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EU Newer Member States: Monetary Integration Maturity

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For the Newer Member States (NMS), since 2004, the issue of convergence and stability is vital. The NMS have made remarkable progress in terms of macroeconomic stabilization. While all of the eleven NMS transformed their planned economies into market economies and integrated them through trade and financial relations into the EU, five of them took the additional step of integrating into the Eurozone – Slovenia (2007), Slovakia (2009), Estonia (2011), Latvia (2014), and Lithuania (2015).

The others, who are not members of the Eurozone, acceded to the EU in 2004, 2007, and 2013 after the euro was launched. At the time of their accession, they did not meet the Maastricht criteria for adopting the euro. Their Treaties of Accession allow them time to make the necessary adjustments. They are EU MS (member states) with "derogation." Among non- Eurozone NMS, only Romania has a target date for the euro adoption - 1 January 2019. The others (Bulgaria, Croatia, the Czech Republic, Hungary, and Poland) still do not have a target date; however, all of them have the obligation to adopt the euro as part of their EU membership.

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EU accession and euro adoption has already served as a powerful focal point and driving force for economic, monetary, and exchange rate policies, and has directed policy-makers and the market.

In the process of transformation from planned to market economies, institutions, and policy frameworks play a key role. Aiming at real convergence – structural and institutional – it is important, as the real GDP per capita levels in the NMS are still lagging far behind those in the Euro area.

There are much greater immediate benefits for the small NMS countries to join the Eurozone than for the larger ones in terms of nominal and real convergence. The small EU MS that are also members of the Eurozone are in favour of new EU economic governance, as they see this from the prospective of economic stability and sustainability that should lead to real convergence. They also aim at avoiding geo-political risks that could negatively impact inflows of foreign investments and joining the Eurozone as a geopolitical choice. In addition, a transparent and competitive market, the single euro payment area, and more cross-border trade impact positively on economic growth. This furthermore reduces the risk of losses caused by global currency fluctuations. Some NMS made a decision to keep the exchange rate fixed. In 2004, three NMS (Estonia, Lithuania, and Slovenia) joined the Exchange Rate Mechanism II (ERM) and three other NMS (Latvia, Malta, and Cyprus) and Slovakia joined in 2005. Having a fixed exchange rate implies that monetary policy independence is largely gone; however, it is commonly aknowledged that euro area accession brings benefits as the result of joining the Eurozone and being part of the monetary policy decision-making process. Poland, Hungary, the Czech Republic, Romania, and Croatia are not yet part of ERMII.

The position of the NMS who are not members of the Eurozone relate to their monetary integration maturity; this maturity is fluid and depends on political and economic challenges at the EU and national levels. For example, the system of vote rotation at the European Central Bank (ECB) and the adoption of the euro by a number of small New EU MS has led, de facto, to a reduction of the impact of the smaller individual countries in the ECB decision-making process. This coincided with Lithuania's adoption of the euro in 2015.

Joining the euro also has beneficial effects for the banking system, as access to ECB liquidity is granted. EMU (Economic and Monetary Union) membership also implies significantly lower interest rates and cheap borrowing is avoided through monitoring by the new EU excessive imbalances procedure. The Macroeconomic Imbalance Procedure (MIP) was established by the EU in 2011 in response to the economic and financial crisis. This is an important tool to monitor and correct macroeconomic imbalances in all EU countries, especially those belonging to the Eurozone, for whom the MIP contains an enforcement mechanism, including the potential use of sanctions. The MIP's monitoring mechanism uses a set of indicators to assess macroeconomic imbalances and divergence in competitiveness.

The MIP is also one of the elements on the road towards a complete Economic and Monetary Union, suggested by Jean Claude Juncker, Donald Tusk, Jeroen Dijsselbloem, Mario Draghi and Martin Schulz in the Report of 22 June 2015 and in the 21 October 2015 Commission Communication: steps towards completing Economic and Monetary Union.

The degree of *long-term* economic success is ultimately determined by the level of progress achieved by NMS with regard to structural and institutional reforms. These include, for instance, the creation of a flexible labour market, reduction of inequalities and unemployment, setting up an adequate social security system, incentives for the formation of human capital, increase of spending on research and development as a percentage of GDP, and ensuring a favourable business environment for investment and entrepreneurial initiative.

What are the key policy motivations and challenges for the NMS on the road to euro adoption?

The recent sovereign debt crisis proved the stability of the Eurozone and did not damage the Eurozone architecture. The EU learns from crises, and the survival of the Eurozone stimulates further improvements to Eurozone governance. However, the group of larger NMS considers the economic divergence between EU MS as an impediment to build a solid foundation for the real fiscal union in the Eurozone. Due to the recent sovereign debt crisis, the Euro area club is now very different from the club as it was in 2007, when Slovenia joined the EMU, as its heterogeneity increased. The political logic dictates that countries join the European Stability Mechanism; however, this is a burden to the countries' budgets. The Euro area is only attractive if it is stable, and every member of the club needs to contribute to this stability.

In conclusion, under certain circumstances, MS of the Eurozone are joined by the non-participating MS of the EU with a view to reinforcing the economic pillars of the Monetary Union, thus improving competitiveness and reinforcing the social and labour markets including EU employment and reducing its heterogeneity. Furthermore, from the geo-political perspective, membership in the Eurozone reduces risks of both political and economic isolation.

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