ROMANIA'S REAL CONVERGENCE TO THE EUROPEAN UNION

Dragoş Mihai Ungureanu [1]
Ruxandra Dana Vilag [2]
George Horia Ionescu [3]
Florian Bogdan Stoian [4]

ABSTRACT: In the process of European integration, switching in 1999 to the third stage of Economic and Monetary Union, has intensified the need to coordinate economic and sectoral policies of the Member States. The process of coordination is necessary to harmonize national economic policy objectives in order to minimize the negative impact of economic policy measures taken by some member countries to other member countries and reduce the temptation for Member States to have behavior riders. Real Convergence is an essential goal of Romanian integration into the European Union. Attenuation of the development gaps maintained between Romania and the EU can not be achieved solely through the use of market forces. Economic transformations occurring globally and increased risk aversion contributed to a signifiant reduction of capital flows to Romania, increased pressures upon exchange rate.

Key words: Real convergence, nominal convergence, integration, European Union

JEL codes: F36, F33, O52

Introduction

To be able to make such an assessment we needed to determine the place that Romania occupies in the European Union Member States ranking. It should also be defined and assessed the speed with which Romania is moving towards convergence with developed countries' group and also considering their growth rate.

Evaluation of real convergence's implementation framework in Romania

From the economic point of view, Romania is still in a marginal position compared with the developed countries' group. For example, compared with EU-25 $_{2004}$ average, the Romanian GDP per capita, calculated at the exchange rate was 8.1 times lower and calculated at the purchasing power parity (PPP), it was of 3.1 times smaller. Compared with the average of the 10 countries that joined the EU in 2004, the Romanian's GDP per capita was in 2004 of 2.35 and 1.75 times lower, according to Eurostat data. Among the 28 States and candidate countries in 2004 (EU 27 + Turkey), Romania "gain" the 26th position (before Bulgaria and Turkey) according to it's GDP per capita (PPP in euro). When considering Romania's position according to the average income per capita, if we go beyond the European zone, is apparent that Romania has a better position. However, the spread between the extremes is more significant than in Europe. Among the 208 countries and independent territories, Romania ranks by GDP per capita far from most extreme cases, but below the media world, presenting these values of key macroeconomic indicators for 2007:

- Population: 21.55 million inhabitants;

---

[1] Permanent Representation of Romania to the European Union
[2] Romania American University, Bd-ul.Expoziţiei Nr.1B Sector 1 Bucuresti, rruxaa@yahoo.com
[3] Romanian American University
[4] "Lucian Blaga" University of Sibiu

- GDP: 166 million USD;
- GDP growth over the previous year 6%;
- IGP increase over the previous year 5%;
- Share of net FDI in GDP 6%;
-unemployment rate 6%.

To answer the question „*Does Romania manages to complete the process of convergence to the European Union in terms of GDP per capita?*", Romania's progress should be compared with the developments in other countries or country groups. If progress is defined by average annual growth rate of Romania GDP per capita and analyzed in relation to other countries or groups of countries we observe that the convergence of Romania is not only very difficult to achieve, but becomes almost an illusion, considering that the disparities are becoming larger and larger, and Romania's annual rate of increase between 1990-2004 was much slower or even negative in 1980-2003.

Even if analysis and forecasting calculations require a long series of data, using the 1980-2000 range for Romania is slightly unrealistic, considering the two decades are non-typical in terms of continuity and economic stability. In that period, Romania's economy experienced a profound and acute crisis, the centralized system (in the 80's) showed inefficiency and lack of capacity to innovate and to adapt, on the other hand the transition to a new system (in the 90's), consisting in a general and profound restructuring of the whole economy (the technological and organizational system, the concept of ownership, the economic and social management, the institutional system, etc..), which resulted in a profound adverse development in the national economy. Changing began to be positive since 2000, when the stability and the functionality of the economy have been achieved on new principles basis (thesis of M. Olson - professor at Yale University - claim that the national economic systems has a natural long term life cycle). Therefore, we should support the idea *that to develope the convergence scenario, for Romania, it will be best to be consider growth rates since 2000* because they are the only ones considered reliable to evaluate the future evolution of Romanian economy - the year 2000 was labeled as the start of a normal development for our country.

Thus, between the nominal and real convergence must be an intelligent balance, as a forced nominal convergence is not sustainable and can explode in time, like inflation, which can be carried down artificially but can explode when no longer controlled.

