

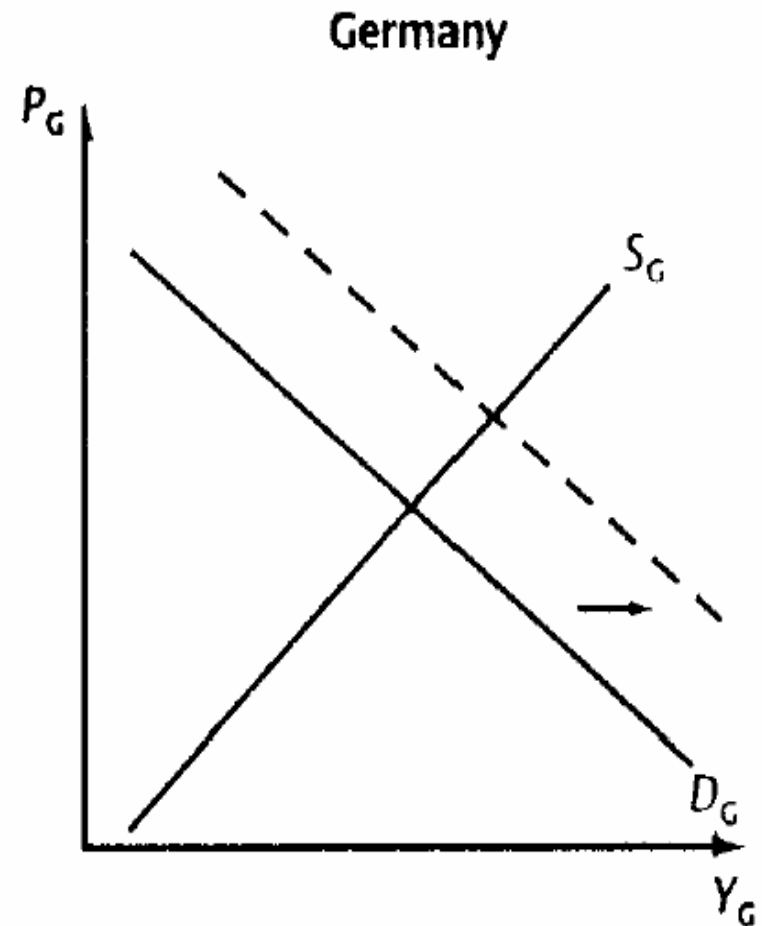
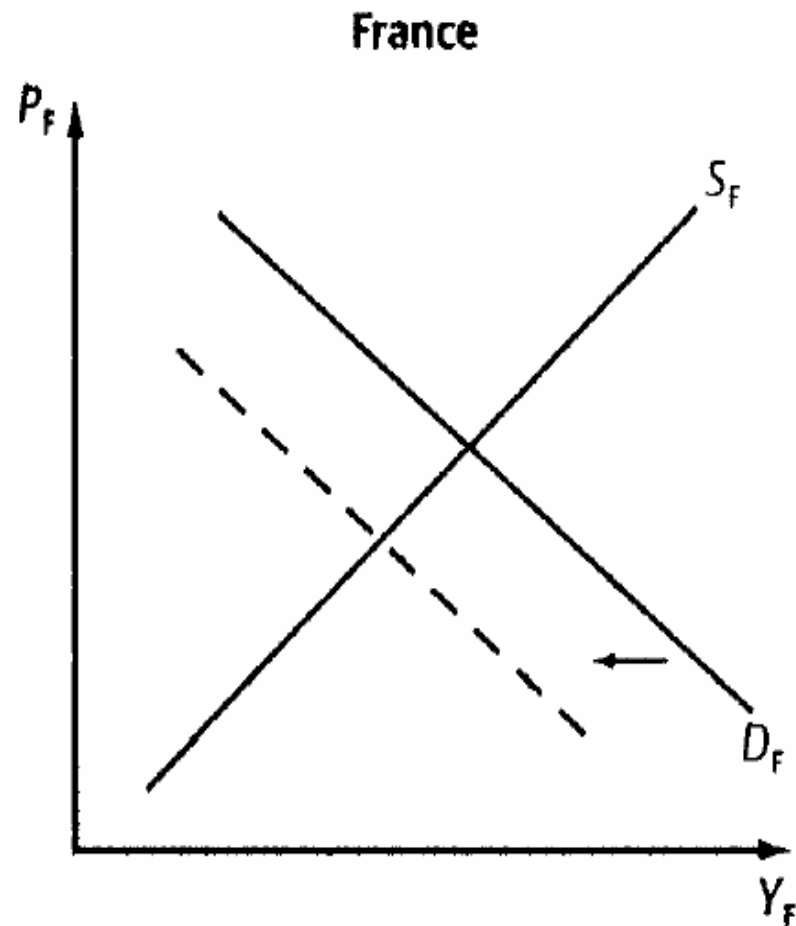
# The stages of economic and monetary union

