CONVERGENCE PROGRAM AND MACROECONOMIC POLICIES FOR ROMANIA JOINING THE EURO-ZONE

Magdalena RĂDULESCU[*]
Carmen SECARĂ[**]

Abstract
Romania submitted a new update of its convergence program on 5 December 2007, covering the period 2007-2010. The budgetary strategy outlined in the program is not in line with the prudent fiscal policy necessary to contain the growing external deficit and inflationary pressures which put the convergence process at risk.
In view of the Commission assessment and the need to ensure sustainable convergence, Romania is invited to: (i) significantly strengthen the pace of adjustment towards the MTO by aiming for substantially more demanding budgetary targets in 2008 and subsequent years in order to contain the risk of an excessive deficit, foster macroeconomic stability and rein in widening external imbalances and address the risks to the long-term sustainability of public finances; (ii) restrain the envisaged high increase in public spending, review its expenditure composition so as to enhance the economy's growth potential and improve the planning and execution of expenditure within a binding medium-term framework; (iii) adopt policies to contain inflationary pressures, complementing the recommended tighter fiscal stance, with appropriate public wage policy and further structural reforms.

Key words: *The budgetary strategy, external deficit, macroeconomic stability, euro-zone, macroeconomic policies for Romania*

Introduction

According to the Treaty of Maastricht, the countries that adhere to the European Union become member states having a temporary derogation regarding adopting the common currency. This mans that, at a certain time, subsequent to the adherence, the new member states shall enter the ERM II, and then, conditioned by meeting the nominal convergence criteria, they shall adopt the EURO currency, which grants a full content to the integration into the Economic and Monetary Union. Although after the adherence to the European Union, the monetary and currency policies of every state become the object of common interest, is, at the same time, obvious that the monetary and currency strategy options after the adherence to the E.U. constitutes, mainly, o responsibility and a prerogative of that member state.

To the Romanian economy, the integration to the EURO area represents a very important strategic objective, and the achievement schedule has been made taking into consideration the benefits and costs which this process draws. The first edition of the convergence Schedule, definitive and published in 2007 – after the previous months it's project had been submitted to public debate - , has to Romania a special importance, being the first document which evaluates the economic development possibilities in the conditions of promoting the achievement of nominal and real convergence policies.

Taking into account the necessity of implementing structural reforms to lead to the increasing of the Romanian economic capacity to handle asymmetrical shocks, within the

[*] Associate Professor, Ph.D., University of Piteşti.
[**] Lecturer, Ph.D., University of Piteşti.

convergence schedule it is appreciated that Romania will not be able to adhere the ERM II sooner than 2012. Within the conditions of joining the ERM II in 2012 and minimizing the participation time to this mechanism, EURO adoption could take place around 2014.

Within the preparation process of the convergence Schedule efforts have been made from all the institutions involved (Labor, Social Security and Family Ministry, National Bank of Romania, the Forecast National Commission, the National Statistics Institute, etc.) under the coordination of the Public Finance Ministry, in order to give eloquent and detailed data and information, in concordance with the European Commission demands through which to substantiate the macro economical increasing and economic and budget stability policies. In 2006, NBR, which had showed since 2003 it's preoccupation for submitting a vision upon the EURO adopting process course, has started to attend the meetings of the common work group in order to issue the convergence Schedule.

The current edition of the Convergence Program was elaborated in correlation with the provisions in the National Reform Program 2007-2010, as drawn up and sent by Romania to Brussels in July 2007.

In 2007, the NBR's Administration Board has analyzed the scheme regarding the BNR strategic options for the convergence Schedule and also the material regarding meeting by Romania the economic convergence criteria, made by specialists within the central bank.

This paper aims to present some considerations about the Romanian convergence criteria comparative to the other CEE states, some monetary, fiscal and structural measures needed for achieving the nominal and real convergence and some scenarios of adopting euro in a short-run or in a long-run. The convergence matter is important for all EU new member states that aim to adopt euro for achieving a complete integration also in the monetary area. The paper is based on the Convergence Programs realized by the new member states and try to present from these some scenarios for adopting euro in the short-run and in the long-run.

Section 2 presents the CEE countries' experience in the convergence area and section 3 presents the feature of the Romanian monetary and fiscal policy and structural reforms according to the Convergence Program elaborated in November 2007. Section 4 presents the advantages and disadvantages of adopting euro in the short-run and in a long-run and section 5 concludes.

CEE Countries experience in the convergence area

Nominal convergence criteria are somehow also inspired by the OCA theory (R. Mundell, 1961), stability prices criteria being in center and the others are complementary with it. Regarding the criteria of the relative stability of the exchange rate with no de-valorizations, the OCA theory states that if the exchange rates of the potential partners didn't face tensions, this means that their economies are compatible for achieving a monetary union and that exist some conditions of symmetry and flexibility. Fiscal Maastricht criteria can be seen as being related to the criteria regarding the fiscal discipline and integration (Demertzis, M., Hughes Hallet, A. şi O. Rummel, 2000). The regulations of the SGP related to the balanced budgets in the view of using some fiscal stabilizers during the recession periods represent in a way a concern for potential adjusting mechanisms. In case of the fiscal des-centralization, although that in reality the SGP leaves less possibilities of using the national budgets for sustaining the markets flexibility, the SGP reform will allow some adjustments by using fiscal policy instruments. But the quality of the Maastricht criteria is given by their clarity and the possibility of measure them and these features were very important and they made the deciders' task to be easier.

Generally, the nominal and real convergence criteria suggest that the new member states have a high level of macroeconomic convergence with the euro-zone, especially in the nominal convergence area. Still, for some countries this pattern is a quite recent one. But regarding the real convergence, in different area of the macroeconomic policies, the convergence results are more different and mixed (Ciupagea C. - coordinator, 2006).

For example, the public finances represent a problem for many new member states. Shortly, the public finances situation per total seems to be relative comfortable in present, if we look at the present indebt ness level. Still, existence of an average high deficit accompanied by a high and increasing level of public consumption (difficult to reduce in the future) don’t allow a future convergence. Another aspect that deserves to be considered is the macroeconomic context of the new member states. These countries have a high level of economic growth comparative to the average level of the euro-zone that makes the actual fiscal situation in many new member states to be critical.

