XYZ

REPORT

ROMANIA ON THE RISE:

Europe's new economic powerhouse?

impact
BUCHAREST

by Michał Kulbacki,
Economist at XYZ, October 2024

Introduction and key figures

3.5% Romania's average annual GDP per capita growth rate from 2019 to 2023, placing it among the TOP 3 fastest-growing economies in Central and Eastern Europe.

79% the level of average EU per capita income Romania achieved in 2023, after adjusting for differences in price levels.

2 Romania's rank among the largest economies in Central and Eastern Europe in 2023. For the first time in modern history, its GDP surpassed that of Czechia, second only to Poland.

27 years the time Romania needed to increase its GDP per capita in purchasing power parity from $15,000 to $40,000—a timeline just a few years longer than that of South Korea, one of the world's most remarkable economic success stories. By comparison, Chile, the wealthiest major economy in South America, has yet to achieve this milestone.

61% the share of ICT in Romania's total services exports, making the sector a key driver of the country's economic growth in recent years.

2035 that year Romania has the potential to reach the European Union average for per capita income, adjusted for purchasing power standards.

- Romania has seen rapid growth in recent years, emerging as the economic star of Central and Eastern Europe.
- Romania's economic growth is driven by the same factors as the rest of the region: a favorable balance between wages and labor force skills, integration with the European Union, and substantial foreign capital inflows. However, Romania stands out from its regional peers due to several unique elements, including a robust IT and business services sector focused primarily on exports, high wage competitiveness, and limited vulnerability to fluctuations in international trade.
- Romania has the opportunity to sustain its growth and close the gap with the EU's per capita income level. However, several significant risks loom on the horizon that could substantially hinder this progress. These include the presence of twin deficits—fiscal and current account—and the potential for massive automation of IT and business services jobs due to artificial intelligence.

A star is born. Romania against the background of the region and the European Union

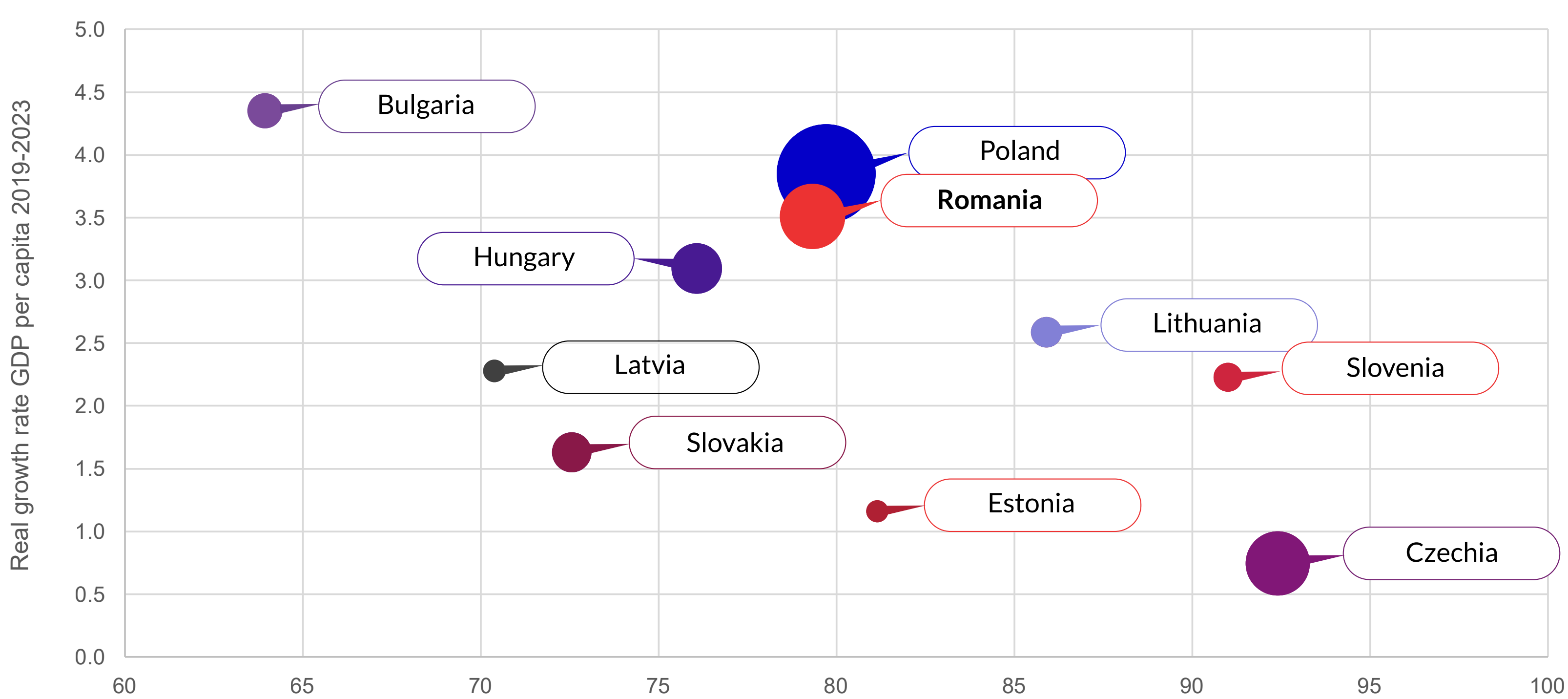
How do you define an economic superstar? Economic success can be defined in various ways, but most analyses converge on three key indicators: the level of economic development, the growth rate, and the overall size of the economy.

