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Edited by
Marlena Gołębiowska

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Executive summary

The analysis of competitiveness in Central European economies, which have undergone significant transitions from centrally planned to market-based systems, offers valuable insights into the dynamics of economic development and integration within the European Union. This Policy Paper focuses on Estonia, Lithuania, and Romania – three countries that represent diverse paths of economic transformation in the region. Their unique approaches to economic policy, institutional reform, and global market integration provide a case study in enhancing national competitiveness. By examining their competitive strengths, challenges, and strategies against the backdrop of other Central European countries, we can extract valuable lessons that are applicable to all countries in the region.

Comparing the competitiveness of Estonia, Lithuania, and Romania

- According to the IMD World Competitiveness rankings for 2023, Estonia leads the three countries,

securing the 26th position out of 64 evaluated countries. Despite a slight drop from its 22nd place in 2022, Estonia maintains a strong overall competitive stance.
- Lithuania occupies the 32nd position, reflecting a moderate level of competitiveness, with notable strengths in business efficiency.
- Romania ranks 48th, marking an improvement from its 51st position in 2022. Although this ranking is lower than its Central European counterparts, it signifies progress in enhancing the country's competitive standing.

Best practices and lessons for other Central European countries

- Estonia's comprehensive and radical reforms in the 1990s, particularly in digitalization and business-friendly legislation, provide a model for rapid and effective economic transformation. Its success in creating a digital society and e-government services demonstrates how small countries can leverage technology to enhance their competitiveness.
- Lithuania's focus on export diversification and economic structure provides valuable lessons. Its success in maintaining a strong manufacturing sector while promoting high-tech industries and innovation shows the importance of balancing traditional strengths with future-oriented development.
- Romania's gradual improvement in the rule of law and its efforts to combat corruption highlight the crucial role of institutional reforms in enhancing competitiveness. Its experience also underscores the need to

move beyond reliance on low labour costs to develop more sustainable competitive advantages.

The experiences of Estonia, Lithuania, and Romania underscore the critical role of institutional reform and adaptability in enhancing national competitiveness. Effective governance, transparent regulations, and the ability to adapt to changing global market conditions prove fundamental in improving competitive positions. Moreover, EU integration has served as a catalyst for reforms and economic development in these countries. This process has not only opened new markets but also encouraged the adoption of best practices, further boosting these countries' global competitiveness.

Marlena Gołębiowska

Foreword: capturing the essence of competitiveness

"Basically, rising competitiveness means rising prosperity"[1]. This simple yet profound statement encapsulates the essence of why competitiveness matters. It is not merely an academic concept or a metric for economists, but an important indicator that reflects a country's ability to efficiently use its resources, create an environment conducive to business growth and innovation, and compete in global markets.

As the International Institute for Management Development (IMD) aptly notes: "Governments play a crucial role, by providing an environment characterized by efficient infrastructure, institutions, and policies that can encourage sustainable value creation on the part of enterprise"[2]. This observation underscores the multifaceted nature of

1 O. Cann, *What exactly is economic competitiveness?*, World Economic Forum, 27 September 2017, https://www.weforum.org/agenda/2017/09/what-is-economic-competitiveness/.

2 *World Competitiveness Ranking*, International Institute of Management Development, 2023, https://www.imd.org/centers/wcc/world-competitiveness-center/rankings/world-competitiveness-ranking/.

competitiveness. It is not solely about the prowess of individual companies or industries, but about the entire ecosystem in which they operate. A truly competitive economy is one where policy, infrastructure, education, and innovation converge to create an environment conducive to sustainable growth and development. In today's rapidly evolving global landscape, marked by technological development, geopolitical shifts, and pressing environmental concerns, the nature of competitiveness is continually being redefined. Countries must not only excel in traditional areas but also demonstrate agility, resilience, and foresight.

Competitiveness is a key focus of the European Union's developmental strategy. The importance of this issue was highlighted by Ursula von der Leyen, the President of the European Commission, in her State of the Union address in September 2023. She emphasized the critical role of competitiveness in strengthening the EU's position on the global economic stage. Earlier in 2023, the European Commission's communique on the 30th anniversary of the single market presented the EU's current competitive position and prospects[3]. While acknowledging many achievements, the document also pointed out significant challenges. These include a slower rate of productivity growth compared to other economies which, combined with demographic challenges, pose a threat to the EU's future ability to compete globally. Such observations underscore the crucial role of competitiveness in driving economic growth and integration across

3 *Long-term competitiveness of the EU: looking beyond 2030*, European Commission, 2023, https://commission.europa.eu/system/files/2023-03/Communication_Long-term-competitiveness.pdf.

the diverse economies of the EU. Furthermore, they emphasize the need for a more in-depth understanding of competitiveness at both the EU and individual member state levels to address these challenges effectively.

A significant role in assessing competitiveness is played by analyses conducted by international organizations. One such organization is the IMD, which publishes the comprehensive World Competitiveness Ranking. This ranking includes 64 economies (including nearly all EU countries except Malta) and is based on more than 330 competitiveness criteria. These criteria are selected based on a broad review of economic reports and international, national, and regional data sources, as well as opinions from business representatives, the academic community, and government agencies. Moreover, the ranking incorporates survey research from executive staff of companies operating in the studied countries regarding key indicators of investment attractiveness.

To provide a comprehensive analysis of competitiveness in the Central European region, this Policy Paper invites authors to contribute in-depth studies of three selected economies, all members of the European Union – Estonia, Lithuania, and Romania (it is worth noting that while focusing on these specific countries, the authors also provide broader insights into the competitiveness landscape of Central Europe, comparing their findings with other countries in the region). These three countries were chosen for their distinct characteristics and experiences, offering a diverse representation of Central European economies. Estonia, known for its advanced digital economy and e-governance initiatives, represents a Baltic state that has made remarkable progress in transitioning from a post-Soviet economy to a modern, innovation-driven one. Lithuania, another Baltic state, showcases a different path of economic development, with a strong focus on export-oriented growth and business efficiency. Romania, as a larger country in the region, provides insights into the challenges and opportunities faced by Central European countries still addressing the legacy of their communist past while pursuing economic modernization. Despite their differences in size, population, and specific economic focuses, these countries share common experiences of post-communist transition and EU integration. Their diverse paths to competitiveness offer valuable lessons for other Central European countries and beyond.

Contributors analyse these countries using data from the IMD World Competitiveness Ranking for the years 2019–2023, along with other relevant economic indicators and qualitative assessments. The primary objective is to uncover the dynamics behind these countries' competitiveness rankings, identify key drivers of competitiveness, and highlight best practices from each country. By benchmarking these economies against each other and other Central European countries, we aim to create a valuable repository of successful strategies and policies that have enhanced their competitiveness.

Meelis Kitsing, in his analysis of Estonia, highlights the country's radical and far-reaching reforms since the breakup of the Soviet Union. He emphasizes that decades of reform efforts have resulted in high government efficiency, an open business environment, and an advanced infrastructure. Despite recent macroeconomic challenges, Kitsing argues that Estonia has key ingredients in place to overcome temporary setbacks, attributing this to long-term evolutions during the last decades.

Jonė Kalendienė, focusing on Lithuania, notes that the country has experienced remarkable growth over the past two decades. Kalendienė emphasizes Lithuania's success in gaining export market shares and its strong performance in business efficiency, as reflected in the IMD competitiveness index. The author highlights three key competitive advantages of the Lithuanian economy: its economic structure, focus on innovation, and business agility.

Radu-Cristian Mușetescu and Mihai Sebe, in their study of Romania, discuss the country's challenging journey from a Soviet-style command economy through timid reforms of transition. They note that while Romania has made progress in establishing a more independent judicial system and a more coherent government, it still faces challenges in areas such as trade deficit and inflation. The authors argue that Romania's main competitive advantage currently lies in its low labour costs, which have attracted foreign companies but may also hinder the development of more sustainable competitive advantages.

These diverse perspectives offer valuable insights into the competitiveness dynamics of Central European economies, revealing how historical legacies, policy choices, and adaptive strategies shape each nation's path in the global marketplace. While focusing on Estonia, Lithuania, and Romania, the analyses draw comparisons with other Central European countries, providing a broader context for understanding regional competitiveness. This approach allows for the identification of common challenges, shared successes, and unique solutions across the Central European landscape, offering valuable lessons for the broader region's economic development and competitiveness strategies.

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Meelis Kitsing

Estonian reforms and competitiveness: past, present, and future trajectories

Introduction

Estonian reform efforts have been among the most radical and far-reaching in Central and Eastern Europe since the breakup of the Soviet Union. The fight against corruption and a push for increasing transparency have been central to the comprehensive reforms carried out by the Estonian government. These reforms have strongly altered economic, trade, fiscal, and monetary policies, as well as overall governance by imposing the rule of law, delivering efficiency, and relying on digitalization.

Recent years have been more challenging with the Covid pandemic, the full-scale war in Ukraine, a rapid increase in consumer prices, and a reduction in key export markets negatively impacting Estonian macroeconomic performance. However, data from the International Institute of Management Development (IMD) World Competitiveness Booklet

2023 reveal that decades of reform efforts have resulted in high government efficiency, an open business environment, and advanced infrastructure.

