ISSUES REGARDING THE NOMINAL CONVERGENCE CRITERIA FOR JOINING THE EURO AREA

ALINA NIȚESCU *

ABSTRACT: *Romania, a member state of the European Union, has committed itself to adopting the euro under the Treaty on the Functioning of the European Union, which means meeting nominal and real convergence criteria, as well as achieving parameters for the functioning of the economy. In this context, this paper aims to analyze a number of issues specific to the degree of compliance with the convergence criteria.*

KEY WORDS: *economic integration, the euro, monetary policy, convergence criteria*

JEL CLASSIFICATIONS: *F00, E52, E58.*

1. EUROPEAN MONETARY UNIFICATION

The European Union Treaty signed in Maastricht in 1991 led to the introduction of a common monetary policy based on a single currency administered by a single independent central bank.

The use of a single currency by the Member States of the European Union and the application of a common monetary policy are the main objectives of Economic and Monetary Union.

Economic and Monetary Union (EMU) it is the result of progressive economic integration into the EU. EMU is an extension of the EU's single market, involving common rules on products and the free movement of goods, capital, labor and services. The euro has been introduced as the common currency in the euro area, which currently consists of 19 EU Member States.

EMU is aimed to support sustainable economic growth and a high level of employment through appropriate economic and monetary policy measures. These cover three main areas (https://www.europarl.europa.eu/factsheets/ro/sheet/79/istoria-uniunii-economice-simonetare):

* *Assoc. Prof., PhD., University of Petroșani,* Romania, *al.nitescu@gmail.com*

- the implementation of a monetary policy whose main objective is price stability;
- avoiding possible negative side effects caused by unsustainable public finances, preventing the emergence of macroeconomic imbalances in the Member States and coordinating to some extent the economic policies of the Member States;
- ensuring the proper functioning of the single market.

The Eurosystem, composed of the European Central Bank and the national central banks of the Member States that have adopted the euro, is the monetary authority of the euro area. The main objective of the Eurosystem is to maintain price stability in the general interest and to promote financial integration at European level (https://www.ecb.europa.eu/ecb/orga/escb/eurosystem-mission/html/index.ro.html).

The European Central Bank is the highest monetary authority in the euro area, being the issuer and constitutional guardian of the single euro currency. In its activity, the priority place is occupied by the establishment of critical short-term interest rates, which indirectly determine the pace of economic growth. As the creator of monetary policy in the euro area, the European Central Bank is the sole and most important determinant of the stability and success of the euro.

The ECB's mission is to support EU economic policies by acting in accordance with the principles of a free market economy and promoting an efficient allocation of resources.

The legal basis for the single monetary policy is the Treaty on the Functioning of the European Union and the Statute of the European System of Central Banks and of the European Central Bank. The Statute provides for the establishment of both the ECB and the European System of Central Banks (ESCB) on 1 June 1998. The ECB was designed as the core of the Eurosystem and the ESCB. The ECB and the national central banks shall jointly carry out the tasks assigned to them (www.ecb.europa.eu/ ecb/orga/escb/html/index.ro.html).

The main functions of the European Central Bank are as follows:

- ✓ Currency issuance;
- ✓ Establishing and implementing a single monetary policy in the euro area;
- ✓ Monitoring foreign exchange operations;
- ✓ Management of foreign exchange reserves;
- ✓ Supervision of payment systems in the euro area;
- ✓ Supervision of credit institutions;
- ✓ Acts as the bank of the national central banks;
- ✓ Lender of last resort;
- ✓ Ensuring the connection with the international financial-banking organizations.

All EU Member States except Denmark must adopt the euro after meeting the convergence criteria. The euro is the second most important currency in the world. The proportion of international payments in euro and US dollars is roughly equal, and the euro ranks second in the top of preferences for borrowing, lending and central bank reserves worldwide.

The euro area was set up in January 1999, when responsibility for monetary policy was transferred from the national central banks of 11 Member States to the

ECB. Greece joined the euro area in 2001, Slovenia in 2007, Cyprus and Malta in 2008, Slovakia in 2009, Estonia in 2011, Latvia in 2014, and Lithuania in 2015. Creation of the euro area and a new one supranational institutions, namely the ECB, was an important step in the complex and long-term process of European integration.

The integration of the European banking system and financial markets is important both for the national central banks by increasing liquidity and reducing the costs involved in operating in several countries, and for the European Central Bank, by increasing the efficiency and proper implementation of the single monetary policy.

