MACROECONOMIC ASPECTS AND CHALLENGES IN ROMANIA IN THE FIRST HALF OF 2016

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ABSTRACT: This paper reveals that fact that although Romania had a significant economic growth during the first half of 2016 (5,2%), and it was the European economy with the highest growth rate, the consolidated general budget had a deficit of 3.12 billion lei after the first 8 months of 2016, equal to 0.41% of the GDP estimated for 2016. The result is 10 billion lei below the same period of 2015, due to a mix of policies that resulted into stimulated demand and fiscal relaxation. The paper also analyses the foreign investments in 2015, per country of origin of investments, development regions and sectors of activity. Romania holds the 62nd place among most competitive 138 countries in the world, according to the WEF 2016 – 2017 report published in September 2016, and a set of problematic factors show that Romania does not have currently the necessary ingredients to leap from a middle economy to a developed economy, and it looks like caught in the „middle income trap".

Keywords: economic growth, macroeconomic policy, budget execution, foreign investments, competitiveness, middle income trap

JEL Codes: E03, E60, O11

Introduction

Romania needs a high economic growth to recover from gaps that separate it from the developed world in terms of the citizens' life standards and the ability to manage the challenges of an extremely complex international environment where terrorism, political and humanitarian crises related to global and regional geopolitical reconfigurations, epidemics, climate changes, failed states and persistent financial imbalances combine to generate tension, instability and multiple risks.

A country with strong economy has several means to face such disturbances, so economic performance is increasingly seen as an element of national security.

During the last 15 years, Romania had a good performance in economic growth: the GDP increased from USD 37.4 billion in 2000, to over USD 200 billion in 2015. After the crisis of 2009-2011, Romania was among the EU members with the highest annual growth rate.

With gross national income per capita of USD 9,520 in 2014, Romania is among the 53 countries classified by the World Bank as „upper middle income". In 2016, this category included countries with a gross per capita income between USD 4,125 – 12,735.

The Romanian National Statistics Institute (INS) confirmed the high dynamics of the GDP growth between April – June 2016, Romania became the European economy with the highest growth rate per quarter and per year, and private consumption and investments were the main growth factors. Labour productivity increased in the 2nd quarter, especially as a result of the recovery of the agricultural production and constructions. Industrial production had a modest growth in July, being supported mainly by the processing industry and by the extractive industry with a shy growth. The production of capital

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goods was the only sector that provided significant support to the processing sector at the beginning of the 3rd quarter. The retail sales were stagnant in July, due to unexpected reduction of food products sales, for the first time since September 2014. Constructions sector had a weak growth in July, taking into account the significant regress in May and June. Annual deflation visibly calmed down in August. The execution of the consolidated budget resulted into a surplus in July but the annual deficit deepened.

However, this is not sufficient. In the best case scenario, Romania can develop some advanced economy poles around cities such as Bucharest, Cluj, Timisoara, Iaşi, while the rest of the country may lag behind. The never-ending initiatives, debates, reforms and projects started and abandoned without completion during the last decades show, despite the drive caused by Romania's capacity of EU member state, and the billions of euro received every year as foreign financing of all kinds (investments, non-reimbursable EU funds, repatriations), with the expertise of the World Bank or other consultants that prepared action plans for various sectors, progress is not guaranteed in any way.

Romania faces the risk of the so called „middle income trap", an economic stagnation which is difficult to overcome due to the lack of productivity, innovation and modern management that should create added value to ensure significant salary increase. This trap is typical of countries under development that have difficulties in making the next step to become developed economies. It means that, once the population's income reach a certain level (between USD 8,000 – 12,000 per year), a flattening tendency appears, says the theory. Generally, countries that fall in the "middle income trap" have economies based on low added value sectors.

The successful economic model validated in countries that have managed to reduce the gaps as against the developed countries (Japan, South Korea, Taiwan, Singapore) combined the market action with the action of the state, foreign investments with local investments, and stimulated economic growth by disseminating knowledge and high qualifications.

The change management ability is essential and it is a factor to differentiate among countries, a factor that is not appreciated as it deserves.

Literature review

In his book, Liviu Voinea places the origin of economic difficulties in Romania within the perimeter of a wrong mix of economic policies, and in the myths that orient the Romanian economy, a mix that, in his opinion, stimulated consumption at the wrong moment and deepened imbalances (Voinea, L., 2009).

On the other hand, the lack of an efficient macro-prudential monitoring that allowed prolonged consumption expenditure as well as the lack of political action to correct internal and external imbalances contributed to the accumulation of financial surplus that led to the financial crisis and the Big Recession of 2007-2008 (Catte et al., 2011).

In the Report on financial stability – 2015, the Romanian National Bank mentions that, although the domestic macroeconomic environment improved, the mix of domestic macroeconomic policies must remain prudent, to promote a healthy economic growth, accompanied by a budgetary deficit within the limits stipulated by the medium term objective of the budgetary-fiscal policy.

Radev (2014) also covered the correlation between economic growth and resources, while Chițiba and Costea-Dunărințu (2015) analysed the sustainable economic increase. Sharipov (2015) made a literature review of the current models and theories regarding economic growth. Lechman (2011) studied economic growth of several countries. Panagiotis and Pantelis (2013) study the link between growth and the cultural environment.

A complex analysis of the Romanian macroeconomics per sectors has been done by Constantin Anghelache (2015), and an analysis of the risk criteria regarding the middle income trap has been done by Eichengreen, Park and Shin (2013).

Research methodology

In order to conduct this study, we have used fundamental research methods consisting in reading of the specialized literature in this field and some statistics, articles and studies covering this topic. Our methods have been: analysis, synthesis, comparison, deduction and induction.

