public budget. Nowadays these debts represent almost 40% of the GDP. This cycle became known as 'the seven meagre years' (1990- 1996), during which the careless reform and economic policies led to Romania's present disadvantageous situation. To quote Koran Janis, this type of delay is omission.

The third governmental cycle (1996-1997) started with reform plans but it soon lost its momentum. It was a period characterized by governmental crises. Under these circumstances, it was difficult to have a consistent economic policy, which would follow strict principles. The rapid increase in inflation in 1997 was relatively slowed down in 1998, but it was still high (35-56%). This was possible because public expenses were diminished and the adjustment of salaries according to inflation was reduced as well. This happened as a result of external pressure. The IMF refused to give the stand-by credit to Romania unless the country radically reduced its budget deficit. The attempts to reform the industrial sector came true in 1997, when very many people were laid off. Among them there were the miners from the Jiu Valley who received important compensations. However, social resistance and governmental inconsistency still didn't allow the structural reform of the industrial giants. In their case, there still were not enough lay-offs and subsidies didn't decrease. 1999 represented the lowest point in the decline of industry and living standards. For the first time the government had to face cash problems when it came to paying public employees. On the other hand, there was the problem of the middle and short-term credit payments, which were due, and this meant \$ 3 billion. This huge sum of money was paid with great difficulty as it represented 35% of Romania's export profit for that year (\$ 8, 5 billion). A direct result of this process was that the foreign currency stock fell from \$ 2 billion to \$ 900 million. Within a year local currency had a 100% fall as compared to the US dollar. There appeared the pressure of financial speculation (1996-1997), which Romania's National Bank hardly managed to contain. But a positive event occurred as well, namely, local currency became fully convertible. The bankruptcy of BANCOREX, a commercial bank, the first event of such kind in Romania, only increased problems as its consolidation required several hundred millions of dollars. This also showed that the

Romanian bank system was vulnerable and it didn't function in a market context. It also showed the effects of the slow privatisation of bank, i.e. giving credit on a preferential basis.

After all these difficult years, stabilization began in 2000 when Mugur Isărescu, former governor of the National Bank, a pragmatic, politically independent man, became Prime Minister. That year macroeconomic indicators showed an increase in all fields, export increased visibly (21.9%) and the industrial production also grew (8,2%), as compared to previous years. Our only comment on these last data is that the main fields producing profit were the export and cheap labour force branches of light industry. The investments of serious multinational companies bringing capital and technology and a real economic break-through were still expected.

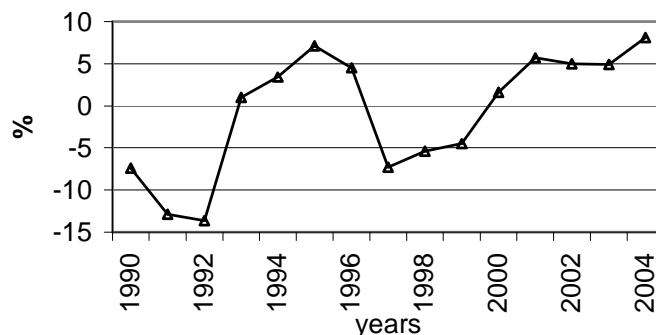


Fig. 1. The changes of Romanian GDP increase rate during the last decade (%). © Der Fischer Weltalmanach, 1996- 2001; A. Bal, 1997, www.insse.ro

The country's political stability increased after NATO's intervention in Yugoslavia, as both Romania and Bulgaria were invited to start negotiations with the EU in order to ensure stability in the Balkans. Romania managed to finalize negotiations by the end of 2004. In March 2004, as a result of the international political changes (fight against terrorism) Romania became a NATO member and in the spring of 2005 Romania and the EU would sign the accession treatise.

The 2000 elections brought back the internal political situation of the early 1990s. The Romanian Democratic Social Party, a central-left one, won the elections. The fourth governmental cycle began. The name of the party had changed into Social Democratic Party since the early 1990's. In the first year of the new government, economic improvement continued although most of the Communist era industrial giants still existed and endangered the sustainability of the positive economic evolutions. The latest elections showed the political risks of economic collapse and mass impoverishment if extremist demagogues could come to power. That is why, without external help (especially from the directly interested EU) Romania's catching up with the other European countries is hardly feasible. In the past 12 years, mainly through its hesitant economic policy, Romania used up all its resources and the population reached the end of their tether. People can no longer bear the burdens of further structural changes.

