EuPI European Policies Initiative

Open Society Institute – Sofia

Summary Report

Economic and Political Challenges of Acceding to the Euro area in the post-Lehman Brothers' World

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The publication is a product of the Open Society Institute – Sofia within the European Policies Initiative (EuPI) and the project "Economic and Political Challenges of Acceding to the Euro area in the post-Lehman Brothers' World".

The publication comprised of nine Country Reports and a Summary Report is available on the website of the European Policies Initiative: www.eupi.eu

About EuPI

The European Policy Initiative (EuPI) aims at stimulating and assisting the New Member States from CEE to develop capacity for constructive co-authorship of common European policies at both government and civil society level. As a new priority area of the European Policies and Civic Participation Program of Open Society Institute – Sofia, EuPI will contribute to improving the capacity of New Member States to effectively impact common European policies through quality research, policy recommendations, networking and advocacy.

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About the publication

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EuPI aims at stimulating and assisting new Member States from CEE to develop capacity for constructive co-authorship of common European policies at both government and civil society levels (www.eupi.eu).

The project was implemented from September 2008 to September 2009. The main outcome of the project is a publication comprised of nine Country Reports and a Summary Report.

Following a uniform structure, and addressing a set of similar questions, the nine Country Reports (Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania and Slovenia) present stylized facts about the patterns of real and nominal convergence with the euro area in nine new EU members, outline the setting and the implementation of the accession policies in those countries and emphasize the incidence of the current crisis on the strategy to adopt the common currency.

Comments are relevant to policy developments until 20 May, 2009 – the cut-off date for the submission of the last revised version of the Country Reports.

The Summary Report reviews the results of the Country Reports and systematizes some of the dominant trends they reveal. The Summary Report checks the countries' experience in dealing with the complicated concentric monetary structure inside the EU (euro area; ERM II; non ERM II countries) and pays particular attention to the evidence gathered about the political economy of the procedures in the different countries.

Each Country Report and the Summary Report include an Appendix, containing Tables that summarize significant data provided in accordance with a standardized set of indicators.

The results of the Project are correctly intelligible only if all its pieces (ToR, Summary Report, Country Reports, Appendix) are considered together.

Advisory Board
The project was able to benefit from the insights of a distinguished Advisory Board. As the Boards' mandate was limited to advice and comments on the methodology and the Summary report, responsibility for the findings and statements rests solely with the authors of the Country and the Summary reports.

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EXECUTIVE SUMMARY

The *Summary Report* is based on the inputs from nine *Country Reports* (Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania and Slovenia). The Summary presents stylized facts about the patterns of real and nominal convergence with the euro area, outlines the setting and the implementation of the accession policies, and emphasizes the impact of the current crisis on the strategy to adopt the common currency.

The *Summary* and the *Country Reports* comment upon policy developments *until 20 May, 2009*.

Economic Convergence

- The strength of the attraction exerted by the core of the European Union (EU) is unequivocal. Accession generated an irreversible convergence momentum driven by the centre of gravity of the monetary union.

- The core convergence model of the euro candidate countries relied on foreign capital inflows that coped with the deficit of domestic savings, sustained investments, boosted exports, nurtured consumption (but also asset bubbles) in the local markets.

- The counterpart of this model has been a strong dependence from external dis/equilibriums that permanently affected the credibility of some countries and their standing in the negotiations with the European authorities. Central and Eastern European (CEE) countries currently suffer from an *imported* crisis in the same way they benefited for years from the bonus of an *imported* growth, which noticeably accelerated convergence.

- The cornerstone of the model was the presumption that the euro shall be adopted in the foreseeable future. Once it became clear that the accession to the euro area is an uncertain, sophisticated procedure and the crisis began to subtract credibility, latent risks were revealed that served to destabilize the model.

- Tensions between the *nominal* and the *real* facets of the master plan for adopting the euro are accentuated by the growing heterogeneity of the EU. Catching-up is about real adjustment and economic flexibility—factors that are hardly compatible with flat nominal parameters.

National Goals and Strategies for the Adoption of the Euro Before the Global Crisis

The nine case studies display shared points as well as distinct differences.

- *Floaters* considered that remnants of monetary autonomy are still useful for fine-tuning macroeconomic conditions and for the adjustment to adverse external shocks. Actually, their monetary independence was severely restricted and local monetary authorities have lost much of their leverage in a *de facto* merged European financial market. Vis-à-vis the euro, *floaters* refrained from taking firm commitments and adopted a cautious stance: a "benign neglect" attitude, or a passive, "silent strategy".

- *Fixers* had already surrendered their monetary sovereignty. They stuck to a simple schedule: fastest entry into ERM II; shortest possible stay in the mechanism; exit from the currency board by adopting the euro. The pursuit of this strategy was not as cloudless as expected, economic developments diverged from a smooth path and textbook basics. The tight euro-adoption timetable of the *fixers* was derailed, giving way to less ambitious strategies on the eve of the global crisis.

The Impact of the Global Crisis

- Its effects are essentially uniform across CEE. The crisis badly hurt the core of their growth model. Features that constituted the success and the assets of CEE for the last decade quickly turned into liabilities.

- The crisis triggered an inflexion of the candidates' strategy. The generalized move was to speed-up the preparation for the euro area. In the new context the cost/benefit trade-off changed dramatically and significantly increased the appeal of the euro.

- A strong case in favour of the euro for *floaters* is the manifest futility of monetary policy independence. Its main feature – the floating exchange rate – turned into a major risk, whereas the supposed advantages vanished. The attractiveness of faster euro adoption strengthened for *fixers* as well: those countries are keen to leave the imitative/truncated "quasi-euro area" regime and to benefit from authentic membership in a monetary union. They have to struggle, however, with growing scepticism about the sustainability of the peg.

- In the current conditions the euro is a moving target. The optimistic momentum from the autumn of 2008 has rapidly faded away. The optimal timing to give impetus to euro adoption seems to have been missed. The new situation generates colliding goals and makes more difficult the working out of a consistent strategy.

- The crisis generates a bottleneck. On one side is the mounting eagerness to join the euro area and the urgent need for the candidates to speed-up the process as the cost to stay *out* has increased substantially. On the other side, the global crisis has made fulfilment of the nominal criteria more difficult, complicated the strategies and blurred the time horizon.

Institutional and Policy Environment Regarding the Euro Adoption

Before the Global Crisis

- The faultless trajectory of Slovenia is a good reference standard that highlights many of the problems faced by the other would-be members. Although the Slovenian example is not directly transposable to other countries, it contains the essential ingredients of success.

- A critical point in the path to the euro is entry in ERM II. The absence of formal criteria for the applicants gives room to complex judgments. The counter-performance of Bulgaria illustrates how a constellation of political, economic, even cultural considerations from one side; of wrong priorities, poor organization and bad political image of the country on the other can tacitly block admission to ERM II.

- Before the crisis, the euro schedule was rarely at the centre of the political debate in most candidate countries, but the exceptions stress the delicacy of the political economy of the process. The compromises reached between political and economic considerations are most of the time far from optimal and the actual timetable often misses the desirable one, due to extra-economic reasons.

- Accession to European Monetary Union (EMU) involves a number of institutional actors whose interplay can accelerate or delay crucial decisions. The changing attitudes of European institutions do not translate into bold statements or institutional/legal or procedural transformations, but into differing nuances of interpretation. Rules at the two check points (ERM II; euro area) are sufficiently flexible to allow for soft opinions, accommodate policy shifts and regulate the process of enlargement.

The Impact of the Global Crisis

- The ongoing crisis underscores the problems with the complicated and concentric monetary structure of Europe (euro area; ERM II; non ERM II countries). The involvement of the International Monetary Fund (IMF) in the current stabilization efforts further complicates the institutional surrounding of the euro area enlargement.

- The incumbents' position vis-à-vis enlargement of the euro area has hardened. Acceleration of the process in a highly turbulent environment is perceived as an additional risk, which diverts political and administrative energy from the more pressing crisis management tasks. The "siege mood" inside the euro area, however, leads to piecemeal (suboptimal) solutions for an issue of overall interest for the EU.

Conclusion: Perspectives

- In the current situation, the intricate perspective of the EMU is characterized by the following (often contradictory) aspects: increasingly integrated financial markets calling for a single currency and common institutional (*inter alia* supervising) entities; general willingness among the non-euro CEE countries to speed-up euro adoption; extremely rigid accession rules; reluctance of the incumbent countries/institutions to enlarge the monetary union in the short term; real economic risks and uncertainties that do not encourage tranquil or strategic decision-making.

- Since the autumn of 2008 the public debate on the prospects of the euro has gone on along three main vectors: possible amendments to the existing enlargement criteria; fast-tracks to the common currency; sustainability of the existing monetary regimes outside the euro area.

- Different adjustments, modifications in the application and/or in the interpretation of the *nominal criteria* have been suggested. The most far-reaching *fast-track* proposal is unilateral *euroization*. This is a natural exit strategy for countries with currency board arrangements (CBA) in case of a possible currency crisis, but unilateralism has serious economic inconvenience, as well.

- All proposals about amendments or faster procedures have been boldly and repeatedly rejected by the European institutions on the grounds of legal, political and economic arguments. *Realpolitik* is the only permitted game in town; the pragmatic institutional standpoint overrides academic considerations. A strictly orthodox stance is noticeable across CEE countries too.

- As it stands now, the probability for major changes in the existing modus operandi are insignificant. Even in periods of chaos not everything is permitted. The institutional/legal fetters, however, should not discourage any intent to rationalize the overregulated procedure.

