

Romania, 2021 CE: The Good, the Bad, and the Ugly

A bird's-eye view of Romania's socio-economic reality in pandemic times

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Notable positive economic developments pre-pandemic

- Economic growth averaged 4.7% per year in 2015-2019 (7.3% in 2017)
 - even with the 2008 and 2020 crises, avg 3.7% per year since 2000
 - (however, driven mostly (>90%) by private consumption)
- Strong labour productivity growth over the past decade
 - (however, from very low basis even among CEE countries)
- Despite fiscal deficits, public debt remained low relative to EU targets or avg.
- WB classified RO as high-income country for first time, based on 2019 data
 - positively impacted investment rating decisions, OECD accession negotiations
- Bucharest Stock Exchange (BVB) officially 'Emerging Market' in Sep 2020
 - two Romanian companies included in the FTSE Global All Cap Index (and three other indexes)

Moderate recovery since 2021, helped by international aid

- Strong rebound in the first half of 2021
 - 2021 GDP growth revised downwards since, but still projected at 7%
 - (3.9% GDP contraction in 2020, less than anticipated, 6.5% GDP growth in first half 2021)
- Despite increasing fiscal deficit, public debt still one of the lowest in EU
 - even pessimistic projections of public debt are at <63% by 2023
- External financial stimulus (essential given limited fiscal space)
 - about 49.5 billion till 2027 under the EU Multiannual Financial Framework
 - about 29.2 billion till 2026 under the NextGenerationEU package
 - (but PNRR barely approved, could be in danger if new gov not acting fast etc)
 - 400 million of pre-arranged financial support from the World Bank to help prevent and respond to the pandemic
 - activated in April 2020

High inequality, poverty, social exclusion

- Inequality higher than in most advanced economies
 - poorest 20% of households earn 5.7% of total income
 - also large disparities (in income, labor participation, education, health) by ethnicity, sex, age, region
- High poverty rates, especially in rural areas, not improving over time
 - overall 24,6% in 2007, and hardly changed at 23,8% in 2019.
 - in 2019, 38,1% poverty in rural, and 12,8% poverty in urban areas
- Extreme risks of poverty/ social exclusion for children and oldage
 - > 40% for children <18 (highest in EU) and old > 65 years old (2nd highest)
- All exacerbated by the Covid-19 pandemic, via inadequate state support
 - E.g., at pandemic start, poor/ vulnerable households less supported by fiscal response measures (which favoured those in formal employment etc.)
 - Poverty forecast to remain high due to the persistence of the pandemic, poor agricultural year, and declining remittances.

Absurd social protection, education, healthcare: in 1 slide

- Unreformed, unsustainable social security system
 - both coverage and replacement rate of unemployment benefits well under EU/OECD average
 - no counseling/ training for vulnerable jobseekers or marginalized communities
 - unsustainable old-age social security is textbook example of "how not to do"
- Underfunded, execrably managed public education and scientific research
 - neglected, deprived schools, particularly in rural areas; low pay → negative teacher selection
 - lowest R&D intensity in EU; public R&D 10 x below the EU target for 2020
 - incompetent/ corrupt governance in higher-education and research
 - parallel universe in scientific standards/ evaluation criteria; rampant plagiarism just tip of the iceberg, substance is "publish AND perish", *originally*
- Public healthcare system in fire, *ad litteram*
 - hospital infrastructure = disaster (euphemism); insufficient spending on pretty much any aspect of healthcare
 - coverage gaps of the public health insurance and access to decent medical care
 - no performance, accountability and governance mechanisms in hospitals
 - inadequate pay/ work conditions → acute shortages of medical staff
 - rampant informal pay/ corruption

As far as possible from a green economy

- 75% of RO's population subject to nocive air pollution on continuous basis
- In terms of water infrastructure, Romania conforms to EU norms/ regulation only in proportion of 6%.
- RO has many EU open infringement procedures concerning the environment
 - e.g., for illegal logging/ deforestation, destruction of protected areas, environmental pollution
- The transport infrastructure is one of the most undeveloped in the EU in general and the worst for road transport by far
- We are well behind most of the EU in terms of utilization of renewable energy, as well as efficientizing traditional energy use
- Sizable chunk of the PNRR funds from the EU earmarked for decarbonisation/ transition to a green economy, but the RO plans in that realm were the heaviest criticised, and for good reason
 - missing quantification of measures to reach the national targets for renewal energy, circular economy; no specific objectives for competitiveness, unclear/ conflicting info on phasing out fossil fuel energy sources, just and fair transition (e.g., impact on employment/ well-being of those in coal mining areas) etc.

