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The Romania's challenges regarding the integration in the Euro Area

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Abstract. *Considering the fact that Romania joining the euro area is a major country project, as was entering the European Union on January 1, 2007, this paper analyzes the way Romania currently meets the convergence criteria, the importance of their sustainability, the level of real convergence and further steps to be taken before adopting the euro. All these issues are meant to secure rigorous economic preparation, in order to reach a certain level of development, that can deal with competitiveness and which can ensure a relatively high level of convergence of income per capita.*

Keywords: Convergence criteria, GDP per capita, Regional gross domestic product, Euro area, Romania.

JEL Classification: E60, F15, F36, F43, O40.

1. Introduction

On January 1, 1999, the euro became the new official currency of 11 European Union member states, by replacing the old national currencies in two stages. During the first stage, starting January 1, 1999, the euro was introduced as a virtual currency for payment operations, which did not imply using bank notes and coins, while the old currencies continued to be used for making cash payments. The second stage began on January 1, 2002, when the euro was introduced as bank notes and coins.

Euro is the single currency, currently adopted by 19 of the 28 European Union member states, which form the Eurozone. The latest country to adopt the euro was Lithuania, on January 1, 2015.

Denmark and the UK chose „the opt-out clause”, while the other 7 member states, including Romania, committed to adopt the euro after meeting the convergence criteria provisioned in the Maastricht Treaty.

Before adopting the euro, any member state of the European Union (EU) must meet certain economic and legal criteria. The role of the economic convergence criteria is to guarantee the fact that the economy of the respective country is sufficiently well prepared to adopt the single currency and that it can easily integrate in the monetary regime of the euro area. The legal convergence refers to the compatibility of the national legislation to the provisions of the European Treaty, especially those related to the national central bank and currency issuance.

2. Nominal convergence criteria (Maastricht Criteria)

In order to adopt the single currency, each member state of the EU must meet the *nominal convergence criteria* set by the Maastricht Treaty, which refer to price stability, sustainability of the fiscal position, exchange rate stability and the long term convergence of interest rates.

For Romania, entering the euro area should represent a country project as important as joining the European Union.

Currently, Romania meets all 5 Maastricht criteria (Table 1).

The medium annual inflation rate in Romania, based on the harmonized index of consumer prices (HICP), is at -1.4% as of August 2016, thus ranking Romania among the top three EU member states with the lowest inflation.

For 2015, *the budget deficit* as a result of the ESA 2010 methodology was situated at 0.7% of GDP, under the 3% of GDP level provisioned in the Treaty.

According to EU methodology, *the government debt* was at 38.4% of GDP at the end of 2015, well under the 60% threshold provisioned in the Treaty, and lower than the level registered at the end of 2014 (39.9% of GDP).

As regards the exchange rate, the leu (Romania's national currency) has not yet entered ERM II (Exchange Rate Mechanism).

Table 1. *The Maastricht Criteria (Nominal Convergence Indicators)*

Nominal Convergence Indicators	Maastricht Criteria	Romania
Inflation rate (HICP) (percent, annual average)	≤1.5 pp above -1.43%* (average of the three best performing EU Member States)	-1.4 (August 2016)
Long-term interest rates (percent per annum, annual average)	≤ 2 pp above 3.02%* (average of the three best performing EU Member States in terms of price stability)	3.42 (August 2016)
Exchange rate vs. euro** (2 years maximum percentage change; appreciation(+)/depreciation(-))	±15 percent	+0.7/-2.6
General government deficit*** (percent of GDP)	below 3 percent	0.7 (2015)
Government debt*** (percent of GDP)	below 60 percent	38.4 (2015)

*) Cyprus, Romania, Bulgaria.
**) Maximum percentage deviations of the bilateral exchange rate against the euro from its August 2014 average level in September 2014 to August 2016 based on daily data at business frequency. An upward/downward deviation implies that the currency was stronger/weaker than the average exchange rate in August 2014.
***) According to ESA2010 methodology.
Source: Eurostat, National Institute of Statistics, Ministry of Public Finance.

For a sound integration in the euro area, it is not enough to meet the nominal convergence criteria, these criteria must also be sustainable. This cannot be reached without ensuring financial stability, fiscal balance and competitiveness (the durability and sustainability of the convergence are also provisioned in the Maastricht Treaty).

