



Romania and the Europe 2020 Strategy

The 6th GEA Report on *Romania and the Lisbon Agenda*

Authors:
Liviu Voinea
Bianca Pauna
Laurian Lungu
Valentin Cojanu
Andrada Busuioc

April 2010

Disclaimer. The opinions expressed hereby are those of the authors. The content of this report does not represent the official position of the European Union.

Introduction

The Europe 2020 Strategy reshapes and revitalizes the Lisbon Agenda. Ten years after Lisbon, many of initial targets are still to be met both at EU and national level.

The Group of Applied Economics has been involved in the process of independent monitoring and reporting on the Lisbon Agenda since 2004, bringing this topic to the public attention in previous years. We published so far five reports on Romania and Lisbon Agenda.

With the new Europe 2020 Strategy in place, we took the opportunity to continue our series with our first report on Romania and the Europe 2020 Strategy, which is in fact the 6th GEA Report on Romania and the Lisbon Agenda.

The report is structured as follows. The first section discusses the macroeconomic context and the structural reforms. The second section presents the structural indicators for Romania, in a benchmarking exercise, at the end of the Lisbon Agenda and at the start of the Europe 2020 Strategy; the analysis is divided on the three main directions of the Europe 2020 Strategy: smart growth, sustainable growth and inclusive growth. The third section deals with competitiveness and business environment. The fourth sections presents in detail aspects of the labour market. The final section concludes and provides policy recommendations.

We express our gratitude to the Representation of the European Commission, which commissioned this report to GEA and acted as a catalyst in the process of disseminating information regarding the Europe 2020 Strategy.

1. Structural reforms and the macroeconomic context

Growing Macroeconomic Imbalances Prior to the Financial Crisis

In 2009 the Romanian economy experienced one of the sharpest contractions in its recent history. GDP fell by 7.1% after going up by the same magnitude a year before. The growth cycle, which started a few years prior to Romania's EU accession, in 2001, was based primarily on consumption and investment. Between 2001 and 2008 alone GDP growth averaged 6.2%. Excess demand accelerated sharply after 2001, going into double digits and reaching 15.7% of the GDP in the first quarter of 2008.

Strong wage rises, an increased volume of remittances and a rapid expansion of non-governmental domestic credit pushed private consumption on an unsustainable path, leading to an overheated economy. Easy access to credit together with anticipations of higher households earnings saw domestic credit growing by 56% in real terms at the beginning of 2001. Although as a share in GDP, domestic credit is still relative low, it amounted to only 41% of GDP in 2009, compared to values observed in other developed economies, its pace of expansion was arguably very high. The NBR adopted several measures to try to stem the increase in credit. In mid 2007 it embarked on a tightening cycle, raising both its benchmark policy rate to 10.25% by the end of 2008 as well as the reserve requirements ratio. Apart from these quantitative measures, the BNR adopted a string of prudential measures aimed at limiting both household debt exposure as well as bank lending.

Increasing inflows of foreign capital, driven by high interest rates and potential gains in the property market, led to a continuous appreciation of the domestic currency, the RON. This, in turn led to an acceleration of imports, which rose faster than exports, widening the current account deficit to -12.3% at the end of 2008.

Also, fiscal policy was procyclical, with the budget deficit rising from -0.8% in 2005 to -5.4% of GDP at the end of 2008. With government revenues boosted by an overheated economy, government spending rose in areas which were less productive, especially public sector wages and consumption.

The Effects of Financial Crisis on the Romanian Economy

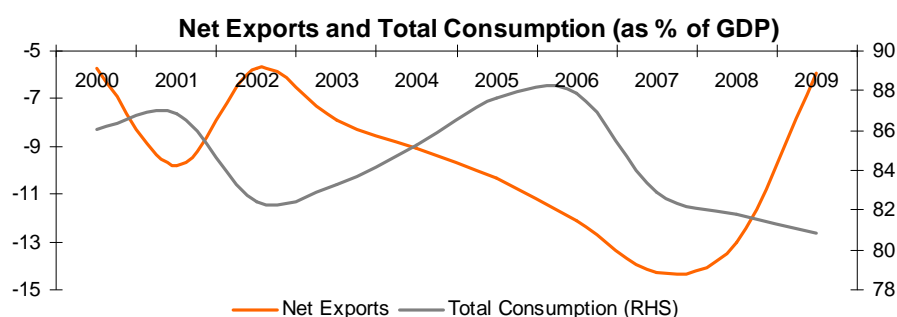
The effects of the financial crisis started to be felt in the Romanian economy during the fourth quarter of 2008. Large existing macroeconomic imbalances were penalised by the markets as global liquidity dried up and uncertainty rose sharply in world financial markets. International credit rating agencies reacted with two of the main three agencies, Standard&Poor's and Fitch, downgrading the country's rating to junk status.

The perspective of a sudden stop of capital implied that finding rapid alternatives for financing lines was a priority. Thus, in early 2009 the authorities turned to the IMF. In March 2009, the Romanian government concluded talks for a EUR 19.5 bn stand-by agreement with a group of international institutions led by the IMF. As a result, the country managed to avoid any potential shortfalls in financing its external and internal deficits. Moreover, the IMF programme detailed the necessary changes needed to be

implemented by fiscal authorities in order to make fiscal policy more transparent and accountable. The rapid response of international authorities were paramount in staving off a foreign capital outflow. In addition to that, through the so called Bank Coordination Initiative, the IMF started a dialogue with the foreign banks operating in Romania whose objective was to prevent the closure of refinancing credit lines.

The slowdown in global demand had profound implications for the Romanian economy. Unable to sustain its demand internally, the Romanian economy plunged into recession. In 2009 private consumption dived by 9.2% year-on-year as the shock to real incomes influenced household purchasing patterns. Prior to the financial crisis, the GDP growth was powered by domestic consumption (see Figure below). The net exports adjusted sharply, contracting from around 15% of GDP in 2007 to a little over 5% of GDP at the end of 2009.

Figure 1.1. Net exports and total consumption, % GDP



Source: GEA, based on INSSE

Gross fixed capital formation, a measure of the how fast the capital stock is being replaced at the economy level, fell by almost a quarter compared to 2008. The construction sector suffered the most among all sectors of the economy, with activity here dropping by more than 17% year-on-year. Activities in the wholesale and retail sectors fell by 11.2% while industrial output slowed down by 4.3% compared to 2008.

In 2009 inflation fell outside the NBR inflation target band for the third year in a row. However, elements outside the control of NBR, such as the course of fiscal policy, played an important role in the evolution of inflation.

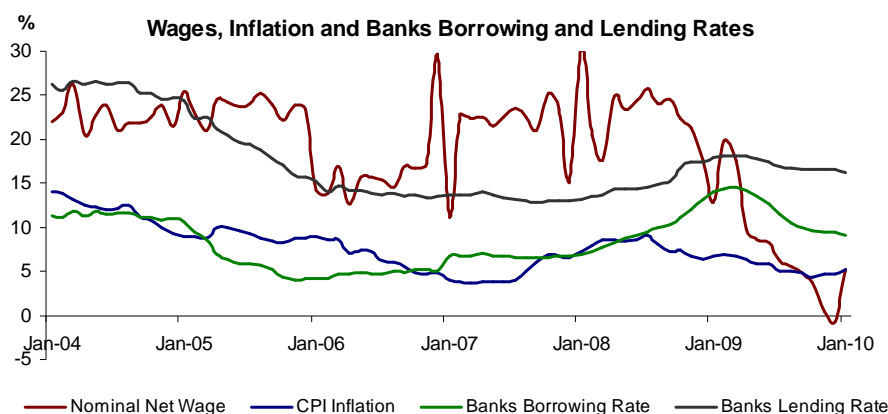
Throughout 2009 monetary policy stance was predominantly loose. Over the year the Monetary Policy Council gradually reduced the NBR benchmark interest rate by a cumulative 225 basis, from 10.25% to 8%. Although at the early stages of the relaxation cycle the reduction in NBR's benchmark interest rate was relatively slow to feed into commercial banks' lending rates, at the end of 2009 and early 2010 this process has already started to gather pace.

Overall, monetary policy was rather prudent. Although the economy was contracting abruptly, the NBR's benchmark interest rate was only gradually reduced. With inflation falling, real interest rates in the economy were too high to help firms easing their borrowing needs.

Forced to adjust, companies shed parts of their labour force, which caused average wage growth to plunge into negative territory at the beginning of 2010. This in itself

is a remarkable event, as nominal wages were growing at rates above 20% for the last two decades. The dramatic fall in wages reduced one important source of inflation pressure and, if sustained, could raise competitiveness.

Figure 1.2. Wages, Inflation and Interest Rates



Source: GEA, based on INSSE

The prudent approach of monetary policy is also explained by the attention the NBR pays to the evolution of exchange rate. Although the NBR targets inflation, concerns about large swings in exchange rate made the NBR to adopt a pro-active stance through foreign exchange market interventions.

Fiscal policy played a large part in the deepening of the existing macroeconomic imbalances. In 2008, the budget deficit rose in the last quarter by more than three GDP percentage points, to 5.4% of GDP. This was mainly due to substantially higher-than-planned current spending, notably in public wages and social transfers. Most of these occurred in October 2008, prior to the Parliamentary elections. The government at the time had also over optimistic budgetary revenue projections. As a consequence of the economic slowdown there was a sudden drop in revenue collection over the last quarter, deepening the budget deficit well beyond the 2.4% of GDP end-of-year target. The inherited plight of the 2008 deficit proved to be difficult to manage in 2009, as the effects of the recession started in earnest.

Looking ahead, 2010 would be a challenging year. Official projections put GDP growth this year at 1.3%, with much of the increase expected to occur in the second half of the year. However, this could be even lower as the economy's performance in the first quarter of 2010 appears to be poor, with the recovery taking place much slower than anticipated.

Table 1.1. Romania. Selected Macroeconomic Indicators

	2008	2009 ^P	2010 [*]	2011 [*]	2012 [*]
GDP (bn. Euro)	136.9	115.9	125.5	139.7	157.9
Real GDP growth (%)	7.1	-7.1	0.9	3.1	4.7
Nominal gross wages, 12-mth average annual change (%)	23.6	8.4	8.1	7.9	7.5
CPI Inflation — annual change (%)	6.3	4.7	3.7	3.4	2.9
Current Account Balance (% of GDP)	-12.3	-4.5	-5.9	-6.2	-6.5

Exchange Rate (avg., RON/EUR)	3.68	4.25	4.10	3.95	3.83
Unemployment Rate – Year End (%)	4.4	7.9	8.6	7.5	6.5
Government Budget Balance (% of GDP)	-4.9	-7.3	-6.2	-4.4	-3.5
Public Debt (% of GDP)	20.1	27.5	31.7	33.0	31.9

p – provisional; * - forecast values.

Source:IMF, local authorities and authors' estimates.

The recovery of the industry sector appears to have already started as industrial production rose in January 2010 in what it could be a signal for a trend reversal. But there still remains considerable uncertainty surrounding this year's GDP projections. The upturn depends to a large extent on the revival of domestic demand, which is yet to emerge. And government policies would play a vital role in helping this process.

Europe 2020 Strategy and Romania

Recently the EC adopted a new approach aimed at facilitating Europe's exit out of the current crisis and then laying out the foundations for future development. Essentially there are three main pillars of growth, namely:

- Smart growth, implying the development of an economy based on knowledge and innovation.
- Sustainable growth, which is aimed at promoting a more resource-efficient, greener and a more competitive economy
- Inclusive growth which would rise employment and strengthen the cohesion among economic, social and territorial cohesion

Romania will have to commit to national targets in all these areas. At its 25-26 March 2010, the European Council identified a few targets, namely, increasing the employment rate of the population aged 20-64, improving R&D by evaluating the impact of those expenditures, achieving the 20-20-20 environmental goals of reducing greenhouse emissions, raising education levels and promoting social inclusion by reducing poverty rate.

