THE IMPLICATIONS OF THE ACCESSION TO THE ECONOMIC AND MONETARY UNION (EMU) FOR THE COUNTRIES OUTSIDE THE EUROZONE

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Abstract: The paper makes a review of the current situation of the countries outside the Eurozone and the future period consequences generated by the transition to Euro upon these countries. The major consequences for the countries wishing to access to the EMU relate to the occurrence of new elements of Community acquis, to the adoption of a monetary policy to facilitate the transition to community monetary policy and to ensure the achievement of inflation criterion, to the adoption of an exchange rate regime compatible with the European Monetary System EMS II and to ensure the criteria regarding the exchange rate. In the paper these elements are compared and the possible options are analysed for the future period for each of these counties.

JEL classification: E42, E52

Key words: Euro; monetary policy; exchange rate; EMS II

1. INTRODUCTION

After the accession to the EU, the Eastern European States have assumed a program of economic convergence and financial stability. This convergence program represents the government's commitment regarding the manner and calendar of fulfilling the Maastricht criteria. This is because all the 10 countries accessing to the EU in 2004 and Romania and Bulgaria are forced to adopt the Euro.

2. OBJECTIVES

The major consequences for the countries wishing to access to EMU relate to new elements of Community acquis (which have to be transposed in the national legislation by the candidate states), the adoption of a monetary policy to facilitate the

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community monetary policy and to ensure the achievement of inflation criterion, to the adoption of an exchange rate regime compatible with the European Monetary System (EMS) II and to ensure the criteria regarding the exchange rate.

3. METHODOLOGY

The paper makes a review of the current situation of the countries outside the Eurozone and the future period consequences generated by the transition to Euro upon these countries.

4. ANALYSES

The major consequences for the countries wishing to access to EMU relate to new elements of Community acquis (which have to be transposed in the national legislation by the candidate states), the adoption of a monetary policy to facilitate the community monetary policy and to ensure the achievement of inflation criterion, to the adoption of an exchange rate regime compatible with the European Monetary System (EMS) II and to ensure the criteria regarding the exchange rate.

The major amendments of the Community acquis are generated by the European monetary unification and refer to the Central National Banks. So, until the moment of these countries' accession to CEE and EU, their national legislation had to ensure the independence of Central Bank; the mandate of the Central Bank's Governor can not be less than 5 years, the Governor can be replaced only if he no longer meets the conditions to have this position or if he made major mistakes; the national legislation thus being compatible with the operation of the European System of Central Banks (ESCB). In all CEE countries left outside the EMU, the legislative framework meets the Community requirements: legislation regarding the Central Bank status ensures the independence of this institution, the mandate of members of the Central Bank management is more than 5 years, the possible loans by the Central Bank to the State are forbidden (or limited and very strictly regulated), and the main objective of the Central Banks is the price stability, the same as Eurosystem (even though the exact statements differ from one country to another).

The fundamental objective of monetary policy in all EU state members outside the Eurozone is the price stability. Nevertheless, the monetary policy strategies have continued to notably vary from country to country.

The major challenge of the monetary policy was the economic slowing which was strongly experienced after the enhancement of international financial crisis and its consequences upon the inflation. The mechanism of monetary policy transfer was affected in many countries.

The Central Banks of the participating countries to the European Exchange Rate Mechanism (ERM) II adopted measures of monetary policy reflecting the policy adopted by the European Central Bank that reduced the fixed interest rate of the main refinancing operations of the Eurosystem. Thus, the countries with monetary councils don't have a reference interest rate, this automatically adapting to the official interest rate practised by the ECB, but they reduced the rates of compulsory minimum reserves.

The Central Banks using inflation targets and not participating to the ERM II responded to the impact intensification generated by the financial and economic crisis and to the fast moderation of the inflationary pressures as a result of some demand deficits by interest reduction. Many of these reductions aimed the stimulation of bank landings and the support of economic activity. Starting with the second half of 2010 and the beginning of 2011 this relaxation was interrupted in most of the states outside the Eruozone. Except the National Bank of Latvia, all Central Banks that previously reduced the interest decided to increase it, mainly to ensure the object fulfilment on medium term regarding inflation. The Central Banks of Hungary and Romanian maintained the highest interest rates of monetary policy reflecting higher levels of inflation rates in comparison with other states outside the Eurozone.

