

THE IMPACT OF ADOPTING THE EURO CURRENCY FOR THE ROMANIAN ECONOMY

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Abstract: *Given that Romania joined the European Union in the hope that in the future the population will have a standard of living similar to that of the community, at present we should continue the efforts to fulfil all the necessary conditions of entry into the great European family. Regardless of the economic problems that our country is facing to join the euro zone, imposed by the need to fulfil the convergence criteria, the adoption of the euro by Romania can be an important achievement of our country, resulting from a sustained process that started many years ago. Although the political decision makers have set a 2015 deadline for the completion of this process, the adoption of the euro currency should not be seen as a purpose itself, but should be followed for the benefits it could bring to the Romanian population.*

Key words: *euro area; cost; benefits; European Monetary Union; euro; convergence.*

Lately, the adoption of the euro currency in Romania has been an intensely debated topic nationwide. The political decision makers have set the year 2015 as a deadline for the completion of this process, and in cooperation with factors in the economic and monetary area the fulfilment of all the necessary conditions to join the euro area is targeted. Based on that, the study of the preparation of the Romanian economy for the entry into EMU is of huge importance, both for the policy makers mentioned above, as well as for the academic environment. And last but not least, the introduction of the euro currency will affect the entire national socio-economic environment, and the consequences will occur before and after the actual process of transition from the

currency leu to the euro.

Adopting the euro currency is conditioned by the prior nominal convergence criteria set by the Maastricht Treaty, which refers to the inflation level, budget deficit, government debt, long-term interest rate and exchange rate stability. Inflation in Romania had a downward path, from 45.7% in 2000 to a minimum below 5% in 2007. The massive increase of prices for energy and food caused an inflation slippage in 2008. Subsequent emergence of the global economic crisis effects and the implementation of stabilization measures that included the increase of indirect taxes and of the administered prices led to maintaining a high level of inflation. Since food and energy commodities have a share of over

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60% of the CPI basket, and further increases are expected in the future to these categories of goods (due to increases in the world and the need to align prices), the measures implemented to reduce inflation will be vigorous. Budget deficits recorded by Romania before 2008 were below the threshold of 3% of the GDP. After the advent of the global economic crisis, they increased from 5.4% in 2008, 8.3% in 2009 and 6.4% in 2010 due to lower revenue, mainly driven by a decline in consumption and the drop in GDP. Thus, Romania joined the Excessive Deficit Procedure and has time until 2012 to get back into the target of 3%. Following the analysis performed, I deduced that this target is a very optimistic one, as the increase of the income attracted is improbable, amid an already burdensome tax system, as well as a minimum level of the capital income. The continuation of the decrease of budgetary expenses is also difficult, due to strong social pressures which exist at present. On a long-term basis, an important vulnerability of the fiscal system will be exposed, being caused by the rapid process of the continuous aging of the population. For the year 2050, the projections of the European Union anticipated a level of population with the age consisting of over years and which will eventually surpass the level of the population with the age between 15 and 65 years. This fact will bring supplementary pressure on the future budgets, even given the positive projections regarding the future economic development of Romania. The level of the governmental debt is the only nominal criteria fulfilled by Romania. It has raised at a minimum of 12,6% from PIB in the year 2007, at over 30% from PIB at the end of the year 2010, on lower GDP and accelerating borrowings to finance deficits. It may be estimated that in the future, the level of the governmental debt will be

raised moderately; however until the moment of adopting the unique currency, it will be situated under the established target of 60%.

The rate of exchange of the leu currency has known an appreciation until the year 2007, when a minimum of 3,2 Ron/Euro was recorded. After the appearance of the crisis of the national currency, a rapid depreciation was recorded, which was accompanied by the rise in volatility. The exchange rate is now stabilised at a level of 4,2-4,3 Ron/Euro, and in the future we can not predict very amplified movements, as the financial and economic climate is not deteriorating significantly. Neither is the criteria of the long-term interest rate fulfilled in Romania, as it is situated 3,4 percentages over the reference level calculated in 2010.

Regarding the evolution of the indicators of the real convergence, despite the fact that at PIB / resident level, considerable progresses have been recorded in this domain, of over 300% (from 1809 Euro/resident in the year 2000 to 5428 Euro/resident in the year 2009), we are still at a considerable distance from the standards of the European Union. This increase recorded during the last decade, until the appearance of the crisis, was based on the annual instalments supported by the economic growth, which is superior to those recorded in the Western states of Europe. Subsequent to the recession and the decrease of the economic activity in a more accelerated pace than the majority of the European states, this process of reducing the differences was reversed. Thus, in real PIB/ resident terms, Romania is situated at a considerable difference from the level recorded in the European Union, representing only a quarter of the level. Things are not extraordinary either if we compare the purchasing power parity, and unfortunately we have not surpassed the level of 50% from the media recorded

al the level of the European Union.