What is important however, is the new approach the EU will place on economic coordination and surveillance. Specifically, measures aimed at addressing countries' imbalances, such as divergences in real effective exchange rates, would be designed so that economic policy will not be design country-specific, in isolation, but together at any given moment in time.

Macroeconomic Policy Challenges Ahead

In the medium term economic policies should be geared towards achieving macroeconomic stability and, implicitly, to fulfil the Maastricht criteria. Current plans envisage Euro adoption in 2015. For this to happen, Romania would need to enter into the Exchange Rate Mechanism two years prior to that. That leaves an extremely short period of time, less than 3 years, for resolving current macroeconomic imbalances.

1. Arguably the most important challenge is to bring fiscal policy on a sustainable path. This will be severely constrained in the medium term, especially in 2010 and 2011, as government revenues would still be low. Government expenditures will need to be trimmed considerably if 2010 end-

year budget deficit target of 5.9% of GDP is to be met. Unless sizable cuts in public expenditure do not materialise soon, the budget deficit could hit 9% in 2010. Both January and February government revenues were disappointing and dissipated any hopes that economy recovery could have started in earnest at the beginning of the year.

2. Apart from maintaining a tight control on its finances, the government would have to pass unpopular legislation in 2010. The timeline for this is detailed in the country's agreement with the IMF. Among the most important decisions to be made are:
 - Revised pension legislation – Initial deadline was December 31, 2009. Currently put forward to end - June 2010
 - New Passage of Fiscal Responsibility Law – Deadline: March 30, 2010
 - An indicative target on the floor for the financial balance of the largest State-owned enterprises (SOE) – Deadline: March 30, 2010
 - Passage of implementing legislation for the organic wage law. Deadline: September 30, 2010
3. One test for the government would be to find the consensus to implement unpopular measures at a difficult time. At the moment the current government coalition enjoys a feeble majority in the Parliament and this could complicate the task of passing the necessary legislation.
4. The challenge for the Romanian labour force is quite high. On the one hand private sector is still adjusting, virtually all created unemployment was done by this. On the other hand, the required reduction in public sector wages would necessary entail some lay-offs. A conservative figure would put at 100,000, or around 8% of the total public sector employees, the number of people to be laid off. This would put an increasing strain on the labour market as well as on the social security costs. Thus, the risk of social tensions remains elevated as pressures to reduce public sector wage costs build up. Unemployment rate could continue to rise in the first months of 2010 although it is likely to remain lower than the EU-average, below 10%.
5. Regaining investment grade status should be a priority for the Romanian authorities. This would translate not only in lower borrowing costs but it would also show a more positive image of the Romanian economy. Recently, Standard & Poor's revised Romania's long term ratings from negative to stable. The rating revision reflects government's progress in pursuing its budget reform programme. This could open the door for a reassessment of Romania's overall risk, which would place the country into the investment grade category. For this to happen however, the government would have to continue its public finances reform.
6. The National Bank reduced its benchmark rate to 6.5%, the lowest level in the last two decades. The move signals an acceleration of the relaxation in

monetary policy, over the first two months of the year alone the benchmark rate was reduced by 100 basis points. However, the choice of monetary policy could be tested over the months ahead.

As the macroeconomic picture improves, capital inflows could try to benefit from higher yield returns – especially in the current economic context where sovereigns such as Greece, Spain, Ireland or Portugal have problems with public debt sustainability.

7. Repayment of the IMF loan in the years ahead could create strains in the foreign exchange market if fiscal policy was not on a sustainable path and macroeconomic stability was still uncertain.

8. There is a question of the parity at which the RON would be exchanged to the Euro prior to entering into ERM II. Previous experiences of other EMU countries show that, a currency of a country entering into ERM II might be subject to some amount of speculation. If this happens, it could affect its 'fundamental' value which could lead to an over/under exchange rate at which Romania would enter into EMU.

9. The latest concerns about the state of public finances in several EU countries have raised the question of how the situation there would affect the Romanian economy. High levels of government debt and large budget deficits observed especially in Spain, Portugal, Ireland and Greece could impinge on domestic financial markets and from there, spread to other EU countries.

Romania is perceived as having a relatively high degree of exposure, especially because Greek banks own 12% of Romanian banking system. In a recent assessment of the Romanian financial system the IMF identified several risk factors to the stability of the financial outlook, among them: slowing down of capital inflows, including a reduction in foreign banks' credit volumes to their Romanian subsidiaries and a prolonged recession in the euro-area

Although at the moment Romanian banking system seems to be relatively well capitalised, some of the banks would need to raise their capital if further deterioration in economic conditions occur. However, the IMF estimates the amount would be in the region of EUR 1.5 bn., the equivalent of 1.5% of GDP, which is much lower than those observed in other developed economies.

To sum up, the challenges ahead for the Romanian economy continue to remain quite a few. Achieving macroeconomic stability and bringing the budget deficit under control would require a strong commitment from the authorities over the next 2-3 years. Romania cannot enter into the EMU with an economy in which structural imbalances persist. The risk would be far too great and could lead to a loss of competitiveness.

Thus, government expenditure would be severely constrained over the next couple of years. And, if the Financial Responsibility Law is adopted – as it should be according to the IMF Memorandum agreement – government expenditure growth would not be allowed to exceed GDP growth. In addition, multi-annual budgeting would provide a more transparent, coherent and forward-looking mechanism of conducting fiscal policy.

2. The structural indicators: what have we achieved, what are the challenges ahead?

Romania has improved its performance relative to the key indicators of the Lisbon Agenda up to 2008. The economic crisis that hit Romania in 2009 reversed the trend for some indicators, but this impact might be only temporarily.

Table 2.1. Progress relative to the key structural indicators

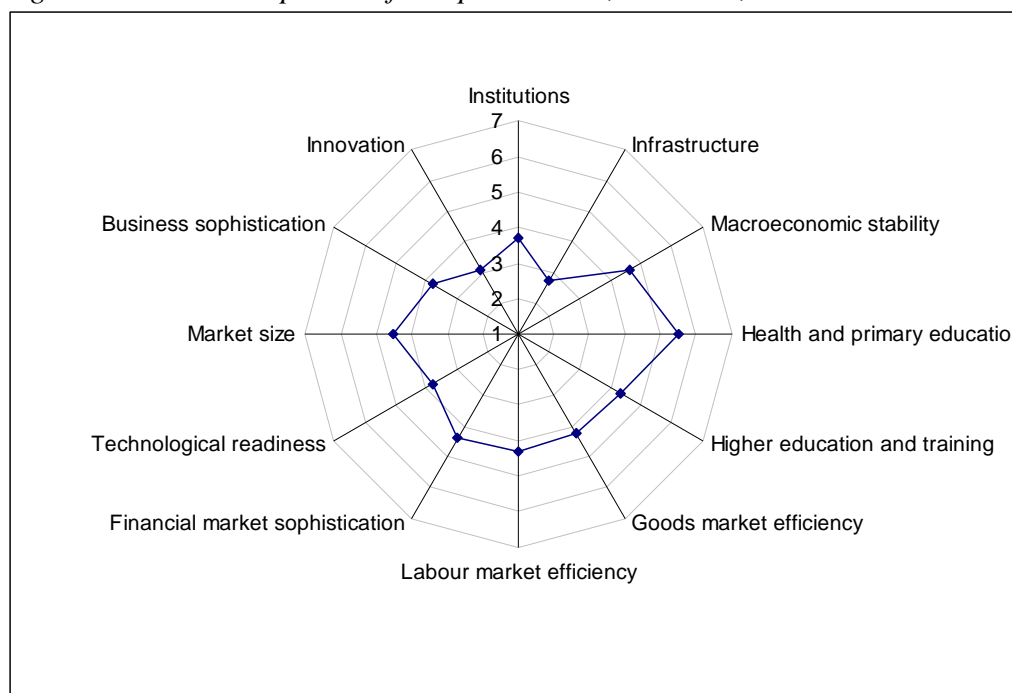
	2004	2005	2006	2007	2008	Evolution up to end-2008	2009
GDP per capita in PPS, EU27=100	34.1	35	38.4	41.6	n.a.	↗	n.a.
Labour productivity per person employed, EU27=100	34.5	36	39.6	43.3	50.2	↗	47.5
Employment rate, %	57.7	57.6	58.8	58.8	58.9	↗	57.4
Employment rate of older workers, %	36.9	39.4	41.7	41.4	43.1	↗	41.3
Youth education attainment*	75.3	76	77.2	77.4	78.3	↗	n.a.
Gross R&D expenditure, % GDP	0.39	0.41	0.45	0.52	0.58	↗	0.4e
Life long learning**	1.4	1.6	1.3	1.3	1.5	→	n.a.
Comparative price levels, EU27=100	43.3	54.4	57.6	63.8	60.9	↗	n.a.
Business investment, % GDP	18.7	19.9	20.5	24.5	26.4	↗	25.4
Long term unemployment rate	4.8	4.0	4.2	3.2	2.4	↘	n.a.
Dispersion of regional employment rates	4.9	3.5	3.6	4.6	n.a.	→	n.a.
Greenhouse gas emissions***	55.9	53.7	55.3	54.7	n.a.	→	n.a.
Energy intensity of the economy***	773.64	736.09	706.23	655.59	n.a.	↘	n.a.

* % of population aged 20 to 24 having completed at least secondary education
 ** % of adult population participating in education and training
 *** base year = 100
 **** kilograms of oil per 1.000 euro of GDP
 e – GEA's estimate
 Source: Eurostat, structural indicators

One should observe the remarkable progress in terms of labour productivity, which is the first and foremost competitiveness indicator. Although it decreased in 2009 when reported per person employed, labour productivity per hour worked improved even in the times of crisis, overcoming Latvia, for example. Gross fixed capital formation (business investment) also reached higher than EU average levels, even in 2009. On the other hand, price convergence is not necessarily a positive fact – on one hand, it signals real convergence to the euro-zone, on the other hand, as prices grow faster than incomes, the purchasing power diminishes and the inflationary pressures mount.

The progress made by Romania was nevertheless matched by the most others New EU Member States. Therefore, the catching-up process has been rather slow, and the main sources of competitive disadvantage of the Romanian economy persist. They are the poor quality of infrastructure and the limited level of innovation (determined by a low demand for innovative products from unsophisticated customers) – as shown in Figure 2.1.

Figure 2.1. The main pillars of competitiveness, Romania, 2009-2010



Source: Global Competitiveness Report 2009-2010

The decade of economic growth (2000-2008) did little to improve these two critical factors. Unfortunately, the current budgetary constraints further impede on the government's ability to invest in these sectors.

We will analyze Romania's position against the three main directions of the new Europe 2020 Strategy: smart growth, sustainable growth and inclusive growth.

Smart growth

The priority area “Smart growth” aims at fostering the knowledge based economy. This objective can be measured against two of the five representative EU headline targets:

- 3% of the EU's GDP should be invested in R&D and
- The share of early school leavers should be under 10% and at least 40% of the younger generation should have a degree or diploma.

