

Swiss - Romanian Economic Situation 2006 / 2007

By joining the EU on January 1st, 2007, Romania has reached an important foreign and economic policy goal. If the EU membership proves to be a catalyst for more foreign investments, even higher economic growth as well as legal and economic stability are expected. The macroeconomic figures for 2006 are nevertheless impressive. Economic growth, inflation, consumption, tax returns and the stock market all have developed positively. However, the gap between Romania and the EU average is still large, and the deep political crisis certainly does not contribute to the consolidation of the Romanian economy in general and to investors' confidence in particular.

Much remains to be done to bring Romania closer to the EU average. The Romanian per capita income is only a third of the EU-25 average. Romania accounts for 4.4 percent of the EU-27 population, but the per capita income is only 0.7 percent of the overall EU-27 per capita income. The Romanian economy is undermined by a mix of delayed reforms, unprofitable state-owned companies, centralism, and corruption, which profoundly block modernization. If, how and when Romania can overcome these impediments to modernization is indeed the key question.

Economic growth developed very positively in 2006. Last year, the Romanian economy grew by 7.7 percent – more than forecasted by the IMF and the EIU. In 2005, after a series of flooding, economic growth was “only” 4.1 percent, in 2004 reached 8.3 percent, while 2003 and 2002 witnessed a 4.9 percent growth. The “valley of tears” after the revolution in 1989 was comparatively deep in Romania, but it is now history. For 2007 the EIU forecasts a growth rate of 6.4 percent and for 2008 of 5.6 percent. The growth forecast of the Deutsche Bank for 2007 is 6.5 percent. Inflation stood at 4.9 percent at the end of 2006, after having been 8.9 percent at the beginning of that year. Inflation decreased further in the first months of 2007.

Unemployment was at 5.2 percent in 2006 (2005: 5.9%; 2002: 14%). The hidden unemployment is, however, considerably higher. The number of employees who drop out of the labour market without being registered as unemployed and those who work part-time though they are employed full-time is difficult to estimate. But it always tends to be relatively high in transition economies. At the same time, there is a shortage of (skilled) labour in certain sectors of the Romanian economy. This is due to labour emigration. Approximately 2.5 million Romanians are working abroad, half of them illegally. The remittances of these Romanians are an important economic factor. Estimates say that these remittances amounted to 4 billion € in 2006.

Especially in the towns, a middle class with an impressive purchasing power is developing. The salaries rose fast in the last few years. Household consumption was up 9 percent in 2006. At the same time, however, household debt also increased. Romania is more and more interesting as retail and consumers' market.

At the beginning of 2005, a flat tax of 16 percent was introduced. The doubts stated at that point have vanished. Tax returns augmented considerably in 2005 and 2006. (This has, of course, also and probably primarily to do with the impressive economic growth). Yet, some analysts think that 16 percent is too low a tax rate for Romania.

In the last two, three years the Bucharest stock market became a dynamic and successful market. The BET index consisting of 10 companies – among them Petrom, BRD, Banca Transilvania, Transelectrica and Rompetrol – was at 8050 points in March 2007, up 6.2 percent compared to March 2006. In 2002, the index stood at 768 points...

These positive trends are to a certain degree offset by a number of problems and challenges, most of which have to do with the fact that Romania's economy is still in a transformation and consolidation process. A basic problem of the Romanian economic structure – and of most other Eastern European economies, by the way – is the low level of social capital and of trust and moral. Opinion polls show that the market economy is not popular at all. This mistrust vis-à-vis the market system, democracy and fellow

citizens can and does often lead to clientele-based mechanisms of economic transactions and to corruption.

Reproaches of corruption are a beloved instrument of many in the fierce political and economic concurrence. Often, these reproaches are simply baseless. On the other hand, it is also a fact that Romania ranks, together with such countries as Sri Lanka and Algeria, on the 84th place in the Transparency International's Corruption Perceptions Index 2006. Therefore, the fight against corruption is (or should be) one of the main priorities of the Romanian government – as the EU and the IMF tend to stress, too.

Other challenges are the regional misbalances, poverty and social disparities, and the informal sector. According to some estimates, more than 40 percent of the overall income is generated in the “black” market. Another problem, which was accentuated in 2006, is the budget deficit. The European Commission urged Romania to more budgetary discipline. The budget forecasts were changed several times in 2006, from -0.5 percent to -0.9 percent and finally to -2.5 percent. Government expenditure rose noticeably by 20 percent in 2006. The IMF points to the fact that Romania should do more with regard to education, the flexibilization of its labour market and the privatization, too.

Swiss Exports and Imports

	Exports (Mio. CHF)	Annual change (%)	Imports (Mio. CHF)	Annual change (%)	Account (Mio. CHF)
1995	191		39		152
1999	179		72		105
2000	252	41	89	24	163
2001	290	15	97	9	193
2002	244	-16	107	10	137
2003	305	25	142	33	163
2004	464	52	155	9	309
2005	594	27	245	37	302
2006	821	38	208	-15	613

July 2007 / Simon Geissbühler, First Secretary, Swiss Embassy in Bucharest