



The Long and Winding Road of Romania's Economic Reform

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*The views expressed are personal and do not represent the official position of the National Bank of Romania

Introduction

- Economic reform has three components:
 - achieving (and preserving) macroeconomic stability
 - implementing structural reforms
 - improving the administrative capacity.

 - Our focus is on the first two items, seen in a historical context:
 - last 100 years
 - last 25 years
 - last 3 years
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Historical context: last 100 years

- **In 1913** “Little” Romania had a GDP/capita (at PPS) equivalent to **67 percent** of the then-European average.
- **In 1938** it fell to **51 percent**, **in 1989** to **32 percent** and **in 2000** (after a slow start in transition and painful reforms), just **26 percent**.
- **In 2016** GDP/capita (at PPS) stood at **59 percent** of the EU average.

After a century, Romania returned to the same level of relative development.

Last 25 years

	1990	1995	2000	2010	2015
GDP, USD bill. (at average exchange rate)	39,75	35,47	36,72	161,63	177,31
Inflation rate % (Dec/Dec)	37,7	27,8	40,7	6,1	-0,6
Unemployment rate %	3,0 (1991)	9,5	10,5	6,9	4,9
Budgetary Deficit (-) or Surplus (+), % (ESA 2010)	+0,3	-4,1	-4,6	-6,9	-0,8
Current Account Deficit %	-8,4	-5,0	-4,6	-5,1	-1,2
Public Debt, %	-	-	22,4	29,9	38,0

Source: NBR

Last 25 years

- Periods of important reforms (1997-2006 and 2010-2014) alternated with periods of modest or stalled reforms (1990-1996, 2007-2009, 2015-2017). The latter were characterized by pro-cyclical fiscal and wage policies.
 - Three important points:
 - ✓ the periods of important reforms covered around half of the time
 - ✓ they were carried under strong supervision from external organizations (IMF, WB, EU)
 - ✓ they were implemented by both centre-left and centre-right parties, irrespective of ideology.
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Last 3 years

- As a result of comprehensive reforms carried out in the period 2010-2014, Romania has achieved, by mid-2015, impressive macroeconomic indicators:
 - fulfilling all five Maastricht Criteria
 - meeting its Medium Term Objective (a structural deficit of 1% of GDP)
 - fulfilling 13 out of 14 Scoreboard Indicators.
 - Most of these achievements have been preserved until today, but are in danger due to pro-cyclical fiscal and wage policies initiated in mid-2015, with the rewriting of the Fiscal Code.
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Maastricht Criteria

(Nominal Convergence Indicators)

Nominal Convergence Indicators	Maastricht Criteria	Romania	Fulfilment of the criteria
Inflation rate (HICP) (percent, annual average)	≤1.5 pp above 0.4% (average of the three best performing Member States*)	0.5 (September 2017)	Yes
Long-term interest rates (percent per annum, annual average)	≤2 pp above 2.5% (average of the three best performing Member States in terms of price stability*)	3.7 (September 2017)	Yes
Exchange rate (vs. euro)** (percentage change)	±15 percent	+0.2/-3.9	Yes
General government deficit*** (percent of GDP)	≤3 percent	3.0	Yes
Government debt*** (percent of GDP)	≤60 percent	37.6	Yes

*) Cyprus, Ireland, Romania.

***) Maximum percentage deviations of the bilateral exchange rate against the euro from its September 2015 average level in October 2015 to September 2017 based on daily data at business frequency. An upward/downward deviation implies that the currency was stronger/weaker than the average exchange rate in September 2015.

