

Get It Right This Time? Leaving the Periphery of the European Economic Development



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1 Introduction

Since 1990, Central and Eastern Europe countries have undergone a complex process of transition from planned to market economy. Such a process had never taken place before and it brought about a series of challenges and incertitude. There was no precedent, there was no optimum solution for the transition, and the expertise required for such an ample process was non-existent. Each country in the region approached transition in its own way, considering both its specificity and its available resources. Almost three decades later, the Central and East European countries display a different picture of their economic and social achievements.

Looking at the GDP in 1990, the states referred to were very close: at that time, Romania's GDP was 59.1% of Poland's, about double Bulgaria's and like that of the Czech Republic. Poland's GDP represented 49% of the aggregate GDPs of Hungary, Romania, the Czech Republic, and Bulgaria. A quarter of a century later, in 2015, all the above-mentioned countries could boast upward-evolving GDPs. For instance, during 1990–2015, Romania's GDP grew 4.56 times, and Poland's 7.23 times. In 2015 Poland was in pole position, at an over 7-time increase. Poland had become, in 2015, the absolute champion of the area, irrefutably leaving the platoon behind:

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in 2015, Poland's GDP represented 89% of the cumulated GDPs of the Czech Republic, Hungary, Romania, and Bulgaria for the same year, compared to the 49% in 1990. In other words, Poland had become the driving engine of the area (World Bank Database 2017).

In its evolution, Romania's GDP experienced three major crises: the crisis that followed the change of the economic system (1990–1992), the liquidity crisis in 1998–1999 when Romania's peak reimbursement of the foreign debt to Japan overlapped with a regional crisis (Russia in 1998) and a global one (South America in 1999), and, finally, the global crisis of 2008–2009, subsequently extended into the sovereign debt crisis at the level of the European Union, which made it more difficult for all the countries in the Economic Community to recover. The impact of economic collapse caused by the change of the economic system was 35%, the recession generated by the liquidity crisis 14%, and that caused by the global crisis 19% (World Bank Database 2017).

Romania's economic growth was only sustained after 2000. This could be explained by Romania's acceptance as a candidate to join the EU, which opened a series of opportunities, and the sustained program of market liberalization and privatization. Unfortunately, the European integration brought about growth of the GDP that was more supported before rather than after the effective joining, which caused increasing contagion risks, also noticeable in the way the GDP evolved after 2007 (highly frequent growths followed by abrupt falls). Claims that the economic growth has not turned into development are increasing; one could rather talk about stagnation and of placing Romania, in many respects, at the periphery of the Central and Eastern Europe member states. In what follows, we shall look at why this is happening and how such a situation can be changed.

2 At the Periphery of the European Development: Romania's Economic Growth, With the Parking Brake Pulled Up

The lack of vision and the stereotypical approach of the various economic ideas led to a situation where, almost three decades after the fall of communism, in 2017, Romania is the “tiger of Europe” in economic growth, scoring a 5.7% GDP raise, compared to the 2.3% EU average (European Commission 2017), without this explicitly reflecting in welfare. In 2017 Romania ranks among the last in the European Union in GDP per capita (8607 euro/capita, followed only by Bulgaria at 6752 euro/capita (Eurostat 2017)). Moreover, Romania has issues of high inequality: in 2015, the richest 20% of the population had incomes eight times higher than the poorest 20%—a significantly larger ratio than the 4.9% scored by Poland or the 4.3% by Hungary (Eurostat 2017).

Romania's economic evolution is meandering and attributed to the lack of structural reforms, displaying, at times, an erroneous understanding of the ideas of economic development. For instance, when consumption underlies economic growth, such

