Adopting The Euro In the New Member States: Any Lessons from Greece's experience?

Hari Vittas

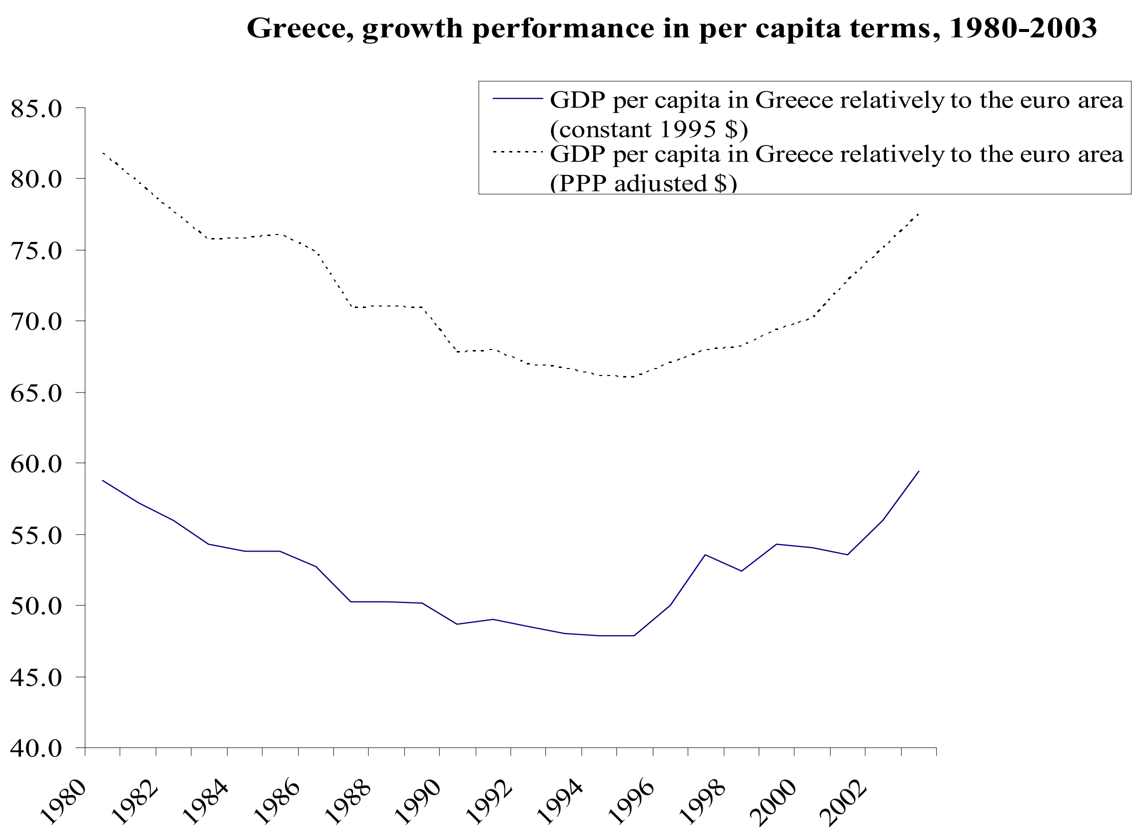
Alternate Executive Director

International Monetary Fund

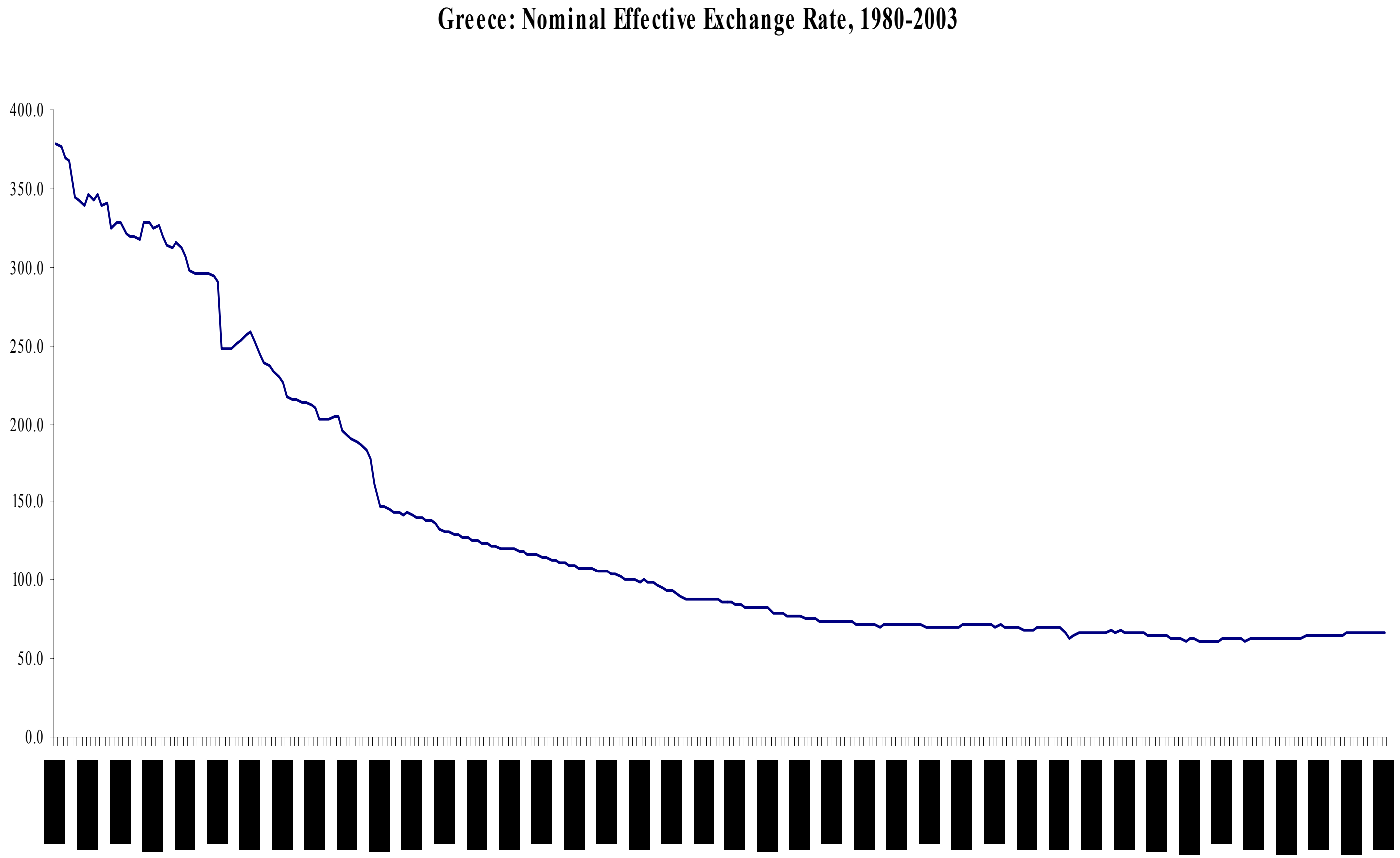
Potential Benefits & Costs of Integration

- Economic benefits potentially very large
- But timing is unclear
  - Do they begin accruing when a country joins the EU (or even before)?
  - Or do they come only after it adopts the euro?
- Main cost is the loss of the ability to pursue an independent MP. This could increase economic instability

Relative Economic Performance



Is Monetary Autonomy worth having?



Conclusions on Benefits & Costs of European Integration

- Potential output benefits may be large, but not automatic. Can be wasted.
- The monetary integration process helps to realize the benefits of integration, in large part by providing strong incentives for disciplined policies
- For GR, the loss of monetary autonomy was more a blessing than a cost.

Timing of ERM Entry & Adoption of the Euro

- Typical advice given to new members includes:
  - Do not rush into entering the ERM
  - Avoid (if possible) prolonged stay in ERM as this could be risky
  - Useful to have a clear target date for adopting the euro
- Greece's experience supports the first and third elements of this advice but not the second.

Do not rush into the ERM

- GR adopted the goal of qualifying for EMU in 94 but entered the ERM only in March 98
  - In 94 the inflation rate & budget deficit were still very high. Clearly life in ERM at that time would have been uncomfortable, to say the least.
  - By early 98, both had been reduced dramatically but remained above the criteria. The credibility of the **commitment to stay the course** had also increased. Hence, it was possible to contemplate ERM entry.