Timing	Actions	Responsibility
By 30 June 1997	<ul style="list-style-type: none"> <li>• Legislation establishing the Euro as a currency in its own right</li> <li>• Stability and growth pact</li> <li>• Exchange Rate Mechanism Mk II.</li> <li>• Blueprint on future monetary policy instruments</li> <li>• Design of Euro coins</li> </ul>	Commission proposal for adoption by the Council Commission proposal for adoption by the Council EMI proposal for adoption by European Council EMI* Commission proposal for adoption by European Council
End of April, early May 1998	<ul style="list-style-type: none"> <li>• Decision on participating Member States</li> </ul>	European Council**
During 1998	<ul style="list-style-type: none"> <li>• Creation of the ECB* and appointment of its executive board</li> <li>• Start production of Euro banknotes and coins</li> <li>• Adoption of necessary secondary legislation</li> </ul>	Council (Member States participating in EMU only) Council and Member States Commission proposes, Council decides
January 1, 1999	<ul style="list-style-type: none"> <li>• Conversion rates are irrevocably fixed and various legislations come into force, notably on the legal status of the Euro</li> <li>• Definition and execution of the single monetary policy in Euro</li> <li>• Foreign exchange operations in Euro</li> <li>• New public debt issued in Euro</li> </ul>	ESCB* ESCB* Member States, European Investment Bank, Commission
January 1, 1999 to January 1, 2002	<ul style="list-style-type: none"> <li>• Changeover to the Euro by the banking and finance industry</li> <li>• Assist the whole economy in an orderly changeover</li> </ul>	Commission and Member States
January 1, 2002	<ul style="list-style-type: none"> <li>• Start circulation of euro banknotes</li> <li>• Start circulation of euro coins</li> <li>• Complete changeover to the Euro of public administrations</li> <li>• Cancel the legal tender status of national banknotes and coins</li> </ul>	ESCB* Member States Member States Member States, ESCB*

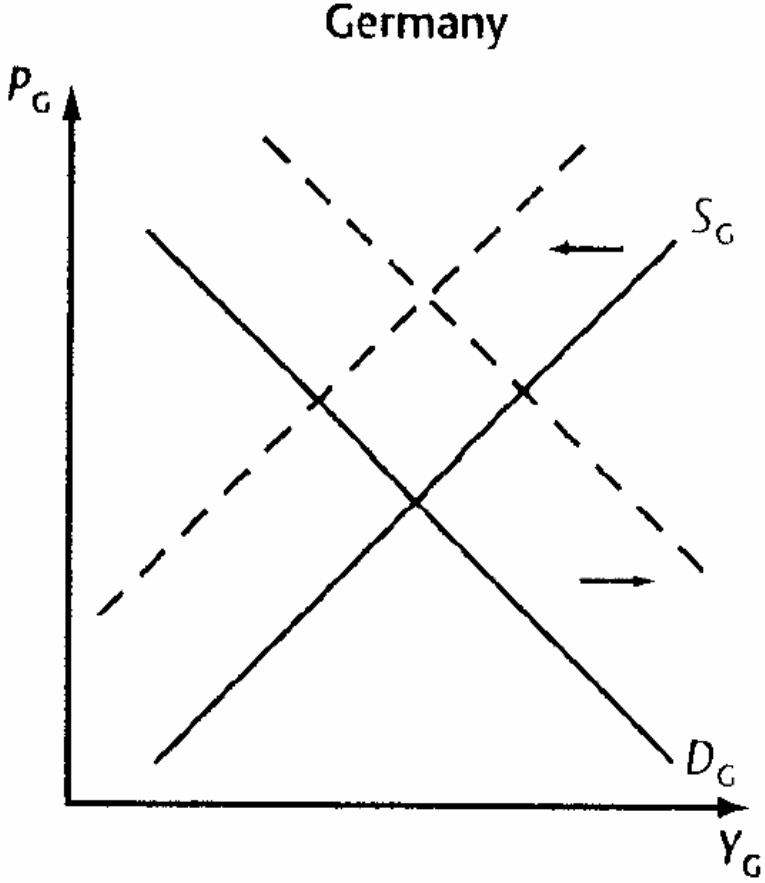
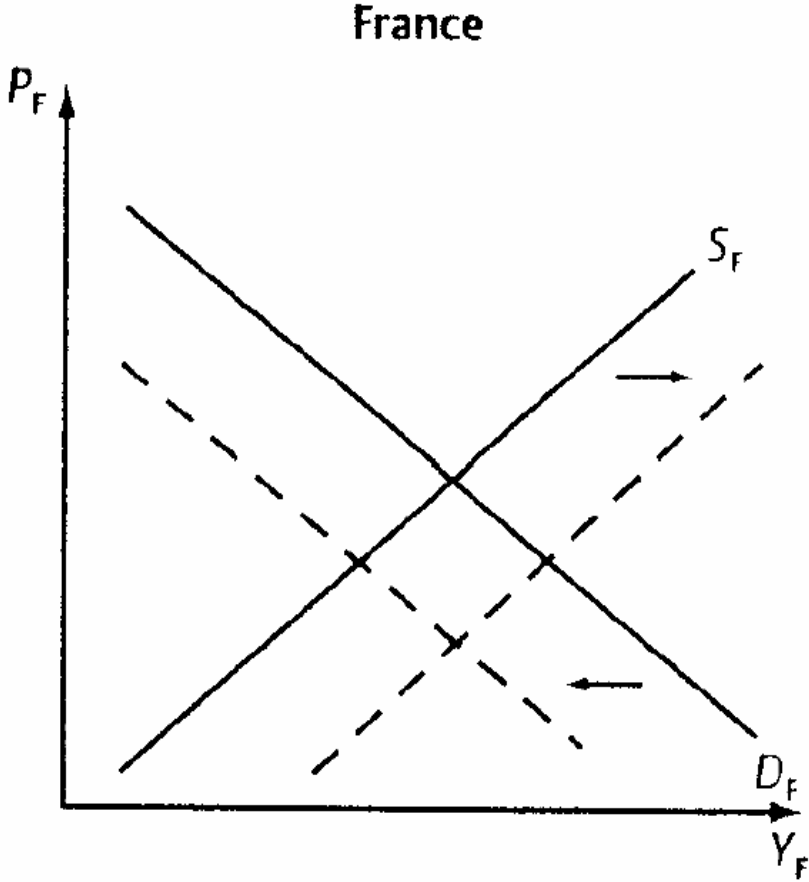
\* ECB - European Central Banks – ESCB - European System of Central Banks – EMI - European Monetary Institute, precursor of the ECB.

