REAL VERSUS NOMINAL CONVERGENCE IN ROMANIA

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Abstract
The recent EU enlargement process brings in attention the next obvious step, entering European Monetary Union. For the two new EU members, as well as for the ten entered in 2004, adopting the euro as national currency seems to be a priority objective, although it is not a choice, but a must. The enlargement is an opportunity to evaluate the Maastricht criteria for adopting the single currency. In the recent years, it appeared more often the question if the nominal convergence criteria are fit and enough for the new members, taking into account the gap between them and the members of EMU, or if all the countries, voluntarily, must evaluate and take into account some real convergence criteria. This paper evaluates the degree of accomplishing both nominal and real convergence by Romania. Even if the euro adoption is still far away from our country, the controversy about nominal and real convergence is actual and we must concentrate in the next few years mainly in the catching-up process. The study shows that even we can fulfill the Maastricht Criteria, we should wait before euro adoption until we will reach the real convergence, for avoiding the asymmetric shocks.

Keywords: European Monetary Union; ERM II; Euro; Maastricht Criteria; real convergence

JEL codes: E52, E42

1. Introduction

The Romanian admittance in the EU in January 2007 represents, without any doubt, a right and useful strategic decision for our country’s long term development. This fact implies a continuous and sustainable economic growth for reducing the economic and social gaps between Romania and other EU members, using the internal potential. The accomplishment of this major purpose will require economic programs able to transcend electoral cycles and to
reach a level of economic growth of the EU average. Improvement in occupation level, together with price stability and a reduced deficit of balance of payments will assure nominal and real convergence with the EU.

The accession to the euro area will represent a second step of great importance for Romania. The period 2007-2012 of preparation for the euro adoption represents a great opportunity to continue the reforms and reduce economic disparities, maintaining in the same time the macroeconomic equilibrium. If the accession to the euro area is itself a strategic objective of great importance, the schedule for euro adoption represents a timing optimization problem in which the speed should be dictated by a costs-benefits analyse with the following restrictions:

- the fulfillment on sustainable bases of the Maastricht criteria;
- the accomplishment of a satisfactory level of real convergence;
- reducing the participation in ERM II at the compulsory period of two years.

Starting from these ideas, this paper analyses the conditions to be accomplished as well as the main options of economic policy in order to fulfill nominal convergence criteria. The second section focuses on general matters regarding ERM II which represents a compulsory stage in adopting euro as national currency. In this section is argued the necessity of accomplishing not only the nominal convergence criteria, stipulated by the Maastricht Treaty, but also with some real convergence criteria, meant to insure a high degree of resemblance and cohesion to the economies of the candidate countries.

The third section analyses the way Romania meets at this moment the nominal criteria, as well as the real convergence ones. The conclusion is that the process of catching-up must concern them in the same measure. The last section of this study proposes a possible middle term strategy for Romania’s accession to Euro, taking into account the advantages as well as the restrictions implied by the process. It is analysed the possibility of using an alternative for the transition to ERM II. Suggestions regarding the orientation and the sizing of the monetary policy and few of real convergence priorities are also presented. Starting from other countries’ experience, arguments are brought for the establishment of a schedule which should allow the adoption of euro as a national currency in 2011-2013.
2. Stages and Criteria for Euro Adoption

2.1 Exchange Rate Mechanism

The initial ERM (adopted in 1979) was a multilateral exchange rate system, through which every participant currency was fixed to each other, with a band of fluctuation of ±2.25 percent around the central parity (derived by cross from the given ECU rate. As a consequence to the ERM crisis in 1992-1993 (when Great Britain and Italy gave up this mechanism, and Spain, Portugal and Ireland devalued their currencies), the fluctuation strip was enlarged to ±15 percent, starting with August 1993.

The adoption of euro in January 1999 has been accompanied by the launch of a new ERM. ERM II established a central rate vis-a-vis the euro for each participant currency and a standard fluctuation band of ±15 percent around the central rate. In the event of pressures on the exchange rate, the European Central Bank is obliged to give support to the national central bank, interfering automatically when the rate level reaches the margins of the strip (marginal intervention) and has the possibility to support the national central bank’s interventions when the rate situates inside the fluctuation strip.

