

Mugur Isărescu: Building our place in Europe - young Romanians pushing the boundaries in technology

Opening speech by Mr Mugur Isărescu, Governor of the National Bank of Romania, at the conference "Building our place in Europe - young Romanians pushing the boundaries in technology", Bucharest, 24 October 2016.

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Ladies and gentlemen,

I am delighted to have been invited to address some of the best and the brightest of Romania's younger generation. I must say I am impressed that you have built such a strong community here in the UK, judging by the large number of people present and the fact that this reunion is at its ninth edition. I congratulate the Romanian Embassy in the UK, the British-Romanian Chamber of Commerce, the Rațiu Foundation and all the other entities involved in the organisation of this event.

I am happy to see that Romanian authorities, academia and non-government organisations are working towards strengthening the connection with Romanians abroad. We, at the National Bank of Romania, are also very interested to make use of the expertise of Romanians who have studied or worked abroad. Let me be more specific: we have now around 75 employees who either got post-graduate degrees at Western universities or have working experience in top European institutions, such as the European Central Bank, the European Commission or the Eurostat. Moreover, our internship programme is open to undergraduates studying abroad and we are glad to see increasing interest from such applicants. To sum up, our gates are open to those of you seeking a career at home. And even if you do not intend to pursue a career in Romania, there are other ways of collaboration. For instance, the NBR has been supporting the Annual Scientific Conference of Romanian Academic Economists Abroad (ERMAS), in partnership with major Romanian universities.

A recent personal experience, during a trip I took to Washington DC, confirmed the interest that many Romanian experts abroad share in staying in touch with their home country. There are more than 60 Romanian economists working for the World Bank, the IMF or the Fed. I have met around half of them and I saw how keen they were to learn not only about the Romanian economy, but also about changes in the society. Many were even eager to engage themselves in various cooperation projects with those working back home in their respective fields of activity. I truly found their enthusiasm and readiness refreshing!

Although idealism is not a trait one would usually associate with people my age, I confess that whenever I am addressing Romanians who are studying or have studied in the West, I cannot help but make the parallel with the revolutionaries of 1848, who engineered the rapid transformation of the Romanian society and created the modern state almost from scratch. Of course, that does not mean you are expected to build a new Romanian state as they did, but you can certainly act as a similar vector of change in the Romanian society, be it in social values, politics, economy or culture. Therefore, no pressure ...

Now, some of you must surely be wondering what a central banker like me and IT have in common.

I could hardly be described as an IT expert, but I am following developments in the sector, not only because they matter in the global economy (explaining a good deal of the productivity wedge between the US and EU starting in the mid-nineties, for instance), but also because the IT&C sector is increasingly relevant for the Romanian economy – its share in GDP is now nearing that of construction and its contribution has become instrumental in building a surplus on the

international trade in services. Solid technical skills, good command of foreign languages and certain versatility are assets that continue to attract investment in this sector in Romania. Although infrastructure quality, in general, is not a strongpoint for Romania, communication infrastructure is – we are enjoying some of the best speed for broadband internet connection in the EU if not in the world, not to mention that access is comparatively much cheaper.

The evolution of the IT sector is part of a wider process of sectoral shifts in the domestic economy, visible across several emerging markets: the services sector gaining ground to the detriment of agriculture and industry, whose roles have been diminishing. Likewise, industry has also shown structural shifts, i.e. the lower share of energy and labour-intensive sectors in favour of increasingly technology-intensive industries.

With the risk of touching on a delicate topic these days, given the location of this conference, I have to mention that EU membership has played a major role in Romania's development. And I am not saying that only because I was the head of the Government that started the EU accession talks back in 2000.

Across the years, there were a lot of discussions with regard to Romania's readiness for EU accession. Even Romano Prodi, the head of the European Commission at the time, warned me on several occasions that we were not ready for accession, not only from an economic and social point of view, but also in terms of people's mentality, which was not fully aligned with European values after four decades of communism.

I was well aware of that, but I also knew that it was imperative to have a target date, that would act as a catalyst for the much needed reforms. Indeed, much of the catching-up progress was obtained during the pre-accession years, as real GDP grew on average by more than 6 percent per year between 2000 and 2007. Significant institutional reforms were implemented in areas such as governance, competition policy, labour markets, privatisation and enterprise restructuring.

It is also true that, in order to comply with the accession preconditions, we had to take some measures a little bit faster than theory and other countries' experience would have advised.

I am referring, for instance, to the liberalisation of capital flows while still having a significant inflation differential and, therefore, a significant interest rate differential. We learnt before long how challenging it is for monetary policy to manage aggregate demand and expectations in a small open economy amid a flood of capital, particularly when having to cover also for an excessively loose fiscal policy. Some of the side-effects of liberalizing the capital flows are still haunting us today. I am referring here to the Swiss franc loans, which have lately become a thorny issue, even if the scale of the problem is by far the smallest among peer countries – less than 5 percent of the outstanding loans and just 2 percent of the total number of individual debtors at the time the problem erupted in early 2015. Its magnitude was from twofold to fivefold larger in Croatia, Poland or Hungary. I dare say the macro-prudential action taken by the National Bank of Romania is not unrelated to this outcome.

Turning back to the EU entry in 2007, all things considered, I could say that we probably caught the last train, especially in the new post-crisis environment. I don't think Romania would have looked the way it does today had we remained outside the European project.

