Volume 21 Issue 8
Originally issued as E1

Global Journal of HUMAN-SOCIAL SCIENCE: E
Economics
Volume 21 Issue 1 Version 1.0 Year 2021
Type: Double Blind Peer Reviewed International Research Journal
Publisher: Global Journals
Online ISSN: 2249-460x & Print ISSN: 0975-587X

Some Questions of the Introduction of Euro in Hungary

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GJHSS-E Classification: FOR Code: 149999



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Some Questions of the Introduction of Euro in Hungary

Tibor Palánkai

I. Some General Remarks

The question of monetary integration was part of discussions on European integration from the beginning, in Hungary. That applied to Euro as well, and there was no question that it is part of our integration project. We have different waves of discussions, but there was an overwhelming support of the project from great number of the experts. The discussions were professional, less politicized and divided compared to Poland or Czech Republic, and several high quality studies were published on the issue. The discussions intensified again last year and early this year and several studies and articles were published. Among them, the initiative of Hungarian Nation Bank (HNB) on Maastricht22, and the dispute between the Hungarian Minister of Finances (Mlhály Varga) and the president of HNB (György Matolcsy) got particular attention. I refer to two articles of the Journal of Counterbalanace (Egyensúly), one from Bod Péter Ákos ((former President of the Hungarian National Bank) and István Dobozi (Former Lead Economist at the World Bank). This article refers and reflects on the main points of these discussions.

The Euro is an economic and business project. Of course, its introduction and construction was determined by complex political expectations and interests, and it is important symbol of the political integration and unity of the European Union.

The Euro stands on *two legs,* its stability and future cannot be understood without them. These are partly the *high level of integratedness of the EU,* and partly the requirements of *creation of the single market* among the member countries.

Some years ago, we made an attempt to determine and measure of level of integratedness of countries and integration groupings. In the framework of so called *Integration Profiles* research we made these comparisons on the basis of about two dozens of parameters. Among them, such as intensity of relations, interconnectedness and interdependence, structural convergence, balances of trade, financial and capital relations, and some indicators of macro-convergence.

We put the countries and organizations *on a 100 per cent scale in 5 groupings.* Accordingly, up to 10 per cent, there is no integration, from 10%, we can speak about low, from 30% about medium, from 50% high and from 70% very high levels of integration. We made calculations only about the EU. But on the ground of estimations, we could assume that in the last 50 years the global interconnectedness has surpassed the 10% level, and therefore, it is justified to speak about *"global integration".* It also seems that the integratedness level of the different interstate regional groupings (ASEAN, Mercosure, Nafta) has not reached the 30%, namely it remained on low level. At the same time, in total the *EU surpassed the 50% (high) integration level.* Among them, about 6-8 countries (small, developed and CEE countries including Hungary) fell into the above 70% category, namely they can qualify for extremely high integratedness. (Palánkai, 2014/1 és 2017/3)

At the high level of integration the savings on transaction costs can be high enough to influence substantially the competitiveness of the region. It is another question, how far they can be calculated exactly. The problem was similar with the customs union. The advantages were obvious, while in the analyses based on Viner methods proved to be marginal. Therefore, it is important to stress that the Euro is not just a political creature, but it is important element of competitiveness of EU economy. One should not forget about this when speaking about the too "early" introduction and relevance of the Euro.

The other "leg" is the *single European market.* There is a large literature about the mutual assumption of the single market and the EMU. We refrain from discussing it, but we refer only on the divergence aspects.

The market liberalization among the countries with high differences in levels of developments and with oligopolistic market structures unavoidably leads to increasing inequalities of distributions of advantages of integration. Based on spontaneous market mechanisms, the rich countries get richer, while the poor get poorer. This problem was already clear by creation of the common market after 1968. But as this was demonstrated rather on regional levels instead of national ones, it was not by chance that after 1975 the Regional Development Fund was created. In reality, it served *compensation,* although the declared aim was rather promotion of development.

The increase of inequalities in the EU was basically connected to the single market, although it is the anomaly of the global capitalism. In absence of corrections and compensations these differences are

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deepened by spontaneous market mechanisms. The extension of regulated market economy to union level, therefore, should be a strategic aim. The Economic and Monetary Union and the single market should form a strategic unity.