An economic star can be defined as a country that reaches a specific level of income, measured by GDP per capita in purchasing power parity, which accounts for differences in price levels between economies. Simultaneously, the growth rate of GDP per capita must significantly exceed that of a comparable group of countries. The overall size of the economy, as measured by GDP, is also crucial. Evaluating the success of small economies, which may thrive through specialization in one or a few sectors, is quite different from assessing the performance of larger economies.

Our analysis compares GDP per capita in purchasing power standards for 2023, expressed as a percentage of the average value for the entire European Union. It also examines the growth rate of GDP per capita over the last five years (2019-2023) and the size of nominal GDP in 2023.

Driving forces of the CEE region.

Comparison of Central and Eastern European economies in terms of GDP per capita (horizontal axis), growth rate (vertical axis), and economy size (circle size)



Source: own compilation based on Eurostat data

Romania has earned the title of economic superstar in recent years. This is evident in the chart above: the level of GDP per capita is close to 80 percent of the EU average, and the growth rate has averaged 3.5 percent over the past five years—one of the highest in the region. Additionally, the Romanian economy became the second largest in the region last year, surpassing Czechia for the first time.

In Central and Eastern Europe (CEE), only one star shines more brightly than Romania: Poland. While Poland has a similar GDP per capita, its economy is more than twice the size of Romania's and has consistently achieved growth rates that are 0.4 percentage points higher each year.

In terms of growth rates over the past five years, both Poland and Romania lagged behind Bulgaria, where the economy grew by an average of 4.4 percent per year. However, Bulgaria stands apart in terms of wealth, with GDP per capita in purchasing power parity not exceeding 65 percent of the EU average.

Hungary has also demonstrated solid economic performance in recent years, maintaining a growth rate above 3 percent while keeping per capita income levels similar to those of Romania and Poland.

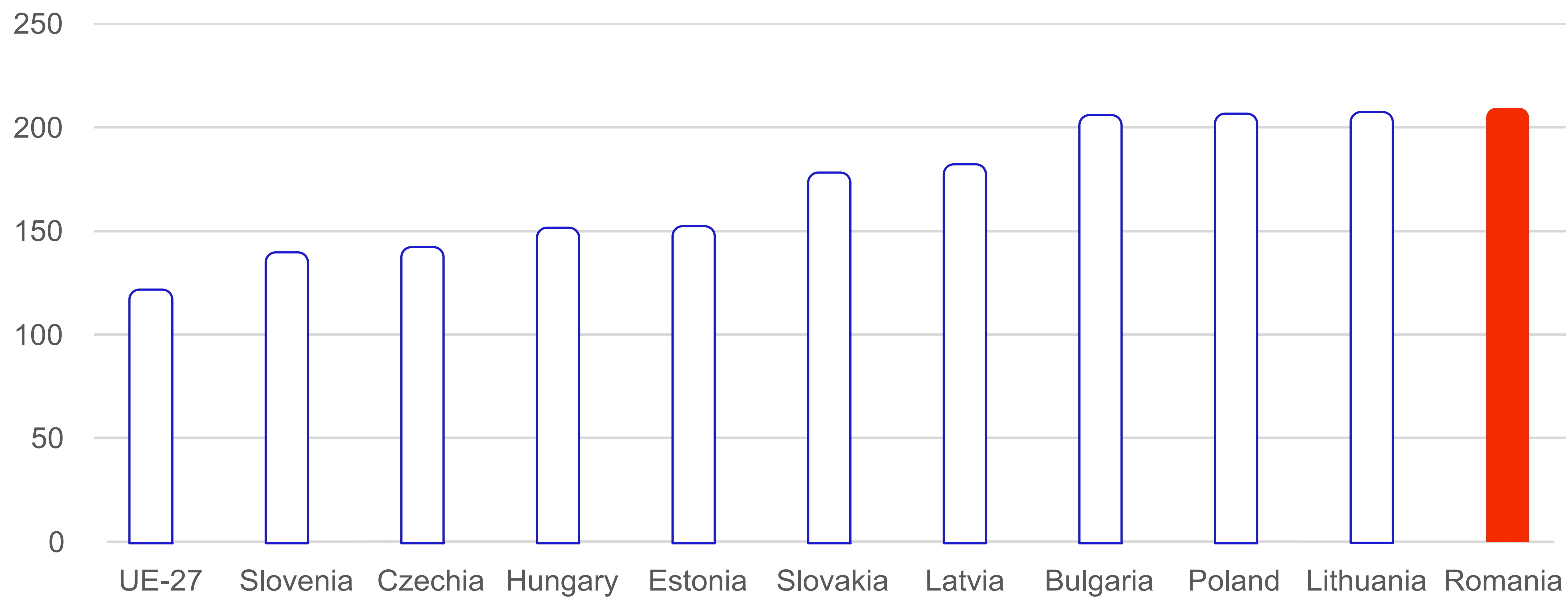
The strong performance of the Romanian economy is also evident in other macroeconomic and financial indicators. Unemployment has remained below 6 percent since 2018, except for a brief period at the beginning of the pandemic. Additionally, the stocks of companies listed on the Bucharest Stock Exchange have risen significantly. The BET index, which tracks the largest companies, was up 150 percent by the end of August 2024 from its level at the beginning of 2019. Moreover, the capitalization of all companies listed on the exchange increased by more than 50 percent in 2023 alone. Inflation has also been declining in recent quarters. In 2023, it stood at 9.7%, and according to the European Commission's spring forecast, it is expected to average 5.9% in 2024. However, this would still be the highest level among all EU countries.

