

Romania's convergence: the way forward

Thoughts on the IMF Regional Economic Issues, May 2016

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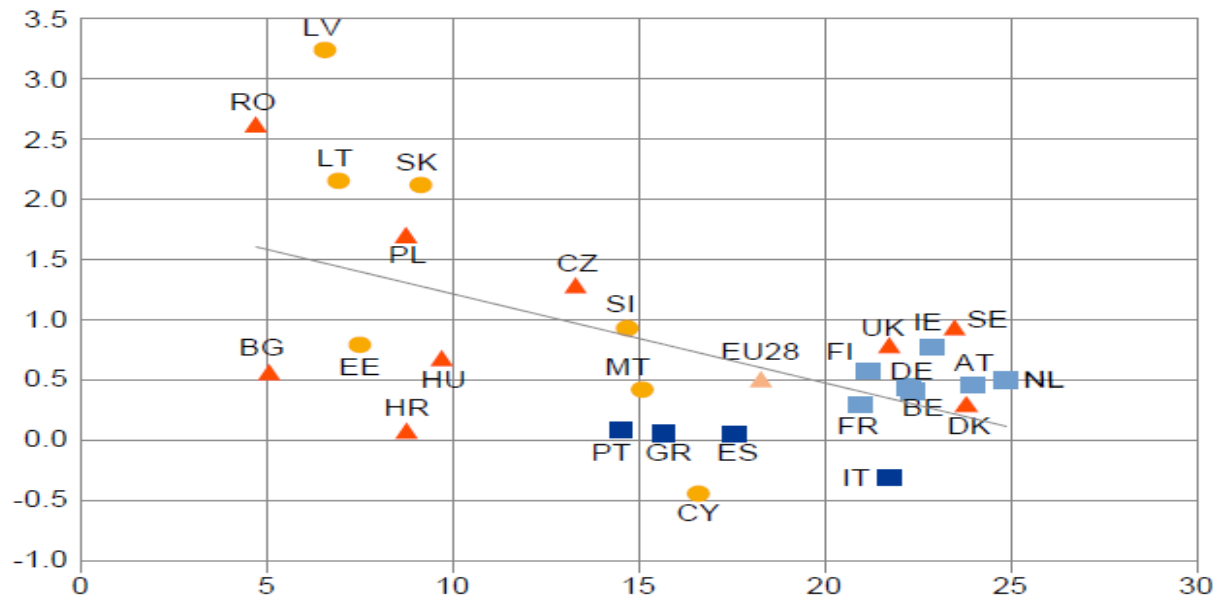
1. Romania's convergence: doing well from a low starting point

GDP per capita and average TFP growth

(GDP per capita in 1,000 PPS, percentage changes)

x-axis: GDP per capita (1999)
y-axis: average TFP growth (1999-2014)

