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Implications of the monetary union convergence for the rate of economic growth in Poland

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Summary

1) The negotiated terms of Poland's accession to the EU oblige us to accede to the EMU too. However, they do not predetermine the date of our EMU entry. In this paper, four most probable, in the author' opinion, scenarios of our accession to the EMU were presented.

Scenario A assumes accession at the earliest possible date, i.e. in 2009-2010. Scenario B1 anticipates a somewhat later EMU membership, i.e. in 2012-2014 because of the inability to fulfil the Maastricht criteria before the end of the current decade. Under scenario B2, like under scenario B1, a more remote accession is assumed, this time however as a result of a deliberate decision of the Polish authorities on postponement of our EMU membership. Finally, scenario C defers our EMU accession into a not precisely defined future in consideration of a permanent inability of the Polish economy to meet the nominal convergence criteria.

2) The main objective of this paper was the attempt at identifying the impact of the above different EMU convergence scenarios on the long-term pace of economic growth in Poland.

The main conclusions were formulated basing on two fundamental propositions.

The first proposition says that the EMU membership will be advantageous to the long-term economic growth in Poland. Sharpening of the competition resulting from further intensification of the trade and capital flows will create conditions favourable to innovativeness and entrepreneurship. At the same time, the access to the resources of productive factors, especially to capital, will improve. However, the scale of advantages to be achieved and the probability of avoiding serious threats associated with the EMU membership will depend in the first place on the degree of real convergence of the Polish economy with the euro-zone, as well as on the direction of the future evolution of the whole EMU. With a favourable course of events, these long-term advantages to the economic growth can be in the order of 0.5 percentage points a year.

The second proposition says that the period preceding the EMU entry (pre-accession period) will generate conditions not very advantageous to the economic growth. Along with the growth-oriented stimuli resulting from the improving economic climate and growing foreign capital inflow, there will also be some marked depressive effects. The latter will stem from the relatively restrictive fiscal and monetary policy imposed by the need of meeting the Maastricht criteria, as well as from the real (and, intermittently, also nominal) appreciation of the zloty. It is to be stressed that both the above propositions were formulated mainly basing on theoretical considerations, since the available empirical material remains very meagre and not always congruent with the Polish economic situation.

3) Our analysis has led to the conclusion that positively best conditions of the economic growth are assured by scenarios A and B2, with a slight preference for the former. However, implementation of these scenarios requires great resoluteness in carrying out the "second wave" of structural reforms as well as discipline in the macroeconomic policy (this, in particular, regards scenario A). In Poland's present political and social situation, this will undoubtedly be difficult. Therefore, unfortunately, it is the B1 scenario that is to be recognized as the most probable from among the scenarios under review, and even scenario C, being a scenario of economic disaster, can not be excluded.

4) On the assumption, however, of a favourable course of events, choice will remain between the scenarios A and B2: to accede to the EMU at the earliest possible date, or deliberately defer the accession by a few years. One of crucial decisions in this respect will have to be made already in 2.5-3.5 years, namely at the time when decision will be necessary whether to enter (or not) the ERM-2.

Till that time, the optimum strategy should consist in positively declaring the intention of the possibly earliest EMU entry (and, above all, acting in accordance with such declarations), but without committing oneself by naming any firm dates. Whereas final decisions on the accession to the ERM-2, and later to the EMU, should be made in taking into consideration in the first line the following factors:

- the already attained progress not only in the nominal but also in the real convergence, as well assessment of further progress in this respect;
- assessment of the utility of maintaining the autonomous monetary and exchange rate policy;
- evolution of the EMU itself;
- strategy adopted by the remaining new EU members with respect to the question of their EMU accession.

1. Introduction

On 1 May 2004 Poland attained the membership of the European Union (EU). At the same time, Poland became a member of the Economic and Monetary Union (EMU), but with the so-called derogation. This means deferment of the EMU membership until Poland meets the criteria laid down in the Maastricht Treaty, while in the meantime Poland's economic policy should be oriented towards their implementation. At least once in two years the EU authorities will assess Poland' progress in its aspiration after the EMU membership. Thus, the date of Poland's attainment of actual EMU membership still remains unknown.

The EMU convergence, understood both as the process of gradual progress on the road to replace the zloty with the euro and, later, as already reaching this objective (actual attainment of the EMU membership), will bring manifold implications for the rate of economic growth. It is just these problems that will be the subject of this paper.