The scale of the Romanian economy's success becomes even more evident when viewed over a longer period. Over the past 20 years, per capita income has doubled, marking the largest growth among the CEE economies. During this time, Romania has grown nearly five times faster than the EU as a whole and more than twice as fast as Slovenia, Czechia or Hungary.

Most impressive, however, is the comparison of Romania's economic growth with world economies often highlighted in the literature as spectacular cases of development. One prominent example is South Korea, a symbol of Southeast Asian progress. In just 30 years, its economy transformed from a medium level of development with an income of $15,000 per capita to one of the richest countries in the world, boasting an income of over $50,000, as illustrated in the chart below.

Romania is a growth leader.

Per capita GDP growth from 2004-23 (2004=100) (vertical axis), and economy size (circle size)

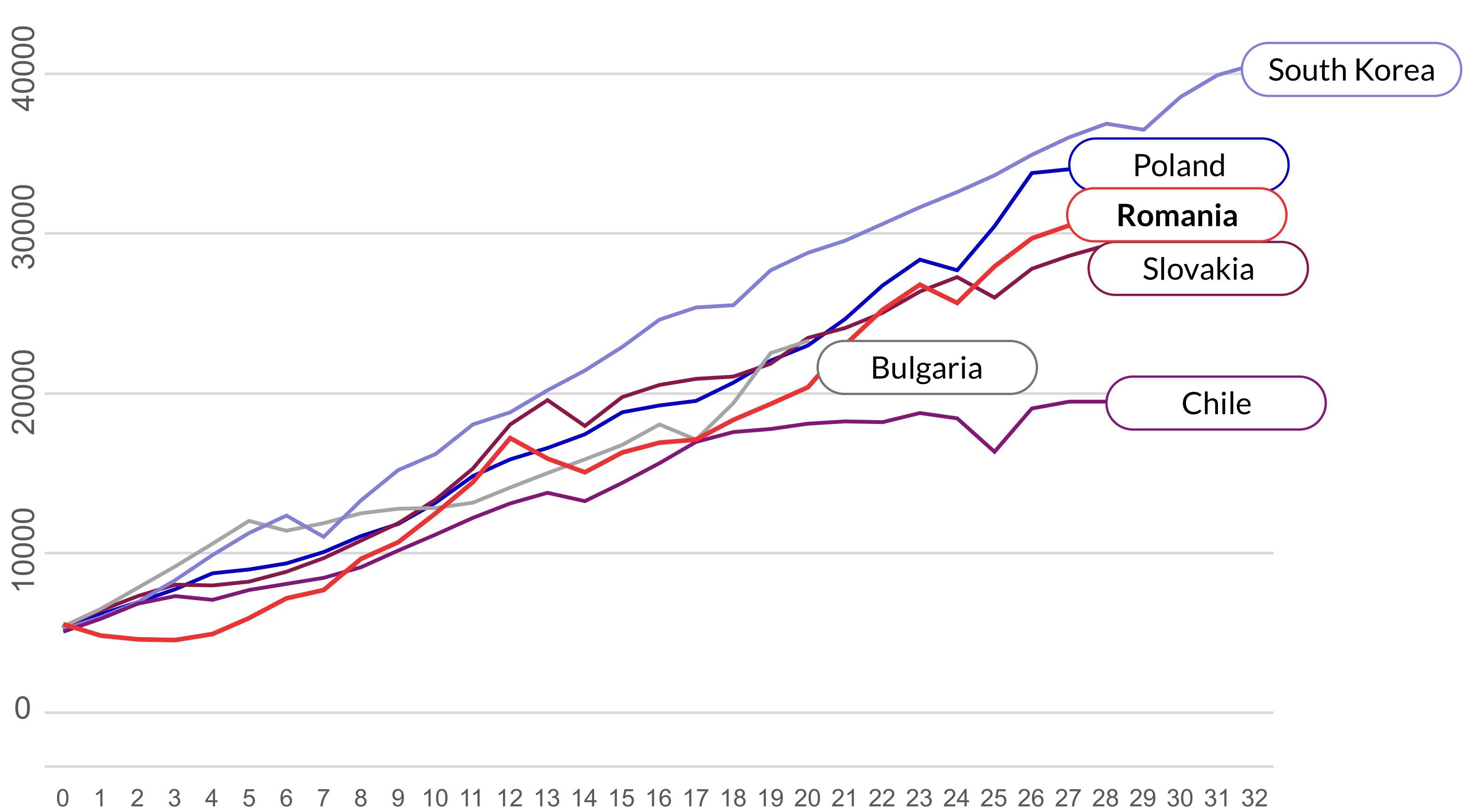


Source: own compilation based on Eurostat data

The second frequently analyzed global example of an "economic miracle" is Chile, the richest of South America's major economies. Chile managed to double its per capita income in less than 18 years, rising from $15,000 to $28,000. A third example of success is Poland, which increased its GDP per capita from $15,000 to $40,000 over 25 years and has continued to experience growth.

