2013

The Greek Crisis, a Lesson for Poland

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Greece is experiencing an unprecedented decline in the level of economic activity and standard of living. Over the period of 2008–12 the nation's real GDP lost a total of over 20 percent and the most recent projections show that the recession will continue for another year and that the nation will lose yet another 4.2 percent[1]. This is an economic catastrophe that has no parallel in the Western world during peacetime. Greece is not the only nation in the euro area that is experiencing severe economic problems. As of May 2013 four other euro area countries, Ireland, Portugal, Spain, and Cyprus, required financial aid from other members of the region and the International Monetary Fund (IMF). The current crisis started in the United States, but it has affected the euro area to a much greater extent. In fact, America managed to overcome this calamity already in late 2009 while the euro area still suffers from its aftershocks.

The diverging post-crisis paths in the United States and the euro area point to fatal weaknesses of the European economic order. The roots of the economic malaise were sown in 1992 when the Continent chose to adopt a single currency. Economists as diverse as James Tobin and Milton Friedman predicted that the euro may cause severe economic difficulties[2]. Those pessimistic predictions originate in the fact that the euro area is not an optimum currency area[3]. Unfortunately, the document that served as the justification for the implementation of the Economic and Monetary Union (EMU) dismissed optimum currency theory as "limited and outdated" and proclaimed that the analysis of EMU feasibility should not be confined to "this rather narrow approach"[4].

[1] *Eurostat*, European Commission, accessed May 20, 2013, http://epp.eurostat.ec.europa.eu/portal/page/portal/statistics/search_database. Accessed on May 20, 2013.

[2] James Tobin, "Monetary Policy: Recent Theory and Practice," in *Current Issues in Monetary Economics* ed. Helmut Wagner (Heidelberg: Physica-Verlag, 1998), 13-21; Milton Friedman in *The Wall Street Journal* "Whither the EMU?" June 20, 1997, A18.

[3] For an extensive overview of the concept see Casimir Dadak, "Political Economy of the Euro Area Crisis," *Panoeconomicus*, vol. 58, issue 5 (2011), 593–604, and in Polish Kazimierz Dadak, "'Grecki kryzys' – czy przyszłość Europejskiej Unii Walutowej jest zagrożona," *Arcana*, no. 97 (2011), 27–37 and "Euro po dziesięciu latach," *Międzynarodowy Przegląd Polityczny*, no. 23 (2008), 5–18.

[4] Commission of the European Communities, "One Market, One Money: An Evaluation of the Potential Benefits and Costs of Forming an Economic and Monetary Union," *European Economy 44* (Brussels: Commission of the European Communities, 1990), 45.

Numerous experts argue that the decision to create the euro was political rather than economic in nature[5]. The present crisis provides strong evidence that the critics were right; the economic disadvantages of the single currency outweigh the benefits.

Mainstream View of the Crisis

Yet, the mainstream position held by euro enthusiasts is that the principal reasons for the economic collapse in Europe are generous spending on welfare programs and, resulting from this, excessive budget deficits and national debt levels. As a result, the key element of all programs implemented to aid failing euro area nations was extreme austerity. The donors, the biggest economies in the euro area and the IMF demand that the receiving nations drastically cut spending and increase taxes to meet stringent deficit and debt levels. But actual economic data point to a much more complex situation.

Indeed Tables 1 and 2 show that prior to the eruption of the present crisis Greece had been persistently violating the deficit and debt levels prescribed in the 1997 Stability and Growth Pact. But this is where the case against budget deficits and debt levels exceeding, respectively, 3 and 60 percent of the GDP, ends. During the years 2001-07, that is after the introduction of the common currency at the retail level and before the start of the present economic disturbance, Germany violated the budget deficit rule five times, euro area as a whole once, and Spain none[6]. Yet, it is Spain and not Germany that requested financial aid from the rest of the euro area. Similarly, Ireland, another nation that was forced to appeal for financial assistance, enjoyed stellar public finances prior to the start of the crisis. With the exception of 2002 when the country recorded a tiny budget shortfall (0.4 percent of GDP), Ireland had budget surpluses that were at times massive throughout the period[7]. For instance, in 2006 the nation had a surplus equal to 2.9 percent of GDP. Cyprus, the recipient of the most recent bailout, suffered from significant budget deficits in the years 2002-04, but by 2007 it turned the situation around and recorded a huge surplus (3.5 percent of GDP). As a result, at the end of 2007 the level of national debt in Ireland, Spain, and Cyprus, equaled, respectively, 24.8, 36.3, and 58.8 percent of GDP.