In policy integration, such fields as monetary, fiscal or financial policies play important role, and the money (Euro) is a basic tool. The increase of inequalities, therefore, does not follow from the Euro, but the EMU as an element regulated market economy model, among others should rather deal with inequality anomalies. It is another question how far the commitments of the Lisbon Treaty for „competitive social market economy" were fulfilled. (Palánkai 2017/1)

The Maastricht decisions on monetary integration were born for 12 members, but they were tailored rather to the 6 core countries. As result, the Maastricht criteria *focused primarily to one single priority, namely price stability*. The requirement of *convergence was practically neglected,* although in a heterogenic monetary union, the stability and coherence without it cannot be achieved. Perhaps, the explanation can be that Ireland and the three Mediterranean countries joining in the 1980s years, in the decade before Maastricht produced a spectacular convergence. Till the approving the Maastricht decisions, even the association agreements with the CEE countries have not been signed. At the time, the membership of these countries was not an agenda, and then from the end of 1990s, the convergence of the CEE regions was also spectacular.

Through enlargements the asymmetries of internal market (rules of which took force "upon entry") increased substantially. The correspondence to optimal currency area was questioned from the beginning, and by enlargements it was even so. In spite of convergence of per capita GDPs, the regional differences remained and due to overwhelming market positions of large companies of developed members, the market inequalities persisted. In these respects, contrary to some views, the role of the Euro cannot be identified.

One of the main arguments of opponents of the Euro is that *we should achieve a certain level of development before joining the Euro-zone*. In general, it should be stressed, however, that *creation of a monetary union does not depend on level of development and its internal divergences.* We have several monetary unions in different federations, let they be, India and Brazil, or US and Canada. It is another question that the construction of these monetary unions due to their specificities and endowments should be substantially differing. The specificities refer to level of developments and structures, to socio economic relations, political and historical traditions and many other factors.

The connection of introduction of the Euro to certain level of per capita GDP is not only theoretically, but also methodologically is false and misleading. The GDP is too much imperfect indicator for using for such an important strategic decision as Euro introduction. GDP is a mix of input and output data, and as it can take into account the actual expenditures, it is unable separate waist and corruption. A railway line can be built for 100 million Euros, but if it was built for 200 in reality, it is calculated on that. By this the waist and corruption become as a factor of growth. Of course, the main factors of competitiveness should be taken into account, like productivity, structural differences, state of trade balance and costs and many others.

Consequently, in the EU as well, the problems arose not just because of monetary union, but due to its given construction. It would be too long to analyse all of the deficiencies of the Euro, but at least, three of them can be specially mentioned. One was the *overestimation of coordination and controlling role of the market mechanisms.* As it turned out the market instead of disciplining rather inspired irresponsible attitudes (cheap money used for buying votes or speculating with real estate), and then only punished afterwards, in fact very cruelly. There were *deficits in the construction of institutions and policies of the monetary union*, which after 2010, in the process of reform of Euro governance were largely corrected, even if the full consolidation is not yet competed. Furthermore, the monetary integration would assume the *strict adjustment and discipline of national policies.* In fact, the break and sabotaging of the rules, and the free riding characterised all of the countries, there were differences only in their extent and consequences. The Euro was a tool, but its guilt is fully irrelevant.

II. Euro and Hungary

I fully agree with those views, according to which the *introduction of the Euro in Hungary is a general national interest.* The excellent analysis of Bod Péter Ákos on the cost and benefits gives a complex and convincing picture. Summarizing the factors, he concludes: „On the basis of thorough examination of the economic arguments and facts, I cannot say other then, that for an economy with similar size, structure and tradition, like Hungary, the permanent use of separate mean of payments, and burdening the related costs and risks on the population, is not advisable." (Bod Péter Ákos, 2019: 8)

More than half of the Hungarian population stably supports the Euro introduction. According to a recent representative (asking 1000 peoples) public opinion research, on the question: "Would you support the introduction of the Euro replacing the Forint as soon as possible?" from the total Hungarian population, 65% answered with yes. (Pulzus Research - Pulzus Kutató, Index, June 3, 2020.)

At the same time, *there is no such a socio-economic interest group, which would take the case of*

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the Euro on its shoulders. Traditionally, in general, the main supporters of the Euro introduction were the *Transnational Companies.* They were the main beneficiaries of the project, and the reduction of the transaction costs served primarily their interests.

The Hungarian economy is one of the most transnationalized among the member countries. As it means dominance of foreign investors, there is no limit that these companies maximally use Euro where it is advantageous and desirable for them. And they broadly use it. At the same time, they have no disadvantage, but it is rather advantageous for them the existence of a parallel national currency, which is gradually devaluating. They conduct their international transactions in Euro, while, in case, it is definitely advantageous to finance wages, local services and supplies in the devaluating local currency. The dual currency systems are good from points of view of tax evasion, profit transfers and speculation.

Both large and smaller domestic companies are not active on global markets. The Euro for them is not of life importance. The main beneficiaries of the structural and agrarian funds are companies primarily oriented to domestic markets (food or construction companies), it is advantageous to get revenues in Euro, while calculating cost in local currency. The banking sector is largely counter-interested. The commercial banks fear of loosing the large conversion fees, while the national bank for loss of seigniorage incomes.