Currently, we can discuss a single banking system in the euro area, characterized by: an integrated money market for euro transfers; interconnection of national banks through a common payment infrastructure; integration of the capital market and financial services. At the level of the retail banking market, international banks must treat each country as an individual market; this is due to the location of demand, country-specific banking products and differences in consumer protection rules and regulatory and supervisory practices.

As a corollary of the above, we note that a single currency and a common central bank determine a unified banking system, and access to a common source of liquidity in a single money market, as well as confidence in a single currency, creates strong links between central banks operating in the euro area.

2. PREMISES FOR THE ADOPTION OF THE EURO CURRENCY BY ROMANIA

Romania is among the Member States of the European Union that have the obligation to adopt the euro, which means full participation in Economic and Monetary Union, once all the necessary conditions, namely the criteria of nominal, legal and real convergence. In fact, the Convergence Reports, prepared every two years by the European Central Bank and the European Commission, place increasing emphasis on real convergence. Thus, in the run-up to the adoption of the single currency, the national economy must make the necessary adjustments for integration into the euro area, marked by far-reaching structural reforms, with effects on its overall competitiveness.

Joining the eurozone means eliminating foreign exchange risk, reducing transaction costs in international trade while lowering market interest rates and a possible increase in the credibility and stability of a government's macroeconomic policies.

In the long run, the benefits of adopting the euro by our country may include:

- elimination of foreign exchange fluctuations and foreign exchange costs
- intensification of trade, in particular intra - Community trade;
- increasing business opportunities for national companies;
- favorable conditions for economic growth, economic stability, a more attractive business environment
- increased attraction of foreign investments;
- reducing the cost of public debt, due to easier access to finance and the credibility of a strong currency;

- strengthening the competitive position of exports, thus raising potential growth, consumption and welfare.

At the national level, preparations for the adoption of the euro are coordinated by the Interministerial Committee for the conversion to the euro, chaired by the Prime Minister, which includes the Minister of Public Finance, the NBR Governor, leaders or their nominees, other public authorities and institutions, as well as representatives of employers and trade unions associations. Following these steps, in 2018 the National Commission for the substantiation of the National Plan for the adoption of the euro was established, in order to identify actions and promote the reforms necessary to modernize the Romanian economy for the transition to the euro. The National Commission has prepared the Report on the substantiation of the National Plan for the adoption of the euro and the National Plan for the adoption of the euro, strategic documents that were approved by the Romanian Government on January 30, 2019. The report concludes that through persevering efforts and solidarity social forces, there are premises for Romania to be able to meet the fundamental requirements for adopting the euro in 2024. Also, since February 2010, the Committee has been working within the NBR to prepare for the transition to the euro, which is a forum for debating issues related to nominal and real convergence, meant to support the central bank's efforts regarding Romania's participation. full rights to Economic and Monetary Union (www.bnr.ro/Procesul-de-pregatire-pentru-adoptarea-monedei-unice-europene-8012Mobile.aspx).

3. CONVERGENCE CRITERIA

The convergence criteria represent a condition for entry into Economic and Monetary Union, a proof that the countries wishing to participate in the euro area have a minimum degree of convergence that can be sustained, precisely to reduce the risk of the need for a divergent national monetary policy, after the introduction single currency.

These compulsory economic and legal conditions were agreed in the 1992 Maastricht Treaty and are also known as the "Maastricht criteria". All EU Member States, with the exception of Denmark, must adopt the euro and join the euro area once they are ready to meet these criteria. The Treaty does not specify a specific timetable for accession to the euro area, but leaves it to the Member States to develop strategies to meet the convergence criteria.

Convergence criteria ensure that a Member State is prepared to adopt the euro and that its accession to the euro area will not cause economic risks for that Member State or for the euro area as a whole (www.consilium.europa.eu/ro/policies/joining-the-euro-area/convergence-criteria/).

The Maastricht Treaty makes participation in the Economic and Monetary Union conditional on the fulfillment of nominal convergence criteria, also known as the Maastricht Criteria. These are aimed at:

1. Price stability: a low rate of inflation not exceeding by more than 1.5% the best performance of the participating Member States in the year before the examination;

2. Long-term interest rates: low interest rates on long-term loans, not exceeding by more than 2% the interest rates of the best performing participating Member States in the year before the examination;
3. Sound and sustainable public finances: a budget deficit not exceeding 3% of GDP; cumulative government debt not exceeding 60% of GDP;
4. The country must participate in the exchange rate mechanism (ERM II) for at least two years without significant deviations from the central ERM II exchange rate and without a devaluation of the bilateral central exchange rate of its currency against the euro over the same period.

