

## Erling Olsen, The Danes and EMU (1998)

**Caption:** In 1998, Erling Olsen, Speaker of the Danish Parliament (Folketing), sets out his ideas on relations between Denmark and Economic and Monetary Union (EMU).

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## The Danes and EMU

by Dr. Erling Olsen, M.P., Speaker of the Danish Parliament

**Why do we have to "wait and see"?**

**On June 2, 1992, the Danes voted on the Maastricht Treaty including the full Economic and Monetary Union. 83.1 per cent of the electorate voted. 49.3 per cent of those who voted came up with a "yes" and 50.7 per cent came up with a "no". This created two serious problems: one for the Danish Government and one for the other members of the European Union.**

The solution of the Danish problem seemed to be the "National Compromise" of November 1992 whereby one of the political parties, which had recommended a "no" to the Maastricht Treaty, promised to recommend a "yes" at a new referendum, if Denmark got four reservations one of which was to opt out of the third phase of the EMU. It was part of the National Compromise that none of these four waivers could be given up unless accepted by a national referendum.

The solution of this problem for the other members of the European Union seemed to be to accept the four Danish waivers. This was done at the Union's December 92 summit in Edinburgh. The Danes were allowed to opt out of the EMU's third phase and to opt in later if Denmark could live up to the criteria for entrance.

On May 18, 1993, a new referendum was held. 86.5 per cent of the electorate voted. 56.7 per cent of those who voted came up with a "yes" and 43.3 per cent came up with a "no". So far, so good.

But the unionizing of Europe is a dynamic process. New steps forward are discussed at the ongoing Inter Governmental Conference preparing a revision of the Maastricht Treaty. If the revision implies a transfer of some sovereignty from the Member States to the European Union and if less than five sixth of the members of the Danish Parliament can accept such a transfer, then the Danish constitution prevents the revised Maastricht Treaty from being ratified unless it is accepted by a national referendum.

No serious political analyst could believe that five sixth of the Danish members of Parliament would endorse a further transfer of Danish sovereignty to the European Union and most political analysts would predict an uphill battle for any Danish Government fighting for a national referendum's "yes" to even a minor further transfer of sovereignty. Most of them have also predicted that if the referendum also includes a "yes" or "no" to the withdrawal of one or more of the four waivers, the "nos" may accumulate. Consequently, the Danish Government has promised the Danish electorate that the four Edinburgh waivers will remain before, during and after the Inter Governmental Conference. It has also made clear that no referendum on withdrawal of any of the four waivers will be held before the Government feels confident that it can get a "yes".

That's why we have to wait and see.

**What do we do while we wait?**

While we wait we shall behave ourselves doing our best to live up to the Maastricht criteria of convergence. Firstly, because this would facilitate a later entrance into the EMU. Secondly, because we believe that this would be the right thing to do - even if we should never join the EMU.

Since the mid-1980s we have tried to maintain a stable rate of exchange vis-à-vis the D-mark and other European core currencies within the European Monetary System and in recent years the Government has made a remarkable effort to live up to the Maastricht criteria. During the 1980s and the early 1990s this was a controversial economic policy, but today it is accepted by all major political parties.

Consequently, by mid-1997 the public sector is starting to repay its debts, the balance of payments shows a comfortable surplus, the annual growth of the Gross National Product is some 3 per cent in real terms, the

annual rate of inflation is some 2 per cent and the rate of unemployment has been decreasing since 1994.

By May 1997, the Danish Government published a forecast covering the period up to the year 2005. Assuming a 2.5 per cent real growth abroad and unchanged economic policies at home, Denmark's foreign debts should be repaid by 2005 and the government debts should be reduced to 40 per cent of the GNP. But much could be different under different assumptions and much would depend upon the EMU we are going to see — or not to see.

### **What kind of an Emu do we expect to see?**

Some Danish political and economic analysts do not expect to see any EMU at all. They may be right, but I do not share their views.