The political scene is deeply divided, even inside the parties. No doubt, that taking over the single currency means limiting national sovereignty and room of manoeuvring (even if illusory), and therefore, the parties, particularly in governing positions are cautiously and reluctantly approaching the issue. The opposition is generally committed to the Euro, but as it is a risky campaign question, it does not hurry with relevant introduction strategy.

The introduction of the Euro in Hungary raises several strategic and also technical questions. In fact, we are parts of the EMU and we were assumed to take the aqui communautaire "upon entry", and in these respects. The only derogation is the joining of the Euro-zone (originally the "third stage" of implementation). For this we have contractual obligation without deadline.

As it is analysed by Bod Péter Ákos, we should stress that *on the basis of high euroization of Hungarian economy, we are parts of the Euro-area* (contrary to "zone"). Theoretically, we can speak about "dollarization" or "euroization", if the proportions of these currencies in the national monetary circulation exceed 10%. There are no relevant and reliable calculations on these, but on the basis of the shares and export role of TNCs, the proportion of the Euro can be estimated substantial (probably exceeding 50%). In the private transfers and the retail sectors, these shares are less extended, but there is not without foundations to speak about a certain *"creeping euroization"*. In several sport sectors, the imported players are paid directly in Euro. In Croatia, the level of euroization seems to be higher (tourist incomes and pension transfers). "It is not exaggeration to tell that the Hungarian (Danish, Bulgarian or Czech) economic players are already long in the Euro-area, and only the population and the state are outside." (Bod Péter Ákos, 2019: 4)

In the last years, *in the group of Euro candidates we can witness the formation a specific monetary construction.* This is *a dual currency system with floating exchange rates.* The exception is Bulgaria, where a currency board was introduced with fixing the national currency to the Euro already since 1997. The differences among the countries are in the mood of floatation (directed or spontaneous), in extent of devaluation and in relation of related policies.

It should be noted, that in Hungary in the following 10 years of 2008, the forint to the Euro was devaluated by about 30%. In the same period, the Czech crone and the Polish zloty showed a relative stability. (We do not speak about the events of last months.)

Due to complexity of processes, the analysis of effects of exchange rate changes is not easy. The impacts of devaluation, and their disadvantages are not easily identifiable.

The devaluation does not improve "competitiveness", but it creates possibility for adjustment. It can keep the producer on the market transitorily, gives a breathing time for making real steps for cutting costs and improving quality of the product. At the same time, as in the national currency it creates quasy-profitability, it can reduce the constraints for adjustment or postpone it. The free riding on the quasy-profitablity may be one of the most negative consequences of devaluation. How general is this free riding, is indicated by the example of continuously devaluating countries.

On the basis of Hungarian foreign trade structure, the question seems to be ambivalent. No doubt, that the devaluation can create unjustifiable incomes for TNCs and many local companies, while it is uncertain how far it helped the acquiring and keeping markets for the local Smes? As the local Smes are unable to hold on the global markets, this deficit of our integration seems to persisting.

Furthermore, as devaluation is reduction of welfare, namely it is restriction. Generally, socially more acceptable as through inflation it diffuses welfare losses to the whole society. The inflationary impacts of forint devaluation were not proportional, which can be explained by several factors. The money inflation was counterbalanced by demand and cost deflation (decrease of oil prices), and it seems that the demand deflation could even counterbalance such cost inflationary pressures as explosion of wages. Of course,

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we should distinguish between statistical and real inflation experience daily during our shopping.

Theoretically, the construction of dual currency system is not new, in fact, it *recalls the British proposals on the monetary integration* (John Major). The Brits did not reject the monetary union. On contrary, they were in favour. And their proposals were not irrelevant.

The proposal was about "common" currency, parallel preserving the national monies. (Not surprisingly from a country formerly having an international key currency.) The proposal was definitely rejected by the German, and they voted in favour of the "single" currency. According to them, the supposed crowding our effects may have undesirable inflationary and redistribution impacts, and they should be avoided. In our region, these crowding out effects cannot be identified.

The dual currency systems of our region seem to be sustainable even for longer run. The direct constraints for changing to Euro are rather political and legal. The system is, however, sub-optimal, the counter-interests (TNCS, local large companies or banks) imply social losses. The arguments for Euro introduction clearly prove that.

For the coming years, it is difficult to make prognoses. From the six candidates, three (Bulgaria, Croatian and Romania) have already an accession program, and even the target dates are indicated. In the past, these target dates were postponed several times, but the chances of implementation are increasing. The possible Euro-zone joining of Romania and Croatia would raise the Hungarian entry to a national-political issue.

