Background information on the convergence report

What are Convergence Reports?

The Convergence Reports examine whether Member States satisfy the conditions for adopting the single currency, namely:

- the economic criteria (price stability, sound public finances, exchange rate stability and convergence in long-term interest rates)

- compatibility of national legislation with Economic and Monetary Union (EMU) rules (independence of the national Central Bank, prohibition of monetary financing, compatibility with the statutes of the ESCB and of the ECB)

Article 140(1) of the European Union Treaty requires the Commission (and the ECB) to assess the fulfilment of the conditions for the adoption of the euro by Member States with derogation[1] at least every two years or at the request of a Member State.

The present report is the latest regular report. The Commission last assessed the convergence progress of all countries concerned in May 2008[2].

What are the Maastricht criteria?

The Maastricht criteria aim at ensuring that a Member State has achieved a high degree of sustainable economic convergence before joining the euro area. They cover price stability, public finances, exchange rate stability and long-term interest rates. This economic convergence is essential for a smooth functioning of EMU. The Maastricht criteria are named after the Dutch town where the revision of the European Union Treaty, including key elements on EMU, was agreed in 1991.

Is this a final decision for Estonia's entry in the euro area?

On the basis of the economic assessment of the Reports, the Commission is formally proposing to the Council that Estonia adopts the euro on 1 January 2011. The formal decision is expected to be adopted by EU finance ministers on 13 July.

What are the next steps?

The Convergence Report will be first discussed on 7 June by the Eurogroup, who will issue a recommendation on euro adoption by Estonia to the Council. The report will then be discussed by finance ministers, at their next meeting on 8 June, and then by Heads of State and Governments at their Summit on 17 to 18 June. The European Parliament is consulted and will deliver an opinion in June. The formal decision is taken by EU finance ministers on 13 July. In case of a positive decision, ministers will at the same time also decide the rate at which the Estonian kroon will be converted into the euro.

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[1] The 10 countries that became EU members in May 2004 were given a derogation from euro area membership since they did not, at that time, fulfil the necessary conditions. Romania and Bulgaria, which joined the EU in January 2007, also have a derogation. In the meantime, Slovenia, Cyprus, Malta and Slovakia adopted the euro.

[2] See 2008 Convergence Report on: http://ec.europa.eu/economy_finance/articles/eu_economic_situation/2010-05-12-convergence_report_2010_en.htm

Who decides the conversion rate – and how?

The Commission plans to propose to the Council a possible conversion rate for the Estonian kroon in June. The formal decision would be taken on 13 July, by the finance ministers of the fifteen countries of the euro zone and the Member State concerned. The decision is taken by unanimity vote, meaning that all ministers and Estonia have to agree to the conversion rate to be adopted.

Once the Council takes the formal decision, what must still be done until €-day?

Estonia must carefully prepare the changeover to the euro by implementing its national changeover plan, which provides all the details for the organisation of the introduction of the euro and the withdrawal of the kroon. It sets for instance the timetable of supplies of euro cash to commercial banks and to retailers, the rules for cash exchanges for citizens to be applied before and after €-day, the strategy for adapting banking accounts, electronic payments systems and ATMs to the euro etc. Importantly, the Estonian authorities must also carefully put in place measures and information campaign aimed at preventing changeover-related price increases.

Which countries are likely to adopt the euro next?

Euro adoption is dependent on the respect of the economic and legal criteria spelt out in the Treaty. The Commission does not endorse national target dates for euro adoption or pronounce itself on their credibility.

Although new dates have been mentioned, none of the newer Member States has yet formally announced a new target date. The Baltic countries had to revise their initial euro adoption targets when inflation started to increase sharply in a context of the strong growth and overheating pressures of 2007-2008. Bulgaria, the Czech Republic, Hungary, Poland, and Romania do not yet participate in ERM II (see below). In addition, these countries do not yet all fully respect the criteria for public finances, inflation and interest rates.

What is the ERMII?

The ERM II is a mechanism for the currencies of EU countries which have not yet adopted the euro. It is based on stable but adjustable central rates to the euro, with standard fluctuation bands of +/-15% around the central rate. Exchange rate policy cooperation may be further strengthened, as is presently the case with Denmark, which has an agreed fluctuation band of +/- 2.25%.

Which countries are currently part of ERM II?

Estonia and Lithuania joined ERM II on 28 June 2004. Latvia joined on 2 May 2005. Together with Denmark, there are presently four participants in ERM II. (Slovenia, Malta and Cyprus, and Slovakia had also joined the ERMII but have adopted the euro in the meanwhile.)

Does the euro increase prices?

The changeover process in 2002 and more recently, when Slovenia, Malta, Cyprus, and Slovakia became members of the euro area is estimated to have increased prices by an additional 0.1 to 0.3 percentage points. So if the average price rise from one year to the next

was € 2.30 for a € 100 basket of purchases, then no more than thirty euro cents of this increase was due to the euro.

When the Maastricht Treaty was politically approved by the Heads of State or Government at the European Council in Maastricht in 1991, the average inflation rate in the euro area was around 4%. Since the start of the third stage of EMU on 1 January 1999, annual inflation in the euro area – as measured by the harmonised index of consumer prices (HICP) – averaged 2%.