growth does not necessarily lead to subsequent development if the respective consumption feeds import instead production (Anghel et al. 2014a, b). Between 1990–2000, when direct foreign investments in Romania were very low, modern technology production overcapacities, conceived to cope with extended economic boom periods, were created by the investments made by foreign companies in the countries around, and they are producing there, not in Romania. Today, the main objective of these investments is to find outlet and not production locations (Anghel et al. 2014a, b). With better know-how than Romanian entrepreneurs and managers, the foreign companies have managed to conquer important market shares in Romania—a country ranking second in the region after Poland in size and inhabitants, hence an ideal market for the sale of products manufactured in Central and Eastern Europe countries. According to Eurostat, GDP dependence on consumption in Romania has not changed significantly during the past two decades: final consumption expenses were 79.2% in 1990 only to drop to 77.6% in 2013. The governments in the last decades associated, to a notable extent, economic growth to stimulating consumption. Still, local production could not keep the pace with this consumption increase. Economic growth in Romania has been continually accompanied by an ever bigger external trade deficit (i.e. imports have always increased faster than exports) during these years of transition. Which means that almost always, sooner or later, economic growth in Romania filled the pockets of the inhabitants of the countries in the region that managed to deal with domestic consumption better than the Romanian producers. Maybe this explains why the 2008–2009 crisis affected the Romanian market the most among the countries in the area (in the same period, Poland, for example, had no economic crash).

The positive element that has allowed Romanian business to evolve for the past two decades, is, in fact, the joining of the European Union, although the lag behind the EU average has not considerably diminished; we may even say that it has slightly increased. The absence of a clear vision on development and of a list of priorities of where to constantly allocate resources explains this *status quo*. Romania failed to maintain its position in the region during 1990–2000, but joining the European Union gave it the opportunity to become a gear in the European production mechanism as a producer of sub-assemblies and components or as a collateral service outsourcing target (Anghel et al. 2014a, b). Nevertheless, this course of market involvement has inherent limitations in the constraints the outsourcing suppliers in a global context are facing: lower added value, high dependence on the external factors, volatility generated by very high competition. About two-thirds of the Romanian exports are generated by companies active in Romania that have benefited from direct foreign investments (*idem*), i.e. companies with international level know-how that have chosen to invest in Romania to benefit from the cheaper labor and the currency stability through controlled flotation by the national bank.

Starting in 2007, when it joined the European Union, Romania has followed, to an ever-greater extent, the European model of public spending allocation. It has shrunk allocations for defense and economic activities in favour of those for social security, environment and the public health care system. However, despite the higher budget allocations towards the latter sectors, Romania has not caught up either with

the EU average or with the other Central and Eastern European countries. Thus, Romanian hospital endowments, although on the rise, remain lacking, e.g. one CAT scanner per 100,000 inhabitants compared to three in Bulgaria (Eurostat 2017). About innovation, Romania ranks 42nd at the global level, behind many East European states—like Slovenia in 32nd place, Latvia in 33rd place and Bulgaria in 36th place (Global Innovation Index 2017). Romania has the lowest share allocated for education in the EU, almost two times lower than the European average, at 2.75% of the GDP in 2014, compared to Bulgaria's 4.22% and Poland's 4.91% (Eurostat 2017).

What exactly has driven Romania to the periphery of economic development such as it is experiencing now, never managing to overtake the last or last-but-one place in the countries of the region platoon? There are three explanations that can lead to possible solutions: (1) for various reasons (a more uncertain political environment, lack of important investments in infrastructure, especially in transport, deindustrialization, etc.), Romania did not benefit as much as the surrounding countries from the wave of investments that followed the fall of communism; (2) it favoured the services, especially trade, which feeds not only domestic economic growth but also that of the other countries in the region that have important production capacities; (3) there was a shortage of domestic capital and limited foreign investments to support development, while, at the same time, funding of short-term profit-generating activities, at the expense of high -added value and knock-on-effect activities, was favoured.

3 In Search of the Appropriate Strategy of Economic Development

Romania's economic growth suffers from inconsistency in time, as the economic growth periods have been constantly succeeded by serious crises that have significantly adjusted the GDP downwards, and wherefrom recovery has been difficult. After the fall of communism, Romania took 8 years to reach the 1990 level of the GDP in real terms. Except for the liquidity crisis in 1998–1999, Romania grew continually until 2007 (the year of joining the EU). This period also witnessed deep structural changes, like lowering the agriculture share in the GDP make-up, deindustrialization and the steady growth of services and trade. After joining, while the economic crisis of 2008–2009 was happening, the Romanian economy meandered, experiencing multiple highs and lows in a short lapse of time. Such a volatility indicates an increasing vulnerability in development and explains, to a certain extent, the slow pace of economic growth felt at the level of the individual, and the lag in catching up with the average of the EU countries with more sustainable growth. This volatility points to a lack of strategic vision and a high vulnerability.

