

# EURO AREA ENLARGEMENT: DILEMMAS AND STRATEGIES AFTER THE CRISIS

S. MĂRGINEAN<sup>1</sup>     R. ORĂŞTEAN<sup>1</sup>

**Abstract:** *The main challenges for the New Member States after joining the European Union were Euro adoption and dealing with the economic crisis. This paper explores the impact of the economic crisis on the New Member States of European Union, both to the four NMS countries that joined the euro area, and also for the eight countries which intend to do this in the next few years. The paper begins with an overview of the current situation and analyses the economic performance of the 12 NMS of EU based on the Maastricht Treaty criteria. Finally, we are considering an answer to the question: is it necessary to reshape the Euro – area entry rules?*

**Key words:** *Euro, New Member States, crisis.*

## 1. Introduction

Until the recent economic crisis Euro was considered one of the most successful projects of the European Union. The irreversibility of the Euro was unquestionable. In 2006, Joaquin Almunia said: "The euro is like an old Catholic wedding: like it or not, happy or not, you are married forever. But, fortunately, you know the bride in advance. You know what it takes and what it needs to live with her and make sure your union is a happy one." In the last year there are political and even economic voices that put under question this essential idea of the European Monetary Union.

The reason is related to the costs of monetary union in crisis time, and also to the impossibility of the member states to fulfill the nominal convergence criteria. Maastricht Treaty set out the conditions which member states have to comply with to be eligible for Euro-zone membership.

Nominal convergence, real and institutional convergence are the three directions for the convergence process.

All New Member States accepted the *aquis communautaire*, including participation in the third stage of European Monetary Union as soon as possible, when the Maastricht Treaty criteria are met. In the period 2004 – 2010 four of the New Member States already entered in Euro Zone: Slovenia (2007), Cyprus and Malta (2008), Slovakia (2009). This paper starts with an overview of the NMS economic performance, looking at the differences between the euro and non-euro New Member States. The purpose of this is to find out if we need a different approach, different strategies and criteria after the crisis.

## 2. Overview of the Current Situation

The key word for describing the economic status of EU in the last two years

---

<sup>1</sup> *Lucian Blaga* University of Sibiu, Romania.

is crisis. Initially, the economic crisis affected the advanced economies, the Old Member States of European Union. The situation changed at the end of 2008, when the entire East European region, all New Member States began to fall, experiencing negative growth rates. The fall in GDP was bigger for the countries with accelerated growth in 2007. There are some possible explanations for New Member States and their great fall: the lack of economic

policies, both in expansion and recession for some countries; external shocks and the dependence of foreign investments; procyclical policies in expansion. [4] As we can see in Figure 1, Lithuania, Latvia and Estonia were particularly affected, but Romania, Hungary and Slovenia had also consistent negative growth rates.

The four NMS that adopted euro look to be better in terms of GDP growth rate.

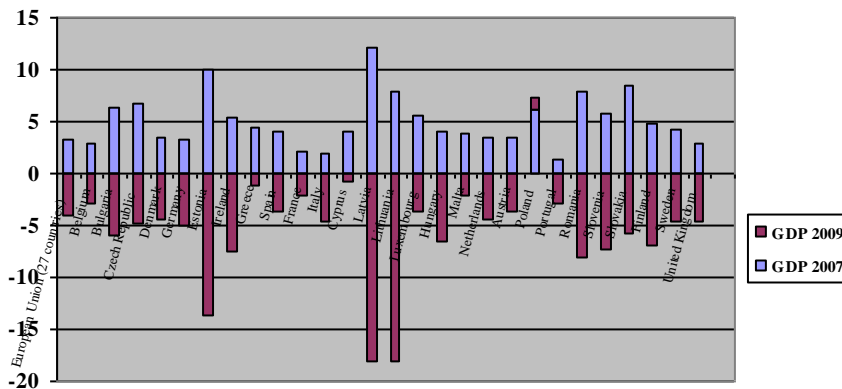


Fig. 1. *Growth and fall in GDP for EU 27 Member States*

Annual growth rates of GDP were: Cyprus 4,1 in 2007 and dropped to -0,7 in 2009; Malta from 3,8 in 2007 to -2,2 in 2009; Slovakia from 8,5 in 2007 to -5,8 in 2009; Slovenia from 5,8 in 2007 to -7,4 in 2009.

In a very interesting article, Regling et al [6] asks an essential question: what was the Euro in the context of economic crisis – part of the problem or part of the solution? The Euro has not facilitated the spread of the crisis and provided an effective shield against the crisis. These affirmations are nuanced with a set of “no, buts ...” and “yes, buts...”.

### 3. Maastricht Treaty Criteria in NMS: Before and After the Crisis

The criteria are mandatory for the participation in euro area. Table 1 shows

where the New Member States were before the crisis. Regarding inflation, only Slovakia, Cyprus and Malta had an inflation rate below the reference value. We had 8 countries (1 from Euro Area) with an inflation rate over the reference value. In all countries, excepting Hungary and Romania, the long time interest rate was below the reference value. In 2007, the general Government deficit was over the Maastricht reference value only in Malta and Hungary were over 60% of the reference value for general Government gross debt.

In 2007, Malta and Slovenia complied three of four criteria, Cyprus and Slovakia all of them.

Romania had reasonable results in two of the four criteria in 2007.

