

# **EURO** **and Its Impact on the** **Banking System in** **Central and** **Eastern Europe**

**edited by Jerzy Kloor, Aleksander Lukaszewicz**

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## Contents

### Tables

### Authors

<i>Jerzy Kleer</i> Introduction .....	9
<i>Christian GHYMERS</i> The Macroeconomic policy mix and the European Employment Strategy .....	13
<i>Krzysztof Rybiński</i> Euro and its impact on commercial banks in Central and Eastern Europe .....	31
<i>Michał Machlejd</i> The influence of euro on the Central and Eastern European banking system .....	39
<i>Władysław Jaworski</i> Polish commercial banks on the eve of entering the European Union .....	45
<i>Grzegorz Wójtowicz</i> The monetary policy of European Union in the globalisation era, and its influence on Central- and Eastern European countries .....	63
<i>Włodzimierz Siwiński</i> Euro and the Central and Eastern European Countries .....	75
<i>Karol Lutkowski</i> The Euro and its Impact upon the Monetary and Banking System of Central and Eastern Europe .....	81
<i>Jan Solarz</i> The Euro impact on functioning of banks in Poland .....	85
<i>Eligiusz Przechodźki</i> Euro and Its Impact on Financial and Banking Systems of Selected Countries in Central and Eastern Europe .....	97
<i>Jerzy Kleer</i> Summary and conclusions .....	109
<i>Hermann Bünz</i> Closing statement .....	121

## Table Contents

Figure 1. Polish trade invoicing currency structure .....	32
Figure 2. Hungarian trade invoicing currency structure .....	32
Figure 3. Share of the EU countries in Polish trade .....	33
Figure 4. Share of the EU countries in Hungarian trade .....	33
Figure 5. Planned Polish bond issues .....	34
Figure 6. Foreign banks in Central and Eastern Europe .....	34
Figure 7. Top five foreign banks in CEE .....	35
Figure 8. International bank lending, by destination and maturity .....	36
Figure 9. International bank lending by destination, share of Euroland banks ..	37
Figure 10. European Union pre-accession aid for Poland in 2000–2002 .....	37
Table 1. Euro zone and the Central and Eastern Europe (CEE) .....	68
Table 2. Monetary map of the region <sup>a)</sup> .....	68
Table 3. The nominal changes of currencies exchange rates to Euro in the 1 <sup>st</sup> half of 1999 .....	70
Table 1. The euro's impact on the quality of managing credit institutions in Poland in time .....	88
Table 2. The impact of the euro novelty on functioning of credit institu- tions in Poland .....	90
Table 3. The impact of the euro novelty on functioning of credit institutions ..	92

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## **Jerzy Kleer**

### **Introduction**

Initiation of common currency as well as the uniform monetary policy within 11 countries of European Union is a great economic innovation; from the economic point of view probably it is surpassing all European accomplishments up to now achieved. To some extent Euro will have revolutionary impact not only on the European economy, but also on the world. It will take a time, but we are unable to assess how long, and all the forecasts – both the optimistic and the pessimistic, up to now could be treated as equal. To a large extent this will depend on abilities to overcome the existing and arising difficulties. This concerns both the objective difficulties related to adjustment processes, as well as the subjective difficulties present in the EU countries, within the elite of authorities, money and business elite as well as within and the societies.

Euro could be considered within two dimensions, and two functions are assigned to this currency. One group of functions includes the functions aimed inwards, to the already created Euro zone. The second group of functions includes the functions aimed outwards, outside the Euro zone – towards the world, world finance and trade, and – broadly speaking – towards the world economy. These functions are convergent only in some areas. But they are significantly divergent – and what is more important – they have to be divergent.

Within the area of common currency – 11 countries which have established the Economic and Monetary Union – the main goal is (and will be, but we do not know how long yet) the wide process of mutual economic adjustment,

especially the banking and financial systems of these economies. This process will be conducted in the two distinct areas. The first area is obviously related to currency and finance systems. The second one is associated with in-depth and long-lasting adjustment processes related to widely treated economy, starting from the insurance systems, taxation systems, wage and salary systems etc. We do not know how long and how fast the economies will be subject to unification. Probably both the 'Euro-enthusiasts' are right, that see a rosy future of EU, and the 'Euro-sceptics' which forecast many troubles, including the troubles related to the partial loss of national identity, i.e. connected with disappearance of national currencies.

Euro – considered as to some extent successor of Deutsche Mark, French Franc, or Dutch Guilder, is going to become a world currency. In the same time Euro is going to become a competitor of US Dollar. We do not know if it would be a more or less peaceful coexistence of these currencies; or would it be strong competition between these currencies. There are no doubts, that world trade will be divided to the Euro-based sector and the sector of further domination of US Dollar. It is not yet known in which proportion will it work. Export from (current) EU zone has almost one-third share in the total value of world export of goods and services. It is very probable, that in the first decade of Euro existing, the shares of export nominated in this currency in the world export value will increase to 40–45%. We can assume that to the Euro zone will be incorporated both the EU member countries and the countries – applicants to EU. It is not excluded that some non-European countries will be incorporated into Euro zone. The scene of the battle will be mainly the Asian economies. It is hard to predict whether domination of US Dollar in Asian economies will exist in the long run.

The relationship between the Central and Eastern European countries and the Euro-countries are presently quite close. More than one half of their export goes to the Euro zone. Moreover, considering the inflow of foreign direct investments, the share of these countries significantly exceeds 50%. The relationship between these countries and countries of Euro zone – not only now, but also in the future – will be progressively stronger. Thus, the general question arises: should this relationship be intensified or rather reduced? The number of the "Euro-enthusiasts" and "Euro-sceptics", both in Poland and in other Central and Eastern European countries, is more or less equal. The conclusion, that Central and Eastern Europe in the long-lasting perspective is doomed to EU membership, is absolutely unquestionable. There is still open question, should such process be accelerated now? There are also some additional circumstances. Up to now, the process of transformation is not

finished yet. There are no convincing enough arguments proving that fast and tight connection with Euro will accelerate (or will delay) and will make the accomplishment of transformation process easier. It is necessary to remember that integration with European Union will impose some rules, which probably will slow down the spontaneously arising entrepreneurship and that the dependence on integrated area will cause not excessive rhythm of economic growth in this area. The recent decade leads to such conclusions. Will such situation continue in the future? Today we are unable to answer the question – how will be the impact of these processes on the economic growth in Central and Eastern Countries? Are the transformation and integration processes totally complementary or competitive?

Somewhat another questions are related to the banking and financial systems of Central and Eastern European countries. These systems work under the pressure put not only by the transformation and integration processes, but also under the pressure of globalisation processes. Regarding these conclusions, the following questions can be asked: (a) How far the transformations in banking and finance systems have to outpace transformations in the remaining sectors of economy? (b) Should the influence of banking industry on transformation processes have higher priority than for example the process of intertwining with world banking? (c) What is the current share of foreign capital engaged into Polish banking sector (or generally into the banking industry within the CEE region) – too big or too small? (d) To what extent the banking system reached world dimension, or does it still remain in the local dimension? The last question can be also asked in the another way: whether the banking system will be dominated by world connections or will it remain local?

**Christian Ghymers**

## **The Macroeconomic policy mix and the European Employment Strategy**

### **1. Scope and implications of the problem**

The level of employment in the EU (presently around 60 per cent of the working age population) is low by historical standards (it was 67% in the early 60s, even before the massive women entrance into the labour force) as well as in comparison with other industrialised countries (presently around 74% for the US and Japan). This is the result not only of high unemployment (presently 9,4% of active population i.e. nearly 17 million persons in 1999) but also of poor employment prospects over long periods which have discouraged many people to seek a job, many of whom are beneficiaries of other social security provisions. However, these people are potential workers. This is shown by the fact that when employment increases by 1 percentage point, unemployment decreases only by about 1/2 percentage point of active population. Thus, rising employment has to absorb not only the unemployed but also a rising participation rate and still some very small demographic increase in the population of working age. According to Commission's estimate, the total labour reserve represents about 30 to 35 millions of workers, i.e. about the same potential than the whole present employment in Germany.

In the short run, the present degree of non-employment is undoubtedly a weakness and the source of large social, economic and budgetary costs. But

the existing labour reserve also represents a very important growth potential beyond the growth coming from labour productivity increases and irrespective of the pace of the latter. The utilisation of this potential over the medium and longer term would greatly alleviate the burden on Member States' public finances and social security systems, helping to fight poverty and social exclusion and thus facilitating the safeguarding and development of common European social values, as well as the reduction of tax pressure both on companies and on individuals. Besides, the very nature of most of the new employment opportunities would also make the transition towards a more environmentally friendly production mode significantly easier.

## 2. Net Employment creation means GDP growth in excess of labour productivity increase

By definition, net job creation can only come from that part of GDP growth which is in surplus of the increase in labour productivity (whatever this rate of increase might be). Absorbing the existing labour potential in the EU requires the ability for its economy to generate and to maintain a GDP growth trend over labour productivity increase during a long period. For giving an order of magnitude, absorbing the existing 30 millions of potential workers would require that the average rate of growth of real GDP exceeds the labour productivity trend by 1.8% per year during 10 years, or by 1.2% per year during 15 years.

## 3. Macroeconomic and structural obstacles to growth and employment

It is essential to understand why Europe has been unable since the mid-seventies to meet these conditions of growth with respect to labour productivity. Looking back to the last 25 years, it is now commonly established that the poor growth and employment performance of the Community over the two last decades relies upon a range of different factors like negative external shocks, inadequate and diverging macroeconomic policy responses, and structural rigidities, whose combination created significant obstacles to growth and employment within the Community.

Amongst them, three main macroeconomic obstacles developed:

(i) Monetary turbulence: currency crises, which to a considerable extent reflected insufficient credibility of economic policies in several countries and a lack of policy coordination in the Community, have had a disruptive influence on economic growth both in countries whose currencies appreciated and in countries whose currencies depreciated.

(ii) Stability conflicts between budgetary policy, wage developments and monetary policy resulted in distorted policy mix and frequent overburdening of monetary policies, which had to be tightened. The resulting higher real rate of interests and negative impact on business expectations shortened the cyclical upswings (and lengthened the recessions), impeding growth and employment.

(iii) The fact that repeatedly the two previous obstacles have shortened artificially sound recoveries, has affected the investment in particular. As a result the rate of growth of the potential output abated to a relatively low path (currently at 2 to 2.5% per year), not much higher than the labour productivity trend (2% a year). Fast growth of the effective demand opens the risk of facing capacity constraints and inflationary tensions. This third obstacle to growth can only be reduced or solved by creating favourable conditions for higher investment (see point 5).

In combination with these macroeconomic obstacles to GDP growth, more structural factors limited unduly the labour creation for each given rate of GDP growth (labour content of growth). These factors have maintained the continuation of the fast trend of macroeconomic substitution of labour by capital. This process was appropriate in the sixties (full employment and low increase in the labour force) but has continued in spite of the fact that the EU shifted from labour shortage to labour excess supply. Such an increase in the capital-labour ratio is essentially explained by:

- past resistance of wages to adjust to the productivity slowdown (from 4.5% per year in the 1961-73 period to 2% for 1974-98) and to the deterioration of the terms of trade (in the wake of the two oil price shocks);
- rigid wage differential between skilled and unskilled workers (relatively small degree of wage dispersion despite change in the pattern of labour demand led by technological bias and external competition pressure).
- rigid employment security rules and non-wage labour costs increase have reduced the attractiveness of labour as a production factor and have compelled enterprises to keep up a strong substitution of labour by capital in order to safeguard their competitiveness

Thus, the trend towards capital-labour substitution in the EU can be seen to reflect an imbalance in the relative prices of capital and labour and an insufficient degree of adjustment in the labour market in particular. This trend plays a significant role in the high unemployment and its concentration on unskilled workers.



#### 4. The two main missions of economic policies for solving the employment problem

If the Community is to achieve a sustained period of healthy economic growth capable of ensuring a significant and lasting reduction in unemployment, it has first to find lasting solutions to these obstacles to growth and employment. Strong medium-term economic growth must be supported by investment to ensure that productive capacity increases in line with rising demand. In the short run, economic growth can and should exceed to a certain degree potential output growth in order to take up idle productive capacity and to absorb the, generally small, cyclical component of unemployment. However, over the medium term the potential growth must be raised by investment response, allowing for actual growth to be sustained without creating capacity tensions and therefore without inflationary pressures.

This is the task for economic policy, whose missions are both (i) to set the conditions for strengthening the recovery and ensuring its transformation into a non-inflationary, self-sustaining, high economic growth process over the medium and longer term – a prerequisite for substantially and durably higher employment, and simultaneously (ii) to try to increase the labour content of growth by reducing the structural rigidities or microeconomic distortions. These two missions require a strengthened programme of macroeconomic and structural policies to address a number of key challenges while allowing the EU economies to better adapt to changing circumstances in the years ahead. This is the purpose of the EU strategy for employment.

#### 5. Macroeconomic policies and the debate about

On the macroeconomic side, the strategy relies essentially upon the strengthening of the policy framework brought about by the move to the EMU regime. Indeed, the euro represents a change of regime which should ease substantially the task of policy-makers for solving the obstacles on the macroeconomic side.

#### 6. The debate about the risk of a sub-optimal policy mix in the euro area

According to usual critical comments, the move to the single currency would create in principle a risk to get a sub-optimal policy mix in Euro zone as a whole due to the generic argument that such an aggregation of countries would not form an optimal currency area. In a nutshell this old academic argument holds that only countries which react identically to monetary policy can enter into a monetary union. Most of critics refer directly or implicitly to

this generic argument, although at different degrees and by focusing on different mechanisms or indirect aspects of it, such as:

- the different structural reactions to the common monetary and exchange rate policies from one member country to another,
- the fact that economic policies are decentralised among Member States while there is only one monetary and exchange rate policy, would provoke a lack of effective co-ordination due to deep divergence amongst Europeans (with a high probability of “free riding” among Member States provoking damaging conflicts for the regional integration),
- the autonomy of the Central Bank would impede a co-ordination with budgetary policies, or the constraints imposed on budgetary policies due to the effectiveness of the Treaty criteria, would impede Member States to cope with asymmetric shocks and would generate a double deflationary bias (monetary and budgetary),
- the excessively rigid labour and product markets in Europe, especially the too low cross-border mobility of workers, and the aggravating fact that these rigidities plague to different degrees the countries for institutional and policy differences deep-rooted in the cultural diversity among European peoples... etc.

Except for some misunderstandings by lack of information or dogmatic a priori position, most of these fears either seem excessively dependent upon extrapolations of past parameters of behaviours now about to be turned obsolete by the change of regime itself, or they seem to underestimate the coherence and the dynamics of the co-ordination process progressively built amongst technicians of the respective authorities in a context of some form of competition between them. It seems that the main reasons for opponent academics to give such a weight to their old theory of optimal currency area, is that they limit the function of the euro to its only microeconomic aspect of being just “the single currency for the single market”, with the resulting efficiency gains and transaction costs reductions. Denying by definition any macroeconomic gains would make that these microeconomic gains are not worth the potential macroeconomic losses from the lack of autonomy for heterogeneous members. This academic vision looks amazingly “backward-looking” and far from present European realities. by assuming implicitly that governments are always in condition to manage optimally their policies and by neglecting explicitly the change of macroeconomic regime brought about by the single currency: much more than the currency for the single market, the euro appears as the stable currency issued by an independent Central Bank working within a new co-ordinated policy framework and especially within the budgetary scheme of the

Growth and Stability Pact. The following developments stress that the macroeconomic aspects of the euro are indeed dominant, as the euro's opponents say, but, contrary to them, because in the real world the euro regime provides more important gains than the risks on which they focused the discussion. The main reason is that full autonomy for national policy cannot lead to the first best solution as a result of being badly biased by external effects and vested interests.

Contrary to what is sometimes said, the Treaty contains a genuine approach of economic governance for the Community as a whole since a experimentally-tested set of formally linked provisions define clearly the economic policy-setting and responsibility of the three main autonomous groups of actors for reaching the Community's objectives. These three poles which fix the policy mix of the euro are the single monetary policy, the Member States budgetary authorities, and the autonomous national or local social partners responsible for the wage-setting according to national practices.

There is no reasonable *a priori* argument funding an impossibility for these three poles to be able to optimise the global policy mix in the stability framework of the Treaty. On the contrary, the existence of formal rules with a surveillance procedure triggers a permanent scrutiny of several autonomous authorities or actors like the Member States administrations and national central banks, the ECB, the Commission, the European Parliament, the social partners and other representative groups of interest as well as specialised press and independent experts or Institutes, included the IMF and the OECD. Beyond the formal surveillance exercise relies a built-in process moved by the self-interest of all the involved actors to impede a sub-optimal result by their vigilance upon the behaviour of the other actors. Although not immune from errors, this collegial and iterative process of search for the best policy mix through "self-correction" provides "a priori" more flexibility than a more centralised one. This is probably less risky because it relies on a consensual process and reflects better the idiosyncrasy and diversity of Europeans populations.