2. Impact of Poland's future EMU membership on the economic growth

In theoretical debates on the monetary union emphasis is most frequently placed on the advantageous effects of its establishment on the economic growth of the member countries.1 In particular, attention is drawn to the emergence of additional stimuli to economic growth, apart from those resulting from previous stages of integration, such as the single market.

Most broadly speaking, those growth-oriented stimuli are supposed to result from:

- sharpened competition in the single market as a result of intensifying trade and capital flows, which creates more propitious conditions for innovativeness and entrepreneurship;
- better access to resources of productive factors, especially to capital (Nosiadek 1999).

Whereas the intensification of trade and capital flows stems from:

- elimination of the foreign exchange risk in trade and capital transactions between member countries:
- reduction in transaction costs (elimination of currency exchange cost):
- increase in transparency of the goods, services and capital markets.

In such conditions, growth in mutual trade is a result of the well-known effects of trade creation and trade shift. This is supposed to lead to specialization of production, sharpened competition and rise in the degree of standardization of its conditions, as well as to a reduction in production costs and product prices and a rise in the quality of goods.

[1] Cf. M. G. Grubel (1997), P. Robson (1984), P. Kenen (1995), P. De Grauwe (1997), J. Masala (1999).

As to the capital market of the member countries, the growth in capital flows is supposed to be accompanied by:

- disappearance of separation of the national markets and a general increase in the substitutabilty of different capital market segments, leading to an increase in the market "depth";
- reduction and standardization of the interest rate;
- widening of the range of financial products being offered and, consequently, of the available investment opportunities.

The above-mentioned developments should enhance the growth in the rate of investment and, in the longer run, lead to faster economic growth (Nosiadek 1999). The only five years' period of the EMU functioning has been still too short to enable reliable empirical research to verify the above assumptions regarding the EMU, the more so as a part of this period fell on a recession time both in the area in question and in the majority of the developed countries. Nonetheless, the majority of the above-mentioned effects very clearly appeared already in the first years following the establishment of the EMU. In particular, already in the course of the first three years of the EMU functioning a growth in the mutual trade volume by as much as about 20% took place.2

However, some possible adverse effects of the EMU membership on the economic growth are known, too.3 Their main cause can be the so-called asymmetric shocks. These are shocks that affect only one, single country and not the totality or, at least, majority of the EMU area. Such shocks can not be absorbed by means of monetary or exchange rate policy, because in such circumstances the EMU authorities do not see any need to adjust their monetary and exchange rate policy. Meanwhile, the member country in question has already been deprived of these economic policy tools, having renounced them at the moment of accession to the monetary union.

As a rule, the given country's possibilities to counteract such shocks by means of fiscal policy are meagre too, since, in the monetary union this policy's autonomy is subject to greater or lesser restrictions. So, as the asymmetric shocks can not be neutralized by the macroeconomic policy, the whole burden of adjustment is shifted onto the microeconomic sphere. And, if the prices and wages are not highly elastic (especially "downwards") and the productive factors (inclusive of, especially, labour) not highly mobile, a decline in production and a growth in unemployment become inevitable. Thus, a monetary union member country

[2] Cf. declaration of Richard Layard (European 2003).

suffering of frequent or strong asymmetric shocks can be threatened with long-lasting stagnation or even recession.

Another source of threat to the economic growth in a monetary union member country can be the low international competitiveness of its economy. In such circumstances, renunciation of sovereign monetary and exchange rate policy can prove utterly unfavourable. The most frequent causes of low competitiveness can be the shortcomings in the restructuring of enterprises prior to the monetary union accession or the conversion of the domestic currency to the single union currency at a markedly overvalued exchange rate of the former. The economic literature devotes much place to the analysis of factors crucial for the balance of advantages and losses from the establishment of the monetary union, especially for long-term economic growth in the member countries. The Optimum Currency Area (OCA) theory lays down the so-called real4 criteria of the monetary union convergence, i.e. of the monetary union establishment in a given area. There are, however, various interpretations of this theory.

R. Mundell (1961) and R. McKinnon (1963), considered to be the authors of the OCA theory, concentrated exclusively on criteria regarding the effectiveness of the adjustment processes automatically activated in the economy following an asymmetric shock. Whereas the origin of asymmetric shocks themselves was left completely beyond these authors' concern (Borowski 2000). In such terms, to meet the optimum currency area criteria, the given area must show a high mobility of all the productive factors (especially the labour) and a high elasticity of prices and wages (especially "downward" elasticity). Meeting these conditions will secure an automatic and relatively quick return to original equilibrium in a country affected by an asymmetric shock.

