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ELEC Monetary Conference in Bucharest
"Eastern Europe and euro adherence: wait and see… but be prepared"

Does it make sense that the Eastern European countries hold on to the ambition to join the euro now that the euro is in crisis? Such was the direct question put at a special Monetary Conference of the European League of Economic Cooperation (ELEC) in Bucharest. The answer was – as can be expected from economists – twofold. Given the present uncertainties it is understandable that most Eastern European countries adopt a "wait and see" stance. But at the same time they should prepare themselves to meet the admittance conditions. A sound economy is in their own interest. In fact the euro calendar can serve as a disciplinary anchor.

The conference of ELEC, an independent network of business people committed to deepen European integration, was organized in Bucharest on October 26th 2012 in close cooperation with the National Bank of Romania. It took place in the historical headquarters of the NBR in Bucharest's Lipscani district.

After a word of welcome and thanks by Radu Deac, president of ELEC Romania, the conference was officially opened by governor Mugur Isărescu of the NBR. Referring to the saying about the "two handed economist", he called for a nuanced approach when investigating Eastern Europe's optimal path for entering the Economic and Monetary Union (EMU). The purpose of this conference is not to find a solution to the delicate euro challenge. But if it can throw a new light on the problems, this might help in a journey that needs constant dialogue. The conference was chaired by Wim Boonstra, president of ELEC's Monetary Commission and chief economist of Rabobank.

A powerful policy instrument

Paul Kutos, Head of Unit "euro adoption" at the Directorate General Ecfin of the European Commission, said that this conference is a timely one because we look too much at the short term problems within the euro area. Kutos pointed out that, apart from Great-Britain and Denmark that have an opt-out, all EU countries are committed to join the EMU as soon as the conditions are fulfilled. So the real question is "when" rather than "whether". Kutos examined the different convergence criteria and also the so-called "additional factors" (external balance, financial and product markets) for candidate EMU countries. Against the background of a difficult external environment, the progress is uneven and has resulted in a scattered and not extremely favorable picture. On the political front, there has been a lack of consensus on the euro adoption timeline. The perception of benefits of euro adoption has changed, but Eastern Europe remains well placed to benefit. The growth model based on competitiveness gains, capital inflows and higher per capita income is still valid but sustainable convergence is needed. The policy agenda should be pursued not only because of the euro, but because it is also in the long-term interest of countries. If the convergence path and the target dates are credible, the euro adoption plan can serve as a powerful policy instrument.

According to Kutos, only Latvia aims to join the euro in 2014. Most Eastern European countries have given themselves more time. Everything will depend now on how sound the policies are that they pursue.

Ettore Dorrucci, head of Convergence and Structural Analysis Section of the European Central Bank, stressed that euro adoption is indeed an opportunity, but as the experience with the "old" members shows, the benefits are not a gift of God; countries have to work for it. If not, the plane can't fly. Both in and out the euro area, there are countries that are more successful than others. One should not forget that in all fixed exchange regimes economic activity is more volatile and that booms and busts are more difficult to contain than in a floating exchange regime. Latvia's example shows that a so-called "internal devaluation" can work. To prevent the errors of the past, sustainability and durability of convergence are essential. Euro candidates have to make their homework, but at the same time the architecture of the EMU itself has to be strengthened and more steps towards a fiscal, economic and political union will have to be taken.

In the debate that followed, a lot of attention went out to Sweden, a country that is very successful but has no immediate plans to join the Exchange Rate Mechanism and by extension the euro. Dorruci stressed that a country's success is in its own hands, whether or not it is in the euro zone. The EMU thought it had an exorbitant privilege like the US and that having the euro was enough for all countries. But there were incentives to over-borrow. More progress than was deemed possible is now achieved in building the economic and political pillars of the EMU: the semester, fiscal compact, six-pack, two-pack, etc. But this is much more difficult to explain to citizens than the relatively simple Maastricht-criteria.

According to Han de Jong, chief economist at ABN Amro Bank, the lessons from the past learn that there was insufficient convergence at the start of the euro. If the southern countries had adopted the same sound fiscal policy and structural reforms as Sweden, we would be in a different situation. The Maastricht treaty was not enough and was not observed, not even by Germany and France. Therefore, before joining every country should have checked whether it was fit enough to do the adjustments necessary to join an EMU that is not homogeneous. The same is true for the Eastern European newcomers. Their external account deficit should in no way be excessive, they should be competitive so as not to price themselves out of the market like the Southern countries did and they should structurally reform their economies. If not, they should simply stay out of the euro and be a B-class economy. Finally Eastern Europe should prepare its banks for the EMU. The new Banking Union involves Eastern Europe. So, joining the euro is not an end in itself, rather it is where the work truly starts.

The debate focused on the question if countries are better "in" our "out". An independent monetary policy does not exist; even Switzerland is limited in its policy. But when you are in, there is at least the chance to influence things.

The critical voice in the conference came from professor Alfred Steinherr (Bolzano, Berlin). "I am a one-handed economist. Forget about jumping into a boat that is already in difficulties", he said. Steinherr thinks the benefits of the EMU have been exaggerated. Growth in the euro zone has been the worst since the fifties, and in Germany it has been the lowest of all. The highest growth was achieved by Greece. "The euro may have been good for what the Germans want - price stability - but it has been bad for growth", Steinherr said. Because of the higher inflation in southern countries, the real exchange rates and the current accounts have diverged. "We have engineered a monetary system that has produced a catastrophe". You can not blame this on the southern countries; it was not irresponsible but a logical response to borrow more when interest rates were low. Steinherr does not believe that the credibility of the euro will be restored. Maastricht was already devalued from the start when Belgium and Italy were admitted on the grounds of being among the founders of Europe, turning a blind eye to their debt of a

100%. Throwing ourselves forward in an even deeper or wider Monetary Union is nonsense.

