Should romania be in the eurozone?

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ROMANIA – TO BE OR NOT TO BE IN THE EUROZONE?

Abstract:

This paper aims to present the current position of Romania's economy regarding its accession to the ' select club' of the Eurozone. I have made a brief analysis of the main problems encountered by Romania on its way to complying with the convergence criteria, presenting as well the measures taken by the country to overcome its condition. Fuelled by the electoral " needs" (being the only country in a hurry to enter the Eurozone), and not backed by the economic reality, Romania still has to undergo key structural reforms before adopting the single currency.

Keywords:

Eurozone, convergence criteria, legislation, real convergence, nominal convergence, structural reforms, competitiveness, inflation, deficit

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If we take a look in the international newspapers, we can easily find a plethora of articles regarding the European countries which decided either not to join the Eurozone, either, due to the economic crisis, opted for keeping their national currency or were constrained to postpone the date of accession. Romania is one of those member states that were compelled to delay the adoption of the single currency, as a premature entry can be harmful not only for the state itself but also for the whole Eurozone.

Adopting the single currency is not an easy step to make, especially when the structure of the economy of the newcomer state is not healthy enough to foster a catch up trend or to resist asymmetrical shocks.

The preliminary activities for the participation to the euro zone are focused towards fulfilling the convergence criteria, also known as the Maastricht criteria[1]: inflation and interest rates close to the ones of the most developed Eurozone members, stability of the exchange rate, low public debt and low deficit. Additionally, the degree of sustainability of the convergence process can be determined by analyzing the indicators of real convergence, such as the level of GDP per capita, the degree of openness of the economy, the structure of the economy, the prospects of funding the public deficit, the cost of labor force, the degree of financial intermediation etc. Another requirement is to ratify and implement on the domestic level the European regulations, reaching thus the juridical convergence. Along with the adoption of the euro comes also the transfer of the decision making power to the Central European Bank, which acts independently and provides common monetary policies for all the members of the Eurozone.

Joining the Eurozone has been a strategic target for Romania ever since it joined the EU in 2007, this being part of the state’s commitment to reach a deeper integration with Europe and to develop a strong market economy. Having set this target, the timing of Romania’s accession is shaped by two main factors: the fulfillment of the convergence criteria and the resolution of the challenges within the Eurozone.

At the time being, from an economic point of view Romania meets only three out of the five Maastricht criteria[2], despite the fact that the country was scheduled to join the Eurozone in 2015. Romania still needs to adopt the common legislation and to tackle with high inflation rate, high interest rates as well as instability of the exchange rate.

While remaining a fundamental objective for the country, Romania has dropped the idea of establishing a clear date for adopting the single currency because the country still has important challenges to overcome, as structural reforms on several fields are lagging behind schedule.

“ *We want to be prepared and competitive when we join the euro zone. I think 2018 to 2020 is a realistic target* “[3]said Victor Ponta, the current Prime Minister of Romania.

Nonetheless, 2013 was a fruitful year for Romania, recording a strong growth of 3. 5% driven by exports and abundant harvest. Therefore, the country has been seen as an awaking “ Tiger” of the Eastern Europe.[4]The forecasts also give a positive projection of the evolution of Romania’s economy: annual average inflation is expected to decelerate to 2. 4% in 2014 and the growth of real GDP growth is forecasted to be above 2%. On the other side, unemployment is expected to decrease only in 2015.[5]

Romania’s president Traian Basescu stated at the beginning of the current year that the country “ *will undoubtedly fulfill all the Maastricht criteria this year* ”[6]. But how realistic is this affirmation? Even if the nominal convergence criteria would show that Romania is ready to adopt the single currency, the real convergence standards do not point out towards a sufficient harmonization of Romania's economy with the euro zone. Even the President of the Fiscal Council of Romania stated that, from the real convergence perspective, the country needs an annual growth rate of 3% – 4% so that in 10 years' time it could be qualified to adopt the single currency[7]. The lack of a real convergence at an adequate level can lead any country which hastily decides to adopt the euro into the problematic situation of Greece or Ireland.

As we can see, in Romania's case the barriers for the adoption of the single currency are mainly a matter of substance, covering a wide range of aspects. This includes the low GDP per capita – which is 45% of the EU average – or the structure of the Romanian economy, where the agriculture represents 6% – 7% of the GDP but makes use of 25% – 30% of the Romanian workforce[8].