\*\* On a recommendation from the Council of Ministers on the basis of reports and recommendations from the Commission and the EMI.

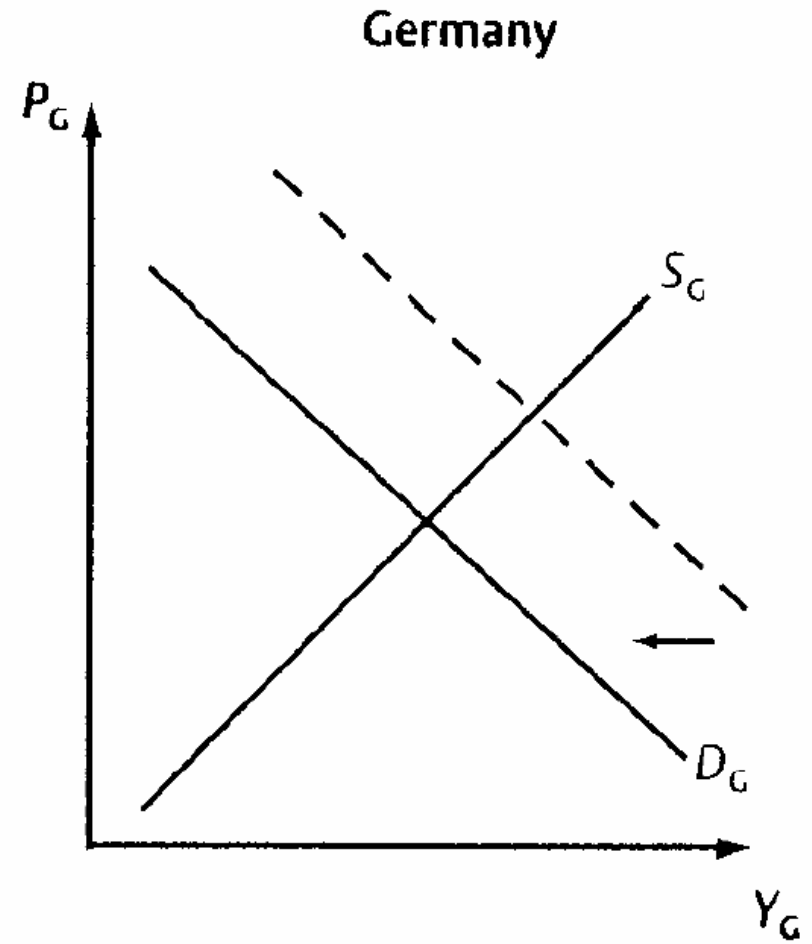
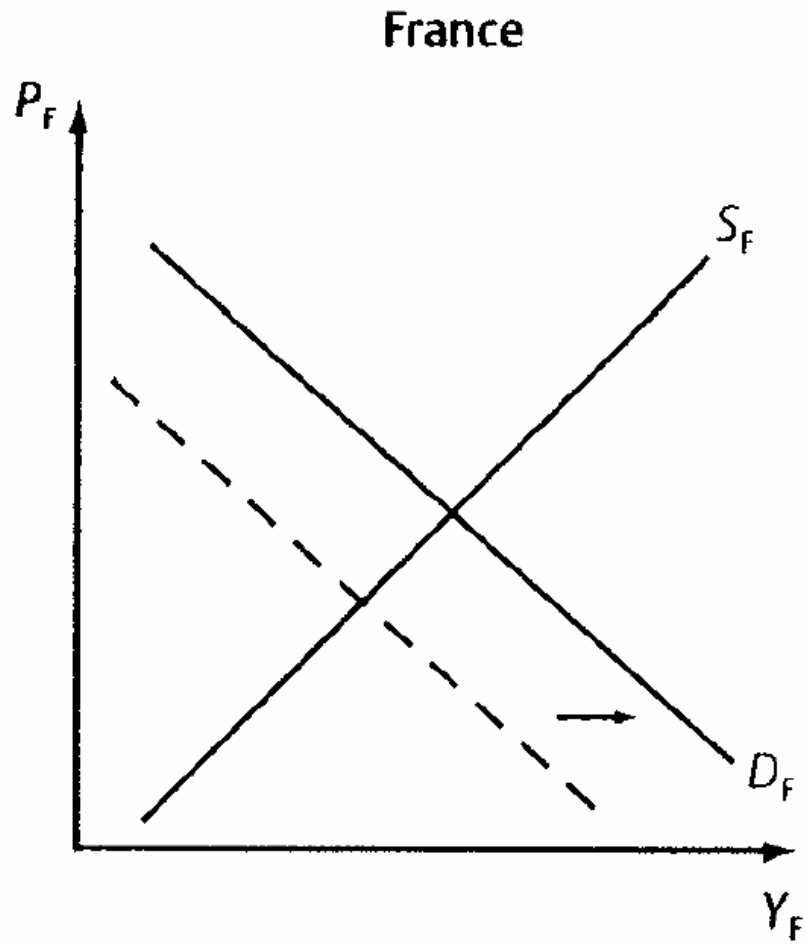
## Aggregate demand and supply in France and Germany