In course of time, the theory of optimum currency area began to be interpreted more broadly than was the case with its originators. At the same time, let us remark that it is not always clear whether the authors who put forward new OCA criteria consider them as supplement to or substitute for the original criteria.

At first, P. Kennen (1969) remarked that in the case of external asymmetric shocks their neutralization was much easier if the country affected by such a shock showed a highly diversified production and (especially) export structure.

Further broadening of the OCA theory tended towards pointing out the conditions that would permit to eliminate the sources of asymmetric shocks. In the first place, internal shocks

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[3] See (P. Krugman (1986), J. Masala (1999), K. Lutkowski 2003).
[4] As opposed to nominal (formal) criteria. See section II of this paper.

were dealt with. D. Gross and N. Thyssen (1998) drew attention to the importance of convergence of business cycles in the countries making up the monetary union. Whereas in the case of external asymmetric shocks, the probability of their occurrence was supposed to be considerably reduced if in the countries constituting the monetary union a similar production and export structure existed (Borowski 2000). The farthest-going "real convergence" concept assumes a marked reduction in income span between the member countries of the monetary union (Borowski 2000). In general, however, the latter interpretation is considered excessively rigorous.

The assessment of Poland's prospects to meet different convergence criteria at the moment of its EMU entry will be still dealt with later on in section III of this paper, since they will have substantial implications for the economic growth already after the accession to the euro-zone. Other factors that will also exert influence on Poland's economic growth after attaining the EMU membership are the peculiarity of this integration group and possible directions of its further evolution.

With respect to the first one of these questions, the opinion is being put forward (Lutkowski) that the EMU mechanism contains in its construction itself an inherent deflationary proneness. It stems from the restrictive monetary policy of the European Central Bank (ECB), to a large extent patterned after the earlier policy of the German Central Bank (Bundesbank) to which fiscal rigours of the Stabilization and Growth Pact have been added.5

The second part of the above proposition seems, however, controversial. If, as assumed by the Pact, in times of good business climate the EMU member countries were achieving budget surpluses or, at least, budgetary equilibrium, the 3% of GDP limit on the budget deficit would make a sufficient safety margin in times of business contraction. So, it seems that the present difficulties of the biggest EMU countries (Germany, France) in meeting the Treaty requirements stem rather from structural problems of their economies. Anyhow, more and more economists and politicians have begun to realize it. Nonetheless, the fact remains that important principles of the Stabilization and Growth Pact have been evidently infringed, this leading to a serious crisis within the EMU. A sensible uncertainty prevails at present with respect both to the future of the Pact itself and to the influence this will exert on the EMU functioning.6

[5] For more on the Stabilization and Growth Pact see E. Wilk (2001).

[6] For more on this subject see H. Bińczak (2004).

3. Prospects of Poland's attaining the EMU membership

As we know, the EMU entry requires meeting five formal convergence criteria (the so-called Maastricht criteria), namely:

1) at least two years' participation in the common exchange rate mechanism (ERM-2) and, over that time, keeping the exchange rate within the "normal" fluctuation band;

2) inflation rate not higher than 1.5 percentage points over the mean for 3 Union countries having the lowest inflation;

3) long-term interest rate not higher than 2.0 percentage points over the mean for 3 Union countries having the lowest interest rates;

4) budget deficit (calculated according to the EU methodology) not higher than 3% of GDP;

5) public debt (calculated according to the EU methodology) not higher than 60% of GDP.

The hitherto held debate on prospects of introducing the euro in Poland based on the fundamental assumption that Poland would be able to fulfil all the above-mentioned convergence criteria at the latest 2-3 years after attaining the EU membership. This optimism was additionally strengthened by information that the methodology of calculating the budget deficit and public debt adopted by the EU was favourable to Poland, since it yielded lower deficit and debt levels than those obtained by means of the methodology presently in force in Poland. What was more, hopes were cherished that the convergence criteria for the new EU member states would, maybe, get somewhat softened.7

In this connection, the debates concentrated on the question whether to aspire after quick fulfilment of the convergence criteria so as to be able to enter the EMU at the earliest possible date, or not hurry so much nor prejudge in advance the EMU (and earlier the ERM-2) entry date.8

However, this debate has already become to a large extent outdated for one fundamental reason: Poland's fulfilment of the convergence criteria in the next years is quite unrealizable and can be very difficult even till the end of the current decade. The main cause is the condition of the Polish public finance sector, which precludes meeting the budget deficit criterion (and maybe some other criteria too). Another cause, but of lesser specific weight, is the reluctant attitude of the EU towards quick extension of the euro-zone on the new EU members.