According to the Treaty provisions, it is clear that national policies cannot only go on their own but shall submit themselves to some Community's rules and principles in specific areas of common interest. Therefore, such a co-ordination principle allows for defining and applying a genuine economic policy at the Community level, preventing when necessary or useful, to fall in the case of a lack of economic government or be blocked into a conflict. The fact that this is only true for these specific cases where common economic objectives are at stake, means that as regards its first pillar, the EU is not and cannot be ruled as a single state but is managed collegially within the Council of national

Ministers in presence of the Commission in charge of protecting the Community interests, under the peculiar combination of the co-ordination principle and the competition resulting from the subsidiarity principle. This original construction cannot be reduced to an Inter-governmental kind of management like for example the UN or the OECD. It relies upon a deep consensus and explicit choices made by European policy-makers and peoples. It therefore permits, by limiting the autonomy just in case of gross mistakes, that most of the economic policy domain do not need to be decided at the highest Union level but remains well in the hands of national or local authorities for efficiency reasons as well as for deep-rooted political choice. Thus, the request for instituting a more formalised economic government would be premature and presently against the basic principle of European construction, since the moral hazard risk should first be solved.

Turning to the interplay between the three respective autonomous poles of the European policy mix, it appears that in Phase III of EMU there is even more chance to get an optimal policy mix than used to be the case in Europe or than would be the case without a single currency. Let's see this reviewing each pole under the new regime.

1. With the euro, by definition, the monetary policy becomes centralised for its members under the responsibility of an independent System of Central Banks (ESCB). However the coordination issue remains for that part which concerns the policy mix for the union as a whole. This is one of the reasons used by some commentators claiming that the single Central Bank should face a single economic authority with which it could manage the global policy mix. In addition to the co-ordination scheme and the budgetary discipline which, as exposed above, make the Council such a single voice authority, the Treaty complements in Art. 105.1 the primary objective of price stability that the monetary policy shall pursue, with another one: without prejudice of price stability, the ESCB shall support the general economic policies in the Community with a view to contributing to the achievement of the objectives of the community as laid down in Article 2, i.e. growth and employment.

The implementation of the above provision of Art. 105.1 means that the macroeconomic policy-mix will be favourable to growth and employment as far as national budgetary policies and wage behaviour of the social partners do not counter-act the essential stability objective of the single monetary policy. This is the basic theorem of macroeconomic policies in EMU formulated in the Broad Guidelines: more Member States budgets and social partners wage setting contribute to the common stability objective, more the monetary stance can be favourable to sustainable growth and higher employment.

Both links established by the Treaty from Art. 2 through Art. 102-a and up to Art. 103 for the co-ordination of national economic policies, and between Art. 105-1 and Art. 2 for the co-ordination between the single monetary policy and the economic policies, define the framework in which economic and monetary policies are the major instruments for achieving the growth and employment objectives assigned to the Union. Thus, although EMU is not as such an employment policy, the Treaty dispositions provide indirectly the means and the motivations for using macroeconomic policy in the Union at the best for job creation.

2. Furthermore, in complement to the general principle of co-ordination and the multilateral surveillance dispositions, EMU establishes a set of rules for warranting a minimum of budgetary discipline among all the Member States (not only for the members of the EMU). Since these policies remain fully in the hands of Member States authorities, the Treaty provides several provisions in order to commit national policy-makers to achieve and maintain this minimum of budgetary discipline for preventing a wrong policy mix and negative spill-over effects for the EMU and the Community.

In this context, a Stability and Growth Pact was enacted by the European Council in Amsterdam in mid-1997. This binding Pact strengthens and accelerates the budgetary surveillance within the existing provisions of Articles 103 and 104-c, by providing their operational modalities, making fully credible the enforcement of the common budgetary discipline. The Pact is composed by two new Council regulations together, under the guidance of a Resolution given by the European Council to the Council and the Commission. It is a way to get and to preserve the pro-growth policy-mix, Members States need for making the EMU obtainable and job-creating. The provisions of the Pact – especially the target of achieving a budget close to balance over the medium-term – confirm the budgetary policies which have already been recommended in successive Broad Guidelines by the European Council since December 1993. The Pact has in fact three purposes:

(1) to prevent an overburdened monetary policy, which would otherwise imply a sub-optimal too restrictive stance of the policy-mix, with damaging effects on growth;

(2) to support the “crowding-in” process of investment the European economy needs for rising its potential output, making a stronger growth path sustainable: budgetary consolidation up to a close to balance position allows to provide the necessary savings for higher investment and helps to keep interest rates low;

(3) to restore the sufficient room for manoeuvre, budgetary and fiscal authorities need for an optimal management of their economies in a full EMU (automatic stabilisers and discretionary action in case of asymmetric shocks):

Countries with a sound structural budget balance will have considerable budgetary flexibility during normal cyclical downturns without breaching the Treaty's limits on budget deficits (the so-called “automatic stabilisers” can play fully their smoothing role in the business cycle) the realisation of a medium-term budget balance in normal cyclical conditions (structural balance) means an accelerated reduction of the debt-to-GDP ratio. So, the combined effect of lower deficits and lower interest rates reduces the heavy burden of government debt-servicing, thereby allowing tax-reduction and/or other expenditures priorities, especially if needed in case of country-specific shocks; this contributes significantly to creating a virtuous circle, re-reinforced by the action of market expectations, whereby the possibility of sound stabilising public action, room for tax reduction and basic collective goods production, improve the supply side and strengthen stability and the endogenous forces of growth.

This secondary legislation is organised in two Council regulations. The first one, based upon the Article 103-5, has an early warning function. It is a preventive approach which puts in place “Stability programmes” (or “Convergence programmes” for the non-participants in the euro) at national levels and sets out the modalities of their implementation and surveillance (their first submission was at the end of the year 1998); the second one, based upon the Article 104-C-14, organises a dissuasive approach for ensuring the full respect of the budgetary criteria by Member States and making operational the application of sanctions in case of non-respect of the criteria. There was indeed a need for more detailed provisions in order to speeding up and clarifying the implementation of this excessive deficit procedure, in particular by establishing clear definitions and setting deadlines for the various steps.

3. Wage developments generally represent the outcome of negotiations between autonomous social partners, which, according to differences in national practices among Member States, are held at different levels of centralisation (national, sectoral, or firm). Thus, in terms of decision-making their direct role and responsibilities in the wage setting as well as in the labour market conditions, make the social partners the third essential pole for the setting of macroeconomic conditions, and therefore the policy mix. Indeed wage trends are a key ingredient of macroeconomic and structural policies. The macroeconomic wage bill (including all social security contributions) is equivalent to about 50 per cent of Community GDP, i.e. the same order of magnitude than total government spending in the Community's economy. Consequently, the

evolution of aggregate wages and wage differentials has substantial implications for inflation, growth, employment and the employment-content of growth. Indeed, firstly it is of crucial importance that the perception of the expected rate of inflation which is embodied in nominal wage settlements is, as much as possible, compatible with the price-stability objective of the central bank. If this is the case, wage developments *de facto* do not place an undue burden on the conduct of monetary policy, contributing to keep interest rates at low level. Secondly, as regards real wages increase compared to productivity increase, their evolution at the macroeconomic level has to take into account the need for safeguarding, and if necessary improving, the profitability of investment, which is a basic requirement for ensuring the needed recovery of the potential output in Europe. In view of their economic importance, it is warranted that policy-makers, whilst fully respecting the autonomy of the social partners in this area, closely monitor wage developments. This is why the broad economic policy guidelines issued on the basis of the Article 103-2 have taken a position on wage development. In the Commission recommendation of May 1996, this position was worded in the following terms: "nominal wage trends consistent with the price stability objective as well as real wage developments consistent with the conditions for strengthening employment-creating investment".

The wage-setting itself is indirectly influenced by the change of regime brought about by the euro. Firstly, the loss of the exchange rate instrument at national level internalises significantly in social partners practices the effects of the wage outcome, making more visible for them the link between wage development, competitiveness and employment. In the past, a currency devaluation or an exchange rate depreciation could always absorb part of the effects of an excess of wage increases, creating a risk of moral hazard in the wage bargaining. Secondly, taking into account the increasing degree of consciousness of the stability priority that the EMU regime credibly brings, lower and more certain inflation makes the outcome from wage bargaining clearer and more predictable for both negotiating parties. Employers are expected to resist better to concede wage increases exceeding productivity growth. Trade unions aware of the negative impact on employment from excessive wage increase, are likely to bring their wage claims closer to productivity trends, in exchange for less uncertainty on future inflation and an easier attainment of target gains of disposable income. This reduces the risks for firms as well as for households, contributing to improve the conditions for economic decisions and especially for investment.

The fact that the average macroeconomic wage development in the EU in the last three years as well as in the expected one for 2000, is considered as appropriate, is indeed an illustration that in EMU macroeconomic wage developments can meet the requirements of an overall policy mix which is favourable to growth and employment. Furthermore, under unemployment concerns, in Euro zone, some European federations of trade unions are now considering to commit themselves to align their wage claims on local productivity increases.

This presentation of the policy-setting in Euro zone leads to the double conclusion:

With the birth of the euro a new policy regime was put in place through a deep institutional change which constitutes a systemic progress for the European economies. There is an effective economic pilot in Euro zone as a result from the interplay of the different autonomous and/or decentralised actors of the policy-making in a stability framework imposed by the Treaty and the Stability and Growth Pact. It is in all actors' individual interest to respect and to make effectively respected by the others, the basic theorem of the macroeconomic policy in EMU enacted by the Broad Guidelines: the more Member States budgets and social partners wage setting contribute to the common stability objective, the more the autonomous monetary stance can be favourable to sustainable growth and higher employment.

Fulfilling the above condition allows for EMU to create a new opportunity for achieving a macroeconomic policy mix in which growth and employment can develop without stability conflict and without monetary turbulence, i.e. without the obstacles which repeatedly halted promising recoveries during the last twenty years. In this new context, the Community's growth potential exceeding the productivity trend can be raised through a sustained increase of job-creating investment. Furthermore, the action plan for the full implementation of the Internal Market and the Cardiff process of structural reforms, can help to strengthen the productivity trend and the dynamism of the European economy. In order to prevent that effective growth be blocked by bottlenecks and in order to increase the employment content of growth, it is important that the whole range of economic policies, i.e. including fiscal and structural policies, contribute to the realisation of Art.2 objectives, namely growth and employment. In this context, the improvement in the functioning of goods, services and labour markets, also contributes to achieve a favourable policy mix, by enhancing competition and reducing inflationary tensions. The structural aspects are thus complementary with the macroeconomic ones, showing

that the euro brings a dynamics of change with both micro and macro dimensions.

## 7. The European Employment Pact

At the Cologne European Council (3-4 June 1999), the Heads of State and Government reaffirmed the employment strategy and they strengthened it by agreeing on a European Employment Pact (EEP) aimed at a sustainable reduction of unemployment by combining mutually-reinforcing measures. The EEP is based on three pillars: The so called Cologne Process (the macroeconomic dialogue established at this summit), the Cardiff process [structural and economic reforms] and the Luxembourg process (coordinated employment and labour market policies. Employment Guidelines).

These processes should not be seen in isolation from the Broad Economic Policy Guidelines (BEPGs), the main economic policy co-ordination instrument in the Community. On the contrary, they are an integral part of the comprehensive and coherent strategy for achieving high and sustainable growth and employment, as set out in the 1999 BEPGs.

## 8. The Macroeconomic Dialogue

After the "Val Duchesse" agreement in 1985 between the European Social Partners, a social dialogue has developed with the technical assistance of the Commission at the European level and its macroeconomic group has permitted to the social partners to speak with one voice on the issues where a consensus among them exists. Through the intermediary of the Commission, this third autonomous pole of the policy mix in the EU has been progressively involved in a kind of "dialogue" with the other policy-makers. De facto they have made significant contribution during the preparatory work of the Broad Economy Policy Guidelines to the content of the policy recommendations. Drawing upon these positive results, the Heads of States and of Governments acknowledged in Cologne the need to upgrade this indirect process of dialogue by defining better and structuring the process whereby all the policy actors enter directly into a dialogue with a view to achieving the Union's central economic and social objective of high employment within the framework of a strong and sustained medium-term growth process. It was in fact an answer to the view expressed by the European Social Partners, that "the evolution of wages and profitability, which are determined by autonomous social partners according to individual countries' practices, is a major factor influencing the decisions of the budgetary and monetary authorities. In turn, those decisions will influence

the behaviour of collective bargainers and thus the overall growth orientation of the policy-mix". This is why they had noted that an "important objective (...) is to build bridges between them and the authorities responsible for budgetary and monetary policies". This is why a macroeconomic dialogue was introduced as the key-component of the European Employment Pact

The purpose is to enhance the policy dialogue on the basis of mutual trust on both the national and European level, with particular emphasis to be given to improve the effectiveness of the policy co-ordination in the Council and reinforce the dialogue between the Commission, the Council, the ECB and the social partners. To this end, on the national and the European level all economic policy actors have to deliver their respective contributions with regard to appropriate wage developments, sound public finances, economic reforms and a stability-oriented monetary policy. To place the responsibility for an appropriate policy mix unilaterally on one of the actors would entail social tensions and result in economically non-optimal outcomes. All actors and groups of actors are urged to co-ordinate closer and better their policy actions with a view to realizing positive synergies, including the greater synergy requested by the Vienna European Council between the Broad Economic Policy Guidelines and the Employment Guidelines.

As concerns the involvement of the social partners in the co-ordination of economic policies, Amsterdam, Luxembourg and Cardiff European Councils have made clear that the social dialogue should be part of the process. As underlined in the Amsterdam resolution on growth and employment, the social partners are responsible — at the national, regional, sectoral or even at a more decentralised level following their respective traditions — for reconciling high employment with appropriate wage settlements and for setting up a suitable institutional framework for the wage formation process. In EMU, with a single monetary regime, the link between wages and employment will become more apparent and strict. For wage developments to contribute to an employment-friendly policy mix, the social partners should continue to pursue a responsible course and conclude wage agreements in Member States in line with the general principles set out in the successive Broad Economic Policy Guidelines. Indeed in terms of decision-making their direct role and responsibilities in the wage setting as well as in the labour market conditions make them the third essential pole for the setting of macroeconomic conditions, and therefore the policy mix.

## 9. The essential role of structural measures

Structural reforms of product and capital markets and policies to improve the efficiency of labour markets are key components of the European Union's

strategy for meeting the employment challenge. They have a complementary role to play in raising employment levels, both by raising the speed limit of growth, allowing for a more accommodative policy mix, and by eliminating microeconomic distortions that limit the job-creation. Under EMU, it is all the more important for Member States to ensure that their product, capital and labour markets are flexible enough to respond to country-specific economic developments. Their key role is to help ensure a tension-free macroeconomic growth process, to reinforce the EU's competitiveness, to increase the employment content of growth and to make growth more respectful of the environment. However, to reach their full effectiveness, they must be coherent with the pursuit of sound macroeconomic policies. In this respect, it is essential that the budgetary costs of structural reform are kept under control and do not jeopardise the achievement of sound budgetary positions. Their economic benefits also emerge only gradually over time and they are clearly more efficient in a context of higher economic growth.

On the structural side, it is necessary:

- that efficiently functioning goods, services, and deep and liquid capital markets facilitate adjustment by allowing for swift changes in relative prices, and that sectoral changes occur smoothly and in a socially acceptable manner;
- that improved education and training increase the supply of high-skilled labour and that measures are taken to enhance employment of the low-skilled.

In particular, it is important to increase the labour content of a given growth trend. From a purely economic point of view, this should result from the elimination of the imbalance in the relative prices of capital and labour. If labour markets in the Community have adjusted gradually with a continuous process of wage moderation at the macroeconomic level, it will take time to bring significant effects. Furthermore, our social model impedes this adjustment to take the more rapid route towards a more employment-intensive pattern of growth through a downward widening of the wage cost scale as in the United States. Reducing wage costs at the low end would enable activities with low productivity to remain and/or to become profitable. For social and political reasons, an emulation of the US-approach which has led to a significant drop in real wage income for low-skilled labour is neither feasible nor desirable in the Community. Hence the need for strong, investment-supported macroeconomic growth assisted by pragmatic solutions, as laid down in the strategy adopted by the successive European Councils, aimed at a higher employment-content of growth without impairing competitiveness.

In order to preserve, in a reformed and streamlined fashion, the key ingredients of the European social model, the following pragmatic approaches are

worth pursuing. The social partners' wage agreements should provide for more differentiation according to qualifications, and between regions and, to some extent, sectors. Non-wage labour costs (or payroll taxes) at the lower end of the wage scale should be lowered with the government revenue losses being compensated for by a stricter control of increases in overall government spending and/or increases in other taxes (e.g. environmental levies). In a similar vein, temporary entry-wages for the low-skilled, youth or long-term unemployed could usefully be introduced. Furthermore, more flexibility in working time arrangements, tailored to the specific needs of Firms and workers, the greater use of voluntary part-time work and the promotion of local employment initiatives are likely to foster both new jobs and higher participation in the labour market.

In terms of procedures and decisions, the structural measures are dealt with in the framework of the called Luxembourg process (Employment Guidelines) and Cardiff process (structural reforms).

#### 10. The Luxembourg process

The aim of the Luxembourg process is to improve the efficiency and overall functioning of labour markets. It was launched at the special Jobs Summit in Luxembourg (November 1997) is an advance application of the employment Title of the Amsterdam Treaty.

