The trade-off between the discipline and the economic growth process

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Abstract: The aim of this paper is to analyse the trade-off between various measures of adjustment and correction needed in areas such as fiscal area, external area, etc. during economic crises and recession period and the economic growth objective which would imply countercyclical measures aimed to augment resumption of economic activity. Thus in this scientific article I wanted to realize a diagnostic analysis on the economic evolution of the last 15 years, the analysis focused on the compromise mentioned above and especially on cyclical and structural challenges that have a strong impact on the key macroeconomic variables in a country .

Key words: economic growth, macro stabilization policies, corrective mechanisms.

JEL classification: E 60, E 61, G28;

1.Introduction

After a serious international crisis, cases of interrupted reform and instances of macroeconomic mismanagement (pro-cyclical fiscal policy, inadequate labor market legislation, etc.) as well as non-sustainable growth premises, Romania has experienced a severe economic downturn. The success of some critical reform which should be market oriented are now once again required. In this context, it is necessary to reassess the growth performance of the country and of the entire zone, determine and understand the sources of economic growth and design a clear and coherent strategy for further reforms.

Studies from topic related literature (Loayza, Fajnzyber, Calderon, 2005) demonstrate that structural factors such as human capital, financial depth, public infrastructure and low government burden have a positive impact on sustainable growth process. Also show that macroeconomic instability (high and volatile inflation and real exchange rate misalignment, etc.) and long run growth are inverse correlated and that external shocks (for instance terms-of-trade or capital flows shocks) have a significant negative impact on economic growth.

Central questions surrounding economic growth in Romania:

- Is physical capital investment crucial for triggering growth?
- Is either investment or total factor productivity responsible for the major shifts in economic growth?
- What is the role of structural and stabilization policy reform in such turbulent economic environment?
- To what extent can business cycle movements and shifting external conditions explain the patterns of fall and recovery?
- What is the country’s growth potential?

During 1993-1999 reality shows that capital stock had a positive contribution to economic growth (which was in average 1.2 per year) while TFP and human resources had a negative impact.

During 2000-2004, the economic growth rate was in average 5.4% which is explained by a positive contribution of capital stock and TFP; the contribution of human resources was still negative

Between2005-2008 the economic growth rate registered in average 6.4% and capital stock was the main contributor.

Starting with 2009 the macroeconomic situation deteriorated a lot, registering a real growth rate of -7.1% but with policy measures and IFI’s help things.

Items that have led Member States to sign programs with International Financial Institutions were different, starting from balance of payments difficulties to excessive sovereign debt and banking crisis. In this context , the IMF used specific instruments for balance of payments difficulties (especially Stand -by Arrangement), releasing the amounts necessary to reconstitute the countries' foreign exchange reserves , thus able to cope with capital outflows without triggering a currency crisis or balance flat or without currency depreciation and stopping payments. This was the case in Hungary , Romania , the Baltic countries.

The recovery and the macroeconomic evolution between 2009-2014 will be further analysed.

2. Macroeconomic evolution in Romania

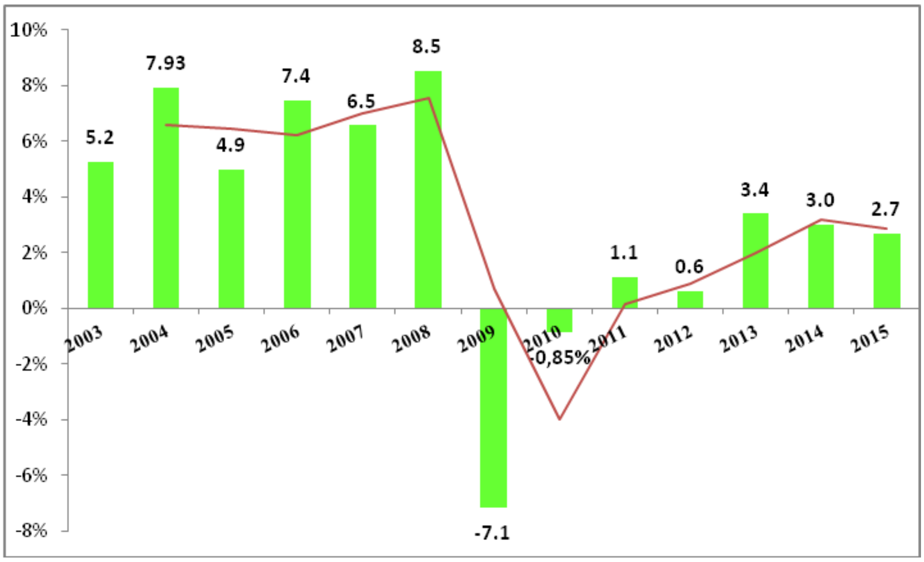
After seven years of high growth rates Romania registered a significant real GDP decrease with a peak of -7.1% in 2009 (Figure 1). After 2 years of negative economic growth rates, Romania rebounded well from the economic crisis with a growth rate of 1.1 percent in 2011, due to macro stabilization policies and IFI's help. Romania had the most drastic fiscal adjustment during programs in comparison with similar countries in the region. The structural deficit improved by 5.5 percentage points of GDP in 2009-2011. Romania had but the weakest starting position, with a structural deficit of -9.5 % of GDP unsustainable in 2009, generated highly pro-cyclical fiscal policy during the years of growth from 2004 to 2008 .