If we analyze the structural factors, we notice that while the commerce integration with the EU-15 evolved very quickly in the last years and it is now at a very high level, the convergence of the GDP structure to the EU standards (charecterized by a low share of the agriculture and a high share of services) was very slow, especially if we measure it in real terms (excluding the relative prices changes). This aspect suggests that, while the relative prices changed in a flexible way, a part of the processes that causes real adjustments (that these prices are supposed to stimulate them) don’t converge (N. Pop – coordinator, 2007). A conclusion could be that the development degree of the financial sectors is significantly lower in the new member states comparative to the euro-zone (Sebea M., Ionescu A., 2006). After entering in the EU in May 2004 and January 2007, the new member states become authomatically candidates for EMU and some of them have already announced the schedule regarding euro adoption.

Only Slovenia entered in euro-zone in 2007. Slovak Republic planns to do the same in 2009, although some analysts are afraid that the new social oriented governments could postpone this accession date.

In the present, the Baltic states watch their ambitions being shattered by a too high inflation rate. First, EU refused Lithuania’s request of entering the euro-zone, the last rejection being in 1999 when the euro-zone was created. The reason was that Lithuania had a too high inflation to afford adopting euro in 2007.

This decision gives a negative signal for the other new member states too, states that hope that the EU accession will rise their competitiveness and so they will manage to complete their transition to the Western economies. In the same time, the largest Estern economies (Hungary, Poland, Czech Republic) postponed the entering in the euro-zone mainly because of the political debates and feuds that followed the elections in 2007 and 2006 (Hungary, Poland and Czech Republic Convergence Program, 2004-2005).

The new political deciders in Poland (which represents the half of the GDP of the total new member states) afirm that they will be able to achieve the economic criteria for entering the euro-zone this decade, but they are sceptic regarding the adoption of euro.

Hungary also intends to enter the euro-zone, but it struggles with the largest public deficit of EU after many years of high public expenses. The social oriented government faces many protests against the austerity measures introducted so it couldn’t settle a new target date for adopting euro.

Czech Republic which has represented for a long time an example of economic stability and healthy performance, states that accession in 2010 at the euro-zone is a quite improbable date if we consider an increasing fiscal deficit and a rather inflexible labor market.

According to the latest prognosis, Poland and Czech Republic will enter in the EMUin 2012, while Hungary will do the same in 2014. The economic growth, mainly induced by the domestic demand, is expected to keep on being important for the whole South-Eastern Europe.

The situation of the balances of payments will worsen as a result of a stronf increase of imports and this effect will also be sustain by the appreciation of the exchange rates in real terms. Macroeconomic stability will maintain although inflation will rise.

Summarizing, we can state that the new member states faced a significant progress in what integration concerns, but many things remain unsolved. There are still many differences between these states. There are some analysts that consider that the requests for a full monetary integration weren't fully achieved by the new member states and, as a result, it becomes necessary a specialized approach (respecting the features of each country) for adopting euro (Convergence Report of European Central Bank, 2007).

For Romania, it is important the experience of the other new member states for understanding the diversity of integration paths of these countries, because the trend of achieving an average level brings advantages and so, the integration becomes functional (Convergence Program of Romania 2007-2010, 2007).

Macroeconomic policies in Romania and the economic environment

The fundamental objective of the Government's economic policy is to promote sustainable economic growth, in conditions of competitiveness, which will in turn ensure nominal and real convergence with the European Union. To guarantee the success of this strategy the Government will give top priority to investing in human capital and in infrastructure. The most important prerequisite for meeting the fundamental objective is the implementation of the right mix of macroeconomic policies to ensure **the continuation of the disinflation process and to preserve the external sustainability.**

At the same time, meeting the economic and occupational performance, correlated with a sound social system represents the essence of the durable development oriented policies of Romania in 2007-2010.

Regarding the stage of meeting the nominal convergence criteria, the Romanian economy does not have problems form the perspective of sustaining the public finances, the shares within the PIB of the public debt and budget deficit being in the last years' net inferior to the ones established by the Maastricht Treaty. Romania's performance regarding the inflation has improved throughout 2000 – 2006, the annual average inflation rate in 2006 being with 3.76 percent points' superior to the reference level of the criteria. In 2006, there weren't issued public securities on a 10 years' term, and the interest rate for the public securities having this due date issued in august 2005 has been 7.49 % (to the reference level of 6.2%); in order to meet the specific criteria, it is imposed to make a long term internal capital market and the convergence of the interest rates. Regarding the exchange course of the LEU to the EURO, in 2005-2006 it has been registered a variation margin of + 10/-6.1% to the average of the 2 year interval considered. The evolution is bordered in the standard-interval of fluctuation of the ERM II, but not in the asymmetrical band of +15/-2.25% which could be used to evaluate the meet without severe tensions of the currency exchange stability criteria.

Although the real convergence criteria are not mentioned in the Maastricht Treaty and they are not expressively followed by the European Commission, these have a high predictable content regarding the success of adopting the common currency by a country, respectively registering a favorable account between the benefits and costs. The unique monetary policy, made by the Central European Bank, can't and shouldn't aim every economy's particularities, it addresses to a group of economies assumed to be homogeneous.

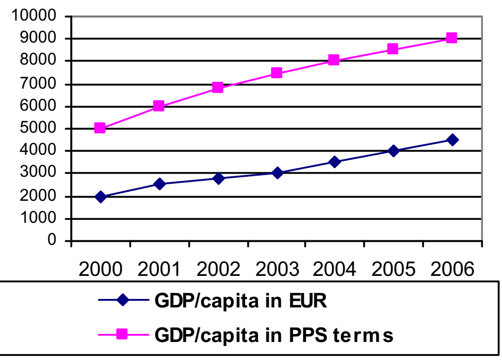
In this context, a premature approach of the monetary policy by a country which has an insufficiently structured economy can produce more costs than benefits. That is why, the people who decide must grant a special attention also to the real convergence criteria, even if they are not part of the "rough core" of the communitarian acquis. Meeting these real convergence criteria insures a high degree of cohesion to the member states economy structures of a monetary union. The main real convergence criteria are (see Figure no.1):

- PIB/habitant level, both in nominal term and the par of exchange of the purchasing power;
- economy sector structure;
- economy opening degree;
- EU trade share in the total of exterior trade.