- Shifts in the *monetary regimes* of the non-euro CEE countries are economically and legally unavoidable. The crisis emphasized the economic case for this move. The bottom line is about the *time spent before the regime change*. An indefinite extension of the period will be damaging for those that are *in*, for the outsiders and for the single currency itself. The perspective for enlargement, however, seems more unclear than ever.

I. Introduction

The *Summary Report* reviews the results of the *Country Reports* and systematizes some of the dominant trends they reveal. Following a uniform structure, and addressing a set of similar questions, the *Country Reports* commissioned by the OSI-Sofia European Policies Initiative Project present stylized facts about the patterns of real and nominal convergence with the euro area in nine new EU members, outline the setting and the implementation of the accession policies in those countries and emphasize the incidence of the current crisis on the strategy to adopt the common currency.

The focus of interest is the consistency, the viability and the sustainability of the national policies vis-à-vis the euro. They are assessed in a comparative perspective among countries and over time. The climax of September 2008 is the evident fault line, but more subtle periodizations are also relevant. For those countries that have joined the ERM II, in particular, the membership in the exchange rate mechanism is a crucial threshold.

The *Summary Report* checks the countries' experience in dealing with the complicated concentric monetary structure inside the EU (euro area; ERM II; non ERM II countries). The recent problems have been faced within relatively coherent institutional arrangements (in the monetary union) and/or through *ad hoc* designs without pre-established rules, involving "external" actors such as the IMF. The basic question is how and to what extent the crisis-induced changes affect national strategies, namely the optimal timing for adopting the euro. A broader issue considered is the adequacy of different monetary regimes (inflation targeting, currency boards) in the current turbulent context.

The Project considers that EMU accession is a broader endeavour than the simple fulfilment of preset technicalities. It is involved in a subtle game among a number of institutional players where key decisions can be softly accelerated or delayed. Thus the *Summary Report* pays particular attention to the evidence gathered about the political economy of the procedures in the different countries. Of importance in this respect are such aspects as the handling of the trade-off between quantitative and qualitative criteria; the role of judgments (e.g. of the "sustainability" criterion); the synergies/conflicts between domestic actors (essentially the ministries of finance and the national banks) and their incidence on the shaping of effective negotiation policies.

The current rethinking of policy issues on a global (and EU) scale is so vast that scores of seemingly untouchable principles are being revisited. Thus the *Country Reports*' authors were encouraged to join a virtual brainstorming session by expressing ideas that are not necessarily constrained by the existing legal arrangements. The received inputs contain valuable discussions about the flexibilization of the Maastricht criteria and their reconsideration (or unilateral euroization). They are commented upon in the *Summary Report* due to the acceptable rationale of their economic logic and to the historical evidence that there are no once-and-for-all institutional arrangements.

The *Appendix* to this Report contains Tables that summarize significant information embedded in the *Country Reports*. A master file is compiled from the time-series provided in accordance with a standardized set of indicators. A second Table reviews the progress of each country towards the fulfilment of the Maastricht criteria. Finally, the national target dates concerning the adoption of the euro are recapitulated.

The goals and the place of the *Summary Report* in the Project's structure require a few clear *disclaimers* which explain some specific features of the text.

- The Report is based on the inputs from nine *Country Reports* (Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania and Slovenia) prepared in accordance with the *ToR* of the Project. Unfortunately, the expected contribution from Slovakia was not received, thus depriving the Summary of a very important case study.

- The *Summary Report* generalizes, arranges and evaluates - according to my views – exclusively the content of the submitted national surveys. The summary deliberately confines itself to the received inputs and strictly matches their common structure. This is neither a state-of-the-art presentation, nor an academic discussion of the debated issues in the field. Correspondingly, references and quotations of academic papers are omitted. (Many relevant publications are quoted in the *Country Reports*). The positions of the European institutions, in particular, are not captured or commented upon directly, but through the accounts and appreciations in the *County Reports*.

- The aims of the *Summary Report* are to generalize and to highlight problems/trends, not to make country by country comparisons. The single explicit taxonomy is between economies with floating (*floaters*) and with pegged (*fixers*) exchange rate.
- All figures are drawn from the *Country Reports.* No responsibility is assumed about possible discrepancies with official (or other sources') data.

- The *Summary Report* discuss only characteristic facts and broad tendencies. Details about the macroeconomic developments by countries before and during the global crisis could be found in the corresponding *Country Reports* and in the *Appendix*.
- Comments are relevant to policy developments *until 20 May, 2009* – the cut-off date for the submission of the last revised version of the *Country Reports*.

- The results of the Project are correctly intelligible only if all its pieces (*ToR*, *Summary Report*, *Country Reports*, *Appendix*) are considered together.

II. Economic Convergence

The Core Model

The spirit and the architecture of the EMU are based on the assumption that its members have achieved, or are on a steady path to reach, a sustainable convergence of their policies, development and economic dynamics. The rationale for this approach is rooted in careful scrutiny of historical evidence, as well as on the recent breakthroughs of economic theory. The operational mechanisms of the monetary union were meticulously prepared in the course of the 1990s. They were based on the closely interconnected concepts of *nominal* and *real* convergence. While equal weight was attributed to the two notions, their visibility was quite different. Procedures focused on nominal criteria, whereas real parameters were assessed implicitly, in less formal and blurry ways. This dichotomy embedded in the original blueprint was not a major obstacle in the initial stage, as the founders of the euro area formed a reasonably homogeneous group. Potential tensions of the dual approach started to surface with the first enlargement (Greece) and turned into a complex problem for the ten new EU members from CEE. The situation was further complicated by the outburst of the global crisis in 2007-2008.

The stories narrated in the nine *Country Reports*, together with the rich data base (*Appendix*) display unequivocally the strength of the attraction exerted by the core of the EU. Accession generated irreversible momentum driven by the centre of gravity of the monetary union. It was powerfully enhanced after the formal membership and corroborated – in negative terms – by the ongoing financial turmoil. Although European integration was doubtless the pivotal force, it has to be emphasized that the unique constellation of favourable circumstances was also essential. The loose conditions in the global markets and the concomitant flood of liquidity were easily captured by a seemingly promised area. The euphoria built a dynamic platform that boosted convergence by rechannelling important amounts of capital. Hence, the martyrologic common assertion that CEE countries currently suffer from an *imported* crisis is a half-truth. The other half is that they benefited for years from the bonus of an *imported* growth which noticeably accelerated convergence.

Growth was only partially the merit of new members' sound policies. In fact, the energy and the strategy came from foreign (basically European) banks striving to exploit the emerging markets' opportunities. Appetite for risk was coupled with very high returns on equity invested; loans' quality was (deliberately) assessed benevolently and moral hazard was unavoidable. Credit - originated at last instance abroad - has been the support of the pre/post-accession boom. Until 2008 its availability was ensured under the assumption that parent banks would sustain an uninterrupted one-way flow of liquidity. When the crisis struck, the hypothesis proved untrue and parents themselves were threatened by substantial exposures to CEE risky assets.

This convergence model shared by all the euro-candidate economies relied on foreign capital inflows that coped with the deficit of domestic savings, sustained investments, boosted exports, nurtured consumption and asset bubbles in the local markets. The intensity of the process varied across countries: it worked aggressively in smaller, regionally integrated states (the Baltics, to some extent Bulgaria); with a somewhat lesser impact in large scale and more "mature" economies. In any event, the ultimate belief has been that the euro shall be adopted in the foreseeable future. Such a strong expectation made the whole process vulnerable. Once it became clear that the accession to the euro area is an uncertain, sophisticated procedure and the crisis started to subtract credibility, the latent risks emerged and began to destabilize the model.

Nominal Convergence: Pre-Crisis Trends

Until the current crisis, convergence to the Maastricht nominal criteria has proceeded at different pace across countries and indicators. (*Appendix*) Although meeting those parameters is legally binding for entry in the euro area, they constituted the guiding targets of macroeconomic policies well beforehand, especially during the stay in ERM II.

The most "attainable" has been the *public debt* criterion. New EU members benefited from the exceptionally favourable conditions in world markets: above-average domestic economic growth, low local interest rates and substantial amounts of FDI. In a mid-term backward perspective the fiscal position of those countries has been alleviated by the privatization proceeds and in some cases by low initial debt levels (the Baltics) or by partial debt forgiveness (Poland). Except Hungary, which has had a growing (but still in the vicinity of the 60% threshold) debt/GDP ratio since 2000, the other countries managed to reduce their public indebtedness or keep it under control.

Budget deficits have been much more volatile. There are economies with chronic budget problems and recurrent maladjustments provoked by the imprudent use of fiscal stimulus and pronounced political business cycles. The rigidity of social expenditures (with its associated structural deficits) is another pervasive issue whose solution clashes with political reticence and makes the fiscal stance strongly cyclically-sensitive. Accession to the EU has affected the budget through the acceleration of economic activity and a series of tax adjustments. The more comfortable revenue stream, however, was often matched by expansion of the expenditures so that many countries were involved in the trade-offs of the Excessive deficit procedure. Where CBA are in place, fiscal policy is supposed to be under stricter check. As a rule, this has been the case: Bulgaria for example generated (with a single exception) surpluses during the last decade, but at different moments even some CBA countries have had difficulties in reaching consensus over restrictive fiscal policies (Lithuania), or have been blamed for loose budget position.