The exchange rate criterion is one of the conditions of the Maastricht Treaty, which must be fulfilled before European Union members adopt the single currency. The European authorities’ position regarding the fulfillment of the stability criterion may be resumed as it follows:

- the compulsory participation in ERM II for at least two years before the access to the euro area;

- it is not allowed the re-alignment of the central parity in the direction of the devaluation during the two years of participation in ERM II;

- although the standard fluctuation strip is of ±15 percent, it is not excluded the possibility of establishing a narrower exchange rate fluctuation strip (Denmark choosing a ±2.25 percent strip). European Commission and European Central Bank will tolerate, however, a fluctuation over the narrow strip margins, but only in the sense of appreciation, not in the sense of devaluation. Theoretically, this is an asymmetric strip of -2.25 and +15 percent, which must be kept for at least two years without external support.
According to the Maastricht Treaty, the new candidate countries which will join the EU will become members with a derogation regarding the single currency. That means that after the accession, the new-comers will join the ERM II, and then, conditioned by the fulfillment of the nominal convergence criteria, will adopt the euro. The architects of the European Community, who conceived the Maastricht Treaty, considered as necessary and sufficient for a country to adopt the Euro only the nominal convergence criteria, respectively: a budgetary deficit under 3 percent from the Gross Domestic Product; a total public debt lower than 60 percent from the GDP in the year of adoption of the single currency; an inflation rate not more than 1.5 percent higher than the average of the three lowest inflation rates among the EU member states and a long-term interest rate not more than 2% higher than the average observed in these three low-inflation countries. Moreover, it is necessary a high degree of stability of the exchange rate, without devaluations during the two years preceding the entrance into the union.

It is remarkable the fact that, if the government budget deficit and the total public debt levels are fixed as proportion of GDP, in the case of the inflation rate and of the long term interest rate we deal with “moving targets”, the criteria level varying from an year to another in terms of performance of the countries members of the EU. According to the ECB Convergence Report, in December 2006, the inflation criterion was of 2.8 percent (a 1.1 percent average inflation of the best three performers, at which are added 1.5 percent), and the long-term interest rate criterion was of 6.2 percent (4.2 percent of the best three performers, at which are added 2 percent).

2.2 Maastricht Criteria and Real Convergence

The Maastricht Treaty does not refer to any real convergence criteria meant to insure a high level of resemblance and cohesion to the economies of the candidate countries. The initial omission is probably due to the fact that, until the beginning of the 90s, European Union was a club house of the rich countries (with one or two exceptions), and their economic structures were, by definition, resembling. At the moment the Western-European decedents realized the importance of the real convergence for a successful integration of the Central and Eastern European economies, the association treaties had already been signed and a reopening of the issue seemed unreasonable. Nevertheless, in the last few years, both European Commission and ECB warned on the risks of a hurried adoption of the euro by a country whose real convergence with the Western-European structures is insufficient.
Without some criteria expressly stipulated in treaties, we can consider that the most important convergence criteria regard: the degree of openness of the economy (expressed through the percent of the exports and the imports in GDP); the proportion of bilateral trade with EU members in the foreign trade; the economy’s structure (expressed through the proportion of the largest sectors in GDP creation: agriculture, industry, services) and, the most synthetic, the GDP per capita level (expressed either at nominal rate, or at purchasing power parity).

A question to be asked is if joining the euro area may be possible in conditions of less restrictions regarding nominal and real convergence. Here, the answer is found in the Optimum Currency Areas Theory: the states belonging to a group can mutually gain after adopting a common currency only when their economic structures are similar and when there is no risk for asymmetric shocks to strike only some of these countries. This is why the single monetary policy (elaborated by the European Central Bank) can not and must not refer to the particularities of each economy, but to address to a group of supposedly homogeneous economies. In consequence, the less advanced countries from Central and Eastern Europe can not drop their own monetary policy as long as the risk of asymmetric shocks (generated by the differences in the economy structure) is high, because the final objective is not only the euro adoption, but also taking advantages of this position. This is the reason why the real convergence issue is as important the nominal convergence one.

3. Romania and the Convergence Criteria

3.1 Nominal Convergence Criteria

Romania differentiate from the majority of the new members candidates at euro adoption through the fact that it does not have problems concerning the budgetary deficit and the total public debt, namely the fields where other countries must make the most radical adjustments; instead, the inflation and interest rate levels still represent a reason of worry for our country. This asymmetry will probably impose a different strategy in the period of participation in ERM II.

