# Mugur Isărescu: Convergence towards euro enlargement

Opening speech by Mr Mugur Isărescu, Governor of the National Bank of Romania, at the Conference "The Danube Triangle", Bucharest, 25 October 2018.

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Distinguished guests,

Ladies and gentlemen,

Allow me to welcome you to the National Bank of Romania. It is the seventh time that the National Bank of Romania hosts an ELEC Conference. It started in 2011 with “Renewable energy and transport infrastructure in the Black Sea Region”, a year later we talked about “Eastern Europe and the EMU: finding the optimal path for introducing the euro“. In 2013 there was the 3rd edition of the Danube Financing Dialogue. The following year the dialogue focused on “Agriculture and environmental protection in Central and Eastern Europe and their contribution to growth and employment“. In 2016 we discussed on “How the EU can generate a virtuous circle in the Black Sea Region – the case of food and energy security” and last year we debated on “the challenges for Eastern Europe in the present turmoil in the EU and EMU – persevering in the reforms and investing for the future”. As one could notice, the topics previously discussed during all ELEC Conferences have most certainly cast a new light on possible ways to handle the challenges ahead of us.

The European League for Economic Cooperation has stood out, ever since its foundation in 1946, as an independent network of business people who put their knowledge and influence together to extend European integration. The diversity and independence of its membership have always inspired ELEC to ask the appropriate questions and formulate coherent opinions, constantly having in mind the European interest.

This year’s ELEC conference promises to be equally interesting as it concentrates on “Convergence towards euro enlargement” and I am honoured to be one of the keynote speakers.

I salute the close cooperation between government officials in the region with high European officials, as well as with the private sector and prestigious organisations such as ELEC.

We should never allow ourselves to lose sight of the fact that these discussions aim to help us on a journey made for the benefit of all. And it is a journey that can only be made through constant and diverse dialogue.

Allow me to greet our renowned foreign guests: Baron Bernard Snoy, President of ELEC International, Wim Boonstra, President of ELEC Monetary Commission, Mr. Servaas Deroose, Deputy Director-General, ECFIN, as well as the distinguished speakers and panelists.

Ladies and gentlemen,

The same as the topics discussed in the previous reunions, “Convergence towards euro enlargement” is highly important and is worth debating at length. Let me start from the fact that euro adoption by the New Member States is a matter of when, not if, because they do not have an opt-out clause. The commitment to join the euro area is undeniable, yet how the complex process of ensuring the prerequisite economic convergence is conducted remains largely at the discretion of the authorities in candidate countries. In this context, the approach has varied both across time and across states.

Shortly after the new Member States’ accession to the European Union, the assumed target dates for euro adoption were very ambitious, although the fulfilment of some of the Maastricht criteria was still a long way ahead at the time. The more prudent stance manifest afterwards does not necessarily point to the inability or difficulty in complying with the nominal convergence criteria. Rather, it occurred after the beginning of the global crisis, when some of the benefits of euro adoption faded away, while the related costs became increasingly visible. We are therefore witnessing a substantially revised and more comprehensive approach to the euro accession process overall.

As regards the actual differences in countries' strategies, for some it might be puzzling that Bulgaria is thinking of joining the euro area sooner than Romania. It is true that these neighbouring countries have a lot in common, but there are also other things that set them apart (not only the Danube!). Bulgaria has a currency board in place and it is natural for it to contemplate euro adoption as a sound exit from this monetary policy arrangement (the adoption of which, two decades ago, meant half a step towards the euro area). By contrast, Romania pursues both a floating exchange rate and a direct inflation targeting strategy, the same as Hungary, Poland and the Czech Republic and, therefore, the approach is different, the changeover to the euro being more complex in this context. This is by no means to say that Romania is sceptical about euro adoption, but merely that it needs a comprehensive view, meant to ensure an adequate timing of this moment and a successful entry into the euro area.

While we are on the subject, it cannot be overlooked either that the New Member States having adopted the euro – Latvia, Lithuania, Estonia, Slovakia, Slovenia – are relatively small countries, with a different level of real convergence. Referring to countries that are currently in the process of adopting the euro, I myself am among those who stress the need for sustainable convergence, being aware that, in order to reap the benefits of euro area accession, several essential prerequisites have to be cumulatively met. The fact that nominal convergence criteria need to be fulfilled in a lasting – not accidental, forced or temporary – manner is just one aspect. Actually, the durability of convergence has been set forth in the Maastricht Treaty itself ("high degree of sustainable convergence" is the exact wording), but this "detail" has been taken too lightly for a while. Moreover, now it is obvious for everybody that real convergence is also essential for the sustainability of the entire process of euro adoption.

