ADOPTING THE EURO CURRENCY

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Abstract

This paper addresses the adoption of the Euro currency in 2014, as estimated in the National Programme. Based on the convergence criteria analysis on the current national background, we can foresee an earlier monetary integration.

Key-words: *recession, convergence criteria, Euro adoption, Romania*

JEL Classification: G_{01}, G_{18}

1. **Romania adopting the Euro coin in 2012**

Romania's accession to the European Union on 1 January 2007, following the remarkable economic progress taking shape in 2000, probably determines the governor of the Romanian National Bank (BNR) to launch a prospective theory – within a regional meeting on the economic environment from May 2007 – regarding the introduction of the Euro currency in 2012, two years earlier than estimated in the National Programme.

What happens meanwhile?

Romania has a rather tight, export-oriented economy, representing approximately 1% of the gross domestic product of the European Union. The external shocks – whether positive or negative – and the economic crisis started in the USA at the end of 2007, subsequently covering other countries as well, especially in Europe, have seriously impacted the national economy. Therefore, after a 2 to 3 year recession, the USA and other developed states find their way to the economic recovery in 2010. This leads to the rejuvenation of the economic sector in Romania as well, through an increased demand for our goods and services.

However, the investors from these countries are highly reluctant, given the liquid assets crisis they have been facing; therefore new funds for foreign investments are still frozen.

Moreover, a part of the foreign investors facing an asset shortage in their countries have withdrawn some of the short-term funds intended primarily for the emergent countries, including Romania.

Having in view the subsequent progress recorded in Romania and abroad, especially in the United States of America and the European Union, we will try to consider the possibility of adopting the Euro currency in 2012 or 2014, to estimate the costs and advantages and eventually to forward another date for the monetary integration.

The analysis will firstly cover the nominal and actual convergence criteria and the way in which BNR may have a determining role in meeting such criteria.

2. **Inflation evolution**

We address inflation because it is the main focus of BNR. In August 2005, BNR adopts a new monetary strategy – inflation targeting. The main challenge for BCR in implementing this strategy is to estimate a target inflation rate the business community and the population can guide on and to maintain credibility. Moreover, optimum cooperation relations with the government (on the budget and the fiscal policy, the income policy and the commercial policy) contribute to an efficient policy mix.

BNR gradually increases the interest rate from 7% in October 2007, to 9,5% in May 2008, monitoring the inflation increase rate from the beginning of 2008. In case the financial relations between Romania and the EU Member States deteriorate, the interest rates in Romania exceed the ones set within the EU Member States. Therefore, it is very difficult for BNR to set the interest rate according to the inflation target. In case of significant deviation from the inflation target, BNR manages the monetary policy in order to reach it.

Calculated every December, the inflation rate drops from 40,7% in 2000, to 9,3% in 2004 (the first year it yields in only one figure) and to 8,6% in 2005. Of course, a price is paid for this significant fall; the real increase in the GDP varies from 8,5% in 2004, to 4,2% in 20005. In 2006 the inflation rate drops to 4,87%, but in 2007 we witness a reversed ratio and the inflation rate reaches 6,57% (the inflation target is 4%), which means 2,57% above the 4% target. The inflation target is set at 3,8 in 2008, 3,5 in 2009, 3,5 in 2010, 3% for 2011 and 2012 and 2,5% for 2013 onwards. What a wonderful decreasing row! We don't have to provide the inflation real figures; the reference to the 2010 inflation rate (~ 8%) is sufficient. Experience shows that the deflation efforts based on a restrictive monetary strategy entail a slowdown of the economic growth by 1 to 2%.

Has the government developed a sustainable fiscal and budgetary strategy and an appropriate income strategy to maintain the inflation target set by BNR?

The 2004-2009 data reveal an apparent relaxation fiscal and income strategy, having in view that 2008 and 2009 are electoral years.

As a consequence, we witness an increase in the budget deficit up to 7,2% in 2009, falling to 5,9% in 2010 and estimated to be under 3% in 2012.

Generally, politicians do not develop a long-term strategy, the political market is a so-called short-term market. Moreover, we cannot make accurate estimates in this field and it is too early to consider a multi-annual budget. It is difficult to reach the inflation target set by BNR in lack of a deflation-based governmental strategy. This could entail a more restrictive monetary strategy slowing down the economic growth process.

3. **Cutting wages and other benefits**

A telling example is the 2008 state budget. The Government announces a decrease by 10% in the number of the employees from the central and local public administration, representing approximately 25% of the total number of employees in Romania. The purpose of the job cuts is to diminish the expense pressure, yet the trade union members threaten to fight the Government's decision.

The number of locally funded jobs in 2007 is about 700 thousands (by 10% more than in 2005), while the number of publicly funded jobs amounts to 400,000 (by 20% more than in 2005).

In 2010, the Government cuts the wages in the public sector by 25% along with a job cutting process, still in progress.

The pensions, indemnifications, compensations and the like are next on the authorities' agenda.

4. **Uncertainties for the business community and the consumers**

Coming across internal and external uncertainties, even the business community can be disoriented and therefore will not pay the necessary attention to the inflation target announced by BNR, believing in it and acting for its achievement.

At the same time, the consumers, who had low incomes in 2010, as a consequence of a restrictive fiscal and budgetary policy, will take action to recover the money loss, not looking forward to a rapid deflation.

