

# Romania`s Eurozone Entry and the Fulfillment of the Institutional Criterion<sup>1</sup>

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*Abstract: The nominal convergence criteria is a necessary condition but insufficient for Romania's entry into the Eurozone. In addition to quantitative economic criteria, Romania must also fulfill the institutional criteria which are as binding as all the others. As the latest convergence report considers that Romanian legislation, „does not meet all the requirements for the independence of the central bank, the monetary financing prohibition and institutional integration of the central bank into the Eurosystem”, the article analyses the compatibility of Law no.312/2004 with the current European legislation, given the fact that Romania must comply with all adaptation requirements set out in Article 131 TFEU. Thus, the aforementioned article examines the central bank's independence in terms of functional independence, institutional, financial and personal, identifying the articles and paragraphs that are not consistent with EU legislation and the Statute of the ESCB and which are to be amended, modified or removed. At the same time, it states that the provisions of national law which contravene EU secondary legislation have to be abolished or amended. Since Romania aims to adopt the euro on 1 January 2019, will mean that up to January 1, 2017 (deadline for entry into ERM II) Romanian law must be fully compatible with EU law.*

**Keywords:** central banks, Eurosystem, Eurozone, institutional convergence

**JEL Classification:** E52, E58

## 1. Introduction

At the conclusion of accession negotiations to the EU, Romania has committed, even if there is not a fixed term to adopt the euro single currency-and thus entered into EMU when it is ready and will meet the conditions. Romania's accession to the euro zone requires meeting the nominal convergence criteria laid down in the Maastricht Treaty. The latest statistical data published as well as the economic developments show that there are high chances that Romania should meet by the end of 2016 the Maastricht criteria, enter the exchange rate mechanism ERM II in early 2017 and to switch to the euro starting with January the 1st, 2019. At the same time remain to be solved a number of difficult problems such as the significant reduction of the competitiveness gaps and fulfilling the institutional convergence.

## 2. Convergence criteria and their degree of fulfillment

Romania is, starting with January1st 2007, an EU Member State with a derogation and in accordance with Article 140 paragraph 1 of the Treaty on the

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Functioning of the European Union<sup>2</sup> is (along with all the other Member States with a derogation) subject to a convergence report in which the European Commission and the European Central Bank shall, at least once every two years or at the request of one of the eight states, evaluate the degree of sustainable economic convergence that was achieved and the compatibility of national legislation with the provisions of the Treaties and the Statute of the ESCB and of the ECB and also the fulfillment of the statutory obligations imposed by the national central banks (NCBs) in order to be an integral part of the Eurosystem<sup>3</sup>. The latest Convergence Report<sup>4</sup> shows the fulfillment by Romania of four out of the five nominal convergence criteria set by the Maastricht Treaty.

The nominal criterion that was not fulfilled by Romania, at the time of the publication of the report, was that of price stability expressed by the HICP inflation rate which in the reference period May 2013-April 2014 was of 2.1% compared to 1.7% level of reference of the average of the first three EU countries on this indicator. The close value of this indicator to the reference level and the downward trend recorded in Romanian inflation would lead to the fulfillment of all five nominal convergence criteria provided in the Maastricht Treaty, starting with June 2014. It is gratifying that the fulfillment of the nominal criteria was achieved without "pressure", Romania not setting specifically this objective as a goal. This is a further proof of the inconsistency of Romanian authorities in charge of formulating structural policies and that have not acquired yet the skills needed to propose and follow up, consistently, important objectives in the medium and long term. At the same time the report also mentioned that Romania does not fulfill the institutional convergence criterion.

### **3. Research methodology**

In the process of assessing the institutional convergence it is examined, both the compatibility of national legislation with that of the European Member States and whether the application of the provisions complies with the spirit of the Treaty, namely the independence of decision-making bodies. The purpose of assessing institutional convergence is to facilitate the adoption by the Council of the decisions on the fulfillment of the obligations of the states with derogation for achieving economic and monetary union.