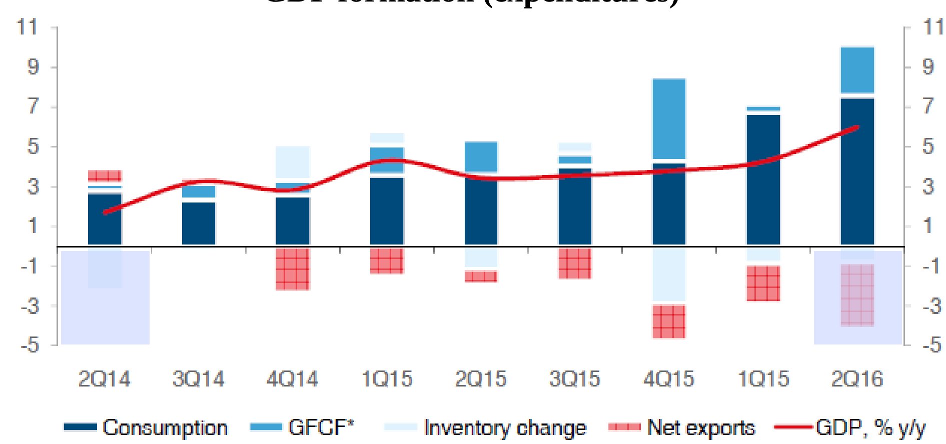
In order to establish and analyse the situation and the performances of the macroeconomic policy in Romania, we have used the data provided by national statistics (from Ministry of Public Finance, National Bank of Romania, National Institute of Statistics) and by various national and international publications that we assessed and interpreted.

Economic growth in the 2nd quarter of 2016, the maximum of the last 8 years

The Romanian National Statistics Institute (INS) confirmed the high dynamics of the GDP growth between April - June 2016. The Romanian economy had the highest growth rate in Europe per quarter (+1.5%), and per year (+6%). Labour productivity increased in the 2nd quarter (+5.8%), especially because of the recovery in agricultural production and constructions. The household consumption was stimulated by the relaxed fiscal policy, reduced prices and increased salaries, which led to its consolidated position of engine of economic growth in the 2nd quarter. Household consumption provided the biggest contribution starting with the 3rd quarter in 2008 (+7.5 pp). Consumers seem to remain in a good state at the beginning of the 3rd quarter in 2016. Their financial state is almost unchanged, they still have a tendency to make high value purchases and to maintain their saving ability. Governmental consumption increased with only 1.9% per year.

Figure 1

GDP formation (expenditures)



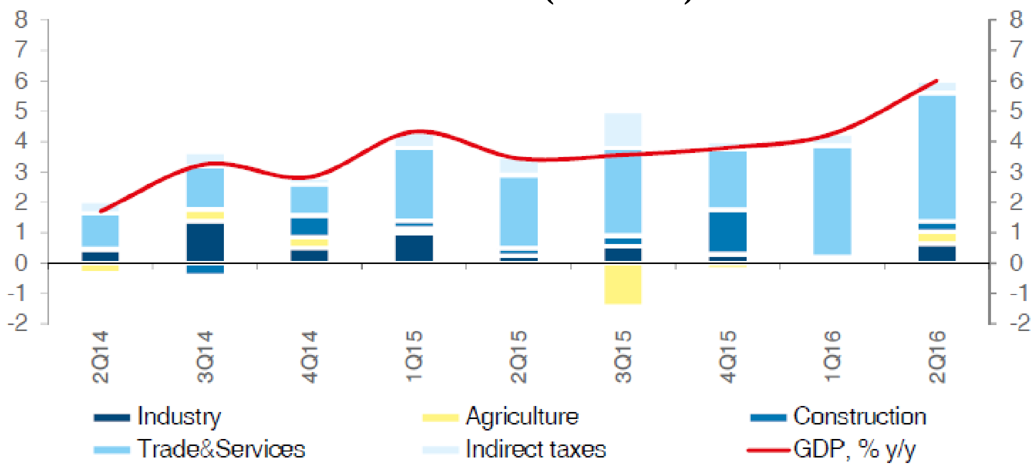
* Gross Fixed Capital Formation

Source: National Statistics Institute data processing

The gross fixed capital formation managed to invigorate the annual dynamics (+10.6%), after the low level in the 1st quarter (+2%). We should look at the figures with caution, after the significant unexpected reduction resulted after reviewing the economic growth figures for the 1st quarter of 2016. Regarding the net investments, construction works have recovered, while the annual dynamics of investments in equipment, including means of transportation, calmed down after the 1st quarter. The stock variation reduced the annual increase of the GDP with 0.8 pp. in the 2nd quarter. Foreign trade still affected the annual economic increase between April – June, with a negative substantial contribution (-3.4 pp), while imports surpassed exports quicker. The deficit in the goods and services balance increased to 692 million euro in the 2nd quarter, from a surplus of 49 million euro in the 2nd quarter of 2015. ”Raw materials”, ”agro-food items”, ”chemical items” and ”other processed items” were the main areas that led to increased deficit of the balance of goods between April – June 2016 as against the same period in 2015 (for capital goods and fuels, commercial balance was positive in the 2nd quarter in 2016). The services balance showed that transports have a lower trend, and surplus is 120 million euro less than for the same period last year. ”Trade and services” generated the biggest positive contribution to the GDP (+ 4.2pp), followed by industrial production (+0.6 pp) and the unexpected recovery of agriculture that increased with almost 18% per year, and corresponds to a contribution of 0.4pp. Services representing ”information and communications” provided the biggest support, 26% of the total growth in the category ”trade and services”, and expectations suggest a good evolution of services in the 3rd quarter in 2016. Constructions sector speeded up its annual progress up to 6.9% in the 2nd quarter, but its contribution was shadowed by the strong progress of agriculture and by ”trade and services” which account for a high percentage of the GDP.

Figure 2

GDP formation (resources)