Achieving nominal convergence requires the fulfillment of the Maastricht Treaty [**The Maastricht Treaty does *not* mention explicit criteria for real convergence**, which involves reducing disparities between the countries on the price level and productivity, involving increase revenue in developing countries rising to the existing level in developed countries] established criteria, namely price stability, long-term interest rate, exchange rate stability, sustainability of the fiscal position:
- an inflation rate no more than 1.5 percentage points above the average of the first three Member States with the lowest inflation;
- long-term nominal interest rate can not exceed 2 percentage points compared to the average interest rate in the first three Member States with the best performances in terms of price stability;
- the budget deficit can not exceed 3% of GDP;
- public debt ratio to GDP can not exceeding 60%;
- the margins of the exchange rate fluctuation should match the margins established by the European Monetary System – not over the limit of + / - 15%, calculated over the last two years before the examination.

The process of catching-up of the Central and Eastern Europe countries is influenced by the management quality of the two types of processes - nominal and real convergence, the latter inducing new constraints on savings plans to join the euro area [Miron, Dumitru, '*Economia Uniunii Europene*' - Editura Luceafărul, Bucureşti, 2004]. The process of nominal convergence has been privileged in relation to the real convergence, because its execution requires a smaller time horizon. Joining the euro area will not be achieved until after the full achievement of nominal convergence criteria set at Maastricht on the inflation rate, long-term interest rates, deficit and debt, and the nominal exchange rate stability.

According to European Central Bank, during April 2007 - March 2008, Romania registered an average annual rate of HICP inflation of 5.9%, significantly higher than the 3.2% reference [calculated in accordance with the Treaty of Maastricht]. The retrospective analysis on a longer period shows that, in Romania, inflation measured by consumer prices was placed on a clear descending trend, although initially it recorded a very high level. The disinflation process occurred in the context of a strong GDP real growth, which has exceeded 5.0% almost every year since 2001. The inflation decrees occurred based on an accelerated growth in labor income, which exceeded 20% over several years. Between 2005 and mid 2007, the import price evolution favored the disinflation process due to considerable appreciation of the leu against the euro. Analyses of recent developments indicate that the annual rate of HICP inflation accelerated from almost 4% in January-July 2007 to 8.7% in March 2008. Significant increasing in prices of food, higher import prices as a result of the leu depreciation since mid-2007 and the growth of commodity prices on international markets, as well as the advance real GDP substantially supported by increased domestic demand continued to increase recent inflationary pressures. Labor income growth reached 20.2% in 2007, exceeding the growth of labor productivity and thereby significantly increases the unit cost of labor.

*Until 2008, Romania has **not** been the subject of a European Union Council decision regarding the existence of excessive deficit.* Given the budget deficit of over 5% in 2008 and visible developments of macroeconomic balances in 2009, chances are high that things would change in this respect. In 2007, Romania had a budget deficit of 2.5% of GDP, below the reference value of 3%. Public debt ratio to GDP was 13.0% in 2007, considerably below the reference value of 60%. Further fiscal consolidation is needed for Romania to maintain a lower weight deficit and meet the baseline medium-term objective stipulated in the *Stability and Growth Pact*. Given the current economic and financial conditions (and the fact that 2009 is an election year) we think that these goals will be almost impossible. In the convergence program this is defined as a deficit adjusted with cyclical effects, which excludes temporary measures of approximately 0.9% of GDP. As for the other fiscal indicators in the years 2006 and 2007, the deficit level has not exceeded the share of public investment in GDP.

Between January 1st, 2007 (accession at the European Union) and April 18th, 2008, the leu did not participate in ERM II, but was traded in terms of a flexible exchange rate regime. In the reference period April 19th, 2006 to April 18th, 2008, the leu has been subject of pressures of impairment until mid July 2006; thereafter, it significantly appreciated against the euro. Starting with August 2007, the national currency has recorded an accentuated depreciation because of a growing aversion towards risk in international financial markets as a result of intense financial turmoil and concerns about the widening current account deficit and inflation inflammation. Generally, most of the reference period, the Romanian leu was quoted against the euro at levels clearly above average exchange rate registered in April 2006, in terms of a relatively high degree of volatility.

Short-term interest rate differentials for three months EURIBOR interest rate have been tempered, easily exceeding 2 percentage points in late 2007, before increasing to 5.1 pp during the three months ended in March 2008.