Table 2.2. “Smart growth” benchmarking

	Year	Romania	EU 27
Gross R&D expenditure, % GDP	2009	0.4 ^e	1.9 ^e
Early school leavers	2008	15.9	14.9

e- estimate

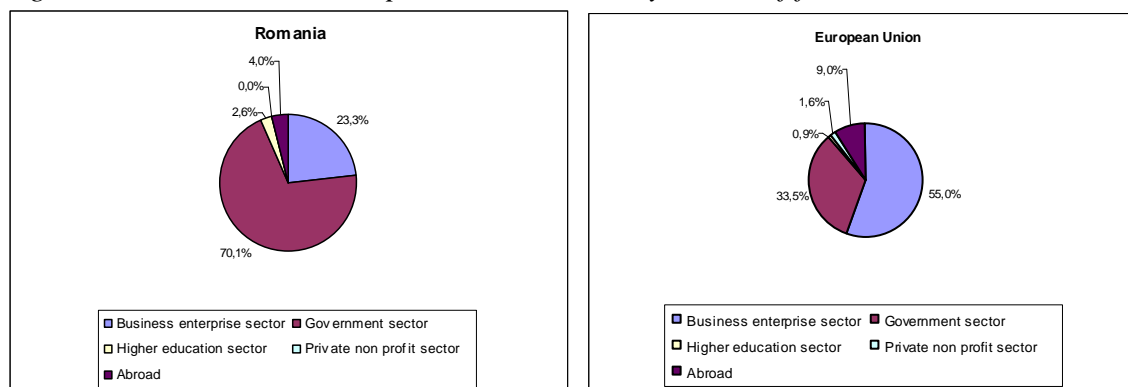
Source: GEA, based on Eurostat data

The Member States have to translate these targets into national targets and trajectories to reflect the current situation of each member state and the level aimed to be reached.

The first target, of investing 3% of its GDP in research and development was set through the Lisbon Agenda, but R&D spending in Europe is below 2% (in comparison, the level reaches 2.6% in US and 3.4% in Japan). Moreover, the progress is extremely slow, with an increase of only 110 bp in the past ten years and only six Member States investing more than 2% in R&D, while in most of the New Member States the level is less than 1%.

Romania is among the countries with the lowest rate of investments in this field, of only 0.58% in 2008. The situation worsened in 2009, when public expenditures returned to the pre-boom level of 0.2% GDP. The weak contribution of the private sector (less than 30% of the total investments in R&D) is explained by the type of competition on the domestic market, led by price not by innovation. Moreover, the public funds for research are used ineffectively, as they fail to create a spreading out effect in the private sector. Also, there is a weak link between academic research and industrial applications. In EU, on the other hand, the main contribution comes from the business enterprise sector and, unlike Romania, the private non profit sector also invests in R&D.

Figure 2.2. Gross domestic expenditure on R&D by source of funds, in 2008



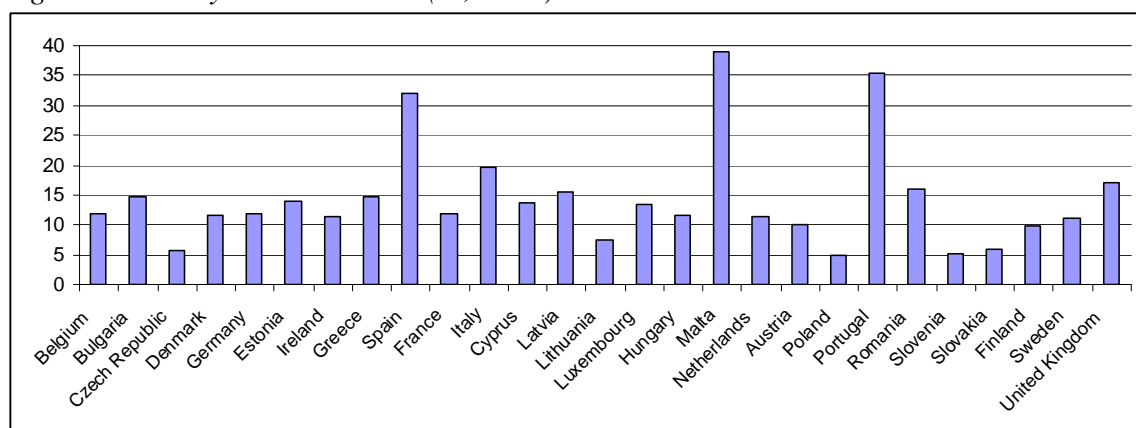
Source: GEA, based on Eurostat data

The innovation and research category includes, however, indicators from a wide range of sectors – internet access, high tech exports or e-government and all three sectors are underdeveloped in Romania, in comparison to the EU average. The progress made in the past years in the field related to internet usage is significant. The percentage of households who have Internet access at home is only 38% compared to 65%, the EU average, but in constantly grew in the past years, with a fast pace (only 14% in 2006). The broadband penetration rate (the number of dedicated, high-speed connections per 100 inhabitants), on the other hand, is the second lowest in EU (12.3%). E-commerce is also a field where the gap between Romania and the EU average is important (in 2007, only 1.2% of the enterprises’ total turnover comes from e-commerce via Internet, while the percentage reaches 4.2 in EU), but the level has tripled compared to the previous year. E-government, on the other hand, is an extremely underdeveloped sector - the rate of e-government on-line availability (measured as a percentage of the 20 basic services which are fully available online) is only 45% compared to 74% EU average (in 2009) and the e-government usage by individuals and enterprises is the lowest in the EU, of 6% and 41%, compared to the 30% and, respectively, 71% average.

The low investments made by the public sector in fields relevant for the "smart growth" objective is also revealed by the low rate of public expenditure on education. Despite the relative low expenditure on education, Romania manages to maintain a youth education attainment level very close to the EU average (78.3% compared to 78.5%), but the level is the lowest among the New Member States (including Bulgaria). Furthermore, the quality of the educational system is influenced by the limited funds available and by their ineffective use.

The early school leavers also represent a target for the Europe 2020 Strategy. The percentage of the population aged 18-24 with at most lower secondary education (and no further education or training) is targeted to decrease below 10%. In 2008, the share of early school leavers was 14.9% in the EU and 15.9% in Romania.

Figure 2.3. Early school-leavers (% , 2008)



Source: GEA, based on Eurostat data

The smart growth objective is endangered by the difficult fiscal position. Raising public debt (although it remains way below EU average) and the budgetary constraints following the IMF agreement cast doubts on Romania’s ability to increase its public spending in innovation and education in the short and medium term.

Sustainable growth

The Europe 2020 Strategy introduces the “20/20/20” energy targets:

- reducing gas emissions by 20% (30% if conditions are right) against the base year;
- reaching a 20% share of renewable sources in total energy consumption;
- increasing energy efficiency by 20%.

Table 2.3. “Sustainable growth” benchmarking

	Year	Romania	EU 27
Greenhouse gas emissions (1992=100)	2007	54.7	90.7
Share of energy from renewable sources in total energy consumption	2007	11.86	7.75
Energy intensity of the economy*	2007	655.59	169.39

* kilograms of oil per 1.000 euro of GDP

Source: GEA, based on Eurostat data

Romania outperforms many EU countries with respect to the “sustainable growth” targets. However, the truth that lies beneath such figures is more complex.

Romania’s dependence on energy imports is only 32% compared to EU average of 53%, but it is forecasted to increase as our natural resources are extensively used.

Greenhouse gas emissions are much lower than at the beginning of transition, but the main reason for that was the de-industrialization process which occurred since the early nineties.

Table 2.4. Comparative levels for environment indicators

	Romania	EU average	The highest value	The lowest value
Greenhouse gas emissions index, (base year = 100)	54.7	90.7	185.3 (Cyprus)	46.6 (Latvia)
Share of energy from renewable sources in total energy consumption	11.86	7.75	30.93 (Sweden)	2.10 (UK)
Energy intensity of the economy (Kilogram of oil equivalent per 1.000 EUR GDP)	655.59	169.39	1016.29 (Bulgaria)	103.13 (Ireland)
Electricity generated from renewable sources (% of total)	33.0	21.0	78.1 (Austria)	3.6 (Hungary)
Volume of freight transport relative to GDP	148.5	104.0	152.5 (Slovenia)	61.8 (Estonia)
Volume of passenger transport relative to GDP	81.8	93.9	137.4 (Lithuania)	66.9 (Slovakia)

Car share of inland passenger transport	75.3	83.4	90.7 (Lithuania)	61.8 (Hungary)
Urban population exposure to air pollution by ozone	3784.0	3909.0	9006.0 (Greece)	938.0 (UK)
Urban population exposure to air pollution by particulate matter	43.1	28.1	59 (Bulgaria)	12.6 (Ireland)
Municipal waste generated	382	524	802 (Denmark)	306 (Czech Republic)
Resource productivity	0.17	1.28	2.58 (UK)	0.14 (Bulgaria)

Source: GEA, based on Eurostat data

Romania has a higher share of renewable energy sources (RES) in total consumption, and the good news is that the trend is upward (11.86% in 2007 compared to 9.95% in 2003). The bad news is that the relatively high potential of renewable energy in theory can not be paralleled in practice due to technological limitations, economic efficiency, dispersed location of resources and environment restrictions.

A recent governmental report commits to a 24% RES target for 2020, but it specifies that in order to reach that target Romania needs to exploit two thirds of its theoretical RES potential. This objective comes very close to the upper threshold of the exploitable potential, which means that after 2020 Romania will no longer have an additional reservoir of RES to cope with the possibility of increasing consumption of changing the energy mix.

Similar to most of the New Member States, Romania scores badly in terms of energy intensity of the economy, indicator that monitors the decoupling of energy use from GDP growth and shows the extent to which energy is being used more efficiently in the creation of wealth. However, the trend is downward, Romania having made significant improvements in the last 5-6 years. Yet, we are still employing 4 times more energy to produce a unit of GDP compared to EU average. This could be a proxy for energy efficiency, which refers to the increasing the performance of energy production and reducing the waste of energy during the transport, deposit, and distribution stages, and optimizing the energy consumption. The governmental program to reduce heat wastes by improving the isolation of residential buildings is a major step forward and we expect that enhanced investments in this program should yield immediate results in terms of energy saving.

Regarding other indicators, the resource productivity, which shows whether the use of natural resources is being decoupled from economic growth, is low in Romania as well as in Eastern European countries in general. The quality of the air is another environmental problem Romania is facing, the indicator measuring the urban population exposure to air pollution being one of the highest in the European Union. Another category of indicators Romania fails to range along the average levels regards the volume of transport relative to the GDP. According to EU's vision, there should be a decoupling between GDP growth and transport growth, because the

increased traffic can damage the environment and economic growth through congestion, noise and pollution.

Despite the promising results of the EU energy policy, the approach on energy sector remains national due to the limited interconnectivity, on the one hand, and the very dispersed interests and resources of the Member States, on the other hand, which prevent a more structured approach at EU-level.

Inclusive growth

One of the targets set through Europe 2020 Strategy is that 75% of the population aged 20-64 should be employed. A primary objective, however, towards which the employment policies are aimed, is that of an average employment rate for the EU of 70% overall and at least 60% for women by 2010. The objectives don't seem very ambitious, given that in 2008 the employment rate was 65.9% and 59.1% for women, but the recession that hit the world economy in 2009 had a massive impact on the labour market. Therefore, the continuous improvement of the indicators regarding employment is likely to have ceased and the trend might even be reversed.

Table 2.5. "Inclusive growth" benchmarking

	Year	Romania	EU 27
Employment rate	2009	57.4	65.9*
At-risk-of-poverty rate after social transfers	2008	23	17

* 2008 data for EU

Source: GEA, based on Eurostat data

In Romania, the employment rate is below the EU average (57.4%) and the discrepancies between men and women are wider (65.7% compared to 52.5%). These differences are even more significant when it comes to the employment rate of the older workers (only 34.4% for women, compared to 53% for men).

