Financial and Economic Review, Vol. 16 Issue 1., March 2017, pp. 188–194.

The New Silk Road into the Future Report on the Lámfalussy Lectures Conference of 23 January 2017*

Ferenc Tóth

On 23 January 2017, the Magyar Nemzeti Bank organised for the fourth time the meeting entitled Lámfalussy Lectures Conference, with about 450 participants, in commemoration of Sándor Lámfalussy, an outstanding European economist of Hungarian descent. Several renowned economists, politicians and representatives of the business sector participated in the conference – including Prime Minister *Viktor Orbán, Jacques de Larosière*, former Managing Director of the IMF and former Governor of the Banque de France, former president of EBRD, *Tien Gouli*, Chairman, Bank of China Ltd. and *Sir Paul Tucker*, former Deputy Governor of the Bank of England.

With regard to the national day of mourning ordered for Monday in memory of the Hungarian victims of the bus tragedy in Italy, the Lámfalussy Gala traditionally preceding the conference was cancelled, and thus as an exception, the Lámfalussy and Popovics prizes founded by Magyar Nemzeti Bank were awarded as part of the Lámfalussy conference. By granting the Lámfalussy Prize, MNB recognises outstanding professional performances that exert influence on international monetary policy. The Lámfalussy Prize was awarded to *Jacques de Larosière* this year. The Popovics Prize, commemorating the first Governor of the MNB, is a recognition awarded by the central bank to outstanding professional achievement in the field of economy and finances. The Popovics Prize was awarded to *Barnabás Virág,* Executive Director of MNB.

In his opening speech, *György Matolcsy,* Governor of Magyar Nemzeti Bank noted that the purpose of the conference was to build strong political, intellectual, economic, financial and human bridges between Europe and Asia, more specifically between the European Union and China. Europe is a strange continent: over the last 500 years a unique European success story has been built. However, in the first half of the last century we devastated Europe, in the second half we managed to rebuild it and to develop very strong cooperation in the framework of the European Union. The introduction of the euro started out as a promising venture, and at first it proved to be a great success, but after 2008 it turned out that huge mistakes had been made in the European Union and in the euro zone. As a result, the vision of the future of the

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

Ferenc Tóth is an Advisor to the Executive Director of Magyar Nemzeti Bank. Email: tothf@mnb.hu.

European Union was shattered, and many jobs were lost. The position of the common European currency was also weakened, and one of the reasons for this weakening is rooted in the economic policy of the European Union. Sándor Lámfalussy emphasised the importance of financial stability several times, which is strongly required in order to ensure growth and create jobs, so we can rebuild the future of a crisis-torn Europe. However, this should not be accomplished by introducing austerity measures, because such measures lead to loss of jobs and the lack of GDP growth and loss of trust, resulting in an unsustainable macroeconomic course. We need financial stability in order to rebuild Europe and make the euro successful, so that we once again should have economic growth, a European vision of the future and jobs. The main message of the opening speech is the recommendation that we should build strong bridges between Europe and Asia, primarily with China. One of the beneficiaries of the "One Belt, One Road" concept of China could be the European Union, within that the Central East European region, and especially Hungary.

Concerning the future of European integration, in the opinion of *Jacques de Larosière* we are lacking a long-term vision of the future, a clear strategy. We need more powerful convergence, homogeneity among members of the euro zone in terms of economic performance, since at present their indicators of competitiveness are substantially different. For that purpose a "Ministry of Convergence" should be set up, which would promote implementation of the required economic adjustments. The European Union is not capable of levelling off the structural disparities among the member states. This could have been an aim, but it was excluded at the very beginning, although at least a minimum level of consistency is very important and should be one of the pillars of the European Union. The real question is whether the European system sounded the alarm bells in time, to warn about the problems. The answer is: no, this did not happen, despite the warning statements of ECB. Finally, the market signals triggered reactions, but too late. In total, the convergence of the member states of the European Union is a failure. We do not need a Europe where the volume of regulations keeps rising and the investors are burdened with more and more constraints, but rather one where capital may flow freely in both directions. In addition, it is important that we cannot request additional fiscal austerity in countries where unemployment is already high.

