

THE EURO ADOPTION – A RECENT CHALLENGE, BUT WITH A FARAWAY RESULT

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Abstract: This work has the purpose to analyse the level of Romanian preparation in the process of adoption of a sole European currency and to seek answers to three questions: "Is Romania ready to adopt the euro?, What involves the adoption of the euro?, Which are de benefits and risks of euro adoption in Romania?". Real convergent criteria are analysed and have the goal and the necessity to fulfil ex-ante criteria from Maastricht, inclusively through the durable tax consolidation, which can lead to the maximization of the probability that Romania could limit the duration of the participation to exchange rates ERM II to the 2 obligatory years. The ERM II is a newly introduced system to reduce the variation of exchange flow which has the purpose to obtain economic stability in Europe. The entrance in ERM II is the precedential step to adhere to the euro area, the step in which the national currency needs to fluctuate between an interval of $\pm 15\%$ from the euro. Romania did some important progress during the last years both in terms of nominal convergence, as well as real, yet they are necessary hereinafter for the economy to be up to a sole monetary area. Balancing the advantages and disadvantages for euro adoption, the work states out the fact that euro adoption does not need to be treated as a sole purpose, the moment of adherence being a Romanian decision according to the efforts which the country will consign to achieve the level of development which can allow the sole monetary adoption.

JEL classification: E52, E58

Key words: euro adoption, convergence, criteria from Maastricht, inflation

1. INTRODUCTION

According to *The Yearly Report of National Bank of Romania (2010)*, the fulfilment of the criteria foreseen in the Maastricht Treaty and the adoption of a sole European currency take part of the European registration process of Romania. The entrance in the euro area implies the transfer of the development and leadership of monetary policies by the Central European Bank, institution whose actions are enterprise in a unitary manner for the whole euro area, without taking into consideration the national economic particularities, of whose degree of smoothness is predisposed to be higher. In this context, in the primary period of the sole currency adoption, it takes a fundamental act

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in order that the national economy covers the necessary adjustment in the euro area². According to Maastricht Treaty, a member state of the European Union benefits of a temporary derogation regarding the euro adoption. But has the obligation to prepare itself for the entrance in the European mechanism and in the exchange rates ERM II, where it will stay for a period of at least two years, after the sole currency can be adopted.³

Furthermore, in the annual report of NBR it is stated that through the Maastricht Treaty nominal convergence criteria have been instituted based upon the candidate economic states for the entrance in the euro area which were assessed. These criteria point out the establishment of prices, sustainability of public finances and the degree of debt, the stability of the exchange rate and the level of interest instalment on long terms. In the determination of the sustainability degree of the convergence process indicators as GDP per habitant, degree of economy opening, the structure on economy sectors, financing the current account deficit, the evolution of salaries, the degree of financial brokerage, are used.

2. THE LEVEL OF NOMINAL CONVERGENCE

Starting with 1st of January 2007 Romania has become a member of the European Union, after a long process of adherence, due to the fact that negotiations have started in the year of 2000. In Romania's case the process of integration in the euro area could be a prolonged one, our country must fulfil the convergence criteria, especially real convergence criteria.

Nominal convergence criteria are the only formal ones that a EU member country needs to fulfil to adopt euro.

Table no. 1. Maastricht criteria (Nominal convergence indicators) – 2010

Nominal convergence indicators	Maastricht criteria	Romania
The rate of inflation (IAPC) (percentage, annual average)	<1,5 pp over the average of the most performing 3 EU members	6,1 Criteria 2,4
Rate of interests on long terms (annual percentage)	<2 pp over the average of the most performing 3 EU members from the price stability point of view	7,3 Criteria 5,2
Exchange rate from the euro (appreciation(+)/depreciation (-) maximum percentage)	±15 percentage	-10,4
Consolidate budget deficit (percentage from	Under 3 %	6,4

² Marin Opreșcu, Alina Georgiana Manta, Mircea Perpelea- Integrarea monetară europeană: între speranțe și împliniri, Revista Finanțe Provocările Viitorului, Anul 10, Nr.13, 2011

