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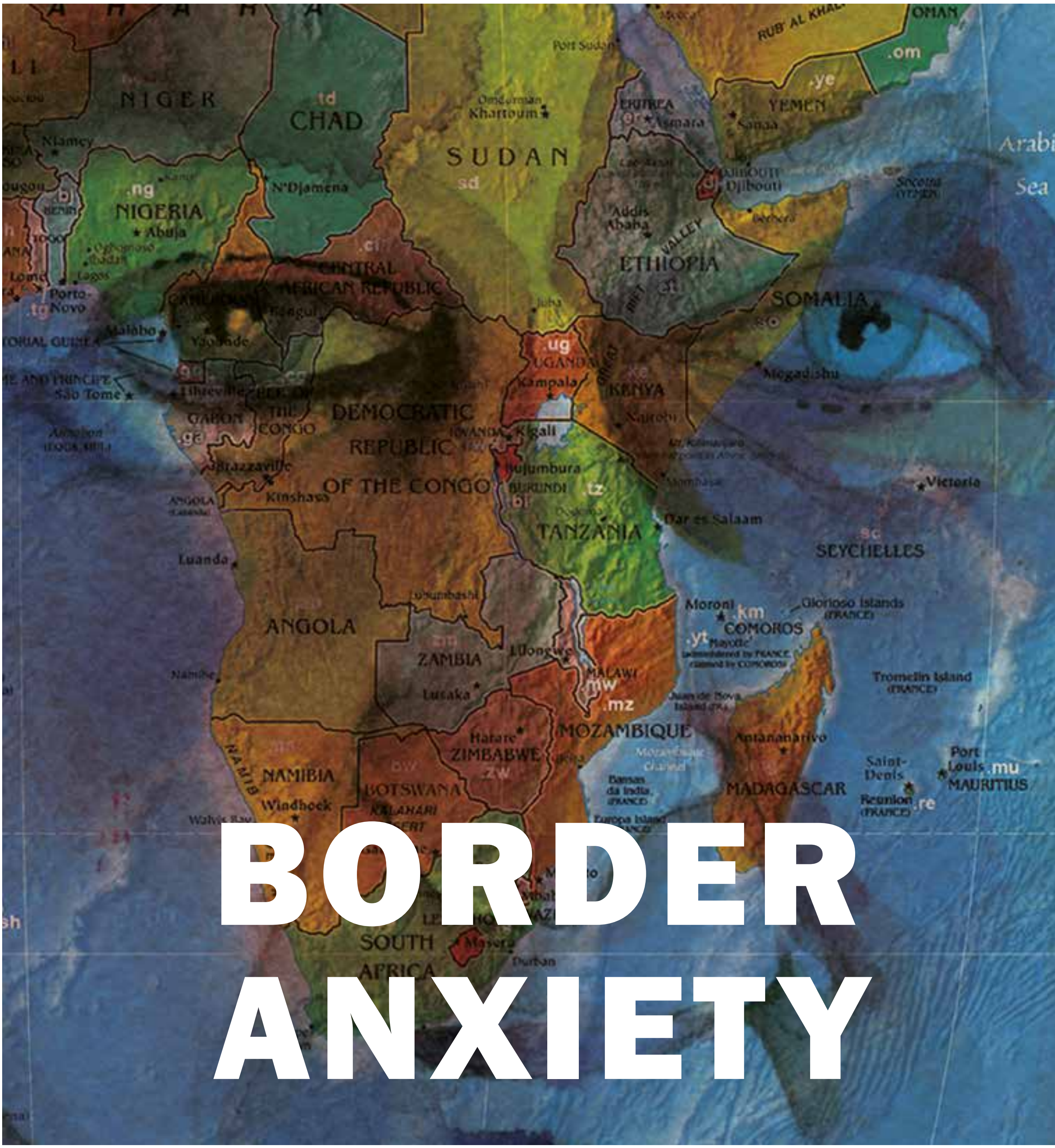

BORDER ANXIETY

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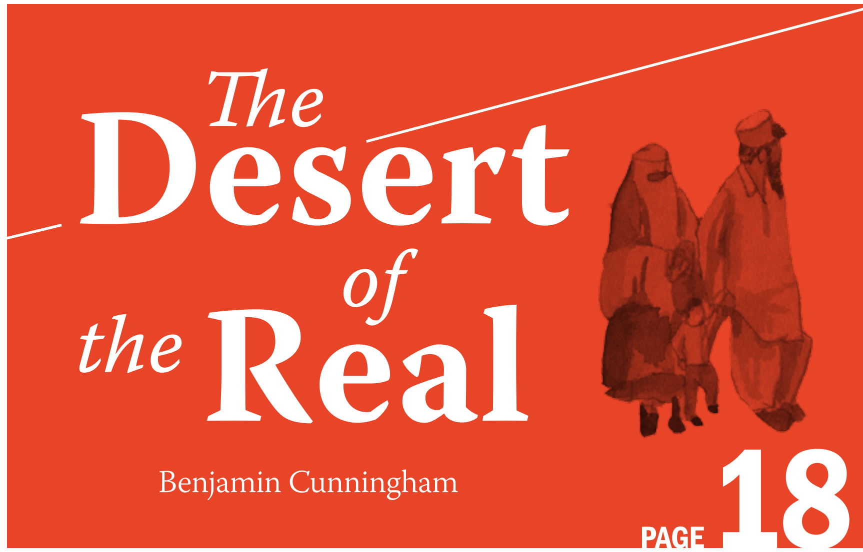

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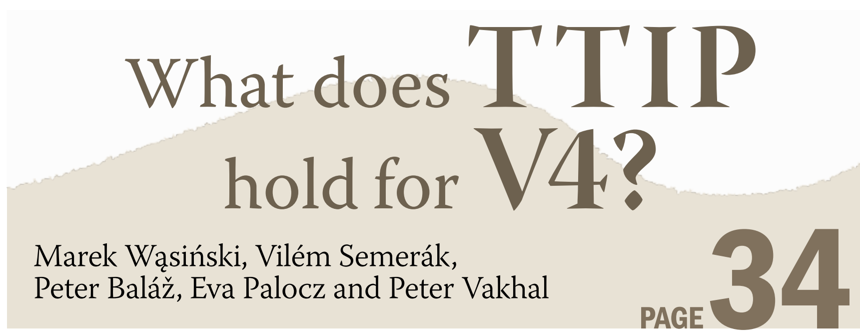

