Good Governance Summit

Romanian Perspectives on Good Governance

Governance in a Central Bank of an EU Member State. The case of Romania

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Contents

Guidelines for good governance deriving from ESCB membership

Governance guidelines and benchmarks

- The National Bank of Romania is one of the 28 members of the European System of Central Banks since joining the EU in 2007
- ESCB membership automatically implies accepting a common set of principles, rules, laws and customs
- Good governance should be judged against a goal: the EU Treaty sets price stability as the primary objective of the central banks
- Independence of central banks is an institutional prerequisite and has four dimensions: functional, institutional, personal, financial
- Prohibition of monetary financing of general government imbalances
- Importing good practices via:
  - ✓ Participation in various ESCB bodies at different levels (from the ECB General Council to ESCB working groups)
  - ✓ Implementing EU legislation and guidelines on bank regulation, supervision and resolution

Independence does not mean lack of accountability or transparency

- The NBR publishes an Annual Report, submitted to Parliament
- A quarterly Inflation Report and a half-yearly Financial Stability Report are also published and presented in public conferences
- The calendar of Board meetings on monetary policy issues is published one year in advance
- Monetary policy decisions are announced via press releases and presented by the Governor during press briefings
- The reasoning behind the monetary policy decisions is also made available through the minutes of the Board meetings

Is good governance confined to obeying rules?

- The ESCB principles – preconditions for good governance: they are necessary, but not sufficient

- Good governance in practice is about more than strictly complying with a playbook

  - ✓ Making appropriate decisions when faced with changing or multifaceted circumstances requires flexibility and creativity

  - ✓ Olivier Blanchard (2006): "Monetary policy must be closer to art if it is confronted to new, poorly anticipated and poorly understood, contingencies. In that case, each of these contingencies requires fast thinking and having to make decisions not fully based on existing research, but rather on well trained intuition"

- The benchmarks for good governance in a central bank depend on the particular functions it is required to perform

Introducing the National Bank of Romania

- Besides the traditional tasks related to monetary policy and currency issue, the NBR is entrusted with a number of other activities, which are not performed by all central banks:
  - ✓ Bank supervision (not a task of central banks in Austria, Denmark, Finland, Poland, Sweden, for instance)
  - ✓ Issuance of secondary legislation concerning bank regulation
  - ✓ Involvement in macroprudential policy (unlike central banks in Finland and Sweden)
  - ✓ Balance of payments survey (not a task of central banks in Denmark, Ireland, Finland, Malta and UK)
  - ✓ First appellate authority for sanctions on credit institutions

- By contrast, the NBR is not responsible for:
  - ✓ Financial services consumer protection (a task of central banks in Italy, France, Hungary, Portugal, Spain, for instance)
  - ✓ Supervising the capital and insurance markets (a task performed by the central banks in the Czech Republic and Hungary, for instance)

A challenge: choosing the right moment for euro adoption

Euro adoption: A challenge for good governance

- From a legal perspective, euro adoption is a done deal
  - ✓ With the exception of UK and DK, there are no other opt-out clauses from the EMU
  - ✓ For Romania, the question is **when,** not **if**
- Nevertheless, states can still control when the legal commitment materializes
  - ✓ *De facto*, there is considerable discretion in managing the economics of euro adoption, in spite of the *de jure* commitment to adopt the single currency
  - ✓ Setting the entry date into ERM II (Sweden)
  - ✓ Formally, the entry date is conditional upon fulfilling the nominal convergence criteria
  - ✓ The Treaty requires a “high degree of sustainable convergence” before a Member State is able to adopt the euro

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 -0.1% (average of the three best performing Member States*)	**-0.5** (March 2017)	Yes
Long-term interest rates (percent per annum, annual average)	≤2 pp above 1.6% (average of the three best performing Member States in terms of price stability*)	**3.4** (March 2017)	Yes
Exchange rate (vs. euro)** (percentage change)	±15 percent	**+0.9/-2.9**	Yes
General government deficit*** (percent of GDP)	≤3 percent	**3.0**	Yes
Government debt*** (percent of GDP)	≤60 percent	**37.6**	Yes

*) Croatia, Ireland, Slovakia.

