THE EVOLUTION OF THE MARKET ECONOMY

Paula – Angela VIDRASCU
The Bucharest University of Economic Studies, Bucharest, Romania
vidrascupaulaangela@yahoo.com

Dana Mihaela NICULESCU
Hyperion University, Bucharest, Romania
niculescudana.hyperion@yahoo.com

Miron DUMITRESCU
National Institute of Economic Research - Romanian Academy, Bucharest, Romania
miron_hyp@yahoo.com

Serban TARANU
Hyperion University, Bucharest, Romania
taranus35@yahoo.com

Abstract:

GDP is a macroeconomic indicator reflecting the market value of all goods and services intended for final consumption only, not for intermediate use, produced in all branches of the economy within a country over a period of one year and it is the sum of private consumption, investment, government expenditure and the gross difference between exports and imports. Equals the sum of the final internal use of goods and services (final consumption and gross capital formation), plus exports and minus imports of goods and services.

It is also equal to the sum of gross value added of the various institutional sectors or the various branches of activity, plus the VAT net taxes on products and imports, but also the amount of remunerations of employees, gross operating surplus of exploitation and taxes on production and imports less subsidies.

Poland, the only country in Eastern Europe which has not been in recession, was actually the only country where there has been a growth in 2009, 1.2 per cent during the year, and 3% in the last quarter.

The economy of Poland, the biggest country in Eastern Europe member of the European Union, has slowed in the last few months of 2009, as the global economic crisis has reduced demand for exports from Poland.

Inflation remains the main critic of the Romanian economy. Failure to comply with this criterion involves the lack of sustainability of macrostabilization of the Romanian economy.

Keywords: *market economy, GDP, inflation, investment, development.*
JEL codes: G11, E6, E43.

1. Real GDP development in Romania and Poland

GDP is a macroeconomic indicator which reflects the market value of all goods and services intended for final consumption only, not for intermediate use, produced in all branches of the economy within a country over a period of one year and it is the sum of private consumption, investment, government expenditure and the gross difference between exports and imports. Equals the sum of the final internal use of goods and services (final consumption and gross capital formation), plus exports and minus imports of goods and services.

It is also equal to the sum of gross value added of the various institutional sectors or the various branches of activity, plus the VAT net taxes on products and imports.

Last but not least, it also sums the amount of remunerations of employees, gross operating surplus of exploitation and taxes on production and imports less subsidies.

1.1. The first stage of the Romanian economy: Years of decline (1990 - 1992)

In the first three years after the revolution, Romania's gross domestic product fell to 858 billion. ROL (40.8 billion dollars) in 1990 to 6 trillion old lei (19.6 billion dollars) in 1992. Subtraction is not evident if we look at the value of GDP in ROL, national currency devaluing strongly at the time, but things become clearer when comparing the equivalent amounts in U.S. dollars.

1990 was also a year in which GDP has fallen in real terms with 5.6% compared to its value in 1989. GDP per capita in 1990 had a value of 37 thousand lei per inhabitant.

At that time the share of industry in GDP was worth 40.5%. Agriculture occupied the second place after the industry in forming GDP, with a value of 21.8%. Transport and communications followed, down from the previous year. Consumption of the population and of public administration increased that year to 65% of GDP.

In **1991**, GDP was 2.2 trillion old lei (28.9 billion dollars)-a new decrease. Most sectors posted declines. Thus, in the industry sector is observed a decrease compared to previous years, to 37.9%. Construction also recorded a value of 4.4%, the lowest of the 90's. Agriculture sector complements the structure of GDP by a percentage of 18.9 also declining.

1.2. Second stage: Years of stagnation or slight increase (1993 - 1999)

Overall, the Romanian economy [4] has increased during this period from a GDP of 6 trillion old lei (19.6 billion dollars) in 1993, at 545 trillion old lei (35.6 billion dollars). Again, the leu devaluation can confuse when amounts in lei are compared, the increase expressed in U.S. dollars over the period of seven years was just 16 Bil. dollars. Noting that midterm (1995-1997) Romania GDP virtually stagnated at around 35 billion. dollars.