The impressive pace of global growth leaders

Growth of GDP per capita (in purchasing power parity, at 2021 constant prices) in subsequent years since reaching $15,000



Note: the first year in which a country's GDP per capita in purchasing power parity exceeded $15,000 was taken as the initial year for comparison.
Source: own compilation based on Eurostat data

When we analyze Romania's growth against this backdrop, it's clear that Romania can also be described as a growth champion. It took the Romanian economy 27 years to grow from $15,000 to $40,000 in per capita income. While slightly behind South Korea, Romania is growing almost "head to head" with Poland and is already one-third richer than Chile.

During this period, Romania not only grew rapidly but also avoided major crises in economic growth. It experienced year-on-year declines in GDP per capita only three times: first, during the crisis of emerging economies in the late 1990s, then during the global financial crisis of 2008-09, when Romania struggled to finance its budget deficit and had to seek assistance from the International Monetary Fund (IMF). The third decline occurred during the 2020 pandemic. After each of these crises, Romania rebounded with rapid growth, demonstrating its strong resilience.

Romania's moderately successful transition through the 1990s, the first decade of its political and economic shift, was also key to its growth. This is evident when comparing Romania with Bulgaria. In 1991, both countries had almost the same level of GDP per capita in purchasing power parity, around $14,000 (in constant 2021 prices). Both experienced declines in the following years, but Romania began to recover more quickly. By 2003, Bulgaria had only just reached a per capita income of $15,000, while Romania's had already risen to nearly $18,000. In the years that followed, both economies grew at similar rates, but this initial gap meant that today, Bulgaria's GDP per capita is 20 percent lower than Romania's.

Romanian model of economic development. What makes Romania's economy stand out in Central and Eastern Europe.

Romania's economic success shares many common factors with other Central and Eastern European economies that have joined the European Union.

However, what distinguishes Romania is its strongly developed ICT and business services sectors, very high wage competitiveness, and limited sensitivity to fluctuations in international trade.

The development model of CEE economies since the 1990s has been built on three key pillars: a highly favorable ratio of wages to labor skills, integration into the European Union, and substantial inflows of foreign capital. These factors, however, were only made possible by the rapid reforms that followed the collapse of socialism, which established free market economies and democratic, inclusive institutions across the region (Piatkowski, 2018).

Romania's economic development fully fits this model, but is distinguished by several important factors. These cause the economy to grow faster than that of other countries in the region, and it also shows greater stability.

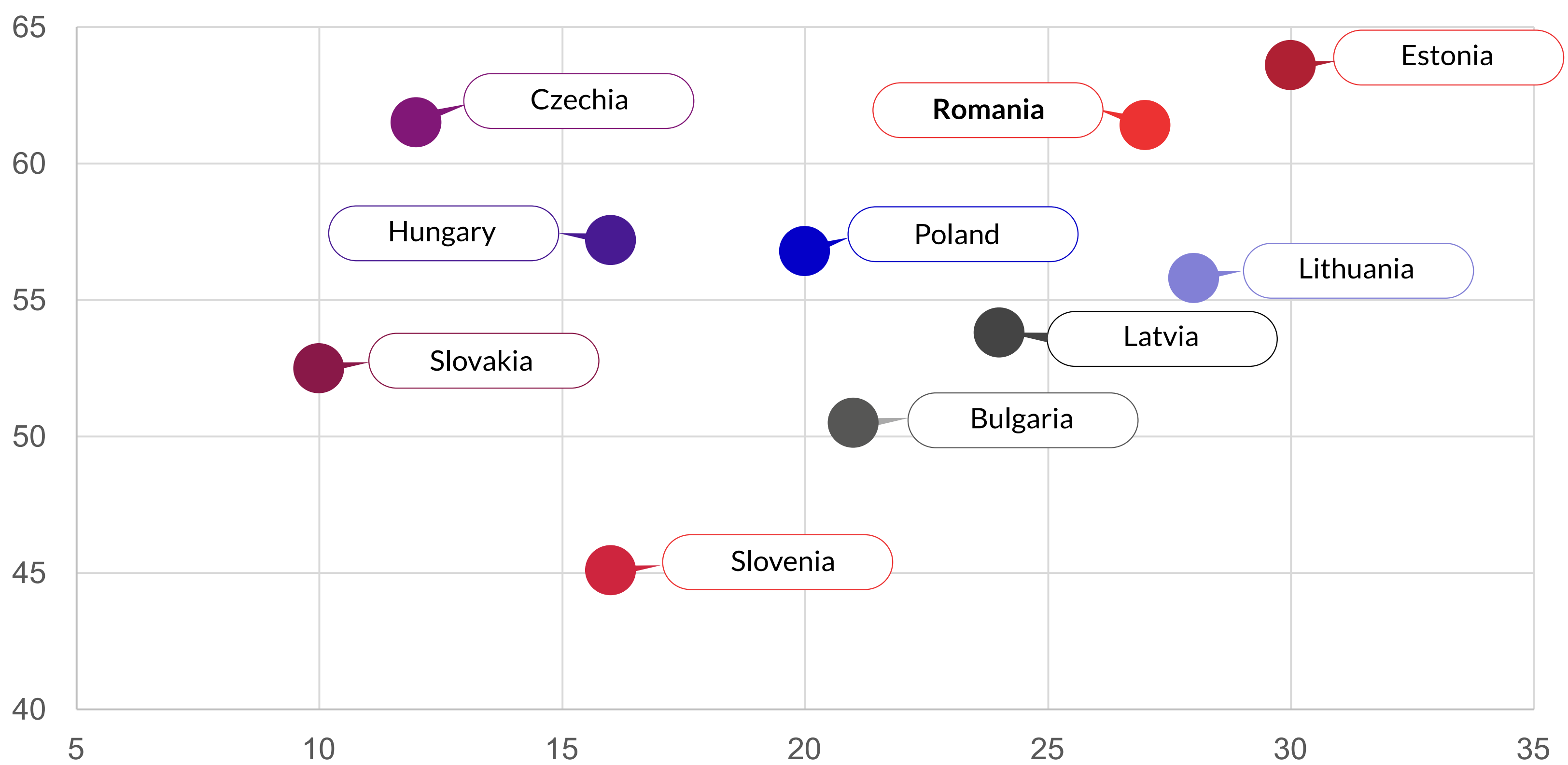
The first key factor is the significant role of the modern services sector, particularly the ICT and business services sector (BSS). This includes shared services centers (SSC) and business process outsourcing (BPO).