- Euro 12
- other euro area country
- ▲ non-euro area country



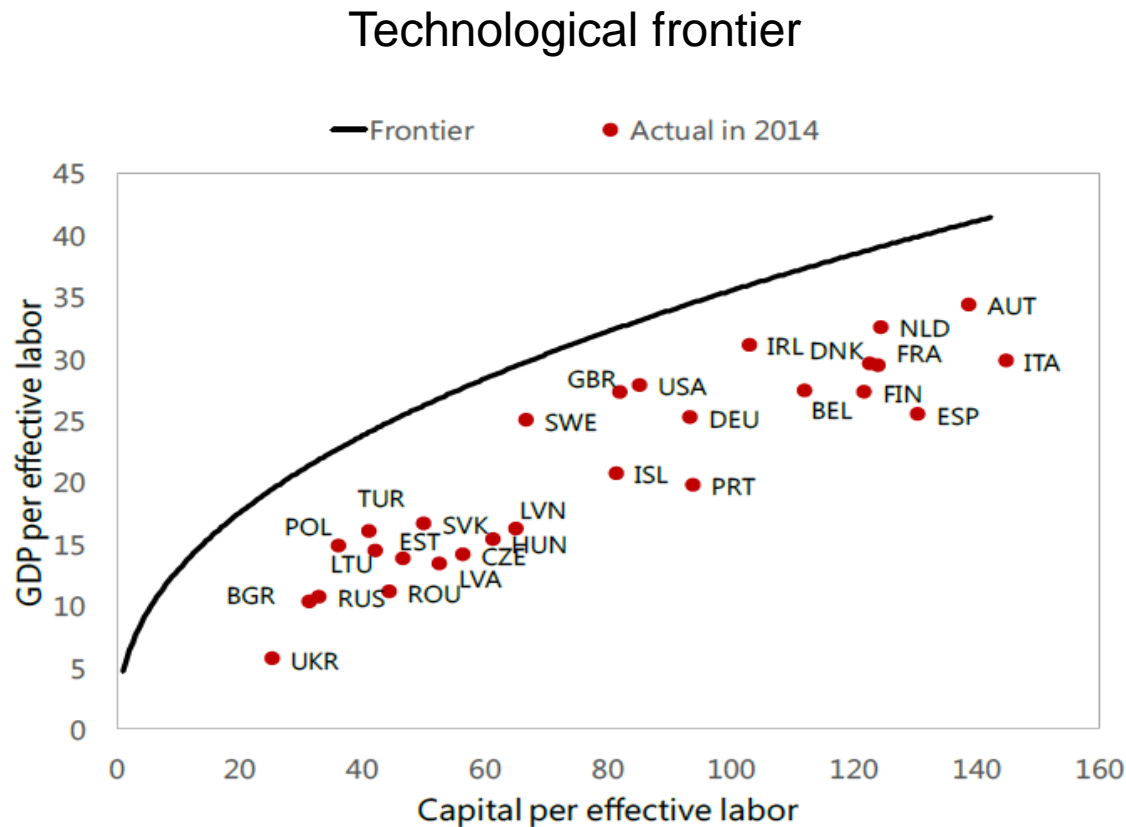
Source: ECB
Economic Bulletin
5/2015

Convergence:
main conditions for going forward

Theoretical consensus (ECB, 2015):

- Macroeconomic stability
- Economic flexibility (being able to reallocate resources fast)
- Higher TFP (total factor productivity) growth

Reducing convergence gap by getting closer to the technological frontier

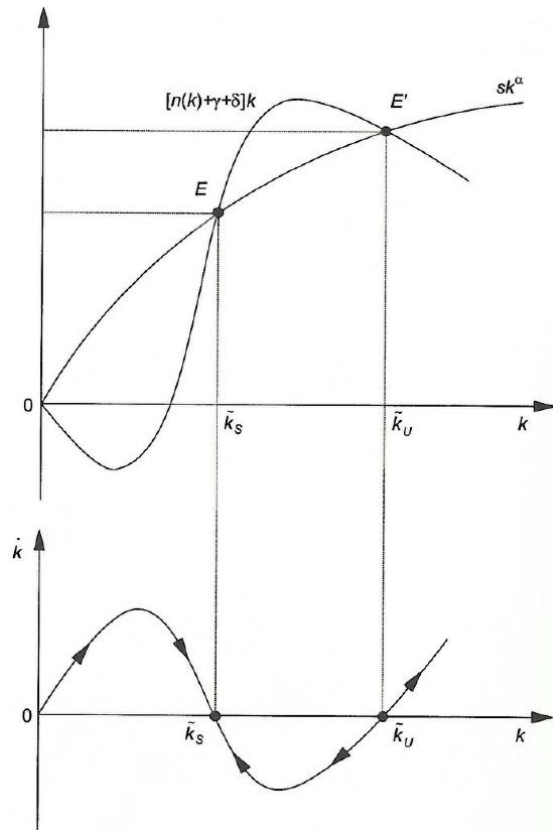


Source: IMF, 2016

“The rate at which lagging economies catch up is determined by the ability to absorb ideas and knowledge from the technology frontier.

Convergence gap does not recede simply because the countries that have developed the technology are growing at a slower pace” (Rodrik, 2011)

Endogenous labor force in the Solow-Swan model



- Aggregate production function $Y = f(K, AL)$ where K - stock of capital, L – number of workers, A – effectiveness of labor
- Capital effective labor $k = K/AL$ (physical capital per unit of effective labor)
- At low levels of capital effective labor ratios, population growth rate is negative (people unable to satisfy their needs) leading to a low or middle income trap (point E in the figure) because it lowers the rate of growth of output

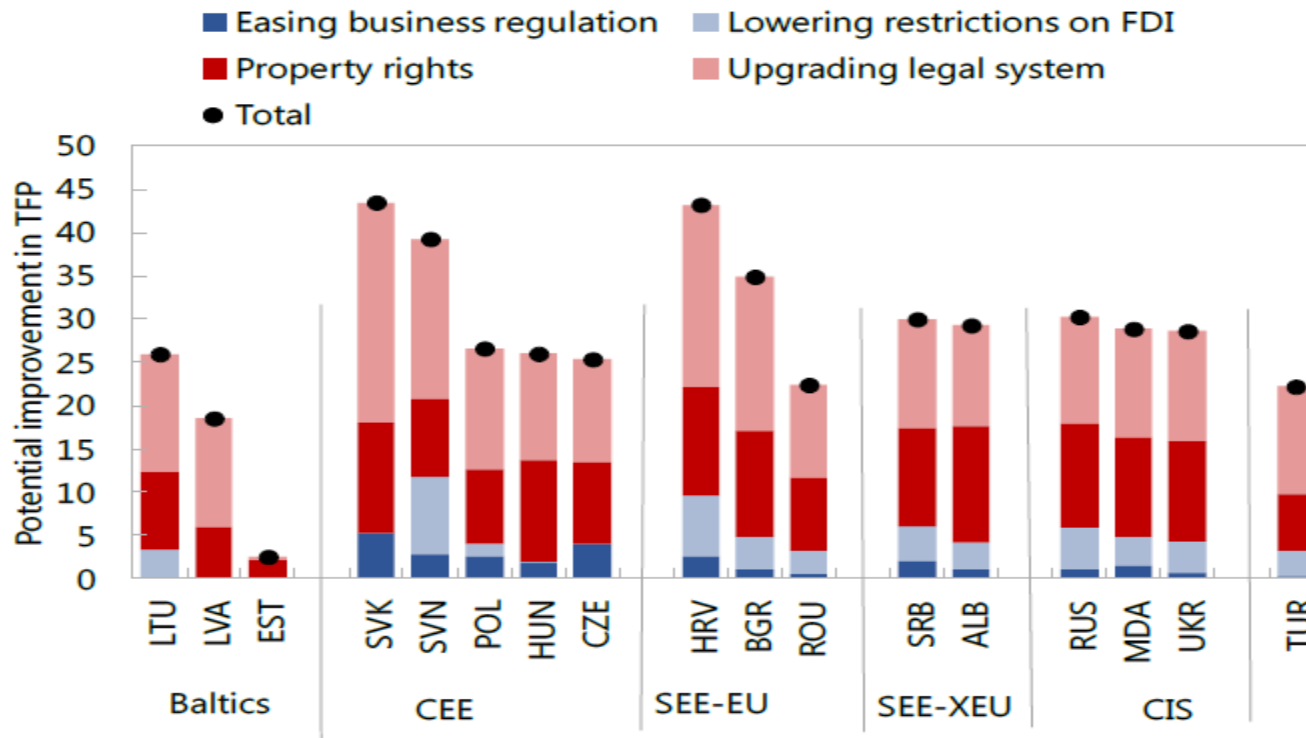
Source: Agenor, 2004, The Economics of Adjustment and Growth – adapted from Burmeister and Dobell (1970)

