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EMU and the CEE

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EMU and the CEE

Tibor Palánkai*

1. Slow or rapid joining the euro-zone

The full EU membership of CEE candidate countries assumes their full EMU participation. This corresponds to the Copenhagen accession criteria, namely they should have the "ability to take on the obligations of membership, including adherence to the aims of political, economic and monetary union", and they have no possibility of opting out, like United Kingdom and Denmark.
As it is stated in the accession treaties, *all countries will take over and implement* the acquis under the chapter of *economic and monetary union as from the date of their entry*, while some derogations are applied. The full membership in the single market serves as a ground for this as its completion and the first "stage" of EMU overlapped for the present member countries. Parallel, the candidate countries are assumed to comply with requirements of stability oriented economic policies, as they adhere to ERM-2 and start to implement their "convergence program", informally and de facto they enter into the second "stage" of the EMU, in fact, again right from the beginning of their EU membership. The member countries will have to treat their monetary policy as a matter of common concern. The CEE finance ministers take part in the Ecofin again upon entry the Union. So when often journalistically, one speaks about a later "EMU entry", it is nothing else than the joining the euro-zone, namely the third stage, and that is what needs formal and official decision and endorsement.
One can say that the first and second "stages" could be considered as preparatory stages of the EMU, or transition periods, which for the new members in time totally overlap. The real monetary integration started with the introduction of the single currency by the third stage. CEE new members enter immediately these preparatory stages with special derogations right from the beginning of their membership. Of course, even in this case, it should be noted that contrary to present members, the CEE new entrants, from the first moment of their membership, will 'co-

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exist' with the single currency, too.
One can realistically assume that most of the CEE candidates will be able to join ERM-2 upon their entry into the EU, and the conditions seem to be assured by that time. The Hungarian National Bank is prepared in terms of both staff and structure for the tasks in connection with exchange-rate interventions. According to official decision of the government, Hungary will join the ERM2 from 2004, while the Poles plan this step from January 1 of 2005. It would be an important condition on the part of the EU to open and provide the monetary funds necessary for exchange-rate stabilization.
Participation in ERM-2 would require already a closer relation between inflation and the stability of the exchange rate in terms of economic policies. As a first step toward gradual approaching to the euro-zone, the CEE candidates pegged their currencies to the euro from early 2000s (Hungarian forint rate was pegged fully to euro on January 1 of 2000). Full pegging to the euro means that Hungarian monetary policy "will be more strongly related to the monetary processes of the euro-zone and the monetary policy of the European Central Bank. As a result of closer relations, the monetary and real-economy shocks of the euro-zone will be more strongly transferred to the forint than in the previous years." (*Világgazdaság, October* 19, 1999.) By that, the monetary policy of the Central Bank became more transparent, inasmuch as the effects of changes in cross rates were eliminated. The exchange-rate risks were reduced substantially.
The other important step was that from May 4 2001, first among the candidates, *the band of free floating of the Hungarian forint was widened* from the earlier +/ – 2.25% to the +/- 15% as applied by the ERM countries. According to the Board of the National Bank, the main aim in widening the band was 'sustainable reduction of inflation', which was halted by several factors. Inflation got stuck around the 10% level and the country could not achieve its target of reducing inflation in 2000 and 2001, first as a result of increases in energy prices, and later owing to the rapid rise in prices of food and some services. It was realised that more monetary rigour was needed.
The joining of ERM2 would assume the consolidation of the economies to such an extent that their participation in the system does not threaten 'sustainable economic growth' or their export competitiveness (the restriction on devaluation), and the difference to the EU inflation rate is probably no more than 2 – 3%, reflecting the productivity growth differences. This aim can be achieved if consistent stabilization policy is maintained in the future.
Upon their interests, the CEE countries not only agree with the acquisition of the single currency, but they are without exception *committed to a rapid and early joining of the euro-zone*. In fact, this is the issue, which is the subject of very broad and intensive dispute.
Earlier, for several reasons, some assumed that the transition period between joining the EU and entering euro-zone might last for many years, probably more than a decade. That was particularly the view of many Western experts, shared by some

Community officials. Later as the official commitments about an early and rapid euro-zone entry on the side of new members have been strongly expressed, the notion was accepted, but the reservations and doubts on side of the present members still remained. The CEE official assumptions about euro-zone entries range from 2006 and 2010. According to the official decision of the government and the Central Bank, in Hungary the euro will be introduced in 2008. In fact, the market analysts set this date to 2008 for six new CEE members, as the most probable possibility, and Czech republic and Slovakia might follow some years later. (Világggazdaság, November 11 2002.) In general, the central banks and the financial circles are those, who force the early entry, while the governments, probably because of the constraint of the cutting budget expenditures, are less enthusiastic. According to public opinion polls, in 2001, 69% of Hungarians and 61% of the Czechs supported the transition to the euro, and from them 19% and 17% were in favour of early introduction, and 5% and 7% are only those, who rejected the notion of loosing their national currency. Poles were more sceptical, only 35% was in favour, from them 13% supported the early entry, and 16% was against. (GfK Hungaria Piackutató Intézet, Népszava, December 29 2001.)

