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SWIMMING IN CLEAN(ER) WATERS. HAVE THE EUROZONE ACCESSION RULES CHANGED?

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Introduction: Parallel Stories

The recent economic crisis in some of the Eurozone countries ignited structural changes in the EU's Economic and Monetary Union (EMU) governance. There are many fall-out questions on how the recreated structures will function in practice. Some of those important questions are also essential for the non-Eurozone members, who find themselves under the legal obligation to join the Eurozone at some point in the future. Those questions include relationship with the Eurozone's changing nature and changing rulebook, but the question that will be addressed here is whether the Eurozone accession rules have been changed or not.

The introduction to the issue needs to have two angles. On the one hand, it is the story of the euro and the Eurozone enlargements. On the other hand, it is a story of the Central and Eastern European (CEE) countries' reintegration with the Western European institutions.

Firstly, there are the formal Maastricht criteria, as described in the Union treaties since the Treaty of Maastricht of 1992. They have paved the way for the establishment of the Economic and Monetary Union, which gave birth to the joint currency, *the euro*'s launch in 1999. They include corresponding levels of inflation, public debt and government deficit, exchange rate and long term interest rates. There is also a legislative framework (for example, independence of national central bank, etc.) that has to be in compliance with the general rulebook. Since not all of the countries met all the Eurozone criteria at the start, and two of them asked for a formal opt-out (the United Kingdom and Denmark), the doors for the Eurozone accession are open since the zone's creation. Originally there were 11 countries in

1999 when the euro started to circulate virtually, and Greece joined in time for the introduction of the physical euro bills and coins in 2001.[1]

Secondly, it is a story of the CEE countries, which were left behind the Iron curtain. Since the Berlin Wall came down, they have pursued – with few exceptions – policies targeted at a close integration with the Western European economic and political structures. Widely this has been perceived in Western and Central Europe, as well as in North America as a geopolitical turn "from the East to the West". The Central European countries' utmost important objective was to secure the newly regained sovereignty. Joining the family of democratic nations was the way to reach this objective. And so in 2004 eight, and by 2013 already eleven of Central and Eastern European countries, became members of the European Union. For all of those countries joining the EU was a major event. However, in many cases, the objective of achieving the same levels of security and prosperity as the Western European nations has not been really fulfilled without full participation in all of the Union policies and benefiting from all of the EU's rights and obligations. The list included issues such as accession to the passport-free Schengen zone, a full access to the national labour markets in all EU countries, and – joining the system of a single currency. None of the states was ready to adhere to the Eurozone the moment they joined the EU. However with time, by January 2015, five out of the 11 countries have become members of the Eurozone.[2] Their wish to join the Eurozone and aspiration to fulfil the Maastricht criteria was enshrined in their respective Accession Treaties for all of those countries, as well as other adherents to the EU since the Maastricht Treaty.[3]

The Eurozone's War for Survival

At first, the linear process of "consolidation" of the European integration looked just fine. The Schengen zone was enlarged to all of EU members from CEE states in 2007 – but none since.[4] Slovenia, Malta and Cyprus were also fast admitted to the Eurozone – all by 2008. Slovakia got in on 1 January 2009 just before the economic crisis hit European economies, seriously challenged the stability of Eurozone countries' public finances and even – according to some commentators – endangered the very survival of the Eurozone. The public discourse in Slovakia is probably still inconclusive whether acceding the Eurozone was providing an extra shelter to the Slovak economy or, quite to the contrary, contributed to its fragility. From the public finances perspective, the economic crisis meant that Lithuania, who was denied Eurozone accession in 2007 because of the country failing to meet the inflation criterion by just 0.1% of the inflation rate, could only reapply almost a decade later, and joined the rest of the Euro users on 1 January 2015. Ambitious plans in other countries to join the

[1] Cyprus and Malta joined the Eurozone in 2008, four years after joining the EU.

[2] Slovenia adopted the Euro in 2007, followed by Slovakia in 2009, Estonia in 2011, Latvia in 2014, and Lithuania in 2015.

[3] This meant a legal obligation for all of those countries to join the Eurozone once they meet all of the criteria. They are: Sweden (in EU since 1995), Czech Republic, Hungary, Poland (in EU since 2004), Romania, Bulgaria (in EU since 2007) and Croatia (in EU since 2013) (in EU jargon "Member States with a derogation").

[4] Hence Romania, Bulgaria and Croatia remain outside of the Schengen zone. Only Cyprus was not admitted to the Schengen zone due to its particular border situation with Northern Cyprus.

