# ROMANIA'S MACROECONOMIC ACHIEVEMENTSFOR JOINING THE UNIQUE EUROPEAN CURENCY

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**Abstract**

*The Romanian government has announced plans to join the eurozone by 2015. Currently, the leu is not yet part of ERM II but plans to join in 2010-2012. The economic advantages of the monetary union grow with expansion of the Euro zone. There is also a high level of skepticism; the main fear about the Euro is the inflation –that is considerable promoted by the Euro currency's exchange rate in comparison with 2002; another restraint is due to member states inability to establish their own interest rates. The IMF arose the option of joining the Euro zone criteria relaxing. A one-sided Euro's joining was suggested by International Monetary Fund on March-April 2009, in a confidential report mentioned by The Financial Times as the emergent states in Central and Eastern Europe to be able to pass to the unique currency, but not being represented in the Central European Bank Board. By its side, CEB considers that emergent states of the European Union must not pass to the unique currency unilaterally, because such a fact could under-mine the trust in Euro currency worldwide. This option would hardly deepen the macroeconomic controversies inside the Euro zone and would contradict the previous conditions already imposed. An acceptable solution could be the fastening of emergent countries joining the Exchange Rate Mechanism 2, after they are aware of risks arisen by such a step. The European Commission endorses in the Convergence Report on 2010 that Romania doesn't meet any criteria needed by passing to the unique European currency, respectively: prices stability; budget position of the government; stability of exchange rate; interest convergence on long run and there are also law impediments. Our paper discusses arguments for a faster passing to the Euro currency versus arguments for a late joining the Euro currency in Romania.*

***Keywords****: Euro currency, the economic depression, stability of exchange rate, monetary policy, the financial depression.*

## Introduction

Theoretical foundation of optimum currency area (OCA) was pioneered by Mundell (1961) and further developed by McKinnon (1963), Kenen (1969), Tavlas (1993), Bayoumi and Eichengreen (1996) and others. Frankel and Rose (1996), found a strong positive relationship between business cycles correlation and trade integration as the participation to a currency union increases the integration of collateral trade which lead to greater business cycles synchronization; Beside the nominal convergence criteria, the states who want to join a monetary union have to take into consideration also the real convergence criteria: business cycle synchronization, demand and supply shocks correlation, market flexibility, etc; Among OCA's properties business cycle synchronization features prominently; Synchronization of Business Cycles: Artis and Zhang (1997,1999), Artis (2003), Darvas and Szapary (2004),Massmann and Mitchell (2003), Fidrmuc and Korhonen (2006);Demand and supply shocks correlation: Blanchard and Quah (1989) and further Bayoumi and Eichengreen (1992), Frenkel and Nickel (2002), etc; The theory of optimum currency areas tries to identify more exactly thereport between the benefits and costs and the opportune moment of entrance in a monetary union. The pioneer of this theory is Robert Mundell (1961):"The Theory of Optimum Currency Areas", American Economic Review 51 (September 1961), pp. 717 – 725, a classic paper. What seemed to be a utopia in 1961 became a reality in 1999. „The European states may agree on a simple act […], they may establish a currency authority or a central bank. This

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is a possible solution, and may be even the ideal solution. From a political point of view, it is very complicated, almost utopian." R. Mundell (1973).The optimality of a currency area is defined within the terms of certain properties (criteria), among which the economic integration of the member states, the mobility of the factors of production, the similarity of the production structure. According to a definition, it is optimum for a country to adopt the currency of the monetary union if the benefits associated to this decision exceed the costs. There is an extremely wide literature with respect to the optimum currency areas, but all articles and books in the field are focused on the manner in which a country may assure the internal stability with the policies remained available after the loss of the monetary autonomy and the rate of exchange policy. This literature refers to the possibilities of insuring a macroeconomic balance (internal and external balance) after an asymmetric shock, namely a shock which affects a country of the union, but not the others. The internal balance refers to bringing the unemployment rate to the level of the natural rate and to the insurance of economic increase. The external balance refers to assuring the balance of payments, seen as balance equilibrium This paper has the merit of elaborating a synthesis of the evolution of the concept of unique currency, as well as the assessment of the performances of the countries which adhered to the Economic and Monetary Union from the point of view of the mechanisms of operation of their economies. It also deals with the steps necessary for a careful preparation of adopting the unique currency by Romania, the efforts and the progresses made by our country in the process of macro stabilization, the main directory lines of the monetary policy in the last years and last but not least a careful assessment of the impact and implications of adopting Euro in Romania

