

New Narrative for Europe*

A report on the Lamfalussy Conference

István Ábel

The „*Lamfalussy Lectures Conference*” of 2015 strengthened the initiative of the National Bank of Hungary to provide a forum for the leaders of European central banks to discuss new approaches in urgent matters. This year’s event was organized around the theme „*New narrative for Europe and for the monetary union after the crisis*”. The festive atmosphere was elevated by the Gala Concert of the award ceremony preceding the conference, where the winners of the Lamfalussy Prize and the Popovits Prize are honored. Both prizes were established by the National Bank of Hungary and both are awarded annually. Named for the world famous Hungarian economist, central banker and capital market expert, *Sándor Lámfalussy*, the prize was founded by the MNB in 2014. Honoring the legacy of *Lámfalussy*, this prize is awarded to outstanding financial, economic professionals who have internationally acclaimed contributions in economics and monetary policy. This year the prize was awarded to *Benoît Coeuré*, member of the Executive Board of the European Central Bank. The Popovics Prize was also awarded in the Lámfalussy Prize Gala accompanied by a concert in the National Theatre. *Sándor Popovics* was the first Governor of the Hungarian central bank. The prize commemorating *Sándor Popovics* is a recognition awarded to a young Hungarian economist, who has distinguished scientific and practical contribution to the accomplishment of the objectives of MNB. This year the Popovics Prize was awarded to *Dániel Palotai*, chief economist of MNB.

The international conference was devoted to the renewal of Europe. In his introductory lecture *György Matolcsy*, Governor of the central bank emphasized that Europe needs a new narrative today, after the European Central Bank launched its monetary policy programs. He reminded that in 2010 the new Hungarian government had to face the dilemma of choosing between orthodox or unorthodox measures to address the crisis. He believed that Hungary would have failed if only conventional measures had been applied. There are three pillars of the success of crisis management. Job creation is one of them. Structural reforms represent the second pillar. They have crucial importance paving the

* The views expressed in this paper are those of the author(s) and do not necessarily reflect the official view of the Magyar Nemzeti Bank.

István Ábel is a chief economic expert at the Magyar Nemzeti Bank. E-mail: abeli@mbn.hu.

way to create new jobs. At the same time, the reforms would have been doomed to fail without political stability.

Benoît Coeuré, member of the Executive Board of the European Central Bank,¹ stated that the integration of the euro zone must be advanced. If government debt cannot be curtailed and fiscal policy is not efficient, everybody will be losing, because such tensions accumulated would cause problems not only to the individual countries but also to the entire monetary union. He reminded that significant advances had been made since the beginning of the crisis. The European Stability Mechanism (ESM/EFSF) was established, which is now capable of participating in the management of the debt crisis, along with and similarly to the IMF. The creation of the bank union, the strengthening of the banking supervisory role of the ECB promotes the efficient operation of the European banking system, facilitating the timely identification and addressing of the problems of weak financial institutes. Talking about the coordination of economic policy, he cited the opinion of *Lamfalussy*: “Policy interactions in a monetary union had to be governed by a proper framework, and not just left up to ad hoc coordination and market discipline.”² Economic decision-makers in different policy areas act independently and are at the same time interdependent. We need to pay attention to the indirect effects of our decisions. The independence of central banks is one of the fundamental principles of the monetary union. The euro zone is built on monetary dominance. This has efficiently served the maintenance of price stability. However, after the crisis we had to recognize that monetary policy in itself is not necessarily the most efficient tool for increasing employment and stimulating growth. Monetary policy becomes more effective in impacting the real economy if other policies act in support. If not, it has less impact and expansionary policy has to last longer. This challenge defines important action points concerning the advancement of the European integration. *Lamfalussy* himself recognized this problem: „The combination of a small Community budget with large ... national budgets leads to the conclusion that, in the absence of fiscal coordination, the global fiscal policy of the EMU would be the accidental outcome of decisions taken by Member States. As a result, the only global macroeconomic tool available within the EMU would be the common monetary policy implemented by the European central banking system.”³ *Mr. Coeuré* pointed out that the crisis has made clear the problems of the European institutional system, indicating that we need a system that is more efficient and capable of handling the fiscal and structural policies in an integrated manner.

1 Benoît Coeuré (2015): Lamfalussy was right: independence and interdependence in a monetary union, Speech at Lamfalussy Lectures Conference organised by Magyar Nemzeti Bank in Budapest, 2 February 2015. <http://www.ecb.europa.eu/press/key/date/2015/html/sp150202.en.html>

2 James, H. (2012), *Making the European Monetary Union*, p. 248. See also Maes, I. (2011), “The evolution of Alexandre Lamfalussy’s thought on the international and European monetary system”, National Bank of Belgium, Working Paper Research, No. 217.