[7] In particular, a possibility was assumed to negotiate a shorter than two years' participation in the exchange rate mechanism ERM-2. Earlier, there was also talk of a possible softening of the inflation criterion in consideration of a high probability of appearance of a strong Balassy-Samuelson effect in the new EMU member countries.
[8] For more on this debate see W. Małecki (2004).

a) Condition of the public finance sector in Poland

From the point of view of meeting the fiscal convergence criteria, the most important data is that on the budget deficit and the public debt, both calculated according to the EU methodology in force (ESA 95). In principle, this data actually appears more favourable (lower) than that calculated according to the methodology hitherto used in Poland.9 In the case of budget deficit, this difference mostly amounts to 1.0-1.5 percentage points.

Nonetheless, even according to the ESA 95 methodology, the budget deficit exceeded 3% of GDP in 2001 and has continued to grow since. In 2003 it amounted to 4.1% of GDP, and for 2004 is estimated at as much as 4.8% of GDP (www.mf.gov.pl)10. This data was calculated on the assumption that the Open Pension Funds (OPF) would be reckoned as a part of the public finance sector. Meanwhile, the Union's statistical office Eurostat stated in its decision of 2 March 2004 that the Open Pension Funds had not to be reckoned as a part of the public finance sector. This means an increase in the public finance sector deficit by the amount of the budget subsidies granted to the Social Insurance Fund to indemnify it for the loss from transferring a part of contributions to the Open Pension Funds. Thereby, the deficit increases in 2004 by 1.5% of GDP (up to the level of 6.4% of GDP). Similar, or even greater, differences (in the order of 2.0% of GDP) will appear also in the following years (www.mf.gov.pl). The Polish authorities propose still to appeal against this decision of the Eurostat, but if the decision is upheld, the public finance deficit calculated according to the ESA 95 will approximate (or even surpass) that obtained in accordance with the methodology till now in use in Poland.

Problems of excessive budget deficit (and growing public debt) result in Poland from permanent postponement of radical reform of the public finance sector. From among many weaknesses of this sector, two are to be recognized as crucial. The first one is the excessive, in relation to Poland's economic potential, level of social expenditures.11 The other one is the statutorily laid down stiffness of a large part of those social expenditures.

The public finance reform is anyhow indispensable not only in order to be able to meet the fiscal convergence criteria. Inflated social expenditures considerably raise the labour costs, thus paralyzing the market forces in the economy. This is one of the sources of unemployment and will make a barrier to long-term economic growth. Besides, excessive budget deficits can, beginning with a certain moment, prove impossible to be financed, which

[9] For more on the methodological differences see A. Wernik (2003).
[10] Data of the European Commission and the Ministry of Finance quoted from www.mf.gov.pl .
[11] What is more, many pathologies manifest themselves consisting in that a large part of the social expenditures

threatens with a public finance crisis and, in its consequence, maybe even currency crisis and economy breakdown.

Still in May 2003, the Deputy Prime Minister G. W. Kolodko, in his Public Finance Recovery Program, assumed meeting the budgetary criterion in 2006 (Program 2003 (a)), but this was contingent on immediate implementation of his reform programme, and even in such case seemed rather difficult to attain. In turn, the present Deputy Prime Minister Jerzy Hausner, in his medium-term fiscal strategy till 2006, drawn up in September 2003, and in his public finance reform programme assumes fulfilment of the Maastricht criteria till 2007 (in that year the budget deficit should amount to 2.6% of GDP) (Program 2003 (b)).

However, even with the most favourable development of events, much more probable seems fulfilment of the budget deficit criterion not earlier than in 2008. Such scepticism is dictated by at least several reasons. First, at the moment of writing this paper (March 2004), only the first few draft bills from the programme for public finance improvement, sponsored by the Deputy Prime Minister Hausner, have been submitted to the Parliament, so the legislative road to final adoption of the programme is still very long. Second, it is practically certain that, even if the programme is implemented, this will be in a more or less mutilated shape. So, the reduction in deficit will go on rather more slowly than assumed by the original version of the programme.12

Third, the programme construction itself increases the concomitant incertitude. More substantial cuts in budget expenditures are foreseen only beginning with 2005, while that will be a year of parliamentary election. So, as to the following years, it is not known who, in fact, will carry this programme into effect.