These conditions concern in particular central banks' independence and institutional integration into the Eurosystem of the National Central Banks. In order to identify the areas in which national legislation should be adapted the following issues are examined: compatibility with the provisions regarding the National Central Bank

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<sup>2</sup>At least every two years or at the request of a Member State with a derogation, the Commission and the European Central Bank report to the Council on the progress made by Member States with a derogation in fulfilling their obligations for achieving economic and monetary union. These reports examine in particular whether the national legislation of each of these Member States, including the statutes of National Central Bank, is compatible with Articles 130 and 131 and the Statute of the ESCB. The reports also examine if it was achieved a high degree of sustainable convergence and to what extent each Member State has fulfilled the following criteria:

- Achieving a high degree of price stability; it results from an inflation rate close to the rate of the three Member States with the best results in terms of price stability;
- The sustainability of public finances; this follows a budgetary position without excessive deficit in accordance with Article 126 (6);
- Observance of the normal fluctuation margins provided for by the exchange rate mechanism of the European Monetary System, for at least two years without devaluing against the euro;
- The durability of convergence achieved by the Member State with a derogation and of its participation in the exchange rate mechanism being reflected in long-term interest rates.

<sup>3</sup> The Eurosystem comprises the ECB and the NCBs of Member States that have adopted the euro (currently 18).

<sup>4</sup>European Central Bank, The Eurosystem, Convergence Report, June, 2014, edition in Romanian.

independence and the compliance with the principles of confidentiality, compatibility with the dispositions on the prohibition regarding monetary financing and the prohibition on privileged access, institutional integration of the National Central Bank in the Eurosystem and compatibility with the single spelling of the euro required by EU legislation.

#### 4. Analysis of the fulfillment of the institutional convergence criterion

The Convergence Report published by the European Central Bank in June 2014 devotes a substantial paragraph to the compatibility of the national legislation from the EU Member States with a derogation from EU law. Thus, in accordance with Article 131 from the Treaty on the Functioning of the European Union (TFEU) "National Law (must) be compatible with the Treaty and the Statute; therefore any incompatibility must be removed. Neither the supremacy of the Treaties and of the Statute over national law, nor the nature of incompatibility, affects the need to fulfill that obligation".<sup>5</sup>

Therefore, according to Article 108 and 109 of the Treaty and the Statute of the European System of Central Banks (ESCB) and the European Central Bank (ECB), Member States with derogation shall meet, when adopting the single currency, in addition to economic convergence also the requirements arising out of the achievement of "institutional convergence".

Institutional convergence envisages the achievement of the compatibility of national legislation (legal convergence) of each member countries with derogation. This compatibility refers to the laws (statutes) of the central banks and to all the laws that might be related to them, including secondary legislation with the EU legislation mentioned above.

The assessment of institutional convergence, presented in the convergence reports, examine in particular the degree of achievement of the National Central Bank Independence (NCBI). This criterion proves also crucial for the proper functioning of EMU given the full degree of independence granted to the ESCB and the ECB.

The evaluation of the "institutional criterion" is conducted taking into consideration the established context by the European Monetary Institute (EMI). This was used in preparing the 1998 Convergence Report for EU countries that were to adopt the single currency - Euro on 1 January 1999. Obviously this framework has been enriched and nuanced afterwards, notably by the ECB suggestions and proposals as they are found in the Convergence Reports prepared by the ECB in 2000, 2002 and 2004.

Communitarian law does not prescribe a recipe, a particular model of achieving the compatibility of national laws that need to be adapted. "The requirement for the national legislation to be compatible...does not mean that the Treaty requires harmonization of the CB statutes among themselves or with the Statute. National particularities may continue to exist to the extent that they do not affect the exclusive competence of the EU in the monetary area... national legislation and CB statutes must be adjusted to eliminate inconsistencies with the Treaties and the Statute and to ensure the necessary level of integration of the CBs in the ESCB".<sup>6</sup>

Therefore, the requirement of achieving compatibility requires that the adjustments and the amendments to the laws (statutes) of CBs relating in particular to their independence, to be enacted before or at the time the CB becomes a member of

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<sup>5</sup>European Central Bank, the Eurosystem, Convergence Report, June, 2014, the Romanian version, pp. 25.

<sup>6</sup>European Central Bank, The Eurosystem, Convergence Report, June, 2014, the Romanian version, pp. 25.

the ESCB. So, consequently, the maximum term of legislative adaptation is when, after a minimum of two years in the ERM II, the single currency will be adopted.

