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HOW TO REPAIR THE EUROZONE? AND WHAT WILL HAPPEN IF WE FAIL?

The economies of the European Union are strongly integrated with each other, and that includes Poland. Although Poland has a relatively low share of exports to GDP, amounting to 49%, it is the highest among the six biggest countries of the European Union. Therefore recession in the eurozone in the years 2012–2013, which was the result of the Eurozone crisis (as a result of expectations that the eurozone might fall apart), translated directly into a Polish slowdown in 2012 and 2013.

It is absolutely obvious to me, and I think also to all economists, that if the eurozone were to fall apart, not only the countries which belong to the eurozone, but also all the others in Europe (including of course Poland) would suffer something akin to an economic catastrophe. Therefore, even if it is true that, as Stefan Kawalec has said, the euro was created too early, it is a fact that it has been created. Europe cannot undo this fact without causing an economic catastrophe for all. A velvet dissolution of the eurozone is impossible. I am absolutely convinced of this.

We are all aware that there is no ideal currency system which would be appropriate for any country at all times, or even at a given time in all countries. Somebody (during an earlier discussion) said that the fact that Poland achieved 2.5% growth in 2009, at a time when the rest of the Western World fell into sharp recession, was the result of our floating exchange rate. In fact, in the very short

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* Former Deputy Prime Minister Jacek Rostowski's speech after the debate on 22 June 2015, 5^{th} European Financial Congress in Sopot.

term the floating exchange rate may indeed have helped Poland. But the Czech Republic also had a floating rate at the time, and it did not protect them from deep recession. If we analyse the situation in the longer term, we see that in the last seven years the cumulative GDP growth in Poland was 24% and in the Czech Republic under 1%. On the other hand Slovakia, which was in the eurozone, and therefore could not benefit from exchange rate adjustment, had 13% cumulative GDP increase. Economics is more complicated than it may sometimes seem during debates. The most important conclusion from the recent economic history of Europe is that we are vitally interested in the recovery of the eurozone, irrespective of whether we are in the euro or not.

Today we are in a situation in which it is quite possible that Greece will leave the euro. Several years ago it was assumed that this would be a catastrophe for the whole of the eurozone. Today we can be less afraid of such a scenario, and there are two main reasons for this. The first is the European Central Bank's quantitative easing, which provides the rest of the eurozone with a firewall against contagion from Greece. This is something that the Polish government pressed for from the very start of the crisis in 2010. The second reason is that – in this particular case of Greece – we do have a political mechanism which allows the euro-zone to decide whether Greece should stay in or leave. That mechanism is the ability (or otherwise) of the members of the zone to agree further rescue programs for Greece. If such programs were to cease, Greece's banks could no longer receive assistance from the ECB, and Greece would have to leave the euro.

However, the fact that there are two mechanisms which would let Greece to leave the eurozone in a way that was safe (for the euro, not necessarily for Greece) is actually an accident. Of course a very fortunate accident, but nevertheless an accident. If Greece leaves the eurozone today, we cannot be sure that in the next crisis such mechanisms will be in place.

To this day the euro does not have a mechanism or a political institution which would allow the eurozone to decide whether a country should stay in or leave. There is nothing on this in the treaties. Nor do we have full freedom for the European Central Bank to undertake quantitative easing in order to keep a given country in the eurozone, until a political decision has been taken on its leaving. Without these two mechanisms, the risk of chaotic, uncontrolled exit (Xit?) by some country in the future is much greater.

This will be particularly the case if it turns out in the meantime that Greece, after leaving the eurozone, has managed quite well on its own. It is possible that Greece will initially have very bad results after leaving. But maybe after five years *Grexit* will not appear that bad at all.

Therefore, I believe that the minimum requirement for a sustained eurozone recovery is the creation of two mechanisms – (1) the option to rescue or secure the presence of a given country in the eurozone by an unlimited purchase of its government bonds by the European Central Bank; and (2) the mechanism of taking a political decision on a country leaving the eurozone. Both these mechanisms require treaty change, and it is clear that such changes will not be easy to achieve.

Of course these two mechanisms, even assuming they were introduced to the treaties, would protect us against the chaotic collapse of the eurozone as a result of chaotic exits of countries, only in case of relatively small member states such as Portugal, Ireland, Slovenia or maybe – at a stretch – Spain. However there are other countries, and especially one which has such a considerable public debt in relation to the whole public debt of the world, that its insolvency and departure from the eurozone would have to cause a giant shock not only to the European economy, but also to the global one. This country is, of course, Italy. Therefore we can say that a safe eurozone is a eurozone where wise decisions regarding economic policy are made not only in Brussels, Frankfurt or Berlin, but also one in which wise decisions are made in Rome.

Putting this issue aside, the good news in recent months has been the fact that quantitative easing has definitely worked well, not only in terms of securing the stability of the eurozone, but also in boosting its economy. It turns out that the very active monetary policy of the European Central Bank over the last year has been effective in causing the Europe's exit from stagnation.

We could not be sure about this in December of last year, and many people claimed at the time that the eurozone needed not only an active common monetary policy, but also a common fiscal policy. I think that even the recent experience of the effectiveness of monetary policy in the eurozone does not mean that in future stagnations or crises it would necessarily have the same effect in counteracting recession. Therefore, the next step in the improvement of the eurozone should be the creation of the mechanisms of common fiscal policy. Such a policy should consist in the creation of a common policy which would be expansive in bad times and restrictive in good times.

Two more thoughts at the end. One of the recent, so called institutional "achievements" of the eurozone, which Brussels often boasts of, is the creation of a "procedure of excessive macroeconomic imbalances" (which is supposed to protect the eurozone from excessive imbalances between countries). This in fact means nothing less than that one of key assumptions underlying the creation of the euro – namely that macroeconomic imbalances in a common currency area tend towards balance automatically – has simply turned out not to be true! We will see how effective the MIB procedure will turn out to be in achieving the same aim *via* policy. But originally it was assumed that in a common currency area a considerable part of any imbalances between its parts will be eliminated naturally, through the normal working of markets.

And one last thought: the UK's threat of leaving the European Union is also a result – at least in part – of the eurozone crisis. It stems both from the crisis itself, because the credibility of European integration has been undermined, but it also stems from the fact that containing the crisis required such deep integration in the eurozone, that Britain felt marginalised from the main flow of European policy. We know that if Britain were to leave the EU it would shatter many aspects not only of the economic, but also of the political, balance in Europe. Unfortunately, the eurozone crisis is not over: its destructive effects, both direct and indirect, are not only still evident but in many areas (such as the threat of Brexit) they are actually intensifying.