Reasons for and against the Early Adoption of the Euro in Romania

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Abstract: In the context of the current turmoil in the European Union and the euro area and taking into account the discussions on the remaining or the exit of Greece from the euro area, in our country there is a trend that supports the early (faster) euro adoption. Given that Romania can not opt out of joining the euro area, as is the case of the United Kingdom and Denmark, the problem which remains to be solved is when and how our country will enter in the euro area. Therefore, this article aims to analyze the indicators of the scoreboard for the surveillance of macroeconomic imbalances for our country, at the same time offering a number of reasons for and against a faster adoption of the euro in Romania. The paper argues its observations based on international and national documents and Eurostat database. The study may have a series of implications for the politicians, public policy administrators, academics and researchers, bringing its contribution to the euro adoption debates.

Keywords: euro adoption; surveillance of macroeconomic imbalances; real convergence;

JEL Classification: F15; F45; H12

1 Introduction

As it is known, the euro presently circulates in 18 of the 28 European Union (EU) member states, only Denmark and the United Kingdom having the opt out clause. Eight countries, among which is also Romania, will have to adopt euro sooner or later. The adoption of the euro is important for any economy, the most important consequence being that the national monetary policy is replaced by the single monetary policy of the European Central Bank. First of all, the adoption of the euro requires meeting the Maastricht nominal convergence criteria, as well as some real or structural criteria, a part of them being stipulated in the scoreboard for the

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identification and surveillance of macroeconomic imbalances. These real indicators (GDP per capita, the structure of the economy, the labour force cost, the level of economy's openness, the financing of the current account deficit, the level of financial intermediation, etc.) are used to evaluate the sustainability of the process of convergence, also being an important landmark in the evaluation and promotion of the national competitiveness.

In Romania, even from May 2011, the coordination of the process of preparation for the adoption of euro at the national level is done by the "Inter-ministry committee for the adoption of euro" [1], which is chaired by the Prime minister. At the National Bank of Romania (NBR) it was established in the spring of 2010 the "Committee for the preparation of euro adoption", an official framework of debates on this topic either regarding the experience of other countries which had already adopted the euro, or who are within the process of preparing the adoption of the euro, or regarding the stage of this process in Romania, and the theoretical and practical trends in Europe and worldwide.

The Program of Convergence 2011-2014, specifies 2015 as the year of adoption of the euro by Romania, while the Program of Convergence 2014-2017 stipulates that the commitment of Romania to adopt the euro will become achievable and necessary on January 1st, 2019. However, several thorough and reasoned debates on this subject, plus the economic development can push the adoption of the euro beyond 2019.

This calendar can be modified either due objective reasons, or due to subjective reasons, or due to Romania's decisions, or due to the European Union and its strategy of enlargement towards the east of the continent. It must be mentioned that no matter how prepared Romania will be at a particular moment in time, it cannot adopt unilaterally the euro; Romania can join the euro zone only when the European Union wants this and when Romania is ready for this process in all aspects. Any wrong or uninspired decision may generate negative effects for the entire euro zone, or even worse, for the entire European Union. The situation of Greece is relevant as example of this situation, both Greece and the European Union (the euro zone implicitly) being currently completely unprepared for the consequences of an unexpected and disorderly exit from the euro zone.

2. Methodology and Data Sources

This article uses the information presented in the Convergence Report of the European Central Bank (ECB) from June 2014, as well as other national documents (the Convergence Program 2011-2014 and the Convergence Program 2014-2017)

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and European Union documents, and documents from public institutions with international vocation. For updating and completions, we use the Eurostat database, as far as this is useful to our purpose.

3. Literature Review

About adoption of the euro references abound when concern international literature (e.g. Verdun, 2002, Schadler, 2005, Dyson, 2006, Greskovits, 2008), and domestically, many authors (Isărescu, 2004, Dumitru, 2009, Lupu, et. alli, 2010, Marinaş, Socol, & Socol, 2011, Pop, 2014, etc.) deals with the issue of euro adoption in Romania, bringing new meaning to the knowledge and understanding of the integration process of our country in the euro area.