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Eurozone were shelved in Bulgaria, Poland or Hungary. Only Estonia managed to keep its public finances in decent order to be willing and able to join the group during the crisis in 2011. "Willing" is an important factor, because the general public was fast becoming hostile toward the Eurozone accession all across the region since 2010/2011. Latest Eurobarometer suggests that in 7 EU members from the region who are outside of the Eurozone, since spring 2011 there are more opponents than supporters of Eurozone accession (see below).[5]

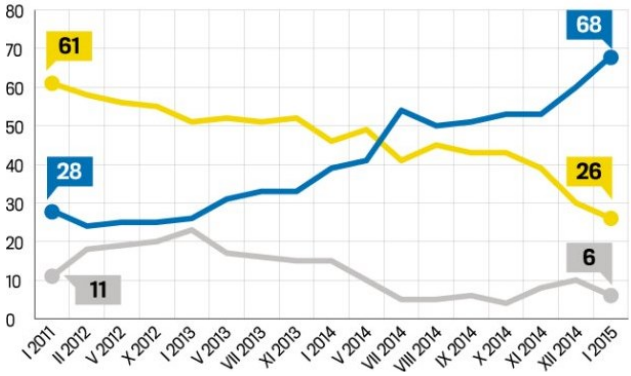
Table 1. Support for Eurozone Accession in 7* EU countries:

	Spring 2011	Spring 2012	Spring 2013	Spring 2014
All Yes	43%	39%	39%	44%
All No	43%	54%	54%	50%
Net Value	0%	-15%	-15%	-6%

Own calculations on the basis of Flash Eurobarometer 400. *Bulgaria, Croatia (since 2014), Czech Republic, Hungary, Latvia (until 2013), Lithuania, Poland, Romania.

After the Eurozone accession, the public opinion perception can change quite considerably. The figures for the support in Lithuania just one month following introduction of the joint currency in January 2015, are quite telling (see below). Why has the general public changed its mind just over one year from being in majority sceptical to become predominantly positive about the Euro adoption? First are the economic arguments, including confrontation with the most significant fear of the public, the inflation risk. The second argument, however, is that "Eurozone is the core of the EU"[6] and by joining it, Lithuania gains a seat by the table. The final set of arguments is geopolitical and linked with the on-going conflict in Eastern Ukraine involving Russia.[7]

Graph 1. Support for Eurozone Accession in Lithuania



Source: Bank of Lithuania, Public Opinion Survey: Euro Adoption in Lithuania 2015. "Awareness Study", January 2015. Graph from: Gazeta Wyborcza, Litwini nie płaczą po licie. Wspólna waluta gwarancją bezpieczeństwa? 15 March 2015,

Still, the situation outside of the Eurozone was only a side-effect of the developments, which took place within the Eurozone. When the economic crisis started in the summer of 2008 in the United States, European leaders did not predict for it to spread over the Atlantic at all,

[5] Flash Eurobarometer 400, Introduction of the Euro in the More Recently Acceded Member States, June 2014, http://ec.europa.eu/public_opinion/flash/fl_400_en.pdf.

[6] Petras Auštrevičius, Lithuania-elected Member of the European Parliament and supporter of the Eurozone accession, as quoted in: Lithuania Warm to Euro, 30 December 2014, http://www.nasdaq.com/article/lithuanians-warm-to-euro-20141230-00311.

[7] A study by the Institute of International Relations and Political Science at Vilnius University, as quoted in: Lithuania Warm to Euro, 30 December 2014, http://www.nasdaq.com/article/lithuanians-warm-to-euro-20141230-00311.

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needless to say – so soon and in such a different form. Its first phase in 2009 meant a large economic contraction across the Western World forcing even the global economy to contract by 0.5%. This phase has had a scare effect on the public and the world stood still for a while waiting for what should happen next. As the Western European governments started injecting money into their economies (hence contributing to their public debt and exaggerating their public deficits), a new (old) loophole became a very imminent threat. The banking sector has been largely left aside from the European legislation and was ruled by domestic laws. Some of the banks were larger than their host countries' ability to bail them out should a need appear. Letting a major bank go bust was never an option due to the risk of a collateral damage on the country-in-question's financial market. As some national banks started to have financial problems, this created a real-life risk of bank collapse. This was a period when terms like "too big to fail" became front-page news. This was a moment when many governments decided to support their financial systems and individual actors by bailing them out. On top of things, in some countries, real estate bubbles burst leaving financial institutions weakened and quite literally millions of people without job overnight. And thirdly, years of economic freeriding by some Eurozone governments (cheap money lending on financial markets, but no domestic economic reforms aimed at improving their economic competitiveness; structural dependence on budgetary deficit) did not improve the status quo.