Hence, Estonia has the key ingredients in place to overcome the temporary macroeconomic setbacks of recent years. These developments did not happen overnight but are the result of long-term evolution over the last decades. Understanding this evolution is crucial for explaining Estonia's current competitiveness.

This chapter begins with a broad overview of key Estonian economic reforms from the past decades to provide context for understanding the current state of Estonian competitiveness. This is followed by a discussion of Estonia's economic performance, business, government efficiency, and infrastructure development. The final section explores potential future trajectories based on scenarios developed at the Foresight Centre of the Estonian Parliament. The chapter concludes by discussing the Estonia 2035 strategy and highlighting five best practices.

The key economic reforms

Five different reforms were essential for Estonia's transition from a socialist planned economy and a country with devastating Soviet legacies to one of the most democratic and freest economies in the world.

First, the Estonian government implemented the rule of law in the 1990s, which secured property rights and established a hard budget constraint[1]. This prevented a select

[1] N.A. Abrams, M.S. Fish, *Policies first, institutions second: lessons from Estonia's economic reforms*, "Post-Soviet Affairs" 2015, vol. 31, no. 6, pp. 491–513.

few with political access and connections from enriching themselves at the expense of the state and taxpayers. The rule of law is crucial for reducing corruption, and today Estonia has the lowest levels of corruption among the former Soviet Union and socialist countries. The credible commitment to the rule of law and equal treatment of all enabled Estonians to carry out rapid and large-scale privatization in the 1990s. Most state-owned companies were sold to international strategic investors. This also helped attract foreign direct investments. Estonia now has the highest level on net inflows of FDI per capita in Central and Eastern Europe.

Second, the Estonian government implemented radical monetary policy reform by introducing a new currency, the *kroon*, in 1992, along with a currency board[2]. The *kroon* was pegged to the German mark (and later to the euro), with the currency in circulation backed by assets denominated in German marks (and later in euros). This was done against the advice of the International Monetary Fund, which had suggested that Estonia remain in the ruble zone. This monetary policy arrangement lasted until 2011, when Estonia joined the eurozone.

Third, the Estonian government carried out one of the most exceptional trade policy liberalizations in world history[3]. From 1993 to 2004 – up until Estonia joined the European Union and adopted its trade policy regime – the country employed a policy of unilateral free trade on all

2 A. Freytag, *Challenges to Estonia's economic policymaking at the eve of EU enlargement*, "Demokratizatsiya" 2003, vol. 11, no. 4, pp. 535–554.

3 M. Feldmann, R. Sally, *Magnus Feldmann and Razeen Sally: From the Soviet Union to the European Union: the political economy of Estonian trade policy reforms, 1991–2000*, Bank of Finland Institute for Economies in Transition (BOFIT), Helsinki 2001, BOFIT Online.

goods, including agriculture. This reform allowed Estonian businesses to reorient rapidly to Western markets. In 2000, only 2% of Estonian exports went to Russia (its main trading partner during Soviet times), while most of its trade was with EU countries.

Fourth, the Estonian government has pursued a conservative and prudent fiscal policy since the early 1990s[4]. During periods of economic growth, Estonia builds reserves which can be used in times of economic downturn. Until the Covid pandemic, Estonia's public sector debt-to-GDP ratio remained below 10% for most of the time. Covid-related emergency measures increased the debt ratio to 20% of GDP, which is still the lowest in the EU. In general, Estonia has aimed to maintain a balanced public sector budget. Estonia has a simple and proportional tax system which was introduced in the 1990s. There is no corporate income tax on re-invested and undistributed profits. However, recent crises have created challenges for the balanced budget paradigm and introduced more progressive elements in the tax policy as well as increases in various taxes.

Fifth, Estonia has been at the forefront of the digitization of both private and public sector services[5]. Internet banking was introduced in 1996, and Since 2000, it has been possible

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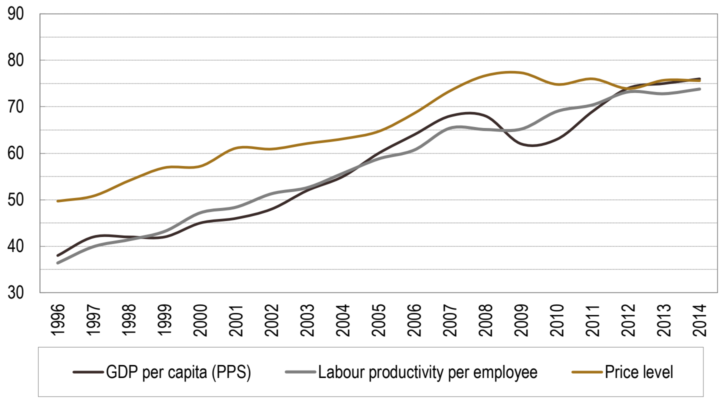
4 Ibid.

5 M. Kitsing, *Internet banking as a platform for E-government*, „The Conference Proceedings of 7th Annual International Conference on Innovation and Entrepreneurship. Singapore", 2017, pp. 99–107; M. Kitsing, *The political economy of digital ecosystems: Scenario planning for alternative futures*, Routledge 2021; T. Martens, *Electronic identity management in Estonia between market and state governance*, "Identity in the Information Society" 2010, vol. 3, no. 1, pp. 213–233; Eurostat, *Data on individuals using internet for internet banking*, Brussels 2024; European Commission, *The Digital Economy and Society Index*, Brussels 2024, https://ec.europa.eu/digital-single-market/en/digital-economy-and-society-index-desi.

to declare taxes online. Since 2005, citizens have been able to vote online, with online voting reaching up to half of all votes cast in some elections. For the past seven years, Estonia has leveraged its digital platform built around the national ID card, inviting people from all over the world to become e-residents of Estonia.

The impact of these reforms is visible in productivity, price levels, and GDP per capita convergence with the European Union average, as the following figure demonstrates.

Figure 1. Estonian labour productivity, price levels, and GDP in relation to the EU average (1996–2014)



Source: Estonian Government Office 2016.

In 1996, Estonia's GDP per capita and labour productivity per employee were less than 40% of the EU average. However, both indicators reached 75% of the EU average by 2014. Nevertheless, progress has been slower as Estonia has grown wealthier over time, and its GDP per capita remains below the EU average. Meanwhile, the capital city of Tallinn and its surrounding county have a GDP per capita of 120%

of the EU average, while in many other parts of Estonia, it is only half of that.

Recent economic performance

Developments in the competitiveness of the Estonian economy are revealed by data from the IMD competitiveness study (for full disclosure, the author was one of the respondents to the survey of this IMD study). Economic performance indicators have declined as Estonia is grouped among the "inflation losers"[6]. Estonia was ranked 26th in 2023, which is an improvement compared to its 36th position in 2019. Among European countries and countries with a population under 20 million, Estonia ranks 19th. The following table gives an overview of Estonia's rankings between 2019 and 2023, and compares Estonia with countries in the region.

Table 1. Ranking of Estonia in comparison with selected countries in the IMD Competitiveness Index

Country/Year	2019	2020	2021	2022	2023
Denmark	8	2	3	1	1
Estonia	36	28	26	22	26
Finland	15	13	11	8	11
Latvia	40	41	38	35	51
Lithuania	29	31	30	29	32
Poland	38	39	47	50	43
Sweden	9	6	2	4	8

Source: Composed by the author based on IMD.

6 *IMD World Competitiveness Booklet 2023*, International Institute of Management Development, Lausanne 2023.

Overall, Estonia's performance has been better than that of the other two Baltic states and Poland. At the same time, Nordic countries have outperformed Estonia. Although the rankings of Finland and Sweden declined in 2023, Estonia's ranking also dropped compared to 2022. This development was caused primarily by factors categorized by the IMD as economic performance. Estonia had its weakest result in the category of domestic economy, where it ranked 61st globally. In other categories, Estonia ranked 42nd in employment, 36th in international trade, 35th in international investment, and 32nd in prices.

The low ranking in employment is somewhat unclear, given that the unemployment rate has increased only slightly. While GDP has been declining over the last three years, it has not affected the labour market significantly. The negative GDP contribution has primarily come from the energy and manufacturing industries, which are capital-intensive rather than not labour-intensive. Specifically, industries exporting investment goods have suffered due to a reduced demand in the Swedish construction industry. Conversely, the export of services has boomed because of globally competitive digital companies. Estonia has 10 unicorns and many startups, translating into the highest ratio of unicorns and venture capital investments per capita. However, this has not been sufficient to offset the reduction in exports from traditional industries.

The following table provides an overview of the dynamics of Estonian key macroeconomic variables and a forecast for the coming years. The forecast by the Ministry of Finance foresees a modest recovery of the Estonian economy. The Estonian Consumer Price Index (CPI) is expected to rise at a slower rate compared to recent years, GDP growth is projected to be driven by productivity growth, though this is not expected to exceed the growth of real wages. Exports are expected to make a positive contribution starting in 2025, while the unemployment rate is expected to decline gradually.

