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ROMANIA – NATIONAL COMPETITIVENESS REPORT

UNITES STATES AGENCY FOR INTERNATIONAL DEVELOPMENT (USAID)

J. E. AUSTIN & ASSOCIATES

CENTER FOR INTERNATIONAL PRIVATE ENTERPRISE(CIPE)

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Marriott Grand Hotel

Bucharest, Romania

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AGENDA
CEE REGIONAL COMPETITIVENESS STUDY BRIEFING
"COMPETITIVENESS IN ROMANIA"
JUNE 12, 2001
MARRIOTT GRAND HOTEL
10:00 A.M.-12:30 P.M.

Welcome	Mark T. McCord, CCE Chief of Party CIPE Romania Office
Introduction of Can Tutuncu	Mark T. McCord, CCE
Overview of the Competitiveness Effort	Can Tutuncu J.E. Austin & Associates
Overview of Findings	Can Tutuncu J. E. Austin & Associates
	Dr. Ion Anton Consultant
Discussion Period	Participants
Where Do We Go From Here?	Mark T. McCord, CCE
Closing Remarks	Mark T. McCord, CCE

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Executive Summary

June 2001

USAID

J.E.Austin Associates,Inc.

EXECUTIVE SUMMARY

Introduction

With the objective of supporting the competitiveness building process in Southeast Europe, the Europe and Eurasia Bureau of USAID has asked J.E. Austin Associates, Inc. (JAA) to carry out a Competitiveness Assessment to instigate a National Competitiveness Building Process in Romania, Croatia, Macedonia and Albania. This brief summary recapitulates the main findings of JAA's work in Romania under USAID Task Order No. GBTI-008 of the Nathan-MSI SEGIR GBTI PCE-I-00-98-00016-00 contract.

Economic Overview

Romania's progress in stabilization and reform since 1989 has been limited compared to many transitional economies in Europe. The country's foreign debt burden (accumulated during the transition process after 1989), the impact of the UN trade embargo on Yugoslavia between 1992-95, and most importantly, its adoption of stop-and-go macroeconomic policies have all contributed to *low economic growth, high and variable rates of inflation*, and periods of *severe balance of payments pressures*. In addition, the country's politics has experienced considerable chaos since 1989, and there has been a marked failure to create a consensus within the government and among various member parties on how to implement economic reform. This has contributed to Romania's *sluggish* economic performance over the past decade.

In 2000, Romania witnessed a slight economic recovery driven by growth in exports and investment[1]. For the first time after three consecutive years of decline (1997-99)[2], GDP grew at a positive rate of 1.6%. Exports increased dramatically by 25%, compared to the previous year's 8.4%, mainly reflecting stronger foreign demand, and the impact of a sharply depreciated local currency. Gross domestic investment also increased by 5.5%, compared to the previous year's contraction of 10.8%.[3] The fiscal deficit was slightly higher than in 1999 at an estimated 4.3% due to the Government's increased spending on wages and a shortfall in excise, VAT and social contribution receipts. However, there was also a pick-up of 17% in imports[4], after a decline of 10% in the previous year, and of almost 20% over the 1997-99 period. In addition, inflation had not yet been brought under control, and the average rate for the year remained high at 45.6%. Registered unemployment, which was 10.9% of the total labor force in Romania in 1994, fell to 8.8% in 1997, but is estimated to have been around 11% since 1998. The Romanian labor force is highly educated; but the country's declining birth rate and aging population is expected to put a further strain on its funding of pensions, social security and medical systems.

[1] Sources for the numerical information presented in this paragraph are IMF, EIU and PricewaterhouseCoopers

[2] GDP contracted by 6.1% in 1997, 5.4% in 1998, and 3.2% in 1999.

[3] The leu depreciated by 30% against the US dollar in 2000 and by 25% against the euro.