**Paper content**

1.Economic advantajes of the euro zone 's extension

The Euro currency is public assets, bringing many advantages to envolved countries. This removes the exchange rate risk for the member countries, by diminishing the interest rate, and allows to those countries to benefit by the advantage of prices stability, the basic purpose of ECB. Also, it creates the conditions for an integrated market, a liquid and compact one, among the participating countries. Once the expansion of Euro zone is done, more EU member states will enjoy these advantages. Much more, some of the advantages of the monetary union, as removing the incertainity of exchange rate, are higher. A currency exchange will not be needed, nor the payment of added taxes for that transactions in the countries inside the Euro zone. Although, to achieve the maximum potential of these advantages, a country must be prepared for passing to Euro currency. The stage will be evaluated on the Maastricht convergence criteria basis.Member States of Euro currency zone gain from being parts of a wider currency block. It is more difficult, for example, for those that speculate to make a quick profit from currency exchange and by this way to remove a great part of pressure affecting the value. A trip in Euro currency zone countries is easier for the EU citizens, with no currency exchange expenses. Also, it's an easier task to compare the prices of goods and services, contributing to a better home market work and suporting a healthy competition, with benefits for consumers.The economic and prices stability as a whole brought by Euro currency is benefic for entire economic environment, from individuals to large companies.

2.The skepticism about the euro currency zone

The main fear about the Euro is the prices inflation –that is considerable promoted by the Euro currency's exchange rate in comparison with 2002. An average citizen could be able to face the conversion from previous currency into Euro. But only those that are systematically registering the prices have a clare vision upon changes of prices for a large quantity of goods. In this context there is another phenomenon: as the use of previous currency was longer, as the sensation that prices grew is stronger. The reason is that the actual prices in Euro are compared with former prices. Often it is neglected the fact that the previous currency would generate higher prices because of inflation. The most frequent restraint is due to member states inability to establish their own interest rates. The member states incapacity to modify interest rates means that they can't decrease the interest rates unilaterally to encourage the investments or to grow them to stimulate savings. A unique European currency means a European unique monetary policy and that needs answers to several questions.

3.Opinions concerning a faster pass to euro currency in the context of economic depression

*3. 1. One-sided pass to Euro currency*

A one-sided Euro's joining was suggested by International Monetary Fund on March-April 2009, in a confidential report mentioned by The Financial Times as the emergent states in Central and Eastern Europe to be able to pass to the unique currency, but not being represented in the Central European Bank Board. According to the report, such a fact would solve the problems of off-shore debts of those countries and would take-off the incertitude on markets in the region. The European Commission rejected the information suggesting that the report is overfulfilled and said that European Union took several decisions to help the Eastern Europe countries to pass the financial depression. The Central European Bank considers that emergent states of the European Union must not pass to the unique currency unilaterally, because such a fact could under-mine the trust in Euro currency worldwide. This option would hardly deepen the macroeconomic controversies inside the Euro zone and would contradict the previous conditions already imposed. An acceptable solution could be the fastening of emergent countries joining the ERM 2, after they are aware of risks arisen by such a step. Entering in ERM 2 means to take the responsibility to keep a stabile exchanging course for a determined period, but this implies risks. For the countries that are targeting the exchange rate (the Baltic states and Bulgaria) the perfect solution is to pass to the Euro zone as soon as possible, but they don't fulfil the conditions for that. For those four countries at least, a one-sided pass to Euro currency could be a solution. Those countries would not be accepted as full-members of the Euro zone, would not take part to political decisions of the Euro zone, could not rise funds from Central European Bank and would not affect the statistics of the Euro zone, but they would remove the exchange rate risk and would be members of a liquid Euro market. Their main next purpose would become to be promoted from the position of semi-member to that of full-member inside the Euro zone. In a way, a one-sided pass to Euro currency could discredit the joining rules; in the end, these countries will pass to Euro currency taking upon themselves all the risks and pay for them from their own reserves. Some analysts consider that by this way the costs would fall for all the European Union countries. The other four applicant countries for the Euro zone (Czech Republic, Poland, Romania, Hungary) are the greatest economies in the region, and their size makes the sudden change of national currency a more risky, more complex and less realistic process. Their floating exchange rate regim makes the change vulnerable to speculations. Although some advantages would be for Romania (removal of exchange rate risk), as long as there are not fulfilled all the criteria for convergence, more riks appear, generated by the inadecvate macroeconomic statement for this approach.

