Monetary integration: from EU accession to adopting the euro

Acquis Screening Seminar

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Introduction

Institutional path to become a full member of EMU and adopt the euro.

3 phases:

→ Pre-accession

→ Member State with a derogation

→ Euro adoption

Pre-accession Phase

- Oriented towards Copenhagen criteria
- Policies targeting a well-functioning market economy and competitiveness
- Secure macroeconomic and financial stability
- Effective and credible monetary policy framework – fiscal and structural policies need to be supportive
- Key factor: institutional capacity to implement a set of coherent policies

Status of new Member States

Member States with a derogation **pursuant to Article 122 by virtue of the future Accession Treaty**

--> Adoption of the euro by abrogation of the derogation. Regulated by Article 122(2)

Post-accession Phase

- Own monetary and exchange policy remains - but in view of the acquis
- Commitment to objective of euro adoption (no opt-out)
- Treaty provisions on management of the single currency area do not apply (Art. 104(9) and (11), 105(1)-(3), 106, 110, 111, 112(2)(b))
- Instruments to address balance-of-payment difficulties in MS with derogation (Art. 119, 120)
- Treat exchange rate policy as matter of common interest (Art. 124)
- ERM II participation becomes possible

Article 122(2): Abrogation of a Derogation

Article 122 (2) states that :

"At least once every two years, or at the request of a member state with a derogation, the Commission and the ECB shall report to the council in accordance with the procedure laid down in article 121(1)"

These reports are called convergence reports

The Convergence Reports

- The Convergence Reports are the basis for the assessment of the progress made towards full participation in EMU
- They constitute the basis for the Council's assessment on whether the MS shall adopt the euro or not
- Article 121 stipulates that the Reports shall include

➢ An examination of <u>legal compatibility</u>

➢ An assessment on the achievement of a "high degree of sustainable convergence", measured against the <u>convergence criteria</u>

➢ Qualitative assessment of <u>other factors</u> (market integration, current accounts, unit labour costs and other price indices)

The Maastricht Criteria: the Gate to the Euro

Article 121 (1)

- High degree of price stability
- Sustainability of the government financial position
- exchange rate stability
- convergence of long-term interest rates

Protocol on the convergence criteria: **details of the convergence criteria**

High Degree of Price Stability

Article 121 (1) 1st indent:

"This will be apparent from a rate of inflation which is close to that of, at most, the three best performing Member States in terms of price stability."

Article 1 of the Protocol:

Sustainable price performance and inflation rate ≤ average of, at most, the three best performers' HICP inflation rate over 12 months + 1.5%

Sustainability of the government financial position

Article 121 (1) 2nd indent:

The MS should not be under an Excessive Deficit Procedure as defined in Article 104 of the EC Treaty

Article 2 of the Protocol:

No Council Decision under Article 104(6) on the existence of an excessive deficit

→ no separate assessment for convergence purposes – link with Stability and Growth Pact

Convergence of long-term interest rates

Article 121 4th indent:

“The durability of convergence achieved by the Member State and of its participation in the exchange-rate mechanism of the European monetary system being reflected in the long-term interest rate levels.”

Article 4 of the Protocol :

Long-term interest rate ≤ previous 12-month average of the long-term interest rate of, at most, the three best performing Member States in terms of price stability + 2%

Convergence of long-term interest rates- in practice

"Interest rate shall be measured on the basis of long-term government bonds or comparable securities, taking account differences in national definitions"

Concept	**Recommendation**
Bond issuer	Long-term government bonds or comparable securities issued by the central government
Maturity	**As close as possible to ten years' residual maturity. Any replacement of bonds should minimise maturity drift; the structural liquidity of the market must be considered**
Coupon effect	No direct adjustment
Taxation	Gross of tax
Choice of bonds	**The selected bonds should be sufficiently liquid. This requirement should determine the choice between benchmark or sample approaches, depending on national market conditions**
Yield formula	Yield to maturity ISMA formula 6.3
Aggregation	Where there is more than one bond in the sample, a simple average of the yields should be used to produce the representative rate.

Exchange rate stability – Treaty definition

Article 121 (1), 3rd indent

"The observance of the normal fluctuation margins provided for by the exchange rate mechanism of the European monetary system, for at least two years, without devaluing against the currency of any other Member State"

Issues:

- ***Definition of normal fluctuation margin***
- ***From EMS to ERM II***

Normal fluctuation margin and transition to ERM II

- At the time of the Treaty: ±2.25% fluctuation margin
- August 1993: ±15% (for stability purpose)
- January 1999: replacement of ERM grid with euro-based ERM II

→ *euro-based methodology of convergence assessments (since 2002):*

- Assessment made in the context of a fluctuation band of ±2.25% around a currency’s central parity against the euro
- Temporary deviations from ±2.25% range to be assessed on case-by-case basis (size, persistence and direction of fluctuations, measures to stabilise exchange rate)

Procedure of abrogation (Art. 122)

- Proposal by the Commission
- Consultation of European Parliament
- Discussion by the Council meeting in the composition of Heads of State or Government
- Decision by the Council by QM of all MS

<u>Accompanying decisions (incl. conversion rate) – Article 123(5)</u>

- ***Proposal by the Commission***
- ***Consultation of the ECB***
- ***Council decision by unanimity of euro-ins and MS concerned***

Abrogation of derogation: new rights and obligations under the Treaty

- Art. 104(9) and (11): Full application of SGP
- Art. 105: Tasks of the ESCB → single monetary policy
- Art. 106: Euro notes and coins
- Art. 110: Legal instruments of the ECB
- Art. 111: Exchange rate policy
- Art. 112(2)(b): ECB Executive Board
- Art. 119, 120 <u>cease</u> to apply (BoP facility, protective measures)

Also:

- ➢ New rights and obligations under ECB/ESCB Statute
- ➢ Policy co-ordination: Participation in Eurogroup