

WHY IS ROMANIA STILL OUTSIDE THE EURO ZONE?

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Abstract: *This paper includes a presentation of Romania's situation as a European Union member wishing to adopt the euro. Along with other 7 countries in the same situation, Romania is trying very hard to meet the convergence criteria set by the Maastricht Treaty. But the analysis of various economic, financial and social indicators representative for our country shows that we are not ready to adopt the euro in 2015, as it was established.*

Key words: *Eurozone, convergence criteria, inflation, exchange rate.*

1. Introduction

Romania joined the European Union on 1 January 2007 and has committed itself to adopt the euro once it fulfils the mandatory conditions.

Adopting the single currency is a crucial step in a Member State's economy. Its exchange rate is irrevocably fixed and monetary policy is transferred to the hands of the European Central Bank, which conducts it independently for the entire euro area.

Changing over to another currency is a major operation which requires massive preparations in order to ensure a smooth transition. Preparations affect all parts of the economy and all levels of society, and are the responsibility of the national government. Both the private and the public sector must adapt their administrative, financial, accounting and invoicing systems. Finally, the country must adopt the necessary laws governing the introduction of the euro, and amend the existing national legislation where needed,

notably to adapt references to monetary amounts.

Timely and effective communication is another essential task for any EU country preparing to introduce the euro, and experience shows that it is critical to a successful changeover. Communication campaigns on the introduction of the euro must strive to ensure that people are able to recognise and use the new currency with full confidence and are fully informed about the consequences of the changeover.

The practical preparations in the EU countries which have not yet adopted the euro are monitored by the Commission, which reports regularly on their current status.

This paper analyses the current situation of Romania and its level of compliance regarding the acceptance criteria in the euro area. While it has been made efforts for the conditions' fulfilment, it seems that Romania will not adopt the euro in 2015, as expected.

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2. The advantages of being inside the Euro Area

The euro area (also known as the Eurozone) consists of those European Union countries which have adopted the euro as their currency. [7]

It currently has 17 member states: Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, Netherlands, Portugal, Slovakia, Slovenia and Spain.

Of the Member States outside the euro area, Denmark and the United Kingdom have not expressed an intention to adopt the euro. The remaining non-euro area Member States are among those which acceded to the Union in 2004 and 2007, after the euro was launched. At the time of their accession, they did not meet the necessary conditions for entry to the euro area, but have committed to joining as and when they meet them. [8]

The main benefits of adopting the euro are: a stable currency, low inflation and low interest rates, price transparency, elimination of currency exchange costs, more integrated financial markets, a better performing economy, sounder public finances, a stronger voice for the EU in the global economy, greater ease of international trade, a tangible sign of a European identity. [9]

The adoption of Euro brings benefits not only at macroeconomic level, but for consumers and businesses too. So, consumer benefits because is more competition between shops and suppliers. Also the prices are stable and borrowing is cheaper. Travelling is easier and cheaper because there were eliminated the exchange cost at every border.

Business benefits because a lower interest rate lead to more investments. The economic stability reduces uncertainty and encourages long-term planning. Also, the investments and trade are stimulated by

eliminating exchange cost rates.

The entire European economy benefits because financial integration increases and the euro area has a greater international presence. The euro is now the second most important world currency after the US dollar, and in some respects, for example in bond markets, has even overtaken it. This gives the European Union a stronger voice in the world.

3. The conditions for joining the Eurozone

Romania is one of the eight Member States which expressed an intention to adopt the euro. The other countries are: Bulgaria, the Czech Republic, Latvia, Lithuania, Hungary, Poland and Sweden.

The 2012 Convergence Report examined whether a high degree of sustainable convergence has been achieved in the Member State concerned by reference to the fulfilment of the convergence criteria. According to the Euro Area leaders, the Maastricht convergence criteria show the meaning of a “healthy” economy.

So, the requirements for a candidate to the euro adoption are the following:

- the achievement of a high degree of price stability; this will be apparent from a rate of inflation which is close to that of, at most, the three best performing Member States in terms of price stability,
- the sustainability of the government financial position; this will be apparent from having achieved a government budgetary position without a deficit that is excessive as determined in accordance with Article 126(6),
- the observance of the normal fluctuation margins provided for by the exchange-rate mechanism of the European Monetary System, for at least two years, without devaluing against the euro,
- the durability of convergence achieved by the Member State with a derogation and

of its participation in the exchange-rate mechanism being reflected in the long-term interest-rate levels.

The following table shows comparatively the situation of convergence criteria

fulfilment in 2012 in the countries which intent to adopt the Euro. Sadly, none of these countries fulfils the condition of adopting the euro.

