WHAT IS AT STAKE FOR ROMANIA IN THE PROCESS OF EUROPEAN INTEGRATION?

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ABSTRACT: Economists consider the social impact of the economic phenomena from a somewhat detached analytical perspective. This article argues that the process of economic integration Romania is pursuing requires instead a more compassionate approach as the social burden looms large enough not to be ignored. Romania is not in the position to capitalize in the short run on the economic or political advantages of the EU enlargement. As this argument suggests, the energy and economic policies should be directed in the near future to alleviate the consequences of declining gains from trade and to improve the existing capacity to increasingly compete in similar industries. The road to periphery with its associated effects of economic dualism and widespread poverty does not necessarily imply a geographic location, but failure to profitably take part in regional economic development.

1. Introduction

The increasing exposure of economies to the external environment puts at disadvantage primarily those countries, industries, or companies, which are less adapted to the international competition or reveal a low potential to do so. Globalization is not made by choice, and when market positions become vulnerable the costs overwhelmingly arise in job losses, economic dualism, and stifled innovation. At regional level, the integration process represents a perfect match for the global institutional, economic, and competitive connections, except for its magnified speed and impact.

The option of non-accession to the European Union's structures has not made any sense, if such issue had been ever put forth, irrespective of each side's perspective. For Romania, the cultural bond, including here the attachment to free and democratic values, has epitomized the strongest link to Western Europe for considerably long part of its history, and seemingly held back an equally important option to have developed. For its part, the European Union (EU) is in the enviable position to extend its own legislative body and political and economic practices over such a sizeable area as Eastern Europe, sooner and easier than its possible rivals – the United States and Russian Federation – could have worked out something alike. The economics provides substantial arguments (e.g. Daianu and Vrânceanu) to regard the integration process as a predictable event as well.

But, if integration is but certain, what is at stake in coming economically closer to Western Europe? It is just this familiar sense, which the integration has come to be perceived in, confirmed by one of the strongest popular support in Romania – which is by no means a result of "costs-benefits" analyses – which seriously affect the judgment on the

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advantages of integration. The lack of any plausible alternative in effect obscures what Romania has to lose most as the EU membership comes later rather than sooner.

The present article argues that the social consequences should be seen as imperative in order to appropriately manage the process of integration. Due to the specific circumstances explained here, Romania is not in the position to capitalize either economically or politically on the expected gains in the short run. The social impact is perhaps the most vulnerable issue of the process of economic integration. It gets such an overwhelming importance because of the need to alleviate to the utmost degree the social problems such as poverty, income inequalities, and interest groups' pressure, which are essentially associated with the openness of the economy, and particularly weigh heavily for the Romanian economy.

2. Argument

The European integration is above all an economic issue. Before the accession negotiations started in 1998, an Association Agreement had been concluded in 1993 with a view to liberalizing trade and establishing a free trade area. Since 2002, the objective has been mostly accomplished. The results did live up to expectations by increasing Romanian trade dependence on the EU market to 70% from approx. 30% in 1989.

As far as the bilateral perspective is concerned, this trade evolution is noteworthy as a good part of the economy faces now open competition, and once the Common Customs Tariff is adopted the competitive impact will be positively amplified by further tariff reductions against non-EU member countries.

These influences notwithstanding, there is not much left to benefit from. Free trade is conducive to increased productive efficiency and hence to economic growth, but it is not by itself inevitably correlated to better prosperity, if one understands it as decreasing gaps in economic performances or multiplication of activities characterized by increasing returns. The period of 1993-1996 provides an example at hand, as it witnessed a relatively long economic and exports growth without any significant change in the export structure; income-generating activities on the external markets performed at the same low parameters. A recent analysis (Zaman) confirms this statistical evidence.