* Gross Fixed Capital Formation

Source: National Statistics Institute data processing

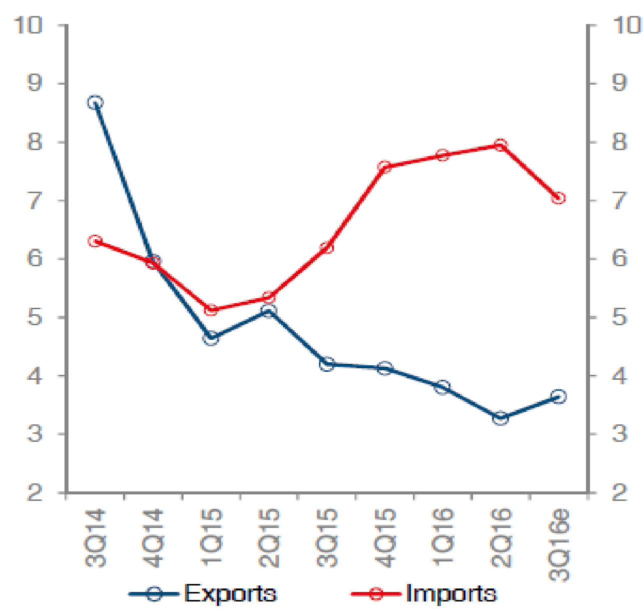
The increased gross added value in industry represented, indeed, a surprise, because the evolution of industrial production was apparently weak in the 2nd quarter. This may suggest a potential upward data revision of the monthly series for the industrial production. The local managers’ replies to the quarterly surveys sent by the European Commission suggest that the processing industry might slow down in the 3rd quarter as against the previous one, as the use of the current production capacity decreased below the level of the previous quarter and below the moving average of 4 quarters. On the other hand, more managers indicated in the latest quarter survey that the unused surplus of production capacity might narrow, suggesting that the slowing down of the processing industry might be modest. The volume of goods exports might improve in the 3rd quarter, according to local managers, supporting, to a certain extent, the processing sector, while the local demand might be less stimulating (the evolution of the new orders stock in July 2016 indicate slow progress). Prospects show an economic growth of 4.5% this year, catalysed further on by domestic demand in the 3rd and 4th quarters. Private consumption might receive an additional impulse in the second half of the year, because agricultural harvest is good, despite the drought and the floods in certain areas. The increased agricultural production in the peasants’ households might support self-consumption better, especially in the rural environment, which is a characteristic of the Romanian agriculture. We do not exclude, however, a stagnation of the private consumption starting with the last quarter of 2016, partly due to the main effect. Foreign demand will continue to reduce the GDP growth during the remaining months this year, as Romania's importer profile becomes more and more obvious any time domestic demand starts having quick growth rates.

Industrial production increased with only 0.6 % in July as against June, helped by the processing industry and to a lesser extent by the extractive industry which saw its 2nd consecutive growth. The production of capital goods was the only element that provided a significant drive for the processing industry at the beginning of the 3rd quarter (+ 3.4%), while durable goods have lost a part of the increase of the previous month (- 0,5%). The power and gas production became negative in July (- 2.5%). Per year, the industrial production stagnated, and slowed down in the 3rd quarter. Exports slowed down with 4.6% annual rate in July, the biggest decline since December 2012 and the 2nd biggest decline in the last 6 months. The annual progress of exports to the EU has almost stopped (+ 0.1%), while the annual dynamics of exports to non-EU countries was strongly negative (-17%). Imports decreased per year for the first time in the last 23 months (- 4.1%), which limited the expansion of the trade deficit (FOB-CIF) to an annual value of 9.5 billion euro, slightly below the previous month. The figures of annual rates of exports and imports decreased as against the previous month to 55.5 billion euro and 65.1 billion euro respectively.

Figure 3

Exports and imports, % y/y*

(* Four-quarter rolling average)



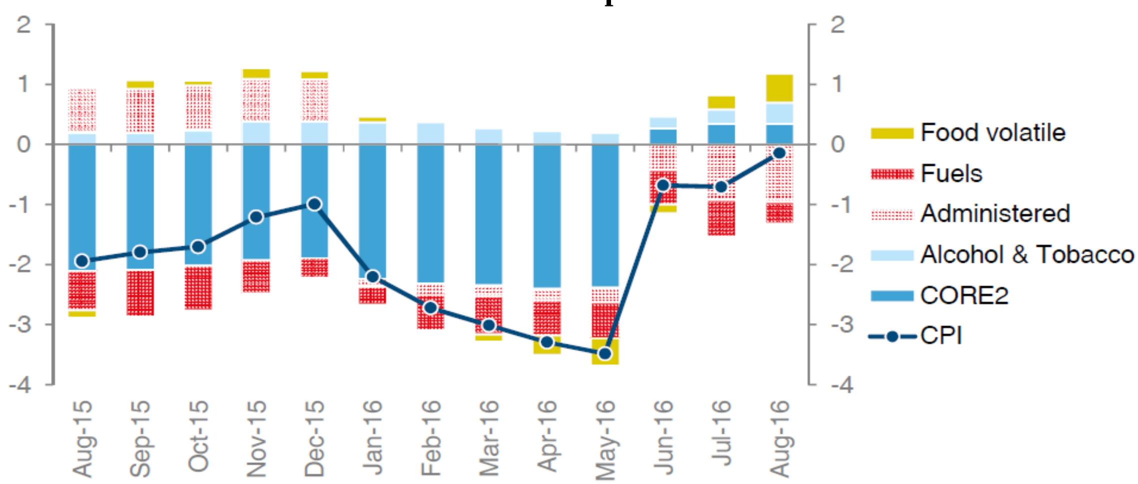
Source: National Statistics Institute data processing

Retail sales per month were stagnant in July because the food sales unexpectedly decreased for the first time since September 2014 and counter-balanced the increase in non-food items and fuels. Under these circumstances, annual retail trade rate slowed down, but still increased at 13.8%. Low prices and the quick increase of salaries would continue to support the retail trade and maintain the population consumption high this year. However, the consumer's trust suggests more visible slowing down in the 1st quarter in 2017, as the main effect loses its traction force and the enthusiasm of the salary increase in the public sector diminishes. Constructions had a weak monthly increase July (+ 0.7%), taking into account the significant regress in May and June. Residential and non-residential constructions supported the progress of this sector, with significant figures, but it could not prevent the slowing down of the annual trend. Engineering constructions decreased with 0.3% in July as against the previous month. In general, constructions restrained their annual growth rate to 3.9%, the moving average of 12 months decreased to 6.5%. The feelings of the managers in the constructions sector deteriorated to a certain extent in August, after two successive increases, as the expectations regarding employment lowered at a minimum of the last 3 months.

The surprising monthly growth of the price of tobacco products (+ 1.7%) with significant weight in the consumer basket and the regress of the food items, lower than expected, caused a weak progress of prices in August (+ 0.07%), reducing the annual deflationist pressure (- 0.2%). For the rest, the inflation behaviour was as expected, 2 main factors – fuels and the LEU currency strengthening – triggered the consumer prices downwards in August. The adjusted CORE 2 annual inflation, a measure of prices used by the central bank, increased marginally to 0.54%, slightly strengthening positively.

