Bulletin of the *Transilvania* University of Braşov • Vol. 6 (55) •No. 1 - 2013
Series V: Economic Sciences

IS THE ESTONIAN MODEL APPLICABLE TO ROMANIAN ECONOMY IN ADOPTING THE EURO?!

I. RADU[1] M.-L. CIUPAC-ULICI[2] A. PETCU[3]

Abstract: *Euro adoption has become a logical step toward the integration of each European state in the EU, even though at the time the bail-out is more often discussed. Romania's new status, which was obtained in 2007, makes it necessary for our country to think twice about its duty on assuring stability and security in the South-Eastern Europe, especially for the Romanian economy. Since the Euro adoption process is a controversial one, in this paper we aim to express our concerns regarding the major changes driven from other member states of the Euro Area, i.e. the Estonian model. Along with this model, our paper attempts to assess the advantages and disadvantages of the Romanian economy and to highlight their effects on ensuring a sustainable development for Romania*

Key words: *European Monetary Union, common currency, ERM II, sustainable economy, Estonian model.*

1. Introduction

All new EU members aiming to join the Euro Zone are bound to face more challenges in the process of entering the Monetary Union under the very serious impact of the financial crisis. Even if at the time the Euro bailout was widely disputed, the "euroisation" seemed to be the way to go ahead the crisis, since Robert Mundell (Nobel economist widely recognized as "the godfather of the euro") states that "the more countries accede to a monetary union, the lower the internal and external instability is and the more efficient the currency becomes", adding later that "a currency union is like an alliance – shedding a small member with more liabilities than assets can make the union stronger". Now, the Greece's case showed the fragility of the Euro, a reason why various economists like Paul Krugman and other claim that the euro was a mistake and Mundell's paper "The theory of optimum currency areas" has deficiencies in terms of fiscal and labour mobility, since Europe did not have either and therefore "the creation of the Euro Zone violated the basic economic rule known as *optimum currency area*" (Robert Mundell. Euro is the way to stay, *Financial Post*, Jun 10, 2012). As a consequence, the Greek crisis repercussions could be felt in the entire Europe, especially in the Euro zone, since the uncertainty regarding the Greek

[1] PhD. Student, *Babes Bolyai* University of Cluj Napoca.
[2] Commercial Academy of Satu Mare.
[3] PhD. Student, Bucharest Academy of Economic Sciences.

economy continues to steadily erode the support for Euro and poses the risk of a further depreciation of the common currency against the USD. given the circumstances, the main European Principle of Stability is affected and with this, all the European countries, especially the Euro Zone members, face a bad situation since they have to repay their debts in a depreciated currency.

In response to the worldwide financial crisis, governments have bailed out their large banks and some of their large companies, thereby earnings equity stakes in these enterprises. In the process, these governments have accumulated massive deficits. On the contrary, Estonia presents on one hand a particular situation and an opposite example for the euro's resilience. Following a reforming process started in 2004, Estonia transformed itself into a dynamic economy, gaining recognition for its sound fiscal record, economic freedom and capacity to develop new technologies. Moreover, Estonia has adopted the Euro beginning with the 1st January 2011 and joined the Euro Zone when things were complicated in both European and world economies. Following other post-communist countries, Slovenia and Slovakia, Estonia became the third one which has fulfilled the Maastricht Criteria on inflation, debt and the budget deficit.

Therefore, in order to reorient Romania's economy toward Euro adoption, we conducted the current study for analysing the best suitable or unsuitable measures or conditions to adopt the euro.

The paper is organized as follows. The first section provides a brief background on the Estonian economy conditions that have been favourable factors for Euro adoption. Section 2 conducts an analysis on the correlation of Estonia's economy with those of the euro area. Section 3 details the main lessons that Romania could learn for the Euro changeover. Section 4 concludes and addresses the potential benefits or risks for Romania.

2. Literature review

Since the Euro developed as a currency and as the European Union continued to flourish, Europe has become one of the main beneficiaries of the opening up of China, Eastern Europe, and the New World. Moreover, about 50 percent of Euro Area exports of goods go to emerging markets, roughly the same share as for the United States. In 2008, extra euro exports of goods fluctuated around 16 percent of GDP, while the United States was less export – oriented at 9 percent (Global Exposure Guide, 2007). The previous comparison has abetted various economists toward explaining the role of the European common currency and its macroeconomic or global impact in order to highlight the importance of the integration and the globalisation process.

Europe has increased in competitiveness afterward the European Union construction. From an undiscovered gem, Europe has become a better alternative, considering the large block of economic advantages offered by the European Union. The euro area certainly qualifies as large in economic size, as measured by GDP, in population size (passing 500 millions), and in political configuration, as it encompasses many nation – states. In this term, the recent globalization process is offering new opportunities through greater international cooperation but also creating a more competitive environment (Radu I., 2010, p.77).