*Maastricht criteria before the crisis*

Table 1

Inflation rate	Long-term Government interest rates (bond yields)	General Government surplus or deficit	General Government gross debt
April 2008	April 2008	2007	2007
Reference value 3,4	Reference value 6,42	Reference value -3,0	Reference value 60,0
Malta 1,9	Euro area 4,3	Bulgaria 3,4	Estonia 3,4
Slovakia 2,4	Slovakia 4,46	Cyprus 3,3	Latvia 9,7
Euro area 2,6	Slovenia 4,47	Estonia 2,8	Romania 13,0
Cyprus 3,2	Lithuania 4,59	Latvia 0,0	Lithuania 17,3
Poland 3,4	Cyprus 4,6	Slovenia -0,1	Bulgaria 18,2
Czech Republic 4,8	Czech Republic 4,72	Euro area -0,6	Slovenia 24,1
Slovenia 5,0	Malta 4,77	Lithuania -1,2	Czech Republic 28,7
Romania 6,4	Bulgaria 4,8	Czech Republic -1,6	Slovakia 29,4
Hungary 7,3	Latvia 5,93	Malta -1,8	Poland 45,2
Lithuania 8,0	Poland 5,99	Poland -2,0	Cyprus 59,8
Estonia 8,8	Romania 7,34	Slovakia -2,2	Malta 62,6
Bulgaria 10,1	Hungary 8,02	Romania -2,5	Hungary 66,0
Latvia 13,0	Estonia n.a.	Hungary -5,5	Euro area 66,6

Source: [1]

In many countries outside the euro zone the currency depreciation and higher inflation rates, fiscal deficit negative growth rates on GDP are some of the characteristics for 2007-2010. (Table 2)

Inflation seems to be the most challenging task for the New Member States outside of the Euro-zone. A reasonable solution would be to define the criterion as the euro area inflation plus 1, 5 percentage points. [2, 3]

According to the fiscal Maastricht Treaty criteria, [5] the Government debt should not exceed 60% of GDP and the Government budget deficit should not exceed 3% of GDP. During the crisis, the second criterion was a real challenge: only Estonia accomplishes this target. Maybe we should accept a temporary relaxation of this criteria, but in the medium and long

run, there are no reasons for changing the reference value of 3%.

We can also say that Eurozone is not a "safe harbor" – Cyprus, Malta, Slovenia and Slovakia are fulfilling only one or two of the Maastricht criteria.

Another key question is whether the crisis in Greece will make the EU authorities stricter in their interpretation of the Maastricht criteria. There is a possibility that the deep Greek crisis is related to the prematurely joining the Euro area. The solidarity inside the Euro-zone was the final answer. The 110 billion euros given to Greece by the other 15 Euro-zone countries – about 10.000 euros per person. A huge sum of at least 500 billion euros is said to be needed if the crisis also takes hold in Portugal, Spain and possibly Italy.

Maastricht criteria after the crisis – December 2009 and March 2010

Table 2

Inflation rate	Long-term Government interest rates (bond yields)	General Government surplus or deficit	General Government gross debt
Euro area 1,0	Euro area 3,63	Euro area -6,3	Euro area 78,7
Bulgaria 1,8	Bulgaria 5,82	Bulgaria -3,9	Bulgaria 14,8
Czech Republic 0,4	Czech Republic 4,02	Czech Republic -5,9	Czech Republic 35,4
Estonia -1,0	Estonia -	Estonia -1,7	Estonia 7,2
Cyprus 2,5	Cyprus 4,6	Cyprus -6,1	Cyprus 56,2
Latvia -3,3	Latvia 10,54	Latvia -9,0	Latvia 36,1
Lithuania -0,3	Lithuania 5,15	Lithuania -8,9	Lithuania 29,3
Hungary 6,2	Hungary 7,11	Hungary -4,0	Hungary 78,3
Malta 1,2	Malta 4,33	Malta -3,8	Malta 69,1
Poland 3,9	Poland 5,72	Poland -7,1	Poland 51
Romania 5,2	Romania 7,11	Romania -8,3	Romania 23,7
Slovenia 1,8	Slovenia 3,94	Slovenia -5,5	Slovenia 35,9
Slovakia -0,2	Slovakia 4,01	Slovakia -6,8	Slovakia 35,7

Source: Eurostat database

#### 4. Conclusions

The Maastricht Treaty criteria are too far for the 8 countries outside the Euro-zone to accomplish, mainly because of the inflation rate and fiscal deficit. Is there possible an adjustment of the rules in hard times?

After the crisis, Europe's monetary enlargement needs a more visionary approach.

#### References

1. Allam, M.: *The Adoption of the Euro in the New Member States: Repercussion of the Financial Crisis*. in EIPASCOPE 2009/1, pp. 27-34, available at [www.eipa.eu](http://www.eipa.eu)
2. Darvas, Z., Szapary, G.: *Euro Area Enlargement and Euro Adoption Strategies*. in *European Economy, Economic Papers* no. 304, February 2008, European Commission, available [http://ec.europa.eu/economy\\_finance/publications](http://ec.europa.eu/economy_finance/publications)
3. Dulkys, A.: *Euro Area Enlargement: Dilemmas and Prospects*. in *Ekonomika*, 84/2008, pp. 40-53.
4. Mărginean, S.: *Business Cycles and Economic Recovery in European Union. A Survey*. In: *Studies in Business and Economics*. vol. 4/2009, pp. 85-94.
5. Neal, L.: *The Economics of Europe and the European Union*. Cambridge University Press, 2007.
6. Regling, K., Deroose, S., Felke, R., Kutos, P.: *The Euro after Its First Decade: Weathering the Financial Storm and Enlarging the Euro Area*. ADBI Working Paper 205, Tokyo. Asian Development Bank Institute, 2010 available at <http://www.adbi.org/working-paper/2010/03/15/3637.euro.after.first.decade/>