Recently, according to Isărescu (2014), "not only in Romania, but also in the other four countries which joined the European Union in 2004 or 2007 and that have not adopted the euro - Bulgaria, Czech Republic, Poland and Hungary - the nominal convergence criteria are met or tangible. However, the authorities of these countries are not considering the entrance into the Euro zone, placing themselves on a waiting position, and Romania, having shared the same option for a year, has recently adopted the target date of January 1st 2019."

Regarding the Czech Republic, Hungary and Poland, according to Criste (2015), the euro adoption date was pushed towards an uncertain future, these countries adopting a "wait and see" type of policy, amid a more cautious attitude related the adoption of the euro, while Romania has set a target date for euro adoption.

4. Arguments for and against the Early Adoption of the Euro in Romania

4.1. Arguments Sustaining the Fast Adoption of the Euro

The adoption of the euro by Romania may anchor and motivate the domestic programs of economic reorganization and the proper administration of the public budget.

Regarding the macroeconomic imbalances, Romania is monitored within a preventive program of macroeconomic adjustment supported with EU-IMF financial assistance.

Analysing the scoreboard for Romania according to ECB data from the June 2014 Convergence report (reflecting the data for 2011-2013), we notice that 9 of the 11 indicators used to monitor the macroeconomic imbalances can allow us an easy access to the euro zone. Thus, in Romania, the real effective exchange rate has depreciated moderately, within the ±11% interval, the labour force cost, calculated as rhythm cumulated on 3 years, was clearly lower than the +12% threshold, the market share of the exports as percent variation over five years scored positive values in 2011-2013, being over the -6% threshold, the flow of credits granted to the private sector, as proportion of the GDP, was practically insignificant during the period of analysis, being below +14%, the price of dwellings deflated with the consumption, calculated as annual percent variation, didn't exceed the level of +6%, continuing to have negative values, reflecting the corrections towards the levels registered in the period before the crisis. The debt of the private sector, the debt of the financial sector and the public debt were below the established thresholds (+133%, +16.5% and +60%). The proportion of the public debt within the GDP increased slightly due to the international economic-financial crisis. The values of these indicators apparently show a low level of external vulnerability of Romania to the contagion generated by the turbulences from the financial markets. However, the high proportion of credits in foreign currencies is a macroeconomic and financial risk because it exposes to the exchange rate risk the debtors who are not covered for this risk. In Romania, there is a significant risk due to the lack of correlation of the currency structure, particularly at the level of the population.

The unemployment rate was below the +10% threshold imposed as reference mark.

The adoption of the euro might speed up the accomplishment of the real convergence targets, but this was not demonstrated in practice (see the case of Greece).

At the same time, the adoption of the euro might support the restructuring of the state institutions by a diminishment of corruption, including at high levels. Presently, Romania struggles against corruption, and this might be beneficial for the acceleration of the process of euro adoption, but this is just one side of the sustainability demands of the process of economic, social and political convergence of any country that gets ready for the euro adoption.

The adoption of the euro means lower costs of transaction because a single currency is used, but the level of economic integration will certainly be offset by the low levels of the national incomes and gains compared to a strong currency like the euro.

The accession to the euro zone should contribute to the reduction of the regional disparities, but the post-crisis developments proved the contrary.

The adoption of the euro might theoretically establish an area of economic, political, social and cultural exchanges, and might relate the realities of our country to other values, but there is no common value and reality of the euro zone countries (for instance, there are important differences in terms of work and working time, leisure, nation and national values, traditions and culture, involvement in society, institutional relations and role, spiritual and material needs, etc.). This heterogeneity might cause the adoption of the euro fail being a success for any European country wanting to join the euro zone, Romania included.