3. Where are we on real convergence?

Within the Maastricht Treaty, there is no reference to *the real convergence criteria,* necessary for creating a high degree of cohesion between the economic structures of the countries *en route* to joining the euro area with the existing ones. This omission may be due to the fact that, at the beginning of the European Union, it was formed by rich countries, with similar economic structures. Although real convergence has not been inserted in the association treaties signed when the euro area was created, both the European Commission and the ECB gave warning on the risks that may arise from the new EU member states joining the euro area, who only meet the nominal convergence criteria, but not the real convergence criteria, necessary for a sound economic integration.

Lacking clearly stipulated criteria, we may consider that the most important real convergence criteria are related to: the degree of economic openness, expressed as the weight of the total imports and exports in the GDP; the economic structure, as the weight of the large sectors in creating GDP – agriculture, industry, services – and the most synthetic criterion, GDP per capita, shown either as the nominal rate, or as the standard purchasing power parity (Isărescu, 2004, p. 6).

According to the *Theory of the Optimum Currency Area,* the states that are part of a group, or who join a group, may mutually benefit from owning a common currency only when their economic structures are similar and there is no risk that asymmetric shocks can harm only some of them. Thus, the monetary policy elaborated by the European Central Bank is meant for a group of supposedly homogenous economies, it cannot and it must not address the particularities of each economy (Isărescu, 2004, p. 7).

For the moment, the countries from Central and Eastern Europe, with a weaker economy, cannot abandon their own monetary policy, as long as there is the risk of asymmetric shocks occurring as a result of the different economic structure. In order for these countries to enjoy the benefits of using the single European currency, they must first reach a high degree of nominal and real convergence, and then join the euro area.

The fact that real convergence is as important as nominal convergence must be taken into account.

In Romania, GDP per capita in 2015, expressed as the purchasing power standards (PPS), represented approx. 57 per cent of the European Union average (Table 2), 53 per cent of the eurozone countries average (Table 3), and well under the Baltic states who have adopted the euro, 69 per cent of the European Union average for Estonia in 2011, 62 percent for Latvia in 2013 and 75 per cent of Lithuania in 2014.

Table 2. *GDP per capita in PPS (percent of the EU average)*

	GDP per capita in PPS Index (EU 28 countries = 100%)									
GEO/TIME	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Romania	38%	41%	48%	49%	50%	51%	54%	54%	55%	**57%**
Bulgaria	38%	42%	45%	46%	45%	45%	46%	46%	47%	46%
Czech Republic	81%	83%	81%	83%	81%	83%	82%	83%	84%	85%
Hungary	62%	61%	63%	64%	65%	65%	65%	66%	68%	68%
Poland	50%	53%	54%	59%	62%	64%	66%	67%	68%	69%
Croatia	58%	61%	63%	61%	59%	59%	60%	59%	59%	58%
Estonia	64%	68%	68%	62%	63%	69%	74%	75%	76%	74%
Latvia	55%	60%	60%	52%	52%	56%	60%	62%	64%	64%
Lithuania	56%	60%	63%	56%	60%	65%	70%	73%	75%	74%

Source: Eurostat (Last update: 11.10.2016).

Table 3. *GDP per capita in PPS (percent of the euro area average)*

	GDP per capita in PPS Index (Euro area 19 countries = 100%)									
GEO/TIME	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Romania	35%	38%	44%	45%	46%	47%	50%	50%	52%	53%
Bulgaria	35%	38%	42%	43%	42%	42%	43%	43%	44%	43%
Czech Republic	74%	77%	75%	77%	75%	77%	76%	78%	80%	82%
Hungary	57%	56%	58%	60%	60%	61%	60%	62%	64%	64%
Poland	47%	49%	51%	55%	57%	60%	62%	63%	63%	64%
Croatia	54%	56%	58%	57%	54%	55%	56%	55%	55%	55%
Estonia	59%	63%	63%	58%	59%	64%	68%	70%	70%	69%
Latvia	51%	55%	55%	49%	48%	52%	56%	58%	60%	60%
Lithuania	51%	56%	58%	52%	56%	60%	65%	69%	70%	70%

Source: Eurostat (Last update: 11.10.2016).

