# Romania 2040 - A Perspective

NAPOLEON POP, PhD
Institute for World Economy
Romanian Academy
ROMANIA
iemnapoleon@gmail.com, www.iem.ro

SORIN-NICOLAE CURCĂ
Institute for World Economy
Romanian Academy
ROMANIA
iemnapoleon@gmail.com, www.iem.ro

*Abstract: - This paper aims to present an image of the main economic and social indicators of Romania in the perspective of 2040. Its purpose is to set possible targets according to the real potential of the Romanian economy in order to create a viable long-term development strategy. Our analysis starts from the current situation of Romania - the insufficiently structured economy, burdened by the existing development gaps compared to other EU member states, while aiming to expose a series of hypotheses regarding Romania's future European path. The paper will also highlight other important topic for the future development of Romania: the evolution of population, overcoming divergences between the state and markets, the impact of adopting the euro, the impact of shifting power balances between the main developed economies, as well as the possible consequences of EU's future enlargements. From a methodological perspective, the forecasts were based on previous evolutions of indicators, using the extrapolation method. The last part of the paper contains a series of recommendations for policy-makers.*

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*JEL Classification: E60, E61, E65*

## 1. Introduction

While 2040 is not so far we have doubts whether certain targets for Romania's macroeconomic indicators that we propose at academic level are achievable. There are contemporary elements, most likely characterized as "stubbornness", which might demonstrate, as in any forecast, that between expectations and possibilities, we shall be facing discrepancies. Those almost three decades of evolution in terms of the new economic and politic system in Romania justifies such an appreciation, especially when we try to draw tendencies with a certain finality.

What has been done well in a few steps is a *suis generis* economic growth that has not materialized itself within long term development, as the public policies failed to be continuously improved g in terms of quality and efficiency in order to produce sustainable economic growth.. It is our strong opinion that only sustainable approach of the policy mix t may produce a structured development wich can provide preventive and resilient tools in order to face challenges whether internal or external, in a globalized world. According to many analysis from the post-crisis period, to limit ourselves exclusively to economic growth, means to expose us to vulnerabilities, the years 2017 and 2018 confirming them piling up, with a certain risk outcomes in a near future.

Romania has a dynamic economy from the point of view of long term tendency, a fact well demonstrated by the evolution of the absolute GDP value or of the GDP per capita with regards to purchasing power parity (PPP) within past 28 years. What we may conclude taking into consideration many macroeconomic development models is the fact that those particular indicators derive from one economy still insufficiently structured, in regards to its potential resources or to the internal demand. In fact this is what explains the regional disparities and precarious mobilization when it comes to potential resources necessary to the overtaking of the avatars belonging to the economic cycle of *"ups and downs"*, sometimes of significant amplitude. Also, the poor structuring of the economy towards opportunities and incentives explains internal and external deficits, as other countries in the region have registered surpluses. If we are talking about the potential of the Romanian economic model for the next three decades, we have several serious problems right now: the evolution of the population - the source of the economically active labor force -, the gross capital formation and the rate of investment.

Based upon these considerations, we aimed to reach to a certain picture comprising the targets of the main economic and social indicators of 2040, starting from the recent strategy of the Romanian Academy targeting 2020 and using not very sophisticated calculations, doubled by our own qualitative analysis. We have obviously started from some hypotheses that we have considered as sine-qua-non conditions. Regarding the assumptions, we underline that their choice was based on the following imperatives: (1) the need for realistically approaching the perspective based on anchors that we must either propose to ourselves, or to make real use of what we are offered, for example as an EU Member State; (2) achieving the normality in the conduct of public policies; (3) and last but not least the need to fairly understand how the market economy works, especially in view of the shared responsibilities between the public and the private sector. We are basically talking about Romania's entry into a period of normal responsibility towards its own European destiny.

We preferred that the targets should not be ambitious and fit for propaganda purposes, but rather aiming for the adjustments necessary for emerging assumptions taking into consideration the need to be cautious, realistic in relation to the history of economic growth and to tend towards sustainable long-term developments in an environment without creating tensions born out of ambitions that are hard to honor.