Figure 4

Contribution of the main subcomponents to headline inflation



Source: National Statistics Institute and National Bank of Romania data processing

Budget execution after the first 8 months of 2016

The consolidated general budget, after the first 8 months of 2016, has a deficit of 3.12 billion lei, which is 0.41% of the GDP estimated for this year. The result is almost 10 billion lei below the performance of the same period in 2015, when, at the end of the first 8 months, the balance was positive (+ 0.91% of the GDP). The cause is 30% the reduction of total revenue (- 2.82 billion lei as against last year), while 70% is due to the increased expenditure (+ 6.76 billion lei). In other words, the state undertook additional payment obligations although it knew that, due to the measures of fiscal relaxation taken, the revenue collected will diminish.

Table 1

Evolution of budget execution during the first 8 months

	2015		2016	
	Billion lei	**% of GDP**	**Billion lei**	**% of GDP**

Revenue	150.04	21.0	147.22	19.4
Expenses	143.58	20.1	150. 4	19.8
Surplus / Deficit	6.46	+ 0.91	- 3.12	- 0.41

Source: Ministry of Public Finance data processing

The increase of benefits from the state, especially salaries in the public sector and social insurance, was done to the detriment of public investments. It led to diminished amounts of non-reimbursable funds received from the EU as payments for these investments. From 9.18 billion lei in the first 8 months in 2015, to only 4.95 billion lei in the first 8 months in 2016, that is a minus of 46.1%. 10% of the GDP, saved from payments for interests on the public debt (diminished in some circumstances after the improved perception of the country on the international capital market) melted in the increased funds for social assistance. 2 tenths of the GDP were re-distributed from the payment of goods and services bought by the state to the expenditure with the staff. However, this balance through redistribution was only apparent. Actually, in both cases, redistribution ended up with a minus of about 3.5 billion lei. Almost 1% of the GDP was added to the deficit of the consolidated budget.

Table 2

Evolution of budget expenditure in the first 8 months

	2015		**2016**		**Variation % GDP**
	Billion lei	**% of GDP**	**Billion lei**	**% of GDP**	
Total expenditure out of which:	143.58	20.1	150.34	19.8	- 0.3
- social assistance	49.85	7.0	53.76	7.1	+ 0.1
- interests	7.49	1.1	7.91	1.0	- 0.1
- expenditure with staff	33.57	4.7	37.01	4.9	+ 0.2
- goods and services	23.32	3.3	23.46	3.1	- 0.2
- subsidies	3.82	0.5	4.06	0.5	0
- projects with no-reimbursable foreign funds	9.17	1.3	4.95	0.7	- 0.6
- expenditure with capital	5.92	0.8	7.85	1.0	+ 0.2

Source: Ministry of Public Finance data processing

What matters is the revenue collected to the budget, derived from the taxes collected. No matter how we may move the money from one place to another, it will simply be not enough, and such operations with an apparent null sum will result into minus, which will have to be compensated and implicitly will diminish the quality of long term social services.

With income of only 19.4% of the GDO in 8 months, which may lead below the threshold of 30% of GDP at the end of 2016, nowhere in the world can be ensured reasonable health services, education or public investment in infrastructure. Hence, the disaster in the projects funded from foreign non-reimbursable funds.

Table 3

Evolution of revenue collected on categories of revenue in the first 8 months

	2015		**2016**		**Variation % GDP**
	Billion lei	**% of GDP**	**Billion lei**	**% of GDP**	

Total revenue, out of which:	150.04	21.0	147.22	19.4	- 1.6
- VAT	38.29	5.4	34.70	4.6	- 0.8
- contributions to insurance	37.24	5.2	39.79	5.2	0
- excises	16.63	2.3	17.72	2.3	0
- tax on salaries and income	17.39	2.4	17.91	2.4	0
- tax on profit	9.89	1.4	10.95	1.4	0
- amounts received from the EU	6.18	0.9	0.60	0.1	- 0.8

Source: Ministry of Public Finance data processing

A quick view at the main sources of budget revenue gives a clear explanation about what happened to the policies of the previous government and translated into practice by the current government. Simply, simultaneous stimulated demand and fiscal relaxation does not and cannot work. The 10 billion lei less in the balance of the budget execution can be found in equal proportions in the diminished collected VAT, as a result of the general reduced VAT (according to the European model but at a bad time) and massive reduction, 10 times, of the money received from the EU for the payments made and pre-funding.

Beyond the basic error of economic policy, the big problem appears where it shouldn't have. If we have a growth rate of 3.8% in 2015 and 5.2% in the first half of 2016, how come that this robust rhythm is not visible in the collected budget revenue? Neither in insurance contributions, although the basis represented by the gross average salary increased with 10%, nor in the tax on salaries and income or in the tax on profit. Despite economic growth based on domestic demand, all these categories of revenue brought not even 10% of GDP additional revenue collected to the budget.

Foreign investments in 2015

Investments are, as we know, expenditure made to obtain capital goods. The character of foreign investments is given, apart from the significance of the concept of investment, by the extraneity component represented by the investors' belonging to a foreign country, the foreign currency to make the payment, the place of the goods sold in another country etc. (Anghel, 2002, p.39). In other words, we can say that foreign investmentsis the capital transferred, under various forms, from one country to another. Transfers of capital will cover mainly the areas where profit can be made with the highest probability and lowest risk.

The net flow of foreign investments in Romania in 2015 was 3,461 million euro (more than the 2% of GDP recorded in 2015). By 31 December 2015, the final balance of the foreign investments in Romania reached 64,433 million euro (40% of GDP), distributed 70% in own capital and 30% net loan received from foreign investors.

The investments for 2015 resulted as difference between the 3,595 million euro own capital of the companies – FDI in which the contribution of the foreign capital is at least 10%, contribution that includes the reinvested profit of 510 million euro, and the 134 million euro negative balance between the loans received and the reimbursement for the previous loans.

The foreign funds, according to statistics, was 3,085 million euro, out of which the greenfield investments were only 96 million euro, less than 3% of the total investment, which reveals low interest in foreign business people to develop new business in Romania. The amounts resulted from mergers and acquisitions diminished the final result with 5 million euro. The most significant money came from the development of already existing companies (1,742 million euro, half of the net flow), the difference of 1,252 million euro being the result of company restructuring.

