Potential benefits and risks from Poland’s accession to the euro area

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Abstract

This paper reviews the selected issues related to the potential benefits and risks of Poland’s accession to the euro area. Poland has joined the European Union in 2004. Being a member of the Economic and Monetary Union, Poland was obliged to adopt the euro as its currency, but the date of the above currency introduction was not specified. Poland’s joining the euro area is often discussed in political and economic debates. Such debates benefit primarily from politics and ideology, and the economic issues, associating possible benefits and risks resulting from Poland’s accession to the euro area. The opponents of the common currency deal with issues related to the financial crisis in the territory of the euro zone counties. According to the study conducted in 2010 by the Public Opinion Research Center, it was observed that the number of Poles supporting Poland’s accession to the euro area was decreasing. The survey conducted by CBOS in 2017 showed that the number of respondents who were against Poland’s accession to the euro area was 72%. The purpose of this paper is to analyze the basic benefits and costs that result from the adoption of the common currency by Poland.

Keywords: euro area, benefits, risks, common currency, public finance crisis, European Union.

Introduction

The purpose of this article is to present the potential benefits and risks related to the adoption of the euro as a national currency. In the subject literature, the benefits are divided into direct and indirect ones. Direct benefits are the ones, the magnitude of which depends on the indirect benefits. They can provide results in a short period of time. Indirect benefits, on the other hand, may potentially occur in the medium and long-term period. Direct benefits occur almost automatically, substituting the domestic currency with the euro. They are permanent and occur at a specific time. In the case of indirect benefits, which take a conditional form, their occurrence is considered as a potential opportunity, in the case of direct benefits (P. Krajewski, 2012).

Apart from benefits and opportunities, adoption of a common European currency may entail costs and risks. The certain risks and the necessity to incur costs will be considered in the short and long-term perspective as benefits and chances. The long-term macroeconomic costs of a country joining the common currency area will result in the loss of the ability to conduct an independent monetary and exchange rate policy and surrender it to ECB. However, in the short term, it will be necessary to incur technical and organizational costs caused by putting the euro into circulation in its cash form as a common currency. While adopting the common currency, a certain country must take into account...
possible disadvantages - the risk of a deterioration in the competitiveness of the country economy in the international arena, and as a result, the necessity to meet the Maastricht convergence criteria, while consolidating a temporary macroeconomic policy (A. Rogut, G. Tchorek, 2021).

### Material and methods

The paper uses the method of observation. It presents the information from the survey conducted by the Center for Public Opinion Research and from the Convergence Report published by the European Central Bank in June 2020. Poland’s accession to the euro area is often discussed in political and economic debates. The paper uses domestic sources.

The supporters of a quick entry to the euro area emphasize that it would strengthen Poland’s position in the European Union and ensure a wider participation in decision-making activities, including creation of the budget, the principles of shaping the single market, macroeconomic management or energy policy. It is worth noting that one of the concepts of EU development envisages the “two-speed” groups in the member states, and participation in the euro area should be the basic criterion for the division. It is possible therefore that the integration processes in the euro area may be accelerated. This would result in creation of a separate budget for the euro area, which would facilitate taxation policy and make the expenditure policy more predictable. In this situation, countries remaining outside the optimum currency area will face a serious dilemma (nik.gov.pl, 2021).

It is worth noting the following benefits in economic sphere resulting from joining the Eurozone:
- investment incentives, as financial stability is conducive to long-term investments;
- entrepreneurs’ access to cheaper credit, because a limited capital supply and a higher risk premium on the domestic market lead to higher interest rates;
- reduction of costs that enterprises incur in connection with currency exchange, in a situation where approximately 80% of Polish trade is settled in euro;
- avoiding the risk of exchange rate instability that is the basis for speculation on the financial market and additional costs of insurance against currency risk;
- higher level of integration with other economies, and thus, easier achievement of scale benefits by Polish enterprises;
- changing the investment profile to more technologically advanced and motivated investments, not only with the possibility of obtaining a cost advantage, but also with access to knowledge, talents and resources of qualified work.

Due to substitution of the national currency by the euro, the crisis risk is reduced directly and can also lead to:
- transaction costs minimization,
- reduction of nominal interest rates,
- increase in price transparency,
- reduction of macroeconomic risk (B. Marczak, M. Ratko, 2015).

Such issues as macroeconomic stability are of great importance to the economy itself, as it positively affects the very opportunity and the propensity of investors to make investment decisions, and is therefore important in economic resources deployment (B. Marczak, M. Ratko, 2015).