The objective of increasing the employment rate is of paramount importance for Romania. In our opinion, it is the single most important objective of the Europe 2020 Strategy. Currently, more than 4 million Romanians from the active population are not employed – at least not in Romania and not in the formal economy. If this figure improves, the budget revenues will also significantly improve and the need for social transfers will decrease. Nevertheless, it is not enough to secure again high rates of economic growth, as the employment rate grew only marginally in the previous boom period. More specific, active policies are needed, both at central and local government level.

The fight against social exclusion is one of the EU's social policy goals. The target set in Europe 2020 Strategy aims that 20 million less people should be at risk of poverty by 2020. Measured as the share of persons with an equivalised disposable income below the risk-of-poverty threshold, which is set at 60% of the national median equivalised disposable income (after social transfers), the indicator reaches 23% in Romania, the second highest in the EU.

A very sensitive indicator is the inequality of income distribution, measured as the ratio of total income earned by the top 20% of the population (with the highest income)

to that earned by the bottom 20% of the population (with the lowest income). Romania has a very high degree of income inequality. Part of it can be explained by the flat tax fiscal policy.

Table 2.6. The inequality of income distribution, 2008

< 4	4.1 – 5	5.1 – 6	>6
<ul style="list-style-type: none"> • Austria • Czech Republic • Denmark • Hungary • Finland • Slovakia • Slovenia • Sweden 	<ul style="list-style-type: none"> • Belgium • Cyprus • Estonia • France • Germany • Ireland • Luxembourg • Malta Netherlands 	<ul style="list-style-type: none"> • Belgium • Greece • Italy • Lithuania • Poland • Spain • United Kingdom 	<ul style="list-style-type: none"> • Bulgaria • Latvia • Portugal • Romania (7)

Source: GEA, based on Eurostat data

The rise of inequality and social exclusion in times of economic growth should be a serious cause of concern, particularly the economic crisis that followed the boom most likely deepened inequality and social exclusion. It is the job of the government to design mechanisms and to promote those engines of growth which will prevent further worsening of these indicators. An economic growth that leaves most of the people out, an economic growth that fails to reduce inequality and to increase social cohesion, has little value and it is not desirable.

3. Competitiveness, innovation and the business environment

Periodically, the competitiveness issue takes the centre stage of public debates. The targets of *Lisbon Agenda* for a knowledge and most dynamic competitive European economy were agreed amidst a world-wide euphoria about the benefits of the "new economy" epitomized by the .com boom. The *Europe 2020* agenda envisions a new concept of growth (smart, sustainable, and inclusive) in times of a sweeping financial crisis that was a "huge shock" for millions of citizens. Competitiveness is now placed among issues of ample public concern like poverty, climate change, energy efficiency, education and employment to announce a shift of emphasis towards a novel perspective for development so that "to escape the reflex to try to return to the pre-crisis situation." (EC 2010, p. 5)

The competitiveness initiative calls in particular for "a framework for a modern industrial policy, to support entrepreneurship, to guide and help industry to become fit to meet these challenges, to promote the competitiveness of Europe's primary, manufacturing and service industries and help them seize the opportunities of globalisation and of the green economy." (EC 2010, p. 15) Given its broad scope, the initiative signals a strategy to avoid the pitfalls of the previous attempt in identifying the "right" structural reforms and to build instead on the consolidated experience of converging trends and policy coordination mechanisms. Confronted with "imbalances and competitiveness divergences" (EC 2010, p. 24), the EU has to adapt this time its strategic drivers to a radically modified landscape. Synergy is more than ever needed to make competitive upgrading possible, and the integrated guidelines invite Member States to draw up national programmes according to "their specific circumstances" but geared to "an integrated approach to policy design and implementation." (p. 25)

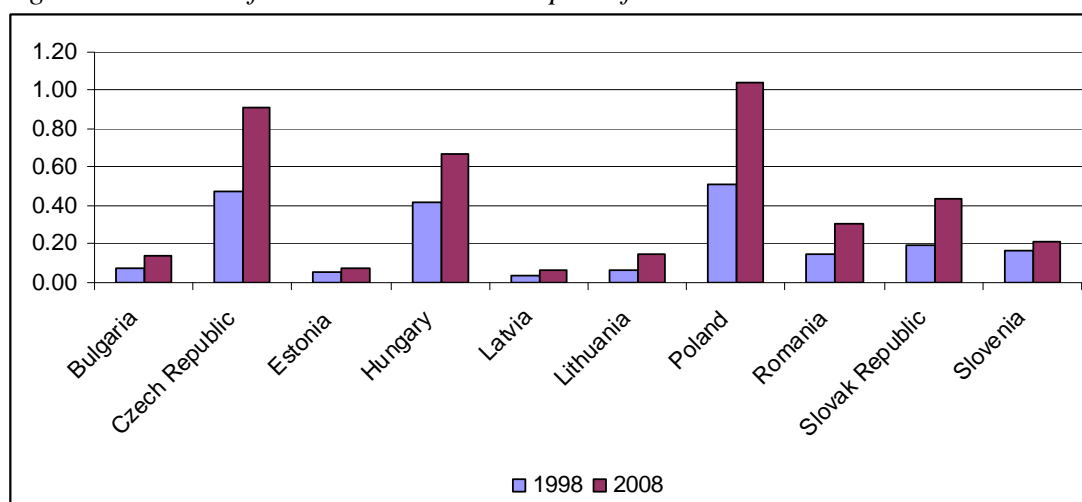
In the following, we draw on recent developments and outline the competitiveness challenges for future action plans. The competitiveness policy in Romania is a result of disparate, if meritorious efforts to take stock of the economic trends as illustrated in programmatic documents like the National Development Plan (NDP), the National Strategic Reference Framework (NSRF), the Industrial Policy Strategy (IPS), the National Export Strategy (NES), the National Strategy for Research, Development, and Innovation 2007-2013 (NSRDI), the Strategic Concept of Territorial Development - Romania 2030 (CSDTR) or the National Reform Programme 2007-2010 (NRP). In spite of this strategic breadth, the scope of initiatives is narrow, the more so one may notice an overwhelming load on some areas in parallel with a lack of it in most sectors. Particularly, coordination in respect to the decision-making process in the competitiveness field is conspicuously missing.

This section continues with an overview of recent trends as to Romania's competitive position and then succinctly presents some key policy issues for an adequate integration of national policies in a European context. The argument sheds light on spatial factors of influence on competitiveness, which are more relevant in view of the increased emphasis on the prospects of a single European economic space. We argue that increased integration of markets and governmental actions is needed to support the transformation of local and regional skills in a self-generating process of positive cumulative feedback between industries.

Trends

Successive steps of trade liberalization – starting with an Association Agreement in 1993 establishing a free trade area, accession negotiations initiated in 1998 and EU membership in 2007 – did live up to expectations by increasing Romanian trade dependence on the EU market to 70% from approx. 30% in 1989. The benefits of increased trade have not necessarily translated in a much better external position. Without being eroded though, the competitive standing, as measured by world exports market shares, lacks the vigour of other Eastern EU members and remains one of the modest, especially in comparison with country size.

Figure 3.1. Share of world merchandise exports for EU Eastern countries



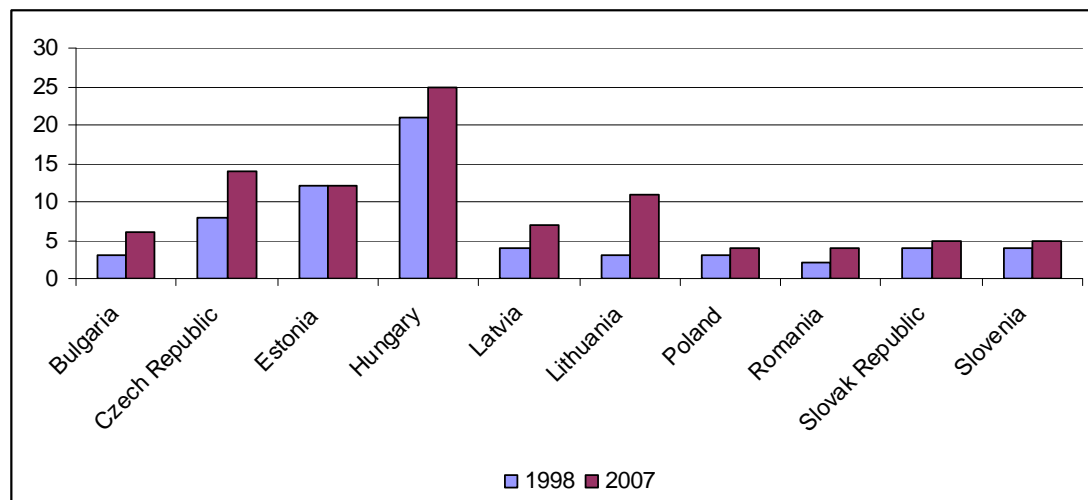
* Including intra-EU (27) trade

Source: WTO, International Trade Statistics, 2009, Table A6,

http://www.wto.org/english/res_e/statis_e/its2009_e/its09_appendix_e.htm [16 April 2010]

Economic integration has not brought so far significant qualitative structural improvements too. Countries with export volumes thrice as large (e.g. Czech Republic and Hungary) continue to achieve comparable, if not bigger, growth rates of high-technology exports, whereas Romania shares with Poland the poorest performance levels among their peers.

Figure 3.2. High-technology exports (share of manufactured exports) for EU Eastern countries



Source: World Bank Development Indicators online, <http://ddp-ext.worldbank.org/ext/DDPQQ/showReport.do?method=showReport> [16 April 2010]

An examination of competitive strengths and weaknesses reveals ambivalent views about prospects. Some of the strengths have largely been exhausted (e.g. trade barriers, firing costs, legal rights), while others (e.g. starting a business) play indeed a large role for a dynamic economic environment, although what impact they may have for competitiveness is undecided. On their part, weaknesses result from institutional inertia reminding of the communist era and may still require time-consuming efforts to alter.

Table 3.1. Romania's competitive strengths and weaknesses

Romania's top five competitive strengths	Romania's top five competitive weaknesses
<ol style="list-style-type: none"> 1. Tariff barriers 2. Firing costs 3. Legal rights index 4. Time required to start a business 5. No. of procedures required to start a business 	<ol style="list-style-type: none"> 1. Quality of roads 2. Transparency of government policymaking 3. Quality of overall infrastructure 4. Agricultural policy costs 5. Extent and effect of taxation / Rigidity of employment

Ranking follows in descending order, where orders, relative to the overall GCI, result from variables are considered to be advantages if ranked higher than the economy's own rank. Any variables ranked equal to or lower than the economy's overall rank are considered to be disadvantages.

Source: World Economic Forum (2009) *Global Competitiveness Report 2009/2010*, Geneva, p. 267

Challenges for converging areas of growth

One of the major challenges for the European policies trying to achieve converging levels of competitive development rests on the connection or lack of it between spatial cohesion, competitiveness and sustainable development, in compliance with Objective 1 (Convergence), Objective 2 (Cohesion) and Objective 3 (Territorial cooperation) of the EU Regional Development Policy. New policies at European level, such as the initiatives within ESPON, *European Spatial Planning Observation Network*, target the reduction of development disparities and a more appropriate distribution of funds

for development inside the regions. The urban / rural dichotomy is no longer valid, and cities must work as bridges of services for the population and industry in a broader perspective. The current terminology advances several new concepts that describe the geographic scale of development, such as FUA - Functional Urban Area, MEGA - Metropolitan Economic Growth Areas, PUSH - Potential Urban Strategic Horizon (OPUS) or PIA - Polycentric Integration Area.

