

## **ROMANIA'S ACCESSION TO THE EURO AREA**

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### **Abstract**

*Romania's decision to join the European Union was a strategic orientation embraced practically all the political forces of the country and the overwhelming majority of the population. Romania's accession to the European Union determined invariably joining the euro area, which gives full content integration in EMU. Joining the euro area is forcing Romania to meet the conditions set by the Maastricht Treaty in mitigating and eliminating gaps as quickly as possible.*

*Article demonstrates that the single currency, the euro, is a strategic objective of great importance when the decision is actually implemented will be evaluated carefully to see what are the advantages, and limitations that this approach entailed.*

**Keywords:** Euro area; nominal convergence; single currency; Maastricht Treaty.

**JEL Classification:** E52; O47; F33.

### **1. Introduction**

According to the treaty of Amsterdam, all the countries acceding to the European Union are obliged to adopt the single European currency, Euro. Thus, entry into the euro area is not optimal but an obligation of a legal and institutional and assumes countries with the signing of the Accession Treaty. There are no permanent derogations as in Great Britain and Denmark, countries benefiting only temporary exemption. Although Member enjoy their temporary exemption does not require a deadline to adopt the euro. This is justified by the fact that when the decision to introduce the single currency must not reflect a hasty choice. Although the changeover is an important strategic objective, this step must be analyzed taking into account the benefits and costs.

Romania joined the European Union on January 1, 2007, assuming the obligation to adopt sooner or later the euro. In order to enter the euro zone, Romania must fulfill, like other states, nominal convergence criteria set by the Maastricht Treaty, a number of conditions relating to real convergence. Achieving nominal criteria does not guarantee that Romania will benefit from the integration of real convergence is the substance of a successful integration.

With the EU accession, countries wanted to enter as soon as possible in euro area. The conditions for adopting the single currency were established by the Maastricht Treaty. Nominal convergence involves following criteria established by the Treaty of Maastricht price stability, long-term interest rate, exchange rate stability, sustainable fiscal policy etc.

## **2. Analysis of nominal convergence criteria**

Analysis of the average rate of inflation over a period of one year shall not exceed by more than 1.5 percentage points the average rates recorded in the three best performing EU members that fall below the ratio of 2.8%. Romania succeeded after 24 years of capitalism to enter the West in terms of inflation. GDP/capita is 22% out of France or Germany. Good agricultural production and reducing VAT on bakery products led inflation to 1.55% in December 2013, the minimum of the last 24 years, inflation falling to the lower limit of the central bank's target range for the past year 1.5 to 3.5%. The central bank has achieved its inflation target in 2006 and 2011 is the first time that Romania's annual inflation below 2%, which is common in Western countries limit to dreaming during hyperinflation and rampant inflation during 1990 - 2000 on the other hand, GDP/capita in Romania is only 7,000 Euros compared to 32,000 Euros in the euro area, so four times lower, and wages are 7-10 times lower than in France, Germany and the Netherlands.

In the absence of reducing VAT on bakery products and exceptional agricultural year 2013 annual inflation rate would be somewhere in the range of 3 to 3.5%, so the upper limit of the central bank target. Moreover, annual growth in non-food prices was 3.6% and services 3.4%, while food prices fell by 1.8%.

With an inflation rate of about 1.6% in 2013, the lower limit of the target NBR, Romania completes the picture of a very low inflation in Central and Eastern Europe.

For 2014 analysts have predicted that inflation continued to hover in the early month around minimum threshold of 1.5%, but then increase to 3-4%.

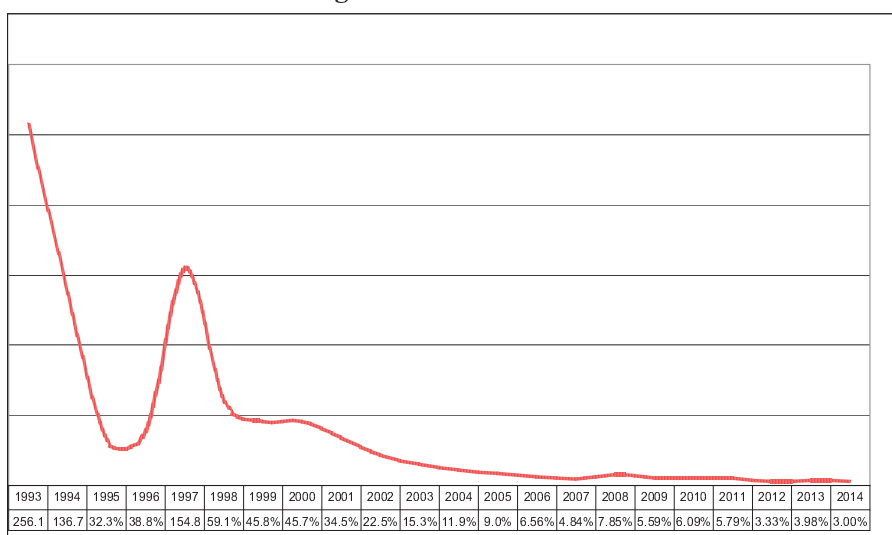
The downward trend of inflation in early 2014 and still weak consumer demand could encourage the central bank to continue easing cycle