According to Eurostat data, the ICT sector accounted for 4.5 percent of Romania's GDP in 2021 (the latest available data), a value that has increased by more than half since 2011. Approximately 80 percent of this was generated by IT services. While this is a moderately high figure compared to other countries in the region, what sets Romania apart is its strong focus on serving foreign markets.

ICT service exports account for more than 60 percent of Romania's total service exports. Additionally, the share of services exports in the country's overall exports, including goods, is notably high. As illustrated in the chart below, Romania ranks second in the region in this regard, surpassed only by Estonia.

IT services as a driver of export growth.

Share of services exports in total state exports in 2021 (horizontal axis) and the share of ICT services in services exports (vertical axis)



Source: own compilation based on COMTRADE and IMF data

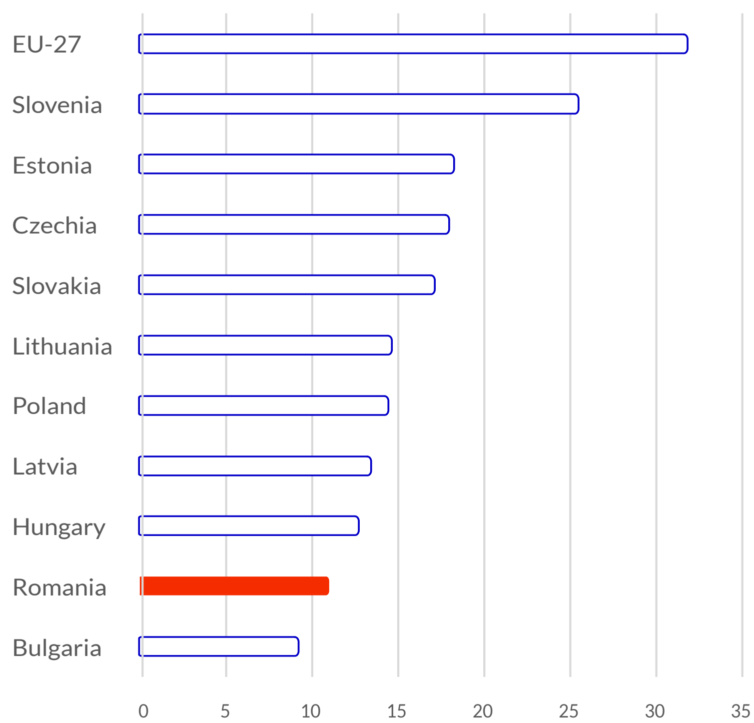
What are the benefits of a strongly developed ICT services sector? The first direct benefit is the creation of high-paying jobs. The second is knowledge transfer. Numerous studies, such as Chatterjee (2017), show that multinational corporations invest heavily in training and upgrading the skills of their employees. This raises the level of human capital in the economy but also increases the likelihood of employees founding local companies. Romania's ICT sector also plays a crucial role in research and development (R&D), accounting for nearly one-third of the entire private sector's R&D spending.

A third benefit of the development of the ICT sector is its role in counteracting the so-called brain drain. The availability of well-paid jobs in Romania reduces the incentive for young, well-educated workers to emigrate in search of better opportunities abroad.

Another factor that distinguishes Romania from other countries in the region is its very high wage competitiveness. In 2023, the average unit labor cost per hour in the private sector—encompassing wages and all non-wage charges that employers must pay—was €11. This figure ranked Romania as having the second-lowest labor costs in the entire EU, just ahead of Bulgaria, and was only one-third of the EU average. In this regard, the Romanian economy diverges significantly from other CEE economies; for instance, labor costs in Poland and Lithuania were 30 percent higher, in Slovakia over 50 percent higher, and in Czechia and Estonia 65 percent higher.