The main problem to be addressed is of course the low rate of employment and the persistently high level of unemployment in the EU. This suggests that labour markets function relatively poorly, although the problem differs a great deal among Member States. Within some countries there are striking regional variations in unemployment. In general, unemployment in the EU is particularly high among low-skilled workers, young people, women and older workers.

The core of the Luxembourg process is the Employment Guidelines, formulated annually by the Council acting by qualified majority under a Commission's proposal, while respecting the differing circumstances of the Member States in line with the principle of subsidiarity. The Member States submit concrete National Action Plans (NAPs) for Employment, describing how they plan to implement the Employment Guidelines. Finally, the Commission and the Council together draw up a Joint Employment Report to assess the NAPs.

The Employment Guidelines are based on the four pillars of improving employability, developing entrepreneurship, encouraging adaptability of businesses and their employees and strengthening policies for equal opportunities

between women and men. While the 22 Guidelines deal with many issues, the core of the employment strategy from an economic point of view is based on:

- increasing the effective labour supply, through skills upgrading and reforms of tax and benefit systems to increase incentives to take up jobs,
- fostering labour demand by reducing taxation of labour, especially at the low end of the productivity scale, and
- improving the functioning of the labour market by reviewing existing and new regulations and enhancing working time flexibility.

Of particular note are Employment Guidelines 1, 2 and 3 on youth unemployment, long-term unemployment and active labour market measures, which specify quantified targets. Member States are required to offer a new start to young unemployed people before they reach 6 months of unemployment, and to unemployed adults before 12 months. They must also set a target of at least 20% for the proportion of unemployed persons benefiting from active measures to improve their employability.

## 11. The Cardiff process

Launched at the June 1998 European Council, the Cardiff process is an annual assessment of structural and economic reforms, designed to feed in to the preparation of the Broad Economic Policy Guidelines. Its objective is to improve the functioning of markets through better surveillance and co-ordination of structural reforms. One main problem is that some markets – particularly in services and public procurement, but also in some goods sectors – remain relatively segmented despite the Internal Market. This may be due partly to taxation, regulatory barriers and inefficiencies in distribution and network industries. Differences in national regulatory environments and fiscal regimes continue to fragment EU capital markets. In public finances, the main problems are generally high levels of taxation, with a particularly heavy burden on labour, a lack of co-ordination among national tax systems, and the impact of an ageing population.

In 1998, the Cardiff process resulted in 15 national reports on structural reforms and two reports from the Commission (Cardiff I and Cardiff II). Cardiff I focussed on the functioning of Community product and capital markets and covered broad issues relating to the Internal Market. Cardiff II evaluated progress and highlighted future challenges for structural reform of labour markets and public finances, as well as product and capital markets. In addition, the Economic Policy Committee carried out an examination of structural reforms in the Member States and produced a Synthesis Report for submission to Ecofin ministers.

The key message of these reports is that to achieve growth and further employment the efficiency of the European economy needs to be improved by making markets more flexible. In other words, structural reform is essential to foster employment and growth in Europe. The Cardiff II report also highlighted the importance of taking due account of the interactions among goods, services, capital and labour markets and public finance. It highlighted the positive experience of those Member States who have followed such a strategy by undertaking co-ordinated and comprehensive reforms.

## 12. Assessment of these two processes

The establishment of the Cardiff and Luxembourg processes has initiated a dialogue among Member States, facilitating the exchange of best practice and encouraging a more comprehensive approach to structural reforms. The Cardiff II report has already highlighted a number of main policy conclusions.

Experience so far suggests that, while structural reforms are underway throughout the EU, they are often less than fully comprehensive and progress remains uneven across policy fields and among Member States. On the whole, progress is relatively satisfactory in goods and capital markets, but much remains to be done in services, including financial services, labour markets and public finances.

Public finances have an important impact on economic efficiency through both the size and structure of expenditure and taxation. In general, more progress is needed on across-the-board tax reductions together with expenditure restraint so as not to jeopardise budgetary consolidation. Reducing high levels of taxation on labour, especially at the lower end of the wage scale, is of particular importance. So too is tackling the budgetary impact of an ageing population.

There is significant room for improvement in the functioning of labour markets, which would in itself do much to address the employment challenge. The problems differ considerably among Member States, regions and categories of labour. But one key lesson is that countries which have undertaken comprehensive structural reforms, as opposed to scattered measures, have been able to improve their employment performance.

These conclusions have led to the formulation of the structural policy guidelines of the BEPGs. The 1999 BEPGs underline the need for a prompt and transparent implementation of the Employment Guidelines and highlight key areas for Member States' attention. Member States are also encouraged to use the forthcoming Cardiff process to increase competition, speed up regulatory reforms and improve the working of the Single Market. A key general

conclusion is that it is particularly important to reform structures that favour "insiders" (those who already have a job or business) at the expense of "outsiders" (those without jobs and potential entrepreneurs).

It is now important to ensure appropriate monitoring of the implementation of these guidelines. In this context, a dialogue with the European Parliament and the Member States could be envisaged in the run-up to the presentation of the new BEPGs. [In line with Art. 99 of the Treaty, the Commission will not hesitate to issue a recommendation to the Council to "make the necessary recommendations" to a particular Member State when its economic policies are not consistent with the BEPGs.] F. Woehrling (1997)

Council Recommendation of 7 July 1997. When comparing at the macroeconomic level wage and productivity developments, it must be taken into account that for the Community as a whole, almost half of the apparent labour productivity increase comes from the substitution of labour for capital. Distributing all the apparent productivity increase would maintain a high pressure for substitution among factors and prevent restoration of an adequate macroeconomic profitability of investment. In addition, despite the fact that the share of profits in GDP is presently above its level of the 1960s, further increases in profitability are still warranted in order to compensate for the significant increase in capital/output ratio that took place during the 1970s and arrive at the level of profitability per unit of capital stock that prevailed during the quasi full employment period 1961–73. Finally, the world-wide determined level of real interest rates tends to be higher than in the 1960s, which confirms the need for a higher level of macroeconomic profitability. (European Economy, 1996)

## Krzysztof Rybiński

### Euro and its impact on commercial banks in Central and Eastern Europe

The emergence of the single currency – the Euro – represents a milestone change for commercial banks in Central and Eastern Europe (CEE). In this brief paper we identify several areas in which the Euro should affect commercial banks in CEE. Several factors related to EMU (such as convergence criteria) and macroeconomic policy will not be discussed here as they extend beyond the scope of this paper.

#### 1. Formal currency regimes

The emergence of Euro should and will affect the formal currency regimes. The zloty (PLN) is formally traded against 55% Euro and 45% US\$ basket, however in practice the zloty often follows US\$ movements and foreign investors use US\$ as a funding base. This poses problems for banks' foreign exchange positions as it is difficult to hedge against Euro/US\$ risk. Hungarian forint floats in a band against 70% Euro / 30% US\$ basket, and has to change to 100% Euro in 1 January 2000. Czech (CZK) and Slovak Kronas (SKK) float freely, but both central banks watch the Euro rate very closely

According to dealers Euro/PLN deals account for 30% of the Polish foreign exchange market in terms of the number of transactions and 5–10% in terms of the volume. This clearly indicates that Euro deals are small and driven by



tiny corporate orders, while large speculative moves are done on US\$/PLN market.

## 2. Trade structure: large EU share and Euro dominance in invoicing

Figures 1 and 2 show that the Euro (and Euro legacy currencies) is becoming an increasingly important currency in foreign trade invoicing. This process is expected to continue. This would have important implications for many bank operations related to trade finance and hedging corporate customers' foreign exchange risk exposure. One should expect that currency liberalisation would lead to a gradual increase in zloty export invoicing, however large currency instability and still low level of derivative market development may hamper this process.

We note also that if currencies become less volatile against the Euro, and relatively more volatile against the US dollar, then this may encourage trade flows to Euroland at the expense of other destinations.

**Figure 1. Polish trade invoicing currency structure**

%	Exports				Imports			
	1994	1997	1998	1 po, 1999	1994	1997	1998	
Euro	41	42	51,3	N/A	N/A	N/A	N/A	
US dollar	49,4	49	40	N/A	41,5	38	32,4	
GB pound	3,8	2	2,1	N/A	3,5	3	1,7	
Zloty	0	0	0	8	N/A	N/A	N/A	
Others	5,8	7	5,6	N/A	9,2	9	7,4	

Note: Euro share computed as sum of shares of currencies that were replaced by Euro. 8% share of zloty is based on comment made by NBP governor

Source: National Bank of Poland (NBP), ING Barings

**Figure 2. Hungarian trade invoicing currency structure**

%	Exports				Imports			
	1994	1997	1998	1 po, 1999	1994	1997	1998	1 po, 1999
Euro	50,6	60,6	65,1	71,1	48,3	57	61,7	59,2
US dollar	34,3	28,7	28,5	22,8	34,3	29,4	27	22,7
GB pound	2,4	2,1	1,7	1,9	1,9	2,1	1,9	1,6
Zloty	b/d	b/d	b/d	b/d	b/d	b/d	b/d	b/d
Others	12,7	8,6	4,7	4,2	15,5	11,5	9,4	16,5

Note: DEM/FRF/ITL/ATS to 1999, then these four plus Euro

Source: National Bank of Hungary (NBH), ING Barings

As shown in figure 3 and 4 regional trade characteristics support the trends described above. Due partly to the Russian crisis European Union accounted for 71.2% of Polish exports (up by 5.2% on previous year) and 75.8% of Hungarian exports (up by 4%).

**Figure 3. Share of the EU countries in Polish trade**

	1998	1999
Exports	66	71,2
Imports	65,2	65,8

Note: Figures refer to January-August period

Source: Central Statistical Office (CSO)

**Figure 4. Share of the EU countries in Hungarian trade**

%	1998	1999
Exports	71,8	75,8
Imports	64	66

Note: Figures refer to January-August period

Source: Central Statistical Office (CSO), ING Barings

## 3. Euro would become an important funding market for CEE enterprises

The emergence of the Euro has created a new large market for corporate bond issues. It has already challenged the supremacy of the dollar-denominated bond. As shown in figure 5 the Euro has already become an important debt issuance currency for CEE issuers. One could expect that the Euro will dominate the US dollar in CEE corporate debt issues due to lower foreign exchange risk (currencies trade against Euro, so the issuer does not take Euro/US\$ risk, Poland may be an exception in the short run).

Figure 5. Planned Polish bond issues

Issuer	Date	Tenor (years)	Size (m)	Currency	Distribution	Purpose
Autostrada Włp.	1999	25	390	USD	Foreign/ Domestic	investments
EFL	delayed	3	100	USD	N/A	N/A
Petrochemia Pock	delayed	N/A		N/A	foreign	N/A
Porty lotnicze	1999	N/A	50-200	N/A	foreign	investments
Stradom	2 H 1999	N/A	10	USD	N/A	investments
TP SA	Oct. 1999	5	400	Euro	foreign	investments
Sovereign	1 Q 2000	N/A	400?	Euro?	N/A	deficit financing

Source: Rating & rynek CERA (2 Nov 1999), ING Barings

#### 4. Euro is important to CEE banks because of the ownership structure

As shown in figure 6 foreign banks control some one third of banking assets in CEE. Figure 7 reveals that most important foreign players in the banking sector come from Euroland countries. Therefore the target return on equity set for CEE subsidiaries will be set in Euro. Also Euro-related preparations launched by headquarters will be forced upon subsidiaries, this will stimulate the transfer of know-how.

Figure 6. Foreign banks in Central and Eastern Europe

	Total banking assets (US\$bn)	Total assets of foreign banks	% share
Poland	84	27,7	33,0
Czech Republic	74,5	30,5	40,9
Hungary	27,8	13,4	48,2
Slovakia	19,8	3,8	19,2
Slovenia	13,3	1,3	9,8
Croatia	13,1	1	7,6
Romania	7,8	1,3	16,7
Ukraine	4,9	0,2	4,1
Total	249	79,3	32,4

Source: Financial Times, 10 November 1999

Figure 7. Top five foreign banks in CEE

Top five foreign banks in CEE	
KBC	Belgium
Bank Austria Group	Austria
ING	Netherlands
HypoVereinsbank	Germany
UniCredito	Italy

Source: Financial Times, 10 November 1999

#### 5. International lending: Euroland banks dominate lending to CEE

International lending has become a very important factor determining growth and economic stability. Following the Asian crisis Western banks reduced their exposure vis-a-vis developing countries by some 10%, while following the Russian crisis they cut lending to Eastern Europe by 8.5%. Poland clearly stands out in these statistics as it boosted both long-term and short-term international borrowing, mostly interbank credit. The ratio of short-term credit to foreign exchange reserves together with the current account deficit are the two most carefully watched leading indicators of the financial crisis.

Figure 8. International bank lending, by destination and maturity

	Total (US\$bn)	Short-term (US\$)	Medium-term (US\$)	Long-term (US\$)
<b>Developing countries</b>				
end-1997	891,7	499,4	56	N/A
mid-1998	860,7	455,3	52,9	N/A
end-1998	842,7	422,2	50,1	N/A
mid-1999	809,6	401,6	49,6	N/A
<b>Eastern Europe</b>				
end-1997	123,3	53,5	43,4	N/A
mid-1998	134	59,1	44,1	N/A
end-1998	126,1	45,1	35,8	N/A
mid-1999	112,9	37,6	33,3	N/A
<b>Czech Republic</b>				
end-1997	10,9	5,5	50,3	55,9
mid-1998	11,3	6,3	56,1	57,6
end-1998	12,9	7,6	58,6	62,0
mid-1999	9,9	5,1	51,3	41,6
<b>Hungary</b>				
end-1997	11,4	3,9	34,2	43,4
mid-1998	14,8	5,6	37,8	62,2
end-1998	16,8	5,7	34,2	61,8
mid-1999	14,5	4,2	29,1	46,9
<b>Poland</b>				
end-1997	9,5	3,6	38	17,6
mid-1998	12,3	5,3	42,9	20,9
end-1998	15,3	6,1	40	22,3
mid-1999	17,2	7,1	41,1	27,4

Source: Bank for International Settlements, ING Barings

While the BIS does not report the currency breakdown of international lending, this can be derived to some extent from the loan origin breakdown. While in mid-1999 some 50% of all international lending to developing countries originated in Euroland banks, this ratio for Eastern Europe topped 75%. Therefore CEE countries have become very closely integrated with the Euroland not only in terms of trade links, but even closer in terms of financial links.

Figure 9. International bank lending by destination, share of Euroland banks

	Total (US\$bn)	of which Euro-land banks (%)	French banks (%)	German banks (%)
<b>Developing countries</b>				
end-1997	891,7	45,5	11,5	17,4
mid-1998	860,7	47,7	11,3	18
end-1998	842,7	49,3	10,9	19,3
mid-1999	809,6	50,4	11,6	19,9
<b>Eastern Europe</b>				
end-1997	123,3	68,5	8,5	40,6
mid-1998	134	69,3	8,3	39,2
end-1998	126,1	75,4	8,2	45
mid-1999	112,9	75,7	8,5	44,4

Source: Bank for International Settlements, ING Barings

## 6. Official aid in 2000–2002 denominated in Euro

One should not neglect the growing importance of EU pre-accession aid transfers. Preliminary estimates show that Poland would receive Euro2.5bn in 2000–2002 period. This could account for some 10% of the capital account surplus expected in this period (2000 budget draft assumes US\$10bn capital account surplus next year).

Figure 10. European Union pre-accession aid for Poland in 2000–2002

<b>Total</b>	<b>2,5</b>
Phare	0,9
ISPA	1,1
SAPARD	0,5

Source: Wstępny Narodowy Program Rozwoju, Ministerstwo Gospodarki

## 7. Convergence and speculations

The launch of the Euro reduced the number of currencies in which traders could speculate. This may lead to increased interest in converging currencies: PLN, HUF, CZK among others. In recent six months zloty derivative market (FRA, swaps) has rapidly developed. While the market for short-tenors (FRA) is still made in Poland (RISK magazine selected ING Barings Warsaw as the world biggest PLN FRA house), the swap market has been taken over by London. Such a situation can be potentially dangerous, e.g. in 1996–1997 CZK

swap market was made in London, and rapid selling out of London forced the Czech devaluation

#### 8. Euro very important to CEE banks' corporate clients

Banks are only as good as their client base. After Asian crisis the risk awareness became prevalent. Banks cut their lending exposure to emerging markets, imposed tight risk limits based on VaR methodology on proprietary activities. Therefore the importance of bank proprietary activity was reduced relative to margin-taking client-oriented activity. Therefore client business will continue to determine the overall business for banks. Corporate clients would rely more and more on Euro because of above-mentioned trade and financial links.

#### Conclusions

As shown above the emergence of Euro has already had some influence of commercial banks in CEE. With EU accession date drawing nearer this impact will strengthen even further. In two-three years even in countries like Poland, which was historically two-currency country – the zloty and the dollar – the Euro will become the major foreign currency, and most foreign exchange operations will be conducted in Euro. Portfolio investors would look at interest rate differentials between CEE countries and Euroland, commercial banks and corporates would consider Euro the major funding foreign currency, benefiting from relative exchange rate stability and lower interest rates.