Coming up to the real opportunities of the European Union, some of them are result of the removing of market inefficiencies and the development asymmetry between the European countries which have been catalyzed toward the convergence and integration

process. In line with the Treaty, a country must be eligible to adopt the euro when it has achieved a high degree of sustainable convergence and its economy is in a position to fully reap the benefits of joining the euro-area. Instead, a lack of sustainability would inevitably result in serious economic challenges for the newcomer and would possibly have negative consequences for other euro-area countries, or even for the euro-area as a whole (ECB Report).

By following the specific criteria of the Maastricht Treaty [*Note:* The Maastricht Treaty required countries to achieve a high degree of convergence, based on specific criteria: a) A high degree of price stability; b) Sound public finances; c) Stable exchange rates; d) Low and stable long – term interest rates; e) Independent central banks], the European countries have achieved a high degree of convergence, demonstrated by several areas of positive changes:

- The Euro Area has become one of the largest economies in the world.
- The single currency eliminated currency risk and volatility and has led to a single market of goods and services that is easily comparable across borders.
- The single monetary policy led to the "harmonization" of rates; key central bank rates are set by the ECB and are the same for all the countries in the Euro Area.
- The legislative and legal framework sought to ensure a single set of rules pertaining to financial instruments and, thereby, equal access to markets, while financial development reduced transaction costs, and institutional investors enhanced cross – border equity – capital flows. (ECB, "The Road of Economic and Monetary Union"; Radu I., 2010, p.78).

The Euro was and is a grand experiment in the history of monetary economics (Kotok, as cited in Kotok & Sciarretta, 2010) and its creation has attracted both favouring and susceptible categories of economists and specialists in order to ensure a resilient economy to cope with potential external shocks by building solid macroeconomic fundamentals and identifying the best manoeuvring of the economies policies. From the plenty of studies conducted on the issue of European integration and the construction of a monetary union, the studies have been orientated and regrouped between sceptics and favouring ones. For example, Lättemäe and Randweer (2006) and others like Mundell, Munchau, Kotok & Sciaretta, Brixiova Z., Morgan M.,& Worgotter, Gabrish H.& Staehr expressed their confidence in the Estonian's economy best synchronization with the EA since Estonia has viewed the euro adoption as the most appropriate exit strategy from the currency board. Others have addressed their worries related to Euro adoption.

For example, Dadush U. et al. (2010) analysed the Euro crisis that had its roots deeper to the secular loss of competitiveness starting with the euro adoption in countries like Greece, Ireland, Italy, Portugal, and Spain. He identified some facts that led to the "secular loss of competitiveness" such as: a) the adoption of the euro was accompanied by a large fall in interest rates and a surge in confidence, as institutions and incomes expected to converge to those of Europe's northern core economies; b) domestic demand surged, bidding up the price of non-tradable relative to tradable and that of wages relative to productivity; c) accelerated growth, driven by domestic services, construction, and an expanding government, while exports stagnated as a share of GDP, and imports and the current

account deficit soared amid abundant foreign capital; e) the result was that indebtedness—public, private, or both—surged. As a result of their study, Dadush U. et al. have proposed three important lessons for the newcomers to join euro in order to assess their situation and apply these valuable lessons to avoid much painful adjustments in the future:

- First, competitiveness needs to be closely monitored and, since currency devaluation is not an option under the euro, reforms must be made early on. For example, a tax structure that weighs more on construction and services could help moderate the demand for and supply of non-tradable goods.
- Second, special attention needs to be placed on wage-setting and labour market flexibility, as well as on how to bolster the tradable sector.
- Third, there is a strong case for moderating the inflow of foreign capital, especially debt-creating capital, during the early years of euro adoption via tighter bank regulations on borrowing abroad and general capital controls.

In addition, Mundell (2012) recognizes that two major reforms need to be done for correcting Euro-areas defects, in order to protect the European Union and the European Monetary Union. The former is that there are 17 banking systems in the Euro-area and the other is that there are 17 nations with national treasury bills and bonds. As a consequence, he proposes that the banking system in Europe should follow the successful model of the United States, that of a unified system that might shift the sovereignty from the different EU members toward the centre, which would implicitly result in substantial increases in efficiency. Also, creating Euro-area bills and bonds would give Europe a potential supply of international capital from central banks that are going to shift their assets to others denominated in Euros.

Comprehensive studies on the impact of financial crisis on the Euro stability are those made by Wolfgang Munchau (2009, 2010). His article “Eastern crisis that could wreck the Euro Zone” analyses the extent to which the crisis can trigger serious problems for the EA and sustains that the recent changes of the European exchange rate mechanism have driven to a slight beginning of the “break-out of the Euro-zone”, since one country after another have become subjects to speculative attacks – leading to the expulsion of the UK and Italy from the ERM.