The Czech and Polish staying outs are explained by strong sovereignty arguments. Of course, it would be difficult to deny how the monetary policy sovereignties are illusory. But they can be overwritten by broader political considerations. Interestingly, the Slovak joining of the Euro-zone were also based on sovereignty considerations, but with opposite signs. If they sit at the table of decision, they may influence them, while outside, these decision are made above their head. In fact, it should be noted, for Poland as for a medium power of the Union, these chances for influencing would be much favourable.

There are chances for further "creeping" euroization. For example, the reduction and elimination of cash transfers may offer several possibilities. In Hungary, it is also a future program. This could mean that the Euro is not introduced in cash forms, while parallel the national currency is also withdrawn from the financial turnover. On the accounts, the prices and the transfers can remain to be registered in both currencies, but the plastic card does not tell anything about what money was used. Of course, it assumes fixing the exchange rates and elimination of conversion fees. Later can be marginalized (tending to zero) by the present information techniques, and the banks can be compensated for loosing revenues from conversion fees.

III. Making Reforms Together

The consolidation and reforms of the Euro-system call for fundamental structural changes. The dealing with debt crisis has of utmost importance. The Euro so far has avoided the classical currency crises (inflation and devaluation), the euro crises were debt crises, originating primarily the Southern members. Management of debts are basically about debt cummulation, and there are no chances that they ever can and will be paid back. The paralyzing impacts are well known, and the situation can be aggravated by the Covid 19 crisis.

Due to largely increased heterogeneity of the participating countries, *besides the stability, the convergence should also become strategic priority of the Euro-zone.* The present cohesion crisis could be solved and the future ones can be avoided only this way.

There are several possibilities, but I think that *the present Euro architectures should be supplemented by a set of Cohesion and Convergence Structures.* Although, I find the "no transfer union" slogan highly misleading, I do not think that they should be about primarily money transfers. (The great parts of transfers are *market transfers,* and related to oligopolistic profits of large companies. While the burdens of *fiscal transfers* fall on tax payers, which raises delicate social and political questions.)

The *new structures should be based primarily on programs and policies.* One of the major integration deficits of our region is the weak presence and position of local companies (mainly Smes) on the global markets. Among others, the supportive programs and policies could help acquisition and strengthening positions of these companies on external markets or their entry and up grading in the global value chains (which could attract the support of TNCs as well). Many of the Smes of developed countries meet the criteria of transnational company behaviours and policies, which in many respects one of the indicators of developed status of a country. The supportive programs could help sub-regional cooperation (including trans-border ones), could be crisis prevention and evasion measures for companies, organizations or individual (re-employment or re-training).

No doubt that we are interested in an economic and monetary union, which promotes *convergence from inside.* It is encouraging that there is a readiness on the developed members to think along these lines (Merkel-Macron).

There are discussions about *premature joining.* It is a *typical alibi argument of opponents* that we join the Euro-zone only when our economy is prepared for that.

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These usually imply that we need still long time till we reach such stage. As the case of several countries (Slovakia or Baltics) indicated, the question basically *depended on the political determination.* By the early 2000s, the economies of the region reached a state that if this will existed and it was supported by a relevant preparation program, the joining could have been realized in a less then a decade perspective. On the other hand, if we are just only waiting for "maturing", the whole thing can fade away for decades.

And as the Slovak example proved, in 2004 (year of joining the EU) our (Hungarian) target deadlines for 2008-2009 Euro introduction could have been realistic. The Slovaks were not in better position than us, and the about 5 years of preparation would have been enough for us as well. But the Slovaks had that determination and consequently implemented their adjustment program. I remember our governmental excuses that we should wait because it would mean too high social costs. At end, as it turned out, we had multiple social costs because of postponing. It is enough only to refer to the suffering of hundred thousands of victims of Swiss franc indebtedness, which could have been largely avoided by adoption of the Euro.

At the moment, again, we have no serious reasons for waiting for fulfilment of vague convergence objectives. Rather we need serious proposals from those who support the case of joining. The bon mot is no longer valid that one should not move into a house which is smoking, but this is not the case with a half-built one. People buy half- built houses as they can decide about the colour of the wall and the tile, and the place of bath tub. I think that it would be basic Hungarian interest to take part directly and actively in the final reforms and completion of the Euro project. We should reconsider the slogan, that the case is not urgent.

It is obvious that due to Covid 19 crisis, the question lost its immediate actuality. But even if the perspectives of reconstruction and consolidation are uncertain, from point of view of rapid getting out from the present paralyzed situation, the issue remained of strategic importance.

05. 15. 2020.

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