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**Figure 1. Economic convergence index for Poland in 2016-2018**

![Economic convergence index for Poland in 2016-2018](image)
The main benefits of Poland’s accession to the euro area include the elimination of uncertainty in the exchange rate fluctuations, and thus the reduction of exchange rate risks, which always occur when many different currencies operate in a certain area (P. Lonczak, 2021). Despite the fact that techniques have been developed to hedge against exchange rate risks, it should be noted that these techniques are expensive, and their application at the same time requires appropriate qualifications (B. Marczak, M. Ratko, 2015).

On the other hand, when referring to the indirect effects of Poland’s accession to the euro area, it should be noted that domestic and foreign investments increase, along with an increase in trade exchange. It is possible in this way to consider these effects as an opportunity that may occur in the long-term period, since the country’s accession to the Monetary Union (B. Marczak, M. Ratko, 2015).

As it was mentioned above, the occurrence of direct benefits is necessary for the indirect benefits (A. Rogut, G. Tchorek, 2021). The scale of the released indirect benefits is determined by the increase in the Gross Domestic Product and by the welfare of the country intending to enter the euro area, it goes here about Poland. Therefore, an important issue may be considered the fact that the direct benefits in this case depend on the level of preparation of the economy for joining the euro area, as well as on the economic policy and structural conditions. Referring to the theory of the optimal currency area, it is possible to conclude that the economic benefits of Poland’s accession to the euro area are greater than the costs associating with giving up Polish currency. Prices will come into effect in one currency throughout the European Union, and therefore their comparability will be facilitated, and that will improve the economic account among the economic entities, and thus contribute to facilitation of decisions on capital allocation (T. Sporek, 2015).

Taking into account the fact that Poland has a low supply of capital and insufficient savings in relation to the investment demand (B. Marczak, M. Ratko, 2015), improvement of possibilities related to the access to foreign currency savings, and at the same time, lower costs of obtaining capital would contribute to increase in the share of Gross Domestic Product investments through the increased value of implemented investments (T. Sporek, 2015).

Among possible costs resulting from Poland’s accession to the euro area, one can note three main aspects:

- pro-cyclical impact of the monetary policy of the European Central Bank,
- risks resulting from deviations of the market rate from the equilibrium in a permanent and irreversible manner,
- abrupt increase in prices.

Referring to the Republic of Poland, it can be pointed out that the risk resulting from the pro-cyclical impact of the monetary policy of the European Central Bank indicates the potential cost, the occurrence of which is not as possible as in the case of other countries in the euro area. The above mentioned results in a relatively high growth in labor productivity in real convergence in Poland, and thus, the level of interest rates and inflation is close to the level in the euro area (T. Sporek, 2015).

It is worth emphasizing that the common currency is useful in the case of those European Union countries that are properly prepared to accept it (B. Marczak, M. Ratko, 2015). Therefore, there are considerations that more important task than a quick entry to the euro area, is to supplement country lags and to make the competitiveness of the economy equal to the level in the euro area countries (nik.gov.pl, 2021).

Pursuant to the provisions of the Treaty on the Functioning of the European Union, each Member State must join the euro area when the necessary conditions for this purpose are met. There are exceptions to Denmark and the United Kingdom, which have negotiated the right to remain outside the euro area. In the case of countries that did not join the euro area, they are required to take all measures to fulfil it. However, no dates are set in the Treaty (nik.gov.pl, 2021).
Among the supporters of the immediate accession to the euro area, there is a belief that such action will strengthen Poland’s position in the EU, and thus contribute to decision-making activities on such issues as (nik.gov.pl, 2021):
- creation of the budget,
- macroeconomic management,
- energy policy,
- principles of shaping the single market.

Acceleration of integration processes in the euro area can result in creation of a separate budget for the euro zone, better coordination in tax policy and a more predictable expenditure policy (nik.gov.pl, 2021).

On the other hand, with regard to the potential risks arising in case of Poland’s joining the euro area, the Supreme Audit Office points to the loss of the state monetary policy, which is an economic policy tool and provides macro-economic shock absorption (nik.gov.pl, 2021).

Among the negative effects resulting from Poland’s accession to the euro area, the Supreme Audit Office also mentions the wrong exchange rate of the Polish złoty to the euro. If this exchange rate were too high, it would constitute a low valuation of Polish assets, thus giving the possibility of a mass buyout. On the other hand, when the exchange rate were too low, then there would be a temporary loss in export competitiveness. If this exchange rate were too high, it would constitute a low valuation of Polish assets, thus giving the possibility of a mass buyout. On the other hand, when the exchange rate were too low, then there would be a temporary loss in export competitiveness (nik.gov.pl, 2021).

