PEST Analysis of Romania

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Political Factors

Romania is an independent parliamentary republic with judicial, executive and legislative branches of government. The president serves as Romania’s chief of state. The Prime Minister serves as the head of the government and is appointed by the president with the consent of the Parliament. The seat of the government is in the capital of the country – Bucharest.\(^1\)\(^2\)

According to the reputable Ducroire/Delcredere agency for risk assessment, Romania has low political risk.

Historical preview

In Romania, the fall of the communist regime was marked by the execution of the emblematic leader of the communist party Nicolae Ceausescu on the Christmas Day of 1989. Ion Iliescu, a former communist, took over the power in the country and was elected as a president. It was not until 1996 when the communist era ended in reality in the country and a centre-right government came into power. However, the new leaders - Emil Constantinescu as a president and Victor Ciorbea as a prime minister, failed to implement their economic reforms which led to the re-election of Ion Iliescu in 2000. Another failure of a successful execution of key economic and social reforms meant that the country was not put on the list of the countries to join the EU in 2004. In March 2004, at the end of Iliescu’s mandate, Romania was admitted to NATO. Despite all the hardships, in April 2005 Bucharest signed the European Union accession treaty and since January 2007 the country has been an official member of the EU.\(^4\)\(^5\)

Ruling Party

The Romanian political life can be best characterized as unstable. The high-level of division between the political parties often results in unsteady coalition governments that spend most of their ruling time and energy trying to ensure their own survival. The current centre-right ruling government is not an exception. Justice and Truth Alliance is a coalition between the National Liberal Party (PNL) of Prime Minister Tariceanu, the Democratic Party (PD) of President Basescu and two smaller parties – the Conservative Party (CP) and the Hungarian Democratic Union in Romania (UDMR). In April 2007, Basescu’s PD party was excluded from the coalition, which made the new government a minority one, made up of the PNL and the Hungarian Democratic Union. The main opposition of the current government is the party of the Social Democrats.\(^6\)

The expectations for the upcoming general elections in 2008 are for a bitter campaign, which is likely to end with the formation of a new alliance between the leading parties.\(^7\)

Latest EU Report

On July 23, 2008 the European Commission issued its second post-accession annual report on Bulgaria and Romania on the subject of judicial and anti-corruption reforms.\(^8\) According to the report, Romania has largely achieved improvements on the matter and thus, only received a warning relating to particular areas. No decisive measures such as the activation of the safeguard clause or retention

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\(^1\) [Website](http://romania.suite101.com/article.cfm/romania_government_profile)  
\(^2\) [BBC News](http://news.bbc.co.uk/2/hi/europe/country_profiles/1057466.stm)  
\(^3\) [FITA](http://www.fita.org/countries/romania.html)  
\(^4\) [BBC News](http://news.bbc.co.uk/2/hi/europe/country_profiles/1058027.stm)  
\(^5\) [EDC](http://www.edc.ca/english/docs/gromania_e.pdf)  
\(^6\) [Business Monitor](http://www.businessmonitor.com/businessforecasts/romania.html)  
\(^7\) [Website](http://www.oxan.com/display.aspx?ItemID=DB144215)  
\(^8\) [Website](http://www.oxan.com/display.aspx?ItemID=DB144215)
of European funds were enforced, while Bulgaria suffered a harsh penalty of around EUR 500 million.\(^9\)

The overall conclusion of the report is that Romania’s performance represents a “mixed picture”. Despite the fact that some progress is acknowledged, the predominant tone of the document is negative.\(^10\) According to the EU specialists, the two major problems are corruption and the still fragile legal and institutional framework.\(^11,12\) The report recommends that Romania significantly enhances the combat against high-level corruption, focusing on case delays due to minor excuses. Specific cases are pointed out in the document and the parliament is harshly condemned for delaying corruption inquiries involving the former Prime Minister Adrian Nastase and other top officials.\(^13\)

Victor Alistar, Executive Director of Transparency International Romania, says that new anti-corruption reform must be designed on a purely technical basis and backed by strong political will in order for Romania to fulfill all the benchmarks set at the time of accession.\(^14\)

**Foreign Relations**

Since the fall of communist regime in 1989, Romania has pursued a policy of strengthening its relations with the other European countries and the United States.