The *exchange rate stability* criterion is assessed in very dissimilar frames according to the adopted monetary regime. The two countries that joined the euro area have had different experiences while in the ERM II: the market rate of the Slovenian currency practically did not deviate from the central rate, whereas the parity of the Slovakian one was adjusted upward. For the *floaters* outside ERM II, exchange rate stability is only a reference indicator. Large swings were recorded over the last decade, but those currencies typically appreciated following the massive capital inflows in the pre/post EU accession periods. CBA countries have their currencies pegged to the euro by law, which boils down to 0% fluctuation bands. In the special case of Latvia, which operates a quasi-CBA regime in the ERM II, a narrow band was adopted (+/- 1% around the central parity). The Latvian Central bank had to intervene in 2007 in order to prevent breaches of the fluctuation band on both sides.

Until 2006-2007 *long-term interest rates* broadly tended to converge toward euro area levels as risk premiums decreased steadily. This was an expected outcome of the accession process, of the capital markets' integration and of the narrowing of monetary policies' options. (Under CBA there is no independent monetary policy at all). For some countries this criterion had limited relevance in technical terms due to a thin market and low liquidity of the government's long-term instruments.

Inflation has been the most elusive nominal convergence target. The underlying reasons are widely discussed by applied and academic research. In very general terms, the persistent divergences are related to the catching-up (Balassa-Samuelson) effect and to the remnant price level differential. Although many of the candidates to the Euro area complied with the criterion in different years, its sustainable achievement has been difficult. Outbursts of inflation were generated by temporary phenomena such as administrative prices' adjustments or world commodities (broadly food and energy) price shocks. Normally EU accession provoked a short-lived inflationary peak related to mandatory tax adjustments and to the initial single-market arbitrages. The strongest systemic factors, however, have been the incomes/expenditures catching-up and the huge liquidity inflows. After the accession, growth of budgetary expenses and wages accelerated everywhere, thus pumping a domestic demand already exuberantly stimulated by positive expectations. The demand pressures were coupled with (fuelled by) the credit expansion. Capacity constraints started to appear, namely in the labour markets. The ability of the authorities to curb inflation depended on the general monetary setting: *floaters* formally had an appropriate toolkit to deal with rising prices as their central banks adopted inflation targeting, while appreciating currencies softened "imported" price increases; CBAs were directly exposed to external (price and capital flow) movements whose repercussions were more violent and hence those countries frequently missed the target. In practice both groups experienced imported shocks and despite the theoretical advantage of *floaters*, their experience as small open economies has been that the independent exchange rate proved to be more often a source of shocks than a shock absorber. Thus, the dynamic inflationary environment made the fulfilment of this criterion a delicate exercise depending on aleatory circumstances. Slovenia applied to join the euro area in a favourable context which could have deteriorated a year latter. So did Slovakia by fully exploiting the impact of its appreciating currency. Lithuania, in turn, touched the correct figure for a while, just to see its entry opposed on the (correct) grounds of mid-term unsustainability.

The global crisis dramatically changed the perspective. Since the summer of 2007 and especially after Lehman Brothers' collapse, every single Maastricht criterion acquired a new outlook. [Cf. III.2.]

Real Convergence: Pre-Crisis Trends

The case for *real* convergence is based on the optimal currency area (OCA) premises and on the presumption that the slighter the departure from average levels in a currency union, the less the probability of harmful asymmetric shocks.

Trends in this respect have been rather uniform, albeit of different intensity. The process was driven by investments, primarily by foreign capital flows. FDI reached as much as 30% of GDP (Bulgaria in 2007). Activity followed suit. After a painstaking period of labour shedding and cost cutting in the end of the 1990s - early 2000s, employment rates increased while unemployment started to decline. Growing labour demand created sectoral shortages, wage levels progressed rapidly (in the four years since the accession nominal wages increased 77% in Estonia). This upward movement was not matched by comparable productivity gains, which started to somewhat erode the comparative advantage related to low labour costs. Overall, however, the impetus has been strong enough to assure substantial export growth. Concomitantly, households' consumption and investments were remarkably dynamic, nurtured by accession optimism, decreasing interest rates and extremely strong credit growth. As it is well known, a few sectors (like real estate) benefited disproportionately from this pattern.

The elapsed decade has marked a substantial, but still uneven, advance in the real catching-up of the CEE economies. PPS GDP/capita range in the broad span from 40% (Bulgaria) to 90% (Slovenia) of EU average. Regional and sectoral discrepancies are even more pronounced. The closer synchronization of the business cycles is evident. It reflects the integration of financial markets (up to 90% of the banking assets in some CEE countries are owned by foreign, mainly European, banks), the intensified trade ties, active capital flows and policy coordination in the EU. In very general terms, the more open (and the smaller) economies have been faster in their rapprochement to European levels.

The counterpart of rapid convergence along this model has been a strong dependence from external dis/equilibriums. The scheme rests upon the building up of current account deficits treated as the mirror image of capital account surpluses, i.e. as the reverse side of a healthy investment effort, not the outcome of declining competitiveness. If in a national accounts framework the identity is unquestionable, the timing and the necessary adjustments are not perfectly smooth. Actually, for most of the period and for the majority of the countries FDI (in several cases: plus other important items such as remittances) have conveniently financed current deficits; overall balance of payments ran surpluses that lead to the accumulation of substantial foreign reserves. The deficits, however, have reached unusual magnitudes (over 25% of GDP in some cases, far above the critical level of current account deficits) casting doubts on the sustainability of such positions and of the fixed peg monetary regimes. They were reinforced by the significant side effect of private foreign debt expansion which more than offset the decline in public debt. Notwithstanding the reliability of the concerns, they have permanently affected the credibility of some countries and their standing in the negotiations with European authorities. Furthermore, the "price" of growth in terms of current account deficits has been quite different among CEE: the Baltics recorded double digit rates with lower deficits than Bulgaria, which attained a relatively modest maximum of 6.5% growth with one of the highest deficits in the region.

The impact of the global crisis on real convergence is mixed and difficult to assess at this stage. The relative position of the catching-up countries vis-à-vis the European averages will not necessarily suffer due to the simultaneity of the shock. There is no doubt, however, that the capacity of the CEE countries to proceed at the same pace will be seriously undermined.

Nominal versus Real Convergence

(Post)accession experience raises question marks about the operational suitability of the nominal/real dichotomy. The institutionalized path to the euro assumes that nominal criteria closely correlate with real convergence: a conjecture which is hardly supported by evidence and is debatable on conceptual grounds. Nominal parameters could easily be decoupled from (not to say manipulatively adapted to) more inertial, ambiguous and intangible processes. To overemphasize nominal tests may be misleading. The episodes with Lithuania in 2006 (but also with the superficial reading of nominal indicators for Greece five years earlier) are examples of the fortuity associated with the approach. This is further corroborated by a number of euro area members which – once inside – breach the entry criteria. The conceptual problem, on the other hand, is with the implicit hierarchy of both set of conditions. The underlying philosophy and the procedures target nominal smoothing. Acceding economies (the fresh EU members), however, cannot avoid larger fluctuations. Catching-up is about real adjustment and economic flexibility which are hardly compatible with flat nominal parameters.

Tensions between the nominal and real facets embedded in the master plan for adopting the euro will not disappear. On the contrary, they are accentuated with the growing heterogeneity of the EU. The point is that when the Maastricht criteria were designed, the issue of low-income countries with rapid economic growth seeking membership was simply not considered. This will continue to leave room for bargains, discretionary decisions and compromises. Despite the seemingly clear-cut rules, introducing the common currency has been a political process and is doomed to be ever more so in the environment of the current turmoil.

III. National Goals and Strategies for the Adoption of the Euro

1. Before the Global crisis

The monetary union is the most ambitious endeavour in the field of European integration. Its legal bases have been laid down by the Maastricht Treaty, while a sustained institutional effort permitted to successfully launch the single currency in 1999/2002. After the Big Bang, the euro area entered the uncharted zone of its enlargement. All those that joined the EU in 2004 and 2007 are bound to introduce the new legal tender but the effective timing of this major step is highly sensitive to the economic stance and the monetary regime of the particular country. The review of the nine case studies display shared points as well as distinct differences. Before the global crisis, the main fault line crossing national euro-strategies clearly discriminated *floaters* from *fixers.* Although the former are a less homogeneous group than the latter, this distinction remains relevant in many essential aspects.

Floaters

This group (comprised of Czech Republic, Hungary, Poland, Romania and Slovenia) is characterized by a preserved monetary policy infrastructure and by inflation targeting (introduced with variable success in the late 1990s or early 2000s). The authorities expected that gradual nominal appreciation would reduce inflation and be slow enough to not undermine competitiveness. The constraints concerning euro-adoption choices were relatively loose. In several instances over the decade, monetary policies succeeded in meeting inflation goals, to cool down demand and squeeze current account deficits. As a whole, however, policy stance has been accommodative, allowing for an extremely intense credit expansion.

No county in this group was in a position to let its currency float freely for the entire period. (Poland has been closest to a free regime). Specific arrangements of managed floating have been introduced, such as foreign exchange interventions, crawling pegs (Hungary until the early 2000s) and intervention bands. Nominal appreciations were a common feature: they helped to contain inflation and provided strong incentives for borrowing in foreign currencies.

Evidently, the actual monetary independence of candidate countries was restricted. Their central banks had very limited resources to countervail financial markets' sentiments. Inflation targeting and exchange rate management have often been inconsistent. With a substantial part of lending and deposits in foreign currencies, integrated financial markets and foreign firms carrying their finances in euro, local monetary authorities have lost much of their leverage. The policy of the foreign banks was to extend credits (contract liabilities) in euro, but the ECB is the only entity empowered to regulate monetary flows in euro, and central banks outside of the euro area cannot refinance in the single currency. The resulting unstable configuration is that financial markets in the EU are to a great extent merged, while different segments of them are under the control of different monetary authorities.