According to the Supreme Audit Office, in the case of an erroneous policy of the financial sector in an environment of flawed construction in the euro area, it has led to the fact that cheap credit is primarily used for financing of:
- excessive consumption growth,
- government expenditures,
- ineffective investments which do not contribute to the growth of the Gross Domestic Product.

The increase in indebtedness did not coincide with the increase in the competitiveness of economies. In this case, Greece can serve as an example, for which a risk of bankruptcy arose (nik.gov.pl, 2021).

![Figure 2. Economic convergence index for countries that have not yet introduced the common currency in 2018](image)

Source: nik.gov.pl, [Access: 30.06.2021.]

Among the potential risks resulting from joining the euro area, the Supreme Audit Office also pointed to the costs of assistance for indebted states which have already joined the euro zone. Each of the countries that introduced the euro currency should participate in a common fund, the purpose of which is to guarantee financial stability and to channel aid to countries in crisis, as well as to take measures to prevent systemic risks in the euro area (nik.gov.pl, 2021).

In case of a crisis in the euro area, the stabilization mechanism is used. It includes the unlimited purchase of a country’s bonds by the ECB in exchange for reforms. However, there may be a situation when the markets do not accept the reforms as the effective measures, and in such situation the purchase may be...
associated with a high risk of loss by the ECB (nik.gov.pl, 2021).

There is also a risk of increase in prices caused by the general tendency to round up the price when converting it. The countries, which were the first to join the euro area, dealt with this phenomenon. Proper preparation however is possible, due to which there is a chance to completely avoid prices increase. In Lithuania, for example, prices have decreased by nearly 0.5% after introduction of the euro currency (nik.gov.pl, 2021).

It should be noted, however that there has been little progress in meeting the convergence criteria since the date of issue of the ECB’s Convergence Report (2018). In five of seven countries, there was the excess over the reference value due to HICP inflation, while in 2018 such situation was only in two countries. As of May 2018, in three of seven countries, the average 12-month difference in long-term interest rates in the euro area continued to decline, and it exceeded the reference value only in one country, compared to two countries in 2018. Neither country participates in the ERM II exchange rate mechanism, but two of them have indicated that they intend to request the inclusion of their currencies in the above mechanism. In some of the countries discussed in the report, the exchange rates of their currencies have fluctuated sharply against the euro over the past few years. Most countries have made some progress in reduction of fiscal imbalances (europa.eu, 2021).

Results and discussion

The adoption of the euro currency in Poland may pose a risk of deep interference with the freedom to conduct economic activity. In addition to the possible facilitation of capital flows, it may be also necessary to introduce solutions that may cause implementation difficulties (nik.gov.pl, 2021). National currency substitution should be preceded by careful considerations before making a decision. At the same time, it should be noted that the potential costs are lower in case of:

- flexible labour market,
- flexible price market,
- mobile capital,
- diversified production,
- mobile labour force (J. Sikora, 2017).

The issue of cost reduction is also influenced by the openness of the economy itself, as well as by the level of integration with other countries within the common currency area. Moreover, when joining the euro area, it is considered necessary to fix a conversion rate that would correspond to the equilibrium rate. In the case when the exchange rate is undervalued, negative consequences may arise in the form of:

- excessive investment,
- excessive consumption,
- increase in the level of debt in the private sector,
- “overheating” of the state economy (J. Sikora, 2017).

Figure 3. Comparison of economic convergence indicators in 2020

Source: europa.eu, [Access: 30.06.2021.]
Sikora, 2017).

In the opposite situation, when the exchange rate is overvalued, there may be economy slowdown and unemployment increase. Thus, the consequences would be also adverse and negative. (J. Sikora, 2017).

Summarizing the considerations in the paper with regard to potential risks and opportunities caused by Poland’s accession to the euro area, it can be indicated that although there are undoubtedly many risks, possible chances in this matter are dominant. The advantages of common currency and the opportunities that result from it relate primarily to the integration of the economy with the euro area. The above benefits cause increase in the market efficiency. Before the euro was introduced, currency exchange was associated with additional costs, and thus, a lack of transparency in cross-border transactions. Moreover, as a result of the common currency introduction, doing business in the euro area is reported to be more cost-effective and less risky (ec.europa.eu, 2021).