Fourth, in such circumstances, it is all the more to be kept in mind that possible advantageous effects of the reform on the budget deficit level will manifest themselves with an often considerable delay. Reforming the public finance will require numerous and sometimes protracted legislative undertakings. In addition, out of legal considerations, limiting and restructuring a part of expenditures will have to take place gradually (the problem of the so-called vested rights, etc.). Besides, high budget deficits over successive years will aggravate the scale of the problem through growth in the public debt and costs of its servicing. Finally, persistence of high budget deficits over successive years can hamper the economic growth as well through rise in interest rates and hindered credit accessibility to the

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does not reach those people to whom they ought to be addressed.

[12] Compared to the original version of the programme, the one adopted by the government provides that smaller cuts will be made in the social expenditures and that a part of these cuts will be put off till later years (Plan

business sector as by undermining Poland's credibility in the international financial markets. Meanwhile, under conditions of slower economic growth the reform of public finance will become still more difficult.

To sum up, the year 2008 seems a more probable earliest possible date of budget deficit reduction below the level of 3% of GDP, and that only upon simultaneous fulfilment of a number of conditions, including a favourable to us interpretation of the deficit calculation methodology (reckoning the OPF in the public finance sector).

b) European Union's reluctant attitude towards quick extension of the euro-zone on the new UE members

Reluctance of the EU authorities to quickly extend the EMU on the new EU members is becoming more and more perceptible. In their public utterances on this topic, representatives of both the European Commission and the European Central Bank emphasize in the first place the fact that such a hurry may not be advisable for the new EU member countries, since initially they will have many problems in restructuring their economies and will over that time need a more flexible economic policy. In reality, not less important is the EU authorities' apprehension lest a quick extension of the EMU still aggravates its present internal problems and, in the longer run, weakens the common European currency. In such circumstances, softening of the convergence criteria for the new member countries can hardly be expected; on the contrary, fears are even being expressed that they might be made more rigorous. This, in particular, regards the exchange rate criterion. Representatives of the European Commission already repeatedly suggested that the stability of currencies of new member countries would be judged by their ability to keep the exchange rate within a narrow band of +2,25% around the central rate and not within the broad band of +15% that made the limits of admissible fluctuations in the ERM-2 system.

In reality, the hitherto existing practice of assessing the exchange rate stability of currencies of the countries running for EMU membership was rather complex (Sławiński 2004). In principle, the assessment was actually made using the narrow fluctuation band of +2.25%, but at the same time this was done in a pretty flexible way. First, the currency's appreciation even markedly over the +2.25 limit was tolerated. Secondly, in special cases, also a depreciation below this limit was "pardoned", if it was ‘an effect of transient disturbances in the financial markets themselves rather than a result of apprehensions about the internal or external equilibrium of the given country [...]. So, one can say that, in practice, the actual basis to assess the exchange rate stability of different currencies was the band of

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2004).

+15%/-2.25%' (Sławiński 2004), while exceptions to this lower limit could be permitted too. Most probably, it is just in this way that the above-mentioned utterances of the EU representatives are to be understood.

Nevertheless, it is quite clear that at present there is no propitious political climate for softening any criterion (e.g. the inflation criterion). Also, negotiating a cut in the obligatory period of staying in the exchange rate mechanism ERM-2 (as in the past was the case of Finland and Italy), and the more so its total avoidance, does not seem possible.

In the light of the above considerations, the following fundamental scenarios of Poland's accession to the EMU can be formulated.13

A. Scenario of earliest possible accession to the EMU (in 2009-10)

Carrying this scenario into effect requires simultaneous fulfilment of several conditions:

- full and timely implementation of the governmental plan for public finance reform. As mentioned above, this will enable meeting the fiscal criteria of convergence at the earliest in 2007 (or, rather in 2008)14;
- materialization of the rather optimistic government's assumptions on the pace of Poland's economic growth till the end of the current decade;
- non-occurrence of difficulties in meeting the remaining convergence criteria;
- the Eurostat's affirmative decision on reckoning the OPF in the public finance sector.

Under this scenario, accession to the ERM-2 exchange rate mechanism is assumed to take place in 2006 or 2007 (contingent upon progress in the reduction of budget deficit) so as to be in time for meeting the criterion of exchange rate stability and, at the same time, not to stay in the ERM-2 system longer than absolutely necessary.

B. Scenario of a later EMU accession (most probably in 2012-2014)

This scenario can be imagined in two alternative variants. In the first case (scenario B1), the cause underlying a later EMU entry will be the inability to meet the Maastricht criteria, in particular the budget deficit criterion, before the end of the current decade. This may result, e.g. from a certain slow-down in the reform programme in consequence of a significant rise in social tensions and/or an unfavourable to us EU authorities' interpretation of the methodology of calculating the budget deficit.