Table 2. Estonian key macroeconomic indicators and forecast in percentages in comparison with the previous year (except for unemployment rate)

Indicator/Year	2023	2024	2025	2026	2027
GDP growth	-3.0	0.00	3.3	2.8	2.5
Consumer Price Index	9.2	3.4	2.5	2.1	2.0
Exports (real)	-6.9	-0.7	2.9	3.2	3.0
Current account	-2.1	-2.5	-3.0	-3.0	-2.5
Investments	-3.4	-2.1	4.6	5.9	-0.7
Unemployment Rate (%)	6.4	7.2	6.7	6.3	6.2
Growth of real wages	2.1	2.5	2.5	2.8	2.7
Productivity growth	-5.4	0.3	2.8	2.7	2.5
Government sector real growth	0.9	1.3	1.5	0.0	1.5

Source: Composed by the author with data from Estonian Ministry of Finance (2024).

Business and government efficiency

The outlook for economic recovery is reinforced by Estonia's performance in other categories used by the IMD to assess competitiveness. Estonia performs well in the business efficiency category, where it ranked 17th in management practices. The ability to manage transformation to a cleaner and greener economy is one of the fundamental challenges for the Estonian economy, and an area where good management practices can make a difference. This is further supported by the fact that Estonia ranked 21st in attitudes and values and 26th in productivity and efficiency. However, Estonia's rankings in labour market and finance are 34th and 32nd, respectively.

The potential for a new growth trajectory is further supported by the IMD assessment of government efficiency, where Estonia ranked 5th in business legislation, 14th in public finance, and 17th in institutional framework among all of the 64 countries studied. There is a direct connection here between reforms outlined at the beginning of this article and these assessments. In terms of societal framework and tax policy, Estonia holds the 23rd and 39th positions, respectively. While taxes in Estonia are not low, the tax base is broad and tax collection is efficient.

Beyond basic infrastructure

In the infrastructure category of the IMD assessment, Estonia ranks 14th in education. The Estonian school system has been constantly ranked as the best in Europe and one of the best in the world by the OECD Pisa study. Health and environment is ranked in 23rd place, technological infrastructure ranks 27th, basic infrastructure ranks 34th and scientific infrastructure ranks 41st. Many innovative breakthroughs in Estonia have been knowledge-based process innovations rather than science-based innovations. Already existing technologies have been combined and applied in novel ways. Many unicorns founded by Estonians such as Skype, Wise, Bolt, Veriff, and others are proof in the pudding.

The broad approach taken by the IMD to assess infrastructure was also used by the author while developing potential scenarios for Estonia up to 2035 at the Foresight Centre of the Estonian Parliament. This work broadly covers the digital, energy, and transport sectors as well as both physical and knowledge-based aspects, i.e., so-called hardware and software. Most importantly, the focus is not only on the availability of technology but also on the willingness, capability, and capacity to implement and manage these technologies.

The development of infrastructure is not a simple matter of the internal affairs of states, communities, and other entities. Due to its networked nature, infrastructure often spans national, local, regional, and other borders. Hence, the development of infrastructure is dependent on multiple actors and the ability to ensure collective action. Different levels of collaboration are possible, such as EU-wide or more national approaches.

It is no secret that infrastructure has increasingly become a geopolitical instrument. This is evident, for instance, in Chinese infrastructure funding through the BRICS' New Development Bank and the Asian Infrastructure Investment Bank which are both under Chinese leadership. Chinese investments in Europe, ranging from ports in Greece to technology companies in Finland, have become an increasing concern for European policymakers – particularly in the context of the platformization of business models.

Furthermore, infrastructure impacts not only economic and social affairs but also the European security architecture. The ability of members of the North Atlantic Treaty Organization (NATO) to respond to attacks in Europe depends on the collective capacity of physical and digital security infrastructure. This collective strength is determined by the weakest links in the civilian, security, and military networks.

The advancement of infrastructure is not only heavily influenced by social attitudes concerning new investments but also by a broader factor known as technological anxiety, which varies considerably across Europe. While technological advancement is a source of economic growth, it can also contribute to anxiety and opposition.

Hence, the advancement of infrastructure is not just about measurable objective developments. It also depends on the perception of how different social groups understand its underlying processes and whether social reality will be shaped by certain half-truths. Therefore, the advancement of infrastructure depends on both social opposition and the conformity of the population.

EU cooperation

The issues of anarchy and order, globalization and deglobalization, the roles of different countries, and global collective action dilemmas have highlighted the importance of cooperation within the European Union as the key driver from a perspective of Estonian decision-makers. Given that Estonia is a small and open economy, developments within the EU and the EU's overall competitiveness will have a direct impact on Estonia. Hence, Estonian competitiveness is directly linked with overall EU competitiveness.

EU cooperation may either strengthen or weaken. It also remains uncertain which areas will be prioritized – whether the focus will be primarily on the single market, economic competitiveness, social affairs, foreign policy, or other areas. Essentially, the uncertainty revolves around the effectiveness and scope of EU cooperation and the areas it will entail.

On the one end of the spectrum, the EU may successfully overcome most collective action dilemmas and focus on key areas, particularly strategic ones such as further integration of the single market. The EU's strength is increased not just among the member states by pooling their sovereignty but also on the global stage. On the other end of the spectrum, member states may not be capable of finding sufficient compromises. Cooperation within the EU is fragmented, which could consequently lead to the decline of EU's influence both within Europe as well as in the world.

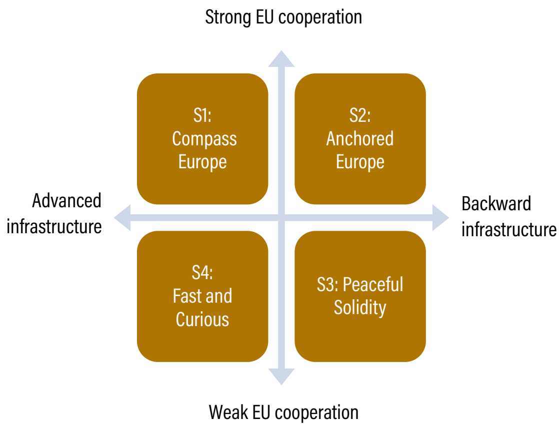
The Estonian competitiveness scenarios until 2035

On the basis of two key drivers – the nature of EU cooperation and infrastructure advancement – the expert-led workshop formulated four scenarios. The combination of advanced infrastructure and strong EU cooperation results in the scenario "Compass Europe", as illustrated in the following figure. Conversely, strong EU cooperation coupled with outdated infrastructure leads to the scenario "Anchored Europe", while weak EU cooperation combined with outdated infrastructure produces the scenario "Peaceful Solidity".

The least likely scenario for the entire EU is the possibility of having advanced infrastructure despite weak EU cooperation, which is labelled "Fast and Curious". However, some parts of the EU may be able to achieve this scenario with the help of Chinese or US investments, as well as a high degree of private sector involvement in developing various infrastructure projects.

The "Compass Europe" scenario implies an increased presence of the European Union in the world and highly advanced infrastructure in the broadest sense, as well as digital infrastructure. In this scenario, cooperation among EU members would increase, and the EU would make substantial investments in energy, transport, and digital

Figure 2. Estonian competitiveness scenarios 2035



Source: Adopted from M. Kitsing, *The political economy of digital ecosystems…*

infrastructure. Through the so-called "Brussels effect", the EU would quietly lead the world by setting standards and creating strong complementarities to the global system provided by European governments and businesses.

The "Anchored Europe" scenario implies stronger EU cooperation, but limited infrastructure development. Here, the EU would focus on expanding social Europe and implementing excessive regulations across various sectors. The EU would remain an important global player, but the ability of European companies to compete in the world market would seriously deteriorate. The EU would adopt a defensive position in the world rather than exercising a more proactive influence on it. Instead of the "Brussels effect", the EU would be characterized by the "Brussels defect", where EU rulemaking is perceived as a barrier rather than an advancement in the digitalization of Europe and the world.

This scenario depicts a world characterized by both a decrease in EU cooperation and outdated infrastructure, including digital platforms that would face fragmentation and social opposition. The limited EU cooperation would also reduce the role of the EU in world politics and economics. The other great powers would shift their focus on Asia and Africa as the EU risks becoming a peripheral region. The EU would not have sufficient resources to invest in its own infrastructure, and other global players would lack incentives to invest in European projects.

This scenario implies limited EU cooperation coupled with the development of state-of-the-art infrastructure in Northern Europe. The EU would focus solely on the single market, which is also often constrained by different policies of member states. In this scenario, China and the US would have an increased presence in Europe. Some EU members would prefer economic cooperation with China while others prefer the United States. The economies of Northern Europe would grow considerably faster than Southern Europe. The Northern economies have also integrated more with the United States. As the states lose their legitimacy, large metropolitan areas and multinational companies would become increasingly important.

Such scenarios highlight a range of probable, plausible, possible, and preferable future trajectories rather than one vision. These alternative scenarios enable the testing of various strategies' robustness for increasing competitiveness.

Estonia 2035

The scenarios discussed above informed the "Estonia 2035" strategy, which sets out five long-term strategic goals for people, society, economy, living environment, and governance. The goals were agreed upon at discussions that took place across Estonia over a period of two years and based on opinion gathering (almost 17,000 people contributed).