Some of the causes that led to this meandrous evolution lie in the modified Romanian economy branch structure: In 2015 the industry share in the GDP had dropped from 49.9% in 1980 to just 23.3% while the share of agriculture decreased

from 12.6% to just 4.3% (Eurostat 2017). The civil engineering sector remained relatively steady throughout this long period of time while trade (services in general) was the only sector showing an upwards trend. The engines of development continually decreased their speed.

The process of deindustrialization was very visible right after the fall of communism and it continued after Romania joined the European Union. At the same time, this process was accompanied by a long-term trend of a steady drop in added value in the Romanian industry (with slight recovery spurts after the economic boom periods). Yet, even if not spectacular, the trend is to rise for most of the countries in the region, which means that Romania continues to use many resources with rather modest results, justifiable by the low level of research—innovation and the industry targeting the production of sub-assemblies and parts. Specifically, “out of a 30,000-euro BMW car, just 1000-euro worth is made in Romania: the steering wheel, the belt drives, the mirrors, etc.” (Hostiuc 2017).

With 1.39 million employees (INS—National Institute of Statistics 2017), industry is the largest employment sector in the Romanian economy, i.e. approximately one in three employed persons in Romania works in industry (a close level to that is only to be found in the service sector, with 1.33 million employees in 2016). Although industry has the highest added value in the Romanian economy, even with the above-mentioned limitations, its gross productivity per employee stands below that recorded for services and trade (INS 2017). Still, industry or infrastructure investments (in 2017 Romania is the country with the lowest number of kilometres in the European Union and it has no high-speed railway whatsoever) can provide a knock-on effect for the development of other economic sectors and hence the premises for long-term development, beyond short-term profitability. In other words, Romania desperately needs infrastructure and complex industry to overcome the vulnerability generated by its position either at the end of the production chain, as an assembler, or, in the case of agriculture, as a provider of raw materials that are processed abroad and imported as end-products, or somewhere in an intermediate position in the production chain, as a sub-assembly producer that only gets a small part of the added value and is much more vulnerable as it is foreign-dependent. Yet such desideratum cannot be reached unless two fundamental problems, funding and research-innovation, are overcome.

Having opted for encouraging sectors of modest added value will have consequences for a long time. Romania faces a dire future to a large extent because of the ease with which it has given up its advanced expertise in many domains, only to set to roughly processing raw materials or assembling industrial components using cheap local labour. Unfortunately, Romania preferred a peripheral position in this division of work, convenient and of low risk, where everything came from abroad on a plate: raw materials, technology, know-how. Such a mentality, still perpetuated also in the IT and the automotive industries, is very hard to overcome.

Any complex production process involves several distinct stages: one stage where the production process is organized as capital investments in equipment, production and auxiliary facilities, infrastructure, etc.; another stage where such production means are effectively put to work in the various operations intended to

produce goods and services meant for the market; and, finally, a third stage where the manufactured goods are sold to the final consumers (or intermediate, as the case may be). This process is enabled by specific mechanisms (the market, the price system, etc.). Every stage of the process has a well-defined role. Production cannot be achieved without the initial investment, which involves capital existence. Still, most often equity is not enough to support production processes, which are complex, very innovative and of high added value. In its turn, the added value in the production process depends on the production stages that the entrepreneurs can afford. The more entrepreneurs understand and embrace innovation and the better the available capital is targeted towards investments in production processes of high added value, the more sustainable the economic activity is. Sadly, Romanian industry capitalization stands, at present, below that of the civil engineering sector. The Romanian capital targets civil engineering rather than industry or agriculture, which affects the economic development.