Table 4. *GDP per capita in PPS*

	GDP per capita in PPS									
GEO/TIME	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
EU*	24,700	26,000	26,100	24,500	25,400	26,100	26,600	26,700	27,500	28,800
Euro area*	26,600	28,100	28,100	26,300	27,500	28,200	28,500	28,600	29,400	30,600
Romania	9,300	10,700	12,500	11,900	12,600	13,300	14,300	14,400	15,200	16,300
Bulgaria	9,400	10,800	11,700	11,200	11,500	11,800	12,200	12,200	12,800	13,300
Czech Republic	19,800	21,600	21,100	20,200	20,600	21,600	21,800	22,300	23,500	25,000
Hungary	15,200	15,700	16,300	15,700	16,500	17,100	17,200	17,800	18,800	19,700
Poland	12,400	13,700	14,200	14,500	15,700	16,800	17,600	17,900	18,600	19,700
Croatia	14,300	15,800	16,400	15,000	14,900	15,500	15,900	15,800	16,100	16,700
Estonia	15,700	17,700	17,600	15,200	16,100	18,000	19,500	19,900	20,700	21,200
Latvia	13,500	15,500	15,500	12,800	13,300	14,700	16,000	16,700	17,500	18,500
Lithuania	13,600	15,600	16,200	13,800	15,300	17,000	18,500	19,600	20,700	21,300

*EU 28 countries, euro area 19 countries.
Source: Eurostat (Last update: 11.10.2016).

From the experience of the latest states to join the euro area, it can be inferred that, for a sound integration, two years before adopting the single currency, the GDP per capita (PPS) should be at around 55-65 per cent of the European Union average.

2-3 years before joining the euro area, Latvia was in the same situation as Romania in 2015, i.e. with a GDP per capita (PPS) at 57 per cent of the European Union average. But, in Romania's case, there still is a large disparity between the 8 regions, as regards the GDP per capita.

4. Analysis of intra-national disparities – Regional gross domestic product (PPS per inhabitant)

In Romania, only the Bucharest-Ilfov region is well ranked as regards GDP per capital (Table 5), as it economically surpasses certain developed areas of the European Union.

Table 5. *Regional gross domestic product (PPS per inhabitant in % of the EU28 average) by NUTS 2 regions*

geo\time	**2010**	**2011**	**2012**	**2013**	**2014**
Inner London – West (England)	541	543	552	528	539
Luxembourg	254	263	258	264	266
Rég. Bruxelles (Belgium)	218	217	215	211	207
Hamburg (Germany)	204	207	205	204	206
Île de France (France)	181	177	177	181	178
Praha (Czech Republic)	175	174	171	173	173
Bucuresti – Ilfov (Romania)	121	131	126	127	129
Comunidad de Madrid (Spain)	130	127	126	124	125
Berlin (Germany)	115	121	119	118	119
Lazio (Italy)	128	126	121	116	114
Cataluña (Spain)	114	109	108	107	108
Vest (Romania)	56	56	58	56	58
Centru (Romania)	47	47	52	51	52
Sud-Est (Romania)	40	41	46	49	50
Nord-Vest (Romania)	44	44	47	47	48
Észak-Alföld (Hungary)	41	42	42	42	43
Sud – Muntenia (Romania)	41	42	41	43	43
geo\time	**2010**	**2011**	**2012**	**2013**	**2014**
Sud-Vest Oltenia (Romania)	38	39	41	40	41
Severen tsentralen (Bulgaria)	29	30	32	32	34
Nord-Est (Romania)	30	30	34	34	34
Yuzhen tsentralen (Bulgaria)	31	32	33	32	32
Severozapaden (Bulgaria)	27	28	29	29	30

Source: Eurostat (Last update: 26.02.2016).