³ Floarea Iordache- *Adoptarea euro de către România: o evaluare a cursului de schimb*, Financial Studies, 2009, vol. 13, issue 2, pages 70-80

GDP)		
Public duty*** (percentage from GDP)	Under 60%	30,8

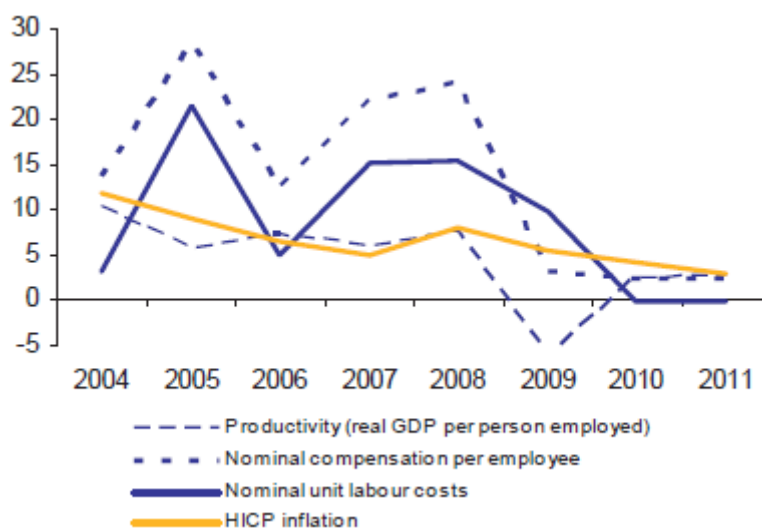
Source: Annual report of the National Bank of Romania (2010)

In Romania the level of inflation had a descending trend from the year 2000, from 45.7% to 12.7% in 2004. If we take into consideration the number, Romania could actually made a remarkable progress in a period of just 4 years, but if we take into account the rate of inflation of approx. 2,5% from EU in that period, it proves to us the fact that there are a lot of progresses left to be made. However this drop of inflation brought the population's trust to a win in the national currency. In the highest measure of this process of disinflation is due to monetary policy of NBR which was a prudent one through a controlled flotation of the exchange rate which meant a reduced flexibility, high predictability and frequent interventions on currency market. Along with the achievement of 12.7% level in 2004, it has been observed that the number of NBR interventions have decreased with a monthly average of 11 in the period of 2000-2003 at 6 in 2004.

There is a very tight link between inflation and the rhythm of economic increase and decrease. According to the Global Bank under the level of inflation of 20% the economic rate of increase becomes positive, yet the case of inflation maintenance between 0-5% the economic growth registers high shares of increasing. This has been proved in Romania as well, in the year 2002 the inflation reaching the level of 20% which continued on to decrease. This backfired and also for the level of GDP from 2002 which was one of the great after the 90s, registering an increase of 4.9%. Which contributed very much to the increasing of this macroeconomic indicator, GDP, was the increase of share services till 45.1% and the maintenance of the constructions activities and from industry (which is constituted in the main source of achievement of the GDP) in high shares.

In the year 2010 inflationist pressures were exercised due to the increase of administrated prices, increase on excise at tobacco, VAT shares increased with 5 percentage points, therefor the rate of annual average of the inflation exceeded with 3,7 percentage points on the reference level.

Chart no.1 Inflation, productivity and wage trends



Source: Eurostat, Commission services' spring 2010 Forecast.

In the last 3 years, the share of consolidated general budget deficit of the state in GDP has exceeded the imposed limit through the Treaty from Maastricht.

Based upon the trigger of global financial crisis and on the process of deterioration for the foreign investors' perceptions regarding the associated risks to the economic countries from Central Europe, and Eastern Europe, the RON has depreciated significantly from the euro. Agreements were concluded with international financial institutions and have started a set of reforms intended to insure the sustainability on medium terms of public finances. Thus in the period of 2009-2010 the variation of exchange rate RON/euro has not exceeded the standard bandwidth.