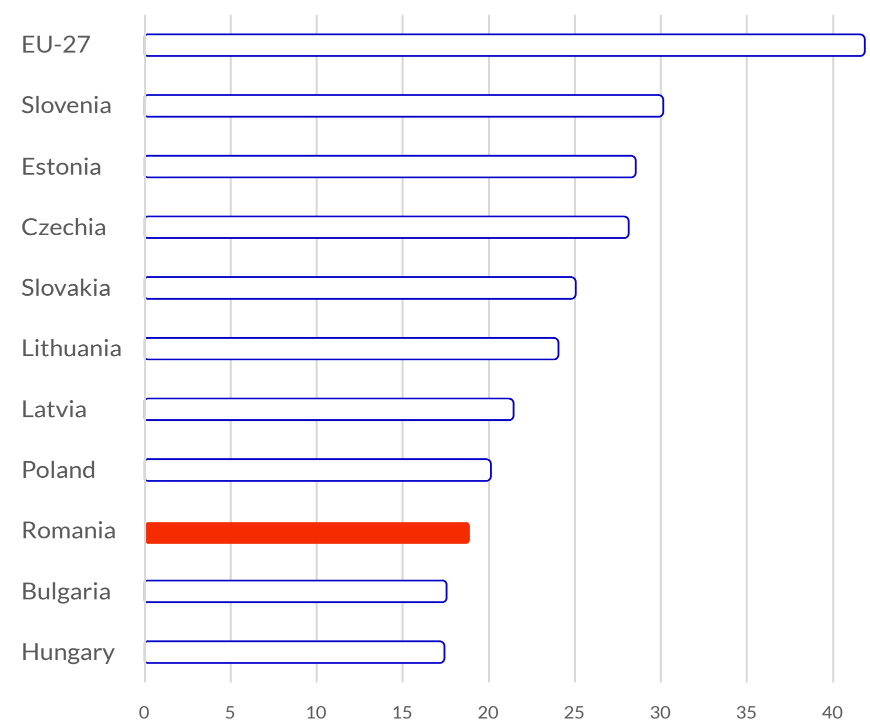
Competitiveness through low labor costs...

Unit labor costs in the private sector in Central and Eastern European countries (in EUR) in 2023.



... also in the IT sector

Unit labor costs in the ICT sector in Central and Eastern European countries (in EUR) in 2022.



Source: own compilation based on Eurostat data

Similarly, average unit labor costs in Romania's ICT sector are low compared to both the EU average and other countries in the region. Although the differences are not insignificant, they remain quite pronounced. Notably, labor costs in the ICT sector—primarily wages—are more than 70 percent higher than in the business sector as a whole. This disparity makes the ICT sector very attractive for employees, while still allowing foreign companies to employ them at a lower cost than in other countries in the region.

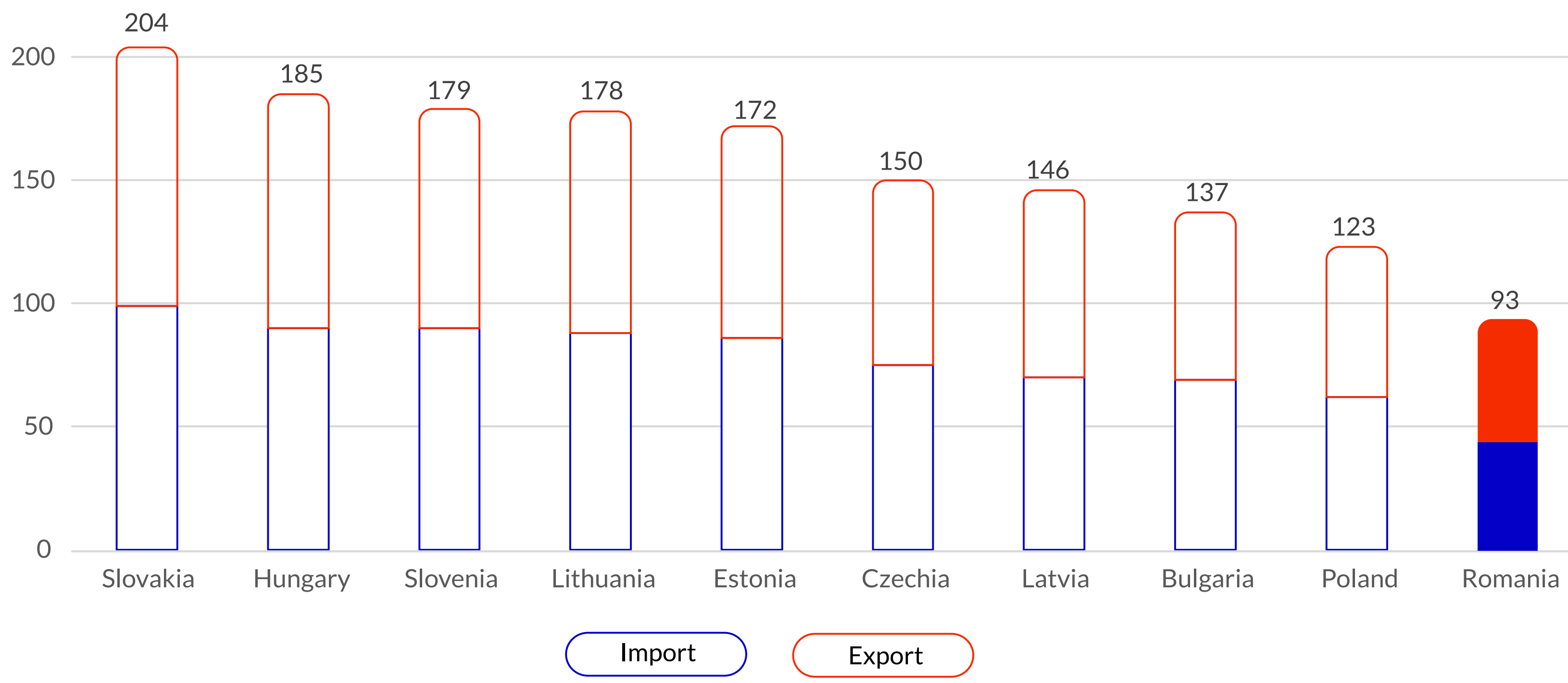
The third factor is the low ratio of international trade to GDP. While this typically indicates a lower level of competitiveness in the economy, in Romania's case, it also limits sensitivity to volatility in global markets.