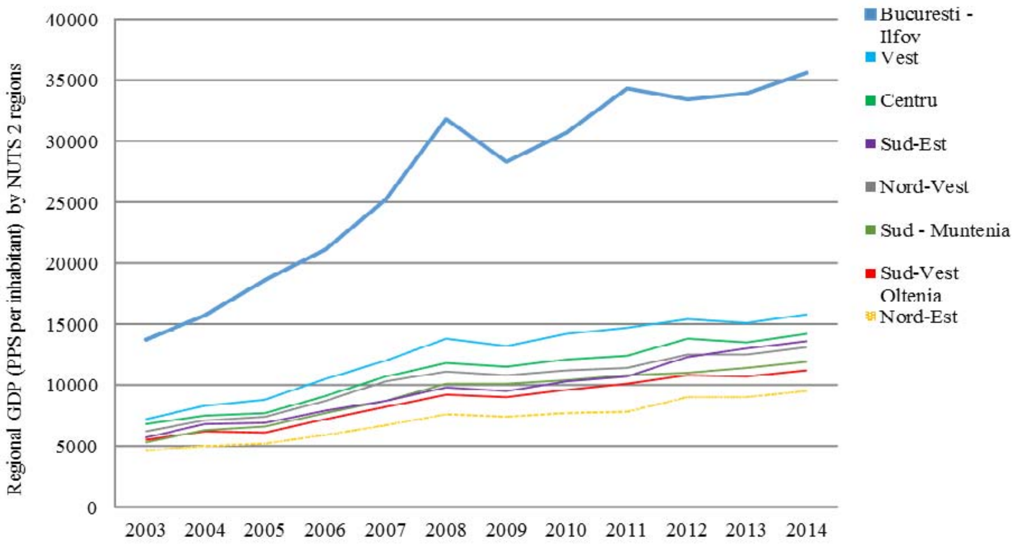
During 2003-2014, there was a rapid growth of the GDP per capita in the Bucharest-Ilfov region. This economic development did not follow this strong trend in the rest of the regions (Figure 1), only two of the seven regions managed to reach over 50% of European Union average in 2014, as regards the GDP per capita at PPS. The other five regions, inhabited by more than half of Romania's population, are at the bottom of European Union rankings as regards economic development.

Table 6. *Regional gross domestic product (PPS per inhabitant) by NUTS 2 regions – Romania*

geo\time	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
București-Ilfov	13,700	15,700	18,600	21,100	25,200	31,800	28,300	30,700	34,300	33,400	33,900	35,600
Vest	7,200	8,300	8,800	10,500	12,000	13,800	13,200	14,200	14,700	15,400	15,100	15,800
Centru	6,800	7,500	7,700	9,100	10,700	11,800	11,500	12,100	12,400	13,800	13,500	14,200
Sud-Est	5,700	6,800	6,900	7,900	8,700	9,800	9,500	10,300	10,700	12,300	13,000	13,600
Nord-Vest	6,200	7,100	7,400	8,700	10,300	11,100	10,800	11,200	11,400	12,500	12,500	13,100
Sud - Muntenia	5,300	6,300	6,600	7,700	8,700	10,100	10,100	10,400	10,800	11,000	11,400	11,900
Sud-Vest Oltenia	5,500	6,200	6,100	7,200	8,200	9,200	9,000	9,600	10,100	10,800	10,700	11,200
Nord-Est	4,600	5,000	5,200	5,900	6,700	7,600	7,400	7,700	7,800	9,000	9,000	9,500

Source: Eurostat (Last update: 26.02.2016).

Figure 1. *Regional gross domestic product (PPS per inhabitant) by NUTS 2 regions – Romania*



Source: Eurostat data, author's calculations.

The lack of infrastructure is one of the main causes leading to a low economic growth in most regions of the country, in some cases even to an economic stagnation, and to a very large gap between the economic development of Bucharest-Ilfov and the rest of the regions.

5. Steps to be taken for a sound integration in the Euro Area

Before Romania enters the euro area, a high level of convergence of the income per inhabitant – GDP per capita – must be reached, because in the absence of an independent monetary policy, a large gap in real convergence may lead to a more difficult management of economic cycles.

GDP per capita at PPS (purchasing power standards) is a real convergence indicator which must be improved; last year it was at only 53 per cent of the euro area average, and at 57 per cent of the European Union average (Tables 2 and 3).

Without clearly defined criteria to indicate the sufficient real convergence in view of adopting the euro, we can use a common-sense benchmark for Romania: the minimum level of real convergence where another state joined the euro area, such as the aforementioned Latvia. However, besides this benchmark, we must also take the population of our country into account, which is much larger than that of Latvia, and the high disparities between the regions as regards the GDP per capita.