Missing competition/ proper regulation in product markets

- Despite some progress, still considerable barriers to competition and rigid/inadequate regulation standards
 - Restrictive product market regulation
 - Lack of proper review of anticompetitive practices
 - dormant, inefficient competition/ antitrust authority ("Competition Council")
 - Cumbersome licence and permit system in some professional services
 - Absence of early warning tools and out-of-court mechanisms for SMEs in financial distress
 - "everything takes forever": Romania the worst in EU from this perspective
- Immature / corrupt public procurement
 - badly-designed and/or outright rigged "public" auctions
- State-owned enterprises lack even basic accountability and corporate governance standards
- In general, promotion of "pro-business" instead of "pro-market" environment
 - *"Being pro-market is being in favor of a competitive market system where you give everybody opportunities, but you don't favor anybody. On the other hand, being pro-business is actually favoring existing businesses at the expense of other constituencies."* (Luigi Zingales)

Pandemic mismanagement, large negative externalities

- 2nd lowest vaccination rate, highest recent mortality rate within EU
 - 30.7% , compared to 65.5% avg. EU, 42.4% avg. worldwide (21 Nov, 2 doses)
 - throughout most of Nov, RO had the highest daily mortality rate in EU
 - "A village vanishes daily in Romania!"
- How did RO get here?
 - not communicating clearly and not trusting the population sufficiently
 - lifting too soon the initial restrictions (after imposing them a bit late, but luckily RO less exposed initially)
 - not doing enough Covid-19 testing, in the beginning or now
 - not being firm enough in re-imposing restrictions/ the Covid-19 certificate
 - using the vaccination campaign politically
 - experts ignored or even removed from authority in the context of the pandemic
 - not combating officially misinformation, including from public figures
- Large lack of trust/ confidence in government/ institutions
 - eroded over time, but new lows in the pandemic: Eurofound survey: 34% trust Gov (Feb-Mar 2021); 17% in another survey (May)
 - at same time, 67% of CEOs did not think the *economic impact* of the crisis is well managed (Nov)

Demographic decline, huge emigration, workforce crisis

- Demographic decline, especially in rural areas
 - population RO July 1990: 23.2 million, of which approx 10.6 million rural
 - population RO July 2020: 19.3 million, of which 8.8 million rural (45,9%).
 - continuing process of ageing in rural areas: >65 years old approx 21% in 2019
- Highest number of young people emigrating directly after studies, within EU
 - inter alia, textbook "brain drain" example, increasing especially after 2007
- Large workforce deficits in recent years, both pre-pandemic and currently
 - both skilled and unskilled, both public and private sectors, becoming more extreme in 2021
 - increased number of work permits for nationals of Vietnam, Nepal, Sri Lanka etc. but not covering the workforce deficit
 - so far no *systematic, long-term* strategy to attract external workforce, immigrants in general, but this will (have to) change
 - sound projects to attract back (particularly highly-skilled/ experienced) emigrated Romanians would be strategic, but the precedents imply it will not happen anytime soon, despite plenty of good examples even in CEE

Twin deficits for the last three decades

- Both fiscal and current account deficit, only country to have done that for the last > 30 years
 - purely consumption-led economic growth
 - also impeding sustainable convergence towards general EU living standards
 - pro-cyclical fiscal policies
 - lack of *systematic* strategy to attract/ incentivize private investment
 - much of RO public investment both ex ante and ex post irresponsible
 - RO does not seem to understand that public investment can be labeled "responsible" iff it creates a positive societal value
 - absence of notable strategic industrial policy, high reliance on imports/ global supply chains
- Wrong moment to reduce fiscal deficit *now*, after 3 decades of incompetence
 - unlikely that the fiscal deficit can be reduced considerably in the next years (however only moderate public debt increase)
 - SPG initial criteria under scrutiny at EU level as well (proposal for "standards" instead of "rules" etc)
 - the government made a mess of the pandemic management, needs to prioritize that and the economic recovery
 - unclear if, when and how Romania will get the Covid-19 crisis under control!

RO is being "prepared" to enter the eurozone since 2014...

- "Convergence criteria" according to Maastricht Treaty
 - inter alia, SGP debt and deficit targets, inflation and long-term governmental interest rates below reference values, stable currency exchange rate w euro
 - expected that last point demonstrated by two consecutive years of participation in the European Exchange Rate Mechanism (ERM II)
- Bulgaria way ahead us, could be adopting the euro already in 2023
 - accepted in the ERM-II/ Banking Union in 2020 (together with Croatia)
- Romania could earliest enter ERM-II (and Banking Union) in 2024-2025, thus aim to be a eurozone member no earlier than 2027-2028
 - Originally, RO scheduled euro adoption by 2014, but since 2012 that started to be delayed; in 2015 even 2020 was no more realistic; then 2022, and later 2024 failed, currently the aim being 2028. I say add 2-3 yrs to that, at least.

Not clear yet how the new governmental coalition will do

- If anything, this ought to be a movement towards *more legitimacy*, the social-democrats being currently the largest in terms of parliamentary seats. Abstracting, of course, from:
 - the (proven) incompetence of the main actors from both major coalition parties
 - the fact that almost 70% of population w voting rights did not actually vote
- It could work, mainly because at stake there are almost 80 billion euro in EU funds for the next 6-7 years.
 - then again, when I see, e.g., whom they propose as Minister for European Funds, I put less than 50% prob. on them performing/ succeeding.
- In any case, not sure people will remember well when time will come to choose again, since we have many precedents already
 - to paraphrase Jean Tirole, there are more Proustians than Bayesians in the Romanian electorate: "Facts do not penetrate the world where our beliefs live." [Marcel Proust, "Du côté de chez Swann", first volume of " À la recherche du temps perdu" (EN: "Swann's Way", from "In Search of Lost Time")]