In view of the above mentioned hypotheses we may state the following axiomatic assertions:

a) **Romania shall continue its European path** with impact on the efficiency of public policies, by striving for a beneficial economic culture; we also take into consideration the probability that Romania will evolve within a **successfully reformed Union (including with Romania's contribution) while working together with the other MS** for the prevention and resilience of any new economic shocks, as a guarantee of deepening the integration process and increasing its security;

b) **the non-encouraging demographic trend is a reality**, preventing the labor force to become a generator of the creative value-added; it is worth mentioning that the drastic decrease of the birth rate phenomenon doubled having as effect the limited transition in terms of expanding labor force;

c) **overcoming the misunderstanding of the relationship between the role of the state and that of the markets forces** in a liberal economy;

d) **government's communication on Romania's adoption of the euro by 2024**, a decision with a special and immediate impact on the accuracy of the future public policies, with minimal risks to macroeconomic balances;

e) **the shifting balance between the global powers - USA, China, EU, India, Russia** – has already impacting the global economy's trend having various effects on most countries; in this context, Romania's membership of the EU and NATO will imply new political commitments doubled by some financial ones;

f) **potential new members of the EU** will not change significantly the economic capacity of the European integration.

## 2. The evolution of the main macroeconomic and social indicators of Romania in the perspective of 2040

Based upon our approach - method and hypothesis - Romania of 2040 could look like, in terms of macroeconomic targets, as follows:

**Table 1. The main macroeconomic and social indicators in 2017-2018 and 2040**

| Indicator/Year | 2017 | 2018 (estimates) | 2040 (targets) |
|---|---|---|---|
| **Population** (millions) | **19.6** | **19.4** | **17.1 – 17.5** |
| **Economically active population** (% from total population) | **44** | **46** | **43** |
| **Employment target** (% from active population) | **68** | **69** | **75 - 80** |
| **Nominal GDP** (billion EUR) | 187.5 | 195.0 | 400-450 |
| **Real GDP** (%. y/y) | 7.0 | 4.0 | 3.1 - 3.5 |
| **GDP per capita** (PPP; % from EU average) | 62 | 64 | 85 - 90 |
| **Private consumption** (% GDP) | 62.3 | 61.7 | 62-65 |
| **Governement consumption** (% GDP) | 15.7 | 16.6 | 15-16 |
| **Productive investment** (% GDP) | 22 | 21 | 25-27 |
| **Exports** (% GDP) | 33 | 34 | 41-45 |
| **Imports** (% GDP) | 40 | 41 | 44-49 |
| **Inflation** (%. HICP. annual average) | 1.1 | 4.1 | 2 |
| **Unemployment rate** (%. annual average) | 4.9 | 4.2 | 3-3.5 |
| **Reference interest rate** (%) | 1.8 | 2.5 | - |
| **Long-term interest rate** (%) | 3.9 | 4.7 | - |
| **Government deficit** (% GDP) | -2.7 | -3.0 | -3.0 |
| **Government debt** (% GDP) | 35.2 | 35 | 62 |
| **Current-account balance** (% GDP) | -3.2 | -4.8 | 2.5 – 3.0 |

Sursa: Eurostat, Institutul Național de Statistică, authors.

We also assume that given our economic outlook and the need to overcome the existing political tensions the targets presented are subject to comments as follows:

1. **Romania's population** is consistent with UN forecasts and studies done by Vasile Gheţău (NIER - Romanian Academy, 2018), the difference between extremes of 17.1 - 17.5 million being a hypotheses of the net migration value, a phenomenon that will keep going. The decrease of Romania's population at this level reflects a significant deterioration of the demographic situation in terms of factors that determine it (birth, deaths, life expectancy) in the last decade, with an impact on changes in age structure. As a result, the share of the **economically active population** may be reduced from the actual 46% of the total population, to 43% in 2040. Absolute values reveal a significant decrease in human capital, even if the overall economic performance implies a more efficient health system, an education system that responds better to the demands of the labor market and a labor remuneration to ensure a GDP per capita expressed in PPP, increasing to 85% and above the estimated EU average of 2040.