Floaters faced a clear trade-off. From one side the introduction of the euro (which means abandoning monetary policy) is mandatory and they were well aware that external constraints are becoming more rigorous with the advance of European integration. From another, those countries considered their real convergence to be incomplete so that the remnants of monetary autonomy are still useful for fine-tuning macroeconomic conditions and for the adjustment to adverse external shocks. The assessment of the two trends (together with some idiosyncratic considerations) shaped the national euro adoption strategies.

The excuse of imperfect real convergence was easy to overcome. As the Slovenian example points out, a decided strategy is always possible, once the benefits of early entry in the euro area are firmly gauged. Immediately after accessing to EU, Slovenia abandoned managing floating (active exchange rate management consisting in consecutive small depreciations), which had served it reasonably well but contradicted the EMU logic based on successive fixing of the exchange rates. Slovenia joined the ERM II within two months with the lucid determination that the country should spend the shortest time possible in the mechanism. The eventual propitious developments compounded adequate macroeconomic policies with favourable circumstances.

The new EU members who stayed outside ERM II adopted a more ambiguous and cautious stance. The simplest argument to play down euro adoption as a priority target was that the economy is not prepared (Romania). Concerns about possible loss of competitiveness, social costs and an inappropriate mix of priorities moulded a softer attitude. The euro area was considered a consensual but distant goal requiring a series of gradual steps. Some countries (Hungary) were unable to meet nominal criteria although they were willing to adopt the euro. In another case (the Czech Republic), euro strategy consisted in a conscious "benign neglect" based on the view that external balances are solid and that the central bank is able to manage successfully a (semi)independent (but still efficient) monetary policy. This reflected a real institutional autonomy of the bank with respect to the government (not the president), as well as the lack of pressing macroeconomic constraints to change policies. In fact, the political class was satisfied that the hard measures associated with euro adoption could be postponed. Finally, a passive, "silent strategy" (Poland) fostered sceptical attitudes toward the euro. Successive governments and political parties intentionally avoided including the issue in their priorities and in electoral campaigns. The general public was kept uninformed about the practical measures and the obligations related to the common currency, whilst its unpopularity was enhanced through the promotion of dubious clichés such as the unavoidability of an inflation shock generated by the introduction of the euro. The ambiance became frankly unfriendly when the Conservative cabinet (2005-2007) and the president adopted an openly hostile position rooted in their deep ideological aversion to any supranational power. This climate sharply contrasted to the resolutely pro-euro position of the central bank.

Whatever the reasons, until the crisis, *floaters* refrained from making firm commitments. Target dates were not set or were continuously changed; official euro strategies were not elaborated upon. As a rule, forthcoming electoral contests diluted previous pledges concerning the accession to the euro area.

At the same time, it has to be stressed that no EU member can completely ignore the perspective to enter the monetary union. The complex institutional arrangement contains numerous reminders that induce and subordinate domestic policies to this goal. The regular Convergence reports, Reports on the practical preparations for the enlargement of the euro area, National changeover plans, Roadmaps, etc. are documents that oblige the authorities to formulate at least sketches of action plans. Furthermore, legislation, the nominal criteria and the other related macroeconomic indicators are continuously reviewed. Central banks, on their side, perform analytical and research studies evaluating details of the path to the euro. The conditionality framework of the European Commission (EC) exerts pressure in the same direction. When, for example, fiscal policies are discussed, they are assessed in last instance with regard to their contribution to the convergence process. Governments (Poland) who estimated that Excessive budget procedures are justification to stop the preparation proved to be wrong: while under this procedure, Slovakia succeeded to organize other tasks and jumped into the euro area once its fiscal stance was appropriate. The euro perspective is a – sometimes intangible – force of gravity which can not be escaped. More often than not, to oppose it is harmful and counter-productive: this holds true for the candidate countries, as well as for the incumbent members.

Fixers

Those economies (Bulgaria, Estonia, Lithuania, and with slight peculiarities Latvia) started the road to the euro from a very different position. They had already surrendered their monetary sovereignty and hence completely opened their economies to external shocks. The only safeguard could come from a strict fiscal stance whilst the real variables have to react in the most flexible way. The dynamics of those economies are directly dependent from the inflow/outflows of foreign capitals (namely FDI) that affect directly the monetary aggregates. From a practical point of view, in many respects CBA countries have *de facto* joined the monetary union. In institutional terms, the central banks lack the statute of members of the euro system. (Actually, their central banks will have to *add*, not – as in the case of *floaters* – to drop some functions after the entry in the euro area.)

The choice of the initial strategy by the *fixers* was almost obvious. Its first step consisted in selecting the reserve currency. Two of the CBA (Estonia and Bulgaria) were pegged to the Deutsche Mark (eventually they switched automatically to the euro). The other two opted for the US dollar (Lithuania) or a currency basket (Latvia), which induced a later re-pegging to the euro. There were no divergences concerning the time schedule: all of them foresaw the fastest entry into ERM II; the shortest possible term in the mechanism; keeping the CBA until "the end" (i. e. an unequivocal exit from the currency board by adopting of the euro). What constituted a true challenge was to convince European institutions (the IMF was a bit more open) about the compatibility of CBA with the pre-designed pattern of accession to the euro area. Doubts were voiced even in some of the candidate countries (Lithuania). The case, however, was convincingly defended (this was one of the few instances of unofficially coordinated positions among the interested candidates) and the ECB/EC shaped a favourable opinion. In statements from April 2000 and December 2003 the ECB confirmed the legal compatibility of CBA with the ERM II. The particular scheme allowed for the preservation of a fixed rate (to be negotiated, but implicitly understood to be the same as the peg) and ruled out any engagement from the ECB in support of the local currency.

The pursuit of this strategy was not as cloudless as expected.

Economic developments diverged from a smooth path and textbook basics: curbing inflation proved to be difficult in an environment of monetary/credit euphoria, asset bubbles and (often earlier than scheduled) tax adjustments. In a historical perspective, CBA have been remarkably efficient for rapid disinflation, but not able to permanently dampen price increases in rapidly catching-up economies "submerged" by foreign capital inflows. Demand expansion was only partly dampened with the limited (albeit helpful) array of available quasi-monetary tools (obligatory reserves in the central bank; government deposits in commercial banks; credit regulations; etc.). In some countries (Lithuania and, to a lesser extent, Estonia) budget discipline was not easily attained despite the verbal consensus on fiscal orthodoxy. There were examples of policy miscoordination, too. Inconsistent steps, contradictory statements or untimely decisions added obstacles.

The result is that the tight euro-adoption timetable of the *fixers* derailed. On the ERM II *entry* side there was only one (ambiguous) digression. While the Baltic states (just as Slovenia and Slovakia) entered the exchange rate mechanism at the earliest possible moment, Bulgaria is still more than two years away. The *exit* side, in turn, was completely disappointing. The most traumatic event was Lithuania's failed application to the monetary union (2006). The setback induced the adoption of stricter budget rules, and of a more flexible formulation of the target date. The rejection brought on a revision of the schedule for neighbouring countries as well: Estonia abandoned the goal of January 2007 and refrained from fixing a new date. Markets had anticipated the incident and did not react violently, but later postponements triggered downgrades of the country's credit rating. 2006 marks a turning point in the credibility of the initial programs, in confidence and expectations. On the eve of the global crisis less ambitious strategies were prevailing. *Fixers* stuck to the vague formula that they are trying to join the euro area "as soon as the convergence criteria are met".

2. The Impact of the Global Crisis

The global turmoil after September 2008 generated a brutal shock to the CEE economies and accentuated negative trends that were already perceptible since mid-2007.

Stylized Trends

In spite of many local nuances, the impact of the crisis is essentially uniform. Contagion through trade and financial channels badly hurt the core of the growth pattern, relying on external financing. The GDP slowdown registered in the autumn of 2008 and accelerated during the first quarter of 2009, investment's fluctuations being more pronounced than those in consumption expenditures. Unemployment started to increase. Risk premiums surged, money markets were paralysed, and stock markets plunged. Previously euphoric real asset prices inverted their trend. Growth rates of monetary and credit aggregates declined: widespread risk aversion, much tighter credit conditions, drying influx from liquidity-strapped parent banks to their local ownerships and preserved interest spreads over foreign markets shaped a credit crunch-like situation. Successive cuts of the (*floaters'*) central banks' interest rates did not revive credit. In those countries depreciation inflated only the figures for nominal credit growth expressed in local currency. As a whole, the banking systems did not incur systemic risks; the run against an important local bank (Latvia) was countered by a partial government takeover. Unavoidably, however, increasing amounts of problem loans started to slowly affect the balance-sheet positions of some banks. Exchange rates of the *floaters* depreciated sharply (volatility increased substantially) and they spent considerable amounts during various attempts to stabilize their currencies. Although floaters benefited from certain competitive gains which were not accessible to *fixers*, foreign demand is so depressed that export remains strangled. Exports collapsed but so did imports, thus adjusting previous current account imbalances. Due to the changed investors' sentiments, FDI declined briskly and net capital outflows were registered. In some countries, foreign reserves were reduced and even dropped to levels that threatened the stability of the peg. The inflationary peak of mid-2008 was followed by rapid disinflation; this, however, lags behind the euro area trend due to counteracting factors (depreciation of *floaters'* currencies, corrections of regulated prices). Budget revenues reacted promptly to the economic slowdown. Fiscal position worsened everywhere. Conditions for external financing deteriorated together with the increase of risk premiums and the downswings of countries' ratings.