The competitive disadvantages against the Western firms diminish further the positive prospects. Ample and time-consuming mechanisms are required to adjust this imbalance, provided that the policy measures are most appropriately chosen. Romania's position in the EU's economy is relatively small – 0.6% of exports, 0.4% of imports, and 0.5% of the GDP – and probably stagnant in the long run. Despite the remarkable foreign trade growth rates Romania has lately evidenced, countries with export volumes thrice as large (e.g. Poland, Czech Republic, and Hungary) achieve comparable, if not bigger, growth rates.

From a global perspective and excepting the commercial costs, it is however more suggestive to note that the increasing trade dependency within the European integration does not provide for the most promising sources of growth. Romania predominantly concentrates its sales on a market where economic growth has been and will remain lower than the US' and much lower still than those of several dynamic Asian economies. The better economic potential other regions present is reason of concern by virtue of the presently inescapable nature of trade geography. From 1990 to 2001, the annual average imports growth rate in Western Europe was 5.7%, but reached levels of 8.1% in USA, 15% in China, 9% in Malaysia or 8% in Philippine (WTO). In the last 20 years, the annual average growth rate was 2.3% in EU, but 3.3% in USA. The 2000 Lisbon Agenda, a promising commitment of the EU member states to create the most competitive economy in the world over the next decade, increasingly disappoints in the absence of major reforms and provides for criticism both within and outside the Union (The Economist *Still Sclerotic...;* Miklos).

As for the political aspect of the European integration, Romania's options are decisively dominated by the NATO membership. This external engagement implies relationships with the US as much truthful and dedicated as within the European space.

If further improvement of the democratic life were envisaged as a political objective, that would be considerably below one could reasonably expect from being part of the EU political structures since it basically relies on the domestic election system. On the other hand, an influential role inside the European politics would probably represent too ambitious a goal if one took into account the present power balance in Europe and, more relevant, the own assumed delayed accession deadline of 2007 at the earliest.

Besides, a positive impact on the domestic political life would have been substantial enough had it not been lost the possibility to get more favorable concessions during negotiations. The opportunity slipped away under circumstances which did not allow the start of the accession negotiations between the EU and the candidate countries *as a group.* Although the EU discussed bilaterally most of its external agreements, the rule does have notable exceptions, as are for instance the negotiations of the European Economic Space with EFTA and of the Association of the Overseas Countries and Territories. The 12 Eastern European countries and Turkey stand as the EU second biggest commercial partner after the US, and for this very reason a common negotiating agenda would have left each of these countries better off in contrast with the case of bilateral negotiations that actually emerged.

Due to the expected benefits, the economic and political linkages may play a decisive role for Romania to consolidate its position within the EU in the long run, but they are nonetheless only a meager incentive to mobilize the energy and to define the policy so that the integration process, once initiated, will be advantageously completed. The trade and production structures developed in relation with the EU member states however point to several areas of utmost interest as regards the integration impact in the near future. They predominantly refer to social problems and address such issues as income distribution and prosperity.

3. The economics of integration and the social impact

The experience of previous enlargements eloquently shows that the convergence or bridging the gap between the new entrants' and the EU's average level of prosperity – though precariously measured by the GDP level per capita – does not necessarily eradicate, but can even deepen the regional problems and the unequal income distribution. Studies of Lima, Storper et al. and Hamilton et al. are illustrative in this respect. The importance of this subject for Romania stems from two origins: the complementary trade and relocation of production as a result European-wide decreasing commercial costs.

Complementary trade

Romania's economy relies to a considerable extent on the external trade, and, because of its share, especially on the relationship with the EU: exports and imports amount to approx. 75% of GDP value. As immediate consequence, factors' opportunity costs and utilization are highly dependent on foreign trade. The strength of this dependency is not by itself a negative development, but the characteristics of commercial flows may be nevertheless indicative of its economic impact.

Statistics presented in Annex point to limited possibilities for the economy to assimilate superior gains from trade and widespread benefits of prosperity. The trade structure with the EU features high shares of complementary flows, where exports are primarily based on low-manufactured goods and imports on high-valued goods. Sales are mainly concentrated on products with low-income elasticity of demand, which may explain exports increases in times of recession, but only in correlation with marginal profits as they are assimilated with necessities.