Romania is a member of more than 60 international and regional organizations. It joined the International Monetary Fund and the World Bank in 1972. The country is part of the European Union since January 1, 2007 and an active member in the North Atlantic Treaty Organization (NATO) since 2004. World Trade Organisations (WTO), United Nations (UN), World Health Organization (WHO) and UNESCO are other international organizations in which Romania is a member.

Romania is an active member in regional organizations as well. The country is part of the Southeast Europe Cooperation Initiative (SECI) and the Stability Pact for Southeast Europe. Romania also is a founding member of the Black Sea Consortium for Economic Development and has been a positive force in supporting stability and cooperation in the area.

Furthermore, Romania has good relations with the Middle East, Israel in particular. The Balkan country was an active participant in the negotiations after the Gulf conflict in 1991.\(^15\)

**Foreign Investors Incentives**

Since the fall of the communist regime, Romania has been gradually liberalizing its trade regulations and incentives and now follows the guidelines set by the EU. The ruling government is constantly updating the laws and financial conditions for doing business in Romania in order to maintain the positive growth of the economy. On June 27, 2008 the Romanian Government approved the latest investment law, the aim of which is to provide an umbrella framework in which processes of application and allocation of state aids will be made more consistent and transparent.\(^16\)

Other business incentives that the country offers are no limits of foreign participation in commercial companies (a foreign investor may establish a 100% owned enterprise in Romania), full repatriation of capital and profits, and equal treatment of residents and non-residents investors.\(^17\)

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9 http://www.state.gov/r/pa/ei/bgn/3211.htm
10 http://www.state.gov/r/pa/ei/bgn/3211.htm
15 [http://www.state.gov/r/pa/ei/bgn/35722.htm](http://www.state.gov/r/pa/ei/bgn/35722.htm)
The corporate income tax rate and personal income tax rate for 2008 are flat at 16%. The standard VAT rate is 19%. There is also a reduced VAT rate of 9%.  

**Trade Partners**

The two main trade partners of Romania, in both import and export terms, are Italy and Germany.

Imports from the EU weight 70% of overall imports. The value of imports in the first three months of 2008 reached 12.9 billion euros, an increase of 12% compared to the same quarter of 2007. The top five partner countries are Germany (16.8%), Italy (11.6%), Hungary (6.7%), Russia (6.4%) and France (6.3%).

The value of exports in the first three months of 2008 got close to EUR 8 billion, an increase of 14 compared to the first quarter of 2007. Exports to the EU weight 71% of overall exports. The top five partner countries are Germany (16.5%), Italy (16.3%), Turkey (7.9%), France (7.7%) and Hungary (5.3%).

**Economics Factors**

**Economic Growth**

Driven by the EU accession, Romania has shown a strong and stable economic growth. The country has managed to overcome the building up of economic tensions in the second part of 2007 and in the first quarter of 2008 recorded one of its highest GDP growth rates since 1989. The economy advanced by 8.2% reaching EUR 24.5 billion, exceeding even the most optimistic forecasts. According to Lucian Anghel, chief economist of Banka Comerciala Romana (BCR), the unexpected GDP growth is the result of a strong base effect in terms of tax collection and generation of electrical power.

Ion Ghizdeanu, the chairman of the National Forecast Commission, revealed that because of the outstanding economic growth, the GDP figure for the whole of 2008 could be higher than previously estimated.

The sectors with the highest contribution to the GDP are industry (36.7%), services (37.7%) and agriculture (8.6%).