Gross domestic product in **1994** had a face value of 49.7 trillion lei, in real terms, increasing by up to 3.9% compared to the prior year. The industry has again had the largest share in GDP, of 36.2%, up 3.4 percent from the previous year. Agriculture was in second place, with a value of nearly 20%, but down about 4 percent over the previous year.

In **1998**, Romania's GDP was of 338 trillion lei (38.1 billion dollars) with an important role for the services sector. Construction sector [3] experienced a period of regression, contributing to the formation of the gross domestic product with 5.2%. A decrease in the GDP has been felt in the sector intended for agriculture, with a value of 16%, 2% lower compared to the previous year. Agricultural activity was badly influenced by the costs of restoration works after flood and storm disasters, by decreasing efficiency in the livestock sector and modest harvests that were obtained compared to previous years.

1.3. The third stage: Years of growth or formation of the economic "bubble" (2000 - 2008)

In the period 2000-2008 Romanian GDP has climbed from 80.3 billion new lei (40.2 billion euros), to 503.9 billion new lei (136.8 billion euros).

The gross domestic product [3] created in **2000** has reached its nominal value of 796,533.7 billion lei and was, in real terms, 1.6 percent higher than in the previous year given that the country's population continued to decrease. The largest contribution to the formation of total gross value added was owned by services (52%), followed by industry (31%), agriculture and construction.

According to the National Bank of Romania, in **2003** the Romanian economy continued favorable trends from previous years in terms of economic growth, disinflation, control the budget deficit and reduce unemployment.

2006 was the sixth consecutive year of economic expansion, with gross domestic product increasing by 7.7%, up from 34.2 billion. new Lei (97.1 million euros). Again, the services and industry were the main engines of growth, with a share of over 73% of GDP. At the same time, the agricultural sector has reduced its contribution to the GDP formation, being prevented from raising important construction sector. The main contribution to GDP growth in 2006 came from the services branch, with about 47%, followed in order, with a share of industry in GDP growth of over 22%, and construction by about 16%.

2008 was the last in which the Romanian GDP has grown, the advance being 7.1%, to 503,9 billion. new Lei (136.8 billion euros). Economic growth, though drastically limited in the last quarter was 1.1 percentage points higher than in 2007, supported by the increase in volume of work and, therefore, the gross value added in agriculture, forestry and fisheries (+ 21.4%) and construction (+ 26.1%) whose contribution to the GDP was 17%.

1.4. Fourth stage: the recession years (2009 - present)

Technically, Romania went into recession in 2009, when seasonally adjusted GDP had fallen for two consecutive quarters compared to previous quarters. In **2009**, gross domestic product was 491,2 billion. new Lei (115.9 billion euros), down 7.1 percent compared to 2008. Many have considered this year were corrected the excesses of previous years, which recorded a sustained growth of the economy.

Table 1. *The evolution of real GDP in Romania and Poland in the period 1990-2013*

YEAR	Romania	Poland
1990	2,6%	4,8%
1991	2,2%	5,2%
1992	1,8%	6,3%
1993	2,3%	4,9%
1994	2,2%	5,1%
1995	2,5%	5,4%
1996	3,5%	6,2%
1997	-4,6%	7,1%
1998	-1,9%	5%
1999	-0,2%	4,6%
2000	2,5%	4,3%
2001	5,8%	1,2%
2002	8,6%	1,5%
2003	5,7%	3,9%

2004	9,1%	5,4%
2005	4,8%	3,7%
2006	8,5%	6,3%
2007	7,9%	6,8%
2008	9,2%	5,1%
2009	-5,8%	1,6%
2010	-0,6%	2,9%
2011	2,8%	4,5%
2012	0,8%	2%
2013	1,2%	1,6%

Source: Eurostat [7]

This data could be shown as the chart in figure 1:

