Institutional convergence - part of Romania's economic development

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Abstract: *This paper presents the issue of economic convergence, reviewing some of the theories used in analyzing this process, theories of economic growth, types of economic convergence: nominal, real and institutional convergence, the effects of the recent crisis on economic convergence. The programme Worldwide Governance Indicators is measuring the indicators of institutional convergence for Romania between 1996-2012.*

Keywords: economic convergence, economic growth, institutional convergence

Introduction

The economic convergence represents the fundamental process of economic integration in the European Union. This process is quantified by macroeconomic indicators. Ensuring economic cohesion of the whole ensemble is one the essential conditions of European Union, in addition to eliminating disparities, reduce deficits and compatibility of administrative structures in different countries and regions.

As stated in the article ,,The Global Financial Crisis and Its Implications on the convergence of Romania with the Economic and Monetary Union"(V. Avram), the convergence is of three types: institutional convergence (reflected in the compatibility of Romanian institutions with the EU, the structure and operation), nominal convergence (it refers to criteria that EU member states must meet to join the Economic and Monetary Union) and real convergence (to be found in labor productivity, GDP/capita and so on). Reaching the state of convergence is a process, the term used is ,,catching-up", but it should not mean the way a country should follow, but rather a goal to which must aim.

Economic convergence implies almost identical evolution of economic variables in two different countries or regions. In the European model, cohesion policy should support sustainable economic growth. Achievements of the EU Single Market had positive effects on the EU economy as a whole, but these benefits have not been equally distributed between Member States, between regions and social groups. In the paper ,,The economic convergence in the European Model"**-** N. Sirghi, L. Cismas, it tries the explanation of defining elements of the European model, emphasizing the link between convergence and the real economic growth.

Economists focus on the issue of economic growth is due to the major impact this phenomenon has on the population of a country. Thus, achieving and maintaining a sustainable growth rate becomes a major objective of macroeconomic policies of a country.

1. Theories of economic growth

Economic literature has been dominated by the neoclassical model of the 60's Solow-Swan (1956). Neo-classical economic approach developed Solow-Swan model, is based on the appearance of exogenous growth, with the next assumptions (,,Economic Convergence in the European Union"- M. Marinaş): the capital is subject to decreasing returns; countries that have the same characteristics in terms of population growth, technical progress and investment rate will record income that will converge to the present value in the most developed country; perfect flexibility of production factors causes the reduction of regional disparities; scale yields are constant; technical progress is exogenous.

On short-term, net capital accumulation contributes to the stimulation of growth. Economies will tend to steady-state, regardless of the capital stock. If countries have the same structural parameters (s, n, δ), then it will tend to the same equilibrium level of income per capita, which leads to the absolute convergence hypothesis: as income levels approaching steady state rate growth is reduced.

According to Solow's vision, technical progress can support the catching-up and investments influence the economy on medium-term. Going forward, the differences may increase if no action is taken to improve education, technology and business. Increasing regional disparities within Member States and the entry of less developed countries in the EU has led to distancing from the neoclassical approach. Interest in this model of growth began to decline in early 1970, when economists have turned their attention to other indicators such as unemployment, inflation and the oil shocks.

Since the 80s (Romer, 1986), there is a revival of interest in growth theory and thus a second generation of models arises. It brings the following improvements: an attempt to explain aspects of data which is not discussed in neoclassical models, highlighting the differences between the growth rates of different countries. These models are seeking to explain the long-term growth rates as the result of rational behavior of economic agents that optimize their behavior reflecting the structural characteristics of the economy. They are models of endogenous growth.

In the economic literature, two main categories of economic convergence highlights: convergence type β and convergence type σ. The first type involves higher growth rates for poorer countries than for richer countries, and the second relates to reduction of the GDP/capita dispersion, in time, within a group of countries. You can add a more recent concept, convergence type γ, which involves using Kendall index for testing beta convergence (,,Convergence, divergence and EU Cohesion: Conceptual and literature review "- A. Zait).

Theories of economic growth are closely related to those of economic convergence. Besides neoclassical theory (which emphasizes the idea of absolute convergence) occur and neo-liberal theories (where, first, the gap is widening, then, it arrives from a period of divergence to one of convergence). In the same paper, it is stated that prudence in the support of convergence is found in the neo-classical theories improved (augmented). Endogenous growth is divided into two groups of theories: of endogenous innovation (Schumpeterian endogenous innovation) and endogenous capital (endogenous broad capital). Finally, the existence of long-term divergence is supported by Myrdal, Kaldor, Perroux under the form of regional growth patterns.