At the same time, the possibility of making a price comparison is favorable for investments and foreign trade. Institutional investors are able to invest more efficiently throughout the euro area without having to bear the risk of fluctuating exchange rates. The euro area is currently a large integrated market that uses the common currency (ec.europa.eu, 2021).

Among the potential benefits of joining the euro area, there is also an increase in opportunities in the world economy. Due to the common currency introduction, this area is an attractive place for business activities from the third countries, which in turn, contributes to stimulation of investments and trade. In case of prudent management of the euro, it is also an attractive reserve currency for other countries, and thus, the position of the area in the world economy increases (ec.europa.eu, 2021).

In the case of an appropriate scale and prudent management, economic stability is also associated with the euro area, as the euro area becomes more resistant to the external economic shocks. Such shocks are understood as sudden changes taking place outside the euro area, and collapses taking place in national economies. An example of such situation may be, for example, the increase in oil prices, or the complications in the world currency markets. The euro area has the potential to better absorb such shocks and thus reduce the negative consequences in economic growth and employment (ec.europa.eu, 2021).

It is emphasized, at the same time, that introduction of the euro currency does not result in simultaneous economic stability and economic growth (mf.gov.pl, 2021). The development of the appropriate benefits is possible due to proper economic management in the euro area, in accordance with the provisions of the Treaty, as well as with the provisions of the Stability and Growth Pact, which is a key element of Economic and Monetary Union (ec.europa.eu, 2021).

The euro area is also of great importance as a mechanism to maximize the benefits of:
- common commercial policy,
- common market,
- political cooperation.

In this way, it is an integral part of the political and economic structures of the European Union nowadays (ec.europa.eu, 2021).

Conclusions

The euro currency has many purposes. It is used by public and private sectors of the third countries, including trade, and serves as a currency reserve. The euro currency is widely used in the international financial and monetary system. It is confirmed by the fact that the euro currency is used all over the world. Increasingly, the euro finds its application in the issuing of state and private loans on a global scale. Global banks offer large loans denominated in euro on all continents. Moreover, the euro is also one of the second most frequently traded currency on a foreign exchange market, it appears in an average of 40% of transactions per day. In
addition, the euro is used for invoices and payments in international trade, not only between the euro area and third countries, but also, to a lesser extent, between third countries themselves. For some countries, the euro acts as a stabilizing and reference currency (T. Sarrazin, 2013).

The euro area was created because of the common currency advantages in relation to previous situations, when each Member State used its own currency. In this way, the risks in exchange rate fluctuations and currency exchange costs were eliminated, the common market was also strengthened, but the main effect was to tighten cooperation between the Member States, focused on a stable currency, stable economy and on the good of every European citizen (B. Elżbieciak, R. Ściga-Stanek, 2015).

It should be also emphasized that it is undoubtedly beneficial for Poland to create conditions enabling the fastest possible accession to the Monetary Union. The long-term pace of economic growth and consumption is in the quick accession scenario. The adoption of the target of rapid accession to the euro area would also constitute an impulse for faster implementation of the necessary structural reforms and changes in the macroeconomic policy, which are a precondition for stable and long-term economic growth. Moreover, delaying the introduction of the euro currency would worsen Poland’s competitive position in foreign direct investments. One should also take into account the non-economic aspects that do not deal with money. They include psychological effects, resulting in greater integration of the citizens of the union having a common currency. By using national elements on euro coins and banknotes, the idea of community is preserved without losing the sense of individuality of separate nations. Moreover, the NBP indicates that the balance of costs and benefits of joining the euro area will be positive. It assumes that the cost of losing an independent monetary policy after the euro introduction will be small and the benefits will be significant. There is also a small risk that after Poland’s accession to the European Monetary Union, the ECB’s policy will be inappropriate for Polish economy. However, a possible short-term decline in GDP growth may occur, resulting from the necessity to meet the inflation convergence criterion. It will be insignificant compared to the long-term positive effects on economic growth. Therefore, joining the euro area will enable Poland to sustainably and significantly increase the level of GDP and consumption, with probably a slight increase in the fluctuations. Thus, the introduction of the euro will be associated with an increase in welfare (A. Wieczorkiewicz, K. Dąbrowska, M. Gruszczynski, 2005). Common currency introduction may cause serious changes in Polish economy. This does not only mean benefits, but also the costs of complying with the required criteria. Each country, including Poland, should create a balance of economic benefits and costs in order to consider joining the euro area (S. Jarka, S. Kurkowska, E. Weiss, 2011).

References


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