Economic and monetary policy cooperation between the EU and the acceding countries following the signature of the accession treaty

The signature of the EU accession treaty has lent added significance to preparations for full EU membership, including those concerning European economic and monetary union. Hence cooperation will be further intensified in this last pre-accession stage and the acceding countries will have observer status at the meetings of the Union's bodies, including those of the European System of Central Banks (ESCB).

Progressive integration of the acceding countries

EU accession treaty signed in Athens on 16 April 2003

After nearly five years of talks, accession negotiations between the EU and ten countries (Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, the Slovak Republic and Slovenia) were concluded at the Copenhagen European Council in December 2002. After the European Parliament had approved enlargement on 9 April 2003, the accession treaty was signed in Athens on 16 April 2003. The accession of these countries, which will increase the EU's population by some 75 million to around 450 million people, is scheduled to take effect on 1 May 2004.[1] By that date, the accession treaty must have been ratified by all current and acceding member states pursuant to their national laws and regulations. In addition, each acceding country, excluding Cyprus, is holding a referendum on accession. For the most

1 Bulgaria and Romania are currently negotiating with the European Union, their goal, supported by the EU, being to accede in 2007.

part, the referenda held thus far have indicated widespread support for accession. The remaining referenda, in Estonia and Latvia, are scheduled for September 2003.

Full integration of acceding countries only on accession

When enlargement takes effect on 1 May 2004, the acceding countries will be fully integrated into the workings of the Community, although certain transitional arrangements will apply specifically to them. In particular, they will participate in the single market and Community policies as well as in the Community's financing system and institutions. Upon accession, acceding countries will immediately join economic and monetary union (EMU), albeit as member states with a derogation pursuant to Article 122 of the EC Treaty. Once the formal conditions for accession – signature and ratification of the accession treaty – have been met, the material conditions also have to be fulfilled prior to the date of accession. The acceding countries have already fulfilled the political part of the 1993 Copenhagen criteria. The European Union expects the economic criteria (the existence of a functioning market economy and the ability to cope with competitive pressure and market forces) to have been fulfilled by the time of accession and the *acquis communautaire* to have been incorporated in its entirety. Key tasks in this regard include strengthening the administrative structures and the court system as well as combating corruption and other forms of crime.

Signing of treaty lends added importance to preparations for EMU

The signing of the treaty has already created strong legal and political ties between the acceding countries and the European Union. This also means that preparations to join EMU and for the subsequent introduction of the euro are acquiring added importance. The dialogue on macroeconomic and financial stability launched in 2001 has been a noteworthy preparatory tool to this end, its most important element being the accession countries' pre-accession economic programmes.[2] In addition, the Eurosystem has been holding regular high-level seminars with representatives from the accession countries' central banks since 1999. Following the signature of the accession treaty, cooperation now has to be taken to the next level, mainly by gradually involving these countries in the coordination processes between member states and in intra-ESCB cooperation. In this context, exchange rate issues – especially the conditions for and the date and modalities of future participation in the exchange rate mechanism (ERM II)[3] in the third stage of EMU – are particularly high on the agenda.

Acceding countries included in the European Union's deliberations

In the last pre-accession stage, which was launched upon signature of the accession treaty, the acceding countries are already being integrated into the workings of the Community and will have observer status at all levels of work in the EU.[4] In some bodies – such as the General Council of the ECB – these countries' observer status will allow them to speak; however, observers are not allowed to vote. The integration of acced-

2 For more on the dialogue on macroeconomic and financial stability see Deutsche Bundesbank, Monetary aspects of the enlargement of the EU, *Monthly Report,* October 2001, pp 15-30.
3 For more details about the exchange rate mechanism adopted in June 1997 see Deutsche Bundesbank, Operational features of the new European exchange-rate mechanism, *Monthly Report,* October 1998, pp 17-23.
4 See the press release issued by the Council – General Affairs – on 28 January 2003, pp 9-10.

ing countries in the deliberations is designed both to intensify cooperation in many fields, including EMU in particular, and to familiarise these countries with their future tasks as full members of the European Union. Now 162 observers representing the ten countries attend the sessions of the European Parliament and its committees; the number of observers matches the number of members these countries will send to the European Parliament in the future under the terms of the accession treaty. Since the signature of the treaty, the acceding countries have also been invited to attend the meetings of the Council of Ministers and the European Council. The first meeting of the Council of Economic and Finance Ministers (Ecofin Council) attended by observers from the acceding countries took place on 13 May 2003. Following the summer recess, the sessions of the Economic and Financial Committee, the main task of which is to prepare the meetings of the Ecofin Council, will also be attended by observers from the acceding countries. Finally, since the end of June 2003 the meetings of the General Council of the ECB have also been attended by the governors of the central banks of the future EU member states as observers. Acceding countries are also each entitled to send one observer to those ECB committees which meet in their extended composition (ie including representatives of the national central banks of the non-euro-area countries). The ESCB's International Relations Committee, in which the monetary aspects of enlargement are also discussed, is a particularly important committee for the acceding countries.

Integration into economic policy coordination

Complete integration into coordination procedures by autumn 2004

Along with their increasing integration into the bodies and committees of the EU, the acceding countries will be gradually incorporated into the regular economic policy coordination procedures beginning in August 2003. This process is scheduled for completion by autumn 2004. The key stages include taking the future member states into account when formulating the broad economic policy guidelines – the core element of the EU's economic policy coordination procedure – and the employment policy guidelines in the context of the Luxembourg process. First, in January 2004 the European Commission will add an "acceding countries" section to its spring report, in which it primarily indicates policy areas where progress is desirable, and in spring it will also present to the Council a guideline package containing recommendations regarding the new member states' underlying economic policy orientations and their employment policies. This will allow the acceding countries to be included in the Commission's January 2005 report on the implementation of the broad economic policy guidelines.