The strategic goals are values-based and crucial for guiding the country's strategic choices. They underpin the implementation of all Estonian strategic development documents and are taken into account in the state budget strategy as well as in the preparation of the government's action program. Achieving these goals involves taking into consideration Estonia's development needs, global trends, the policy framework of the European Union, and the global objectives of sustainable development[7].

The basis for achieving these goals is a democratic and secure state founded on freedom, justice, and the rule of law. This foundation respects the principles of the rule of law and is committed to preserving and developing the Estonian nation, language, and culture. This is ensured by a creative, responsible society that values openness and community, preserves and promotes Estonia's identity, and ensures a diverse, accessible, and up-to-date vibrant cultural space[8]. The strategic goals address challenges for improving governance, the economy, and broader social well-being. The strategy document is accompanied by a concrete action plan of government detailing concrete steps to be taken each year to achieve these goals.

7 *'Estonia 2035' development strategy*, Republic of Estonia, Tallinn 2022.
8 Ibid.

The five best practices

Even though institutional contexts are different, the following five best practices can be shared on the basis of Estonian reforms and developments in competitiveness.

First, comprehensive and radical reforms are essential for countries transitioning from a centralized planned economy to a competitive market economy. Gradual and stop-and-go approaches do not work, particularly in the context of multiple overlapping challenges. Estonia carried out simultaneous reforms in the areas of rule of law, privatization, trade, monetary and fiscal policies.

Second, digitalization in both private and public sectors is key to enhancing both government and business efficiency. Comprehensive digitalization in Estonia began in the mid-1990s with the introduction of internet banking, which fostered a culture of using complex digital services in everyday interactions. This, in turn, served as a springboard for constant digitalization experiments in both private and public sectors. Now, Estonia's highly digitalized public services, along with its high number of unicorns and venture capital per capita, position it as a global leader in digitalization among other countries.

Third, Estonia has business- friendly legislation, as highlighted by the IMD study. It is easy to start companies and the tax system is simple. Through the e-residency program, it is possible to use Estonian digital infrastructure all over the world without physical presence in the country.

Fourth, the concept of infrastructure should be broadened within the public policy approach to include education and human capital development. The 2023 IMD study reflects this broader approach, aligning with best practices exemplified by Estonia. Estonia's education system can be perceived as having a soft infrastructure, which is ranked highly by the IMD and ranked best in Europe by the Pisa study of the OECD. While Estonia does not have remarkable outcomes in basic infrastructure and scientific infrastructure, the country's education system has provided the basic skills and knowledge necessary to excel in non-RD innovation. This translates to the development of many innovative business models where a skilful combination of existing technologies has led to 10 unicorns (companies valued more than 1 billion USD) such as Skype, Wise, Bolt, Veriff, and others. In other words, brains matter more than asphalt.

Fifth, the Estonian government has been employing a long-term approach for increasing economic competitiveness. Over the decades, a relatively strong implicit consensus has existed on key economic development goals such as re-integration with the West, trade, monetary, and fiscal policies, while different coalition governments have come and gone. A comprehensive government strategy has been created until 2035. The Estonian parliament hosts a semi-independent think-tank, Foresight Centre, with the aim of stress-testing various strategies and policies against alternative scenarios.

Conclusion

Competitiveness is multidimensional and outcomes are often overdetermined, i.e., many factors contribute to competitiveness at the same time. Estonian reforms starting in the 1990s provide valuable insights into current potential outcomes in competitiveness. The comprehensive and radical nature of these reforms makes Estonia in many ways an extreme case in the broader context of countries who joined the EU in 2004 and later (see Seawright 2016 for a discussion of extreme cases).

However, understanding these Estonian reforms is relevant for the current Estonian government in restoring economic performance and may also be relevant for other countries. Those who dismiss the relevance of Estonian experience on the grounds of size may have a point. Obviously, the Estonian population is 1.3 million. Nevertheless, Estonian reforms can be scaled if adopted in a proper way and within the specific context.

This requires ownership and a focused approach to reform efforts. A deeper understanding of structural reform needs is also necessary, as well as a willingness to make clear choices based on an overarching vision. This also requires a robust strategy by leveraging scenarios and a concrete focus on how to execute the appropriate strategy. The 'how' is often more important when defining the strategy rather than the "what." There must be a clear commitment to the reform process, with an emphasis on rapid implementation.

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Jonė Kalendienė

Assessing the competitiveness of the Lithuanian economy based on the IMD competitiveness index

Introduction

Lithuania, the largest of the three Baltic states, remains a very small economy compared to the rest of the European Union. At the end of 2023, its population was 2.8 million. At the same time, Lithuanian GDP was 42.6 bln EUR which is 0.35% of the EU's GDP. It is the 5th smallest economy in the EU and similar in size to Slovenia. Lithuania, as well as the other two Baltic countries, have adopted the euro. This occurred on the 1st of January 2015. As a small economy, Lithuania finds it beneficial to be a member of the Eurozone, as this has provided a more stable political and economic environment and reduced exchange rate risk for companies involved in foreign trade. The Lithuanian economy is very much focused on exports, and the adoption of the euro has facilitated a faster growth in the export of goods and services compared to the overall economy. This has resulted in an increase in its relative size from 72.3% of GDP in 2014 to 86.8% of GDP in 2022.

Becoming a member of the European Union, transforming its economy towards market-based principles, implementing reforms necessary for restructuring and increasing competitiveness, as well as strengthening political, legal, and social systems have all contributed to Lithuania's rapid economic growth. According to the OECD, the Lithuanian economy was the fastest-developing country among its members over the past 20 years. In 2003, Lithuania's GDP per capita was one of the lowest in the EU, at 9,900 EUR (at PPS), surpassing only Romania, Bulgaria, and neighbouring Latvia. Now, Lithuania's GDP per capita has more than tripled, reaching 32,600 EUR (at PPS) at the end of 2023. In terms of economic development, Lithuania overtook not only newer members of the EU (Poland, Estonia, Slovakia, Croatia, and Hungary) but also some older members (Greece and Portugal). None of the other EU members performed this well during this period.

Despite its good performance, the Lithuanian economy is still lagging behind EU averages. Its GDP per capita is only 87% of the EU average. The gap in productivity is even greater, and productivity is one of major factors of competitiveness[1]. In 2023, labour productivity per hour worked was only 69.8% of the EU average, which corresponded to the 6th lowest in the EU. Productivity in Lithuania surpasses only Greece, Bulgaria, Latvia, Poland, and Estonia. Since 2019,

1 J. Falciola, M. Jansen, V. Rollo, *Defining firm competitiveness: A multidimensional framework*, "World Development" 2020, vol. 129.

productivity in Lithuania has been insufficient. According to economic theory, productivity growth is linked to wages. However, the average wage in Lithuania is not particularly low compared to other EU countries. Over the past 10 years, the average wage in Lithuania has grown at the highest rate in the EU – 10% per year on average. In 2022, the adjusted average wage in the country was 24,284 EUR per year, which correlates to 69% of the EU average. By this indicator, Lithuania outperforms many countries in terms of wage levels compared to productivity. This discrepancy indicates that Lithuanian labour might be seen as comparatively expensive in relation to the value a worker produces, potentially impacting competitiveness when attracting foreign investment or selling Lithuanian goods abroad.

The competitiveness of an economy could also be assessed by changes in global market shares[2]. If exporting companies are performing well and successfully selling their products to foreign consumers and other producers, the economy typically has strong prospects. Despite all the challenges mentioned above, the Lithuanian economy has made notable gains in export market shares. It is the second economy in EU after Ireland with the biggest gains in global trade. Over the past five years, amid a turbulent global economy marked by the Covid-19 pandemic, the war in Ukraine, imposed sanctions on Russia and Belarus, increasing political tensions in Asia, and an unofficial trade war between Lithuania and China, Lithuanian exporters were able to sell their goods and services at an increasing rate.

2 V. Ruzekova, Z. Kittova, D. Steinhauser, *Export performance as a measurement of competitiveness*, "Journal of Competitiveness" 2020, vol. 12, no. 1, pp. 145–160.

When analysing the competitiveness of a country, instead of examining different macroeconomic indicators, indexes can be used. The International Institute for Management Development (IMD) is one of the organisations that developed their own methodology for the measurement of competitiveness. Every year, the IMD publishes world competitiveness rankings that include more than 60 countries from different regions of the world. In 2023, Lithuania stands in the middle of these rankings. According to the IMD, Lithuania is the 32nd the most competitive economy in the world. A study by Z. Hajdouva et al.[3] found that Lithuanian competitiveness decreased by 3 positions from 2018 to 2020. This article aims to break down the competitiveness index and analyse the changes to Lithuania's position during 2019–2023, offering a better understanding of the success factors that drive competitiveness in this country.