It is true that the opinions on the optimal level and even on the relevance of this factor for successfully joining a currency union are quite diverse. However, to attain a certain degree of per capita income convergence before switching to the euro is essential, as a large convergence gap may complicate business cycle management in the absence of independent monetary policy. But even the countries that are already euro area members should continue to increase their level of real convergence. In my opinion, the direction of the real convergence process and its sustainability and smoothness are just as important as its degree.

Romania has certainly come a long way in terms of economic convergence, a process whose inception is tied to the prospects of EU membership, witnessing a significant increase in per capita GDP as a share of the euro area average (based on PPS), from 31.7 percent in 2005 to 58.6 percent in 2017. Peer countries recorded a similar trend: Bulgaria went from about 33 to 47 percent, while the Czech Republic, Hungary and Poland, which started from a more advanced level, added 9 to 20 percentage points to the same indicator during 2005–2017. However, this process is still far from completion in these non-euro New Member States.

A smooth convergence path requires a combination of prudent macroeconomic policies (be they monetary, fiscal or macroprudential), even though in practice it is difficult to build support for such policies. In this context, allow me to mention that the concern of central bankers for achieving the price stability objective is not always consistent with the desideratum of fast economic growth. This sometimes gives the impression that central bankers are over-conservative and limit the stepped-up development of national economies. The fear of inflation tends to be dwarfed by the desire for quickly-gained prosperity and the central banks' "obsession with stability" may be seen as a refusal of progress.

Coming back to macroeconomic policies, in order to increase their effectiveness, they should go hand in hand with structural reforms aimed at providing for a more flexible economic environment, so that their combined usage paves the way for a smooth and long-lasting convergence of living standards. In other words, countercyclical policies and structural reforms are not at odds, but in a relation of complementarity.

In general, structural reforms are critical for strengthening convergence, ensuring durable growth and making the economy more flexible in order to benefit from euro area entry, as the advantages of euro adoption are not unconditional. What exactly do we mean by structural reforms? As Draghi said in 2017, for many, they describe a pragmatic policy agenda to raise long-term growth and accelerate adjustment to shocks, which is essential for countries in a monetary union; but for others, the term is viewed as a "catch-all" for a wide range of policies, some of which have potentially negative short-run costs and adverse distributional effects.

One area that would definitely benefit from the implementation of such reforms is the labour market, at a time when the Romanian one faces challenges that are certainly not new or uncommon. Given our status of an open catching-up economy, within a European Union which has at its core the free movement of capital and labour, we were bound to end up sooner or later in somewhat of a dilemma. To be more specific, there are various opinions in our economy about where wages should be: on the one hand, they should be governed by productivity dynamics, so as not to lead to an erosion of the competitive position, yet on the other hand, they cannot be significantly below what is available in other economies, as it would simply lead to a labour force drain, with dramatic consequences if not addressed quickly. We are actually dealing with an emigration problem today, as more than three million Romanians (a significant percentage of the population) have left their homeland for other EU Member States.

In order to mitigate this, wages should go up. As noted above, the only way to do that without upsetting competitiveness is to boost productivity. This can be done along a number of avenues, many of them involving, however, a significant amount of time (for example, one cannot solve the population-aging problem overnight).

Foreign direct investment in recent years helped total factor productivity, but employers are currently being challenged by the shortage of labour force, in part determined precisely by the significant emigration. As a result, we can even talk now about discouraged employers, as opposed to the periods that follow a crisis, when the employees are the discouraged ones. Thus, we have ourselves another dilemma: ensuring that wage levels are compatible with attracting investors, but acknowledging that, at least in certain areas, wages need to come up at present, in order to mitigate the labour force drain, which affects the private and public sector alike. The key is, in my opinion, to increase wages at an adequate, sustainable pace, so as to ultimately benefit from an improved living climate reflected in a higher purchasing power, but also from preserved macroeconomic equilibria, as well as higher-quality public goods – roads in particular –, because, after all, wages are not the only part of the emigration story.

Speaking about roads, I would like to point out that infrastructure is essential for connecting different regions of Romania and promoting cohesion. This is all the more important that, even though EU membership has acted as a catalyst for country-level real convergence, the development gaps across the regions of the New Member States, including in Romania, have not diminished significantly.

Let me conclude by recalling the words that Otmar Issing said during a dinner speech on his leaving the ECB, back in 2006, when things seemed to move into the right direction all by themselves: "We were all privileged to participate in a historically unique experiment: the creation of a new currency for Europe. We had to manoeuvre through uncharted waters and we may not yet have arrived in the Promised Land". It is obvious that for a smooth economic catch-up it is important to maintain a long-term perspective and to implement coherent policies and reforms.

Past achievements in nominal and real convergence, while significant, do not guarantee future success (for instance, joining other countries in the middle-income trap is a real danger). A realistic and balanced approach to euro adoption implies that it should be steered taking into consideration absolutely all relevant elements for the sustainability of economic convergence. It is the only way we can safely sail to the port of destination…

Thank you for your attention and I wish you lively, yet equally fruitful debates!