***) 2016; ESA2010 methodology.

Source: Eurostat

Macroeconomic Imbalance Procedure Scoreboard*

		Current account balance	Net international investment position	Real effective exchange rate (based on HICP)	Share of world exports of goods and services	Nominal unit labour cost index	House price index	Private sector debt	Private credit flow	Public sector debt	Unemployment rate	Financial sector liabilities (non-consolidated)	Activity rate – % of total population aged 15-64	Long-term unemployment rate – % of active population aged 15-74	Youth unemployment – % of active population aged 15-24
		% of GDP 3 year average	% of GDP	3 years % change	5 years % change	3 years % change	1 year % change	% of GDP	% of GDP	% of GDP	% 3 years average	1 year % change	3 years change in pp	3 years change in pp	3 years change in pp
		-4%/+6%	-35%	±5% (EA) ±11% (non-EA)	-6%	+9% (EA) +12% (non-EA)	6%	133%	14%	60%	10%	16.5%	-0.2 p.p.	0.5 p.p.	2 p.p.
Bulgaria	2014	0.2	-75.2	-2.8	5.9	18.0	1.5	123.6	-1.1	27.0	12.2	5.6	3.1	0.6	-1.2
	2015	0.4	-61.2	-4.2	12.2	14.9	1.6	110.5	-0.3	26.0	11.2	6.2	2.2	-1.2	-6.5
	2016	1.8	-47.8	-4.7	8.2	9.5	7.1	104.9	4.0	29.0	9.4	11.1	0.3	-2.9	-11.2
Croatia	2014	1.0	-86.8	-0.9	-18.7	-5.6	-1.1	119.3	0.1	85.8	16.8	0.2	2.0	1.7	8.3
	2015	2.7	-77.3	0.2	-3.7	-5.7	-2.4	114.4	-1.4	85.4	16.9	2.1	3.0	0.0	0.1
	2016	3.2	-70.8	0.1	9.9	-6.2	2.1	107.2	-0.1	82.9	15.6	2.5	1.9	-4.4	-18.1
Czech Republic	2014	-0.6	-36.6	-10.0	-5.8	4.0	1.8	71.5	1.7	42.2	6.7	5.2	3.0	0.0	-2.2
	2015	0.0	-32.9	-8.1	-1.8	0.1	3.8	68.1	0.3	40.0	6.1	8.1	2.4	-0.6	-6.9
	2016	0.5	-24.6	-3.7	2.9	2.9	6.7	68.7	4.4	36.8	5.1	14.5	2.1	-1.3	-8.4
Hungary	2014	2.3	-80.7	-6.8	-16.3	5.9	3.3	91.2	-0.1	75.2	9.6	8.6	4.6	-1.5	-5.6
	2015	2.9	-68.4	-7.1	-7.8	-0.2	13.3	84.3	-2.6	74.7	8.2	0.6	4.9	-1.9	-10.9
	2016	3.7	-65.7	-5.0	-0.4	3.3	13.6	77.0	-3.6	73.9	6.5	19.5	5.4	-2.5	-13.7
Poland	2014	-2.4	-69.1	-1.0	5.2	2.9	1.2	78.1	4.6	50.2	9.8	0.7	2.2	0.2	-1.9
	2015	-1.3	-62.1	-1.3	9.6	0.3	2.6	78.9	3.5	51.1	8.9	2.4	1.6	-1.1	-5.7
	2016	-1.0	-61.0	-5.0	18.1	-0.7	2.5	81.9	4.7	54.1	7.6	8.9	1.8	-2.2	-9.6
Romania	2014	-2.2	-56.9	-1.0	20.7	7.3	-3.2	62.1	-2.4	39.4	6.9	1.3	1.6	-0.1	0.1
	2015	-1.0	-53.6	2.7	20.9	0.3	1.9	59.1	0.2	37.9	6.9	4.0	1.3	0.0	-0.9
	2016	-1.3	-49.4	-2.5	23.6	6.0	6.5	55.8	0.6	37.6	6.5	7.6	0.7	-0.2	-3.1