2. **The target value of GDP** and the indicators based on it envisaged a potentially cautious GDP of 4 - 4.5%, consolidated with a flexible and convergent economic structure, even if it could exceed 5%, function the structural policies actually put into action. It is advisable for the GDP *gap* to remain negative or at most equal to the potential preventive one, in order to maintain **sustainable economic growth with price stability and financial stability**. In view of the possible economic cycles, a potential GDP reserve is needed to overcome them with the smallest shocks and to protect the economy of inflationary shocks (due toverheating) and excessive budget and current account deficits.

The starting-up of the GDP target also comes from some existing vulnerabilities as well as the premise of a possible global crisis, placed after various analysis, less this year and safer in 2020, with some lasting effects. The monetary policy of the FED, China's economic downturn (forced by the already visible impact of the trade war with the US, regardless of the understanding between the two powers at which it is finally possible), the effects of Brexit, the manifestation of a fatigue in the growth economic impact of the EU, all have a medium and long-term impact on the growth rate of the global economy and trade, affecting Romania's economic and trade presence niche. Their dynamics has always been downgraded by international financial organizations and development (IMF, WB, OECD) after the overcoming the last crisis.

3.Concerning GDP contributors real convergence studies show that Romania is able (probably due to structural funds, the involvement of large foreign companies, preparing for joining the euro area) to significantly reduce the structural divergence towards the euro area in terms of the Krugman index, its value for Romania being 27.8 percentage points in 2017, compared with 34.4 points in 2000. This indicator shows Romania may continuously synchronize itself with Hungary, Poland and the Czech Republic tendencies.

However, by major branches, Romania has a structural divergence from the euro area to the industrial sector, with a weight of 26.7% compared to 20%, for the Eurozone today. This divergence could be an advantage if gross added value (GAV) created by industry would be significantly higher through production chains with a higher value. **It is important to note that the recent crisis has shown that recovery has been easier for intensive economies in industry**.

Significant reduction of the structural divergence towards the euro area was achieved by the agriculture sector, with a share of total gross added value (GAV) of 4.8% in 2017 compared to 12% in 2000, but with the observation that this reduction reflects the still high level (but not factual) employment and relatively low productivity. At the opposite side, Romania has to recover in terms of real convergence in the areas of financial and public services.

It is preferable that the structural and real convergence similarities be guided by policies that do not erode neither the comparative advantages when we talk about the potential in some natural resources or the competitive advantages achieved through the restructuring of the productive chains and the increase of the labor productivity through a better qualification and assimilation of new technologies.

4. **Increased attention should be paid to the formation of gross capital as a percentage of GDP, in order to guide investments** towards areas that may increase expenditures, with a productive impact on domestic and export supply, as well as on the development of the tax base.

**We believe that Romania should pass from economic growth to a structured development on branches and territory. Development needs financial resources, and fear of frowing debt surpassing 60% of GDP, as long as it has multiplier effects and easy reimbursement of public debt, must be overcome**. The dynamics of public debt could be diminished by better use of European structural funds - large value drawdowns and spending orientation on projects with impact on development. We could benefit in this period by another 85-90 billion euros, with firmer projects which can attract these funds to their higher limits..

It is also supposed an increase of the investors interest in Romania with the provision of a friendly business environment and a real and functional expansion of public-private partnership (PPP), which would have an impact on the budget revenues and trade balance. Romania, through the nominal convergence imposed by the adoption euro and its stable use as a mean of payements and the real convergence achieved through productive investments and in modern infrastructure (physical, education, health, public services) may tend towards a relatively balanced and even with surplus foreign trade, with a share of exports in GDP over 45%. In this context, an important role is played by the increase in unit value of exports, as a result of investments in advanced technologies and strengthening internal factors for improving competitiveness.

Exports should no longer be seen as a currency resource but as a factor in capitalizing competitive advantages on foreign markets, with goods and services reflecting a changing economic structure. Obviously, the pressure generated by imports from companies to produce more and more diverse goods in the country will also cover domestic consumption and, implicitly, will improve the current account deficit.