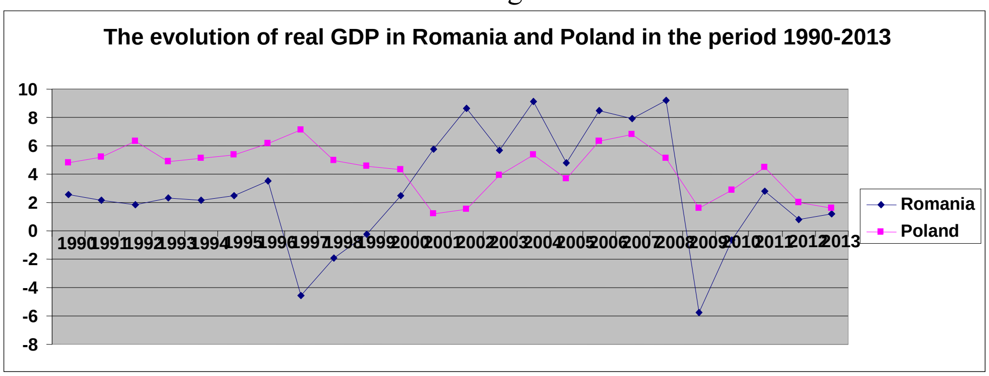

Figure 1. *The evolution of real GDP in Romania and Poland in the period 1990-2013*

Source: Eurostat [7]

In 2014, Romania’s gross domestic product growth should speed up to 2.2% (similar to the forecast in January) and in 2015 in Romania's economy would register a growth of 2.7% (compared with 3% estimated in January).

Romania's current account deficit is expected to reach 3.7 percent of GDP in 2013, to 3.6 percent of GDP in 2014 and 2015, after in January the World Bank estimated that the current account deficit in 2013 will be 4.3% of GDP, 3.9% of GDP in 2014 and 3.7 percent of GDP in 2015, compared to 3.8 percent of GDP estimated for 2012.

Poland has seen uninterrupted economic growth over the past 14 years (according to data published by Eurostat), the country's economy being on plus including in 2009. During this period, GDP per capita increased from 3,200 to 9,500 euros, then dropping to 8,500 euros last year amid more than 20% devaluation of the zloty.

2. The analysis of inflation in Romania and Poland

The status of the National Bank of Poland (the BNP) explicitly states that its ultimate objective is price stability, the Central Bank being empowered to support other objectives of economic policy only to the extent that they do not threaten the primary objective.

However, it can be concluded that at the time of the adoption of the strategy of direct inflation targeting (and even in the first year of operation of the new strategy) this precondition was not met, the *crawling band* mechanism imposing virtually a second objective, with respect to the exchange rate.

In 2006, the inflation rate in Poland was 1.4%, and the unemployment was 12.8% compared with 1.5%, 6.7% in the Czech Republic. The country's gross domestic product grew by 6.2%, being preceded by a 3.3% growth in 2005 and 5.4% in 2004.

Poland, the only country in Eastern Europe which has not been in recession, was actually the only country where there has been a growth in 2009, 1.2 per cent during the year, and 3% in the last quarter.

The economy of Poland, the largest EU member state in Eastern Europe, has slowed down in recent months as the global economic crisis has reduced demand for exports from Poland.

With a growth rate of over 5% per annum, the Polish economy has grown by more than half since 1989, significantly transforming living standards and attracting public support for new reforms.

Latest estimates by the Central Bank of Poland indicate a growth of 3.1 percent this year and 2.9 percent in 2011. Recently, the Central Bank in Warsaw forecasted that the gross domestic product (GDP) will advance in annual rate, with 3.2% in the second quarter.

The rate of inflation of the zloty [5] is quite stable due to the BNP's policy of stabilizing the currency. From 2006 to 2013 the rate of inflation exceeded for three times the norm established by BNP, as follows: in 2007 inflation has exceeded the norm established with 0.5 p.p., in 2009 with 0.2 percent, while in 2010 it was 0.1 p.p. under the norm defined by the BNP.

Polish banks offer quite low interest rates for time deposits, due to the stability of the inflation rate, but also due to banks' policies to create as many deposits in euros as possible.

The average rate for deposits in the Republic of Poland between 2006 and 2013 is 4.23% which is much lower than the average interest rate in Romania which is 11.39%.

According to the inflation rate and interest rates for term deposits Romanian citizens in the case of purchase of a deposit in January 2013 for a year would gain 3.95% of the initial amount, and in the case of Polish citizens they would have increased savings with 2.2%.

In terms of credits, although the Poles have lower inflation rate and interest rates, for short-term loans interest rates are pretty high.

Interest on loans to legal entities is much smaller than in the case of individuals, thus some consumer loans in Poland may have interest rates similar to consumer loans in Romania.