Those events indicate the exhausting (at least for the current business cycle) of the growth pattern followed by CEE during a decade. In the West, the collapse suggested to an oblivion-prone generation pampered by the myth of firmly controlled risks and by a long series of mild recessions, that capitalist dynamics are inherently (and sometimes violently) cyclical. The canonical model for the adoption of the euro was designed in an exceptionally auspicious context that is now over. Many features that for years constituted the success and the assets of CEE briskly turned into liability. It is understandable why the current crisis triggered an inflexion of the candidates' strategy.

The Euro: A Stronger Appeal

The generalized move (noticeable since early 2008; obvious after Lehman Brothers' bankruptcy) was to speed-up the preparation for euro area entry. In the new context the cost/benefit trade-off changed dramatically, significantly increasing the appeal of the euro.

In the aftermath of September 2008 "Euroland" appeared as the best of the possible islands in a turbulent world. The common currency provided shelter, insurance against speculative attacks, effective shock-absorption and protective policy tools. An additional positive point was that the euro financial market proposed liquidity that is inaccessible to non-members. Finally, it was believed that CEE countries *within* (Slovenia and Slovakia) are hit less than the others. To be *in* meant to eliminate the most threatening risk - intense volatility of exchange rates, whose erratic dynamics are extremely harmful for the servicing of foreign currency denominated domestic and external debt. The impact is immediate for the *floaters*, but it could also be potentially explosive for *fixers* if they are forced to adjust their long-standing peg. Depreciations are particularly damaging in widely "euroized" economies where liabilities (mostly mortgages) in foreign currency expose un-hedged households (and, to a lesser extent, firms) to exchange rate fluctuations.

A strong case in favour of the euro was the manifest futility of monetary policy independence. Its main feature – a floating exchange rate – turned into a major risk, whereas the supposed benefits vanished. Previously sound policies and solid macroeconomic stance were not rewarded at all since the generalized financial contagion neutralized the available adjustment tools. The "monetary autonomy *versus* peg to the euro" dilemma lost its *raison d'être*.

Faster adoption of the euro increased in appeal in the CBA countries, as well. By default, they reacted to the crisis via *real* adjustment whose success will depend upon the flexibility (relatively high in the private sector) of wages, employment and public expenditures. However, to prolong this situation too much might be detrimental since the economy would have to continue in a quasi-euro area milieu without benefiting from full-fledged institutional insertion.

Amid the rapidly deteriorating situation and the search for global solutions, CEE authorities started quickly to compete by writing down blueprint "anti-crisis" programs. They aimed to simultaneously express concern, register activism and try to calm the public. Putting aside the uniform monetary components seeking to restore confidence/liquidity in the financial markets, the drafts differed in their particular mix of demand support, direct government interventions, spending packages, and fiscal tightening. As a rule, the first plans were self-confident, suggesting that "simplistic" Eastern Europe is more or less isolated from the calamities of hyper-sophisticated financial institutions. Eventually, the worsening forecasts left little room for illusions. Finance ministers who typically played the game of overoptimistic budgets had to revise their accounts: the needed fiscal squeeze reached 7% of GDP (Latvia, Lithuania).

Beyond those exercises in stabilization policies, interest in euro adoption awakened. "Benign neglect" or simple unawareness of the problem was no longer possible. It became evident that a hazy perspective generates uncertainty. Countries that for years had avoided any firm engagement with a target date felt obliged to indicate at least a tentative objective. The case of Poland is emblematic. Before 2008 it never mentioned the euro as key objective, but now suddenly voiced the overambitious target of 2011 (eventually corrected to 2012) in its Convergence Program. A handful of official documents and statements issued by different institutions reiterated the commitment to enter the euro area at the earliest possible date, and to consistently subordinate economic policies to this objective. The results of a vast analytical effort performed by the Polish central bank also reinforced its strong support for fast adoption of the euro. By early 2009, the focus of the target dates for the *floaters* converged to 2012-2014.

Fixers did not necessitate such major strategic shifts. Basically, they restated on an even more resolute tone the consensus that the CBA is to be preserved until the accession to the euro area: a position that rules out devaluations, considered as catastrophic events whose negative effects by far exceed any negligible short-term gains. *Fixers*, however, have to struggle with growing scepticism about the sustainability of the peg. Talks about the viability of the CBA became overt; the topic is no longer taboo. To maintain credibility in deteriorating global and local macroeconomic contexts in some cases requires (Latvia; Lithuania) the strongest pledge to restrictive practices. This is an additional incentive to shorten the pre-euro period for economies which already have (except Bulgaria) a long experience in the ERM II.

The Euro: A Moving Target

The effects of the global crisis on the attainability of the euro area are unambiguous. The budget deficit became a hard barrier for most of the candidates. Current budget position and (for some countries) the public debt prospects worsened. In order to observe on a sustainable basis the 3% threshold and to preserve chances, the most "advanced" *fixer* (Estonia) opted for a strategy of drastic budget cuts, maintaining the fiscal buffer and reliance upon the foreign reserves as long as borrowing from international markets remains difficult. Exchange rate volatility of floating currencies increased manifold. In many countries the long-term interest rates criterion is also escaping from control. Spreads augmented substantially, making access to foreign financing prohibitive for some countries. Only inflation provided some "positive" hints. Thanks to the depressed prices' growth and the crowding of the indices in a tinier band, it seemed for a while that deflationary pressures made it easier to meet the criterion. But in many cases, positive differential with euro area levels subsisted.

Given the current conditions, the optimal timing to give impetus to euro adoption seems to have been missed. The situation generates many colliding goals and makes working out a consistent strategy more difficult. Short-term stabilization aims often divert energies from the longer-term euro issue. "Anti-crisis" programs engender trends (deeper budget deficits, growing debt, future inflationary pressures) that undermine the probability of meeting nominal criteria. Demanding fiscal adjustments (with dubious outcome) could make the euro less popular. *Floaters* that are at the door of the ERM II might be reluctant to enter the mechanism while exchange rates' volatility is so high; hence the path to the euro is extended. Determining the correct parity rate becomes a conceptually and practically challenging exercise.

The optimistic momentum from the autumn of 2008 rapidly faded away. In some countries (the Czech Republic; Hungary) political reshufflings undertaken in the spring of 2009 interfered with the process of strategy-setting. The prevailing general mood is a more cautious approach and a disposition to push ahead the (choice of a) target date. Declared willingness to enter the euro area as soon as possible is hazily associated with the precondition of reaching tangible results with crisis management measures: the euro obtains anew the status of a mid-term goal; the importance of precise timing is downplayed and decisions are postponed for the end of 2009 (at the earliest); risks are put to the fore. If for the debilitated governments in Hungary and the Czech Republic this posture is in part politically determined, the move is more telling in the Polish case. Faced with the complexity of the institutional procedures, with the perceptible economic deterioration, and the unsustainable prospective to meet nominal criteria (namely to reduce the fiscal deficit below the 3% mark), authorities silently shifted the goal from 2011 to 2012. The changeover was based on the assumption that entering the ERM II could be postponed from the first to the second half of 2009, but this compromise is premonitory for a softening of the position and for a readiness to adjourn the euro adoption date, as well. The least prepared *floater* (Romania) sticks to a loose indicative date (2014) and to a gradualist philosophy. In what concerns *fixers*, the national debates about the entry date in the Baltics are interdependent. In Bulgaria, the discussion is bogged down in procedural dilemmas, whereas pleas/steps to accelerate the process (in this case – of joining the ERM II) surface only sporadically.

The new circumstances are entangled. From one side is the mounting eagerness to join the euro area and the urgent need for the candidates to speed-up the process as the cost to stay *out* increased substantially. From another, the global crisis has made it more difficult to fulfil the nominal criteria, has complicated the strategies, and has blurred the time horizon.

IV. Institutional and Policy Environment Regarding the Euro Adoption

Accession to the EMU includes a number of institutional actors whose interplay can softly accelerate or delay crucial decisions. In this ambiguous field, differences between pre/post crisis patterns are perhaps even more striking than the discrepancies in strictly economic matters.

1. Before the Global Crisis

In the calm waters before 2008, candidates to the euro area navigated with intermittent success. Two of them (Slovenia, Slovakia) were able to perform the full program, three (Estonia, Lithuania, Latvia) joined the "waiting room" of the ERM II, four countries (the Czech Republic, Hungary, Poland, Romania) opted for "independent" monetary policy and Bulgaria was not able to register any advance in the institutional itinerary to the euro. The experience gathered since 2004 outlines important patterns of the ongoing euro area enlargement.

Success Story

The apparently faultless trajectory of Slovenia is a good reference standard that highlights many of the problems faced by the other future members. The Slovenian success was based on a sober assessment of the cost/benefit balance of maintaining formal monetary sovereignty for a longer period. It was considered that the interest of the country is to adopt the common currency as early as possible, ERM II being treated as a risky arrangement with built-in instability. Once conceptual alternatives were cleared, the policy mix was consistently subordinated to the aim, while a firm commitment was declared about the nearest credible target date. This permitted a quiet stay in ERM II with marked exchange rate departing insignificantly from the central parity. The exact timing of the key decisions was of prime importance. A lead with a mere couple of months mattered: the admission in the exchange rate mechanism at the end of 2004, instead of June 2004 (as it happened), would have delayed the euro by a year. At the exit from ERM II timing was equally important: the early request for the Convergence report in May 2006 (instead of the year's end) coincided with the most favourable outlook for the nominal criteria, in particular for inflation.

