Appendix 4

Outlook for EMU expansion in coming years

On May 1, 2004, ten new countries became Member States of the European Union (EU): Estonia, Cyprus, Latvia, Lithuania, Malta, Poland, Slovakia, Slovenia, the Czech Republic, and Hungary. A scant three years later, on January 1, 2007, Bulgaria and Romania joined them. According to the Maastricht Treaty, EU entrants must adopt the euro when they have achieved sufficient economic stability; that is, when set convergence criteria have been met. Only two Member States – Denmark and the United Kingdom – have been granted a formal exemption from this requirement. Therefore, all other EU accession countries plus Sweden must adopt the euro at the first suitable opportunity

The Maastricht criteria

Considerable preparation must take place before countries can adopt a common currency. Increased economic convergence among members of the European Monetary Union (EMU) is considered a prerequisite to successful adoption of the euro. In order to ensure that this convergence takes place, EMU members must meet certain economic conditions usually referred to as the Maastricht criteria.[1] These requirements centre on the following economic fundamentals: inflation, interest rates, exchange rate stability, fiscal performance, and public sector debt.

Table 1 The Maastricht criteria

Requirement	*Description*
Price stability	The inflation rate of a given Member State must not exceed by more than 1.5 percentage points that of the three best-performing Member States in terms of price stability.
Interest rate differential	The nominal long-term interest rate must not exceed by more than 2 percentage points that of, at most, the three best-performing Member States in terms of price stability.
Exchange rate stability	Member States must have participated in the European Exchange Rate Mechanism (ERM II) for at least two years without severe tensions and without currency devaluation. Their currency may not deviate by more than ±15% from the median value determined by ERM II.
Fiscal performance	The fiscal deficit may not exceed 3% of GDP.
Public sector debt	Public sector debt may not exceed 60% of GDP; otherwise, the ratio must have diminished sufficiently and must be approaching 60% at a satisfactory pace.

1. So named for the Dutch city Maastricht, where the treaty stipulating the criteria that countries must fulfill in order to adopt the euro was signed.

In addition to these economic requirements, EMU members must fulfill specified conditions concerning institutional infrastructure. Furthermore, prospective members must implement certain monetary policy changes aimed at guaranteeing the central bank's independence from the government.[2]

EU accession countries[3]

Of the 10 countries that became EU Member States in 2004, seven of them had the stated objective of adopting the euro as soon as possible. As a result, Estonia, Cyprus, Latvia, Lithuania, Malta, Slovakia, and Slovenia joined ERM II soon after joining the EU. Three of these countries have already adopted the euro – Slovenia on January 1, 2007, and Cyprus and Malta a year later – thus joining the 12 countries that had previously done so.[4] Slovakia will be the 16th country to adopt the euro. On May 7, 2008, the European Commission announced that Slovakia fulfilled all of the Maastricht criteria and could therefore proceed with its plans to begin using the euro on January 1, 2009.

Estonia and Lithuania had planned to adopt the euro on January 1, 2007, and Latvia on January 1, 2008; however, none of them fulfilled the Maastricht criteria in time to carry out their plans because of the difficulty in meeting price stability criteria. As a result, they were forced to abandon those plans. Inflation has been on the rise in Estonia, Latvia, and Lithuania in the recent term, and inflationary pressures are still evident, due in part to exogenous factors such as high oil and commodity prices. Forecasts indicate that inflation in these countries will not fall to levels compatible with the Maastricht criteria until after 2009. It is considered that Lithuania could perhaps adopt the euro after 2010, Estonia beginning in 2011, and Latvia some time during the period 2012-2014.

Non-ERM II countries

One of the first steps a country takes towards adoption of the euro is to join ERM II. Of the 12 countries that have joined the EU since 2004, Poland, the Czech Republic, Hungary, Bulgaria, and Romania have not joined ERM II. The governments of the Czech Republic, Poland, and Hungary have decided that ERM II membership shall last as short a time as possible so that the convergence requirement concerning exchange rate stability is fulfilled. Therefore, the exchange rate of these three countries' currency will not be pegged to the euro until about two years prior to the planned adoption of the euro.

Poland, the Czech Republic, and Hungary, apart from not having joined ERM II, are all countries with a fiscal deficit in excess of the requirement for public sector performance. They are now working on

2. Further information on the Maastricht criteria can be found on the website of the European Union: www.europa.eu.
3. Further information on the EU accession countries discussed in this section and the following section can be found on the websites of their respective central banks.
4. The 11 EU Member States that have been members of the EMU since its inception and adopted the euro on January 1, 1999 are as follows: Austria, Belgium, Finland, France, Holland, Ireland, Italy, Luxembourg, Portugal, Spain, and Germany. Greece adopted the euro on January 1, 2001, the 12th country to do so.

measures designed to improve fiscal management. Apart from Slovakia, Poland is the only EU accession country that is close to meeting the price stability requirement. Until recently, inflation in Poland was within the limits stipulated in the Maastricht criteria. However, inflation has increased in the recent term because of rising food, energy, and oil prices. Higher wage costs have also increased inflationary pressures. Current forecasts indicate that inflation in Poland will return to levels compatible with the Maastricht criteria in 2010. The Polish, Czech, and Hungarian governments have not specified an exact date for the adoption of the euro, apart from declaring that they will adopt it as soon as possible. It is clear, however, that they will not be able to do so until at least 2011.

Bulgaria and Romania joined the EU nearly three years later than the 10 countries discussed above; therefore, they have had a shorter time to prepare to adopt the euro. However, both Bulgaria and Romania have ambitious plans for doing so. The Bulgarian government aims to join ERM II soon and to adopt the euro as soon as possible. Romania aims to adopt the euro in 2014.