Unfortunately, the financial crisis has taught non – Euro Area members and the European Union that it is better to be part of the Euro Area than to go it alone. Moreover, most of the remaining countries in the European Union are attempting to qualify and enter the Euro Area through the Exchange Rate Mechanism (ERM). For example, Baltic countries are attempting to accelerate their qualifications so that they can be admitted to the Euro Area. In other countries that are not qualified and in peripheral European countries that are not EU members, the euro is the dominant outside currency (Radu I., 2010, p.81).

At the time when EA became EA17, the President of the ECB, Jean-Claude Trichet, in order to enhance the powerful symbol of the Euro and to pursue actively the strategic road of the European countries towards the unification of the Euro Area , declared: “There is no better way to demonstrate that the euro area is not a “closed shop” but is open to those countries and economies that are fully compliant with the entry criteria in a convincing and sustainable manner” (Speech by Jean-Claude Trichet, President of the ECB, at the Euro Conference hosted

by Eesti Pank, Tallinn, 20 September 2010, www.ecb.int/press)

3. The success of the Estonian growth model

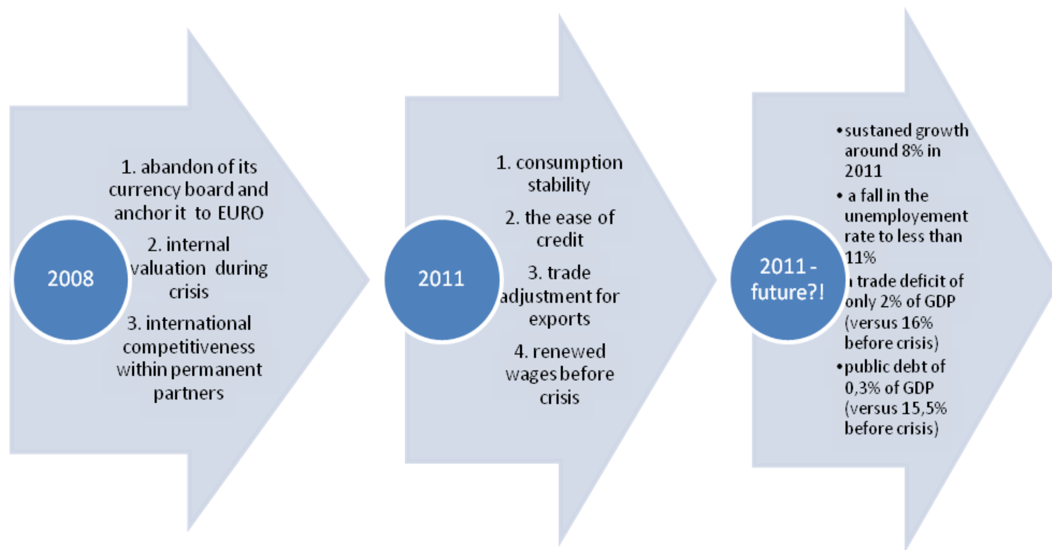
3.1. The Estonian Model of Growth

Following 11 monetary reforms (since 1914, but the milestone was the 1992 monetary reform when the currency board arrangement was set – the fixed exchange rate 1 EUR = 15,6466 EEK kroons) and other socio-economic reforms over the last fifteen years, Estonia has become a successful growth model among the most emerging markets in the Central and Eastern Europe.

The Estonian growth model has its roots in 1992, shortly after regaining independence from the Soviet Union, when Estonia left [1] the ruble zone and established its own currency (kroon), and simultaneously introduced the currency board, pegged initially to the German mark and since 1999 to the euro. With the adoption of the currency board, Estonia gave up its exchange rate and monetary policy in order to enhance the credibility of its monetary stance and reduce inflation (Brixiova Z., Morgan M., Worgotter A. (2010). Later, in June 2004, by joining the EU and the ERM II and aiming at an early euro adoption (at the prevailing exchange rate), Estonia has strengthened its commitment to a fixed exchange rate regime.

Moreover, Estonia's success has been a source of continuous studies since its peak during the 2008/2011 economic crisis. Its model stands as an example since Estonia abandoned its currency board by adopting the Euro on 1st January 2011 with the assumed risk of massively devaluating its currency - the kroon. Their internal devaluation has become the best strategy on driving and exposing international competitiveness. Even if this method had its disadvantages (e.g. significant decline of wages - up to 10%-15% at the peak of the crisis - which have generated a few strikes and demonstrations), the government decisions on complying with the economy sector with a more flexible labour market (e.g. easier redundancy procedures, etc.) have induced the economy to become more competitive.

Therefore, by devaluating its currency, lowered wages and implicitly a weak demand, Estonia led to "trade war between the countries" since the main trade partners - Sweden and Finland - upturned their position during the crisis (Levasseur S., 2012).



