TOWARDS SUSTAINABLE DEVELOPMENT: REAL CONVERGENCE AND GROWTH IN ROMANIA

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Abstract

The complexity of the current global economy requires a holistic approach regarding the subject of economic growth and sustainable development. This approach is necessary since it is well known that countries have different degrees of economic development. Fulfilling the criteria of nominal and real convergence for any EU country is the first step towards achieving a common goal, sustainable development. Therefore this paper is based on the idea that a country can achieve a sustainable development by meeting real and nominal convergence criteria for an extended period of time. The convergence criterion is explored through a series of indicators. The present study investigates these indicators in the case of Romania, such as: GDP per capita, labour productivity, investment and interest rates and public debt. The analysis shows that although there is an economic growing trend, given especially by EU membership, since 2007, the problems are much deeper and are related to social inequality and regional disparities in development. As a solution this paper identifies several monetary and fiscal measures to improve these indicators and eventually to achieve a sustainable development.

Keywords: real convergence, sustainable development, determinants of growth, fiscal policies, monetary policies

JEL classification: E2, E6, O23.

1. Introduction

Sustainable development involves merging economic, social and environmental elements. The main issue is the lack of correlations between the three dimensions which causes the appearance of serious imbalances in society, e.g. social inequality, difficulties regarding income

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distribution, major environmental damage and unsustainable economic growth.

The fundamental aim of sustainable development is the well-being of the people of today and tomorrow. The welfare can be measured through a number of indicators. This paper suggests that the analysis of the nominal and real convergence criteria can reveal the level of economic well-being for the countries in question. However the evaluation of all the three pillars of sustainable development is very complex. The present article examines the socio-economic area.

Because the matter in question is how Romania can achieve sustainable development in the next sections, the main indicators regarding economic sphere are analysed. Moreover, because Romania is a member of the EU, a comparative analysis is also approached. The countries selected for the comparison are from the CEE zone and the reason lies in identifying the gaps and differences between nations. A sustainable development can reduce these gaps at all levels: regional, national, transnational.

2. The nominal convergence criteria

Currently the euro zone covers the 19 European Union Member States that have adopted the Euro. These countries are Austria, Belgium, Cyprus, Finland, Estonia, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Portugal, Spain, Slovenia and Slovakia. Smaller states such as Andorra, Monaco, San Marino and the Vatican have signed monetary agreements and are attached to the euro zone. The bases of this monetary area were put in 1999 when eleven countries introduced the Euro.

The responsibility for the leading of the monetary policy in the EU lies with the European Central Bank (ECB) which, together with the central banks of the Member States, forms the European System of Central Banks (ESCB).

Due to the fact that the monetary policy strategy is common to all member countries, decisions taken at the central level increase their exposure and influence on national economies. It therefore creates an impact on the European economy as a whole.

The main objective of monetary policy is price stability and this is defined by annual growth in the Harmonized Index of Consumer Prices (HICP) for the euro zone below 2%.

The 2% level sets a limit on the inflation rate measured on the basis of the HICP, and provides an adequate margin to avoid the risk of deflation. Achieving price stability by targeting inflation is achieved in the medium and long term. The aim of the monetary policy is to lead the euro zone economy to growth on the basis of an open economy and free competition in the conditions of efficient resource allocation. Other objectives of the Euro system are to preserve financial stability and to cooperate with European and national authorities.

In drawing up the monetary policy strategy, the ECB is based on two pillars: economic analysis and monetary analysis. The first pillar refers to the evolution of total output, exchange rates and evolution of tax credits. The second pillar, monetary analysis, follows the relationship between inflation and money supply growth for medium and long term, and changes in liquidity. The conditions that member countries have to meet to be part of the Economic and Monetary Union (EMU) have been transposed into the Maastricht Treaty.

Euro zone countries have a number of advantages such as: the integration of financial markets, the elimination of currency and transaction costs and the access to a single market for goods and services.

The nominal convergence criterion involves the following elements of national monetary policy: price and exchange rate stability, budget deficit, government debt and long-term interest rates. Some of the indicators for nominal convergence will be analysed in the present paper.