In early 2009, the real effective exchange rate of the RON against the euro situated a level superior to historical averages recorded in the past ten years and the bilateral real exchange rate against the same currency easily surpassed the average. However, real economic convergence makes difficult any assessment of the historical evolution of real exchange rate. Regarding other external developments, since 2002, Romania had a progressive increase in current and capital account deficit of the balance of payments, which have been 13.5% of GDP in 2007. Although significant external deficits may be partially generated by the alignment of an economy like Romania, deficits of this magnitude raise sustainability problems, especially if they persist for long periods. It seems that very large deficits have recently been caused also by an overheating economy. In terms of financing, net inflows of direct investment covered almost entirely the external deficit until 2006. However, lately, a significant proportion of the deficit was financed by inflows of other investment consisting of external loans made the banking and the non-banking sector. In this context, the Romanian international investment position deteriorated from -19.3% of GDP in 1998 to -46.6% of GDP in 2007. In the reference period April 2007 - March 2008, long-term interest rates were located on average at 7.1%, higher then the reference value criteria of the interest rate.

Achieving an environment conducive to a sustainable convergence in Romania requires, inter alia, the implementation of sustainable strategies and credible fiscal consolidation, which can help reduce inflationary pressures on the demand and macroeconomic imbalances. Supplementary budget corrections inorder to finance current expenditure as a result of non-use items of investment expenditure causes serious problems in the national institutional framework of the fiscal policy, thus raising concerns about the stringency of the budget execution. Also, credit expansion, a large current account deficit and finance need to be carefully monitored. In terms of goods' markets, Romania have undertaken steps to complete the liberalization of the network industries and to boost the efficiency of the energy sector. In addition, improving the conditions of manpower supply is of particular importance, because large workforce shortages continue to „successfully" affect the alignment, and previous accomplishments in terms of disinflation. Although job creation should be stimulated by adjusting the tax system and granting aid, it's necessary that tax cuts be accompanied by expenditure restraint, which needs to be supported, inter alia, increased efficiency of budgetary expenditures. Measures taken to increase the quantity and quality of manpower supply should include the adjusting of the training level to labor market needs, development of professional training programs for rural population, higher flexibility of labor contracts and more substantial incentives for regional mobility. Moreover, wage growth should reflect the achievement of an environment s required for dustainable convergence in Romania, among other things, the implementation of sustainable strategies and credible fiscal consolidation, which can help reduce inflationary pressures on the demand and macroeconomic imbalances. Restrictive public sector wage policy is important to generally moderate wage developments. These measures, combined with a stability oriented monetary policy will contribute to an environment conducive to sustainable price stability, and to promote competitiveness and increasing employment of labor.

Romanian legislation does not meet all legal requirements on independence and integration into the Central Bank Eurosystem. Romania is a Member State with a derogation and therefore must comply with all the adjustments referred to in Article 109 of the Treaty.

The Opportunity in achieving (real and nominal) convergence with European Union

In terms of real convergence process there was some formal criteria and no full agreement in terms of variables that should be taken into account, some of which refers to growth rates of GDP per capita and productivity levels in different sectors with high share in GDP, the evolution of the economic integration degree. To highlight the Romanian level of economic convergence to the European Union, compared to other CEE countries, we analyzed the indicators proposed by Deka Bank - Europe converging Indicator (DCEI) and, respectively, of Deutsche Bank. The first refers to

four categories of variables which highlights the level of adjustment of an economy in accordance with EU accession process:

a)Money convergence - inflation, interest rates on long-term nominal exchange rate and increasing financial intermediation;

b)Fiscal convergence - the budget deficit, public debt, external debt;

c)Real Convergence - GDP per capita, agriculture share in GDP, unemployment and the EU trade share;

d)Institutional convergence - EBRD's transition indicators analysis, and implementation status of the Community acquis.

Table no.1

Convergence indicator in Europe 2004 (100 = average EU15)

	Total convergence	Real convergence	Institutional convergence	Monetary convergence	Fiscal convergence
Estonia	84	75	85	90	85
Slovenia	83	100	80	80	75
Czech Republic	81	90	80	90	65
Poland	74	60	85	80	75
Slovakia	74	60	80	85	75
Hungary	71	85	85	60	60
Lithuania	71	45	80	85	85
Latvia	69	60	85	65	70
Bulgaria	59	25	80	75	80
Croatia	48	30	55	80	40
Romania	41	50	75	10	75

Source: Hanusch A. and Balzat M., "A new era in the dynamic of european integration", 2004

The analysis of this index in 2004 (Table no.1) reveals the following groups of countries, depending on the degree of performance: the first, including Estonia, Slovenia and the Czech Republic. The second country is the leader in terms of real convergence, but Estonia has made major progress in nominal convergence field (following the successful implementation of monetary council and tax reforms) and institutional. Czech Republic recorded a lower score due to fiscal nature problems (significant subsidies from the state budget and the level of public debt); the second, which includes Poland, Slovakia, Hungary, Lithuania and Latvia, Slovakia has introduced flat quota of 19 % regarding the income, with positive effects in attracting FDI. Hungary had some problems in terms of inflation and budget deficit, which negatively influenced the nominal convergence criteria fulfillment. In Lithuania and Latvia case, adopting the Monetary Council will enable faster accession to the euro area, the leader of the third group is Bulgaria, following the progress towards fiscal and monetary convergence. Romania is the last in this ranking, and Croatia is worst because of lower performance in ensuring macroeconomic stability. In these conditions, although the evolution of real GDP since 2000 and a low unemployment rate improved the score

afferent to the real convergence process, Romania hasn't recorded a higher degree of convergence in 2004, it decreased compared to 2003.

