„Problems of monetary integration with the euro area: the case of Poland”

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Warsaw School of Economics
Monetary Policy Council Member
Contents

1. Conditions of effective functioning of a single currency area
2. Benefits of the integration with euro area
3. Costs of the integration with euro area.
4. Benefits vs costs of Poland`s monetary integration with the euro area
5. Concluding remarks
Members of the single currency area

Members of the euro area:
- since 1999
- since 2001
- since 2007
- since 2008
- since 2009
- since 2011

EU members outside the euro area:
- with special status (opt-out clause)
- with derogation
## Euro as an international currency

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Source: EBC (2009 international role of the euro, July, Frankfurt, s.12)
Conditions of the effective performance of a single currency area

1. Convergence of a countries’ business cycles
2. Close reactions to external shocks
3. Full mobility of the main production factors
4. High degree of openness of domestic economy
5. Financing of regional differences in the level of regional development
Euro exchange rate against US dollar strengthened until the middle of 2008. Next, euro exchange rate has weakened as the result of subprime crisis.
Benefits of Poland`s monetary integration with euro area

1. Elimination of exchange rate risk
2. Trade creation phenomenon
3. Abolition of exchange transaction costs
Benefits of monetary integration - continuation

4. Improvement of real-sector competitiveness

5. Inflow of foreign direct investment

6. Stability, higher competitiveness and development of domestic financial sector

7. Higher GDP growth
The world an the euro area trade growth

Source: International Monetary Fund
The share of internal trade of EU and euro member countries in their all international trade transactions

Source: Eurostat

EU countries using national currencies
An influence of euro area performance on its international trade

— Developments in the euro area exports and imports volume were consistent with world trends

— Euro area international trade growth has been lower than world trade dynamics

— An internal trade across EU member countries has dominated in their whole international trade and services transactions
Single financial market of euro area.

— the task to integrate local financial markets into unified single financial market seemed to be nearly reached in the middle of 2008

— the level of long-term market interest rates of all euro countries was similar and oscillated around 4-4.5%

— however, the subprime crisis has revealed fragility of single financial market performance

— the gap across local long-term interest rates has widened again
The difference between the highest and the lowest long-term interest rates shouldn`t exceed 2% according to the Maastricht Treaty.

Source: Eurostat
Share in world GDP
World and euro area GDP growth (in %)

Source: IMF

2011 - estimation
### GDP growth of Euro area members

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Source: IMF  
Join euro zone after 2002  
estimation

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GDP growth of euro area economy has been significantly slower than world GDP dynamics.
The share of real investments in GDP

Source: IMF
Population growth in euroland

Euroland has had strongly negative demographic tendencies
Labour unit productivity changes in euro area economies in relation to unit productivity in the whole European Union (27 countries)

Labour unit productivity competitiveness in euroland has worsened against the whole European Union

Source: Eurostat.
Costs of Poland`s monetary integration with the euro area

1. Loss of exchange rate as an instrument of economic policy
2. Loss of independent monetary policy including:
   - interest rate level policy and credit expansion
   - shaping of money supply
3. Resignation of the country’s exchange reserves
4. Lack of influence over decisions of the European Central Bank
Costs of monetary integration - continuation

5. Inflation growth – cappuccino effect

6. Long-term price level convergence and increase of domestic inflation

7. Loss of fiscal deficit policy to shape aggregate demand and macroeconomic activity
Euro area economies characterises strong market rigidities

- limited flexibility of prices and wages
- separation of local financial markets
- barriers applied to services industry flows
Benefits vs costs of Poland’s monetary integration with euro area – openness of domestic economy
Poland is small open economy
European Commission`s approach  Paul Krugman`s approach

- Commission`s approach – higher degree of economic integration leads to lower production and employment divergence (intra industry cooperation)

- Paul Krugman`s approach – higher degree of economic integration leads to higher production and employment divergence (regional industry specialisation)

Source: P. De Grauwe, „Unia walutowa”, PWE, Warszawa 2003
An impact of business cycles divergence on euro area performance

- Growing business cycle divergence strengthens the impact of asymmetric shocks on euro area countries.