Because of excessive deficits, perpetual and enormously overgrown public debts, limited competitiveness of national economies, national banks too large to collapse and the real estate bubbles, the situation became unsustainable. A new series of rules and governing structures needed to be implemented. In a way, many EU member states were like a sick patient seeking treatment. The first prescription was to swallow a very bad pill (you could receive conditional support to allow you to sustain your national financial system) in order to contain the disease from spreading (making your country bankrupt). But when you swallow a bad pill, you should not be surprised there may be negative side effects (the macroeconomic conditions imposed by the international lenders). This is exactly what happened after individual member countries started to have problems with servicing their sovereign debts. The front-page news changed, now it was all about the "Eurozone sovereign debt crisis". When the ship sinks and there is panic, little can be done. The European response was not to give in to the panic, and produce an orderly way out.

This is when the Eurozone economic governance was created. On paper, the European treaties talked about the "Economic and Monetary Union" already in 1992. The treaties did not provide a genuine economic union, while they created a federal-type monetary union. The crisis was a perfect illustration of the limits of sustainability of the European monetary policy with a weak macroeconomic cooperation. Major reports published in this period include precisely the adjective "genuine".[8] While the debate continues, activities making the "economic"

[8] See Herman Van Rompuy, "Towards a genuine Economic and Monetary Union. Report by the President of the European Council", Brussels 26 June 2012, EUCO 120/12; and European Commission "A blueprint for a deep and genuine economic and monetary union. Launching a European Debate", Communication from the Commission, 30 November 2012, COM(2012) 777 final/2.

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side of the EMU more realistic concern three main areas: (1) a major reform in planning and execution of the national budgets, (2) the so-called "banking union" and (3) the European monetary policy management.

The Euro Pact Plus of 2011 was an early attempt to improve the competitiveness of national economies. The objective of the Fiscal Compact negotiated the same year and signed in 2012[9] was to introduce more stringent rules on national budgetary procedures in order to avoid future crisis of similar proportions. The idea was to incorporate the Fiscal Compact rulebook into the system of European laws. On the first attempt it failed because of the veto of the British Prime Minister to amend the Union treaties. On the second attempt, many of the rules have been introduced by the so-called "Six-Pack"[10] and its subsequent "Two-Pack".[11] Application of the Fiscal Compact and the six-pack and two-pack rules to the Eurozone countries became compulsory; the non-Eurozone countries can pick and choose which rules they want to adhere to.

Simultaneously, a loophole was discovered. Under the Union treaties macroeconomic and financial support could be provided to the Member States outside of the Eurozone. However, once a country became a Eurozone member it was illegal to help the country out. In order to mitigate the situation as the Greek case turned more and more severe, an ad hoc instrument was created to help the government in Athens.[12] It took two years to change the Union treaties allowing for the assistance to a Eurozone country with problems (bail out). This assistance is provided since 2012 by a new permanent instrument, the European Stability Mechanism (ESM). The ESM treaty is separate from the EU laws; only the Eurozone countries have signed it. Participation in (and financial contribution to) the ESM is therefore separate from the membership in the Eurozone; however as it is compulsory for all the Eurozone countries to participate in it, the two processes happen in strict succession. This is how Latvia and Lithuania have proceeded (earlier Eurozone accessions took place before ESM treaty entered into force): when the Economic and Financial Affairs Council gave a final green light for these countries to join the Eurozone, then the countries begun their accession to the ESM treaty. In both cases, Latvia and Lithuania joined the Eurozone a few weeks before their ESM treaty accession has been completed.

The banking union will attempt to solve (and prevent) the problems, which originated with banks. It aims to re-establish banks as safe and reliable financial institutions. Should a bank's

[9] Treaty on Stability, Coordination and Governance in the Economic and Monetary Union entered into force on 1 January 2013.

[10] The six documents are: (1) Regulation No 1175/2011 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies; (2) Regulation No 1177/2011 on speeding up and clarifying the implementation of the excessive deficit procedure; (3) Regulation No 1173/2011 on the effective enforcement of budgetary surveillance in the euro area; (4) Directive 2011/85/EU on requirements for budgetary frameworks of the Member States; (5) Regulation No 1176/2011 on the prevention and correction of macroeconomic imbalances; (6) Regulation No 1174/2011 on enforcement measures to correct excessive macroeconomic imbalances in the euro area. The five regulations entered into force already in December 2011 and the directive in 2013.

[11] Regulation No 472/2013 & Regulation No 473/2013 where Member States agree to prepare their budgets according to common standards and a common timeline, submitting drafts to the European Commission and each other. The Two-Pack entered into force in May 2013.