Table 2 also dispels the myth that excessive government expenditure was the culprit. Spain's government was spending much less, as a percentage of GDP, than the euro area's average and Germany throughout the pre-crisis period. The same is true of Greece until 2006. In fact, before 2007 the Greek government was spending a smaller share of GDP than an average nation in the euro area or Germany. The problem in Greece was

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[5] For instance: Václav Klaus, "The Future of the Euro: An Outsider's View", *Cato Journal*, vol. 24, no. 1–2, 2004, 171–7 and Dadak, "Political Economy".

[6] Spain, a country in many respects similar to Poland serves as a counterfactual in this paper.

[7] *Eurostat*, European Commission.

not excessive spending, but insufficient taxation. The nation's government was collecting a smaller share of GDP than those accumulated in frugal Spain. In sum, the argument that excessive government expenditure, budget deficits, and debt levels are the root causes of the present crisis in the euro area has at best weak foundations.

Table 1

Government budget position and national debt (% of GDP)

Indicator	Area	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Budget position	EA	-1.5	-2.6	-3.2	-2.9	-2.5	-1.5	-0.9	-2.4	-6.9	-6.5	-4.5
	D	-3.1	-3.8	-4.2	-3.8	-3.3	-1.7	0.2	-0.1	-3.2	-4.3	-1.0
	E	-0.5	-0.2	-0.4	-0.1	1.3	2.4	1.9	-4.5	-11.2	-9.3	-8.5
	GR	-4.4	-4.8	-5.7	-7.4	-5.6	-6.0	-6.8	-9.9	-15.6	-10.5	-9.2
National debt	EA	61.0	60.4	61.9	62.3	62.9	61.6	59.0	62.5	74.8	80.0	82.5
	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	43.2	39.7	36.3	40.2	53.9	61.2	68.5
	GR	103.7	101.7	97.4	98.6	100.0	106.1	107.4	113.0	129.4	145.0	165.3

EA = Euro area (16), D = Germany, E = Spain, GR = Greece.
Data: Eurostat.

Table 2

Government expenditure and revenue (% of GDP)

Indicator	Area	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Government expenditure	EA	47.2	47.5	48.0	47.5	47.4	46.7	46.0	47.1	51.2	51.0	49.4
	D	47.6	47.9	48.5	47.1	46.9	45.3	43.5	44.0	48.1	47.9	45.6
	E	38.7	38.9	38.4	38.9	38.4	38.4	39.2	41.5	46.3	45.6	43.6
	GR	45.3	45.1	44.7	45.5	44.6	45.2	47.6	50.6	53.8	50.2	50.1
Government revenue	EA	45.2	44.8	44.8	44.5	44.8	45.3	45.3	45.0	44.8	44.7	45.3
	D	44.5	44.1	44.3	43.3	43.6	43.7	43.7	44.0	44.9	43.6	44.7
	E	38.1	38.7	38.0	38.8	39.7	40.7	41.1	37.0	35.1	36.3	35.1
	GR	40.9	40.3	39.0	38.1	39.0	39.2	40.8	40.7	38.2	39.7	40.9

EA = Euro area (16), D = Germany, E = Spain, GR = Greece.
Data: Eurostat.

