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The future of the euro area – Poland's geo-economic perspective

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Abstract

The article presents the discussion about the future of the euro area. The starting point of this analysis is an outline of the main conclusions drawn from the crisis in this area, which began in 2010. Next, the documents regarding future reforms of the Economic and Monetary Union (EMU), submitted by the European institutions during 2015-2017, will be analysed. Subsequently, the discussion on these proposals among the member states, especially the most influential – France and Germany, is being analysed. The article is aiming at considering the preliminary results of these negotiations and the possible reforms of the euro area. The Author is also wondering whether these reforms can adequately prepare the monetary union for another crisis or even worsening the economic situation in Europe. In this context and in relation to the broader geopolitical situation in 2018, the question is raised whether Poland should mull over joining the EMU. Finally, the geo-economic consequences of entering the EMU or being outside the monetary union will be examined in a situation where the reforms of this area are incomplete and the eurozone seems to be not well prepared for a possible next crisis.

Keywords: the Economic and Monetary Union, reforms, geo-economics, Poland

Przyszłość strefy euro – perspektywa geo-ekonomiczna Polski

Streszczenie

Artykuł prezentuje analizę dyskusji na temat przyszłości strefy euro. Punktem wyjścia analizy jest zarys głównych wniosków wynikających z kryzysu w tej strefie, który rozpoczął się w 2010 r. Następnie zostaną przedstawione dokumenty dotyczące przyszłych reform unii gospodarczej i walutowej (UGW), przedłożone przez instytucje europejskie w latach 2015–2017. Następnie analizowana jest dyskusja nad tymi propozycjami wśród państw członkowskich, zwłaszcza tych najbardziej wpływowych – Francji i Niemiec. Celem artykułu jest rozważenie wstępnych wyników tych negocjacji i możliwych do wprowadzenia reform w UGW. Autor zastanawia się również, czy te reformy mogą odpowiednio przygotować unię walutową na kolejny kryzys lub pogorszenie koniunktury gospodarczej w Europie. W tym kontekście i w związku z szerszą sytuacją geopolityczną w 2018 r. zostanie postawione pytanie, czy Polska powinna przystąpić jak najszybciej do UGW. W celu zbadania tej kwestii zostaną przeanalizowane geo-ekonomiczne konsekwencje wejścia do UGW lub pozostawania poza nią w sytuacji, gdy reformy tego obszaru są niekompletne, a strefa euro wydaje się nie być dobrze przygotowana na ewentualny następny kryzys.

Słowa kluczowe: unia gospodarcza i walutowa, reformy, geo-ekonomia, Polska

The aim of the article is to analyse the discussion about the future of the euro area. The starting point of this analysis is the main conclusions resulting from the crisis in this area, which began in 2010. Next, the principal documents regarding future reforms of the Economic and Monetary Union (EMU) will be analysed. These reports were presented by the European institutions in 2015–2017. Subsequently, the discussion on these proposals among the member states, especially the most influential – France and Germany, will be analysed. The discussion has intensified since the election of a new president in France (2017) and the new cabinet came through in Germany (2018). The article is aiming at considering the preliminary results of the negotiations instigated in 2018 and the possible short-term or long-term reforms of the euro area. I am also wondering whether these reforms can adequately prepare the monetary union for another crisis or can even worsen the economic situation in Europe. In this context, the question is raised whether Poland should join the EMU down the road. Finally, I will examine geo-economic consequences of entering or being outside the monetary union in a situation where the reforms of this area are incomplete and the eurozone seems to be not well prepared for a possible next crisis.