Those, who argue for caution, and a later acquisition of the euro, express their fear about the danger of deflationary effects of meeting the monetary and fiscal criteria, a loss of growth, postponement of convergence and the restructuring, and the constrains for "one size fits all" common monetary policy. Both, the Commission and the European Central Bank "have urged the candidates not to rush into the euro, but to concentrate on structural reforms. (The Economist, April 5 2003.) Both bodies "have given warning that hasty euro entry could endanger the applicants' growth prospects by depriving them of the monetary flexibility needed to cope with the pressures of the single market." (The Economist, December 7 2002.) As Csaba László, the Hungarian Finance Minister stated, Hungary should join the euro-zone "not by forcing, but by naturally growing into it". (*Népszabadság*, July 24, 2002.)

In an interview about why new member should be cautioned about the quick introduction of the euro, Otmar Issing, the member of the executive Board of ECB stated: "It is simply a good advise that the affected countries should thoroughly consider the timing of introduction of the euro, and should thoroughly prepare the economy for the obligations of monetary union. All questions, for example, the further structural reform ahead of countries, the necessary price corrections, the investments in infrastructure, should be carefully examined, before the countries announce that they are ready for complying with the rules about inflation, deficit or state debt. The early giving up the means of autonomous interest and exchange rate policies could be a big mistake." (Népszabadság, March 1 2003.) Christa Randzio-Plath, Chair of the Committee of Economic and Monetary affairs of the European Parliament told: "The accession countries would be well advised not to push too hard for early EMU membership before their economies have 'digested' the competitive shock of participation in the single market." (The citizens' Euro, Informa-

tion Program for the European Citizens. 2001.)
For the future, indeed, the real question is, how the rapid euro-zone entry will contribute to the sustainability of their economic growth, restructuring and modernization or how could it hinder and delay the process of convergence? "For the future new members the basic economic policy question is, what can be the interaction between the real economic convergence and the introduction of the euro, taking into account the minimum nominal convergence requirements for the entry into the euro-zone, and the expected shocks in the preceding period to introduction of the euro. The discussions center around whether it is worth to introduce the single currency only after a longer preparatory period, when the significant lagging behind of income levels substantially moderated, or just on contrary, the earliest introduction of euro means for the future CEE member countries the disciplinary force of economic policy, and the safety net against the external shocks, which is the precondition of the strengthening of young market economies, and achievement of a more dynamic growth path." (Neményi, 2003: 481)
The Ecostat, a Hungarian research institute summarized the pros and cons in a model analysis of euro introduction in Hungary for years of 2007 and then for 2010. (Ecostat, 2003)

Advantages	Disadvantages
2007 entry:	
Elimination of exchange rate risk	Cessation of autonomous monetary policy
Lower interest rates	Narrower scope of action of economic policy
Lower inflation	Slower economic growth
2010 entry:	
Greater scope of action of fiscal policy	Exchange rate risk remain
Gradual price convergence	Higher inflation
Smaller real-economic losses	Danger of speculative attacks

One major conclusion of the model calculations that "the more rapid entry is accompanied first slower, and then after introduction of the euro more rapid growth compared to the later variant. From 2012, the growth rates basically equalize. In totality, by 2020 the later variant brings a 2% higher volume of the GDP." (Ecostat, 2003: 2) The loss of growth is not substantial, while with the later entry, the exchange risks and speculative attacks mean great uncertainties. Just, the damages of a strong speculative attack could be much greater than the small advantages of later entry. Many argue, the monetary and fiscal stabilization are not against to the rapid and stable growth, on contrary if they are accompanied by structural reform, the monetary and fiscal rigor is condition of the sustainability of growth. When the broader balance of costs and benefits is carefully analysed, the arguments for rapid entry are more strengthened.
The Balassa-Samuelson effects are often cited as risks of early EMU joining. These

are realistic assumptions, as in recent years in Hungary inflationary expectations in the non-tradable sectors were more than double those of the other sectors. Above-average inflation may mean low or negative real interest rates, which may have an accelerating effect on inflationary processes, and may frustrate efforts at disinflation. On the other hand, low or negative interest rates may greatly help in the maintenance of higher growth rates and the convergence process, which is important from the point of view of closing development gaps. Higher inflation may make CEE goods overvalued in terms of euro exchange rates, which may worsen competitiveness and may have a negative effect on growth in these highly export-dependent countries. On the other hand, overvaluation may support disinflation, and promote increasing productivity and efficiency.
Beyond the anxieties about destabilizing effects, broader implications of early euro-zone entry of new CEE members should be equally analysed from points of view of present members. No doubt, that great part of the advantages is mutual, and the trade creation effects are equally beneficial for both parts. Fears are too general, and the policy factors, which might greatly influence the balances of costs and benefits, are not properly expounded.

2. Process of joining of the euro-zone

The CEE new members, concerning the EMU have to meet and comply with the same conditions and accession criteria as the present members, but probably with different timing and sequencing. Upon entry they join, more or less at the same time, the two first stages of transition to the EMU, which consider as a certain preparatory period before entering the euro-zone.

