Galileu
Revista de Economia e Direito
Vol. X, n.º 1, 2005, pp. 25-36

What should Romania expect for? A few comments on the subjects of convergence, cohesion and divergence in the EU

Adriana Zait[1]

1. Context

With the Maastricht Treaty as a guide, starting with January 1st 1999 (the official start of the third stage of the European Economic and Monetary Union), a train travels across Europe, with stops in the railway stations of the member states, the newly entrant countries and those still waiting for the future integration. In order to get in, countries have to meet specific rules: (1) budgetary deficit less than 3% from the GDP, (2) public debt less than 60% from the GDP, (3) price stability and medium inflation rate, no more than 1.5 points bigger than the average of the three most performant member states (in terms of price stability), (4) interest rate on long run not more than 2 points higher than the average of the three most performant member states and (5) exchange rates that fluctuate within the normal limits established by the European Monetary System, without severe tensions for at least the last two years. If these conditions are not met, a country cannot get into the train – even "older" members know this (the cases of Greece and Spain are well known). But integration and convergence are different things – the convergence criteria are not integration criteria, and being part of the EU does not necessarily mean being also a part of the EMU. The Growth and Stability Pact is clear: countries which cannot participate to the monetary union have to present a Convergence Program, receiving important structural funds in order to pursue this objective; if, once in the train, convergence conditions cease to be fulfilled, the country will be politely invited to get off! How close, or how far is Romania from the moment of catching this train? Would Romania be able to get in and preserve its place? But this is just one side of the convergence picture, or just one of the trains that could be used for travelling inside enlarged Europe. Is nominal

1 Professor Dr., Management-Marketing Department, Faculty of Economics and Business Administration, Universitatea "Alexandru Ioan Cuza" Iani, Romania, e-mail: azait@uaic.ro

convergence a priority, just because it represents an EMU integration criterion, or is real convergence more important, since this is a long term desiderate for every country? Are convergence objectives realistic? Should they be changed for the new entrant countries? Can nominal and real convergence dilemmas be solved? Apart from all these metaphoric discussions, the economic reality stands cold and non-impressed: Romania seems to fulfill the integration criteria, can hope to probably fulfill, with big efforts, the nominal convergence criteria, and is far away of a real convergence. What should Romania expect for, in these conditions?

2. About convergence – conceptual aspects

There are different meanings for the concept of convergence. First of all a distinction is made between nominal and real convergence. *Nominal convergence* requires a gradual fulfillment of the Maastricht Treaty criteria, in order to participate to the third round of the economic and monetary union; it is all about the convergence of those key nominal variables that reflect a certain degree of macroeconomic stability. *Real convergence* supposes, generally speaking, gradually closing the gap, in terms of real macroeconomic variables, between the economic and social levels of development of analyzed countries – the initial EU countries, the newly entrant countries, the candidate countries; it does not represent a compulsory criterion. There are many voices that claim that nominal and real convergence criteria are in conflict and cannot be set as simultaneous objectives (see the Balassa-Samuelson dilemma). Further more, many specialists consider that real convergence criteria should actually be a priority, and only than should nominal convergence criteria be dealt with; others, though, support the present EU decisions, considering that nominal criteria are the most important ones, in order to rapidly accede to a monetary union, and after this the problems of the real convergence can be approached. In a somehow integrative view of the two concepts, other specialists talk about a sustainable convergence (Padoa Schioppa, 2002).