The Introduction of the Euro and Diverging Macroeconomic Paths

Table 3

Annual GDP growth (%) and inflation (CPI, %)

Indicator	Area	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Ave.
GDP growth	EA	2.0	0.9	0.7	2.2	1.7	3.2	3.0	0.4	-4.4	2.0	1.4	1.2
	D	1.5	0.0	-0.4	1.2	0.7	3.7	3.3	1.1	-5.1	4.2	3.0	1.2
	E	3.7	2.7	3.1	3.3	3.6	4.1	3.5	0.9	-3.7	-0.3	0.4	1.9
	GR	4.2	3.4	5.9	4.4	2.3	5.5	3.5	-0.2	-3.1	-4.9	-7.1	1.2
Inflation	EA	2.2	2.4	2.3	2.1	2.2	2.2	2.2	2.1	3.3	0.3	1.6	2.1
	D	1.4	1.9	1.4	1.0	1.8	1.9	1.8	2.3	2.8	0.2	1.2	1.7
	E	3.5	2.8	3.6	3.1	3.1	3.4	3.6	2.8	4.1	-0.2	2.0	2.8
	GR	2.9	3.7	3.9	3.4	3.0	3.5	3.3	3.0	4.2	1.3	4.7	3.4

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

Data: Eurostat.

Table 4

National gross saving and gross capital formation (% of GDP)

Indicator	Area	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Ave.
Gross saving	EA	20.1	19.7	19.5	20.2	19.9	20.7	21.5	20.6	17.9	18.2	19.0	19.8
	D	20.2	20.1	19.7	22.3	22.4	24.6	26.8	25.6	22.3	23.1	23.7	22.8
	E	22.0	22.9	23.4	22.4	22.1	21.9	21.0	19.5	19.3	18.8	18.2	21.0
	GR	11.8	9.6	12.2	12.0	10.6	11.2	8.8	5.8	4.0	3.9	3.2	8.5
Investment	EA	20.6	19.7	19.7	20.0	20.3	21.2	22.1	21.7	18.4	18.8	19.2	20.2
	D	20.3	18.1	17.9	17.6	17.3	18.1	19.3	19.4	16.5	17.3	18.2	18.2
	E	26.4	26.6	27.4	28.3	29.5	30.9	31.0	29.1	24.4	23.3	22.1	27.2
	GR	23.2	22.3	24.5	22.5	21.4	24.2	25.7	23.7	18.3	16.2	14.5	21.5

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

Data: Eurostat.

Tables 3 and 4 shed some light on actual origins of the euro area troubles. In the period 2001-07 both Greece and Spain experienced an above euro area rate of investment (gross capital formation) and GDP growth. In fact, Spain was frequently mentioned as a success story of the European monetary union. To a significant extent this was a result of rapid interest rate decline and foreign capital inflows that financed the investment

spurt[8]. This was especially true in Greece where the difference between the level of saving and investment was exceptionally high. In both nations the saving rate had been declining while at the same time the investment rate had been increasing. In sum, an ever growing proportion of gross capital formation was financed with capital inflows[9]. When the crisis exploded, capital flows reversed and both the private and public sectors found it exceedingly difficult to raise money[10]. Hence the need to ask for financial aid from other euro area nations. Data in Table 3 also indicate that over the same period Germany, a slow-growth nation, enjoyed an excess of saving over investment; hence, it was not exposed to the adverse effects of capital flows during the crisis.

Table 3 also provides evidence on substantial inflationary differentials among euro area member-states over the years 2001-07[11]. Greece and Spain experienced a much higher growth rates and, consequently felt an above average inflationary pressure. None of them could have taken a preventive measure, for instance by adopting a restrictive monetary policy, because they gave up their own currency and control over the interest rate. The rate is now set in Frankfurt by the European Central Bank (ECB) and, as long as Germany, the biggest economy in the region, was experiencing sluggish growth the bank maintained monetary policy that from the point of view of high-growth nations was too lax. As observed above, Spain conducted a very restrictive fiscal stance, but even this policy was insufficient to counterbalance the impact of ECB's relatively loose monetary policy and foreign capital inflows.