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PUBLIC ADMINIS-TRATIONS ARE NEVER AS SMART AS THEIR CITIZENS

Interview with International Visegrad Fund Director Beata Jaczewska

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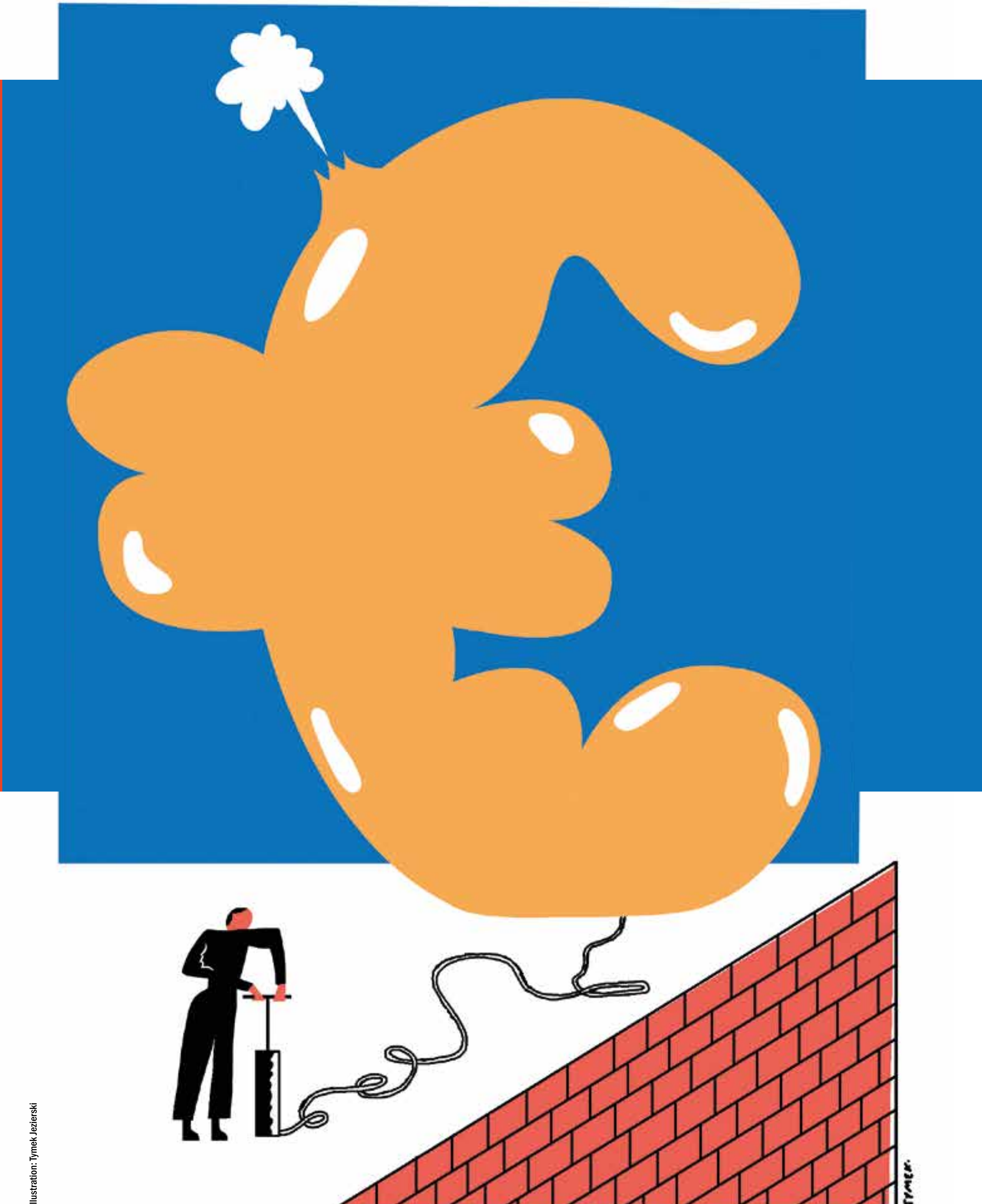
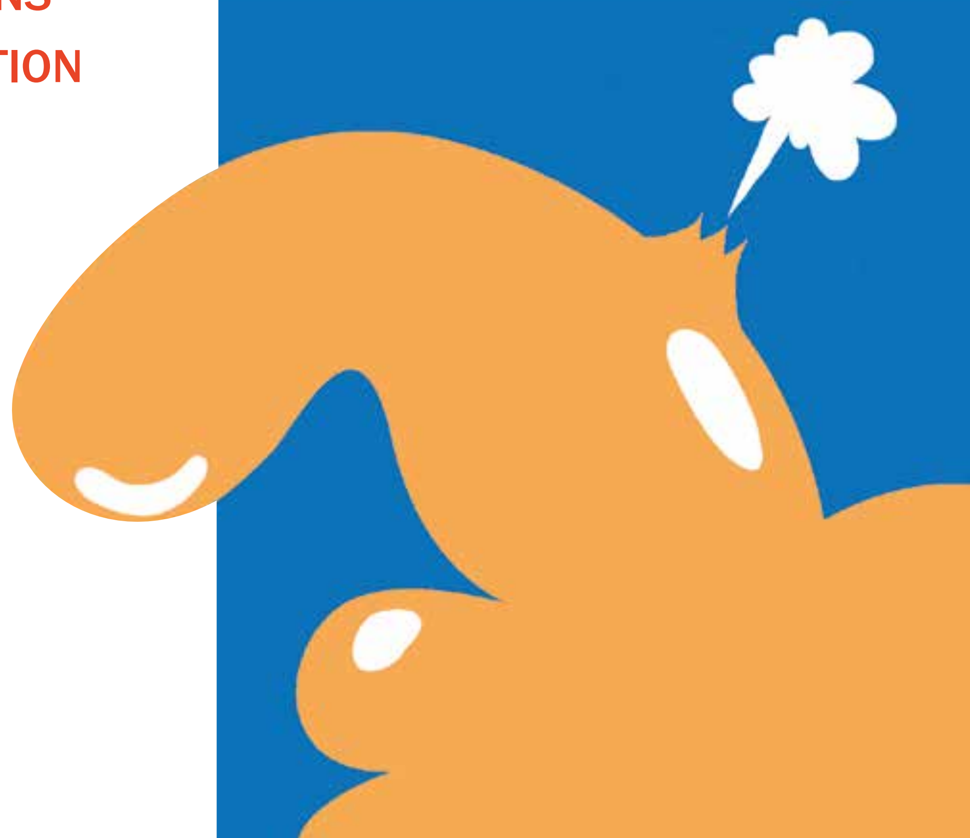