Table 2: Evolution of inflation rate in Poland and Romania between 1990-2013

YEAR	INFLATION RATE - % Romania	INFLATION RATE - % Poland
1990	5.1%	2.8%
1991	170.2%	3.4%
1992	210.4%	4.5%
1993	256.1%	15.2%
1994	136.7%	12.2%
1995	32.3%	14.8%
1996	38.8%	15.9%
1997	154.8%	18.2%
1998	59.1%	17.5%
1999	45.8%	21.5%
2000	45.7%	19.5%
2001	34.5%	17.8%
2002	22.5%	22.2%
2003	15.3%	18.6%
2004	11.9%	14.2%
2005	9%	16.2%
2006	6.56%	13.8%
2007	4.84%	14.2%
2008	7.85%	12.8%
2009	5.59%	10.1%
2010	6.09%	9.8%
2011	5.79%	8.9%
2012	3.33%	7.2%
2013	3.98%	6.5%

Source: Eurostat [7]

This data shows as the chart in Figure 2:

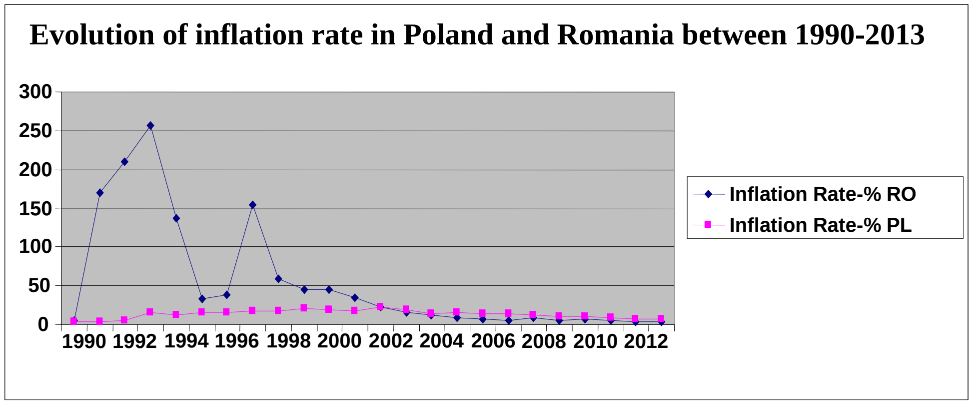

Figure 2. *Evolution of inflation rate in Poland and Romania between 1990-2013*
Source: Eurostat [7]

Inflation [2] remains the main critical feature of the Romanian economy. Failure to comply with this criterion involves the lack of sustainability of macrostabilization of the Romanian economy. According to BNR statute (Law No. 312/2004), "the fundamental objective of the National Bank of Romania is achieving and maintaining price stability."

In Romania, inflation based on the CPI (December/December) fell from 40.7% in 2000 to 8.6% in 2005, 4.87% in 2006, then increased at 6.57 percent in 2007, 6.3% in 2008, and then drops to 4.57% in 2009. Year 2004- when there has been recorded an inflation of 9.3% - was the first year with an inflation rate expressed through a single figure in the period after 1990, confirming the disinflation trend of recent years.

However, Romania remains one of the EU member states which record a relatively high level of inflation in comparison with other members.

In 2008, the world financial crisis has generated widespread sense of mistrust and significantly increased investors' aversion to risk. [1]

The size of the current account deficit, banks' reliance on foreign funding, the need for relatively large external financing and the high ratio between loans and deposits in foreign currency have made Romania a risky economy for investors.

Calculations showed that for 2009, Romania could have a funding shortfall estimated between 7.5 and 16 billion euros, depending on the feelings of foreign investors and their desire to renew the funding of banks and private companies. These negative feelings were reflected in devaluation of the Leu between October 2008-February 2009.

In these circumstances, the authorities have decided to promote policies that ensure minimum foreign funding cuts of Romania.

Accordingly, in this new context, the Central Bank policy [2] concerning interventions on the foreign exchange market has been guided by the philosophy that a high volatility of exchange rates is harmful for both the objective of inflation, as well as to the health of the real and financial sectors.

A small-sized emerging economy and with a significant degree of openness is permanently exposed to the danger of certain capital movements with potential to destabilize the financial market, especially the currency.