Addressing labor force

- The IMF report points to the negative growth rate of labor force as a factor affecting convergence
- To compensate for it, we need to reduce inequality in the distribution of profits between capital and labor, and to reduce income inequalities within the labor force
- We also need technological progress, which is both labor and capital augmenting.
- Public policies should focus on these areas.

2. Convergence: structural reforms

Potential efficiency gains from structural reforms



Source: IMF, 2016

Convergence: Structural reforms

- Romania has undertaken reforms, as gains from further reforms appear in line with PL, CZ, HU.
- But some areas of second generation of reforms are overlooked or not quantified: better tax collection, tackle private sector losses, prioritization of public investments, centralized acquisition in the healthcare sector.

3. Further analysis needed

- The report has two possible caveats influencing results:
 - Taxonomy (e.g. euro and non-euro together, Romania in SEE region, etc.)
 - Data consistency (not the same starting point – e.g. Romania 92, Bulgaria 01; qualitative data from 3 different international surveys; many different cut-off dates for different tables)

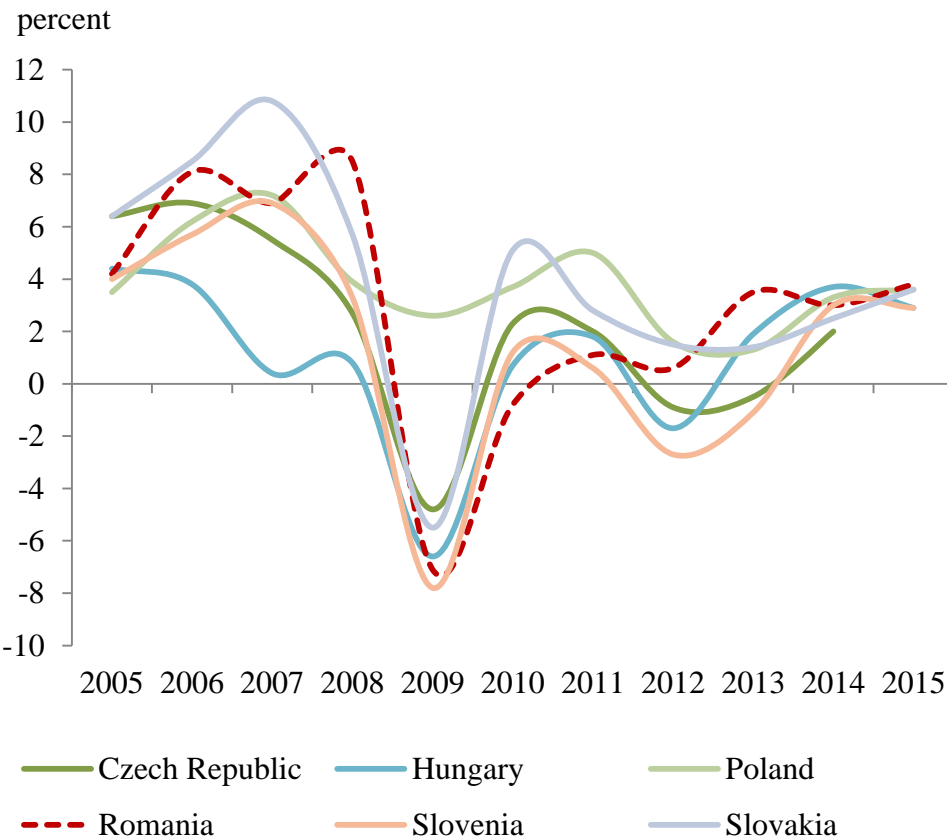
Romania: more common grounds with CEE

As in the report:

- size of the estimated output gap (largely closed, like in Poland, Hungary, Czech Republic, Slovakia - figure 1.2),
- gross financing requirements (similar to Poland, just below 10% of GDP),
- potential efficiency gains from structural reforms (around 20% improvement in TFP, like PL, HU, CZ – but twice less than HR or BG, which signals that much of structural reforms as described in this report have been undertaken),
- similarity of policy recommendations.