5. **GDP per capita and GDP per capita at the PPP, become indicators directly expressed in euro**; they will see a dynamic under the influence of factors such as: (a) the evolution of the population in general and of the economically active population in particular, taking into account the Lisbon Strategy on the employment target; (b) the average level of salaries in the economy correlated with a dynamic labor productivity impacting both purchasing power and the competitiveness of goods and services. The potential erosion of the purchasing power and competitiveness is countered by an annual inflation controlled by the effect of joining the euro area (no more than 2%) and an optimal structure of economic activity domains that create GDP: agriculture, industry, construction and commerce; (c) the reduction in the number of people exposed to poverty and social exclusion.

We mention that in 2017, the calculation basis for establishing the poverty line in Romania, compared to the other EU Member States, was 1800 euro/year, which requires an adjustment to approx. 4000 euro/year in 2040. An important path for achieving the target is that Romania should follow the principles of the European Social Rights Pillar, respectively to ensure a minimum wage adequate to decent living for workers and their families.

Convergence in GDP per capita in PPP could reach over 80% of the EU average, compared with 61% in 2018, a dynamic that assumes that the EU average will also progress through the impact of institutional reforms, but amended by real growth rates of around 3%. At the same time, Romania has to recover also the regional disparities in the incomes, respectively their flattening towards a higher and uniform national average, by stimulating the influence and the expansion of the poles of economic growth, the inclusion of new geographic spaces in the performing economy (stimulation of the local entrepreneurship, private and public investment, development of physical infrastructure, attracting skilled labor etc.).

6. **Inflation** will enroll in the quantitative definition of price stability, Romania having this obligation by being in the euro area and following the ECB's monetary policy. Macroeconomic equilibrium could be ensured only through the fiscal policy as stated by TFEU and **the Stability and Growth Pact (SGP)** rules in terms of macroeconomic discipline constraints. The advantages of national economic policies that support the euro will be translated into the real benefits for the population and the business, , being already overcome and passed the shocks of the euro adoption. Moreover, it is assumed that in 2040 the euro area will be similar to the geographical area of the EU, which also means a more suitable balance in risks and benefits sharing between member states.

7. The projected **unemployment** target of 3.0% - 3.5%, takes into account the economically active population and its employment target, benefiting from a competitive and flexible labor market, the overall and individual economic conditions providing better internal mobility. This level of unemployment must also be related to a declining economically active population, as we have established in section 1, of the conditionalities underpinning the targets.

8. **One of the conditions for achieving the targets is the orientation of public policies, supported by a fiscal policy geared to sustainable, robust and durable economic growth**. Entry into the Eurozone in 2024 would ensure this necessary adjustment over the next 16 years, which means another approach to the fiscal code, budgetary and current account deficits and, in particular, the external (public and private) debt. We can talk about any economic model, but we can’t deny to it the generally valid macroeconomic balances ensuring the dynamic of an sustenable economic.

We should accept an increase in public debt to reduce the development gap between Romania and the best performing states of the EU. This means that debt should be contracted exclusively for public investment with multiplier effect, which makes it easier to reimburse it. . It is worthmentioning that being in the euro area, Romania will benefit from reduced long-term interest rates. What counts accordindg to the latest analysis of economists is the economic and social results rather than the cost of debt.

9. The chance to create well-paid jobs with attractive retirement schemes by stimulating productive public investment and the expansion of the private sector has an effect on internal labor force mobility, its retention in the country and the attraction of another from outside. The stability of the private sector's contribution to GDP formation, as a result of a predictable and more stable business environment, can be sustained through **a coherent and especially fair fiscal policy**, in terms of pressure on taxpayers of all kinds.

The development of the tax base should reduce the gap in the share of public revenues in GDP compared to the EU average. Citizens' expectations and state capabilities to serve them can only be brought to a common denominator only with a share of public revenue in GDP rising from 28% today to over 36% in 2040. We need to pursue a continuing budget consolidation (reducing deficits in parallel with some taxes increase) and control of external deficits. All these involves structural reforms to increase labor productivity calling for a fully reformed and competence-based education system and a robust financial system in order to avoid possible austerity programs with adverse effects to long term economic growth.