In his lecture *Tien Gouli*, Chairman, Bank of China Ltd. said that the "One Belt, One Road" initiative of China offers a vision of the future and several opportunities. It connects two markets of outstanding importance. On one end Europe can pride itself on its developed technology and great experiences, on the other end we have Asia with its fast growth, huge demand and ample labour force. They mutually complement each other, and once these two markets have been integrated, it will become the longest economic corridor of the world, with the largest potential. This initiative was suggested by Chinese President Xi Jinping in 2013 and was also highly appreciated by the UN. Hungary was the first European country that signed the relevant cooperation agreement with China.

The first priority area is infrastructure, with the purpose of implementing infrastructure connections. He highlighted the development of the Budapest – Belgrade railway line, expected to be completed in 2017, which means a connection of key importance in the Chinese – European mainland and sea express routes, and which will contribute to Hungary becoming a regional transport and logistic hub.

The second emphasis is on production, on our support of capacity cooperation between China and Europe, furthermore, the creation of economic and commercial cooperation zones. Leaders of Europe and China have reached consensus in coordinating the Chinese initiative with Juncker's investment for Europe. The third focal point is on institutions and systems, in order to facilitate trade and investments.

Regarding financial resources, the Asian Infrastructure Investment Bank (AIIB) and the European Bank for Reconstruction and Development (EBRD) will play a significant role. China joined the latter in 2016.

In his speech, Prime Minister *Viktor Orbán* recalled his memories of Sándor Lámfalussy, who worked with him as an advisor, and who could differentiate between the current political regime and the country, which is a sign of great wisdom. Sándor Lámfalussy was a person of open mind and integrity. The Prime Minister explained that we believe in a democracy based on argumentation. The euro required firm political will. Sándor Lámfalussy said that politicians would eventually recognise the need to establish a fiscal and political union to support the monetary union.

We learned from Sándor Lámfalussy that politics, the stability of politics, is the basis of successful economic policy. A prerequisite for a strong economy is that representatives of the financial world and politics should draw the cart in the same direction. When the MNB was in opposition, Hungary underwent much unnecessary suffering. Since the MNB has not been in opposition and seeks cooperation with the current administration, economic growth has been spectacular.

Since 2008 a paradigm shift has been happening in world economy and politics. It is a benchmark of success how well the individual countries are able to follow this change. After 1990 the world was unipolar for 20 years. The new paradigm is about a world with multiple centres of power, but there is no consensus on this.

One of the key questions is: How should we interpret today's world situation? The President of the largest state, the USA, has resolved to accomplish great changes. One of his key statements is this: "Every nation has the right to put itself first." The era of multilateralism is over and the time of bilateral relations is starting. This is good news for us. There will be more poles, more models, which open up space for bilateral solutions. Today, the world economy is sustained by the existence of different economic models. This opens up opportunities.

Russia has survived the attempts of the West to isolate it and topple its political regime, the low oil prices, the sanctions, the operations of NGOs. It would not be reasonable, especially in Europe, to ignore the power and also the opportunity provided by Russia.

It is important to realise that long forgotten commercial roots are being revived. One of the first steps in this process is the “One Belt, One Road” initiative of China.

The other important question is: What does Europe look like, as seen from Central Europe? The answer is: we can hardly recognise it. It is struggling with four great crises at the same time, but so far it has not been able to settle any of these appropriately:

1. growth, competitiveness crisis,

2. demographic crisis,

3. security/public safety (terror) crisis.

4. foreign policy crisis (Syria, Ukraine).