Currency interventions have had in mind in the first place to avoid an excessive depreciation of the national currency, while the level and pace of devaluation should be linked with progress in the adjustment of the current account. In order to achieve this goal, the Central Bank has followed the evolution of the actual real exchange rate in conjunction with the external competitiveness pressures stemming from wage negotiations progress. The interventions have been calibrated according to the evolution of the foreign currency reserves.

3. Foreign direct investments - comparative analysis: Romania versus Poland

Foreign direct investments, the expression of expanding policies of companies with great economic power, have appeared once with the initiation by such companies of programmes which were targeted to penetrate foreign economies for the purpose of opening of subsidiaries which have led to the emergence of the first transnational corporations.

The emergence of transnational corporations as an expression of the accumulation of capital, of its concentration, reflected in the increasing economic power of these societies is inextricably linked to direct investment activity in other states.

Multinational companies [2], the leading actors of the international process for resource allocation, reorganize the regional division of labour within an economically integrated range by modifying production locations within this area according to the distribution of comparative advantage.

The process of economic integration may enhance the locanion specific benefits of the states' markets by distributing them among the markets, thus providing new opportunities for profit growth through productive activities within the integrated economic area.

Table 3: *The evolution of foreign direct investment in Poland and Romania during the period 1990-2013*

Year	Value (million euro) Romania	Value (million euro) Poland
1990	2,256	941

1991	3,081	1,082
1992	3,445	1,892
1993	3,486	1,956
1994	3,125	2,058
1995	4,128	2,089
1996	5,598	3,082
1997	6,177	3,178
1998	7,188	3,456
1999	7,256	3,285
2000	7,645	3,489
2001	8,452	3,529
2002	9,125	3,588
2003	9,662	3,689
2004	15,040	10,353
2005	21,885	6,212
2006	34,512	11,197
2007	42,770	12,459
2008	48,798	14,281
2009	49,984	15,082
2010	52,585	22,098
2011	54,265	31,074
2012	59,126	42,088
2013	62,145	51,988

Sursa: Eurostat [7]

Graphically, this will look like the following chart:

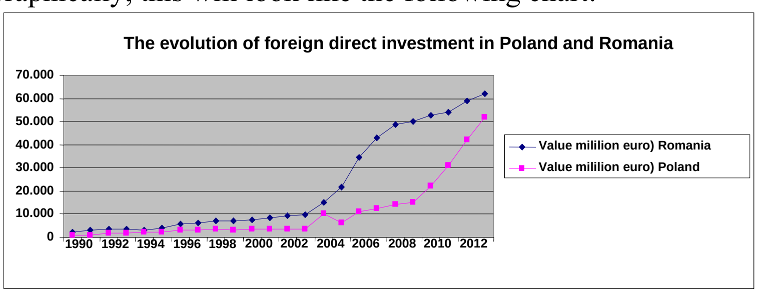

Chart 3. *Evolution of FDI in Romania and Poland in the period 1990-2013*
Source: Eurostat [7]

As shown in the table above, the decrease in private investment was nearly 3% of GDP, while increasing private savings was less than two percent. In fact, the change of private savings was lower and that of investment was higher. However, between the two periods there was a different situation, negative changes being recorded both in private savings, as well as in private investments.

With regard to Romania's progress during this period, it has attracted the most foreign direct investment in South-Eastern Europe, about half of their total for this region. [6]

Romania has had inputs of foreign direct investment of 6,388 billion dollars (5.02 billion euros) in 2005, while the following were ranked Bulgaria and Croatia, who reported FDI of 1.76 billion euros, 1.36 billion euros respectively.

FDI inflows have accounted in 2005 for about 28% of the gross fixed capital formation in Romania, down from nearly 40 percent in the previous year. Percentage of gross fixed capital formation in Romania was above the average of South-Eastern Europe, which had an average of 25.4%.

Romania ranked 24th of 141 countries in 2005, rising from 31st position in 2004 and 65th in 2003, from the point of view of the performance of foreign direct investments (FDI) and is the third country in the region after the volume of entries.

4. Unemployment rate - comparative analysis: Romania versus Poland

In Romania, the unemployment rate is almost double the level existing before the crisis. This means that the unemployment rate grew quickly when aggregate demand fell. But it doesn't mean they will drop just as quickly, some politicians say, with the resumption of economic growth.

