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EURO AREA ENLARGEMENT: DILEMMAS AND STRATEGIES AFTER THE CRISIS

S. MĂRGINEAN[1] R. ORĂŞTEAN[1]

Abstract: *The main challenges for the New Member States after joining the European Union were Euro adoption and dealing with the economic crisis. This paper explores the impact of the economic crisis on the New Member States of European Union, both to the four NMS countries that joined the euro area, and also for the eight countries which intend to do this in the next few years. The paper begins with an overview of the current situation and analyses the economic performance of the 12 NMS of EU based on the Maastricht Treaty criteria. Finally, we are considering an answer he question: is it necessary to reshape the Euro – area entry rules?*

Key words: *Euro, New Member States, crisis.*

1. Introduction

Until the recent economic crisis Euro was considered one of the most successful projects of the European Union. The irreversibility of the Euro was unquestionable. In 2006, Joaquin Almunia said: ”The euro is like an old Catholic wedding: like it or not, happy or not, you are married forever. But, fortunately, you know the bride in advance. You know what it takes and what it needs to live with her and make sure your union is a happy one.” In the last year there are political and even economic voices that put under question this essential idea of the European Monetary Union.

The reason is related to the costs of monetary union in crisis time, and also to the impossibility of the member states to fulfill the nominal convergence criteria. Maastricht Treaty set out the conditions which member states have to comply with to be eligible for Euro-zone membership. Nominal convergence, real and institutional convergence are the three directions for the convergence process.

All New Member States accepted the *aquis communautaire*, including participation in the third stage of European Monetary Union as soon as possible, when the Maastricht Treaty criteria are met. In the period 2004 – 2010 four of the New Member States already entered in Euro Zone: Slovenia (2007), Cyprus and Malta (2008), Slovakia (2009). This paper starts with an overview of the NMS economic performance, looking at the differences between the euro and non-euro New Member States. The purpose of this is to find out if we need a different approach, different strategies and criteria after the crisis.

2. Overview of the Current Situation

The key word for describing the economic status of EU in the last two years

[1] *Lucian Blaga* University of Sibiu, Romania.

is crisis. Initially, the economic crisis affected the advanced economies, the Old Member States of European Union. The situation changed at the end of 2008, when the entire East European region, all New Member States began to fall, experiencing negative growth rates. The fall in GDP was bigger for the countries with accelerated growth in 2007. There are some possible explanations for New Member States and their great fall: the lack of economic policies, both in expansion and recession for some countries; external shocks and the dependence of foreign investments; pro-cyclical policies in expansion. [4] As we can see in Figure 1, Lithuania, Latvia and Estonia were particularly affected, but Romania, Hungary and Slovenia had also consistent negative growth rates.

The four NMS that adopted euro look to be better in terms of GDP growth rate.

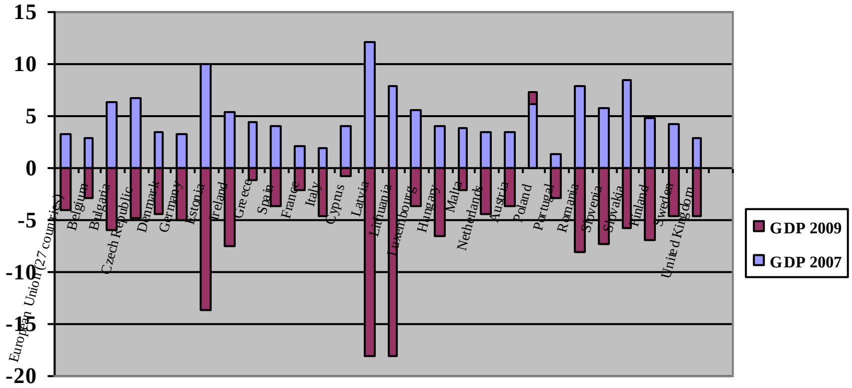

Fig. 1. *Growth and fall in GDP for EU 27 Member States*

Annual growth rates of GDP were: Cyprus 4,1 in 2007 and dropped to -0,7 in 2009; Malta from 3,8 in 2007 to -2,2 in 2009; Slovakia from 8,5 in 2007 to – 5,8 in 2009; Slovenia from 5,8 in 2007 to -7,4 in 2009.

In a very interesting article, Regling et. al [6] asks an essential question: what was the Euro in the context of economic crisis – part of the problem or part of the solution? The Euro has not facilitated the spread of the crisis and provided an effective shield against the crisis. These affirmations are nuanced with a set of “no, buts …” and “yes, buts…”.

3. Maastricht Treaty Criteria in NMS: Before and After the Crisis

The criteria are mandatory for the participation in euro area. Table 1 shows where the New Member States were before the crisis. Regarding inflation, only Slovakia, Cyprus and Malta had an inflation rate below the reference value. We had 8 countries (1 from Euro Area) with an inflation rate over the reference value. In all countries, excepting Hungary and Romania, the long time interest rate was below the reference value. In 2007, the general Government deficit was over the Maastricht reference value only in Malta and Hungary were over 60% of the reference value for general Government gross debt.

