

THE REFORM OF THE NATIONAL BANK OF ROMANIA AFTER ACCESSION TO THE EU: CHALLENGES AND PERSPECTIVES

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Abstract: In January 2007, Romania became a member of the European Union and the National Bank of Romania a member of The European System of Central Banks (ESCB). This event was a confirmation of the success of Romanian reforms, but, at the same time, it was the beginning of a new stage in the process of accomplishing the nominal and real convergence conditions, set in the Maastricht Treaty. In this study we have explored some considerations about the NBR's reform performances before and after the EU accession and, also, we have discussed about the main challenges and perspectives for the Romanian central bank in the new economic environment imposed by the integration process.

Key words: European integration, central bank, reform, challenges, perspectives

Introduction

In this study we have tried to highlight the main challenges that the National Bank of Romania (NBR) would have to overcome in the EU integration process. In January 2007, Romania became a member of the European Union along with Bulgaria. In this context, the NBR has to continue its reforms and work towards accomplishing the nominal and real convergence conditions, in the perspectives of the Euro adoption.

For the beginning we will explore some consideration about the NBR's reform performances before and after EU accession. In this direction, we will calculate the Grili, Masciandaro and Tabellini - GMT (1991) central bank independence index and the coefficient of correlation between interest rates and inflation in the Romanian economy. Also, we will analyze the level of nominal and real convergence indicators accomplished in the last two years, emphasizing the NBR's contributions. After that, we will talk about the challenges and perspectives for the Romanian central bank in the near future.

Central banking in Romania before accession to EU

The perspective of accession of our country to European Union was a very influent factor regarding structural reforms of the Romanian economy and banking system. In this context, the National bank of Romania has had a very important role in the process of nominal and real convergence imposed by the new economic environment conditions.

The efforts of the National Bank of Romania to adjust to the European integration conditions were in the same direction with the transition to a market economy. The economic development got to a point were it was a real benefit for the accession process, and, at the same time, those reforms imposed by the EU accession process were a very welcomed stimulant for achieving a high degree of functionality for the Romanian economy.

In line with the objectives of European Union accession of Romania, the adjustment of the National Bank of Romania's policies to integration requirements has been related to the following aspects: harmonization of banking legislation; adoption of a proper monetary regime for achieving price stability as mentioned by the Maastricht Treaty convergence conditions; restructuring of the national banking system in the direction of strengthening financial stability; coordination of monetary policies with fiscal ones; modernization of national payment settlement system; participation of NBR to negotiations of the European acquis' chapters.

The National Bank of Romania's role after the accession to EU: challenges and perspectives

As a predictable scenario²⁵⁵ of the Euro adoption and accommodation to the single monetary policy, we could consider the following stages (some of them have been already achieved): adoption of Euro as a reference currency (3rd of March 2003); liberalization of the capital account (April 2005); denomination of the national currency (1st of July 2005); implementation of inflation targeting regime (July 2005); introduction of M3 monetary aggregate (January 2007); entrance in ERM II for at least two years before the Euro adoption.

In the perspectives of this reform continuance, the main objectives and transformation of our central bank consider the following: participation of NBR in the ECB/Eurosystem; improvement of surveillance of the Romanian banking system; implementation of Basel II principles; elaboration and implementation of the convergence program; an adequate monetary policy conducted in accordance with the fundamental objective of price stability; coordination of banking regulations with the *acquis* of the European Union.

On January 1st, 2007 the National Bank of Romania became a member of the Eurosystem/ESCB and the Governor became a member of the ECB General Council. Since this moment, NBR has been fully represented in all working structures of The European System of Central Banks (General Council, dedicated committees, working groups), participating in the decision process regarding regulation in European Union, which implies four working tiers (Lamfalussy procedure). The main benefits of this process include the faster pace of decision-making due to the delegation of powers regarding technical regulations to dedicated Committees and the possibility to achieve, over time, convergence in the field of supervisory practices at the level of competent authorities in the EU²⁵⁶.

In the next years, the NBR has to accomplish the convergence criteria for adopting the Euro. Hence, it has to elaborate and implement a coherent convergence program that addresses the starting point and the time spent (maximum 2 years) in ERM II. There can be two big problems: early entry might extend the stay in ERM II and, also, late entry might weaken the rationale for fast-paced reform. Officials estimate the entrance in ERM II for 2012 and the effective entrance in the Euro zone for 2014.

Before entering the ERM II, Romania has to fulfill nominal convergence criteria and be successful in real convergence. Thus, the NBR has to consolidate a low inflation trend, establish the domestic market for long-term capital and interest rate convergence, and accomplish a sustainable exchange rate. Also, it must be continuing the structural reforms²⁵⁷.

Here are Romania's economic performances in the perspective of nominal and real convergence.