During 2001-2004, countries have made progress in the process of convergence with the European Union, due to a favorable evolution of nominal convergence variables. Following this methodology, the convergence of the Romanian economy is higher than in 1995, when the DCEI index value was 27. But, if we take as reference Bulgaria, our progress has been limited, given the fact that this indicator was 21.

The second indicator of economic convergence - proposed by Deutsche Bank Research - is built taking into account the same criteria as the index DCEI, but with emphasis on the external balance of transition economies: real economy (GDP per capita, agriculture share in GDP, unemployment, private sector share in GDP, investment rate, growth rate of GDP and productivity), quality of institutions highlighted the EBRD index (legal system, governance, banking, trade liberalization and foreign market) ; external sector (current account balance from GDP adjusted by the flow of FDI, the degree of integration with the European Union) fiscal and monetary conditions (inflation rate, budget deficit and public debt).

The evolution analysis of this indicator between 1999 - 2003 (according to data presented in Table 2) shows an improving convergence of the Romanian economy with the European Union, all the same our country being the last of the candidate countries. But compared with DCEI index, the degree of economic convergence is higher and the gap with Bulgaria lowers. Also, the scattering of the convergence index was reduced in 2003 compared to 2002, making it difficult to emphasize the different groups of countries based on performance. The most convergent is Slovenia and the other countries that joined EU formed a compact group with a value located between 66.3% and 71.3% of the EU-15 average.

Table no.2

The Deutsche Banck convergence index 1999-2003 (% EU-15) [Deutsche Banck Research, 2001-2004**]**

	1999	2000	2001	2002	2003
Czech Republic	66	69,9	70,1	73,2	70,6
Estonia	62,7	66,3	70,1	69,4	71,3
Hungary	65,6	70,3	71,8	71,4	69
Latvia	58,7	62,1	64,9	70,6	69,2
Lithuania	45,3	56,9	59,3	67,1	66,3
Poland	60,7	63,5	65,1	65,1	67,4
Slovakia	57,4	61,7	64,3	70,3	69,4
Slovenia	57,3	71,3	73,6	82,9	75,5
Bulgaria	53,8	56,5	59	65,8	63,1
Romania	44,2	50,9	53,3	59,3	61,8

Romania is the only country that improved the economic convergence degree in each year of this period, due to higher rates of economic growth since 2000, and the process of disinflation. But the evolution of the external sector and the quality of institutions explain the lower growth rate of convergence. Even though this index was calculated only until 2003, it can be estimate a trend, depending on structure variables. Analysis suggest increasing convergence, due to the positive influence of real variables (GDP growth, productivity, unemployment rate developments), analyzed in Table no.3. Current account balance deterioration is not a problem, as long as it is covered largely by stable capital flows - FDI, but adversely affects the value of this index of convergence. However, the results should be interpreted with caution, since a simple comparison of growth rates of different variables is irrelevant, in terms of major initial differences.

Comparative analysis of real and nominal variables evolution reflected the extent to which business cycle in Romania is correlated with that of the European Union. In a study by Figuet and Nenovsky (2006) it's analyzed the degree of nominal, real and financial convergence, as well as business cycle synchronization with the EU (using the beta and sigma convergence) for Romania, Bulgaria, Hungary and Czech Republic. The studied variables are income, inflation rate, interest rates, monetary aggregates and credit volume. Also, they rated the degree of convergence in terms of response to various shocks, and their absorption channels, decisive in this respect are the chose monetary regime and also the degree of the economy flexibility. The period analyzed was 1997 (quarter 3) - 2005 (quarter 3), according to quarterly data.

Table no.3

The evolution of the real variables: GDP, productivity, unemployment [Source BNR, Eurostat]

	2002		2003		2004		2005	
	EU-15	Romania	EU-15	Romania	EU-15	Romania	EU-15	Romania
GDP real growth %	0,7	5,1	1,0	5,2	2,3	8,3	1,4	4,5
Productivity growth (%)	0,6	7,9	0,6	5,0	1,6	8,4	1,1	5,6
Unemployment rate (%)	7,6	7,5	7,9	6,8	8,0	7,1	8,0	7,0

Romania has made progress in the process of convergence of the analyzed variables, the effects of fixed signs being positive (and not negative as suggested by beta convergence) and less statistically significant. Econometric simulations carried out by the conintegration method shows no convergence trends in terms of real variables, for a low inflation rate and domestic credit and an average money supply and interest rate.