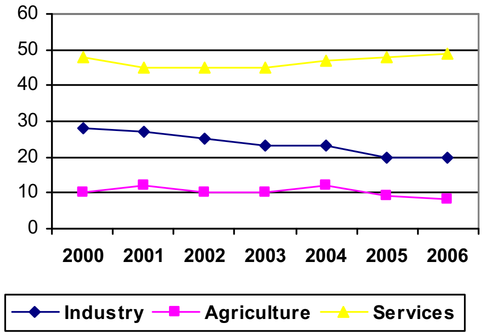
BNR perspective regarding the EURO adoption process is favorable to joining the ERM II in 2012 and, in the context of creating the corresponding conditions for minimizing the participation time to this mechanism, the passing to the EURO in 2014. National Bank of Romania's policy has as objective supporting the macro economical development and encouraging the concentration of structural reforms within the first years of post-adherence time, including by the existence of a limited flexibility of the monetary and currency exchange policy (subordinated to the scheduled deflation achieving objectives and approaching the BCE definition regarding the price settlement) during this interval.

Figure no.1

GDP/capita growth

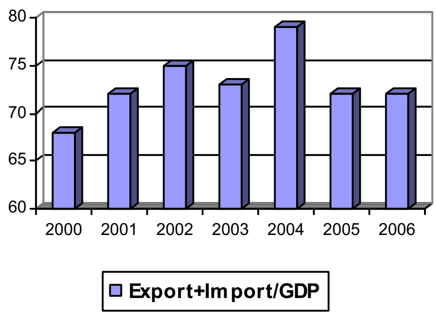


The share of the economic sectors of GDP (%)

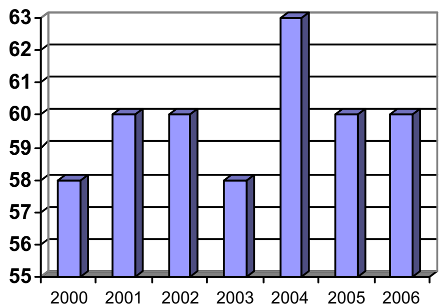


Source: National Statistics Institute, NBR, EUROSTAT.

Openness of the Romanian Economy (%)



The share of the commerce with EU in the total Romanian commerce (%)



Source: National Statistics Institute

Romania's indebtedness stays under 20% of GDP, which is by far under the threshold of 60% of GDP set in the Maastricht Treaty. Hence, against the background of a sustained economic growth, at the end of 2006 the government debt calculated according to the EU methodology (ESA95) was 12.4% of GDP, out of which the domestic debt was 2.7% and the foreign debt 9.7%. At end 2007, this index is estimated to reach the level of 11.9% of GDP.

The structure of the government debt as at 31.12.2006 on debt instruments shows that the government securities issues account for 28.4% of the total debt, with the difference covered by loans. Regarding the initial maturity of the government debt, 9.5% of the debt was short-term and 90.5% medium and long term, whereas the average maturity of the debt balance at the end of 2006 was 5.1 years. At the same time, it is worth mentioning that 33.4% of the debt was floating interest rate debt. The local currency debt at end-2006 was 21.5% of the total debt, while in the foreign currency debt the highest share was represented by the debt in Euro, namely 63.2%.

The macroeconomic development scenario on medium term laid down in the current program is not substantially different from the one presented in the latest edition of the Convergence Program.

The differences between the two programs are mainly related to the following elements taken into account:

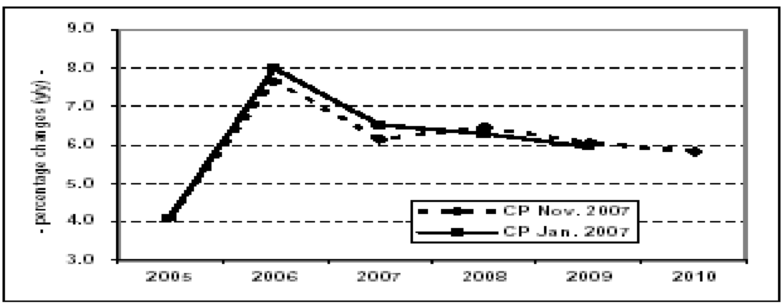
(a) the evolution of the economic context during 2007;

(b) the up-grading of the statistical data for 2006;

(c) the increasing estimation of the economic potential.

Thus, the real GDP growth achieved in 2006 was basically lower than estimated one in the previous version by 0.3 pp (Figure no.2). The economic evolution in 2007 was characterized by two phenomena with a significant impact: an unprecedented increase in construction and a decline in agricultural output as result of the drought. The projections regarding the economic potential growth were upwardly revised by 0.5 pp, in average, based on an increase in the contribution of the stock of capital.

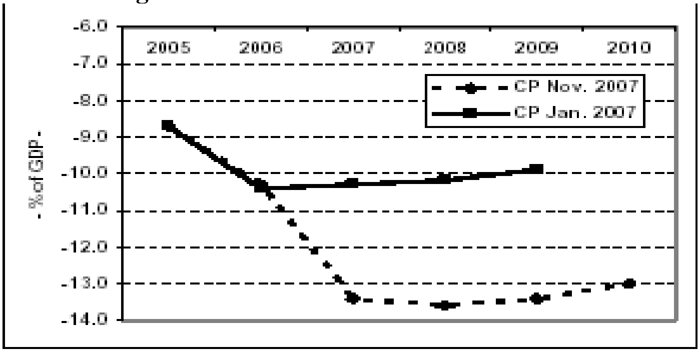
Figure no.2 GDP growth



Source: National Commission for Prognosis
CP Nov 2007=Convergence Programme, November 2007 Edition
CP Jan 2007= Convergence Programme, January 2007 Edition

As a result of this evolution of the domestic demand on a trend superior to the previous program and in a more moderate perspective regarding the domestic supply's ability to meet the additional demand, the imports of goods are estimated with higher growths than exports of goods that will lead to deterioration of external balances compared to the previous one. Hence, the current account deficit was estimated at over 13% of GDP in the interval 2007-2009 and in slight decline in 2010 (Figure no.3).