Real convergence has many meanings, as well. In a very *large sense*, we talk about real convergence when there are similarities in the performance patterns of different national economies, on long term, or a certain synchronicity of their business cycles. In a *narrow sense*, real convergence occurs when the developmental gaps and the gaps in the level of GDP for different countries are decreasing. For this last type of real convergence we speak about at least three different sub-types, such as:

- *Beta convergence* – on long term, poorer economies grow faster than richer ones, so that it is possible to obtain a certain alignment of macroeconomic variables. Testing such a convergence needs an analysis of the evolution of GDP per capita for the targeted countries (regression equations for the increased GDP per capita towards an initial level for a group of analyzed countries). There is an *absolute beta convergence*, as well as a *conditioned beta convergence* – the tendency of the analyzed countries to converge on their individual equilibrium paths on long term as a function of a certain number of preconditions or conditional variables.
- *Sigma convergence* – the tendency of the dispersions of per capita GDP (measured by the standard deviation) to decrease over time, for a certain group of countries. For a sigma convergence, the beta convergence is a necessary, but not sufficient condition; a progress in the case of sigma convergence is a function not only of the differential rates of growth between more developed (richer) and less developed (poorer) countries, but also of the initial gap between the GDP levels for the analyzed countries.
- *Gamma convergence* - more recent concept (Boyle and McCarthy, 1997 and 1999 – after Martin and Velazquez, 2001), that supposes the utilization of a Kendall index of rank concordance in testing for beta convergence, measure considered more appropriate for capturing the potential mobility of countries (or regions across a country) as far as the distribution of GDP levels in time is concerned.

None of the forms or calculus procedures for real convergence is considered superior to the other ones; one can use one technique or another according to the available data, on one side, and the purpose of the analysis, on the other side. The same diversity of opinions can be noticed in the selection of the variables used to determine the degree of real convergence. These variables can be:

- the level of GDP per capita
- the unemployment rate (as a complementary variable)
- the social protection expenditures as a percentage of GDP
- the stock of human capital
- the stock of technological capital
- the stock of physical capital
- the transportation and communications infrastructure, as part of the physical capital
- certain indicators of the institutional quality

- certain combinations of these variables.

Moreover, when data concerning GDP per capita are not reliable or cannot be obtained, alternative approaches can be used (Economic Survey of Europe, January 2000), such as:

- the calculus of the purchasing power parities (PPP) for groups of countries
- using certain physical indicators as a base for the calculus of internationally comparable GDP
- the reevaluation of some national data in order to eliminate distortions (deflation, imposing price structures etc.)
- using hybrid approaches, combining the above mentioned ones.

All this diversity of opinions, variables and approaches makes almost impossible for someone to obtain significant and reliable comparisons between the results of different studies, so that generalized conclusions regarding real economic convergence could be obtained.

3. Theories and models of economic growth and convergence – confluences

All the different theories of economic convergence are related, of course, to the different theories of economic growth.

Neoclassical theories, for example, sustain the idea of absolute convergence, possible especially because inequalities in revenues stimulate investments and growth, and so these inequalities become practically growth engines.

According to *neo-liberal theories,* initially gaps become more important, but than they narrow down, so that from a period of economic divergence we can arrive to one of economic convergence, an evolution similar to the Kuznets curve; moreover, it is possible to have technological leaps for the poorer countries, the so called leapfrog, that allow less developed countries to catch up with the more developed ones. In this category could be also placed some of the new economy thought type theories, that stress the influence of the demand side factors on capital, having as effect a certain transfer of the capital towards the poorer countries; so, again, convergence is possible, and this is how one could explain the increased gaps from the last two centuries and the signals of a decrease in gaps in the last years (Lucas, 2000, according to Rapley, 2001).

The augmented neoclassical theories are more reluctant in supporting the idea of economic convergence. Having as growth engines the human and physical capital, and the exogenous technological progress, universally valid, it is possible to obtain a certain degree of convergence, but it would be an extremely slow convergence and especially a conditioned one, registered by those clubs of countries with similar social and economic structures. In order to obtain convergence, governments have a crucial role, for the formation of the social capital, for investments in education, high saving rates, political stability, and minimum of corruption. The main adepts of these theories Barro, Mankiw, Romer, Weil, Sala-i Martin, Armstrong (Martin and Sunley, 2000).