# The automatic adjustment process



# Effects of a revaluation of the DM



# THE MAASTRICHT CRITERIA

To participate in European Monetary Union a member country which had not negotiated an 'opt-out' should have fulfilled the following conditions:

- It should have achieved an inflation rate over a period of two years before the examination of no more than 1½ percentage points higher than that of the 'three best inflation performers' (interpreted by the Council as the average of the three lowest inflation countries).
- Over the same period, it should have exhibited a long-term interest rate within 2 percentage points of the average of the three best inflation performers.
- It should have maintained its exchange rate, also over a period of two years before the examination, within the normal bands of the Exchange Rate Mechanism (ERM) without stress and without undertaking a devaluation.
- It should have fulfilled two fiscal criteria - its budget deficit (in ratio to GDP) should not have exceeded a reference value of 3 per cent, and the ratio of its government debt to GDP should not have exceeded 60 per cent. In both cases, some escape clauses were added, allowing infringement of the reference value in certain cases.
- Finally, the country should have a Central Bank which was independent of its government.

## Extracts from the Maastricht Treaty

Article 104 (ex Article 104c) of the Treaty on European Union

1. Member States shall avoid excessive government deficits.
2. The Commission shall monitor the development of the budgetary situation and of the stock of government debt in the Member States with a view to identifying gross errors. In particular it shall examine compliance with budgetary discipline on the basis of the following two criteria:
  - (a) whether the ratio of the planned or actual government deficit to gross domestic product exceeds a reference value, unless:
    - either the ratio has declined substantially and continuously and reached a level that comes close to the reference value;
    - or, alternatively, the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value;
  - (b) whether the ratio of government debt to gross domestic product exceeds a reference value, unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace.

The reference values are specified in the Protocol on the excessive deficit procedure annexed to this Treaty.

3. If a Member State does not fulfil the requirements under one or both of these criteria, the Commission shall prepare a report. The report of the Commission shall also take into account whether the government deficit exceeds government investment expenditure and take into account all other relevant factors, including the medium-term economic and budgetary position of the Member State. [...]
6. The Council shall, acting by a qualified majority on a recommendation from the Commission, and having considered any observations which the Member State concerned may wish to make, decide after an overall assessment whether an excessive deficit exists.
11. [...] the Council may decide to apply or, as the case may be, intensify one or more of the following measures:
  - to require the Member State concerned to publish additional information, to be specified by the Council, before issuing bonds and securities;
  - to invite the European Investment Bank to reconsider its lending policy towards the Member State concerned;
  - to require the Member State concerned to make a non-interest-bearing deposit of an appropriate size with the Community until the excessive deficit has, in the view of the Council, been corrected;
  - to impose fines of an appropriate size.

## **Extracts from the Stability and Growth Pact**

*Council Regulation (EC) no. 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and co-ordination of economic policies*

*Article 3:*

- 1. Each participating Member State shall submit to the Council and Commission information necessary for the purpose of multilateral surveillance at regular intervals [...] in the form of a stability programme, which provides an essential basis for price stability and for strong sustainable growth conducive to employment creation.*
- 2. A stability programme shall present the following information:*
  - (a) the medium-term objective for the budgetary position of close to balance or in surplus and the adjustment path towards this objective for the general government surplus/deficit and the expected path of the general government debt ratio;*
  - (b) the main assumptions about expected economic developments and important economic variables which are relevant to the realisation of the stability programme such as government investment expenditure, real gross domestic product (GDP) growth, employment and inflation;*
  - (c) a description of budgetary and other economic policy measures being taken and/or proposed to achieve the objectives of the programme, and, in the case of the main budgetary measures, an assessment of their quantitative effects on the budget;*
  - (d) an analysis of how changes in the main economic assumptions would affect the budgetary and debt position.*

*Article 5: [...]*

- 1. Based on assessments by the Commission and the Committee set up by Article 109c of the Treaty [i.e. the Economic and Financial Committee], the Council shall, within the framework of multilateral surveillance [...], examine whether the medium-term budget objective in the stability programme provides for a safety margin to ensure the avoidance of an excessive deficit, whether the economic assumptions on which the programme is based are realistic and whether the measures being taken and/or proposed are sufficient to achieve the targeted adjustment path towards the medium-term budgetary objective.*