In our country, this trend may be due to the following causes:

1. corrections necessary to reduce the budget deficit to levels that do not escalate into an issue of public debt. Corrections are inevitable and will run over several years, negatively influencing growth and the unemployment rate. In the public sector, any increase in salaries in 2011 and 2012 will have to be offset by the reduction of overemployment.

2. Amplification of labour market structural problems by the economic boom and by the social policy. Efficiency (already reduced) with which the labour market matches the supply of those seeking work with the demand for labor has fallen mostly due to the housing *boom*.

Paradoxically, during the *boom*, the number of social assistance and those who receive them has grown, more and more people becoming disinterested with searching for a job. Then, the crisis has made it necessary to extend the period for granting unemployment benefit, thus weakening the incentive to find a job faster. Long periods of vacancy reduce the quality of human capital and the chance to be employed again.

3. Reducing unemployment rate slowly in response to the resumption of economic growth is due to the rules (moral values, preconceptions) that companies have in terms of employment. Due to these rules, there are people with ancillary work incurred in excess of the number required by the technology. These are efficiency stocks of companies.

This evolution and the above menitonedv causes bring back the measures that should be taken to reduce the unemployment rate. When the economy is functioning below potential, stimulating demand seems to be a solution.

Table 4: *The evolution of unemployment in Romania and Poland in the period 1990-2013*

YEAR	Romania	Poland
1990	2.3%	2.1%
1991	3%	3.1%
1992	8.4%	3.5%
1993	10.2%	4.2%
1994	10.9%	4.4%
1995	8.9%	3.8%
1996	6.2%	4.5%
1997	9.3%	4.8%
1998	10.4%	4.6%
1999	11.8%	3.9%
2000	10.5%	3.8%
2001	8.8%	4.5%
2002	8.4%	4.8%
2003	7.4%	5.2%
2004	6.3%	5.6%
2005	5.9%	5.8%
2006	5.2%	6.2%
2007	4.2%	7.4%
2008	4.1%	7.8%
2009	5.3%	8.7%
2010	6.8%	8.7%
2011	5.9%	9.1%
2012	5.4%	8.8%
2013	4.8%	7.2%

Sursa: Eurostat [7]

Graphically, this will look like the following chart:

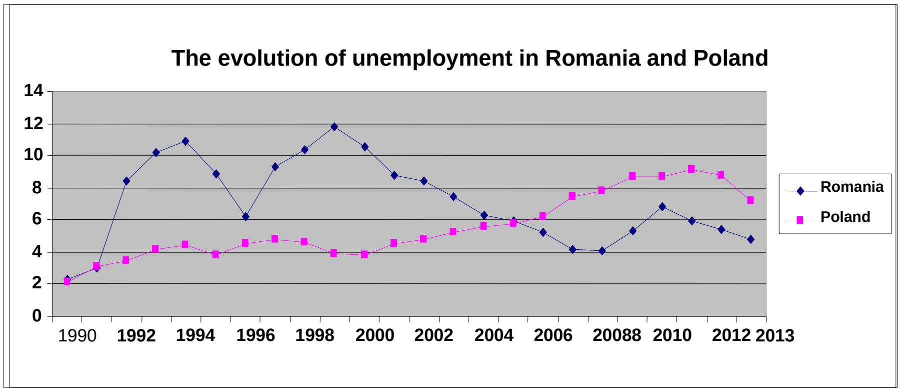

Chart 4. *The evolution of unemployment in Romania and Poland in the period 1990-2013*
Source: Eurostat [7]

The gross average salary in Poland in 2009 was approximately 800 euros, significantly higher than that of the Romans (478) and slightly less than that of the Czechs (865 euro).

The number of unemployed in Poland declined steadily both after the opening of labour markets in 2004 by the European Union and after the increase in the amount of investment and exports.

Wage policy in the year before the adoption of the inflation targeting system was cautious, wages increasing in real terms by only 1.5%. Wage increases were recorded, mainly in the private sector and have been determined both by increases in productivity, as well as tightening the conditions on the labour market.

Accordingly, it can be asserted that the lack of coordination between monetary policy, on the one hand, and the wage and fiscal policy, on the other hand, has considerably affected the quality of the economic policy mix, in spite of an institutional framework favourable for harmonization of various components.