Romania’s performance concerning the budgetary deficit is satisfactory, as the 2006 deficit, calculated in accordance with the ESA95 methodology, harmonize comfortably with the Maastricht criterion, of 3 percent, superior performance comparing with other countries members of the EU since 2004.
Table 1 Budgetary Deficit (-) / Surplus (+) (% of GDP)

<table>
<thead>
<tr>
<th>Countries/Years</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007 (estimation)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bulgaria</td>
<td>0.3</td>
<td>1.9</td>
<td>3.1</td>
<td>3.7</td>
<td>2.0</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>-6.6</td>
<td>-2.9</td>
<td>-2.6</td>
<td>-3.8</td>
<td>-4.6</td>
</tr>
<tr>
<td>Poland</td>
<td>-4.7</td>
<td>-3.9</td>
<td>-2.5</td>
<td>-1.7</td>
<td>-3.6</td>
</tr>
<tr>
<td>Romania</td>
<td>-1.7</td>
<td>-1.3</td>
<td>-0.4</td>
<td>-1.8</td>
<td>-2.8</td>
</tr>
<tr>
<td>Hungary</td>
<td>-6.4</td>
<td>-5.4</td>
<td>-6.1</td>
<td>-9.8</td>
<td>-6.8</td>
</tr>
<tr>
<td>EU-15/EU-27</td>
<td>-3.0</td>
<td>-2.6</td>
<td>-2.3</td>
<td>-2.3</td>
<td>-2.2</td>
</tr>
</tbody>
</table>

*Source: EUROSTAT, National Banks*

Romania’s performance concerning public debt is also very good; the actual level of below 20% of GDP is much lower than the threshold of 60% of GDP set by the Maastricht Treaty. At the end of 2005, the government debt, calculated in accordance with the ESA95 methodology, represented 15.9% of GDP, out of which the domestic debt was 3.2% and the foreign debt was 12.7%. At the end of 2006 this indicator reached the level of 12.8% of GDP.

Table 2 Public Debt (% to GDP)

<table>
<thead>
<tr>
<th>Countries/Years</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007 (estimation)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bulgaria</td>
<td>46.1</td>
<td>38.6</td>
<td>29.9</td>
<td>26.7</td>
<td>28.2</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>30.0</td>
<td>30.6</td>
<td>30.5</td>
<td>31.5</td>
<td>33.2</td>
</tr>
<tr>
<td>Poland</td>
<td>43.9</td>
<td>41.9</td>
<td>42.5</td>
<td>45.5</td>
<td>46.8</td>
</tr>
<tr>
<td>Romania</td>
<td>20.7</td>
<td>18.0</td>
<td>15.2</td>
<td>12.8</td>
<td>18.2</td>
</tr>
<tr>
<td>Hungary</td>
<td>56.7</td>
<td>57.1</td>
<td>58.4</td>
<td>59.9</td>
<td>62.2</td>
</tr>
<tr>
<td>EU-15/EU-27</td>
<td>62.0</td>
<td>62.4</td>
<td>63.4</td>
<td>63.2</td>
<td>63.0</td>
</tr>
</tbody>
</table>

*Source: EUROSTAT, National Banks*

Although the fiscal position of our country – if we analyze the two indicators – is comfortable now, there are elements that must be taken into consideration in order to maintain this evolution in the future. The quasi-fiscal deficits and high public expenditures which must be budgeted in the future oblige to maintain the present public deficit in more close limits than the ones set by the Maastricht Treaty.

There are also criteria where Romania’s position is not that comfortable. The most important of them is the one concerning the annual inflation rate, which was of 6.56 percent in 2006.
The causes of this situation could be found in the late ending of the prices’ liberalization process, as well as in adopting a gradually reducing inflation strategy, together with the attached costs and benefits. In Romania, the last “wave” of prices and exchange rate liberalization took place in 1997, while in other countries more advanced in transition, this process took place in 1992-1994. Also, the strategy of reducing the inflation gradually, with nearly a quart from the previous year’s value, initiated in 1999, was preferred to a radical solution (of the currency board’s type) from the following reasons: the importance still big that Romania’s external creditors continued to give to the current account deficit; the necessity of alignment to the European prices, tariffs and incomes starting from lower levels than the other countries in transition; the concern that through a fast reducing of inflation, due to adverse selection and moral hazard phenomena, the developed part of the economy should suffer more than the undeveloped one. Of course, the choice of this strategy also involved costs, especially regarding the foreign investors’ under-trust in an insufficiently stabilized macroeconomic environment.