**Michał Machlejd**

### **The influence of euro on the Central and Eastern European banking system**

The day 1<sup>st</sup> of January 1999 will be always remembered as the day of most important event happened in 20<sup>th</sup> century. That day the 11 of European Union countries – which stay a members of European Monetary Union – was a starting day of new common currency named Euro. Establishing of the single currency zone in Europe was forwarded by the long lasting preparations to ensure the monetary unification within the group of most developed and financially stable European countries. These countries have recognised the potential benefits coming from the implementation of common currency within associated quickest growing economic systems. Therefore these countries have definitely resigned from their national ambitions and the historical tradition, then they delegated their independent rights pursuance of monetary policy to the supranational institution – European Central Bank. This bank with a network containing the central banks of member countries makes the European System of Central Banks.

Thanks to the expected benefits coming from participation in an integrated European market, it is possible to expect that the broadening of EMU will be continued. This will regard both the present members of EU (which did not meet the criteria of convergence on time; or which decided to apply different speed of integration processes) and the countries already aspiring to the EU membership. Poland belongs to the group of the countries being qualified for the joining negotiations in the first line.

The perspective of Poland's qualification to join EU – considered as the optimistic aspect – goes to year 2003. But the formal Poland's participation in the group of countries – members of European Monetary Union is a more distant question, the date of this participation is estimated for year 2005. It comes from the fact, that the currency of the country aspiring to EMU for at least two years have to participate in European Monetary Mechanism (ERM 2). This mechanism is a restriction for the fluctuations of such currency, as well as it is a stimulation to establish more disciplined macroeconomic policy. After the mentioned period, the exchange rate should be fixed and the Euro currency should be implemented then. Taking into consideration the fact, that the process of integration of Poland with European structures is already advanced now, considering also that Polish economy is indirectly (through its foreign partners) included into European financial market – the utmost goal for Poland is to meet – as soon as possible – the political, economic, organisational and legal requirements of EMU. The adjustment efforts are focused especially on the Polish banking system.

The general and detailed legal requirements concerning the banking system of countries aspiring to EU are described in the Annex to White Book of European Commission. This document is a guide for associated Central and Eastern European countries, helping them to adjust their legal structures to the full membership in the common internal market.

The general requirements are related to establishing banks and their activity. The requirements are related to the basic conditions of secure activity of financial sector. They include e.g. the following questions:

- The minimum volume of banks' equity,
- The uniform rules of funds qualified to the bank's equity,
- Abiding by the bank's solvency ratio (minimum requirement: 8%),
- Establishing of guaranty system for deposits taken,
- The preparation and implementation of system preventing the "money laundry".

The detailed requirements are based on strengthening of banking precautions' rules. This concerns e.g. the following aspects:

- Licensing of the banking activity – the rules of issuance of banking licenses,
- Establishing the uniform accounting standards applied to the banks, as well as implementation of uniform rules of the supervision of the banks' activity including the financial results of the banks,
- The control of the bank shareholders' structure and non-banking activity of the bank,

- Limiting the risk related to the excessive level of loans concentration and the debt portfolio,
- The consolidated supervisory over the banks and banking groups (bank holdings).

A goal of fulfilment the requirements mentioned in White Book is a preparation of Polish banks to their better activity within integrated European environment. However, not all the EU regulations could be immediately and trouble-free harmonised with Polish law regulations. For example, the equity requirement is especially hard to achieve by Polish co-operative banks. The majority of these banks in Poland have lower equity than European regulations require.

All Polish banks have probably initiated the process of adjustment to the EU standards adapted to Polish law system. The Polish banks legally entitled to foreign currency transactions had to conduct technological and institutional efforts to prepare themselves to transactions in the new currency before year 1999. Implementation of legal regulations proposed by EU is longer lasting process. These regulations especially concern the following questions: the bank's solvency ratio, loan issues (incl. the banking precaution rules related to loan concentration limits), or the regulations on accounting rules (incl. the principles related to financial statements creation and the valuation of bank's assets nominated in domestic and foreign currencies). But establishing of the institutional and legal basis of activity within integrated European environment has no automatic impact on the improvement of Polish banks' competition, although it is a starting point to the more efficient activity.

Polish bank BGŻ S.A. (Bank Gospodarki Żywnościowej S.A., Bank for Food Economy) – being an active player in foreign trade area – started its adjustment efforts in the significant advance, to be well prepared to forthcoming Euro reality and expected liberalisation of equity and financial services transfers. The formal and legal preparations, enabling the settlements in Euro and offering the services based on Euro nominated banking products, have been finished before 1<sup>st</sup> January 1999. However, bank BGŻ S.A. started the preparations to create its long-term strategy, assuming a priori that free incorporation to the integrated European market will mean the appearance of huge range of risk related to technology, to the program, as well as the transformation and commercial risks. Within the bank's strategy there were the areas of activity selected; these areas need the successive and integrated adjustments.

To meet the requirements imposed by time and to withstand the competition, BGŻ has assumed that the best efficient solution will be establishing the strong banking group, based on integrated equity. The fundamentals of such banking

group will be market-active co-operative banks and other groups of investors. Among the goals of bank BGŻ is to be a co-ordinator of domestic co-operative banking sector. The experience of large commercial bank will simultaneously assist the co-ordination of co-operative banking sector.

Bank BGŻ S.A. is a bank specialised in financial services offered to food and agriculture industry as well as the countryside areas. But without any existing contradictions, this bank is also a universal commercial bank active in other types of banking activity as well as in non-banking sectors of economy (e.g. on the retail market). The mission of bank BGŻ S.A. is to keep a leadership in services offered to Polish food and agriculture industries. Considering the fact, that Polish agriculture industry is still touched by structural troubles, it is necessary to point out that such mission is hard to execute.

The process of integration Poland with EU makes new conditions of development of Polish food and agriculture complex. The agricultural sector may receive some benefits coming from joining the EU structures, but on condition that the significant funds (investments) will be aimed on modernisation and structural changes of this sector. There is an opinion of Polish Ministry of Agriculture, that the adjustment of Polish agriculture to the EU requirements will cost approximately 25 to 26 billions Polish Zlotys. We could expect that more or less 5 to 5.5 billions will be financed by State Treasury (budgetary funds), and ca. 10% of expenses will be financed by EU funds (PHARE, SAPARD). The remaining ca. 18 billions Zlotys should be received from the agricultural sector (farmers and food processing industry). Assuming that:

- (1) Total number of Polish farms amounts approx. 2 millions, and
- (2) Approximately 700-800 thousands of them are producing goods for market sale,

It means that the average expenses to cover the adjustment costs in three years period should be 7.500 Zlotys per each year per one (market oriented) farm.

According to the assurances of Polish Government, the government will determine the instruments supporting the development of Polish agricultural sector. The efficient mechanisms of distribution of the funds coming from EU will be also created. The interested investors can expect e.g. the loans issued on the favourable terms and conditions, as well as some financial graces. In a short time there is a modification of customs tariff (the increase of customs rates for some agricultural commodities).

The very important aspect is also the attitude towards Poland's membership in EU as the opportunity to receive benefits, without focusing on the dangers only. This of course does not exclude the necessity of risk area identification.

The results of recent research show, that in food and agricultural sector, the feelings concerning an incorporation of Poland to the EU structures are presently more disturbing than hopeful. And it concerns all market participants, from farmers to the consumers. Due to the underinvestment of Polish agriculture and related to this fact needs for external financial support, European farmers are afraid that their incomes will decrease due to reduction of EU funds destined for EU agriculture. On the other hand, the same farmers are forecasting that opening of EU markets for agricultural commodities from Poland will make the competition stronger, because on EU market will be available cheaper food, having another features (e.g. new taste). The new member incorporated to EU – a country with obsolete agricultural structure – for European consumers will be treated as the necessary increase of costs related to common agricultural policy.

The fears of integration with EU are also present on the Polish side. Polish consumers are afraid that due to inflow of higher quality commodities from EU will generate a growth of consumer prices. On the other hand, Polish farmers think, that the commodities imported from EU will replace production of domestic agriculture sector.

Considering such opinions, the change of Polish farmers' attitude regarding incorporation of Poland to EU is absolutely necessary. It is necessary to make the farmers aware of the benefits resulting from membership. These benefits mean the additional funds for development and modification of infrastructure of agricultural sector, increased inflow of foreign capital, and new markets.

On the other hand, it is good to point out that agricultural sector should feel the necessity of integration with banks or other supporting institutions. It will be a factor determining the future position as well as it will determine economic capacity of Polish agriculture concerning its competitive ability.

Considering the state interest as viewpoint, it is possible to allege that following the patterns of EMU Member States, the existence of co-operative banking institutions is justified. Thanks to such institutions, it is possible to implement e.g. different credit lines related to restructuring of agriculture, or execution of other supplementary programs inspired by Government.

Bank BGŻ S.A. is ready to execute skilfully made transfers of EU accession and pre-accession funds to the agricultural sector, as well as is ready to take a part in restructuring processes related to this sector. Bank BGŻ – not considering the passive attitude, is actively striving for its stake in channelling the EU supporting funds.

**Władysław Jaworski**

## **Polish commercial banks on the eve of entering the European Union**

I. The following problem that is being considered at the moment is based on the fact that the Polish banks are presently not generally owned by Polish (domestic) shareholders (unlike in almost all the EU countries) – there is a question: having no banks based on domestic capital, will Poland be therefore in good or rather worse conditions inside EU structures? Probably the remaining Polish banks based on domestic shareholders' structure presently have not satisfying conditions. This study is made to justify the arguments, that the possible decision not to maintain banks based on domestic shareholders' structure and capital would make Poland totally dependent on the EU companies of advanced technology, competitive and having adequate infrastructure.

II. There was a serious progress in banking sector profile, but in the same time they have got both considerably lower potential (capital) and management skills (costs) in comparison with foreign banks. This could be shown using data regarding several fields of economy. Polish banking industry is characterised by very modest share in money operations (transactions) executed in favour of companies. This situation is tightly connected with low monetization of Polish economy, calculated on the basis of money supply in GDP. In 1998, this share was 40%, while in Germany this share exceeded 200%.

There are many market sectors (market niches) in which banks are not present at all. According to the market research made by Polish agency Pentor, only 46% of Polish people used banking services in 1996. There is a visible

increase therein (in 1996: 6 percentage points), but still the ratio is low in comparison with the Western countries. These figures show that 13,5 millions of Polish people are not banks' customers at all.

Polish banks capital is rather small in comparison with the leading world banks. According to the ranking of a monthly "Bank" (1998) among Top-1000 banks of the world there were 7 Polish banks included into this ranking. The first of them was Bank PKO S.A. with the capital of USD 989 millions (ranked as 322), next the Bank Handlowy S.A. with the capital of USD 384 millions (ranked as 392)\*.

In 1997 in the commercial banking in Poland 150 thousands people were employed and the banking network encompassed 1,650 branches. The average number of customers in Poland is 455 thousands of inhabitants per one commercial bank, while in Italy the same ratio amounts 220 thousands, and in Denmark\*\* this amounts 90 thousands people per one bank. This comparison shows that the thesis that consolidation will lead to establishing no more than 10 banks in Poland is erroneous. The consolidations of 8 Polish commercial banks (without acquisitions of liquidated banks) not resulted in significant increase of consolidated banks share on financial market, as well as in profit increase.

Low labour efficiency (productivity) is a characteristic feature of Polish banking system. The Cost/Income ratio in Poland amounts 0,84, in comparison with 0,69 average ratio for EU countries. In Poland, cost of labour related to the assets is also on the unfavourable level – this ratio in Poland amounts 1,29%. This is considerably more than in most EU countries – in France 0,78%, and in Germany 0,80%.

III. Strengthening of Polish banking system first of all requires further privatisation of state-owned banks. The privatisation will favour increase of the capitalisation of these banks as well as this will be conducive to implement more efficient management. Consolidation of banks will create banking system able to compete with foreign banks.

The goals of banking privatisation in Poland are following\*\*\*:

- Capital reinforcement and easy access to capital resources,
- Identification of banks' owner (preferably Western commercial bank) responsible for bank activity concerning the capital,
- Independence of bank's strategy on current needs,
- Increase the efficiency of bank's activity,

\* Source: "Bank", 1999 no. 9, page 81 (written by G. Wójtowicz).

\*\* Source: Material from 5<sup>th</sup> Banking Forum 1999 (paper presented by W. Baka).

\*\*\* The basic trends of privatisation in 1992, the Act of Polish Parliament, dated 5<sup>th</sup> June 1992.

- Increase of budget receipts generated by privatisation processes,
- Majority share in Polish banks capital should be represented by Polish shareholders – State Treasury, employees, public offer (tenders) of shares purchase.

Privatisation of Polish banks has been achieved through the following ways:

- The banking licences issued for just established banks based on private capital (private shareholders),
- Public offer (tenders) organised for investors interested in buying blocks of shares issued by banks based on 'mixed' capital,
- Banking licenses issued for foreign banks,
- Sale of big state-owned banks shares.

This program has been partially executed in the period of 1992–1994. The 9 banks organized by way of separation from the central bank – National Bank of Poland (NBP) – have been transformed into State-wholly-owned joint stock companies. The following banks were privatised: Wielkopolski Bank Kredytowy (WBK S.A.) located in Poznań, Bank Śląski located in Katowice (BŚK S.A.), Powszechny Bank Kredytowy (PBK S.A.) in Warsaw and Bank Przemysłowo-Handlowy located in Cracow. As the next step of privatisation of Polish banks, the sale of majority shares portfolios of State-owned banks to the foreign investors was provided.

But speeding up the privatisation processes cannot be justified by conditions related to Poland's entrance to EU. In the beginning of the 90's in the majority of EU countries, the state-owned banks share amounted from 40% to 80% of the whole banking sector. Nowadays, for example in Germany, private banks share in total assets of banking sector amounts only 37% (1997). However, the share of banks acting as public companies amounts 47%, and co-operative banks – 16%. The accelerated privatisation, generally resulting in undervaluation of assets and liabilities of the bank, can be justified only by willingness to keep low budgetary deficit as well as to remove inconvenient management staff from the banks. Privatisation should not be treated as a source of banking capital. According to foreign investors' assessments, the received benefits (profits and impact on economy) do not require any additional investments to these banks. For example: two Polish banks – Bank Śląski and Wielkopolski Bank Kredytowy, which are not outstanding banks among other banks, despite their acquisition by foreign capital 5 years ago.

The consolidation of the banks means their capital and organisational merger. The general trend of banking consolidation results from the benefits received from extended range of financial services. Polish followers of consolidation processes considered establishing the large banking organisations, able



to compete with foreign banks. The proponents of consolidation argued that keeping the dominant importance of Polish banking system is a necessary condition to independent economic policy of Poland, so that it should be treated as Polish *raison d'état*. Consolidation of banking sector could not be executed by the natural expansion of domestic banks, but only as the result of decision taken by the owner (State Treasury), if the owner wants to increase banks' activity range and protect them from the foreign competitors.

The Act of Polish Parliament (dated 14<sup>th</sup> June 1996) concerning the merger and consolidations of some banks to establish joint stock companies, was just an attempt to implement procedures applicable to establishing the joint stock companies, banking mergers and increasing banks' joint stock capital. The mentioned regulations are applicable to the banks acting as joint stock companies, wholly-owned by State Treasury.

According to the mentioned Act the Pekao SA banking group was established, including following banks: Bank Depozytowo-Kredytowy located in Lublin, Powszechny Bank Gospodarczy located in Łódź and Pomorski Bank Kredytowy located in Szczecin.

IV. Transformation of Polish banking system takes essentially into consideration the directives of European Union as well as the practice of foreign banks (Polish Banking Law Act, 1997, and Act on National Bank of Poland, 1997). However, some solutions can be subject to the following reservations about the matter.

a) The legal solutions concerning location of the general banking supervision are different in the EU countries. The Article 105 of the Maastricht Treaty is unambiguously stating that "European System of Central Banks" is "only (-) conducive to run the efficient policy of its own authorities, to exercise the precautions supervisory over the banking institutions". The regulations of mentioned Treaty locate the banking supervisory outside the central banks. The problem of banking supervisory location should be also considered regarding the necessity of changing the character of banking supervisory activity. The isolation of the Banking Supervisory allows NBP to be a real "bank of the banks" and to have impact on the activity of the banks by the economic instruments instead of the administrative ones.

b) The Act enables only banks to execute banking operations. This restriction eliminates any action of banking supervisory if the banking activity is taken by non-banking institutions (without "bank" status). These regulations contradict the tendencies present in the EU countries to eliminate the barriers appearing in several segments of financial market. European Union provides

for existing of loan institutions, investment institutions and companies, co-operative savings banks, mortgage banks, instalments sale financing institutions.