The cost of long term financing was greater than the level of reference.

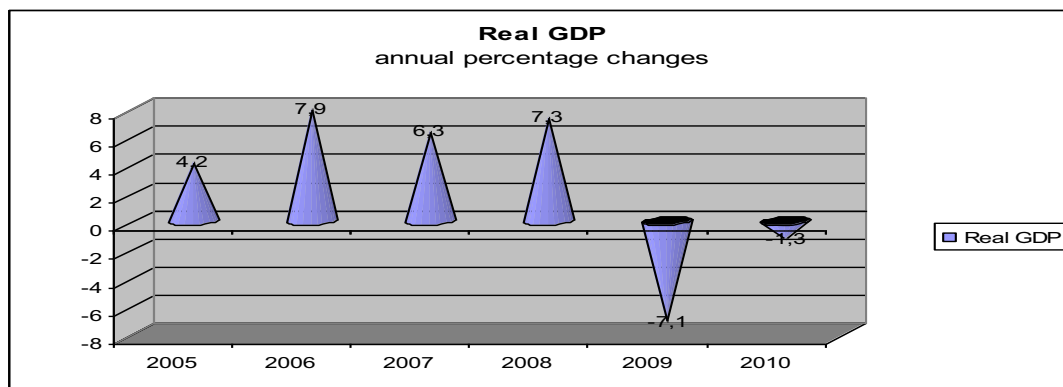
The problems confronted by our country remind us, on one hand, about the long term interest, where a solid constituted market does not exist and nor the appreciation of rating agents for the BBB appellation, minimum for the recommendation of investments, and on the other hand the inflation, bringing us to Europe's back of the line.

3. THE STATUS OF REAL CONVERGENCE

Regarding the real convergence, the Maastricht Treaty does not make reference to the real convergence criteria, which can insure a high degree of similitude and cohesion of candidate economic structures. In the lack of some clearly stated out criteria, we can consider the most important real convergence criteria regarding: the degree of economic opening (expressed through the shares of exports and imports of a country that has in GDP); the share of bilateral commerce with member countries of the EU in total with the exterior commerce; the economic structure (expressed through the shares of grate sectors that have in the creation of GDP: agriculture, services, industry) and, the most synthetic criteria, the level of GDP/habitant (expressed be it on nominal rates, or through parity of standard buy power)⁴.

Briefly, the real convergence represents the process of social structures adjustment, political and economic to the ones from euro area. Shortly, it represent the reduction of delays in terms of economic development., used indicators for assessment being, usually, linked to the GDP per habitant, productivity, life standard, etc⁵.