1. As "first stage" of EMU, new members *integrate into the Single European Market.* The importance of this is long recognised by all partners. As Werner Riecke, vice-president of the Hungarian National bank, stressed that from the point of view of EMU preparation the most important thing is that "the Hungarian economy should be able to hold its own in the European single market." (*Magyar Nemzet*, January 15, 1999.)
Although, the Accession Treaties assume immediate participation in the single market, the real question marks arise about the compromise involving a 5 – 7-year transition period with regard to free movement of labour (with the similar delay in acquisition of arable land in the CEE candidate countries by foreigners). Of course, one can argue that really it is the free movement of capital that counts mostly from the point of view of the smooth functioning of EMU, and that will be fulfilled. Although labour mobility is considered important by the theories of the optimum currency area in terms of avoiding aggravation of regional differences, from the point of view of the CEE countries' joining the euro-zone these are not exclusive limitations. It seems that only Austria and Germany insist on limiting free move-

ment of labour, while the others open their labour markets. The question of arable land is also a marginal issue. The question still remain, could the transition period prior to full single market integration be overlooked, or does it automatically imply the same transition period prior to joining EMU, as it was the case with present members? Could *the fulfilment of the convergence criteria* (the second stage of EMU) be enough for joining euro-zone, or is it irrelevant without full integration into the single market? To put it differently, some countries may well fulfil the Maastricht convergence criteria, but still remain unprepared for the euro-zone.

2. The *meeting of the convergence criteria* (second stage) is important as a way of stabilizing the economies of the candidate countries. It assumes the joining of ERM2, in which the stability of central rate for 2 years is one of the conditions. New members prepare their pre-accession economic program till August 15 2003, submit their report about structural reforms concerning product, labour and capital markets till October of 2003, and till May 15 2004 they work out their convergence program. They have to adjust their statistical data to EU regulations and introduce the rules of calculation of harmonized consumer price index.

Table 1 – State of fulfilment of convergence criteria by the 8 new members, 2002

	Country	**Inf. In %**	**Budget Deficit (GDP %)**	**Public debt In GDP %**	**Interests (nominal)**
	Czech Rep.	**1.8**	4.1	**23.3**	**4.2**
	Estonia	3.6	**0.4**	**5.1**	**4.3**
	Hungary	5.3	10.2	**57.0**	**7.0**
	Latvia	**1.9**	**1.8**	**13.9**	9.3
	Lithuania	**0.3**	**1.8**	**28.4**	**6.6**
	Poland	**2.2**	5.4	**46.7**	**6.5**
	Slovakia	3.4	**1.0**	**34.6**	7.4
	Slovenia	7.7	**2.8**	**31.0**	10.0
	AC-10*	**2.7**	5.3	**-**	-
	EU-15	**2.5**	**1.9**	**-**	-
	Reference value	**3.0**	**3.0**	**60.0**	**7.1**

Source: Eurostat. AC – Accession Countries

The new CEE Members have made great progress for meeting Maastricht convergence criteria, and some of them (particularly the three Baltic states) practically fulfil them upon their EU entry in 2004. There is no problem with public debt, and with exception of Hungary, they are far bellow the 60% reference value. The average debt level of the new CEE members is around 32% in their GDP, which is much lower than it was the case with most the present euro-zone members before their joining. In terms of inflation, only Hungary and Slovenia are behind (Slovakia

and Estonia only slightly), while concerning budget deficits Hungary, Czech Republic and Poland had to make efforts to comply. (In 2002, Hungary had extremely high budget deficit exceeding 10%, but by 2003 it is brought down to 4.8%.) If these countries have enough determination to consolidate their economies, it is realistic they are able to converge by 2007-2008, including the requirement of exchange-rate stability. The chance of stabilization still supports the idea of early EMU joining, while such a commitment may contribute to the process of that stabilization. As Csaba László, the Hungarian Finance Minister, stated, "the commitment to early joining of the euro-zone is one of the most important factors which make the program of disinflation credible in the eyes of market agents." (*HVG*, July 27, 2002: 19.)

Of course, we cannot exclude the possibility of a prolongation of the stabilization process due to external factors, such as unfavourable development of the European or international economic situation. The 2001 recession justified those reservations. It is not clear how full membership will affect national budgets. Even if the transfer of 4% of GDP from the EU budget were realised, the net effect on the national budget could be negative. If that is the case, this stage might become longer, especially if on entering euro-zone the CEE countries are called more strictly to account for their fulfilment of the convergence criteria than the present members. There are discussions about, how far Maastricht criteria and the Stability and Growth Pact can be applied to the new CEE members, should they be applied more strictly because they might mean a stability risk, or taking into account their specific problems (need for real convergence), even different and more flexible parameters and conditions should be considered? Some feel that the CEE candidate countries, being far below the level of development of the present EU members, should probably face stricter conditions, because their meeting of "the Maastricht criteria in themselves would not secure the stability of the European currency." (A study by the German HypoVereinsbank published by Eubusiness. *Világgazdaság*, May 3, 2001.)