In 2022, the share of international trade—calculated as the sum of the volume of exports and imports of goods and services relative to GDP—was 93 percent for the Romanian economy. This figure was by far the lowest among CEE countries. For comparison, Slovakia had more than double this indicator, while Hungary and other countries also recorded significantly higher values.

Part of this is attributable to Romania's relatively large economy in the region, which allows it to conduct much of its trade within the internal market. However, the trade-to-GDP ratio in Romania was almost 30 percentage points lower than that of Poland, whose domestic market is more than twice the size. This indicates that the Romanian economy is simply less integrated into the global economy. On the positive side, this situation presents an opportunity for Romania to potentially catch up faster with more developed economies, as the trade-to-GDP ratio increases.

The Romanian economy is poorly globalized.

International trade as a share of countries' GDP in 2022 (in percent).



Source: World Bank based on Eurostat data

While a low ratio of international trade to GDP can be viewed as a negative phenomenon—since, in general, international trade promotes development—it also has its advantages. Economies with a high share of international trade in GDP often experience significant volatility, as trade, particularly in certain commodities, can fluctuate dramatically. For instance, Slovakia felt the impact acutely during the 2009-10 global automotive market collapse, which led to a crisis as demand for cars—the country's main export commodity—plummeted. Similarly, weak foreign demand is currently driving the recession in the Baltic states. In Romania's case, the risk of a crisis due to fluctuations in international trade is limited.

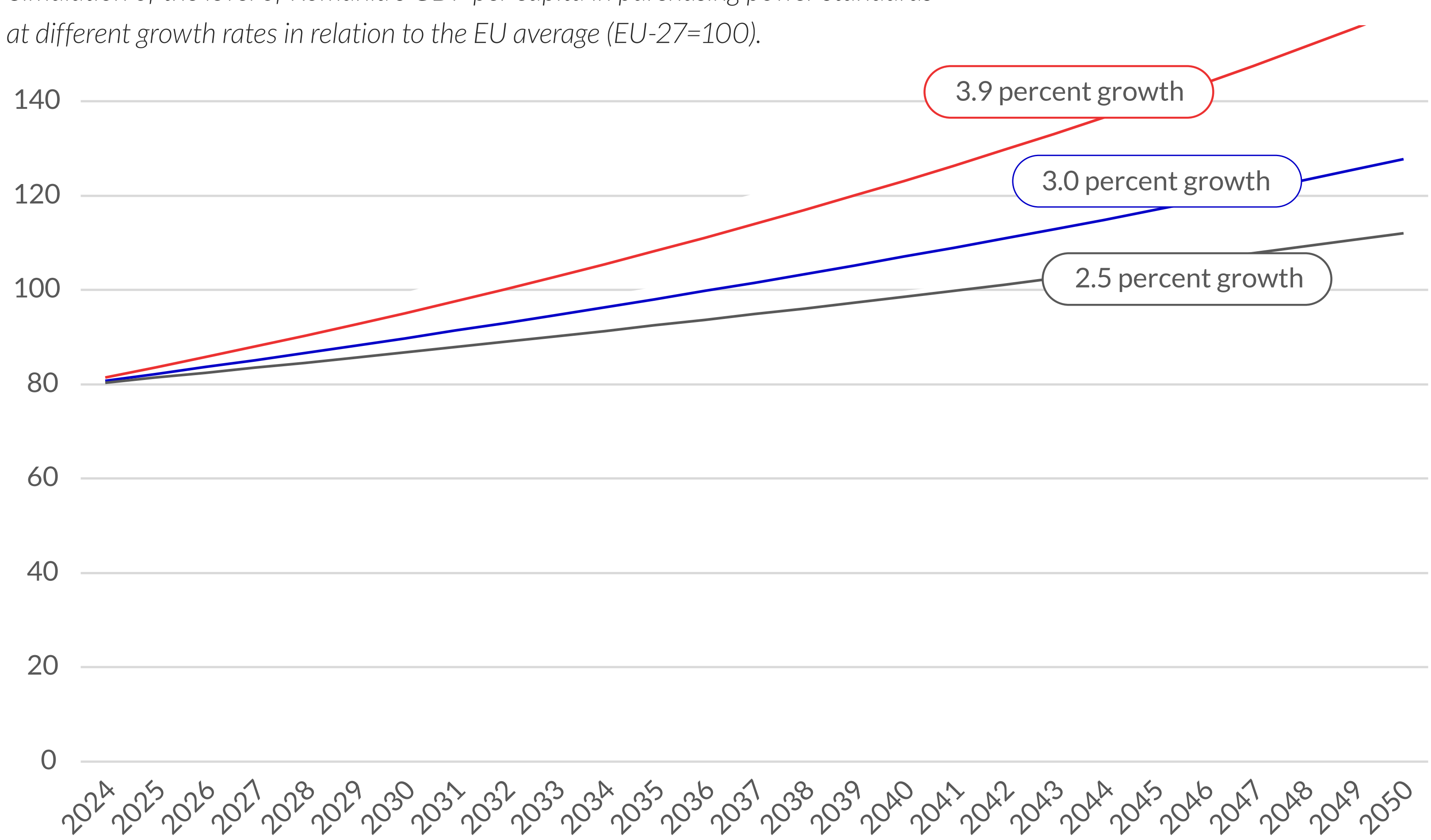
A global IT powerhouse? The future of the Romanian economy

Romania faces a significant journey in its economic development, with two major milestones ahead. The first is to match the average wealth of the European Union's population—a goal that could be within reach in the next decade, despite several looming risks that could jeopardize progress. The second, more ambitious target, is to join the global economic elite. Achieving this will demand a profound transformation of Romania's economy, a challenge that lies much further in the future.