3.2 Change of criteria for passing to the Euro zone

On the background of the new economic depression it was arisen the problem of *relaxing criteria* for passing to the Euro currency. Western countries' leaders gave different answers during discussions refering to this subject. Although leaders as Angela Merkel (Germany's Cancelor, a country considered the most uncompromising about respecting the passing rules to the Euro currency) considered that the decision concerning *pre-joining period* could be re-examined, the criteria of passing to the Euro zone were not modified. Most leaders reject the idea of more flexible criteria that are limiting the level of budget deficit, public debt and inflation. Behalf of the Czech Presidency of the European Union, MirekTopolanek declared that there is a wide consensus among the 27 members of the Union upon the fact that would be an "error the play rules to be changed at this moment". Several leaders of the EU countries said they agree an acceleration of passing for the East European countries, but they don't discuss about relaxing criteria, nor exceptions to the rules.

Fulfiling criteria also means to ensure the sustenability of nominal convergence indices. Lithuania had been refused to join the Euro zone on 1st January 2007, because it didn't fulfiled the criterium about prices stability in the referred year and the inflation rate surpassed the accepted level. Although the inflation rate is a moving target, known *post factum*, it was considered that a sustenable inflation low rate is not enough, implying many risks.

4.Eu member states and passing to euro

The less member states non-members of the Euro zone can join the Euro zone faster than greater countries. Estonia, Lithuania and Slovenia joined to ERM 2 on June 2004 (less than two month since the moment of their adjoining to EU), and in May 2005, Cyprus, Malta and Latvia made the same thing. The Baltic states are preparing to pass to the Euro zone as soon as the economic conditions will permit them to. At the begining these countries planed to be ready for passing to Euro in 2007-2008. All of them are fighting to fulfil the inflation criteria seriously and also the need of re-considering the national targets being realistic. The non- EU micro-states as Vatican, San Marino and Monaco, passed to Euro as a part of the union with states they are involved to, EU members. Andorra, Montenegro and Kosovo passed to Euro zone one-sidedly. On contrary, although Slovakia entered the ERM 2 in 2005, it seems to be accepted not very soon, while bigger states as Bulgaria, Czech Republic, Hungary, Poland and Romania still didn't that. Czech Republic and Hungary planed to pass to the Euro zone in 2010, and both of them have now a delay and didn't proposed a new date. Poland has no official date-target yet for passing to Euro currency. Bulgaria proposed its dead-line for 2010 but certainly will be a longer time to wait, as long as Romania seems to pass to the Euro zone about 2014.The public opinion of some new entered countries into the EU is changing. Many citizens feel that the benefits of a member statement could be seen very few. They are very suspicious about finding themselves into a way to get a stable position about the limiting economic policy that seem be represented by the Economic Monetary Union. They can see the most of economies inside the Euro zone fighting for economic growth, as long as their own economies had been growing faster some years ago. If the main performance for the new accepted states is to reach the same economic performances as older states into the Union, as fast as this is possible; so it arises the question: why such a rush to impose more difficult economic policies, that make these tasks more and more difficult. The new member states could see that the older ones dislike to suport them to develop, being afraid of their potential competition in the future. Much more, some new member states feel that economic criteria required are more strictly imposed than the already adopted Economic Stability and Growth Reformed Pact that is working now.

5. Romania' way towards the euro zone

*5.1.Analyse belonging the Convergence Report – May 2010*

Romania doesn't fulfil any criteria for passing to unique European currency, it is said by the European Commission in its Convergence Report on 2010, respectively: prices stability; budget position of the Government; stability of exchange rate.Convergence of interest on long run, but also faces law obstacles. Behind the *economic problems*, as a too high inflation or rather high variations of national currency during the last two years, due to the economic global depression, *Romania also has legislative problems.*The Commission considers that the law referring to the statement of National Bank of Romania is not aligned to European standards yet, neither concerning the independence of institution, nor about the interdiction to grant loans to financial institutions, excepting "the rescue aid". Strictly referring to economic criteria, the Commission emphasizes that Romania had a too high rate of inflation since 2007, the year of joining EU, to present day, for passing to the Euro zone. Actually the procedure for excessive deficit is started by the Commission against Romania, the dead-line for reducing the deficit below 3% of GDP being 2012. The deficit was 5.4% for 2008 and rose to 8.3% for 2009. For this year the deficit is estimated to 8% of GDP. Another problem is the public debt that will rise from 30.5% this year to 35.8% of GDP for the next year. Although the Joining Treatise stipulates that the maximum level of the public debt could be 60% of GDP, the economists consider that Romania can't afford such a big debt, its economy being rather weak. Romania doesn't seem for a moment being interested in joining the Euroland in 2015 as it was predicted, a more reasonable horizon being 2018. Actually it is not known if the costs of passing to the unique currency could be higher than the future benefits. We need an anchor like passing to Euro currency, but it is better to look realistically. For an economy with such sized GDP, the Euro currency "umbrella" could offer protection.