illustration: Tymek Jezierski

SHOULD WE ALL HAVE ONE CURRENCY?

PROS AND CONS OF EURO ADOPTION IN THE V4



POLAND

KRZYSZTOF BLUSZ

The common currency for the European Union was meant to be the culmination of a political project that united aspirations for integration among Europeans. Paradoxically, in thanks to the lessons being learned from the eurozone crisis about the macroeconomic mechanisms currently in effect, there may soon be a fundamentally new Europe and a variety of "unions" Meanwhile in Warsaw, Polish membership in the euro has been postponed *ad kalendas Graecas* by almost all political forces in the country.

Since 2010, several countries belonging to the eurozone have been experiencing a multidimensional crisis resembling a protracted political thriller, with Alexis Tsipras and Angela Merkel in the lead roles. Results from Poland's recent economic performance have confirmed the suspicions of Polish eurosceptics in their belief that the benefits of Eurozone membership have been disproportionately emphasized in comparison to the risks. Adding to this tension is the understanding that the struggles facing the southern economies can be attributed to government mismanagement. So it is no surprise that in terms of adopting the common currency, recent Polish political opinion shifted from support for the idea to a preference for sticking with the złoty. In Warsaw, it is difficult to see a direct link between membership in the euro and security, especially in terms of the economy. Key interests for Poland remain maintaining monetary sovereignty and control over the management of the exchange rate, and these take priority over deeper integration with the EU body and its institutions.

In spite of the novel circumstances surrounding the current reform of the eurozone, the debate in Poland is still dominated by the polarized options of either entering in or staying out of it. This perspective, sorely lacking any sort of nuance, is increasingly proving to be of little help in the search for a clear, informed decision. The struggle that led to the agreement between the EU and Greece was a palpable example of how membership in the eurozone redefines the sovereignty of a member in the field of economic policy. And this sovereignty is not the same kind everyone was accustomed to prior to the introduction of the euro. For a moment, it seemed like the Greek crisis would repeal the premise that the eurozone permitted only entries and never exits. However, the material consequences for participants now appear to be an envisioning of the euro project to include possible "anti-invitations" or "suspensions" from eurozone membership. It's true that no one fully understood what the legal, political, and financial consequences would be for this kind of union. But it is quite possible that through this difficult experience, the eurozone will come out stronger. Additionally, this has also prompted European leaders to introduce political reforms that could prevent a future crisis from hitting the eurozone while also allowing them to symbolically address the concerns of the European community that have focused on the stability and durability of the system.

This is why it is pertinent for Poland to reflect beyond the decision to enter the eurozone or not, and ask: what kind of eurozone would Poland be willing to join and what sort of structure would best foster Polish aspirations? Should it be a eurozone based on the "German model" meaning constructed on a platform of Kantian order, which coordinates economic policies without requiring common political or fiscal structures between partners? Perhaps it should resemble the "French model" which combines elements of political and fiscal union? Or maybe the current political climate does not permit this kind of thinking, and Poland must continue to believe that it is better off refusing invitations to join the eurozone? And if in fact, we come to this conclusion conclusively, what form should Polish relations have with the countries belonging to the eurozone?

The answers to the aforementioned questions are pressing for all nations currently harboring notions of entering the eurozone. In the next few months – in thanks to the cathartic performance of the Greeks and the sentiment of the "grexit" circulating throughout Europe – a process of fragmentation and reintegration could be catalyzed in Europe by the common currency. If that happens, the script to announce a "genuine monetary union" will take a while to get through because of the inclusion of structurally advanced political and economic policies that will ensure the consistency of fiscal and political strategies, hopefully creating a more durable and safe system. And then what? How are the member states that remain tied to their own currencies affecting the risks associated with a slow diffusion of these policies throughout the union? Although a seemingly plausible counter-example, the UK, in this case, may not be the most effective strategy. Not every nation is an island in the Atlantic, and Poland is more deeply integrated into the geopolitical and economic happenings in Europe than the British.

Membership in the eurozone has existed long enough to be able to witness the variety of economic gains and losses, benefits and risks that the system affords. It is high time to look at the situation through a new and updated perspective. Accession to the EU in 2004 and 2007 provided the impetus for modernization and cemented a political anchor that would provide Poland with security and geopolitical stability. But there are many signs today that suggest, without taking inherently risky steps towards joining the euro, it is unclear whether these promises will be fulfilled. /

Translated by Sylvia Gozdek

The author is co-founder and president of demosEUROPA-Center for European Strategy.

LEON PODKAMINER

Until 2008, Polish elites were generally quite eager to give up their national currency. To the intellectual elites the adoption of a common currency would seal the process of the country's "return to Europe." Civic Platform (in power since 2007) also favored an early euro adoption while the opposition represented by Mr. Jarosław Kaczyński's Law and Justice Party (PIS) resented the idea. In practical terms, the National Bank and the Finance Ministry were busy designing a roadmap for the monetary switchover which was planned to culminate on the 1st of January 2012.