**) Maximum percentage deviations of the bilateral exchange rate against the euro from its March 2015 average level in April 2015 to March 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 March 2015.

***) 2016; ESA2010 methodology.

Source: Eurostat

Euro adoption by NMS: from compliance with the Maastricht criteria to choosing the right moment

2004

- The initial concern related primarily to fulfilling the **nominal convergence criteria**
  - ✓ As laid down in the Maastricht Treaty

2006

- Stronger focus on the **sustainable** compliance with the criteria
  - ✓ In the case of Lithuania, it was not the 0.1 pp overshooting of the inflation rate criterion that prevented its accession to the euro area starting 2007, but rather the lack of sustainably low inflation
- Changes in the **cost/benefit ratio** of joining the euro area *(not only benefits*)

Post crisis

- The issue of sustainable convergence gained more weight in the debate, hence the **increased importance attached to achieving a certain level of real convergence** (measured by GDP/capita)

The change of attitude towards euro adoption is also underpinned by country-specific considerations

- 5 NMS already adopted the euro: Slovenia (2007), Slovakia (2009), Estonia (2011), Latvia (2014), Lithuania (2015)
  - ✓ Small countries (Bucharest size, for the most part)
  - ✓ Mostly fixed or quasi-fixed exchange rate regimes in place
  - ✓ Relatively high level of real convergence
  - ✓ Geopolitical considerations played a part in the Baltics' case
- Larger countries with a flexible exchange rate regime such as Hungary, Czech Republic, Poland and Romania are more cautious as regards euro adoption
  - ✓ The euro adoption is a fundamental shift in the *modus operandi* for an economy which currently has in place a flexible exchange rate and enjoys an independent monetary policy

None of the non-euro NMS have currently announced a target date for euro adoption

	Initial target	Date of setting the initial target	Current position
BG	2010	2004 – Pre-accession Economic Programme	No target date
CZ	2009/2010	2003 – Czech Republic's Euro Accession Strategy	No target date
HU	2008	2003 – Pre-accession Economic Programme	No target date
PL	2008/2009	2003 – Pre-accession Economic Programme	No target date
RO	2014	2007 – Convergence Programme	No target date

Why caution as regards euro adoption?

- A single currency area is no place for economies with competitiveness issues or rigid markets, therefore structural reforms are a prerequisite for success
- The advantage of lower borrowing costs can no longer be taken for granted
  - ✓ Lower pre-crisis risk premia appear now to have been largely the result of the widespread mispricing of risk at the time
  - ✓ Markets started again to evaluate risk on a country-by-country basis
- Strong trade integration with the euro area was achieved irrespective of having adopted or not the single currency
- CEE economies with floating currencies went through relatively milder economic contractions than those with fixed exchange rate regimes
- There are now direct costs associated with the sovereign debt crisis and the crisis resolution mechanisms
  - ✓ Politically difficult to justify to the general public contributions made to the benefit of relatively richer countries (see the collapse of the Radičová government in SK)

A longer waiting period may be warranted given recent historic experiences (Greece)

- Nobody disputes that in the long term it is in the best interest of countries to adopt the euro
  - ✓ High degree of business cycle correlation and market integration
  - ✓ Entry in a stability zone
  - ✓ Avoiding being left out of the EU core

- Yet the benefits of euro adoption are not unconditional, therefore it is important:
  - ✓ To make sure that nominal convergence criteria are achieved on a sustainable basis
  - ✓ To attain a certain degree of per capita income convergence before switching to the euro
    - a large convergence gap may complicate business cycle management in the absence of independent monetary policy
  - ✓ To demonstrate the effectiveness of the new institutional setup in preventing and dealing with looming imbalances
    - it is important that alternative policy instruments exist in order to take over from monetary policy in case corrections are needed

Statements reflecting the more cautious approach to euro adoption in non-euro EU countries