As Romania has proposed adopting the euro on 1 January 2019 it results that up to January 1st 2017 Romanian legislation must be fully compatible with EU law. Although compatibility requirement explicitly refers only to the TFEU and the ESCB Statute, must be removed or amended also the provisions of national law which contravene EU secondary legislation.

As a way of working which became mandatory, Member States with derogation must consult the ECB on the legislative projects necessary to achieve compatibility. Since "Romanian legislation does not fulfill all the requirements for Central Bank independence, the monetary financing prohibition and institutional integration of the Central Bank into the Eurosystem"<sup>7</sup> results that the legislative compatibility process should be accelerated due to the fact that "Romania is a EU member state with a derogation and therefore must comply with all adaptation requirements under Article 131 of the Treaty".<sup>8</sup>

The ECB Convergence Report chapter concerning Romania published in June 2014 opens with a series of legislative recommendations, which should ensure complete independence to the NBR. In terms of the requirements and provisions of the EU, Central Bank independence includes several types namely: functional independence; institutional independence; personal independence and financial independence.

The functional independence of CBs is the tool that ensures the fulfillment of a fundamental objective, clearly defined and must prevail over any other objective, and is performed independently of any other authority. In accordance with the requirements of the TFEU, the fundamental objective that best fits the purpose of independence is to maintain price stability. Without bringing prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Union in order to contribute to achieving the EU's objectives, as defined in Article 3 of the Treaty on European Union. ESCB shall act accordingly to the principle of an open market economy with free competition, favoring an efficient allocation of resources and respecting the principles laid down in Article 119 of the Treaty on the functioning of the European Union".<sup>9</sup> At the same time the CB independence involves assuming the responsibility for its own decisions, something that requires transparency and dialogue with third parties.

Institutional independence refers to the exclusion of any influence on decision-making bodies of the CBs. Also the members of the decision making bodies cannot solicit nor accept instructions from the EU or its member states governments. Are prohibited any forms of influences in the sense that no one can give instructions, approve, suspend, cancel or censor the decisions of the CB. Also, CBs must have legal personality and cannot be part of government administration. If the CB would be organized by shares, shareholders' rights should be limited to ensure its independence.

Are considered as incompatible with the EU provisions and therefore prohibited and eliminated a number of clauses that refer to: soliciting or accepting instructions; approval, suspension, cancellation or relinquishment of the CB decisions or of their governing bodies; censorship, on legal basis, of the decisions on CB's activity by various bodies other than independent legal courts; third-party participation in decision-making bodies of CBs with voting right, even if their vote is not decisive; respecting the governor of the CB's quality as member of the Governing

<sup>7</sup>European Central Bank, The Eurosystem, Convergence Report, June, 2014, the Romanian version, pp.100.

<sup>8</sup>Ibidem

<sup>9</sup>European Central Bank, The Eurosystem, Institutional dispositions, November 2012, pp 7-8.

Council of the ECB and the confidentiality of information as required by law; prior consultation to the decision-making by the CB or its management bodies, except their dialogue with third parties - the government - for example when national legislation provides for the exchange of information and opinions, but that does not interfere on the independence of the members of the governing bodies of CBs.

Also, it is recommended that in the text of the statutes (laws) of the CBs to be included provisions on not harming any member of the Board of Directors of CB or any of its decision making body due to procedures that concern the discharge procedures or tasks when they are conducted by third parties (eg. government).

The reference to **personal independence** considers the role, status and structure of the governing bodies of CBs. Both the procedures for appointment and dismissal and the duration of the mandate, the possibility its of renewal and the requirements regarding professional competence, situations of incompatibility and conflict of interest are considered.

CB statutes must have, according to EU requirements, clear rules on personal independence of the Governor and of the other members of the management bodies on the basis that the governors of the CBs of the countries that become EU members automatically receive membership of the General Council of the ECB.

Functional independence, institutional and personal does not ensure full independence of the CB without the existence of financial independence, respectively budgetary independence.

Financial independence requires for the CBs to have sufficient financial resources to fulfill both primary objective and other duties and tasks, including meeting obligations related to participation in the ESCB. So financial independence implies that no third party (even the government) can intervene directly or indirectly in the performance of the functions of the CB or on its budget.