Chart no.2

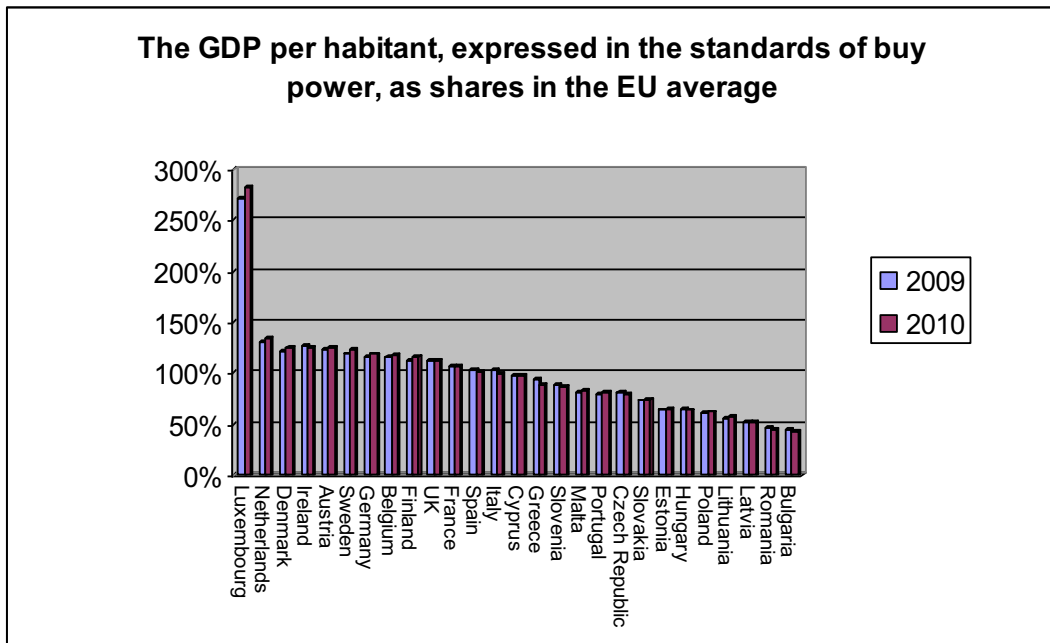


Source: processing the author supplied information by INS

⁴ Isărescu, M., *România: drumul către euro*, Prezentare la Conferința organizată de Colegiul Academic al Universității Babeș –Bolyai., 2007

⁵ Ionuț Dumitru- *Adoptarea euro în România*, MPRA Paper No. 18612, posted 13. November 2009

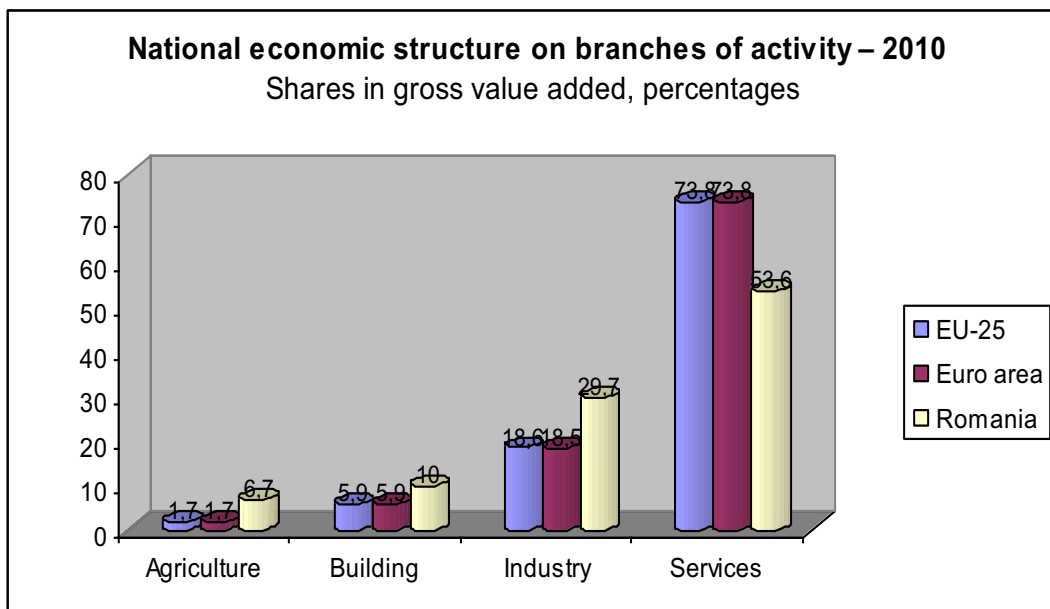
Chart no.3



Source: processing the author supplied information by Eurostat

Romania, next to Bulgaria, has registered in 2010 the smallest GDP per habitant in the European Union, with 55% under the average of a community block. The standard of living from Romania and Bulgaria has dropped in 2010, GDP per habitant going far out the European Union average.

Chart no.4



Source: processing the author supplied information by Eurostat and INS

Regarding the structure of economic sectors these converge in a relatively lent rhythm towards the euro area.