*Article 6: [...]*

- 2. In the event that the Council identifies significant divergence of the budgetary position from the medium-term budgetary objective, or the adjustment path towards it, it shall, with a view to giving early warning in order to prevent the occurrence of an excessive deficit, address [...], a recommendation to the Member State concerned to take the necessary adjustment measures.*

*Council Regulation (EC) no. 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure*

*Article 11:*

*Whenever the Council decides to apply sanctions to a participating Member State [...], a non-interest-bearing deposit shall, as a rule, be required. [...]*

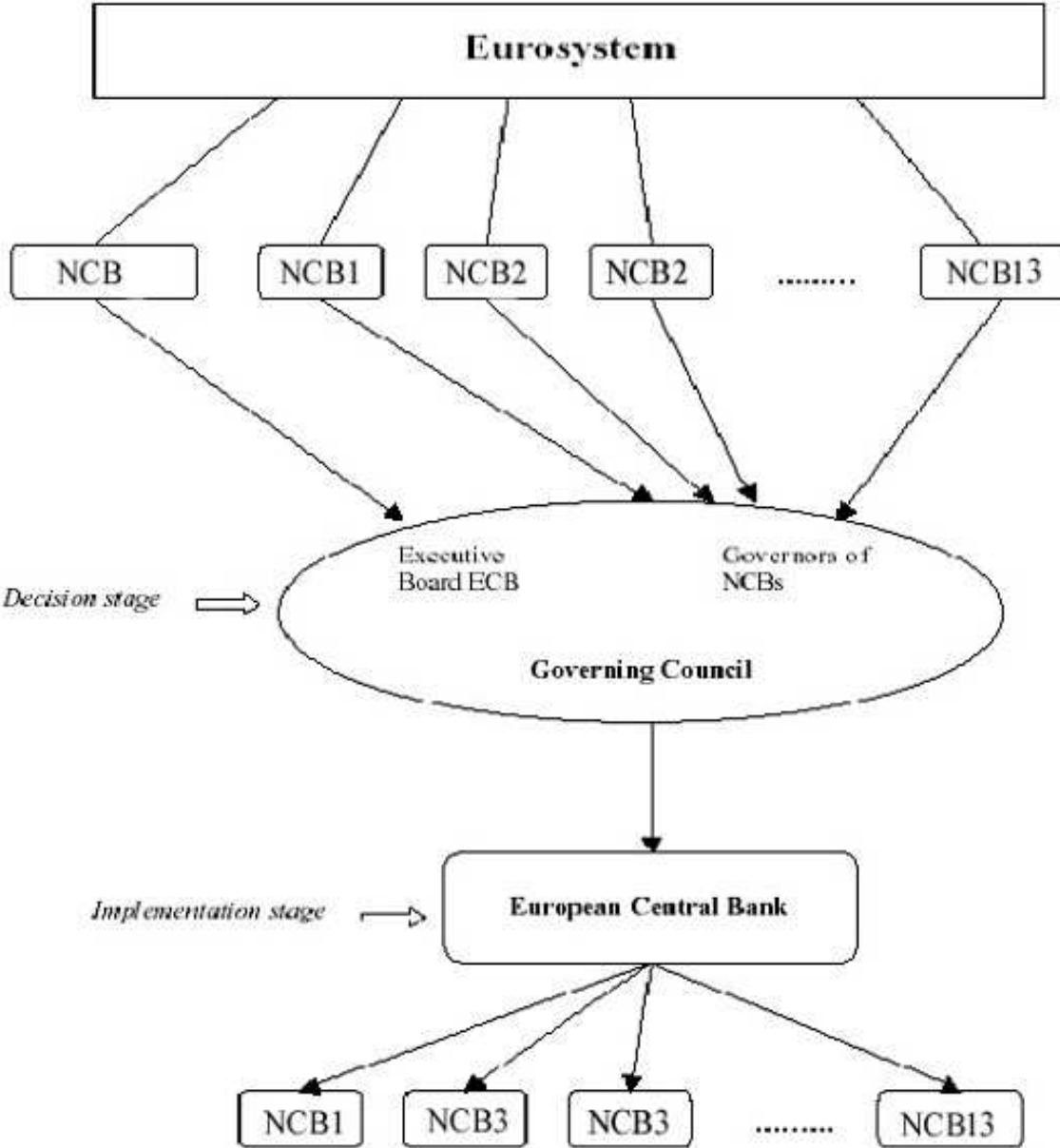
*Article 12:*

- 1. When the excessive deficit results from non-compliance with the criterion relating to the government deficit ratio [...], the amount of the first deposit shall comprise a fixed component equal to 0.2% of GDP, and a variable component equal to one tenth of the difference between the deficit as a percentage of GDP in the preceding year and the reference value of 3% of GDP.*
- 2. Each following year, until the decision on the existence of an excessive deficit is abrogated, the Council shall assess whether the participating Member State concerned has taken effective action in response to the Council notice [...]. In this annual assessment the Council shall decide, [...], to intensify the sanctions, unless the participating Member State concerned has complied with the Council notice. If an additional deposit is decided, it shall be equal to one tenth of the difference between the deficit as a percentage of GDP in the preceding year and the reference value of 3% of GDP.*

*Any single deposit referred to in paragraphs 1 and 2 shall not exceed the upper limit of 0.5% of GDP.*



**Organizational framework of Eurosystem**



## Key provisions from the Treaty and the Statute of the ESCB

This box includes selected key monetary policy provisions taken from the Treaty and the Statute of the ESCB. The full legal texts are available from: [www.eu.int](http://www.eu.int) and [www.ecb.int](http://www.ecb.int).

