Waiting for Euro

By Huw Pill

Economic Systems, *Vol. 25, No. 3, September 2001, Munich*

For the 13 countries waiting patiently to enter the European Union (EU), Brussels offers only the menu du jour. There is no a la carte service. Applicants cannot pick and choose among the requirements of this exclusive establishment—it is all or nothing.

Foremost among these requirements is the eventual adoption of the euro, the single European currency. Yet while aspiring nations have no option but to adopt the new money, they do enjoy some choice in deciding how to get there. Those choices are the subject of a special issue of the quarterly journal *Economic Systems*, produced by the East European Institute in Munich in collaboration with the European Association of Comparative Economic Studies. The issue explores how East and Central European economies should mold their monetary policy with an eye toward EU membership.

Most mainstream North American economists (including many from the International Monetary Fund and U.S. Treasury) believe exchange rates must either be irrevocably pegged to an established external currency, as in Estonia, or allowed to float freely, as in Poland. These economists point to the currency volatility of the 1990s as proof that hybrid systems (including "fixed but adjustable" and "managed float" arrangements) produce destabilizing capital movements that ultimately culminate in financial crises.

The contributors to *Economic Systems* challenge this orthodoxy and, in so doing, implicitly question the assumption of financial

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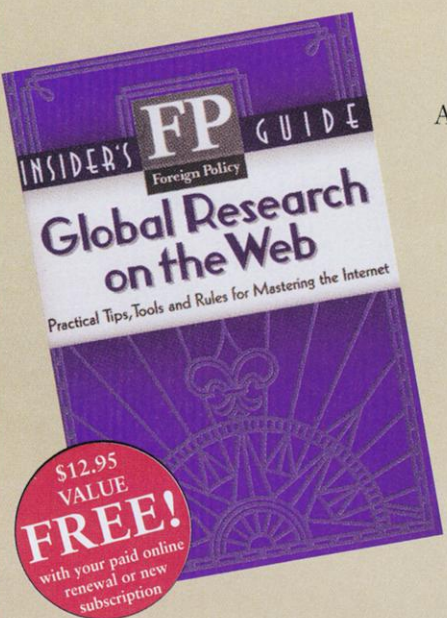

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market efficiency that underlies the standard prescriptions.

In their article "Is There a Third Way to EMU for the EU Accession Countries?" economists Peter Bofinger and Timo Wollmershäuser from Germany's Würzburg University argue that herdlike investors and financial bubbles—not underlying economic fundamentals—often cause exchange rate volatility in otherwise healthy economies. Central bankers in transition economies should therefore have the freedom to intervene in foreign exchange markets (buying and selling foreign currencies with their stock of exchange reserves) in order to stabilize their own currencies. Indeed, smoothing out sharp exchange movements is a necessary component of the "convergence" process needed to adopt the euro.

The authors make a valid point: Capital markets are undoubtedly imperfect, particularly in transition economies and emerging markets. (European academics and central bankers are more likely than their North American counterparts to acknowledge this fact and adjust their policy advice accordingly.) Yet the existence of such imperfections alone does not mean they are exploitable or even "manageable." Indeed, attempts to exploit market imperfections in the pursuit of ambitious macroeconomic objectives appear to be a cause, not a cure, of the financial crises of the 1990s. The Czech Republic's financial crisis of 1997 is a clear case, as efforts to stabilize the exchange rate attracted inflows of "hot money" that undermined macroeconomic and financial discipline.

Economist Lucjan T. Orlowski of Sacred Heart University in Connecticut provides another alternative to the conventional theories in his article "From Inflation Targeting to the Euro-Peg: A Model of Monetary Convergence for Transition Economies." Orlowski believes that transition economies should first seek to establish an effective, independent, and credible monetary policy, preferably through the use of a publicly announced inflation target. Only later can they focus on nominal convergence with the euro area and stability of the euro exchange rate. Orlowski turns the rationale for currency pegs upside down: Effective domestic monetary policy is a prerequisite for a credible exchange rate peg, not the other way around.

Orlowski makes a compelling case, with one caveat: Inflation tar-

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geting may be optimal in some contexts, but not all. As the variety of approaches adopted by Central European monetary authorities bears out, better to adopt a policy framework that works well in one's particular environment than remain enslaved to a specific textbook strategy. Estonia—a small, open economy with weak fiscal institutions—may find its currency board a more effective vehicle to establish a credible monetary policy, whereas a larger economy such as Poland may require the greater maneuverability offered by a floating exchange rate and an inflation-targeting regime.

Ultimately, not only does the EU offer just a menu du jour, it also requires good table manners. The exchange rate parity at which members adopt the euro is a joint decision, not a unilateral one. How will countries that have already adopted the euro respond to prospective expansion of the euro area? In the face of its *Standortsproblem* (the relocation of business to low-wage Central European countries), will Germany be prepared to see its eastern neighbors lock in their cost advantages by adopting the euro at a favorable parity? To understand the dynamics of EU expansion, we must not only look outside the union but within it as well. FP

Belarus Plays Catch-Up

By Luke Allnutt and Alex Znatkevich

■ Nasha Niva (Our Field),
September 10, 2001, Minsk

In the early 1990s, a resurgence of nationalism in the various Soviet republics helped tear the Soviet Union apart. But one former republic, Belarus, experienced no such upsurge. As the intelligentsia across the region—notably in the Baltic republics—used nationalism to fuel democratization, a majority of the ruling elite in Belarus remained hostile to independence and still hankered after the glory days of the Soviet empire.

A prodigy of the ruling elite, Belarussian President Aleksandr Lukashenko—in power since 1994—stifled nationalism, repressed democracy, and pushed for economic and political union with Russia in his first term. Lukashenko will be around for another five years after his victory in the September 2001 presidential elections.

Despite the opposition's dismal defeat, the elections may stimulate democratization and the development of nationalism in Belarus, argues Valerka Bulhakau, editor in chief of the Belarussian monthly magazine *Arche*. Writing in the independent cultural-political weekly *Nasha Niva*, Bulhakau contends that, after the election, "people [will] begin not only to live, but to think in terms of an independent state."

Before the 1990s, nationalism in Belarus was already weaker than elsewhere in the region. A larger proportion of the Belarussian intelligentsia was destroyed in the Stalinist purges of the 1930s compared with other Soviet republics. Belarussians, mainly rural dwellers until the 1950s, embraced the Russian language and culture as a means for upward social mobility.

As a result, Belarus today has a very large and fairly homogenous population that speaks Russian, regards itself as Russian, and maintains a Soviet-era social and economic outlook. Lukashenko has been a dab hand at manipulating these people—who Bulhakau terms "creoles" because they speak pidgin Russian and still view Belarus as part of the Russian empire—and has capitalized on popular nostalgia for the Soviet Union. The predominance of this mentality, nationalists say, has slowed down the growth of an effective opposition movement.

In the early 1990s, the ruling elite in Belarus still hankered after the glory days of the Soviet empire.

Under Lukashenko, Belarus has remained a harsh, authoritarian state. Media are kept on a short leash, and democracy protests have been brutally quashed. In the recent elections, the Organization for Security and Co-operation in Europe noted serious elections violations, including

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