The nefarious impact of international capital flows within the euro area is also present in international trade data. Table 5 illustrates the magnitude of current account deficits in Greece and Spain. Especially Greece was running huge trade deficits prior to the start of the crisis and a trade deficit by definition is balanced by a surplus on the capital account. The introduction of the euro resulted in significant integration of financial markets in the region and fostered enormous capital flows among member-states. These flows allowed both Spain and Greece to maintain robust rate of investment and, resulting from this, above average rate of economic growth. But these positive developments also led to unpleasant consequences, both nations experienced above average inflation rates and, with the exchange rate effectively fixed within the euro area, they lost international competitiveness. As an overwhelming majority of their exports was going to other members of the euro area, Greece and Spain suffered trade deficits. Once the crisis struck, both nations

[8] Rafał Kierzenkowski, "Preparing for euro adoption in Poland", *OECD Economic Department Working Paper No. 790* (Paris: OECD, 2010), especially pages 30–1.

[9] At the end of 2009 banks that report to the Bank of International Settlements had total assets of $240.8 and $1,104.4 billion in, respectively, Greece and Spain (*Bank of International Settlements*, "BIS Quarterly Review, Statistical Annex", March 2011, http://www.bis.org/publ/qtrpdf/r_qa1103.pdf.). In each case, those investments were equivalent to approximately three quarters of GDP.

[10] *Bank of International Settlements*, "BIS Quarterly Review, Highlights of the BIS International Statistics", September 2012, 14–16, http://www.bis.org/publ/qtrpdf/r_qt1209b.pdf.

[11] The sharp increases in inflation observed in 2009 in Spain and Greece were a result of huge tax hikes.

found themselves in an unenviable position. In the absence of devaluation they have to regain competitiveness through deflation. Typically, a price and wage compression is accomplished through recession and high unemployment, and Greece and Spain, as well as Ireland, Portugal, and Italy are no exceptions from this rule.

Table 5

Net exports of goods (% of GDP) and exports extra-EU-27 (% of total)

Indicator	Area	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Net exports of goods	EA	0.4	0.9	0.7	0.4	-0.1	-0.6	-0.7	-1.1	-0.3	-0.4	-0.6
	D	4.7	6.3	6.0	6.9	7.0	6.9	8.2	7.3	5.7	6.4	6.0
	E	-5.6	-5.0	-5.1	-6.3	-7.5	-8.4	-8.6	-7.8	-4.0	-4.5	-3.7
	GR	-18.4	-19.2	-18.5	-18.1	-16.3	-17.1	-20.0	-20.8	-16.0	-13.8	-13.3
Exports extra-EU-27	EA	32.1	32.0	31.2	31.5	32.2	31.7	31.8	32.5	33.3	34.7	35.3
	D	36.4	36.6	35.1	35.4	35.7	36.4	35.3	36.7	37.6	39.9	40.7
	E	25.6	25.2	24.7	25.7	27.6	28.8	29.2	30.4	30.2	31.3	33.1
	GR	35.9	39.2	35.1	35.8	38.2	36.1	35.0	34.8	36.6	37.4	49.4

EA = Euro area (16), D = Germany, E = Spain, GR = Greece.
Data: Eurostat.

Fiscal Federalism, American and European Experiences

Theory of optimum currency areas also provides important hints to other factors that contribute to the current situation in the euro area. It stipulates that states choosing a common currency have to have well correlated business cycles, highly flexible labor markets, and a common fiscal authority. A common fiscal authority, frequently referred to as fiscal federalism, may be necessary to overcome the adverse effects of asymmetric economic shocks, especially on the demand-side. Kenen made this crystal clear stating that members of a monetary union must be "armed with a wide array of budgetary policies to deal with the stubborn 'pockets of unemployment' that are certain to arise from export fluctuations combined with an imperfect mobility of labor"[12]. In other words, states that assume a common currency and give up their own monetary policy need to become a transfer union.