Since 2009, the poor performance of the euro area's economy has had a sobering effect – at least as far as the government and the national bank are concerned. Nonetheless, some politicians and economists still deplore Poland's staying outside of the eurozone. They have been joined by no less a figure than Professor Grzegorz Kołodko who recently delivered a passionate plea for the switchover.

Essentially, the proponents of the switchover keep repeating two arguments. First, that by staying outside the eurozone Poland consigns itself to the political periphery. By implication, by entering the area, the country is believed to gain international stature. Second, that the euro as the national currency would substantially lower various costs (e.g., relating to foreign trade transactions) and accelerate the country's economic growth (e.g. via lower interest rates and easier credit).

Neither of the above arguments is convincing. First, Poland still has relatively low economic potential; the country's ruling elites will have little real say on global (or even European) affairs – whether the country adopts the euro or not. As a point of argument, what international prestige do Portugal and Greece derive from not having their own national currencies?

Now let us consider the "economic" case for the euro adoption. Certainly, this could lower some transaction costs. But these costs are rather hard to assess and in any case seem rather minor. In contrast, the risks – and potential disadvantages – likely to materialize upon the adoption of the euro are grave. These risks must not be overlooked.

One essential risk relates to the sudden – and possibly excessive - lowering of interest rates. This could lead to a real estate bubble and a consumption boom fuelled by inflated capital inflows. Currently, Poland's foreign debt stands at 306 billion euros (70% of GDP). With lower interest and exchange rates, the foreign debt could balloon further. Would that mean increases in the level of Poland's competitiveness and productive investment? Possibly. But more likely it would mean higher inflation combined with falling competitiveness, yawning current account deficits, and additional external indebtedness. Financed by foreign borrowing, the post-accession boom would end badly, either sooner or later. Does all this sound familiar? But of course: this is the shortest description of the developments that had led to the perpetual crisis which started in Portugal, Spain, Italy, and Greece in 2008.

Retaining the złoty is not without some drawbacks. The exchange rates tend to fluctuate – occasionally the złoty is too strong vis-à-vis the euro, which may affect the external competitiveness negatively. But these negative effects could be controlled as demonstrated, for instance, by the practice of the monetary policy conducted in the Czech Republic.

A country which does not have its own (floating) currency may end up in permanent crisis lacking any exit strategy. Such a situation develops when – for some reason – such a country cannot withstand competition from its much stronger economic partners. It is an illusion to believe that Poland (or other Central European countries) could prosper in the euro area if only the initial conversion rate of the national currency into euro is chosen correctly (so as to guarantee proper level of external competitiveness). Italy converted its lira into the euro at the rate which seemed correct in 1999. However, the course of events – specifically the aggressively mercantilist policy of the successive German governments has made Italy increasingly uncompetitive. The same applies to all other developed members of the euro area (excluding Austria and Holland – both tightly integrated with Germany since the 1960s). There is no reason to believe that Poland's eventual euro area membership could bring about sustainable and fast growth. At best Poland's growth would be anaemic – in line with the very feeble growth characterizing Germany whose (unsustainable) export-led growth has been achieved with the consequences of stagnating domestic consumption and repressed domestic wages. /

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CZECH REPUBLIC

LUDĚK NIEDERMAYER

In the Czech Republic, the discussion about whether to adopt the euro has been deadlocked for years. Czech public opinion needs a wakeup call on the issue.

The Czechs have accepted as a given fact that Slovakia, partly thanks to switching to the common currency, has started to overtake the Czech Republic in terms of growth and, increasingly, also in terms of wealth. On the other hand, "the euro's bad reputation," brought about by the economic crisis and intensified by the avowed euroscepticism of many politicians, has taken deep root in people's minds. To exacerbate the situation, the politicians who favor the euro have also kept quiet.

All sorts of arguments against the euro are alive and well in the Czech Republic, preventing an informed debate about whether its adoption might benefit the country. So, unless this resistance is overcome such a debate is unlikely to happen. The conviction that the euro as a project has been badly thought through and is unsuitable for Europe, that it has hampered growth in individual countries and given rise to political tensions, is widespread in this country. And the majority of people believe that the euro was to blame for tax payers in eurozone countries having to bail out the "lazy" Greeks to the tune of billions.

In addition, the Czechs are fond of "their crown" which, they believe, has served them well since 1993 (when Czechoslovakia split in two). They have conveniently forgotten the occasions when the crown was too strong, slowing down economic growth and raising unemployment, and thus the only remaining point for discussion is the ongoing currency policy of the Czech central bank, which weakened the crown by a few percentage points two years ago and has kept it at this level ever since, to the great joy of exporters and the lesser joy of households.

So let us take a look at what arguments really ought to be raised in the discussion about whether the Czechs should adopt the euro, were it not dominated by petty politics and deep-seated untruths.

From a purely Czech perspective, there are two key categories of issues. The first one is whether the eurozone is "good enough" for us, and, provided the answer is yes, the second type of question is whether being members of the club is better for us than lurking on the side-lines.

However, this narrow Czech point of view may be ignoring the rationale behind the creation of the euro, which aimed at much more than being merely a currency union since the euro is part and parcel of the project of European integration as a whole. This view may also be indifferent to the fact that the original rules proved too weak for the reality of twenty-first century politics.

The current architecture of the eurozone is based on a much clearer set of rules. These include mechanisms for the coordination of fiscal policy (including sanctions), the identification of and pressure to remove any imbalances (within the European semester), the creation of a crisis system for problem solving (the EFSM and ESM funds which provide loans conditional on reforms rather than generous gifts), and the Banking Union, including a mechanism for reducing the need to use public funds to resolve banking problems (bail outs). The new rules, along with past experience, provide better guarantees that mutual responsibility won't make the life of eurozone countries more complicated, and that it won't damage the credibility of the common currency, which is otherwise working well.