Another characteristic of the main exports industries – textiles, clothing, and footwear – is the lowest level of wages their laborers earn among the other employees in the tradable sectors. Export jobs admittedly offer relatively better earnings perspectives – for instance, in USA estimates show export earnings approx. 17% higher than the average level in the economy – precisely because they allow for specialization according to comparative advantages. The relatively more productive factor employment in the domestic market is valued better on the external markets. Contrary to this prediction and common sense business expectation, the Romanian economy witnesses an evident loss of these advantages while nurturing impoverishing structures of trade and production. The "minimal wage" syndrome in the export industries takes a considerable part in explaining the delay in productive restructuring.

On the other hand, for the cases where the intra-industry trade appears appreciable exchanges are mostly vertical in nature – similar but qualitatively different goods change hands – between industries belonging to the same branch. If horizontal intra-industry trade – exchange of substitute goods of similar quality – had been instead the case, the evolution would have been illustrative of actual convergence with the EU productive structures and of better resilience to competitive pressures. Research available (Aturupane et al.) points to an appreciable gap as to the horizontal trade index against several Eastern European countries (e.g. Czech R. and Slovenia), although the disparity somewhat attenuates as to the rest ex-communist countries.

Noteworthy differences however remain (Exhibit 1). The proportion of two-way trade is markedly diminished on the segment of higher processed goods as compared with the most accession candidates. Besides, Romanian industries compete with the EU ones only to a negligible extent, both in exports, and especially in imports. Elementary reasoning shows that complementary trade may have different nuances of impact, but the social issues it engenders as reflected by minimal wages, idle productive capacities, unemployment, and factor immobility are prominent and sources of potential political conflict in all cases.

The inherently gradual evolution of the productive and trade structures does not allow the import-competing industries to employ in the short run advanced and well-remunerated factors, as are for instance highly qualified labor, knowledge, investments and innovations. It is for this very reason that the commercial flows lay a supplementary burden on the social problems, as long as they are based on different occupational structures between exports and imports, with notably dissimilar qualifications and incentives. Besides, political and academic opinions (quoted by The Economist *Drowning...*) draw attention to the neglected issue of regional aids, object of various pre-accession programs, which may perversely distort the resource allocation by encouraging activities not necessarily aiming at a better factor utilization locally, but the opportunistic exploitation by local entrepreneurs of temporarily subsidized funds.

An economy capable of taking part in proportionately more intense similar trade or intra-industry trade is little exposed to those problems as it creates greater scale productive opportunities. History tells that transformation of economic structures is time consuming, and hence the associated social problems remain severe.

Production location [1]

Economic integration calls attention to another issue of concern: clustering of production and trade around traditionally developed business and productive networks. The adoption of the common customs tariff (CCT) and of the rules regarding free movement of factors induce unevenly dispersed opportunities for growth from the mere fact of being part of a greater customs territory.

Trade costs constantly fade away and thus create increasingly accurate opportunities to assess the economic attractiveness of various regions by a wide range of indicators: purchasing power of population, extension of technological networks, informational stock, average qualification of labor, innovative capabilities etc. The technological characteristics of the new production processes converge to deepen existing specialization by clustering production around regions with favorable prospects for further development. Industries tend to cluster in particular areas thanks to location external economies, such as specialized providers of inputs or uniquely specialized labor market and knowledge generation. Disparities in potential of this sort are the main sources of gradually but regularly disconnections among regional developments.

It could be the case that some industries be better situated than others and thereby inherit historically location advantages; or it may be that some regions come closer through integration – by diminishing transaction costs – to markets, which disproportionately attract a bigger slice of the productive pool of factors (labor, innovation, technology and so on). A prevalent view is that Romania participates to the enlarged European economic space largely at competitive disadvantage as regards both external trade, and foreign investments. The two areas of trade and investments are closely linked by business decisions to develop production and employ factors in a particular location. How does the market assess

[1] This part partly draws on Ciupagea et al., III.3, 62-69.