This constraint must be perfectly understood and assumed in the idea of spending the public money for more for development and less for consumtion ensuring, by a fair pay of the work, a level of civilized life standards for most of the citizens of this country.

10. It is expected that the differences in the functioning of the market mechanisms in different sectors of the Romanian economy towards the requirements of the single market have been substantially exceeded, which implies **a correct relationship between the role of the state (as regulator and not as administrator) and that of the markets**. It si necessary that national hybrid legislation to be reviewed and to become more approximated with Community law. Among other things, the first priority should be a compaction and simplyfing legislation and protect it towards almost endless and surprising changes, creating confusion and uncertainty, especially for the private sector becoming dominant in its role and contribution to development of the country.

## 3. Conclusion

The objectives presented may be criticized, but an optimistic or pessimistic change in their levels always implies the same: **the political factor has to assume the quality of national policies in the fiscal, budgetary, macroprudential and labor market fields**. The discipline of public policies in these areas must become the exclusive prerogative of national government, just so that **normal development** does not collide with the requirements of European institutions or other international financial organizations.

We mentioned a hypotheses and a reason, namely the transition to the euro and a possible confrontation of Romania with a crisis. Both comments invite the government, with insistence and speed, towards a normality in terms of public policy conduct. We know what this means from the many controversies and conditionalities in our negotiations with the IMF, for example. As ever, the return to economic growth since the last crisis has always been announced with rising risks, its firmness hardly reached and having the deficiency due to the lack of sustainability (see IMF, World Bank, EU Commission).

The statistical indicators at the end of 2018 reveal a slowdown in growth for many representative countries. For many European countries the question arises as to how much their economic recover is due, with the amplification of some vulnerabilities, to the imposed and/or applied austerity programs. On this issue, there is a serious debate about the finality of austerity in results, most of its costs being seen in loss of production with social effects: income cuts and more unemployment. Concretely, some austerity programs have been successful, but the figures across the global economy are saying something else. Rescue operations of systemic financial institutions with public money (bail-out) have consumed 3% of global GDP. Between 2007 and 2014, the period of the implementation of austerity programs, global public debt increased by 34%. The living standard of the population has decreased by 10% and the difference seems to have become perpetual.

For the future, we must bear in mind what economic theory and good practice tell us about the nature of the last crisis and the unfortunate assessment of the austerity programs, which were too harsh, too late, with the loss of confidence in politicians and drifting towards populist, radical parties, illiberal, nationalist and protectionist tendencies. The economic growth recovery has been fragile, long-lasting, with falls and sustained by the unorthodox instruments used by central banks (quantitative easing - QE), as governments lacked intervention resources, i.e. sufficient fiscal space.

Knowing the definition of austerity in peacetime and in the absence of disasters (the action to reduce large government deficits, some accumulated in the context of economic growth and financial stabilization), it can be avoided by an adequate fiscal policy, practiced on the economic ascent slopes. This means offsetting periods of reduced tax revenues in times of recession with increased public spending accumulated in times of economic growth. This has to be understood and assumed seriously to show that a "certain austerity" governments should impose first to themselves by reducing their expences. Many times such an assumption led to economic expansion.

The recommendation is that, in times of economic growth, the government must look to opimise its expenditure while providing money for investements and controlling deficits at the level of existing taxes. Such a situation can be welcomed by the private sector, respectively can lead to the efficiency of public policies by lowering their costs. The private sector welcomes such type of austerity versus a public policy that raises taxes.. However we should bear in mind that raising first taxes triggers a reduction in overall output for society with social effects and a narrowing the tax base. In this context of a low and uncompetitive supply, an increase in household consumption through increased revenue through purely administrative channels creates pressure on imports while affecting external balances (current account deficit and public debt). Being passed through such an experience, we believe that it is necessary to avoid it for the future.

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