A picture of economic geography as depicted by such measure as size of settlements, geographic dispersion and level of connectivity is still deficient to indicate the degree or optimal spatial configuration of territorial development. The scope of development policies should be sufficiently large to allow, on the one hand, spatial links between cities and between cities and villages and, on the other hand, the economic maximization of net benefits of specialization and diversification in a wider European context. In the following, we provide both an internal and external view of these challenges.

The internal perspective

The evaluations of regional competitiveness are incomplete, because they focus mainly on socio-economic indicators, based on the (false) hypothesis that economic integration is capable to evenly distribute the benefits of growth in the territory. Some preliminary results (Cojanu 2009) show that there are significant unused resources to strengthen competitiveness, through proper understanding of the factors of agglomeration as sources of development:

- *The existence of an urban and industrial vacuum inside the polycentric network of major urban centres* (over 100,000 inhabitants) that includes significant areas of the national territory, particularly in South-West, South, North West, partly in the Centre region, East and South East. The balanced distribution of urban networks is obviously lacking the ability to achieve functional development regions, which leaves important parts of national territory outside the mainstream of economic activity.
- *Polycentric development does not necessarily support the development of a competitive potential* at regional level, so that important urban networks are not able to establish the conditions of competitive development, as it can be represented by indicators such as GDP/capita, number of SMEs/1000 inhabitants or RDI expenditure/1000 inhabitants. This result is most visible when representing the expenditures on research and development, where the size and distribution of urban poles play an insignificant role for most of the national territory.

The above motivations point to operational forms of implementing the territorial development initiatives for strengthening competitiveness at four co-existent levels:

(1) Urban field (UF) is the area whose socio-economic and administrative identity includes the metropolitan area (a big city, secondary cities), cities and rural areas (villages and settlements) and therefore may overlap, cover or be included in the representation of polycentric urban networks (e.g. FUA, MEGA or PUSH). This economic space of development is centred on a representative urban centre and the networks formed between this centre and the secondary satellite cities, between urban and rural areas and inside the rural areas. An area of development has a spatial dimension, related primarily to distance and congestion, and an economic dimension,

related primarily to the effects of scale. Development needs are met by the integrated use of a residential area and through economic agglomeration centres, connected by one or more urban and rural settlements. Both specialization and diversification of activities are important for the development of an economic space; both can contribute to productivity growth, in the same manner in which they can curb this desirable trend.

(2) Groups of related industries (GRI) (clusters) which can be connected to an urban field or cross several urban fields and areas of development. They represent a community in itself, whose function is primarily economic. Foreshadowing an area is visible when the activities belong to a production chain, vertical or horizontal, but it is more difficult when the influences are felt along a dispersed network of factors. Organizing development at this level involves the formation of a network of collaboration between two or more urban fields, depending on the territorial dispersion of added value activities in the space of the industrial concentration. At European level, initiatives of this kind have been facilitated through existing programs of cooperation between the European Commission and the private environment (e.g. www.clusterobservatory.eu, <http://www.cluster-research.org/>), and reinvigorated through *Europe 2002* initiatives.

(3) Area of Development (AD) of regional and national importance, with possible cross-border location, assimilated to a great extent to the Potential Integration Area (PIA). The space of an AD is a complex socio-economic system, which may combine specific converging benefits of a relatively wide development space, administered by different jurisdictions (national and international). The economic activity takes place in Romania on a relatively wide area at European level, which is why it is normal for phenomena of territorial integration to take place both nationally and internationally.

(4) Disadvantaged areas can include categories of territories such as areas with deficient positioning (e.g. mountain regions), scarcely populated regions, specific natural areas (the Danube Delta, natural reservations), areas with low accessibility (rural interstitial areas), and areas with temporary socio-economic difficulties (e.g. mining areas, restructuring industrial areas).

The external perspective

Standard taxonomies of regional groupings (e.g. the European Union (EU), the Commonwealth of the Independent States (CIS), South Eastern Europe) or manifold geographic delineations (e.g. the Baltic Sea, the Black Sea) are in fact conventions that incidentally favour geopolitical rather than economic circumstances of spatial development. Economists are not used to map territories of development because there is no primer of the kind. Their research ground is populated by atomized actors (firms, locations, individuals) in a virtual arena of economic linkages characterized by aggregate variables. They apply normative concepts like 'optimum currency area', 'convergence paths', 'business cycle synchronization', 'dichotomised' (e.g. 'core-periphery', 'urban-rural', 'agrarian-industrial') or 'trichotomised' (e.g. 'core-semi-periphery-periphery') models of growth to gauge the *strength* of economic interdependencies that unfold over a given territory.

The 2009 World Bank annual report timely establishes a significant point in reorienting the research agenda to also gauge the *geography of competitive*

development. The findings suggest that completing a plan for economic growth is not necessarily conducive to improved competitive territorial capabilities and for that matter to better living conditions. The integration effects get virtually distorted for better or worse in a complex web of trans-national evolutions engendered by sources as diverse as agglomeration (population density, concentration of production), distance (local administration and taxation, infrastructure), exchanges (integration, factor mobility) or culture (institutions and law, tacit knowledge, social networks).

Recent empirical evidence (Clark, Beckfield 2009, Kose et al. 2008) reinforces the idea that converging cyclical fluctuations is primarily a consequence of evolutions within a territory of *homogeneous conditions of growth*. This choice helps place both less developed and developed locations in a more dynamic perspective, with their specific developmental constraints, beyond the familiar image of core-periphery models. Identifying *contexts* of development becomes possible by redirecting attention from *comparable variables* to *comparable threads of economic evolution*. It is true that circumstances that bind one country to another in a group *should* eventuate in converging cyclical fluctuations of key macroeconomic aggregates—output, consumption, investment, demography, employment—that reflect an established pattern of regional productive networks. This is indeed the case for large country groupings (e.g. ‘developed’ or ‘core’ vs. ‘developing’ or ‘peripheral’). Equally true though, the emerging spaces of self-sustaining opportunities for development may not appear visible from statistical tests alone. There are historical determinants that more often than not obscure or deflect our scrutiny of ‘single economic units’.

A striking division between the Germanic space and the southern space—of mingled Arab and Latin influences—seemingly sets the stage for a differentiated view of the European space from the very beginning. Table below looks further and summarizes *prima facie* evidence about the defining elements of evolutions coalescing at intra-group level relative to likely candidates of optimum competitive areas at the level of smaller regional groupings.

Table 3.2. *European contexts of development, a selected snapshot*

Regional groupings	Institutional anchors	Centripetal forces	Centrifugal forces
<i>South Eastern Europe</i> Bulgaria, Croatia, Romania, Serbia, Turkey, Bosnia and Herzegovina, Montenegro and Albania	The Black Sea Economic Cooperation organisation (BSEC) (1992) The EU ‘Black Sea Synergy’ initiative (2007) the EU’s Stability Pact for the Balkans (1999)	Former Ottoman dominions Transit route for Europe-bound gas Security regionalism (illegal migration and trafficking of drugs and people, and movements of terrorists)	Regional economics (weak intra-regional trade and investment links, low level of development, weak institutions) No regional centre of economic or political power (emerging: Turkey)
<i>The Mediterranean basin southern Mediterranean</i> Algeria, Cyprus, Egypt, Jordan, Israel, Lebanon,	The Euro-Mediterranean partnership (the “Barcelona process”) launched in 1995 NATO (the Mediterranean	<i>Mare Nostrum</i> Energy transport routes	The Israel-Palestinian and Western Sahara conflicts EU internal political process Disparate

Regional groupings	Institutional anchors	Centripetal forces	Centrifugal forces
Malta, Morocco, Libya, Syria, Tunisia, Turkey, the Palestinian Authority (including Cisjordan and Gaza), <i>northern Mediterranean</i> France, Greece, Italy, Spain and Turkey	Dialogue, 1995)		democratic standards Incomplete liberalization of markets
<i>Nordic countries</i> Norway, Iceland, Finland, Sweden, Denmark, Estonia, Lithuania, and Latvia	The EU Northern Dimension (1999) the Council of the Baltic Sea States (CBSS) (1992) VASAB (Vision and Strategies around the Baltic Sea 2010) The EU Baltic Sea strategy (2009) the Nordic Council of Ministers the U.S. Enhanced Partnership in Northern Europe (e-PINE) Programme (2003) the Barents Euro-Arctic Council (BEAC) (1993)	New focus on Arctic energy and transport cooperation Energy transport routes (NORD-EL grid) Nordic electricity Market (Nordpool) Management of sea resources	The EU-Russia relationship Low interoperability of national transport networks

The research only belatedly picked up the interest in studying how different regions synchronize their economic cycles with the first two papers on the topic published in 1998, just a few others added by 2002, and considerably amassing after the EU enlargement became a sure scenario (Fidrmuc, Korhonen 2006). The findings invite to a radical overturn of Cold War era prejudices about the representation of competitive areas. Evidence of spatial convergence clubs among EU regions is a confirmed hypothesis. Country clusters like some EU Mediterranean countries (Greece, Portugal and Spain), the 2004 EU entrants, and their hitherto former communist peers in South Eastern Europe seem irrevocably launched on different trajectories of business cycle correlation relative to the euro area that is the very core of the integration process.

Indecisiveness in tackling the variable geometry of self-sustaining areas of growth is still difficult to dispel, although incremental steps ahead are visible. Facing an ever varied neighbourhood, the EU replied by vigorously negotiating geographical extensions of partnerships, the only missing dimension pointing to the Atlantic Ocean. Security issues of course play a key role in this design, but the whole process magnifies those regions' potential to foster locally devised solutions for competitive

advance. On economic side, this is the case, for example, with the EU funds targeting major trans-European transport axes that reinforce connectivity and accessibility within periphery in the first place. On political side, the proposal made by France in March 2008 to create a Union for the Mediterranean took many aback, especially Germany, by mentioning a project scope that would encompass *selected* EU countries (i.e. the northern shore of the Mediterranean) and non-EU Mediterranean coastal states (Emerson 2008). The unprecedented initiative has been in the meantime watered down by political manoeuvring without refraining to advance yet another singular scheme in the form of the Union's twin overseeing, with chairs from both the south of the EU and Southern Mediterranean states.

Winnowing out functional from inert competitive areas, viable from destructive contexts of development should naturally precedes political decisions and, concomitantly, provide the rationale for both public and private economic initiatives. The following final section looks at the perspectives and outlines an action plan to frame policies for competitive development.

Perspectives

The road to periphery with its associated effects of economic dualism and polarised poverty is not necessarily a result of geographic location, but failure to profitably take part in regional economic development. This is explained by the fact that competitive development also depends on location factors besides the traditional criterion of economic efficiency. The potential for absorbing the effects of growth at the level of the territory has its origins in phenomena related to:

- Competitive exposure: economic borders limit an area where companies and institutions go through a process of maximizing competitive development. They face competition of similar value, technologically and economically, and thus become motivated to innovate and to overcome what they understand as a direct threat, not distant or insurmountable, compared to their current performance.
- Institutional development: associated with decentralized administration, regional expertise and knowledge. Administrative centres of government are replaced by functional centres of decision, which favour a widespread use of the sources of competitive power, free of political influence or bureaucratic obstacles.
- Social development: problems relevant for any development policy, such as income disparities, labour motivation and conflict resolution or underground economy, have an almost identical sensitivity to a broader area of economic activity.
- Cultural development: tastes, attitudes towards work, consumption propensity, all lead towards the formulation of effective business strategies that target an easily identifiable market. A level of integration based on economic history and cultural identity reinforces the premises of enhanced flows of information and knowledge.