Source: authors own interpretation

Fig. 1. *The Estonian Growth Model*

Since Estonia became "a kind of a European wonder child which, in the midst of the grimmest recession" (www.vm.ee, *Estonia on the road to the Euro Zone* apud Helsingin Sanomat, 06.02), we bring to the forefront Estonia's efforts made for complying with the euro criteria. Its harsh economic policy based on a rigorous self discipline and willingness of sacrifice through reduced costs, lowered salaries and dropped national incomes, but with an attractive site for production and trade, has managed to fulfil the euro criteria.

a. Compliance with the inflation criterion

According to the Treaty on European Union, a Member State's inflation rate must not exceed the average of the three best-performing Member States in terms of price stability by more than 1.5 percentage points.

Three out of four Estonians fear that the changeover to the euro will lead to a rise in price. But the Estonian government advertised a Euro campaign which would prevent prices going up when the euro is introduced by joining the businesses to the "Fair Price Campaign" or Fair Pricing Agreement.

Evolution of inflation during 2000 - 2012 Table 1

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
EU**	1.9	2.2	2.1	2	2	2.2	2.2	2.3	3.7	1	2.1	3.1	2.6*
EU***	3.5	3.2	2.5	2.1	2.3	2.3	2.3	2.4	3.7	1	2.1	3.1	2.6*
Estonia	3.9	5.6	3.6	1.4	3	4.1	4.4	6.7	10.6	0.2	2.7	5.1	4.2

Source: Eurostat; Note: * - provisional, ** - EU6-1972, EU9-1980, EU10-1985, EU12-1994, EU15-2004, EU25-2006, EU27, *** - 27 countries

Estonia adopted the euro in January 2011, in the middle of an economic crisis. The common currency was popular before its adoption, but the inflation rate in the country and high prices in the shops contributed to a change of heart with the population. The currency change has greatly affected the daily lives of Estonians.

Following the data in Table 1, it could be seen that Estonia has the highest inflation rate in the Euro-zone, averaging 5.1 percent in 2011. But it is also its poorest country. The average monthly salary in Estonia is 809 Euros. Thus, the country offers investors the cheapest labour in the EU and as a consequence it maintains its competitiveness among the Nordic countries.

b. Long-term interest rate

The long-term interest rate of a Member State must not exceed the average interest rate of the three best performing Member States in terms of price stability by more than 2%.

The long-term interest rate criterion is not directly applicable for Estonia, as no benchmark long-term government bonds or other appropriate securities are available to assess the durability of convergence as reflected in long-term interest rates.

Evolution of long-term interest rate [2] during 2000 - 2012 Table 2

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
EU*	n.a.	5	4.92	4.23	4.38	3.7	4.03	4.56	4.54	4.13	3.82	4.31	3.74
EA**	5.44	5	4.91	4.14	4.12	3.42	3.84	4.32	4.31	3.82	3.61	4.41	4.01
Estonia	9.67	8.77	7.14	5.67	4.49	3.72	4.55	5.62	5.85	4.41	3.75	3.85	3.34

Source: Eurostat; Note: * - 27 countries, ** - EA11-2000, EA12-2006, EA13-2007, EA15-2008, EA16-2010, EA17. n.a. – not available

The absence of suitable bonds reflects a very low level of gross public debt, reflecting the budget surpluses in 2002-2007. While financial market risk perceptions vis-à-vis Estonia increased at the peak of the crisis, their development during the reference period, as well as a broader assessment on the durability of convergence, including Estonia's continued prudent policies, supports a positive assessment on Estonia's fulfilment of the long-term interest rate criterion.

c. Stable exchange rate

The country must, for at least two years, participate in the currency exchange rate mechanism ERM II and keep the exchange rate of its currency stable against the euro (in particular without devaluation on its own initiative).

The kroon was reintroduced as Estonia's currency on 20 June 1992, replacing the Soviet ruble at a rate of 1 kroon = 10 rubles. Initially, the Estonian kroon was pegged to the Deutsche Mark at a rate of 8

kroons = 1 Deutsche Mark. After the introduction of the euro, the fixed exchange rate of 1.95583 DEM to EUR led to an exchange rate of 15.64664 kroons to the euro. On 27 June 2004, as Estonia joined the ERM II-system, the central parity of the Estonian kroon was revalued to 15.6466 kroons per euro. On 1 January 2011, the euro replaced the kroon as the official currency of Estonia. The kroon circulated alongside the euro until 15 January 2011 at which point it ceased to be legal tender.

From a different perception, by joining the Euro-area, Estonia distances itself from Russia and as a consequence, the euro will help not only the Estonian economy, but also the sense of security (Foreign Policy Institute, Kasekamp A.)

d. Public finances criterion

The general government deficit must be lower than 3% of GDP. Government debt must be less than 60% of GDP or approaching the required level at a satisfactory speed.