### 1. EXCERPTS FROM THE TREATY ESTABLISHING THE EUROPEAN COMMUNITY

#### Article 2

The Community shall have as its task, by establishing a common market and an economic and monetary union and by implementing common policies or activities referred to in Articles 3 and 4, to promote throughout the Community a harmonious, balanced and sustainable development of economic activities, a high level of employment and of social protection, equality between men and women, sustainable and non-inflationary growth, a high degree of competitiveness and convergence of economic performance, a high level of protection and improvement of the quality of the environment, the raising of the standard of living and quality of life, and economic and social cohesion and solidarity among Member States.

#### Article 4

1. For the purposes set out in Article 2, the activities of the Member States and the Community shall include, as provided in this Treaty and in accordance with the timetable set out therein, the adoption of an economic policy which is based on the close coordination of Member States' economic policies, on the internal market and on the definition of common objectives, and conducted in accordance with the principle of an open market economy with free competition.

2. Concurrently with the foregoing, and as provided in this Treaty and in accordance with the timetable and the procedures set out therein, these activities shall include the irrevocable fixing of exchange rates leading to the introduction of a single currency, the ECU, and the definition and conduct of a single monetary policy and exchange-rate policy the primary objective of both of which shall be to maintain price stability and, without prejudice to this objective, to support the general economic policies in the Community, in accordance with the principle of an open market economy with free competition.

3. These activities of the Member States and the Community shall entail compliance with the following guiding principles: stable prices, sound public finances and monetary conditions and a sustainable balance of payments.

#### Article 105

1. The primary objective of the ESCB shall be to maintain price stability. Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Community with a view to contributing to the achievement of the objectives of the Community as laid down in Article 2. The ESCB shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources, and in compliance with the principles set out in Article 4.

2. The basic tasks to be carried out through the ESCB shall be:

- to define and implement the monetary policy of the Community;
- to conduct foreign exchange operations consistent with the provisions of Article 111;
- to hold and manage the official foreign reserves of the Member States;

- to promote the smooth operation of payment systems.
3. The third indent of paragraph 2 shall be without prejudice to the holding and management by the governments of Member States of foreign-exchange working balances.
  4. The ECB shall be consulted:
    - on any proposed Community act in its fields of competence;
    - by national authorities regarding any draft legislative provision in its fields of competence, but within the limits and under the conditions set out by the Council in accordance with the procedure laid down in Article 107(6). The ECB may submit opinions to the appropriate Community institutions or bodies or to national authorities on matters in its fields of competence.
  5. The ESCB shall contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system.
  6. The Council may, acting unanimously on a proposal from the Commission and after consulting the ECB and after receiving the assent of the European Parliament, confer upon the ECB specific tasks concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings.