[12] European Financial Stability Facility (EFSF) was established in 2010.

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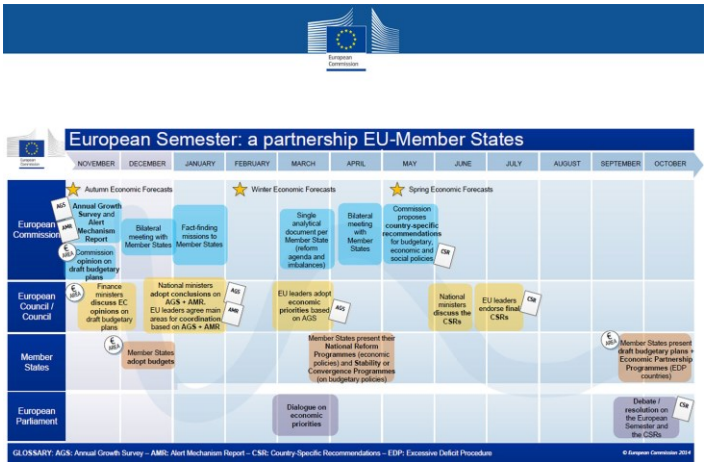
financial situation become unsustainable, this should not require public money involvement. There are two elements in the governance structure. The first is the Single Supervision Mechanism (SSM) and the second is the Single Resolution Mechanism (SRM). They are compulsory for all Eurozone members but are open for the non-Eurozone countries. The SSM and the SRM are the add-up to the EU-wide common financial rules, such as 100 000 Euro deposit guarantee scheme, applicable in all EU member states. The European Central Bank (ECB) provides since November 2014 the single supervision for the largest banks. The details of the single resolution scheme (SRM) are still in the EU legislative pipeline, but the objective is to create a system enabling for it to cover the costs of eventual banking bailouts by the financial institutions (banks and others) without the involvement of the taxpayers' money. Within a few years a Single Resolution Fund should be created for this purpose.

The Crisis Fall Out: New Instruments

In a nutshell, the European economic governance is organised within the "European Semester". This is a process run by the European Commission between November and October each year according to a timeline:

Graph 2. European Semester:[13]



There is a series of activities aimed at early discovery of problems in order to address them as early as possible in cooperation with the country in question. For this purpose some activities serve predominantly as monitoring instruments, other as preventive instruments and there are two punitive instruments, the Excessive Deficit Procedure and the Excessive Imbalance Procedure. What is important is that the European Semester distinguishes countries as those that require assistance and those that do not – but all 28 of them are monitored, advised and consulted.

The new instruments that apply to the Eurozone countries but not the non-Eurozone countries are (1) the fiscal compact rules on budgetary compliance; (2) obligation to become a part of the banking union; and (3) participation in the ESM (financial) instrument. Yet all of them have clear objective to close the loopholes in the Eurozone governance. The latest changes of the management of the European economic governance should make the system more coherent and stable and, in a mid-term consequence, should contribute to the financial stability and economic growth of the Eurozone countries. Participation in the banking union and the ESM should be looked at as "collective defence" making the participants much safer.

[13] European Semester overview from the European Commission website, http://ec.europa.eu/economy_finance/economic_governance/the_european_semester/index_en.htm.

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As a result a safer, more stable Eurozone, could emerge from the economic crisis. Yet to a large degree it remains a subject of a political debate. The Eurozone members are diverse states with various political objectives. Enlarging the Eurozone, rather than shrinking it, has always been the objective of the European Commission. Joining the Eurozone by economically sound states would be welcomed. Hence it comes as no surprise that German Chancellor Angela Merkel shows consistent support of Eurozone accession of economically sound CEE countries[14] as well as for smaller steps in the process.[15] Also the new President of the European Commission Jean-Claude Juncker focuses on consolidation of the Union. Consolidation should mean bringing greater stability and economic growth for the already existing European Union of 28 states, but also securing the situation in the Eurozone and enlarging it to other EU members.[16]

However, there is another development. The tighter budgetary control and macroeconomic rules require a stronger "economic union" between the Eurozone countries. Such an economic union would call for a stronger political dimension. Since there are already strict Eurozone rules and control mechanisms (and a Eurozone members-limited ESM treaty), a notion of need of increased Eurozone democratic legitimacy has been discussed repeatedly;[17] there were various ideas presented over the last years how to organise it. First, example a new separate Eurozone parliament was mentioned.[18] Second idea was to establish a separate Eurozone countries-elected Members of the European Parliament committee.[19] At the moment every time the ESM funds are used, most Eurozone countries do not require a parliamentary vote, whereas German parliament needs to approve it. As for the debate in the Eurozone continues, it is clear that a greater involvement of the national parliaments and of the European Parliament is necessary to increase legitimacy of the Eurozone. The shape and detailed arrangements have not been determined yet; except for much more frequent cooperation between the budgetary committees of national parliaments and the European Parliament. Former President of the European Council Herman Van Rompuy drew projects based on the current Eurozone infrastructure, to include, inter alia, contracts between Eurozone countries to finance national structural reforms

[14] Merkel pledges support to Poland's future Eurozone accession; http://www.kyivpost.com/content/world/deutsche-welle-merkel-pledges-support-to-poland-on-path-to-the-eurozone-367560.html.