The econometric estimation of the economic convergence degree provides information only about the direction of movement of different variables in the analyzed country in comparison with the European Union. We appreciate that a degree of divergence has not to be considerate as an imposer of an unfavorable evolution of an economy, so that Romania has registered an increase in real GDP in each year of the period analyzed, and the EU has shown a lower growth since its 2000. Thus, this non-synchronization with the business cycle "allowed" Romania to recover a certain part of the income gap? The conclusions of the study are still more significant in terms of nominal variables, as they show a low and relatively stable level in the EU.

The situation is different for other countries, which show a positive influence of changing interest rates in the euro area; this is explained by the greater financial integration compared with Romania. It was estimated that the common monetary policy shocks generated by the European Central Bank explained almost 30% of the variation of income in Bulgaria, the explanation consisting in the monetary policy regime nature.

The correlation of business cycles is important in terms of joining the euro area, as common policies (in this case, monetary policy) may generate asymmetric shocks if economic developments are different. According to the theory of optimum currency areas is considered that a „fine-tuning" economy against asymmetric shocks in countries of the euro zone implies the existence of a higher flexibility of the economy. This is correct if the economy has undertaken structural reforms, received increased flows of foreign capital and has a labor market with a low degree of stiffness (Miron Dumitru, Păun Cristian, 2009). Even though Romania has made some progress in these areas, however, the economy has a low capacity to adapt; an example of this is the slippages that have generated growth in domestic demand, following the introduction of the flat rate. To increase the flexibility of an economy we should encourage measures on the aggregate supply, which are able to

positively influence the potential growth of the economy (restructuring, stimulate investment, labor market flexibility, entrepreneurial activity, the incorporation of technologies to). Promoting such policies is also imposed by the criteria of nominal convergence, which will reduce the margins of maneuver of both monetary and budgetary policy. In addition, it will allow both to stimulate the process of disinflation and the one of revenue growth.

Romanian economy Structural stiffness lasts as long as it promotes policies to stimulate aggregate demand, in order to adjust the structural shocks. The exchange rate tool was a surrogate managed by the economy to boost exports, which delayed the restructuring process; also, under the conditions of high rigidity in real wages, using the exchange rate was a less effective tool.

In terms of accommodative budgetary policy, it generates externalities - increasing current account deficit, increasing inflation, decreasing private investment (crowding-out effect). However, this policy should not neglect the role of long-term aggregate supply, namely through reducing direct taxation and increasing budgetary spending for research and development.

If will not be achieved a shift to the policies to boost supply, Romania will not qualify as a candidate for joining the euro area, because of the low economy flexibility degree, so, even if will fulfill all the criteria of nominal convergence.

The impact of the financial assistance in the current economic context
Romania registered in recent years very high growth rates (an average of 6.5% since 2002, reaching the 7.1% in 2008). The increase was mainly due to domestic demand for consumption and investment, nourished by a „boom" financed by foreign sources in the field of financial intermediation, and a massive increase in wages. External borrowing led to a rapid increase in external debt, reaching levels of 53% of GDP at the end of 2008, and loans in foreign currency led to an awareness and vulnerability of the companies' assets due to sudden movements of the exchange rate. Were exacerbated pressures on demand and pro-cyclical fiscal policy, with a net public debt increasing from 1.2% of GDP in 2005 to 5.4% of GDP in 2008, despite successive views of the European Union Council in June 2008 and Commission Recommendation, who supported fiscal consolidation and efficient budget management.

Globally economic changes and an increased risk aversion resulted in a reduction of capital flows to Romania. It also increased the pressures on the exchange rate - depreciation accumulated more than 30% of the national currency since August 2007. In the fourth quarter of 2008, aggregate national demand has contracted by more than 4% from the same period a year ago, mainly due to decrease in consumption - external competitiveness developments in productivity being affected by slow pace of the structural reform implementation required by the EU. The Government is also facing difficulties on the bond market, with an average rentability increased by only 300 bps compared to 2007, and based solely (almost) on short-term maturities.

Early March, Romania called on the European Union and the International Monetary Fund support for in order to sustain the balance of payments stability, facing also massive decreasing of external capital flows; nine of the „mother companies" of major foreign banks operating in Romania backs the loan by promising to maintain exposure in Romania and to provide additional capital if necessary.