by reducing key interest rates and the gradual decrease reserve requirements, measures that will lead to cuts in interest rates credit and credit recovery, with a favorable impact on the economy. Moreover, the central bank started the year with a reduction in key interest rate from 4% to 3.75%, as accompanied by the decrease of the USD reserve ratios from 15% to 12% and currency 20% to 18 %.

Price developments since 2005, the first year of inflation targeting, consumer prices grow by 6.56% compared to the annual target of 7.5% in 2006; annual inflation fell spectacularly at 4.9%, below the target of 5%, and in 2007 went back as spectacular to 4.84%, above the target of 4%.

Neither in period 2008 - 2010 had the annual inflation failed to reach the central bank's target range. Fight with prices became much tougher on the international financial crisis, the higher prices of oil and other materials (see Figure. 1).

**Figure 1. Inflation rate**



Source: <http://www.insse.ro/cms/ro/content/ipc-serii-de-date> - Author's processing

In the crisis, commitment to inflation targeting came into conflict with the possibility that the central bank to help counter recession. In addition to the inflation target, the central bank had settled sometimes conflicting objectives related including exchange rate policy and regulations in lending - that had the control and rein in lending.

Year 2011 ended with inflation at 5.79%, the target, while in 2012 Romania reached an inflation rate of 3.33% outside the target band in low agricultural production, a higher energy, gas and oil, and because of

currency depreciation. Weak demand in the economy could not offset a series of price increases.

Inflation fell sharply in the autumn months, less than 2%, after the first two quarters of 2013 has fluctuated between 5-6%. The downward trend of inflation encouraged monetary policy easing by reducing key interest. Central bank cut the key interest rate in the second half of last year by 1.25 percentage points, bringing it to a historical low of 4%, in the hope that banks will reduce interest rates on loans in lei making the cost of borrowing in the currency comparable national euro credit.

Disinflation was influenced particularly by good crop year and reduces VAT on bread since September, from 24% to 9%. In the case of bread, the transmission has been significantly reduced by about 95%. In September, the annual inflation rate slowed significantly to 1.88% compared to 3.67% in August. In November, consumer prices stagnated from the previous month, due to cheaper food, so that the annual inflation rate stood at 1.83%.

In December 2013 the inflation rate was 0.3% compared to November, so that from December 2012, consumer prices rose by 1.55%. Non-food products recorded an annual increase in prices of 3.6% and prices of services rose 3.4%, while food prices was a decline of 1.81%.

The central bank revised its inflation forecast for the end of 2014 from 3.1% to 3% (without taking into account the impact of higher taxes), anticipating a decline in the rate in the range in the early part of next year and then a comeback, especially base effect. NBR inflation target is 2.5% +/- one percentage point.

Price stability is a major concern for many countries, so it is not surprising conditioning of the Treaty on European Union, especially given the concerns of Germany in the field. An assessment of the state of compliance with this criterion in recent years in countries of Central and Eastern Europe shows that inflation is under control now, but is expected to contribute to European integration, at least in the beginning, to an increase in price (alignment to the European average) and therefore the indicators suffer an increase in the coming years. Among the first steps to be taken to achieve average inflation target set by the Treaty of Maastricht, include: maintaining a prudent wage policy in the public sector; improving revenue collection rate from the state budget, particularly VAT Reduce the budget, particularly interest costs; strengthening fiscal discipline; reduction in administered prices; maintain the exchange rate at a level consistent with the inflation target set in; reduction credits, especially in foreign currency granted governmental sectors and lowering interest rates.

Nominal convergence analysis takes into account the average nominal long-term interest in the last 12 months before the examination

must not exceed by more than 2 percentage points the average long-term interest rates in the three best performing EU Member States.

