

Overview

Despite valuable assets and strong growth potential, the Romanian economy has yet to catch up with the transition economies of Central and Eastern Europe

Romania covers an area comparable to that of the United Kingdom. It is a lower middle income country with GNP per capita of USD1 850 (at end-2002). With 22 million individuals, it is the second most populated country in Central and Eastern Europe (after Poland) and larger in population terms than 19 of the 25 current members of the European Union (EU). It benefits from a strategic geographic situation, an educated low-cost labour pool, a dynamic S&M enterprise sector and good energy and agricultural resources. It has, however, lagged behind the advanced transition economies and remains one of the poorest countries in Europe.

Since the end of 2000, the government has been determined to reverse forty years of command economy and a poorly designed first decade of transition

In the last four years, the government has vowed to engage in a more consistent macroeconomic stabilisation policy and a firmer programme of reforms than its predecessors and to anchor these efforts in its process of accession to the EU. It also decided to actively seek the advice and financial assistance of international organisations, notably the IMF, the World Bank, the European Development Bank and the OECD. Romania has been one of the three co-chairs of the Investment Compact for South-East Europe programme sponsored by the Organisation.

Much remains to be done. Effective implementation will be key

Despite recent progress, the general wisdom remains that Romania still faces considerable challenges in completing its structural and institutional

governance reforms. Top priority must be given to the continuing downsizing of the public sector and enterprise restructuring, as well as to the removal of impediments to investment. Major obstacles that need to be overcome are administrative barriers, the inflexibility of the labour market, burdensome tax administration, a weak judiciary and widespread corruption.

Romania accounts for 36 per cent of the accumulated FDI stock in South East Europe and is the fourth largest recipient of FDI in Central Europe. FDI has proven to be a trustworthy ally of Romanian reforms

After a slow start as a location for foreign direct investment (FDI) and a sharp increase in 1997, Romania has experienced a noticeable comeback, with inflows rising by over 60 per cent between 2002 and 2003 and with a record level of \$1.84 billion in that year. Romania is the largest recipient of FDI in South-East Europe with an accumulated FDI stock of \$15 billion forecast for the end of this year. The IMF projects annual inflows to average out at \$2.4 billion until 2008, which will make Romania a large destination for foreign equity in Central Europe. This is to be welcomed as Romania is in great need of foreign capital for its economic development.

Europe and the United States are the main investors in Romania. Their presence is largely concentrated in industry

Mirroring trade patterns, European (80 per cent) and US investors (20 per cent) account for the bulk of FDI in Romania. The interest of foreign companies mainly focuses on industry, construction, agriculture, tourism and other services. FDI also dominates mobile telecommunications, banking and insurance and oil and gas. Spread among some 100 000 firms, FDI is considered to be integrated into the local economy.

The attraction of manufacturing reflects Romania's comparative advantages

The 60 per cent concentration of FDI in manufacturing is a reflection of Romania's comparative advantages. Foreign firms invest in capital-intensive steel and chemical industries as well as in the labour-intensive clothing and footwear trades. Several automotive and electrical machinery manufacturers have chosen Romania for their location. As these firms sell over 50 per cent of their production abroad, Romania has become a significant export platform.

Privatisation of major state-owned companies is likely to dominate FDI figures in the coming years. Brownfield and Greenfield investment would be desirable as well

The recent sale of the largest commercial bank, four major energy distributors and the giant oil company Petrom plus large state-owned transport and mining companies, is likely to dominate FDI figures for the years to come. The completion of these privatisations is needed for Romania to become a fully functioning market economy. The next challenge will be to channel new investments in brownfield and greenfield investments. There are hopeful signs that this will happen. Newly subscribed capital by established foreign companies is six times as great as the capital invested in new firms. Reinvested earnings constitute a larger proportion of Romanian FDI than in other SEE countries.

The business environment has improved

The government has taken several other steps to improve the business environment. A tacit approval procedure and a new registration system have been adopted. Prior consultation and procedural transparency have been made mandatory features of the regulatory process. New channels of communication have been opened with the business community and society at large. The new bankruptcy law and judicial reorganisation law are designed to facilitate the demise of unprofitable businesses and improve creditors' rights. A comprehensive Fiscal Code and a medium-term fiscal strategy have been adopted to ensure greater stability and predictability in business decisions. A new competition law sanctions anti-competitive practices. The rule of law has been strengthened with the reform of the judiciary and a new action plan has been elaborated to combat corruption. Romania has ratified the Criminal Law Convention on Corruption of the Council of Europe and plans to ratify the United Nations Convention against Corruption.

The breadth of the reform agenda is putting the government's capacity to the test

The performance and competitiveness of Romania can nevertheless still be improved. Amendments to the Tax Code and less zealous tax collection as well as revisions to the new Labour Code are being recommended by various stakeholders. It is also recognised that the reform of the judiciary and civil administration will not be completed for some time, while dealing with corruption remains an uphill battle.

Romania believes in non-discriminatory treatment of foreign investment

Romania has an open and liberal regime towards FDI. Except for the government agency ARIS which has been created for the purpose of informing and assisting foreign investors, there are no specific laws on foreign investment. National treatment is generally enshrined in domestic legislation, the granting of investment incentives and privatisation. This means foreign investors are generally allowed to invest in any field or in any juridical form. They are not confronted with screening, equity or performance requirements and can benefit from any available incentives. They can convert and transfer abroad lawful income derived from their investment.

However some investment incentives will need to be revisited

The question arises as to whether and how Romania will be able to compete in the Union under EU competition rules. Along with other transition economies, Romania has made use of investment incentives such as free trade zones or industrial parks to attract foreign investment. Such state aids will need to be aligned on EU disciplines and in some cases, dismantled. This undoubtedly increases the urgency of completing other structural and institutional reforms.

Domestic policy has been underpinned by active international economic diplomacy, resulting in participation in numerous bilateral, regional and multilateral agreements

Romania is party to several bilateral, regional and international agreements which commit the economy to open trade in goods and services and open capital accounts. Adherence to these instruments serves to anchor domestic reforms in long-term, legally binding undertakings and to integrate the country better into the global economy. Romania has entered into 84 Bilateral Agreements on the Promotion and Reciprocal Protection of Investment and some 74 Agreements on the Avoidance of Double Taxation, largely based on OECD models. Parties to these agreements have included a wide range of non-OECD countries in addition to Romania's traditional economic partners.

The OECD Investment Committee concluded in September 2004 that Romania is willing and able to adhere to the OECD Declaration on International Investment and Multinational Enterprises

The OECD Investment Committee reviewed Romania's legal regime in September 2004 and concluded that the country is willing and able to adhere to the *Declaration on International Investment and Multinational Enterprises* and its related Decisions and Recommendations. The Committee encouraged Romania to pursue its reforms actively, to complete the privatisation of major state enterprises and to pay particular attention to implementation problems, particularly in the fields of corruption, the reinforcement of the judiciary, the protection of intellectual property, government procurement and administrative barriers. Solving these problems will require that particular attention be paid to Romania's capacity for policy execution and transparency. The Committee encouraged the authorities to address these problems firmly and to report back to the Committee in one year's time on the progress achieved in the implementation of its institutional and structural reforms.

As an adherent to the Declaration, Romania will become an equal partner in the OECD Investment Committee's related work

As an adherent to the Declaration, Romania will be entitled to participate in work related to the Declaration and Related Acts conducted by the Investment Committee of the OECD. It will benefit from efforts deployed to improve the business environment and the promotion of good corporate behaviour. It will also be able to share its own experience with other key investment players who are signatories to the Declaration, to the mutual benefit of all concerned.