The notion that the euro has been a success is not widely shared because citizens are not particularly interested in the fact that it has worked well as a reserve currency, rapidly rising to the rank of the world's second most important currency. However, a quick look at the statistics is enough to refute one of the myths – that it was the common currency that has caused a slowdown in economic growth. Focusing on EU member countries for the purposes of this argument, the data shows that among the countries which have thrived in recent years, some are within the eurozone while others are outside the euro (for example, Germany and Slovakia which have adopted the euro, or the UK and Poland which have not). Likewise, there are countries which have run into difficulties or have experienced slow growth (Portugal and Greece within the euro, and Hungary and, until recently, also the Czech Republic, which are outside the common currency). Even during the eurozone credit crisis, it was not only the countries which use the euro that faced problems; five countries that are members of the eurozone and three countries that are not have drawn on the EFSF bailout fund.

Even more misleading, however, is the actual sense among many people that the causes of success or failure of individual countries are mostly due to currency or monetary policies. The euro has affected the development of individual countries, but the nature of its impact depended on their specific economic policies. Some countries – such as Germany and Slovakia – have exploited the advantages arising from the creation of the euro (the lowering of transaction costs, the elimination of currency uncertainty). Others have deplorably wasted this opportunity (which usually involves the lowering of interest rates and inflation) or worse, transformed it into the seeds of crises.

Thus, the main question is this: whether the Czech Republic is a country that would benefit from adopting the euro or whether we are one of those that might face economic hardship. Two factors are essential in this respect. The first is whether the eurozone currency policy would represent a degree of change that might help stimulate our economy. The second is whether the benefits of adopting the euro would outweigh the "giving up" of Czech monetary policy.

Given that we have been accustomed to low interest rates for years and that switching to the euro rates will not cause a nominal shock of cheap money, the risks that some countries faced after the adoption of the euro will definitely not affect the Czech Republic. At the same time, our country's similarity to the core of the eurozone—as well as the increasingly harmonized and strong trade—suggests that ECB policies would not necessarily constitute an obstacle for our prosperity and stability.

The actual pegging of the crown, in turn, represents several economic phenomena. Not only the elimination of currency uncertainty (which is welcomed by the business community), but also lower expenses for the industry and individuals (as well as a reduction in bank income from crown-euro exchanges) against the risk of the unsuitability of Frankfurt's currency policy. The aforementioned risks, although not particularly high, call for new policies which function well; primarily budgetary policies that would reconcile the absence of a domestic currency policy.

Last but not least, a political question arises with regard to the future of the club that we might be joining. As a result of fixing the eurozone's architecture, the main risks we are facing today are not bad rules or the behaviour of its members. What might constitute the greatest risk is the fact that the overwhelming majority of Europeans are lost amidst rules that are good yet complex, and that some people feel they are just puppets in a play directed by the elites in Brussels.

Furthermore, they feel all that the euro entails plays against their interests, a sense stoked by the aggressive rhetoric – which pays no heed to accuracy and truthfulness – from those who criticize the euro and the Union as a whole. Therefore, the future of the euro will not be decided by any sophisticated economic analyses but by the way European politicians behave and by what the people want. The European Union is a far more democratic project than either its opponents or its supporters believe. Should the Union, or just the euro, lose the support of its users, both would be headed for a fall. This is not an imminent scenario but it would happen eventually. And it would occur at a great cost; a cost incurred by the public if the euro were to be partially dismantled, let alone if the bonds of EU as a whole were to be radically loosened.

To reiterate, the greatest cost of this disintegration would be borne by the citizens of small nations. They would lose whatever influence they now have to shape the future of their continent, as well as the benefits they derive from the current situation. That is why, as long as countries such as the Czech Republic don't pluck up the courage to take what I believe is the rational step of adopting the euro, they should, as a minimum, wake up to the significance of the issue. And they should support the club instead of questioning it, which might ultimately bring the date of our joining the eurozone quite a bit closer. /

Translated by Julia Sherwood

The author is a former deputy chairman of the Czech National Bank.

MOJMÍR HAMPL

The main reason why the Czechs should keep the koruna can be expressed neatly by the wise adage: "if it ain't broke, don't fix it;" and the monetary policy in the Czech Republic is simply not in need of fixing.

Since 1998, the Czech National Bank has been using an inflation targeting framework to steer its monetary policy with notable success. After an initial period of disinflation, the CNB has been able to keep inflation expectations close to its set targets. More specifically, the goals were to have low, positive levels of inflation which it considers the most effective match for price stability. In the view of the CNB, inducing inflation expectations to hover near price stability is the best that monetary policies can achieve in order to nurture robust investment and support the sustainable growth of the economy.

A welcome implication of low average inflation has been a trend of real appreciation – as implied by economic convergence to Western European peers – which has resulted, at least nominally, in an advantageous exchange rate. This strengthening of the exchange rate has taken place at a mostly moderate pace. One notable exception was the first half of 2002, when the pace of appreciation became rather dramatic, mostly due to expectations of recently privatized properties transferring to foreign investors and entities. But the CNB and the Czech government took lessons from that episode and, since then, the two institutions have exhibited a high degree of mutual policy communication and co-ordination. As a result, the foreign exchange market has had little reason to speculate on any exchange rate-sensitive, domestic policy blunders.

Another fruit of the long-term price stability has been a low level of nominal interest rates. Thus, the domestic market has had no reason to demand loans in foreign currencies – a product which, in recent years, has caused so much trouble and public discontent in some other Visegrad countries.

Needless to say, the actual price developments have been dramatic whether due to domestic policy changes, such as indirect tax changes, or due to shocks coming from abroad, such as swings in the price of oil. But this is and always will be the case for any small open economy, regardless of who determines domestic monetary conditions. Forcing actual inflation to stay close to the target at all times would perhaps be possible, but only at the cost of sizeable monetary policy shocks, which would have adverse implications for the real economy.

In fact, developments in recent years have only reinforced the idea that autonomous monetary policy, if conducted properly, is an advantage. Just compare the Czech and the Slovak cases. In both economies, the relevant monetary policy authority has hit the lower boundary on nominal interest rates. However, the Czech authority (the Czech National Bank), unlike the Slovak one (the European Central Bank), was able to start using the exchange rate between the local currency and the euro as a supplementary monetary policy tool in an effort to avoid deflation and to bring inflation back to the target. I would assume that, as a result, future longer-term inflation expectations will be better anchored near price stability in the Czech Republic than in Slovakia.