*) last update: 24 October 2017

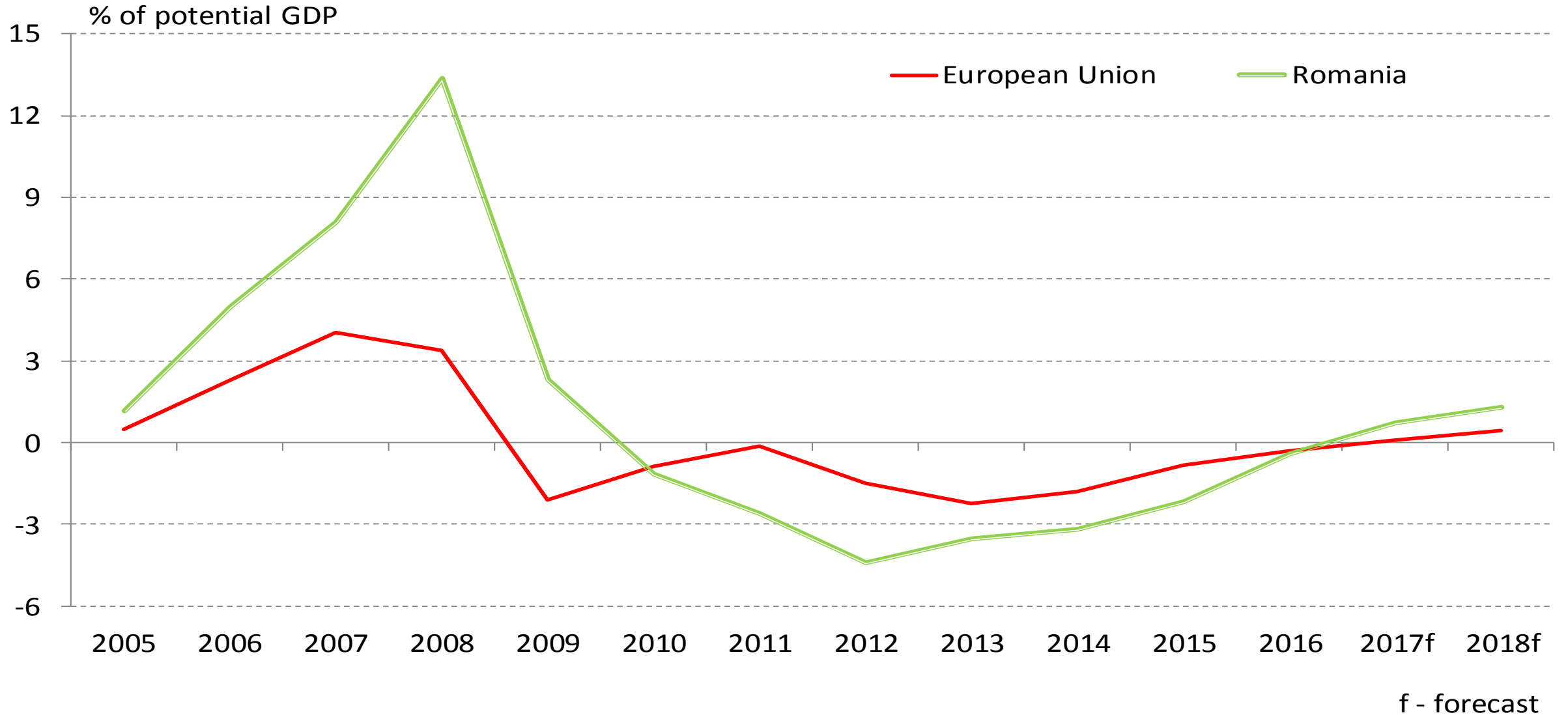
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Source: Eurostat, NIS, NBR