3 Lamfalussy, A. (1989), *Macro-coordination of fiscal policies in an economic and monetary union in Europe*, Collection of Papers. Committee for the Study of Economic and Monetary Union, Luxembourg, 1989, January, p. 101.

Ewald Nowotny, Governor of the Central Bank of the Republic of Austria, analyzed the catching-up processes of the region for the last 25 years. As a result of the changes that have taken place, the region has advanced on the development scale. This could open up new opportunities, even though risk ratings had not always reflected the significance of changes: Several investors continued to assign the region to the “developing European” portfolio. Governor *Nowotny* highlighted that despite the progress, the disparities did not disappear and there are still very significant differences even between two neighboring economies. Concerning the upcoming period, he indicated that new opportunities could open up for development, but there is also a high geopolitical risk that Hungary would be relegated to a periphery exposed to war tension.

In his lecture *Erdem Başçı*, Governor of the Central Bank of the Republic of Turkey,⁴ assessed price stability and highlighted that central bank actions against inflation had a diverse and well-known toolset. However, the tools available to counter deflation - which is a current phenomenon threatening several European economies - are not so well-known. Governor *Başçı* expressed the view that the best a central bank can do for the benefit of the economy of its country is to maintain price stability in any case.

Carlos da Silva Costa, Governor of Banco de Portugal, emphasized sustainability in the national and Community level. He noted that the nature of national economic policies and the coordination of these policies across the EU as a whole determine the sustainability of the development model.⁵ He highlighted that every step in economic policy is based on the assessment of risks. We need an outcome that contributes to the permanent solution of the problem instead of one that looks promising on the short run but would lead to social conflict 6 or 8 years later. In order to improve the integrative capacity of the European cooperation, national economic policies must also make sacrifices.

Boštjan Jazbec, Governor of Bank of Slovenia, assessing the experiences of the introduction of the euro in 2007 noted that this step generated a large influx of capital, but the Slovenian economy could not take advantage of this opportunity properly. They only learned slowly how to “use the money of others.” He noted that the high ratio of state ownership in the Slovenian banking system probably contributed to the slow adaptation. In Slovenia now steps are being taken towards the privatization of banks.

Boris Vujčić, Governor of the National Bank of Croatia talked about the paradigm shift of central bank policies. The experience of Croatia indicated that despite the textbook example, exchange rate stability can be sustained in a small, open economy as well, while pursuing an autonomous anti-cyclical monetary policy. Although the methods applied prior

4 <http://www.tcmb.gov.tr/wps/wcm/connect/tcmb+en/tcmb+en/main+menu/announcements/press+releases/2015/ano2015-09>
<http://www.tcmb.gov.tr/wps/wcm/connect/19ab7e30-6ed6-45dc-a874-cec42e896484/Budapest.pdf?MOD=AJPERES>

5 <https://www.bportugal.pt/en-US/OBancoeoEurosistema/IntervencoesPublicas/Lists/LinksLitsItemFolder/Attachments/89/intervpub20150202.pdf>

to the crisis to moderate lending and capital inflows, including a high required reserve ratio and capital controls, were of questionable efficiency and “rough regulatory tools” in themselves, but they still had the advantage that when the crisis broke out, there was a latitude that enabled the easing of monetary policy. In the global economy the efficiency of monetary policy has changed, externalities have played an increasingly important role. Prices are shaped by global factors in an increasingly widening array of products. The cross-border relationships of money and capital markets enable larger swings in the balance of payments and the price-shaping effect of the demand and supply characteristics of the national economy has weakened. Capital flows transmit global monetary conditions and these conditions have an increasing influence on monetary conditions of the national economy, even if the exchange rate is flexible. Central banks must pay attention to this change and draw conclusions accordingly. One such conclusion is that their opportunities in decreasing external vulnerability have narrowed significantly. The other important conclusion is that the monetary policy is only able to boost growth efficiently only if other policies (fiscal, institutional, and structural policies) change in line with it in a coordinated manner.

Erkki Liikanen, Governor of the Bank of Finland warned that⁶ the measures of the European Central Bank and the quantitative easing cannot replace the need for adaptation in national economic policies, although they could temporarily attenuate the pressure for such adaptation. There is a need for improvement in the European institutional system, in order to avoid the risk that additional liquidity resulting from quantitative easing would feed speculative bubbles leading to a new crisis.

The lectures were followed by a panel discussion with the following participants: *Agnès Bénassy-Quéré* (Sorbonne), *Dániel Palotai* (MNB), *André Sapir* (Université libre de Bruxelles) and *György Szapáry*, former ambassador of Hungary in Washington. The discussion was moderated by *Csaba Lentner* (Public Service University). Assessing the new challenges and the efficiency of the responses of monetary policy, the discussion supported the contention that the answer to this question would be decided by growth.

6 http://www.suomenpankki.fi/en/suomen_pankki/ajankohtaista/puheet/Pages/150202_EL_puhe.aspx