There would be little need for such use of autonomous monetary policy if at least one of the two following conditions were met. Either the Czech economy would have to be very similar to that of the euro area so that the European Central Bank's monetary policy stance would be appropriate for the Czech economy as well. Or the Czech economy would have to be flexible enough to easily weather any mismatch between the monetary policy stance it actually needs and whichever stance the ECB takes. None of these two conditions, however, have been met. The set of comparative analyses that the CNB has produced at the end of every year since 2005 shows that the two economies differ considerably, and that neither the Czech labor market nor the public coffers are ready to work as a reliable adjustment valve.

To sum up, the CNB's monetary policy seems to have earned quite a lot of credibility. Indeed, a survey in April 2015 showed that almost 70% of Czechs are more or less against adopting the euro. This general feeling can also be documented by deeds; despite its geographical proximity to, and close trade links with, the euro area, the degree of spontaneous eurosisation within the Czech economy is low – in comparison with Poland and Hungary – and is not growing. /

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SLOVAKIA

ZUZANA GABRÍSOVÁ

Slovakia had the appeal of a common European currency almost completely figured out since joining the EU. Slovak and Czech readers can recall a famous quote from the notorious Czech 1988 movie "How Life Tastes to Poets" ("Jak básníkům chutná život"):

"The departure point is the marriage, of course. Hereafter, there are only positives and social benefits. First, a holiday in Yugoslavia; the first child follows. Then comes the purchase of the automobile. Here (pointing to a spot on the diagram) I become the deputy director, second child."

The Slovak departure point was the "marriage" with the EU. "Positives and social benefits" were soon to follow, namely joining the Schengen zone (2007) and the adoption of the euro (2009), which were both perceived as final steps towards the very core of civilized and wealthy Europe.

As for euro adoption, surely there were specific economic arguments at stake. To begin with, it was the elimination of transaction costs for people and businesses, along with transparency of prices when comparing the costs for goods and services abroad. Increased attractiveness for foreign investors and creditors was also expected, together with the effect of sharing the same strong currency with some (not all) of the main trading partners – Germany, Austria, Italy, France.

With fiscal prudency being the indispensable condition for joining the Eurozone, Slovakia tamed its levels of debt and deficit, as well as met the other Maastricht criteria. Slovakia and the euro embarked on a common journey with an exchange rate fixed at the very strong level of 30,126 koruna for 1 euro; which was favorable favourable for the people and not so much for exporters. The currency transition itself was smooth, people proved to be flexible enough, and the fears of radical increase of prices appeared to be largely unfounded, at least in the short term.

So far, so good. However, there is the obvious factor that puzzles almost every evaluation of the Slovak experience with the euro. As the character in the film also says while looking at his planned life-diagram, "coincidences are out of the question, or they are accounted for." But coincidences do happen and they are rarely acccounted for as was the case with the sovereign debt and economic crisis that hit the Eurozone just as Slovakia became its 16th member.

Despite the crisis that has shaken the Eurozone to its core, Slovakia enjoyed some of the expected positive developments of euro adoption. The transaction costs saved in the first year alone matched the level of expenditures linked to the transition to the new currency. Being a permanent benefit, the savings has amounted to 0.3 % of GDP annually, according to the National Bank of Slovakia. While it is true that due to the economic downturn, foreign direct investments recorded a drop after 2009, some investments had pre-emptively reached Slovakia once the investors had taken the adoption of euro as a foregone conclusion. It is a common understanding that the euro has sheltered Slovakia from more adverse effects of the crisis, such as the extreme volatility of exchange rates and loss of capital that has hindered the situation in Hungary.

Where Slovakia used the euro as remedy and shelter, the Czech Republic took advantage of the means of its own monetary policy. The different parameters of the economies at that time probably allows for an evaluation of both of these strategies as more suitable to their respective countries. It is probably fair to add that Slovakia's shopping tourism suffered in the bordering regions for some time as a result of differing price levels. Having eurozone membership in mind, Slovakia has undergone fiscal consolidation in terms of deficit and debt required by the Maastricht criteria. The truth is that public expenditures were largely relaxed right after joining the euro which also eliminated the benefits of lower borrowing costs for some time to come.

In general terms, the euro was seen by Slovakia as one tool for convergence with more advanced EU economies, but it definitely was not the only one and perhaps not even the main one. Political elements were definitely present in the euro-debate and the political class was especially enthusiastic about the assertion that, with the euro adoption, Slovakia would be the first from the former Eastern bloc countries which had met all the metrics for full EU-integration.

Just like for the founders of the common currency, for Slovakia the euro has never been just an economic project. This has become even more obvious as the cracks in the eurozone architecture are painfully exposed, and the Greek situation brings it to the brink of collapse. The membership in the eurozone during the crisis years has put Slovakia in an unprecedented position. It has faced numerous political dilemmas unknown by any EU-newcomer until now and has barely figured out what it wants to achieve within all of the elite EU-clubs. The instinctive rejection of the bilateral loans programme to Greece was gradually replaced by more constructive thinking about the conditions of the second programme for Athens, about the design of the permanent eurozone bail-out fund (the European Stabilisation Mechanism), and about the basis for new economic governance in the eurozone area. The obligation to abide by the formally strengthened

EU-fiscal rules has not only been supported by Slovakia vis-a-vis others, but has been consensually adopted domestically as well. Last year, Slovakia stepped out from its excessive deficit procedure that had been in place from its adoption of the euro in 2009.