Last 3 years

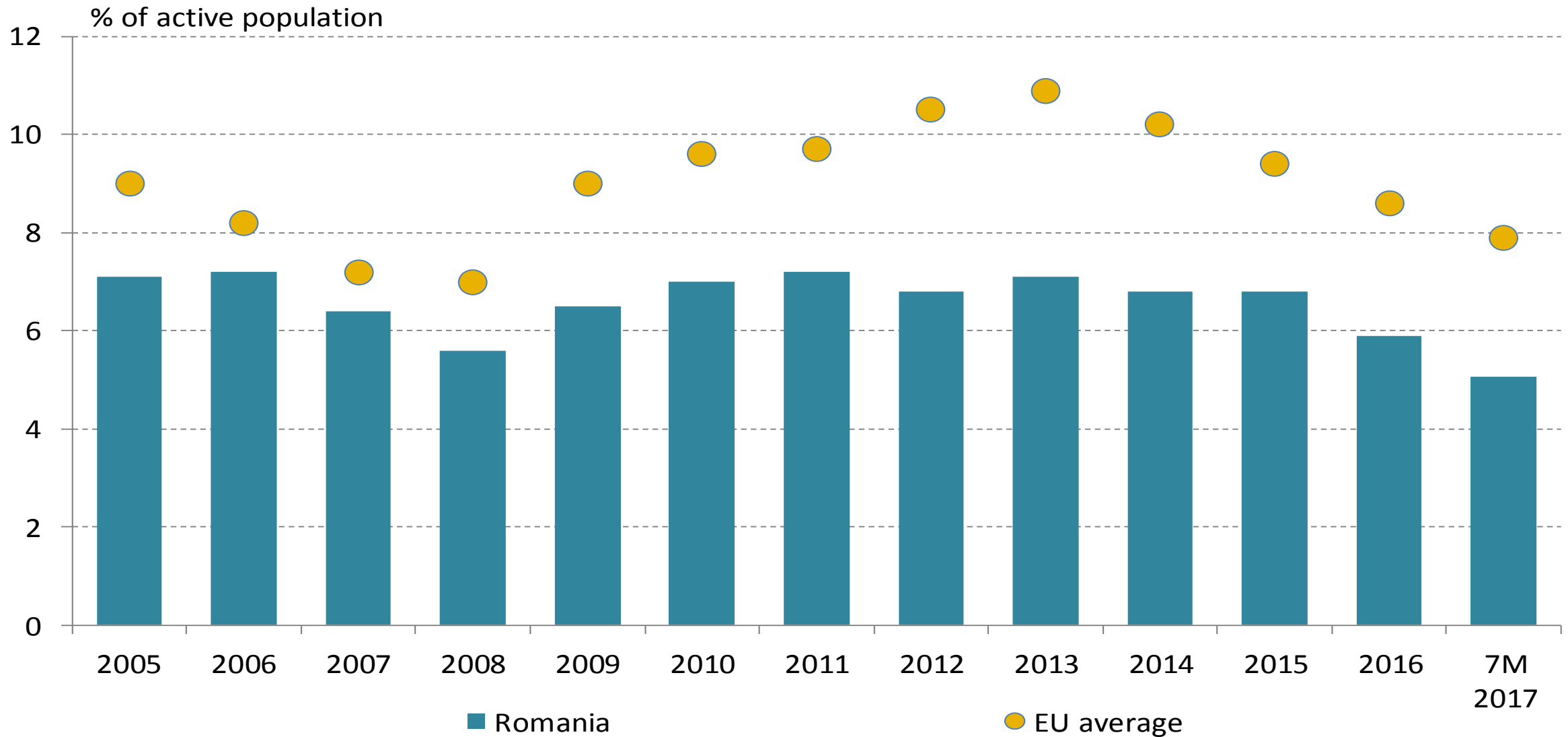
- As a result, the output gap closed in 2016, well before other peer countries and since then Romania has a widening **positive** output gap.
 - Unemployment fell close to pre-crisis levels.
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Output gap



