

The EU's new members and the euro

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Towards a united Europe

Sweden is not the only country to hold a referendum this year on its European future. The peoples of the Czech Republic, Hungary, Lithuania, Malta, Poland, Slovakia and Slovenia have all also gone to the polls, and this autumn Estonia and Latvia too will hold referenda. In all these countries, the referenda are on membership of the European Union.

This year's referenda represent the outcome of a decision made in October 2002 that ten of the 13 candidate countries for membership of the EU now qualify to join. Of these ten, only Cyprus will not be holding a referendum; there the national parliament has already approved Cyprus's application to join.

In the seven countries that have so far held referenda there were large majorities in favour; in some countries 80-90 per cent of the electorate voted for membership of the EU. This means that as of May 2004 the EU will most probably consist of 25 member states with a total population of more than 450 million people. Most of the candidate countries were liberated from communism and Soviet oppression just over ten years ago.

This long-standing and unnatural division of Europe will be brought to an end in May next year, when these ten countries become members of the EU. The Baltic Sea, for centuries a focus for maritime trade, but during the 20th century more like a protective moat, will once again see free trade flourish. This prospect holds out great promise, and is the effect of pulling down walls and barbed wire fences. A far wider union can serve as a guarantor of peace and prosperity in Europe.

The process of enlargement that the EU is now looking forward to is one of the most important events in the history of the union. As a member, Sweden has played an important part in accelerating and making possible this early expansion.

The opposition

However, not everyone is in favour of European integration. We can see that prior to the referendum on Sweden's membership of the EU almost nine years ago, and now in the current debate on the euro, those who were then opposed to participation in the European community are often equally sceptical regarding the benefits of enlargement:

- Per Gahrton (Greens): "Hungary, Czechoslovakia and Poland can be expected to apply for membership of the EU. They risk being greatly disappointed. The illusion that the EU is the path towards a pan-European community will be dashed in the nineties."¹
- Roger Höögh (Left Party): "To suppose that any East European country could satisfy the convergence criteria is, to say the least, a faulty analysis. Conse-

¹ Instead of the EU, 1994.

quently, these countries won't become members within the foreseeable future either."²

- National Democratic Party's EMU manifesto: "The coming enlargement of the EU will increase the number of member states by ten. Soon Turkey's application will be back on the table, and more than 60 million Muslim Turks could become members of the EU. This could happen sooner than we think. ... Yes to Sweden – No to the EU/EMU."³
- Jonas Sjöstedt (Left Party): "The economies of most of the candidate states are far weaker than those of the existing members, and they will find it difficult to satisfy the EMU's convergence criteria. It's likely that several of the candidate countries will remain outside the eurozone for a very long time to come."⁴
- Björn von der Esch (Christian Democrats): "Germany's economic problems are partly due to reunification. And now we're letting ten new countries into the EU. Countries that are poor – their GDPs are in some cases less than half of ours. This could cause problems. The risk is that we will have to foot the bill."⁵

It is evident that the integration of Europe is also creating a breeding ground for negative forces such as isolationism and protectionism. Just when the EU is extending a welcoming hand to the new countries, the opponents of the EU and the currency union are endeavouring to keep the candidate countries out. Some of them believe that these countries are too poor to qualify as members of the EU, and that they would consequently be nothing but a burden to the union. Others have more explicitly chauvinistic reasons for their opposition to enlargement.

The claims made by the opponents of the EU before the referendum in 1994 have turned out to be wrong. The European community has not fallen apart – on the contrary, it has developed. The claims they are now making are equally wrong. The economies of the candidate countries have not stopped growing; on the contrary, they have strengthened rapidly and the convergence criteria will most likely be satisfied in the near future.

The new countries will then not only be members of the European Union but also of the European Monetary Union. Everyone, candidate countries as well as the present members of the EU, will benefit from closer integration. The reunification of Europe will be a gain for all the countries involved and not a threat that any country, rich or poor, needs to fear.

The will to belong

The ten new member states are setting their sights on more than merely joining the European Union; they also intend to become part of the European Monetary Union as soon as possible. Many of them are thinking of 2006 or 2007 as the date for accession.

² Värmlands Folkblad, Aug 18, 1994.

³ Nationell Idag No 5, 2003.

⁴ Norrköpings Tidningar Dec 19, 2002.

⁵ Debate in Trosa, Aug 18, 2003.

The attitude towards the euro in the candidate countries is that the benefits of membership far outweigh any possible drawbacks. The arguments put forward refer mainly to the euro as an important factor contributing to more stable economic conditions, growing trade and a more active role in Europe. Even if the basic reasons for wishing to participate in the monetary union are the same, each country emphasises different aspects of the European and Monetary Unions.