An increase in the GDP per capita towards the EU average is not a result of the monetary or fiscal policies. The strategic solution is to focus on a systematic increase of competitiveness through investments in the human capital, infrastructure and other productive fields of the state's economy, thus reaching a significant competitive advantage.

The good news is that Romania can make use of the European funds to make the necessary reforms so as to catch up with the other states from the euro zone. The efficient use of these funds, working on short term projects that have a common goal from a long term perspective, could allow Romania to overcome its currents issues. Unfortunately, Romania's rate of absorption of the EU funds is surprisingly low: 26. 49% in the FY 2013[9], wasting thus so many chances to increase the economy’s productivity, to improve the performance of the human capital and to increase the quality of the infrastructure. This glaring incompetence of the economic policies from Romania underlines the lack of a long-term planning entangled with the deeply bureaucratized administration of the state.

Nonetheless, while Romania fails to attract key financial resources, other European states excel in improving their performance, which eventually leads to higher development gaps and decreased capacities of Romania to catch up with the other Eurozone members.

The world is a stage for continuous competition where only the best prepared players win the game. At this moment it becomes clear that if Romania doesn’t reconnect itself to the European level of development and decision making, there will be an increasing gap that will affect Romania not only from an economic point of view, but also politically.

But let’s have a short look at the measures taken by the Romanian government and the National Central Bank towards creating a sustainable economic development, propitious for the adoption of the single currency.

From an administrative point of view, the Romanian authorities did create the necessary institutions for the coordination of the euro adoption process. The most important one, the Inter-ministerial Committee for the transition to euro, was created in 2011 and is led by the Prime Minister.

From a legal perspective, along with the convergence criteria, the national legislation of the state must be fully compatible with the “ acquis” as regards the independence of the national central bank and its integration in the European System of Central Banks. The Romanian legislation doesn't fully comply *yet* with all the requirements for the central bank's independence, the monetary prohibition and the legal integration into the Eurosystem[10]. Being an EU member with derogation, whether it wants or not – and, of course: the sooner, the better – Romania has to comply with the legislative requirements for the single currency, as they are " per se" criteria towards reaching the adoption level.

With regards to the labor market, the reforms in the context of the new Labour Code had been implemented only starting 2013. This can be considered rather late, as an increase in the labour quality and flexibility is essential for the competitiveness of Romania's economy and long term evolution.

Concerning the fiscal governance, during 2010 Romania implemented several reforms as part of the EU – IMF financial assistance program, which included the introduction of new fiscal rules and the set-up of an independent council. Nonetheless, further efforts to improve fiscal accounting and statistical reporting are needed in order to ensure a proper functioning of the new institutional fiscal framework. If only the fiscal evasion decreases by 2%, from currently 14% of the GDP, the country's budget can reach surplus[11].

Directly targeting the inflation, the National Bank of Romania was continuously preoccupied with maintaining the stability of the financial system and the attenuation of the external imbalances. Although all the measures taken were focused towards fulfilling the necessary criteria to join the European Exchange Rate Mechanism (ERM II), Romania still has issues with the increased rate of inflation. Currently the Romanian currency Leu (RON) is being transacted on the basis of a flexible exchange rate system. It is not surprising then that Romania also has issues with the long term interest rate in its national currency, as it is in strong correlation with the evolution of the inflation rate. Besides, Romania still lacks properly developed instruments for the long term indebtedness.

To sum up, even though Romania might fulfill the nominal convergence criteria by the end of this year, the country still needs many years of work to create a real, sustainable convergence and to avoid a hasty entrance in the Eurozone. Joining the Eurozone is a foreseeable result for Romania, but the concrete moment cannot be seen yet in clear sight.

The process can speed up through structural reforms that can lead to an increased efficiency of the state owned enterprises. Also, the absorption capacity of the EU funds must be significantly improved. Achieving an environment favorable to sustainable convergence requires stability oriented monetary policies complemented with further fiscal consolidation and structural reforms in line with Romania’s commitments under the economic programs led by the EU and the IMF. All these measures are necessary not only from the perspective of the euro adoption, but also from a sustainable view on the long term and efficient development of the country.

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