

Chazen International Study Tour Report

Romania: Governmental Challenges and Opportunities

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Chazen International Study Tours

Designed to enhance the classroom curriculum, Chazen International Study Tours offer students and their faculty adviser an intense, firsthand experience of the business and culture of their chosen country or region. Study tours are initiated by students and organized with the help of the Jerome A. Chazen Institute of International Business. During the study tours, students meet with leading executives and government officials while visiting businesses, factories and cultural sites. Destinations change yearly, as study tours are student-initiated. Recent destinations include Brazil, China, Dubai, India, Japan, Mexico, Romania and South Korea.

In March 2008, a group of 23 Columbia Business School students visited Bucharest, Romania, on a Chazen International Study Tour. We stayed at the InterContinental Bucharest, from whose balconies journalists watched as the country's famous revolution took place in late 1989, toppling Communism and ending 34 years of Communist rule by the infamous Nicolae Ceausescu. In the two decades since Ceausescu's overthrow and eventual execution, Romanians have tried to emerge from his grip and form a functional democracy. Despite great strides, political discord has stymied economic progress throughout the country's post-Communist history, hampering development in infrastructure and education and bringing about considerable fiscal woes. However, based on what we learned during the study tour, we believe that the country is poised for success over the next two decades if its current leaders continue to focus on development and reform.

Romania's economy has grown at a steady rate of more than 6 percent per year since late 1999, when accession to both the European Union and NATO first began to seem feasible.¹ We witnessed an impressive display of wealth during a trip to Bucharest's Bamboo Club, a soaring 3,000-person capacity nightclub visited by lavishly dressed men and women arriving in luxury cars. Yet despite its growth, Romania continues to face a variety of economic and political challenges, including a fractious political system hampered by corruption, a widely dispersed population and weak infrastructure.

During our time in Bucharest, we met with the head of the presidential chancellery, Catalin Avramescu. He gave us a general briefing of certain challenges facing the country's government. We learned the country's current president, Traian Basescu, and prime minister, Calin Tariceanu, were elected in 2004, the same year that the country joined NATO. The two politicians hail from different parties and have notoriously icy relations. In 2007, Parliament attempted to impeach the president, on the grounds that he had exceeded his constitutional powers.² This, however, seems to have been largely an attempt by angry lawmakers to stifle his criticism of the prime minister and of political corruption.³ Because the prime minister is actually responsible for appointing the president's cabinet members, the president essentially has no leverage over the cabinet members when policy issues are being debated and implemented. With the political system clogging the functioning of the cabinet departments, progress on key issues is difficult. A political system that

¹ Quentin Peel and Thomas Escritt, "Laying a Red Carpet Over the Cracks," FT.com, March 6, 2008, <http://www.ft.com/cms/s/0/94c0fcf6-ea07-11dc-b3c9-0000779fd2ac.html>.

² BBC News, "Country Profile: Romania," BBC, http://news.bbc.co.uk/2/hi/europe/country_profiles/1057466.stm (accessed December 4, 2007).

³ Associated Press, "Referendum on Whether to Impeach Romanian President to Be Held May 19," *International Herald Tribune*, April 24, 2007, <http://www.iht.com/articles/ap/2007/04/24/europe/EU-POL-Romania-Presidential-Referendum.php>.

houses an abundant number of political parties compounds the problem, as does the lack of a majority party in parliament.

Additionally, Romania's population of 21.4 million people is scattered widely throughout the country, with Bucharest containing only 20 percent of the population. Although we only visited the urban center, we learned that a full 25 percent of Romanians are employed in agriculture, a sector that makes up 10 percent of national GDP.⁴ For political leaders, this diverse population translates into a complex set of political constituencies with divergent wants and needs.

Despite the electorate's calls for reform and for streamlining of Romania's young constitution, the government has been largely non-responsive. According to the *Financial Times*, the "lack of political decision-making compounds the other problems holding up the economy."⁵ The country's political impasse prevents progress in several key areas. One of the biggest problems the country faces is its weak infrastructure. For example, the country's government has built 500 kilometers of new highways at most in the past 15 years. We witnessed traffic problems ourselves while at the InterContinental—even on weekends, traffic in the area brought the city to a near standstill. The mass-transit system in Bucharest lacks the necessary investment required to help alleviate the city's congestion. We saw at least two different subway stations that, while apparently functional, looked almost postapocalyptic, with the escalators leading down to them long halted and covered with grime and trash.

Similarly, the educational system in Romania still lags behind the rest of Europe and has not been able to contribute the appropriate mix of skilled workers that the expanding economy needs. The president's chancellor, Avramescu, a professor, commented on the dismal state of the country's educational system. When asked what he thought would bring about improvement, he shared three key points. First, the government needs to support a more competitive compensation system in order to attract talented and trained teachers. Second, the system needs to focus not only on general education but also on job readiness in order to better train the country's future workers. Third, the country needs to work harder to retain talented students, because a brain drain has resulted from the outflow of students who leave Romania to be educated in western Europe and never return.