Figure no.3 Current account deficit share in GDP

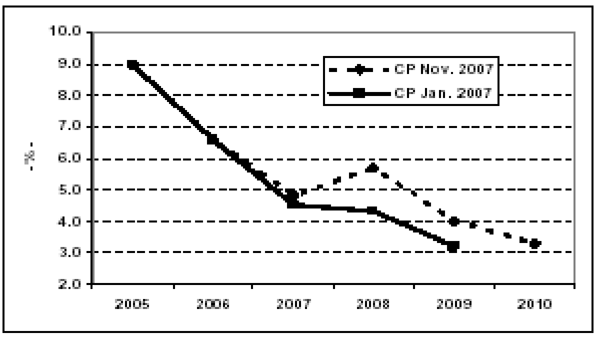


Source: National Commission for Prognosis

The evolution of the consumer prices in 2007 was different from what had been predicted in the previous edition of the program. The initial inflation target set up by the central bank at the beginning of the year at 4% plus/minus 1 percentage point was overshoot.

Consequently, the forecasted evolution of the annual average inflation is significantly different, meaning that in 2008 we will witness an increase as compared to 2007, under the circumstances of higher agricultural products prices both on internal and external market during the first part of year and the base effect stemmed by the 2007 evolution. Afterwards, the annual average inflation rate is expected to start declining again (Figure no.4).

Figure no.4 Annual average inflation



Source: National Commission for Prognosis

Under the current circumstances, characterized by the simultaneous expression of many inflationary risk factors, as well as by persistent turbulence on the international financial markets, maintaining the macroeconomic stability and consolidating the progress in the nominal convergence require the direct approach of the higher inflation event by the overall macroeconomic policy and structural adjustment mix, as its consistency is more important than the focus on each of its individual components.

At the same time, it is necessary that the fiscal and revenue policies substantially support the disinflation, in order to facilitate the monetary policy mission, which is to anchor the inflationary expectations to the low inflation levels that have been reached so far. The implementation of this task has already been started by the central bank; however, the effectiveness of the monetary policy is limited by the existence of a significant external imbalance.

The economic policy mix consisting of a restrictive monetary policy (focused only on relatively high interest rates, translated in a slightly higher exchange rate), alongside a rapid revenue increase, exceeding by far the labor productivity dynamics, leads to unwanted consequences which may undermine the sustainability of the short run disinflation process: (i) a more deepened current account deficit of the balance of payments, persisting at levels which are difficult to sustain on a long term without a substantial increase of productive capital autonomous inflows; (ii) an increased risk of a sudden correction (in the sense of depreciation) of the exchange rate, resulting in a rise in inflation; (iii) a negative impact on the financial situation of the businesses and households which contracted foreign currency loans by counting on a continuous appreciation of the domestic currency, without taking adequate protection against the currency risk.

Hence, promoting a coherent economic policy mix is all the more necessary since: (i) the international financial turbulence will continue to persist, as shown by the developments of the *sub-prime* credits in the American real estate industry, their duration being difficult to anticipate. The probable consequence for Romania would be an increased aversion of the foreign investors to risk, which will lead to higher costs for accessing the foreign financing, leaving the room to significant spontaneous corrections of the exchange rate; (ii) the increase of the food prices on the international markets seem to be a lengthy phenomenon, reflecting both a higher pressure on the demand side (especially coming from a number of highly populated developing countries), but also supply side pressures (taking into account the new fuel-producing technologies using agricultural raw materials); (iii) the most significant increase in the oil price within the past 25 years occurred, due to a difficult geo-political context and against the background of shortfalls of the extraction and refining capacities relative to the rapid increase of the demand; (iv) Romania’s current account deficit reached a high level. Although this deficit does not represent a target-size for NBR, as its correction is the responsibility of the fiscal and revenue policies, there is a risk to be unevenly reflected on the price level and on the inflation rate, due to corrective depreciation as a result of an unsustainable appreciation.

This risk goes up with the inflation targets becoming more and more ambitious, on a medium term. The long term sustainable convergence process with EU living standards requires both the maintenance of the macroeconomic stability and the continuation of structural reforms. The main challenge is the convergence with the European living standards, simultaneously with maintaining the macroeconomic stability (in other words, with the evolution of the nominal parameters towards the levels stipulated in the Maastricht Treaty) while preserving, at the same time, the economy’s international competitiveness.

Given the above, in the next period of time, the economic policy mix needs to be conceived, as follows: (i) continue the structural reforms, so that the constraints on the aggregate supply could be eliminated, by stimulating the increase in productivity and foreign competitiveness of the Romanian products; (ii) maintain the monetary and fiscal policy in a relatively highly restrictive environment, alongside with a better coordination of such policies; (iii) a revenue policy which does not put additional pressure on the demand side.

a. Monetary and Exchange Rate Policy

In accordance with its statute, the National Bank of Romania has a primary objective to ensure and preserve the price stability. As of August 2005, the monetary policy has been implemented in the context of the inflation targeting strategy, co-existing with the managed floating exchange rate environment. This exchange rate regime is in compatible with the use of inflation targets as a nominal anchor for the monetary policy, allowing a flexible response of this policy to unexpected shocks which may affect the economy.

Considering the need to implement additional structural reforms that will increase the Romanian economy's capacity and flexibility to face asymmetric shocks, Romania will not be able to join the exchange rate mechanism (ERM 2) sooner than 2012. Joining ERM 2, expected in 2012, will represent an important stage on the convergence

A higher degree of exchange rate stability can be ensured by increasing the credibility of the convergence process and by the stabilization of the long-term exchange rate expectations. In line with the expected productivity growth and the inflow of foreign direct investments, a gradual appreciation of the ROL versus the Euro is likely to continue, this adjustment supporting the nominal and real convergence of the Romanian economy.