2.1. Price stability

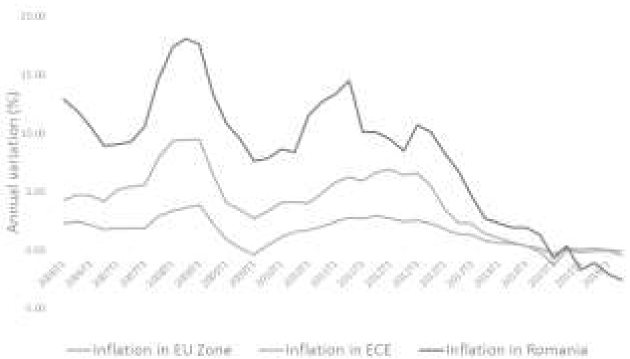
The first indicator examined is price stability. This is achieved through a low inflation rate. Inflation is a complex economic and social phenomenon with varied aspects, becoming persistent and almost omnipresent in the current world. Most of those who have studied inflation agree that it is generally a negative phenomenon that generates many problems and affects multiple plans. Fisher (1961) sees inflation as "the direct result of the price factor, considered proportional to money in circulation" and Friedman (1948) in the quantitative theory of money considers that "inflation is always a monetary phenomenon."

Thus, as a result of the above, it can be concluded that inflation is, in essence, a macroeconomic, real-monetary imbalance which consists of a cash surplus in circulation in relation to the need for money in the economy. This imbalance is manifested by the depreciation of the national currency and the generalized and lasting increase in consumer goods prices, production goods and services fees with a number of negative consequences for the entire economic system and the living standard of the population.

In Romania the fundamental objective of the monetary policy conducted by the National Bank of Romania is the price stability. It is part of the inflation targeting strategy and has been implemented since August 2005.

The empirical analysis is presented in the Figure 1. Price stability, Inflation in ECE, EU Zone, Romania. It can be seen that inflation is negative for Romania and the CEE. According with some reports in 2016 the EU zone recorded an inflation of 0.1%. In the case of Romania this negative value is due to fiscal measures, namely the effect of lowering the VAT rate from 24% to 20%. The downward trend was driven by the influence of external prices and the low level of inflation expectations.

Figure 1. Price stability, Inflation in ECE, EU Zone, Romania



Source: own projections based on the IMF data statistics-Fiscal Monitor, Eurostat

As external impact on low inflation in both Romania and the CEE countries, is due to import restrictions imposed by Russia. Regarding this external factor that influences the entire European Union, in the literature of the last years appears the concept of global inflation. The main cause is the globalization of the markets and the development of external competition. Conti, Neri and Nobili (2015), and Ciccarelli (2015) prove empirically for the euro zone that the evolution of inflation in many states is influenced by the action of common external factors.

The overview in the literature regarding the influence of fiscal policies on price stability is very large. It is shown that there is a link between budget deficit and inflation. Unsustainable public deficit lead to high inflation.

Regarding the long-term interest rates for Romania, it can be seen an evolution of the monetary policy rate, the interest rate on the deposit facility and the credit facility from 2012 until today. The NBR stated in the last year, the monetary policy interest rate is at a historical minimum of 1.75%.

In order for monetary policy to reach the target levels of economic variables set by the monetary authorities, they have some instruments to influence the magnitude and dynamics of monetary variables.

The adjustment of these monetary policy instruments is intended to ensure medium-term price stability according to the inflation target of 2.5% ± 1 percentage point in a way that contributes to sustainable economic growth.

In conclusion, the price stability through a low level of inflation allows authorities to remain in the declared margins such that economies can prosper and sustainable development can be achieved.

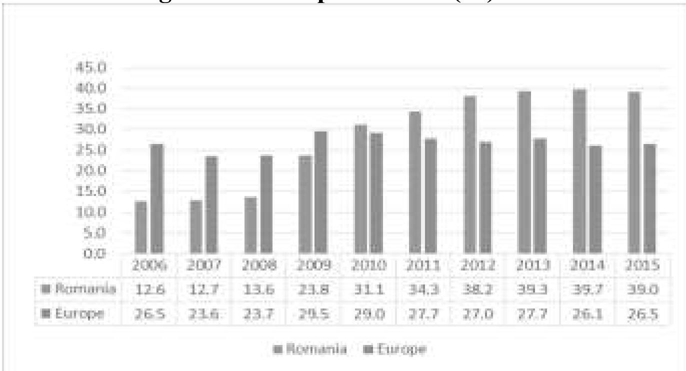
2.2. Gross public debt and budget deficit

The increasing importance of fiscal policies arises in the context of monetary constraints such as interest rates approaching zero or when countries deliberately abandon independent monetary policies to join a monetary union. Therefore, the importance of fiscal policies has increased.

In Romania's case, the public debt is below the 60% reference value. At this level, Romania may be able to contract new loans for investments and improve transport networks. Developing the infrastructure is a key factor underpinning economic growth. Moreover, as a consequence foreign direct investments can increase. On the other hand a high public debt can generate instability and consequently an economic crises.

Specifically in the Figure 2. Gross public debt (%) GDP, it can be seen the dynamics of the debt, compared to the overall of Europe. In order to achieve sustainable development, it is essential to stabilize fiscal indicators.