[13] Of course, this does not mean that no other scenarios can appear. However, they either have been recognized as little probable (e.g. a scenario of disintegration of the EMU or a scenario of Polish goverment's decision not to accede to the EMU), or constitute only certain modifications to the scenarios recognized as fundamental.

[14] However, even meeting the budgetary criterion as early as in 2007 will practically (out of procedural considerations) rather not permit us to join the EMU earlier than on 1 January 2009. For more on this subject see E. Pietrzak (2003).

It is however to be realized that, beginning with May 2004, the question of budget deficit has ceased to be exclusively our internal problem. Most probably, the excessive deficit proceedings will be instituted against Poland. In practice, this will mean the obligation to present a plan for reducing this deficit to less than 3% of GDP within 2-3 years. Then, in case of failure to implement this programme, we can be threatened with sanctions in the shape of limited access to a part of the EU funds (especially the so-called cohesion funds). Maybe, these sanctions might be avoided over a few years, if the EU acquiesced in our possible request to recognize the "extraordinary" state in which Poland finds itself because of the deep economic transformation. Anyhow, excessive budget deficit can not be maintained for a too long time.

Under the second variant (scenario B2), deferment of the EMU entry is assumed to be a deliberate decision of the Polish authorities. It can be dictated by one or several of the following reasons:

- acknowledgement that it will be more safe to maintain a sovereign monetary and exchange rate policy for a longer time;

- acknowledgement that a less restrictive monetary policy than that indispensable to early fulfilment of the inflation convergence criterion will be more advantageous to the economic growth;

- acknowledgement that thanks to a later date of the EMU accession the latter will take place at a time of higher degree of meeting the real convergence criteria, which will reduce the risk of the adverse effects of the monetary integration;

- acknowledgement that a later EMU accession will diminish the risk of performing the zloty-to-euro conversion at an overvalued exchange rate of the Polish currency.15

Of course, in the case of delaying our EMU entry (e.g. through non-accession to the ERM-2) we will have to explain ourselves to the EU authorities every two years. Nevertheless, both the hitherto known precedents and the EU authorities' attitude towards a quick extension of the EMU prompt the conviction that, at least till a certain time, this may raise no special difficulties.

[15] K. Lutkowski (2003) maintains that only a significant further progress in restructuring the Polish economy on the micro level (and, thereby, a substantial improvement in its international competitiveness) can bring about a rise in the "equilibrium exchange rate" of our currency up to the level of the market exchange rate, while the latter will most probably begin once more to rise strongly as soon as the prospects of our accession to the EMU become more and more realistic.

C. Scenario of the EMU accession receding into a farther, not precisely defined future

This scenario assumes that the plan for public finance reform will be either rejected or mutilated to the extent that will make the improvement of the public finance quite urealizable. In such circumstances, the chances to meet the budget deficit criterion will recede into an indefinite future and the fulfilment of the remaining convergence criteria too will become dubious. In a still worse, but highly probable case, Poland can be affected in the next years by a public finance crisis and, finally, a deep economic crisis as well.

4. Implications of different scenarios for the economic growth

In this section, save for a few exceptions, exclusively effects on economic growth that result from the different EMU convergence scenarios (presented in section II) will be dealt with. There will be, apart from them, many other factors influencing the pace of economic growth, but those problems are beyond the scope of this paper.

Scenario A

Over the period preceding the EMU entry (i.e. in 2004-2008/09) differentiated, thus both advantageous and adverse effects on economic growth will appear. The advantageous ones will result from more and more real expectations of a forthcoming EMU membership. This will create a climate propitious for business activity in general and for investment making and development of entrepreneurial spirit in particular. At the same time, there will be an increase in the inflow of foreign capital, and that in the shape of both direct and portfolio investment (i.a. as a result of resumption of the "convergence play"). Whereas the adverse effects will result from the restrictiveness of the fiscal and monetary policy as well as from the real (and, intermittently, also nominal) appreciation of the zloty.

The restrictiveness of the fiscal policy will manifest itself in reducing the expenditures and the deficit. In the longer run, the public finance reform and reduction in budget deficit undoubtedly will foster the economic growth, but in the short and even medium run a certain deflationary effect of such moves can manifest itself.