The theoretical basis for my analysis is the geo-economic perspective, a concept that closely links geopolitics with economic policy. According to this approach, public actions taken in the sphere of economy can serve geopolitical purposes (Luttwak 1990: p. 17–23; Blackwill, Harris 2017; Baldwin 1985; Haliżak 2012; Grosse 2014a: p. 40–65). This is especially true for currency regimes. In this article, I try to deepen theoretical reflection on the relationship between economy and geopolitics in relation to the monetary system in Europe. I am asking two basic theoretical questions. Firstly, whether external geopolitical conditions and objectives should have a primary impact on the decision to enter an economic and monetary regime (in this case EMU)? Secondly, if maybe rather the internal conditions and functionality of a given regime should be taken into account, which may have also geopolitical repercussions? Obviously, both dimensions should be taken under consideration, although the external geopolitical circumstances are of great importance in the Polish public debate, and internal ones are usually overlooked or neglected. Therefore, the main hypothesis adopted in the study is that the institutional incompleteness of the monetary regime may have negative geopolitical consequences, unless the member state is adequately prepared to participate in such cooperation. The methods employed in the study are as follows. Firstly, examining the programming documents proposing reforms in the

EMU, secondly, scrutinising the feasibility of these reforms in the short and long term, and thirdly, assessing whether reforms respond to the main challenges arising from the recent crisis and can protect EMU against any serious problems in the future.

The euro area has been slowly emerging out of an existential crisis since 2015, which threatened its existence or could cause it to partially disintegrate. The first time such a risk occurred was in 2012, when the stabilisation of the financial markets was the result of a daring declaration by the head of the European Central Bank (ECB) about its readiness to use all means of monetary policy necessary in order to defend the EMU. The second time this happened was in 2015, when the future of Greece as a member of the eurozone came into question. Painful experiences of crises indicated a number of weaknesses within this monetary system.

The first conclusion to be drawn from this crisis is that taking part in this project leads to serious economic, social and political consequences, especially when a given country's economy is not ready to join the monetary union. One must first carry out structural reforms and increase convergence with the most advanced economies of the euro area, before entry into such a union can take place, seeing as macroeconomic convergence does not occur automatically once a given country is in the eurozone, as was forecast earlier by certain economists (Christodoulakis 2009: p. 86–100).

Secondly, for countries which are included in assistance programmes coping during a time of crisis literally involves shock therapy, the suspension of democratic rules and political dependency on lenders in the most basic domestic policies. Monetary unions do not have the instruments needed to reduce the social impact of crises in countries which are most vulnerable, such as social transfers or anti-unemployment measures, which are described by economists as automatic stabilisers. The EMU also seems to lack policies which actually promote economic growth and restoration of competitiveness. Instead, the anti-crisis policies dictated by the EMU have multiplied both social and political costs. According to the International Monetary Fund (IMF), policies concerning countries such as Greece have focused too much on fiscal austerity, while failing to increase economic competitiveness (*Greece*... 2017). At the same time, they have also been ineffective in terms of limiting debt increases and failed to lead to substantial structural reforms within Greece itself.

Thirdly, the single currency system is asymmetrically beneficial for countries with the most competitive economies and with the greatest political influence within the monetary union. An example of this is Germany, which even during the time of crisis recorded high export and budgetary surpluses. In this, they clearly increased their geopolitical influence over the EU. The monetary union simultaneously aids the accumulation of all sorts of costs by the weakest countries, especially during times of economic downturn. Meanwhile, there is no political discourse about a systematic and effective reduction of this asymmetry, even though for decades such solutions, which balance inequalities arising out of monetary unions, have been discussed by economists (Whyman 2014: p. 399–415). The mechanisms operating within the EMU move the impact of such adjustments onto individual countries and have proven generally ineffective, both in relation to countries which possess a surplus, as well as current account deficits (Grosse 2016a: p. 28–50).

Fourthly, entering a monetary union is not easy, because it is loaded with a series of conditions and at the same time is dependent on negotiations which are, among other things, meant to define the exchange rate of the national currency for the euro, one which is most beneficial for all parties. Leaving the monetary union, however – even if it turns out to be a total catastrophe – is almost impossible. This creates an incredible dependency for states which are weaker or which are experiencing economic difficulties when compared to other countries in the union, especially those which are politically dominant.

Fifthly, the permanent asymmetry of the monetary union in favour of Germany (and, to a lesser extent, of the Netherlands) and at the expense of the other member states, as well as the difficulties in the institutional balance of the EMU – make this system vulnerable to further crises and internally unstable. German leadership (referred to as hegemony) is in this situation unstable or relatively fragile (Strange 2018: p. 125–139). Also, the relations between Germany and France (and their allies from Southern Europe) may be compromised if the economic and political imbalances between Germany and other members of the EMU last longer or even increase.

