András INOTAI

Bern, February 23, 2003

On behalf of the Institute for World Economics of the Hungarian Academy of Sciences I would like to welcome all participants of this workshop. It is my particular pleasure to co-host the conference with the National Bank of Hungary and the Center for European Integration, Bonn, Germany.

Following the successful conclusion of official negotiations on accession, ten candidate countries are at the threshold of full membership in the enlarging European Union. Among them, there are those Central European countries, the representatives of which have been invited to this meeting. I think, we all are interested not only in membership, in general, but in a successful membership, in particular. We do know that the degree of success also depends on the future of the European Union, the implementation of the necessary reforms both on the nation-state level and on the EU level. In addition, it goes without saying that the success of the monetary union and its impact on further and indispensable reforms within the (enlarged) EU can also be considered as a key element of the framework conditions within which the new member states have to formulate and implement their basic tasks and objectives.

In the shorter run, all countries face four clear challenges. First, they have to organize and hold referenda on accession. Second, they have to devote utmost attention to the adjustment tasks which result from the accession treaty and have to be implemented, both in legal terms and concerning institution-building before the date of accession on May 1st, 2004. Third, immediately following the – hopefully successful – referendum, a broad dialogue has to be started with the society in order to prepare the people for the chances and challenges of membership. The success of accession largely depends on the maturity of societies, not only at the moment of joining the Union, but in the first and, in some way certainly difficult years of membership. Finally, each new member state has to clearly define its national strategy in all community policy-relevant areas. Only on this basis, they will be able to develop their activities as full members, implement their interests, enter reasonable compromises and, first of all, contribute to the shaping of a new Europe.

Preparing for the Economic and Monetary Union is an overarching task. Even if not officially, but on the microeconomic, i.e. business level, it has already started in all applicant countries. The process will undoubtedly characterize the next period and go on after institutional membership in the EU as well. Obviously, it is a key element, or even more the crowning of a successful membership in the enlarged integration.

As a representant of the Hungarian research community, let me share with you in this short introduction some observations, questions and dilemmas. I am sure, this conference will be an excellent opportunity to shed light on some of the problems, provide a convincing answer to some questions and, as natural, raise a number of additional issues to be dealt with carefully in the next months and years.

Each of the new member countries is firmly committed to the objectives of the Economic and Monetary Union. Not only because this commitment is part of the fulfilment of the Copenhague criteria (sharing the community policies in all aspects and areas), but in order to be able to enjoy all benefits of a large economic and monetary union in Europe, in the age of globalization. In this context, we devote particular attention to two basic issues: the developments and trends within the current monetary union, which will constitute the framework conditions of our entry into the EMU at a given time in the next years, and the domestic tasks of preparing for a successful participation not only in the EU but also in the EMU.

Concerning the first set of questions, the future of the Euro, both as a stable currency of Europe and a more and more important international reserve currency, are of crucial importance. I am convinced that the sustainable success of the monetary union requires further steps of deepening the European integration. They include economic measures mainly in the fiscal policy area, institutional reforms, mainly in the labour market and most probably also enhanced political cooperation in all fields that may, directly or indirectly, affect the internal stability and the international standing of the Euro, as a common currency. The behavior of the member countries, their ability to reform their domestic economies has become a key element of the success of the EMU. At the same time, this kind of reforms are indispensable for the success of the integration of Europe as a growing global economic player as well. Moreover, to some extent, even the successful membership of new countries may be influenced by the growth perspectives of our main trading partners, such as Germany, France or Italy. The monetary union, better to say, the sustainable fulfilment of the Maastricht criteria has been seriously challenged by the recent and, according to various signs, lasting world economic recession in general, and an above-average slowdown in the EMU economies. The higher than permissible budget deficits in some key member countries raise not only the question of the „omnipotence" of the Maastricht criteria in a gloomy world economic situation but direct attention to the importance of having balanced or surplus budget in the years of high growth, so that such „savings" could create a manoeuvring room for the national economies in more difficult times. One of the basic questions is whether the common currency and the sound monetary policy of the European Central Bank will be a sufficient „disciplinary" instrument to withhold some influential member countries from pursuing an „independent" fiscal policy. How can national fiscal policies, considering a number of national lobby interests and political pressures, be efficiently influenced by the monetary instruments of the ECB? In case differing economic and productivity growth rates resulting in different levels of international competitiveness cannot be rebalanced by the adequate flexibility of the labour market, wages and production costs, the sustainability of the EMU, as an unquestionable cornerstone achievement of European integration, may require additional instruments, including the possibility of introducing a system of transfer payments. This, however, would fundamentally challenge the solidarity of the member countries. There is no doubt that such payments, if necessary, would be twice to three times higher than the present ceiling of the EU budget of 1.27 per cent of the GNP of the member countries. In other words, such a development would be a much more crucial challenge to the common budget than the very low costs of the coming enlargement. With or without this possibility, the substantial restructuring of the present EU budget as of 2007 is anyhow a must for a sustainable European integration. In all these areas, the current member states and the current European integration have a high level of responsibility concerning the successful enlargement in general, and the successful and healthy preparation for membership in the EMU for the new countries, in particular.