The euro area has no central government and no institution that is in charge of collecting taxes and making transfers among member-states. The idea of the euro area becoming

[12] Peter B. Kenen, "The Theory of Optimum Currency Areas: An Eclectic View," in *Monetary Problems of the International Economy*, eds. Robert A. Mundell and Alexander K. Swoboda (Chicago: University of Chicago Press, 1969), 41–60.

a transfer union is anathema to some nations, especially Germany[13]. Chancellor Angela Merkel dismissed even a modest proposal to issue common euro area bonds[14]. The entire EU is ill equipped to serve such a function, too. The EU receives funds from member-states that are equal to about 1.25 percent of the region's GDP. But the monies are distributed according to a rigid seven-year framework. Moreover, an overwhelming majority of the funds are devoted to two items, common agricultural policy and cohesion funds. The Union, by law, is barred from running budget deficits and, overall, the region has little, if any, flexibility to address problems stemming from adverse demand-side shocks.

On the other hand, the United States has a strong central government that collects a majority of all taxes, on average an equivalent of 19 percent of GDP. The federal government transfers a significant part of its revenues to states, for instance in 2006 the U.S. Treasury collected $2,407 billion and of the above total it passed onto states over $434 billion[15]. The federal transfers made almost a quarter of all state revenue in that year. Also, the federal government has no limits on running annual budget deficits and the country took full advantage of this possibility during the current crisis. In 2009 and 2010 the budget deficit of the central government equaled about 10 percent of GDP. The federal government used its borrowing capacity to drastically increase aid to states and, consequently, by 2010 the share of federal transfers in total state revenue rose to over 35 percent[16].

The policy of austerity

The experience of American fiscal federalism is not imitated in Europe at all. Just the opposite, the euro area member-states decided to implement an exactly the opposite policy, the policy of extreme austerity. The policy is deeply rooted in neoliberal views of the economy, including that any government involvement in economic matters, especially discretionary fiscal policy, is harmful[17].

This thinking permeates economic policy not just in the euro area, but in an overwhelming majority of EU members. For instance, in 2012 the EU countries, with the

[13] *The Economist*, "We Don't Want No Transfer Union," December 4–10, 2011, 63–4; Wolfgang Schäuble, "Why Austerity is only Cure for the Eurozone," *Financial Times*, September 5, 2011, http://www.ft.com/cms/s/0/97b826e2-d7ab-11e0-a06b-00144feabdc0.html#axzz257cnwVNV

[14] Thorsten Severin and Catherine Bremer, "Merkel buries euro bonds as summit tension rises," *Reuters*, June 26, 2012, http://www.reuters.com/article/2012/06/26/us-eurozone-idUSBRE85O0CS20120626.

[15] Office of Management and Budget, *Historical Tables*, Table 12.1. (2012), http://www.whitehouse.gov/omb/budget/Historicals.

[16] Cheryl H. Lee, Robert Jesse Willhide, and Nancy I. Higgins, "State Government Finances Summary: 2010", *U.S. Census Bureau, Governments Division Briefs*, December 2011, http://www2.census.gov/govs/state/10statesummaryreport.pdf.

[17] For instance, John B. Taylor, "The lack of empirical rationale for a revival of discretionary fiscal policy," *American Economic Review: Papers & Proceedings*, vol. 99, no. 2 (2009): 550-5.

exception of the United Kingdom and the Czech Republic, adopted the Treaty on Stability, Coordination and Governance, commonly known as the Fiscal Pact[18]. The Pact sets new, more stringent budget deficit and national debt levels. Structural annual budget deficit cannot exceed 0.5 percent of GDP[19]. Additionally, nations that accumulated public debt in excess of 60 percent of GDP are required to bring it down to the above benchmark at a rate of one twentieth per annum.

Austerity has been the rallying cry throughout the euro area crisis. The temporary European Financial Stability Facility (EFSF) extended loans to Greece, Ireland, Portugal, Spain, and Cyprus in exchange for strict conditions[20]. Those conditions strive to limit budget deficits at all costs. The European Stability Mechanism (ESM), the permanent instrument that replaces the EFSF in the middle of 2013 has identical goals. The ESM Treaty stipulates that a euro area member-state can obtain aid that is "**subject to strict conditionality**" [emphasis added] that may "range from a macro-economic adjustment programme to continuous respect of pre-established eligibility conditions"[21].