The debate about the necessity to enter the euro area flared up in Poland in 2018. Any discussion about the perspective of Poland's membership of EMU has to take into account the above experiences. This is why before such a move can be made, we have to ask a few fundamental questions: has the EMU been reformed since the most recent crisis and are these sorts of reforms the subject of considerations by political decision-makers, and also can they be introduced soon? Can they fill the institutional gaps which were revealed during the recent economic crisis? And as a result, will the monetary union in Europe become better prepared for another crisis, or at least reversal in the economic trends? According to Jean-Claude Trichet, the former boss of the ECB, the level of public and private debt across the globe is worryingly high, which is also true of the prices of various assets, which indicates the rising likelihood of speculative bubbles. In his opinion, this could foretell of a new economic crash in the near future (Trichet 2018). If this is the case, is there a chance that future anti-crisis political strategy will be less focused on austerity measures and more on increasing growth? And finally, the key question is whether a system of monetary union has been thoroughly balanced, if we are talking about relations between states which are most competitive and have the highest export surpluses, and then those which have weaker economies and are operating with a chronic current account deficit? If not, this means that the monetary union remains a firmly asymmetrical system. This would give some states economic benefits and strengthen their geopolitical position, and the rest would pay in economic and social terms, while diminishing their role in the international community, thereby increasing their political dependency on states which have a dominant position within the EMU and the EU.

Initial proposals for reforms: the European Commission (EC), France, Germany

Since the start of the crisis in the eurozone in 2010, European decision-makers have tried for some years to tackle ensuing problems. The majority of experts and politicians themselves admit that the eurozone was not sufficiently prepared for the crisis, nor has it managed to introduce essential reforms which could, even in 2018, protect it effectively from another large-scale crisis. Clearly, some partial and incomplete reforms have been undertaken, such as the introduction of the banking union. Nevertheless, the political strategy for emerging from the crisis depended largely on shifting the burden of making adjustments onto countries mired in internal turmoil.

The monetary union and the IMF provided aid in the form of loans for the most vulnerable states. The terms these loans involved were meant to tighten budgetary discipline within member states and force structural reforms. They were intended to reduce public debt, make labour markets more flexible, improve administrative efficiency and the conditions for enterprise investments, as well as stabilising the financial sectors, especially leveling the balance sheets of banks. In spite of all these efforts, the ECB took upon itself a substantial part of the burden involved in halting the crisis. And it is mainly thanks to its policy of quantitative easing and the lowering of the exchange rate that we have seen a gradual improvement of the economic situation as of 2015 (Grosse 2016b: p. 11–56).

European institutions Reports

In the 2017 report covering the reforms of EMU, the European Commission highlighted the basic problems within the eurozone (*Document*... 2017: p. 12–17). This included difficulties in achieving internal convergence, which changed into macroeconomic divergence between individual members of the monetary union during the crisis. It drew attention to the low level of public and private investments, which make it harder to begin the process of quick rebuilding of economic growth. It covered existing risks in financial systems, connected with burdening banks with too many risky loans, as well as the rising level of debt within member states. The Commission concluded that the EMU is still struggling with the problem of institutional gaps and is managed in a way which is ineffective (on the European level). Finally, the EMU suffered from a serious deficit of democratic legitimacy, which made managing the zone even harder. The diagnosis thus presented by the Commission was in line with the opinions held by numerous economists (Stiglitz 2016; Kawalec, Pytlarczyk 2016; Grosse 2016a).

The Commission's recommendations covering future reforms within the EMU repeated in many ways the proposals put forward earlier, in a report produced by the five leading EU presidents (Juncker et al. 2015). Both documents draw attention to the need to tighten fiscal discipline in member states so as to reduce the budgetary deficit and public debt, in line with requirements set out by the Maastricht Treaty. It was deemed necessary to complete the construction of the banking union. This involves additional – aside from those delivered by the banks themselves – mechanisms of financing a single resolution fund by member states and a special line of credit from the European Stability Mechanism (ESM). Another element of the banking union should be the European deposit guarantee schemes. Both documents support the idea of creating a capital markets union, hence a greater integration and control over non-banking financial institutions. They also support the creation of a European Monetary Fund (EMF), which could replace the ESM (which was established during a time of crisis). And yet, they do not mention an increase to the financial scale of this fund, which in fact turned out to be sufficient in the case of Portugal, Spain, Ireland and Greece, but would definitely not prove to be so in the case of economies such as Italy becoming insolvent.