Source: European Commission

Unemployment



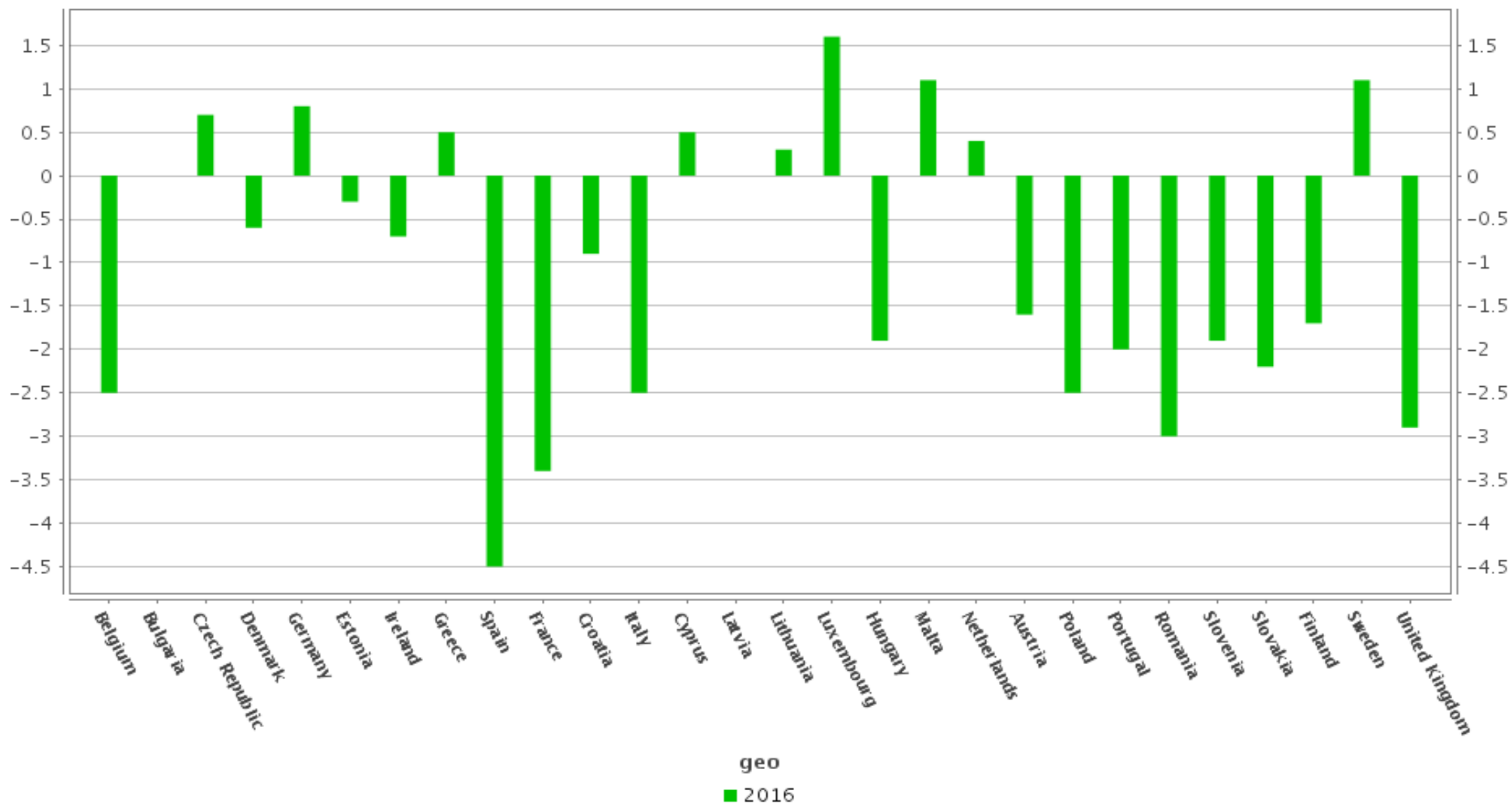
Source: Eurostat

Last 3 years

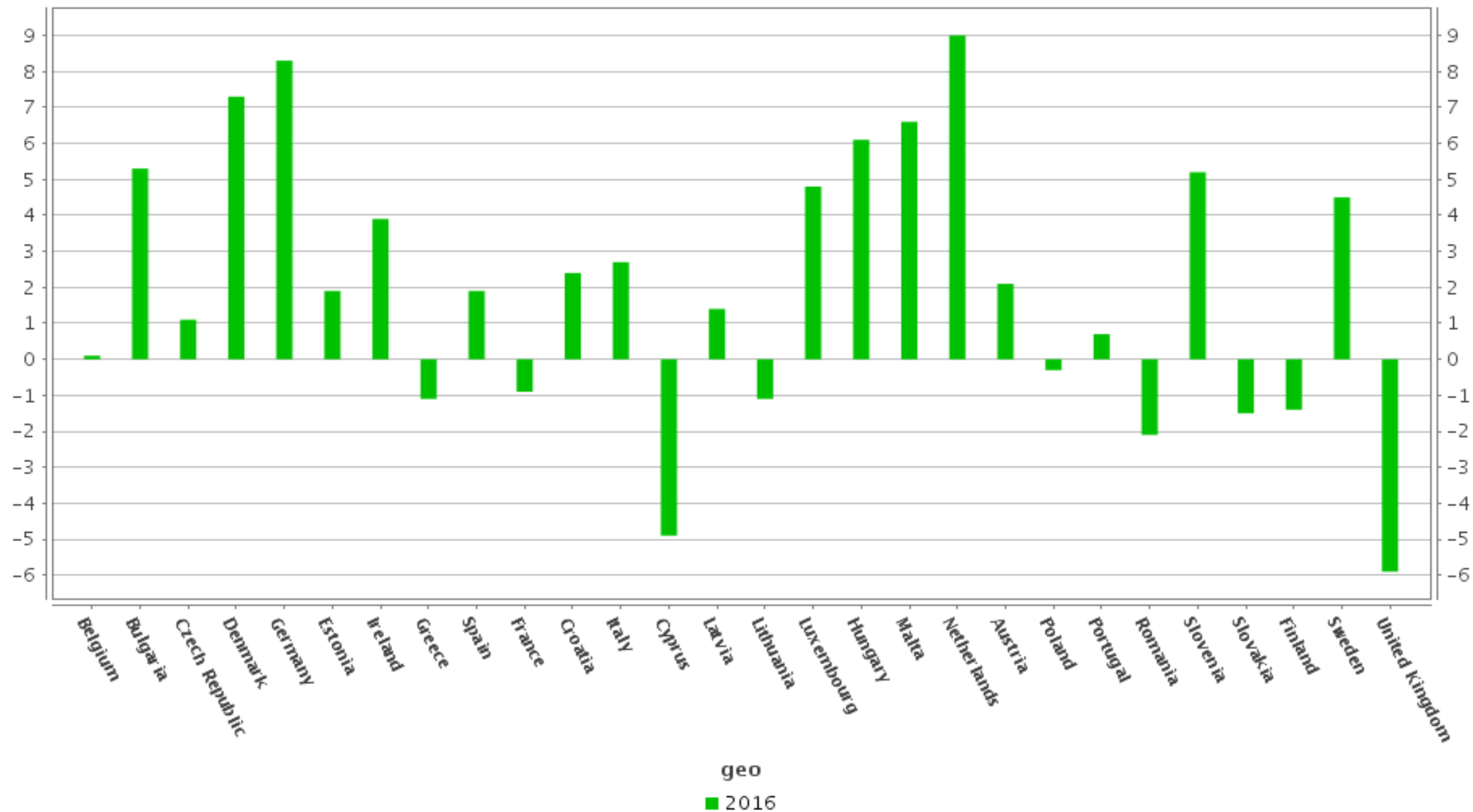
- Particularly worrisome is the twin deficits evolution in the last few years:
- Concerning the **budget deficit**, Romania had in 2016, the third largest deficit in the EU, after France and Spain.
- Concerning the **current account deficit**, Romania had in 2016 the third largest deficit in the EU, after the UK and Cyprus.
- **Public debt** (as a share of GDP) is still at a comfortable level, but only because of:
 - very high GDP growth
 - very low interest rates

Neither is likely to persist in the medium run.

General government deficit (-) and surplus (+) - annual data
Percentage of gross domestic product (GDP)