Poland's external imbalance was accentuated in the period 1998-2000, so that at the time of the adoption of the strategy of direct inflation targeting the share of current account deficit in GDP exceeded 6%.

After a significant adjustment in 2001 (the current account deficit has been reduced to 3.4% of GDP, from 6.2% in the previous year), the 2002 electoral pressures have led to a further deterioration in the external accounts.

Thus, due to the rise of substantially increased imports (supported by the lax fiscal policy and of the wage) and lower growth of exports (amid the climate of recession that dominated the economy of the euro area and the nominal appreciation of the Hungarian forint) the share of the current account deficit increased to 3.9% of GDP in 2002 and to 6.7 percent of GDP in 2003.

5. Conclusions

In conclusion, the two countries, Romania and Poland, have been consistently reducing inflation in order to meet the convergence criteria necessary for entry into the Economic and Monetary Union.

The best results were obtained by Poland – a country that has applied a "shock therapy" as early as 1990, but had to face difficulties due to the structure of the national economy.

Poland has seen uninterrupted economic growth over the past 14 years (according to data from Eurostat), the country's economy being on plus including in 2009.

Czech performances are less convincing, though they started from a better economic situation - a well-balanced budget, very low external debt, more balanced economy and a good GDP per capita.

Poland is the only country in Eastern Europe which has not been in recession, was actually the only country where there has been a growth in 2009, 1.2 per cent during the year, and 3% in the last quarter.

Romania remains an EU Member country recording a relatively high level of inflation in comparison with other members.

These conclusions highlight the fact that the transition is a complex and time-consuming process. Even if countries that have switched to a better level and benefited from sustained external support, they still must follow coherent and prudent policies in order to be able to enjoy the fruits of mature and dynamic market economies in long-term.

Loans in foreign currencies have had a sustained dynamic and a possible rapid and excessive depreciation of the Leu would have created negative effects in chain at the level of the banking system.

A small-sized emerging economy with a significant degree of openness is permanently exposed to the danger of certain capital movements, potentially destabilising to the financial market, especially the currency market.

Due to the low level of domestic savings, economic growth remains dependent on the resumption of capital inflows, and the latter shall depend on policy coherence. But with a natural rate of unemployment increased, only a relatively small amount of capital can be absorbed without producing unsustainable imbalances.

ACKNOWLEDGMENT

The author, (Vidraşcu, Paula - Angela), would like to specify that this paper has been financially supported within the project entitled „SOCERT. Knowledge society, dynamism through research", contract number POSDRU/159/1.5/S/132406. This project is co-financed by European Social Fund through Sectoral Operational Programme for Human Resources Development 2007-2013. Investing in people!"

Bibliographic references

[1]. Burghelea, C., Aceleanu, M., I., Gheorghiu, A., Gheorghiu, A., *Development and progressive growth after the global crisis phenomenon*, 23nd IBIMA Conference, Valencia, Spain 13-14 May 2014, ISBN: ISBN: 978-0-9860419-2-1

[2]. Dumitru Ionut, Vass Andreea Maria, Bucsa Dan Dumitru, Moinescu Bogdan, Ionela Costică (coord.), (2005), *Tintirea inflatiei versus tintirea agregatelor monetare Strategii de politica monetara alternative in perspectiva aderarii la Uniunea Europeana,* Editura ASE, Bucuresti.

[3]. Moraru, Dan; Stanescu, Cristina; Preda, Oana; Nedelescu, Mihai, (2007), Finante publice: Sinteze, aplicatii, teste – grila. Bucuresti: Editura Economica.

[4]. Mosteanu T., Catarama D.F., (2008) *„Buget si Trezorerie Publica"*, editia 3 revizuita Editura Universitara, Bucuresti.

[5]. Popa A.F., Popa N., (2008), „*Impozitele si taxele reglementate de Codul fiscal"*, Editura Contaplus.

[6]. Vasile, V., Stanescu, S., Balan, M., (2013) *Promoting the Quality of Life: Challenges of Innovative Models versus Payment Policies*", in „The European Culture for Human Rights the Right to Happiness", Cambridge Scholars Publishing, UK.

[7]. www.eurostat.ro