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On Some Currency Regime Considerations for the Visegrad Countries

Edited by

Günter Heiduk and Julius Horvath

Duncker & Humblot · Berlin

GÜNTER HEIDUK / JULIUS HORVATH (Eds.)

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Acknowledgement

To Roman and Robert

Julius Horvath

This volume is the result of a co-operation project that started at the end of 1999 and was finished with a conference at Gerhard-Mercator University Duisburg in October 2001.

Co-operation with colleagues from Warsaw School of Economics already has a longer history than this project and started even before the year 1989. The first book together with Prof. Stanislaw Ladyka was published in 1987 and more publications followed in 1991 and 1992 in this series. When some of the Central and Eastern European Countries applied for European Union membership, this provided an impetus to expand the co-operation that was at that time limited to colleagues from Warsaw School of Economics. We were very glad to gain the Institute for World Economics, Hungarian Academy of Sciences, Budapest, as well as the Vienna Institute for International Economic Studies, Austria as partners. Finally, the project team was completed when Julius Horvath, Central European University, Budapest, joined us. Our teamwork was embedded in a series of three workshops. For the final conference, external experts were invited whose contributions are included in the conference volume.

Cooperation with the colleagues from Poland and Hungary was made possible by funding within support programs of the German Academic Exchange Service (DAAD). The Peter-Klöckner Foundation supported the participation of a larger circle of scholars in the final conference. We also gratefully acknowledge their support in the publication of this conference volume. Both editors and project participants highly appreciate the support given by both institutions. My special personal thanks go to my co-editor Julius Horvath. The timely preparation of the manuscript would not have been possible without his commitment.

Finally, this multilateral project has set the stage for a network that will – there is little doubt – promote future knowledge exchange. Even after the accession of the CEECs many exciting questions related to integration on commodities and factor markets will certainly remain to be answered.

We would like to acknowledge the carefull work done by Nadja Kremser in editing this volume.

Duisburg, in Spring 2003 *Günter Heiduk*

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Editors Introduction

This volume contains, for the most part, the papers and their formal discussions presented at an International Symposium EUFORIKZ held at Gerhard Mercator University at Duisburg on October 26-28, 2001. Some papers presented at the conference were not included into this volume; however, in addition the volume also contains invited papers. Each paper was assigned a discussant. Authors were given the opportunity to revise their papers after the conference.

First group of papers - by Jürgen Jerger, Peter Backe & Cezary Wojczik, Jarko Fidrmuc, and Julius Horvath - addresses the general considerations of the exchange rate policies of European as well as Visegrad countries. Ansgar Belke, Volker Clausen, Shin-Ichi Fukuda, and Rainer Schweickert were discussants to these papers.

Second group of papers by Adam Budnikowski & Rafal Wieladek, Kálmán Dezséri, Josef Pöschl and Julius Horvath analyzes specific problems of the particular Visegrad countries (Poland, Hungary, the Czech Republic, and the Slovak Republic). Andrzej Kazmierczak, Harald Sander, Luboš Komárek, and Bas van Aarle, respectively were discussants to these papers.

This introduction by the editors highlights the main issues discussed in this volume.

In the first paper Jürgen Jerger discusses the policy of the European Central Bank. More specifically, he follows the track record of the ECB monetary policy since 1999 and investigates its impact on member-countries' inflation and output record. He also discusses policy coordination in the monetary union, and the ECB policy rules. All in all, he presents a positive view concerning the performance and consequences of the ECB policy. Jerger concludes with an advice about desirability of the EMU membership for the accession countries. He writes that in this respect it is vital to evaluate the importance of the exchange rate policy for a particular economy and to judge the maturity of the economy in terms of the Maastricht criteria. Last but not least – Jerger argues – it is essential to have a strong public support for the EU and EMU membership.

Peter Backe and Cezary Wojczik provide a general discussion of possible alternative options for the monetary integration of the accession countries. They evaluate different strategies of joining of the euro area. The new member countries of the European Union will join the euro area, at the earliest, two years after their EU accession. The authors argue that against this background, it is for the accession countries to decide whether they would aim for an early introduction of the euro or opt for a more gradual strategy of monetary integration. Their paper in a stimulating way reviews the main arguments for and against either of these approaches.

Jarko Fidrmuc discusses the issue of proper exchange rate regime in the framework of the optimum currency area criteria, with a specific emphasis on the endogeneity hypothesis. His paper addresses the importance of structural variables for the harmonization of business cycles. In particular, intraindustry trade is shown to cause the convergence of business cycles in the OECD countries. His paper confirms earlier findings that the Visegrad countries have rapidly converged to the EU countries in terms of business cycles and trade integration. On the other hand, he argues that the observation period is still too short to conclude that the business cycles have already become similar. Fidrmuc's results indicate that there is a sound base for business cycle convergence, and thus for a fulfillment of optimum currency area criteria in the medium and long run. These results do not confirm the hypothesis that the Central and Eastern European countries already constitute an optimum currency area with the EU. But it seems that in the future they will fulfill these criteria to the same degree as the current EU-members do.

Christopher Klisz in his paper considers the consequences ofthe Harrod-Balassa-Samuelson real exchange rate effect for the consistency in the inflation and exchange rates targets for joining the European monetary union. This issue has some relevance for the future members of the EU and EMU to the extent that their economies converge towards the average of current Euro-land economies. Klisz demonstrates that the Harrod-Balassa-Samuelson effect does not necessarily require a higher rate of inflation for those countries experiencing relatively more rapid growth.

Julius Horvath comments on some aspects of unilateral euroization. He reviews some of the main arguments of proponents and opponents of unilateral euroization. Then he discusses the benefits and costs of unilateral euroization with an emphasis on the relevance of asymmetric shocks, seignorage, and the lender of last resort function of the central bank.

The second part of the volume deals with country studies.

Adam Budnikowski and Rafał Wielądek depict Poland's progress towards fulfillment of the Maastricht convergence criteria. They describe this process as relatively slow, but successful with respect to the general long-run tendency of the Polish inflation rate to fall. They illustrate that situation is similar concerning the convergence of interest rates. Discussing budget deficit they point to differences in definitions between various concepts. The authors also argue that the Polish deficit is expected to be slightly higher than the convergence requirement. However, they expect that Polish public debt would remain well below the Maastricht threshold level.

Kálmán Dezséri describes how Hungary is handling problems of joining the EU and later the Euro land. The author reviews different exchange rate regimes in Hungary in the 1990s. He also discusses potential dangers on the exchange rate policy due to volatile short-term capital inflows.

Josef Pöschl provides the reader with a general picture of the Czech economy. He evaluates the growth performance of the Czech economy as well as the external economic relations and the monetary and fiscal policy of the country. His emphasis is not only on the fulfillment of the nominal Maastricht criteria but also on the general competitiveness requirements of the Copenhagen criteria especially concerning the wage level and the level of non-tradable prices.

Finally, Julius Horvath discusses different exchange rate perspectives for small transition economy as Slovakia. Some optimum currency area considerations – as the smallness of the economy and the diversification of the production – suggest that Slovakia should opt for the fixed exchange rate regime. However, the asymmetry of shocks affecting Slovakia and Germany implies that this solution may be costly.