With the Romanian economy still in disinflation process – the medium term sustainable inflation rhythm compatible with the quantitative definition of the price stability hasn't been reached yet – the inflation targets are annual (December/December) and set by NBR together with the Government for a two-year period. Consequently, the annual inflation targets set for 2008 and 2009 continue to show an descending trend, with levels of 3.8 per cent ±1 percentage point and 3.5 per cent ±1 percentage point, respectively.

These target values satisfy, on one hand, the requirement for attaining, according to the Euro joining schedule, an inflation rate level which is compatible with the inflation criterion stipulated in the Maastricht Treaty, as well as with the quantitative definition of price stability adopted by the European Central Bank.

On the other hand, the targets for 2008 and 2009 reflect the NBR's concern to consistently reach the set inflation objective, which is essential for strengthening the central bank's credibility – in the context of the relatively short history of the direct targeting strategy in Romania – and eventually for effectively anchoring the inflation expectations on a medium term.

NBR's precaution – highlighted by this *pattern* of the inflation targets – is justified under the current circumstances by the anticipation of persistent inflationary factors outside of Central Bank control, the most important factors we can mention: (i) the influence on the price development by the continuation of the convergence process in the Romanian economy; (ii) the programming of administered price and indirect tax adjustments during this period of time; (iii) persistent asymmetrical nominal rigidities; (iv) the risk of manifesting of significant external shocks on the aggregate price level in Romania.

Maintaining the annual inflation rate on a trajectory compatible with attaining the medium term inflation targets has recently become a real challenge for the central bank, in the context of the consistent disinflation process started in 2000 being interrupted in the third quarter of the current year under the impact of the shocks occurred on the domestic as well as the foreign markets during this period of time; these triggered an increase of the annual inflation rate, in October, up to the level of 6.84 percent (3.7 percent in March this year) – which is incompatible with attaining the inflation target set for 2007 (4 percent ±1 percentage point).

During this interval, the major cause for the spike of the consumer price index was the inflation effect of the drought related lower agricultural output, whose level substantially exceeded the forecast; this effect was also intensified by the increase of the prices of the agricultural products on the foreign market. This was accompanied by the impact of the exchange rate correction in nominal terms due to turbulences on the international financial markets.

Against this background, the inflation perspective on the monetary policy transmission horizon has deteriorated. Thus, according to the most recent forecast by the NBR, the projected annual inflation rate is in December at 5.7 percent, and at the end of 2008 at 4.3 percent, until the third quarter of 2008 its trend going beyond the upper limit of the variation interval which frames the central point of the inflation target.

At the same time, the complexity and the size of forecast-associated risks deepened, especially the one related to: (i) the revenue increase not sufficiently sustained by a boost of productivity, (ii) the potential deterioration of the public's inflationary expectations, mainly under the impact of adverse supply shocks and (iii) the uncertainty related to the investors' behavior towards the emerging markets.

Under these circumstances, NBR responded promptly by strengthening the monetary policy, with the monetary authority increasing, on October 31, the monetary policy interest rate up to 7.5 percent, by 0.5 percentage points, after the central bank in September had pushed up the sterilized liquidity volumes in a move to bring the levels of the interest rates on the inter-bank monetary market closer to the monetary policy interest rate level, which was translated into an increase of the inter-bank interest rates on the short term by around 2 percentage points.

Moreover, in order to consolidate the restrictiveness of the monetary conditions in a broad sense and taking into account the rapid growth of credits granted to the private sector, in terms of all the components thereof and especially the credits in foreign currency, the Management Board of NBR decided to keep at the current levels the rates of the minimal obligatory reserves applicable to both liabilities in lei (20 percent) and in foreign currency (40 percent), respectively, of the credit institutions.

In this context, was reiterated the need to orient the monetary policy, alongside the other components of the macroeconomic policy mix, to anchor, in a firm and sustainable way, the inflationary expectations to the low inflation levels reached previously to the recent inflationary shocks, in order to keep the annual price increase on the medium term disinflation trend set in a joint effort with the Government and, in a broader horizon, to ensure the convergence of the aggregate price level in Romania to the price stability as defined in EU.

This orientation of the macroeconomic policies is considered to be all the more necessary since de foreign deficit is at levels which are difficult to sustain in the long run, in the context of deepened uncertainties which affect the international economic environment.

From this perspective, through the increase of the monetary policy interest rate, NBR aims at ensuring an adequate level of the real interest margin, expected to stimulate savings and to improve the relationship thereof with investments, having as effect the gradual reduction of the foreign deficit in the future.

Putting the annual inflation rate back on the trajectory that is compatible with attaining the inflation targets is expected to happen in the last quarter of 2008; the main cause of this evolution is the action of a number of real monetary circumstances, the restrictiveness of which shall be ensured by the adequate calibration of the interest rate policy, correlated with the forecasted appreciation trend in real terms of the domestic currency in the longer term, under the impact of continuing productivity gains to be recorded in the Romanian economy and the persistence of sustainable productive capital inflows.

Hence, in the next period, the adequate restrictiveness degree of the monetary conditions shall be ensured through the monetary policy operational framework specific to the direct inflation targeting strategy. Including through an adequate management of the liquidity conditions on the monetary market, the central bank will seek to consolidate the role of the interest rate policy in transmitting the impulses of the monetary policy, as well as the signalling role of the monetary policy interest rate and implicitly the capacity thereof to anchor the inflationary expectations.

The minimal obligatory reserves mechanism will continue to be, at least on the short term, an important pillar of the liquidity management and control policy; a higher austerity of this instrument related to the ECB practice in the field is justified, on one hand by the persistence of a substantial structural liquidity surplus in the banking system and, on the other hand, by the still very high dynamics of the credits in foreign currency, based on the increasing level of foreign resources drawn by the credit institutions.