The structure of the branches of the national economy is another indicator of the real convergence, as our country is based on a development which is mainly orientated towards agriculture, as compared to the countries in the euro zone. Thus, the contribution in agriculture to the formation of the PIB for the level of the year 2009 was of 7%, meaning approximately a 4-time increase in the case of Romania, as compared to the standards recorded in the Monetary and Economic Union. The rapid decrease process of the contribution of agriculture to the formation of PIB must be mentioned, as in 1990, the contribution of agriculture for forming the PIB was of 19%. On the contrary, the contribution of services represent only a little over a half of the total in Romania (55,7%), while in the euro zone, the average is close to 75%. The difference is given by a more accentuated development of the sector of constructions (which was heavily deteriorated due to the crisis), as well as the industry, which, in comparison with the one in the euro zone, is non-competitive and energy consuming. Regarding the exterior commerce, although it has seen a revival in the last year and a half, at a value level, it has decreased in comparison with other powerful European states or even with the ex-communist neighbouring countries.

The evolution of the general GDP in the following years may represent the most important component of the success of the future adoption of the unique currency. Relaunching the economic growth, as forecast by the Romanian and European institutions, will bring beneficial effects for the population. However, as any long-or medium term prognosis, we will see only in the following years if the prognosis established until the year 2014 follows the course state or if a new wave leads to the re-evaluation of these models.

The real convergence must take place along with the fulfilment of the criteria of nominal convergence, before the adoption of the unique currency. The adoption of the unique currency by our country before achieving a minimum real economic convergence would represent a potential source of counter-productivity and high risks. Even if the adhesion in the Monetary and Economic Union is not conditioned per se by the fulfilment of these criteria, the adoption of the unique currency and the loss of the possibility of having our own monetary policy will decisively influence the attempt to reach our own economic growth potential. as a consequence of renouncing the single currency, practically the only markets left for adjustments would be the labour market, the goods market and the fiscal policy, thus giving rise to the risk that in the absence of control referring to amendments in the interest rate and the exchange rate, one could not ensure the optimum occupation of the labour force and the establishment of the prices. The adoption of the euro currency must thus represent the final point of the effort to attain a high level of the real convergence and not an initial condition in order to commence this process.

We may state that the Monetary and Economic Union is the most daring project of a united Europe. The idea conceived after the second world war from the desire to avoid other conflicts was initially based on the concept of economic cooperation, commencing from the premise that when multiple countries present convergent interests regarding the well being, they will cooperate so as to attain this objective.

The adoption of the euro currency by Romania may represent an important achievement of our country, the result of a durable process which started many years ago. The most important aspect of this process is related to the fulfilment of the

real convergence criteria. This represents a capital condition for a positive track subsequent to the introduction of the euro currency, so as not to record permanent and substantial imbalances, as in the case of Portugal.

One may easily suppose that the preoccupations for attaining a high level of the real convergence are not on the list of the present preoccupations of the decisional factors and this might have repercussions in the future. I mainly refer, in this case, to the actions regarding the growth of the GDP/ resident, the increase in productivity of the labour force, the increase of the volume and competitiveness of the exports. Nonetheless, measures must be implemented which focus on changing the structure of the economy, because it is closer to the existing economic structure in the euro area. This would lead to increased synchronization of business cycles between Romania and the euro area countries, thus preventing installation of major adverse effects induced by the emergence of asymmetric shocks. The speed of the real convergence growth will be one limited in this short period of time, namely four years, as even the optimistic forecasts of policy makers in our country anticipate a modest recovery in the economy by 2015. Taking into consideration the fact that during the last decade of macroeconomic variables and that present and future uncertainties are much higher, the more likely it is that future euro adoption will occur without major changes in the level of real convergence, but only by means of the great efforts directed mainly to the strict criteria of nominal convergence. In this case, it can be expected that the long-awaited introduction of the single currency in our country will be possibly followed by a period of instability in which the capacity of responsiveness and adaptation of the

national economy will be much diminished by the lack of the monetary policy of the state. On the other hand, from a less optimistic perspective, the acceleration of the entrance in the euro zone may have traumatic consequences for the Romanian economy, namely unemployment and reduced economic growth or the accumulation of imbalances of the type seen within the "PIIGS" countries. Romania will not be fully prepared to adhere to the Monetary Union than after the restructuring and consolidation of the economic competitiveness. The global economic crisis that began in 2007 and has affected Romania since 2008 unearthed a lot of inefficiencies in the global monetary system and economic policy systems that react in these situations. Among these, the structure on which the euro zone was built was the most affected. Meanwhile, examples such as Greece, Portugal, Ireland and Spain have raised many questions about the benefits of joining the euro area. Thus, many countries that were prepared to enter the euro area decided to postpone the adoption of the single currency. Romania did this in 2010, and now the official date for accession to the euro area is 2015. The main reason given by officials was the economic crisis. In fact, Romania had no way to meet design conditions imposed by the Maastricht Treaty in 2012. Can we say that it is too early in the year 2015? Or, better yet, given the present conditions, can we say that the adoption of the euro currency still represents an option for Romania, taking into consideration that the euro zone is struggling to survive? Romania joined the EU in 2007 and, by signing the Treaty, it subsequently undertakes to adopt the euro. Therefore, Romania has the option not to adopt the euro but only to delay the moment. In terms of the euro area, accession conditions are clear and they are stipulated in the Maastricht Treaty, as the criteria for