Total GDP for 2007 was estimated to be EUR 115 519 billion. According to the International Monetary Fund (IMF), GDP per capita for 2008 is estimated to be EUR 7 868, which is still only about 37 % of the euro area’s level.
Graph 1. GDP of Romania – real change in % against previous year (2006-2010)

Inflation

The current increase in inflation is mainly a consequence of the supply shocks of food and energy which Romania experienced last year. In 2007, drought destroyed one-third of Romania’s agricultural yield, which triggered an increase in food prices. As a result, the inflation rate rose from 3.7% in May 2007 to 8.6% in April 2008. As a natural consequence, food experienced the largest price increase of 9.14% in 2007. More worrying for the country in the long-term is the fact that the booming domestic demand is increasingly running up against the capacity of Romania, particularly the tight labor market and the underdeveloped public infrastructure. Private-sector wage growth is outpacing productivity growth, which has direct impact on the increasing inflation. This fact is confirmed by the recent surge in Producer Price Index (PPI) inflation, driven from the higher unit labor costs associated with doing business in the country.

Graph 2. Consumer Prices in Romania – change in % against previous year (2006-2010)

While the macroeconomic outlook is likely to remain stable, additional fiscal policy contraction may well be needed to keep inflation into the end-2009 target range.
Current Account Balance

Capital inflows have nourished a constantly increasing domestic spending boom. Although current account deficits are normal during the phase at which the Romanian economy is going through, Romania’s gap is above what could be considered a “normal” level and raises concern over medium-to long-term sustainability.\(^{34}\) In case of recession on the global markets, foreign investors may suddenly draw their investments out of Romania, which can cause a huge collapse in the country’s economy.\(^{35}\)

After the increase with over three percentage points in 2007, the current account deficit reached the worrying 14% of GDP. Due to the larger growth of exports in comparison to imports in the first quarter of 2008, with more than 1% year-on-year basis, the gap shows signs of stabilization. After the latest ratification of the budget, the targeted deficit was lowered from 2¼ percent of GDP to 2½ percent of GDP. Despite the right direction of economic policy, the IMF recommends even lower target of 1¾ percent of GDP.\(^{36,37}\)

According to the IMF, the huge account deficit has been created by investments mainly in the industry sector, which will certainly boost the productive capacity and will have positive effect on the exports in the middle-term.\(^{38}\)

![Graph 3. Current Account Deficit of Romania in % of GDP (2006-2010)\(^{39}\)]

Interest Rates

In accordance with Albert Jaeger’s advice, IMF’s Romania Mission Head, the RCB continues to raise the interest rate in the country in order to manage a tighter monetary policy.\(^{40}\) On the last day of July, Romania’s Central Bank set a new interest rate of 10.25% (a hike of 0.25%), which marked the highest interest rate in the EU. This was the seventh consecutive time for 2008 in which the central bank corrected the interest rate in order to prevent a boom in the private borrowings, which registered a rise of 63.4% in June.\(^ {41,42}\)

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\(^{35}\) [http://www.businessmonitor.com/businessforecasts/romania.html](http://www.businessmonitor.com/businessforecasts/romania.html)


\(^{39}\) [http://www.wiiw.ac.at/pdf/FC2_presse_eng.pdf](http://www.wiiw.ac.at/pdf/FC2_presse_eng.pdf)


This policy, despite being in harmony with IMF’s recommendations, is not supported by the Romanian Banker’ Association. The latter warned that higher interest rates and further restriction on private borrowing are among the key components which could lead to a crisis in Romania’s real estate market. The market has already started to experience the influence of the tight monetary policy by recording a drop by half of the sales of new apartments in the first six months of the year, compared to the monthly average in 2007.  

FDI

Over the past few years, Romania has experienced a steady increase in FDI flows. The quality of the business environment has improved significantly and in 2007 Romania progressed from 55th to 48th place in the World Bank’s Doing Business report, ranked higher than other countries in the region such as Hungary, the Czech Republic and Poland. In addition, Romania emerged as the leading Eastern/Central European economy in attracting FDI with 150 projects taking it to sixth position in the The Ernst & Young Investment Monitor (EIM) league table.