Competitiveness analysis

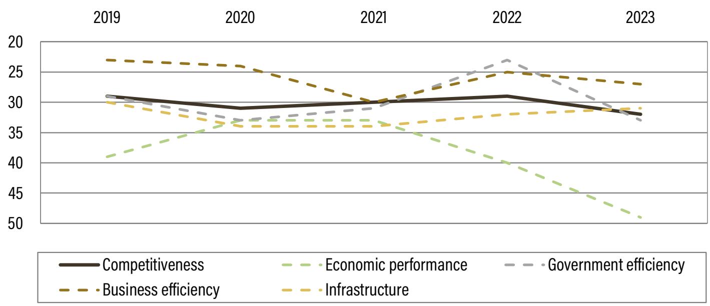
Based on the IMD competitiveness index, we can imply that over the past five years, Lithuanian competitiveness has been moderate, generally ranking around the 30th position out of 64 countries. The highest achievement was the 29th place, reached in 2019 and 2022. The latest observed indicator was in 2023, when Lithuania was ranked at its lowest, 32nd place.

The deviations of the general IMD competitiveness index do not appear very dramatic, but its subindexes exhibit

[3] Z. Hajduova et al., *Competitiveness of the selected countries of the EU with a focus on the quality of the business environment*, "Journal of Competitiveness" 2021, vol. 13, no. 4, pp. 43–59.

more variability. Their deviations could also explain movements of the entire index and economic trends. Figure 1 illustrates the values of the IMD competitiveness index and its subindexes for Lithuania in 2019–2023. We can see that two subindexes consistently remain lower that the total index, suggesting that these are the areas where the Lithuanian economy faces the most challenges – that is economic performance and infrastructure.

Figure 1. IMD competitiveness index rankings of Lithuania



Source: Composed by the author based on IMD data.

Regarding economic performance, Lithuania was ranked 49th in 2023. There are certain objective reasons for a lower ranking. First, the index includes some indicators at their nominal values in USD terms. Therefore, Lithuania, as a small economy, can never overcome other bigger countries despite their economic performance. We can also see that the economic performance of Lithuania was improving during the Covid-19 period (2020–2021). At that time, measures that were taken to fight the pandemic in Lithuania were very similar to the rest of Europe. However, the economic structure was the major competitive advantage of the country. The exporting sector was booming at that time, which compensated for economic losses in the service sector and the domestic economy. The recent decline in economic performance competitiveness does not indicate that there are dramatic changes in the country. High inflation caused by energy prices and uncertainty related with geopolitical tensions in the region as well as decreasing foreign demand in the EU caused an economic recession that is also tangible in the rest of Europe. Therefore, we can conclude that the loss of competitiveness is temporary and apparent only in a broader, global context rather than the region.

The other subindex consistently lower than the overall competitiveness performance is infrastructure. Lithuania's ranking in this area shows almost no deviations over time, but its raking changes as other countries improve or decline. The development of infrastructure, especially scientific, takes time and requires much investment. Both the Lithuanian government and businesses have made significant efforts to improve this area, recognizing it as a crucial area for future competitive advantage of the economy. Consequently, we can anticipate improvements in these indicators, as well as in the entire competitiveness index, in the coming years.

In many other competitiveness measures and rankings, Lithuania outperforms in evaluations of government decisions. Government efficiency is also one of the strong aspects of Lithuanian competitiveness, according to the IMD. Its major advantage is the stability of public finances. Historically, Lithuania has maintained low public debt, with GDP growth outpacing government borrowing. As a result, budget deficits and government financing need do not harm public debt. Long-term upgrades in government stability and credibility, transparency of the public sector, and business legislation have resulted in improvements in the economic environment. These are the most important issues for competitiveness. The IMD competitiveness index also includes measures that represent political will or could be explained by the economic policy chosen at that time. Lithuania is one of the most active countries with regard to the implementation of economic and political sanctions on Russia and Belarus. While these measures have harmed free trade, they are expected to reduce risks and improve the overall economic performance of the country in the long term. However, in the IMD competitiveness index, Lithuania does not perform well in terms of taxation. This outcome results from deliberate government decisions to keep income and profit tax rates low to attract foreign companies and investors. The current discussion on tax reform suggests the possibility of a change in the situation in the future.

According to the IMD competitiveness index, Lithuania's biggest competitive advantage is business efficiency. During 2019–2023, Lithuania's ranking in business efficiency consistently remained within the top 30 out of more than 60 countries. Finance remains a constraining factor for business efficiency as the Lithuanian capital market is still developing, the loans market is very concentrated, and the financial literacy of households and companies is comparatively low. All this results in restricted access to finance for business. Meanwhile, management practice is the biggest competitive advantage of the Lithuanian economy: in 2022, it was ranked 11th globally. According to the IMD, Lithuanian business is very agile, responds quickly to opportunities and threats, and entrepreneurship values are widely spread among businessmen.

Best practices

The analysis of Lithuania's economic competitiveness, based on the IMD competitiveness index, indicates that there was no significant improvement during 2019–2023. However, the Lithuanian economy maintains its position in the middle tier among the 64 countries included in the index. This stability indicates a few important advantages that support the country's economy, enabling its growth and allowing the economy to remain competitive with advanced countries. In this paper, I would like to discuss three of these advantages: economic structure, innovation, and business agility. While these are all are interlinked, they each require different policies and measures to be effectively promoted.

One of the biggest competitive advantages of the Lithuanian economy during recent years is the structure of its economy[4]. The manufacturing sector in Lithuania is comparatively large, making up about 25% of the total value added in the economy, compared to the EU average of about 20%. This manufacturing sector is heavily export-orientated. It is estimated that exports account for about 50% of the total value added in the country, indicating that foreign demand is of equal importance as domestic demand. This feature of the Lithuanian economy helped to balance economic activity, and as a result, the country did not experience severe

[4] J. Bruneckienė et al., *Smart economic development patterns in Europe: interaction with competitiveness*, "Competitiveness Review: An International Business Journal" 2023, vol. 33, no. 2, pp. 302–331.

economic recession during the Covid-19 pandemic, the energy price peak, or the period of reduced global demand.

As measures that were taken during the pandemic primarily affected the domestic market (closing shops, cafes, entertainment), the manufacturing sector experienced a boom, producing and exporting household goods or their parts as the global demand for them increased[5]. While the peak in energy prices and the disruption of global supply chains due to the war in Ukraine affected the manufacturing sector, domestic demand became the major driver of the economy.

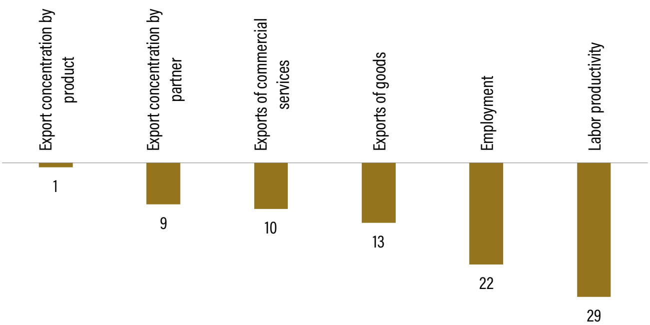
Traditionally, the manufacturing sector has been important in Lithuania, but it is promoted by government policies. There are green corridors for big investments and financing schemes to facilitate transition, and expansion. Openness to trade and trade promotion policies is seen as an important factor for competitiveness[6]. The government and its agencies have made significant efforts towards export promotion, where the major focus now is on the diversification of markets. This is very important when aiming to reduce Lithuania's economic dependence on the EU business cycle and to make it more resilient. As Figure 2 illustrates, according to the IMD competitiveness index in terms of export diversification, Lithuania ranks among the global leaders. It takes 1st place in export concentration by product and

[5] K. Benkovskis, J. Meriküll, A. Proškute, *The transmission of trade shocks across countries: firm-level evidence from the Covid-19 crisis*, Latvijas Banka, 2024, Working Paper Series, https://www.lb.lt/uploads/publications/docs/43841_a7c15a1faed678362052dac3ecab8493.pdf.

[6] M. Marčeta, Š. Bojnec, *Analysis of the economic performance and competitiveness of the European Union countries*, "Serbian Journal of Management" 2022, vol. 17, no. 1, pp. 219–236.

9th place in export concentration by partner. Figure 2 also shows Lithuanian rankings in terms of the relative size of its exports. Additionally, it takes 10th place in the export of commercial services and 13th place in the export of goods in the IMD competitiveness rankings.

Figure 2. Lithuanian rankings in IMD competitiveness measures of economic structure, 2023



Source: Composed by the author based on IMD data.

A strong and competitive manufacturing sector, and thus the overall competitiveness of the country, cannot be sustained without innovation[7]. Therefore, innovation promotion, creation and implementation, and fostering a culture of innovation is essential for maintaining Lithuania's competitiveness in the future.

Lithuania's rankings in the IMD competitiveness index, which could be associated with innovation competitiveness, are not yet very high yet. The manufacturing sector

[7] T. Boikova et al., *The determinants and effects of competitiveness: The role of digitalization in the European economies*, "Sustainability" 2021, vol. 13, no. 21; J. Bruneckienė et al., *Smart economic development patterns in Europe…*

is comparatively large in Lithuania, but it is dominated by traditional industries. Food processing, furniture, and wood sectors together create half of the total value added in manufacturing. The good diversification of exported goods indicates that there are other strong sectors. Over the past 5 years, the share of the food processing industry has slightly decreased, while the shares of the chemical, electronics, and optics sectors have increased. This shift might be linked to strong government support for high-tech industries and innovations[8]. Many financial support schemes today are focused on the innovation of products and services. However, as we can see in Figure 3, in terms of economic complexity (sophistication of goods produced in the country), Lithuania ranks only 32nd. According to data from the Harvard Atlas of Economic Complexity, the most complex product that was produced in Lithuania ranks only 41st in terms of product complexity globally[9]. These findings suggest that there is much room for improvement.