In exchange, the leveraging role of the monetary policy given to a number of prudential and administrative measures the central bank resorted to since 2005 in order to slow down the growth pace of the credits in lei and foreign currency granted to the private sector, has been in part cancelled by NBR in the first quarter of the current year. Hence, in early 2007, NBR cancelled the ceiling imposed to the credit institutions' exposure to the unhedged currency debtors, because of the limited and asymmetrical effects that this measure was generating in the context of the cross-border mobility of the financial service supply within EU.

b. Fiscal policy

A top objective for the Government in the next years is the consolidation of the predictability, the stability and the transparency of the fiscal policy. The Government' fiscal policy is designed to support the convergence objectives, by maintaining the budgetary deficit at a prudent level in order to continue the disinflation process and maintain the external deficit within sustainable limits, by stimulating improved collection rates, by promoting measures for enlarging the tax base and increasing the quality of the public expenditures. Consolidating the quality of public finance in a coherent medium term budgetary framework represents the priority objective of the Government, and its success thereof is the main prerequisite for reaching the medium term budget objective and for promoting the efficient functioning of the automatic stabilizers.

Regarding the specific medium-term objective, we started from the premises that the cyclically adjusted budget deficit will be 0.9% of GDP by 2011. This level provides a satisfactory safety margin to prevent breaching the budget deficit ceiling of 3% of GDP in the context of possible future adverse shocks to the rate of economic growth.

The Government's efforts over the medium-term are directed towards the provision of improved public services, including a high-quality educational and vocational training system, a modern and reliable transport network and a responsive and efficient health service, through sustained increases of the net investments in the public sector, including the effective appropriation of the EU funds. Moreover, measures will be taken to create adequate conditions for maintaining the long-term sustainability of public finance.

Managing financial resources efficiently is central to this objective, with a view to allow sustained improvements of the fiscal policy performance in the long term. In this respect, the introduction of program budgeting, increasing the expenditure flexibility and the consolidation of the three year medium term budget framework in government financial planning will ensure the expected efficiency gains in public sector spending.

c. Structural reforms

The targets set by Romania, through the National Reform Program, are similar to the targets assumed at European level, but adjusted to the level of performance of the labor market and of other connected areas, with the purpose of ensuring economic stability and public finances sustainability, increasing productivity and economic competitiveness and improvement of the labor force market functioning.

In the labor market area, Romania assumed two priorities: improving the labor market activity rate and improving the quality of human resources. The objectives established for these two priorities aim at ensuring a favorable environment, from a legal and institutional point of view, for the creation of new jobs and attracting the highest number of persons to the labor market (reduce the inactivity rates within socially vulnerable groups).

The labor market in Romania is characterized by a relatively low activity rate as compared to the EU average, high unemployment rates for the age groups of 15-19 years and 20-24 years, a high percentage of early retirement from the formal labor market and significant employment in the agriculture sector with work relationships that are not subject to taxation.

The Government aims at increasing on average by 1.1 percentage points annually of the activity rate for the active population in the age category 15-64 years. Reaching the total employment rate target of 62.1% and the ILO unemployment rate target of 6.6% before 2010 requires reforms on the labor market, to allow an increase of the competitiveness.

The Government will concentrate its efforts on the three priorities laid down in the Re-launched Lisbon Strategy: attract and uphold more people in the labor market improve adaptability and boost investments in human capital, correlated with the demographic problem and migration, social exclusion as well as the associated elements such as population's health and sensitive aspects of poverty.

In the context of the ongoing adjustment of the labor market, the government focuses to ensure equal access and reinsertion for the youths, women, elderly people and the persons considered disadvantaged. Thus, special attention will be paid to the consolidation of the institutional capacity, especially at local level, with a view to efficiently use the grants of European Social Fund. The objectives set by the government regard the decrease in the long-term unemployment rate from 4.1% in 2006 to 3.4% in 2010, the ILO unemployment rate from 7.3% in 2006 to 6.6% in 2010 and the increase in the elderly employment rate from 41.7% in 2006 to 43.0% in 2010.

The Government will concentrate its efforts on the three priorities laid down in the Re-launched Lisbon Strategy: attract and uphold more people in the labor market improve adaptability and boost investments in human capital, correlated with the demographic problem and migration, social exclusion as well as the associated elements such as population's health and sensitive aspects of poverty.

In the context of the ongoing adjustment of the labor market, the government focuses to ensure equal access and reinsertion for the youths, women, elderly people and the persons considered disadvantaged. Thus, special attention will be paid to the consolidation of the institutional capacity, especially at local level, with a view to efficiently use the grants of European Social Fund. The objectives set by the government regard the decrease in the long-term unemployment rate from 4.1% in 2006 to 3.4% in 2010, the ILO unemployment rate from 7.3% in 2006 to 6.6% in 2010 and the increase in the elderly employment rate from 41.7% in 2006 to 43.0% in 2010.

For the implementation of the measures and activities necessary in the objective "improvement and consolidation of the business environment", an *Action Plan* was drawn up in order to develop and consolidate the Romanian business environment, the implementation of which led to a gradual reduction of the administrative barriers in the business environment, through the simplification of legal and administrative procedures necessary to start up and develop businesses, with a significant impact on the efficiency of the authorization and approval process.

The concrete measures and actions in this respect, as set for the next period, aim at: boosting the quality of regulations; further developing the administrative capacity required for a homogenous implementation of the legal provisions at a territorial level, modernizing procedures and laws regulating the intellectual property, improving the IT infrastructure of the public administration, reviewing the system of taxes and contributions representing own revenues and analyze the opportunity and efficiency thereof from an economic perspective, extending the one stop administrative offices for making various formalities and continuing the effort to internalize the document flow within the administration, improving the dialogue with the business environment and the civil society, etc.