[15] Merkel welcomes Czech announcement that it will adhere to the Fiscal Compact; http://www.bundeskanzlerin.de/Content/EN/Artikel/2014/03/2014-03-13-gespraech-sobotka-merkel.html.

[16] Jean-Clause Juncker, A New Start for Europe: My Agenda for Jobs, Growth, Fairness and Democratic Change. Political Guidelines for the next European Commission, European Parliament, Strasbourg, 15 July 2014.

[17] In institutional sense starting with the Herman Van Rompuy report, "Towards a genuine Economic and Monetary Union" of June 2012, ibid.

[18] See for example Ruth Berschens, "EU will eigenes Parlament für die Euro-Länder", Handelsblatt, 6 September 2012; Henning Meyer, "Why we need a Eurozone Parliament", The Guardian, 24 September 2012.

[19] See for example, "Final Report of the Future of Europe Group" (The Westerwelle Report), 17 September 2012, Andrew Duff, "How not to improve European parliamentary scrutiny for the Euro", 17 December 2012, http://andrewduff.blogactiv.eu/2012/12/17/how-not-to-improve-european-parliamentary-scrutiny-for-the-euro/, or Benjamin Fox, "Would a eurozone committee enrich the EU parliament?", EU Observer, 12 February 2014.

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on policies (labour market, pension schemes, other social policies, etc.) in such a way to enhance countries competitiveness, economic growth and jobs.[20] The new President of the European Commission Jean-Claude Juncker picked up on those ideas when he mentioned in July 2014 in the European Parliament a future possibility for the Eurozone to have its own budget capacity.[21]

It seems that in a context of fast integration within the Eurozone of not only the monetary policy, but also of the economic one (with consequences for many other policies, institutional set up and budgetary affairs) the remaining non-Eurozone countries have three strategic options:

- The first option would be to stay away from the Eurozone for whichever reason. Already in 2011 some CEE countries indicated that they might not want to be associated with the Eurozone in crisis.[22] However legitimate those arguments are, one needs to recognise that by remaining outside of the much more closely integrated Eurozone could mean to be relegated into a second-class membership position within the larger European Union.
- The second option would be to try to downplay the significance of the process, which is taking place. This halfway approach is possible when a country happens to be in a particular situation not allowing it to join the Eurozone within a relatively short time horizon. Most likely this strategy will remain difficult to sustain in a longer period.
- The third option is to try to join the Eurozone for the same geopolitical and geostrategic reasons the first CEE countries joined the EU in the first place in 2004 or later. Contrary to some beliefs, the reformed Eurozone does not require any changed accession rules that would apply to the acceding country except for the improved Eurozone system in the first place. The accession rules and the procedure did not change; what could change is the balance between the benefits and costs. Do the benefits of joining the Eurozone (for example, cheaper credit, lower transaction costs, increased security of commerce, etc.) still outweigh the costs (for example, compromising on flexible exchange rates to improve countries' competitiveness)?

[20] Herman Van Rompuy, in close collaboration with Jose Manuel Barroso, Jean-Claude Juncker and Mario Draghi, "Towards a genuine Economic and Monetary Union" 5 December 2012.
[21] Jean-Clause Juncker, A New Start for Europe: My Agenda for Jobs, Growth, Fairness and Democratic Change", ibid.
[22] http://www.euractiv.com/euro-finance/new-eu-members-break-free-eurozone-duty-news-507564

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Conclusion

No, there are no new rules to accede to the Eurozone. Joining the Eurozone now is like to jump into a lake, if before it was a much shallower swamp with muddy water. In any case, you still need to know how to swim. Even though the accession rules have not changed, the system has been improved. The options for freeriding have been limited. What has deteriorated in the last decade is the mutual trust between the participating nations as well as political stability, especially in countries with momentous macroeconomic difficulties.

Even though the situation remains dynamic and far from perfect, the CEE countries (and Sweden) may need to reconsider their political stance on the Eurozone accession. Their legal obligation to join the Eurozone is still in place.

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