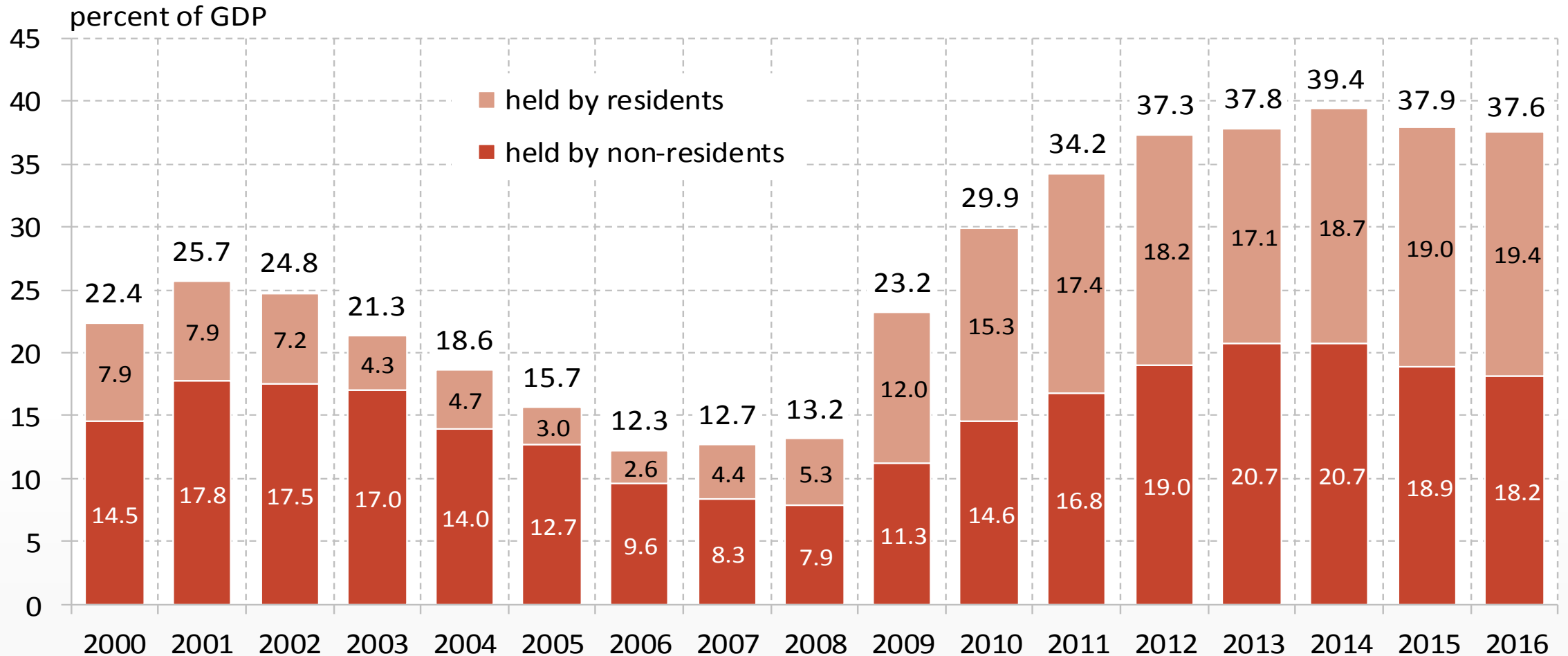


Current account balance - annual data
Percentage of gross domestic product (GDP)



Public Debt

(according to ESA2010)



Note: Government securities in MFIs portfolio as a share of GDP in Dec.07=1.4%, Dec.08=2.1%, Dec.09=7.0%, Dec.10=9.4%, Dec.11=10.6%, Dec.12=11.6%, Dec.13=11.1%, Dec.14=11.3%, Dec.15=11.2%, Dec.16=10.9% and Sep.17=10.4%.

Source: Ministry of Public Finance, National Bank of Romania, National Institute of Statistics, National Commission for Prognosis

The Way Forward

Part 1: Production

- If Romania wants to grow **sustainably** at a rate of 5% per annum, it should abandon nominal stimuli (fiscal and wage relaxation) and concentrate upon enhancing **potential GDP**, by structural reform of its components:
 - capital
 - labour
 - productivity (TFP).
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CAPITAL

- **European Funds**
- **Stock Exchange (BVB)**
- **Foreign Direct Investment**

LABOUR

- **Education**
- **Health**
- **Demography**
- **Re-attracting the Diaspora**

PRODUCTIVITY (TFP)

- **R&D and Innovation**
- **Agriculture**
- **ITC**
- **Cultural and creative sectors**
- **Tourism**