The global economic slowdown is accelerating Lithuania's economy towards high-tech industries and advanced manufacturing. In 2023, production volumes of manufacturing sectors declined with the exception of high-tech activities and the engineering industry. The value of high-tech exports also increased, while exports of other goods declined. This illustrates the competitiveness of high-tech

8 P. Patanakul, J.K. Pinto, *Examining the roles of government policy on innovation*, "The Journal of High Technology Management Research" 2014, vol. 25, no. 2, pp. 97–107.

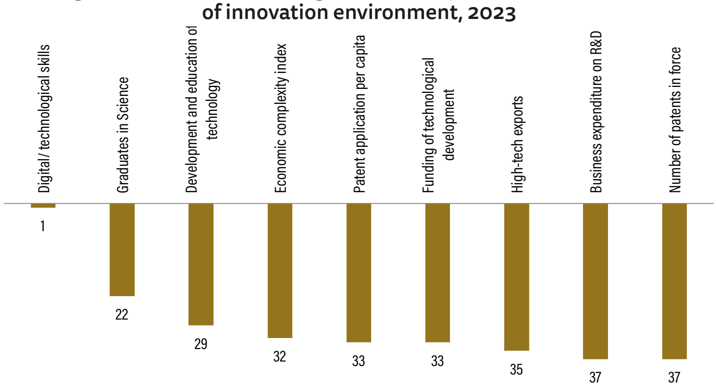
9 N. Dovydėnas, *Ekonomikos sudėtingumas Lietuvoje*, VšĮ Versli Lietuva, 2021, https://inovacijuagentura.lt/site/binaries/content/assets/analitika/tyrimai/2021-12-31_complexity_report_final.pdf.

manufacturing in Lithuania, suggesting a potential improvement is some sub-indexes of the IMD competitiveness rankings in 2024.

The Lithuanian rankings in the IMD competitiveness index illustrated in Figure 3 suggest a solid foundation for further improvements. In terms of digital and technological skills, Lithuania ranks1st. Additionally, the share of graduates in science is the 22nd biggest globally. The legal environment and the availability of funding necessary for technological transformations is also favourable. Consequently, the government tries to maximize efforts to create the necessary infrastructure and environment for innovation. For now, the results are not exceptional in terms of business expenditure on R&D or the number of patents. However, in 2023, IMD rankings indicate that this area has already shown the most significant improvement in Lithuania.

A very important factor of competitiveness is business agility, or the ability to react quickly, to change, and to adapt

Figure 3. Lithuanian rankings in IMD competitiveness measures of innovation environment, 2023



Source: Composed by the author based on IMD data.

to situations in the market[10]. As mentioned earlier in this paper, Lithuania consistently ranks high in the sub-index for management practices. Historically, the Lithuanian economy has undergone many changes and transformations. First, after gaining independence in 1990, the entrepreneurial class had to be created and educated[11]. Later, during the Russian crises, businesses had to rapidly reorient from East to West; that is, from Russia as the major market to Europe, which was completely new. As was mentioned earlier, businesses continue to look for new markets. Today, their biggest efforts are focused on Asia, where Lithuanian businesses create partnerships with Taiwan, South Korea, Japan, and others.

Another notable example of Lithuanian business agility is its reaction to the war in Ukraine. Within the first days of the conflict, many businesses launched campaigns to help Ukraine. Russia and Belarus were very important import markets for materials and resources used in manufacturing. However, when economic sanctions were imposed on these countries, it only took a few months for Lithuanian businesses to manage the associated risks and to find solutions and alternative supply markets, some of which were as far as Brazil.

Figure 4 presents the most important competitiveness indicators associated with business agility in Lithuania.

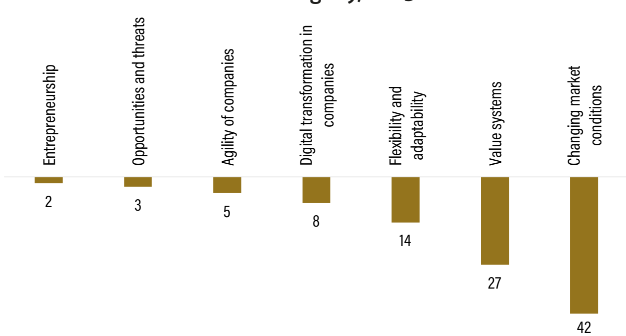
10 S.A. Sari, N.H. Ahmad, *Connecting the dots: Linking entrepreneurial leadership and strategic agility towards SME competitiveness*, "Vision: The Journal of Business Perspective" 2022, pp. 104–118.

11 G. Pauliukevičius and D. Skusevičienė, *Modeling of the institutional system of enterpreneurship promotion: The case of Lithuania*, "Business, Management and Education", 2013, vol. 11, no. 2, pp. 350–375.

It shows that Lithuanian businesses are not particularly strong in anticipating future changing market conditions (42nd place). Lithuania is a small and very open economy. Therefore, it is affected by many global disturbances that cannot be controlled nor elevated by the local government. Despite this, companies respond very quickly to opportunities and threats (3rd place) by minimizing risks and entering new markets. In the NATO challenge, 5 out of 11 companies on the short list are from Lithuania, a country without a defence industry. A high level of entrepreneurship (2nd place) supports these previous features. Additionally, as an example of high adaptability, Lithuanian companies are among the global leaders in digital transformation (8th place).

All this could not be achieved without attitudes and values that support competitiveness. In general, in Lithuania, the flexibility and adaptability of people when faced with new challenges (14th place) is high. Moreover, the entire value system in the country supports competitiveness (27th place).

Figure 4. Lithuanian rankings in IMD competitiveness measures of business agility, 2023



Source: Composed by the author based on IMD data.

Conclusions

Summarizing the analysis of Lithuania's rankings in the IMD competitiveness index and its trends in 2019–2023, we can say that Lithuania is able to maintain its competitiveness. Although there was a decline in the IMD competitiveness index in 2023, it was most likely the result of temporary economic challenges caused the decline of the EU economy. Statistical data supports this suggestion. During 2023, when major exporting industries experienced slowdown and negative growth, the high-tech industry and its exports continued to grow at two-digit rates. The domestic economy also remained strong with almost no changes in unemployment and a very strong growth of wages.

Lithuanian competitiveness is rooted in economic stability, which is created by a well-diversified economic structure. A relatively big manufacturing sector makes the country an export-oriented economy and reduces its dependence on the domestic market. Despite the country's small size, exports are well-diversified in terms of both products and markets, with many ongoing activities aiming to increase further diversification.

As wages increase rapidly and productivity growth remains relatively low, maintaining and increasing competitiveness will require technological transformation and an orientation towards greater innovation[12]. Thus far, Lithuania's performance in the science and innovation field has been moderate, but positive movements have been observed

12 C. Fontanari, *The role of wages in triggering innovation and productivity: A dynamic exploration for European economies*, "Economic Modelling" 2024, vol. 130, DOI: 10.1016/j.econmod.2023.106571.

in the orientation of business attitudes and the government. Lithuanian companies are among the most agile, flexible, and adaptable in terms of opportunities and threats, which means that they quickly step into new products and markets. A high level of entrepreneurial skills, a strong background in education, a favourable legal environment, and the availability of adequate financial resources create the necessary environment for innovations. A skilled workforce is constantly listed as a key factor of attractiveness in the Lithuanian economy according to the IMD competitiveness index reports. However, the greatest competitive advantage of Lithuania lies in its people and their values, which foster a culture of competitiveness.

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Radu-Cristian Mușetescu
Mihai Sebe

Romania’s economic competitiveness: trying to emerge from the darkness of a soviet-style command economy and the timid reforms of transition

Introduction

Romania has been one of the Central European countries with the poorest performance in economic reforms following the fall of communism. The country was under one of the most autarchic regimes in the socialist bloc, which praised itself for following a path toward a “multilateral developed society”[1]. As the only former communist country where the leader was executed by an ad-hoc Revolutionary Tribunal, its unique position led to the expectation of a radical and abrupt change. However, the initial agenda of the new regime was focused on preserving certain key mechanisms of

[1] W.E. Crowther, *The political economy of Romanian socialism*, New York 1988, p. 78.

the old economy, such as state-owned enterprises and large agricultural farms. Moreover, counterintuitively, Romania signed one of the Soviet Union's last treaties in 1991, which allowed Moscow to veto its accession to any other organisation. This move represented a complete failure to understand the dynamics of the region under the new geopolitical and economic conditions. Fortunately, the disappearance of the Soviet Union rendered this treaty irrelevant.