The structural transformation of the economy and the rapid catching development is achieved through economic convergence of a country that has both community and internal sources. Economic convergence process is supported by cohesion policy (,,Economic Convergence in the European Union"- M. Marinaş).

The financial crisis of 2007-2008 brought to light a number of weaknesses within the European Union and the euro area. Amid them, the need for better coordination between Member States' economic policies became evident. Fiscal surveillance is the first component in the new coordination, introducing constraints in real convergence process towards limiting public investment for the catching-up process.

As it is noted in the article ,,Romania between sustainable development and real convergence" (Ghizdeanu I.), an improvement in the real convergence is a difficult process because of the international context of the financial and economic crisis, and the divergence of macroeconomic stability and growth necessary to accelerate the process of catching-up to the EU average. This process is affected by globalization and financial integration.

There are many issues that our country should consider: catching-up process is lengthy, financial discipline should be imposed in the economy, macroeconomic policies should promote growth and stability.

Member States wishing to join the euro area must turn their attention to the risks related to convergence. Countries that accumulate large internal and external deficits are very vulnerable. With the financial crisis, lending slowed and conditions of grant have escalated.

Also, the recent financial crisis illustrates the attempts that a monetary union, which contains different countries, encounters. Costs and benefits of a monetary union have been considered in the literature and are closely related to the theory of optimum currency areas (R. Mundell, 1961). Among the criteria of optimum currency areas there is the similarity of business cycles with a very important role because the more synchronized business cycles are, the costs abandoning monetary independence are lower (,,Has the Business Cycle Changed euro synchronization? Evidence from the core and the periphery"- S. Lehwald). Frankel and Rose (1998) argues that the mere participation in a monetary union may lead to a greater synchronization of business cycles. On account of the recent financial crisis, a new line of argument has emerged. According to the Sinn et al. (2011), the introduction of the euro promoted imbalances on inflows of private capital and competitiveness of Member States. Excessive capital imports supported economies on the periphery of Europe (in countries such as Greece, Ireland, Portugal and Spain) and at the same time, the core Eurozone countries have experienced low rates of investment, which led to economic stagnation. Changing the perception of risk occurred with the appearance of the financial crisis changed the existing models and has led center countries on a faster return, while the periphery countries have encountered difficulties in economic recovery.

2. Institutional convergence

Institutional convergence is reflected in the economic and administrative compatibility, in that the same values, laws and uniform procedures and consistent business environment in the European Union. If it would be made an analysis on the basis of institutional performance, assessing the quality of political and economic institutions of society, it would start from the known analysis of the institutional framework, namely: Worldwide Governance Indicators program from the World Bank, Index of Economic Freedom from the Heritage Foundation, Bertelsmann Transformation Index, indicators of the European Bank for Reconstruction and Development etc.

The question is to what model of institutional convergence should head a developing country? The role of the institutions, relationships between them, how they affect social and economic activities, could formulate a response. Worldwide Governance Indicators Program examines and measures the quality of governance in 215 countries based on governance indicators. The quality of governance can be assessed in three ways, according to the authors of the program:

the process by which governments are selected, monitored and replaced, the capacity of the government to formulate effectively and implement sound policies and the respect of citizens and the state for the institutions that govern relations between them (Prisecaru, P. - The process of institutional convergence).

Launched in 1990, the program examines six aggregate indicators of governance: 1) control of corruption; 2) the effectiveness of the government (the government's ability to implement policy measures); 3) political stability and absence of violence; 4) freedom of speech and accountability; 5) the quality of regulations; 6) the rule of law.

The first indicator measures people's perception of the degree of corruption. The second aggregate indicator, government's ability to implement and formulate sound policies, is measured by the quality of public services. The indicator shows people's perceptions of the quality of public services, dependence on political pressures and people's perception of the competence of civil servants.

Political stability and absence of violence refers to indicators on which measured people's perception of the possibility that the government will be overthrown by unconstitutional or violent means.

The fourth indicator includes elements such as aspects of the political process, the extent to which a country's citizens are able to elect governments, freedom of expression, media independence. Quality regulations indicates people's perception on the ability of governments to formulate and implement policies and regulations to promote private sector development, market control, monitoring banks etc.

The primacy of the rule of law includes indicators that measure the extent to which economic agents follow the rules of society, the way people perceive efficacy judgments, enforcing contracts and property rights.