Opening of deficit procedures probably immediately after EU accession

Immediately following their accession to the EU scheduled for 1 May 2004, the new members will present their first convergence programmes under the Stability and Growth Pact. This rapid adoption of the budgetary monitoring procedure is an important precondition for new member states to obtain access to financial resources from the EU's Cohesion Fund. The Commission can be expected to open deficit procedures as early as summer 2004 against those countries whose budget deficits are in excess of 3% of their GDP in 2003. Under the rules of the Stability and Growth Pact, "excessive deficits" must generally be corrected during the following year; however, acceding countries will probably be given more time to correct their imbalances because of their specific circumstances. As EU member states with a derogation, they will also not be subject to sanctions. Between mid-October and early December 2004 the new member states will, pursuant to the code of conduct on the format and content of stability and convergence programmes, join the current EU member states' schedule and present "normal" programme updates, which the Council will then use to assess whether acceding countries' economic policy orientations are in line with the recommendations in the broad economic policy guidelines and whether national fiscal policies are consistent with the rules of the Stability and Growth Pact. The remaining accession countries will also adapt their economic pre-accession programmes to this schedule.

Early participation in the Cardiff process and Lisbon strategy

Moreover, acceding countries may voluntarily present national reports on economic policy reform from as early as October 2003. At the beginning of the following year they would then be included in the "Cardiff Report", which gives a detailed analysis of the way their goods and capital markets function and provides the Commission with important data for its recommendations regarding the single market strategy. The aim of the Cardiff process is to promote economic growth and employment through structural reform in the goods and capital markets. The new members could then be involved at an early stage in the Lisbon strategy, the objective of which is to make Europe the world's most dynamic knowledge-based economic area by 2010.

No fixed timetable for informal macroeconomic dialogue

The macroeconomic dialogue, also known as the Cologne process, is a further initiative intended to reduce unemployment. This involves an informal gathering, with a limited overall number of participants, of representatives of the governments of the EU member states, the European Commission, the ESCB and the social partners and is intended primarily to promote a confidence-building exchange of views among economic policymakers. From autumn 2003 the acceding countries will be able to take part in this dialogue as observers.

The role of the exchange rate mechanism in the acceding countries' monetary integration

Introduction of the euro only upon positive assessment of convergence

The EU distinguishes between three distinct phases leading to the full monetary integration of the acceding countries: the pre-accession phase, the post-accession phase and the final phase beginning with the introduction of the euro. The EC Treaty does not allow the euro to be introduced immediately: the introduction of the euro has to be preceded by a positive assessment of convergence, which in turn has to be preceded by two years of membership of ERM II without tension or devaluation. This convergence assessment addresses not only exchange rate stability but also the other criteria stipulated in the Treaty relating to price stability, budget deficits, government debt and long-term interest rates.

Unilateral "euroisation" incompatible with the Treaty

In this connection, a decision by a country to "euroise", ie to unilaterally adopt the euro as its legal tender before joining monetary union, would be unacceptable. This would contradict the spirit of the Treaty, which holds that the introduction of the euro should come at the end of a structured convergence process. "Euroisation" is therefore not an acceptable way of circumventing the multiple stages of the structured, multilateral process for introducing the euro as provided for by the Treaty. The EU's view is that decisions on the compatibility of existing currency boards, ie monetary systems where the money in circulation is completely backed by foreign reserves, with ERM II have to be taken on a case-by-case basis. A currency board, however, is not a substitute for the required two years of tension-free membership of ERM II.

Equal treatment for acceding countries and initial euro-area participants

In its report on the exchange rate aspects of enlargement presented to the 2000 Nice European Council, the Ecofin Council emphasised that the same criteria governing the initial members' participation in EMU were to be applied to the acceding countries. The report defined what the EU believes should be the guiding principles behind the acceding countries' exchange rate policies. Upon accession, the new member states are required, pursuant to Article 124 of the EC Treaty, to treat their exchange rate policies as a matter of common interest. In order for the single market to function smoothly, competitive devaluation is therefore not permitted. Moreover, the acceding countries are expected to join ERM II after acceding to the EU, although not necessarily immediately. For this to happen, the acceding country must submit an application and an agreement needs to have been reached on the central rate and the fluctuation margins.

Delayed accession to ERM II may make economic policy sense under some circumstances

Most of the acceding countries have already declared their intention to join ERM II as soon as possible after acceding to the EU. From an economic perspective, this raises the question as to the optimum point in time for them to take that step. The acceding countries are in the middle of a complex process of transformation and adjustment; a high degree of exchange rate flexibility may make the situation easier to manage. That is particularly the case for those countries which have only recently liberalised their exchange rate regimes to obtain greater freedom of action in economic policy. Careful consideration should therefore be given to the timing of their joining ERM II. Further progress in economic convergence and exchange rate stabilisation first needs to be achieved.

Participation in ERM II is a distinct stage in monetary policy convergence

Once an acceding country has already made enough progress in convergence to justify its joining ERM II, membership of the exchange rate mechanism should not be understood as a "waiting room" before the euro is introduced as swiftly as possible. The requirement of two years of tension-free membership of ERM II without any devaluation is naturally the key criterion in the Treaty for assessing exchange rate stability. However, membership of ERM II is also a distinct stage in monetary policy convergence. ERM II is an exchange rate framework geared to monetary stability. It can lend considerable support to the acceding countries' convergence process by means of focusing on an exchange rate target, yet it simultaneously affords sufficient flexibility because it accommodates the option of adjusting exchange rates.