Table no.1 Monetary policy strategies of the EU member states outside the Eurozone

Country	Monetary policy strategies	Currency	Characteristics
Bulgaria	Exchange rate objective	Bulgarian lev	The Monetary Council, exchange rate objective with a parity of 1,95583 BGN/EUR
Czech Republic	Inflation target	Czech koruna	3% inflation target until 2009, then 2%; managed floating of exchange rate
Denmark	Exchange rate objective	Danish krone	Participates to ERM II, band of fluctuation of ±2,25% round the central parity of 7,46038 DKK/EUR
Estonia	Exchange rate objective	Estonian Kroon	Participated to ERM II, band of fluctuation of ±15% round the central parity of 15,6466 EEK/EUR and maintained the Monetary Council. Starting with January 1st, 2011 has adopted Euro at irrevocably fixed exchange rate of 15,6466 EEK/EUR
Latvia	Exchange rate objective	Latvian lats	Participates to ERM II, band of fluctuation of ±15% round the central parity of 0,702804 LVL/EUR, band of fluctuation of ±1% by unilateral agreement
Lithuania	Exchange rate objective	Lithuanian litas	Participates to ERM II, band of fluctuation of ±15% round the central parity of 3,45280LTL/EUR, maintains the Monetary Council
Hungary	Inflation target	Hungarian forint	3% inflation target starting with 2007, free floating of exchange rate
Poland	Inflation target	Polish złoty	2,5% inflation target, free floating of exchange rate
Romania	Inflation target	Romanian leu	3,5% inflation target for 2010, 3% for the end of 2011 and 2012 and 2,5% for the end of 2013, managed floating of exchange rate

Source: ECE, Annual Report 2009, 2010

At the level of Eurosystem, prices stability represents one of nominal convergence criteria. As it can be observed in table no.1, countries that adopted the single currency chose either the strategy for inflation target or the strategy based on exchange rate stability.

A wide subject discussed in literature is the one related to the current relation between the current regime of the transition countries, on one side and the stringency of monetary policy of the Central Bank, on the other side. The studies on this subject reveal that a credible regime of fixed courses represents an important anchor for the transition economy, requiring a stringent monetary policy of some Central Banks orientated towards a lax monetary policy. Nevertheless, it was discovered that the Central Banks engagement to a fixed exchange regime and a prudent monetary policy depends on the current institutional and political frame. So, some former communist countries have set up the exchange regime called the Monetary Council amounting to the resignation of a sovereign monetary policy and have the advantage of quickly fixing the problem of credibility. These countries (Estonia, Lithuania, Bulgaria) have postponed the moment of permanent exchange rate used as pivot within the ERM II, which offers the time needed for economy accommodation with market laws and correlation of economic cycle of Eurozone. However, as a series of Romanian economist demonstrated this can not guarantee the coherence of macroeconomic policies and of structural one, necessary for the avoidance deterioration of economic basis of the exchange rate.

Other communist countries adopted the monetary policy strategy called the inflation target (Czech, Poland, Hungary, Romania) correlated with fluctuation more or less free of the exchange rate. The transition to inflation target was determined by the liberalisation of capital movements, which caused the choice between monetary policy autonomy and exchange rate stability. This is because various researches on inflation target showed that in this sort of strategy the market finds by itself the level of stability of the exchange rate. This stability exchange rate will subsequently become the pivot rate within the ERM II. The major advantage would be the constraint of limitations, less profitable when the Central Bank occasionally interferes on currency market. But the strategy also has some disadvantages generated by high volatility of exchange course, in order to discourage the export trade and foreign direct investments.

The types of exchange rate regime applied by each country have also influenced the evolutions registered by the exchange rates in the EU state members outside the Eurozone.

The countries participating to ERM II (Denmark, Estonia, Latvia and Lithuania) have maintained a standard band of fluctuation of ±15% round the central parity against the Euro, except of Danish krone whose band of fluctuation has been narrower, respectively of ±2,25%. The participation to ERM II is often accompanied by unilateral engagements of some countries in order to maintain o narrower band of fluctuation. The Estonian Kroon and Lithuanian litas accessed to ERM II in the current conditions of the Monetary Council. The Lithuanian authorities decided to maintain the exchange rate of litas at the central parity against the Euro, with a band of fluctuation of ±1%. The agreements of participating to ERM II based on a series of other engagements of authorities regarding the adopted policies, like the application of some moderate tax, salary evaluations in accordance with productivity increase, application of prudent landing policy and implementation of some new structural reforms.