At the end of 2006, the year on year inflation rate declined to a historical minimum level of 4.87 percent, with a more obvious deceleration in April, due to a base effect, and also in July and September, when quarterly changes in CORE 1 inflation highlighted a clear slowdown in the pace of price increases. The more intense disinflation process was the result of an appropriate monetary and fiscal policy mix, improved market expectations regarding the sustainability of the disinflation process and increased competition in the retail sector.

Figure 1 Inflation Rate (CPI) 2000-2009

Source: National Institute of Statistics, National Bank of Romania
For 2007, the inflation target was set at 4% dec.-on-dec. with a tolerance band of one percent point in either direction; for 2008, the central target will become 3.8% dec.-on-dec., with the same margin of tolerance, and, over the medium term, the inflation targets will be set in accordance with the path necessary for maintaining the disinflation process in accordance with the convergence criteria.

Closely tied to the inflation criterion is also the long term interest rate criterion. The interest rate at the last governmental bonds issue on 10 year term, realized in august 2007, was of 6.73 percent. Of course, as the disinflation process will strengthen, and the economic agents will be convinced of its sustainability, this criterion will have chances to be fulfilled.

The fifth nominal convergence criterion, regarding the exchange rate stability, depends on the fulfillment of the inflation rate criterion. Since inflation was brought to a one finger value, exchange rate began to show a degree of stability compatible with the fulfillment of this criterion. In the period 2005-2006, the maximum daily appreciation/devaluation compared with the last two years average of the RON/EUR exchange rate was of +10.0%/-6.1%, values within the band of fluctuation set by ERM II.

Figure 2 Exchange Rate (daily data)

Source: National Bank of Romania
It must be specified that the relationship between the inflation rate and the exchange rate is biunivocal, in the sense that they mutually intensify. To put it differently, the much stable exchange rate is not only the result of a lower inflation, but a lower nominal depreciation (or – meaning the same thing – a higher real appreciation) may lead to a decrease in inflation rate. Therefore, a very important conclusion is that a real appreciation of the exchange rate intensifies the disinflation process. However, this real appreciation cannot be arbitrarily imposed, without observing the “gold rule” according to which the increase in labor productivity (seen as a stimulatory factor of external competitiveness) must be every year higher or at least equal with the sum between the real appreciation of the national currency and the real increase of the average wage (seen as inhibitor factors of external competitiveness).

The level of achievement of nominal convergence criteria for Romanian economy is summed up in the following table:

**Table 3 Achievement of Nominal Convergence Criteria by Romania (2006-2007)**

<table>
<thead>
<tr>
<th>Nominal convergence indicators</th>
<th>Maastricht criteria</th>
<th>Romania</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>2006</td>
</tr>
<tr>
<td>Inflation rate (percent, annual average)</td>
<td>&lt;1.5 % above the average of the 3 most performers members of the EU (2.8 percent)</td>
<td>6.56</td>
</tr>
<tr>
<td>Long term interest rate (percent per year)</td>
<td>&lt;2 % above the average of the 3 most performers members of the EU (6.2 percent)</td>
<td>-</td>
</tr>
<tr>
<td>RON/EUR exchange rate (maximum daily appreciation/devaluation compared with the last two years average)</td>
<td>±15 percent</td>
<td>+10/-6.1</td>
</tr>
<tr>
<td>The budgetary deficit (percent of GDP)</td>
<td>Below 3 percent</td>
<td>1.9</td>
</tr>
<tr>
<td>The public debt (percent of GDP)</td>
<td>Below 60 percent</td>
<td>12.4</td>
</tr>
</tbody>
</table>

*Source: EUROSTAT, ECB, National Institute of Statistics, National Bank of Romania*
3.2 Real Convergence Criteria

Romania has an average degree of openness of the economy of 76.7 percent in 2006. From this point of view, the Romanian economy is less opened than the economies of Czech Republic, Slovakia or Hungary, for which the foreign trade plays a much important role, similar to that of Benelux countries. Nevertheless, Romania has a degree of openness higher than Poland, fact explained by the inverse correlation between the openness of the economy and the size of the internal market. It is estimated that in the following years the percent of imports and exports in GDP will continue increasing, and Romania will become a much opened economy, similar to the small and middle-sized countries from the EU.