<i>Nominal Convergence Indicators</i>	<i>Maastricht Criteria</i>	<i>Romania</i>	
		<i>2006</i>	<i>2007</i>
<i>Inflation rate</i> (percent, annual average)	<1.5 pp above the three best performing Member States 2.8 percent**	6,56	4,84
<i>Long- term interest rates</i> (percent, per annum)	<2 pp above the three best performing Member States 6.2 percent**	...	6,7²
<i>Exchange rate (vs. euro)</i> (maximum percentage change vs. 2- year average*)	+ / -15 percent	+6,4 / -9,1	+11,0 / -6,4
<i>General government deficit</i>	below 3 percent	-1.9¹	-3.2¹

²⁵⁵ Stoica, Ovidiu; Căpraru, Bogdan; Filipescu, Dragoș – Efecte ale integrării europene asupra sistemului bancar românesc, Ed. Universității Al. I. Cuza, Iași, 2005, p. 61

²⁵⁶ Raportul anual al BNR 2006, cap II, p. 62

²⁵⁷ Isărescu, Mugur – România – Trecerea la euro, Forumul Financiar Sud-Est European, București, 17 mai 2007, www.bnr.ro

<i>Nominal Convergence Indicators</i>	<i>Maastricht Criteria</i>	<i>Romania</i>	
		2006	2007
<i>(percent of GDP)</i>			(-2.8 according to IMF's methodology)
Government debt <i>(percent of GDP)</i>	<i>below 60 percent</i>	12.4¹	12.6
Real Convergence Indicators <i>(GDP/ capita) 2006</i>	EUR	4498	-
	PPS^{***}	8800	-

1) According to ESA95 methodology

2) 10th September 2007

*) For the period 2005-2006 and Oct. 2005-Sept. 2007

**) According to ECB's Report of convergence - December 2006

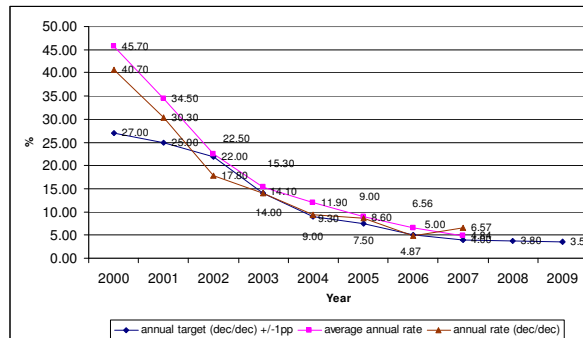
***) Purchasing Power Standards

Source: www.bnr.ro

Table no. 1. Real and nominal convergence indicators for Romania in 2006-2007

As we can see, the nominal criteria are still partially achieved, with monetary criteria being the weakest. So far, the National Bank of Romania has achieved high performances regarding the levels of inflation. Beginning year 2000, inflation rates have been dropping sustainably from 45,7%, and, since 2004, the levels of inflation rate have achieved one digit value. Even if in 2007 the annual rate has increased, the average annual rate has dropped 1,72%, confirming a deflationist trend.

Although the National Bank of Romania has achieved good levels of inflation rates in the last years, the gap between the European levels of inflation and the Romanian ones are still large. Only in the perspective of the year 2009 Romania has programmed an inflation rate target comparable with inflation rates in occidental European countries.



Source: www.bnr.ro

Figure no. 1. The evolution of inflation rates in 2000-2008

Calculating the correlation coefficient between monthly inflation rates and the main interest rates for different periods of time, we can observe a higher correlation, as we move toward year 2007, the year of our accession to EU (it gets positive value, closer to 1). This situation denotes a good functionality of interest rates formation mechanism, confirming the efficiency of the interest rate as a monetary policy instrument in the context of Romanian disinflation.

average active interest rates for non-bank clients – monthly inflation rates	
Jan 1994 – Dec 2006	0<0,5396<1
Jan 1998 – Dec 2006	0<0,7632<1

Jan 2000 – Dec 2006	0<0,7790<1
reference interest rate – monthly inflation rates	
Jan 1998 – Dec 2006	0<0,6938<1
Jan 2000 – Dec 2006	0<0,7170<1
Jan 2000 – Jul 2007	0<0,7412<1
average passive interest rates for non-bank clients – monthly inflation rates	
Jan 1994 – Dec 1999	0<0,4804<1
Jan 1994 – Dec 2006	0<0,6038<1
Jan 1998 – Dec 2006	0<0,7673<1
Jan 2000 – Dec 2006	0<0,7782<1

Table no. 2. The correlation coefficient between monthly inflation rates and the main interest rates of economy for different periods of time

The monetary policy strategy of inflation targeting will be kept until the ERM II entrance, because cohabitation between inflation targeting and an explicit exchange rate target is not appropriate. For the moment, it is the best choice that can be made in order to gradually achieve nominal and real convergence, in accordance with the fundamental objective of price stability. Also, the NBR would have to implement a performing communication strategy with the public, in order to be transparent and proactive.

Since January 1st, 2007, the NBR has reconsidered the structure of monetary aggregates in compliance with the ECB methodology and classification of financial instruments by institutional sector according to ESA 95. This change gave rise to influences between monetary aggregate components and between their counterparts. We can observe that the definition of M2 mirrors the interest in analyzing and monitoring a monetary aggregate which, apart from cash, includes *highly liquid* deposits as well.