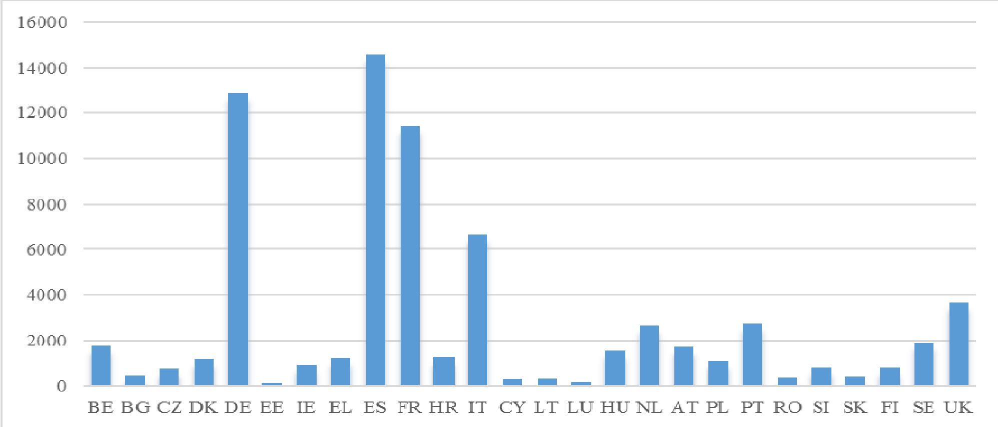
The very large gap between the Bucharest-Ilfov region and the rest of the regions regarding economic development (Table 6) could be substantially reduced, if all regions were interconnected through good quality transportation infrastructure, thus attracting new investors, creating new jobs and, as a result, increasing the standard of living.

Romania must cover the GDP per capita gap against the rest of the European Union countries, all the while keeping economic macro stability, and not insisting on a fast, short term growth, which could lead to macroeconomic disequilibrium.

A ranking made by the European Union Road Federation and shown in the „Yearbook 2014-2015", on European level, ranked Romania in 2011 among the last countries as regards the total number of road kilometers linking regions, and also as regards the density of the total road network. At the end of 2011, Romania had a total of 84,053 public road kilometers, out of which only 350 kilometers were the highways, and it was surpassed by countries with a much smaller territory, such as Bulgaria with 459 highway km, Belgium with 1.763 km, Czech Republic with 745 km, Denmark with 1.143 km, Austria with 1.719 km etc. The highest ranking country in the European Union as regards the number of highway kilometers is Spain, with 14,554 kilometers, followed by Germany with 12,845 kilometers (Figure 2).

The National Statistics Institute, through their press release no. 101 from April 25, 2016, mention a total of 86,080 public road kilometers, out of which 747 are highway kilometers, registered as of December 31, 2015.

Figure 2. *Length of motorway network by country in EU member states (km) – 2011*



Source: Eurostat, EC, European Union Road Federation – Yearbook 2014-2015.

Romania has problems absorbing structural funds, which could significantly contribute to financing important investments.

According to the most recent data published by the Ministry of European Funds, at the end of September 2016, Romania had reached a 86.74% absorption rate (the amount collected from the European Commission, down payments included), from the financial framework 2007-2013, as opposed to 60%, which was the rate at the end of November 2015.

Out of the approximately 19 billion Euros in European funds allocated for Romania, it was only able to attract 14.4 billion Euros.

Table 7. *The absorption stage of the Operational Programs 2007 – 2013, by Romania*

Euro

Operational Program 2007-2013	EU Allocation 2007-2013	Down payments received from the EC	Statements of expenditure submitted to the EC (current absorption rate)		Reimbursements from EC (effective absorption rate)		Rate amounts collected from EC (with down payments)
			Amount	%	Amount	%	%
	1	2	3	4=(3/1)*100	5	6=(5/1)*100	7=[(2+5)/1]*100
SOPIEC	2,536,646,054	229,879,990	2,377,677,852	93.73	2,179,933,761	85.94	95.00
PO TA	170,237,790	15,321,401	193,092,021	113.42	146,404,499	86.00	95.00
SOP E	4,412,470,138	520,775,940	3,477,489,101	78.81	3,302,536,830	74.85	86.65
ROP	3,966,021,762	335,341,959	3,372,862,138	85.04	3,372,867,345	85.04	93.50
SOP DHR	3,476,144,996	451,898,849	2,347,894,037	67.54	2,243,811,890	64.55	77.55
SOP T	4,288,134,778	525,615,535	3,314,972,970	77.31	3,007,751,462	70.14	82.40
OP ACD	208,002,622	27,040,341	205,211,213	98.66	170,562,150	82.00	95.00
TOTAL	19,057,658,140	2,105,874,015	15,289,199,332	80.23	14,423,867,938	75.69	86.74

SOPIEC = Sectorial Operational Program Increase of Economic Competitiveness, PO TA = Operational Program Technical Assistance, SOP E = Sectorial Operational Program for Environment, ROP = Regional Operational Program, SOP DHR = Operational Program Development of Human Resources, SOP T = Sectorial Operational Program for Transport, OP ACD = Operational Program Administrative Capacity Development.