According to the *theories of endogenous growth* – the most pessimistic or the most realistic ones? – convergence might never be attained! There are two big groups of theories or models of endogenous growth (Crafts, 1996, after Martin and Sunley, 2000) – those of the endogenous capital, respectively those of the endogenous innovation. For the first group we talk about models of *"endogenous broad capital" type*, according to which capital investments generate externalities, becoming engines for a cumulative divergence, possible to control through the governments' actions (governmental expenditures and taxes), respectively about models of *"intentional human capital" type*, which emphasize the role of investments in education and training, from the part of individual agents, capable to lead to development through "learning by doing" effects and "knowledge spillovers"; in this case, convergence depends on the profitability of investments, on the public policy and the patterns of industrial and commercial specialization. To the second group belong the models of *endogenous schumpeterian innovation,* which consider that the technological innovation is possible through the actions of oligopoly producers and there are certain diffusion, transfer and technological imitation processes. As a result, situations of persistent divergence can occur, certain clubs of convergence being, however, possible, as well as a certain catching-up effect.

Finally, *the models of regional growth* (initially supported by Perroux, Myrdal, Kaldor) consider, at their turn, the existence of long term divergences, due to some processes of cumulative concentration of the capital, so that the regional development is rather self-reinforcing.

4. Further debates on the subject of convergence

An analysis of the extremely diverse amount of studies published in the generous and controversial field of convergence in the context of the European integration reveals the persistence of some supplementary subjects of discussion, beside the definitional ones or those related to the economic theory. Very often there can be found subjects as:

- The *Balassa – Samuelson dilemma,* concerning the possibility of reaching both nominal and real convergence. As far back as the 60's, Balassa and Samuelson alert specialists about the dilemma that less developed countries face, when they try to catch-up with the more developed ones: a rapid growth in productivity has negative impacts upon inflation, on one side, and on the other side, a rapid adoption of Euro can generate an inflation rate superior than the one targeted through the Maastricht criteria, thus determining a conflict between the goal of achieving the nominal convergence and the goal of achieving a real convergence. Recent studies (Begg, 2001, after De Grauwe and Schnabl, 2003) suggest that the dilemma is confirmed for the CEE candidate countries (as a matter of fact, Ireland has already experienced this dilemma, and so is Estonia, the process being started in Poland, as well). The negative shocks associated to a very tight monetary and fiscal policy, required by the Maastricht criteria, can be extremely powerful and, moreover, they can have permanent effects (hysteresis type), especially for poor regions, beside the effects produced by the assignments assumed through the Stability and Growth Pact (Danson, 1999). Despite all these, UE considers that the objectives of real convergence and those of nominal convergence can and should be followed in parallel (Padoa-Schioppa, 2002). Solutions, at least realistic ones, are not abundant. The easiest one would be to renegotiate some of the Maastricht Treaty criteria, especially the one concerning the exchange rate (McKinnon 1984, Szapary, 2000, Buiter and Grafe 2002, after De Grauwe and Schnabl, 2003), the arguments being rather common sense related ones – the initial criteria were established having in mind the reality from countries with similar structures and economic stages of development, and we would need adjusted criteria for the new members or the candidate countries. No matter how "elegant" (according to specialists) this solution is, it is a rather unrealistic one, as far as the probability of being applied by the EU is concerned. Another solution suggested by some specialists (ibid.) would be that of a certain derogation from the inflation criterion for those countries for which the Balassa – Samuelson effect is very strong. None of this solution – the renegotiation or the derogation – is appreciated at the Central European Bank level. Therefore, only the so called "tough" solutions could be applied, such as restrictive macroeconomic policies – very tight financial policy, with the risk of a significant temporary recession, or gradual nominal appreciation in the ERM2 corridor, with less severe effects on output and, apparently, less failure risks in terms of time and dosing of the policy (De Grauwe and Schnabl, 2003).