The monetary policy will have to be directed towards meeting the convergence criteria (in particular the inflation and the exchange rate stability criteria). An unquestionable impediment in this respect will be the appearance of the so-called Balassy-Samuelson effect.

This effect is meant to explain the often observed phenomenon of increase in the inflation rate in the countries that are making up for the economic backwardness and are showing a higher rate of economic growth than their trade partners. The run of reasoning is as follows: a) in such countries the growth in productivity concentrates first of all on the sector of tradables and is in this sector faster than in the sector of non-tradables; b) this leads to a growth in wages in the sector of tradables, since prices of these goods are exogenously set by their world market prices; c) because of the mobility of labour and the trend towards equalization of the level of wages throughout the economy, a comparable increase takes place also in the sector of non-tradables; d) as this increase finds no justification in an equivalent increase in productivity in the latter sector, the prices of non-tradables are growing, thus raising the rate of inflation in the entire economy.

'It is to be remembered that, anyhow, the scale of inflation unrelated to the Balassy-Samuelson effect will be in Poland probably higher than the inflation in the euro-zone (especially in the countries having the lowest inflation)' (Chmielewski 2001)16. A precise estimation of the scale of the Balassy-Samuelson effect in Poland for the next years is extremely difficult, but the majority of available estimates oscillate around the level of 1.5 percentage points a year17, while this is just the magnitude of the margin stipulated in the Maastricht Treaty. Thus, meeting the inflation criterion will require a certain combination of a restrictive monetary policy with a nominal appreciation of the zloty.

A real (and, intermittently, also nominal) appreciation of the zloty will be the more probable as with the approaching EMU entry date there will be an intensification of the foreign capital inflow. What is more, in accordance with the present functioning mechanisms of the foreign exchange markets, the ascending trend in the zloty exchange rate can in itself become a driving factor of a further strengthening of the Polish currency.

In the foreign exchange markets, forecasting the short and medium-term changes in the exchange rate is practically impossible. In such conditions, speculating on trend is safer and less expensive than speculating against trend. It is only an unusually drastic deviation of the exchange rate from the long-term equilibrium rate (known only in rough approximation) that can provoke the so-called stabilizing speculation interrupting the existing trend.18

To sum up, the above-described combination of advantageous and adverse effects will create conditions only moderately propitious for the economic growth. This can be dangerous insofar as a high rate of economic growth in the period under discussion is one of the preconditions of success of the public finance reform and fulfilment of the Maastricht criteria.

After the EMU entry, the advantageous effects on the economic growth resulting from the monetary union membership are expected to gradually manifest themselves. In the first

[16] For more on the reasoning underlying this proposition see T. Chmielewski (2001) and M. Jedliński (2003).
[17] Ibidem
[18] For more on these mechanisms see A. Sławiński (2004).

line, these will be effects stemming from growth in exports and increase in internal demand induced by optimistic expectations as to the future path of growth as a result of decline in the real interest rates. Next, effects of the growth in investment will appear. This growth will be induced as well by the low level of interest rates as by the facilitated access to external sources of financing. At the same time, the intensified inflow of foreign capital will no more provoke an appreciation of the exchange rate and, in consequence, an adverse impact on the competitiveness of Polish firms.

The advantageous effects of a deepened specialization of production, integration of financial markets, progress in innovativeness and development of entrepreneurial spirit will begin to manifest themselves only in the longer run. The degree of utilization of the above opportunities of accelerating the economic growth as well as the probability of avoiding the threats to this growth (in the shape of asymmetric shocks, imperfection of the internal adjustment mechanisms, breakdown of the competitiveness of the Polish economy, financial crisis induced by an excessive expansion) will depend on two factors. The most important one will be the degree of real convergence that the Polish economy will reach till the moment of attaining the EMU membership. The second factor will be the condition of the entire EU and EMU at the moment of Poland's joining this integration group.

A fact of crucial importance will be the way in which the Polish economy will make use of the 5-6 years' time available till the EMU accession. What is meant here, is not a complete elimination of the still remaining shortcomings of the Polish economy, since that will be quite unrealistic, but the initiation and proper orientation of the reforms that still await implementation. Apart from the already widely discussed public finance reform, this may regard the unfinished or not yet initiated structural reforms (including, in particular, the labour market reform and the judicature reform), as well as a significant progress in building the economy infrastructure and, especially, in restructuring the economy on the micro level. Implementation of the above objectives will secure a satisfactory degree of the Polish economy's real convergence with the euro-zone and prevent the zloty-to-euro conversion at a markedly overvalued exchange rate of our currency.