Of course, the Slovenian example is not directly transposable to other countries. Its success rests to a great extent on its close level of GDP/capita (and correspondingly of the price level) to the EU average. Slovenia combined propitious external circumstances, bureaucratic good fortune, a relatively high welfare level and (something that is not uttered) a cultural closeness to "Europe". But this case contains also the essential ingredients of its success – a well designed strategy, coherent policies, good timing and the responsive attitude of the European institutions. The failure of other countries to attain their objectives is due, at least partially, to the absence of some of those elements.

ERM II: a Delicate Threshold

A critical point in the path to the euro is entry into the ERM II. According to the existing arrangements, there are no formal criteria for the applicant, which creates space for complex (not to say arbitrary) judgments. An important peculiarity is that the opinion of the ECB at this stage is crucial, whereas the bank has no veto power when a country exits from the exchange rate mechanism to join the euro area. The experience so far shows that the missing quantitative indicators have been substituted by a set of narrative conditionalities. They engage the candidate to follow macroeconomic policies aimed at convergence with the Maastricht targets and reducing external imbalances. In fact, there are no financial penalties for non-compliance; it is current practice to deviate from initial promises.

A very sensitive issue for *fixers* is the determination of the central parity. Although the level has been questioned during the preliminary discussions, in the three cases the exchange rate of the peg was preserved. Actually, there is no economic rationale to touch a parity that has been maintained for years. In what concerns *floaters*, they try to find the sustainable equilibrium rate which supposes to let market forces work as freely as possible.

The record of Bulgaria is an edifying counter-performance. Well before accession to the EU, a clear-cut and ambitious strategy was formulated. It was expected that the country will immediately join the ERM II and after the minimal term of two years will enter the euro area. The schedule was re-confirmed by three successive governments only to stand in front of a complete deadlock since 2007. Bulgaria met four out of five Maastricht criteria (the only one missed was inflation), but its external position (excessive current account deficit) was assessed as unsustainable by the ECB. Deeply suspicious to CBA, the ECB was convinced that considerable adjustment and significant financial needs are unavoidable in the mid-term. The informal weighing of the different trends lead to an overall negative outlook which was not overcome by the encouraging hint that the euro area's finance ministers agree in principle with ERM II membership, or by the readiness of Bulgaria to accept any kind of conditionality. From the political side, the government is in an extremely weak bargaining position. Hurt by a reputation problem (corruption; judiciary power), it found itself mired in the impossibility to activate any diplomatic and political instruments in support of ERM II entry. Access to European funds was at stake and considered a much higher priority than the prospective to adopt the euro. (A similar trade-off was observed in Hungary at the early stage of its membership.) Accordingly, the authorities diverted their main efforts to assure the transfers and adopted a low profile concerning the euro. They did not dare to raise the issue and to risk a formal veto by the ECB, preferring to follow a "no application – no rejection" policy. The timid breakthrough achieved by the end of 2007 was not developed further. Fast track to ERM II dropped from the government's agenda before succumbing to the rearranging of the European agenda with the outburst of the crisis. In late 2008 – early 2009 the prime minister attempted to stage an unconvincing comeback of the topic. It was met by the indifference of Europe and the opposition of his own finance minister. The latter expressed publicly the opinion that rapid accession to the ERM II is not a priority, that the national project is maintaining the CBA (not pursuing the euro), and that the only valid goal for the moment (March 2009) is macroeconomic stability. The ministry of finance had given up and had stopped any practical preparation. The Bulgarian example illustrates how a constellation of adverse factors can tacitly block admission to ERM II. There were no written rules, nor was there explicit denial. But the informal blend of political, economic, even cultural considerations from one side, and of wrong priorities, poor organization and the political insignificance of the country from the other, suffices to bar the road to the euro.

Adequate coordination between the relevant institutions is one of the important conditions for a smooth procedure. Joint programs were adopted in many countries by the ministries of finance (or the governments) and the central banks. Good relations between them definitely added synergy and credibility to the process. Inversely, frictions debilitated the negotiating positions. As a rule (with the remarkable exception of Poland since 2008), central banks have been the more resolute pro-euro promoters and carry out the bulk of the technical preparation for the accession. Governments pursue a wider range of objectives, which can contradict the euro-related targets. Ministers of finance have argued, for instance (Estonia, 2006), that development is more important than the common currency and that they will not sacrifice growth for the sake of the nominal criteria (inflation). In other instances (the previously cited example of Bulgaria, 2009), the clash inside the administration was more visible.

Political Economy of the Euro Adoption

Before the crisis, the euro was rarely at the centre of the political debate in most candidate countries. Since the choice is *when,* not *if*, there was a vague consensus, broken only while this seemingly technical issue without any substantial electoral appeal touches more down-to-earth problems. The common case is to utilize the euro roadmap for selling unpopular measures: its requirements are presented as unquestionable conditions that impose strengthening of the financial discipline, budget cuts or overall budget balancing.

Some particular political contexts, however, have transformed the topic into a hotly discussed subject. In the Czech Republic, important constituencies oppose the euro: the sceptical position of the president has a direct impact since he is empowered to nominate the board of governors of the central bank. In Poland, political considerations have had an even stronger incidence. They focused in the issue of a referendum about the necessary constitutional amendments (an idea launched by the president and his party), which became an essential piece of euro-politics after October 2008. (The possibility of a referendum was also discussed in Estonia in 2005.) By turning support for the Euro into a pre-condition, the referendum added uncertainty and undermined credibility. To enter ERM II without political consensus on constitutional changes would increase the risks: discrepancies already accentuated the exchange rate volatility. This undoubtedly contributed to the shift of the target date from 2011 to 2102, while the pro-euro monetary authorities had to explicitly link their backing for the ERM II application to prior constitutional amendments. Eventually, during the spring of 2009, worsening financial conditions weakened the position of the opponents to the euro and dampened the legal/political disagreements. The debate was focused again on the economic attainability of the common currency. The Czech and Polish cases highlight the importance of the political business cycle. Matching political and economic considerations is a delicate play whose results are most of the time far from optimal rationality. In terms of euro-strategy this means that the actual schedule often misses (lags behind) the desirable one due to extra-economic reasons.

The counterparts of the candidate countries are the European institutions whose general attitude and concrete practices determine the pace of the euro area's enlargement. Their approach has evolved. Soon after the establishment of the monetary union, future members were considered mostly from the point of view of real convergence. Given the distant horizon, the debate was still chiefly academic. The implicit understanding that EMU membership presupposes sufficiently close welfare levels was widespread. At the approach of the accession of the CEE countries, this exclusive assumption was gradually relaxed without being completely rejected. A more pragmatic attitude recognized that sticking to uniform development levels would postpone enlargement indefinitely. In fact, historical evidence points out that even substantial inter-regional GDP/capita inequality within individual countries are not an obstacle for the existence of national currency areas. Arguments were provided that the euro area with the new CEE members would be at least as optimal a currency area as with the less developed incumbents. Actually, the first wave of enlargement met a favourable stance, a readiness to consider on a case-by-case basis every applicant susceptible to fulfil the criteria in a reasonable time span. The outcome was a rapid admission to ERM II but a very selective one for the EMU. During the following years emphasis shifted to the sustainability assessment which added randomness to the process. With only one new member (Slovakia) and no changes at all in the statute of the other countries, the immediate pre-crisis period could be considered very cautious. As a whole, this parsimonious outcome is hardly a demonstration of openness. Global turmoil, of course, only increased reticence to enlargement.

Changing attitudes were not translated into bold statements, institutional/legal or procedural transformations, but into differing nuances of interpretation. Although founded, the rejection of the Lithuanian application in 2006 was seen as a penchant for the strictest possible scrutiny of the formal criteria. Rules at the two check points (ERM II; euro) are sufficiently flexible to allow for soft opinions. Entry in the exchange rate mechanism is not formalized at all, which implies the use of panoply of quantitative and qualitative evaluations. Entering into the monetary union is much more "quantified", but the convergence criteria are complemented by other factors such as "the results of the integration of the markets, the situation and development of the balance of payments on current account and an examination of the developments of unit labour costs and other price indices" (Article 121 (1) of the EU Treaty). Sustainability is an even more ambiguous, less measurable and difficult to enforce concept. It is no wonder that suspicions of double standards (unequal treatment) have emerged. They are based on asymmetric differences in the macroeconomic performances of accepted/rejected countries; on a relative worsening of indicators (vis-à-vis non member counties) once in the euro area; on non-compliance with Maastricht criteria, and by EMU members without serious sanctions. The admission procedures are widely treated as political instruments that regulate enlargement according to altering perceptions of the European institutions (the incumbent states). In fact, *policies* have managed to change within a fairly stable legal framework.

Finally, an important part of the political economy of euro area enlargement is the concomitant reshuffling of the ECB governance structure. The entry of Slovakia (the 16th member of the euro system) had to trigger a new voting system foreseeing for the first time a rotation procedure in the board. This move was suspended until three more central banks join the monetary union. The decision is symptomatic about a latent concern of the viability of ECB governance with a growing number of members. The board seems convinced that the institutional interest of the bank and its manageability could be preserved only as long as the moderate size of the euro area is maintained. The question is not so much about numbers but about the mix introduced by entrants who bring in heterogeneous monetary cultures, sensibilities and legacies. This problem adds *internal* uncertainty to an entity already facing the major challenge of being the only authentic federal institution in a fiscally and politically fragmented Europe.

2. The Impact of the Global Crisis

The ongoing crisis is not only rearranging the global financial architecture but also the rules and the geometry of the financial relationships inside the EU. Whatever the speed and scope of the changes, it is clear that the concentric monetary structure of Europe (euro area; ERM II; non ERM II countries) causes concerns. The turbulences asymmetrically affect every one of those elements, the national strategies and the political economy of the process, the optimal timing to join the ERM II or the Euro.