2.1. When preparing for euro and complying with *inflationary performance,* should they stick to Maastricht criterion (1.5% divergence from inflation average of the three best performing countries, or from 2% ECB ceiling), or due to price convergence more flexible approach could be allowed? Should be the inflationary target absolute priority or should it be subordinated to the general economic conditions and convergence conditions of the country? In Hungary, from June 15, 2001, as an important step, 'currency (exchange-rate) stability' as a primary *monetary policy objective* was replaced by *inflation targeting*, as in Poland and the Czech Republic, with the only difference that these countries floated their currencies. The National Bank and the Central Statistical Office of Hungary agreed on a uniform calculation of core inflation, which will be also used in deciding on the necessary monetary policy measures. "The objective of price stability in the future CEE member countries means the achievement of 'optimal" inflation, which is determined by the structural char-

acteristics and equilibrium track of converging economy. The interest of the new EU members is not the "crash" of the inflation, but realization such a des-inflation track, which takes into account the aspects of monetary stability and the competitiveness, namely the development with out break downs." (Neményi, 2003: 498.) As noted by Csaba László, Hungarian finance minister, "It is more useful to reach Maastrich criteria through structural reforms, than simply use the monetary policy for reducing inflation." (Népszabadság, May 24 2003). The proper inflation targeting, and during the time, setting realistic targets is important condition of preparation and adjustment.

2.2. It is clear, that the *budgetary constraints of 'enlargement'* are one of the most serious problems, for both sides. Although the euro-zone member countries have managed to bring down their budget deficits in recent years, the 2001 recession seems to have led to some deterioration. The budgetary implications for CEE candidates of adjustment and preparation for membership are enormous, particularly in terms of infrastructure, the environment and structural modernization, even under boom conditions. According to calculations, in order to meet the membership obligations concerning the chapter on the environment, Hungary needs investments of several hundred billion euros in environment improvement. The transfers envisaged by Agenda 2000 are relatively modest in the light of these needs, and the national budgets of the candidates can cope only partly with these problems. Owing to postponed structural reforms and the 2001 recession, the budgets of many countries deteriorated (the Czech Republic, Hungary, Poland, Slovakia and Romania) and deficits increased well above the magic figure of 3%. Of course, the financing of adjustments should be done mostly on a commercial basis, but this depends on several economic and political factors. The budgetary implications are probably the most complicated dilemmas of economic policy on both sides.
Under these circumstances, is it realistic to assume that new CEE members should meet not only the 3% budget deficit ceiling, but according to *the Stability Pact* they should aim at balanced budget? On the one hand, there is a broad agreement that the objective of a balanced budget for the new members is totally irrelevant. Consequently, the "golden rule" should be considered particularly concerning these countries, and on capital investments even lasting deficits could be accepted. "Rather, the logic of the "golden rule" should apply: distinguishing between current and capital spending. Since public investment increases the growth capacity of the economy, part of the cost can be safely spread over a longer period via deficit financing, without adversely affecting the sustainability of public finances." (Financial Times, July 31 2002) On the other hand, one can argue that the flexible application of the Pact rules is satisfactory enough, and no special treatment is needed for the new members. We feel while the balanced or positive budget should be rejected for the new CEE members, the satisfactory compromises can be found by flexible application of the rules. As all new members are bellow the 60% debt ceiling, in case, it gives them enough manoeuvring room for allowing transitory surpassing

the budget ceiling under the strict conditions that deficits are related to restructuring, and on longer run by recovering they do not increase the indebtedness of the country.

2.3.Discussions go on about *the participation in ERM2*. Should the new member countries immediately join the ERM2 as they aim for rapid euro-zone membership, or could they choose the policy of free floating, which could better save them from speculative attacks against their currencies? In case, in reality, the necessary exchange rate stability required for euro-zone membership could be achieved this way as well, it is an other question, that even if it is proved, would it be excepted by the Union? It is a further question whether the +/-15% band is applicable, or new CEE members should be required to spend the two years in a +/-2.25% band for demonstrating the stability and convergence. It is suggested that CEE countries should spend more than two years in ERM-2 prior to EMU entry, and keep their exchange rate within a 2.25% band (unlike, for example, Greece, which enjoyed the 15% band). The narrower band could easily rejected on political ground as discrimination not supported by any justification, but also by practical considerations because it could put these countries under the intolerable pressure of speculation of financial markets, again not supported and justified by any rational reasons. In favour of rapid joining, the averting of danger of speculative attacks is particularly stressed. "The accession countries worry that until they join the euro-zone their borrowing costs will be higher, their currencies more vulnerable to attack, and their political heft diminished within the EU." The Economist, May 24 2003).