Estonia is not the subject of a Council decision on the existence of an excessive deficit. The deficit and debt are well within the acceptable limits for the convergence assessment: the deficit was 2% of GDP in 2009 despite an unprecedented 15% decline in nominal GDP.

Evolution of the general government debt as percentage of GDP during 2000 - 2011 Table 3

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
EU*	61.9	61	60.5	61.9	62.3	62.8	61.6	59	62.2	74.6	80	82.5
EU**	62.1	61.2	60.7	62.2	62.6	63.2	62.1	59.6	63	75.3	80.7	83.2
Estonia	5.1	4.8	5.7	5.6	5	4.6	4.4	3.7	4.5	7.2	6.7	6.1

Source: Eurostat; Note: * - EU6-1972, EU9-1980, EU10-1985, EU12-1994, EU15-2004, EU25-2006, EU27; ** - 27 countries; n.a. – not available

Evolution of deficit as percentage of GDP during 2000 - 2011 Table 4

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
EU*	0.6	-1.5	-2.6	-3.2	-2.9	-2.5	-1.5	-0.9	-2.4	-6.9	-6.5	-4.4
Estonia	-0.2	-0.1	0.3	1.7	1.6	1.6	2.5	2.4	-2.9	-2	0.2	1.1

Source: Eurostat; Note: * - 27 countries, n.a. – not available

The deficit is expected to amount 2 ½% this year and in 2011 according to the Commission's spring forecasts. The general government debt stood at 7.2% of GDP in 2009, which is also well below the Maastricht limits, and it will remain so even though the public debt is forecast to further increase by 2013.

e. Legal requirements for the adoption of Euro

Assessment of the compatibility of national legislation, including the statutes of the national central banks, with the Treaty on the Functioning of the European Union and the Statute of the European System of Central Banks.

The first and foremost assessment of complying with the legal requirements was the independence objective of the Estonian Central Bank, i.e. Eesti Pank.

Estonia was close to fulfilling legal criteria for the first time in 2006, but it started to amend the Eesti Pank Act - the Act on the Introduction of the Euro needs to be adopted – on June 7, 2006. The Act became effective on July 8, with 66 votes in favour and the time for the changeover to euro started to be clearer.

According to the Convergence Report of the European Commission, the Eesti Pank Act is in conformity with the Treaty and the Statutes of the European System of Central Banks (ESCB), whereas the European Central Bank's Convergence Report suggests some adjustments in the Act. These adjustments concern additional supervision over the activities of Eesti Pank, open market and loan operations and the minimum reserves (Source: Report on the adoption of the Euro, Eesti Pank, Bank of Estonia, May 2007).

While drawing up the Convergence Reports of 2010, the European Commission considered it necessary to revise the Eesti Pank Act and thus also the Statutes of Eesti Pank. On 22 April 2010, the Parliament adopted the Law on the Introduction of the Euro, which also amended the Eesti Pank Act and repealed the Currency Law and the Law on the Security of the Estonian kroon, with effect from the date of the introduction of the euro. The Convergence Reports of the European Commission and the European Central Bank, published on 12 May 2010, considered that the Estonian legislation is legally compatible with the Treaty on the Functioning of the European Union and the ESCB Statute (Source: Report on the adoption of the Euro, Eesti Pank, Bank of Estonia, Sept. 2010)

3.2. Financial market

The Estonian Banking System is stable and quite bank centred since the largest banks are subsidiaries and affiliates of Scandinavian banking groups (Swedish, Finnish and Danish). Also, the European Commission reports that the Scandinavian-connected banking system of Estonia is modern and efficient, being the strongest and best-regulated in the region. (http://estonia.eu/about-estonia/economy-a-it/a-dynamic-economy.html). In addition, the current situation of the financial market of Estonia is a result of several facts, i.e:

- the banking system is part of the common banking market of the Northern Baltic region and Europe;
- the banking market is concentrated around 7 banks and more than 90% of the banks operating in Estonia are under Scandinavian ownership;
- the interbank money market is very small, that is why potential problems in one bank should not have a direct impact on other banks;
- the banks operating on the Estonian financial market are well capitalized and confer a high protection;
- the Estonian capital market allows accessing, operating and investing without barriers on Latvian and Lithuanian Markets (40,3%);
- the loan burden ratio of the Estonian private sector to GDP is relatively low;
- Estonia has a small public debt.

The total capitalization of the 15 companies quoted on the Tallinn exchange has reached EUR 1,24 billion by the end of 2011, 26,33% less than at the end of 2010 and, compared to the pre-crisis period – as of the end of 2007, down by 69,8%.

The substantial decline in capitalization resulted from the crisis on the global financial markets, because due to high

liquidity, investors were able to easily divest their holdings in companies on the Tallinn exchange.