Figure 2. Gross public debt (%) GDP

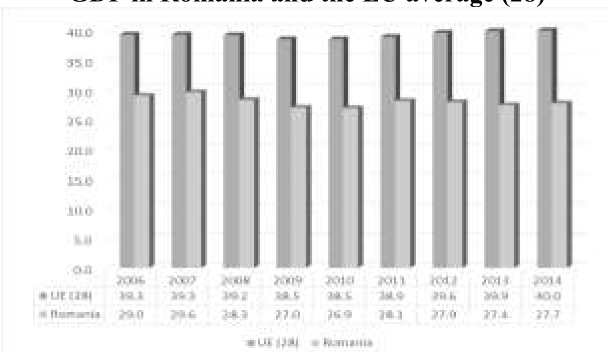


Source: own projections based on the IMF data statistics-Fiscal Monitor, Eurostat

Fiscal policy refers to decisions of the government authorities regarding taxing and spending. Fiscal policy has effects on all the three pillars of sustainable development: economic, social and environmental protection.

Figure 3. Comparative chart between total tax revenues and contributions (%) GDP in Romania and the EU average (28), presents the evolution of the revenue part between the years 2006-2014. It can be noticed that after the crises this indicators have a dynamics evolution. In comparison with the EU average, Romania has to recover a difference considering that taxes in the EU have a constant evolution.

Figure 3. Comparative chart between total tax revenues and contributions (%) GDP in Romania and the EU average (28)



Source: own projections based on the data from Eurostat

Meeting the nominal convergence criteria, but not consistent from year to year, does not lead to sustainable convergence. In fact, fulfilling these criterions sporadically shows how vulnerable and unstable an economy is.

3. The analysis of real convergence criterions

The nominal convergence criterions are complemented by a number of real convergence indicators. The real situation of an economy can be determined by analysing them on the long term. Meeting these indicators e.g. GDP per capita, productivity, and nearly accomplishing the targets, in comparing with the EU average, can lead to sustainable development and joining the euro zone.

There are situations where the nominal convergence criterions are met, but to see the real economic situation of a country it is necessary an assessment of the real convergence criterions. Nominal and real convergence criterions cannot be divided, they are merged to achieve the sustainable economic growth target.

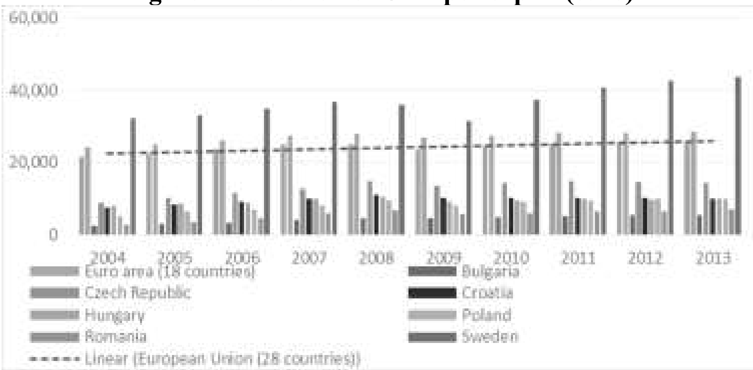
Analysing these indicators can give a picture that is close to the economic reality of a country. The interest in the nominal and real convergence criterions is justified by the fact that only monetary and fiscal policies can lead to their fulfilment. Practically, if these criterions are met in a sustainable way, the economy is on the right track. Some of the indicators for real convergence will be analysed below.

3.1. Gross Domestic Product (GDP)

An indicator often used to measure the economic growth is GDP per capita. According to the International Monetary Fund, GDP is defined as "an indicator that measures the monetary value of end-use goods and services produced by a country over a certain period of time, usually one year."

In the Figure 4. Evolution of per capita GDP (euro) one can observe the evolution of the GDP per capita from 2004 to 2013 by comparison with several non-euro countries and the average in this area. By interpreting the data, Romania had a constant growth in these years. In comparison with other countries, Romania is the last but one for this indicator, followed by Bulgaria over the analysis period. In 2013 there was a GDP per capita of 7,100 euros, but this figure is well below the European average (EU28) and below the euro area average (EU18), which is 28,600 euro per inhabitant. Most of the countries from the former communist zone, that have joined the EU, are on the same page regarding this very important indicator.