It is believed that long-term interest rate reflects the durability of convergence achieved. Considered rate is calculated as the average nominal interest rate on long-term government securities in the last 12 months. Government securities issued in Romania market have a maturity far and enjoy a high degree of liquidity, with no liquid secondary market where they can be traded.

Money market interest rates increased slightly during March to June 2010, manifesting a high degree of volatility, especially in the segment guaranteed. Spreads between interest segment unsecured guaranteed and were also characterized by volatility and remained at elevated levels compared to previously recorded turmoil in financial markets in August 2007 partly reflected developments tensions market participants' concerns about sovereign risk in some euro area countries, despite the persistence of broad liquidity conditions.

This criterion is directly related to the one shown above, the inflation, and without fulfilling the former is almost impossible for the second to be made. Because of inflation, nominal interest rates in Romania have remained extremely high, well above 10%. Control of inflation will reduce interest rates to the level required. Romania's entry into EMU could decisively influence the development of long-term interest rates, in order to ensure convergence at the level of Member States.

If the analysis refers to the exchange rate stability, we must note that the exchange rate of the national currency against the euro must be within the range of  $\pm 15\%$  without severe tensions for a period of two years before the examination.

At least at first, keeping the national currency in a fixed course against the euro, the  $\pm 15\%$  of parity should not be a problem. In Romania, in the period 2008 - 2009, appreciation / depreciation maximum daily exchange rate leu/euro average of two years was  $15.05\% / - 6.37\%$ <sup>1</sup>.

In fact, the central bank's policy of slight appreciation of the leu against the euro and dollar (basically depreciated less than the annual inflation rate), emphasizing targeted disinflation, but on the other hand is the only way to increase purchasing power national currency, something of interest from the perspective of European integration and the approach, even in a small way, the level of income.

Exchange rate chart presents an increase in the exchange rate of the Romanian leu against the euro, reaching a maximum of 1 EUR = 4.3219 RON In January 2012 until 1 EUR = 4.4654 RON in June 2012, in the next

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<sup>1</sup> [www.mediafax.ro](http://www.mediafax.ro), accessed on 19.09.2014

period characterized by a slight appreciation of the RON / EUR is currently keeping around rate 1 EUR = 4.4173 RON (see Figure 2).

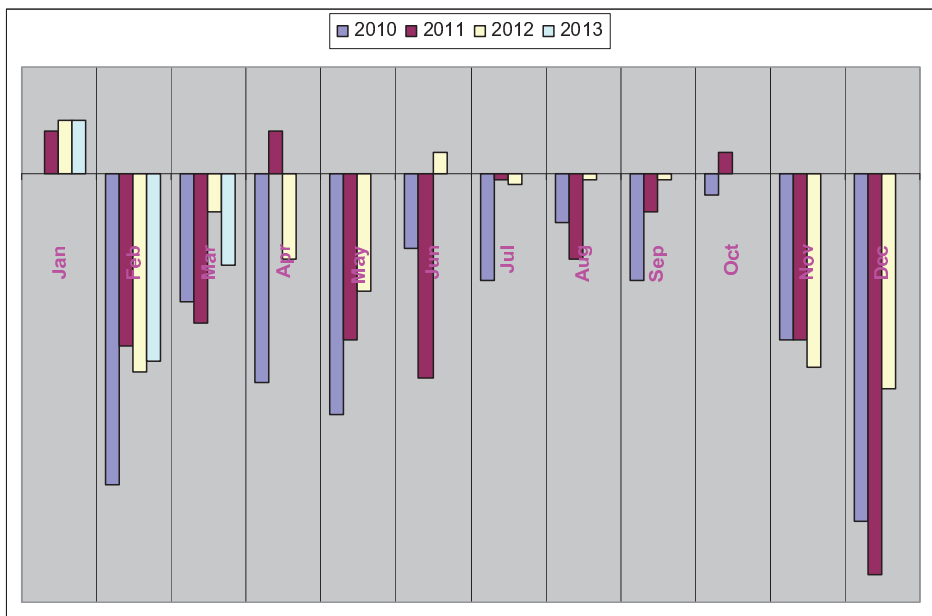
**Figure 2. Exchange rate**



Source: <http://www.cursbnr.ro/grafic-valute>

Analysis of the budget deficit is a basic parameter of macroeconomic policy, being correlated with other indicators to ensure macroeconomic balance necessary to comply with the commitments assumed by Romania's EU accession process (see Figure 3).