Evolution of market capitalization during 2000 – 2011(mld. $) Table5

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
EA	5435.4	4326.2	3515.5	4971.5	5953.6	6357.3	8651.3	10474.6	5154.6	6147.6	6276.9	5482.9
EU	8506.5	6866.1	5701.1	7926.6	9451.1	10198.7	13545.4	15631.7	7582.3	9823.2	10504.4	9265.9
Estonia	1.85	1.48	2.43	3.79	6.20	3.50	5.96	6.04	1.95	2.65	2.26	1.61
Latvia	0.56	0.70	0.71	1.14	1.65	2.53	2.70	3.11	1.61	1.82	1.25	1.08
Lithuania	1.59	1.20	1.46	3.51	6.46	8.18	10.19	10.13	3.62	4.48	5.66	4.08

Source: World Bank Database

Compared to the Lithuanian exchange, the capitalization companies on the Tallinn exchange was significantly smaller (2,5 times, but compared to the Riga stock exchange, 1,5 times larger), turnover on the exchange was somewhat larger than in Lithuania (EUR 176 million) and several time larger than that of the Riga exchange.

3.3. Labour market and the quality of life

Even though the Estonian strategy imposed the currency devaluation during 2011, now the adjustments of the nominal wages are an essential step to a gradual correction of the competitiveness losses and the return to sustainable output growth. But a more important stage on restoring the competitiveness will be reaching a sustainable wage dynamics, with increases in line with the productivity process - a fact that will be crucial on maintaining a low inflation. As a fact, the Estonian trade unions want a 10 percent increase in the minimum monthly wage from January 2013 to keep income gaps between the rich and the poor from widening and reduce tax avoidance. Also, the unions are demanding the minimum gross wage rise to 320 Euros from 290 Euros, according to a statement published on the website of the Confederation of Estonian Trade Unions late yesterday.

Earnings of the richest increased four times more than those of the poorest fifth of Estonians between 2003 and 2010. The move would also reduce the so-called envelope pay or undeclared cash payments by employers, which amount to 10 percent of the total.

Minimum wages (EUR/month) Table 6

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Estonia	89.5	102.3	118.2	138.1	158.5	171.9	191.7	230.1	278.0	278.0	278.0	278.0	290.0
Latvia	87.8	111.3	100.2	107.9	121.8	114.9	129.3	172.3	227.1	255.8	253.8	282.0	287.1
Lithuania	112.6	126.8	124.6	124.5	144.8	159.3	173.8	202.7	231.7	231.7	231.7	231.7	231.7

Source: Eurostat

Today, the Estonian Chamber of Commerce and Industry (www.koda.ee) reports the World Bank review on "Doing Business in 2011", placing the country on the 17th rank among 183 countries and in 2012 on the 16th out of 183, being one of the freest economies in the world, because: starting business is easy (number of

procedures – 5 and minimum starting capital of most wide-used company form is only 2500 EUR), taxation is simple and transparent, investors feel secure, trading across borders is active, communication is easy, job regulations are flexible. Among the EU countries, Estonia comes fourth after Finland, Ireland and UK (CATO Institute, Canada's Fraser Institute, Heritage Foundation, Wall Street Journal, etc.). Therefore, among the international ratings for 2012, Estonia enhanced best credit ratings. For example, Moody's note Estonia with A1 grade, Standard&Poor's: AA-/A-1+ and Fitch: A+, all comprising a stable outlook that stated that Estonia has the fourth-highest investment grade and the highest rating in eastern Europe on a par with the Czech Republic.

In addition, the World Economic Forum's Global Competitiveness Index 2012-2013 ranks Estonia 34th among 144 countries. The survey among business leaders measures economic competitiveness based on a combination of technology, the quality of public institutions and the macroeconomic environment. All these have been the result of the Estonian Growth Model that has been implemented by the time Estonia anchored its currency to the euro.

3.4. Lessons derived from the Estonian case

Estonia became "the real test case for euro accession, showing whether the Euro-zone enlargement is a credible and open process" (Wall Street Journal, 12.05), a reason why we emphasize the Estonian experience in encouraging other EU member countries to contribute to a sustainable functioning of the Economic and Monetary Union in the years ahead.

The Estonian case demonstrates that the membership in the common currency area is associated with various benefits that by far exceed the costs.

1) First, the elimination of the exchange rate excludes the possibility of a currency crisis, which in turn results in foreign currency debt rating.
2) Second, giving up the domestic currency will contribute to the decline in domestic interest rates due to the elimination of the exchange risk premium.
3) As a consequence, the cost of capital decreases, which leads to increasing domestic investments.
4) Fourth, the elimination of the foreign exchange rate volatility results in exchange rate reduction, and consequently in the international trade expansion.
5) Also, the economy will benefit from higher foreign investments inflow and increased competition in the goods and services market.
6) Stronger competition induced by the monetary union fosters better allocation of labour and capital, and increases pressure on a more efficient use of existing resources, which boosts the factor productivity.