As a relatively new member of the EU, Romania shows a strong integration into the European economic life. More than 80% of the total invested capital in 2007, which amounted to EUR 7 076 million, came from European countries.

Figure 1. Percentage of foreign currency invested capital in companies as of 31 December 2007

Stable FDI inflows have been concentrated in export-oriented industries, such as machinery and equipment, textiles and footwear, metals and metal products, minerals and fuels, which shows strong interest and profitability in Romania’s export-oriented industries and suggests that potential for future real economic growth is present.

46 http://www.onrc.ro/statistici/is_may_2008.pdf
47 http://mpra.ub.uni-muenchen.de/7280/1/MPRA_paper_7280.pdf
49 http://www.onrc.ro/statistici/is_may_2008.pdf
Some of the top foreign investors in the country are METRO, Ford, Carrefour, Nokia, OMV, Erste Bank, Gaz de France, Bamesa Otel, Arcelormittal Galati, Vodafone, ENEL.  

According to the Financial Minister Varujan Vosganian, FDI for 2008 may exceed the “psychological threshold” of EUR 10 billion due to the recorded EUR 4.2 billion in the first five months of the year.  

Gilbert Wood, the president of the Foreign Investors Council (FIC), adopts the widespread optimistic view on the current business environment in Romania. Nevertheless, he thinks that Romania needs to improve the flexibility of its labor market, to level the playing field for all businesses, to uniform the enforcement of the existing legislation, and to clarify its tax laws in order to unleash the country’s full potential.  

*Figure 2. FDI in Romania (EUR million) (2005-2008)*

**Employment Growth, Income and Wages**

The Romanian labor market can be best described as tight. The strong economic growth combined with the labor force emigration is among the main reasons for the 6.4% unemployment rate recorded in 2007. The positive trend continued in 2008, as the favorable conditions boosted seasonal hiring and the unemployment rate fell to 3.9% in April. In comparison to other middle-sized or large European countries such as Poland and Spain, this figure is very low.

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52 http://www.ambbukarest.um.dk/da/menu/Eksportraadgivning/Markedsmuligheder/SidsteNyt/ForeignDirectInvestmentInRomania.htm  
53 http://www.roconsulboston.com/Pages/InfoPages/Businesspages/RetailOct07.html  
56 http://www.roconsulboston.com/Pages/InfoPages/Businesspages/InvestClimate.html  
57 http://www.wiiw.ac.at/pdf/FC2_presse_eng.pdf  
58 http://seeurope.net/?q=node/16183  
59 http://www.answers.com/topic/romania
By economic sector, 29.5% of the total employed population worked in agriculture, 31.4% in industry and constructions, and 39.1% in services.  

According to ING Bank Romania, wage growth is to remain stable throughout 2008. The experts of the bank expect nominal net wage economy-wide to increase by near 20% year on year, which is a little bit lower than the 22% in 2007. Latest data reveals more optimistic results and shows that for April 2008 the increase in the wage is 25% year on year. The official data from National Statistical Institute show that the average monthly wage is EUR 354. The highest wages of EUR 1,030 is received by bank employees, while wood processing workers get only EUR 193.

Despite the increase in the earnings of the Romanian citizens, unions have protested since the beginning of the year. They demand an increase of the minimum wage, which now stands at EUR 143, to EUR 171 from September 2008. However, the Minister of the Economy, Varujan Vosganian,
denied the request, stating that inflation target and labour productivity criteria had not been fulfilled and a potential increase of the minimum wage is dangerous for the economy.\textsuperscript{67}

\textbf{Figure 3. Romania Net Average Earning (Monthly, year on year % change)\textsuperscript{68}}

\textbf{Economic Ratings}

According to the rating agency Fitch, Romania is in the low-risk countries in terms of investments, having a rating of BBB\textsuperscript{69}.