Table no. 1 Regional disparities indicators*

	2003	2004	2007	2010
N-E Region	0. 723	0.693	0.673	0.679
S-E Region	0.857	0.908	0.867	0.872
South Muntenia Region	0.812	0.836	0.813	0.820
S-W Region	0. 847	0.835	0.830	0.832
W Region	1. 129	1.147	1.155	1.141
N-W Region	0.966	0.973	0.951	0.951
Centre Region	1.072	1.043	1.060	1.054
Bucharest-Ilfov Region	1.940	1. 906	2.027	2.007

Source: 2003 and 2004 NIS; 2007 and 2010, NCP forecasts

*) Calculated as ratio between the GDP per capita at region level and the national average

Through the National Development Plan (NDP) and the National Strategic Reference Framework (NSRF) drawn up for the programming period 2007 - 2013, Romania intends to promote a regional policy in which the general objective is a balanced regional development of the country and the reduction of social and economic disparities between regions.

Romania and EU Member States, by improving the competitiveness of the regions and attaining an additional GDP growth of 15% by 2015 as a result of the absorption of the EU grants (Table no.1).

In the field of public policies management, Romanian Government started the implementation of an improved system of taking decisions, aiming at increasing the responsibility of public institutions against the results of the promoted public policies. The main achievements estimated as a result of implementing this new system are as follows: training for 150 public administration specialists in the field of impact analysis and assessment techniques; the use in a proportion of 70 percent of performance indicators within the monitoring and assessment of the public policies by the end of 2008, followed by a 100% use of these indicators by 2010.

More modernization measures of the public function will be gradually applied by 2010 envisaging the public servants career, development of motivation policies and instruments and accomplishment of training requests.

Advantages and disadvantages of the extreme solutions regarding the EURO adoption schedule

The EURO adoption schedule proposed by the NBR corresponds to a balanced approach, representing a middle way between the two extreme options: postponing on a long term of adopting the unique currency and it's adopting in a relatively short term. The approach proposed by the NBR insures a complementarily relation between the desirable character and the proposed trajectory feasibility. The adjustment time between the moment of adherence to the European Union and the start to participate at ERM II is necessary due to point of view of:

- approaching in a sustainable way of the annual inflation rates with comparable levels to the specific criteria from Maastricht and to the definition of price stability in the Central European Bank's view;
- surpassing the top period of capital inputs;
- continuing to synchronize the national economy business' cycle with the one of the EURO area and achieving a real convergence process, not just of the convergence nominal dimension;

- creating ex ante of the conditions in order that Romania's attendance to the ERM II to limit probably in a minimum time of two years, which would assume compliance with the Maastricht criteria during the attendance time to this mechanism.

Postponing on a long term the EURO adoption

Advantages:
1. a longer time to prepare the economy in achieving unconcluded adjustments;
2. achieving substantial progress in the real and nominal convergence plan;
3. synchronizing the Romanian business cycle with the EURO area;
4. keeping for a longer time the autonomy of the monetary and exchange course policy.

Disadvantages:
1. the persistence of higher transaction costs associated to the currency risk, having inhibiting effects upon the investments and upon the sustainable economic growth throughout the entire period until adopting the unique currency;
2. the possibility to generate a contrary effect of the longer preparation period of the economy, manifested by postponing the structural reforms and also a relaxing of the macro economical policy especially on a fiscal and income plan, in the conditions of establishing a far targeted – horizon of adopting the EURO;
3. the unclear message sent to the international capital markets, the postponing on a long term being assigned to structural weaknesses or of economical policy less visible to investors rather than the decision of the authorities; in the conditions of full liberty of the capital movement without anchoring credible data of adopting the EURO, this message can diminish the inputs or the outputs of capital, that could perturb the convergence process.

Adopting the EURO in a short-relative term

Advantages:
1. a faster submission of the benefits of currency risk loss, having a stimulating effect upon the economic growth;
2. the minimization of relaxing structural reforms rhythm motivation;
3. stimulating the consequence in time of the macro economical policies ensemble.

Disadvantages:
1. shifting the entire burden of the considerable structural adjustments which are to be made upon the level of the economic activity and occupation, in the conditions of a still limited flexibility of the Romanian economy;
2. the rise of generating asymmetrical shocks as a result of insufficient synchronizing between the business cycles within Romania and the EURO area;
3. the difficulty to detect a central parity representative for the RON/EURO balance exchange currency, which would probably lead to increase the attendance to the ERM II, situation that could be pressured upon the exchange currency or speculative attacks to the national currency;
4. limiting the time in which it could be made the inflation target efficiency of the strategy, that achieving step by step an influence upon anchoring the anticipations, in the extent of increasing the credibility of the central bank's within the process of confirming reaching the proposed deflation trajectory.

According to the NBR vision, it is essential that the precursor time before joining the ERM II to be used by the authorities for the purposes mentioned and not be interpreted as a timeout to postpone potential painful adjustments. It is also important to insure public support for the convergence Schedule, the existence of a consensus close formula being favorable to the idea of continuing the efforts within the structural adjustments despite the sequence of the electoral cycles, and that is why it is imposed a transparent and credible public communication of the strategy to pass to the EURO and keeping an active dialogue with the international markets throughout its implementation.

The NBR balanced approach regarding adopting the EURO is found in the convergence Schedule, the calendar of the process being established after a cost-benefit analysis, submitted to the following demands: (i) durable fulfilling the nominal convergence criteria; (ii) achieving a satisfying level of real convergence criteria; (iii) reduce the period spend inside the ERM II, mandatory minim period is 2 years.

The schedule proposed by the Romanian authorities for joining the ERM II and, eventually, for adopting the EURO currency, meets the following conditions:

- insures a time interval sufficient for achieving substantial progress in the nominal and real convergence plan;
- it is ambitious enough to embody the political will in continuing the reforms.

Concluding the seven years time (2000 – 2006) of E.U. adherence preparation and the start of another time, having almost the same period (2007 – 2013), of preparing the Romanian economy to enter the EURO area, constitutes an opportunity for continuing the reforms and cutting the dissimilitude of the regional economies. The progress in the real convergence plan must be achieved in a manner not to affect the macro economical balances and not damage the nominal convergence criteria achievement process.