The Commission proposed the creation of a new type of securities in the eurozone, secured by treasury bonds (*sovereign bond-backed securities*). They would in theory make it easier to facilitate the recovery of balance sheets of banks burdened with risky loans. And yet, they are criticised by economists and ratings agencies, as involving many threats to financial institutions (Münchau 2018b: p. 9).

Another tool for rectifying the eurozone, both in relation to the banking sector and the member states threatened with insolvency, would be the introduction of common eurozone debt. For many countries in Northern Europe this proposal means covering the debts in Southern European states, as well as opening the gates to increased public debts within the EMU. This would, however, be a form of systemic mechanism for eliminating macroeconomic imbalances from the level of the monetary union, especially if these sorts of common bonds were used to achieve investment aims in the weakest member states.

The Commission assumes that the main mechanism for eliminating these macroeconomic imbalances should be market mechanisms (*Document*... 2017: p. 24), which seems to omit existing EMU experiences. It also seems to indicate that states should individually make economic adjustments, encouraged by macroeconomic monitoring procedures and the European Semester, conducted by European institutions. Up till now, the aforementioned procedures were not effective in reducing these inequalities in terms of monetary union, even if these supervisory activities were supported by aid funds. The Commission stressed the need to increase macroeconomic conditionality for EU funds (including those dedicated to cohesion policy), and therefore conditioning their availability based on the ability to carry out the recommendations taken from the European Semester. At the same time, in both the documents under analysis there are contradictory recommendations covering the reduction of economic inequalities. On the one hand, there are recommendations to strengthen structural reforms in member states, intended to improve economic competitiveness, such as liberalisation of labour markets, limiting access to and level of welfare and pension payments and so on. On the other hand, the documents also cover the ideas of minimum welfare standards and social benefits in the EU, stabilising taxation and regulating labour markets, which in the case of some member states could lead to increased worker protection, levels of taxation and welfare payments. In the case of Poland, this type of activity would rather damage economic competitiveness and increase debt, rather than lead to reforms which make it ready to enter the monetary union.

Both documents mention the question of introducing automatic stabilisers, especially in the case of so-called “asymmetric shocks”. The Commission proposed, among others, a unified system of unemployment benefit payments in cases of sudden increases in levels of unemployment in given member state. It also proposed a mechanism for protecting public investments, so that the EMU can take over responsibility for such investments from member states in which the economic climate has worsened. In the report drafted by five EU presidents there was mention of the European Fund for Strategic Investments, which would support weaker member states in rebuilding economic growth and competitiveness. On the other hand, the Commission report encourages the introduction of a separate budget for the eurozone, which could be a source of financing both for structural investments, as well as social security in times of economic hardship. In these documents, there is mention of the need to set up a ministry of finance for the eurozone, which could both oversee fiscal policies in member states, as well as managing investment funds, social spending and other forms of financial redistribution within the EMU. Finally, both documents cover the question of gradual building of a political union with the intention of reducing the democratic deficit. There is talk of strengthening the Eurogroup (an informal body which brings together ministers from the euro area countries), introducing a unified representation of the eurozone among external organisations, especially the IMF, as well as strengthening the role of national parliaments and the European Parliament (EP) in managing the EMU. Experiences show that instruments such as the European Semester or financial assistance programmes in the eurozone markedly weakened the role of national parliaments and national democracies in relation to budgetary policies, while work of the EP in managing crises situations was merely symbolic (Fasone 2014: p. 164–185).

France and Germany

Emmanuel Macron, the president of France, came out in support of some of the ideas presented above during his speech at Sorbonne University in 2017 (*Initiative*… 2017). This has had substantial political impact, seeing as neither the position of the Commission nor the presidents of European Union have any decisive influence on the future of the eurozone. The decisive role in terms of these reforms is played by member states, and especially France and Germany. Macron supported the idea of budgets and a minister of finance for the eurozone with the aim of increasing structural investments and boosting economic growth. He concluded that the budgets for the eurozone should come mostly from European taxes. At the same time, he backed the idea of more standardised taxation systems, harmonised regulations of labour markets and social welfare payments across the whole of the EU.