Table no. 2. The degree of economic opening of Romania

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Degree of opening *	70,2	73,8	76,1	77,0	80,6	76,3	76,3	72,4	74,0	67,6	77,1

*) (export + import) of goods and services/GDP *100

Source: processing the author supplied information by INS, NBR, The National Commission of Prognosis

The degree of economic opening has registered a minimum level in the last decade in the year 2009 also it has recovered at a level that is over 75% in the year 2010.

4. ADVANTAGES AND DISADVANTAGES IN THE EURO ADOPTION

The euro area is in present in 17 states, the last entered being Estonia, at the beginning of this year. In the last years the following states have adhered at the euro area: Slovenia (2007), Cyprus (2008), Malta (2008) and Slovakia, the 16th member state of the euro area (2009). Estonia has become the 17th member state at the 1st of January 2011, increasing the population from EU member state which utilise the euro as common currency at 331 million inhabitants.

The euro adoption brings a series of advantages which can be grouped directly and indirectly but also disadvantages.

The direct advantages are:

- ✓ Removal of currency risk from the euro;
- ✓ Reduction of volatility of the exchange rate from the currency of other commercial partners;
- ✓ Reduction of transaction costs;
- ✓ Reduction of administrative costs;
- ✓ Reduction of capital cost.

The indirect advantages:

- ✓ Growth in the exterior commerce;
- ✓ Growth in the direct foreign investments (DFI);
- ✓ GDP growth/habitant due to the increase of exterior commerce and DFI;
- ✓ Increase in competition and transparency;
- ✓ Increase in the level of living on long terms.

Disadvantages:

- ✓ Technical and organizing costs referred to the conversion in euro;
- ✓ Specific costs in the bank sector and reduction of bank income sources;
- ✓ Loss of monetary independence policy and the exchange rate;
- ✓ Risk of asymmetric shocks;
- ✓ Possibility of a greater inflation on long terms.

Regarding the benefits due to the adoption of euro, they are absolutely cert. The most important from them is the one referred to the removal of the exchange rate risk and the stimulation of exterior commerce.

Analysing the disadvantages of the euro currency adoption it is found that the Romanian economy is completely different than the euro area. After the adherence to the euro area, Romania cannot use the exchange rate as an adjusting instrument. The exchange rate facilitates the shock absorbance and the impossibility to use the exchange rate as a silencer for the economic shocks imposes a stable economy, solid, competitive. In the contrary the effects which will occur can be dramatic. The major disadvantage of the

adherence brings is the loss of monetary policy, this thing can lead to the apparition of the so called asymmetric shocks.

5. CONCLUSIONS

In an interdependent global financial frame and with advanced incertitude, the ideal monetary policy should characterize itself by employment, dynamic consistency, transparency, responsibility assumption, quality assessment, avoiding excessive fluctuations and flexibility, sets of tasks which imply inevitably a certain degree of complexity.

To adhere to the euro area, we should concentrate firstly on the increase of competitiveness, on public coherent policies and on an agenda of structural reforms.

At enterprise level, the competitiveness is the capacity to maintain on the market through products with equal characteristics or superior ones the competitive similar products.

At nation's level, to be competitive, means that, taking into account that a series of indicators (occupation, productivity, exterior commerce, financial stability, business environment) to put us over the average and close to the most performing states from the euro area.

The moment of the euro adoption is not only a decision of Romania, through the efforts which need to be taken to achieve that level of development which can allow the adoption of the sole currency. Even if the criteria are the same for all states which want to integrate from the economic and monetary point of view, each country needs to create its own strategy of monetary policy of transaction according to the needs and individual circumstances.

Likewise, it is to be remarked that the passing to the euro area does not need acceleration in useless way, but the adoption of the sole currency does not need to be treated as a sole purpose. Besides the achievement of nominal convergence goals, the realization in the shortest time of the real convergence represents the goal to which would be indicated to subsume the policies followed by Romanian authorities⁶.

It is absolutely cert that Romania has a long way ahead in terms of convergence, especially the real one, but also the nominal convergence. What needs to be insured, is however the sustainability of the convergence process.

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