Development funding can be achieved from public or private sources. If public funding belongs rather to the Keynesian economic thinking, with its inherent limitations, private funding is generally specific to entrepreneurship and can be covered from sources such as equity, borrowings or direct foreign investments. At present, the investment project complexity is such that it makes it almost impossible to develop a business only with internal resources, consisting only of reinvested profit or equity owned by the project initiators. To cope with competition in a globalized world, entrepreneurs must cooperate with the other capital holders and be intensely connected to the global financial system. Yet, capital imports, vital for emerging economies where domestic capital shortage is noticeable, involves losing economic independence to some extent, putting additional pressure on the current account deficit and increasing vulnerability to greater contagion from crises and external factors.

The added value in an economy involves developing complex production processes that include as many production stages as possible. Along the manufacturing stages, the need for capital increases as the advanced stages become capital-goods (equipment, technology, etc.) intensive. In other words, a nation's capacity to add economic value strongly depends on the volume of capital. At the same time, we cannot fail to notice that capital inflow is correlated to a specific personal behaviour: saving. Any blip in the relationship added value—capital—saving clearly disrupts development. Nations save in different ways, they allocate capital in different ways, make their own mistakes, and finally get to having different development levels, even if, apparently, their initial resources were similar.

The rate of saving in Romania increased steadily, especially before its joining the European Union and before the 2008–2009 economic crisis (after a significant drop that lasted until 2004–2005). Still, Romania falls short of the region average, displaying insufficient advances compared to countries like Hungary, Slovenia, Slovakia, and the Czech Republic, all with smaller populations. This raises the need to find other funding sources. They can be either efficient public investments, especially from European funds, or sustainable foreign investments that are not speculative.

A funding alternative to saving is represented by the European funds, all the more so as an important part of them have an investment component, partly meant for the

private business environment. Unfortunately, Romania's economic development and the post-crisis recovery have been negatively affected by the fund's slow rate of absorption. Thus, for the period 2007–2013, from the total allocated funds, the average monthly rate of absorption was just 1.06%, only reaching a maximum of 3.6% in January 2016 (Romanian Ministry of European Funds 2018). At such an average absorption rhythm, Romania needed about 100 months to achieve the absorption equal to that of a European budgetary cycle of 60 months (almost double the absorption time). Additionally, a very high volatility of the absorption rate can be noticed from one month to the next, pointing to the authorities' lack of a steady effort to ensure the proper carrying out of the local recipient projects.

For a country like Romania, where saving is not enough to support the development process and where European fund absorption is questionable, foreign investments are vital and make up for the shortages associated with development funding. Attracting direct foreign investments is a successful development funding recipe provided it is done with vision and attention. For instance, starting in 1997, South Korea's reform to attract such investments has been an example of best practice for all OECD countries, proving not only the importance of targeting investments towards priority sectors of the economy but also to be a high quality approach to investment-attracting authorities, which, in this case, can be summarized as follows: pre-announcing the reforms; planning the reforms (as a rule for 5-year periods); continuing the realistic and credible planning of announced reforms; functional forums for public dialogue, also with the foreign investors; including the process of investment attraction in a wider reform framework (Nicolas et al. 2013). In South Korea there was a vision, with a clear path where to and how to allocate the capital resources.

The level of foreign investments in Romania had a positive course yet they did not make a steady contribution to the economic growth and development. In 2016, the foreign investment contribution to Romania was like that of 1995–1996, which means that, unlike other countries in the region, no significant steps towards connecting Romania to the international capital markets were made. Moreover, a rather high speculative feature is present in these foreign investments (high volatility) and, during the crisis, their withdrawal from Romania was spectacular. It is unfortunate that, because of the lack of trust in the Romanian economy and of the perceived apparent instability, attracting foreign direct investments back in post-crisis periods is hard to achieve. This explains the low resilience of the Romanian economy and can also raise serious doubts as to the sustainability of the entire process of economic growth and development in medium and long terms.

4 Economic Development Driven by Exports: A Mandatory Challenge for Emerging Romania

Romania is a country where the formation of GDP was constantly based more on the exporting capacity: in 1995 the dependence of GDP from exports was only 25.5% and in 2017 this dependence had increased to 41.4% (Eurostat 2017). This increased

capacity is due to the openness of the economy to the international capital and the international markets (especially from the European Union—Single Market).

