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Progressive Thinking for a Global Age

Hard luck on Lithuania
Kept out on a technicality?
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On May 16 the European Commission and the European Central Bank will meet to consider the applications of Slovenia and Lithuania to join the Eurozone on 1 January 2007. The hot tip is that Slovenia will be accepted, but Lithuania will not.

Formally, these will only be recommendations. The actual decision will be taken some time later by the Council of Ministers, but few expect them to go against findings which are based on a strict interpretation of the Maastricht treaty.

This set out four criteria which must be met:

- Currency stability within the narrow band of the ERM (exchange rate mechanism).
- Not to be running an excessive budget deficit.
- Long-term interest rates no higher than 2 per cent more than the average of the three best performing member states.
- Inflation, over the previous year, not more than 1.5 per cent of the average of the three best performing states.

Both countries easily meet the first three; Slovenia meets all four, but Lithuania loses out over inflation by the narrowest of margins.

The reference level for inflation is 2.63 per cent, based on an average of just under 1.2 per cent for the three best performing states – Poland, Sweden and Finland.

Lithuania's inflation rate in 2005 was 2.7 per cent, 0.07% above the target, but much lower than that achieved by existing members of the Eurozone, such as France, Germany, Italy, Belgium and Greece.

The Lithuanian government argued forcefully, in a letter which Prime Minister Algirdas Brazauskas recently sent to Commission President José Manual Barroso and ECB President Jean-Claude Trichet, that the reference figure should be rounded up to 2.7 per cent, which would mean it would clear the hurdle.

An even stronger argument was that it was unfair to include Sweden and Poland in the calculation, as they are not members of the Eurozone. If the three best performing members of the zone were taken as the benchmark, Lithuania would clearly qualify, he argued.

Brazauskas's argument received heavyweight backing from two distinguished London-based economists in an article in the *Financial Times* on 3 May. Citing the Shakespearean maxim that "the law is an ass", the two authors, Professors Willem Buiter and Anne Sibert, argue that it was against the spirit if not the letter of the Maastricht treaty to enforce "a harmful and senseless rule".

Not only Lithuania, but Slovakia and Estonia (which recently put back its application until January 2008) would qualify for immediate entry if this common-sense interpretation of the criteria were followed, they assert.

The Commission and the ECB have not publicly responded to these arguments, but are believed to consider that they have no alternative but to stick to the letter of the treaty, which clearly specifies "three member states". rather than Eurozone members as the reference base.

They also doubt the sustainability of Lithuania's low rate of inflation, which is forecast, both by the IMF and by the Commission, to increase to 3.5 per cent later this year. Economic and Monetary Affairs Commissioner Joaquin Almunia earlier visited Lithuania to warn that there might well be an inflation problem.

There is also a distinct disinclination to bend the rules, after the experience of admitting Greece to the zone, in 2001, on the basis of what later turned out to be seriously inaccurate statistics. There have also been serious retrospective doubts as to whether it was wise to accept Italy and Portugal when the Eurozone was first set up.

Brazauskas may well raise the issue at the European Council meeting in mid-June, which is - in any event - likely to review the situation in the light of the anticipated applications of other new member states, all of which, except Poland, have now set their own targets for entry (see table)

Country	**Target date**
Slovenia	2007
Lithuania	2007
Estonia	2008
Cyprus Malta	2008 2008
Latvia	2008
Slovakia	2009
Czech Republic	2010
Hungary	2010*

Poland	?

*Likely to be postponed until 2012.

[ends]

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