The Netherlands, Austria and Germany cover more than half of the foreign investments, if we judge by the declared official residence of the foreign capital. Obviously, however, the real origin may significantly differ, which places countries like Cyprus on 4th place and Luxemburg on 7th, while the USA holds the 10th place and the UK on 13th.

Table 4

Countries of origin of foreign investments in Romania, in 2015

Country	Value of investment - million euro -	% of total
The Netherlands	16,100	25.0
Austria	9,131	14,2
Germany	7,991	12.4
Cyprus	4,421	6.9
France	4,308	6.7
Italy	3,349	5.2
Luxemburg	2,700	4.2
Switzerland	2,231	3.5
Greece	1,747	2.7
USA	1,627	2.5
Belgium	1,444	2.2
Spain	1,423	2.2
UK	1,346	2.1
Hungary	938	1.4
Czech Republic	652	1.0
Other countries	5,025	7.8

Source: National Bank of Romania and National Statistics Institute research

To note the weak positions of France and Italy, holding the 2nd and 3rd places in the foreign commercial exchanges with Romania, which appear here on 5th and 6th places, as well as the apparition above the threshold of 1% of Eastern countries, Hungary and the Czech republic, which also needed foreign investments, but this did not prevent them from taking advantage of opportunities in other countries.

Per development regions, the capital city attracted almost 60% of the FDI. Followed, at long distance, by the most developed Romanian regions, while Oltenia and Moldova are the last interesting for the foreign capital. The development imbalance deepened and led to gaps of 4 : 1 (Bucharest-Ilfov 131% of the EU average , as against North-East with 34%).

Table 5

Distribution of foreign investments in Romania, per development regions, in 2015

Region	Value of investment - million euro -	% of total
Bucharest– Ilfov	38,423	59.3
Centre	5,831	9.0
West	5,237	8.1
South– Muntenia	4,626	7.2
North - Vest	3,793	5.9
South- East	2,869	4.5
South- West Oltenia	2,172	3.4
North - East	1,662	2.6

Source: National Bank of Romania and National Statistics Institute research

Contrary to stereotypes of the public and the daily visual impact, the main destination for FDI was the industry, 44.6% of the total money invested by foreigners in Romania, most of it (over 20 billion euro -31.8% of the total) in the processing industry. 2nd place is held by banks and insurance companies, 3rd place with almost the same amounts, trade and constructions. To note, in the processing industry, a clear difference between similar amounts as FDI in the petrochemical industry, which determine almost entirely the trade deficit of Romania, and the industry of the means of transportation which, on the contrary, ensure increased weight of the medium and high-tech products and obtained a significant sectorial surplus to ensure the equilibrium of the commercial balance.

Table 6

Distribution of foreign investments in Romania, per main economic activities, in 2015

Activity	Value of investment - million euro -	% of total
Processing industry, out of which:	20,477	31.8
- petrol processing, chemical products, rubber etc.	3,859	6.0
- means of transport	3,803	5.9
- metallurgy	2,639	4.1
- food, drinks, tobacco	2,198	3.4
- wooden items, furniture	1,711	2.6
- cement, glass, ceramic	1,456	2.3
Financial business and insurance	8,428	13,1
Constructions and real estate transactions	7,877	12.2
Trade	7,861	12.2
Industry – Electricity, gas, water	6,317	9.8
Professional, scientific, technical activities etc.	4,056	6.3
IT&C	3,690	5.7
Extractive industry	1,952	3.0
Agriculture, forestry, fishing	1,662	2.6
Transport	1,191	1.8
Hotels and restaurants	504	0.8
Other activities	418	0.7

Source: National Bank of Romania and National Statistics Institute research

Although almost unnoticed, the low FDI in hotels and restaurants affected the development of an economic sector below the natural potential and accommodation capacity available in Romania. This stays valid for agriculture as well, which has a large potential of productivity, a key element to improve national competitiveness.

Romania's competitiveness as global level according to WEF 2016 – 2017 Report (Global Economic Forum) and the middle income trap

Romania is ranked the 62nd among the most competitive 138 countries in the world, 9 positions lower as against 2015, according to WEF 2016 – 2017 Report (Global Economic Forum) published in September 2016. Switzerland, Singapore and the US are in the top while Bulgaria is the 50th, Hungary – the 68th, the Republic of Moldova – 100th. India had the most spectacular evolution, now the 39th, 16 positions higher than in 2016. This scoring is due to improvements in health sector, primary education and infrastructure, says WEF report. India cut to half the infantile mortality rate (from 62 to 37.9 in 1.000 children) and increased the attendance in primary education (from 88.8%, to 93.1%). Life expectancy climbed from 62 to 68 years. In infrastructure, India improved little until 2014, when the government increased the investments and speeded up the approval procedures to attract private resources. Albania ranks the second in increased competitiveness, climbing from 93th to 80th.

The overall scoring for Romania is 4.30 points (compared to 4.32 points last year) *on a 1 to 7 scale*. Countries such as Estonia (30th place), Czech Republic (31st), Lithuania (35th), Poland (36th place), Russia (43rd), Latvia (49th) and Bulgaria (51st) are before Romania. Countries such as Slovenia (35th), Hungary (69th), Croatia (74th), Greece (86th) and the Republic of Moldova (100th) come after Romania. Romania has low scoring in indicators regarding innovation (93th out of 138), business sophistication (104th in the world), and institutions (92nd in the world) and infrastructure (88th in the world). It received higher scoring for the criterion ”macroeconomic environment” (28th in the world, best place held by Romania) and ”market size” (42nd).