So called "deregulative" action taken inside the EU structures is going to enable different groups of business institutions to execute banking operations with the consent of banking supervisory authorities.

c) Other crucial problem is unalterable obligation of the banks to establish funds destined to support the banking system (special reserves). In the EU countries the activity against bankruptcy of banks important for the economy is a huge charge of State treasury (budget) as well as of central bank. But this obligation is not a charge for commercial banks. It is still open question to establish the separate loan institution instead of Polish banking support institution BFG (Bankowy Fundusz Gwarancyjny); this would be a similar solution like for example in German banking system.

d) Neither the Article No. 25 of Polish Banking Law Act (concerning the change of shareholders' share), nor the Article No. 30 of this Act (the conditions of banking licence issuance) includes the condition that the decision of Banking Supervisory Commission (Komisja Nadzoru Bankowego) should be taken in accordance with the interest of national economy. Although this solution is consistent with the EU Directives, this outstandingly liberal solution practically is not used in EU countries. As the good example could be considered recent action of Portugal authorities, which thanks to the existing adequate banking regulations did not allow the acquisition the Portugal banking group Mundial Confanco by Spanish bank Banco Santander Central Hispano. However, the Portugal authorities allowed the hostile take-over of this group by Portugal bank named Banco Comercial Portugues. Polish law regulations make the refusal decision of banking supervisory (Komisja Nadzoru Bankowego) to purchase Polish banks (or its shares holding blocks) by foreign banks difficult.

V. Within several years Polish banking system has not only been transformed, but also it has been significantly adjusted to the new conditions of market economy. However, it does not mean that Polish banking system reached the parameters similar to the foreign banks, especially concerning the capital and cost level. Nevertheless during next years (assuming the favourable conditions for Polish economy), Polish banking system could introduce solutions similar to requirements of "Western" banks, and typical therein. Meanwhile – in order to subordinate Poland to the foreign capital – a liquidation of the Polish banking system has been started, although in the EU countries banks are generally owned by the domestic capital (80–95%). The action aimed at the liquidation of Polish banking system was executed in two ways. On the one hand – The

Finance Ministry, National Bank of Poland and the Banking Supervisory Commission were going to de-capitalisation (depreciation) of the Polish banks, on the other hand – Ministry of State Treasury is selling Polish banks exclusively for the foreign investors, at low prices.

Despite of meagre chances to maintain the banks based on Polish capital on the domestic market, nobody should give up the opportunity to criticise the monetary policy, financial policy as well as the banking supervisory (as it was above mentioned), and to express criticism of the Banking Guarantee Fund (BFG). For many years National Bank of Poland (NBP) not only has not reduced the extremely high rates of obligatory reserves for banks, but also has additionally reduced the share of cash coverage of these reserves from 50% to 10%. NBP made also some difficulties in application of these funds to cover short-term liquidity gaps, the rules of calculation of these reserves have also been tighten by Polish central bank. Replacing the reserve with treasury bonds with low interest rate is just only a partial compensation for their reduced incomes. Such solution undercuts position of the existing banks vis-à-vis the newly established ones.

In case of high inflation rate, the real interest rate should not only offer the good conditions for application of suitable deposits interest rate, but also should be a source of initial capital supplement to protect this capital against its depreciation (de-capitalisation). The fiscal policy of Government should consider the above questions and should allow, at least partially, inclusion the ownership capital supplements into costs' volume. But meanwhile, such solution is presently included neither into current fiscal government policy, nor into the methods of dividend calculation nor the methods of calculation of banks' obligatory reserve as well.

In the EU countries – contrary to Polish banking system – each justified reserve made by commercial banks is considered as the cost unit of the bank activity and has got no impact on the earnings of the bank (it does not charge financial results – profits of the bank). In Poland the majority of reserves charge the banks' profits after taxes.

For Polish banks especially severe are new solutions regarding the purposeful reserves<sup>\*</sup>. This include the following:

- Establishing the reserves for State Treasury outstandings, based on the payment maturity criterion. The alternative moderating solution is to enter the agreement with the representative of State Treasury to reschedule the term of establishing these reserves,

<sup>\*</sup> The Regulation No. 13/1998 dated 22nd December 1998 of Banking Supervisory Commission regarding establishing of obligatory reserves related to banking activity risk. Source: Dziennik Urzędowy NBP Issue no. 29 of 1998, item no. 61.

- Establishing the reserves for consumer loans nominally as 0,5% of its amount before 31 December 1999 r., as 1,5% of its amount before 30<sup>th</sup> March 2000 and 2% of its amount after 1<sup>st</sup> July 2000.

In the same time the reserves for the bad loans are established like for the remaining loans from 20% to 100% – depending on the delay in loan repayment.

It is highest time to take notice to the problem connected with Polish co-operative savings and loan institutions (in Poland they are called: Spółdzielcze Kasy Oszczędnościowo-Kredytowe, Polish abbr.: SKOK). These institutions have been established on the basis of the Act dated 14<sup>th</sup> December, 1995<sup>\*</sup>. In 1998 there were already 290 such institutions operating in Poland, their total assets amounted 553 millions PLN. Expected in next years quick development of such institutions would bring them the market position almost equal to Polish co-operative banks. Regarding this matter presently arise the following questions:

- Is it right to tolerate the privileged competition between these "parabanks (quasi-banks)" and remaining banks, especially co-operative banks?
- Does so huge real economic difference appear between the activity of co-operative banks and SKOK institutions, that the SKOKs are not a subject of banking supervisory as well as they are not obliged to transfer funds regarding the obligatory reserves, and there are no capital requirements related to these institutions?

In many countries (i.g. in Germany) there are no differences regarding the treatment of the agricultural and employee co-operatives; the co-operative's head office – Genossenschaftsbank – unites both of them.

VI. Within the period 1995–1998, the government's policy has changed significantly. In the first project of "Strategy of Polish banking system strengthening" (September 1995) there were following conclusions:

"The Government's intention is to introduce such legal regulations that allow creation of the banks' activity conditions to operate in competitive market conditions towards foreign banks. The action taken by the Government and Polish central bank will focus on:

- maintaining the proper policy of banking license issuance,
- supporting the processes of banks' consolidation as well as drawing up such legal regulations concerning the relationship between banks and other financial institutions, which finally allow banks to develop their activity more efficient.

<sup>\*</sup> Source: Dziennik Ustaw 1996, No. 1, item no. 2.

Considering the mentioned proposals, and due to strategic role of banking system for the economy, we can state that it seems to be necessary to consider such rules of Government and central bank policies, which will be conducive to keep the foreign capital share in banking system on the level similar to the banking systems of many other countries (i.e. Spain or Canada)".

In 1996 (the Strategy – October 1996) it is already visible the departure from conclusions issued one year ago:

"The privatisation rules regarding commercial banks so far realised, based on the offering the general sale of all bank's capital by the public offer sale (assuming that target share of foreign investors' in the bank capital could not exceed 30% of the capital during the privatisation processes), was ineffective because of two reasons. The first reason was no interest coming from investors to buy banks' shares on the Warsaw Stock Exchange (GPW), the second one was the lack of strategic investors' interest regarding purchase of minority blocks of shares of Polish banks being subject to privatisation".

The "Program of privatisation banks with the State Treasury share in capital – before year 2000" contained the resignation from the dominant importance of Polish banks:

"Recently the interest of foreign investors (which could be a strategic investor in the banks) to buy shares of Polish banks was noticeable. But in the initial negotiations they only declare to buy the majority blocks of shares (more than 50% overall shares volume), because such kind of capital purchase will enable the investors to have the controlling interest in the privatised bank. Considering the above mentioned it appears that the Government should allow the possibility of sale the majority blocks of shares of the banks PBK and BZ – even up to 75% – to the foreign strategic investors. The State Treasury target share in the privatised banks should amount at least 5% of shares in these banks".

The presently conducted strategy of Polish banking system development is based on following premises:

- domestic banking sector should strengthen its market position based on its own efficiency,
- all state-owned banks will be privatised – except bank BGK (abbr. Polish name: Bank Gospodarstwa Krajowego SA), which is destined to act as an agent of the Government,

\* An interview A. Kornasiewicz: "Not only seller", in: monthly "Bank" 1998, No. 6, pages 6,7.

- Price and the guarantees-obligations related to the development of the bank will be only considered at banking privatisation, neither the macroeconomic nor the political criteria will be considered,
- globalisation of the financial markets justifies the resignation from Polish banking system,
- the strategic investor is necessary (foreign investors are preferred) to make the privatisation processes correctly conducted,
- The term like "national affairs" in the European Union does not exist and it is impossible to protect it within the EU structures and legislation.

VII. It is necessary to disprove the myths recently determining the strategy of Polish banking system development.

First, the progress made by Polish banks regarding banking technology is impressive. Within the five years period Polish banks made up for a few dozen years of 'Western' banks development. Within the next five years Polish banks have got a chance to compensate the differences in this matter.

Secondly, there is no significant development and progress regarding banking technology, no additional capitalisation (bank's capital improvement), no progress in automation etc. inside the banks took over by foreign investors (WBK and Bank Śląski).

Next, the takeover of Polish banks by the foreign investors means not only the change in the shareholders structure of the bank and the capital owner changes, but also it means the changes in the strategy of these banks. Such bank – acquired by the parent company – starts its activity in the interest of the parent company.

Next question is that the dependence of the subsidiary banks on their parent banks is the same as the dependence of foreign bank branches on their foreign head offices.

Last but not least, the necessity of banks' privatisation has not to arise within next two years (state-owned banks are present in all the EU countries).

Generally, it could be stated that the offer to sale of Polish banks to the foreign investors neither comes from the economic necessity nor this would not bring the special benefits to the Polish economy. The obvious benefit for economy is the budget revenue only. It is worth to state that the public opinion in Poland (source: by daily newspaper "Rzeczpospolita" dated 8<sup>th</sup> June 1998) generally (in 54%) is opting for the conclusion that Polish banks should be based on Polish capital and should be owned by Polish capital. The 76% of

\* "Foreign banks execute the transactions on financial market on their own responsibility, but in co-operation with their parent banks as well as according to their hints". Source: H. Buschgen, "Banking enterprise", Poltext 1997, vol. 2., page 39.

respondents also consider that the presence of big Polish universal banks on domestic market is necessary. Despite the above mentioned figures, the foreign investments share in joint stock capital of Polish banks in 1999 increased up to 60%, and the forecast for 2000 year is considered as 70% share. The argumentation related to the positive role of foreign investments, as the significant participant in the privatisation processes in Poland is considered as questionable. The following advantages are stressed: the owner's supervision over the bank, higher capitalisation of the bank, improved knowledge, as well as the higher current budget receipts.

Especially the conclusion that the strategic investor is necessary for the bank – in the opinion of Ministry of State Treasury this could be the foreign investor only – is questionable. In Western banks neither the term 'strategic investor' nor such institution presently exist. The banking management is disciplined by the market price of bank shares on the stock exchange, the salaries (over 50%) of management are dependent on the financial results of the bank in the given fiscal year and the next years (options).

The research made in Western economies confirmed the conclusion that in the environment of increased market re-orientation of banking strategy, both the increased banks shares value for shareholders and the increasing impact of shares market on the banks' efficiency and results assessment were more and more considered\*.

There is common opinion pointed out both in the professional literature as well as in the banking practice, that it is necessary to aim at the diversification of shareholders' structure to disable the individual shareholders to subordinate banking activity in their interest. Increasing of the bank capital assets is not treated as the fundamental goal. The growth of profitability of the bank is more important. Moreover, the following opinion has arisen: the capital increasing is necessary for these banks, which would like to be "global players" on the financial markets. However, the regional banks based on several niches of the market or providing special services, are not so dependent on capital (assuming that these banks are profitable) like large banks are. The benefits received from the banking mergers are not so much certain as they were generally assumed. That is not true that there is 'automatic' correlation between increase of efficiency and the size of the bank\*\*.

\* Source: E.P.M. Gardener, "Impact of uniform financial market on strategy and policy of European banks" in: "European integration and strategy of commercial banks", Katowice 1998, page 44.

\*\* Source: P. Molyneux, "Impact of uniform market on banks consolidation processes and the development of cross-border financial services" in: "European integration (...)", Katowice 1998, page 59.

In the world banking there is recently stressed the superiority of the banks' profitability over the increase of banks' size (so called "increase for itself" like "art for art's sake") – what before the EU banking regulations appeared as a priority\*.

In this situation the conclusion about necessity to significant reduction the number of Polish banks seems not to be correct. Further needs will appear for specialised financial institutions dealing on the domestic market, and making this market flexible enough and making it close enough according to the customer needs\*\*.

The level of current banking knowledge in the Polish banks is already relatively high; therefore further progress depends on the promptness of knowledge implementation, rather than supplementing of this knowledge. It is important to remember that revolutionary progress related to the IT sciences and telecommunications contributes to the obsolescence of knowledge in Western banks.

Let us consider the last argument for the presence of foreign investors in Polish banks: it is necessary to sell banks as soon as possible because of the budget requirements to cover its expenses. 'As soon as possible' means that there would be a foreign investor able to finance such transaction. The liquidation of the Polish banking system means the resignation from the independence of Polish economic policy:

- First of all, the banking activity will be conducted in accordance to the foreign shareholders needs, which means that only the undertakings which are not contradictory to the shareholders needs and not competitive to their interest will be financed.
- In case of crisis circumstances, foreign banks can transfer their assets abroad what could result in dispossession of funds in Polish economy,
- Some financial instruments of Polish central bank (NBP) used on domestic financial market would be inefficient, because the liquidity of such instruments will depend on the parent banks.

If the significant financial, investment and loan decisions are taken in foreign decision centres – such situation would have been dangerous for the state economic independence as well as for the economic stability of Poland.

Domestic banks could be treated as a kind of dam stopping the capital outflows from Poland in case of downgrading the Poland's rating for emissions, or in case of any disturbances in the world banking system. Foreign capital

\* E.P.M. Gardener, *Integracja Europejska...*, Katowice 1998 s. 44.

\*\* Source: J. Krawczyk, "Merger-mania that is an abundance for consolidations", in: daily newspaper "Rzeczpospolita" dated 15<sup>th</sup> June 1998.

located in Poland can be transferred abroad within 24 hours. After that on the domestic market only the banks based on Polish equities\* will remain.

Such opinion was presented by Mr. M. Stańczuk (Vice-president of Westdeutsche Landesbank, Poland)\*\*: "I do not know such case where – for example – local savings banks would be owned by the foreign capital having majority share in their capital. In my opinion, maintaining the national character of banking sector would be important for example in the period of possible economic slump of prosperity regarding this part of Europe we are located. Economic crisis in one country may cause a nervous chain reaction in treatment of other countries in the same region. I am considering – for example – the possible reduction of limits related to refinancing of foreign holdings subsidiaries located in Poland, or the impact of the global position of parent companies for the loan policy of Polish subsidiaries (bad loans and high volume of reserves in south-east Asia could impact on the tightening of loan criteria on other emerging markets – where the impact of Asian events is not significant and limited – in Eastern Europe as well). Limited liquidity of domestic money market as well as relatively low general propensity for savings in Poland, the critical situations in other world regions – not having indirect influence to the economic conditions in Poland – can contribute to deterioration of the liquidity of financial institutions related to foreign financial groups as well as to limit their natural expansion".

The takeover of Polish banks by foreign investors may result in the disturbing consequences as follows:

- Small investors have confidence to the domestic state-owned banks. Takeover of these banks by foreign investors may cause the reduction of savings propensity among small investors,
- Lack of the country-wide domestic bank based on Polish capital, which would execute the foreign exchange of Polish currency to Euro without any additional charges – will generate additional profits for foreign banks able to execute such transactions,
- Lack of country-wide Polish bank will cause the lack of institutions financing the restructuring of regions and industries at the level of costs lower than market level (access to network, general confidence in State),
- Lack of country-wide bank will cause difficulties with operations between banks and the State Treasury, as well as this will increase the costs of such transactions.

\* Source: J.K. Solarz, "The scenario of additional capitalisation of domestic banks" in monthly "Bank i Kredyt" 1998 No. 5, page 26.

\*\* Daily newspaper "Rzeczpospolita" dated 13<sup>th</sup> July 1998.

Additional consequence of Polish economy acquisition by foreign investors (especially banks, 70% of Polish respondents voted for maintenance of the banks based on Polish capital) is dislike of Polish people for Poland's entrance into EU structures (recent research show 47% acceptance for Poland's joining EU).

The accelerated privatisation based on foreign investments causes identification of Poland's access to the EU with liquidation of companies and banks based on Polish capital, or – it is associated with transformation of Poland into selling market for commodities from EU, this could be also associated with unemployment resulting from replacing the domestic production with foreign (there is approx. 6 billions PLN deficit in the Poland-EU countries foreign trade).

Privatisation processes are in accordance with Polish economy interest, but it does not mean that it is the condition for joining the European Union. Privatisation in the EU countries is the goal aimed in accordance with the rules of national economic affairs. As the good example could be the privatisation of Austrian bank Creditanstalt; before 1995 it was a state-owned bank (51% State Treasury share). The process of privatisation was so long, that other Austrian bank – Bank Austria acquired Creditanstalt by eliminating foreign competitors.

Ministry of State Treasury – speeding up banks privatisation maximally – is going to sell out state-owned banks at low prices (despite their profitability), not considering current market conditions, the experienced and skilled staff, etc. We should assume that it concerns not much the budget revenues only, but rather it is intended to bring into effect the willingness of foreign financial and political centres to establish neo-colonial economic subordination of Poland.