*Table nr.1*
*Arguments for a fast passing vs. Arguments for a late passing to Euro currency in Romania*

| *Arguments for a fast passing to Euro currency* | *Arguments for a late passing to Euro currency* |
|---|---|
| Faster benefits due the exchange rate disappearance, implying a sustenable economic growth stimulation. | Delaying in structural reforms implementation would have negative effects on long run if the passing to Euro currency is made too soon. |
| Actually we have a high exchange rate risk due to the high level of indebting in foreign currency (the exchange rate could be sooner a propagator of shocks than an instrument for adjustment). | High inflation pressures – low potential for prices convergence. |
| The delay could lower the motivation for making structural reforms. | A low correlation of Romanian economic cycle with that of the Euro zone; the synchronization of the business cycle is a pre-condition to diminish the asymetric shocks risks. |
| The actual essemby of policies would continue to be stimulated. | The low sustenability of the public finance – a high pressure on expenses and a very low level of budget rises. |
| The trade affairs with the Euro zone would make possible a faster passing technically. | A different structure of economy. |
| | The low level of the real convergence (GDP per capita). |
| | Difficulties on the labour market. |
| | A longer independence for monetary policy and exchange rate. |
| | It would facilitate the progress of real and nominal convergence. |

*5.2.Possiblescren-plays for Romania's passing to Euro currency*
*5.2.1.A delay on long run for passing to Euro currency*
*(1) Advantages*
A longer period to fulfil the structural adjustments still not made
A better progress of real and nominal convergence

The synchronization of the business cycle in Romania with that in the Euro zone countries (pre-condition to diminish the asymetric shocks risks).

A longer independence for monetary policy and exchange rate

*(2) Disadvantages*

Higher transacting costs together exchange rate risks, that could inhibit investments and economic growth

The possibility to delay some structural reforms and to relax the macroeconomic policies (mainly in fiscal and salary fields) if a long run is decided for passing to the Euro currency

The unclear message given to international capital markets, the delaying could be atributed to some structural or economic policy weakness, hard to be seen by investors

*5.2.2..An accelerated passing to Euro currency on a short run*

*(1) Advantages*

Faster benefits due the exchange rate disappearance, implying a sustenable economic growth stimulation

Lowering motivations for relaxing the rhytm of structural reforms

Stimulating the consistency of macroeconomic policies assambly

*(2) Disadvantages*

The loss of monetary and exchange rate independence would move the pressure of structural adjustments to the economic activity and labour market, in the actual condition of a limited flexibility of Romanian economy

The lack of synchronization between Romanian business cycle and the Euro zone countries would increase the risk of asymetric shocks, very difficult to be controlled without independent monetary and exchange rate policy

The difficulty to find a representative central parity for a stable exchange rate Leu/Euro, that could delay on long run the belonging to ERM2

A higher probability to act the Balassa-Samuelson effect in the first part of the economic adjustment process after the moment of joining EU, it having cosequences upon targeting inflation and/or the national currency growing up

A limited period to finish the target inflation effectiveness as a monetary policy

A passing to Euro currency would remove the exchange rate risk, and lower the costs for firms in commercial activities, that meaning a higher stability for Romanian economy. But the exchange rate decided at the moment of passing is very important; a low rate for Leu means an increasing in prices. On the other hand, the salaries couldn't grow easily, and the National Bank of Romania couldn't decide the interest rates and the inflation would be hardly controlled. But, the purpose of passing to Euro currency remains an available improvement for the future coherent policies.

