

**General Political Environment:** Romania acceded to membership in the European Union in January 2007. Since then there have been ongoing political disagreements between rivals President Traian Basescu and Calin Popescu Tariceanu. In general, Romanian politics are characterized by extreme fractiousness resulting in shaky coalition governments. As a consequence, governments spend most of their time and energy trying to ensure their own survival and manage party infighting.

Romania is a parliamentary republic, currently governed by the centre-right Justice and Truth Alliance which is a coalition between the National Liberal Party (PNL) of PM Tariceanu, the Democratic Party (PD) of President Basescu and two smaller parties – the Conservative Party (CP) and the Hungarian Democratic Union in Romania (UDMR). In April 2007, PM Tariceanu reorganised the government to exclude Basescu's PD. The new government is a minority one made up of the PNL and the Hungarian Democratic Union; it is being propped up in Parliament by the main opposition party the Social Democrats.

The Justice and Truth Alliance was in place from 2004 to April 2007 was inherently unstable and functioned with little cohesiveness. Despite the cooperation in order to win the election, the stability of the government was thrown into question a number of times since November 2004. In July 2005, Prime Minister Tariceanu announced he would resign in order to force a new election, with the hope that the Justice and Truth Alliance would gain a majority in the legislature. However, he reversed his decision just a week later. Additionally, President Basescu has pressured the Prime Minister to step down, citing insufficient action on anti-corruption, but there are indications that Basescu's actions may be influenced by his own interest in assuming the PM's post. Basescu was suspended by parliament in April 2007 for unconstitutional conduct, but was able to ultimately retain his post after he survived a referendum on his presidency. The new minority arrangement is likely to fall in the short-term with the Social Democrats expected to try their hand at forming a government with either the PNL or other opposition parties.

In the past, governments have lacked political will and have backed away from reform at the first sign of popular opposition. One area where progress has been notably lacking is in the area of corruption, which remains a serious problem for the government, especially in the area of public procurement. The lack of progress in reducing corruption had held up Romania's accession to the EU. However, the EU has targeted corruption in Romania and is working with the, albeit weak, government to address the issue in a concerted fashion. Progress on dealing with corruption will continue to be slow. In comparison to its EU Balkan neighbours Romania comes a distant third in terms of the World Bank's Control of Corruption indicator behind Slovenia, Croatia and Bulgaria.

**Investment Environment:** On the whole, the regime has shown a favourable attitude towards improving the investment environment. However, government capacity to implement much-needed economic reforms is weak and this is further exacerbated by a general lack of competence within the bureaucracy.

Corruption remains a particular challenge for Romania. However, corruption charges have been brought against some high-profile politicians including former PM Adrian Nastase. The state bureaucracy is slow and cumbersome with the result being that some foreign investors may encounter substantial delays and problems in sorting through red tape.

Privatisation of larger state enterprises has been slow and fraught with difficulties due to the cumbersome nature these entities which were created during the Communist era.

The legal environment is unpredictable and there has been considerable legislative change throughout the past three years in the lead up and following Romania's accession to the EU in January 2007. Laws are in place to protect property and contractual rights, including guarantees preventing expropriation, but the enforcement mechanisms are weak.

**Political Violence:** There are no major political violence issues in Romania. Overall, foreign investors face few significant security issues when operating in the country. Petty criminal activity is a frequent occurrence; however, this does not generally have an impact on foreign businesses.

## Political

### Political Structure

Parliamentary Republic

### President

Traian Basescu (PD)

### Prime Minister

Calin Popescu -Tariceanu (PNL)

### Legislative Bodies

- Chamber of Deputies: (332 seats)
- Senate: (137 seats)

### Major Parties (Ch. of Dep.)

Centre-right governing Justice and Truth Alliance (DA) coalition

- National Liberal Party (PNL) 54 seats
- Democratic Party (PD) 55 seats

With assistance from

- Conservative Party (PUR) 15 seats
  - Hungarian Democratic Union (UDMR) 22 seats
- Opposition parties
- Social Democratic Party (PSD) 103 seats
  - Greater Romania Party (PRM) 28 seats

### Last Elections

- Parliament: November 2004
- Presidential: December 2004

### Next Legislative Elections

- Parliament: 2009
- Presidential: 2009

### Press Freedom Survey:

- 2007 Score: 42 Partially Free
- (0: Free; 100: Not Free)
- [freedomhouse.org](http://freedomhouse.org)

### Control of Corruption Index:

- 2006 Score: -0.18 (-2.5: Worst; +2.5: Best)
- [worldbank.org](http://worldbank.org)

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### Political Outlook

The main issue for the Romanian government is continuing to meet the requirements imposed by European Union (EU) as part of the accession process and addressing various operational challenges. The main obstacles are corruption and the slow pace of legal reform, especially in the case of competition regulations. The post-April 2007 minority government is inherently unstable and likely to fall in late 2007 or early 2008. Romania's first elections to the European Parliament will take place in late November 2007 and are likely to provide a strong indication of which way the political tide is moving domestically.