VIII. Current position taken by Polish Government – justifying the acquisition of Polish banks by foreign banks – has been mentioned in the document presented to the Parliament (September 1999)\*.

The conclusions mentioned in this document show that its Authors stick to the thesis not fully based on the European banking practise and therefore they raise serious doubts:

1/ Slowing down the privatisation processes does not mean the "come-back to the 'manual' and state-centralised directive methods of economic management". If the Authors themselves were familiar with the development of banking system in the EU countries, it would turn out that the privatisation process lasted there for many years and it is not finished yet. In these countries

\* The official position of Polish Government concerning the project of Parliament's Act regarding directions of further privatisation of Polish Banking Sector (printed matter no. 1106).

conducting of the privatisation processes treated as general trend of economy does not mean the hurriedly action. Promptness of privatisation is subordinated to the interest of the national economy and it may be long lasting process (a few dozen years).

2/ The argument regarding the increase of competitive power of Polish banks in comparison with foreign banks is incomprehensible. The take-over of Polish banks by foreign investors will eliminate such competition. There is a following question: do the subsidiary banks compete with parent banks? Polish banks are being included into the international banking competition conducted by parent banks which has nothing in common with the efficiency of subsidiary banks operating in Poland. The subsidiary bank will lose its economic identity; therefore conclusion that these banks become stronger "Polish banks" would be treated as pointless. The standing of such banks will depend on standing of the parent banks.

3/ The argument that the supervision over foreign banks will be performed by institutions provided by Act on Banking Law and Act on Central Bank (NBP) is total misunderstanding because:

a) National Bank of Poland and Monetary Policy Council will not be able to conduct its independent monetary policy because the foreign banks liquidity will depend on parent banks. This will lead to situation in which the foreign banks will dictate money policy of Poland.

b) Banking Supervisory Commission (KNB) according to the current legal regulations (here is no criterion: the affairs of national economy) is practically giving its assent to and accept all the requests of foreign banks automatically. The inspection of financially menaced banks by KNB has got no sense because the security of these banks depends on parent banks.

4/ Authors of mentioned positions do not understand that banks are not the same kind of institutions like productive companies, service providers or trading enterprises. Bank is an administrator of savings in the given country, so that it is the country's interest not only to keep the bank profitable, but also to keep the right usage of these savings to bring the benefits to the country or even to the region. Such practise takes place in the EU countries; therefore these countries do not allow the access of foreign capital to their domestic banking system.

5/ In the Authors' opinion, the liquidation of Polish banking system meets the "integration with EU structures". Unlimited transfer of capital did not lead to serious ownership changes in the EU countries. Interpreting this trend as the EU requirement shows ignorance of the EU banking practise.

6/ Every banker knows that the decision process taken inside banks depends on shareholders' structure. Therefore the argument that the share in bank's assets determines the economic role of foreign capital – should be treated as absolute misunderstanding.

7/ In the Government's opinion, there is no danger related to the transfer of certain part of economic independence in favour of foreign investors, because this will mean the legal regulations violation. Well, there are no existing regulations made to protect the "national economic interest". Neither central bank (NBP) nor the Banking Supervisory Commission (KBN) can influence directions of foreign banks' activity. They could be interested in security of these banks, but parent banks guarantee the security of these banks.

8/ The consolidation process of the banks in the EU countries is being continued, but in most cases inside one selected country, just in order to withstand competition of other EU countries. Therefore, the strategy of Polish Government contradicts the strategies of Western countries.

9/ The argument that "foreign banks will not transfer Polish savings abroad" shows total misunderstanding of world banking practice. In case of any economic troubles related to the Polish economy, all the more the financial crisis, nothing can stop foreign banks to execute transfers of Polish savings deposits to the world regions, in which the funds can bring higher profit under much better financial security.

10/ The presented opinion based on consideration that acquisition process of Polish banks by the foreign investors "will not be different from European standards" is simply false and shows the ignorance of the Authors.

11/ The opinion that foreign banks will be interested in financing of large projects related to the infrastructure, is just an illusion. These investments are not profitable. The banks consider such investments only having highly amounted and expensive guarantees issued for these projects.

12/ According to the Authors' opinion, acquisition of Polish banks by foreign investors will reduce the dependence on foreign financing resources as well as to make Polish economy immune to the troubles on the world financial market. In reality financing the Polish economy by foreign banks makes it more dependent on foreign financing. The close relationship between subsidiary banks and their parent banks increase the dependence on the world markets situation.

IX. The action taken by Polish authorities combining privatisation processes with total sale out of shares being in possession of these authorities is absolutely incomprehensible. The only chance to keep the remainders of Polish capital engaged in Polish banks is presently maintaining the 51% of shares of two

banks being privatised – state savings bank (PKO BP) and BGŻ (Bank Gospodarki Żywnościowej, Bank for Food Economy) at disposal of State Treasury. The transfer of the whole joint stock capital of these banks to the private shareholders (even if they are Polish ones) does not guarantee that the shares will be subject of further sale to foreign banks (due to current legal regulations and considering that Banking Supervisory Commission cannot have objections regarding such transaction – the re-sale of shares is possible).

The globalisation in the banking system concerns first of all the banks having world-wide range. The recent consolidation of the banks which takes place in many countries is subject to very critical assessments. The recent research shows that only 25% of consolidations have been successfully finished. There is generally dominant opinion that banking system should be differentiated, its components should meet the requirements related to national economy's needs. The region and province are an important component of national economy. The region has got its abilities and its needs, to which should be customised the adequate banking system.

The inclination represented by significant part of customer base to prefer rather smaller banking institutions (eventually associated to the banking groups) is an important argument to create the banking institution with the relationship with given region. Such customers dread to lose their identity, they are 'local patriots' attached to their region. For such type of customers should exist the banks which can establish direct relationship with customers by creating an image of peculiar intimacy.

The liquidation of Polish banks can lead to unfavourable situation that some areas of economic activity (or geographic regions) will have no access to banking loans. The shareholders of the foreign capital based banks will invest in such fields as well as in such countries, which will ensure both profits and financial security at the higher level than Poland is able to sustain.

In such conditions it is very important to remember, that the funds collected in the given region should be applicable in each region. These funds could be backed by the co-operative institutions, the municipal savings banks as well as by the small commercial banks.

The above mentioned principle requires strengthening of the mentioned loan institutions (credit providers), their activity should also be a subject of interest of regional authorities. Savings remaining in the given region should first of all be engaged into coverage of the regional loan needs and financing local projects. This conclusion concerns i.e. the local government funds (commune, Polish administrative units named 'powiat', or province). These funds should

be collected on accounts maintained in the books of regional financial institutions.

The establishment of the municipal governments at the province and 'powiat' level is just a revolutionary solution regarding the government funds administration. Decentralised funds temporarily placed on banking accounts can be a source of loans financing in the given region. Reciprocally offered financial services (deposits taken against loan offered) are very popular and established type of banking activity.

Financing the municipal governments and services related to the issue of their bonds in EU countries are offered and executed by local institutions, which in the same time are collecting the savings. Tight relationship existing between the deposit and credit activity, determines that in many cases the local governments are wholly-owners or joint-owner of these banks. This is a characteristic feature of the so called municipal banks.

In Poland there is presently a necessity to create specialised institutions involved into services offered to communes, 'powiat' units, as well as the provinces to meet their financial needs. This would be realised by establishing the municipal banks or by the services offered by other institutions such as co-operative banks, decentralised savings banks or small commercial banks. The authorities have got an opportunity to decide which way is the best solution.

**Grzegorz Wójtowicz**

## **The monetary policy of European Union in the globalisation era, and its influence on Central- and Eastern European countries**

### **1. Introductory remarks**

The monetary history of Europe is marked by many interesting facts. From the half of XIX th century the currency unions were established on the basis of one currency or on the currencies based on the fixed exchange rates. The world crisis (1929–1933) and the breakdown of the gold standard led to the establishment of currency zones with the dominant role of European currencies. All the countries, which currently are the members of the European Union, have been engaged in these international monetary programs. For 30 years it was gradually implemented the concept of the structures recently called as Euro zone (Euroland). The key event of this process was the Maastricht Treaty, signed in the year 1992. This document opened the way to reach the final stage. The initiation of the Euro zone in early 1997 was unsuccessful. Just the results reached in the year 1997 allowed fixing the structure of zone participants. There was a consideration that the 11 countries met the joining criteria. But some tolerance was necessary. Only Finland, France and Luxembourg unreservedly met one of conditions – the required ceiling of public debt (it should not exceed 60% of GNP). This could be an example of too high requirements for countries – applicants (e.g. low inflation rate, low long-term interests rates,



stable foreign exchange rates, not excessive volume of budgetary deficit as well as not excessive public debt volume). Therefore, it is necessary to judge the ambitious criteria as the fundamental conditions of common currency implementation and maintenance of uniform monetary policy.

Meanwhile the following countries being the EU members were not included into Euro zone:

- Denmark, Sweden and Great Britain were the countries which – despite their economic readiness – have not decided to join Euro zone since it was created,
- Greece, despite the progress made – was unable to meet the criteria of joining the Euro zone.

The “Union-in-the-Union”, that is the Monetary Union inside the European Union structures started its activity – it is common knowledge – on 1<sup>st</sup> January 1999.

## 2. The monetary policy of the European Union

Within the Euro zone the monetary policy is implemented by European Central Bank (“Eurosysteem”) with the network consisted of 11 domestic central banks of each Euro zone member country<sup>\*</sup>. Its basic goal is maintenance of prices stability inside Euro zone, what is considered as aversion both to the inflation and to the deflation. The stability has been defined as the prices growth not exceeding 2% p.a., measured by the so-called harmonised index of consumer goods prices. In order to calculate this index, the current fluctuations of money aggregate (M3) are studied, what expresses the convictions regarding the power of relations existing between money and inflation rate. In other words, it is assumed that demand for money is relatively fixed and sensitive to the fluctuations of interest rates. Moreover the several indices are subject to analysis, including domestic forecasts of inflation rate and the foreign forecasts. This information is used to calculation of short-term interest rates, which can be best designed to keep the medium-term prices’ stability. At the end of 1998, before the Euro zone has been established, the short-term interest rates allowed to standardise these rates on the level of 3% (this amount has been taken by European Central Bank as its basic rate). In April 1998 this rate has been lowered due to the weakening of dangers related to inflation; the new basic rate has been lowered to 2,5%. But on November of the same year, due to increase of money supply, the basic rate has been increased to 3%.

<sup>\*</sup> The philosophy of such policy has been presented by L.H. Hoogduin (1999).

There is a significant attention paid for the fact, that the mechanism of monetary policy transmission inside the Euro zone is not sufficiently recognised yet. Such situation is of course caused by the lack of statistical data related to the past. It is very important argument to apply the hybrid strategy; it means the simultaneous control of inflation and money supply.

The stability of prices is considered as the contribution of monetary policy into the system of conditions being conducive to the economic growth in Euro zone, including the potential level of employment. If it does not hamper the goals to be achieved – stability of prices – the monetary policy should support the economic policy oriented on the stable and noninflationary growth with high level of employment.

There is an opinion that the monetary policy has its impact on the real sector in the short-term periods. If there are no market signals that the inflation goal is endangered, the reduction of interest rate is possible. The reduced interest rates will be beneficial for the real activity and for the employment level. But if there are some dangers related to medium-term inflation goal, the monetary policy have to respond to such situation. To avoid uncertainty in the real economy, the measures of monetary policy should be gradually applied. It is also assumed that the stability of prices regarding the medium-term periods is favourable for the necessary structural reforms.

The monetary policy within the Euro zone has its obvious impact on the exchange rate of Euro. But the exchange rate is not a goal of the monetary policy, but rather its consequence. In particular, there are no currency intervention taken to modify exchange rate of Euro, but only in the unusual cases such interventions are taken to correct the undesirable fluctuations of exchange rates.

The policy of “Eurosysteem” is subject to consultation with the European Council (Ecofin)<sup>\*</sup>. The Council co-ordinates macroeconomic policy of Euro zone countries with the policy of the EU countries being outside the Euro zone. Among many crucial facts related to above questions, the following should be pointed out:

- Denmark, Greece, Sweden and Great Britain signed the agreement with European Central Bank regarding the Mechanism of Exchange Rates Stabilisation ERM II,
- Within the confines of the mentioned mechanism the exchange rates of Danish Krone and Greek Drachma are being stabilised against Euro currency,

<sup>\*</sup> This question has been discussed by L. Oręziak (1999).

- Sweden and Great Britain (which currencies up to now do not participate in ERM II) apply the direct inflation strategy, what make their action close to the Euro zone reality; up to now these countries introduced the policy regarding the short-term interest rates policy according to the Euro zone policy.

Is there a monetary policy of the European Union?

Yes, but we should of course remember, that this is the uniform policy for the eleven countries creating the Euro zone. This policy also includes the co-ordinated policies of the EU countries being outside Euro zone – these countries are autonomous, although the independence of Sweden and Great Britain is subject to the restrictions due to economic policy of the EU. The independence of Denmark and Greece are regulated by the membership rules of ERM II.

### 3. In the age of globalisation

Euro appeared not long ago, but this currency is a successor of currencies playing international role like Deutsche Mark, French Franc, the currencies of other countries incorporated to the Euro zone, and the European Currency Unit (ECU).

Therefore, Euro is a regional currency in Western Europe, but from the beginning of its existence Euro is also an international currency. The position of Euro is comparable with US Dollar. The further development of situation will determine the range of Euro as the currency of international trade and finance.

The global success of Euro is not settled in the short-term period. Uncertainty regarding the power of Euro has already been a reason of desertion to Swiss Franc or British Pound. The depreciation of Euro caused some concerns for real power of new currency and its perspectives. It seems that there is some time required for Euro approval process, and therefore all the far-sighted conclusions should not be drawn on this stage. The globalisation should be considered as factual, and the necessity of globally considered adjustment of trade and finance to the new currency, also became fact. Euro is an obligatory currency in Euro zone, but it is voluntary outside the zone. The decision to choose Euro instead of other currencies will depend on many factors. The monetary policy introduced inside Euro zone will be undoubtedly one of these factors.

Beside the global dimension, the regional aspects are also very important. Euro and the policy related to this currency are the factors having strong influence on such regions tightly related with Euro zone with regard to trade

and finance. In this context, there are considered: 18 Central- and Eastern European countries, the 11 of Mediterranean countries as well as 13 African countries of Franc zone. The foreign trade volume between EU and the above mentioned countries amounts adequately: more than one half, a half and somewhat less than a half of total volume of their foreign trade global volume. The financial links are considered as the somewhat less important than their trade relationship\*.

### 4. The influence on the Central and Eastern Europe.

#### 4.1. The region against the background of the zone.

The region of Central and Eastern Europe contains 18 countries, including: 13 countries founded as a result of break-up of other countries (Czechoslovakia, former Yugoslavia and former USSR) and the other countries like Albania, Bulgaria, Poland, Romania and Hungary.

It is necessary to point out the following facts:

- The mentioned countries are subject to transformation of their economies, from the centrally planned economy to the market one – since no more than 10 years (excluding some events like internal conflicts and Balkan wars – the average amounts 8 years),

- The time passed from the moment of introduction by these countries the currency exchange regime according to the rules of International Monetary Fund, could be treated as the measure of "currency readiness" of these countries. According to the rules of IMF it can be no more than 5 years (average time: 3 years); the currencies of 4 countries up to now are not a subject to this regime.

- Among the 18 countries of the mentioned region, ten countries are the associated members of EU, since only one year the five countries are involved into the negotiations of full EU membership (Czech Republic, Estonia, Poland, Slovenia and Hungary).

There is large distance between Central and Eastern Europe and the Western Europe. The volume of GDP per capita generally expresses this distance: on the basis of purchasing power parity, the volume of 28% has been to that reached in Euro zone. Considering this question generally, the Euro zone – being an economic power and stabile area – is a neighbour of the region, which feathers its nest regarding each field of activity. The below table shows the clear comparison of these regions.

\* It was mentioned in the publications issued by World Bank and International Monetary Fund e.g. "Global Economic Prospects", (1999).

**Table 1. Euro zone and the Central and Eastern Europe (CEE)**

Description	Euro zone	CEE
Number of countries	11	18
World = 100		
– GDP	15,5	2,7
– Export (commodities and services)	32,0	2,8
– Population	4,9	3,1
GDP growth	2,9	2,4
Inflation rate	1,3	17,7

Source: World Economic Outlook (May 1999).

#### 4.2. Monetary and exchange rates policies within the region

The countries of mentioned region – in their efforts to create market economies – have decided to use the different ways regarding the monetary policy (four different strategies) and to use different ways regarding the exchange rates fixing (six different ways). In practise, this brought the nine combinations of monetary and exchange rates policies. These combinations are presented in the table No. 2 (see below).