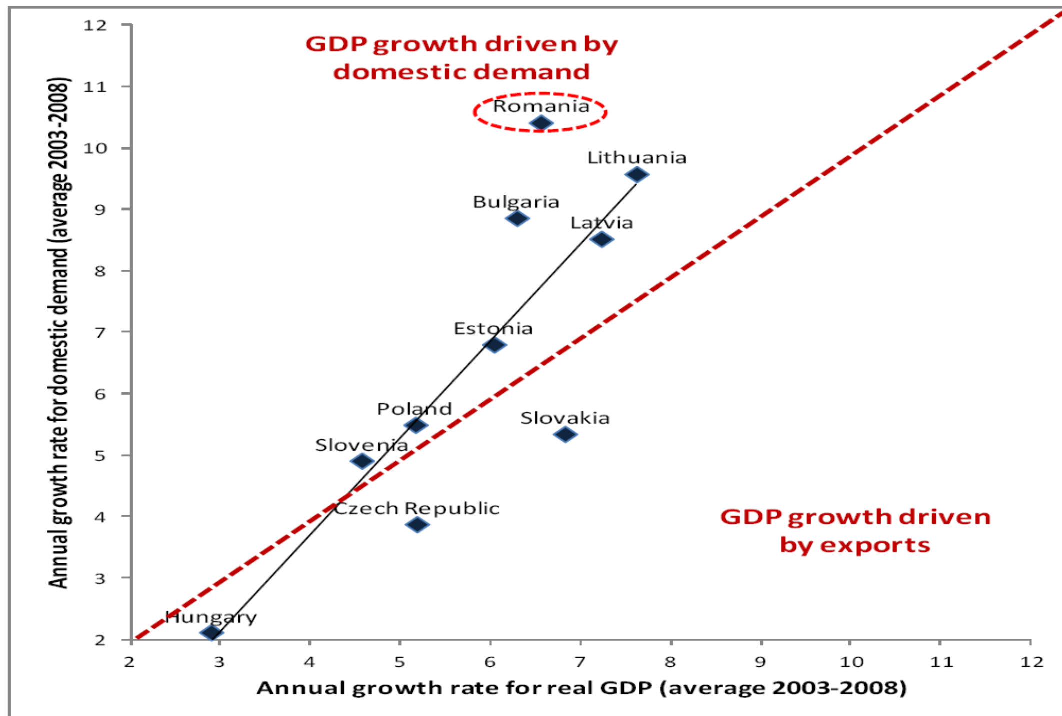
According to Jean-Claude Trichet, president of the ECB, Estonia's economy and its citizens have demonstrated a remarkable capacity for correcting the economic imbalances driven from the adjustments made since 2009 for maintaining its growth in the future. As a consequence, today's competitiveness is being gradually restored and the current and capital account balance has recorded a surplus since the beginning of 2009. Moreover, Estonia has been considered likely to be a model student of the Euro-zone, which, despite its own poverty, is ready to help those in need (Ireland and Greece) (Aamulehti, 29.12).

4. Romania facing the Economic Crisis and Euro adoption

4.1. Romania's position in the Euro Area perspectives

Romania's accession to the EU in 2007 appeared to boost economy and it seemed that the country had found an exemplary path to growth and prosperity. Despite the marked economic upswing, Romania's national debt continued to rise. In 2008, when growth and employment reached a high point, the budget deficit stood at 5.5 per cent of GDP. Because of the economic boom, however, the structural deficit was not heeded and only with the outbreak of the crisis did the pro-cyclical finance policy develop into a problem. Romania's role model status came under strain with the onset of the global economic crisis: domestic demand fell by 13.7 per cent, exports by 10.1 per cent and capital inflows fell by 20 per cent, as a result of which unemployment rose to 7.8 per cent at the end of 2009. Since state revenues slumped and spending rose steeply, the deficit grew to eight per cent of GDP in 2009, well over the threshold laid down in the Stability and Growth Pact. Although public debt was only 25 per cent of GDP, the burden doubled virtually throughout a year (Stability Programme Romania, 2010 as cited by Heise A. and Lierse H., 2011).

Just as in the case of Estonia, Romania registered a sharp growing rate (of 6.3% per year calculated as an average during the period 2001-2008) in the years before crisis, being the fourth highest average growth of the EU-27. The fast economic growth has had two components. The first was a sustainable component that reflected the process of the real convergence of Romania's economy (given the low level of economic development of the country, the economic growth in Romania must be greater than that of the Euro-zone in order to support the convergence). Secondly, there has been a non-sustainable component deriving from an exuberant consumption and investment behaviour (i.e. an excess of the aggregate demand). In addition, the rate of consumption and investments (i.e. the domestic demand) stood at 10,4% as an average per year, in real terms, during 2001-2008, being significantly above the real growth rate of the GDPs of 6,3%.



