EU enlargement

What convergence?
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Central Europe's candidates love the Union but fear the euro

WITH European Union enlargement apparently steaming ahead, the bond markets are pricing in “convergence” as if it were a done deal. Moody’s, a rating agency, recently upgraded the foreign-currency debt of the eight Central European candidates. The process of integration with the EU was now “virtually irreversible,” it said. Not so fast.

Negotiations for entry in May 2004 are due to be wrapped up at the Copenhagen summit next week. Then each candidate must hold a referendum—most likely with positive results. But they now seem less anxious to get to the next stage after accession: adoption of the single currency, which is obligatory for new members. That is because they will have to fulfil the strict Maastricht criteria for levels of inflation, budget deficits and public debt. Several EU hopefuls have already breached the budget deficit ceiling of 3% of GDP (see chart). Standard & Poor’s, a rating agency, recently downgraded Poland’s and Hungary’s increasingly burdensome long-term domestic debt.

The European Commission and the European Central Bank have given warning that hasty euro entry could endanger the applicants’ growth prospects by depriving them of the monetary flexibility needed to cope with the pressures of the single market. Even some rich West European countries have been harmed by the single currency, with interest rates too high for sluggish Germany, but too low for buoyant Ireland, for example.

Until recently, candidate states would not have dared to question openly the rules underpinning the single currency, lest the markets send their currencies plunging and their borrowing costs spiralling. But stinging comments on the “stability and growth pact” from within the EU have given some the courage to complain. György Suranyi, a former governor of Hungary’s central bank, declared last month that, if the EU adopted a more flexible fiscal framework, Hungary’s growth prospects would doubtless improve.

Poland’s government still insists that it will be ready to join the euro in 2006 or 2007. But last month Grzegorz Kolodko, its finance minister, presented his EU counterparts with proposals to loosen the fiscal rules. He argued that budgetary rules should apply to the aggregate deficit in the euro-area, rather than to each country—an extension of a British proposal. One Dutch official fumed privately that profligates would be “free-riding” on the backs of more frugal countries. But Mr Kolodko is unrepentant: “the EU should think about Italy or Belgium’s public debts—not to speak of their levels on the eve of EU and [euro-zone] accession.” These are bold words, although they would carry more weight if Poland’s awesome budget deficit was itself designed to stimulate economic growth not to put off reforms.

Most analysts doubt that Central Europe’s biggest countries—Poland, Hungary and the Czech Republic—have a chance of meeting the 3% deficit limit by 2007. Having secured their places in the EU, these governments may be even more inclined to let budgets and borrowing rip, delaying euro entry as late as 2010. By that time the stability pact may no longer exist, and new members may be able to enter on looser criteria. Punters betting on
speedy convergence may have jumped the gun.