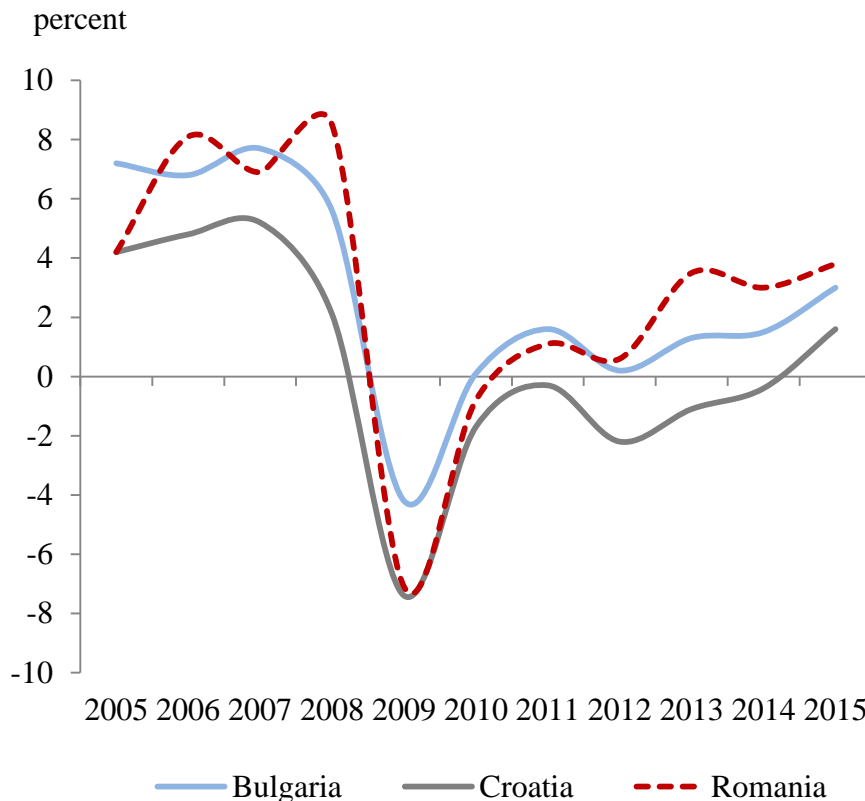
Romanian economic growth accelerated over the past years