3. *Joining of euro-zone by CEE candidates, and replacement of their national currencies with the euro* (the third stage of EMU). The member countries gave themselves 3 years for the accomplishment of this task. CEE candidates do not have to stick to the same schedule and pace, but they may have to face some difficulties. The preparation of the micro- (especially the commercial banks) and the macro-spheres may be done continuously and it is possible that the technical transition (replacement of the currencies) can be completed quickly. Some assume that the introduction of the euro can happen in one stage (immediately in cash form, unlikely to the present member countries).
If we consider the above circumstances, in the case of the CEE countries integration into the internal market, meeting the convergence criteria and the changeover from national currencies to the euro could and should be achieved parallel. The separation of these stages in time will not be necessary, though as it was with the original members.
There are discussions about unilateral or consensus *"euroisation"*. Euro was unilaterally introduced as a "national" currency" in such countries as Monte Negro, Bosnia-Herzegovina and Kosovo, and some countries (Croatia) have waved to possibility to take similar steps. The EU accepted it as a fact, particularly as far as in volume they represent no problems. Euroisation could be based on "consensus",

namely the introduction of the euro is not connected with fulfilment of Maastricht criteria, but when the inflation and budget deficits are pushed down to an "optimal" level, which is in harmony with the needs of a balanced structural convergence, it can realised. The full entry into the monetary union would be achieved only later, when the convergence have satisfactorily progressed. The EU officially rejects this idea. In 2002, the Lithuanian parliament eliminated the exclusive legal tender status of the litas, and in official transactions any other currency can be used. In the cash payments the euro got the status of legal tender. Spontaneous and unilateral euroisation can not be excluded including in the potentially non member countries.

3. Are CEE members "mature" for monetary integration?

Fulfilment of the structural and institutional requirements (how they fulfil the demands concerning the 'optimum currency area') has also to be examined. We have to emphasize that *fulfilment of the structural and convergence criteria is not only a precondition of integration but also the only way in which the advantages of integration outweigh its costs*. This is the only way in which integration serves their interests, and it is an expression of integration maturity.
Consequently, the main question, which arise, *how are the CEE candidates meeting the requirements of the 'optimum currency zone'?*

The mobility of 'factors': Theoretically, liberalization of the movement of capital and labour is one of the important preconditions. Owing to its relatively low internal mobility it is hard to tell how mobile the CEE workforce could become under international conditions. (In this latter dimension, we do not have to take the underdeveloped real-estate market into consideration, but we have to pay attention to certain other factors – the lack of knowledge of languages, the hardships of fitting into a different society; but the huge differences in terms of wages may have a strong motivational effect.) The relations between the factors mentioned above require further research in terms of both the sectoral and the regional mobility of the labour force. While the regional mobility of the Hungarian labour force even inside the country has proved to be modest, the situation was different on a sectoral basis. There has been a substantial shift from industry and agriculture to services in the last ten years. It is widely estimated that the Polish labour force would probably be the most mobile among those of the Visegrad countries. But the fears expressed by the derogations in terms of labour mobility seem exaggerated, particularly in the long run, and for the whole Union.
The movement of capital has been and will be liberalized by the candidates upon their entry to the EU. The development of capital market, however, is still far behind of the EU members. As it is stated by the Report of the Hungarian National Bank on financial stability: "The depth of financial transmission of domestic bank-

ing could be considered very low in comparison with the Union, the extent of domestic bank sector does not reach even half of the level of the less developed bank sector of South European countries. The lagging behind of the Central and East European countries from the level of the Union increased further in the past years." (Hungarian National Bank, 2003.) The *weakness of transmission*, which is an expression of structural problems of capital markets, is one of the major question marks about the *"maturity" for monetary integration*.

The flexibility of 'factor prices': The years of transition proved that wages are much more flexible in the CEE countries that wish to join than had been assumed. What is more, they are more flexible than in the majority of the EU countries. The great decreases in real wages in the CEE region, accompanied by intra-sectoral mobility, took place without any serious social turbulences. Real wages dropped in Hungary by nearly 14% between 1993 and 1996, and showed positive growth only in 1994 (election year). As is proved by the demonstrations against the closing down of certain factories in Belgium, France and Germany, the social and political limits of wage-flexibility are stricter in the EU countries than in CEE. However, the tolerance of CEE society may change in the future. The labour market regulations of CEE countries introduced after 1990 were generally more liberal than those existing in the EU members, and the recent labour laws secure rather satisfactory market flexibility.

The *possibility of 'asymmetric shocks'* (sectoral or regional). For structural reasons, this possibility is relatively greater in the candidate countries than in the member countries. Owing to the export-dependence of these countries, this results in a high degree of sensitivity towards international business cycles. At the same time, the proportion of 'sensitive products' in Hungarian export, which was about 58% in 1989, has dramatically decreased to below 15%, and the increasing share of intra-sectoral trade may reduce these countries' vulnerability to external shocks. In this respect, the trends of recent years have been encouraging. "Several studies also suggest that the supply and demand shocks which effect the GDP are not, for the majority of the CEECs, less correlated with those which affect the large countries of the euro area than those affecting the peripheral countries (Finland, Portugal, Greece, etc.). More specifically, Hungary shows a relatively high degree of business cycle correlation with France, Italy and Germany. This symmetry apparently exists, but to a lesser extent, in Estonia, Poland, Slovenia and the Czech Republic." (Revue Elargissement No. 45. May 19, 2003.