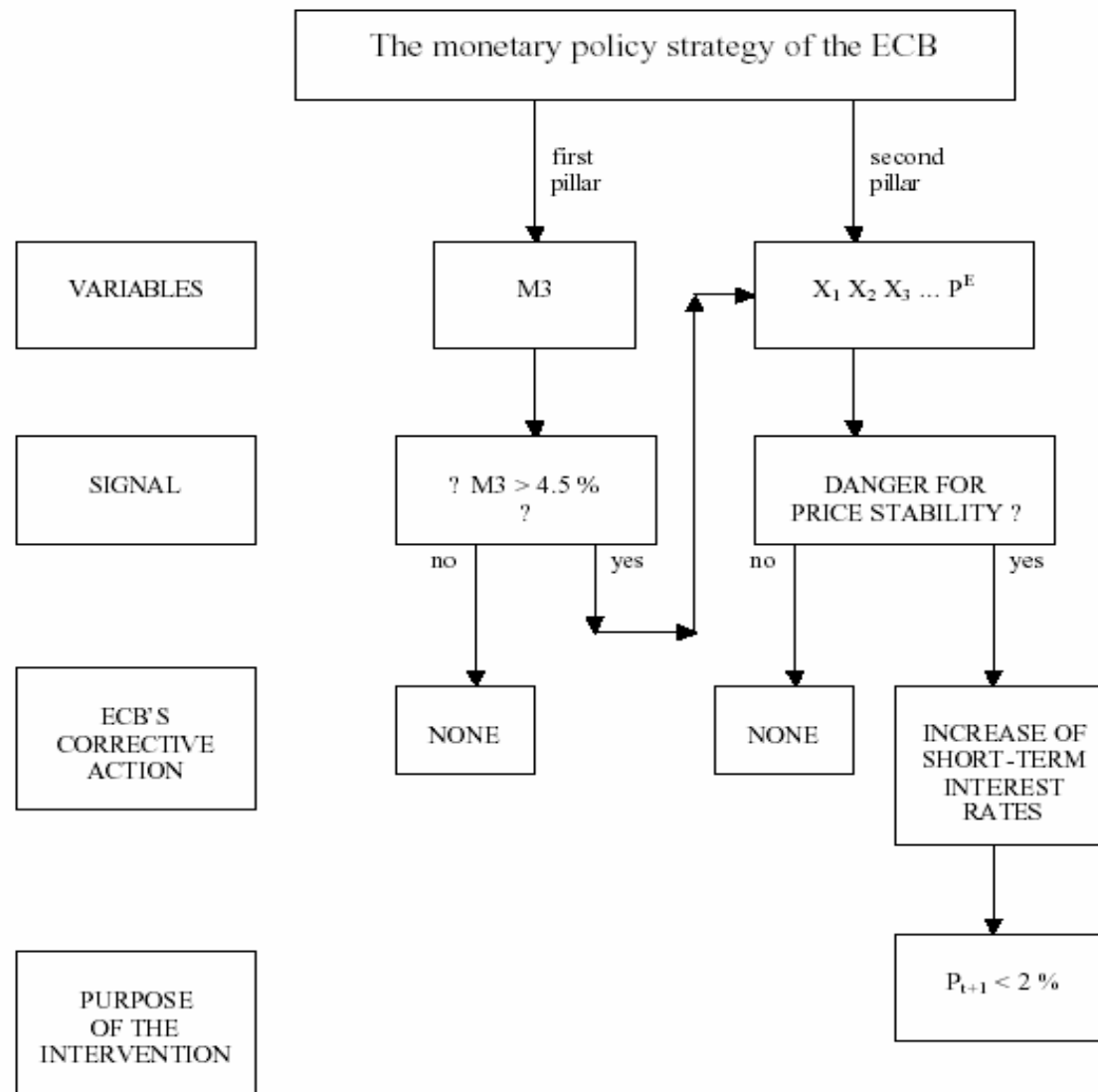
#### **Article 107**

1. The ESCB shall be composed of the ECB and of the national central banks.
2. The ECB shall have legal personality.
3. The ESCB shall be governed by the decision-making bodies of the ECB which shall be the Governing Council and the Executive Board. [...]

#### **Article 108**

When exercising the powers and carrying out the tasks and duties conferred upon them by this Treaty and the Statute of the ESCB, neither the ECB, nor a national central bank, nor any member of their decision-making bodies shall seek or take instructions from Community institutions or bodies, from any government of a Member State or from any other body. The Community institutions and bodies and the governments of the Member States undertake to respect this principle and not to seek to influence the members of the decision-making bodies of the ECB or of the national central banks in the performance of their tasks.

## The monetary policy of the ECB



$X_i$  = Further variables utilized by the ECB and different from M3  
 $p^E$  = ECB's inflationary expectations

# Enlargement



# The Europe & Association Agreements

<b>Country</b>	<b>Europe Agreement signed</b>	<b>Europe Agreement came into force</b>	<b>Official application for EU Membership</b>
Bulgaria	March 1993	February 1995	December 1995
Czech Rep.	October 1993	February 1995	January 1996
Estonia	June 1995	February 1998	November 1995
Hungary	December 1991	February 1994	March 1994
Latvia	June 1995	February 1998	October 1995
Lithuania	June 1995	February 1998	December 1995
Poland	December 1991	February 1994	April 1994
Romania	February 1993	February 1995	June 1995
Slovakia	October 1993	February 1995	June 1995
Slovenia	June 1996	February 1999	June 1996
<b>Country</b>	<b>Association Agreement signed</b>	<b>Association Agreement came into force</b>	<b>Official application for EU Membership</b>
Turkey	September 1963	December 1964	14 April 1987
Malta	December 1970	April 1971	16 July 1990
Cyprus	December 1972	June 1973	3 July 1990

# The Copenhagen Criteria

In June 1993, the European Council at Copenhagen laid down the foundations of the current enlargement process by declaring that “*the associated countries in Central and Eastern Europe that so desire shall become members of the European Union*” and by defining the membership conditions, the so-called Copenhagen criteria. Under the Copenhagen criteria, membership requires that the candidate country ensures:

- “*stability of institutions guaranteeing democracy, the rule of law, human rights and the respect for and protection of minorities*”: the political criteria.

Since the entry into force of the Treaty of Amsterdam in May 1999, these requirements have been enshrined as constitutional principles in the Treaty on European Union, and have been emphasised in the Charter of Fundamental Rights of the European Union, that was proclaimed at the Nice European Council in December 2000.

- “*the existence of a functioning market economy as well as the capacity to cope with competitive pressure and market forces within the Union*”: the economic criteria.

These criteria are consistent with the principles for economic policies as enshrined in the EC Treaty by the Maastricht Treaty that entered into force on 1 November 1993.

- “*ability to take on the obligations of membership, including adherence to the aims of political, economic and monetary union*”. This criterion refers to the implementation of the Union's legislation, known as the *acquis communautaire*. For that reason, it is referred to thereafter as the *acquis* criterion. Subsequent European Councils, in particular the Madrid European Council in 1995, have highlighted the importance, not only of incorporating the *acquis* into national legislation, but also of ensuring its effective application through appropriate administrative and judicial structures.