Control of corruption captures the extent to which public power is exercised for private gain, both small and large forms of corruption, and state capture by elites and private interests. Estimated aggregate indicator gives the score for the country in units of a standard normal distribution, -2.5 to 2.5, where higher values correspond to better governance. Distribution indicates the country rank among all countries covered by the aggregate indicator, with 0 corresponding to the lowest rank and 100, the highest rank.

Between 1996-2012, according databank.worldbank.org, Romania had the best level of estimation in 2006 (-0.15123) and the lowest level in 1998 (-0.68355) and on the distribution between countries, the best level 2011 (55.45024) and the lowest all in 1998 (30.2439). Corruption is a major problem in Romania and is sometimes regarded as an institution itself. It may harm economic growth in that public funds may be diverted to corrupt politicians, it may distort public investments. Development of local institutions and their transparency should lead to lower corruption.

Government effectiveness capture people's perceptions of the quality of public services, the degree of independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies. Romania recorded the best level of estimation in 2004 (-0.16741) and the lowest level in 1998 (-0.62289) and on the distribution between countries, the best level in 2004 (51, 21951) and the lowest in 1998 (28.29268).

Political stability and absence of violence/terrorism captures perceptions of the likelihood that the government will be destabilized or overthrown by unconstitutional or violent means, including politically-motivated violence and terrorism. Romania recorded the best level of estimation in 1996 (0.491467) and the lowest level in 2000 (-0.48184) and on the distribution between countries, their best all in 1996 (62, 5) and the lowest in 2000 (30.28846).

Freedom of expression and accountability capture the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of association and a free media. Romania recorded the best level of estimation in 2006 (0.523252) and the lowest level in 1996 (0.242133) and on the distribution between countries, the best level in 2003 (55.76923) and the lowest in 2000 (47.54902).

Rule of law refers to the degree to which businesses and individuals trust and respect the rules of society. Romania recorded the best level of estimation in 2011 (0.047627) and the lowest level in 2002 (-0.26889) and on the distribution between countries, the best level in 2011 (56.80751) and the lowest in 2003 (44.97608). Property rights are considered one of the most important economic institutions, having a big influence on long-term growth and on financial development.

Quality of regulations indicates people's perceptions on the ability of government to formulate and implement sound policies and regulations that permit and promote private sector development. Romania recorded the best level of estimation in 2011 (0.656941) and the lowest level in 2000 (-0.11845) and on the distribution between countries, the best level in 2011 (74.40758) and the lowest all in 2000 (47.54902).

The quality of institutions reflects their performance. However, there is danger of confusing good institutions with those that generate growth, ie, a set of economic institutions can be good in certain periods and weak in others. Although empirical evidence are supporting a strong effect of economic institutions on economic growth, it can be said that the relationship would be reversed, ie, economic growth leads to the formation of better institutions.

Romania has made progress on institutional convergence line in the community acquis, which led to joining the European Union in 2007, meeting the criteria of membership. The four sets of criteria for membership (political, economic, acquis absorption, public administration reform) led to the redefinition and restructuring of old institutions. But the institutional convergence process is not completely; it must continue, increasing the convergence potential of Romania to the European Union.

Conclusions

From Adam Smith to the founders of the new institutional economics (Ronald Coase, Douglass North and others) it is written in the literature about the impact of institutions on economic growth and convergence. Douglass North and Robert Thomas emphasize the important role of institutions in economic growth. How people decide to organize society is the way that determines its prosperity. Thus, public institutions outlined with their specific tools the economic environment, stimulating or discouraging capital accumulation, adoption of new technology etc. The difference between institutions and other fundamental causes that underlies the economic growth lies in the fact that it is a social choice, choice that is made by the majority of society, or a group of individuals. It can be said that the manifestation of economic convergence is determined by the quality of public institutions, given that adoption of new technologies is influenced by economic policies, level and quality of human capital depends on the education system, on the policies adopted in education and research (Prisecaru, P. - „The process of institutional convergence”).

Economic convergence is an essential component of development, but not the only one. Development is not simply an economic phenomenon, meaning more than the material and financial aspects. It is equally a social phenomenon that requires more than an increase in productivity per capita. Development means the elimination of poverty, unemployment and inequality (discrimination). The path to human development is given by both the development and economic convergence. Therefore, development should be conceived as a multidimensional process involving the reorganization and reorientation of entire economic and social system.

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