The recovery was led by a rejuvenated manufacturing sector, which contributed towards export growth, and a strong performance from the agricultural sector. Romanian growth remained fragile and easily swung with external factors.

Economic recovery started in 2011 was accompanied by a change in the composition of growth, which began to rely on healthy elements, namely investment and continued growth in exports.

Still, growth reached a 0.6 percent in 2012, having been restrained by a mixture of domestic and external developments. A harsh winter at the start of the year hit the transport, mining and manufacturing sectors as well as retail. A drought resulted in a poor harvest, which knocked an estimated 0.5 percentage points off growth compared with an average harvest. The poor economic performance in the EU, which accounted for 70 percent of Romania's goods exports in 2012, resulted in relatively flat exports in the year. The most important decrease of the volume of activity was recorded by Agriculture, forestry and fishing (-21.2%), by Industry (-2.1%) and by Financial intermediation and insurance (-0.2%).

Figure 1: Real Growth Evolution between 2003 – 2015



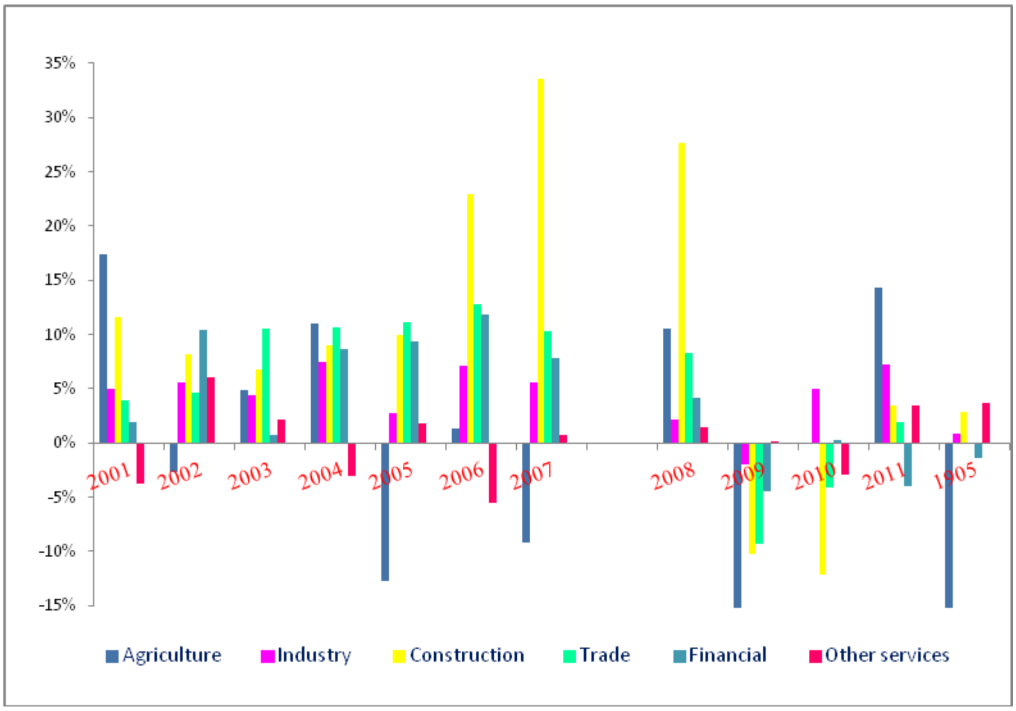
Source: Self calculation based on Eurostat data

After positive growth in the Q2, Romania contracted by 0.3 percent (q/q) in the Q3 and turned to a low positive value of 0.4 percent in Q4 of 2012. The contraction was driven by a poor agricultural harvest (a result of drought). This places annual growth at a modest level of 0.6 percent. Industrial indexes suggest some sectors performed well during the year, notably durable goods, car parts and information technology.

However, industrial production as a whole remains flat (driven by the performance of large industries, such as power generation) and is unable to compensate for the poor agricultural output. In 2013 and 2014 the growth process was more evident registering 3.4 percent respectively 3.0 percent (Figure2). Exports and internal demand were the main drivers but in spite of the real growth rate registered, credit, foreign direct investments and some other variables didn't perform well.