MAIN STATISTICAL INDICATORS (2002)

	Area	Population		GDP in purchasing power standards (PPS)			GDP growth	Share of agriculture	
	1 000 km <sup>2</sup>	Million inhabitants	Inhabitants/km <sup>2</sup>	Billion €	Per capita, in €	Per capita, as % of EU average	% change	As % of gross added value	As % of employment
<b>Bulgaria</b>	111	7.9	71	47.4	5 900	25	4.8	12.5	10.7
<b>Cyprus</b>	9	0.8	86	14.0	17 400	72	2.2	4.3	5.3
<b>Czech Rep.</b>	79	10.2	130	146.9	14 400	60	2.0	3.7	4.9
<b>Estonia</b>	45	1.4	30	13.5	10 000	42	6.0	5.4	6.5
<b>Hungary</b>	93	10.2	108	138.2	13 600	57	3.3	4.3 <sup>(1)</sup>	6.0
<b>Latvia</b>	65	2.4	36	19.9	8 500	35	6.1	4.7	15.3
<b>Lithuania</b>	65	3.5	53	34.3	9 400	39	6.7	7.1	18.6
<b>Malta</b>	0.3	0.4	1 259	4.6 <sup>(2)</sup>	11 700 <sup>(2)</sup>	55 <sup>(2)</sup>	1.2	2.8	2.3 <sup>(1)</sup>
<b>Poland</b>	313	38.2	122	363.0	9 500	39	1.6	3.1	19.6
<b>Romania</b>	238	21.8	92	128.9	5 900	25	4.9	13.0	37.7
<b>Slovakia</b>	49	5.4	110	61.3	11 400	47	4.4	4.5	6.6
<b>Slovenia</b>	20	2.0	99	35.3	17 700	74	3.2	3.3 <sup>(1)</sup>	9.7
<b>Turkey</b>	775	69.6	90	382.9	5 500	23	7.8	11.5	33.2
<b>EU15</b>	3234	378.4	117.0	9166.5	24 010				
<b>Acceding 12</b>	1088	104.0	95.6	97.4 <sup>(3)</sup>	9364.4 <sup>(3)</sup>				
<b>EU 27</b>	4322	482.4	111.6	9263.9 <sup>(3)</sup>	19203.8 <sup>(3)</sup>				

Sources : Eurostat from national sources.

(1) 2001

(2) 1999

(3) This figure is an approximation based on PPS calculated for the EU15; PPS is at this stage not yet available on the basis of EU25.



	Inflation rate	Unemployment rate	General government budget	External trade				Current account	Foreign direct investment	
	Year-on-year, in %	% of labour force	Balance in % of GDP	Exports in % of imports	Exports to EU in % of total exports	Imports from EU in % total imports	Balance of EU with country, in million €	Balance, in % of GDP	Stock in € per capita <sup>(2)</sup>	Net inflow in % of GDP
<b>Bulgaria</b>	5.8	18.1	-0.6	78.2	55.6	50.2	606	-4.7	273	3.9
<b>Cyprus</b>	2.8	3.8	-3.5	12.5	48.0	55.8	2 173	-5.3 <sup>(1)</sup>	n.a.	4.3
<b>Czech Rep.</b>	1.4	7.3	-3.9	94.4	68.4	60.2	1 673	-6.3	2 289	13.4
<b>Estonia</b>	3.6	9.1	1.3	71.6	68.0	57.9	847	-12.3	2 092	4.4
<b>Hungary</b>	5.2	5.6	-9.2	91.4	75.1	56.3	-68	-4.0	n.a.	1.8
<b>Latvia</b>	2.0	12.8	-3.0	56.4	60.4	53.0	620	-7.7	978	4.6
<b>Lithuania</b>	0.4	13.1	-2.0	71.0	48.4	44.5	1 290	-5.3	723	5.3
<b>Malta</b>	2.2	7.4	-6.2	74.1	46.6	67.0	1 575	-3.9	6 418	8.8 <sup>(1)</sup>
<b>Poland</b>	1.9	19.9	-4.1	74.4	68.7	61.7	9 165	-3.6	963	2.2
<b>Romania</b>	22.5	7.0	-2.2	77.6	67.1	58.4	1 003	-3.4	252	2.9 <sup>(3)</sup>
<b>Slovakia</b>	3.3	18.6	-7.2	87.1	60.5	50.3	-982	-8.2	903	17.0
<b>Slovenia</b>	7.5	6.0	-2.6	94.7	59.4	68.0	1 806	1.7	1 543	8.3
<b>Turkey</b>	45	10.4	-10.0	69.1	51.5	45.5	2 178	-0.8	296	0.6

Sources : Eurostat from national sources.

(1) 2001

(2) 2000

(3) 1999

Time needed for new members to reach average income per person in EU15 countries

Countries	Average annual GDP growth per person, %	Years to catch up*
Bulgaria	3.8	63
Czech Republic	3.7	39
Estonia	4.8	31
Hungary	4.0	34
Latvia	3.9	58
Lithuania	3.8	53
Poland	3.8	59
Romania	3.8	80
Slovakia	4.0	38
Slovenia	3.2	31
Weighted average	3.8	56
Cyprus	3.4	21
Malta	4.1	29

\*Reaching EU15 average GDP per person assuming average EU15 GDP per person growth of 2% per year

Source: EU "Europe Enlarged: Understanding the Impact"