[4] This increase in imports came as a result of stronger demand for immediate and capital goods as well as higher fuel prices

Overall, significant changes have been made in Romania's laws and legal institutions to improve its investment framework, and to unify the system with international and European standards. However, Romania has faced considerable problems at the implementation level. Examples include persistent corruption, restrictive bureaucracy in administrative procedures such as land/construction permit, cumbersome customs procedures at the borders, poorly trained customs staff, and bureaucratic hurdles in the approval procedures for special types of investment. There is also much room for improvement in the judicial system, including the acceleration of judicial procedures; and better pay, training and status for employees of the judicial system in order to attract and retain high-qualified staff.

Competitiveness Benchmarking

JAA has carried out a competitiveness benchmarking exercise to reflect how Romania ranks relative to the other countries in the Southeast Europe[5], the EU accession countries, the EU countries themselves and all countries of the world for which data was available in the areas that are generally understood to be closely correlated to competitiveness. Informed by competitiveness theory and by the methodologies used by the World Economic Forum, Harvard University and the Institute for Management Development along with its own work in 80 countries over 15 years, JAA has selected 40 indicators related to 8 competitiveness-related categories: economic performance, exports, investment, financial sector, human resources, science/technology, infrastructure and government policy.

The competitiveness benchmarking indicated that although it is a larger country located somehow disconnected from the rest of Balkans with a larger population, Romania shared some of the common institutional problems of the Southeast Europe region. While the country ranked relatively better in the human resources, the infrastructure and the investment competitiveness indicators, it did poorly on economic performance, financial sector and policy environment rankings. The country has a problematic financial sector and a poor record of economic growth. However, the export growth of Romania has shown some recovery over the last couple of years.

Remaining problems are related to instability and conflict in Southeast Europe, Romania's poor domestic financial sector and a policy environment hampering economic growth. In particular, the slow pace of reforms may have further limited Romania's competitiveness. Also typical for Southeast Europe, Romania's financial sector is underdeveloped. However, large foreign investments have shown that Romania's opportunity lies with its comparably large market, human resources and the continued development of a viable export sector. Even though the Government of Romania recognizes the importance of information technology sector, the computer ubiquity is very low in Romania.

With a well-educated workforce and a sound privatization program, the country has not yet managed to garner impressive amounts of foreign investment; and the high amount of inward FDI may be linked to the privatization transactions. Attracted FDI will prove beneficial in the years to come, but did not have an immediate impact to counterbalance

[5] Croatia, Bulgaria, Macedonia, and Albania

the recent recession that hit Romania. The key issues that Romania faces are microeconomic liberalization, which will open up business opportunities, and macroeconomic stabilization, which will lead to hardening of budget constraints. Romania needs to act upon its introduction of reforms necessary for a successful transition that have been delayed due to slow progress of the public sector to move quickly to address the limitations revealed in these indicators.

Competitiveness Constraints

Romania faces various weaknesses in its political and economic environment that can hamper its ability to achieve higher competitiveness, and therefore, better overall economic development. Major constraints, based on JAA's preliminary study of the Romanian economy and industry clusters, are summarized below. It is worth noting that many of these constraints are similar to those confronted by other transitional economies in Southeastern Europe.

General Competitiveness Constraints

- Although the Government has indicated its commitment to furthering economic reform, there is *uncertainty about sustained political stability* in Romania.
- Romania *lacks an action-oriented roadmap* for its development, and the *capacity to translate words into concrete actions.*
- The *quality of law enforcement* is an area of serious concern that erodes Romania's competitiveness.
- Although significant improvements have been made to the legislation and institutional framework, the *deficient policy framework* that is in existence in Romania erodes the country's competitiveness by discouraging both domestic and foreign investors.
- The *banking system in Romania is still weak* with a low level of intermediation, high cost of capital, severe lack of financial discipline, and poor allocation of credit although the banking sector has undergone a reform.
- *Corruption and non-transparent procedures* in Romania are diminishing the country's competitiveness as they reduce its attractiveness as an investment destination.
- Romania's *relatively poor physical infrastructure* is a constraint on its economic development and its competitiveness.
- *Delayed engagement in higher-technology and higher value-added economic activities* is wearing away Romania's competitiveness.
- Private sector's *lack of focus on international and domestic markets* undermines Romania's competitiveness.
- Romania has a cheap labor force, but *lacks a market mentality and management system* as well as *access to information about both domestic and foreign markets* in order to compete better in a new global market context.
- Government's policy-making process *lacks private sector consultation* and policies fail to reflect the concerns of the private sector and hamper its competitiveness.
- *Lack of thrust and bonds between the actors in civil society, between the government and different civil society actors* causes the formal NGOs to have only a marginal impact in influencing social and economic policy.