- Is the enlarged *European Union an optimum currency area - OCA?* This is a tough question, despite the obviously positive answer expected or wanted. Developed during the 50's, the OCA theory has already been through several different phases (Mongelli, 2002): pioneer years, 1950-1960; cost-benefit analysis, during the 70's; reassessment, the 80's- 90's; and empirical – the last 15-20 years. Debates advanced, gradually, from the field of exchange rates (fixed or floating), through that of the structural characteristics of an economy, to that of the monetary integration and the establishment of an optimum border for the unique European currency. There is no equal sign between OCA and EMU, since the two concepts respond to different questions; OCA supposes the delimitation of the optimal geographic area for the common currency, while EMU requires the definition of the optimal economic and monetary competencies for the previously delimited geographic area, as well as the establishment of an optimal pace of monetary integration (Mongelli, 2002). Since the risks of a premature inclusion of a CEE country in the Euro zone can not at all be neglected (asymmetric shocks, losing the instruments of the monetary policy and the exchange rate, unemployment and decline of the economic growth etc.), candidate countries try to establish different scenarios – more or less optimistic, pessimistic or realistic – by putting into balance risks and benefits. Many of the newly entrant countries seem to be rather optimistic (Lavrac and Zumer, 2003). Romania is in the phase of building scenarios, rather optimistic, as well.
- *Are cohesion and diversity possible through convergence?* Debates on these issues started with the first Report on the Economic and Social Cohesion of the European Commission, in 1996. (Danson, 1999) Theoretically, the two objectives mutually potent each other; in practice there are often many tensions, determined by the diversity of economic structures, by *core-periphery patterns* (huge regional disparities), by phenomena of *spatial polarization* (metropolis and the rest of the national territory) and by the huge regional inequalities from the transitional economies. The core-periphery patterns (with significant differences in terms of economic development and standards of life, especially unemployment rates and net migration), have been already experienced by the initial EU members and they seem to be extremely rigid, with sustained disparities in time, with present structures not being much different from those in place in the 70's or in the 90's; these

facts rise significant question marks concerning the process of economic cohesion and real convergence at the EU level.

- *Consecutive or simultaneous periods of economic divergence or convergence?* In connection with the polarization process, there are also debates regarding the alternative systems for periods of economic divergence and economic convergence at the EU level (Molle and Boeckhout, 1995, from Danson, 1999). O part of the specialists supports the idea of consecutive periods of divergence and convergence (Barro and Sala-i-Martin, 1991), stating that all countries experience first a process of divergence, and only than one of convergence; as arguments they bring the connection between disparities and the short term regional or national shocks, which take longer periods in order to be absorbed (and thus making convergence possible). Others support the idea of simultaneous economic divergence and convergence processes (Boltho and Holtham, 1992, from Danson, 1999) so that, at the same time, certain countries or regions experience a convergence process while other countries experience a divergence process. This is how the idea of a certain convergence process at the EU level can be sustained, even if just on a very long term and at a very slow pace, despite the fact that important disparities at national or regional level are registered.
- *What are the connections between globalization, autonomization, regionalization, and real convergence?* There are voices who claim that the tensions between the cohesion processes, respectively the processes of regionalization and autonomization determined by the general globalization phenomenon represent and will continue to represent major problems for the European integration (Rumford, 2000). The objectives of increased cohesion at the European level could suffer from a certain "sabotage" from some internal EU processes, upon which the EU does not have any control, since they are influenced by the general globalization phenomenon.
- *CAD versus CAF development strategies*. The dilemma concerns the selection of the most appropriate governmental strategy regarding industrial development, so that the most rapid and less costing real economic convergence could be achieved for the CEE countries. The choice will be made between two groups of strategies, CAD – comparative advantage defying – and CAF – comparative advantage following (Lin, 2003). Studies performed by specialists in order to determine the effects of adopting one strategy or the other by a less developed country lead to the conclusion that many countries tempted by the idea of a rapid convergence select the wrong

strategy. The desire to eliminate or at least reduce the technological/industrial gaps often push countries towards CAD strategies, for an industrial development of capital – intensive type, costly, for which the necessary structure for a sustainable development on long term does not exist (non-viable firms on a free market receive governmental support, leading to preferential financing, price distortions, anomalies in exchange rates and interest rates, thus resulting a deeper divergence, instead of the desired convergence). In opposition, the technological borrow, at more reduced costs, can prove to be more profitable, when a CAF strategy is selected; on long term it is thus possible to obtain a real convergence, governments' unique role being that of keeping a free, competitional market.