Figure 3 Romanian Economy Degree of Openness (percent)

![Figure 3 Romanian Economy Degree of Openness (percent)](image)

Source: Author’s calculation on NIS data

Considering the proportion of trade with the European Union in the total external trade, Romania is well placed, similar to the countries that entered in 2004, reaching in the last three years a proportion of almost 65 percent.
According to this indicator, our country is placed near Czech Republic, Poland and Hungary. Still, these aggregate figures are not significant for the structure of the trade with the EU countries. While Hungary’s external trade is mainly based on motor vehicles, household goods and computer hardware (intra-industry trade), Romania’s external trade is mainly based on low manufactured goods (clothes, furniture, metallurgic products). This problem can be solved only through a sustained process of attracting foreign investments in the fields with high added value.

Table 4 The Contribution of Main Economic Sectors in GDP Formation

<table>
<thead>
<tr>
<th>Country</th>
<th>Agriculture</th>
<th>Industry</th>
<th>Services</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU 15</td>
<td>2.0</td>
<td>1.8</td>
<td>1.5</td>
</tr>
<tr>
<td>Romania</td>
<td>11.1</td>
<td>11.6</td>
<td>8.0</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>12.3</td>
<td>10.0</td>
<td>7.0</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>3.5</td>
<td>2.8</td>
<td>…</td>
</tr>
<tr>
<td>Poland</td>
<td>4.4</td>
<td>3.9</td>
<td>3.9</td>
</tr>
<tr>
<td>Hungary</td>
<td>4.6</td>
<td>3.7</td>
<td>3.7</td>
</tr>
</tbody>
</table>

Source: EUROSTAT
Data show that in the GDP sector structure, agriculture continues to play a way too important role (8 percent), similar to Bulgaria, but four times bigger than in the Central-European countries. Moreover, the proportion of population working in agriculture is of 25 percent in Romania, a few times higher than in other Central-European countries. Also, we can observe an underdevelopment of services, contributing with less than 50 percent of GDP in Romania, a percentage net inferior to all other countries in the area.

The reasons of these disparities are structural, deep, and will not be solved without a steady political will. First of all, concerning the agriculture, in the last years, in Romania, it was massively used against increasing unemployment. That is why our country has one of the lowest unemployment rates in the area, but is the only one that in the last decade registered a net flood from urban to rural. Secondly, as a consequent of land retrocession, it was reached a point where the great majority of households (more than 80 percent) own small land surfaces (less than 5 hectares), on which it can only be practiced a subsistence agriculture, showing its "back" to the market. Land’s fusion faces serious reticence in our country, and a true land market is still in an embryonic stage. Thirdly, the Romanian rural environment suffers of lack of infrastructure endowment: asphalted roads and sewerage. The lack of elementary infrastructure (unique in Europe) makes difficult the development of services in the rural environment. In fact, Romania’s economy has a dual appearance, which emphasis every year: an urban sector, dominated by the XX century industrial paradigm and with faint modern elements, respectively a rural sector resembling to a XIX century economy.

If we take into account localities’ classification, Bulgaria, Estonia and even the Czech Republic appear as “more rural” countries than Romania. Still, in these countries, rural does not mean exclusively agricultural, but it means involvement in services and (by commutation) in industry. Only in Romania rural remained synonym to agricultural, and the last term is already synonym with subsistence agriculture. It’s obvious that, having such a structure of the economy, Romania will face serious difficulties of adaptation inside the EU and in the euro adoption.

