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CEEC Accession Countries and the EMU - An Assessment of Relative and Readiness for Euro-Area Membership

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Abstract

Eastward enlargement of the Eurozone will result in transition economies sharing a currency with well-established market economies. We compare the suitability of the candidates relative to current members at a similar time before joining, as well as their readiness to comply with Maastricht criteria. Using fuzzy clustering and principal components, we assess patterns of convergence, possible inhomogeneities within the future Eurozone and create readiness and suitability indexes. We find the CEECs more suitable in terms of OCA criteria and more ready than some of the current members once were. Moreover, they are not found to follow distinct convergence paths.

- **JEL Classifications:** F33, F0, F15, C6
- **Key words:** EMU, Nominal convergence, Real convergence, OCA, Accession countries, CEECs

I. Introduction

On the 1st of May 2004 ten European countries joined the European Union. The enlargement agreement does not allow for any opt-out clause, as in the case of the U.K. and Denmark, thus these countries will be bound to eventually enter the European Monetary Union. Due to the entry requirements, this should not happen earlier than 2007. As the benefits of joining the common currency seem significant,

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it is often argued that it would be desirable for the candidate countries to adopt the euro unilaterally (see for example Nuti 2002, Coricelli 2002, Bratkowski and Rostowski 2002). This option, however, is strongly discouraged by the EU, and therefore does not seem plausible for the time being. This means, that the candidate countries will have to fulfill the entrance criteria posed by the Maastricht Treaty. But are they all ready to fulfill these requirements? Are they, in general, suitable for common currency area membership? Will this be done through steady convergence, or be a one-time effort and perhaps yield problems in complying with the Stability and Growth Pact or any arrangement that may replace it?

This paper aims to find whether and how the Central European accession countries tend to fit in the patterns distinguished among current members of the EMU. The exercise searches for similarities among the convergence towards common currency adoption of the current Eurozone states and that of candidate countries. In order to shed some light on the performance of the accession states, the analysis looks at how they fit in the core and north/south periphery partition found in previous work.

Below, the Maastricht Criteria are used to give an idea about readiness, and the effort it will take to fulfill the entry requirements, while the Optimum Currency Area characteristics serve to judge the suitability of the accession countries, relative to current members. Historically, the 8 Central-Eastern European enlargement states are former communist countries with centrally planned economies, 6 of them formed parts of other countries, and in fact of other currency unions, just slightly more then ten years ago. This suggests significant differences from the current members.

If the CEECs can be found to exhibit strong, persistent dissimilarities in comparison to EMU members, this may be an indication that they may be significantly less suitable for EMU, or add to the inhomogeneity of the Eurozone. In this case, entrance will have an impact on monetary policy and vice versa. While finding they converged in a similar way as current members did can help predict the impact of a common currency by looking at Eurozone states and their troubles in complying with the SGP, their potential gains and losses from joining the Euro. The idea of this simple experiment is to apply fuzzy clustering to look for partition among a set of current EMU members and accession states, as possible entrants to the euro area. The results are confronted with that of another multivariate analysis tool - principal components, which serves for the creation of ‘readiness’ and ‘suitability’ indexes for the candidate countries and relating them to