Policy Puzzles

The coherent institutional arrangements inside the monetary union permit it, in principle, to take consistent measures. *Euro area countries* are believed to be best protected against the crisis through the single currency, and are afforded easier access to finance, institutionalized support and solidarity among themselves and from the ECB. However, deep economic (namely interest rate) differences among members persist and hamper monetary policy. *Fixers* (into ERM II) are in most vulnerable position: they do not suffer from exchange rate instability but face a harsh test of their peg. *Floaters* have to tackle exchange rate fluctuations with a set of debilitated instruments. According to its statutory obligations, the ECB assisted ERM II members (Latvia), but participated also in euro swaps with central banks outside ERM II (Hungary) without imposing conditionality. Albeit outside the common monetary structure, the latter had to be supported in view of the feedback impulses sent to the core of the monetary union and the menace of contagion. Monetary policies have to take into account developments outside the union, as well. Handling of this byzantine configuration was based on *ad hoc,* case-by-case measures and for the time being, lacks neat strategy and firmly established rules.

The first reactions to the crisis combined urgent design of rescue packages with ideas to push ahead the Grand project about the euro. National authorities tried to present in every possible manner their country case as unique (usually on the good side). A one-size-fits-all approach to the region was blamed, differentiation evoked, and common actions avoided. The dominant vision in the east was that economies should be helped according to their specific needs and it was often observed that a few euro area countries (namely Ireland, Greece and Spain) are in worse shape than, say, Poland or the Czech Republic. Markets were "accused" for their pessimistic global view which does not discriminate the risks proper to each country, thus unfairly penalizing "decent" economies.

The stabilization efforts introduced a new institutional actor in the euro strategy. Quite unexpectedly, the IMF entered (returned) to the scene by affecting directly or in indirect manner the path to the monetary union. Assistance of different kind was provided both to *floaters* (Hungary, Poland, Romania) and to *fixers* (Latvia, possible call is discussed in Lithuania and Bulgaria). Funding came to cope with the most pressing needs, essentially the support of the fixed exchange rate (Latvia), the replenishment of foreign reserves (Latvia, Romania), or financing of budget deficits (Hungary, Romania). A new facility was created for boosting credibility (even without making immediate disbursements) of countries with good macroeconomic fundamentals and policies (Poland). The distinctive feature of the arrangements is their unusually softer conditionality. (In Romania the stand-by agreement allowed for higher deficit than the –overoptimistic – government draft.) IMF support refrains from fiscal stimulus, enhances budget discipline and provides opportunity for external financing when the market conditions are extremely unfavourable.

IMF involvement complicates the institutional environment of the euro area enlargement. A conditionality hierarchy between the IMF, European entities and other contributors had to be established. Progress evaluation is made jointly with the EU (Hungary), but diverging positions have been expressed. The IMF, for instance, leaked rumours of a favourable opinion concerning fast track to the euro, or recommendations to devaluate in a CBA country (Lithuania). Some points of the stand-by agreements are explicitly incorporated in documents referring to national Euro strategies or referring to the fulfilment of Maastricht criteria. Inversely, ECB and EC have not been directly associated in the negotiation of IMF loans (Poland).

The informational background becomes so complex that governments are not able to work out consistent communication policies: there are continuous "forecast fights" where outlooks originated in international financial institutions or in the European institutions overrule those of the local authorities. Typically, the former are gloomier and largely shape public expectations at home and abroad about the euro timetable. To follow a coherent strategy in this context is extremely difficult.

The major, probably decisive, shift in the euro enlargement landscape is the hardening of the incumbents' position. The familiar view is that acceleration of the process in a highly turbulent environment adds risks, diverts political and administrative energy from the more pressing crisis management tasks. Such evaluation is shared by many decision-makers in CEE who do not oppose a more cautious attitude. As it is now, this outlook governs the position of the European institutions concerning ERM II and the near future of the monetary union. The problem is that a "wait and see" approach is prone to other dangers, while a "siege mood" inside the euro area leads to piecemeal (suboptimal) solutions for an intrinsically global issue of overall interest to the EU. Common sense suggests that there is no point to leaving currencies floating in countries where most deposits and credits are denominated in euro and therefore any exchange rate movement may be detrimental to banking or corporate stability; that it is hazardous to keep some countries indefinitely *outside* because their risk is not neutralized: as far as European banks dominate the market, risks are transferred to the euro area. A further delay means keeping a zone of macroeconomic instability on the EU periphery and, in political terms, to design a de-facto two speed Europe.

V. Conclusion: Perspectives

In the current situation, the intricate perspective of the EMU is characterized by the following (often contradictory) aspects: increasingly integrated financial markets calling for a single currency and common institutional (*inter alia* supervising) entities; general willingness among the non-euro CEE countries to adopt the euro and to speed-up the process; extremely rigid accession rules; reluctance of the incumbent countries/institutions to enlarge the monetary union in the short-term; real economic risks and uncertainties that do not encourage tranquil and strategic decision-making. The ambiance is propitious for new (revived) ideas, policy combinations and legal constructs. Since the autumn of 2008 the public debate on the prospects of the euro has been remarkably active. Discussions go on along three main vectors: possible amendments to the existing enlargement criteria, fast-tracks to the common currency and sustainability of the existing monetary regimes outside the euro area.

Exploring New Options

Nominal criteria have been subject to criticisms since their inception. Ten years after the launching of the euro it is frequently reminded that the criteria's design corresponds to a different reality and to a much smaller and homogeneous economic union. Academic research, but also negotiation tactics (Estonia), have pointed out that the Maastricht criteria suffer from serious shortcomings when applied to less developed, rapidly converging countries; that a narrow technocratic interpretation of the price stability criterion is unfair for such economies; that there are inconsistencies between the inflation and exchange rate stability criteria (impossibility to control them simultaneously). The recent debates have suggested different adjustments, modifications in the application and/or in the interpretation of the rules in order to soften them. What follows is a far from an exhaustive list:

- Inflation: to base it on the euro area inflation rate instead of taking into account non-member countries' rate; to review the "three best performing" benchmark (for example, to use a rate close to the ECB 2% target).

- Fiscal deficit: to replace the absolute benchmark with an average (like the "three best performing ones").

- Exchange rate stability: allow more flexibility in the current turbulent period for countries committed to sound fiscal policies and with institutional maturity – to treat candidates not as homogenous block but to punish or reward them according to their individual failure/success.

- Not to rely excessively on the assessment of performance "sustainability".
- Smallness is sometimes mentioned: the weight of the future entrants is so insignificant that negative implications for the monetary union are impossible.

The simplest *fast-track* scheme discussed is to eliminate or to shorten the two years period in the ERM II (namely by including in it the post-decision period of six to eight months). But the really far-reaching proposals in this field concern unilateral *euroization*. (A slightly amended version is the use of the euro as a joint legal tender, i.e. the parallel use of two currencies.) The idea has circulated for many years as an exotic academic suggestion. With the onset of the global crisis it acquired not only larger audience, but also a sort of fashionable respectability. Euroization surfaced from the intellectual underground to be debated without taboos, even by officials. It is presented as an easy, quick fix and a technically straightforward solution. Actually, euroization is a natural exit strategy for CBA countries in case of a possible currency crisis. Unilateralism, however, brings serious economic inconveniences, which remind in certain points those of the CBA: the country is not institutionally integrated in the eurosystem and constitutes a second-order holder of the single currency; the ECB liquidity facilities are not accessible; senorage is lost; euro in circulation are not freely issued but "bought", which boils down to a capital loss equivalent to an important fraction of foreign reserves. Furthermore, euroization in no way eliminates deeper structural problems of the economy. Exchange rate risk is simply transformed into country risk, but the latter augments everywhere: the economies in the euro area are not immune at all.

Economic versus Legal Logic

All proposals about amendments or faster procedures have been boldly and repeatedly rejected by European institutions on the grounds of legal, economic and political arguments. Equal treatment and impossibility to revise the Treaty are regularly invoked as absolute legal constraints. The legitimate concern about a negative impact on the credibility of the euro is advanced as the key economic reason. The EU has demonstrated good will only for targeted measures tackling urgent monetary issues (the establishment of the 50 billion euro fund for the financial stabilization of its members), or for stressing the responsibility of parent banks from old EU members vis-à-vis their subsidiaries in CEE. Any across the board bail-out plan has been ruled out. Unilateral euroization is considered blasphemy, all the more that its incompatibility with the Treaty was officially proclaimed long ago (April and December 2003). The recent clues of empathy in this direction from the IMF have been dismissed.

In fact, CEE countries are trapped in an unsolvable equation with merely controllable (rational) economic variables and completely out of reach (often economically irrational) legal parameters. *Realpolitik* is the only permitted game in town and there is hardly a more expressive "personalized" illustration of the status-quo's strength than the "conversion" of the Polish Finance Minister Jacek Rostowski. (Cf. the *Country Report* on Poland). Widely known as one of the most prominent and respected academic advocates of euroization, Rostowski abandoned the idea after taking office in 2007 and adopted a strictly legalistic approach to the euro. The intellectual twist was explained with the argument that euroization could have been an adequate step in the unstable pre-accession macroeconomic milieu of the late 1990s (characterized by expanding public debt and untamed inflation), but owing to the significant progress in macrostability that made it possible to fulfil most if not all of the Maastricht criteria, such radical move becomes needless. The Polish government (like any other) has no political choice other than to stick to the orthodox euro adoption strategy. The tacit disregard of the proliferating fast-track proposals by the once fervent adept of euroization is a symbolic sign, his major personal contribution to the credibility of the process. The question of why he does no longer consider euroization a viable option is related to the sociology of science, not to scientific integrity. This is one more case of the existential split (so proper to the economic profession) between the point of view of economic theory and that of the policy-maker: a split where the pragmatic institutional standpoint typically overrides academic considerations.