Industry-Specific Constraints

After consultation with key stakeholders and counterparts in Romania, four industry sectors of key importance to Romanian economy were selected for in-depth analysis. These were export-oriented apparel, information and communications technology, wood and furniture, and tourism sectors. A SWOT (Strengths, Weaknesses, Opportunities and Threats) analysis and a Competitiveness Diamond analysis were carried for each sector. The constraints that hamper the competitiveness of each of these sectors are summarized below:

a. Apparel: Romania has so far relied on the exploitation of a low-cost and labor-intensive strategy to compete with other countries. Like in many other SEE countries, the industry has experienced an erosion of its competitiveness over the past decade. The following are some of the main factors that have contributed to this decline:

- Declining labor cost advantage, due to competition from other low-cost countries;
- Strong competition from illegal imports of finished products;
- Delays in developing and securing a strong access to foreign markets;
- Inadequate information about both domestic and external markets;
- Inadequate access to financing for domestic private firms;
- Lack of product differentiation;
- Lack of foreign investment in the sector, which is considered a crucial source of management know-how, technology transfer, and access to foreign markets;
- Relatively high transportation costs, due to Romania's insufficient infrastructure;
- Inadequate recapitalization and restructuring efforts to infuse new technology into the industry, and to establish industrial linkages that help Romania engage in high value-added activities;
- Lack of strong private sector investment, which is considered a driving factor behind any country's sustained growth and employment generation;
- Lack of strong individual companies that pioneer and lead the technological change and upgrade the processes in the industry;
- Lack of market-oriented management and marketing skills that can improve efficiency in the industry, make Romanian brand names better known in the world markets, and proactively find new markets for Romanian products; and
- Lack of an overall industrial strategy and coordination/cooperation within the industry in order to acquire new technology, share market information, or access new markets.

b. Information and Communications Technology (ICT): Romania has built up reasonable levels of technological capability in the production of both hardware and software following the building of its first computer in 1957. Since 1989, Romania has been trying to further develop the sector, including the gradual liberalization of the telecommunications sector and the encouragement of foreign investor participation in the ICT sector. In recent years attempts have been made to develop legislation that would address a number of e-commerce and e-business related issues. However, the development of Romania's ICT remains limited. Major impediments include the following:

- Limited availability and high-cost telecommunications access;
- The high tax burden on the ICT sector erodes competitiveness of businesses in this sector;
- Need for stronger focus on project management within the state and polytechnic universities' curricula and inadequate access to ICTs as part of the studies diminish the market readiness of the graduates from these schools;
- Lack of capital in the country to support expansion of existing businesses and formation of start-up businesses;
- Inadequate legal and regulatory framework to support the sector, particularly the export software trade;
- Lack of reliable electric power supply, and reliable and pervasive telecommunications infrastructure that links both domestically and internationally, to support Romania's software exports;
- Lack of sizeable or demanding domestic market that can stimulate the sector's development, or attract IT multinationals into collaborative relationships with local partners to serve such a market;
- Loss of students graduating from Polytechnic Universities that leave Romania for better paying jobs in Western Europe, USA and Canada.
- Lack of information about both domestic and foreign markets;
- Limited participation of foreign investors who could introduce new managerial know-how and technology to the industry;
- Lack of entrepreneurship, marketing and management skills that could bring more international exposure and experience to domestic firms;
- Ineffective protection and enforcement of intellectual property rights;
- Limited R&D base, and insufficient investment in R&D for new technologies and software;
- Lack of private sector consultation in policy formulation to support the industry as well as in R&D activities; and
- Need for more proactive policy support from the government to stimulate the growth in the industry and make it internationally competitive.