Czech Republic

- "I am convinced the question of [euro] adoption ... is not whether we will accept it but how to time adoption well." (Bohuslav Sobotka, Prime Minister, October 2016)

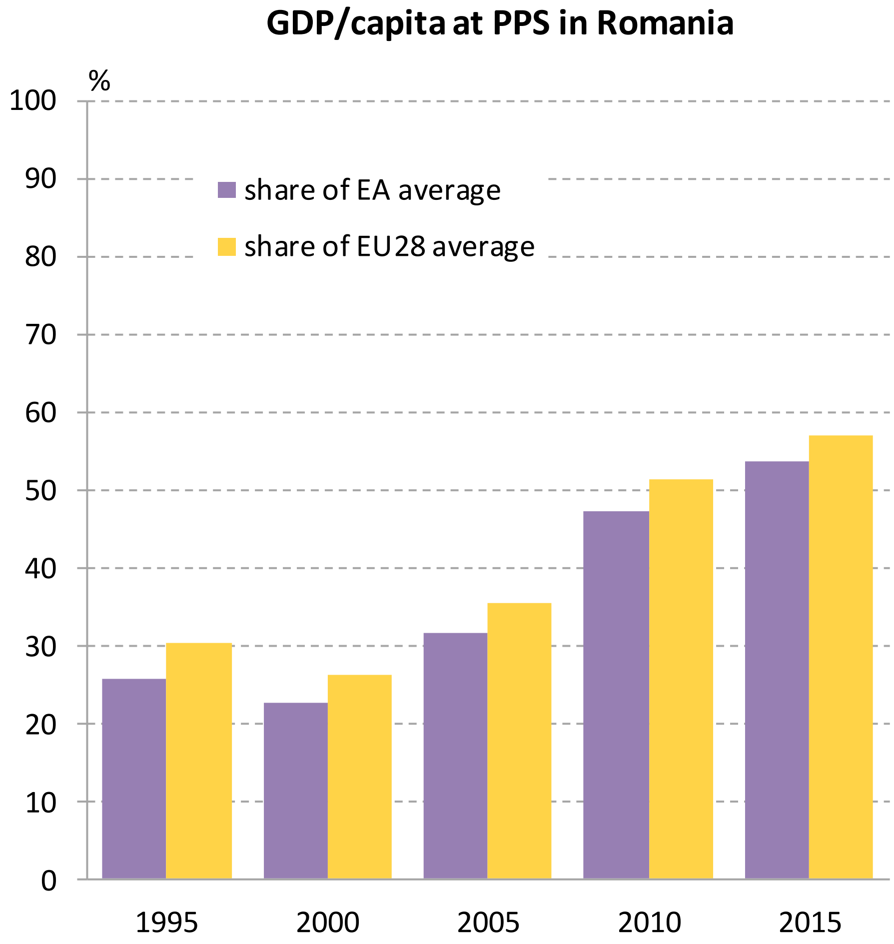
Hungary

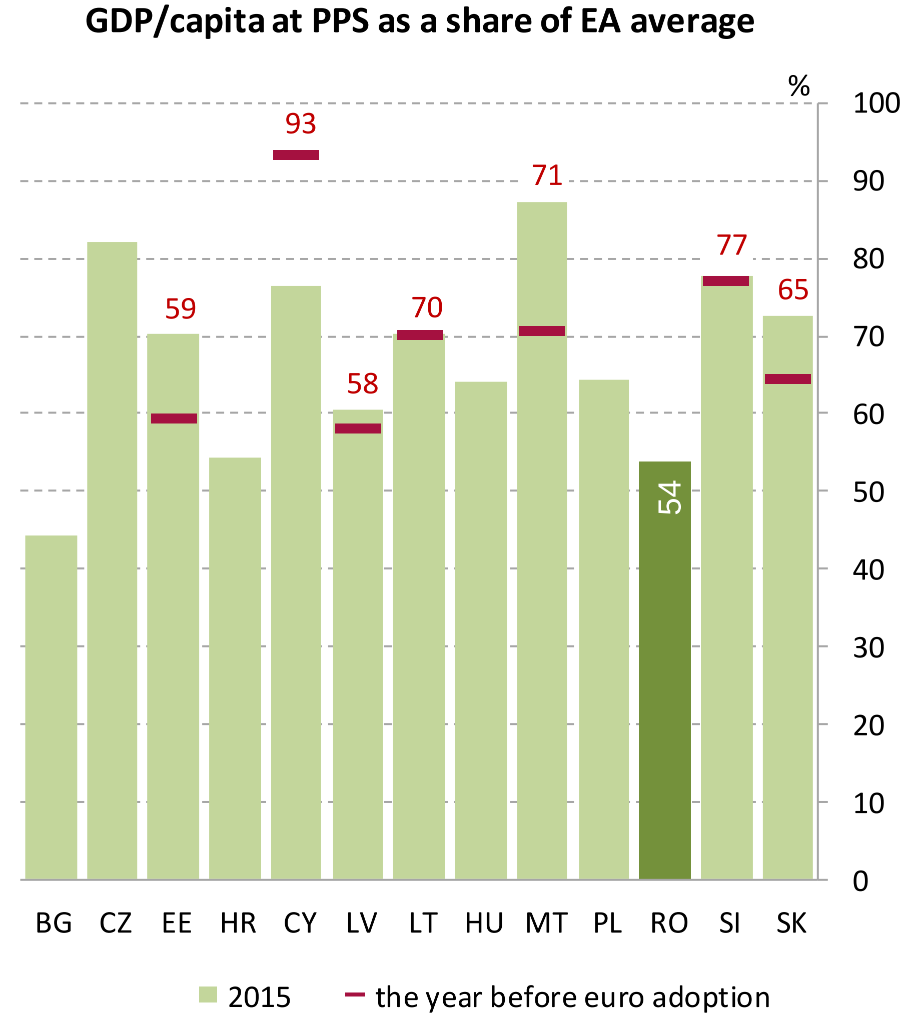
- "Hungary cannot seriously consider joining the euro zone until the country's average economic development reaches 90 percent of the level of euro states." (Viktor Orbán, Prime Minister, April 2013)

Poland

- "You shouldn't rush when there is still smoke coming from a house that was burning. It is simply not safe to do so. As long as the eurozone has problems with some of its own members, don't expect us to be enthusiastic about joining." (Marek Belka, NBP Governor, July 2015)