The European continent has been increasingly weaker, it is drowning in debt and economic growth is slow. From a global player it has become a regional player, and it has to fight even for that status. Europe has set ambitious objectives, but it has not been able to deliver on any of them (e.g. that the euro should be one of the reserve currencies of the world, that it should build up a security policy relying on its own power, and develop the economic region of Eurasia). We are not talking about a general decline, but rather the failure to accomplish specific objectives. The reason is: Brussels has become captive to the utopia of a supranational Europe. This is an illusion. Europe has always been strong when it was controlled from several centres of power.

The fundamental question is: how can we make Europe competitive.

1. We should abandon the illusion of federalism.

2. Europe should be made multipolar. This is exactly the aim set by the Visegrád countries for themselves, and they want to become one of these poles, also competing with the rest of the European poles.

3. Europeans should embark on new types of cooperation schemes, e.g. with the USA (instead of the now dead free-trade agreement) and with China. Let us reconsider the question of Russia. Let us participate in the competition for concluding agreements, from which we are constantly left out.

4. The financing of the individual European national economies should be reconsidered. EBRD understands this problem quite well and knows the right direction, Hungary is interested in expanding the activities of this bank, especially in Central Europe. The Bank of China is here, and supports us with financing issues.

5. There should be more emphasis on innovation in a European context. The position of Hungary is good in this, but we should increase the appropriations allocated for this purpose in the Hungarian budget as well.

Connected to the thoughts of Mr. De Larosière, concerning the issue of demography it is safe to say that a nation or community that is not capable of reproducing itself does not believe in its own future. As for the common foreign and security policy, it is a substantial issue whether or not we can defend the continent without America. The solution is a security cooperation between Germany and France, in order to create a common European defensive alliance.

It can be said about Hungary that from a black sheep it has become a success story. In 2010, there was no economic growth, public debt exceeded 85 per cent of GDP, inflation could not be pushed down below 6 per cent, the deficit of government finances was out of control, it stood at 7 per cent, unemployment was hovering in the range of 11.5 to 12 per cent. Now, the public debt to GDP ratio is on a declining path, the deficit of government finances is steadily hovering around 2 per cent, the economy is growing at a rate of about 3 per cent, the unemployment rate is about 4.5 per cent and is approaching full employment. This required political stability, without it there is no economic success. We need a tight, equitable fiscal policy, the creation of a work-based society, and the establishment of a dual training system. Opening to the east is part of the Hungarian recipe.

The panel meeting held in the morning, moderated by *Dániel Palotai*, Executive Director and Chief Economist of Magyar Nemzeti Bank, discussed the topic of "Can the Silk Road Tune up Growth? Opportunities in the European-Asian Economic Cooperation". It was also about the future of the European integration.

Dr. CHEN Zhimin, Dean and Professor, Fudan University presented the "New Silk Road" concept and the three-level commitment of China to Europe. These three levels are: the level of the state, the subregional level and the level of the European Union. In his opinion, the essence of the "One Belt, One Road" initiative is the establishment of an economic network. We need projects aimed at creating connections: transport connections, connections between commercial and financial policies, connections between people. We need flexible agreements adapted to the local conditions.

Dr. YAN Xuetong, Dean and Professor, Tsinghua University explained that in his opinion bilateral agreements are easier to conclude than multilateral ones. Cooperation extends not only to the economy, it should also focus on politics, security and culture, otherwise its effects will be limited. Cooperation at the level of the state is not enough, it is also important that relations be established in the private sector. Countries should not and cannot copy the models of other countries, because they are so different. In the Chinese – Hungarian cooperation, Hungarians are able to retain their characteristics and their uniqueness. The experience of foreign countries should be utilised in such a manner that we should convert them in a way suitable for our own country, nothing should be adopted as it is.