Budget transfers: These could be the most important constraints of enlargement. It should be examined how the 'costs' of these and of competitive devaluations relate to each other on both sides.

The structural reforms that are essential for successful integration into the unified

market (law harmonization, modification of economic planning structures and institutional reforms) will take a long time and all the fields of the integration process will be affected by them. A lot of EU documents call the countries to account for the sluggishness of 'radical structural reforms' (the Country Reports). When planning the integration process, it is absolutely essential not only to work out the schedule of EMU-related harmonization but also to calculate its effect on the balance of the budget as well.

As far as the institutional conditions are concerned, in Hungary the 1991 law created an independent national bank, and the regulations mostly correspond to EU requirements. The HNB has well-trained staff. As was stated before the European Integration Committee of the Hungarian Parliament, the Hungarian commercial bank sector was fully prepared for receiving the euro from January 1, 2002. The same can be said about most of the other candidates.

"We have argued that membership in Europe's monetary union will be radically different as soon as five years from now. EMU will include a substantial number of new Eastern European members, since these countries will be anxious to join and will likely be able to do so. They come as close as the incumbents to satisfying the classic optimum-currency-area criteria for participation. They will satisfy the criteria in the protocol to the Maastricht Treaty governing qualification. By threatening to exercise their veto power in the ECOFIN Council, they will have political leverage." (Eichengreen and Ghironi, (2002: 402)

4. Costs and benefits of monetary union

To sum up, the *effects of EMU on the CEE candidates* will be complex. Some of them are quantifiable and some not, and they can be influenced for good or ill by proper policies. The candidates will enjoy the same benefits and face the same losses as the present member countries.

For CEE candidates EMU will mean getting into a monetary zone the stability, which would hardly be achievable for them if left to their own devices. For countries where the currency was for decades completely valueless (owing to its non-convertibility) and then, at the beginning of transformation, went through rapid devaluations (which slowed down or turned around as a result of stabilization), joining the EMU is a *benefit of unique significance*.

The promise of a stable single currency had great influence on public opinion in the member countries. It happened to be fairly negative in Germany, since the citizens did not want to lose their strong national currency. The case is opposite in the candidate countries. The socio-psychological potential of this fact is an important factor as far as the relation of public opinion to European integration is concerned.

The introduction and taking over of the single currency would mean savings, which in many respects, if quantified, would be substantial. According to calculations by the Hungarian National Bank, for economic actors the gains due to *savings in conver-*

sion costs and transaction expenses would be around 0.1 – 0.2% of GDP on an annual basis. (Hungarian National Bank, 2001.) The higher degree of monetary stability will make it possible for the banks and stock markets to *reduce their general risk premiums*, even if as a function of national financial positions they may remain divergent. This would mean that for example companies and institutions could substantially reduce their present 3 – 4% risk premiums. One of the most important gains will be *a reduction in the costs of anti-inflation policies*. With decreased rates of interest, *it will be easier to manage the state budget (and the national debt)*. The gains for Hungary from lower real interest rates may bring about a 0.4% 'growth surplus' in GDP in the coming 25 years (ibid.)

The single currency may *contribute to the expansion of trade* (it may have a significant trade-creating effect, according to some analysts), and it may improve the competitiveness of given sectors and the potential of national economies. The increased trade as a result of participation in the euro-zone may generate about 0.1 – 0.3% annual growth in GDP (ibid.) Exchange risk will be excluded to some extent, which may create *a better commercial environment* from the point of view of both the development of trade and investment decision-making. The benefits would be mutual.

Joining the EMU is likely to *make the countries even more attractive from the point of view of foreign investment*. The EMU may become an important factor in real integration. Analyses show that exchange-rate expectations play an important role in determining where the leading companies choose to invest their capital. This might be the 'most important impact' of enlargement for all sides. (Views of Richard Baldwin, Joseph Francois and Richard Portes.) At the same time, recently with the establishment of the euro-zone we have experienced certain investment diversion effects from CEE to euro-zone countries. (Investment by Toyota was diverted from Hungary or Poland to France, on the grounds of euro-zone considerations.)

The euro may take over the role of the dollar on the energy (oil) markets, since Russia, the Mediterranean and the Arab oil countries may later on prefer the euro to the dollar. In this respect, EMU could mean for CEE countries that they would buy oil for their own currency. In the longer term the dominance of the dollar could be replaced by a bipolar or tri-polar international monetary system.