Enhancers

- **Transport Infrastructure**
- **Cadaster**

- **De-bureaucratization**
- **Energy efficiency**

The Way Forward

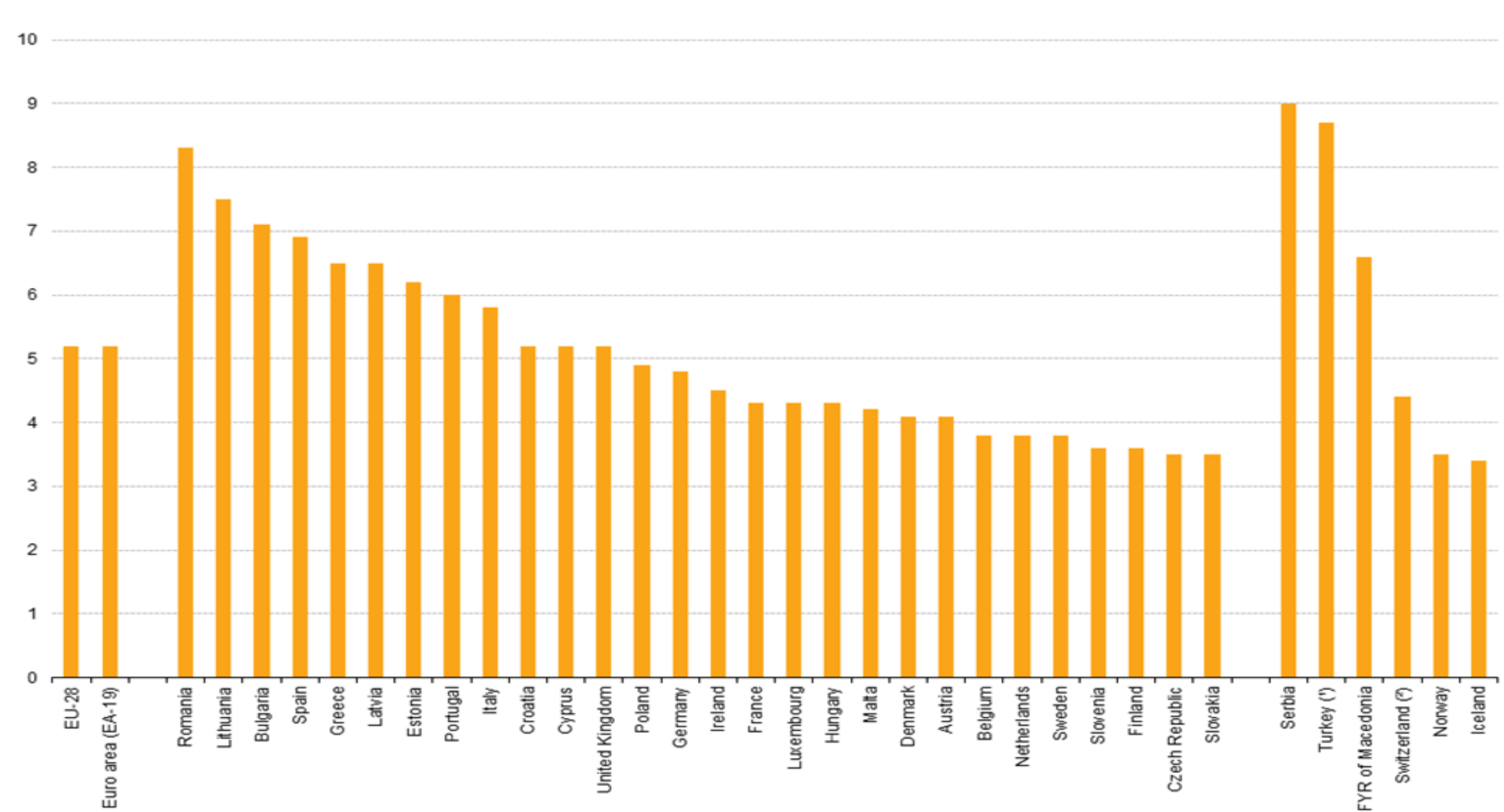
Part 1: Production

- However, implementing such a program would mean:
 - avoiding future decreases of taxation
 - better collection of existing taxes
 - increases in wages only in line with productivity
 - indexation of pensions to remain subunitary vis-a-vis wages.
 - If implemented thoroughly, such a program would yield positive results within the same electoral cycle:
 - not only an economic win-win, but also a political win-win.
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The Way Forward

Part 2: Redistribution

- If Romania wants to grow **inclusively**, it should tackle the problem of it having the highest degree of inequality between the first quintile and the fifth quintile.
 - This leads to a Gini coefficient of 35,9, compared to 30,9 for the EU.
 - Possible solutions to mitigate income inequality:
 - return of income globalization and progressive taxation
 - increase of the minimum wage (**not** of allowances for non-workers and **not** of wages across the board)
 - improving education
 - enhancing labour mobility.
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The Way Forward

Part 2: Redistribution

- Not only people, but also regions suffer from an increased inequality.
 - Possible solutions:
 - building highways to the NE Region (highway Târgu Mureș - Iași) and to the SW region (highway Pitești-Craiova)
 - Enhancing the Universities of Iași and Craiova.
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THANK YOU!