December 31, 2015: deadline for eligibility of expenditure incurred by beneficiaries.

Source: Ministry of European Funds (Last update: 30.09.2016).

There were significant delays in implementing EU financed programs, as a consequence of certain irregularities in the public acquisition procedures. These had a negative impact on the business environment and contributed to delays in investments in infrastructure.

The energy and transport infrastructure continue to stifle Romania’s economic growth.

A brake on Romania's economic growth and development is represented by the energy infrastructure and the transport.

There were not created sufficient conditions for small and medium enterprises to have a easy access to finance.

Romania is among the top countries in the European Union as regards the number of people working without a legal contract, as over 1.5 million Romanians are undocumented workers.

Abiding the VAT legislation is among the lowest in the European Union, as the number of employers who use undocumented workers continues to be high, thus affecting budget income. This type of evasion prejudices the state budget by 4 billion Euros every year, as shown by the Fiscal Council. Working illegally is also not beneficial for the employees, as they cannot benefit from social security, health, unemployment and pension insurance, and from other legal provisions related to work accidents and occupational diseases.

Low quality education, which isn’t correlated to the labor market, limited capacity of public administration, topped with an unstable fiscal policy, all have a negative effect on investments and export.

The rate of early school drop-out, calculated as a percentage of the total population of ages 18-24 was 19.1% in 2015, over the EU-28 average of 11%. Availability and access to education and care for preschoolers are limited, especially in the rural area. Lifelong learning is also far below EU average, and tertiary education graduation rate ranks Romania as second to last in the European Union, at 25.6% for individuals aged 30-34, ahead of Italy with 25.3%, and below EU-28 average of 38.7%.

In Romania, competitiveness should not only be based on low costs, but on other factors as well, such as innovation, timely delivery of goods and services, ensuring good quality service and creating own distribution networks. This way, high quality products and services, based on modern technologies, will become available on the market.

In 2015, the hourly cost of labor force in EU-28 was estimated at 25 Euros and at 29.5 Euros in the Eurozone. In Romania, there was the lowest cost of hourly labor, 5 Euros, ahead of the 4.1 Euros in Bulgaria. In 2015, Denmark had the highest hourly cost for labor force, namely 41.3 Euros.

Reducing the social security contributions paid by employers reduced the fiscal burden on the cost of labor, but it did not target workers with small and medium-sized income. The fiscal burden for individuals with small income is 40%, which continues to be high, compared to other European countries (European Commission, Country Report Romania 2015, pp. 57).

During this time, exports can be stimulated through the depreciation of the national currency, as a result of the much higher value of the contract currency, compared to the internal currency. After joining the euro area, this advantage will disappear, and the Romanian exporters will be interested in capitalizing better on productivity and efficiency, in order to be more competitive. Consequently, an increase in work productivity is necessary, which would increase economic efficiency, and which would, in turn, reflect in more competitive products on a larger market.

The Eurostat data show for Romania a level of hourly productivity at 5.6 Euros/hour in 2013, which represents 17.45% of the EU-28 average, and only 15% compared to the Eurozone average. Calculated based on PPS per working hour, the level of work productivity in Romania reaches 45.1% of the EU-28 average.

As regards the number of weekly working hours, the study undergone by Eurofund for 2012 ranks Romania in first place, at 41.2 hours. Other values: Germany (40.5 hours), Bulgaria (40.2 hours), Italy (38 hours), France (37.9 hours).

Table 8. *Real labour productivity per hour worked (Euro per hour worked) in the EU member states*