To sum up, it is clear that early euro-zone joining raises several risks, but these risks can be avoided and the conflicting processes can be reconciled by *careful selection of economic policies and by proper policy mixes*. They can be supplemented by social contract compromising between the interests of different social partners, which may greatly help to keep inflation under control. As Gábor Obláth, the member of the Board of Hungarian National Bank stated: "There is a possibility for such a medium-term economic policy program, which is simultaneously able to promote the continuation of desinflation, the improvement of competitiveness and the rapid growth of economy. If the active support of social partners can be obtained for such a program, then the unified and forceful communication of desinflationary and competitiveness improving objectives of the program by the government and the national

bank can become practical force: it may contribute to moderation of inflationary expectations and improvement of competitiveness." (Világgazdaság, July 16 2002.)
The Hungarian National Bank made concrete complex analysis about the costs and benefits of euro-zone joining. A more comprehensive cost-benefit analysis for the whole region would require more precise data and knowledge of conditions in order to enable quantitative estimates to be made regarding the factors mentioned above. This would be very important and should be done later. But it is clear even without such estimates that if these countries meet the basic criteria (structural and convergence as well), *the net balance of integration into the EMU of the CEE countries is favourable and positive for both sides*. According to the Hungarian National Bank, the aggregate effects of joining the euro-zone may mean about 0.3 – 1% annual growth surplus in the coming 25 years. (Hungarian National Bank, 2001.) Beyond that the euro may bring and enforce more policy discipline, and need for more responsibility for sound policy making, which can be the major dividend of the whole exercise. The introduction of the euro will contribute to a 'stronger Europe', which is basic interest of both sides.

APPENDIX

Performance of the Hungarian economy

	GDP Annual growth in percentage	Inflation (CPI)	Ind. Production	Agr.	Budget Deficit	Unemployment
1950-59	3.8	-	-	-	-	-
1960-69	3.1	-	-	-	-	-
1970-79	2.3	-	-	-	-	-
1980-88	1.1	-	-	-	-	-
1981-6*	1.5	6.7	-	-	-	-
1987	4.1	8.2	-	-	-	-
1988	-0.1	16.5	-	-	-	-
1989	-0.2	17.0	-	-	-	0.6
1990	-3.3	28.3	-10.2	-9.2	0.0	1.7 (23)**
1991	-11.9	35.0	-16.6	-6.2	-4.4	7.5
1992	-4.5	23.0	-9.8	-20.0	-6.5	12.3(675)**
1993	-2.3	22.5	4.0	-9.7	-5.8	12.1
1994	3.0	18.8	9.6	-3.4	-8.1	10.4
1995	1.5	28.2	4.6	2.7	-6.5	10.4
1996	1.3	23.6	3.4	4.1	-3.0	10.7
1997	4.4	18.3	11.1	-0.5	-4.6	8.7
1998	5.1	14.3	12,6	-1.5	-4.5	7,8
1999	4.5	10.0	10.4	0.9	-3.9	7.0
2000	5.2	9.9	18.3	0.0	-3.7	5.9
2001	3.8	9.2	4.1	9-11	-3.5	5.7
2002+	3.4	5.5	3.8	1.0	-3.1(9)	5.5

* Inflation 1980-85
** Number of unemployed
\+ Prognoses .

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State of fulfilment of convergence criteria[1]					
Country	Year	Inf. In %	Budget Deficit (GDP %)	Public debt In GDP %	Interests (nominal)
Central European countries (CEFTA)					
Hungary	1990	28.3	0.0		
	1991	35.0	5.0		
	1992	23.0	6.5		
	1993	22.5	5.8	64.2	25.4
	1994	18.8	8.1		
	1995	28.2	6.5	72.6	32.6
	1996	23.6	3.3	-	
	1997	18.3	4.9	62.9	
	1998	14.3	4.9	61.1	18.0
	1999	10,0	3.9	60-61	15.0+
	2000	9.9	3.7	58-60	13.0+
	2001	9.2	3.5	55-58*	11.5
	2002	5.8-6.0	3.1	55*	-

[1] Commission of the European Communities; Creditanstalt. CEE Report.. 2001. No.4.

State of fulfilment of convergence criteria					
Country	Year	Inf. In %	Budget Deficit (GDP %)	Public debt in GDP %	Interests (nominal)
Central European countries (CEFTA)					
Poland	1992	43.0	6.0		
	1993	36.8	5.5	55.7	
	1994	33.2	4.0		
	1995	28.0	3.3		
	1996	19.9	2.5		
	1997	15.5	2.8	34.7*	
	1998	11.8	2.9*	37.6*	15.0
	1999	7.3	3.2	42.0*	20.5+
	2000	10.1	2.7*	44.1*	21.5+
	2001	5.5	5.5	38.9*	-
	2002	3.8	3.8	38.7.2	-

Czech Republik	1992	11.1	0.0	-	8.1
	1993	20.8	0.1	27.2	
	1994	10.0	1.0	29.7	
	1995	9.1	0.6	35.0	
	1996	8.8	0.0	34.6	
	1997	9.0	2.3*	38.1	
	1998	10.7	2.9*	43.2*	14.8+
	1999	2.1*	3.4	42.6*	8.8+
	2000	3.9	4.6	40.7*	7.7+
	2001	4.7	6.9	40.4*	-
	2002	3.1*	9.2	37.7*	-