The last real convergence criterion (and the most synthetic) is represented by the GDP per capita. Expressed at nominal exchange rate, its level was of 4498 euro in 2006. However, a more relevant indicator is the GDP per capita at purchasing power parity.
Table 5 GDP per capita

<table>
<thead>
<tr>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>UE 15</td>
<td>23100</td>
<td>24800</td>
<td>27700</td>
<td>119.9</td>
<td>21800</td>
<td>23400</td>
<td>26200</td>
<td>120.2</td>
</tr>
<tr>
<td>Romania</td>
<td>1775</td>
<td>2421</td>
<td>4498</td>
<td>253.4</td>
<td>4900</td>
<td>6500</td>
<td>8800</td>
<td>120.2</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>1700</td>
<td>2300</td>
<td>3300</td>
<td>194.1</td>
<td>5300</td>
<td>6700</td>
<td>8700</td>
<td>164.2</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>6000</td>
<td>7900</td>
<td>11100 (e)</td>
<td>185.0</td>
<td>13000</td>
<td>15200</td>
<td>18600 (e)</td>
<td>145.4</td>
</tr>
<tr>
<td>Poland</td>
<td>4900</td>
<td>5000</td>
<td>7100</td>
<td>144.9</td>
<td>9200</td>
<td>10100</td>
<td>12400</td>
<td>134.8</td>
</tr>
<tr>
<td>Hungary</td>
<td>5100</td>
<td>7400</td>
<td>8900</td>
<td>174.5</td>
<td>10700</td>
<td>13100</td>
<td>15300</td>
<td>143.0</td>
</tr>
</tbody>
</table>

(e) - estimations
Source: EUROSTAT, NIS, NBR

Between years 2000-2006, in Romania, GDP per capita at nominal exchange rate increased 2.53 times and GDP per capita at purchasing power parity increased 1.79 times, while in the EU 15 the increase was of 1.19, respectively 1.20 times. Really important is the fact that Romania recorded the highest level of increase, followed by Bulgaria, Czech Republic and Poland.

In 2006, GDP per capita at purchasing power parity in Romania was of 34.2 % relative to the EU 27 average, less than Czech Republic (75%), Poland (51%), Hungary (63.2%), Slovenia (83%), but more than Bulgaria (33.3%)%

Table 6 GDP per capita at purchasing power parity (EU average=100)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Romania</td>
<td>34.0</td>
<td>36.3</td>
<td>36.6</td>
<td>37.9</td>
<td>42.5</td>
<td>44.2</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>31.9</td>
<td>31.7</td>
<td>32.6</td>
<td>33.6</td>
<td>36.3</td>
<td>37.7</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>62.0</td>
<td>64.3</td>
<td>68.6</td>
<td>70.4</td>
<td>72.3</td>
<td>73.4</td>
</tr>
<tr>
<td>Poland</td>
<td>59.6</td>
<td>62.0</td>
<td>62.7</td>
<td>63.8</td>
<td>60.4</td>
<td>61.9</td>
</tr>
<tr>
<td>Hungary</td>
<td>66.8</td>
<td>68.1</td>
<td>70.1</td>
<td>71.6</td>
<td>73.7</td>
<td>74.5</td>
</tr>
<tr>
<td>EU 15/EU 27</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: EUROSTAT

We can estimated that, assuming a difference in GDP increase of 4 percent on long and very long term (for example, an increase of Romania’s GDP of 5.5 percent per year, relative to an average increase of European GDP of 1.5 percent per year), the gap would be recovered in about 60 years, without taking into consideration the real appreciation of the Romanian leu vis-a-vis the euro.
Forcing the rhythm of economic growth towards 7-8 percent per year is a real problem: it doesn’t seem sustainable on long term and risks to lead to a superheating of the economy and to recession periods, on the pattern *stop-and-go*; moreover, it may generate either inflation or current account deficit or a mixture of the two. That is why we appreciate that an excessive enforcement of the GDP increasing rhythm is not capable of bringing nearer the fulfillment of the long term objective. On the other hand, it can be taken into consideration the shortening of the horizon of time by adding a certain real appreciation level to the economic growth differential. Until joining the ERM II mechanism, this real appreciation can be of 3-4 percent per year (off course, conditioned by the “golden rule” of correlation with labor productivity). Even after the euro adoption, Romania can register a real appreciation of GDP per capita through inflation higher than the inflation of other countries members of the euro area, in order to get closer the GDP in current prices and the GDP in purchasing power parity. In this situation, Romania would reach the average level of the GDP per capita of the EU estimated for that moment, in 2044.