Making a proper use of this period will undoubtedly be very difficult. The first obstacle can be the unstable political situation and, in particular, the lack of a political force that would be willing and able to carry out the politically difficult reforms. Another obstacle will be the negotiated terms of our accession to the EU. They are considerably worse than those obtained in the seventies and eighties by Ireland, Greece, Spain and Portugal. They mean, in fact, lack of financial aid for easing the costs of the second wave of structural reforms indispensable to the accomplishment of the Polish transformation (Płowiec 2003).

Quantification of the consequences of the scenario under discussion is extremely difficult. A certain idea of the probable order of magnitude is given by the simulations performed by economists from the National Bank of Poland (Raport 2004). They have estimated that, on assumption of Poland's accession to the EMU in 2010, the average yearly rate of GDP growth over the period till 2030 will be by 0.35 percentage points higher compared with a scenario assuming no euro-zone accession at all (thereby, the 2030 GDP is estimated to be by 10% higher than under the variant with no EMU accession). However, in the above simulations only two from among the growth-oriented stimuli were taken into account: the fall in capital acquisition costs and the additional inflow of foreign direct investment. Thus, the above simulation quite ignores the long-term growth-oriented stimuli stemming from the membership of the monetary union. On the other hand, the possible threats to the economic growth after the EMU accession as well as the depressive effects during the pre-accession period have been ignored too. In general, however, the above simulation rather underestimates the advantages to the long-term economic growth.

Scenario B1

In the period preceding the EMU accession, protracted under this scenario, the conditions of economic growth will probably be worse than those under scenario A. To be sure, the adverse effects brought about by the restrictive fiscal and monetary policy and the appreciation of the zloty will be weaker and distributed over a longer time. Meanwhile, the advantageous effects stemming from optimistic expectations of both the Polish firms and the foreign investors will be weaker and delayed, too. Above all, however, some very serious threats to the economic growth will arise.

First of all, the threat will appear of overstepping the constitutional limit on the public-debt-to-GDP ratio (60%), this meaning the necessity to equilibrate the budget in the following years by making drastic cuts in practically all the budget expenditures. It seems, however, that there is a chance to avoid it under this scenario. In an extreme case, the government will have still two "nest-eggs": utilizing a part of the so-called revaluation reserve to reduce the public debt or making use of a "strained bookkeeping" in calculating the public debt. A more serious threat will be the possible occurrence of a public finance and/or currency crisis. Persistence of relatively high budget deficits and the above-mentioned manipulations in calculating the public debt can undermine the confidence of the financial markets.

Another threat can be the loss of a part of the EU aid funds. As already explained above, this threat can most probably be avoided for a few next years, but not for very long.

At the moment of the EMU entry, the degree of real convergence and, consequently, the conditions of economic growth will probably be very near to those under scenario A. To be sure, the pre-accession period will be markedly longer, but this scenario bases just on the assumption of a slower pace of reforming the economy. So, on balance, this scenario can be evaluated as less advantageous from the point of view of the long-term economic growth. The advantages from the EMU membership will manifest themselves later, and during the protracted pre-accession period the economic growth conditions will be worse than under scenario A.

Scenario B2

This is a scenario more propitious for the long-term economic growth than the B1 scenario. First, there will be more advantageous proportions between the growth-oriented and depressive effects during the period preceding the EMU accession. In particular, the former ones (associated with good economic climate and inflow of foreign capital) are expected to manifest themselves more markedly and, at the same time, the risk of the majority of the above-mentioned threats coming true will be smaller. Second, at the moment of accession the degree of real convergence is expected to be higher. Thereby, this scenario can be taken into account as an alternative to scenario A.

Nonetheless, there is one danger inherent in it that is worth keeping in mind, namely Poland's staying outside the euro-zone for a longer time than countries such as the Czech Republic, Hungary and Slovakia. This may lead to Poland's losing a considerable part of direct investment. Besides, solitary staying in the exchange rate mechanism EMU 2 can increase the threat of a speculative attack on the zloty.

Scenario C

Most shortly, it can be described as a scenario of economic disaster that will occur rather earlier than later, i.e. in the next few years. Whereas other countries' experience shows that, following the crisis two alternative courses of events are possible. Under the first variant, a feedback takes place between the economic crisis and the political crisis, which precludes any radical restorative moves and plunges the economy into a long-lasting recession and, then, stagnation. Under the second variant, the crisis proves to be a shock that prompts to undertake the hitherto permanently postponed reforms.

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