Moreover, both the business community and the consumers may fear that a rigid and rapid deflation may have an important cost reflected in a slow economic growth, followed by the loss of jobs and, consequently, the decrease of the salaries. (the experience certain countries comparable to Romania show that, in order to reduce the inflation with approximately 0.5 percentage points, had to accept a reduction of approximately 1 percentage point (pp) of the real production).

On the other hand, most of the economists consider that there is no strong proof that the reduction of the inflation from 5 pp to 2 pp, for example, would contribute to the production growth on the medium or long term.

Probably even the Maastricht criterion regarding inflation is too narrow for the new countries that are to accept the euro currency (only 1.5 pp above the average inflation rate in the first three countries that have the lowest rate.) This limit should probably grow to 2 pp, in order to offer more flexibility to the emerging countries, including Romania.

The fact that all the emergent countries have exceeded the term announced to adopt the euro currency is important; Hungary lengthened 3 times the announced term for the adoption of the euro and Poland recently announced that the probable year is 2015.

In these conditions, BNR can still "push things" for the achievement of the inflation target in a short period of time, but the cost will be high.

5. **Who can support BNR**?

Who can support the efforts of BNR from now on? The authorities continue to make the labour market more flexible, proposing a new Labour Code, supporting the compulsory private pensions, streamlining the public sector, modernising the education and health sector, continuing the privatisation. There have been made important progresses for the development of the business environment by modernising the procedures of granting the business licences, the registration system and tax payments.

However, the total openness of the trade and of the stock account, together with the too optimistic expectations given by the EU adherence, led to a growth in the current account deficit as percentage of the Gross Domestic Product (GDP).

Although this deficit has been financed mainly by substantial entries of foreign direct capital and by the remittance of the workers from abroad, the private short-term debt has increased, especially during 2007-2009, leading to more vulnerability to the external shocks.

On the medium and long term, it is necessary to establish a correct priority of the projects and a direction of the expenses for the Romanian infrastructure development, in order to increase the trade and competitiveness and, of course, the productivity.

All these actions will support the capital investment development.

Meanwhile, the net financial flows from EU, such as the structural funds for the project financing, the funds derived from the common agricultural policy, compensatory payments, will stimulate the economic agents.

If the nominal convergence were to be really significant in the future, for the purpose of the euro currency adoption, the Romanian prices should also converge towards the EU level, within a single market. This has to be made at the same time with a convergence of the real incomes.

How close should Romania be to the EU average regarding this aspect, for the convergence process to make sense, taking into consideration that currently the gap is 1 to 3?

In our opinion, the gap should be of 1 to 2 (approximately 50%) and until then the inflation rate in Romania may stay higher than in the euro area.

Without going into detail about the real income differences, the statistics show that these represent only 30% of the European average.

6. **The gap regarding the minimum income**

The data below apply to the period before the crisis, but I consider them relevant for the present analysis.

In 2006, the minimum monthly salary regulated by the Romanian government was of approximately 94 euros, Romania being ranked last in the EU.

According to the Eurostat data, in 2006, the minimum salary in Romania was 14,4 times lower in Romania in comparison to Ireland; 5,7 times lower than in

Slovakia, 3,1 times lower in comparison to Estonia, 2,9 times lower than in the Czech Republic and 2.7 times lower than in Poland and Hungary.

Moreover, between 2003-2006, the minimum salary, expressed in euro, increased by 39% in Estonia, 38% in Slovakia, 31% in the Czech Republic, 23% in Romania and 20% in Spain.

Between 1996-2006, the annual productivity level per worker, expressed in euro, increased 5 times, while the net minimum monthly salary increased approximately 3, 5 times. In 2007, the minimum salary in Romania increased to 114 euros, and in 2008, to 140 euros. There is a long way until reaching a real convergence with the EU average.

Nonetheless, it can be shortened by a good choice made by Romania: the growth in productivity, a better education, research and development, the technological congruence, the innovation, the intellectual capital, efficient markets, the institution's modernisation. These are all medium and long-term objectives and we must persevere every day.

7. **Why should we hurry to adopt the euro currency**?

There are pros and cons regarding this issue. I shall not mention them here. I shall only mention that on April 15, 2010, the BNR Governor announced the date for the adoption mentioning that a delay of one or two years would be less important.

Of course, the nominal convergence criteria, the inflation, the interest rate, the budgetary deficit, the public debt, the currency exchange might be satisfied sooner, but the price will be paid, sooner or later (lower economic growth for a few years).

8. **Our proposition**

In 2008, based on the hypothesis of a real GDP annual increase in Romania, of approximately 6% and of 1,5% in EU for the next decade, we calculated that the real income in Romania will reach approximately 50% of the real medium income in EU, in 2016.

Consequently, we proposed that Romania adopted the euro currency in 2016, with an entrance in ERM II in 2014.

Currently, the crisis makes me correct my work hypothesis and consider for Romania a medium growth rate of only 4%. For this year, only a growth of 1,3% is predicted and for 2012, a growth of 3,7%, which are too optimistic growth rates in my opinion.

In the framework of the second scenario, the euro adoption date in Romania would be 2019, with an entry in ERMII in 2017. In case this strategy made sense, in compliance with our proposition, only at the end of 2016 the inflation should reach 2-3%. In the precedential period, 2011-2015, the inflation should be let to fluctuate between 4 and 6% per year. This policy would give four years more, especially to the small and medium undertakers of Romania, to better adapt to the competition and the economic environment of the EU.

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