Figure 5

Romania's global competitiveness according to WEF 2016 – 2017 report

Key Indicators, 2015

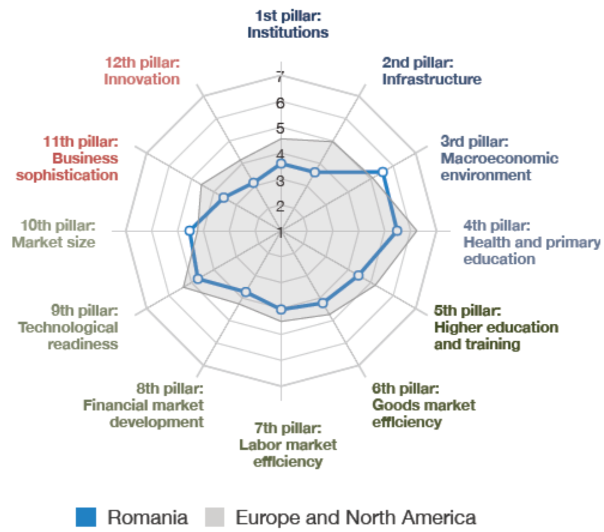
Source: International Monetary Fund; World Economic Outlook Database (April 2016)

Population (millions)	19.9	**GDP per capita** (US$)	8906.3
GDP (US$ billions)	177.3	**GDP (PPP)** % world GDP	0.36

Performance overview

	Rank / 138	Score (1-7)	Trend	Distance from best
Global Competitiveness Index	62	4.3		
Subindex A: Basic requirements	72	4.6		
1st pillar: Institutions	92	3.6		
2nd pillar: Infrastructure	88	3.6		
3rd pillar: Macroeconomic environment	28	5.5		
4th pillar: Health and primary education	88	5.5		
Subindex B: Efficiency enhancers	55	4.3		
5th pillar: Higher education and training	67	4.4		
6th pillar: Goods market efficiency	80	4.2		
7th pillar: Labor market efficiency	88	4.0		
8th pillar: Financial market development	86	3.7		
9th pillar: Technological readiness	48	4.7		
10th pillar: Market size	42	4.5		
Subindex C: Innovation and sophistication factors	100	3.3		
11th pillar: Business sophistication	104	3.6		
12th pillar: Innovation	93	3.1		

Edition	2012-13	2013-14	2014-15	2015-16	2016-17
Rank	78 / 144	76 / 148	59 / 144	53 / 140	62 / 138
Score	4.1	4.1	4.3	4.3	4.3

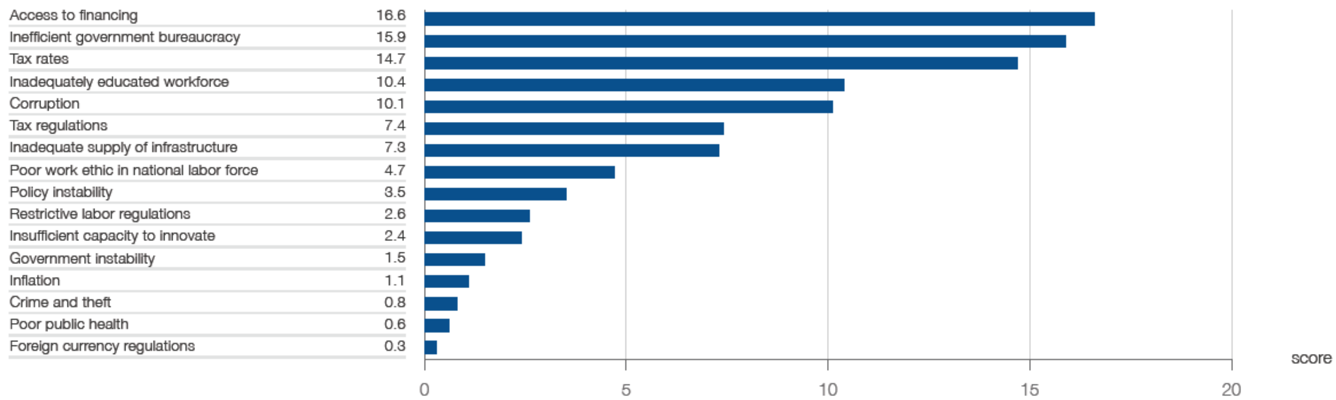


Source: World Economic Forum - The Global Competitiveness Report 2016–2017, available at: [*https://www.weforum.org/reports/the-global-competitiveness-report-2016-2017-1/*](https://www.weforum.org/reports/the-global-competitiveness-report-2016-2017-1/)

According to Global competitiveness report 2016-2017, the biggest problems for Romania are: access to funds, governmental inefficient bureaucracy, taxes, labour force that is improperly trained and fiscal regulations.

Figure 6

Most problematic factors for doing business



Note: From the list of factors, respondents to the World Economic Forum's Executive Opinion Survey were asked to select the five most problematic factors for doing business in their country and to rank them between 1 (most problematic) and 5. The score corresponds to the responses weighted according to their rankings.

Source: World Economic Forum - The Global Competitiveness Report 2016–2017, available at: *https://www.weforum.org/reports/the-global-competitiveness-report-2016-2017-1/*

Romania's objective is obviously to become a developed country, which means to surpass the threshold of USD 12,735 per capita. As the income categories used by the World Bank to group countries in developed, middle income and poor are corrected annually with the inflation, the target for Romania is higher: approx. USD 14,900 in 2025 and over USD 16,100 in 2030 (estimated based on the threshold average correction for the last 10 years).