Therefore in the CB statutes must exist clear provisions at least for establishing its own budget. Consequently, determining or influencing the budget of the CB is incompatible with financial independence unless the law provides a safeguard clause stating that such a power to a third party will not affect the means of funding necessary to fulfill in good conditions the CB mission. Meanwhile, the CB account plan will be adopted by it, possibly with the assistance of independent accounting bodies.

The CB, by law, must have the last word on any decision arising from the activity of financial supervision in order to safeguard its independence, in general, and financial, in particular.

Institutional integration into the Eurosystem of the CBs involves, apart from statute, adapting national legislation that interferes with their problems so as to ensure full compatibility with EU legislation in areas such as their duties, financial provisions, exchange rate policy, international cooperation, etc.

The deadline for adopting and adjusting the national legislation and institutional integration into the Eurosystem of the CB is the term by which full integration becomes effective, ie the date on which the Member States with derogation adopt the single currency, the euro. After euro adoption and integration into the Eurosystem, all CBs provisions incompatible with the TFEU and the ESCB Statute must be eliminated. Thus, the CB statutes shall provide that the duties related to monetary policy will be met by the Eurosystem and that the monetary policy instruments are identical with those of the EU.

The CB's exclusive right to issue banknotes will be replaced by the Governing Council of the ECB's exclusive right to authorize the issuance of euro banknotes and denomination, production, withdrawals of euro banknotes, coins and their volume.

Meanwhile, official foreign reserves of the Member States participating shall be transferred to the ECB.

In order to adopt the euro, the national legislation must reflect the fact that the responsibility for the exchange rate policy is transferred to the EU Council and the ECB and the international representation to the Eurosystem, ECB establishing concrete ways on how to do it and the provisions relating to participation in international monetary institutions of the CB.

According to the analysis on convergence criteria undertaken by EU experts published in the Convergence Report of June 2014, the English version, the Commission identified a number of legislative flaws or incompatibilities with the Treaty on the Functioning of the EU (TFEU) and the Statute of the ECB. Thus, in the period since the 2012 Convergence Report and the one in 2014, the Law 312/2004 (NBR Statute) has not been reviewed and therefore the observations presented in the Convergence Report 2012 were largely repeated in this year's assessment.

ECB experts state that in accordance with Article 33 paragraph (10) of the NBR Law, the Minister of Public Finance and one of the State Secretaries in the Ministry of Public Finance may participate, without voting, in meetings of the NBR Board. Although the dialogue between a central bank and third parties is not prohibited as such, this dialogue should be constructed so that the Government may not be able to influence decision making process in areas where central bank independence is protected by the Treaty. It is estimated that the active participation of the Minister of Finance, even without the right to vote, at meetings of the NBR Board of Directors which sets the NBR policy, can provide the Government the opportunity to influence the central bank in its key decision-making and in this context, Article 33 paragraph (10) of the NBR Law is inconsistent with Article 130 of TFEU.

ECB experts consider necessary to amend the law which clarifies that the institutional independence of the NBR is protected vis-à-vis national institutions or bodies, foreign bodies and of EU, and to oblige, specifically, the Government not to influence the members of the NBR's decision-making bodies in fulfilling their duties.

It is also stated that the NBR Law should be complemented by rules and procedures capable to ensure a smooth and continuous operation of the central bank in case of termination of the mandate of the Governor. So far, Article 33 paragraph(5) of the NBR Law provides that in the case the Board of Directors of NBR is incomplete, vacancies will be filled following the procedure for appointing members of AC by NBR. Article 35 paragraph(5) of the National Bank Law provides that if the Governor is absent or is unable to act, the First Deputy Governor will replace him.

Since in accordance with Article 33 paragraph (9) of the NBR Law, the decision on revoking a member of the Board of NBR (including the governor) can be appealed to the Romanian High Court of Cassation and Justice within 15 days from its publication in the Official Monitor of Romania, Part I, ECB experts consider that it should be complemented with the right to judicial control of the Court of Justice of the European Union referred to in Article 14.2 of the ESCB / ECB Statute in case of dismissal of the governor.