In addition to the nominal convergence criteria, a number of criteria have emerged at the initiative of the European Commission and the European Central Bank to ensure the convergence and cohesion of the economic structures of the Member States and the candidate countries. These so-called real convergence criteria concern:

- the degree of openness of the economy, calculated as a share of foreign trade in GDP;
- the share of bilateral trade that the member countries of the European Union in the total foreign trade;
- the structure of the economy on the three main branches (industry, agriculture and services);
- GDP per capita, calculated according to purchasing power parity.

In addition to these criteria, a number of other factors were taken into account, such as: the degree of market integration; the balance of payments balance; the unit labor cost as well as other elements relevant to market stability.

4. ACHIEVEMENT THE NOMINAL CONVERGENCE CRITERIA

The 2020 Covid-19 pandemic has caused a sudden and deep recession around the world, putting pressure on both health and social protection systems and the socio-economic environment. Under these conditions, according to the autumn forecast, the Eurozone economy and the European Union economy will contract with aprox. 7% in 2020. The recovery prospects are uneven from country to country depending on the spread of the virus, the strictness of the public health measures adopted, the sectoral structure of the national economies and the economic policies implemented.

In this context, our country is part of the same trajectory of the countries marked by the crisis generated by the COVID-19 pandemic, which affected both domestic and external demand, producing important effects both economically and socially and morally.

According to data published by the National Institute of Statistics, in the first half of 2020 the Romanian economy recorded a decrease in the volume of economic activity by 4.6% compared to the first half of the previous year, but is one of the smallest decreases from the European Union, which demonstrates that government policies have had a positive effect in mitigating the shock of the COVID-19 crisis (https://ec.europa.eu/info/sites/default/files/economy-finance/raport_edp_2020_final_ro.pdf).

Overall, in 2020, the Romanian economy experienced a period of decline; private consumption declined sharply, especially at the end of the first quarter, and declining external demand and supply chain disruptions affected exports. Restrictive measures introduced in the first half of 2020 to combat the COVID-19 pandemic have had a negative impact on consumer spending, the main factor of economic growth in previous years. On the other hand, investments have significantly contributed to GDP growth, mainly due to the performance of construction activity. A smaller decline in imports than in exports led to a further deterioration in the trade balance (Ministry of Finance, 2020).

Regarding the evolution of nominal convergence indicators in the first quarter of this year, they generally followed the previous trends: the budget deficit and public debt registered additional increases, under the impact of the medical emergency caused by the coronavirus pandemic, while the rate inflation and the long-term interest rate improved slightly.

Table 1. Evolutions of nominal convergence indicators in Romania

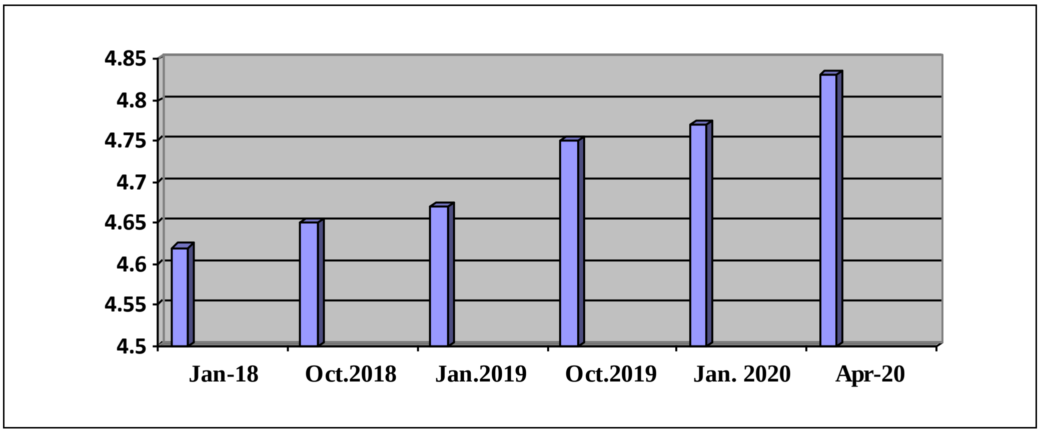
	2015	**2016**	**2017**	**2018**	**2019**	**T1 2020**
Inflation rate (%)	-0.6	-1.5	1.3	4.6	3.9	3.7
Long-term interest rates (%)	3.5	3.3	4.0	4.6	4.6	4.4
Exchange rate against the euro percentage appreciation (+) / depreciation (-)	+1.8/ -1.8	+1.4/ -1.8	+1.3/ -3.3	+1.3/ -4.8	+0.8/- 3.8	+0.9/ -3.8
Consolidated budget balance (percentage of GDP)	-0.7	-2.9	-2.9	-2.9	-3.87	-3.0
Public debt (percentage of GDP)	37.8	37.3	35.1	35.3	34.5	37.9

Source: National Institute of Statistics, Eurostat, National Bank of Romania, Ministry of Public Finance

According to the data in Table 1, the average annual inflation rate recorded by our country in the first quarter of 2020 was 3.7%, a level above the reference value of 1.8% corresponding to the criterion on price stability. Although the national authorities have adopted specific measures to keep the inflation rate under control, there is still a high degree of uncertainty about the evolution of this indicator in the future, while there are serious concerns about the longer-term sustainability of inflation convergence in Romania.