Romania's opportunities so that to offer clues as to the integration in the European structures of commerce and production?

Romania is in the position to manage the change from a commercial partner to a regional player in the European economy. That emerging perspective is important: the sources of prosperity, and hence of lessening regional developmental problems at a national level, increasingly rest on the successful integration of economic sectors in regional productive networks rather than some ambiguous effects of domestic economic policy. Experiences of Spain, Portugal, and Ireland, where declining regions coexist with some others flourishing, are illustrative of the misleading association between geography and periphery. The latter is more appropriately understood in terms of manifest failure of regions and industries therein contained to benefit from the most advantageous productive and commercial networks essential for spreading prosperity at a regional level.

Several recent researches (e.g. Ciupagea et al.; Sachs et al.) underscore that underlying commercial, economic, and geographic circumstances leave Romania better positioned to benefit from the advantages of regional integration within the South-East Europe, both with the EU members, and the candidate countries. To put it differently, the businesses' decisions are to evaluate by and large equally the opportunities revealed by this economic space. This perspective helps deepen the horizontal intra-industry trade, that is, products qualitatively distinct from other competitors, because it sharpens the competitive advantages among similarly developed industries.

New industries and part of traditional ones alike see the market growth potential small not only compared to national boundaries, but to an entire region as well. The automotive industry offers an example. Estimates indicate an Eastern European market share of 13% of Western European companies' sales no sooner than 2012 (The Economist *European Carmakers...*). Yet, the investors' decisions already discriminate among markets by choosing different locations for their production centers despite comparable labor costs: expensive Peugeot Citroën and Toyota models assembled in Slovakia and Czech R., while more popular Renault models start up from Romania.

The new regional determinants of competitiveness do not transfer by themselves the burden of losses to certain locations. As the previous example shows, it is the exploitation of the existing potential which matters and that in as many as possible industries. There is not within easy reach to find the appropriate ways of improving the competitive standing of industries by redirecting attention and policies to economically distant countries which Romania does not possess either the right location, or the capability to engage mutually flourishing trade with. Trade liberalization with the EU just makes this opportunity more discernible as it allows companies to choose among different locations according to their existing and prospective advantages.

4. Conclusions

The challenges of complementary trade and production location outline a less evident context to discuss on the current advantages and disadvantages of the integration process and point out some policy recommendations. Firstly, the impact on factor employment and particularly on labor should be checked by an adequate administration of structural funds and generally of pre-accession financial instruments (SAPARD, ISPA, PHARE). The objective to alleviate the social burden is directly opposed in the short run to the harmful consequences generated by commercial exchanges. The conclusion is however qualified by the specific role those funds play to only counterbalance as much as possible the social impact; they do not guarantee a prosperity surplus, but the conditional support to bear inherent losses. Romania will probably benefit from the largest amount of structural assistance in the EU history, and that speaks eloquently enough about the urgency of Romania's social problems at the Community level even in absolute terms.

Secondly, the internal effort should be supplemented with work on common programs between the government and business community in order to optimally exploit the most productive local factors. There is a documented risk that transferring funds to a region may distort resource allocation and consequently diminish in the long run the gains from the most efficient factor employment.

Thirdly, the institutional development to expand regionally similar trade flows is deemed to have a positive economic impact with positive social consequences. The challenge here is to eschew potential ambitions to compete with economically distant economic regions at the expense of a more considerate approach to the opportunities to integrate production inside zones of equivalently economic potential. A possible solution would be working out selected regional programs to cooperatively promote investments and trade projects with countries as much attractive as regards the relatively abundance of factors and productivity levels. If taken separately, countries and industries enjoy only limited resources, at least in contrast with rivals from developed countries, to successfully deploy marketing strategies or widen their distribution channels. Besides, individual market shares of products with comparative advantage are insignificant. It is for this reason that ventures to jointly deploy sales or promotional efforts, for example in the case of a mutually favorable tourism location, would arguably enjoy better market reception.