This approach is in conflict with both academic research and opinions propagated by major international organizations. For instance, the IMF estimated that, under current conditions fiscal multiplier in the euro area is much higher than it had been thought before. Instead of being only 0.5, it actually is as high as 1.7[22]. Therefore, a sudden fiscal consolidation does more harm than good. This position is consistent with an OECD recommendation stressing that such policies should be implemented at "**a steady, gradual pace** consistent with a medium-term plan to restore fiscal stability".

Many academics agree with the above position. Paul Krugman has been the most vocal critic of the use of neoliberal prescriptions in combating the crisis[23]. But many others agree with Krugman. For instance Ball, Leigh, and Loungani show that a one percent reduction in government expenditure has a significant negative impact on economic growth, employment and equitable distribution of income and; hence, budget deficit reduction should coincide with robust economic growth[24]. DeLong and Summers advocate that, given the exceptionally low interest rates and unusually low demand for credit from the private sector, governments should substantially increase borrowing and spending and that this fiscal stimulus will pay for itself as economic growth and

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[18] *Treaty on Stability, Coordination and Governance in the Economic and Monetary Union*, 2012, http://european-council.europa.eu/media/639235/st00tscg26_en12.pdf.

[19] *Treaty on Stability*, Title III, article 1, paragraph b.

[20] Council of the European Union, *Extraordinary Council Meeting, Economic and Financial Affairs, Press Release 9596/10*, 2010, http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/114324.pdf.

[21] *Treaty Establishing the European Stability Mechanism*, T/ESM 2012/en, article 12, paragraph 1, http://www.esm.europa.eu/pdf/esm_treaty_en.pdf. Article 20, par 1 of the Treaty specifies that pricing of such loans should cover costs and "include an appropriate margin".

[22] International Monetary Fund, "World Economic Outlook", (Washington, D.C.: IMF, 2012), 41–43.

[23] Paul Krugman, *End This Depression Now!* (New York: W. W. Norton & Company, 2012).

[24] Laurence Ball, Daniel Leigh, and Prakash Loungani, "Painful Medicine", *Finance & Development*, September 2011, 20-3.

rising employment should lead to a dramatic increase in government revenue and no long-term increase in national debt[25].

Table 5 also points to the fact that austerity in the euro area has an adverse indirect impact on struggling nations in the region. As EU member-states strive to limit government spending and, therefore, experience at best a sluggish rate of economic growth Greece and Spain have to find export markets elsewhere. Over the last couple of years Greece managed to drastically redirect its exports, in 2011 almost half of its exports went outside the EU, a remarkable increase form only 35 percent in 2008.

International Competitiveness

One of the main reasons thanks to which Germany managed to escape the present crisis is the nation's international competitiveness. Data in Table 5 clearly show that Germany, unlike Greece and Spain, has had significant trade surpluses not only prior to the outbreak of the crisis but also throughout this catastrophe. Table 5 also demonstrates that Germany exports to regions outside the EU substantially more than the euro area average. This is possible because Germany has many firms that operate on a global scale and enjoy strong brand-name recognition, not only in the traditional heavy industry sectors, for instance car manufacturers, but also in other fields. SAP is a leading international provider of industrial software, Adidas is a global player in sporting goods, and Deutsche Bank and Allianz are among the largest providers of financial services. Table 6 sheds more light on the sources of Germany's international competitiveness. The country spends considerably more on research and development activities (R&D) than the euro area average and the difference in this category between Germany and Spain and Greece is truly shocking. As a result, a relatively large percentage of German exports is in the high-tech sector, an area that is less sensitive to business cycle fluctuations.

Overall, as opposed to Spain and, especially Greece, Germany has not suffered from the deleterious effects that the adoption of a common currency conferred on the euro area. It has the largest economy and, therefore, the policies of ECB are more in line with its needs than those of smaller member-states. It is a highly developed economy with very well developed infrastructure and, therefore, Germany does not need to invest heavily in this area. It enjoys a deep-rooted culture of thrift and, hence, it is a net saver. Germany also has a very strong export sector that is less dependent on economic fortunes in the euro area and is able to benefit from expansion in other regions of the world, giant emerging markets in Asia in particular. The nation spends a relatively large proportion of GDP on R&D and, hence, it is able to maintain a high degree of international competitiveness.