Economic growth in Romania and CEE countries



Source: Eurostat

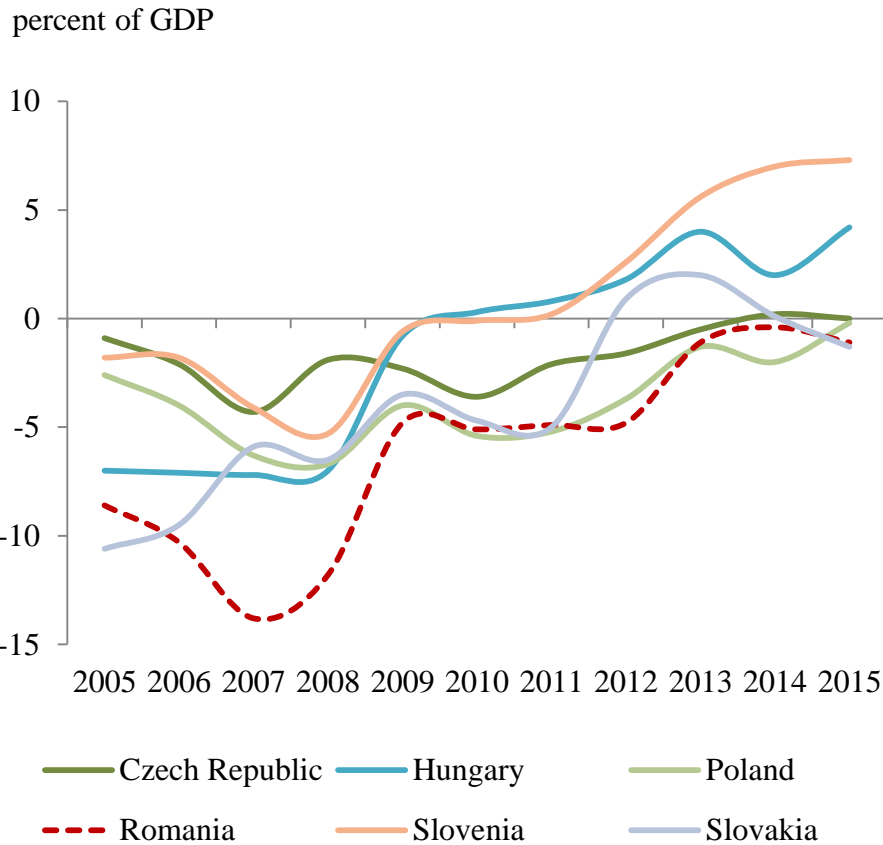
Economic growth in SEE EU countries



Source: Eurostat

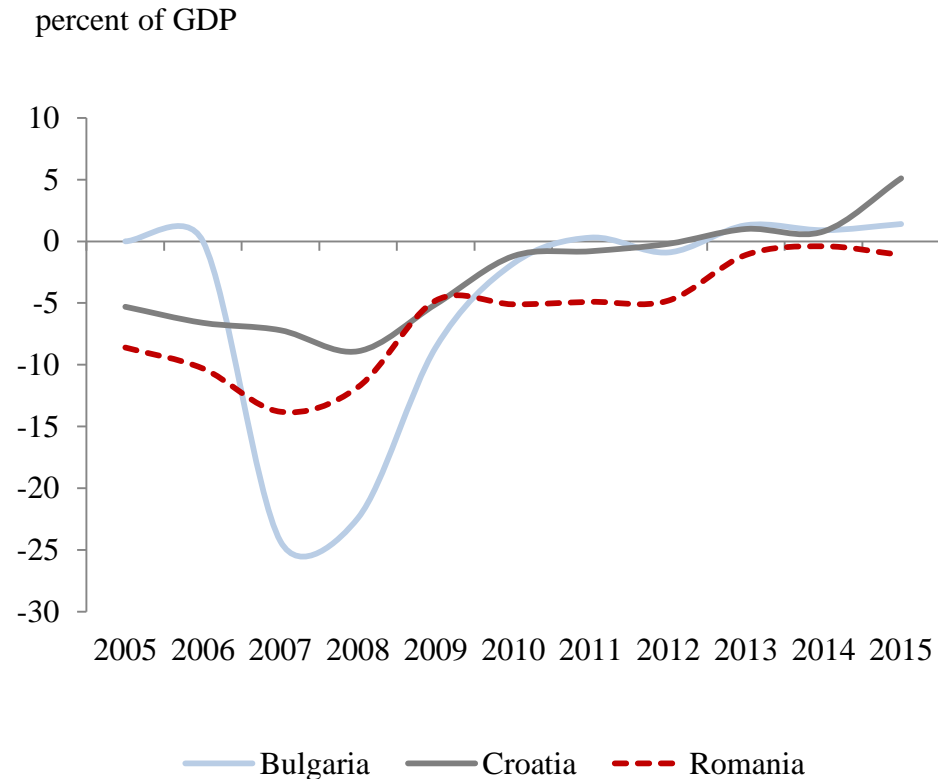
Current account deficit adjusted gradually with moderate volatility