Another important change in the monetary aggregates' structure is the introduction of M3 - broad monetary aggregate, which comprises M2 plus marketable instruments issued by monetary and financial institutions. Money market instruments, in particular *money market fund shares and units* and *borrowings from repurchase agreements*, are included in this monetary aggregate (their highly-liquid nature makes these instruments be substitutes for deposits).

Calculating the degree of the National Bank of Romania's independence with Grili, Masciandaro and Tabellini – GMT (1991) central bank autonomy index on December 2007 we have obtained a score of 12 out of a maximum score of 15. This score suggests good central bank independence degree for NBR.

Political independence

No	Criteria	Scor	Value	Details
1	Governor not appointed by government	1 – yes 0 – no	1	Statute of NBR, Law no. 321/2004, Art. 33, alin 3
2	Governor appointed for more than five years	1 – yes 0 – no	0	Statute of NBR, Law no. 321/2004, Art. 33, alin 4 (no more than five years)
3	Board not appointed by government	1 – yes 0 – no	1	Statute of NBR, Law no. 321/2004, Art. 33, alin 3
4	Board appointed for more than five years.	1 – yes 0 – no	0	Statute of NBR, Law no. 321/2004, Art. 33, alin 4 (no more than five years)
5	Government representatives not required to participate in board	1 – yes 0 – no	1	Statute of NBR, Law no. 321/2004, Art. 33, alin 10,

				art. 34, alin. 1
6	Government's approval not required for formulation of monetary policy.	1 – yes 0 – no	1	Statute of NBR, Law no. 321/2004, Art. 33, alin. 1 lit a) – hotărâri ale CA
7	There is a charter (or legal, or even constitutional) requirement that CB pursue monetary stability as one of its primary objectives;	1 – yes 0 – no	1	Statute of NBR, Law no. 321/2004, Art. 2. alin 1
8	There are legal provisions strengthening CB's position in the event of conflict with government	1 – yes 0 – no	1	Statute of NBR, Law no. 321/2004, Art. 3, alin 1
	Total		6	

Economic independence

9	Direct credit not automatically extended;	1 – yes 0 – no	1	Statute of NBR, Law no. 321/2004, Art. 7, alin 2
10	Direct credit provided at market rates	1 – yes 0 – no	1	Statute of NBR, Law no. 321/2004, Art. 7, alin 2
11	Direct credit is explicitly temporary;	1 – yes 0 – no	1	Statute of NBR, Law no. 321/2004, Art. 19, alin 1
12	CB does not participate in primary market for public debt securities.	1 – yes 0 – no	1	Statute of NBR, Law no. 321/2004, Art. 7, alin 2
13	Direct credit subject to limitations on amount;	1 – yes 0 – no	1	Statute of NBR, Law no. 321/2004, Art. 7, alin 2
14	Discount rate set autonomously by CB;	1 – yes 0 – no	1	Statute of NBR, Law no. 321/2004, Art. 20
15	Banking supervision not assigned to CB	1 – yes 0 – no	0	Statute of NBR, Law no. 321/2004, Art. 2, alin 2, lit b), Chapter V
	Total		6	
The overall “economic autonomy” index (Political independence+ Economic independence)			12	

Table no. 3. Grili, Masciandaro and Tabellini index – GMT (1991) calculated for NBR, December 2007

Regarding the real convergence, indicators reveal a great gap between Romanian values and EU15 ones, even when compared to some central and eastern European countries. Thus, in 2006 the Romanian level of GDP per number of inhabitants in PPS represented 33,5% of the EU15 average, 47,3% of the Czech Republic one, 57,5% of the Hungarian one, and 70,9% of the Polish one. Even so, the Romanian economy has developed very rapidly – in 1999, the starting year of negotiations with EU, the level of GDP per number of inhabitants in PPS was 23,2% of EU15 average, at that time.

Starting since the late of year 2006, the NBR has adopted some regulations regarding the harmonization of Romanian financial-banking legislation with the European one, as an action of adaptation to the new conditions of the European economic environment. In this direction, in January 2008, the Single European Payment Area (SEPA) came into force in the entire EU, and in Romania, as well. This is an important measure of modernizing our payment settlement system and connecting with the ones in other European countries. That has implied an adaptation of the banking infrastructure to the new conditions and better payments services for clients.

In this context, we think that the main challenges and preoccupations for the NBR in the next years will be the following: threats of capital movements that can influence currency evolutions; maintaining of a deflationist trend and achieving inflation targets; a growth in balance of payments deficits; winning the market-maker position for the banking system; the contagious effects of the American subprime credit crunch; wages pressure; a quick harmonization of our financial-banking legislation with the future Directives of EU; a growing competition in the banking system due to the single market passport and an increase of the capacity of the central bank in banking and payment settlements supervision; greater central bank independence; efforts for rising the NBR's communication strategies' efficiency.

Conclusions

The European economic environment will have a major influence on the National Bank of Romania's institutional reform. At the same time, the NBR will still be one of the most active institutions in the restructuring of our economy in the perspective of European integration. Its main objectives will be focused on its contribution in achieving nominal and real convergence and adoption of the Euro at the right time. In this direction, the NBR will be confronted with many challenges and thus it must adopt the proper policies for every situation.

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