The impact of a large area of development on the consolidation of competitiveness is both positive and negative, as it supports the emergence of *growth potential* because:

- it enables the diversification of occupations and thus regional specialization;

- it makes possible to develop bigger production capacities, of greater productivity;
- it allows the monetization of trade through an adequate financial circuit;
- it encourages the consolidation of social capital in various forms, as a direct source of growth, etc.

and at the same time, by the same causal chain, it multiplies *degrowth effects*:

- the emergence of power concentrations and the decoupling of production from real needs;
- increased exposure to financial risk (fiscal, monetary);
- disintegration of personal ties in favour of formal, institutional ones;
- negative network effects (e.g. congestion, pollution) etc.

The overlapping of the new development challenges with the devastating impact of the international crisis requires careful consideration of the recent recommendations included in *Europe 2020* initiative. A new competitiveness policy is both necessary and possible to be developed within the remaining time of the current financial exercise (2007-2013); it has been justified by the latest EU regulations¹ which allow adjustments based on new priorities for development. Romania is part of an economic space characterized by considerable differences of economic performance, usually at a lower level as we move from the West to the East of Europe. A policy to strengthen competitiveness must meet the challenges arising both from the need to decrease disparities towards more developed countries, and from the need to better harness the existing economic potential.

¹ COM (2008) 803, Proposal amending Regulation (EC) 1083/2006 on the ERDF, ESF and Cohesion Fund, COM (2008) 838, Proposal amending Regulation (EC) 1080/2006 on the ERDF, COM (2008) 813, Proposal amending Regulation (EC). 1081/2006 on the ESF

4. The Romanian labour market context of the Europe 2020 Strategy

The Lisbon Strategy was initiated by the European Union in order to create a European competitive economy able to cope with population ageing that most countries are experiencing. The goal of the strategy was to transform the European Union into "the most dynamic and competitive knowledge-based economy in the world by 2010 capable of sustainable economic growth with more and better jobs and greater social cohesion and respect for the environment".

The mid-term 2005 review of the countries progress has revealed that the original Lisbon agenda was over ambitious, and European countries were slow to achieve the strategy's targets. As an effect, the revised agenda focused on growth and jobs, in order to concentrate the efforts of the member states on what was perceived as the most important challenges the European countries will face in the future. This year, is the deadline for achieving the set goals. The economic crisis that engulfed the world in 2009 has eroded at least part of the progress that countries achieved during the last years. Unemployment was increasing around Europe in 2009; growth rates were negative in most countries, the budget deficits, as well as public debt was soaring in the same interval. Even under recent conditions, there is indication that some progress has been made, despite failing to meet the specific targets. The average employment rate of the EU was nearing the 70% mark in 2008 but the crisis has eroded part of the progress.

In March this year, the European Union launched the European 2020 Strategy for smart, sustainable and inclusive growth. From a labour market point of view, the strategy aims at achieving 75% employment rate by 2020. In addition, the strategy recognizes the importance of the education system for creating a well educated, qualified work force, and therefore sets targets in terms of early school leavers, and tertiary graduates as well.

This chapter presents the effect of the Lisbon Agenda over Romania's labour market. Although Romania has enjoyed robust economic growth, for the most part of the decade, its progress towards fulfilling the Lisbon Agenda's targets was not as smooth as one might have expected. The labour market was experiencing large and increasing shortages of labour and skills, which coexisted with low participation rates, as well as excess supply of labour in declining sectors (mainly agriculture). Still, we do not expect that the employment figures for 2009 be very dire, in comparison to the 2008's figures, despite the economic crises. Although the growth rate plummeted to -7%, even with a budget deficit as high as 7%, the government policy in 2009 was to maintain public jobs and to reduce the public wage bill through „voluntary” decreasing the number of days of work in some months. This year might be more challenging from the employment point of view since the government policy of maintaining employment is not sustainable in long run, and numerous job cuts were announced in the public sector. In the private sector, the situation is not better from the employment point of view, since there are no signs of economic recovery, and therefore private companies will at best maintain employment if not continue with cutting jobs.

The labour market conditions in Romania are particularly challenging, although the unemployment rate is not particularly high, in comparison to the EU average, unemployment is asymmetric, affecting especially the unskilled workers, as well as

young and older workers. This raises questions with respect to Romania's education system's capabilities as well as the versatility of the continuous vocational education and training to create a competitive labour force.

The negative growth rate of the Romanian population, which has started in the early 1990 has already reduced the population by 10%. On top of this, there is the migration of the work force which is estimated at between 1 to 2 million of the work force population, most of which are short term. Most of the migrants are still included in the labour market statistics, as inactive, but are absent from the Romania's labour market, which makes the meeting of the Lisbon activity target more difficult, and might be partly responsible for the slow progress of employment rate in Romania.

The labour market shortages experienced during the economic expansion, have managed to drive wages up at higher speeds than the increased productivity would have dictated, and as a consequence, eroded even further the external competitiveness of Romania. Once the crises struck, the increased wages became too large both for both the public and the private sector to manage on the decreased demand, forcing employers to adjust their workforce, therefore temporarily easing the labour market pressure.

Policy-making should do more to address these challenges. Although economic growth is expected to return in the foreseeable future, and should create favourable conditions to increase participation and foster sustainable job creation, policy reforms need to focus on bringing back into employment those labour categories which are unable to take advantage of growth. The youth, older workers, women and the long term unemployed are particularly affected by high unemployment and/or low participation. The skills with which the education system endows graduates appear to often be out of line with the expectations of the employers. A better alignment of the curricula with the demand for labour is therefore imperative. Opening segments of the labour market to foreign workers should also be considered in order to fill the gap between the existing supply of labour and the expanding demand. Policy-making should also focus on those that are in poverty and inactivity

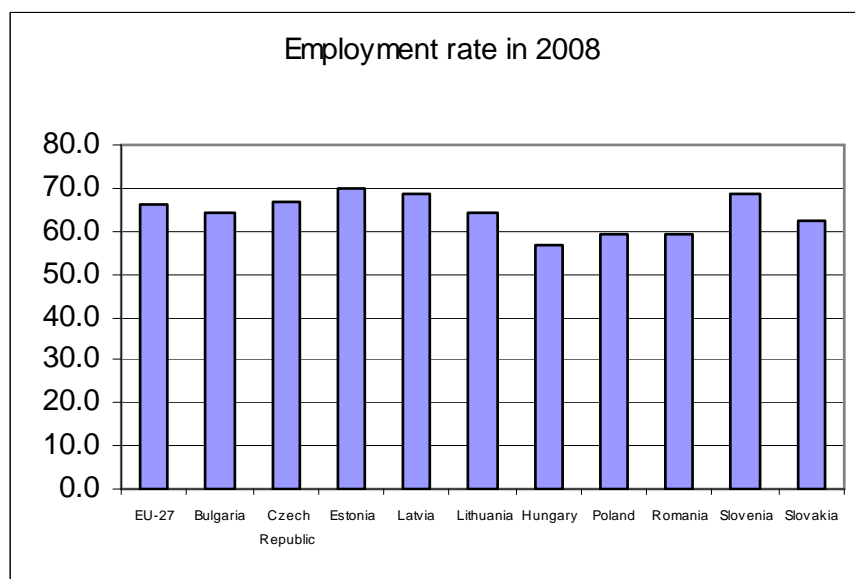
Recent labour market trends

Following seven years of robust economic growth, Romania's employment rate for the population aged between 15 and 64 years has slightly picked up in 2006, after a significant period of quasi-stagnation. Casual evidence indicates that the introduction of the flat income and profit tax rate in early 2005 has had a contribution, although a direct causality has not yet been established. Although the official figures of the 2009 have not yet been published, the preliminary figure for Romania indicates that in the third quarter 2009 the employment rate was around 60%². The policy of the Romanian government to maintain public employment and "voluntary reduce" hours of work and therefore, the wage bill in order to reduce public sector wages, seemed to have worked. Nevertheless, in spite of the recent increase, the overall employment

² See Lisbon Strategy evaluation document. 2010.

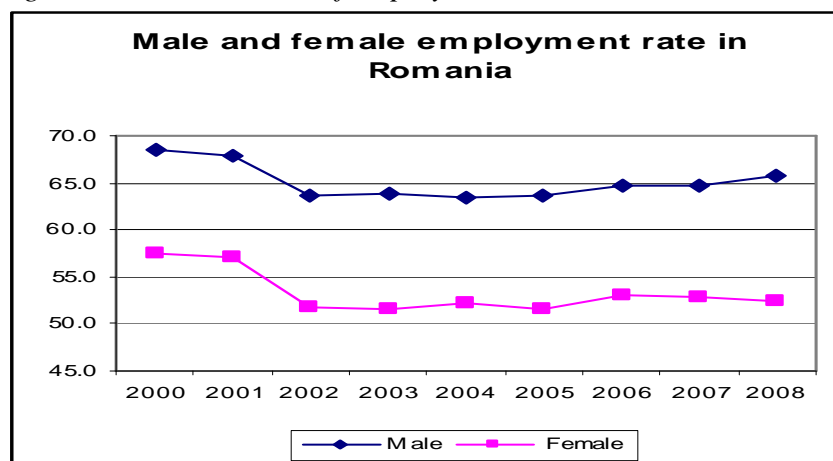
rate³ in Romania remains modest relative to the Lisbon agenda target of 70%, the EU 27 average and the best performers in the new member states, such as Estonia, Latvia, Slovenia. Despite the failure of EU individual countries to meet the employment rate target, the new strategy raises the employment rate to 75% employment by 2020, but leaves some room for setting national targets, so that each country tailors the strategy to its particular situation. Unless Romania finds a way to attract back the short term migrants, it is doubtful that it will succeed in producing so high employment growth rate in the next decade. Although no targets are set for the employment rate of women and older workers, the strategy recognizes the need to increase them as well, in order to react to the ageing of the European population.

Figure 4.1 Employment rate in new member states in 2008



Source: Eurostat, structural indicators

Figure 4.2 The evolution of employment rate in Romania



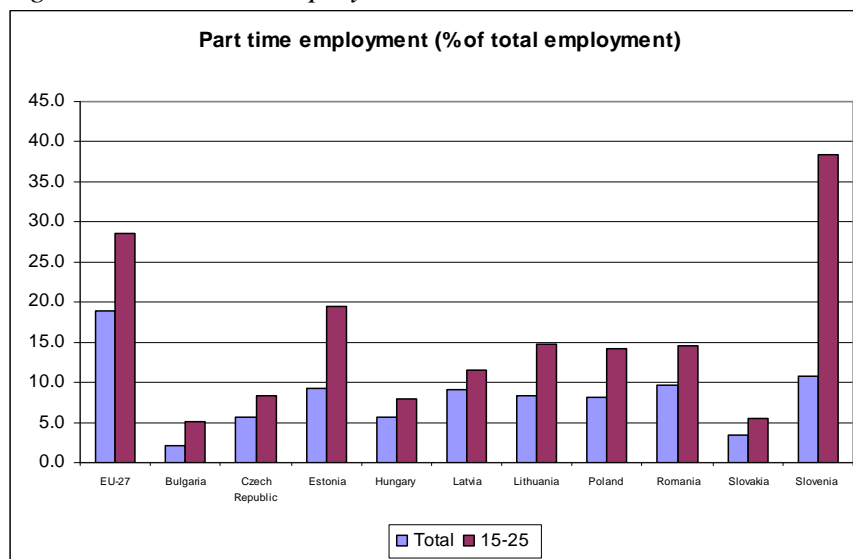
Source: Eurostat, structural indicators

³ The employment rate figures in Romania's case have to be treated with caution, since a large percentage of the emigrants are still included in the labour market statistics as inactive population, due to the fact that they are illegal migrants, and do not legally reside in the country they work in. Depending on how big the emigration is, the corrected participation rates can be higher by as much as 20% than the official statistics.