The so far conclusion is that the real appreciation of the exchange rate is favorable both from the nominal convergence criteria perspective (because it contributes to inflation rate decrease) and from the real convergence criteria perspective (because it helps to the shortening of the time necessary to equalize the GDP per capita levels). In these conditions, the problem is to find the way to stimulate exports, other than the competitive depreciation of
the national currency. These measures must be microeconomic measures, every Romanian exporter being interested in taking advantage of his productivity and efficiency resources. High competitiveness must not be founded exclusively on low cost, but also on other factors, such as: innovation incorporated in the product, delivery in time, specific products for specific customers, creating a private distribution network, ensuring service and guarantee periods etc.

In conclusion, our country does not accomplish, at this moment, neither the nominal nor the real convergence criteria. Ignoring the last ones as not being stipulated in the treaties is a big mistake. However, the Romanian economy evolution in the EU can still be endangered, generating more costs than benefits, if serious measures are not to be taken for making compatible all economic structures.

4. Middle Term Strategy for Euro Adoption in Romania

4.1 ERM II Transition and Alternatives

ERM II represents a step on the way to euro adoption as national currency, and during the test period represented by this mechanism it appears there are rather more risks than advantages. Therefore, the question is weather the adoption of the euro is possible without going through this mechanism.

A solution is the transition to a currency board with euro anchor. In other words, the Romanian leu continues existing to a fixed and unchangeable parity vis-a-vis the euro, fact that would repeat the Bulgarian experience. The main argument against such a solution is that the currency board is a unilateral decision of that country, while the adoption of the euro by a member is a common decision of the whole “club house”, since it has implications on the other countries using the same currency. This aspect is equally true for other countries which have a currency board at the moment (Estonia, Lithuania and Bulgaria), because the final conversion parity will be negotiated with the European authorities. In conclusion, the adoption of a currency board is not a guarantee for the transition to euro, but keeps all the disadvantages and the rigidities generated by such a solution.

Another solution could also be the unilateral abandon of the Romanian leu as a national currency and the admission of euro as a widespread currency in our country. The same as for the currency board, such a solution represents a way for facing a severe crisis, rather than a possibility to be taken into consideration in a stabilization process. In such a case, the abandon of the national currency is like an unconditional surrender, and its effects
would be hardly predictable. The total disappearance of the monetary policy and the loss of the seigneurage given by the monetary issue are only two of the arguments for which the unilateral adoption cannot be taken into consideration.

As we could see so far, only constant and long-term efforts would lead to the fulfillment of some nominal convergence criteria and especially of the real convergence ones by our country. Even admitting that through a constant effort the Maastricht criteria would be fulfilled in a relatively short period of time (of 1-2 years), the sustainability of this nominal convergence depends eventually on the achievement of the real convergence. Moreover, the adoption of monetary restrictions in order to force the achievement of the nominal convergence in a relatively short period of time, could have a negative impact on maintaining an accelerated rhythm of economic growth, which in fact would delay the fulfillment of the real convergence objectives. That is why we consider that the adoption of programs with clear but realistic objectives will support the accelerated development of the Romanian economy even after euro adoption.

In an inflation targeting strategy, each time the inflation projections deviate from the established objective, the monetary policy reacts more or less mechanically, using both the “classic” anchors (interest rate, rate of obligatory reserves), and the exchange rate anchor. This strategy is applied by Romania since August 2005. An important element to be taken into consideration is that the exchange rate policy remained a controlled float, more “floating” than “controlled”. Managed floating exchange rate system fits the choosing of the inflation rate as a nominal anchor and admits a flexible answer to the unpredictable shocks which might interfere. A higher degree of stability of the exchange rate can be achieved through an increasing credibility of the convergence process and through the stabilization of the long-term anticipations of the exchange rate. Taking into account the forecasts regarding the increase in labour productivity and in foreign direct investment floods in the next period, we expect the progressive appreciation of the Romanian leu vis-à-vis the euro to continue, this adjustment contributing to the support of the real and the nominal convergence of Romanian economy.