  - New members have much lower imbalances than those GR had in 94. Although some may not yet be ready for the ERM, the time “in waiting” will probably be shorter

Is the ERM too risky?

- GR stayed in the ERM 34 months, of which about 27 months prior to the assessment.
- Significant tensions emerged only in the early part of ERM participation. They proved manageable.
- Tensions subsided as progress was made in further lowering inflation and the budget deficit and as the credibility of the final goal was further enhanced
- Hence, the concern about the riskiness of the ERM may be exaggerated

Clear Target Date Helps

- Setting a clear & credible date for the final goal helps to sustain the effort to meet the qualification criteria and to stabilize market expectations
- GR was fortunate in that it had an easy choice to make, i.e. it “had” to be in in time for the introduction of the euro notes and coins
- Not clear if the choice will prove equally simple for new members. While this may give rise to some tensions, these should be manageable given the inherent flexibility of ERM2.

Challenges after the Adoption of the Euro

- Risk of a credit boom and asset price bubbles?
  - Boom: yes. Bubbles: No
- Risk of complaceny, adjustment fatigue, and an unwarranted relaxation of FP
  - To guard against it, try adopting a new goal
  - Not easy to do, but the SGP provides some assurance that fiscal slippages will be contained
- Risk of Asymmetric Shocks and/or loss of competitiveness
  - This increases the desirability of creating room for fiscal manoeuver and makes it desirable to strengthen incentives for Structural Reforms