Standard & Poor’s(S&P’s), however, lowered their rating for Romania and it is currently BBB- with a negative outlook. If further downgrade rating appears, it will lead to a departure from the “investment grade” category.\textsuperscript{70}

Despite the poor grading, Romania managed to top the S&P’s 2008 Fiscal Flexibility Index (FFI). The index, calculated for 30 European countries, shows the governments’ ability to adjust to adverse economic trends, and to react effectively in the presence of economic shocks by modifying tax and expenditure policies. In comparison, Bulgaria got the eighth place in the ranking.\textsuperscript{71}

A pool conducted by KPMG shows a decrease in the trust of the multinational companies concerning the economic stability of Romania. Only 40% of the foreign companies shared an optimistic view about the future of the financial situation in the country, while in the previous bulletin the number was 65%.\textsuperscript{72}

\textbf{Banking System}

The banking sector in Romania has continued its outstanding performance. In an extensive Business Monitor International (BMI) study of the banking industry in 59 countries worldwide, Romania is ranked first in terms of local currency loan growth and of local currency deposit growth as well as fifth in terms of local currency asset growth.\textsuperscript{73}

\textsuperscript{67} http://www.seeurope.net/?q=node/16059
\textsuperscript{68} http://www.romanianewswatch.com/2008/06/romania-wages-and-salaries-april-2008.html
\textsuperscript{69} http://www.zf.ro/articol_159262/second_agency_downgrades_romania_s_rating.html
\textsuperscript{70} http://www2.standardandpoors.com/portal/site/sp/en/us/page.topic/ratings_sov/2,1,8,0,0,0,0,0,0,0,3,0,0,0,1,1.html
\textsuperscript{71} http://www.seenews.com/news/latestnews/romaniafiscalflexibilityindex-133116/
\textsuperscript{72} http://www.zf.ro/articol_159262/second_agency_downgrades_romania_s_rating.html
\textsuperscript{73} http://www.researchandmarkets.com/reportinfo.asp?report_id=603376&amp;t=d&amp;cat_id=
Last year's net profit in the industry amounted to EUR 825 million and the expectations for 2008 are that the number will exceed EUR 1 billion. The industry is characterized by a high-concentration of profits with BCR and the BRD - Groupe Société Générale holding almost 65% of the total earnings.\(^7^4\)

**Social Factors**

**Demographics**

Naturally, the Romanians dominate by far the ethnic composition in the country. The second largest group is Hungarians with near 7% of the population and the rest are Roma, German, and Ukrainian. The lack of diversity in the ethnic composition is due to the restricting policy of movement of people in Romania forced by the communist party during the second half of last century.\(^7^5\)

![Ethnic Composition of Romanian Population](http://www.zf.ro/articol_176287/in_four_months__bankers_make_half_of_last_year_s_profit.html)

**Figure 4. Ethnic Composition of the Romanian Population**

The official language in Romania is Romanian, an Eastern Romance language. In a region of predominantly Slav linguistic base, Romania is the only country having Latinity. Hungarian and German are also widely spread.\(^7^6\) Nearly 87% of the population belongs to the Romanian Orthodox Church. The Hungarian minority makes up almost the entire group of followers of the Roman Catholic Church. Reformed Protestant, Baptist, and Pentecostal add up to 5% of the population, the rest being adherents to the Muslim and Jewish faiths.\(^7^7\)


**Figure 5. Romanian Population (1962 – 2007)**

\(^7^4\) [http://www.zf.ro/articol_176287/in_four_months__bankers_make_half_of_last_year_s_profit.html](http://www.zf.ro/articol_176287/in_four_months__bankers_make_half_of_last_year_s_profit.html)

\(^7^5\) [http://soderkoping.org.ua/page2468.html](http://soderkoping.org.ua/page2468.html)


\(^7^7\) [http://www.state.gov/r/pa/ei/bgn/35722.htm](http://www.state.gov/r/pa/ei/bgn/35722.htm)
It is estimated that Romania has a population of 22,246,862 in 2008 with an average population density of 94 people per sq. km. The population growth rate is -0.136%, birth rate and death rate being 10.61 births/1,000 population and 11.84 deaths/1,000 population respectively. Life expectancy in the country is calculated to be 72.18 years.

