The Emergence of a German-Dominated Europe: Economic and Political Implications for Poland

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Optimum Currency Area (OCA) theory

Mundell, Robert A. (1961)

McKinnon, Ronald I. (1963)

Kenen, Peter B. (1969)

Conditions for a successful monetary union:

- High volume of mutual trade
- Closely synchronized business cycles
- High degree of mobility of resources (labor)
- Common fiscal authority

European Economic and Monetary Union (EMU) is not an OCA

EMU does not satisfy the last three criteria

Barry Eichengreen (1992)

Tamim Bayoumi and Barry Eichengreen (1993)

Tamim Bayoumi and Barry Eichengreen (1997)

Michael Artis, Marion Kohler and Jacques Mélitz (1998)

If a region is not an OCA, than economic costs may exceed benefits

"My considered opinion has long been that the loss outweighs the gain. The potential members of the EMU do not have sufficiently flexible wages and prices, or sufficiently mobile workers, or a sufficiently effective fiscal compensatory mechanism, to serve as a satisfactory substitute for flexible exchange rates."

Milton Friedman (1997)

Benefits & Costs

Foreign exchange risk & trade

Exchange rate

Fiscal policy

Monetary policy

Adverse asymmetric demand-side shocks

Automatic stabilizers

In the U.S. up to 40% of an adverse economic shock is absorbed with automatic stabilizers

Widely EU-accepted causes of the euro area crisis

Overspending (excessive budget deficits)

Too much national debt

Rigid markets (labor)

Table 1
National finances and economic growth

Indic.	Area	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Budget posit. (% of GDP)	EA	-1,9	-2,6	-3,1	-2,9	-2,5	-1,4	-0,7	-2,1	-6,4	-6,2	-4,1
	D	-3,1	-3,8	-4,2	-3,8	-3,3	-1,6	+0,2	-0,1	-3,2	-4,3	-1,0
	E	-0,5	-0,2	-0,3	-0,1	+1,3	+2,4	+1,9	-4,5	-11,2	-9,3	-8,5
National debt (% of GDP)	EA	68,2	68,0	69,2	69,6	70,2	68,6	66,4	70,2	80,0	85,4	87,4
	D	59,1	60,7	64,4	66,3	68,6	68,1	65,2	66,7	74,4	83,0	81,2
	E	55,6	52,6	48,8	46,3	43,1	39,6	36,2	40,2	53,9	61,2	68,5
Real GDP growth (%)	EA	2,0	0,9	0,7	2,2	1,7	3,2	3,0	0,4	-4,3	1,9	1,5
	D	1,5	0,0	-0,4	1,2	0,7	3,7	3,3	1,1	-5,1	3,7	3,0
	E	3,7	2,7	3,1	3,3	3,6	4,1	3,5	0,9	-3,7	-0,1	0,7

EA = Euro area (16), D = Germany, E = Spain

Data: Eurostat.

Prior to the crisis

Spain:

substantial budget surpluses or insignificant budget deficits. Between 2001 and 2007 the nation's national debt declined by over 19 percentage points.

Germany:

exactly the opposite trends in.

Table 2
Labor market

Indic.	Area	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Temp. empl. (% of total)	EA	14,8	14,6	14,5	15,1	16,1	16,7	16,7	16,3	15,4	15,7	15,8
	D	12,4	12,0	12,2	12,5	14,3	14,6	14,7	14,8	14,6	14,7	14,8
	E	32,1	32,1	31,8	32,1	33,4	34,1	31,7	29,3	25,5	25,0	25,4
Part-time empl. (% of total)	EA	15,8	16,0	16,5	17,5	18,6	19,2	19,4	19,5	20,0	20,5	21,0
	D	20,3	20,8	21,7	22,3	24,0	25,8	26,1	25,9	26,1	26,2	26,6
	E	8,0	8,0	8,2	8,7	12,4	12,0	11,8	12,0	12,8	13,3	13,8
Unemployment rate (%)	EA	8,1	8,5	9,0	9,3	9,2	8,5	7,6	7,6	9,6	10,1	10,1
	D	7,9	8,7	9,8	10,5	11,3	10,3	8,7	7,5	7,8	7,1	5,9
	E	10,5	11,4	11,4	10,9	9,2	8,5	8,3	11,3	18,0	20,1	21,7

EA = Euro area (16), D = Germany, E = Spain

Data: Eurostat.

Prior to the crisis

Spain:

adopted economic policies that made its labor market quite flexible.

Germany:

implemented policies that induce firms to keep employees working part-time rather than fire them.

The real cause of the crisis

- Economic structures
- Economic competitiveness
- Absence of automatic adjustment mechanisms

Proposed *solutions* to the crisis

Austerity

- Pact for the Euro
- Fiscal Compact
- European Stability Mechanism
- Banking Union
- Separate budget for the euro area

All the above agreements involve only euro area member states

Effective *division* of the European Union into two tiers.

Basic *tenets*

- Political integration
- Voting based on economic power
- Close policy coordination (including taxes)
- Strict budget and debt targets
- Strict conditionality
- Some “fiscal capacity”

Where does Poland stand?

Should Poland join the euro area?