The current account has been rebalancing, even is in 2013 there was a deficit. This small deficit is expected to increase in the next years due to a stronger internal demand which will lead to a bigger demand for imported goods. FDI remains very weak at a level below 2 percent of GDP.

Figure 2: GDP Growth by Components (production side), annual % change

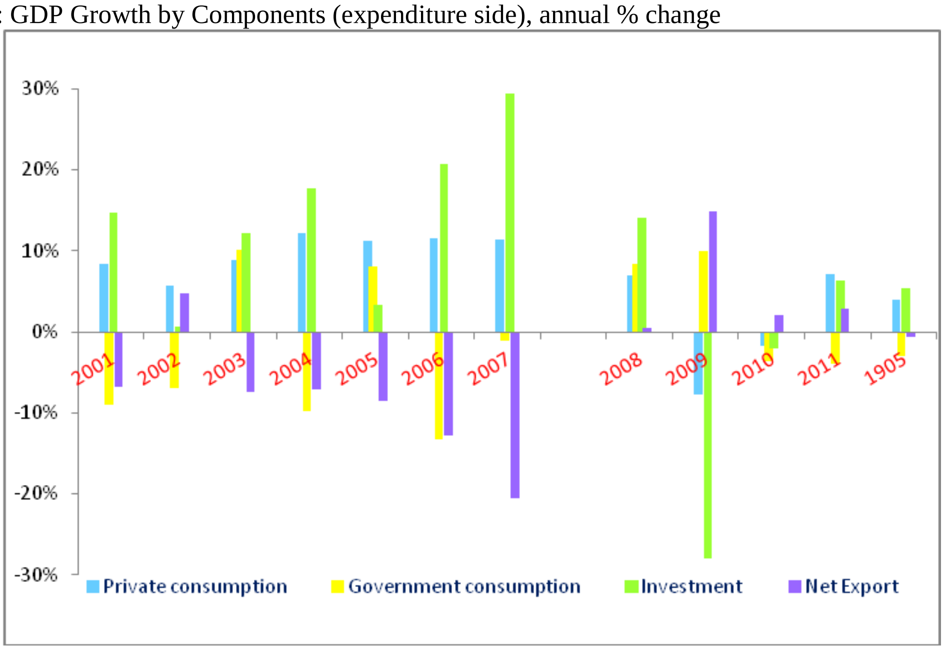


Source: Self calculation based on Eurostat data

The most important decrease of the volume of activity was recorded by Agriculture, forestry and fishing (-21.2%), by Industry (-2.1%) and by Financial intermediation and insurance (-0.2%). The volume of net taxes on products increased by 3.7%. In 2012 total final consumption increased by 0.9% as compared to the previous year, on behalf of the increase by 0.6% of the final consumption expenditure of households and by 1.9% of the final consumption expenditure of government. Gross fixed capital formation recorded an increase, by 4.0 percentage points.

From the expenditure side components (Figure 3), Investments and net exports had a high volatility. After 7 years of negative contribution with large current account deficits, Net exports had a positive contribution in 2009-2011. In 2012, due to a slight increase in internal demand the net export had a negative impact to growth rate of about -0.7%.

Figure 3: GDP Growth by Components (expenditure side), annual % change



Source: Self calculation based on Eurostat data

Since spring 2009 Romania has had financial assistance from International Financial Institutions. The first two agreements were Stand-By and the next one was a Precautionary one which is set to end by September 2015.

Sovereign funding on the markets was completely restored by mid-2011, so were extended maturities of government securities issued by the MFP. International markets were well capitalized. Romania's international visibility has been enhanced by its inclusion in JP Morgan and Barclays indices for emerging markets since March 2013. In addition, fiscal consolidation has helped reduce the structural public financing needs.

Even if the current account, the fiscal deficit, etc. had some important correction, the surveillance of imbalances was still an important task. However, on the ongoing arrangement, there were some negative factors and no review of the program has been successfully completed.

3. Conclusion

Descriptive tools are very important in order to analyze sources of growth which decomposes output growth into pre-identified sources. Also this tools permit to clearly see the long-run sources of growth and growth accounting represents one of these scientific instruments.

As recommendations, Romania should increase the stock of foreign capital and this could be done by:

- Macroeconomic balance preservation
- Reduction of bureaucracy regarding structural funds absorption, business environment, etc.
- Appropriate privatization of certain parts of state own companies

The perspectives for 2015 are positive. Taking into consideration the good evolution of some key macroeconomic variables (as an example the FDI which almost doubled compared to the value correspondent to the same period last year) in the first quarter of the current year and also the business environment perception the growth rate is expected to register at least 2.7%.

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