Turning to the domestic tasks of the candidate countries I would like to stress that the basic discussion is not whether to join or not to join the EMU but about the timing and the instruments of accession to the monetary union without threatening the sustainability of a relatively high growth process. Since catching-up is a basic precondition of successful membership, and it needs a constant strengthening of their competitiveness, monetary policies should not hamper this process. This challenge assumes particular importance in a period of slow world economic growth which may constitute a barrier to export-led growth, and, simultaneously, under conditions of partly understandable wage pressure on the eve of EU accession, as well as substantial currency appreciation.

While everybody agrees on the necessity of entering the EMU (otherwise, the accession treaty stipulates this condition as well), there are cross-country differences in priorities and also different approaches within one country, between or among different expert groups. Some of them emphasize the evident benefits of becoming part of a currency area and consider the costs lower than the advantages. Others believe that a more cautious behaviour should be followed, and fear that a too early entry could seriously jeopardize the sustainability of growth and the continuous improvement of competitiveness, particularly under „unpleasant" global and domestic developments.

The key policy issues can be summarized in two areas: budget deficit and inflation. Again, all experts seem to agree that both budget deficit and inflation have to be substantially reduced and, in a certain time, have to meet the Maastricht criteria. The disagreement lies in the definition of the length of this period and, not least, in the policy mix to be applied to achieve the above goals without constraining growth. In my view, and from today's perspective, the achievement of the inflation target seems to be easier, even if we know that the catching-up (modernization) process is always accompanied by the so-called Balassa-Samuelson effect, which, for a certain period, results in higher inflation rates than those in „mature" economies. More problematic seems to be the budgetary deficit which, for various reasons, reached record levels in some candidate countries in 2002. Part of this deficit can and must be abolished in a rather short time. Another part, however, linked to the financing of the catching-up process and to the starting of still necessary big reforms (health, education, taxation, partly institutions, regional policies, etc.) can hardly be implemented without a fundamental reform of the central budget as such. The difficulties, by far not economic ones, are well known in a number of EU member countries, and have been responsible for the large deficits of more than one EMU member country in the last year. Therefore, the main challenge of successfully preparing for membership in the EMU comes from the budgetary side. And since budgetary reforms need substantial time, all candidate countries would be well advised to start with these reforms in order to be able to join the EMU at a relatively early time after accession to the EU.

However, here a very special budgetary problem emerges, paradoxically, in connection with the accession process. According to the forecasts, the first year(s) of membership in the EU are likely to generate additional budgetary constraints, particularly if the European economy will not be able to come back to a higher growth path by this time. The challenge partly comes from the still heavy financial burden of completing the adjustment process to the EU criteria (legal and institution building, prior to accession), and the additional (in part unforeseeable or not quantifiable) costs of further adjustment in the first period of membership. Another part, which can already be quantified, stems from the advanced direct payment to farmers (up to 55 per cent of the EU level) and the costs of cofinancing in order to have access to EU resources. Not less importantly, a large part of these resources will be paid in the last stage of or after finishing a given project, so that the national budget may be forced to prefinance also these costs, which, later, will be reimbursed from the EU budget. Since the new member countries will have to pay their full contribution to the EU budget from the very beginning, and their net financial position will certainly not much better than before 2004, a budgetary crunch (squeeze) may easily be generated. One of the key areas of policy-oriented research and economic policy-making should be to find the right answers to this serious challenge without curtailing those parts of the budget which are basic preconditions of a successful membership, namely the areas linked to human resource development (health and education).

I am very pleased that this conference will be dealing with the relevant experience of some EMU member countries, who, based on their major economic indicators, a few years before the common currency, have had little chance to enter the monetary union from the very beginning. Their experience will certainly be very helpful to the applicant countries. In fact, they were able to substantially improve those performance indicators which were crucial to fulfil the Maastricht criteria in a surprisingly short period. It would be interesting to know how could they perform so well, what were the economic and social costs, and how sustainable they consider the present situation. Some framework conditions should, however, not be forgotten, once such comparisons are being made. First, they have already been members of the EU for a decade at least when they started preparations for the EMU. Second, the decisive part of this effort was accompanied by favourable world and European economic development. Third, and not less importantly, they have been large net beneficiaries of EU resources which substantially helped them ease the budgetary burden by transferring the financing of large projects from the central budget towards the EU resources, and sustain growth and competitiveness. Just in the first and crucial period of successful membership in the EU and the fundamental stage of preparing for EMU, these conditions are either missing or difficult to be identified in the case of the newcomers.