Current account balance in Romania and CEE countries



Source: Eurostat

Current account balance in SEE EU countries

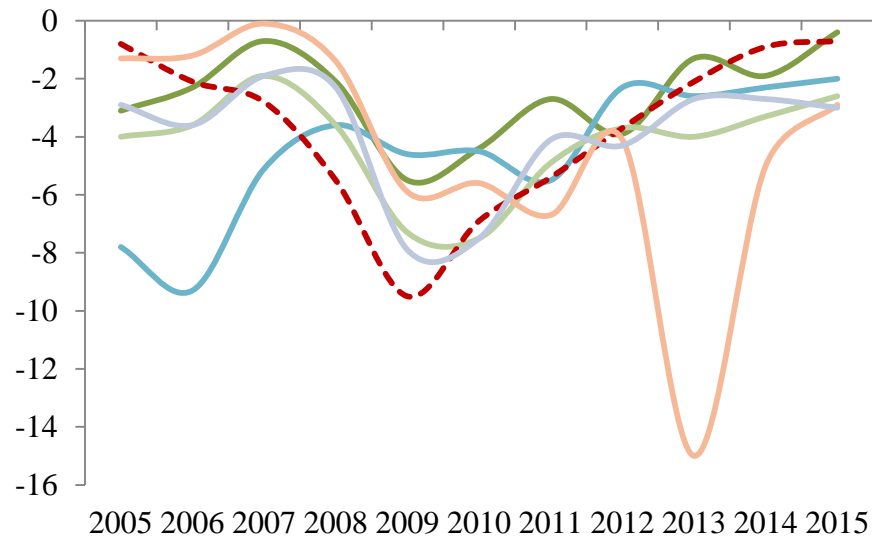


Source: Eurostat

Budget deficit entered a robust consolidating path after the crisis

Fiscal balance in Romania and CEE countries

percent of GDP

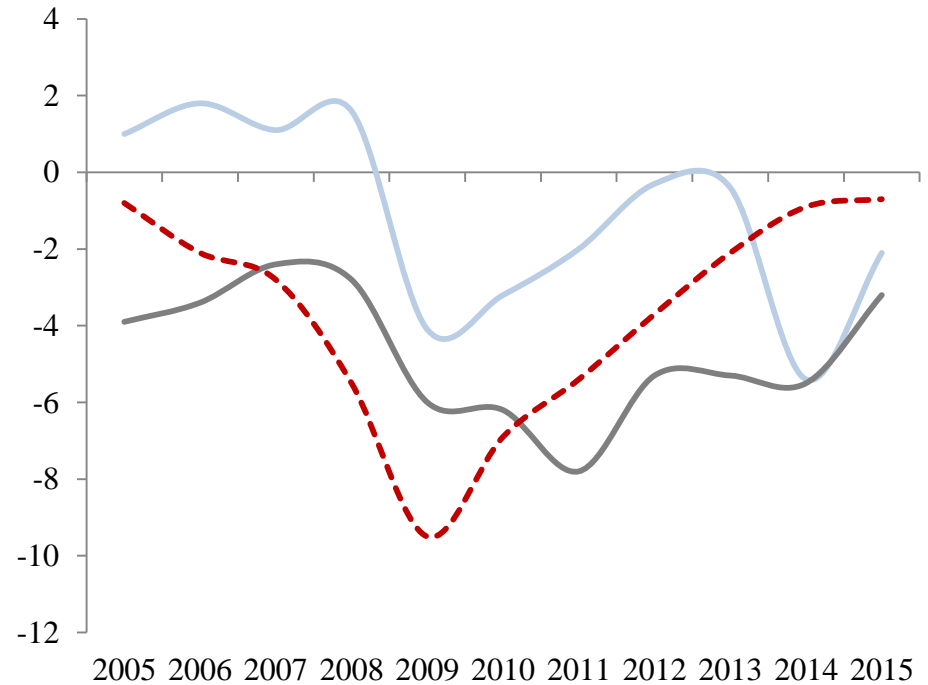


— Czech Republic — Hungary — Poland
- - - Romania — Slovenia — Slovakia

Source: Eurostat

Fiscal balance in SEE EU countries

percent of GDP

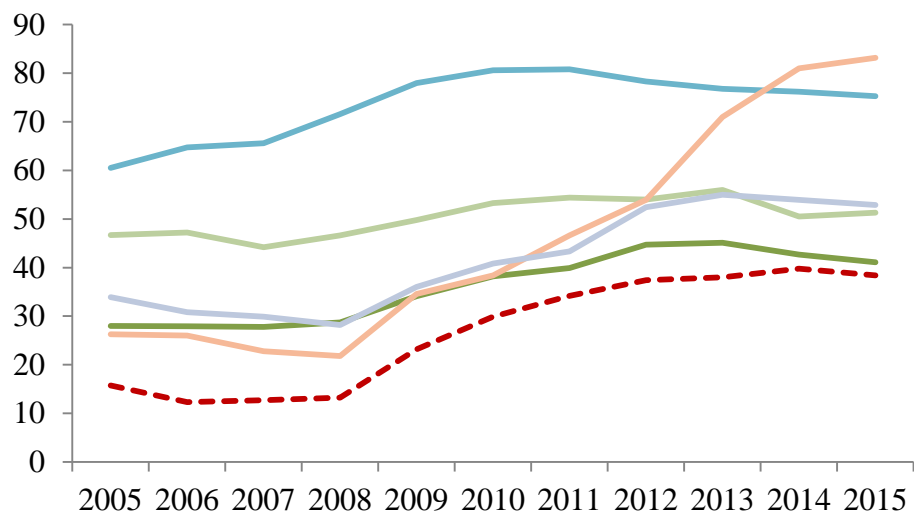