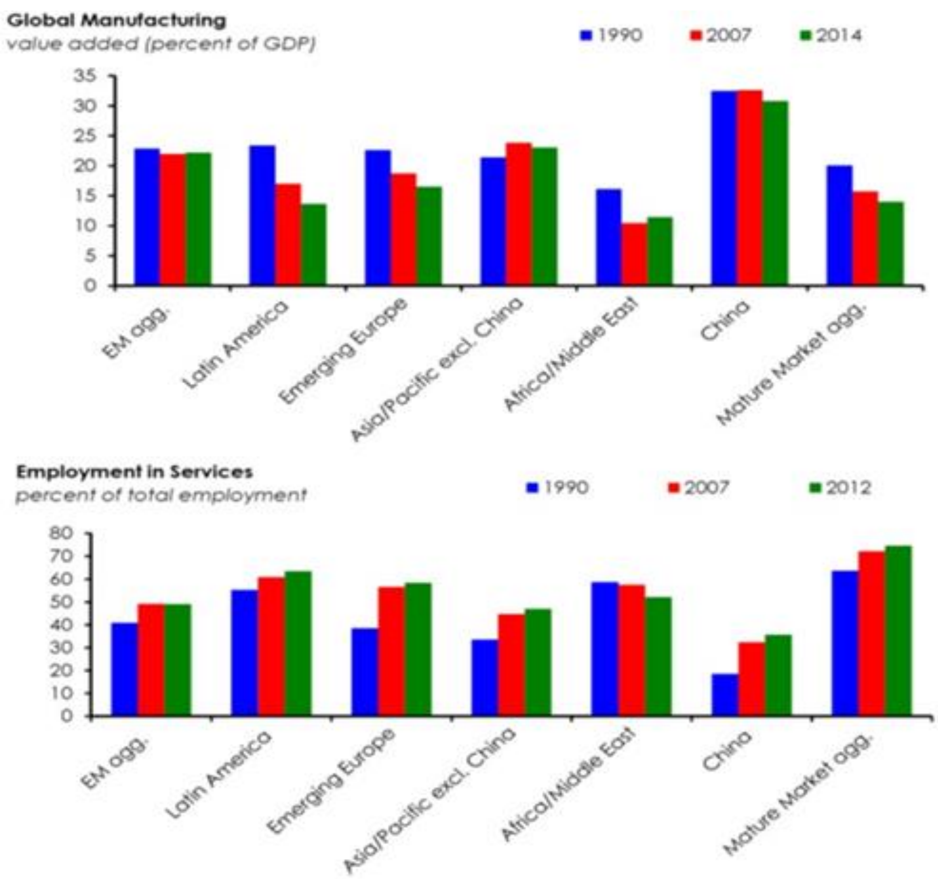
With an average annual growth per capita of 3.5 %, Romania would reach the developed countries in 2030; an annual growth of 4 % would surpass the threshold in 2026, and a 5 % growth rate would surpass the threshold in 2024. Such a performance does not look unreachable if we take into account the growth rates in the last years. However, global experience in development shows that, although many countries fall into the category middle income, very few leap into the developed country category. In a survey from 2012, World Bank shows that out of the 101 economies in the category middle income in the 1960s, only 13 managed to reach the level of high income by 2008: Equatorial Guiney, Greece, Hong Kong, Ireland, Israel, Japan, Mauritius, Portugal, Puerto Rico, Republic of Korea, Singapore, Spain and Taiwan.

Economists proposed the term „middle income trap" to describe this phenomenon empirically found, but difficult to explain through the standard theory of economic growth and development (Gill et al., 2007). Statistical series that describe the long term GDP reveal, repeatedly, a sudden slowing down of the economic growth rate when the income per capita reaches a certain level.

Eichengreen, Park and Shin (2013) try to establish the level of income per capita from where economic growth remains flat, by analysing the growth trends in several countries that fall into the category middle income per capita between 1957-2010 and reach the conclusion that there are 2 thresholds where the convergence with the developed countries stops for most economies. The 1st is around USD 10,000-11,000 per capita and the 2nd around USD 15,000-16,000 per capita. Romania is close to the 1st threshold and obviously Romania wonders if it will surpass the middle income trap. For many economists, the middle income rap reflects actually the inability to surpass an economic model that exhausted its productivity growth reserves. Global experience shows that passing from poverty to middle development can be done relatively fast, using more efficiently the production factors: the labour force migrates from agriculture to high productivity sectors in industry, using relatively cheap, well-known technologies. With a high rate of savings and investments (in some countries and moments in time, 50% of the GDP), development can continue in this way for several decades, and then the growing pace slows down. The cheap labour force attracted in agriculture run out and its cost increases, the technologies used in industry reach their limits and investments in new equipment no longer bring important advantages. The way to increased productivity is the structural economic change by expansion of new industries /sectors /activities with higher added value. Few countries, such as Japan, Israel, Ireland and some „Asian tigers" discovered after the WWII the way to a structurally different economy in which new sectors, with high added value, occupies the largest labour force. In other countries such as Brazil, Mexico, Turkey, Argentina etc., the leap has not taken place yet, although there have been moments when it seemed close. The difference between developed countries and middle countries is not in „how" they produce (technological efficiency), but in „what" they produce (structural efficiency). Processing industries are concentrated in China and other emerging countries, while in mature economies, services employ most of the labour force.

Figure 7

Structural changes in economy per categories of countries



Source: Institute of International Finance, The rise of services - what it means for the global economy, Dec. 2015

A new division of labour is appearing at the global level (Fig. 7), in which middle countries become competitive in the main processing industries, while developed countries control the advanced industries and the research-development-innovation and services sectors, activities with higher added value.