In Malta's case, for example, cultural factors predominate. Given that the country has always been an intrinsic part of Europe, not only economically but also culturally and institutionally, and that its trade with the rest of Europe is so extensive, it feels natural for it to join the EU and introduce the euro. Thanks to its geographical position Malta also expects to be able to play a useful role in the EU's relations with the Mediterranean and the North African countries.⁶

Generally speaking, the countries that were liberated from communism just over 10 years ago see immense economic benefits in being members of the EU and the euro. Poland's government would like the country to introduce the euro as a means of making the competitive market economy stronger. In Slovakia the government considers that the euro will boost the country's imports and exports and for this reason it has already introduced the euro as its reference currency.⁷

Representatives of Slovenia point out that the euro will have a stabilising effect and help to lower inflation. Hungarian representatives claim that there is a consensus among economists and political decision-makers regarding the economic advantages the euro will generate. They mention, for example, faster growth thanks to lower interest rates, lower transaction costs and higher exports.⁸

In Lithuania's case, economic effects are cited as the most important factor influencing their wish to introduce the euro. The Lithuanian government believes that by participating in the European Monetary Union the country can help to strengthen economic ties with the rest of Europe while strengthening its domestic economy. Lithuania is a country with a small, open economy and a liberal trade policy. At present the EU is its largest trading partner – more than 50 per cent of Lithuania's exports go to EU countries.⁹

Qualifying to be a member

The new members have not applied for any exemptions from the treaties that will determine when they will join the EMU and introduce the single European currency. Consequently the question of accession to the euro becomes a matter of when rather than if.

⁶ Interview with a representative of Malta's Embassy in Stockholm.

⁷ Interview with representatives of the Polish and Slovakian embassies in Stockholm.

⁸ Interviews with representatives of the Slovenian and Hungarian embassies in Stockholm.

⁹ Interview with representative of the Lithuanian embassy in Stockholm.

If the EMU is to function effectively it is important that certain aspects of the economic conditions and economic policy regimes of any one member state do not deviate excessively from those in the other euro states. Consequently, certain conditions, known as the convergence criteria, have been drawn up, which countries that wish to introduce the euro have to satisfy. These convergence criteria require that:

- inflation must not be more than 1.5 per cent higher than the average for the three countries with the lowest inflation rates;
- the budget deficit must not exceed 3 per cent of GDP;
- the consolidated public sector debt must not exceed 60 per cent of GDP;
- the long-term interest rate must not be more than 2 per cent higher than the average in the three countries with the lowest inflation rates;
- the national central banks must have full autonomy (be free from government control);
- the exchange rate between the country's currency and the euro must have been stable for a long period of time.

As the aim of the candidate countries is to introduce the euro as soon as possible, the convergence criteria have served as guidelines for the economic policies conducted by these countries over the past few years. The East European countries in particular have expressed great satisfaction at this fact. The countries themselves have recognised the need for a low inflation policy that will enable each country's prosperity to be based on sustainable grounds without recourse to large budget deficits. The convergence criteria have functioned as a further means of overcoming what had in the past been rather intractable problems.

It is fairly clear that this policy has been successful. The candidate countries in Central and Eastern Europe now have stable economies with steady, sustainable growth and low inflation. Their indebtedness is low, and government budgets are tending to balance to much greater extent than before. The underlying economic conditions are summarised in the table below.

Table 1 Economic situation in candidate states

Country	Inflation, %	Budget deficit (-) /surplus (+)	Public sector debt	Autonomous central bank
Cyprus	2.8	-3.5	54.6	No
Estonia	3.6	1.3	4.8	Yes
Latvia	1.9	-2.5	15.9	Yes
Lithuania	0.3	-1.8	23.1	Yes
Malta	2.2	-6.1	65.3	Yes
Poland	1.9	-4.2	38.7	Yes
Slovakia	3.3	-7.7	43.0	Yes
Slovenia	7.5	-1.8	27.5	No
Czech Republic	1.4	-6.5	23.6	No
Hungary	5.3	-9.1	53.0	Yes

Source: 2003 European Economy, KOM

A couple of years ago the economic conditions in most of the candidate states were a long way from satisfying the convergence criteria. For example, in 1995 the average rate of inflation in the candidate states was 18.7 per cent. By 2001 it had been reduced

to around 5 per cent, and in 2002 the figure was 2.7 per cent. Budget deficits and public sector debt have also been reduced in the majority of these states, and they are now running at levels that are acceptable under the convergence criteria.

Nor have exchange rates and their stability caused any problems. Most of the candidate states, including Estonia and Lithuania, have already tied their currencies to the euro. Other candidates, such as Malta, Latvia, Cyprus and Hungary, have linked their currencies more loosely to the euro, which is possible by using a currency index (a “basket” of currencies) with a highly weighted euro or by tying the currency to the ERM II exchange rate mechanism.

The sound economic conditions and the marked improvements that have been achieved in the candidate countries’ control over their economies, combined with their strong determination to introduce the single European currency indicate that they should qualify to join the euro very soon after becoming members of the EU. As these candidates will most probably be joining the EU in May 2004, and then join ERM II, many of them will already be in a position to introduce the euro in 2006 or 2007.

