

# Euro adoption and Maastricht criteria: Rules or discretion?<sup>☆</sup>

Jiri Jonas

*International Monetary Fund, 700 19th Street NW, Washington, DC 20431, USA*

Received 1 February 2006; received in revised form 1 June 2006; accepted 22 June 2006

---

## Abstract

In connection with the prospective euro adoption by the new EU members, the issue of how strictly to enforce the Maastricht criteria for joining the European Economic and Monetary Union (EMU) has been discussed for some time. Arguments have been made in favor of a more flexible interpretation of some Maastricht criteria to take into account the specific conditions of the new member states (NMS). This paper makes a case for a more flexible interpretation of the Maastricht inflation criterion and proposes a different specification. Further, it examines the compatibility of inflation and exchange rate Maastricht targets and argues that under the specific circumstances of euro adoption, and taking into account the way these targets are defined, meeting both of them during a limited period of time should not pose a problem. Finally, the paper argues that both for short-term cyclical and long-term sustainability reasons, the NMS may aim at somewhat more ambitious fiscal targets before euro adoption than required by the Maastricht fiscal criteria.

© 2006 Elsevier B.V. All rights reserved.

*JEL classification* : F33; F36; F53

*Keywords*: European Economic and Monetary Union; Maastricht criteria; Euro adoption; Policy rules; ERMII; Inflation target; Fiscal deficit; Public debt; Interest rate convergence

---

## 1. Introduction

For a long time, economists have been debating what would produce superior economic results: sticking to firm rules or allowing more room for discretion and flexibility in decision making? Perhaps the best-known example of the rules versus discretion debate is the debate about the conduct of monetary policy. Opponents of discretion argue that too much discretion

---

<sup>☆</sup> Views expressed here are of the author and do not represent an official view of the IMF.

*E-mail address*: [JJONAS@imf.org](mailto:JJONAS@imf.org).

would lead to inferior economic performance. They emphasize that excessive discretion inhibits forecasts of economic and financial variables and could adversely affect investment. Opponents of rules argue that their application in a dynamic, difficult-to-predict and ever-changing economic system would produce policies that are not responding flexibly enough to changing circumstances, and therefore produce inferior economic performance.

While the debate about rules versus discretion in the conduct of monetary policy may have been put on a backburner for the time being,<sup>1</sup> it has appeared in another area: how to apply the Maastricht criteria in assessing the compliance of the new member states of Central Europe (NMS) with the conditions for euro adoption?<sup>2</sup>

Some argue that the NMS are sufficiently different from the present members of the European Economic and Monetary Union (EMU) that a more flexible interpretation of the Maastricht criteria, would be justified on economic grounds.<sup>3</sup> On the other hand, the representatives of the European Central Bank (ECB), the European Commission (EC) and of the present EMU members (for short, the European institutions) have often argued that the conditions for euro adoption should be applied in equal measure to the new applicants as they were to the existing members.<sup>4</sup>

Is there a risk that an excessive emphasis on rules relative to discretion would force the NMS to pursue economic policies that would be damaging to their economic performance and slow down their real convergence? Or, conversely, is there a risk that a less strict interpretation of rules and application of more discretion in managing the process of euro adoption would weaken the credibility of the EMU's legal and institutional framework?<sup>5</sup> These are difficult and legitimate questions. This paper aims to contribute to this debate.

In Section 2, we will discuss the potential problems that could arise for the NMS from a strict interpretation of the Maastricht inflation criterion and make a case for a modified interpretation. In Section 3, we will address the exchange rate stability criterion and the potential conflicts that monetary policy could face while trying to meet simultaneously the inflation and exchange rate objectives. We will discuss how serious such a conflict could be and how to deal with it. The final section discusses fiscal policy: it examines whether a more ambitious objective of fiscal consolidation than the Maastricht criteria for public debt and fiscal deficit should be pursued.

## 2. Maastricht inflation criterion: in need of overhaul?

The objective of the Maastricht inflation criterion is to ensure that only countries with low inflation are able to adopt the euro. Because decisions about monetary policy in the monetary union are taken collectively, it was feared that the presence of countries with a higher tolerance

---

<sup>1</sup> More recently, the debate has intensified whether the Fed should move from a discretionary approach to monetary policy conduct to a more rule-based approach by introducing a more formal inflation target.

<sup>2</sup> In this paper, we focus on the Czech Republic, Hungary, Poland, Slovak Republic and Slovenia. We do not cover the Baltic countries, Cyprus and Malta, partly because the issues discussed here are less relevant for these countries.

<sup>3</sup> For example, see Szapary (2000) and Kenen (2003).

<sup>4</sup> For example, the 2000 Convergence Report, Annex B states that “The Treaty makes no distinction between initial and later entrants to the euro area as regards the application of the criteria. The principle of equal treatment implies that, *as far as possible*, member states joining later should not be confronted with additional hurdles, nor be allowed to join on looser terms than the first-round entrants” (italics by the author).

<sup>5</sup> This issue has become even more pertinent with the recent modification of fiscal rules governing fiscal policies of the existing EMU members. See European Central Bank (2005).

Download English Version:

<https://daneshyari.com/en/article/5056647>

Download Persian Version:

<https://daneshyari.com/article/5056647>

[Daneshyari.com](https://daneshyari.com)