Macroeconomic perspective
After several years of increased GDP growth (an average of 6.5% in 2002), growth has declined sharply in the fourth quarter of 2008 - reaching a rate of 2.9% - mainly due to contraction of consumption to almost 4% Vs. 2007, with more drastic requirements on bank loans. Decreased demand has an impact on imports, registering negative rates towards the end of 2008 (-18% vs. 2007), and even more in early 2009 (-28% vs. 2007). Export performance had suffered as well: -8% at the end of 2008 and -13% in early 2009. Thus, the current account deficit for May 2008 was

diminished, continued to remain at high levels (12.3% of GDP, vs. 13.5% of GDP in 2007), 54% of this deficit was financed by foreign direct investment. The offer decreased due to contraction in the industrial sector by almost 8%; the targeted sectors were primarily construction and services.

During the period of economic boom, due to labor migration and to a high proportion of unskilled workers we witnessed the building of a wages spiral [Nominal growth of 25% in the first second trimester of 2008, decreasing to 13% in January 2009Nominal growth of 25% in the first second trimester of 2008, decreasing to 13% in January 2009], far exceeding the growth rate of labor productivity.

It's predicted a negative growth of GDP of approximately -4% for 2009, due to contraction in consumption, investments, the worsening global level economic perspective, easily corrected external deficit.

Public finances

Romania followed an appropriate fiscal cycle for an economic boom period between 2005-2008, with deficits increasing from 1.2% of GDP in 2005 to 5.4% of GDP in 2008, despite an increase of 6.5% of GDP and repeated recommendations received from the European authorities. This was mainly due to a weak budget planning and budget execution, along with an occasional reckless of budgetary rectification of income spending, a low level of capital expenditure projects for execution and resources transferring from operational budget chapters, such as investments, to current expenses – budgetary staff salaries [Between 2005-2008 the nominal growth of public sector wages was of 100%.] or social transfers.

The 2009 budget contains several measures aimed to reduce the deficit from 5.4% of GDP to 2.0% in 2009, under the assumption of real GDP growth of 2.5%; measures relate to freezing new recruitment and cancellation of various public sector employees bonuses, a reduction in goods and services spending, limiting wage increases to public staff pensions by linking it with inflation rate rather than wage growth, it also provides an increase in public investment. Given the design of unrealistic revenue policy unrealistic - much too optimistic, a comprehensive reform of expenditure policy, there are a whole series of risks in implementing the 2009 budget.

Financial markets

Romania's financial system is dominated by the banking sector, which developed with a very vigorous pace in recent years. Total net value of banking sector assets amounted to 315 billion euro at the end of 2008 (62% of GDP) - 88% is held by foreign institutes of credit from Austria, Greece, Italy and France operating in Romania.

Credit expansion promoted by banks led to a credit/deposit rate of 122% in 2008, loans denominated in foreign currency amounted to 59% of the total loans, in the second half of 2008, lending activity has slowed to 60% June 2008/June2007 and 36.5% in December 2008/December 2007.

Although, currently, the banking sector remains strong and is apparently well-capitalized (with a capital adequacy ratio of 12.3% at end 2008), financial stability in Romania can be easily canceled due to forecasted growth rate of bad loans during coming months. Also, as the private sector in Romania is based on a fairly high percentage on loans in foreign currencies, any further depreciation of the leu will have an impact on the accounts of economic enterprises, as well as on the population -who also avoided loans in national currency.

Balance of payments and financing external requirements

Romania's strong development in recent years has been characterized by the emergence of unsustainable external funding. Actual current account deficit increased from 5.8% of GDP in 2004

to 13.5% of GDP in 2007 and remained above 12% in 2008. Thus external debt level reached 55% of GDP in December 2008.

Financial markets in Romania were under continuous pressure since October 2008. The low investments level heavily pressure national currency, interbank market, shares and bonds market, also the need for short term financing of 20 billion euro seems to not be supported by foreign direct investment during 2009-2011; some are due to the need of covering the current account deficit, reaching maturity certain extern loans, to cover capital outflows (such as nonresidents deposits) and build a prudent level of reserves in foreign currency. The starting premise is for a negative growth of -4% of GDP in 2009, to 0% in 2010, a current account deficit of 71 / 2% of GDP in 2009 and 61 / 2% of GDP in 2010.

Romania's total financing need sum up in first quarter of 2011 around 20 billion Euros. EU assistance (5 billion) for Romania joins the support of the International Monetary Found standby agreement worth 11.4 billion SDRs (about 12.95 billion Euros); an additional multilateral aid worth 2 billion Euros will be provided as it fallows: World Bank - 1 billion, and the rest, up to 1 billion from the European Investment Bank and European Bank for Reconstruction and Development together.