**Figure 3. Budget deficit**



Source: Author processing

In March 2013, budget revenues increased by 8.3% and 14.1% spending, deficit increasing by 140% compared to March 2012 - from 0.7 billion to 1.7 billion.

In the first quarter of 2013, the deficit was 4.19 billion compared with 3.39 billion USD in 2012 deficit target for this year is 13.3 billion and in the first quarter reached 31.5 % of this target.

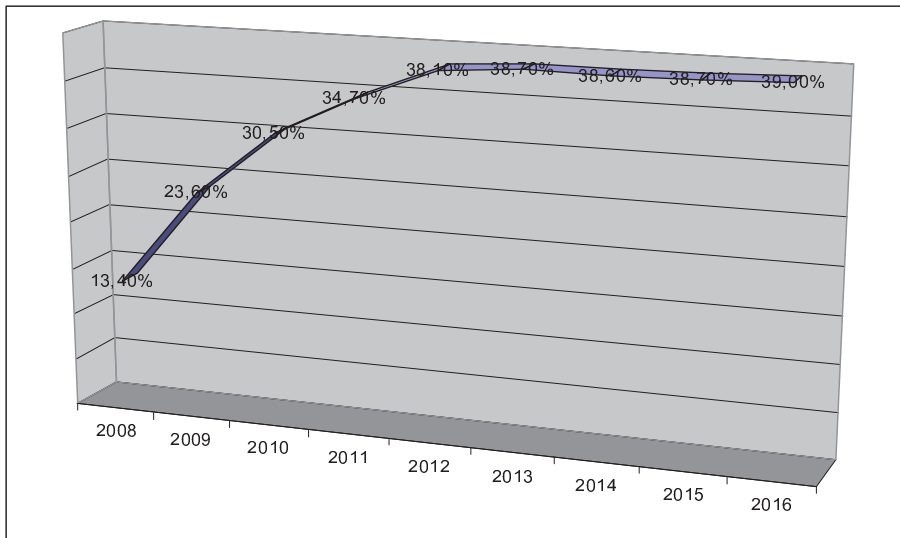
Given that investment fell 2 billion, and however, the deficit rose to 0.8 billion from last year, most likely in the middle of this year, the government will be forced to make a budget amendment by to cut back on expenses.

The main objective of public debt management is to maintain its level within sustainable limits and providing resources to finance budget deficits and resources to pay debt service at the lowest possible cost and acceptable risk levels<sup>1</sup>.

The budget for 2013 estimated a debt level of 225.7 billion lei (approx. 50.15 billion Euros), up from 207.3 billion Lei in 2012. These figures represent net debt of Romania and reflect steady increase in the level of this debt as a percentage of GDP in recent years (see Figure 4).