## Conclusions

The papers offers a short in time to the idea of monetary unionwhich allows us a more objective appreciation of the political dimensions of themonetary unions, approaching with accuracy the history and the bases ofcreation of the European Monetary System (SME) and especially the political andeconomic context of the time. There are presented the basic elements of SME, the stages and effects of UEM incorporation.Thepaper presents the European integration regarded synthetically, which is reduced to the incorporation and use by the members of the monetaryunion of the unique currency, which replaces the national currencies. "The currency is a macroeconomic phenomenon, and by this a political phenomenon", the monetary integration is therefore, in its essence, an integration from thepolitical perspective. The currency, regarded as institution, has a social-politicalnature and relies on the "trust of the agents in the system which proposed and warrants it". From a functional perspective, the currency fulfils the role of unique tool of transactions, of reserve, of valueand cash or of value standard. The institution of unique currency – EURO – is a synthetic expression of European monetary integration and the visible sign of the European Monetary Union. EURO imposes the formation of the consciousness that all members of this union belong to a sole monetary space and compels the citizens of the member states of the Union to acknowledge it as material form of the right of obtaining by it a part of the goods and services offered for sale on the territory of the Union. Robert Muldell, the author of the theory of „optimum currency areas", stated that Euro would be a factor of understanding, prosperity and peace. Is presented the evolution and the impact of adopting Euro. The creation and acceptance of the unique currency, was without any doubt an act of trust in Europe, and at the same time a challenge in the context of global economy. All changes generated by the passing to unique currency wereincurred for the increase of the capacity of competing in a globalization economy, the passing to Euro being favoured by the economic stability whichallowed the subsequent development of he member states, without the risk of inflation.is presented the impact of creating the unique currency Euro TheEuro currency was a protection wall before the financial crisis, registering an increased interest of the countries of the European Union (UE) which were not convinced of the importance of a unique method, as Denmark and Sweden, as well as of Iceland, which is not even a part of the communitarian block. "During this period of crisis, Euro protects the companies in front of volatilisation of the

rate of exchange, which affected them strongly during the previous periods of recession", stated the president of the European Committee, Jose Manuel Barroso But Euro has other advantages as well. Being the second global currency, after dollar, the European unique currency - in which are denominated 27% of the global currency reserves – is considered as important as the dollar and yen on global plan and allows the avoidance of some monetary crises. However, the Euro area shall be affected by the adverse representation oninternational plan, not having individual representatives within the internationalorganisations, such as the International Monetary Fund or the Group of Seven (G7). A special attention is paid to the manner in which Romania was situated in the process of preparation of adhering to the European Union, by stating the advantages and costs of this demarche. The quality of EU member has a major impact on our country with respect to the economic, political and social dimensions. The economic implications shall be preponderant, but radical mutations shall also be registered in the political, security, social and cultural fields. From the political perspective, the mechanisms of taking decisions shall have to be reconfigured, in the sense of a transfer of competences to the communitarian institutions. At the same time, Romania shall benefit of the possibility of participating, within the Union, to the collective complex decisional processes, having thus the possibility to promote and protect, better, its own interests. The development of the economy shall not be performed homogenously between the economic sectors, since there shall always be

relative losers and winners. The introduction of unique currency raises problems of strategy and tactic for the economy of Romania. It is accepted the idea that Romania is interested and preoccupied of the future of Euro in the international system of payments and, as a reserve currency, of the evolution of Euro- American dollar rate of exchange, of the connections which may be established between leu and Euro. Euro involves a series of modifications both in the global economy and in the Romanian economy. "All the people agrees that the occurrence of the sole currency shall involve transformations of historical importance, but also that our possibilities of anticipating the nature of these transformations are extremely limited".( Romano Prodi, "A vision on Europe", 2001). The paper confirms some previous results in the literature, concerning the quantitative and qualitative properties of the business cycles which vary across detrending techniques by extracting different types of information from the initial data (Canova, 1998). Most of the CEECs showed a certain tendency to move toward higher synchronization level, especially during 2004-2008, however Romania, Hungary and Bulgaria still register the most reduced business cycle correlations among CEECs. This study support strong correlations between the GDP cyclical component of the Baltic States and Euro zone after 2004, explained by the collapse of trade with Russia and reorientation toward Western countries. The study support also the endogeneity hypothesis of the optimum currency area criteria which tells that a common market intensifies the bilateral trade with impact on higher business cycle synchronization degree. However, we observe the clear impact of the financial crisis on the last analyzed subperiod, where all the correlation coefficients increased significantly as most of the countries faced strong GDP contractions. Demand shocks for most of the countries included in the study, are negatively correlated with few exceptions (France and Poland), while supply shocks are positive and strong for France and Poland, while for Germany and Italy is negative and seems relatively week. In Romania's case, demand disturbances are negatively correlated with the Euro zone and are quite significant for the analyzed period; supply disturbances are important and positive due to the different policies and exchange rate regimes in time. The major result of our paper is that, Romania as well as others CEECs countries still need time to progress and to real converge toward Euro zone, in order to reduce the costs of loosing the monetary and the exchange rate policy independence.

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