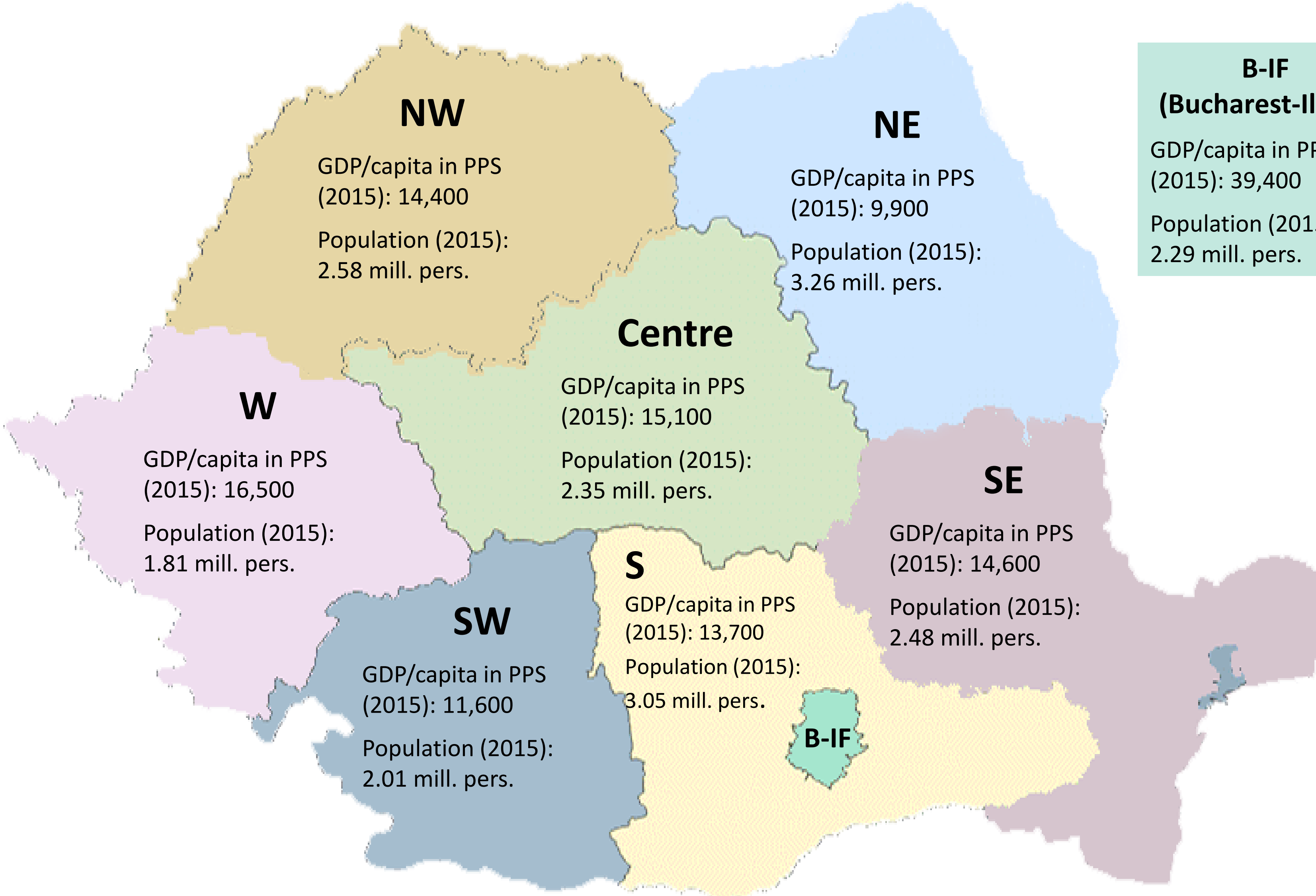
Romania: Compliance with nominal criteria since July 2015 and steady real convergence trend