If Romania sustains its 3.9% growth rate from the past five years while the EU maintains its 1.2% per capita GDP growth, the country could catch up to the EU average in just eight years. Although keeping up such a high growth rate will be challenging, even with a slowdown to 3%, Romania could still reach this goal in roughly 12 years. In a more drastic scenario, where growth slows to 2.5%, Romania would still catch up to the European average before 2045.

When will Romania catch up to the EU average?

Simulation of the level of Romania's GDP per capita in purchasing power standards at different growth rates in relation to the EU average (EU-27=100).



Source: World Bank based on Eurostat data

However, Romania's economy faces several fundamental risks that could hinder its rapid growth as early as the next decade.

The first major risk is the rapid advancement of artificial intelligence in professional services, leading to the mass automation of IT jobs and shared service centers. Recent studies by international financial institutions (Lane et al., 2023; Brollo et al., 2024) and labor market data from developed economies show AI's potential to displace IT professionals. This trend is also emerging in fields like accounting and remote customer service. As a result, investment in these sectors could slow, or existing investors may pull out. However, there's also the possibility that new jobs created by AI's growth could offset these losses.

The second major risk involves structural changes in sectors where Romania is a key exporter. As noted in chapter two of this report, Romania's economy benefits from a relatively low share of international trade in its GDP, which enhances its resilience to global economic fluctuations. However, foreign demand fluctuations are one thing—structural shifts in global value chains are another. Such changes can cause global companies to lose market share or even exit the market entirely.

Romania's merchandise exports are quite heavily concentrated in three sectors - electrical machinery and equipment (19 percent of merchandise exports), automotive (15 percent) and industrial equipment (11 percent). Nowadays, especially in the automotive sector, we are seeing major changes related to the development of electromobility, which put the future of some players in question. They may lead to the reorganization of supply chains, including production cuts and even the closure of production facilities.

The third significant risk lies in Romania's macro-fiscal policy, particularly its so-called twin deficit—the simultaneous fiscal and current account deficits. According to the European Commission's spring forecast, Romania's fiscal deficit was 6.6% of GDP in 2023, and it's projected to deepen to 7% by 2025. The current account deficit stood at 6.7% and is expected to remain at that level through 2025. This makes Romania vulnerable to external shocks, particularly those tied to financing its borrowing needs and the rising cost of such financing. Moreover, Romania is currently under the EU's excessive deficit procedure, and in July 2024, the EU Council ruled that Romania had failed to take sufficient steps to reduce the deficit. This could lead to a freeze on certain EU funds as early as 2025. To avoid this, Romania will need stronger fiscal consolidation in the coming years, which could, in turn, slow down economic growth.

Another area of concern is security risks. The war in Ukraine has permanently altered the region's geopolitical landscape, making it impossible to fully rule out the possibility of a conflict between NATO and Russia. Fortunately, the likelihood remains low, and the risk of such a conflict directly affecting Romania is even lower. However, if it were to happen, it would trigger a sharp outflow of capital from the region, and Romania would likely be drawn into the conflict. This could place a long-term drag on the country's economic development.

Adding to these challenges are domestic issues, particularly political instability and corruption. Romania has seen nine prime ministers in the past decade and consistently ranks among the worst in the EU on the Corruption Perception Index. This instability makes it difficult to implement a coherent, long-term socio-economic policy.

Romania’s economy also has several opportunities that could sustain its dynamic growth. Among these are the trends of nearshoring and friendshoring. Nearshoring involves relocating factories closer to target markets, primarily from Asia, to avoid supply chain disruptions—such as the transportation delays that plagued global trade during the pandemic. Friendshoring, on the other hand, refers to shifting production from countries like China to politically allied nations, driven by the escalating tensions between China and the US, and the West more broadly. Romania stands to benefit from both of these trends in the coming years.

Romania’s economy could also attract investment related to climate transformation and the development of "green" supply chains—production chains focused on low-carbon technologies. The World Bank highlights Romania’s strong potential in this area, particularly in manufacturing for the wind energy sector (World Bank, 2023).

If Romania can effectively mitigate its risks while capitalizing on emerging opportunities, will it join the ranks of the world's economic leaders? Unfortunately, not yet. Achieving this status will require a profound transformation of the economy and a shift towards fostering global-scale innovation. However, there are signs of this potential beginning to emerge in the IT sector. A prime example of Romanian success is UiPath, a company specializing in software for automating robotic processes. Founded in 2005 in Bucharest, UiPath is now listed on the New York Stock Exchange (NYSE) with a market capitalization of $7 billion.

There are many more companies in the broader Romanian IT sector that provide a solid foundation for building a thriving ecosystem of innovative start-ups on a global scale. Achieving this goal necessitates a combination of various factors, also in economic policy—improving the quality of science and human capital, ensuring adequate financing, and enhancing the capacity to attract highly skilled workers through immigration. While this will undoubtedly be a challenging endeavor, the progress of the Romanian economy thus far demonstrates that such a mission is attainable.

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