4.2. Arguments against the Fast Adoption of the Euro

The crediting process is still disconnected in Romania from the rhythm and trend of the economic growth and it still lacks the capacity of motivated support (both as proportion of the GDP, and as duration in time) for the national economy. In order to speed up the process of real convergence there must be a sustained contribution of the crediting activity to GDP increase. These credits must be directed not just towards consumption and volatile areas, like it was done until 2008-2009, but particularly to areas of sustainable development (health, transportation infrastructure, education, green businesses, IT, renewable energy, etc.). This phenomenon presumes resynchronization of the monetary-financial cycle to the business cycle, particularly since the revival of crediting will still be difficult because of the phenomenon of financial disintermediation which is rather strong in Romania and within the EU. Also, the excessive dependence of the financial intermediation on the banking sector must be reduced, while the faster development of the capital market must be supported.

According to Eurostat, the GDP per capita is extremely low in Romania, being in 2014 almost four times lower than the EU 28 average (just 6900 euro per capita, in real terms, compared to 25800 euro per capita, the EU 28 average), and more than 2 times lower than the real GDP per capita of Greece (17000 euro per capita).

According to Lazea, V. (2015) „At the end of 2014, GDP/capita in Romania (PPP adjusted) represent about 54% of the EU average. The Baltic countries, the poorest countries received so far in the euro area, had at those times the GDP/capita adjusted with PPP between 60 and 66 percent of the EU average. It is unlikely that eurozone to receive a candidate state with a GDP/capita below the mentioned levels. Romania's current growth differential of 2 percent faster than the EU average, requires a minimum of six years to achieve 60 percent".

The GDP per capita in Romania should be at the same level, or slightly below the EU 28 average, in order to ensure a sustainable accession to the ERM. Hence, GDP per capita growth might be stimulated only by a two-fold higher rate of growth of the real economy in Romania than the EU average for several years in a row, at least 10 years (the growth rate must not necessarily be the same every year, which is very hard to accomplish because of the economic cycles and because of the hardly predictable dynamics of the economic variables). This would take us to a compatible or comparable level with the EU 28 average GDP per capita.

The expansion of the public debt crisis in countries such as Greece, Ireland, Portugal or Spain, proved the lack of protection against adverse phenomena yielded by the affiliation to the euro zone. These countries are less competitive and they still have very vulnerable structural economic elements. The euro area is no panacea.

The adoption of the euro by Romania in 2019 seems extremely optimistic, particularly since the Exchange Rate Mechanism II presumes at least 2 years of participation in this area. During this period, the exchange rate can no longer be regulated by the market and controlled administratively by NBR, which presumes that the economy will have to be managed only through fiscal instruments, because the response to the key interest rate of NBR and RMO does not always play an efficient role in "piloting" the monetary policy and the economy. Besides the fact that NBR will lose an extremely valuable instrument for the management of the monetary policy (by losing the exchange rate instrument), the automatic adjustments of a variable exchange rate mean even more important losses for the economy.

The loss of the exchange rate instrument, once we join the euro zone, will deprive the economy of an instrument of defence against the asymmetric shocks by regulating the exchange rate and ensuring the flexibility necessary for the restoration of the economic competitiveness in relation with the advanced euro zone economies.

Sustainability and durability are extremely important at the EU level, and the nominal criteria must not be fulfilled just at a particular moment in time (ECB, Convergence Report June 2014). Therefore, the fulfilment of the nominal convergence criteria is no guarantee that as the economy will have to cover the gaps from the real economy, the nominal convergence criteria will not slip, and the adopted euro will no longer be beneficial, but rather a "mill stone", like in the case of Greece.

The euro zone "exit" mechanism must be made clear, so that the departure from this zone, if strictly necessary, should be done in a safe way, with no serious turbulences for the particular economy, or for the entire euro zone and the entire European Union.