Frequent examples of countries, regions, or companies suggesting cooperative initiatives paved already the way in favor of a consistent policy model. A short list of international experiences will include at least the common stance adopted by the CAIRNS group within the framework of WTO agricultural negotiations; the economic development policy of Catalonia, a Spanish province, where the local government, universities, and business community converge their interests to the benefit of regional prosperity; the marketing links and acquisition policies lately undertaken by wine producers in USA and Australia to oppose the competitive threat from such countries like France, Italy or Chile.

Finally, against this background of complex economic and social evolutions, Romania experiences a process of assimilation of Community standards, such as quality and environmental norms, financial discipline and fiscal rules, which develops to an unparalleled extent. Because of unpredictable capability to appropriately assimilate such a huge legislative and policy body, the impact looms obviously ambiguous in the long run. An analogy can be drawn as regards the competitive ability of Romanian industries to adapt to the circumstances of an enlarged market.

It is the main point of this article that all these ongoing processes are hardly beneficial on the short term, while the benefits are conditional on the quality of transformation on the long term. However, an immediate and discernible benefit can be enjoyed if the socially negative effects inherently associated with open competition are successfully counterbalanced. Passing by the 2004 accession momentum creates a disadvantage just because leaves Romania beyond an economic space which it will however adhere to. The social stake would be a harmful consequence of integration if ignored since it is the only economic policy area which real and beneficial influence can be exercised on in the immediate present.

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Annex

Exhibit 1: Comparative view on selected CEECs' trade structures with EU (2000)

Main products in **exports**	% of total	Intra-industry trade intensity*	Main products in **imports**	% of total	Intra-industry trade intensity *
Romania					
Articles of apparel and clothing	33,8	164,1	Textile yarn, fabrics	16,4	20,2
Footwear	11,3	147,7	Electrical machinery	9,6	65,2
Furniture and parts thereof	5,5	178,2	Road vehicles	6,5	28,6
Electrical machinery	5,3	65,2	Telecomm., sound recording apparatus	6,5	75,6
Telecomm., sound recording apparatus	4,5	75,6	Articles of apparel and clothing	6,5	164,1
Iron and steel	4,4	147,3	Machinery specialized	5,1	24,3
Non-ferrous metals	4,2	167,5	General industry machinery	4,9	61,3
Poland					
Road vehicles	11,4	81,5	Road vehicles	11,4	81,5
Furniture and parts thereof	8,3	169,6	General industry machinery	7,4	40,4
Articles of apparel and clothing	7,9	163,1	Electrical machinery	6,9	81,8
Electrical machinery	6,9	81,8	Textile yarn, fabrics	6,0	44,6
Power generating machinery	6,5	130,1	Machinery specialized	4,7	36,7
Manufactures of metals	5,3	96,3	Telecomm., sound recording apparatus	4,4	65,9
Slovakia					
Road vehicles	21,5	112,9	Road vehicles	17,7	112,9
Electrical machinery	9,7	101,2	Electrical machinery	10,1	101,2
Articles of apparel and clothing	6,9	170,7	General industry machinery	6,7	90,4
Iron and steel	5,9	154,1	Textile yarn, fabrics	5,9	71,4
General industry machinery	5,2	90,4	Power generating machinery	5,2	57,0

Hungary					
Power generating machinery	13,2	156,4	Road vehicles	18,1	72,6
Telecomm., sound recording apparatus	11,8	129,4	Electrical machinery	13,2	91,8
Electrical machinery	11,8	91,8	Office machines	6,4	122,1
Road vehicles	10,8	72,6	Telecomm., sound recording apparatus	6,1	129,4
Office machines	10,5	122,1	General industry machinery	5,1	64,1
Articles of apparel and clothing	4,8	143,2	Textile yarn, fabrics	3,8	48,6

* The index can vary between 0 and 200: 0 means only imports, 200 only exports and 100 means balance in trade (Index: (((x+m)-(x-m))/(x+m))*100).

Source: Parliamentary Documentation Centre/European Parliament, **Task Force Enlargement. Statistical Annex** , March 2001.