International financial aid need not meet all necessities as it leads to inefficiency. It need only support the principal points of stress. Otherwise, lack of motivation will lead to delaying economic reforms further.

Before going on I'd like to return to the problem of international debt. It is worth mentioning that in this case Romania had a very advantageous position when the former regime fell. Romania was the only country of the region with no international debt, though this had had important social costs in the previous years.¹ However, Romania couldn't use its advantageous position because its economic collapse was more and more obvious as compared to the members of the Visegrad Union, for instance. International debt reached \$ 12 billion in 1999, the year when \$ 3 billion were paid back. Between 1999-2001 the amount of debt was stabilized at \$ 9 billion. The import-based investments of the past years and the negative influence of foreign trade "managed" to increase the international debt to \$ 18 billion, in 2003. In the present international context, this amount can be regarded as a fairly good one, as it represents only 31.4% of the GDP, and it slightly exceeds the annual export rate. In such situations, analysts consider that debt can increase up to \$ 25

¹ In 1989 Romania and Iran were the only ones not to have external debts in the entire world

billion without problems. This is also motivated by the urgent highway investments which need capital and for which the national capital will surely not suffice.

The social-democratic Năstase government had several achievements as far as economic reforms are concerned. Consequently, in October 2004, though with certain critical observations, Romania received the status of “functional market economy” from the EU. Another achievement of this government was the closing-down of several unprofitable companies and the privatisation of several heavy industry structures (oil refineries and the metal works in Reșița and Galați (SIDEX), the PETROM oil company. The privatisation of the regional energy distributors started. Consequently, in 2004, Romania had a serious amount of flow-type FDI (more than \$ 2 billion, by the end of 2004). This infusion of capital improved the general financial situation of the country and probably the international monetary institutes would revise Romania’s classification as a ‘B’ category debtor. A completely privatised banking system is necessary, which would lead to its increased stability. This top service branch as well as insurance agencies has stabilized since the bankruptcies in the early 1990s. Credit is given in accordance with market values as both local and international capital is present (Raiffeisen, HVB, ABN AMRO, ING, Citibank, Volksbank, Soci t  G n rale, etc.). This makes preferential crediting, so common during the previous years, impossible. Firstly, the Romanian Commercial Bank (BCR) and CEC should be privatised until the more competitive competition doesn’t sweep them off the market. It is also very important to create better market conditions, as potential increase is possible. The capitalization of the Romanian banking system (hardly \$ 20 billion) is still low as compared to other countries in the region.

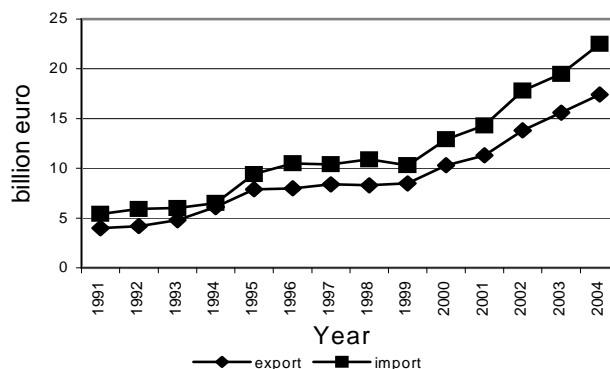


Fig. 2. The Romanian foreign trade indicators in the 1990s (billion euros). © Romania’s Statistical Yearbook, 1999.

By the end of 2004 the centre left government had managed to limit salary increases. Also, in accordance with the monetary policy of the National Bank, it managed to keep the real value of the national currency relatively stable. As a result, in 2004 decreasing inflation reached single figures (9.3 %) for the first time and the long planned monetary reform (denomination) became possible. Though present-day evolutions might cause the nominal overvaluing of the local currency, this has to be avoided by all means in order to preserve and increase competitiveness. The low and remediable budget deficit (1.5% of GDP in 2004) is not worth decreasing, as it would endanger economic growth. It is more important to go on and finish the structural reforms already begun. Still the financial balance deficit is high (5.8% in 2004).