Source: Eurostat, NBR calculations

Still, disparities between Romania’s regions remain significant



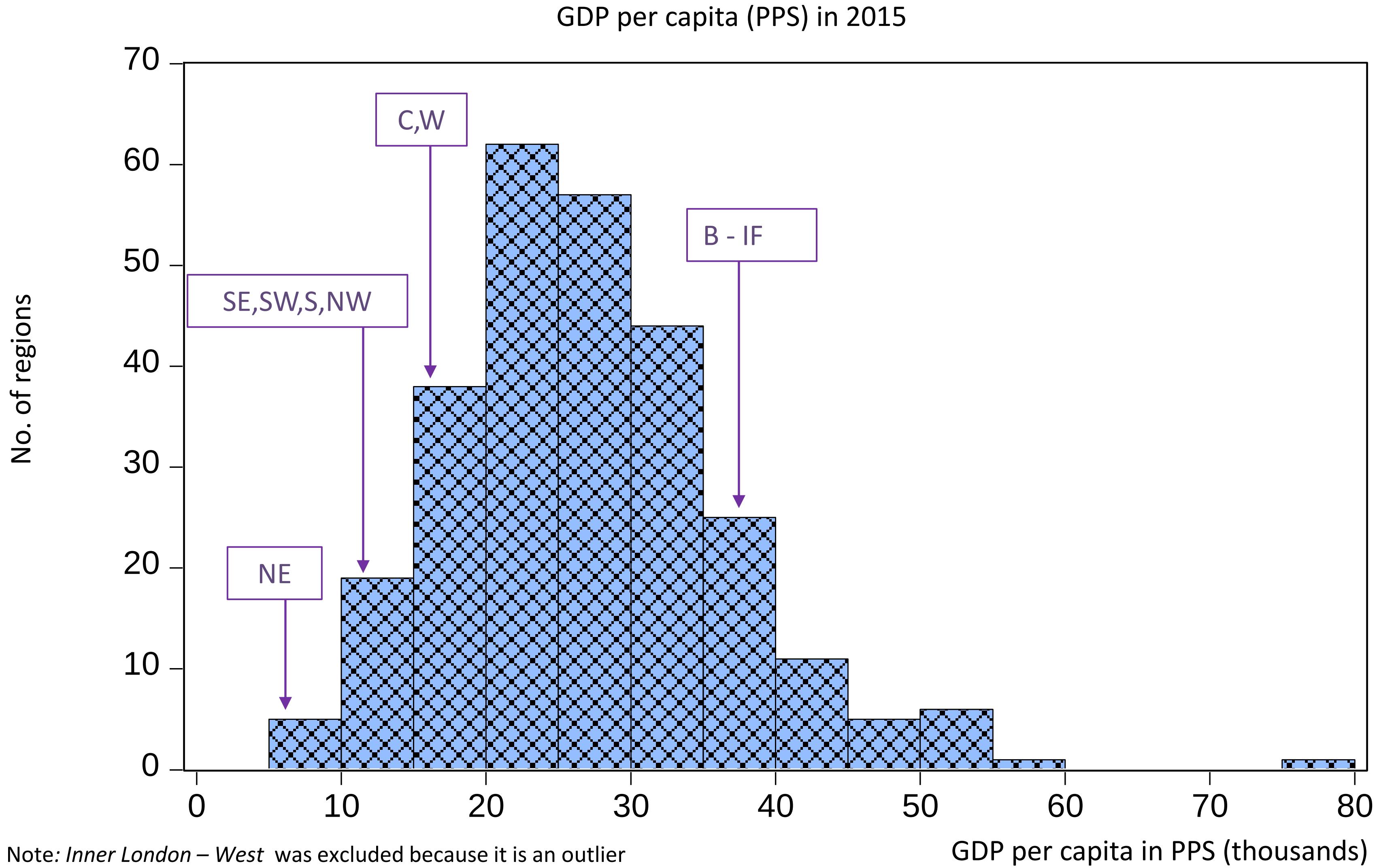
B-IF (Bucharest-Ilfov):

GDP/capita in PPS (2015): 39,400

Population (2015): 2.29 mill. pers.

Source: Eurostat

Most of Romania's regions are in the left tail of the income distribution in the EU



Note: *Inner London – West* was excluded because it is an outlier

Source: Eurostat, NBR calculations

A concrete task for good governance for euro adoption in Romania: alleviating regional disparities

- The dimension of inter-regional development gaps should not be overlooked when assessing real convergence
  - ✓ Romania is the EU Member State recording the highest disparity across regions
  - ✓ The poor infrastructure connecting historical provinces favours the concentration of investment near the western border and the persistence of development gaps
    - both EC and IMF analyses point to the lack of infrastructure as a major obstacle to economic growth
    - a recent IMF assessment shows that the annual growth in potential GDP may be increased to about 4.5 percent provided that EU fund absorption is adequately maximised
      - EU fund utilisation is associated with more efficient public investment and allocation of these funds targets areas where Romania is seriously lacking in such investment (e.g., large infrastructure) → the role played by the EU funds in underpinning lasting economic growth is of the essence

By way of conclusion

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- ESCB membership provided the NBR with a valuable set of benchmarks that shaped the way its activity was conducted over the last decade

- Good governance implies more than mechanically applying the textbooks and playbooks, as the day-to-day reality often proves more complex than imagined by theoreticians

- Without promoting a discretionary stance, economic policies should be formulated and implemented in a flexible manner

  - ✓ Remarkable progress in monetary theory has been achieved in the last decades and, from this perspective, monetary policy is much closer to science than 30 years ago

  - ✓ However, the global crisis has exposed the limits of our knowledge and the fact that monetary policy is still very far from being a science