	2005	2006	2007	2008	2009	2010	2011	2012	2013
Euro area (18 countries)	34.8	35.5	36.0	35.9	35.5	36.3	36.7	37.0	37.3
European Union (28 countries)	30.2	30.9	31.3	31.2	30.7	31.4	31.8	31.9	32.1
Luxembourg	63.1	63.9	64.9	60.8	59.4	60.0	59.5	58.2	:
Denmark	51.4	51.9	52.2	51.1	49.8	52.4	52.5	52.6	53.4
Ireland	44.1	44.6	45.1	45.0	46.5	48.2	50.1	50.4	48.8
Belgium	45.4	45.8	46.2	46.0	45.3	45.9	45.8	45.7	45.9
Netherlands	44.7	45.5	46.2	46.2	45.1	46.0	46.1	45.6	45.8
France	43.6	44.9	44.9	44.4	44.2	44.7	45.3	45.4	45.6
Sweden	42.7	44.0	44.1	43.3	42.3	44.0	44.4	44.9	45.5
Germany	39.9	41.3	42.0	42.0	40.9	41.7	42.4	42.6	42.8
Austria	36.1	37.3	38.1	38.3	38.2	38.9	39.1	39.5	39.9
Finland	38.4	39.5	40.8	40.3	38.2	39.4	40.0	39.5	39.7
United Kingdom	38.9	39.7	40.8	40.3	39.3	39.8	40.0	39.3	39.2
Italy	32.4	32.5	32.6	32.4	31.7	32.5	32.5	32.2	32.2
Spain	27.9	28.1	28.5	28.7	29.4	30.0	30.4	31.5	32.1
Cyprus	20.1	20.4	20.8	21.2	21.0	21.3	21.2	21.5	21.6
Slovenia	18.2	19.3	20.1	20.1	20.1	20.6	21.4	21.3	21.4
Greece	19.8	20.8	21.5	22.2	21.1	20.4	19.9	20.2	20.2
Portugal	15.6	15.8	16.1	16.1	16.1	16.7	16.9	17.0	17.1
Malta	15.3	15.5	15.4	15.4	14.6	15.2	14.2	14.5	:
Slovakia	10.4	11.0	11.8	12.1	11.8	12.3	12.6	12.8	13.2
Czech Republic	11.7	12.4	13.0	13.0	12.8	13.0	13.3	13.2	13.1
Hungary	10.7	11.1	11.1	11.3	10.9	11.0	11.0	11.3	11.5
Estonia	9.2	9.7	10.3	10.0	10.3	10.9	10.8	11.2	11.4
Poland	8.4	8.6	8.8	9.0	9.1	9.8	10.2	10.4	10.6
Lithuania	7.7	8.2	8.7	8.8	8.3	9.4	10.1	10.3	10.6
Latvia	5.9	6.3	7.9	7.3	7.2	7.6	7.9	8.2	8.4
Romania	4.6	4.9	5.2	5.6	5.4	5.3	5.4	5.4	5.6
Bulgaria	4.0	4.1	4.3	4.3	4.3	4.5	4.7	4.8	4.9

: Not available.

Source: Eurostat.

Romania needs structural reforms that will ensure the sustainability of nominal convergence, by eliminating the sources of repressed inflation, such as the liberalization of the energy market or the gas market. On January 1, 2015, a small step was taken in regards to gas price liberalization when the non-household gas price liberalization entered into force. According to the first calculations, the final natural gas price dropped by 10% in the first 3 months after this measure was taken. Prices dropped because 40% of the contracts have been renegotiated, contracts which have been regulated in the past, and which passed into the free zone (Declaration Havrileț, president of ANRE, capital.ro – 05.03.2015). But the liberalization of energy prices for households was delayed.

The European Commission encourages national governments of the EU member states to liberalize basic services (energy, telecommunication, transport, postal services), so that consumers may eventually benefit from lower prices, new and more efficient services, and to be able to choose their own service providers, and so that European economy may become more competitive.

No reforms were yet made with regards to privatizing and restructuring state enterprises that generate losses and a series of measures that would improve the business environment.

Corporate governance may be an essential factor to make state entities perform. But so far, there has been no progress as regards corporate governance reform within the energy and transport state entities. There is still political interference in the current management of the entities, which does not secure a separation between the authorities' capacity as owners and their function as policy makers.

In the 2014 annual report drawn up by the Romanian Fiscal Council, the overdue payments accumulated at the end of 2014 by state companies, mostly organized as commercial entities or autonomously administrated entities, represented 20.7% of the total arrears registered on the entire economy; the arrears for state companies represented 3.7% of GDP. Their contribution to the total turnover in the economy was only 4% and their contribution to the gross added value economy was modest, only 9.9%.

Also in 2014, state companies recorded the best gross profit in the last few years, 3,568 million lei, which was mostly due to an increase in profitability of a small number of companies. If we deduct the profit of the most profitable 5 state companies in 2014 (ROMGAZ SA, HIDROELECTRICA SA, TRANSGAZ SA, Societatea Uzină Mecanică Cugir SA, CNADNR SA), the gross profit of state companies becomes negative, as loss increased from 387 million lei in 2013 to 957 million lei in 2014.