State of fulfilment of convergence criteria					
Country	Year	Inf. In %	Budget Deficit (GDP %)	Public debt in GDP %	Interests (nominal)
Central European countries (CEFTA)					
Slovenia	1992	208	0.2		
	1993	25.0	0.5		
	1994	19.8	0.2	16.0	
	1995	12.6	0.0		
	1996	9.7	0.1+		
	1997	8.8	0.5		
	1998	7.9	0.8*	25.6*	17.3+
	1999	6.1	0.6*	27.4*	14.2+
	2000	8.9	1.4*	34.3*	17.4+
	2001	8.4	1.1*	35.8*	-
	2002	6.9	2.4*	35.3*	-
Slovak Republic	1992	10.0	3.1		
	1993	26.2	6.2	27.8	
	1994	13.4	3.4+		
	1995	9.9	3.1+		
	1996	5.8	1.3		
	1997	6.5	1.8		
	1998	6.7	4.7	57.5*	17.0+
	1999	10.6	3.9	53.4*	15.3+
	2000	12.2	6.8	54.8*	14.2+
	2001	7.3	6.0	55.0*	-
	2002	4.2	6.9	50.6*	-

Foreign debt. In Hungary, the internal public debt was 26,5% in GDP. This has to be added to the foreign debt for the total.

State of fulfilment of convergence criteria					
Country	Year	Inf. In %	Budget Deficit (GDP %)	Public debt in GDP %	Interests (nominal)
Baltic countries					
Estonia	1992	1076	1.5		
	1993	37.0	2.0		
	1994	42.0	2.0		6.2*
	1995	27.0	1.0*		
	1996	24.0	-		
	1997	11.2	+2.2*	55.3*	
	1998	8.2	-0.3*	56.1*	
	1999	3.3	-4,7	56.1*	
	2000	4.0	-0.7*	59.6*	
	2001	5.8	-0.2*	60.9	
	2002	4.6	-0.9*	62.7	
Latvia	1992	951	1.6		
	1993	35.0	3.5		
	1994	26.0	4.0		9.0*
	1995	23.0	2.2*		
	1996	19.0	-		
	1997	8.6	+0.9*	48.9*	
	1998	4.7	+0.2*	50.9*	
	1999	2.4*	4.0	57.8*	
	2000	2.6*	3.2	64.5	
	2001	2.5*	1.8*	69.3	
	2002	3.0*	2.4*	71.7	
	1992	1021.0	0.0*		
Lithuania	1993	188.0	4.0		
	1994	44.0	4.0		7,2*
	1995	39.5	4.5	20.5*	
	1996	24.6	4.6	29.5*	
	1997	8.9	1.8*	33.8*	
	1998	5.1	5.9	34.7*	
	1999	0.8	8.7	41.6*	
	2000	1.0*	3.3	43.0*	
	2001	1.5*	1.4*	43.7*	
	2002	2.4*	1.5*	42.6*	

State of fulfilment of convergence criteria					
Country	Year	Inf. in %	Budget Deficit (GDP %)	Public debt in GDP %	Interests (nominal)
Other candidates					
Bulgaria	1992	80,0	10,6		
	1993	63,9	10,7		
	1994	96,2	6,3	106,3	
	1995	62,2	7,3	81,2	
	1996	123,3	9,0	97,9	
	1997	1082.2	3.1	95.3	119.0+
	1998	22.3	+1.1	83.8	14.0+
	1999	0.3*	0.9*	82.3	11.5+
	2000	9.9	1.1*	86.5	11.5+
	2001	7.4	0.9*	76.7	
	2002	7.9	1.0*	75.4	
Romania	1992	210,0	4,3		
	1993	256,1	1,7		
	1994	136,7	4,0	15,1	
	1995	32,3	4,2		
	1996	38,8	5,8		52.0
	1997	154.8	3.6	29.0*	63.7+
	1998	59.1	2.8*	25.6*	56.9+
	1999	45.8	2.6*	28.9*	65.9+
	2000	46.2	3.6	29.8*	55.0+
	2001	34.5	3.5	31.1*	
	2002	25.0	3.2	32.4*	

* Maastricht criteria fulfilled.

+Lending rate

Hungarian Forint in the crawling peg

Monthly rates of devaluation of HUF

03. 12. 1995	1,9%
07. 01. 1995	1,3%
01. 01. 1996	1,2%
04. 01. 1997	1,1%
08. 15. 1997	1,0%
01. 01. 1998	0,9%
06. 15. 1998	0,8%
10. 01. 1998	0,7%
01. 01. 1999	0,6%
07. 01. 1999	0,5%
10. 01. 1999	0,4%
01.01. 2000	0,3%
04.01. 2001	0,2%

Abolished from October 1 of 2001.

The currency basket to which HUF has been fixed

December 9, 1991.	USD 50% - ECU 50%
August 2, 1993.	USD 50% - DM 50%
May 16, 1994.	USD 30% - ECU 70%
January 1, 1997.	USD 30% - DM 70%
January 1, 1999.	USD 30% - Euro 70%
January 1, 2000	Euro 100%

Intervention bands for HUF

July 1, 1992.	+ and - 0.3%
July 1, 1994.	+ and – 0.5%
August 5, 1994.	+ and – 1.25%
December 22, 1994.	+ and – 2.25%
May 4. 2001.	+ and – 15%

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