The age structure of the country is as follows: 0-14 years: 15.6%, 15-64 years: 69.7% and 65 years and over: 14.7%. Due to the ex-communist regime policies, Romania has extremely high proportion of young adults in its population. The only Western country with higher ratio is Slovenia. 8.55% of the Romanian population was born in the period from 1976 to 1980, compared with 6.33% of the Britons. However, after the fall of the communist regime, the country has been experiencing a downturn in this trend.

![Figure 6. Population by Age Group (1975-2025)](image)

**Households**

Household expenditures on food, beverages and tobacco amount to 50% of the total household expenditures in Romania. Standard house expenditures, including rent, water, electricity and other furnishings and fuels, amount to 19.4% and expenditures for clothing equals 6.2% of total household expenses.

The average size of a Romanian household in 2007 was 2.92 people.

**The Human Development Index (HDI)**

The HDI “provides a composite measure of three dimensions of human development: living a long and healthy life (measured by life expectancy), being educated (measured by adult literacy and enrolment at the primary, secondary and tertiary level) and having a decent standard of living (measured by purchasing power parity, PPP, income).” Romania’s score in the index is 0.813, ranking the country 60-th out of 177 countries.

In comparison, Bulgaria, Hungary, Poland, Slovakia and the Czech Republic have all better ranking.
**Technological Factors**

**IT Sector**

Recent statistics show that 70% of the Romanians do not have basic computer skills and 43.5% of the urban inhabitants in the country own a computer. However, the nationwide number drops to 24.6%. Computers are still not very popular at the working place with only 9.8% penetration.  

According to BMI, Romania will continue to be the leader in the IT markets in Eastern Europe. In 2007 total domestic spending on IT services and products amounted to US 1.3 billion, with forecast that the number will rise to US 2 billion in 2012.

Romania has internet penetration of 23% which is the lower in comparison to the neighboring countries Bulgaria, Serbia and Hungary. The volume of finances invested to online advertising is projected at EUR 10 million for 2007.

In 2008, the rate of penetration of the telephony in Romania is of 80% which can be considered as low. In terms of wireless access through networks of mobile phones, Romania has managed to catch up European levels of 4%.

**Research & Development**

Closely related with its excellent economic growth, Romania’s Research and Development (R&D) system is currently recovering after the decline in the transition years when he number of R&D employees recorded a loss of about 10,000 researchers. The government is increasing with a stable pace the public R&D expenditures achieving 0.7% of GDP in 2008. The final aim is to meet the Lisbon Strategy criteria of 3%. Therefore, the estimation for 2010 is that R&D expenditures will be 1% of GDP.

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86 [http://www.businessmonitor.com/it/romania.html](http://www.businessmonitor.com/it/romania.html)
Graph 6. Public R&D Expenditures as part of GDP (2006-2010)

According to the 2007-2013 National Strategy for R&D and Innovation (RDI), public investment in RDI will be oriented towards priority RDI fields such as information and communication technologies, advanced technologies and innovative products, new materials in industry, agriculture and food safety, health, energy, environment and transportation; sustainable development (including bio- and eco-technologies), and frontier sciences.

Prime Minister Calin Popescu said that the current government has introduced numerous fiscal advantages for private companies performing in the field of R&D in Romania. Such examples are the centers of excellence, such as the ones created by Renault, Microsoft or Ericsson.59

59 http://www.publicservice.co.uk/feature_story.asp?id=9207