Although the Agreement for Romania's Association to the European Union (European Agreement) was signed as early as 1993, the transition period has been described as lacking a clear agenda. Political and social crises followed, including the use of violence in order to control political events. "Mineriadele" (the use of labourers from the state mining industry in order to pulverise political opposition) were orchestrated in 1990, 1991, and as late as 1999. Although in 1995 all the parliamentarian parties signed the so-called *Snagov Declaration* in which they stated their support for Western integration (both in NATO and in the European Union), the path ahead was not always straightforward. However, in 1996, the first democratic change of power following the Romanian Revolution occurred, and the monopoly of political power started to implode.

In the first decade after the 1989 Revolution, Romania lagged behind all other former Communist countries when it came to reforms, in terms both of speed and depth. The War in Yugoslavia, along with the major internal economic difficulties experienced in the late '90s (hyperinflation, bank failures, a significant decline in the living standards), pressured the political elites to take more consistent steps toward economic reform and joining the European Union.

In 2000, the desire for European integration became the key catalyst for all political and economic reforms. In an attempt to fulfil the necessary prerequisites for accession, slow and sometimes contradictory economic reforms were implemented, including the significant privatisation of state companies. This marked the so-called "stop-go" transition[2]. New rules regarding state aid allowed for a slow but ever-increasing discipline, which counteracted the arbitrariness of government intervention. European conditionality began to take effect[3].

Competitiveness analysis. The impact of the institutional framework

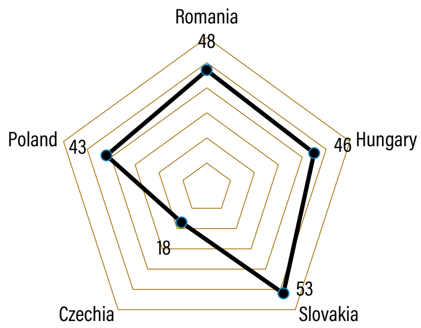
In terms of economic competitiveness pertaining to the 2019–2023 period, it is worth noting that in 2023, Romania ranked 48th, compared to 51st in 2022. A comparative analysis focused on the specific criteria that determine economic competitiveness can help identify certain areas which need improvement and where Romania is lagging behind its Eastern European neighbours, especially the Visegrad countries.

When discussing Romania's competitiveness in the region, it is important to note the impact that its institutional framework has on the matter. The core challenge of the Romanian transition may be perceived, at a first glance, to be the poor performance of reforms in the judicial system. Unfortunately, this sector has been perceived as being one of the most difficult nuts to crack in the whole governance

2 D. Phinnemore, D. Papadimitriou, *Romania and the European Union: From marginalization to membership*, Routledge 2008, p. 131.

3 G. Pridham, *The Scope and Limitations of Political Conditionality: Romania's Accession to the European Union*, "Comparative European Politics" 2007, vol. 5, no. 4, p. 347.

Figure 1. Competitiveness Ranking 2023 Romania and Visegrad countries



Source: Composed by the authors based on IMD.

system of post-communist Romania. As a consequence, during the transition period, the country has been viewed by many as rather corrupt in comparison with other Central European states, with a perceived direct impact on the quality of governance as a whole.

Since joining the European Union, Romania and Bulgaria have been monitored for progress in the fields of judicial reform and corruption prevention[4]. The Cooperation and Verification Mechanism for Bulgaria and Romania was created to oversee the successful development of such reforms.

As the progress made by Romania under the CVM was sufficient to meet Romania's commitments made at the time of its accession to the EU, the system was put to a stop, and it was decided that "the cooperation and monitoring of the justice system and anti-corruption policies in Romania can be taken forward under the Rule of Law Report and other

4 F. Zerilli, *Corruption and anti-corruption local discourses and international practices in post-socialist Romania*, "Human Affairs" 2013, vol. 23, no. 2, p. 223.

established parts of the rule of law toolbox applying to all Member States"[5].

Gradual but consistent progress has been registered in this field. According to the World Justice Project[6], in 2023, Romania ranked 40th, placing lower than Czechia (20th), Slovenia (27th), Slovakia (34th), and Poland (36th) regarding the adherence to the rule of law, but higher than countries such as Bulgaria (59th) and Hungary (73rd). From the perspective of the protection of property rights[7], Romania is ranked 41st, behind Czechia (23rd), Slovenia (36th) and Slovakia (39th), though, maybe surprisingly, above Poland (46th), Hungary (48th), and Bulgaria (59th). This confirms Romania's progress in establishing a more independent judicial system and a more coherent and disciplined government, reflecting the emergence of a truly capitalist system where the justice system operates independently. According to Hans-Herman Hoppe, "capitalism and socialism are definable in terms of property: (...) socialism being an institutionalized policy of aggression against property and capitalism being and institutionalized policy of recognition of property and contractualism"[8].

The legal system is a critical aspect of the infrastructure of the economy, as free enterprise, property rights exchange, and innovation cannot be manifested unless there

5 *Report from the Commission to the European Parliament and the Council on progress in Romania under the cooperation and verification mechanism*, COM/2022/664 final, European Commission, 2022, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX-%3A52022DC0664&qid=1678957535928.

6 *WJP Rule of Law Index*, World Justice Project, 2023, https://worldjusticeproject.org/rule-of-law-index/global.

7 *International Property Rights Index*, Property Rights Alliance, 2023, https://www.internationalpropertyrightsindex.org/countries.

8 H.-H. Hoppe, *Theory of socialism and capitalism*, Kluwer Academic Publishers, 2010.

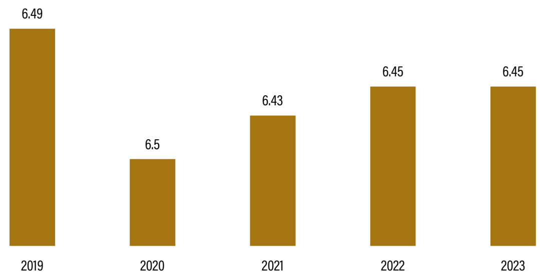
is a system where private property rights are protected and enforced. This has played a preemptive role and has curbed corruption, as seen in the latest Corruption Perception Index[9]. In this index, Romania is positioned relatively close to most of the Visegrad countries. Currently, from the perspective of corruption perception, Romania (63rd) ranks higher than Bulgaria (67th) or Hungary (76th), and is on par with countries like Montenegro or Jordan.

Democracy also matters when addressing competitiveness. Romania and the Visegrad Group countries were classified in 2023 as "flawed democracies" by the Economist Intelligence Unit. An area of importance is the "functioning of government" category, which comprises a series of 14 indicators that reflect the way in which citizens interact with their governments and the impact of governance on the economic system. Romania has kept a rather stable track record since 2019, which helps maintain its attractiveness. Compared to its peers from the region, the way in which its government functioned in 2023 seems to be close to the average. From a political point of view, Romania's multiparty system has ensured regular rotations of power through competitive elections, and civil liberties are generally respected[10].

9 *Corruption Perception Index*, Transparency International, 2023, https://www.transparency.org/en/cpi/2023.

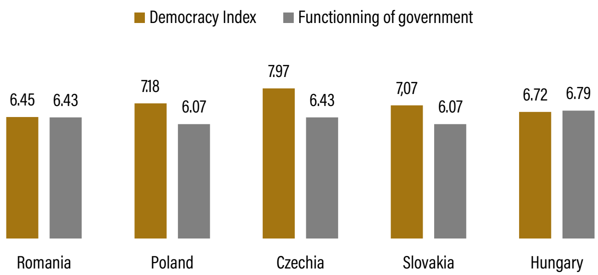
10 *Democracy Index 2023*, Economist Intelligence, 2024, https://www.eiu.com/n/campaigns/democracy-index-2023.

Figure 2. Romania Democracy Index evolution 2019–2023



Source: Composed by the authors based on Economist Intelligence – Democracy Index 2023.

Figure 3. Democracy Index and Functioning of government 2023 comparative view



Source: Composed by the authors based on Economist Intelligence – Democracy Index 2023.

Economic governance

In terms of taxation, in 2022, Romania ranked among the better positioned countries, when considering government tax revenue as compared to GDP[11]. Data shows that Romania's total tax revenue is 26.9% of the country's GDP, placing

[11] *Data on Taxation Trends*, European Commission, 2024, https://taxation-customs.ec.europa.eu/taxation-1/economic-analysis-taxation/data-taxation-trends_en#summary-tables-by-country.

it below countries such as Czechia (35.3%), Hungary (35.1%), Poland (34.5%), as well as Bulgaria (31.1%). The informal economy of Romania, while traditionally large following the Revolution and an image of poor operation of the rule of law, has been reduced under the threshold of 30%. In 2020, the World Bank estimated Romania's informal economy[12] at 25.8% of GDP, ranking higher than the Slovakia (15.9%), Czechia (16.7%), Hungary (22.5%), and Poland (22.9%), but lower than Bulgaria (27.8%) or Greece (26%).

Inflation is a macroeconomic factor that has a significant negative impact on the Romanian economy, often exceeding the rates of its regional peers. According to the present authors, inflation – even if it is not a contractual or conventional indicator – is a reflection of poor economic governance. Fundamentally, unbalanced government budgets are frequently financed through monetary expansion which leads to a non-contractual, non-transparent redistribution of wealth in society and impairs economic freedom[13].