Table 9. *The evolution of some indicators of companies in Romania*

		2010	2011	2012	2013	2014
Number of companies	Total companies excluding financial sector	613,080	644,379	630,066	627,545	643,644
	The weight of the state companies in total	0.1%	0.2%	0.2%	0.2%	0.2%
Gross added value (mil. lei)	State companies (SC)	22,881	24,202	22,339	23,805	25,220
	Total companies excluding financial sector	195,849	196,151	197,392	227,615	255,957
	The weight of the state companies in total	**11.7%**	**12.3%**	**11.3%**	**10.5%**	**9.9%**
Gross profit (mil. lei)	**State companies (SC)**	**-2,101**	**1,372**	**-561**	**3,093**	**3,568**
	SC, excluding the top five	**-4,201.71**	**-2,449.37**	**-3,026.17**	**-386.80**	**-957.37**
	Private companies	27,934	10,421	15,623	23,856	27,479

		2010	2011	2012	2013	2014
Arrears (mil. lei)	State companies (SC)	28,012	26,251	25,363	26,187	24,369
	Private companies	69,193	88,882	91,536	90,358	93,508
	Total companies excluding financial sector	97,205	115,133	116,899	116,545	117,878
	The weight of the state companies in total	**28.8%**	**22.8%**	**21.7%**	**22.5%**	**20.7%**
		2010	**2011**	**2012**	**2013**	**2014**
Arrears (% of GDP)	**State companies (SC)**	**5.2%**	**4.6%**	**4.3%**	**4.1%**	**3.7%**
	Private companies	13.0%	15.7%	15.3%	14.2%	14.0%
	Total companies excluding financial sector	18.2%	20.4%	19.6%	18.3%	17.7%

Source: RA2014 – Fiscal Council, Ministry of Public Finance.

Romania has the largest part of the population in the European Union that owns small land areas, which can only be used for subsistence farming. The lack of infrastructure further contributes to an underperforming Romanian agriculture, as the rural areas suffer from unpaved roads and lack of sewerage. A lack of elementary infrastructure makes service development in rural areas problematic.

According to the National Institute of Statistics, in 2013, small farming areas of up to 1 hectare represented an important 54.5% of all farms in Romania (and they were using only 5% of the used farming area), while those smaller than 0.1 hectares represented 11% of the total farming areas.

The number of small farms, of up to 1 hectare, was diminished in 2013, compared to 2010, by 3%, i.e. by 76.000 ha of small farming areas. This reduction was mainly the result of the contribution of individuals using a farming area of up to 0.1 hectares.

In the European Union, there is a trend for a long term increase of farming areas, from small ones to medium and large ones, but this does not automatically mean that all small farms are inefficient.

Romania has made progress in regards to a growing independence and efficiency of the judicial system, as well as to combating corruption on all levels. Still, the level of actual carrying out of court rulings remains low, as well as preventing and combating small acts of corruption. All these political areas are the object of the mechanism for cooperation and verification.

Starting 2014, the corporate holding fiscal regime was regulated and Romania became as investor-friendly as Cyprus or the Netherlands. The corporate holding regime was regulated by the Fiscal Code for the first time.

The functioning of the holding regime was based on meeting two minimum conditions: tax exemptions on capital income and on dividends.

The tax relief provisioned in the new fiscal code may stimulate setting up holding companies in Romania. From now on, Romanian investors looking for more favorable jurisdictions for registering their business, in countries such as Cyprus or the Netherlands, will benefit from better conditions to start doing business in their own country. The fiscal changes target strategic development investments, not speculative ones. This is why most countries with a corporate holding regime impose minimum thresholds for shareholding percentage, in order to exempt dividends from tax. Romania chose a minimum of 10%

ownership of the share capital within a subsidiary that yields dividends, and set a minimum holding period of one year, as opposed to the Netherlands, who have a quota of 5%, and Cyprus, 1%.

6. Conclusions

Romania still has a lot more steps to take on the way to the Eurozone, as this is a complex process, which still requires many reforms for creating a developed, sustainable and competitive economy within all of the eight regions, which would generate benefits for the Romanian people. The process of adopting the euro must benefit from national consensus, untainted by the election cycle or by doctrinal differences.

Romania's accession to the euro area must represent a strong anchor for structural reforms, one that would lead to a better standard of living for Romanians, one closer to the European average.

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