Steinherr was sharply countered by both the other speakers and by the audience, and he also got critical questions from the journalists in the room. Imagine Italy would not be in the euro; they would be worse off, and the recent reforms would not have taken place. If the south was pushed to a higher inflation, it was because productivity growth lacked. Instead of good policy, the south pursued a policy of free gifts. If there had been no euro, we would be in a Deutsche mark zone. The financial crisis would have hit us even more, with a currency crisis on top. Steinherr admitted that he had not done a cost-benefit-analysis of a break-up of the euro zone but said that the cost probably would be so huge that a break-up will not happen. "But it is like a marriage. Better stop when it no longer works", Steinherr said.

The newcomers' moving target

Steinherr's outspoken remarks had the advantage of fuelling the debate on the ambitions of the potential newcomers: are they really sure that they want to join the euro? During a panel discussion, representatives of four Eastern European countries that are not yet member of the EMU had a chance to give their countries' view and to react to the other viewpoints.

Kalin Marinov, executive director of the Economic Policy Institute in Sofia explained that Bulgaria adopts a waiting stance vis-à-vis the euro. When Bulgaria joined the EU, it did not think of joining the EMU too. The convergence criteria focus on inflation, but for Bulgaria the 6% economic growth was more important, even if this meant more inflation. The convergence policy also has a high social cost. Sooner or later, Bulgaria will join the euro, it is a moving target. It will only happen after the new rules of the euro area have been established.

Ludek Niedermayer, director at Deloitte Czech Republic (and former vice governor of the Czech central bank) pointed out that the possible membership of the euro is the subject of political games in the Czech Republic. Over the years the different governments had different opinions, and public opinion is widely divided over the issue. The euro is not very credible in Czech eyes. Joining the euro will in the first place be a political decision, just like the Czech veto of the fiscal compact. Niedermayer pointed out that Slovakia joined the euro in 2009 and has done well. Growth has been higher than in the Czech Republic and even the Slovak exports to Germany have increased faster than Czech exports to the Federal Republic. Migration between the two former parts of Czechoslovakia helps to find an equilibrium, but language remains a barrier.

Ryszard Kokoszczynski, director of the Bureau of Macroeconomic Research at the National Bank of Poland, said that in the beginning the European Union was very popular in Poland and that in 2007 plans were made to fix a date for euro entry. But popular belief in the euro waned. The general consensus is that Poland should wait and see. But we can not postpone forever. If the costs are not too high, Poland will want to be part. But if it joins, it has to do so on a relatively short term, because it makes no sense to wait for a long time.

Finally, Valentin Lazea, chief economist of the National Bank of Romania stressed that his country is rather in favor of the euro, but elections are coming up in December and the original euro adoption calendar is difficult to maintain. The nominal convergence criteria do not pose many problems, but the real convergence criteria (GNP/capita, level of services, commercial integration EU) are more difficult to meet. So it looks as if Romania, like most Eastern European countries, will not announce a new time calendar in the immediate future. Public attention and political will are waning. Present euro members too will interpret this negatively. But convergence needs time, and one should not forget

that the disciplining effect of euro adherence has been taken over by new measures such as the two-pack and the six-pack.

Bridging the democratic gap

In the debate that followed a lot of attention went to the negative views of both politicians and the public opinion in Eastern Europe towards European integration and towards the euro. Euro-skepticism and nationalism are increasing everywhere, an opinion not shared by a participant from Latvia where public support for the euro is high and one third of deposits are in euro. In all candidate countries, and even in existing euro countries, more should be done to educate politicians and public opinion, including economists. The arguments for integration should be better explained. Europe is not only about economics, it is also about peace. "Brussels" is used as a scapegoat. Sometimes national politicians even ask the EU for a list of what they should do so that they can hide behind "Brussels". European leaders should take the lead, not follow the short term fears of their pampered population.

In his closing remarks ELEC president Bernard Snoy said that this conference on finding the optimal path to the euro was more about the validity of the process than about the process itself. The EMU was first and foremost an economic process designed to achieve political objectives. When the single market was endangered in the seventies by currency movements and by liberated capital movements, Maastricht was designed to preserve this acquis, although we knew it was not enough. Europe is more than an economic project. We have to pool sovereignty to exert it better. Europe is a process of institutional excellence. The Greek problem was a problem of governance, and the Greeks know this all too well.

Can the lost credibility of the EMU be regained? Steinherr was doubtful, but it is incredible how much has been achieved. Snoy said he was encouraged by what he heard at this conference. The Eastern European countries stand to benefit from the euro, and the convergence demands in itself are in their self-interest. If the Eastern European countries grab this opportunity, they gain an important policy anchor. What we heard from Bulgaria, the Czech Republic, Poland and Romania strengthens Snoy's conviction that they should not burry their adherence plans – and the disciplinary role of the adherence calendar – too soon.

At the end of the day, European integration is all about politics. Economic strength will be important in the future, but the greatest challenge is to explain this to the people and to bridge the democratic gap, Snoy said. For ELEC the conclusion is that it has to do even more in promoting and explaining the European idea.

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