In 2007, Malta and Slovenia complied three of four criteria, Cyprus and Slovakia all of them.

Romania had reasonable results in two of the four criteria in 2007.

Maastricht criteria before the crisis Table 1

Inflation rate		Long-term Government interest rates (bond yields)		General Government surplus or deficit		General Government gross debt	
April 2008		April 2008		2007		2007	
Reference value	3,4	Reference value	6,42	Reference value	-3,0	Reference value	60,0
Malta	1,9	Euro area	4,3	Bulgaria	3,4	Estonia	3,4
Slovakia	2,4	Slovakia	4,46	Cyprus	3,3	Latvia	9,7
Euro area	2,6	Slovenia	4,47	Estonia	2,8	Romania	13,0
Cyprus	3,2	Lithuania	4,59	Latvia	0,0	Lithuania	17,3
Poland	3,4	Cyprus	4,6	Slovenia	-0,1	Bulgaria	18,2
Czech Republic	4,8	Czech Republic	4,72	Euro area	-0,6	Slovenia	24,1
Slovenia	5,0	Malta	4,77	Lithuania	-1,2	Czech Republic	28,7
Romania	6,4	Bulgaria	4,8	Czech Republic	-1,6	Slovakia	29,4
Hungary	7,3	Latvia	5,93	Malta	-1,8	Poland	45,2
Lithuania	8,0	Poland	5,99	Poland	-2,0	Cyprus	59,8
Estonia	8,8	Romania	7,34	Slovakia	-2,2	Malta	62,6
Bulgaria	10,1	Hungary	8,02	Romania	-2,5	Hungary	66,0
Latvia	13,0	Estonia	n.a.	Hungary	-5,5	Euro area	66,6

Source: [1]

In many countries outside the euro zone the currency depreciation and higher inflation rates, fiscal deficit negative growth rates on GDP are some of the characteristics for 2007-2010. (Table 2)

Inflation seems to be the most challenging task for the New Member States outside of the Euro-zone. A reasonable solution would be to define the criterion as the euro area inflation plus 1, 5 percentage points. [2, 3]

According to the fiscal Maastricht Treaty criteria, [5] the Government debt should not exceed 60% of GDP and the Government budget deficit should not exceed 3% of GDP. During the crisis, the second criterion was a real challenge: only Estonia accomplishes this target. Maybe we should accept a temporary relaxation of this criteria, but in the medium and long run, there are no reasons for changing the reference value of 3%.

We can also say that Eurozone is not a ”safe harbor” – Cyprus, Malta, Slovenia and Slovakia are fulfilling only one or two of the Maastricht criteria.

Another key question is whether the crisis in Greece will make the EU authorities stricter in their interpretation of the Maastricht criteria. There is a possibility that the deep Greek crisis is related to the prematurely joining the Euro area. The solidarity inside the Euro-zone was the final answer. The 110 billion euros given to Greece by the other 15 Euro-zone countries – about 10.000 euros per person. A huge sum of at least 500 billion euros is said to be needed if the crisis also takes hold in Portugal, Spain and possibly Italy.

Maastricht criteria after the crisis – December 2009 and March 2010 Table 2

Inflation rate		Long-term Government interest rates (bond yields)		General Government surplus or deficit		General Government gross debt	
Euro area	1,0	Euro area	3,63	Euro area	-6,3	Euro area	78,7
Bulgaria	1,8	Bulgaria	5,82	Bulgaria	-3,9	Bulgaria	14,8
Czech Republic	0,4	Czech Republic	4,02	Czech Republic	-5,9	Czech Republic	35,4
Estonia	-1,0	Estonia	-	Estonia	-1,7	Estonia	7,2
Cyprus	2,5	Cyprus	4,6	Cyprus	-6,1	Cyprus	56,2
Latvia	-3,3	Latvia	10,54	Latvia	-9,0	Latvia	36,1
Lithuania	-0,3	Lithuania	5,15	Lithuania	-8,9	Lithuania	29,3
Hungary	6,2	Hungary	7,11	Hungary	-4,0	Hungary	78,3
Malta	1,2	Malta	4,33	Malta	-3,8	Malta	69,1
Poland	3,9	Poland	5,72	Poland	-7,1	Poland	51
Romania	5,2	Romania	7,11	Romania	-8,3	Romania	23,7
Slovenia	1,8	Slovenia	3,94	Slovenia	-5,5	Slovenia	35,9
Slovakia	-0,2	Slovakia	4,01	Slovakia	-6,8	Slovakia	35,7

Source: Eurostat database

4. Conclusions

The Maastricht Treaty criteria are too far for the 8 countries outside the Euro-zone o accomplish, mainly because of the inflation rate and fiscal deficit. Is there possible an adjustment of the rules in hard times?

After the crisis, Europe's monetary enlargement needs a more visionary approach.

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