**Table 2. Monetary map of the region<sup>a)</sup>**

The mechanism of exchange rates fixing	Monetary policy			
	Exchange rate control	Currency control	Inflation control	More than one goal
Floating rate (an intervention of central bank is taken only in case of undesirable fluctuations of exchange rate)				Albania Moldova
Regulated floating rate (an intervention can change the fluctuations of exchange rate)		*Slovenia	Czech Republic	Belarus, Romania, Slovakia
Floating strip of exchange rates fluctuations	Hungary		Poland	
Fixed strip of exchange rates fluctuations with relation to fixed central exchange rate	*Croatia Ukraine			
Exchange rate fluctuations not exceeding $\pm 1\%$ with relation to central fixed exchange rate	Latvia *Macedonia			
Currency chamber (the mandatory exchange of domestic currency at the fixed exchange rate)	Bosnia *Bulgaria *Estonia Lithuania			

a) Information on Yugoslavia is not available

- Strong relationship with Euro

Source: Author's study based on *International Financial Statistics* (August 1999) and P.R. Masson (1999).

The mentioned data have been prepared on the basis of the available information, but there is no guarantee that the information used is fully updated. There was assumed a principle of most probable assessment of introduced policy – therefore it does not mean that the presented interpretations are faultless. The combination of monetary and exchange rates policies, which has been assigned to a given country – is not necessarily adequate to the policy practically introduced by this country. These reservations are necessary to avoid any disputes regarding the methodology used. However, the problem concerns the relationship between individual currencies and Euro, to disclose and to describe such relationship.

In practice, it may happen a loosening of relationship due to the market fluctuations of exchange rates, or due to some administrative decisions taken regarding the exchange rates. It is possible to reveal tight relationship between the domestic currencies and Euro in such cases, where the currencies were not long ago associated with Deutsche Mark. This concerns the following countries: Bulgaria, Croatia, Estonia, Macedonia and Slovenia. In these countries the depreciation (or appreciation) of Euro generates the analogous trend of exchange rates, with the positive (or negative) influence on competition.

In Poland and Hungary the currency basket is based on Euro and US Dollar, this is a restrictive factor for the impact of Euro on the competition through the Polish Zloty and Hungarian Forint exchange rates.

In the countries like Albania, Belarus, Czech Republic, Moldova, Romania and Slovakia, the free and unlimited fluctuations of exchange rates are present; without any relationship with Euro. In Lithuania, Latvia and Ukraine, the fluctuations of exchange rates are related to other foreign currencies.

Concerning Bosnia and Yugoslavia there is no reliable information available.

On the basis of statistical data, the mentioned relationship can be verified – the results of such verification are presented below (Table No. 3)

**Table 3. The nominal changes of currencies exchange rates to Euro in the 1<sup>st</sup> half of 1999**

The connection of currencies with Euro			
Tight		Limited	Weak
Macedonia	0,3	Poland 2,5	Lithuania 9,3
			Latvia 5,5
			Albania 0,2
Bulgaria	–	Hungary -0,3	
Estonia	-0,2		
Croatia	-2,7		Belarus -2,5
Slovenia	-2,8		Czech Republic -4,2
			Ukraine -4,5
			Slovakia -7,5
			Moldavia -18,7
			Romania -23,7

All figures in % (pct.)

Note: the positive values mean appreciation, the negative ("–") mean depreciation.

Source: Author's study based on: *International Financial Statistics* (August 1999).

The diversity of exchange rates fluctuations confirms the diversity of the used mechanisms related to exchange rates fixing. This also confirms the influence of market adjustments and/or administrative decisions focused on changes of exchange rates within these mechanisms. It concerned the period, in which Euro has been touched by the 10% depreciation in relation to US Dollar.

#### 4.3. Euro vis à vis trade and finance

The short period of Euro presence on the financial market as well as lack of statistical data make it impossible any assessments of the impact of Euro on foreign trade and the economies of the mentioned group of countries. This could be only noticed that according to the previous analyses<sup>\*</sup>:

- Export from Central and Eastern European countries to the Euro zone exceeds 50% of their total export volume (Poland: 57%) and amounts approximately 16% of their GDP (Poland: approx. 10%),

<sup>\*</sup> Author's estimation on the basis of World Economic Outlook (October 1998).

- Assuming the 1% growth of GDP in Euro zone, it will be possible an approximate 1% increase of export volume from region (from Poland: 0,9%) and the 0,3% growth of GDP in the region (Poland: 0,2%).

Such relations suggest a huge importance of Euro zone for the region and for the competition of export to Euro zone. Considering the region's viewpoint, favourable monetary policy in the zone would be a policy stimulating the demand and economic growth – thus it should be a policy based on low interest rates, applicable in case when no dangers concerning the prices stability are present. But, this may cause the dominant tendency to depreciation of Euro. Such depreciation can lead to the various fluctuations of currency exchange rates within the region; these fluctuations will be either favourable for export, or make it difficult. Presently, when many countries have the significant deficits on current accounts, it is really hard to overcome the strong willingness to introduce the administrative or market devaluation of currency. According to the statistical data related for 1998<sup>\*</sup>:

- The deficits on current accounts of Moldova, Lithuania, Latvia and Slovakia exceeded 10% of GDP,
- The lower deficits, but exceeding 5% of GDP, were in Estonia, Macedonia, Romania, Croatia, Belarus and Albania,
- The deficits not exceeding 5% of GDP were in Poland and Hungary, as well as in Bulgaria and Czech Republic,
- Slovenia had balanced accounts.

Although in the viewpoint of short-term interests of exporters it is unfavourable, the appreciation of currencies in the region may reduce the import prices and hamper the inflation pressure. It will be verified by the practice, which scenarios will appear in the economic reality.

In the same time, the policy based on low interest rates within Euro zone (more exactly: the disparity of interest rates) has got an influence on finance, especially on the incoming of the portfolio investments, as well as on the inclinations of domestic companies for overseas borrowing. Such phenomena generate both many challenges and dangers; generally let say "the dilemmas of monetary policy in the conditions of free transfer of capital"<sup>\*\*</sup>. To avoid the dangers, it is postulated the way to achieve the macroeconomic stability and the decision taken concerning the relevant mechanism of exchange rates fixing. The preferred choice is a floating exchange rate. The significant capital inflow will cause the nominal appreciation of domestic currency; this appreciation could be limited by the reduction of the differences between interests rates in

<sup>\*</sup> Transition Report 1999.

<sup>\*\*</sup> This is a title of the article of Mr. D. Rosati (1999).

relation with Euro zone. It should protect the economy against the real appreciation and deterioration of the balance of payments, and last but not least – it should limit the short-term capital inflows. Other solution could be proposed – the domestic currency should be related to Euro. When the inflation rate is relatively high, such solution could cause dangerous appreciation and it could lead to diminish the competitive ability. The sudden inflow and next the outflow of short-term capital could be the final consequence of the mentioned solution. However, the future relation to Euro is unavoidable for these countries, which by joining the European Union will be automatically the applicants to the Euro zone membership. Then these currencies – by entering ERM II – will stabilise their exchange rates in relation to Euro<sup>\*</sup>. Therefore, the Euro-realism should beat both the Euro-enthusiasm, exhorting the countries to immediate transformation to Euro (what is impossible even if due to political reasons), as well as the Euro-scepticism, which move the prospect of the transformation to Euro into unspecified future<sup>\*\*</sup>.

## 5. Concluding remarks

Considering the long perspective, Euro will replace the currencies of Central and Eastern European countries. The national monetary and exchange rates policies will be replaced by the policy of European Central Bank. Some countries need a short time, another need a lot of time, but all the countries generally have not so much time not only to meet the requirements for applicants to the EU and Euro zone, but – what is more important – also operate in the conditions of free competition.

Poland and some other countries are on the road to European Union. The remaining countries of the region will be probably the next candidates.

Considered by the individual countries the adjustments to consequences of monetary policy introduced in Euro zone, undoubtedly will be an important test of readiness to introduce such policy, when Euro will be their currency too.

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**Włodzimierz Siwiński**

## **Euro and the Central and Eastern European Countries**

The establishment of the monetary union made it impossible for the member countries to run their own monetary policy, which is of great importance not only for the economies of those countries but for the ones not associated in the union as well. It was Dr Grzegorz Wójtowicz to have shown this very well in his paper. What is worth adding is that the principles of the monetary union – in spite of formal fiscal policy that was left at the level of the governments of the member countries of the union – have fundamentally changed terms of its running, extorting its further co-ordination which resulted in the institutional solutions accepted in the Amsterdam Treaty. Setting up a common currency in the monetary union is undoubtedly a historic event – it is for the first time that developed countries forgo an attribute which is considered to be an essential feature of the state sovereignty, namely, the ownership of a national currency and the possibility to run their own, independent monetary policy.

On the other hand, in the areas adjacent to the union countries, there were also further events which undoubtedly have no equivalent in, namely the attempt to change the political, social and economic systems peacefully. One of the features of these changes is external opening of the transforming economies. Those two processes are overlapping, which is important to the extent that at least some of those countries seek membership in the European Union along with the monetary union. The economic significance of the European Union to those countries is obvious and that is why the economic openness of the Central and East European countries undergoing the transfor-

mation is naturally followed by a huge increase of trade and capital turnover with the European Union. Hence, any events, which take part in the European Union, make an immense influence on the economy of those countries, pointing out to a big extent the opportunities for openness and integration with the international economy.

It is clear then, that the establishment of the euro bloc represents a great significance to those countries. As the establishment of the currency union is a new phenomenon and, as I have mentioned above, without a precedent, and a one that is still being created, its implications, especially long- and mid-term ones, are empirically unknown and can be conducted more in the aspect of theoretical assumptions without the necessary support of an empirical study.

The dr Wjotowicz's paper remarkably pointed out the institutional conditions of those implications and the probable mechanism of influence and possible results. From the point of view of the analysis of outer implications it is important to note the statement of a fact emphasised by dr Wjotowicz, saying that the euro currency rate will certainly not be an objective for the monetary policy as its shape will be a resultant of that policy rather than a consciously shaped parameter. The policy can be oriented to achievement of a definite low inflation rate, or to monetary aggregates or an interest rate, but not to the currency rate. This policy seems to be directed explicitly to the inflation rate, i.e. maintaining of a very low, practically close to zero inflation, with a simultaneous monitoring of other rates, among which the monetary aggregates play a big role. However, the rates of economic activity are taken into consideration, too.

The initial unexpected euro depreciation most of to the US dollar (first of all), Swiss franc and some other currencies is likely to be considered within the monetary policy but it certainly has not constituted the core argument for its change.

The long-term results of the establishment of the monetary union will rather be beneficial to the countries being transformed. The introduction of euro is not an objective in itself but it is a mean to increase the macroeconomic stability of the member countries of the Union and to create more favourable conditions for the economic growth. If that happens, the higher economic growth of the member countries of the Union will have a positive influence on their foreign trade, which will be to the benefit of the export possibilities of the countries not associated in the Union, also including those under transformation. That should facilitate the opening of economies of those countries. However, on the other hand, it is theoretically possible that the increase of competitiveness of the Union market will improve the position of the Union enterprises which will

adversely influence the export possibilities of the countries not associated in the Union and not exposed to those effects. It seems, however, that the joint effects of trade creation and movements will rather be beneficial to third countries as well.

The faster economic growth in the Union (if it really comes about) should also increase savings and reduce interest rates, and hence, increase capital flows. An overall effect of the establishment of the monetary union will also be a further reduction of the already highly reduced barriers for capital flows and deepening the capital market. The common policy also decreases risk premiums: already today the capital markets of such countries as Spain, Italy and even France are considered to be more secured than before the introduction of euro. As the whole area is perceived as one region, it can increase the inner capital flows, if investors tend to keep up a risk diversification and the profit margins, and instead of the previously separate markets of the member countries of the Union, they will start diversifying their portfolios and increase investments in third countries.

Generally, it is considered that the faster growth and the bigger stability of the member countries will increase the capital flow which can be of a significant importance to the Central-European region. The capital inflow can become an essential supplement to domestic savings and create opportunities for acceleration of the economic growth of those particular countries, if that possibly increased inflow will materialise in the form of direct investments.

The existence of a stable area in the developed countries can also be significant to neighbouring countries as a stabilising factor, which constitutes a particular importance against possible currency crisis. It stems from a possible acceptance of the monetary as well as institutional policy standards by the countries striving for joining the Union.

Nevertheless, within a short period of time a risk of short-term disturbances is likely to occur, which probably nobody knows how to get rid of, in a situation where the member countries cannot react by their own monetary policy or cannot cushion those disturbances through exchange rate changes and have limited possibilities for running a fiscal policy. It mainly concerns the case of, so called, asymmetric disturbances, i.e. those only touching a certain area of the Union, while in other areas those disturbances do not occur or, if they do, they are completely opposite. Then a discrepancy over stipulated reactions of the monetary policy for the different Union areas is likely to occur, creating an unsolvable dilemma for that policy. Such a situation happened over a period of 1992-93 leading to serious difficulties in the European Monetary System and practically to the necessity of giving up its principles. On the other hand,

a chance for bringing about the disturbance asymmetry is considered to be slighter after applying a joint monetary policy (it mainly concerns the monetary disturbances). That implies that the monetary union should protect against such asymmetry, putting away the threats of the crucial dilemma of the joint monetary policy.

Those problems can increase the euro rate fluctuations. From the point of view of the countries being transformed, the exchange rate changes can have an influence depending on the currency system of those countries. Dr Wjotwicz has transparently presented a range of existing solutions for the currency systems. At the same time, he has very clearly described the mechanism of connection of particular currencies to the euro. Bearing in mind those connections and differences over reactions of particular countries resulting from them, however, one can outline certain general rules concerning the influence of the euro exchange rate change on the situation of the countries under discussion.

First of all, the euro exchange rate change can influence the terms of trade. For instance, an appreciation of euro can adversely affect the terms of trade in the countries, which import more from the Union, especially industrial goods, but export more to the countries which are not members of the Union, especially less processed goods. In this situation the domestic prices on the imported goods would increase, whereas the domestic prices on the exported goods would fall. A weak euro can, for instance, increase the prices of the imported energy, which are usually denominated in the US dollars. In view of relatively approximate shares of the Union in exports and imports of the majority of those countries (very high, anyway), this effect does not seem to be essential.

The euro exchange rate change can be of a bigger importance to the foreign debt service. The figures show that in the majority of those countries the share of revenues from their exports to the member countries of the Union in the total export volume is considerably bigger than the share of their debt denominated in the euro in relation to the debt denominated in the US dollars and other currencies. The euro exchange rate fluctuations can potentially be of quite a big significance (a depreciation of euro makes costs of debt service more expensive, whereas an appreciation decreases costs respectively). In this case, possible adverse results of the euro exchange rate change can be reduced by means of appropriate operations on the capital market, which would adjust the debt structure to the present euro exchange rate changes and other currencies, mostly in which the debt is denominated.

Inability to react within the monetary union by means of changes of expenses (through monetary and the fiscal policies) for separate regions or member countries and lack of exchange rate mechanism within the region – causes a situation where adjustable processes, reacting to disturbances that occurred, would to a bigger extent depend on flexibility of the goods and services markets and both production factors and the labour market. The mechanism of those markets must take over the whole burden of those adjustments. This condition seems not to be met with regard to the labour market. It is estimated that there are considerable delays and obstacles in the adjustment of the labour market which hamper the adaptive processes. At present, a very considerable unemployment rate exists in the countries of the Union. It constitutes a potential threat even to the success of the process of the establishment of the monetary union. For particular countries, the lack of possibility to separately react with their economic policy can discourage some members on the Union level from the joint policy and/or – something that is important from the perspective of the countries seeking membership – it can raise objections to enlarging the European Union in the fear of competition of cheaper workforce. It can constitute a serious danger for the Central and East European countries where wages are much lower than those in the Union, even those poorer ones, in their efforts to become members of the Union, and which ones can especially perceive that as a threat to maintaining of their own employment level.

Additionally, the inclinations to such an attitude can be strengthened by the high unemployment rate that prevails in the member countries of the Union, which, on average, exceeds 10% of the workforce. Moreover, these phenomena can cause protectionist reactions. The increased competition on the labour and labour-intensive goods markets, especially the ones which require less skilled labour, can be a threat to the certain labour circles of the Union member countries, which can more easily organise an influential lobby exerting a pressure on politicians who the final decisions will depend on. The threat for the decision on expansion of the Union is the more essential as so far such decisions have required unanimity, achievement of which is not necessarily certain.

Summing up: whereas long-term results of introduction of the euro seem to be beneficial, also to the countries being transformed, and rather favourable to them to open to outside, then in a short or even medium term adverse phenomena can occur which would weaken the possibilities for the outer openness. Also in the case of the asymmetrical disturbances which can occur, and a certain policy helplessness about them on the level of the monetary union, it



can weaken the accord of the member countries for an enlargement of the grouping, which would postpone the process of integration of the group of countries in question with the international economy. In the predictable future the European Union will constitute the main area which the process of opening of economies of those countries will depend on.

**Karol Lutkowski**

## **The Euro and its Impact upon the Monetary and Banking System of Central and Eastern Europe**

### **Long – run dimension of changes in the monetary sphere:**

1/ The magnetic attraction of the euro-zone membership as a long-term objective for the transition countries (the balance of advantages and disadvantages) arguably tipped in favour of joining the EMU – new members of the EU wishing to become part of the core (for economic as well as non-economic reasons) as progressing interweaving of the periphery with the core area ultimately leads to the fulfilment of the optimum currency area requirements within the extended bloc. Realistically, perils remain – e.g. possibilities of asymmetrical shocks and other potential sources of trouble. Nevertheless – as there will be ample time for a review and corrections of the weaknesses of the EMU mechanism and much improvement will probably be made before expanding the membership of the euro bloc, some important sources of dangers for the countries of Central Europe will probably be defused in the meantime.