- *Theoretical approaches for the enlarging through integration.* Several such approaches are discussed by specialists: rationalist institutionalism (individualism and materialism, for which the action logic is that of consequentiality); sociologic institutionalism or constructive (social and ideational, for which the action logic is that of appropriateness); actions at the macro level or the so called polity, or substantive level – the so called policy (Schimmelfennig and Sedelmeier, 2002). Putting into the same pot such theoretical issues of the European integration and enlarging process could further complicate debates on the subject of convergence. Candidate countries should deeply analyze the real motivations they hold for integration, in order to see what kind of approach they fit in; from here, in combination with growth theories, they could select a strategy more appropriate to their economic, social and especially cultural realities.

5. If... how?

Simplifying in an extreme way, we could resume that all the discussions arrive to a kind of "if... how" approach. We first ask if real convergence exists, if it is possible, from theoretical and practical point of view, to attain such a convergence, without praying for miracles and within a reasonable time horizon; then, if the answer to the first question is yes, the most important question is how, through what kind of strategy, policy, actions etc. can such a convergence occur, for less developed candidate countries, such as Romania?

If we put into balance theories and studies that claim the existence and possibility of real convergence, offering not always proofs, but rather hopes, and those that claim the alternative of a long term divergence process, we could, on the edge, accept the idea that convergence at the EU level is possible for candidate countries, but on a very long term (more than half a century sometimes), with considerable risks and efforts and in certain conditions, at a quite slow pace. It is not a scientific conclusion, maybe not a conclusion at all; putting together, in the present material, such complex and diverse subjects lead us to a rather weird mosaic of debate issues on the field of convergence, with a questionable utility. However, associating such different subjects, although it can be unnatural for the specialists of each narrower issue, could give birth to new ideas for future reflections and researches. This is, after all, what Romania should expect for: many issues to be solved, many difficulties, lots of possible scenarios, no absolute answers or recipes, shadows and lights. Maybe because, despite of the desire to have a positive and objective science, quantifiable and predictable, we end up with rather absolutely subjective conclusions: "It is clear that the potential of economic convergence in Europe exists, and it is the role of the imaginative political leaders and creative economic politicians from transitional economies to find the key for success." (Economic Survey of Europe, 2000).

Bibliography

Andres, Javier, Bosca, Jose, Domenech, Rafael, (2004), "Convergence in the OECD: Transitional Dynamics or Narrowing Steady-State Differences?", *Economic Inquiry*, Vol.42, No.1.

Arestis, Philip, Palignis, Eleni, (1993), "Financial Fragility, Peripherality, and Divergence in the European Community", *Journal of Economic Issues*, vol.XXVII, no.2.

Barro, Robert J., Sala-I-Martin, Xavier, (1991), "Convergence across States and Regions", *Brookings Papers on Economic Activity.*

Bunyaratavej, Kraiwinee, Hahn, Eugene, (2003), "An integrative Approach to Measuring Economic Convergence: The Case of the European Union", *Working Paper.*

Daianu, Daniel, (2003), "Institutional and Policy Variety: Does it Matter for Economic Development?", *Southeast European and Black Sea Studies*, Vol.3, No.2.

Danson, M.W., (1999), "Debates and Reviews", *Regional Studies*, vol.33, iss.3.

De Grauwe, Paul, Schanbl, Gunther, (2003), "Nominal versus Real Convergence with Respect to EMU. How to Cope with the Balassa-Samuelson Dilemma", *Working Paper*, Preliminary Version August 19.