The changing of Art. 33 of BNR Law is also solicited, by introducing an explicit clarification of the situation in which a member of the Administration Council falls under the law 161/2003 and/or 176/2010 concerning the declaration of assets and incompatibilities in the exercise of public functions, in the sense that the failure in meeting some provisions of those laws do not constitute grounds for dismissal except the cases stipulated by Art.33(7) which states that "No member of the Board of the

National Bank of Romania will not be replaced for other reasons or by other procedure other than that referred to in paragraph (6)<sup>10</sup>.

In accordance with Articles 21 and 23 of the Law on the organization and functioning of the Court of Auditors (No. 94/1992), the Court is empowered to control the creation, management and use of financial resources of the public sector, including the financial resources of the central bank and to verify the performance in the management of the funds by the central bank. These provisions constitute an incompatibility and therefore, for reasons of legal certainty, it is recommended to be clearly defined in the Law the area of application of the audit the Court of Auditors, without bringing prejudice to the activity of the central bank independent external auditors in accordance with Article 27.1 of the Statute of the ECB/ESCB.

Article 43 of the NBR Law provides that NBR must transfer to the state budget a share of 80% of net its profit, calculated on monthly basis, remaining after the deduction of the expenses related to the financial exercise, including provisions for the risk of credit and any loss related to the earlier financial exercise that remain uncovered. Such a procedure could be interpreted, in certain circumstances, as an intraannual loan granted by the central bank which would adversely affect its financial independence.

A Member State cannot put its central bank in a position where it does not have sufficient financial resources to fulfill tasks in the ESCB, and also national tasks related to financing its administration and own operations.

Because Article 26 of the NBR Law provides that "In order to fulfill the NBR attributions concerning ensuring the financial stability, exceptionally and from case to case, the National Bank of Romania may grant the credit institutions with other loans too, unsecured or secured with assets other than those referred to in art. 19" it results that the prohibition on monetary financing is violated and therefore incompatible with Article 123 of TFEU. Therefore Article 26 of the NBR Law should be amended to prevent such lending operations.

In accordance with Article 7 paragraph (3) of the NBR Law, the credit institutions with major state capital are exempt from the prohibition of granting loans and overdrafts or any other type of credit facility in accordance with Article 7 paragraph (2) of the NBR Law and from receiving loans from the central bank in the same way as any other eligible credit institution in accordance with NBR regulations. Therefore Article 7 paragraph (3) of the NBR Law is incompatible with the wording manner of the Article 123 paragraph (2) of TFEU, which exempts only credit institutions with state owned patrimony "in the context of the supply of liquidities by central banks," and must be changed.

In accordance with Article 2 paragraph (3) of the NBR Law, the secondary objective of the NBR is "to support the general economic policy of the state without prejudice to its primary objective of ensuring and maintaining price stability." According to the Convergence Report, in the ECB experts opinion, Article 2 paragraph (3) of the NBR Law contains a flaw because it should also contain a reference to the general economic policies of the EU, in accordance with Article 127 paragraph (1) of TFEU and Article 2 of the ESCB / ECB Statute, since these latter items have priority over central bank law.

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<sup>10</sup>Article 33 paragraph 6 of Law 324/2004 provides that "recalling from office of any member of the Board shall be made by the Parliament at the joint proposal of the standing committees of the two Houses of Parliament, if he ceases to meet the conditions required for the performance of his duties or if he is guilty of serious misconduct."

## 5. Conclusions

From what has been presented there results that from a legal standpoint, given the objectives and tasks of the central bank, there are still many incompatibilities between the Law no.312 / 2004 on the NBR Statute and the ECB. All this should be put in agreement and the time remaining until January the 1st, 2019 is pressing due to the long legislative procedures and the necessity of their recognition by the EU experts. However we must take into account also the duration of some possible corrections. Therefore Romania has to meet the institutional criterion too which is as important and mandatory as the economical quantitative ones.

In conclusion, the process of adoption of the single currency must be accelerated given the need to achieve sustainable economic convergence together with an increase in competitiveness, in the degree of labor occupancy, in the sustainability of the public budget, in ensuring the financial stability and in the harmonization of the positions on the taxation policy.

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