Finally, after euro adoption, the responsibility for the monetary policy conduction will be transferred from NBR to the European Central Bank, who practices a heterodox strategy, based on two pillars: a quantitative pillar, given by the forecast of money supply (M3), its relationship with the inflation rate being considered stable and long term predictable, and a second pillar, qualitative, taking into consideration as many financial-banking indicators as
possible, such as: financial market evolutions, bounds and real assets evolution, inflationist anticipations evolution.

4.2 Real Convergence Priorities

Among the policies and the macroeconomic decisions having great impact on the fulfillment of the nominal and real convergence objectives, there are three domains that worth being taken into account.

First of all, it must be solved the problem of the arrears and in the subsidiary that of the quasi-fiscal deficits. Arrears represent a form of survival of the inefficient industries that cannot beneficiate of endlessly subventions. Arrears represent a first class inflationary factor, and the enterprises surviving on them contribute to the waste of resources and put bars to the economic growth. The fact that the arrears stagnate for a few years at a level of around 40 percent from GDP shows that the magnitude of the problem remains dangerous, and that the waste of resources in the economy is significant.

Secondly, we must have in view the transition from the present pension system (where the present generation pays the past generation pensions, and the next generation will pay the present generation pensions), to a system based on funds storage, where pensions depend on own contribution. The process is for sure difficult, long and costly, but the postponement of taking decisions in this regard only increases the gap to be covered from public resources. Once adopted and correctly managed, the new pension system generates important resources for investments, which contribute to internal accumulation and an acceleration of the development. In our country, we must have in view the collapse of some important private investment funds. This negative experience forces the authorities to pay maximum attention and to offer the suitable settlement background for the development of the new pension system.

Thirdly, our country must allocate substantial sums for infrastructure projects designed to bring us closer to the European Union’s standards. Road networks – starting with highways and ending with communal roads - , sewerage and water supply, urban heating systems and ecologic projects are only a few targets needing financial resources summing the present GDP value for many years. One important source for financing these infrastructure projects may be the efficient use of European Funds. Since 1st January 2007, Romanian authorities must spend 9 million euro a day. In the period 2007-2013, European Union approved for Romania 28 billion euro cohesion and structural funds. But the Romanian absorption capacity of European
structural funds remains weak. During 2005-2006, from ISPA programme Romania spent only 11.6% and from SAPARD programme 43%. In case of cohesion and structural funds, the forecast level for Romania in 2007 is only 4%.

Another important way of financing these projects is the development of public-private partnerships and the adoption of coherent strategies for private investments in public fields. These programs accelerate the economic growth, but in the same time force public expenses in a way that could endanger the maintenance of the fiscal deficit and of the public debt in comfortable parameters at this moment. In order to realize the balance between nominal and real convergence, it is preferable that the public deficit continue decreasing in order to release non-inflationist resources for budgetary co-financing of important infrastructure projects.

One suggestion may be a lax fiscal policy, allowing in the near future budgetary deficits higher than 3 percent from GDP, limit stipulated in the Maastricht Treaty. The motivation of such a measure stands in the necessity of numerous budgetary expenses connected with EU and NATO accession, with the pension system reform and with the infrastructure improvement. Although motivated, such a solution implies risks. If other countries with high budgetary deficits put the inflation rate under control, in Romania this has not happened yet, and one of the main anti-inflationist policies consists in controlling the budgetary deficit. If we will give up the small budgetary deficits, Romania would lack one of the conditions that qualify it for the later euro adoption.

5. Conclusion

The transition to the euro area mustn’t be needlessly accelerated, and the adoption of the single European currency must not be treated as a simple goal. Besides reaching the nominal convergence objectives, all economic policies must have as objective the achievement as soon as possible of the real convergence. Romania must not hurry its accession to the euro area, as our country has to cover important gaps. The accession in the ERM II mechanism is foreseen for 2012, so that the accession to the euro area may occur in 2014 – admitting that during the whole period the catching-up process is taking place.

The fixation of the year 2012 as target-date for the accession in the ERM II mechanism must be understood and treated as an extra opportunity for the real convergence of
the economy and not as a time-out that would allow untimely relaxation of the macroeconomic policies followed by the authorities.

The period between the accession to the EU and the accession in the ERM II must be wisely used for deep economic reorganization and for realizing some investment programs capable of reducing, in the shortest time, the gap which separates us from the present standards of the European Union.

References