Today, Slovakia is present, active, and some say also listened to in the discussions whether the eurozone should have its own budget and how far the political project of the eurozone economic governance should go. It is one of the most exciting political and economic exercises of our time, and thanks to the early euro adoption Slovakia is at the table where these decisions are taking place. Sure, the EU, Schengen, and eurozone come with specific and non-marginal strings attached, but that is a notion that Slovakia desperately needed to understand to make the perception of the EU project genuine. /

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JURAJ KARPIŠ

For numerous and understandable reasons, the Slovaks were very keen to join the eurozone. After the stormy 1990s, people remembered only too well how local politicians could make a mess of the currency. The way the political class wrecked public finances and plundered the banks by offering irrecoverable credit to their pals, masquerading as "Slovak capitalists," did nothing to contribute to the idea that Slovakia could manage its own independent currency. Things finally came to a head during a currency crisis that had to be resolved with the help of an IMF loan; but the rocketing inflation, exceeding 20% in some years, did not boost the people's love of their national currency either.

At the start of the new millennium the public was more than ready to experiment with another currency. People believed that a currency good enough for the Germans could not possibly be worse than the Slovak crown. Furthermore, the euro held local symbolic value for Slovakia. It was meant to be the final step, the crowning achievement of a successful period of reform and integration at the turn of the millennium. After finally ousting Vladimír Mečiar in 1988, two successive governments under Mikuláš Dzurinda managed to restructure the looted banks, reform the labor market, and lower taxes. Dzurinda's administration was able to steer a country known as "the black hole of Europe" into NATO and the European Union, and it attracted new investments that helped bring unemployment down. As a result, the economy grew by leaps and bounds, catching up on previously missed opportunities. The euro was supposed to be the culmination of both the political and economic achievements of this Central European "tiger" that had become the talk of the world. However, far from being just a feather in the cap of ruling politicians, everyone in Slovakia – from opposition politicians to businessmen and economists to the plebeian on the street – wanted the euro. Apart from hoping for a more stable currency, lowering foreign trade transaction costs, and eliminating black market currency speculation occurring on the country's borders, prestige and national pride also played a major role. The Slovaks, who until then had lagged behind neighboring post-communist countries in terms of nearly every economic indicator, finally had an opportunity to be first in something. And, by adopting the euro, the Slovaks have finally bested the Czechs.

The overwhelming enthusiasm for the euro affected the discussion of its advantages and disadvantages; which turned out to be dismally shallow. The central bank made no special effort to investigate the potential negative scenarios and risks. Its creativity in assessing the negative aspects of introducing the euro was limited to pointing out one-off costs that the state and the banks would incur in the course of the transition. The Slovak National Bank (NBS) did not regard the increasing practice of "fiscal fare-dodging" in the currency union nor the badly functioning Stability and Growth Treaty as problems that would directly affect Slovakia. According to them, none of this would prevent the currency union from working smoothly "for some years or decades" and they believed that in the long term the problem would be resolved through "closer political integration and improved economic policy coordination."[1] The NBS had a much clearer picture of the advantages and was more than happy to list them. Eliminating transaction costs in euro deals was supposed to add an annual growth of 0.36% to GDP, and the elimination of currency risks was meant to boost GDP by a further 0.02%. Pricing would become more transparent, capital expenses would go down due to lower interest rates, and the influx of direct foreign investment would increase. Even though Slovakia had one of the most open economies in the world before it had adopted the euro, and was busy trading with Europe and the rest of the world, the NBS believed that the euro would give a boost to foreign trade, increasing it by between 30% and 90%. This might perhaps not happen immediately, but it would definitely occur within two decades. And together with foreign investment this would "ultimately grow GDP by 7% to 20%."

In fact, the influx of foreign investment following the introduction of the euro decreased compared with previous years. In relation to GDP, it was actually even lower than that in the Czech Republic, which had retained its currency. In the four years preceding the introduction of the euro, the result of subtracting inflation from the volume of imports and exports had grown faster year-by-year than in the four years after the foreign currency was adopted; even disregarding the entire crisis year of 2009.[2] Although the crisis caused a decrease in volume of foreign investment, the fact that a marked spike in trade did not occur after the adoption of the euro is not really surprising. Comparisons of earlier developments in various parts of the EU indicate that a change of currency does not constitute a serious barrier to trade. The euro could not have played the role of a saviour to the economy because, the first ten years of existence for the common currency showed that those EU countries that did not adopt it (Sweden, UK, Denmark) may have had higher interest rates but their macroeconomic indicators were better than those in the eurozone. These countries enjoyed lower inflation and a faster decrease in unemployment as well as growth in real GDP. At the same time, the level of debt went down in non-euro countries and their public finance deficit was lower.[3]

In the wake of the crisis, analyses of the expected revenues and expenses resulting from the introduction of the euro have provided ample evidence to show how naive medium-term quantitative economic predictions have been. In hindsight, it is quite amusing to note that it was Ireland with its manic and unsustainable growth that had been cited in Slovakia as a favourite example of the positive effects of the euro on lowering interest rates. A few years later, as Ireland narrowly avoided defaulting, exceedingly low interest rates were proved to be more of a curse than an advantage to the euro. In May 2010, as the eurozone crisis erupted, the fundamental rules of the currency union were changed without a referendum. By introducing joint mutual guarantees, politicians have transformed the currency union into a debt union. Slovakia joined the elite club of the eurozone just before the end of a riotous feast; barely managing to order a drink before the waiter arrived with the bill. To our great surprise, it was suddenly decided that instead of dividing the bill based on how much each guest had consumed, it would be settled by using a joint credit card. The result is a perverse kind of solidarity that has forced Slovak taxpayers to guarantee credits for richer Europeans in problematic countries on the periphery and to help cut the losses of French, Italian, and German banks whose wrong decisions had financed the debt bubbles in the first place. /

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HUNGARY

BALÁZS ROMHÁNYI

When assessing the current chaotic situation within the eurozone, there are two fundamentally different courses which seem plausible. Either the country specific problems (Greece, Portugal, Slovenia, etc.) will largely be solved, or a splintering will occur if enough countries opt for a two-speed Europe, with the faster club decisively going after much stronger integration.

The first case, by and large, is reminiscent of the 2001-2007 period which would accompany lower growth rates but would also include the same options and threats. It would again be possible and attractive to join the eurozone, but it does not suggest that the same local problems could reoccur of that the same bubbles (real estate, competition, etc) could pop. A country like Hungary should only join the eurozone if its intention to avoid such macro and fiscal imbalances is serious. History has shown that a repeat of the 2002-2011 Greek example would be a clearly worse option than staying out.