The resilience associated with the stationary trend visible in recent years (see Figure 4.3) indicates that the economy seems to remain deficient in developing the appropriate incentive systems to attract people back into employment, especially some labour categories which have particularly low participation rates, as we shall see below. The still high social contributions and the rigidity of the employment protection legislation might discourage employment expansion, in spite of the consolidation of economic growth and income tax relaxation. The large external migration flow affects employment trends, as many working age people seem to have left the country in search of better opportunities abroad.

Evidence suggests that some labour market categories have particularly low employment rates. These categories are primarily women, older workers outside agriculture and young people. Their employment rates are significantly below the Lisbon targets. Women's employment rate is, for example, at 52.5% in 2008, over 12 % points below that of males, which was 65.7% in the same year, and one of the lowest in Europe. As the chart suggests, it has been rather stable since 2002, and after it peaked in 2005 (probably due to the reduction in social security contributions), it reversed its trend. Similarly, the employment rate of older workers gravitates around 40%, well below its Lisbon target. The trend was positive in recent years, unlike the case of female employment, suggesting, that the reforms aimed at attracting older worker back to the labour force, and/or discouraging them from moving to inactivity most likely through early retirement, was partially successful.

Figure 4.3 Part time employment in new member states



Source: Eurostat

Part time employment is high, especially among the young. A significant expansion in European employment was attributable to the relaxation of the labour legislation by promoting part-time and temporary employment during the nineties. In fact, most of the growth in employment in the EU visible since is in the two categories. In the case of Romania, as the chart suggests, the introduction of provisions allowing for part-time employment in the 2003 Labour Code appear to have yielded positive results, despite its failure to attract proportionally more of the female population back in employment (the part time employment of males and females is roughly similar).

Currently, around 10% of employment is part time (see Figure 4.3), one of the highest in Central and Eastern Europe after Slovenia, although still well below the EU 27 average and the top European performers. Encouraging is primarily the fact that the share of part-time employment for the 15-25 years age group is significantly higher, at over 15% of the total employment for this category, particularly as this group has a low participation rate and a high unemployment.

A phenomenon which has become increasingly evident in recent years in Romania, especially in the pre-crisis period, as well as in most of the new EU member states, is the coexistence of labour and skills shortages in some sectors with excess supply in other areas of the economy. While labour participation remains low by European levels and only slowly picking up, labour demand has expanded substantially in recent years (prior to the 2009 economic crisis). This has led to important shortages of labour and skills in segments of the labour market and has exacerbated imbalances by pushing wages above productivity gains, affecting competitiveness and augmenting inflationary pressures. While there is no systematic evidence on the magnitude of the labour shortages, sectoral studies and casual information seem to suggest that they affect both skilled and unskilled segments of the demand. Industries ranging from constructions and manufacturing to ICT, as well as services ranging from retail trade to public services, including health and education, seem to be affected and the gap will be widening again, once the economy starts growing.

The situation is somewhat paradoxical, as Romania should not suffer from overall labour shortages, in spite of the large external migration flows. Inactivity rates are high, including among the young population, and there is a large under-employed pool of labour in the rural areas. With around 45% of the population living in the rural zones, and a significant unemployment, with rates often in double digits, in small urban mono-industrial localities where traditional industries collapsed raises the fundamental question why this important labour potential has not been appropriately exploited yet.

Evidence points towards several explanations for this context. First, it indicates a substantial mismatch between the skills of the labour released in the process of enterprise restructuring and the changes in the demand for labour. Put it simply, the large cohorts of workers who lost their jobs throughout the transition in the declining sectors have not been absorbed by the growing ones and have rather been pushed into unemployment, usually long term, into agriculture or out of the labour force. These outflows of labour, predominantly from traditional heavy industries, have been very large, as job destruction in Romania was among the most substantial in the former socialist bloc, relative to the size of its labour force.

A second explanation is associated with the relevance of education for the needs of the labour market. Labour force surveys point to an important flow of graduates, at all levels of education, going directly into unemployment and out of the labour force, including through discouragement. This suggests that there are important gaps that the current curricula fail to address in terms of endowing student with the appropriate mix of general and specific skills in order to make them attractive for employers. In additions, the low scores registered by Romania in standard cross-country tests, such as PISA or TIMSS, indicate that not only the focus but also the quality of education remains an unsolved issue. Further, as the number of tertiary education students coming from rural areas is almost insignificant, it suggest the existence of important

obstacles to access to education in rural areas which, inevitably, are reflected into labour market imbalances.

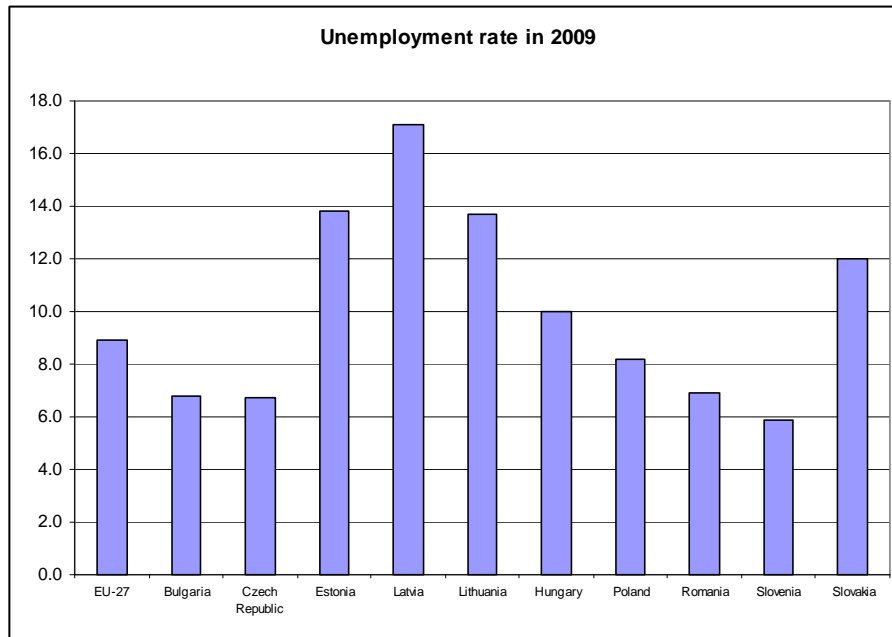
The proposal for the 2020 European Strategy for smart, sustainable and inclusive growth underlines the importance of education in achieving the employment targets. In order to increase employment one needs to have an education system capable of creating graduates able to integrate swiftly into employment, which means that the qualifications/skills/competences that the education provides need to be as close as possible to the ones that the labour market requires. The new European strategy acknowledges the importance of a good education system, and it sets targets for reducing early school leavers to fewer than 10% and the percentage of younger persons with tertiary education who should be over 40%. Romania is not very close to the European target for early school leavers, with 16% of students dropping out of the education system, but the trend is descending, from 23% in 2003, therefore if progress continues at the current speed, Romania should have no problem in reaching the desired value. With respect to the younger persons with tertiary education, the definition of the rate is not clarified (what is considered to be younger persons) and therefore it is not possible to have an estimate for Romania. Even considering the attractiveness of the tertiary education in Romania, around 30% of the 19 to 24 age group were enrolled in tertiary education; we are not near reaching the European target.

A third factor explaining the current widening imbalances is the low internal labour mobility, particularly between the rural areas, where the surplus of labour largely rests, and the growing urban regions, the engines of growth, where the demand for labour comes from. The complex transition Romania has gone through has seen large outflows of labour from the declining urban industries into agriculture and rural areas, while the migration from the latter to the former has been relatively modest. The situation is partly explained by the large external migration, as people appear to be better off by leaving the country and working in the old EU members, rather than moving to the cities. While there is migration from rural to urban, the inflows do not seem sufficient enough to keep up with the expansion of the demand. Cultural factors also seem to be at play as, traditionally, people do not move where the jobs are, a feature characteristic to much of Europe.

Stabilizing at around 7% of the labour force⁴, Romanian unemployment is not high relative to European levels. It is actually well below the EU 27 rate (see Figure 4.4). Registered unemployment, which measures the number of unemployment benefit claimants, is even lower, at around 4% on average, and less than that in the fast growing regions and cities. Men are more affected than women by unemployment (Figure 4.5), as their rate is around two percentage points higher, suggesting that the decline of the male-dominated heavy industries has taken a significant toll among the male workers. Female unemployment has been constantly declining since 2004, (with the exception of 2009). While the overall level of joblessness is not large, it nevertheless has several important characteristics that need to be highlighted.

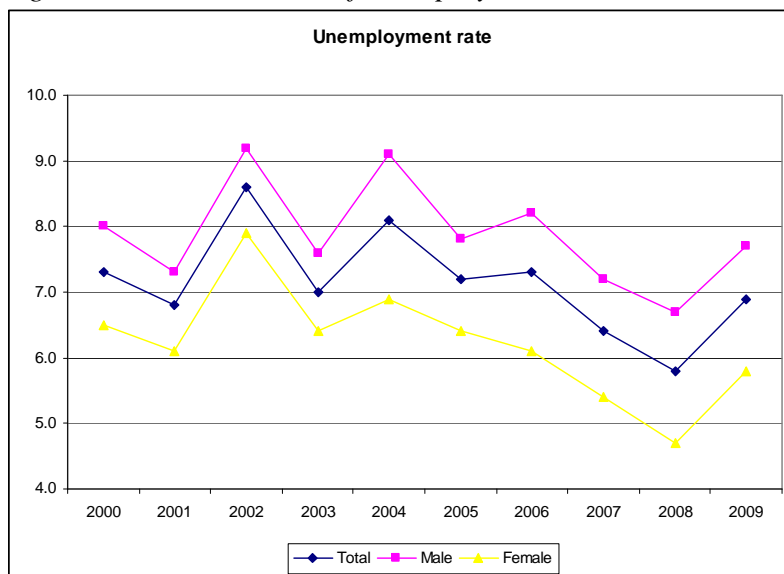
⁴ LFS figures, following largely the ILO definition of unemployment.