— Bulgaria — Croatia - - - Romania

Public debt remains one of the lowest in the region

Public debt in Romania and CEE countries

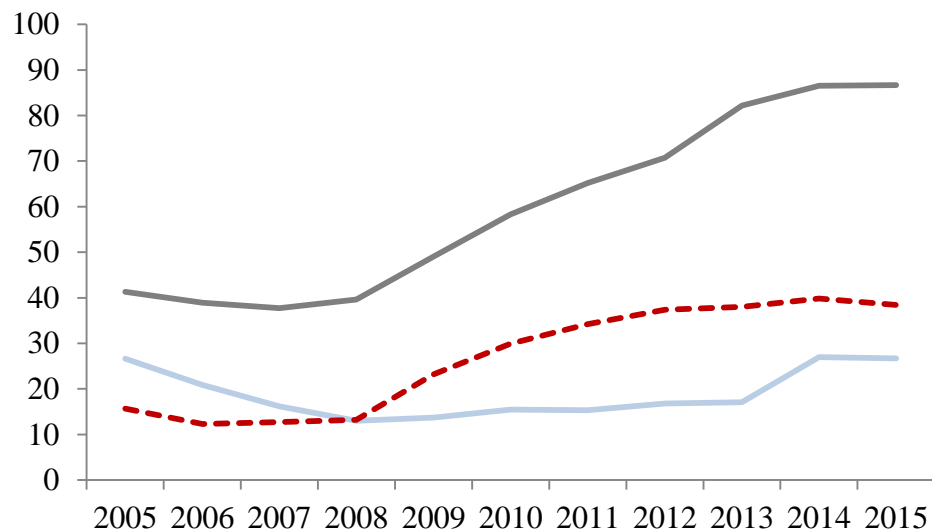
percent of GDP



— Czech Republic — Hungary — Poland
- - - Romania — Slovenia — Slovakia

Public debt in SEE EU countries

percent of GDP

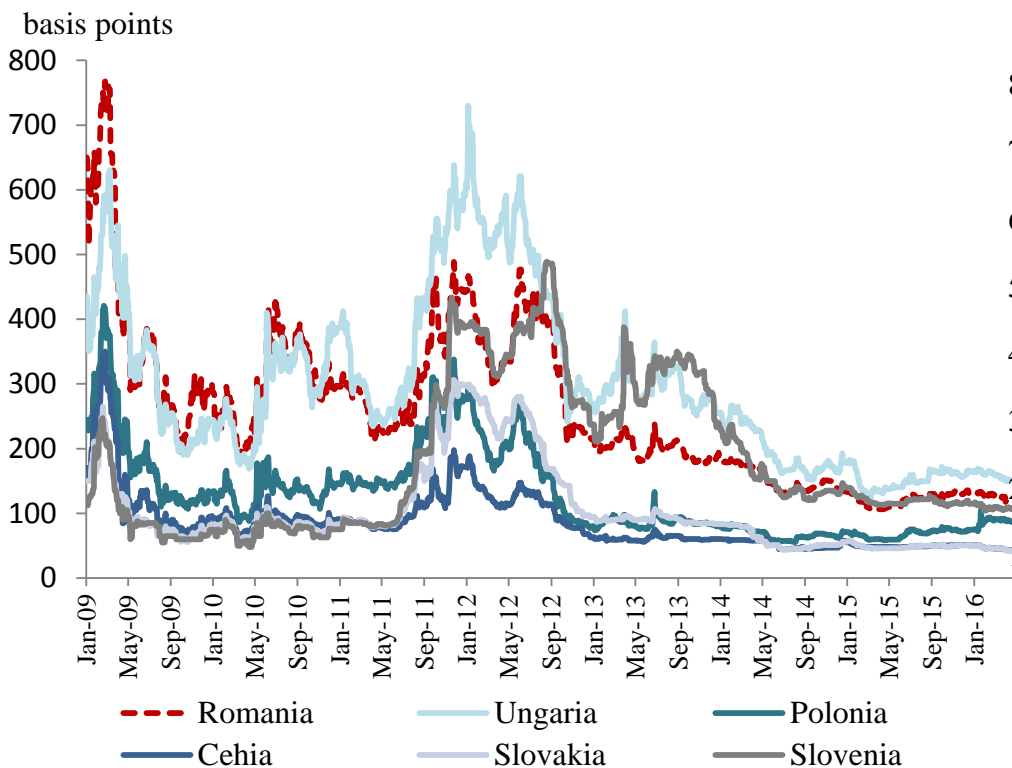


— Bulgaria — Croatia - - - Romania

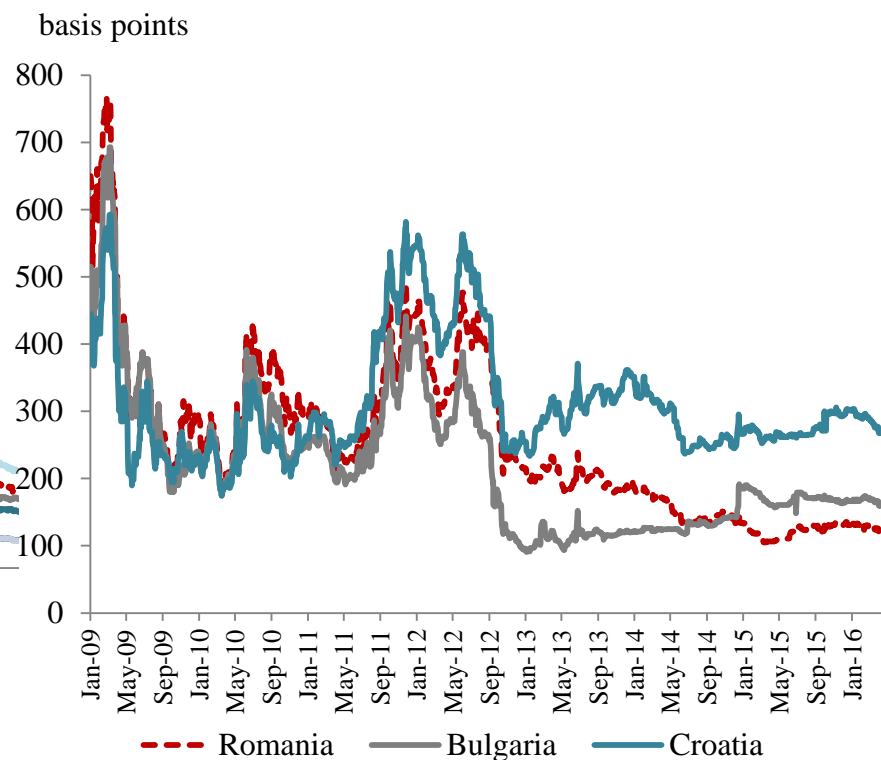
Source: Eurostat

Restored macroeconomic equilibria improved to a great extend investors' perception on country risk