Most analysts are, however, more concerned about whether the European Central Bank System may be as strong as the German Bundesbank has been. Many are doubting this and for several reasons. Firstly, they fear that some countries may be allowed to join the EMU without really living up to the Maastricht criteria. Secondly, they see a problem in the fact that the euro's rates of exchange vis-à-vis the non-member's currencies are the business of the Council of the Ministers of Economy and the Ministers of Finance, the ECOFIN, and not the business of the ECB. Thirdly, they fear a mis-match of the monetary and the economic policies within the EMU because the dialogue between the ESCB and the ECOFIN could never be as tight as the dialogue has been between the President of the Bundesbank and the German Ministers of Economy and Finance. Fourthly, they fear that the relatively high unemployment rates in most of Europe and the inclusion into the EMU of countries favouring “soft” economic policies may set the ECB under a political pressure which could be difficult to withstand. Hence, some of these analysts recommend Denmark to stay away from the EMU for ever.

I can accept part of their analysis, but my conclusion is a different one. Even if the ESCB may be weaker than the Bundesbank was, it is not a weak bank system at all. To this may be added that most political parties in Europe have given up most of their Keynesian ideas. No longer do they believe that inflationary policies and devaluations can help them solve their persistent unemployment problems. Labour market reforms and other structural policies are now in their minds.

Hence, I expect to see an EMU governed by a relatively strong ESCB and an ECOFIN determined to pursue stable economic policies leading to sustainable economic growth and a remarkably low rate of inflation, if not price stability. Remaining outside the decision process of such an EMU - and having to adjust to the decisions made by its members - is politically unsatisfactory and economically detrimental. But this is what Denmark has to accept until it has become obvious to so many Danes that it is time for a new referendum.

In the meantime, I expect Denmark to join the Exchange Rate Mechanism II, keeping variations in the rate of exchange vis-à-vis the euro within rather narrow limits. If so, it is being discussed whether current economic policies should be adjusted according to movements in the rates of exchange or according to changes in the rate of inflation. The point is, however, that such a participation in the ERM II leaves little room for adjustments in Danish monetary and fiscal policies. If major adjustments in Danish economic policies are necessary, then labour market policies and structural reforms must be emphasised.

[...]

### **Will the euro drive out the Krone?**

According to the (by economists) well known Gresham's law bad money will drive out good currency of circulation. A Danish joke applies this law to the ongoing EMU debate where it seems as if the bad arguments drive out the good ones. More seriously, it has been discussed whether Gresham's law may be inverted in the EMU letting the good euro drive out the national currencies of circulation. There is no doubt that the inverted Gresham's law is valid in countries with a runaway inflation. When such a country's money loses most of its value, a stable foreign currency will drive it out of circulation. This would, however, not be

the case of the Danish krone. But gradually, Danes going abroad would bring Euros with them, many export and import payments would be made in euro and some Danish corporations would present their annual financial statements in euro. It is difficult to estimate the strength of these tendencies, but they would probably be stronger than the moderate tendencies of Canadians to use US dollars and the moderate tendencies of Austrians to use D-marks.

### **Which gains will we miss?**

To wait and see is not free. It does cost money to change Danish kroner to foreign currencies. According to an estimate by the Ministry of Economy, an EMU membership would have saved Denmark direct and indirect currency transaction costs amounting to some 0.25 per cent of GNP. Denmark would also have had access to the ESCB's attractive TARGET credit facility.

Joining the EMU would also have eliminated Denmark's 0.5 per cent interest differential vis-à-vis Germany. In the long run, this would have increased our GNP with an estimated 1.4 per cent.

EMU membership would also have increased the level of competition and thereby productivity in Denmark and, most important of all, it would have made Denmark one of the decision makers in European economic and monetary policies. Staying outside and having to adjust our economic and monetary policies to those of the EMU makes Denmark to one of the decision takers.

### **Which problems will we postpone?**

To substitute the krone by the euro will entail a number of one-and-for-all expenses for new notes, new coins, new automats, new accounting systems etc. These are avoided as long as we stay outside the EMU.

We will also save the trouble of converting krone amounts into euro amounts and the trouble of drawing up clauses on contract continuity.

### **What will we end up doing?**

In its European policies, the Hamlet syndrome has made Denmark dragging its feet from the very beginning of European economic and political integration. But sooner or later, the Danes have found it more attractive to belong to the group of European decision makers instead of belonging to the group of European decision takers. This will also be the case when the EMU is well established.

Consequently, I guess that Denmark may join the EMU not before the year 2002 and not later than the year 2005.