As far as public debt is concerned, although in our country case this indicator has been in the level provided by the corresponding criterion, the budget deficit exceeded the reference value of 3% of GDP in 2019, so the excessive deficit procedure was initiated in April 2020, according to which Romania needs to correct its excessive deficit by 2022. The economic forecast of the European Commission in the spring of 2020 anticipates that the budget deficit will have a trend of growth over the 3% of GDP reference value, which will contribute Also, at an increase in public debt share in GDP. In this context, there is further necessary to adopt significant consolidation measures to lead to the correction of the excessive deficit and to ensure the sustainability of public finances.

As regards the stability of the exchange rate, in the period 2018 and the first quarter of 2020, the national currency was traded under the conditions of a flexible exchange rate with controlled flotation. The exchange rate of the national currency in relation to the euro has, on average, showed a low degree of volatility during the reference period. At the end of the first quarter of 2020, the exchange rate was 4,836 lei for one euro and 4.4% more depreciated compared to the average level in January 2018.



Source: www.bnr.ro

Figure 1. Evolution exchange rates

As regards long-term interest rates in our country, between April 2019 - March 2020, they were averaged at 4.4%, higher than 2.9% of the convergence criterion on interest rates. The long-term interest rate for our country continued to rise in April 2020 and reached 4.83%, according to data published by Eurostat (www.ecb.europa.eu/pub/convergence/html/ecb.cr202006~9fefc8d4c0.ro.html#toc4).

5. CONCLUSIONS

For now, our country does not meet the nominal convergence criteria needed for euro area accession. The pandemic crisis has determined the "removal of" our country of reaching the convergence criteria, and the deterioration of economic indicators has been relatively rapid, especially in terms of increasing budget deficits on the background of increased sanitary sectors and increasing social protection measures.

In order to join the euro area, the nominal convergence must be accompanied by real, structural and institutional convergence, all of which are based on solid macroeconomic foundations and on the application of a set of economic policies oriented towards comprehensive structural reforms.

At the same time, Romania must undertake significant efforts to increase the absorption rate of European funds, attracting foreign investment, correlation of labor competences with market requirements and reducing labor deficits while increasing the activity rate, improving the quality and efficiency of public administration and so on. In order to stimulate trust in the financial system, national authorities must continue to improve their supervisory practices, by complying with the applicable recommendations made by relevant European and international institutions and by close cooperation with other national supervisory authorities in the Member States of the EU.

The Romanian national authorities maintain their commitment to the euro area, but in the context of the Pandemic of Covid-19, efforts are a priority focusing on minimizing its negative effects and on the implementation of economic recovery measures, and the attention of the authorities will be directed towards the adoption of the euro as soon as the macroeconomic balances are restored.

REFERENCES:

[1]. Dăianu, D. (coord.) (2020) *România - Zona Euro*, MONITOR Nr. 3| An 2 | 2020
[2]. Ministerul Finanțelor (2020) *Raport privind datoria publică guvernamentală*
[3].https://www.europarl.europa.eu/factsheets/ro/sheet/79/istoria-uniunii-economice-simonetare
[4]. https://www.ecb.europa.eu/ecb/orga/escb/eurosystem-mission/html/index.ro.html
[5]. https://www.ecb.europa.eu/ecb/orga/escb/html/index.ro.html
[6]. https://www.bnr.ro/Procesul-de-pregatire-pentru-adoptarea-monedei-unice-europene-8012 Mobile.aspx
[7]. https://www.consilium.europa.eu/ro/policies/joining-the-euro-area/convergence-criteria/
[8]. https://ec.europa.eu/info/sites/default/files/economy-finance/raport_edp_2020_final_ro.pdf
[9]. https://www.ecb.europa.eu/pub/convergence/html/ecb.cr202006~9fefc8d4c0.ro.html#toc4
[10]. https://www.bnr.ro/Comitetul-de-pregatire-a-trecerii-la-euro-16872.aspx
[11]. https://www.ecb.europa.eu/pub/pdf/other/escb_ro_webro.pdf