Despite the country's economic boom, several economic risks are emerging, and the government has done little to address them. With Romania's robust growth, inflation has become

⁴ Fita Online, "Country Profiles: Romania," Federation of International Trade Associations, <http://www.fita.org/countries/romania.html>.

⁵ Peel and Escritt, "Laying a Red Carpet."

a concern: the central bank has raised interest rates three times since October 2007, to a current rate of 9 percent, in order to dampen rising prices. Despite this, the government seems unrestrained in its spending, which could fuel further inflation. Introduced in 2005, the country's flat-tax rate of just 16 percent for both companies and individuals has reduced government income. Before 2005, corporate profits had been taxed at 25 percent, and personal income taxes ranged between 18 percent and 40 percent.⁶

While people seem to agree that fiscal reform is needed—both Avramescu and Viorel Hrebenciuc, head of the opposition party, told us that taxation is a major area of concern for them—there is little agreement on how exactly to proceed. In addition to the budget deficit, the current-account deficit is now 14 percent of GDP, which increases the potential risks to the economy if capital flows to the country are diminished.⁷

Romania must improve its financial management, especially considering the prospect for slower global economic growth.⁸ Remittances from approximately two million Romanians working abroad have been a key contributor to the country's expanding economy. If these remittances slow as the global economy cools, Romania will need to be prepared to absorb the economic impact.

The utter suppression of political opposition under Ceausescu's Romania has complicated the country's transition to a parliamentary political system, but there are numerous reasons to be optimistic that the country will succeed in that transition. Generally speaking, political leaders are realistic about the challenges ahead and seek to address them. All of the study-tour speakers agreed that the government must continue to stamp out corruption and work toward reform, the sentiment being that many of the issues facing the country are so clear-cut that they do not necessarily need to be debated in a polarizing contest between liberals and conservatives.

Romania's recent alignment with the international community has enabled it to make great strides in the past four years. The country qualifies for approximately €30 billion in funding from the European Union over the next five years, designated for structural reforms, home affairs and administrative infrastructure improvements.⁹ This funding from the EU will likely enable the

⁶ Economist.com, "Country Briefings: Romania," <http://www.economist.com/countries/Romania/profile.cfm?folder=Profile-FactSheet> (accessed February 20, 2008).

⁷ Peel and Escritt, "Laying a Red Carpet."

⁸ Subir Lall, "World Economic Outlook: IMF Predicts Slower World Growth Amid Serious Market Crisis," *IMF Survey*, April 9, 2008, <http://www.imf.org/external/pubs/ft/survey/so/2008/RES040908A.htm>.

⁹ Alecs Iancu, "EU Grants Romania Over 31.5 Billion Euros," *Bucharest Daily News*, September 16, 2005, <http://www.roconsulboston.com/Pages/InfoPages/Businesspages/EUInfo/EUFunding.html>.

country's leaders to push through reforms that might otherwise not be possible. Bucharest, the EU's easternmost capital, hosted 5,000 politicians, officials and military personnel at NATO's largest-ever summit in early April 2008. President Bush alone brought an entourage of more than 1,500 people from Washington, D.C.¹⁰ He remarked that Romania's willingness to host the conference was "a big deal," adding, "What's interesting is 20 years ago . . . the Romanian people suffered under a cruel dictator. Today, think how things have changed."¹¹

During our trip, we also sensed that the country's often-discussed historical brain drain might now actually be turning into an advantage for the country and even starting to reverse course. We met with the director of McKinsey Romania, one of many young Romanians who have decided to return to their homeland after being educated in western Europe. We also met with the leaders of the Bucharest Stock Exchange, all of whom had worked in finance in London or New York before returning to Romania. These young, internationally educated business leaders were visibly eager to catalyze change in the country and seize opportunities for wealth within the country's booming economy.

A number of major multinational companies are eager to partake in the boom as well. Orange and ING seemed to have offices on every block in Bucharest, and we also noticed Bucharest outposts of Deloitte and Citibank. While we were on our trip, our speakers hinted that Ford Motor Company might soon be acquiring a major automobile plant in the country. On March 21, shortly after our return to the United States, Ford formally took over the plant from the Romanian government, enabling the country to become southeastern Europe's largest car producer. This acquisition not only will flood the country with money but also will create as many as 5,000 new jobs for Romanian workers.¹² Speaking of the Ford acquisition, Prime Minister Tariceanu remarked, "The impact will be extraordinary for Romania. For a businessman, to invest is the supreme proof of confidence."¹³ The prime minister's optimism, echoed by the politicians and businesspeople we met, hopefully will catalyze continued growth and change in Romania, especially as the country continues to join in business and political alliances with the rest of Europe and the world.

¹⁰ Peel and Escritt, "Laying a Red Carpet."

¹¹ Office of the White House Press Secretary, "President Bush Participates in Joint Press Availability with President Basescu of Romania," news release, April 2, 2008, <http://www.whitehouse.gov/news/releases/2008/04/20080402-3.html>.

¹² Associated Press, "Romania Hands Keys to Ford," March 21, 2008.

¹³ Ibid.