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JOINING EURO VERY RAPIDLY – A STEP FORWARD FOR NON-EURO EU MEMBERS?*

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Abstract: Just before the last G20 meeting in London and following the quantitative easing measures taken by FED it has broken into the news that, during an internal discussion, IMF raised a really provocative issue: should the non-Euro EU members join the Euro very rapidly?! Considering the developing international economic situation we plead that adopting the Euro at a fast pace will be benefic for both sides of Europe: the Western developed countries and the Eastern emerging economies.

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Introduction

Just before the last G20 meeting in London and following the quantitative easing measures taken by FED it has broken into the news that, during an internal discussion, IMF raised a really provocative issue: should the non-Euro EU members join the Euro very rapidly?!

At a first glance, the selected G20 members dismissed or at least played down such kind of action. But the question still remains: will be such an action a bad one or a good one?!

Considering the developing international economic situation we plead that adopting the Euro at a fast pace will be favorable for both sides of Europe: the Western developed countries and the Eastern emerging economies.

Overview

We have to mention first that no one of those emerging economies is in a position to join the Euro according on the existing criteria. That means that the rules for joining the Euro should be relaxed. No need to say that the ECB (that was built on Bundesbank old tradition) and a good part of the developed Western countries, especially Germany, strongly rejected such kind of action saying that growing budget deficits in some of those countries have already damaged the Euro credibility and

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adding new struggling economies to the Euro zone will further put pressure on the European single currency.

In favor of faster introducing the Euro in the Eastern developing countries we have to remind the great exposure banking systems like those of Sweden or Austria or Greece have on the Eastern Europe. For example loans made to Baltic States by Swedish banks left them exposed to almost 30% percent of the Sweden GDP. A sharp decline in these countries' currencies would cause huge trouble for the Swedish economy. The same kind of situation are experiencing banks in Austria that have lend large amounts of money to Romania as well as banks in Greece have done. A currency crisis in Romania could lead to a disastrous economic situation in Austria and in Greece, too. In this kind of respect, we have to add that, as authors rightfully do remark in when a lender (a bank, for example) is exposed to a certain group of emerging countries, when a country of this group might encounter financial problems, those problems could easily spread to the entire group despite the fact that all the other members of the group are economically healthy and stabile. Such kind of situations could far easier be managed if those countries already have been using Euro.

In order to avoid such kind of situations adopting the Euro in Romania as well as in Baltic states seems to be a good solution. And such kind of solution is not impossible to reach. Emerging economies could very well introduce the Euro without being "de facto" members of the Euro zone meaning that they will not have sits – yet – at the ECB board.

More else, countries like Bulgaria or even Romania that are running significant current account deficits could benefit nicely by introducing the Euro. In this kind of respect, on one hand, any currency collapse will be avoided and, on the other hand, those current account deficits will not worsen by adopting the Euro because their economies are contracting, jobs are lost and wages are diminishing. In case of Romania, for example, the latest economic developments put this country on the verge of a rapidly contracting of its current account deficit as GDP ratio. It could mean a lot in terms of the competitiveness of this country as well as in terms of enforcing its financial discipline. More else, this ongoing situation could as well encourage foreign investments flowing into to Romania both as green field investments and investments on capital markets.

The legislation in emerging economies is still far from what it has to be. Adopting Euro sooner rather than later will push these countries to fulfill the so-called "EU community acquis" and to promote more social justice in their legislation (and we are talking here especially about Romania and Bulgaria). That will ease the wage pressures with good outcome in terms of productivity, competitiveness and will also ease pressure on their budget deficits

We don't have to forget that the ongoing crisis is due to the so-called cheap money policies and the US financial crisis seems to be more like a symptom rather than the cause of global problems. The US trade gap has exploded because the credit has exploded. Once the US trade deficit will start to narrow (and it has already started to narrow!) this country will borrow less money from overseas and especially from Euro zone countries. This money could (and should!) very well be lend to the Eastern emerging European countries in order to keep them grow at a sustained pace and healthy. Having Euro as currency their credit markets will become more competitive, more transparent because they will be forced to meet those well-known criteria and their real economies will have only to benefit. In this kind of respect a healthy growth

in the emerging European economies will stimulate growth in the EU developed countries as the trade speed between EU partners will start to increase.