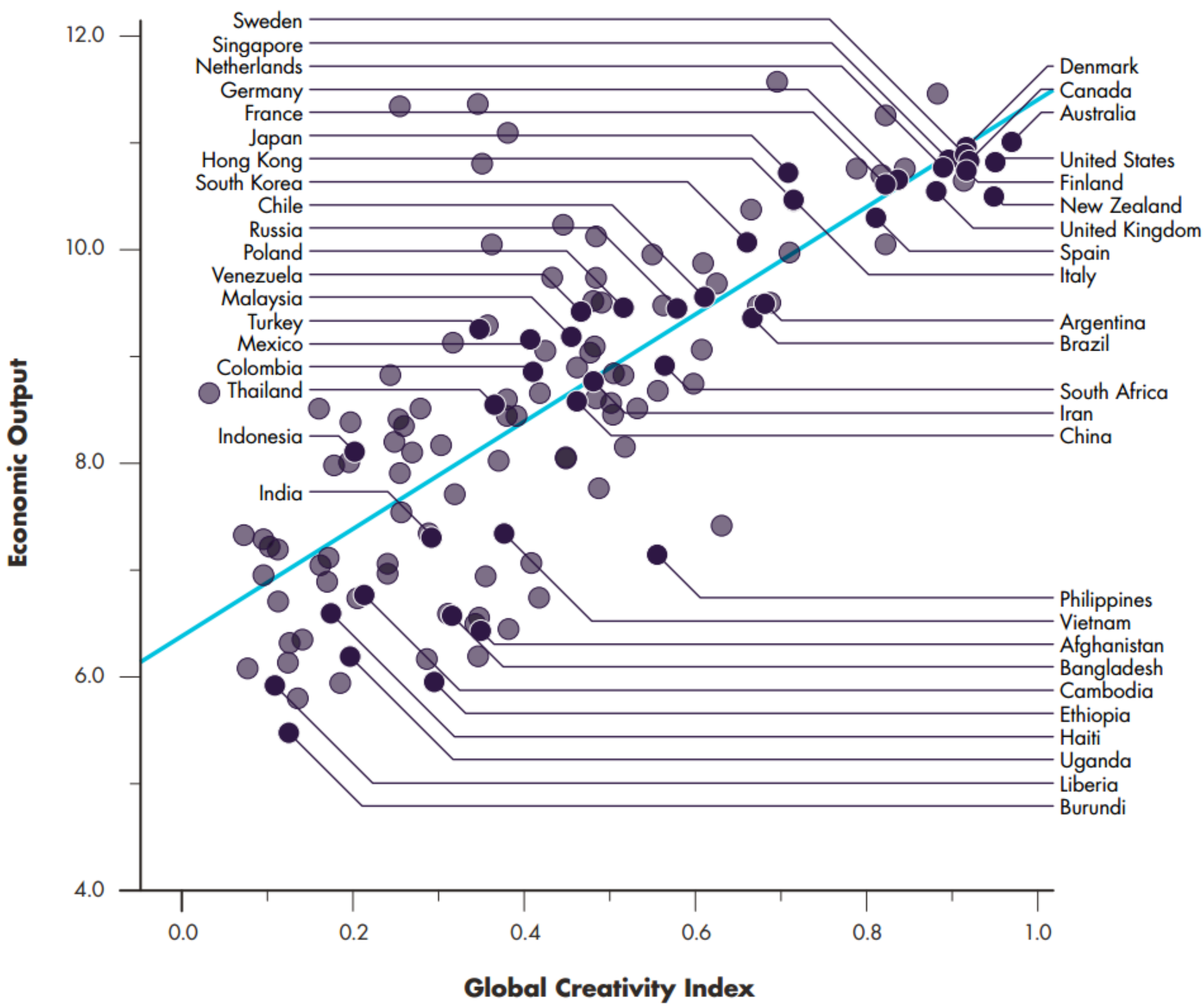
The Global Creativity Index measured by Martin Prosperity Institute for 2015 (Florida et al., 2015) places Romania on 68th place out of 139 countries, with a scoring of 0.425. Close, at the middle, countries such as Cyprus (66th), Georgia (64th) and China (62nd), while Bulgaria and Poland hold the

48th and the 46th places, and Hungary the 28th . First places in the Global Creativity Index are held in 2015 by Australia, the US, New Zeeland, Canada and Denmark. The Creativity Index is combined with 3 components – Technology, Talent and Tolerance – and it is close connected to the economic success of a country. The countries with high scoring in the Global Creativity Index have high levels of productivity, competitiveness, entrepreneurial spirit and human development in general – a link illustrated in Fig. 8.

In most developed countries, the creative class, made up of people who are active in the „knowledge-based economy", namely science and technology, art and culture, mass-media, business management, liberal professions and education and health, represents more than 1 third of the total employed people, even 54% in Luxemburg and 47% in Singapore and Switzerland. In Romania, 20%.

Figure 8

The Global Creativity Index and economic output correlations



Source: The Global Creativity Index 2015, Martin Prosperity Institute, *http://martinprosperity.org/media/Global-Creativity-Index-2015.pdf*

All these indicators show that Romania does not have currently the necessary ingredients to make the leap from middle economy to a developed economy. The current status is not guaranteed either, since the contemporary world is undergoing what Klaus Schwab, president of Davos Economic Forum, calls the „4th industrial revolution”.

Artificial intelligence, robots, the science of materials, nanotechnologies, intelligent networks and other sectors that made outstanding discoveries are about to combine and multiply their effects with potential revolutionary outcome in terms of production systems, life style and human interaction. This ongoing industrial revolution complicates further on the goal of structural modernization of our economy and reveals the insufficiency of our resources.

Conclusions

The simultaneous implementation of stimulated demand and fiscal relaxation simply could not work. The 10 billion lei less in the budget execution balance are found in equal proportions in the diminished VAT collection, resulting from the reduced VAT (copied from an European model and implemented at the wrong time) and massive reduction (10 times) of the EU funds received for payments and pre-financing. The absorption of the EU funds for 2014-2020 is very weak and cannot replace the revenue collected corresponding to the preceding financial year. The higher percentage of expenditure with salaries and social benefits in an electoral year and the limited collection of revenue might determine measures to restrict further on the investments in order to keep the deficit below 3% of the GDP.

The level of foreign investments was rather low compared to the size of the economy, with an average of less than 2% of the GDP per year. Comparable with the payment obligation to the public debt which reached almost 40% of the GDP (another interesting coincidence, after 25 years of capitalist economy). To lose foreign money and opportunities of quick development for the reason that the budget cannot allocate the little amount of co-financing money (5% – 15% of the total value of the projects) and the expertise needed to draw the bid documents and organize the bid according to the EU requirements is a story no longer believed. It looks rather that ”if no personal win, no interest in”, so preference to stay out.

What can we do to increase Romania’s chances to have it economy advance structurally towards innovative activities with high added value? Unfortunately, no prescription can be given to guarantee success in the social and institutional conditions of our country.

The modernization of the educational system and professional training is undoubtedly a major component, but it will not go too far if it doesn’t take into account the large disfavoured categories of young people, caught in the vicious circle of poverty, separated families, lack of model and school dropout. The Romanian higher education holds a modest place in international hierarchies and there are no sufficient human resources to change this situation. Entrepreneurial courage can be cultivated only during classes given by experts, it can be transmitted only in an environment with successful models. Local research and development lack not the funds but institutions to make efficient the use of these funds and orient resources to solve relevant problems for economy.

Romania does not have enough large urban agglomerations which facilitate the apparitions and development of diverse, innovative culture that can generate new ideas and solutions; half of the population live in the rural area, in localities lacking the facilities needed for a modern life. The flawed transport infrastructure makes communication difficult and it is an obstacle for investments.

Social fragmentation and insufficient cohesion is reflected at the political level in the lack of substantiated long-term and medium-term governing programs, with objectives largely shared and pursued beyond the electoral cycle. There is, in addition, an old, strong inertia of the social institutions that makes advanced technologies present rather in countries that have always had advanced technologies

(Comin, 2010), and entrepreneurial spirit blossom where there is already a large entrepreneurial culture (Guiso et al., 2016).

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