Another important step in stabilizing the functional market economy is to decrease state subsidies (at present they are 3.2% of the GDP, three times bigger than in the EU) and continue the privatisation process. All these are important chapters in the EU accession treatise.

Romania had important achievements in the creation of informational society. Between 2001-2003 the number of Internet users increased five times in comparison with the previous period, there are 190 Internet terminals for every 1.000 inhabitants, and every third person has a mobile phone. But Romania is still very much behind the other EU countries or the countries that accessed to the EU in 2004. The number of patents granted in the EU is eight times greater than in Romania (0.7/1 million inhabitants). R&D funds are 0.4% of the GDP; a quarter of the sum spent by the EU, the number of researchers is five times smaller than the EU average (880 researchers/1 million inhabitants). The number of inhabitants attending some form of training is three times lower than in the EU (1.3%). These indicators show the difficult way to reach the knowledge-based society model. The specific energy use is still five times higher than in the EU, which is an indicator of

inefficiency (CAPITAL, 2004 NR. 49). These indicators point out to structural backwardness and show that, in spite of its good economic results, Romanian economy still has a long way to go to get the characteristics of developed economies.

The elections at the end of 2004 brought about a political change, the centre-right coalition came to power. In accordance with the IMF, which plays an important role in Romania's international financing, the government approved a major fiscal reform, valid from the 1st of January 2005, namely the 16% taxation rate for profit and personal income. This is a positive signal for economic agents and foreign investors because of the real taxation competition among the countries of the region in order to attract foreign capital. In the future, these countries, and Romania as well, must increase competitive advantages more than comparative advantages. In such a competition-improving economic milieu, foreign investment might increase a lot as salaries are still among the lowest in Eastern Europe. There is also the expectation that the "black economy" (about 40% of the GDP) will "whiten," and under these legal circumstances tax income might increase after a short period of decrease. Analysts consider that this last factor will change the employed-maintained ratio by the end of the cycle (2008); the number of employees will increase from the present 4.6 million to 5 million. Planning for 2008 also includes an average income increase from 144 euros to 244 euros, an inflation decrease from the present 9.3% to 3%, and the slight increase of international debt from the present 31.4% to 32.2%, proportional to GDP. GDP will increase from 56 billion euros in 2004, to 89 billion euros in 2008, a 6.5- 7% yearly increase rate. In 2004 Romania registered a record breaking GDP increase of 8.1% as a result of the extremely high agricultural production. International circumstances were favourable for some branches of industry (iron and steel industry, naval industry, construction), which led to an increase of production and, subsequently, to the GDP increase. But as agricultural production is seasonal, depending on many subjective factors, the ambitious expectations for general production in the following years seem a bit exaggerated, especially when taking into account that expectations of the EU are modest for the next year.

Romania is an increasingly liberal minor economy moving towards becoming a part of the world economy. It depends very much on international economic processes/evolutions and obviously; its most important relations are with the EU (75% of its international trade). As the Romanian economy's sustainable development very much depends on the EU trends, it can only be export-oriented. EU competition policy might be an impediment for Romania's new monetary policy, which is another instability factor. There may also be additional political risks because of governmental instability taking into account the slight parliamentary majority of the coalition now in power in Romania. At the same time, capital transfers from European funds will be "fertilizers." (In 2005 Romania will get 800 million euros as pre-accession funds.)

As a conclusion, we can say that Romania's economy is on a constrained path. Its short-term development can be characterized as a quick and successful catch-up starting from a low point (possible economic miracle?), because the present fiscal context is market-oriented and performance-oriented. By regional standards the amount of international debt is fairly good, the budget deficit has been successfully controlled until now, which can also ensure future growth. A stable government is absolutely necessary in order to achieve success, but containing corruption (by developing capitalist relations in the economy), further decentralization, and the reduction of bureaucracy are also necessary.

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