Despite this increasing exporting capacity, the internal market and internal consumption remain the most important problems for Romania. The dependence of GDP on households' final consumption had not significantly changed over the same period: in 1995, the final consumption of households to the GDP was 81.4% and slightly decreased to 77.7% in 2017, after a maximum of 86.2% in 2005 (Eurostat 2017). This constant significant dependence of GDP on local consumption should be correlated with the constantly increasing dependence on imports: in 1995, the weight of imports to Romania's GDP was 30.5% and increased to 43.6% in 2017 (idem). This dependence of Romanian GDP on imports has always been higher than its dependence on exports. Moreover, the international trade deficit has always been a problem for Romania: this deficit is negative, starting from 1990 until today. This negative trade balance kept the local currency under pressure and it constantly lost purchasing power compared with foreign currencies. Romania and Poland are the countries in the region that have had a negative international trade balance for almost three decades. This high dependence on internal consumption and the increased importance of imports (higher than exports; international trade deficit not surplus) in the Romanian economy prove that local producers have a limited capacity to produce and sell for the local market. Before focusing on external markets, Romanian producers should focus more on the internal market and internal consumption. Romanian exporters should give, at least, the same importance to the local market as the external ones.

To enhance export-led economic growth, a country must develop its internal specialization by considering the possible comparative and competitive advantages, by stimulating capital allocation in the most efficient and competitive sectors and by benefiting from increased economies of scales (Jaunky and Lundmark 2016; Popa et al. 2016). Therefore, a more agile entrepreneurial activity, with a real added value to the local production, is a mandatory first step to decrease dependence on imports and to create the framework for a healthy export strategy. The value added by Romanian industry (dominated by manufactured goods such as food and beverages and vehicles, which account for 75% of the total industrial production) decreased from 38.4% in 1995 to 34.9% in 2015 (Eurostat 2017). This is due to insufficient capital investments in the economy: the gross capital formation to Romanian GDP slightly increased from 21.4% in 1995 to 22.6% in 2017 (idem).

The data on the Romanian international trade balance reveals not only the fact that in the boom phase the deficit is significantly higher but that any attempt to increase the Romanian exports is doubled by an increase in the level of imports (the dynamic of exports is highly correlated with the dynamic of imports). This situation is explained by the fact that local production is significantly dependent on the import of raw materials and spare parts (in the case of vehicles produced and exported by Romania, the engines and major components are imported from other countries). The import of technology is the second explanation: the import of machineries and tools increases every time a Romanian producer wants to increase its production and exporting capacity.

Romanian international trade data (Eurostat 2017) reveals other important issues that are undermining a possible export-led growth strategy: an increasing dependence on Romania's exports by the European Union (which was only 37% in 1990 and increased to 75.8% in 2017; this dependence is the same today in the case of imports) and a limited diversification of Romanian exports. The leading exports in 1991 were machinery and electric tools (16%), basic products manufactured from common metals (15%) and minerals (15%). The leading exports in 2000 were textiles (20%), basic products manufactured from common metals (18%) and machinery and electric tools (8%). The leading exports in 2017 were machinery and electric tools (28%), vehicles (18%) and basic products manufactured from common metals (9%). These structural changes in Romanian exports over time reveal a constant high dependence on a very limited number of products and explain the limitations in terms of value added and the manufacturing capacity of the Romanian economy. In the last decades, Romania has continued to export basic products and raw materials and has replaced a less sophisticated *lohn* production (textiles and machineries/electric tools) with a more sophisticated *lohn* (vehicles and machineries/electric tools) that are strongly dependent on the imports of components produced elsewhere.

Therefore, an export-led growth strategy for Romania can be a successful one, but only with some changes: reducing the dependency on Romanian exports by the EU by searching for new markets for exports outside the EU; reducing the dependency of Romanian exports on the mentioned limited number of products; increasing the manufacturing level for Romanian exports by adding more production stages to basic products exported today; increasing the participation of local producers (especially Romanian SMEs) to the manufacturing and exporting activities; and stimulating the investments in the exporting capacities and continuing the efforts to promote the local products among the local consumers (to reduce the international trade deficit).