Senior economist *Erik F. Nielsen*, Group Chief Economist, Global Head of CIB Research, UniCredit Bank AG noted that in the majority of the euro zone per capita GDP growth is still similar to that of the USA. Naturally, the euro zone has its own problems, as do other countries. He considers the Chinese initiatives to be a great idea, for a number of reasons, including the support provided by the initiative to the growth of investments in the public sector. This is one of those areas where countries of West Europe are rather weak, especially in the build-up of infrastructure between states. This initiative should also be welcome because it strengthens competition. He highlighted the role of the private sector in the cooperation with China. He emphasised that he fully respects and admires China for the results it has accomplished over the last 40 years, especially in the field of growth and the elimination of poverty and privation on the largest scale ever. In addition, it has also seen amazing development in the field of tools and institutions of governance.

After that, *Ivo Maes*, Senior Advisor, National Bank of Belgium and Robert Triffin Chair, Catholic University of Louvain reviewed the book "Alexandre Lamfalussy – Selected Essays" he edited and presented the professional career of Sándor Lámfalussy.

The title of the discussion forum of the panel moderated by *Jacques de Larosière* was: "The future of European integration. What are the centrifugal forces threatening it and what should be done about it?".

Sir Paul Tucker, former Deputy Governor of the Bank of England raised the following issues in his discussion opening speech: the banking union, the monetary union, the capital market union and the institutions of the EU. He noted that it was important to ensure that the legislation of the Union should be in accordance with the values and interests of the given member state. The establishment of the banking union is a great accomplishment, but it should have been created much earlier. At the same time, it cannot be deemed completed. For example, the European deposit insurance system is missing, which would be a precondition for financial stability. In addition, a certain degree of fiscal union is also necessary. Several options may exist for a way out of the fundamental competitiveness problem: 1. German wage inflation should significantly exceed the level of the countries of the periphery 2. a significant transfer of resources should take place from Germany and the Nordic countries towards the southern countries, 3. some countries should leave the euro zone.

The capital market union could improve the operation of the euro zone by assigning the risks to the private markets, and let them price the incurred risks.

Paul De Grauwe, Professor, John Paulson Chair in European Political Economy at the London School of Economics and Political Science, shared his thoughts on the future of the euro: the euro zone is characterised by low growth and high unemployment, the system was already developed wrongly in the stage of design. The solution is a political and budgetary union and a kind of consolidation of national debts. Fiscal policy should focus on government investments, since the austerity programmes have so far led to a drop in government investments. Germany in particular should launch more investments of this kind, since it can practically finance itself at no cost. It is difficult to understand why the governments are unable to find investments whose return rate exceeds 0 per cent. A kind of integration "fatigue" can be felt, and although the political union seems far away, small steps should be taken in this direction.

Thomas Mayer, Founding Director, Flossbach von Storch Research Institute, gave a presentation with the title of "Future of European integration – centralisation is dividing Europe". He sees two major problems: the lack of efficient control on the Schengen borders, and the euro as the only currency of the euro zone. Upon its birth, the euro was provided with two characteristics: 1. Commodity money (means for exchange and store of value); 2. State money (financial instrument, the central bank is the Lender of last resort not only for banks, but also for governments). It must be decided which of the two is the real identity of the euro.

Europe needs a more modest vision of the future: the EU can only be created as the political community of several distinct nations, in such a manner that fundamental sovereignty is retained at national level, certain areas should be delegated to Union level, and various circles of integration should be established in European Union.

György Szapáry, Chief Adviser to the Governor of Magyar Nemzeti Bank, said that now is the first time in the history of the Union that the Union is divided by multi-dimensional political issues, as well as non-technical economic issues, such as the Maastricht criteria, financial requirements, which have generated complex and time-consuming disputes but did not create such a deep division. He spoke about migration, Brexit, Russian sanctions and the issue of Turkey. He highlighted that the FX rate agreements preceding the euro had been worse than the euro. For the European economic integration to be strengthened, we need responsible governments and stronger institutions that honour the rules.

György Matolcsy closed the conference by stating that Hungary intends to continue acting as a bridge between Europe and Asia in the future as well, in which the Lámfalussy Conference is an important station. Several valuable thoughts have been stated and many important questions have been raised, which we can respond to together.