Source: Consiliul Fiscal, 2012, Dumitru I., *Revisiting the economic growth model in Romania – some lessons from the crisis*

Fig. 2. *The Romanian growth model*

As a fact, the faster growth of the domestic demand as compared to the one of the GDPs shows that the investments and consumption were largely covered by imports (instead of relying on national production), thus generating external imbalances (i.e. national current account deficit). Unlike similar patterns of growth, such as Poland, Hungary, Czech Republic, Slovakia, there has been equilibrium between the domestic demand and the GDPs growth. As a result, the Romanian model closely follows the Bulgarian and the Baltic countries model (including the Estonian one).

4.2. Is the internal devaluation a solution for Romania?!

In order to revive the competition, the internal devaluation by lowering the wages (the incomes in general), increasing unemployment, increasing prices and rates, any country might face social turbulences. Moreover, the most important issue is how much devaluation the countries can stand by trying to rebuild or to restore their competitiveness and growth.

As a fact, in Romania, the unit labour wage (i.e. unit labour cost per unit of GDP) is already strongly decreased, just as in other peripheral Euro-area countries, and in all the cases a high adjustment is needed in order for them to be aligned with the EU average.

For example, deep structural reforms are needed to improve conditions in the labour market and goods markets. Nevertheless, solving the Euro-zone crisis requires strong political willingness on creating a fiscal union and a joint issuance of bonds, both being the only viable measures to establish solid foundations for the monetary union (Romania Fiscal Council, 2012).

Also, Dumitru I., the president of the Fiscal Council of Romania recommends the following key pillars in order to maintain Romania's economic stability:

(1) creating a new growth agenda that should include:
   a. higher domestic savings and lower reliance on foreign savings;
   b. higher employment rate and higher labour productivity;
   c. limited real exchange rate appreciation and strict control of wage-productivity growth balance;
   d. increasing EU funds absorption;
   e. increasing reliance on the tradable sector, expanding and diversifying exports;
   f. accepting immigration to offset partially the negative demographics.

(2) developing a new banking model by adopting an "Asian model" on financing the national capital market by attracting and investing the local savings;

(3) applying a prudential fiscal policy in the future in order to improve longer-term fiscal sustainability, public spending efficiency, the tax collection improvement and by default the limitation of the tax evasion.

The European Central Bank addresses that for Romania and other euro-area countries it will be important to support the relocation of domestic resources to export-oriented, high value added sectors in order to ensure a return to sustainable external positions. To encourage sustainable creation, it will be important to ensure that wages remain sufficiently flexible. It will be more important that Romanian authorities remain alert and take appropriate actions to ensure that the low inflation environment that has been achieved in the past is sustained over the years to come.

5. Final remarks

The experiences of Estonia and various euro-area countries over the past years highlight the importance of rigorous and effective surveillance inside the single currency area. In order to benefit of the euro's advantages, it is essential that every country that aims to join to the EA adopt appropriate policies, thereby contributing to robust economic growth on a sustainable basis.

Moreover, Estonia's case demonstrates that the success of the euro depends on all Euro-area countries which are engaging in responsibilities on one hand and share benefits on another.

In line with the euro benefits, we have to highlight the fact that Romania's role in the economic policy of the European Union will increase after becoming a member of the euro area. Romania will participate in making decisions on the fiscal policy of the EU, including setting key interest rates in the Euro area. Until now, Romania has introduced the Euro interest rates through the EURIBOR rate to the Romanian new leu. The Euro Area membership also involves a rise in Romania's credibility for foreign investors, as long as the economy competitiveness is maintained. Also, we have to be aware of the risk of the national currency devaluation, but this will disappear all along, the trades will no longer need to invest in exchange risk hedging, and travelling will be more convenient.

Summing up, it can be stated that the euro adoption itself will result in further integration and convergence between the economies of Romania and the Euro Area, thus facilitating the absorption of asymmetric shocks and lowering the cost of giving up autonomous monetary policy. Like all the other European countries, Romania has to implement a consistent economic recovery plan to align its economic and financial policies. Depending on the way it responds, the future will be shaped for many years to come.

Other information may be obtained from the address: ioana.radu.bv@gmail.com, ulici_maria@yahoo.com,angela.broju@gmail.com.

Notes

1] In the summer of 1992, Estonia changed roubles into kroons and during three days every resident could exchange 1500 roubles into Estonian kroons, and by this Estonia distances itself from Russia and separates European Estonia from a totalitarian metropolis.

2] Non-financial corporations, households

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