c. Tourism: Romania's rich natural resource endowment offers many opportunities for a strong tourism development. The sector so far has been following a low-end, low-price competition strategy, and suffers from a lack of quality and strategy that could increase its competitiveness relative to other countries in the region. Major constraints on the tourism industry in Romania include the followings:

- Decline of low-cost advantage due to price competition from other countries in the region;
- Delayed engagement in the high-end and more sophisticated tourism products;
- Limited knowledge of outside markets and high-end product segments;
- Degrading and inadequate infrastructure facilities, including roads, hotels, telecommunications, airports, and utilities;
- Lack of quality market-oriented customer service;
- Lack of management and marketing skills that can increase efficiency, attract more clients, and generate high-end demands for the sector;
- Lack of strong private sector investment in the sector; and
- Absence of an adequate legal and regulatory framework to support the sector.

d. Wood and Furniture: The wood and furniture industry plays a significant role in Romania's economic development. In 2000, furniture exports accounted for 4.6% of total exports, while exports of wood products (excluding furniture) were 5.4%. The industry faces a number of constraints on its long-term development and establishing a competitive position in the global market, which can be summarized as follows:

- Reliance on price-based competition, which erodes the sector's competitiveness over time due to competition from other countries;
- Delayed engagement in high-end and more sophisticated products;
- Weak domestic product design capacity;
- Weak domestic brand names;
- Limited domestic purchasing power;
- Weak producer bargaining leverage due to the industry's low firm concentration;
- Limited knowledge of outside markets and high-end product segments;
- Dependence on few buyers and intermediaries; lack of access to foreign markets and their distribution networks;
- Relatively high transportation costs due to degrading and inadequate infrastructure facilities;
- Lack of quality market-oriented customer service;
- Need to maintain consistency in product quality;
- Obsolete equipment;
- Lack of management and marketing skills that can increase efficiency, attract more clients, and generate high-end demands for the sector;
- Absence of an adequate legal and regulatory framework to support the sector.

Recommendations for Next Steps

Building Romania's competitiveness requires a complex set of mutually reinforcing activities at the level of the firm and the industry cluster, reinforced by policy and institutional action at the national and local government levels. A key barrier to competitiveness is the mindset of people combined with the ability to build social capital of trust and cooperation. Learning from nations that have built prosperity quickly and aided by the foregoing analysis, one can formulate recommendations that deal with the private sector, with the public sector and with the dialogue that connects them. In this process there is also an important role for the institutions of civil society such as business associations, think tanks and social enterprises.

a. Private Sector: Firms in the private sector are in very different conditions and no one set of recommendations applies to all. In general, competitive firms will seek direct exposure to the most demanding customers, clients and markets and adapt their products, services and strategies to respond to the signals that these demanding customers are providing. This requires openness to change and the desire to innovate products, service and processes that respond to these needs.

Romanian firms that have exportable products and services have new opportunities now to serve European markets, but will need to invest in learning how to take advantage of these opportunities. Firms that have non-tradable products and services and that serve the Romanian market only can explore trends in neighboring countries that have longer experience with privatization, liberalization and globalization and selectively test the introduction of innovations in Romania. Firms that are not competitive will need to take stock of their human, capital and organizational resources and then migrate to other market segments or even industries.

Competitiveness also requires the ability to cooperate as a cluster to be able to achieve this as no one firm can do it all. Competitiveness depends on the ability to form good alliances and partnerships. At the industry level, business associations can participate in efforts representing business sector before government.