Figure 4.4 Unemployment rate in new member states



Source: Eurostat, structural indicators

Figure 4.5 The evolution of unemployment rate in Romania

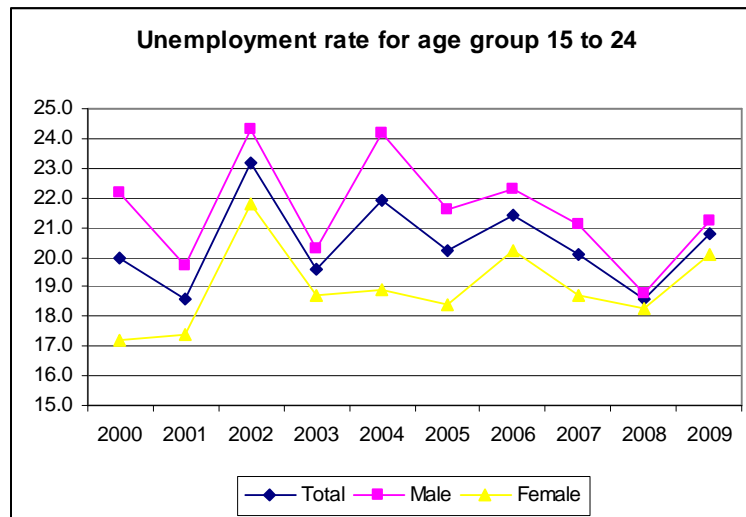


Source: Eurostat, structural indicators

First, the decline in unemployment has not been matched by a proportional rise in formal employment, suggesting that external migration and other factors are playing a role in driving unemployment down. In the absence of job opportunities at home many have preferred to migrate rather than face unemployment. The large informal economic sector, estimated at least 20% of GDP, may also explain the low formal employment figures and the low unemployment paradox. The grey economy appears to provide a large number of low paid jobs to mostly unskilled individuals who cannot find formal employment. This phenomenon is evidenced by the large discrepancy between the LFS and registered unemployment, which indicates that a large number of ILO-unemployed does not actually qualify for unemployment benefits while, at the same time, a large number of claimants are not actually unemployed following the

ILO definition, that is they do not actively search for work, one reason being probably that they are already informally employed. Limited quality job opportunities and long unemployment spells discourage people from actively looking for jobs, and push them out of the labour force or into subsistence agriculture. The number of discouraged workers seems to be large, especially among the young.

Figure 4.6 The evolution of unemployment rate for the 15-24 age group

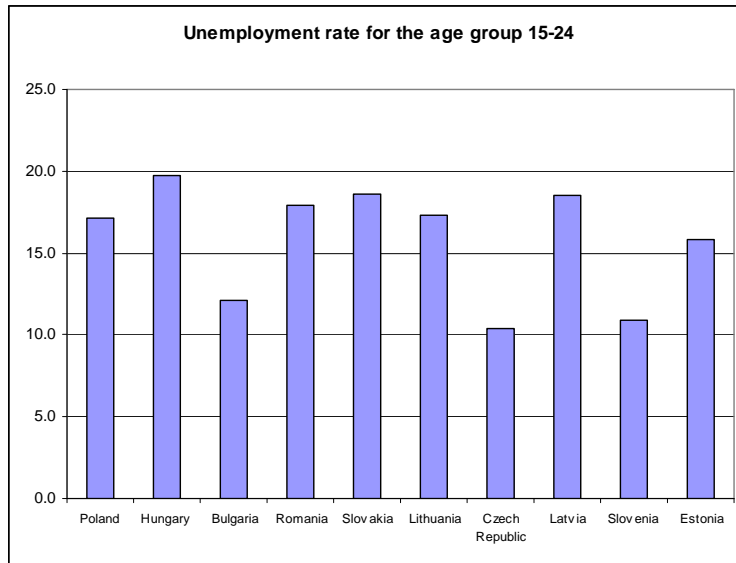


Source: Eurostat, structural indicators

Second, unemployment disproportionately affects the young population (see *Figure 4.6*). The unemployment rates of the 15-24 years groups are particularly high and resilient, at around 21% for males and around 20% for females. These are among the highest in the new member states, only below Hungary and Slovakia, two countries characterized by high unemployment, and above the EU 27 average. Evidence suggests that youth unemployment is high for practically all educational attainment levels, primary, secondary or tertiary, indicating low employment opportunities for the young irrespective of their level of formal education. The figures point again towards the limited relevance of education for the recent changes in the structure of the demand for labour and skills. This situation is particularly detrimental as it affects the long term human development potential of the country and encourages external migration.

Romania has promoted, in recent years, a series of reforms aimed at enhancing the flexibility of the labour market and increasing participation and sustainable job creation. This includes the revision of the Labour Code, more emphasis on active labour market policies and improvements in the business environment to reduce transactions costs for companies, including by simplifying company registration. The effects have been beneficial and have resulted in increased employment and lower unemployment. This said, one should not omit the safety valve which is represented by the massive migration of workers abroad, contributing to maintaining unemployment relatively low.

Figure 4.7 Unemployment rate in new member state for 15-24 age group



Source: Eurostat, structural indicators

The high economic growth enjoyed for the most part of the decade, and which is expected to return next year, should make job creation easier, indicating that the increase in participation is likely to continue. At the same time, important labour market categories are not taking advantage of the enhanced employment opportunities offered by economic growth. These are in particular the youth, older workers and the long term unemployment. Female participation is also low by European standards. These categories need to be addressed by well targeted policies in the future.

5. Final remarks and policy recommendations

- For Romania, the most problematic targets of the Europe 2020 Strategy are those related to the “**smart growth**” objective. Our investments in research, development and innovation are very low; increasing both public and private spending on these activities is directly related to the model of development that Romania will embrace after the economic crisis. If we return to a consumption-led growth companies will not feel the pressure to innovate and public money will continue to be spent ineffectively in these domains. We recommend the creation of an independent national council on research, comprising business and academic representatives, which would allocate the public money for RDI. When a country faces budgetary constraints, it is of paramount importance that the limited funds available are spent wisely.

Regarding the promotion of economic growth, we recommend the re-thinking of the action plans concerning country’s physical infrastructure and agriculture. Both sectors could benefit from large inflow of EU funds and be sizable contributors towards ensuring a positive rate of growth in 2010 and beyond.

The government should focus on specific sectors which provide a basis for future growth. Setting up the appropriate framework and incentives for investments in physical infrastructure and the energy sector should be a priority. This would also be in line with the EU proposals. The poor state of physical infrastructure has negative spillover effects in the economy, imposing large costs on economic agents. Over the last four years, realized infrastructure investments were, on average, around three quarters of the planned expenditures. Exploring alternative financing solutions – such as partnerships with reputable private sector agents or international financing institutions – could boost the country’s investment while creating more jobs.

Also, we recommend ensuring complete transparency of the government financial accounts – especially those pertaining to contracts with the private sector and current expenditures. This would enhance authorities’ credibility and the ongoing reforms of the public sector would benefit of a public opinion support.

Romania should also raise its capacity to attract EU funds by rapidly creating the necessary mechanisms and institutions. 2010 and 2011 are the ‘peak’ years, when a maximum amount of EU funds are available.

Regarding the aim of enhancing competitiveness, public policy interventions (i.e., public or private initiatives supported by institutional or financial public resources) should be based on specific guidelines.

First, public policy interventions should be adjusted to a geographically variable scale / scope of intervention. The most recent recommendations in the European Union warrant once more the priority of policy adjustment to involve cooperation between neighbouring local authorities or between neighbouring countries, or even between the EU and neighbouring regions. The adoption of the four operational concepts for spatial development as „destination” for public policy initiatives to strengthen competitiveness is consistent with the current model of reporting to the territory the

projections of development, by identifying a system of axes, hubs and areas as physical support for the development processes.

Second, the gradual allocation of the financial assistance should be made according to the difficulties of integration in the area of development, which are sized locally, regionally, nationally and perhaps internationally. The ESPON program recommendations suggest that the new Member States focus structural funds during the first phase on developing significant urban systems and other major agglomerations, a process that will facilitate convergence at European level but may even cause an increase of economic disparities and therefore can only be justified for a limited time. The next phase should include a national program of regional development with emphasis on increasing the second pillar of territorial development. The justification for these plans is based on the analysis of the potential functions and contributions to the positive spatial development of the development areas.

Third, we recommend increasing the role of interventions in the development of programming capacity in the field of competitive development. The competitiveness consolidation policy is a process that requires continuous learning and real-time action for adjusting to changes in the economic situation and technological development. The integration of the new concept of territorial planning is gradual, long-term, with considerably high learning economies. Expected objectives may come from measures such as mapping the economic activity in the territory or the non-governmental institutional constructions for observation and monitoring.

Fourth, we recommend enhancing the role of complementary financing programs by diversifying funding sources and stimulating private investment initiatives. At the level of the European Union a considerable multiplication of funding programs took place in the last decade, brought on by specific regional and sectoral needs. On the one hand, it is necessary to increase the institutional capacity to maximize the use of these sources. On the other hand, domestic economy should see a similar entrepreneurial effort to revive private initiative for investment programs. Stimulating the attraction of investment towards public intervention measures should be complemented by initiatives of the research community, of the local communities and by sectoral programs.

- The objective regarding “**sustainable growth**” will also need substantial efforts from the Romanian authorities. As we described in section two of this report, the situation is far less favourable than it might seem at a first sight. We recommend the creation of a public holding company comprising only the producers of energy from renewable sources, as a mean to increase awareness on this subject and to create positive synergy and coordination effects.

We also recommend the acceleration of investments in the program aimed at rehabilitating buildings in order to increase energy efficiency, by relocating funds from other public investments programs which are less relevant for the Europe 2020 targets (such as “First House”) and which create less spreading out effect in the economy.

- Regarding the “**inclusive growth**” objective, in addition to promoting growth as a means to increasing employment, Romania needs policies targeted at

improving the labour supply incentives of some special categories of workers: the youth, older workers, and females. Such measures would include more flexible work arrangements, such as part-time and temporary contracts, improved job search assistance and counselling, and targeted programs, including job subsidization, where needed.

Limiting the scope of the early retirement programs with the objective of increasing the effective retirement age of workers should help to gradually correct the imbalance in the ratio between contributors and pension beneficiaries, enhance revenues of the pension fund and increase the replacement rates without resorting to transfers from other public budgets. Financial incentives to encourage workers to stay longer in employment should be considered. Retraining and skills upgrading programs should be made available to older workers and long term unemployed and the performance of the schemes should be monitored, in terms of achieving the objective of bringing people back into work.

While the creation of new jobs per se is important, the quality of the human capital they embody is equally central. The distribution by levels of education of the labour force is positively correlated with value added, and hence with the overall competitiveness of an economy. Evidence suggests that in Romania the quality and relevance of education to the needs of the labour market affects participation and exacerbated skills shortages. To address this challenge, the education system is undergoing a comprehensive reform, which has already produced changes, especially in compulsory education. Nevertheless, more needs to be done, in particular by better aligning curricula with the demand for graduates skills. Improving the effectiveness of public spending on education, including by introducing performance related incentives, such as per capita financing, should be part of the reform agenda. Expanding the use of long life learning opportunities should better link the provision of skills to the fast changing sectoral and occupational profile of the demand for labour.

References (selective)

Cojanu, Valentin (2009), „Către un concept operațional al dezvoltării competitive în plan teritorial”, *Revista Transilvană de Științe Administrative*, 1(23), 2009, 19-38

Clark, R., Beckfield, J. (2009) “A new trichotomous measure of world-system position using the international trade network”, *International Journal of Comparative Sociology*, 50 (1), 5-38

Emerson, Michael (2008) “Making sense of Sarkozy’s Union for the Mediterranean”, CEPS Policy Briefs 155, March

European Commission (EC) (2010), “Europe 2020: a strategy for smart, sustainable and inclusive growth”, COM (2010) 2020, Communication from the Commission, Brussels, 3.3.2010

Eurostat, Structural Indicators, retrieved online in April 2010

Fidrmuc, Jarko, Iikka Korhonen (2006) “Meta-analysis of the business cycle correlation between the euro area and the CEECs”, *Journal of Comparative Economics* 34, 518–537

Kose M. Ayhan, Christopher Otrok, and Eswar S. Prasad (2008) “Global Business Cycles: Convergence or Decoupling?”, WP/08/143, IMF Working Paper, June

World Economic Forum (2010), *Global Competitiveness Report 2009-2010*, Geneva