Sovereign CDS for Romania and CEE countries



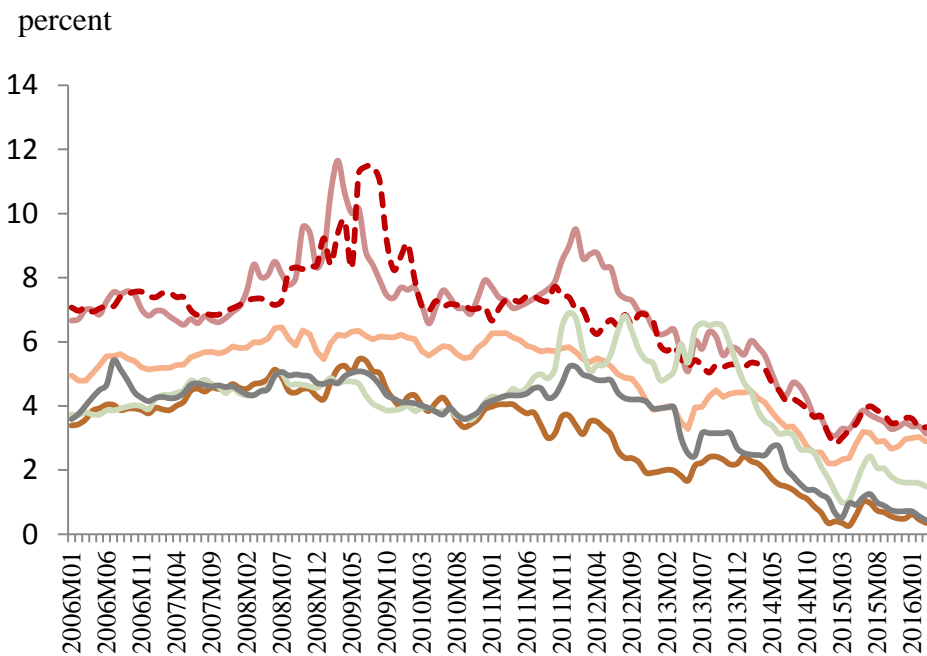
Sovereign CDS for SEE EU countries



Source: Reuters

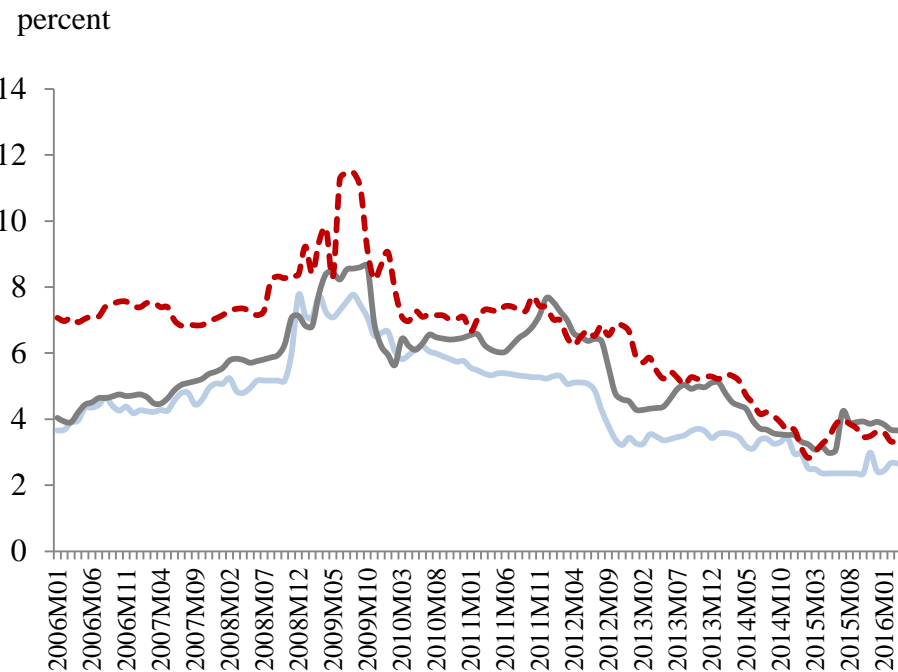
... and brought down the level of long term government bond yields

Long term government bond yields in Romania and CEE countries



- Czech Republic — Hungary — Poland
- - - Romania - - - Slovenia — Slovakia

Long term government bond yields in SEE EU countries



- Bulgaria — Croatia - - - Romania

Source: Reuters

Concluding remarks

- Fundamentals recommend Romania to be considered as a CEE country, and as emerging economy
- Prudent domestic policies are further necessary to preserve the macroeconomic balances, as well as to mitigate external contagion risk
- Further TFP gains are needed
- A wider and also more cost benefit analysis of structural reforms is needed.
- The sense of direction is more important than speed. Avoiding low-middle income trap is essential.



Thank you