The convergence criterion level of fulfilment

Table 1

Criterion Member state	LEGISLATION	PRICE STABILITY	PUBLIC FINANCES	EXCHANGE RATE	LONG-TERM INTEREST RATES	ADOPTION OF THE EURO
BULGARIA	Not fully compatible	Fulfilled	Will be fulfilled	Not fulfilled	Fulfilled	does not fulfill the conditions
THE CZECH REPUBLIC	Not fully compatible	Not fulfilled	Not fulfilled	Not fulfilled	Fulfilled	does not fulfill the conditions
LATVIA	Not fully compatible	Not fulfilled	Not fulfilled	Fulfilled	Fulfilled	does not fulfill the conditions
LITHUANIA	Almost compatible	Not fulfilled	Not fulfilled	Fulfilled	Fulfilled	does not fulfill the conditions
HUNGARY	Not fully compatible	Not fulfilled	Not fulfilled	Not fulfilled	Not fulfilled	does not fulfill the conditions
POLAND	Not fully compatible	Not fulfilled	Not fulfilled	Not fulfilled	Fulfilled	does not fulfill the conditions
ROMANIA	Not fully compatible	Not fulfilled	Not fulfilled	Not fulfilled	Not fulfilled	does not fulfill the conditions
SWEDEN	Not fully compatible	Fulfilled	Fulfilled	Not fulfilled	Fulfilled	does not fulfill the conditions

Source: own calculation based on the Convergence Report, May 2012

Regarding the price stability criterion, three countries examined in this report, namely Bulgaria, the Czech Republic and Sweden, have 12-month average inflation rates below – in the case of Sweden, well below – the reference value. In the other five countries, inflation is well above the reference value, despite a relatively weak economic environment in most countries.

Concerning the exchange rate criterion, the currencies of Latvia and Lithuania are participating in ERM II. With regard to the convergence of long-term interest rates, Romania and Hungary are above the reference value of the interest rate convergence criterion. [4]

An interesting fact is that some of the candidates do not rush to adopt the euro and seeks to postpone the deadline. The expanding debt crisis from Greece, Ireland, Portugal and Spain, which are less competitive countries, highlighted last year the disadvantages of belonging to the

Eurozone and the need for deep reforms.

So, the largest eastern EU members, Poland, Czech Republic and Hungary, have slowed preparations for joining the euro area.

Poland announced that it won't join the Monetary Union until the problems are not solved here. In Hungary, the Economy Minister warned that his country should avoid adopting the euro for two decades from now and should strengthen the economy according to an own model.

Bulgaria froze indefinitely the plans to adopt euro as an answer to the deteriorating economic conditions and the worsening eurozone crisis.

4. Romania's efforts to adopt Euro

Romanian law does not comply with all the requirements for central bank independence, the monetary financing prohibition and legal integration into the Eurosystem.

Before adopting the euro, Romania as an EU member state with derogation, must go through an intermediary period of at least two years, called the exchange mechanism (ERM II). In this period it will be tested the national currency stability. Thus, the exchange rate needs to remain within a variation of plus-minus 15% against a centrally agreed level. Other convergence criteria are related to fiscal stability, price stability and interest rates.

5. The Romanian indicators in 2012

Before entering the euro area, Romania must meet the economic criteria included in the Maastricht Treaty (the budget deficit cannot exceed 3% of GDP, public debt should be limited below 60% of GDP and inflation should not exceed by 1.5 % the average of the best performing countries from euro area). [2] The following table shows the percentages achieved by our country in 2012.

Denomination of the table

Table 2

MAASTRICHT CRITERIA		Romanian indicators in 2012*
1. Budget deficit	Max. 3% of GDP	2,8%
2. Public debt	Max. 60% of GDP	34,6%
3. Inflation rate	2.8% +1.5%=4.3%	3,3%
4. Long term interest rate	2.4% +2%=4.4%	6.5%
5. Exchange rate	2 years ERM II	

Source: <http://www.ecb.int/pub/pdf/conrep/cr201205ro.pdf>

Price stability in Romania

The Romanian economy is estimated to have been operating well below its potential during the global economic crisis.

The 12-month average inflation rate for Romania, which is used for the convergence evaluation, was well above the reference value at each convergence assessment since EU accession in 2007.

Average annual inflation increased from below 5% in mid-2010 to a two-year high in June 2011, before decreasing sharply thereafter. In 2012 the average inflation rate in Romania was 3,3% [9] while the Euro Area average inflation rate was 2,8% with Sweden, Ireland and Slovenia being the best performers.