[25] Bradford DeLong and Lawrence H. Summers, "Fiscal policy in a depressed economy", March 20, 2012, http://www.brookings.edu/~/media/Files/Programs/ES/BPEA/2012_spring_bpea_papers/2012_spring_BPEA_delongsummers.pdf.

Table 6

Innovation, high-tech exports (% of total) and spending on R&D (% of GDP)

Indicator	Area	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
High-tech exports	EA	19.2	17.6	17.0	17.0	17.1	16.7	13.7	13.2	14.8	14.9
	D	18.3	17.5	16.9	17.8	17.4	17.1	14.0	13.3	15.3	15.3
	E	7.8	7.2	7.5	7.3	7.3	6.4	5.1	5.3	6.2	6.4
	GR	10.3	12.0	12.6	11.8	10.6	11.0	7.4	9.3	10.9	10.2
Spending on R&D	EA	1.86	1.88	1.87	1.85	1.84	1.87	1.88	1.96	2.06	2.06
	D	2.47	2.5	2.54	2.5	2.51	2.54	2.53	2.69	2.82	2.82
	E	0.92	0.99	1.05	1.06	1.12	1.2	1.27	1.35	1.39	1.39
	GR	0.58	N.a.	0.57	0.55	0.6	0.59	0.6	N.a.	N.a.	N.a.

EA = Euro area, D = Germany, E = Spain, GR = Greece, N.a. = not available.
Data: World Bank. Eurostat.

What Are the Lessons for Poland?

The present crisis offers invaluable lessons for Poland. The euro deprived the members of the European Monetary Union of control over monetary policy and the exchange rate. Recent developments in the EU also point to a drive to limit the use of fiscal policy in fighting harmful effects of adverse economic shocks. Consequently, nations that do not possess highly competitive economies may be exposed to unprecedented economic disasters that result in extraordinary declines in the standard of living and unparalleled levels of unemployment. Tables 7 and 8 provide important clues to the potential impact on Poland, if it chooses to adopt the common currency and implement new economic policies that are being endorsed in the euro area, for instance the Fiscal Pact.

Data in the tables point to Poland's serious economic weaknesses. The nation has been recording serious budget deficits. Over the period of 2001–11 Poland has had much higher budget shortfalls than the euro area average. As a result, the country has been substantially increasing its national debt burden. It is important to note that the rise in indebtedness was not a result of a spurt in investment spending. Although, Poland is lagging behind other East-central European nations, let alone the most advanced Western European countries in infrastructure development, this was not the main reason behind government borrowing[26]. Consequently, the government failed to accumulate assets that it could sell off to retire the debt or that could boost the rate of economic growth and, thus, government revenues. The rate at which Poland augments its productive capacity is slow, close to that of well developed, mature economies of the euro area rather than

[26] Kazimierz Dadak, "Twenty Years of Economic Transformation: The Price of Economic Orthodoxy," *Warsaw East European Review*, vol. 2 (2012), 131–45.

to, for instance, the Asian Tigers[27]. Moreover, like in the case of Greece and Spain, gross capital formation is financed with foreign capital to a considerable extent. Over the years 2001–11 savings in Poland have been insufficient to fund investment expenditure.

Table 7

Poland, macroeconomic performance

Indicator	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Ave.
Budget position (% of GDP)	-5.3	-5.0	-6.2	-5.4	-4.1	-3.6	-1.9	-3.7	-7.4	-7.9	-5.1	N.a.
National debt (% of GDP)	37.6	42.2	47.1	45.7	47.1	47.7	45.0	47.1	50.9	54.8	56.3	N.a.
Gross saving (% of GDP)	18.4	16.5	17.0	15.9	18.1	18.0	19.4	19.1	17.3	17.2	17.4	17.7
Investment (% of GDP)	20.8	18.6	18.7	20.1	19.3	21.1	24.4	23.9	20.3	21.0	21.7	20.9
GDP growth (%)	1.2	1.4	3.9	5.3	3.6	6.2	6.8	5.1	1.6	3.9	4.5	4.0
Inflation (CPI, %)	10.1	5.3	1.9	0.7	3.6	2.2	1.3	2.6	4.2	4.0	2.7	2.9

N.a. = not applicable.
Data: Eurostat.