Because of their elections and difficult coalition talks, Germany waited half a year to respond to Macron's speech. In the coalition deal arrived at in 2018, the parties of the new German cabinet devoted only five out of 177 pages to the future of the EU (*Ein neuer Aufbruch*... 2018). The document stressed the need to strengthen austerity policy within the EMU and follow the fiscal criteria set out by Maastricht. This was seen as a continuation of Wolfgang Schäuble's earlier policies by Olaf Scholz (from the Social Democratic Party), considered to be a proponent of budgetary discipline (Karnitschnig 2018). Nevertheless, the agreement supported the proposal for extracting some investment capital for the EMU. At the same time, there was no mention in the text about a separate budget or a finance minister for the eurozone. The coalition members have agreed to setting up the EMF, and even mentioned the possibility of including it into European law. These were very general statements, which were later on interpreted by government politicians as not leading in any way to limiting the competencies of the Bundestag in terms of overseeing all financial transfers from the EMF (Böttcher et al. 2018). Some prominent politicians even questioned the need to establish the EMF (Rettman 2018a).

The government coalition supported actions needed to harmonise taxes and social standards in the EU. The document makes no mention of a banking union, but German politicians signaled that the condition for progress with reforms in this union will be the stabilisation of the banking sector, and especially solving the problem of high-risk loans (Spahn 2018). The coalition deal made by the new government clearly dampened the expectations some had regarding reforms in the eurozone.

Proposals being discussed in 2018

Reform proposals under consideration

Although officials, politicians and experts from the eurozone are discussing a series of reforms, they were being introduced very slowly and in rather limited ways. The most important question regarding the permanent mechanism of macroeconomic balancing of the eurozone was not even being discussed among politicians in 2018. This might include systemic financial transfers from countries with a trade surplus to those who have a deficit in their current accounts. This is an idea which was proposed far back by John Maynard Keynes as part of the plan of establishing an International Clearing Union (Cesarano 2006; White 2012; Grosse 2017: p. 65-82). Everything suggests that policies intended to respond to new crisis in the EMU will involve austerity, and will not support economic growth and competitiveness among the weaker countries. There was no agreement about reducing the social costs related to the crisis with the aid of European funds, such as EU social transfers. Although the German finance minister, Olaf Scholz, initially offered that an insurance fund could be established for national social security systems in the event of a sudden increase in unemployment, it would only be ad hoc loans to the state in crisis, not transfers of non-returnable assistance. In addition, Scholz's proposal met with opposition to part of the ruling coalition, including Minister of Economy, Peter Altmaier (Greive et al. 2018). Even if Chancellor Merkel ultimately supports this proposal, she will probably limit Germany's financial commitments to a maximum. This means that the least competitive and the most indebted states will have to struggle alone with social costs arising out of further austerity policies, even if they would be spread over time.

The reforms planned in 2018 included a humble investment line for the eurozone, as part of a future multiannual financial perspective for the whole of the EU. The level of this funding in terms of initial proposals was set at around EUR 25 billion. This is not a sufficient investment mechanism to encourage structural reforms or reduce potential outcomes of economic downturns. This was mainly because of German politicians who were not keen on a separate EMU budget, nor on any sort of investment provision for weaker economies within the monetary union. These sorts of modest investment funds, much like stabilising loans within the EMU, were first and foremost meant to have a mobilising effect in terms of introducing austerity policy and internal structural reforms.

There were also plans to rebrand the ESM as the EMF, and yet only with a minor increase of powers given to this institution (such as restructuring debts). A heated dispute around this structural transformation related mostly to secondary issues, as seen from the perspective of the whole system: for example the question of whether the EMF is meant to be covered by EU laws and be under the influence of the European Commission. This also related to whether stabilising loans issued by the EMF are automatically supposed to involve compulsory losses for private investors involved in bonds of the country which receives support from the Fund (in the way that Greek debt was restruc-