### Economic

#### Credit Agencies

Moody's: Baa3  
S&P: BBB-  
Fitch: BBB

#### Nominal GDP (2006)

USD118.8bn

#### Population (2006):

21.6 million

#### Total Trade / GDP (2006):

69.3%

#### Currency:

Romanian lei

#### Exchange regime:

Crawling band

#### Merchandise imports from Canada (2006):

CAD 213.2m

#### Main sources of Foreign Exchange (excl. FDI):

Apparel & Machinery

#### Largest Merchandise Trading Partner (2005):

Italy (19%)  
Germany (14%)

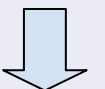
#### Main imports (2005):

Machinery (23%)  
Mineral Fuels (16%)

#### Risks to the Outlook



Advancement of fiscal and economic reform.



Unconstrained government spending & higher interest rates.

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**Market Spotlight:** ♦ Consumer price inflation was recorded at 3.7% in February ♦ Industrial production was up 10.2% y/y in February ♦ Trade deficit declined in February, decreasing \$700 million to \$1.8 billion ♦ Romania's currency (lei) appreciated 3.6% in April, to US\$2.43 ♦ Broad money supply growth was 29.2% y/y in March

**Economics & Growth Outlook:** Romania's economy has expanded rapidly, with growth of 7.7% in 2006—well above potential growth. Domestic demand and credit growth have been strong. Credit expansion has paralleled a widening current account deficit, but the overall balance-of-payments remains robust. Despite an increasing current account deficit, Romania's exchange rate appears to remain competitive. Export activity remains robust, driven by manufacturing exports and an increasing shift towards higher value-added export goods. Moreover, EU accession benefits (financial support and reduced trade barriers) have helped structural change and will boost trade. Foreign direct investment covers most of the current account deficit, external debt remains low, and reserve cover is reasonable. Looking forward, economic growth is expected to average 6.7% in 2007 and 5.4% in 2008.

**Monetary:** Romania's inflation performance has been excellent, consumer price inflation averaged close to 6.6% in 2006 (down from 9.0% in 2005). In early-2007, upward pressure on the exchange rate prompted the NBR to loosen policy. However, this move may prove to be premature as the economy is operating well above potential and expansionary fiscal policy has added to wage pressures. Over the next 6-12 months, the NBR may be forced to tighten monetary policy further and engage in further sterilization operations to help keep inflation in check. Recent central bank announcements and analysis indicate the central bank is prepared to tighten policy and exert firm control over money market liquidity.

**Fiscal:** The government's fiscal policy is understandable but disconcerting. The budget targets a government deficit of \$10.7 billion in 2007 (close to 2.8% of GDP) and assumes slightly weaker GDP growth compared to last year. Most of the increase in planned spending is in public capital infrastructure, public sector wages and subsidies payments. Projections of government revenues net of EU transfers are fairly conservative, with only a small increase budgeted. The problem is that an expansionary fiscal policy at this stage in the business cycle will only add to already high domestic pressures in the economy and will make very hard work for the NBR to maintain control of inflation.

**External Balances and Finances:** A widening current account deficit is not encouraging. Although the near term risks are balanced off against EU membership benefits and strong direct investment, it becomes more troubling beyond 2008 as repeated current account deficits greater than 10% of GDP cannot be sustained indefinitely. Further economic reform and government prudence will be needed to offset risks beyond 2008. If not, market sentiment may change for the worse, possibly resulting in a fall in capital inflows and a destabilizing swing in the exchange rate. Encouragingly, the financial sector is in good financial shape and communication between the various commercial banks and central bank are positive. Over the next five years, deepening trade and financial and institutional integration within the EU will gradually bolster Romania's ability to withstand potentially destabilizing capital flows and other external shocks.

#### Economic Indicators

	01-05 avg.	2006	2007	2008
GDP (% growth, real)	5.7	7.7	6.1	5.4
Inflation (% , year-end)	18.3	6.6	4.2	4.5
Fiscal Balance (% of GDP)	-2.0	-1.6	-3.0	-2.8
Exports (USD bn)	21.7	17.5	19.3	14.5
Imports (USD bn)	25.4	26.9	25.6	17.4
Current Account (% of GDP)	-6.4	-10.3	-12.0	-13.1
Reserves (month of imports)	3.9	5.5	5.7	6.0
External Debt (% of GDP)	37.1	44.7	48.0	52.9
Debt Service ratio	16.3	19.2	19.4	19.8
Currency (per USD, year-end)	3.2	2.6	2.6	2.6

Romania's Current Account Deficit (% GDP)