The main elements of Romania's economic recovery plan

The main elements constituting Romania's economic recovery plan are the following:

a) *fiscal consolidation* that will focus in particular on budgetary expenditures. Primary government spending will be reduced in 2010 to 0.85% of GDP over the 2009 budget, which will be achieved by continuing the process of reducing staff costs for public employees, goods and services expenditures of public institutions, and reduction of capital costs, while ensuring a realistic timetable for the implementation of investment projects. On the other hand, public investment is expected to grow in 2009 compared to 2008 from 3.75% of GDP to 6.5% of GDP. On the revenue, will take measures to eliminate some tax deductions, especially in the automotive field;

b) *government tax reform* will be adopted in order to reduce budget deficits and improve strategy and budgetary process. A key component will be the responsibility of the tax law that will establish a multi-annual budget procedures, limitations of budget corrections and rules aimed at improving the rate of budget implementation, together with the creation of a tax board which has to provide expertise, independently. To improve budget predictability and transparency, the public compensation system will be restructured, as well as the level of wages and bonuses along with some key parameters of the pension system. These will include public pension indexation depending on price index, limiting discretionary increases and gradually increase the retirement age, particularly for women, taking into account the evolution of life expectancy. In the same area the pension programme provides further implementation of the second pillar with the gradual increase of contributions against the level previously established;

c) *monetary and financial policy* will be directed towards price stability and achieving BNR inflation targeting (currently 3.5% + / - 1% by the end of 2009). Regarding the financial sector, the BNR will apply stress tests to banks' balance sheets, and to their portfolio officers, following the different scenarios proposed by the European Union in order to assess the need to increase their funds so as to ensure the solvency ratio over 10% during the program. Other measures that will lead to the power strengthening of intervention of the bank in case of adverse events, will provide a significant increase in capital gains of banks and banks' shareholders limit or even prohibit to income bank distribution. Also in order to strengthen the supervision reporting requirements will increases the liquidity and the amount of minimum solvency ratio. Also, in order to simplify cash flows, will be implemented a lighter legislation on deposit insurance (insurance will be activated since the 21st day of deposit) and the range of assets accepted as collateral was widened;

d) **structural reforms** include policies aimed at improving efficiency and effectiveness of public administration, improving public expenditure quality, increasing the degree of absorption of European Union funds, improving business environment, combating illegal employment and contributing to local development.

Conclusions

From the Romanian perspective, the coordination of economic policies include the interactions between policy makers at the national and the supranational level (especially the European Commission and European Central Bank), as representatives of the common interests of Member States (especially in the fiscal and monetary domain).

Coordination motivations at economic level are found in the increasing interdependence of the Romanian economy and that of other European Union members (70% of Romania's trade is with the European Union), the single internal market properly functioning and achieving the objectives of Economic and Monetary Union (adopting the euro and fulfilling the Maastricht criteria on inflation rate, nominal long-term interest rate, budget deficit, public debt and low exchange rate fluctuations).

If the European Central Bank has competencies in formulating common monetary policy for all Member States of the euro area, other economic policies such as fiscal policy, structural policies, and also the income policy are still the responsibility of the Romanian policy makers. Monetary policy is called to answer any symmetric shock that could affect euro zone countries. Otherwise, according to the principle of subsidiarity, national governments must deal with specific problems (asymmetric shocks is manifested by increased aggregate demand in a country while reducing aggregate demand in another country).

References

1. Allen, David, *Coeziunea* si *fondurile structurale*, Institutul European din Romania, 2005.
2. Andergassen, Rainer si Nardini, Franco, *Endogenous Innovation Waves and Economic Growth,* February 2003.
3. Bassanini, Andrea si Scarpeta, Stefano, *The Driving Forces of Economic Growth: Panel Data Evidence for the OECD Countries,* 'OECD Economic Studies', nr.33, 2001.
4. Benhabib, J. si Spiegel, M.M., *The Role of Financial Development in Growth and Investment,* 'Journal of Economic Growth', vol.5, 2000, p.341-360.
5. Bryan, Caplan, *The Idea Trap: The Political Economy of Growth Divergence,* 'European Journal of Political Economy', vol.19, 2003, p.183-203.
6. Castro, Villaverde José, *Indicators of Real Economic Convergence. A Primer,* United Nations University, UNU-CRIS E-Working Papers, w-2004/2, 2004.
7. Ciupagea, C-tin si colab., *Romania intr-un cadru comparativ. Convergenta nominala si convergenta reala in procesul de preaderare in Uniunea Europeana*, 'Modificari structural si performanta economica in Romania', vol.I, IRLI, Bucuresti, 2003.
8. Dalgaard, Carl-Johan si Vastrup, Jacob, *On the Measurement of Convergence,* 'Economics Letters', vol.70, 2001, p.283-287.
9. Dobrescu, Emilian (coord.), *Seminarul de modelare macroeconomics,* Centrul de Informare si Documentare Economica, mai 2004.
10. European Commission, *Second Report on Economic and Social Cohesion*, 2001
11. Guellec, Dominique si Pottelsberghe De La Potterie, Bruno Van, *R&D and Productivity Growth: Panel Data Analysis of 16 OECD Countries,* 'OECD Economic Studies', nr.33, 2001.