**Figure. 4. Percentage of public debt in GDP**

<sup>1</sup> www.gov.ro, accessed on 19.09.2014

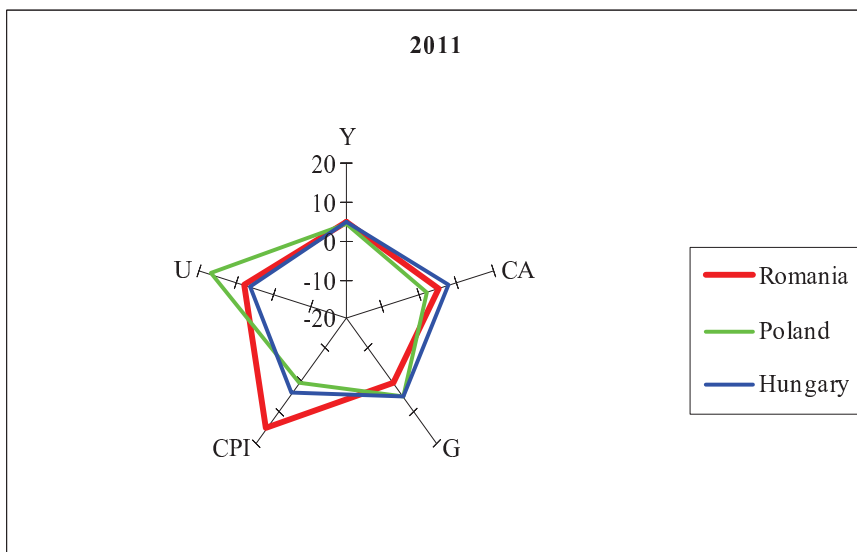


Source: Author processing

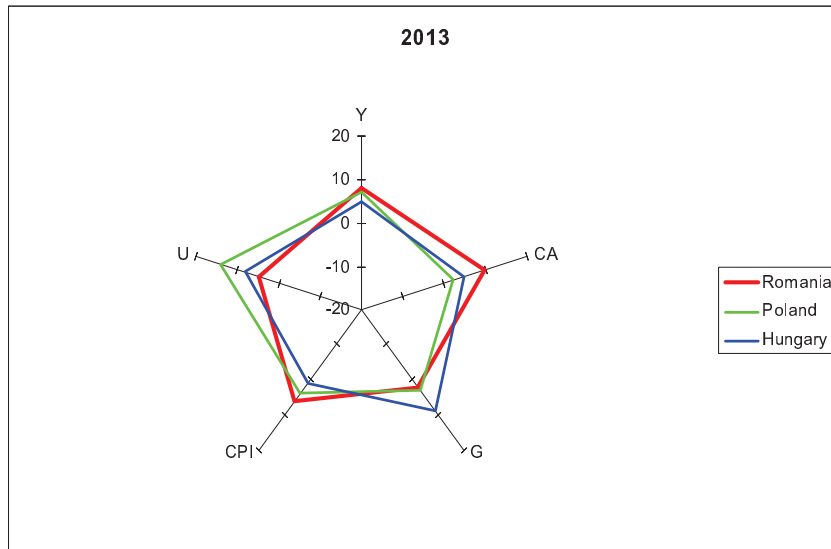
In terms of debt, we can say that Romania already meets the convergence criteria of sustainability financial position of the Government. Public debt will register in the coming years, growth controlled so that its level to maintain reasonable limits set by the Maastricht criteria, falling public debt ceiling, approved annually by law.

Synthesizing previous indicators presented can be achieved by building the following figures, known in the literature as the pentagon indicators and comparison of these indicators by many countries (in this case Poland and Hungary) (see Figure 5).

Figure 5. Macroeconomic pentagons for 2011 and 2013







Source: Author processing

Where: Y: Real GDP (%)

CA: Current Account deficit / GDP (%)

G: Government deficit / GDP (%)

CPI: Consumer Price Index (%) annual average

U: Unemployment (% at end of period)

Pentagon construction principle allows the same graphical representation of the five traditional indicators, considered as representative of the "economic health" of a state (real GDP, the current account deficit, fiscal deficit / GDP, inflation, unemployment), and represented on a scale from 20 to 20.

In this graph I represent the size of these indicators in three countries, namely Poland, Hungary, Romania comparing position largest economy in the states and they are aligned size of the convergence criteria.

There is an improvement in the following indicators presented in 2013 for Romania, from 2011: real GDP volume (increase for Romania and Poland about 8% and stability in Hungary), the inflation rate decrease to around threshold of 6.5% for Romania, stability in the two countries; unemployment rate fluctuates around the threshold of 13% for Romania (less than in Poland and Hungary), the other two maintaining relative position; fiscal deficit relative to GDP also presents a favorable situation Romania (around the threshold of 2.5% of GDP); show an increase in the

current account deficit for Romania to around 10% of GDP threshold and a decrease in Hungary, Poland showing a certain stability.

### 3. Conclusions

The euro is designed to foster the achievement of the single European market on which the goods, capital and people. With Romania joining the European Union started a new dispute over the transition to the euro. However, if joining the euro zone is in itself a very important strategic objective, when the decision is actually implemented will be considered with caution to see the advantages, and limitations that this approach entailed.

As they began to take shape and the views of the other new EU member countries, the transition to the euro area should not be unnecessarily accelerated and adopting the euro should not be treated as an end in itself.

Through this prism, Romania must not precipitate joining the euro area, since our country has important catch.

Romania with the GDP/capita of 54% is not ready to join the euro area. For GDP/capita to increase to the value of 60% Romania needs five years the GDP growth to be 4% per year. The structure is still different sectors of the euro area but is closer than in previous years. The evolution of economic openness had an upward trend reaching over 85% and the degree of trade integration with the euro area is quite high.

If I make a recommendation to our country can only say that Romania's entry into the euro area should be made in the period 2018-2020.

Following the experiences of countries that have already adopted the euro it can be concluded that once announced the probable date for euro adoption, the whole society should be mobilized to support this option, and microeconomic and macroeconomic policy decisions must be subordinate<sup>1</sup>.

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