In 2013, GDP growth should recover to 2.2%. For 2014, growth is expected to accelerate to 2.7% as the effects of the reforms implemented in labour and product markets start kicking in.

The labour market was considerably impacted by the economic downturn.

Employment fell markedly in 2009-2010 and staged only a modest recovery in 2011, of 0,4%. For 2013 growth is expected to accelerate to 0,8% and in 2014 to 0,9%. [5]

Exchange rate stability in Romania

The nominal exchange rate of the leu against the euro fluctuated in a wide range in the pre-crisis years. Following agreement in early 2009 to provide Romania with a coordinated package of international financial assistance, financial market pressures eased and the leu broadly stabilised against the euro – at levels that then prevailed for most of the period from 2009 to 2011. The leu's exchange rate against the euro remained broadly stable in early 2012, though at a moderately weaker level than the 2009-2011 average. The ron depreciated against the euro by 7,6% in 2012 compared to 2011. [3]

Long-term interest rates

In March 2012, the latest month for which data are available, the reference value, given by the average of long-term

interest rates in Sweden and Slovenia plus 2 percentage points, stood at 5.8%. In that month, the 12-month moving average of the yield on the Romanian benchmark bond stood at 7.3% (1.5 percentage points above the reference value).

Additional factors

Romania's economy is well integrated into the EU economy through trade and investment linkages. The trade openness of Romania has however been lower compared to other non-euro area Member States with derogation; it declined temporarily during the global crisis, but recovered in 2010.

Trade with other EU Member States is predominant (particularly with Germany, Italy and France) and has been increasing since the EU accession in 2007.

Concerning the business environment, Romania scores poorly compared to euro area Member States in international rankings. For instance, Romania ranks on 77th and 72nd place according to the 2011-2012 Global Competitiveness index and the 2012 World Bank Doing Business respectively. This weak performance can be explained by particularly low scores for starting a business, trading across borders, and registering property.

The Romanian financial sector has been well integrated into the EU financial sector, particularly through strong interbank linkages. The share of assets of foreign-owned credit institutions – mainly euro area banks – in total assets of credit institutions in Romania hovered at around 80% since EU accession.

Market penetration rates for non-bank services are low and were also impacted by the recent economic downturn. In the insurance sector, written premiums declined by 7.5% in 2010 compared to 2009.

The strength of the institutional environment, including in the area of statistics, is another important,

complementary variable to be examined as an additional factor relevant to the sustainability of economic integration and convergence. In Romania, the quality of institutions and governance is reported as being relatively weak, on average, compared with most euro area countries. From this point of view, Romania has the last rank among the 8 candidates, and the 26th among EU countries.

6. Other problems on the path to euro adoption

Last year, the foreign banks launched a series of reports that questioned the convergence plans of the Romanian authorities in adopting the euro in 2015, indicating the possibility of transition to the single currency in 2019 or even 2024.

Creating a favourable environment to sustainable convergence in Romania requires, among other things, a stability-oriented monetary policy and implementing strict fiscal consolidation plans.

In addition, Romania has to face a big number of challenges in terms of economic policy. The specialists claim that Romania could be structured in three different parts: “the Romania with cities”, “the Romania with small towns” and “the rural Romania”. The biggest problems about adopting the euro will come from the rural areas. The structure of agricultural land in our country shows that almost 40% of all are farms of less than five hectares – and so we have the largest degree of fragmentation in Europe.

Greece is ranked second with a share of less than 20%, while in developed countries, such as France, this type of agriculture does not exist anymore. From here start the problems related to agricultural productivity in Romania, a lack of efficiency that continues to pull us down our living standards and our GDP. The general price level in Romania is less

than half the EU average. Even so, the GDP per capita (relative to purchasing power) is only 46% of the EU average. The adoption of euro in these conditions will be almost unbearable for the population, because the prices will continue to rise to close to that of the common market. [1]

7. Conclusions

Romanian economy is not yet ready to meet the competitiveness demands posed by the euro area and there are needed economic restructuring before passing the “fire test”. Moreover, recent events give us to understand that the Eurozone will suffer changes and restructuring, and for Romania it would be better to be outside this area.

The accelerating entry into the euro area can have traumatic results for the Romanian economy - unemployment and low economic growth, or the accumulation of imbalances such as those seen in PIIGS countries (Portugal, Ireland, Greece and Spain).

On the other hand we must not lose sight of the fact that the fulfilment of convergence criteria by Romania is not only a condition for adopting the euro. Achieving this target by gathering stability may lead to improve the economic and social situation which Romania aspires to.

Although there is a high probability that euro adoption deadline to be postponed again, Romania does not have to give up the idea of doing as soon as possible the next step towards a deep European integration.

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