The exchange rates of the national currencies of the EU member states outside the Eurozone not participating to ERM II can be identified by two types of evolutions. The Czech koruna, Bulgarian lev, Polish złoty and the Romanian leu continued to strongly depreciate in 2009, evolution determined by increasingly uncertainties of the international financial markets, of economical perspectives degradations in Europe and the investment apprehensions regarding the external vulnerabilities of the region. During 2010 the Czech koruna and Polish złoty continued to appreciate against the Euro, sustained by the economic performances of the countries, the Bulgarian lev and Romanian leu maintained on a relative stable level, with brief periods of volatility determined by political tensions and risks associated with the implementation of tax consolidation measures agreed on with international organisations. The Bulgarian lev maintained at the same level against the Euro as a result of the Monetary Council based on Euro.

The analyses from the perspective of monetary integration in Europe highlight the fact that a big dimensioned country, with low inflation is disadvantaged by a country with a high rate of inflation, so that the interest of this kind of country would be the decreasing of the countries accessing to the single currency and to prevent the access of countries with high inflation. This is meant to induce a competitive phenomenon between member countries and countries wishing to become member of the Union.

The average annual inflation experienced a very different evolution from 2006 to 2010 in all EU countries outside the Eurozone as can be notices in Table no.2. So, starting with 2009, the average annual inflation decreased in all EU member states outside the Eurozone, but the variation from one country to another is significant. In 2009 the highest inflation rates were registered in Romania (5,6%) and Lithuania (4,2%), followed by Hungary, Poland and Latvia. In Bulgaria, Sweden, Denmark and Czech Republic the inflation registered between 2,5% and 0,6%. The aspects determining the decreasing of inflation were mostly the same, namely: decreasing prices of raw materials, modest intern request and negative increase of salaries, under regular terms.

In 2010 the average annual inflation increased in most of the EU member states outside the Eurozone although the law level of intern request persisted, the production capacities continued to remain unused and the salaries maintained at inferior levels. The inflationist impulses are a consequence of the rising of food prices and energy prices and in some countries also the indirect taxes had a contribution. The highest inflation rates were reported in Hungary after the increase of excise tax and VAT and in Romania that increased the VAT. In the other countries inflation was between 2,2% and 3,3%. Latvia was the only country registering a negative medium rate of inflation in 2010 of -1,2% suggesting the low level of inflationist pressures of demand in 2010.

Table no.2 Inflation Harmonized Indices of Consumer Prices (HICP) EU member states outside the Eurozone

Country	2006	2007	2008	2009	2010
Bulgaria	7,4	7,6	12,0	2,5	3,0
Czech Republic	2,1	3,0	6,3	0,6	1,2
Denmark	1,9	1,7	3,6	1,1	2,2
Estonia	4,4	6,7	10,6	0,2	2,7
Latvia	6,6	10,1	15,3	3,3	-1,2
Lithuania	3,8	5,8	11,1	4,2	1,2
Hungary	4,0	7,9	6,0	4,0	4,7
Poland	1,3	2,6	4,2	4,0	2,7
Romania	6,6	4,9	7,9	5,6	6,1

Source: Eurostat

5. CONCLUSIONS

Because the European Central Bank doesn't suggest any exclusive course for the adoption of the single currency, there isn't a sole solution considered to be adjustable to all countries. So, between the objectives of monetary policy and the priority mode of these objectives there are significant differences among the countries outside the Eurozone, as it appears from the accomplished comparative analysis. Irrespective of the adopted monetary policy, the common issue of these states is the maintenance of prices stability in conditions of some economies with sustained increase rates and significant structural reforms.

The successful entrance and participation to ERM II depends of every state's capacity to proceed to structural reforms, liberalization and especially to tax consolidation. The stability of an adequate exchange rate is essential for the participation to ERM II and subsequently to EMU. In order to eliminate the subsequent issues related to rate adjustment is necessary that before its regulation to be analysed a wide range of economic indicators and relations between them. Thus, the examination of some condition is asserted, namely in what measure the normal exchange rate has significant effects over the volume of production and, or the balance of payments. Moreover, in what measure the evolutions of certain economical measures depend on variations of nominal exchange rate or the variations of real exchange rate, if the variations of nominal exchange rate determine variations of real exchange rate, reactions of request and changes of the balance of payments.

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