I have already mentioned how important it was to have an anchor for domestic policies in a country where drifting from the set course tends to be the rule rather than the exception. If we add the contribution of EU membership to securing a more solid business environment, which allowed us to reap more fully the benefits of our competitive advantages, I guess it is pretty clear why I believe it was an inspired choice. Foreign investors started to look more confidently at the local economy, which became the destination of increased capital inflows – the flood I mentioned previously. Granted, part of them were volatile in nature or directed towards the non-tradable

sector. Still, some of these inflows were aimed to create or enhance production capacities or to set up businesses in tradable services, which were essential to securing welfare through job creation and increased income, the type of welfare that is more resilient when faced with worldwide volatility such as that seen during the crisis.

These positive developments continued to produce effects in the aftermath of the crisis as well, when Romania experienced an export-driven recovery, to which sectors on the receiving end of FDI inflows made a significant contribution, and which enabled progress in terms of income per capita. The indicator, expressed as a ratio to the EU28 average (the UK still included), currently stands at close to 57 percent (after around 41 percent in 2007 and just over 25 percent in 2000).

There is still very much room for progress. I say this having in mind the GDP per capita gap that is still substantial (and larger than those of most regional peers). In a scenario where Romania experiences constant 5 percent growth each year, while the EU grows on average only by 2 percent, it will take us 20 years to achieve full convergence. Under more pessimistic scenarios, I guess you don't want to hear how long it would take to catch up.

At this point, some of you may wonder why would anyone be pessimistic if local output currently grows at over 5 percent, at 6 percent in fact, in the second quarter of 2016, the highest rate in the EU? Well, as the effects of the recent fiscal stimulus wear off, GDP dynamics will come down, while additional stimulus, if implemented, will put even more at risk the already weaker fiscal position. Above all, growth needs to be achieved in a sustainable fashion, backed by productivity and while keeping fiscal and external deficits in check.

The lessons taught by the most severe teacher of all, the economic crisis, should not be wasted...

When I am talking about much room for progress, I am also referring to developments sometimes overlooked, especially if one has in mind only the aggregate figures.

More specifically, I am referring to the fact that EU accession benefits were not evenly distributed across the economy, as reflected for instance by rising regional divergence. Bucharest, alongside other important cities, as well as areas either in the proximity of the Western border or in which industrial clusters appeared, did much better than other areas, particularly those in the North-East, which are lagging behind.

The North-East of the country could constitute an attractive investment destination. As there are other regions where the gap between demand and supply of skilled labour is becoming more evident, firms have often encountered difficulties in overcoming the challenges posed by poor transport infrastructure – the one that makes us sigh. Because of the lack of investments, administrative units do not have an economic core and people have little choice but to move to a larger city or to another country.

This is perhaps the most important challenge Romania is facing right now and I see only one way of overcoming this: continuing to increase our competitiveness and productivity in such a way as to preserve macroeconomic balances and reduce inequality. No country can obtain sustainable economic growth by boosting consumption and undermining contractual discipline, but by implementing structural reforms leading to productivity gains. As Paul Krugman said “productivity isn't everything, but in the long run it is almost everything. A country's ability to improve its standard of living over time depends almost entirely on its ability to raise its output per worker”.

EU membership brought about economic progress and positive changes in the Romanian society. One example is student mobility, so that Romanian young minds have the opportunity of studying at universities abroad, which – I guess – brings many of you here today.

Your decision to study in a prestigious institution abroad is admirable, as moving away from your home country and studying in a language other than your own is definitely not the most convenient choice, yet it shows maturity, determination and long-term thinking.

There was a time when leaving Romania for a Western country was a definitive, even dramatic choice: it literally meant cutting all bonds with your native country and with everything it implied – family, friends, way of life, in general. Fortunately, times have changed: today's globalised world allows you to shape an optimal professional path, so that there are always sufficient degrees of freedom.

For instance, a young high-school graduate from the city of Galați/Piatra-Neamț can choose to complete his or her education in Galați, Bucharest, London or anywhere else in the world. Should he or she decide to study abroad, that does not necessarily mean leaving Romania for good. Upon completion of studies, he or she may decide that the best place to turn the gained knowledge to good account is actually the Romanian market. Or, in case of deciding to join the Western academic world, he or she may participate in joint projects with experts from Romania. It is better to keep all options open – you never know what window of opportunity may arise at some point in time.

After all, an emerging society – with niches still to be exploited and transformations to be implemented – provides more opportunities both for entrepreneurs and for top professionals when compared to a more developed society, which has already settled on a stable structure. It is precisely these opportunities, along with all guarantees implied by EU and NATO membership that make Romania an interesting place to work and live in, even sometime it may not appear to be so. I guess that the things you hear about Romania most often, covered in everyday news, sometimes show discouraging situations, yet many things are moving in the right direction.

To better understand this, it helps to think of the Romanian society in the late 19th and early 20th centuries. Ion Luca Caragiale, who lived those times, tells us in his brilliant literary work that corruption, lack of meritocracy and a general disregard for rules were part of everyday life.

Taking a step back from day-to-day reality (influenced by its mostly negative coverage in the media) and putting things into perspective, one realises that those times represented in fact one of the most successful periods in our country's development.

I believe that things are pretty much the same nowadays. I don't know whether you share my optimistic opinion and view, I do hope so, but either way, the fact that you are here on a Saturday shows that you want to stay connected, both with other members of the Romanian diaspora and with your home country.

Thank you for your attention and I hope that at the end of the day you will have plenty of reasons to consider it a day well spent.