Stopping now at the convergence issue, we must show that officially, the European deciders have given a greater importance to the nominal than real convergence. About achieving the nominal convergence we can make two important conclusions:

1. In a certain measure the criteria are interpretable in both ways: both the possibility to have a rigid interpretation and the possibility to have an easier interpretation (see the case of attendance term to the MRS 2, and the public debt issue);
2. The states aspirant to the EURO must understand that it is not important only the criteria within the reference time (one year before the exam), but it also is important the dynamic of these criteria, which assumes their tracking for a 4-5 year period, and also other conditions such as the adequate function of the capital market on a long term.

That is why the correct evaluation of the attendance conditions to the UEM shall be determinant in preparing the convergence schedules for the states that want to adhere to the EURO area. Through the real convergence, expressed first through the PIB / habitant level, the situation is more complicated, especially if we look to the new member states. The issue is the more burning that the economic measures necessary to eliminate the economical deviations are sometimes at conflict with the ones necessary to reach the nominal convergence in order to attain the "entry ticket" into the EURO area. The Eastern states have much to learn from Ireland's experience which looks like an optimal combination between it's own efforts, direct foreign investments and structural instruments can lead to a fast recovery of the development differences. Regarding us, we strongly believe that achieving the established objectives through the National Development Plan, having as base the efficient use of the funds, in a great part with co financing from the communitarian budget, it can represent the key of Romanian success, through that being insured the real and structural convergence of Romania to the EURO area, so that we could benefit of the advantages to passing to the EURO in 2012 – 2014. Moreover, this term estimated by the authorities coincides with concluding the first schedule period through which Romania shall benefit from the structural instruments granted by the European Union.

Conclusions

The coordination of the economic and budgetary surveillance policies is one of the European Commission's permanent concerns, as it represents a requirement for increasing the interdependence generated by the completion of the Internal Market and the Economic and Monetary Union. Moreover, according to the provisions stipulated in f the EC's Stability and Growth Pact, budgetary assistance in the EU is based on the in-depth and correlated analysis of the Stability or Convergence Programs.

The first edition of this Program, underlines the fact that macroeconomic and budgetary scenarios in the Convergence Program are plausible, but, at the same time, there are risks related to meeting the budget objectives after 2008. As a global appreciation, the European Council shows that Romania has positive perspectives for a strong economic growth, but only with an increased foreign deficit and moderate progress in the fiscal sustainability, the MTO requirements being envisaged to be met only after the programming period.

The recommendations in the "European Council Opinion" refer to setting more restrictive budgetary targets for the following years and improving the quality of the public expenditure structure.

The second edition of the Convergence Program presents – as an answer to these recommendations – Romania's capacity to bring the structural deficit down to less than 1% by 2011, thus ensuring a sufficient safety margin to avoid exceeding the 3% threshold of the budget deficit in the GDP.

Moreover, there is presented a medium term budgetary framework characterized by a restructuring of the expenditures with the aim of sustaining the economic sectors with a high value added, as well as the investment in knowledge, education and research in a move to improve the capacity of the Romanian economy to cope with global competition and to provide qualified labor supply for the services sector, under the circumstances of the labor force cost inevitably going up as a result of the convergence process.

The updated Convergence Program took into account the latest developments of the internal and international economic environment and was based on the current legal framework as well as on the provisions stipulated in the 2008 budget draft currently under parliamentary approval procedure.

Adopting euro in the short-run is dangerous because of the lack of real convergence and this may cause asymmetrical shocks in the Romanian economy. In the long-run the real convergence will be achieved at some level, but with the cost of a rising exchange rate risk and this will affect the foreign investments and so, the economic growth. The outcomes from the Convergence Program and from the macroeconomic policies needed were important for establishing the scenarios of adopting euro in the short-run and in the long-run. Still, the paper is more focused on the macroeconomic policies (less on revenue policy) and less focused on studying the structural reforms that need to be taken in order to realize the real convergence. These reforms will also impact on the scenarios presented above. This may represent a subject for future research.

References:

1. Beaulande, Janique. „Competition in quality inside Monetary Union: What about Intra-Industry Trade and Asymmetric Shocks?”. 21èmes Journées Internationales d’Economie Monétaire et Bancaire, Nice, (10-11 June 2004).
2. Centre of Financial and Monetary Research „Victor Slăvescu ”*Monitorizing adopting euro of the new EU member states. Analysis and synthesis*, (Research Projects Centre of Financial and Monetary Research, Second Tom, Bucharest, 2005 and 2006).
3. Ciupagea, Constantin (coordinator), Atanasiu, Isabela, Câmpeanu, Virginia, Ţurlea, Geomina. „Analysis and evaluation of the economic, institutional and social developments for the new EU member states, after 1st May 2004*”. Impact Studies* III, Study no. 9, Bucharest, European Institute of Romania, (2006).
4. Van de Coevering, Clement. “Structural convergence and monetary integration in Europe”. (december 2003).
5. Demertzis, M., Hughes Hallet, A. and Rummel, O. „Is the European Union a Natural Currency Area, or Is It Held Together by Policy Makers?”. *Weltwirstschaftliches Archiv* 136 (4), 657-79, (2000).
6. Pop, Napoleon (coordinator), Lupu, Iulia, Criste, Adina, Glod, Alina, Moşneanu, Elena Ana, Nagy, Ágnes, Imre, Székely. „Adopting euro – how the new EU memers states are preparing for this. Comparative analysis”. Centre of Financial and Monetary Research „Victor Slăvescu”, Research Project, Bucharest, (2007).
7. Sebea, Mihai, Ionescu, Alexandru. „Realizing EMU and the necessity of convergence”. European Institute of Romania, Studies Colection, no.18, Bucharest, (October 2006).
8. *** Convergence Programs of Czech Republic, Poland, Slovak Republic, Slovenia, Hyngary, Estonia, Latvia, Lithuania, (2004-2005).
9. *** *Convergence Program for Romania 2007-2010*, Bucharest, (november 2007).
10. *** *Convergence Report of European Central Bank*, (May 2007).
11. *** European Comission, *European Economy no2/2006. Economic Forecast*, (Spring 2006).