Figure 4. Evolution of GDP per capita (euro)



Source: own projections based on the data from Eurostat

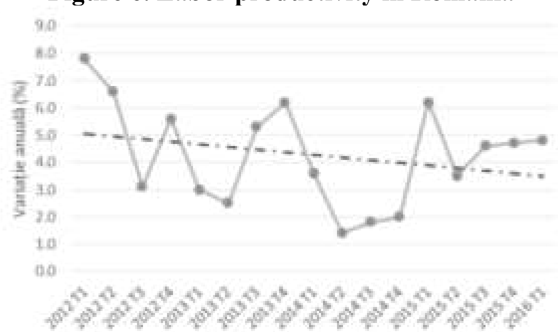
In addition the GDP per capita, expressed as a share of the euro zone average, increased 2.4 times, from 23% in 2000 to 56% in 2016 in Romania.

Although it is considered a necessary condition for the development of the country, GDP growth does not really show how well people live and how good the quality of life is. According to experts in the field, to measure the well-being of the population, the quality of human capital, the decrease of inequality and the structural changes that improve the quality of life must be considered. Measuring this development in a country is based on a composite statistical index of human development that is determined by the following three factors: life expectancy, the level of education and the income per capita. The value of this index (HDI) for Romania was 80.2% in 2015, with an EU average of 90.2% (the one before the last position in the EU, ahead of Bulgaria). In 2000, HDI was 70.7% (+9.5 pp in 2015).

Another indicator that shows the origin of the differences between the levels of the GDP in different countries is the productivity. Reviewing the literature it has been found that this indicator is a very important pillar for raising living standards and economic conditions. Beyond the differences imposed by the social structure, level of education in the analysed countries, and the fact that not all countries had the same starting point and the speed of development, the increase in productivity is an essential aspect of the progress of real convergence.

The development of productivity can be correlated with a number of factors, such as: productive enterprises are generally large, which belong to the private sector rather than to the public sector, with foreign capital; the high degree of competition on the domestic and foreign markets. Also, the quality of human capital is important, intuitively, but also from econometric estimates, it results that firms with a larger share of employees with technical abilities are more productive.

Figure 6. Labor productivity in Romania



Source of INS, NBR calculations, own data processing

The above figure shows labour productivity in Romania, which on average has a downward slope since 2012, and fluctuations are high from one year to another, indicating some instability in the labour market. Currently, there are very large differences between the regions of the country in terms of productivity and salary levels. In the economic theory, the increase in real wages is based on high productivity. A superficial increase in electoral cycles is unsustainable and entails large macroeconomic imbalances. Therefore, even a nominal revenue growth that does not mirror an increase in the production of goods and services does not solve the vital problem of poverty.

Another very important aspect is that in Romania according to Eurostat statistics, there is a part of the employed population living on the brink of poverty. In conclusion, productivity is an indicator that actually measures the economic situation in a country. Together with a financial stability an economy can prosper.

4. Conclusions

In conclusion, fulfilling the economic convergence criterions, both nominal and real, through the use of appropriate monetary and fiscal policies, is an important starting point for achieving sustainable development. Given the limitations of monetary policy, fiscal policy carried out by national authorities plays a significant role.

After analysing the data, it can be concluded that at the level of the nominal convergence criterions the CEE countries are within the normal limits. Regarding the indicators for real convergence, countries such as Romania and Bulgaria do not meet the requirements such as productivity or GDP per capita. These countries must therefore recover these gaps and the solution also comes from a high degree of absorption of European funds. Concerning the accomplishment of the sustainable development goal, these countries need to meet several indicators for economic growth on the long run.

Expected effects, namely reducing poverty, increasing employment, productivity and investments, imply coordination among the monetary and fiscal policies. From the perspective of the monetary policy it is necessary to reposition the objective of price stability towards financial stability by mobilizing all resources in this direction. On the other hand, fiscal policy has the first step towards achieving and maintaining a stable economic growth.

The effects of the latter are reflected in the economic reality by implementing measures on the basis of tax revenues and by a better transparency in the way of collecting and spending public funds. Moreover, in addition to introducing environmental taxes, polluting consumer excise and regulating other taxes that lead to sustainable development, it is also necessary to measure the efficiency of public spending. Income from these taxes should be directed towards spending on poverty reduction, education and technological development. Another direction would be to support small and medium-sized companies and the development of entrepreneurship, which through services and goods offered would lead to sustainable development.

Likewise it is important that a strong economic growth doesn't jeopardize other aspects of sustainable development, such as environmental protection and social security. Taxes are the ones that shape the behaviour of the consumer and an education in this sense can lead to a decreased pollution. Reforming the public system by improving the work of public institutions should become a priority. It is also necessary to improve the public goods and services offered by the state.

In conclusion, the achievement of sustainable development takes place through the co-operation of monetary and fiscal policies with impact on the three pillars: economic, social and environmental.

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