We have to add to the picture that Europe of our days is a Europe of regional random financial interconnections. And these interconnections do concern especially the Eastern European Countries and that mainly due to the huge increase in foreign ownership of the banking systems of these countries we've seen in the last ten year or so. In this kind of respect we have to notice that the financial and real economic connections between Western and Eastern Europe are now stronger and more diversified than ever. And there is no secret that even the IMF has been encouraged and is still encouraging this ongoing situation. The banking systems of Eastern European countries are now far from what they were used to be in late 90s. And what makes them so different from they were, is that foreign ownership are among the highest in the world (almost 100% in Estonia, almost 90% in Romania and examples could easily go on). In fact, due to this situation, *the banking sectors of those countries are quite unique.* We don't have to forget that those emerging economies had practically no financial intermediation when they started their roads as market-orientated economies in early 90s. With no internal capital resources, the main engine of growth in their GDPs was, of course, *the consumption* that leaded to current account deficits in almost all these countries. The most advanced of them in terms of democracy and economic transparency (Poland, Hungary, Czech Republic, etc.) received, during the 90s, quite nice amounts of western investments, so, they enjoyed smooth and sustainable growth. This situation leaded to a smooth and gradual credit growth in this group of "advanced" countries. No wonder that, when the credit bubble had exploded in late 90s, these countries were less exposed to economic excesses than their poorer colleagues coming "from behind" (Bulgaria, Romania, etc.). These countries were, actually, attracted, in the credit bubble in a very irresistible way. Europe, as an economic entity has to face a very provocative and, somehow, dangerous situation: *its poorest members that joined the EU in the last wave have the highest levels of average growth in private sector credit as ratio of GDP* (Estonia 46%, Bulgaria 32.5%, Romania 39.4% versus some of their "advanced" colleagues like Poland 16.1% or Hungary 12.1%) during the 2004 – 2007 period of time. We have to consider that almost all this credit was driven to *consumption*. And we also have to consider that almost all this credit was financed by Western European banks directly or thru their fresh-acquired local branches. So, no need to add that the largest current account deficits are to be found in these countries having the highest private credit growth/GDP ratios. Most of credit, in these countries, is *Euro-denominated*. So, the Western European banking system – or at least a significant part of it - is directly or via its local branches exposed to *those current account deficits*. We consider that, introducing Euro sooner rather than later, this exposure could suffer smooth and well controlled decrease without "currency accidents" and without affecting too much the investing activities.

More else, the private credit growth in these emerging economies is still high and has to remain high in order to reach some kind of natural saturation in consumption as well as to reach a new quality in their investment-related activities: diminishing the role of governments in the investment expenditures as part of their GDPs. In this kind of respect, we have to mention that the dependence of non-deposit funding has increased significantly almost in all countries of emerging Europe the way that loan-to-deposit ratios have also increased as well ratio between bank credit-to-GDP ratio and bank deposits-to-GDP ratio. And, as we mentioned, before, most of those credits are

Euro-denominated. This situation requires a truly reliable foreign financing. *And this financing must be a market-related one*. In order to reach such an important but sensible goal the emerging economies branches of Western European banking system *must to develop their own independence* and must be helped to develop *their own relationships with the ECB*. The fact that *not all* the Western Europe countries have really big exposures to the eastern emerging countries could be helpful in order re-think and re-built Europe financially. In fact, only Austria, Belgium, Sweden and, maybe, Greece are heavily exposed but their banking sectors are nicely integrated in the Western Europe banking sector as well in the world banking sector, while countries like Germany, France, Italy or even Netherlands have exposures that can be actually neglected.

We strongly believe that for each an every western bank heavy exposed to the Eastern European region the first step could consist in *diversifying its portfolio as well as its assets*, in other words *restructuring* its activity. And this step has to be made by *remaining in the region and not by leaving the region*. And a quick adoption of the Euro in these emerging countries could be helpful in dealing with these challenges.

Of course, skeptics might argue: " … okay, but how about the budget deficits target established at the Maastricht Treaty ?!". In this kind of respect we have to remind to those skeptics that even Germany and France brought this target. The Maastricht treaty was held in 1993 in a reviving world economic environment and we are now in 2007 and (still) experiencing the worst financial and economic crisis after the Great Depression of the 30s.

Last but not least we have to add that the faster Eastern emerging economies will introduce the Euro, the greater are the chances for a rapid EU budget convergence.

Even Dominique Strauss Kahn, the managing director of the IMF has warned earlier this year (March 2009) that the main threat for the global economy could come from a delay in restructuring of the countries' banking systems rather from deterioration in some specific countries' budget deficits. In this kind of respect he avoided to make specific nominations but almost in the meantime he and some of his fellow colleagues made explicit approvals on the US Federal Reserve quantitative easing actions while recommending a quick Euro adoption in the Eastern European countries.

Conclusions

Maybe some kind of "road map" approved by both ECB and European Commission for the Eastern European countries having as target quickly joining the Euro by these counties could be nothing but helpful.

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