

## **Now they see the benefits of the eurozone**

*di Wolfgang Munchau*

It was a Friday but for Denmark it might as well have been Black Wednesday - that day in 1992 when sterling was forced out of the European exchange rate mechanism. After a speculative attack on the Danish krone on October 24, the country is now considering whether to adopt the euro.

Last week, Hungary received a €20bn (\$25bn, £16bn) rescue package led by the International Monetary Fund and the European Union. The austerity conditions ensure that Hungary will all of a sudden fulfil the criteria for membership of economic and monetary union. I also hear that diplomats from Iceland made discreet inquiries in Brussels about accession.

While I am still hesitant to make predictions about the long-term economic and geopolitical effects of the financial crisis, it looks like it will accelerate the enlargement of both the EU and the eurozone.

The latter is particularly important, since several EU countries had planned to stay outside the eurozone indefinitely. The UK and Denmark negotiated their opt-outs in the early 1990s. Others piggy-backed, claiming these opt-outs for themselves as well. This group came to include Sweden, Hungary, the Czech Republic and, until last year, Poland.

For Hungary, it turned out to be a near catastrophe. The socialist administration under Ferenc Gyurcsány, prime minister, ran amok with a reckless fiscal expansion after EU accession. No less unsustainable were his government's financial policies that encouraged the adoption of foreign currency mortgages.

This was usually defended by enthusiastic economists in terms of birth rates and fanciful long-term projections of economic growth - the same silly arguments used to defend the doubling or trebling of house prices elsewhere. Towards the end, almost all Hungarian mortgages were denominated in Swiss francs or euros. National insolvency would follow from simple currency devaluation.

The country will now pay the price for this madness in the form of an IMF-imposed austerity programme at a time when the economy is shrinking. Looked at from boomtown Budapest in 2006, membership of the eurozone seemed absurd. The perspective from depression-bound Budapest in 2009 will be different.

Denmark is wealthier and better run. It experienced one of the biggest property booms in Europe. It also boasts a banking sector several times the size of national annual output. Unlike the British, the Danes never cared about economic independence. Their reasons for staying out of the eurozone were largely political and symbolic. Denmark has participated voluntarily in the ERM and dutifully shadowed the European Central Bank's monetary policies at every turn.

Ten days ago when the krone was attacked, the Danes discovered there was a price to be paid to maintain this schizophrenic arrangement. The Danish central bank intervened heavily in the foreign exchange market and was forced to raise interest rates from 5 per cent to 5.5 per cent - a full 1.75 points higher than the ECB's rate. Anders Fogh Rasmussen, the Danish prime minister, who

supports euro membership, had already talked about holding a referendum as the mood in the country was shifting.

In Iceland, support for EU membership has soared since the crisis erupted. The Reykjavik newspaper Frettabladid carried a poll last week showing approval for EU membership up from 48.9 per cent a year ago to 68.8 per cent now. The number in favour of adopting the euro is even higher. Along with Norway and Liechtenstein, Iceland is a member of European Economic Area, which extends the EU's single market to those countries. This means membership negotiations, normally long and complex, could be wound up in a short period of time. Talking points will be the euro and fish.

In an illuminating policy paper, the economists Willem Buiter and Anne Sibert\* say Iceland is only an extreme case of a more general phenomenon - of a small country with its own currency, and banking sectors too large to be bailed out by national authorities. Others are Denmark, Sweden and Switzerland. The UK is larger and also enjoys - say professors Buiter and Sibert - "minor-league legacy reserve currency" status. But some of the arguments apply to the UK as well. I would expect a renewed debate about eurozone membership to surface in the UK as well, as the country's 15-year long credit-crazed economic binge unwinds. I will address the issue of future UK euro membership in a separate column.

One of the lessons from Iceland's and Hungary's fiasco is that non-eurozone Europe may not be economically viable during times of crisis. Several countries are financially overextended but even those that are not, such as Poland, may be caught in the maelstrom.

Of course, membership of the eurozone offers no panacea. As an EU member, Iceland would still have a crisis, because each country ultimately has to meet the costs of its own financial adjustment. But Iceland's interest rates would be 3.75 per cent, not 18 per cent. Apart from lower interest rates, eurozone membership offers a joint policy framework and protection from speculative attacks. In good times, few people care, but these are not good times. As I argued last week, the crisis will ultimately produce stronger economic governance. It will also make the eurozone larger, sooner.