Some euro zone countries have structural vulnerabilities, such as: a high level of indebtedness and a high level of the foreign debt, gaps in the level of competitiveness compared to some international partners, insufficiently dynamic institutions, precarious stimulation of the innovation activity so as to support competitiveness, insufficient correlation of the workforce qualifications to labour market demands (which can be seen through the high level of unemployment among the young people), integration of immigrants, lack of demographic policy to make the population younger, speculative bubbles and volatile markets (such as the real estate market), lack of sufficiently strong and uniform mechanisms and procedures in the field of fiscal-budgetary policy monitoring and remediation of the macroeconomic imbalances, rapid contagion with turbulences and slow contagion with positive phenomena from the markets of the member countries (such as the financial-banking markets of the EU member states), economic, politic, social and ideological fragmentation between the northern and southern, eastern and western member states, not just among the euro zone countries, but among the whole EU member states, or between the euro zone member states and the rest of EU member states, non-members of the euro zone. Given these structural deficiencies of the euro zone, we wonder whether it is recommended or not to join the euro zone before it solves much of these problems.

Furthermore, the European Union (the euro zone implicitly), didn't define clear its prospects, remaining in some kind of institutional inertia, with no hierarchy of priorities and policies, as it should have been normal. Should the observation of the nominal criteria be the most important, or should the countries target the sustainable development? Are EU policies and objectives harmonized with each other? Which is the final goal of the European Union? Which is the path to follow? Can there be a consensus in this matter?

Looking at the scoreboard for Romania, according to ECB calculations from the Convergence Report of June 2014, we may notice that not all the indicators grant the successful accession of our country into the euro zone. Thus, the investment position exceeded the threshold of -35% for all three years covered by the analysis (2011-2013), having larger negative values. These high values reflect the high previous deficits of the current account, the rather high level of the foreign direct investments in the economy and other more volatile investments (such as loans). It can thus be seen that the fiscal and structural policies didn't contribute significantly to the support of the foreign sustainability and of the competitiveness of the national economy.

The three-year average of the current account balance, expressed as percent of the GDP, has improved slightly (on the background of the turbulences caused by the international financial crisis). However, it can be seen from the ECB Convergence Report of June 2014, that this criterion has been met only in 2013, while it slipped in 2011 and 2012, showing that this indicator is not fulfilled in a sustainable manner.

The information supplied by the scoreboard must be read with caution and without reading them mechanically. Thus, it should be taken into account that the 3 or 5-year averages are influenced by the adjustments from the post-crisis period, which will not last long. Hence, the analysis should also take into consideration other factors, such as the whole macroeconomic context (economic, financial, social, etc.), as well as the macroeconomic perspectives.

Furthermore, the decrease in the price of real estate must not always be judged positively, because it may show a possible crash risk of this sector if it perpetuates and gets more serious. However, in Romania, after the pre-2009 boom, the corrections to the price of dwellings are only natural. The price of houses should reflect the income of the inhabitants, having a fair relation with it, while in Romania the cost of the dwellings is according to the European levels.

Also, the flow of credits for the private sector is extremely low in Romania, much below the set threshold (+14%), which means that this sector is underfinanced. The threshold allows increase of financing, but both the banking sector and the businessmen display reticence. This situation might be improved if the stock of bad credits would decrease by over a half, and if it would approach the European average, while the banks balance sheets would get "cleared" of burdening costs and products with improper performance. At the same time, the business environment should be stimulated to collaborate with the banks, while the banking system should come with a correct and "friendly" offer, thus understanding the intrinsic mechanisms of running any business in order to facilitate the proper functioning of the companies, rather than making it difficult. The state should also have a contribution to the use of the business credit by granting fiscal facilities and/or guarantees if the bank and the company can prove that they can have fruitful cooperation for at least 3 years.