In the second case, there would be three groups of EU member states; a further integrating euro group, a non-euro group, and a group between the two. The integrating euro group would start to behave more and more like a single country which would consist of at least 40% of all EU inhabitants and produce an even higher share in GDP. The European Central Bank would then have ample opportunities to differentiate between the integrating and non-integrating members of the eurozone, so a free-riding option on low, German interest rates, as the Greeks did for a decade, would only be a (theoretical) option in the fast club. In this situation the non-integrating euro-members will basically have to take on all the burdens of the single currency, but without the benefit of the free-riding option. Moreover, attacks on such countries to exit the zone can become a new, popular game. Being in the middle group would be even worse than belonging to any of the other two individually. A country like Hungary should only join the eurozone if it has the clear intention of joining the further integrating group, should the option arise.

Since 2011, the market has leaned towards a devaluation of the forint, both in nominal and real terms. Some experts even claim that the forint is now slightly undervalued. There are at least three reasons behind this trend. First is the notorious unpredictability of Hungarian economic policy, which certainly would not be part of any desirable, new equilibrium. Second is the current Hungarian government's belief in old logic to foster growth of exports via devaluation. However, the key factor for Hungarian exports is clearly the demand from Chinese and US consumers for luxury cars and not a dependence on the exchange rate. Moreover, while Hungary seems unable to make sustainable cuts in budget expenditures, they are content with the fast growing wages and subsequent tax revenues; this nominal wage hike more than offsets the competitiveness gained from the nominal devaluation. At the end of the day, this deliberate devaluation will not have a long term effect on export growth. Third is the recent switch from the exchange rate to the short term interest rate as the most sensitive, political, financial variable.

Although there was a long series of shocks that hit the Hungarian economy, the government could not afford to let the currency devalue as much as it should have done because of the number of Hungarian households which owed mortgage payments in foreign currencies (a total estimated value up to 15% of the GDP) was far too high. Now, after having converted close to all of these mortgages into variable rate forint-loans, the short term interest rate will affect directly the debt repayment burden, and hence the purchasing power of the indebted households. It is a safe bet to say that the pro-government central bank will be more than reluctant to increase the base rate, hence the currency will have to devalue. Perhaps it sounds logical; it is still an internal imbalance problem that necessitates the exchange rate change. The deleveraging of the households will take a few years, but this process can also be looked at as a preparation for the euro entry. It is clearly far less dangerous to enter the zone at a slightly undervalued exchange rate than at an overvalued one. As far as the future is concerned, not only foreign made, but also homemade country specific shocks should be avoided. This is much in line with the requirements of the revised Stability and Growth Pact.

My view is that Hungary should join the eurozone, more specifically its further integrating part because it would be a better, more consistent economic policy package than what we have now. At present, we are outside the currency union, the banking union, the financial market union, and running an economic policy full of unnecessary and detrimental shocks. However, if Hungarian governments in the future are not willing to give up their heavily used and misused toys in their short term political games, then it is better not to pretend to be a temporarily sober member of an elite club. /

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ÁDÁM BALOG

Considering the current challenges facing many states, the euro system is clearly broken and needs fixing. Why do these events happen? Some might say this is because the whole euro system was based on a delusional idea.

Considering the developments after the crisis, the answer would be that even a great plan can get off the track when the implementation is wrong. The Greek example suggests speed is a secondary factor in the case of euro adoption. From the EU's point of view, clear rules, regulation, and strict assessment are the top priorities for the process.

From a macro perspective, the success and development of a country is only partially dependent on its currency. What exhibits greater influence are the good or bad decisions that parallel finding the right balance between monetary and fiscal policy. The adoption of the euro is a major decision, but it is not the only one within this context. Countries can be successful in economic terms outside the euro bloc, while others may suffer from structural vulnerabilities within the eurozone. However, they have to keep in mind one thing regarding the currency union: this is a one-way road.

The World became quite a different place from what it was in 1993 when the Maastricht Treaty came into force. The 2008-2009 economic-financial crisis is still in the memories of us all, and these recollections make policymakers very cautious about making such a major decision. The suffering of the Greek people affects politicians and decision makers alike. First, because the example shows that things can get really bad in the eurozone even with a fixed exchange rate; second because the system itself could not prevent this situation.

Hungarian decision-makers are looking through cautious eyes when taking considering joining the eurozone. As a member of the European Union, the country is obliged to join the eurozone once all Maastricht-criteria are met. Hungary already managed to meet three out of five existing criteria during the past few years. Meanwhile, the country is on a good track to meet the debt-to-GDP criterion, as well. This figure stands at 78.2% and it has been continuously declining.

The ratio is expected to reach the 60% goal in the mid-term fueled by Hungary's solid GDP-figures and the government's strict attitude towards debt reduction. The fifth criterion dealing with the vitality of the exchange rate does not apply currently, as the country is not participating in the ERM II system.

These criteria are in line with what most economists think are good policies for the country. The crisis has shown that economic vulnerabilities, coupled with the irrational and irresponsible fiscal policies occurring before 2010, can lead to a major crisis regardless of membership in the eurozone.

Hungarian authorities have to adopt smart policies that support economic growth which also reduce both external and internal vulnerabilities. That was the key reason why policymakers have focused on reducing and keeping the budget deficit below 3% of the GDP since 2012. This was tied with the idea of lowering the proportion of FX-denominated financing within the government debt.

Regarding a few of the central bank's decisions, the funding-for-lending program launched in 2013 provided relief for SMEs amid liquidity shortages. In addition, the introduction of stricter rules for commercial banks to lower the operational risks of the banking system also supported the aforementioned mentioned goals.

These are all critical factors supporting Hungary's economic expansion and the aim of adopting the euro as a "by-product." Local policymakers and central bankers mostly agree on the necessity of the adoption of the euro. The key question is finding the right timing, as they would like to pick the best moment possible for euro entry. /

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