- External shocks can result in booms in some regions of the euro area and in recessions in others.

- Different external shock effects on euro area countries need diversification and adjustment of economic policy tools to local conditions.

- Fiscal deficit policy should be adjusted to the level of real activity conditions of each country.
Poland hasn`t accomplish inflation condition of Maastricht Treaty. Consumer Price Index was higher in Poland than euro area inflation reference rate in 2011.
Fiscal criteria of the Maastricht Treaty are not adjusted to economic conditions of separate euro countries

- **Fiscal policy Maastricht criteria:**
  
  - public sector deficit cannot be higher than 3% of GDP
  - public sector total debt cannot exceed 60% of GDP

- **Subprime crisis revealed that most euro area economies have been not able to accomplish Maastricht fiscal conditions**

- **Countries fiscal deficit resulted from huge public spendings directed to fight 2008-2009 recession**
General government deficit (% GDP) in UE - 2010
Public debt (% of GDP) in EU countries – 2010

EU (27 countries):
- Belgium: 85.3%
- Bulgaria: 80.1%
- Czech Republic: 43.7%
- Denmark: 16.3%
- Estonia: 6.7%
- Finland: 41%
- France: 61%
- Germany: 83.2%
- Greece: 144.9%
- Hungary: 38%
- Ireland: 82.3%
- Italy: 61%
- Latvia: 61.5%
- Lithuania: 31%
- Luxembourg: 19.1%
- Malta: 69
- Netherlands: 81.3%
- Poland: 54.9%
- Portugal: 62.9%
- Romania: 71.8%
- Slovakia: 38.8%
- Slovenia: 62.9%
- Spain: 118.4%
- Sweden: 39.7%
- United Kingdom: 79.9%

Euro area (17 countries):
- Austria: 93.3%
- Finland: 48.3%
- Greece: 144.9%
- Ireland: 92.5%
- Italy: 61%
- Latvia: 61.5%
- Lithuania: 38%
- Luxembourg: 19.1%
- Malta: 69
- Netherlands: 81.3%
- Poland: 54.9%
- Portugal: 62.9%
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Source: Eurostat  
Source: Eurostat  e- estimation  Join euro zone after 2002
Real effective euro exchange rate of all member countries in 2010

- The higher is the euro effective exchange rate of the member country, the lower is its export price competitiveness.

- The lower is euro effective exchange rate of the member country, the higher is its export price competitiveness.

- Germany and France have gained additional price competitiveness of their products inside common currency area thanks to real depreciation of the euro.

- Greece, Spain, Portugal, and Ireland have lost price competitiveness of their products as the consequence of real appreciation of the euro inside their economies.
Echange rate is an important tool of economic policy for Poland

- Exchange rate changes allow to maintain price competitiveness of exports as Poland is small open economy

- Exchange rate changes allow to cushion negative external shocks influencing domestic economy

- Poland shouldn`t resign of exchange rate as the tool of monetary stability shaping and as an instrument of growth expansion, until it improves its economic competitiveness in relation to the euro area members
Competitiveness of Poland’s economy
Position of country in rankings of competitiveness World Economic Forum

Concluding remarks:

- Integration with the euro currency area could bring benefits to Poland’s economy, but is also related to costs. The costs will surely be managed by Poland, while the benefits are only probable.

- In the situation of a significant delay of Poland’s in relation to euro area, it would be beneficial to take advantage of the upcoming decade to maintain high rate of GDP growth under stable macroeconomic conditions. And close monetary integration with the euro-area will only be possible after competition of the real process of economic convergence. Real economic convergence means a long-term process of bringing Poland’s GDP per capita close to the average per capita income in euro countries. This process will take time but it will allow the level of the economic development of Poland approximate the level of euro member countries.

- Premature currency unification poses the risk of preserving and escalating existing differences in the levels of economic development between Poland and euro area.
Thank You