Table 8

Poland, international competitiveness

Indicator	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Net exports of goods (% of GDP)	-4.0	-3.7	-2.6	-2.2	-0.9	-2.0	-4.0	-4.9	-1.0	-1.8	-2.1
Exports extra EU-27 (% of total)	18.8	18.8	18.1	19.7	21.4	21.0	21.1	22.2	20.4	20.9	22.2
High-tech exports (% of total)	3.2	2.9	3.1	3.3	3.8	3.7	3.0	4.3	6.1	6.7	N.a.
R&D spending (% of GDP)	0.62	0.56	0.54	0.56	0.57	0.56	0.57	0.6	0.68	0.74	N.a.

N.a. = not available.
Data: Eurostat.

Regrettably, similarities between Poland, Spain, and Greece do not end here. Poland has had substantial trade deficits over the period 2001-11. This shows that the economy is not internationally competitive and that the Polish currency is overvalued. Moreover,

[27] Dadak, "Twenty Years".

the nation's exports are primarily destined to other EU nations. As Greece, Poland possesses no firms that operate globally and are recognized for value and quality. The proportion of exports that are considered high-tech is quite small, too. This should come as no surprise because Poland spends very little on R&D.

The experience of the past five years offers direct proof that having its own currency saved Poland from the fate of Greece, Spain, Portugal, and Ireland. Between the summer of 2008 and the spring of 2009 the value of its currency, the zloty, drastically declined. This devaluation allowed the country to boost exports, close the trade deficit and avoid recession[28]. The National Bank of Poland analysis finds that "the flexible exchange rate" has been the main stabilizing force in Poland after 2007 and that adopting the euro "would have removed that protection"[29]. This finding is in line with earlier research that demonstrates that the process of real and nominal convergence between Poland and the euro area is largely incomplete and that an early adoption of the common currency could create substantial difficulties and risks[30]. Kierzenkowski especially warns against the danger of the boom-bust cycle that occurred in Spain and Ireland and is also likely to emerge in Poland should the country join the euro area not fully prepared.

Conclusions

The present crisis validates reservations that many experts voiced before and after the implementation of the EMU. The euro exposes the region to adverse asymmetric shocks and, therefore, requires remedies, for instance, fiscal federalism, that the euro area members are loath to implement. Instead, the region follows a policy of extreme austerity that is clearly counterproductive. In such an environment only countries that have internationally competitive economies can withstand economic crises relatively well. Unfortunately, Poland is not in this category. The nation suffers from considerable trade deficits and exports few high-tech products. The likelihood of a speedy catch up is exceedingly low. Poland's investment rate is low and a significant part of gross capital formation is financed with foreign capital. This makes the country a net debtor and will burden it with sizeable capital transfers in the future. The persistent budget deficits and a growing national debt burden do not inspire a great deal of optimism about the future. Additionally, Poland spends disproportionally small amounts on R&D and, therefore, is not likely to break out of the present predicament soon. The key factor that has allowed Poland to avoid recession is the ability to maintain a flexible exchange rate. Should Poland adopt the euro, this most important defense would be gone forever.

[28] Kazimierz Dadak, "Krach mniemany", *Wprost*, November 9, 2008, 62–63.
[29] Michał Brzoza-Brzezina, Krzysztof Makarski and Grzegorez Wesołowski, "Would it have paid to be in the eurozone?", *Narodowy Bank Polski, Working Paper, no. 128* (Warszawa: NBP, 2012), 21.
[30] Kierzenkowski, "Preparing for".