	GDP growth (2000-10 av.)	GDP/capita at PPP (euros)	Total GDP (bil. euros at current prices
Euro area	1,38	26 500	9 175
Poland	3,93	15 300	354
Germany	1,12	29 000	2 496

Gross domestic product

	Investment (2000-10 av. % of GDP)	Gross savings (2000-10 av. % of GDP)	Trade balance (2000-10 av. % of GDP)
Euro area	20,7	21,4	1,4
Poland	21,2	17,2	-2,7
Germany	18,6	22,4	4,6

Catch-up potential

	EU Innovation index (2010)	R&D spending (% of GDP, latest)	Hi-tech exports (% of total)
EU-27	0,516	2,04	15,3
Germany	0,696	2,82	15,3
Greece	0,364	0,58	10,2
Poland	0,278	0,68	6,7
Spain	0,395	1,38	6,4

Catch-up potential

Poland during the crisis

The only EU member that recorded no GDP decline.

Indic.	Area	2007	2008	2009	2010	2011	2012	2013
GDP growth (%)	Euro Area	**3,0**	**0,4**	**-4,4**	**2,0**	**1,4**	***-0,3***	***1,0***
	Poland	**6,8**	**5,1**	**1,6**	**3,9**	**4,3**	***2,7***	***2,6***
Unemployment rate (%)	Euro Area	**7,6**	**7,6**	**9,6**	**10,1**	**10,1**		
	Poland	**9,6**	**7,1**	**8,2**	**9,6**	**9,7**		

Economic growth and unemployment

Indic.	Area	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Budget posit. (% of GDP)	EA	-1,9	-2,6	-3,1	-2,9	-2,5	-1,4	-0,7	-2,1	-6,4	-6,2	-4,1
	D	-3,1	-3,8	-4,2	-3,8	-3,3	-1,6	+0,2	-0,1	-3,2	-4,3	-1,0
	PL	**-5,3**	**-5,0**	**-6,2**	**-5,4**	**-4,1**	**-3,6**	**-1,9**	**-3,7**	**-7,4**	**-7,9**	**-5,1**
National debt (% of GDP)	EA	68,2	68,0	69,2	69,6	70,2	68,6	66,4	70,2	80,0	85,4	87,4
	D	59,1	60,7	64,4	66,3	68,6	68,1	65,2	66,7	74,4	83,0	81,2
	PL	**37,6**	**42,2**	**47,1**	**45,7**	**47,1**	**47,7**	**45,0**	**47,1**	**50,9**	**54,8**	**56,3**

National finances

A critical point

Polish zloty's exchange rate

	2004	2005	2006	2007	2008	2009	2010	2011
USD/PLN	0,274	0,309	0,322	0,361	0,415	0,321	0,332	0,337
% change		13,0	4,3	12,1	14,8	-22,7	3,3	1,8
Cum. change, 2004-08					+51,7			
EUR/PLN	0,221	0,248	0,257	0,264	0,284	0,231	0,250	0,243
		12,6	3,3	3,0	7,6	-18,7	8,3	-3,0
Cum. change, 2004-08					+28,9			
Trade bal. (% of GDP)	-2,4	-0,7	-1,8	-2,9	-4,0	0,1	-1,2	-1,2

Zloty's exchange rate and international trade

Monetary policy in Poland

The National Bank of Poland has just one economic goal:

Price stability

Policy of high interest rates

As of now, short term interest rates in the euro area are 0.75% and in Poland 4.75%.

Such policy attracts short-term capital inflows and causes appreciation of the zloty.

In sum,

- Joining the euro area is *NOT* in Poland's best interest.

- But staying outside the euro area may cause loss of funds and influence.

Two-dimensional strategy

- Politics
  i. Keep the EU from disintegrating,
  ii. Coordinate policies with other E. European countries.
  iii. Deepen relations with the U.S. and the U.K.
- Economics

  Drastically increase economic capacity

Sikorski 2011 Berlin speech

"What is crucial is that we maintain coherence between the Euro area and the EU as a whole. Community institutions must remain central."

Sikorski 2011 Berlin speech

"The biggest threat to the security and prosperity of Poland would be the collapse of the Euro zone."

Sikorski 2011 Berlin speech

Poland's goal is to join the euro zone.

"Poland also brings Europe a willingness to make compromises—even to pool sovereignty with others—in return for a fair role in a stronger Europe."

Sikorski 2011 Berlin speech

"Which brings me to the issue of whether an important member, Britain, can support reform. … Are you sure markets will always favour you? **We would prefer you in, but if you can't join,** please allow us to forge ahead. And please start explaining to your people that European **decisions are not Brussels' diktats** but results of agreements in which you freely participate."

Economic challenges

- Poor institutional capacity
  - Public administration
  - Courts
  - Laws
  - Academe

Legacy of the pre-1989 period

Thick line (**“gruba kreska”**) policy

	EoDB rank	Days-to-start-business								
	2011	2003	2004	2005	2006	2007	2008	2009	2010	2011
EU-27	39	41	35	27	23	20	17	15	15	14
EA	39	51	42	29	25	21	16	15	14	12
OECD	32	35	30	24	20	18	15	14	14	12
Germ.	19	45	45	24	24	18	18	18	15	15
Greece	100	38	38	38	38	38	19	19	19	10
Poland	62	31	31	31	31	31	31	32	32	32
Spain	44	114	114	47	47	47	47	47	47	28

Bureaucratic burden

Infrastructure (motorways, density km per 1000 sq. km.) – 2006

Germany – 35

Portugal – 25

Spain – 24

Hungary – 11

Czech Republic – 8

Poland – 2

Corruption Perception Index (2011)

Germany – 14 (8.0)

Spain – 31 (6.2)

Portugal – 32 (6.1)

Poland – 41 (5.5)

Italy – 69 (3.9)

Greece – 80 (3.4)

Poland's potential

Solidarity Movement

Orange Alternative

Mobility