However, it is important to gather together as an industry cluster—that is the entire value chain plus the related and supporting industries. The industry cluster can then benchmark the industry, develop industry strategies and implement specific action initiatives to boost competitiveness. These will vary by industry. For example, the tourism cluster should formulate specific strategies for attracting higher-spending tourists to Romania and for diversifying the product base that is available. The IT sector should explore initiatives for E-Government, reducing bandwidth constraints, boosting software exports and retaining talented professionals. The textile and apparel sector will need to move beyond its focus on providing assembly labor so as to survive after the expiration of quotas in 2005. The wood and furniture sector should diminish its dependence on a few buyers and intermediaries and increase its knowledge of outside markets.

Business associations, working with the Government of Romania, can develop international trade and investment linkages to get access to markets and technology. However, this undertaking requires greater communication and cooperation between the private sector and the public sector.

Industry clusters can also implement workforce development, human resource and training initiatives by working with education and training providers so that the latter adapt their programs to industry needs.

Another field of activity will be that of research, development, testing and certification initiatives that can add value to the industry while adapting to ISO and similar standards.

b. Public Sector: With regard to policy and institutional reform, this can be analyzed by industry cluster. For example, in tourism there is a need to accelerate the privatization efforts and complete the privatization agenda. The Government should also start implementing ideas such as pilot tourism centers to be opened up in various areas with support of the local administrations and foreign investment or such as development of agro-tourism centers. The industry itself is in the best position to design and implement initiatives to migrate from beach tourism to higher end markets such as theme tourism, adventure tourism, and eco-tourism, but public sector's support to the sector by means of introduction and implementation of appropriate policies is a requisite for increasing competitiveness of this sector.

In the information and communication technology sector, the Government needs to play a promotional role rather than stepping into the shoes of the private sector, as it used to do in the past, or ignoring the private sector and leaving everything to market forces. In this regard, the government should stimulate supply of working capital and venture capital to software firms, and consider changing some of its direct financing in order to provide its contractors with a greater incentive to commercialize the products that have been developed. As the prime source of fundamental skills relevant to software industry development, the Government needs to focus on education and training, mainly on the analytical and managerial skills that the Romanian software industry lacks. Government investment in Romanian software research and development needs to continue and should particularly focus on customization to meet local needs. Subsidizing attendance of Romanian firms at overseas IT exhibitions would help the local software producers who needs information on markets and on potential collaborators within and outside Romania.

Following the example of Ireland, the Government of Romania, with the help of the leading think-tanks in the country should publish an annual Romania Competitiveness Benchmarking report that could provide sound data on Romania's competitiveness in areas related to investment, exports, technology, human resources, economic policy, economic performance and infrastructure. This would help to inform government leaders and also industry leaders with regard to the strengths and weaknesses of Romania relative to other EU accession countries while helping to inform the efforts to set priorities and monitor implementation.

c. Romanian Competitiveness Council: It is recommended that the key private sector leaders establish a Romanian Competitiveness Council (RCC) to institutionalize dialogue between the private and public sectors. This Council would establish priorities for reform and communicate these clearly to Government and then monitor implementation. It would also undertake its own initiatives and help coordinate the work of various industry clusters.

The Council would set the initiatives such as:

- Support the institutionalization of private-public dialogue by identifying the priority concerns
- Conduct annual survey of SMEs and systematically remove bureaucratic constraints to business formation and entrepreneurial activity
- Cooperate with the Government in negotiating access to foreign markets on good terms

In the early months, it would be useful to have encouragement from the Government of Romania and it would be helpful to have technical and perhaps even financial support to jump-start such a Council. The RCC would meet monthly or more often if necessary and would commission specific initiatives designed to build Romania's competitiveness. It would review progress on these and provide leadership and vision.

The Council should work through existing business associations and research institutes and not attempt to duplicate them. It should also build on prior research done on Romanian competitiveness, on policy reform and on specific industry clusters, rather than doing new and repetitive research. The focus should be on action rather than study and on building a self-reinforcing virtuous cycle of private-public cooperation to implement change.

There are many things that must be done to build the competitive advantage of Romania. The recommendations above suggest some of the priorities that need to be undertaken. More importantly, this study recommends a mechanism in the Romanian Competitiveness Council to move to action while building trust and private-public partnership that is necessary to a strong economy and civil society.