accession are divided into monetary and fiscal criteria. Maastricht convergence criteria are criteria which in the vision of the leaders of the euro zone characterize a "healthy" economy: the low inflation, sound public finances and a stable exchange rate. If the criteria are met, it can be assumed that the economy could adopt the single currency. Compliance with the criteria should be ensured, but as we now know, it is not a guarantee that the economy will remain competitive after joining EMU, and it will not be a burden for other Member States. In this context, 4 alternative scenarios of adopting the unique currency in Romania may be represented. The scenarios will be weighted adequately before giving a verdict. This may be appreciated especially due to the fact that, beyond any possible argument, adopting the euro currency must not be envisaged as a final purpose, but appreciated for the benefits it brings to the Romanian citizens.

1. Official scenario – Romania enters the euro zone in 2015

It is a very unrealistic scenario as, at present, the euro zone requires a reformation process before extending itself. We are in a situation where nobody knows for sure whether countries like Greece, Portugal and Spain will be able (or want) to stay in the euro zone.

But one thing is certain. The main reason they are in this situation lies in its non-performance. Romania must not miss the most important lesson of the economic crisis—the multitude of the costs associated with the joining of the euro zone depends on the differences between the states. In case of the existence of these differences, both in the economic structure and from a legal and institutional point of view, the economies in cause must present alternatives to the monetary instruments, as to adjust shocks. What we must know is

what might be the nature and possibility of the asymmetrical shocks, what alternative instruments may be used in the absence of the exchange rate or the interest rate. Romania has made considerable progress in terms of nominal criteria; however, the aspects related to the recuperation of the differences in the real economy are at least of the same importance. From this perspective, the euro adoption scenario in 2015 is unrealistic. Studies show that Romania has very limited capacity to adjust the national economy. There is a correlation between Romania and the euro zone, namely a negative one for the stocks application and weak for the offer shocks (estimations based on the methodology Blanchard – Quah). Thus, Romania does not yet present alternative stabilization instruments at the macro-economic level, capable of replacing the instrument of rate exchange, which it shall lose once joining the euro zone. Neither does it embody the adequate market level (structure of the economy, the volatility of production, wage flexibility, mobility of factors of production, convergence of business cycles, financial market integration, similarity cycles, etc.), or the level of the stabilization of economic policies - weak mechanisms of automate fiscal stabilization, etc.

The only advantage of maintaining the objective - 2015 (although unrealistic) is to use it as an anchor for continuing the economic reforms.

2. Pessimistic scenario. Romania indefinitely postpones the entry into the euro area

As long as the Romanian economy recovers and stabilizes the differences in the real economy, the best change would be to take all actions and necessary efforts to enter the euro zone. Benefits will be felt at the macroeconomic level, but especially at the microeconomic level. Romanians

will benefit mainly as a result of macroeconomic stability and due to a better international positions.

Moreover, the benefits will result from the stability of prices, access to a wide-spread and transparent market, the removal of fluctuations in productions which might result from the different economic policies. For some countries (e.g. Greece) price stability and all the benefits for achieving this goal is a motivation for participation in the euro area. Price stability leads to lower interest rates, and this represents an advantage for both the government and consumers or firms. At the microeconomic level, the benefits of euro adoption refer to the elimination of transaction costs associated with the exchange rate, reducing administrative costs, reducing capital cost and eliminating the risk caused by uncertainty about the future evolution of exchange rates. The gain of the wide public resulted from the elimination of costs for exchanging a currency with another currency is obvious.

3. Extremely pessimistic scenario. The collapse of the European Union and the disappearance of its institutions

It is a difficult scenario to accept, but if we think of the empires theory which states that any "construction" has an expected end (its collapse in one form or another), then the hypothesis must be taken into consideration.

4. Realistic scenario. Romania joins the euro area in the years 2018-2020

This is the most possible scenario, if we were to guide ourselves according to the internal and international context. Mainly, adhering to the euro zone also implies finding the most favourable compromise between the real and nominal convergence. The Maastricht Treaty does not refer to real convergence criteria; however the issue of real convergence is at least as

important as the nominal convergence. At the moment, I think the real challenge for Romania will be to choose our own way, although we all have the same destination. Regardless of how difficult it would be to achieve real and nominal convergence at the same time, the effort is worthwhile.

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