How the rest of the EU will benefit

Europe shares a rich and remarkable heritage. Diversity and plurality will continue; European co-operation in certain areas will not bring that to an end. Nor are the differences a barrier that will prevent cooperation in other fields. Moreover, the economic differences – in incomes and living standards – are of lesser importance when it comes to the functioning of the EU and the EMU, even though most analysts believe that these differences will eventually be equalised as the new members catch up economically.

Some people use the differences as an argument for claiming that enlargement will not work, and that a union in which Eastern Europe meets Western Europe is an impossibility. Admittedly, there are wide differences between the member countries and the candidate states. For instance, the aggregate GDP of all the candidate countries is only some seven per cent of that of the present members of the EMU.

The belief that enlargement will work, despite the differences, is borne out by that fact that the economic differences are currently wider within individual EU countries than between different member states. In Germany, for instance, Hamburg is three times richer than Saxony-Anhalt. In Finland, Uusimaa is twice as rich as Itä-Suomi. In Sweden Stockholm is 45 per cent richer than the national average while central Norrland is ten per cent poorer.

In spite of these differences, few people have argued against these regions within individual countries having a single currency. The euro extends the advantages of having a single currency within a country to a significantly larger area without the economic gaps within the currency zone becoming any wider.¹⁰

Nor is it correct to claim that the expansion of the EU towards the East will cause economic problems. The mistakes made when Germany became reunified will not be re-

¹⁰ Robert Huggins Associates, “European Futures”, 2003.

peated. No commitments have been made to pay huge subsidies to finance the reconstruction East European economies, in contrast to Germany. The new members will join the EU on their own merits and when they introduce the euro they will be joining a currency union at a market-based exchange rate and not at an incorrect, politically determined one.

The EU Commission has on several occasions drawn attention to the great progress so rapidly made by the candidate countries. The measures that have been taken to adapt these countries to the economic and political realities of a market economy and to the demands made on the potential member states are extremely far reaching. If the current situation is compared with the conditions prevailing only a couple of years ago, we can see that the difference is huge; these countries are far closer to satisfying the convergence criteria than anyone could have expected a few years ago.

Thanks to rapid economic growth and unremitting action to improve economic institutions and create a climate for enterprise and welfare, the new EU countries are developing their own economies and contributing to the growth of the whole of Europe.

It can be seen in the table below that the annual rate of economic growth has been higher in the candidate countries than in the EU in seven of the past eight years – only in 1999 was their average growth rate lower than the EU average. Naturally, many of them began at very low levels, but the curve is pointing sharply upwards.

Table 2 Average annual percentage change in GDP

	1995	1996	1997	1998	1999	2000	2001	2002
EU 15	3.2	2.6	4.0	4.0	3.9	4.5	1.8	1.6
Candidate states	4.6	3.9	5.3	4.2	2.4	4.9	3.6	3.6

Source: Eurostat

As yet, the aggregate GDP of the candidate states is only seven per cent as large as the EU's, but this proportion is growing as their importance in the European economy increases. The fact that we too in Sweden are very much affected by developments in the candidate countries emerges clearly in the form of the sharp growth in Sweden's trade with them. Since 1999 trade between Sweden and the 10 candidate countries has expanded by 120 per cent.¹¹

An open Europe, combining freedom and mobility within a single market, has immense potential not only to become a stable democracy but also in terms of increasing prosperity. When the new members join, yesterday's mistakes will not be repeated. But above all their rising economic star will spread light throughout the rest of Europe.

¹¹ Source: Statistics Sweden, SCB.

Conclusion

In October 2002, it was decided that the EU would be expanded in May 2004 to include ten new member states. This assumes that each candidate agrees to join. So far, eight of them have decided in favour of joining, and the remaining two will hold referenda this autumn.

All the new EU countries also wish to introduce the single European currency, the euro. They see the euro as holding the key to greater economic stability and growth and as an opportunity to become more closely linked to Europe as a result of growing trade and other contacts.

The demands made on potential members of the EU have been satisfied by the ten candidate states. If they are to qualify as applicants to join the EMU they will also have to satisfy the convergence criteria, and they have taken numerous measures to harmonise their economies with these criteria.

The situation in the candidate states is currently characterised by long-term growth, relatively low inflation, small budget deficits, and public sector indebtedness that is within reasonable limits. The necessary process of adjustment to national legislation and by national central banks is also well advanced. Several of the countries will probably already have qualified to introduce the euro by 2006 or 2007.

It is not only the candidate states themselves that will benefit from becoming a part of Europe. In seven of the past eight years, the candidate countries have enjoyed faster economic growth than the EU on average. We who are already members of the EU will also benefit greatly when these growth locomotives and the markets they provide are more closely linked to us.