Confirmation of orthodoxy (sometimes after doubts and discussions) is noticeable in other countries as well. Euroization and relaxation of the criteria, for instance, were rejected in Lithuania, where the focus of policies is back on fiscal balances and low inflation. It is assumed that softening is likely to reduce the benefits of EMU membership and that the most effective strategy seems to be prioritizing the nominal criteria by making other domestic policies consistent with this goal. For the most tormented *fixer* (Latvia), the IMF has speculated on a radical acceleration of the adoption of the euro at a depreciated exchange rate, but the idea was rejected by local authorities. A "conformist" position is shaped by the trade-off between political and economic considerations, too: European institutions have access to sufficiently efficient instruments (like funding) to retaliate to undesirable digressions and to dissuade through potential political complications. To essay actions that will be rebuffed with a high price in terms of credibility is counterproductive.

This explains why more candidates prefer to declare allegiance to the established ritual than to try bravados.

As it stands now, the probability for major changes in the existing modus operandi are insignificant. This holds true despite the iconoclastic ambiance of the global crisis. To rely on the illusive, apparently general, cheerful keenness to breach long established rules is tempting but misleading. Even in periods of chaos not everything is permitted.

The institutional/legal fetters, however, should not discourage any intent to rationalize an overregulated procedure. Good luck, favourable timing or suddenly acquired bargaining power has to be utilized. Despite the fact that precedents are deceiving and that the trend is centrifugal, rare occasions when coalition building is feasible should be seized. In this eminently political game, negotiation skills are a precious asset: they are more so in fuzzy situations such as the Bulgarian entry in ERM II, where intelligent, self-confident diplomacy (not paralyzing fear) could have helped. Consolidation, coherence and administrative support of the national position are other reserves. Finally, a country's image problem may represent a major obstacle to be overcome.

Shortening Transitory Arrangements

Shifts in the *monetary regimes* of the non-euro CEE countries are economically and legally unavoidable. The crisis emphasized the economic case for this move. Opportunity costs to stay out outweigh the benefits from continuing with the existing half-tinted arrangements. *Floaters* have (and want) to cross two institutional milestones and they particularly dislike the ERM II, which (according to their experience) is considered just a necessary evil. *Fixers*, in turn, are most interested to quit orderly a transitory (half-way to the euro) regime. The robustness of CBA is frequently underestimated (if not misunderstood) outside of those economies. The crisis only confirmed that the currency board is a monetary standard that can (with the adequate support of other policies) no less than other alternative regimes contribute to real convergence and to economic stability. In fact, the system is homeostatic and in the European context (unlike in Argentina) its hypothetical debacle would provoke a spontaneous euroization that – at the end of the day - will have to be sanctioned by the EU. For *fixers*, however, a disorderly option or long waiting period is definitely not desirable. Those countries are keen to leave the "imitative/truncated" regime and to benefit from authentic membership in a monetary union.

The experience of CEE countries does not validate a single monetary regime in the sense that neither the *floaters*, nor the *fixers* have recorded a distinctly better success rate. Membership of Slovenia and Slovakia are not indicative as they are, owing to many specific circumstances, unrelated to the monetary regime. In the current uncertain context both standards are vulnerable, with ambiguous qualities/liabilities. The crucial advantage of the *fixers* is that they got accustomed to conditions that are similar in many aspects to those in the monetary union. For them the future shift will be smoother.

The bottom line is about the *time spent before the regime change* in the candidate countries. An indefinite extension of the period might require protracted austerity policies justified by the defence of the currency stability. This could generate political tensions and, ultimately, result in a decline in public interest or support for the euro. A "Swedish syndrome", some argue, could appear and spread across "willing-but-kept-aside" candidates. This will be damaging for those that are *in*, for outsiders and for the single currency itself. The prospective for the enlargement of the most far reaching project in monetary engineering, however, seems more unclear than ever.

VI. Appendix

TARGET DATES FOR JOINING ERM II
AND ADOPTING THE EURO*

ERM II	BG	CZ	EE	LT	LV	HU	PL	RO	SL
2002									
2003						2004			2004
2004	2007		XXX	XXX					XXX
2005					XXX				
2006									
2007	loose discussions								
2008		2013				2009/ 2010	2009		
2009	2009/ 2010							2012	

EURO	BG	CZ	EE	LT	LV	HU	HU	RO	SL
2001						2006			
2002									
2003						2008			2007
2004	2009 at earliest		2007	2007		2010			
2005					2008	2010			
2006			2008						
2007	no precise target		2011			2011/ 2012			XXX
2008		2013		as soon as possible		2012/ 2013	2011/ 2012	2014	
2009			2011				past 2012		

* **Based on the facts and comments provided in the *Country Reports.***
The target dates are from official documents or statements.
XXX - Date of the effective entry in the ERM II or the Euro area

HICP Inflation, %, annual average

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Reference Value	**2.7**	**3.1**	**2.9**	**2.7**	**2.2**	**2.5**	**2.8**	**2.8**	**4.0**
Bulgaria	10.3	7.4	5.8	2.3	6.1	6.0	7.4	7.6	12.0
Czech Republic	3.9	4.5	1.4	-0.1	2.6	1.6	2.1	3.0	6.3
Hungary	10	9.1	5.2	4.7	6.8	3.5	4.0	7.9	6.0
Poland	10.1	5.3	1.9	0.7	3.6	2.2	1.3	2.6	4.2
Romania	45.7	34.5	22.5	15.3	11.9	9.1	6.6	4.9	7.9
Estonia	3.9	5.6	3.6	1.4	3.0	4.1	4.4	6.7	10.6
Lithuania	1.1	1.6	0.3	-1.1	1.2	2.7	3.8	5.8	11.1
Latvia	2.6	2.5	2	2.9	6.2	6.9	6.6	10.1	15.3
Slovenia	8.9	8.6	7.5	5.7	3.7	2.5	2.5	3.8	5.5

Government Balance, % of GDP

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Reference Value	**-3.0**	**-3.0**	**-3.0**	**-3.0**	**-3.0**	**-3.0**	**-3.0**	**-3.0**	**-3.0**
Bulgaria	-0.3	0.6	-0.8	-0.3	1.6	1.9	3.0	0.1	1.5
Czech Republic	-3.7	-5.7	-6.8	-6.6	-3.0	-3.6	-2.6	-0.6	-1.5
Hungary	-2.9	-4.0	-9.0	-7.2	-6.4	-7.8	-9.2	-4.9	-3.4
Poland	-3.0	-5.1	-5.0	-6.3	-5.7	-4.3	-3.9	-1.9	-3.9
Romania	-4.7	-3.5	-2.0	-1.5	-1.2	-1.2	-2.2	-2.5	-5.4
Estonia	-0.2	-0.1	0.3	1.7	1.7	1.5	2.9	2.7	-3.0
Lithuania	-3.2	-3.6	-1.9	-1.3	-1.5	-0.5	-0.4	-1.0	-3.2
Latvia	-2.8	-2.1	-2.3	-1.6	-1.0	-0.4	-0.5	-0.4	-4.0
Slovenia	-3.7	-4	-2.5	-2.7	-2.2	-1.4	-1.3	0.5	-0.9

Government Debt, % of GDP

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Reference Value	**60.0**	**60.0**	**60.0**	**60.0**	**60.0**	**60.0**	**60.0**	**60.0**	**60.0**
Bulgaria	74.3	67.3	53.6	45.9	37.9	29.2	22.7	18.2	14.1
Czech Republic	18.5	25.1	28.5	30.1	30.4	29.8	29.6	28.9	29.8
Hungary	54.2	52.1	55.8	58.1	59.4	61.7	65.6	65.8	73.0
Poland	36.8	37.6	42.2	47.1	45.7	47.1	47.7	44.9	47.1
Romania	24.6	25.7	24.9	21.5	18.7	15.8	12.4	12.7	13.6
Estonia	5.2	4.8	5.6	5.5	5.0	4.5	4.3	3.5	4.8
Lithuania	23.7	23.1	22.3	21.1	19.4	18.4	18.0	17.0	15.6
Latvia	12.3	14.0	13.5	14.6	14.9	12.4	10.7	9.0	19.5
Slovenia		26.8	28	27.5	27.8	27	26.7	23.4	22.8

Long-term Interest Rates, % annual average

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Reference Value				**6.1**	**6.3**	**5.4**	**6.2**	**6.4**	**6.3**
Bulgaria			8.26	6.4	5.4	3.9	4.2	4.5	5.4
Czech Republic	6.94	6.31	4.87	4.1	4.8	3.5	3.8	4.3	4.6
Hungary	8.55	7.94	7.09	6.8	8.2	6.6	7.1	6.7	8.2
Poland	11.79	10.68	7.32	5.8	6.9	5.2	5.2	5.5	6.1
Romania							7.2	7.1	7.7
Estonia				5.2	4.4	4.0	4.3	5.7	8.2
Lithuania			5.97	5.3	4.5	3.7	4.1	4.5	5.6
Latvia				4.9	4.9	3.9	4.1	5.3	6.4
Slovenia					2.49	3.81	3.9	4.54	4.67

ERM II or Eurozone Membership

	ERM II	Eurozone
Estonia	28 June 2004	
Latvia	2 May 2005	
Lithuania	28 June 2004	
Slovenia	28 June 2004	1 Jan 2007