Getimis, Panayotis, (2003), "Improving European Union Regional Policy by Learning from the Past in View of Enlargement", *European Planning Studies*, vol.11, no.1.

Grabbe, Heather, Hughes, Kirsty, (1998), "Reform of the Structural Funds: Central and Eastern European Perspectives", *European Planning Studies*, vol.6, Issue 6.

Keefer, Philip, Knack, Stephen, (1997), "Why don't Poor Countries Catch Up? A Cross-National Test of an Institutional Explanation", *Economic Inquiry*, Vol.35.

Kowalski, Przemek, (2003), "Nominal and Real Convergence in Alternative Exchange Rate Regimes in Transition Countries: Implications for the EMU Accession", CASE – Center for Social and Economic Research, Warsaw.

Lavigne, Marie, (2000), "The Economics of the Transition Process. What Have We Learned?", *Problems of Post-Communism*, vol.47, no.4.

Lavrac, Vladimir, Zumer, Tina, (2003), "Exchange Rate Regimes of CEE Countries on the way to the EMU: Nominal Convergence, Real Convergence and Optimum Currency Area Criteria", *Ezoneplus Working Paper* no.15.

Lin, Justin Yifu, (2003), "Development Strategy, Viability and Economic Convergence", *Economic Development and Cultural Change*, vol.51, no.2.

Lombard, Marc, (2000), "Restrictive Macroeconomic Policies and Unemployment in the European Union", *Review of Political Economy,* Vol.12, No.3.

Martin, Carmela, Velazquez, Francisco, (2001), "An Assessment of Real Convergence of Less Developed EU Members: Lessons for the CEEC Candidates", *European Economic Group*, Working Paper No. 5.

Martin, Ron, Sunley, Peter, (2000), "Slow Convergence? The New Endogenous Growth Theory and Regional Development", chapter in New Endogenous Growth Theory.

Meeusen, Wim, (2003), "Economic Convergence, the 'Stylised Facts of Growth' and Technological Progress. An introduction from the perspective of the theory of growth", CESIT Discussion Paper No. 03.

Mongelli, Francesco Paolo, (2002), " 'New' Views on the Optimum Currency Area Theory: What is EMU Telling Us?", European Central Bank Preliminary Draft.

Padoa-Schioppa, Tommaso, (2002), "Accession Countries on the Way to the Euro: A Central Banker's View", *Conference* on "Economic Policy Directions in the OECD Countries and Emerging Markets: Analyzing the Experiences", Warsaw, 21 March 2002.

Percoco, Marco, Dall'erba, Sandy, Hewings, J.D., (2004), "Structural Convergence of the National Economies of Europe", *Working Paper*, REAL 04-T-1.

Petrakos, George, (2001), "Patterns of Regional Inequality in Transition Economies", *European Planning Studies,* Vol.9, No.3.

Rapley, John, (2001), "Convergence: myths and realities", *Progress in Development Studies*, vol.1, no. 4.

Rumford, Chris, (2000), "European Cohesion? Globalization, Autonomization, and the Dynamics of EU Integration", *Innovation*, vol.13, no.2.

Schimmelfennig, Frank, Sedelmeier, Ulrich, (2002), "Theorizing EU enlargement: research focus, hypotheses, and the state of research", *Journal of European Public Policy*, vol.9, no.4.

Wallace, Helen, (2002), "Enlarging the European Union: reflections on the challenge of analysis", *Journal of European Public Policy*, vol.9, no.4.

Westbrook, Jilleen R., (1998), "Monetary Integration, Inflation Convergence and Output Shocks in the European Monetary System", *Economic Inquiry*, vol. 36, no.1.

*** - "Catching Up and Falling Behind: Economic Convergence in Europe", *Economic Survey of Europe*, 2000, Issue 1.

*** - "Elargissement de l'Union Européenne: un nouveau marché», DREE Dossiers, Ministère de l'Economie, des Finances et de l'Industrie France, Avril 2004.

*** - http://www.ccir.ro