Let us roll out the euro to the whole Union

By Marcin Piatkowski and Krzysztof Rybinski
Published: June 11 2009 19:27 | Last updated: June 11 2009 19:27

When our great-grandchildren look back at the past 100 years of European history they are likely to remember Jean Monnet and Robert Schuman, fathers of the European Union, or Lech Walesa and Mikhail Gorbachev, destroyers of communism. However, when they turn to the first decade of the 21st century there will be little to impress them. They will see the EU brought to its knees by recession, with no transformational leaders to rekindle its spirit. They will see that strategic thinking was in short supply, protectionism flourished and there was no common immigration policy, single market or common monetary policy.

Crisis times call for great leaders and projects that create hope. We call on the EU leaders to show leadership and launch a “big bang” euro area expansion to introduce the euro in all 27 member states by 2012. Such a bold decision would give a credibility boost to the enlarged eurozone, accelerate replacement of the dollar by the euro as the global reserve currency and breathe new life into a united Europe.

Eurozone candidate countries in central and eastern Europe would be ready to join the euro within a year or two, starting with non-cash transactions. They are in many cases better prepared than the founding eurozone members: their trade, financial sector and labour markets are more integrated with the eurozone, their labour and product markets are more flexible, their business cycles are fully synchronised with the eurozone, as the crisis has unfortunately shown. Fiscal policy of candidate countries is also more responsible than that of current eurozone members: according to the European Commission, the budget deficits of eurozone candidate countries in 2009 will be lower than in the eurozone, while public debt in proportion to gross domestic product will be only about half that of the eurozone. Inflation will be higher in candidate countries than in the eurozone, as it should be for faster-growing economies, but next year’s regional inflation is expected to be only 1 percentage point higher than in the eurozone. If all CEE countries were allowed into the eurozone, it would increase eurozone average inflation by less than 0.1 percentage points.

Foreign exchange rates have been stable in the Baltic states and Bulgaria, countries that have fixed their currencies to the euro, but volatile in candidate countries with floating exchange rates. This volatility, however, is not due to faulty economic policies: foreign exchange rates reflect the global flight to safety. The euro has been highly volatile relative to the US dollar. It would not pass its own eurozone entry stability test.

Candidate countries would not just sit and wait to be invited into the eurozone; they know they need to increase their economic flexibility further and improve their fiscal positions. But they know how to reform. They have done nothing else in the past 20 years and have achieved spectacular success. They will continue to reform, but need a clear signal that they are truly welcome in the euro club. Today they have doubts.

The big bang eurozone expansion would not complicate monetary management in the eurozone, since the combined GDP of all eurozone candidate countries in central and eastern Europe amounts to less than 10 per cent of the eurozone’s GDP. Equality of treatment would also be adhered to; after all, many of the original eurozone members have not fully met the entry criteria, in letter or in spirit.

Expansion would strengthen the eurozone, as new members would provide impetus for reforms such as strengthening fiscal co-ordination, integrating financial markets and creating the world’s largest, most liquid bond market. Candidate countries do not just want to enter the eurozone; they want to become part of the most successful global currency area.
Eurozone expansion would prevent the rise of the “euro curtain” dividing EU members into central and peripheral categories, and provide a new reforming spirit to the European project. It would help save countries such as Latvia, struggling to defend its currency peg with the euro. New leaders are needed to make it happen.

Marcin Piatkowski is a scholar at the Tiger economic think-tank, assistant professor of economics at Kozminski University in Warsaw and a former economist at the IMF. Krzysztof Rybinski is a partner at Ernst & Young, a professor at Warsaw School of Economics and a former deputy governor of the National Bank of Poland.