12. Hausmann, Ricardo; Lant, Pritchett si Rodrik, Dani, 'Growth Accelerations', National Bureau of Economic Research, June 2004.

13. Iancu, Aurel, 'Dezvoltarea intensiva si specializarea natiunilor', Editura Economica, Bucuresti, 2003.

14. Iancu, Aurel, *Problema convergentei economice*, 'Oeconomica', nr.4, 2006.

15. Idu, Pompilia, *Instrumentele structurale si convergenta statelor in Uniunea European*a, 'Oeconomica', nr.3, 2006.

16. Kang, Sung Jin, *Relative Backwardness and Technology Catching up with Scale Effects*, 'Journal of Evolutionary Economics', Springer Verlag, 2002.

17. Kutan, Ali M. siYigit, Taner M., *Convergence of Candidate Countries to the European Union*, 2003.

18. Langlois, Richard N., *Knowledge, Consumption, and Endogenous Growth*, 'Journal of Economic', vol. Econ., 2001, p.77-93..

19. Meeusen, Wimsi Villaverde, José (ed.), *Convergence Issues in the European Union*, Edward Elgar, UK, 2002.

20. Meijers, Huubsi Hollanders, Hugo, *Investments in Intangibles, ICT-Hardware Productivity Growth and Organisational Change: An Introduction*, September 2001.

21. Mihtescu, Flavius, *Convergenta intr eeconomiile central si est-europene*, Daianu, Daniel si Isarescu, Mugur (coord.), 'Noii economisti despre tranzitia în România', colectia Bibliotecii Bancii Nationale, Bucuresti, 2003.

22. Miron, Dumitru, '*Economia Uniunii Europene'* - Editura Luceafarul, Bucuresti, 2004.

23. Miron, Dumitru, Paun Cristian, '*Testing the convergence of Romanian economy in line with Economic and Monetary Union's requirements'; 11th International Conference. SGBED; Bratislava; 2009*

24. OECD, *OECD Economic Studies,*nr.33, 2001.

25. Otianu, Daniel, *Convergenta economic*s*. Cerinte si posibilitati*, Iancu, Aurel (coorod.)*,* 'Dezvoltarea economict a României.Competitivitatea si integrarea în Uniunea Europeana', Editura Academiei Romane, Bucuresti, 2003.

26. Pelkmans, Jacques, *Integrare european*a*. Metode si analiz*a *economic*a, Institutul European din România, Bucuresti, 2003, ed. a II-a, traducere din limbaengleza.

27. Ranis, Gustav; Stewart, Frances si Ramirez, Alejandro, *Economic Growth and Human Development,*'World Development', vol.28, nr.6, "Economic Development and Growth Papers", June 2000.

28. Reiner, Martin, *The Impact of the EU's Structural and Cohesion Funds on Real Convergence in the EU,* NBP Conference, 'Potential Output and Barriers to Growth', Yalesie Górne*,*2003.

29. Romer, P., *Theories of Economic Growth (Endogenous Technical Change) Economics of Growth and Innovation,* 'Journal of Political Economy', vol.98, nr.5, February 2004, p.71-102.

30. Schreyer, Paul si Pilat, Dirk, *Measuring Productivity,* 'OECD Economic Studies', nr. 33, 2001.

31. Thirlwall, A.P., *Growth and Development with Special Reference to Developing Economies*, 2001 sixth ed.

32. UNCTAD, *Handbook of Statistics*, 2005.

33. World Bank, *World Development Indicators*, 2006.

34. Zipfel, Jacob, 'Determinants of Economic Growth', Florida State University, 2004.

35. Wallace, Helen; Wallace, William si Pollack, Mark A., *Elaborarea politicilor în Uniunea Europeana*, Institutul European din Romania, 2005, Editia a cincea, p.205.