5 Instead of Conclusions: About the Power to Restart

The economic theory on drivers of development has continuously evolved. In the beginning, the factors considered were natural resource endowment, money accumulation and protectionism, which were soon replaced by market liberalization, capital accumulation, the theory of comparative and/or competitive advantages in the mutual exchanges, the demographic factor, industrialization, the technological factor, education, innovation, entrepreneurship and creativity, and the quality of the institutions. And then, maybe the most debated on, the state as an initiator of knock-on-effect public investments. Economic development is not possible without adequate transport and telecommunication infrastructures. Among the investment priorities of the nations interested in sustainable development we should find such projects as intensifying economic activities, sustaining the addition of more production stages, getting consumers and suppliers closer to one another in the territory, and

improving and enhancing market mechanisms. Any other kinds of investments will only turn into simple consumption and, in time, become a burden to a nation's development.

Romania finds itself in an unbalanced situation: although there is economic growth, this comes after a history of meandrous progress and does not translate, to the same extent, into welfare. Romania's population was, in 2016, 19.71 million inhabitants compared to 23.2 million in 1990 (World Bank Database 2017) due to emigration and a negative demographic growth. Thus, if in the past the country was facing problems related to employment and the development policies had to focus mostly on creating more jobs, at present the situation is no longer so black and white. To go beyond the periphery level, within which it may advance yet without catching up with the rest, the country needs investments—maybe public and very likely foreign—that are of high quality, non-speculative, and targeted towards activities with medium and long-term knock-on effects: infrastructure, cutting edge industry—and not just assembling or making sub-assemblies or raw material processing. Certainly nothing is possible in the absence of real results from research—development. Innovation, a key element in development, greatly depends on the quality of the system of education and its capacity to relate to the real needs of the economy. Technology advance is not achievable or effective unless it relates constantly to the needs of the market, while innovation and research-development carried out away from the market wear out resources rather than include them in a sustainable development process. With the lowest GDP share in education spending in the EU, Romania is far from being able to step on this development pedal.

Economic growth is important for economic development but it should not be achieved at any cost or sacrifice. When economic growth is not confirmed in the general improvement of the living standard or when it widens the gaps among regions, communities or individuals even more, we cannot say that it produces economic development nor that it will last long enough without being overtaken by its downside—recession. That is why periods of economic growth that are not accompanied by higher welfare, as in the case of Romania, are only half-good news and, sadly, are not a safeguard for development.

Regardless of the way a country develops, accessible funding is needed for activities aimed at economic development. Lacking capital, no economic process, as complex as they are nowadays, can be initiated, while the failure to allocate the existing capital to economic priorities essential for the nation will confine economic development. Financial market globalization helped emerging economies as they accepted opening up to foreign capital imports (external credits, direct foreign or portfolio investments) that cover shortages in domestic capital accumulations, but, at the same time, they make such countries more vulnerable to external shocks. Romania needs a vision on development while it attracts capital for the support thereof, starting from saving stimulation to foreign investments targeted towards activities that have a knock-on effect in the economy. At the same time, it needs to enhance the quality of the public investments and to attract and use European funds more efficiently.

There is no unique recipe for development or an optimum combination of factors that inexorably leads nations to prosperity. Each nation must uncover what suits it best according to its specificity in competitive or comparative advantages. What is certain in this case is that opening up to external markets can help tremendously in more rapidly identifying such elements and in their subsequent turning into welfare for one's own nation and not only—yet with an eye on limiting the negative effects of such opening up. And, finally, words like “policy” or “vision” need to be concretized and ensured continuity—this being, perhaps, the first condition for Romania to be able to finally move on from its peripheral position in European development.

Economic growth cannot turn into development without a clear and assumed vision to back it up. This vision needs to be made starting from understanding the context, then moving on to identifying the development drivers indicated by the various schools of thought as the most adequate for the targeted economy and which propose resource allocation towards such priorities that serve best their capitalization. Development must not be tackled chaotically; the approach needs steadiness over time and to be generally assumed by all the political forces so that no change of vision occurs every new election cycle.

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