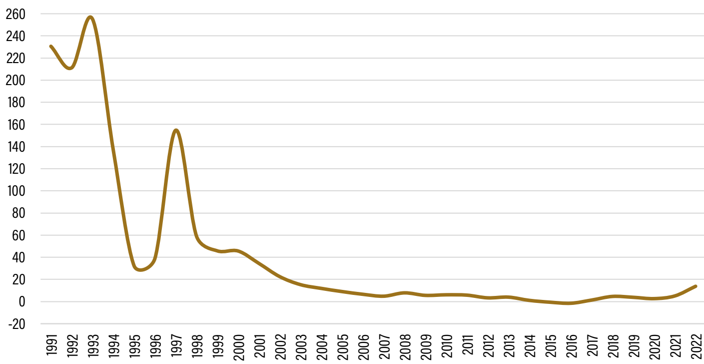
As in other cases, the desire for European integration and prospects of economic conditionality have forced relevant public decision makers to alter the approach toward monetary policy and government budget processes.

Despite macroeconomic imbalances and significant structural issues in the economy, the Romanian currency – the Leu – has remained remarkably stable. While this could be seen as a positive aspect, it could also be a challenging one.

12 *Informal Economy Database*, World Bank, 2024, https://www.worldbank.org/en/research/brief/informal-economy-database.

13 R.J. Cebula, *Budget Deficits, Economic Freedom, and Economic Growth in OECD Nations: P2SLS Fixed-Effects Estimates, 2003–2008*, "Journal of Private Enterprise" 2013, vol. 28, no. Spring, pp. 75–96.

Figure 4. Rate of inflation of Romanian Leu (%)



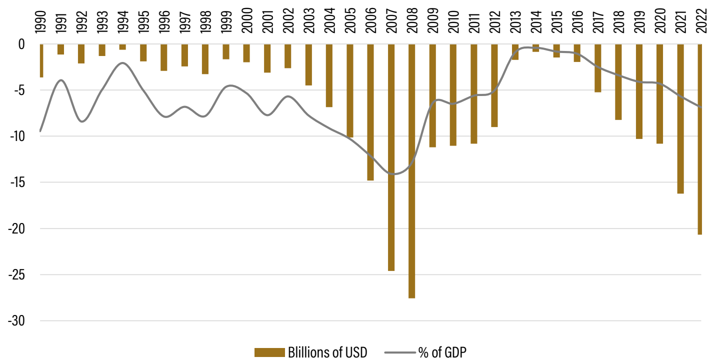
Source: Composed by the authors based on Macrotrends, 2024.

The currency policy has been based on a strictly market approach, in the sense that the National Bank of Romania has succeeded in keeping the foreign exchange rate consistently stable by financing it through foreign debt. This has been possible due to the legacy of the communist regime in Romania: in 1990, there was no significant foreign debt. At the end of 2023, Romania's foreign debt (long and short term) was around 170 billion EUR[14]. This market-based approach to the currency market has been somehow decoupled from the real dynamics of the economy and has led to an inhibition of the emergence of a competitive advantage. It has contributed to an overvaluation of the Leu during a large part of the transition period, especially after the country's accession to the EU. This has led to a consistent trade deficit throughout the entire transition period, which had negative

[14] *Balance of payments and external debt – December 2023*, National Bank of Romania, 2023, https://www.bnr.ro/page.aspx?prid=23841.

consequences on efforts to acquire a national competitive advantage. Darrat (1998) points that "movements in the dollar exchange rate, interest rate and the monetary base along with budget deficits all seem to be key variables causing changes in the trade deficit"[15].

Figure 5. Foreign trade deficit in the Romanian economy



Source: Composed by the authors based on Macrotrends, 2024.

The core advantage of Romania's slower pace of development is its low wage levels, which attract foreign companies. From this perspective, Romania remains one of the European Union countries with the lowest average wages[16]. With a level of 13,245 EUR/year in 2021, Romania is only above Hungary

[15] A.F. Darrat, *Have Large Budget Deficits Caused Rising Trade Deficits?*, "Southern Economic Journal" 1988, vol. 54, no. 4, pp. 879–887.

[16] *Average full time adjusted salary per employee*, Eurostat, 2023, https://ec.europa.eu/eurostat/databrowser/view/NAMA_10_FTE__custom_4232263/bookmark/table?lang=en&bookmarkId=fafb4e3b-f3aa-4907-9102-16be8df6f775.

(12,716 EUR/year) and Bulgaria (10,345 EUR/year), but below Czechia (18,193 EUR/year) and Poland (14,574 EUR/year).

It could be argued that the attractiveness of a less developed economy based on low wages attracts important companies in the process of relocating production activities. However, this does not facilitate the emergence of economic specialisation or the development of a competitive advantage, as companies from all sectors are attracted by the advantage of lower labour costs. This specific advantage minimises other competitive advantages and, in a certain sense, prevents the emergence of a competitive advantage. In consequence, it obstructs the development of a "real cost advantage".

This may lead to a different perspective from the conventional understanding of what is known as "economic complexity", which measures the range and amount of products that a country manufactures. In an index published by Harvard University[17] in 2022, Czechia placed 7th globally, followed by Slovenia (11th), Hungary (14th), Slovakia (15th), Romania (26th), Poland (28th), and Bulgaria (38th). The top places covered by Central European countries compared to countries from other regions in the world are not, according to the authors of this study, always something to celebrate. Sometimes, "complexity" may be the opposite of "specialisation". These statistics merely reflect the false advantage acquired by offering cheap labour. For example, in the case of research and technology, Romania ranks 42nd

[17] *Economic Complexity Index*, Observatory of Economic Complexity, https://oec.world/en/rankings/eci/hs6/hs96.

(after countries such as Ukraine or Colombia) and 71st (after countries such as Zambia, Albania, and Bangladesh).

The emergence of Romania as a backyard workshop for large European companies is also illustrated by the role of industry in the country's GDP. Standing at around 28.9% in 2022[18], according to the World Bank, Romanian industry is only behind Ireland (41.5%) and Czechia (29.6%) as a percentage of the national economy (measured by GDP). Interestingly again, from the top 6 countries in this respect, 5 are from Central Europe: Slovakia (28.5%), Slovenia (28.1%), and Poland (28.1%). Meanwhile, the average for the European Union is 23.5%. Even Germany, the industrial powerhouse of the European Union, is behind them.

This leads to another challenging set of data. Out of all the European Union members[19], the Eastern European countries were the most reliant on their exports to the Common Market in 2022: Czechia (81.6%), Slovakia (80.1%), Hungary (78.4%), Poland (75.5%), Romania (72.3%), and so on. These countries occupy 5 of the top 6 positions in this respect (the other being Luxembourg, an EU member with just 650,000 inhabitants). Very interestingly, this "dependence" on the Common Market may reflect a form of "captive trade" between related-parties, or entities belonging to the same transnational private groups. The low figures related to exports outside the European Union suggest the relative

18 *Industry (including construction), value added (% of GDP – European Union)*, World Bank, 2024, https://data.worldbank.org/indicator/NV.IND.TOTL.ZS?locations=EU&most_recent_value_desc=true.

19 *International trade of EU, the euro area and the Member States by SITC product group*, Eurostat, 2024, https://ec.europa.eu/eurostat/databrowser/view/EXT_LT_INTERTRD__custom_5507856/bookmark/table?lang=en&bookmarkId=9e5fa369-c688-44b4-8de3-a77049aaef38.

lack of international competitiveness for these Eastern European economies, with Romania exhibiting an abysmal performance in this respect.

Meanwhile, the trade balance of countries in the region paints an interesting picture. Romania records the largest trade deficit (2022), with a level of -31 billion EUR. This data, coupled with the core nature of "captive trade", suggest a lack of direct presence of the Romanian economy on international markets (non-EU). This, again, reflects a lack of international competitiveness and the failure to explore and identify sources of competitive advantage.

In fact, according to the RCA Index, the most specialised Romanian products are sunflower seeds, sheep and goats, processed tobacco, non-retail combed wool yarn and steel ingots[20]. This is, obviously, based on non-processed agricultural and low value-added industrial products which place Romania in a very precarious position concerning contemporary global high-tech competition. This, however, is contradicted by the fact that the Romanian business environment has succeeded in keeping the pace with other Central European performers regarding the emergence of high-tech international technology players.

Conclusions

Our analysis concludes that the Romanian economy primarily functions as a low-labour-cost economy. This is generally the profile of all post-communist countries from Central Europe, but Romania may be the most obvious example in

[20] *Romania*, Observatory of Economic Complexity, 2024, https://oec.world/en/profile/country/rou.

this respect. Its complexity along with foreign data seem to support this assessment.

The main competitive advantage of Romania's economy seems to be obscured by the process of large European transnational companies attempting to undercut costs inside the European Union by relocating their production capacities eastward.

To be sure, this process has led to a more competitive and efficient national economy, contributing to a consistent increase in the living standards of the population. However, the exploration of a real competitive advantage seems to be hidden under these circumstances. In consequence, we could argue that the Romanian economy still has some time before a real, market-based, competitive advantage can emerge. At this stage, advancing forward on a path of future development in this respect appears uncertain and challenging.

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