Regarding the labour market, although the unemployment rate is within the set limits by the scoreboard, there are forms of unemployment which are not covered by the statistics, and the situation of the unemployment is often accompanied by a lack of correlation between the existing competencies and the requirements of the employers. There also are territorial disparities regarding the employment rate, for instance higher demand for labour force in west and north-west of Romania, and a higher offer of labour force in north-east and south-west of Romania, the mobility of the work force being rather low in Romania. This will maintain the risk regarding the convergence of the real income of the Romanian population. According to Europe 2020 strategy, in 2014, the employment rate in Romania (people aged 20-64) was of just 65.7%, compared to the 70% national target, or 75% EU target. This situation must also be correlated with other social variables of the Europe 2020 Strategy such as school dropout, which is extremely high in Romania (18.1% in 2014, the national target being 11.3%, while the EU target being 10%); tertiary education (25% in 2014, the national target being 26.7%, while the EU target being 40%); gross domestic expenditure for research and development (just 0.39% of the GDP, compared to 2% national target and 3% European target); severe poverty. All these social, educational and labour market indicators from Europe 2020 Strategy show how unprepared Romania is. This is an argument not to force the accession without being prepared.

The indebtedness of the private sector doesn't always contribute to the revival of businesses and support of production, particularly under the conditions of a restrictive financial-banking environment, while the foreign currency loans, the euro included, may engender a high currency risk that may affect those particular entities (the population included) and possible their branch of activity. Therefore, it would be then necessary an active protection against the currency risk, or granting credits mostly in lei.

Still talking about the scoreboard, the requirements for the countries members of the euro zone are more restrictive than for the non-euro zone countries, like it is for the real effective exchange rate and for the nominal unit labour cost, calculated as rate of growth over 3 years. Thus, for the real effective exchange rate, the threshold is ±5% for the euro zone countries and ±11% for the non-euro zone countries, while the threshold for the nominal unit labour cost is +9% for the euro zone countries and 12% for the non-euro zone countries (European Commission, 2012). Hence, a too early adoption of the euro might entail normative restrictions for which Romania is not yet ready**.**

Beyond the arguments of the scoreboard indicators, an extremely important aspect that doesn't yet qualify Romania for entry into the Euro zone is the competitiveness level. Thus, according to 2011 Romania's Competitiveness Report, our country is below the EU average on indicators on physical infrastructure and human resources (requiring an increase in fixed capital) and on the quality of fiscal and monetary policies. According to the report, Romania recorded a total of 25 advantages and 49 disadvantages and other 22 indicators were classified as neutral in terms of competitiveness. The overall performance of our country positions it in a slightly competitive disadvantage compared to countries such as: Austria, Bulgaria, Czech Republic, Hungary, Poland and Slovakia, which was compared with at the regional level.

5. Conclusion

Although Romania largely meets the requirements of the relevant EU indicators of the scoreboard of macroeconomic imbalances surveillance, they should not be read mechanically, but correlated with the economic and social reality, particularly since some indicators of the nominal convergence criteria imposed by the Maastricht Treaty are not met in a sustainable manner.

Furthermore, the global economic and financial crisis altered the natural evolution of some macroeconomic indicators, and their adjustments due to the crisis cannot be done on the long-term. It is therefore necessary to understand what and how much from the evolution of the indicators is cyclic or conjectural, and what and how much is structural, these elements becoming clearer in time. This is also valid for all scoreboard indicators.

Beyond the evolution of the scoreboard indicators for Romania, we must highlight that our country still displays a low quality of institutions and governance efficiency and efficacy (almost an institutional "autism"), an incapacity to draw and absorb European funds, a vulnerable business environment and a high rate of corruption, which sent Romania to the bottom of the European institutions quality (ECB, 2014), after Greece. This requires correcting all these serious deficiencies before accession to the euro zone. A corrupt institutional environment disturbs the accomplishment of the criteria of nominal and real convergence, and of the Europe 2020 criteria, and the accomplishment of the sustainable development goals. Such institutional environment might undermine the sustainable development of the economy and might make more difficult some economic adjustments and the efficient implementation of economic policy measures.

Although the target for accession to the euro zone was set for 2019, in our opinion this target is not realistic due to the low level of economic and social integration of Romania. Hence, we consider that euro adoption in 2019 is too early. A reasonable time could be 2025 for ERM 2 accession and 2027-2028 for the adoption of euro.

The establishment of an environment which favours the sustainable convergence in Romania for the adoption of the euro also requires the implementation of economic policies which ensure the macroeconomic stability and the increase of national competitiveness.

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