2/ The long-term objective of joining the EMU and of substituting euro in place of national currencies does not require any basic change in the character of the overall transformation strategy. It does give an additional impetus and urgency to the need for a thoroughgoing reform of the monetary and banking sector to suppress inflation, make the currency fully convertible and enhance the soundness and stability of the commercial banking sector. Long-term aim of joining the EMU raises the stakes by imposing additional burdens, applying harsher standards and demanding to meet them sooner (the continued relevance

of the Maastricht criteria) in order to gain access to the European reservoir of capital and technology and to enjoy the benefits of a vast common market.

3/ Joining the EMU may also be regarded as the most effective safeguard against potential dangers of remaining in isolation in the face of the global capital market, while being fully open to the outside world, – defusing possible sources of instability (e.g. “hot money” flows both ways) and facing up to potential threats jointly with the partner countries, while preserving the benefits of the large trading area free of exchange rate risk and of other inconveniences of national currencies.

4/ Fundamental tasks to perform within the central banking sphere on the basis of a two-tier banking system may largely be regarded as already accomplished – this applies to the status of the central bank within the institutional system of the state, its autonomy (guaranteed by the Constitution) and freedom from outside pressures, the way its chairman and its executive board is selected, the way the central bank is governed, the conduct of monetary policy by the Council of Monetary Policy, the tools and procedures of monetary policy, interdiction of the use of central bank credit for purposes of budget-deficit financing, legal ceiling imposed upon the magnitude of the public debt in accord with the appropriate fiscal criterion of the Maastricht Treaty, etc. Much work has recently been done to make basic standards in the sphere of central banking in Poland fully congruent with the instruments and procedures of the European Central Bank. The same applies to the strategy of national central banks in that sphere. The National Bank of Poland has relinquished instruments of monetary policy in the form of monetary aggregates (intermediate targets of the quantitative type) it experimented with for a time and switched instead to direct inflation targeting – a strategy compatible even though not fully identical with the strategy followed by the ECB (which applies a blend of strategies for the same purpose). The goal of monetary policy of the central bank has been defined in a similar fashion as well. It is unequivocally defined as preserving the stability of the price level. Thus, the task of bringing Polish central banking (its structure, instruments and modes of operation) into conformity with the standards implemented within the euro bloc may be regarded as essentially completed by now.

5/ What remains to be done in this sphere, is basically to reduce inflation permanently to low, single – digit levels and to implement in practice the liberalised foreign-exchange law already enacted, which seems suitable to form the cornerstone of full convertibility, in accord with the European standards – a more arduous task, of course, than changing the financial law and largely dependent upon fundamentals of the economy.

### **The short-term dimension of reform in the monetary sphere:**

6/ Apart from being a long-term goal, the existence of the euro bloc – and especially the existence of the external euro zone (the European Monetary System, version II) – offers a much needed, potential reference frame, which might be helpful in anchoring the credibility of stability regarding a prospective EU member's currency. This may be instrumental in helping ward off possible monetary disturbances in the transitory period. Poland's monetary problems today – a revival of inflationary pressure and volatility of the rate of exchange we see today – is a good illustration of the nature of problems, which might be better dealt with, had Poland decided to link its currency to ecu-euro at an earlier date, instead of attaching it to a basket with a prominent weight ascribed to the US dollar. Negotiated (or even unilateral) link to the euro, within a broad band of permissible fluctuation of  $\pm 15\%$  in breadth, would – in my view – be superior to the present arrangement (a crawling peg within a similar band with the declared intention of floating the currency for an unspecified period, before eventually joining the EMS on becoming an EU member).

### **Consequences of the emergence of the euro bloc for the commercial banking sector:**

7/ Preparing the ground for opening the financial service sector, including the commercial banking sector, and for the impact of the free entry of foreign financial institutions and free cross-border trade in financial services has been a major challenge and a factor for a dramatic institutional overhaul of the sector, with the intention of making it stronger, safer, more efficient, properly regulated and properly supervised. Institutionally, the Polish banking sector is already well advanced as far as the formal and practical implementation of the provisions of the EU banking law is concerned. Considerable progress has also been made in restructuring and privatising the banks, improving the quality of the loan portfolio and strengthening their capital basis to secure basic solvency of the banks. Where progress is still insufficient is in the sphere directly relevant to efficiency and profitability of banking (a need for further modernisation, restructuring, improvement in credit evaluation techniques and credit-granting procedures, downsizing the personnel, reduction of costs and generally improving the quality and scope of the services offered) to make it capable of facing up to the competitive challenge posed by the opening entailed by the prospective EU membership.

8/ The emergence of the euro – a decisive factor in enhancement of efforts to improve the efficiency of the payment system, including the efforts to improve and extend the use of electronic means of telecommunication and

transfer mechanisms, with the ultimate intention of the sector to be eventually able to become a full-blown member of the TARGET system.

9/ The rise of the euro and the emergence of the monetary union, which Poland is, hopefully, poised to join sometime in the future poses the challenge to face and to cope with the similar trends in development of the sector, as those witnessed nowadays in western Europe (including a wave of mergers and acquisitions, and ultimately perhaps a relative shrinkage in the share of the commercial banking in financial services volume) – a challenge which demands an adaptive response in the form of increased efforts to modernise and to be more competitive.

**Jan Solarz**

## **The Euro impact on functioning of banks in Poland**

### **Introduction**

The process of introducing the euro to a third country which is not a member of the European Union differs to a great degree from introducing the common currency in the European and Monetary Union member states, as well as in the states which are members of the European Union but are temporarily deferred from the EMU. However, most publications on changes in banks functioning, influenced by the euro, deal with the consequences brought by the euro for West-European financial institutions and economies. Therefore while attempting to describe the impact of the euro on commercial banks in a country passing through economic transformation which is negotiating conditions of its access to the EU, it is not possible to make a full use of foreign economists' expertise regarding this great financial innovation as the euro is. For example, American economists first maintained that Europe was not able to cope with its centrifugal forces and to introduce a single currency. Later on, however, facing the facts and final dates, they predicted that the rise of the common currency would generate unfavourable phenomena in the world economy. They based their opinion on the fact that the Eurosystem did not fulfil the optimum currency area requirements. Nowadays they tend to regard changes in the euro exchange rate as the evidence supporting their opinions. For the supporters of the European integration this is merely a sign of differences in phases of the business cycle.

Economists employed by national banks can not afford to be as sceptical as American experts are. Poland's membership in the European Union constitutes its vital national interest. It is dangerous for a state to remain outside such a powerful regional economic group in the face of economic globalisation, since it means isolation when confronted with increasing disturbances on international financial markets.

While searching for an appropriate for Poland perspective describing introduction of the euro, it has been recognised that such a description needs to be multidimensional without limiting itself to an argument between optimists and pessimists on the euro's role as the world currency, or as a competitor for American dollar on the world financial markets. From the viewpoint of Poland's situation, the most important is that the process of intensifying and expanding European integrity is accompanied by another equally relevant process, namely, the process of transforming strategic management of banks: from the amount of profit -oriented into the capital return rate - oriented.

The euro's impact on a third country's banks is linked on many different levels with the change in the competition strategy in the domestic banking sector. The subject matter of this analysis requires to be presented within a framework which would allow focusing on mutual relations between the following dimensions of the euro: time and the cycle of financial innovation and stages of strategic management in commercial banks.

## 1. Impact of euro on banks' management strategy

### 1.1. Time

The schedule for introducing the European Monetary Union was concluded in the Maastricht Treaty. It assumes that the transition period - from defining the participants states of the EMU and introducing the non-cash euro to introducing the cash euro - will be completed by the date 31 December 2001. In two months from this date at the latest the exchange of cash national currency for the euro is planned to take place for 11 EMU Member States. After the date 1 July 2002 the cash and non-cash euro will be the only common currency of the Eurosystem.

The schedule for Poland joining the European Union is known in general terms. According to it Poland will be technically ready for joining the European Union by the date 31 December 2002. Poland's access to the EMU is assumed to take place, depending on the scenario, between the date 1 January 2005 as the earliest and 1 January 2008 as the latest date.

In order to compare the schedules for introducing the euro in EU and Poland it is necessary to adopt a conceptual division into a short, medium and long period. Thus, as the short period we understand the time up to the date 1 January 2001, as the medium period to 31 December 2002, and as the long period - time up to the date 1 January 2005.

### 1.2. The novelty of the euro

The euro is not another national currency. It is a great financial novelty which does not have any historical analogy. Any attempts to compare it with already historical currency unions are really defective. The novelty of the euro can be analysed with respect to its material, attributive or operational aspects.

In the material approach, it is emphasised that the euro functions in the non-cash form before it takes the form of eurocash.

The attributive approach stresses the deepening economic integration as a prerequisite for the currency union implementation. The common currency is based on many complex mechanisms which are not present in the national states or federations. Therefore the euro has attributes which other national currencies lack. This is the common currency of 11 states with different economic structure, different phase of the business cycle and sensitivity to asymmetric shocks.

In operational approach to the euro as a financial innovation it is emphasised that this is a carefully planned process, with its phases and stages and having institutions responsible for the realisation of every particular action.

Considering the euro as a financial innovation substantially expands possibilities for improving the management of the process of its introduction. Many of the so far known regularities of an innovation diffusion may be applied to the description of the euro consequences for the transformed countries. They include: the resistance to novelty and the pendular support for changes.

## 2. The euro's impact on functioning of credit institutions in Poland

The analytical dimensions of the euro's impact on banks in Poland, pointed out above, are in a way a simplification of complex changes taking place in functioning of banks. However, such a simplification is necessary in order to understand major tendencies of changes without a risk of getting lost in numerous technical details which may overshadow the tendencies of changes bearing more substantial weight. It is known that banks have born considerable expenditure on changing their software and they have lost much income from settling foreign trade operations in currencies of EMU states. There is much reluctance towards the new currency in banks. In this regard banks' manage-

ment task is to prevent transmitting this negative attitude to the client using settlements in the euro.

**Table 1. The euro's impact on the quality of managing credit institutions in Poland in time**

Long period	Building up trust for the euro	Globalisation of financial sector	Stabilisation of financial markets
Medium period	The optimum euro rate	Transparency of prices	Reducing transaction cost
Short period	Arranging commission from currency change	Increasing competition	Absorption of asymmetric shocks

Time is the first aspect of the analysis on the euro's impact on the quality of managing banks in Poland. In the short period the key issue is the margin of exchanging currencies to those of the EMU Member States. The central bank of a third country does not have instruments allowing for preventing taking margins of non-cash exchanges of currencies of the Eurosystem states. Moreover, controlling margins of exchanging those states' currencies into Polish zlotys is difficult owing to a lack of relevant legal regulations. Only the competition pressure may teach the banks management that taking money from clients for calculation of two currencies in the non-cash form – which are a fractional expression of the common currency – is not only unethical but also damaging for the bank's interest in a country aspiring to the European Union membership. Banks devoid of the long-run thinking ability can use the habit of talking about e.g. the exchange rate of German mark to Polish zloty in order to take a margin up to 2 interest points while exchanging them. Therefore since 1 January 1999 using the customary expression: German mark exchange rate should be avoided. What should be used instead is a calculation rate whose value should not be used for settlements between banks.

In order to fight pathologically different levels of bank margins while exchanging notes of the currencies belonging to the Eurosystem states in the European Union anti-monopolist legislation has been used. By the European Commission initiative an inspection was conducted in 6 banks of the EMU Member States in order to determine whether the occurring difference in the level of margins taken by particular banks is not a result of monopolist agreement between banks. Since while chasing profits it may occur that good banking practice principles are infringed. These principles assumed not taking margins for calculating currencies and considerable reduction of commissions for exchanging cash of the Eurosystem states.

In the short period the opportunity of introducing the euro may be observed in the form of renouncement of the exchange rate policy as the instrument restoring economic equilibrium. Introducing the euro encouraged monetary authorities to adopt the flexible exchange rate system, and by doing so renouncement of previous announcing the devaluation scale of Polish zloty and unconditional intervention on the currency market. Floating the exchange rate is the activity which leads to increasing competition pressure on enterprises participating in foreign trade. Before they operate on the internal European market they need to learn how to prevent exchange rate risk in their business activity.

In the medium period the key issue becomes the exchange rate of the euro to American dollar. Some opinions advocate strengthening the euro; others would like to see revival of exporters possibilities through depreciation of the euro. It is difficult to decide what euro rate is optimal from the point of view of the transforming countries aspiring to the EU membership. A relative closing of European fortress against the world economy influences after introducing the euro may be counterbalanced by guaranteeing transparency of prices and wages in the Eurosystem. The hitherto activities in this regard are very limited and still the client has difficulty in comparing offers expressed in different currencies and in using a different concept of rounding up prices. Only the European capital market from the first day of introducing the common currency is fully transparent. Denominating securities so far issued in the euro and renouncing a country risk measures for the sake of the sector risk are elements of a new organisation of the European capital market. There are some warnings that in the Eurosystem the arbitration of ratings for the state treasury bonds of particular EU states will appear instead of the currency risk. Its occurrence could have burst the European integration from inside.

In the face of such a threat conservatism of banks operating on the common market makes them postpone indicating offers prices in the euro. The Eurosystem banks through their political delay of the confrontation of services prices act adversely to themselves. Some clients will use the single European capital market in order to acquire financial means without any intermediary role of banks. The pressure on reduction of transaction costs has an objective character and it results from increased competition pressure on banks' clients. If banks want to keep their best clients they will have to help them in the fight with manufacturers operating on the global as well as regional scale.

In a longer run the globalisation of financial markets and internationalisation of manufacturing is inevitable. The intensified co-relation between the world

financial centres generates a new awareness of the need for co-operation and concluding strategic alliances between "the eternal enemies". One of the planes of their operation is aiding with currency which both parties trust. Building up trust for the euro as the international currency is a long-term process. There is a hope that introduction of the euro will lead to reducing volatility of international financial markets. Its realisation depends on the condition of relations between the euro sphere and the sphere of American dollar.

Another plane of the analysis of the euro's impact on functioning of national banks regards enhancement of the Eurosystem position in the world economy. Attributed to the euro capacity to improve competition is supposed to considerably enhance the cost-benefit accounts due to deepening and expanding European integration. Their spread in time is supposed to reduce social cost of this great innovation. The key issue will be the capacity of the state administration to use only the euro currency in the defined periods of time. If this leads to disturbances in relations between European citizen and national administration of the Eurosystem states – then adopting settlements in the euro may be subject to strong political controversies. The counterbalance for such dangers can be effective conducting the exchange of the Eurosystem national currencies for the euro. Poland's experiences in denomination point out the importance of a lack of time pressure, which is needed for smooth implementing this kind of huge logistic actions involving participation of millions of people.

Effective realisation of the schedule for introducing the euro should make the national deponents use the euro as a reserve currency. As the date of Poland's membership in the EU and EMU becomes more concrete, the interest in the euro as the currency for saving and property trade will be increasing. Dethroning the American dollar in this role would be of crucial importance in strengthening European identity among the Poles.

**Table 2. The impact of the euro novelty on functioning of credit institutions in Poland**

<b>Operational aspect of the innovation</b>	Abiding by the schedule of the transition period	Effective exchange of currencies for the euro	Guaranteeing for the euro the status of the first reserve world currency
<b>Attributive aspect of the innovation</b>	Liberalisation of the settlements in the euro market	Eurosystem	Polarisation of the national market
<b>Material aspect of the innovation</b>	Improvement of the euro-cash project	National reverse of the euro cash	Institutions issuing electronic money

Scarce interest of institutional and individual clients in the banks' offers for conducting settlements in the euro should not mislead national banks. They need to be aware that the conclusive phase has come in the fight for division of the settlement market together with introducing the euro and recognising it as a currency convertible in Poland. A good position on the settlement in the euro market provides a great starting point for acquiring all settlements in Polish zlotys. Exchanging Polish zlotys for the euro has been decided over immediately when Poland undertook negotiations on its membership in the European Union.

Poland having very close economic relations with the EU has to change its settlements of foreign trade from dollars settlements into settlements in the euro. The extent to which economic agents will use a chance for their direct access to the market depends on the supply of instruments of the domestic capital market and on the ability of strategic thinking on the scale of the Eurosystem. If the strategies of banks and enterprises will not use the advantage of the Eurosystem scale – then the actual impact of our membership in the EU on the economy will be much weaker than it is estimated today.

The aggregates describing national economy will comprise resultants of two different market types: the global and internal sector market and the local and multi-sector market. Polarisation of the nation-wide market whose catalyst will be introducing the euro, will cause the necessity to expand municipal capital market and municipal banks on the one hand, and the global settlement and investment banks present in Poland on the other hand.

Introducing the euro will enhance already existing tendencies on financial markets and it will enforce the process of mergers and acquisitions. They are of fundamental importance for ensuring services complexity and following the development of the activity scale and extent of the most profitable banks' clients. Detailed scenarios for development of national banking sector under the influence of the euro go beyond the framework of this analysis\*. Suffice to say that introducing the euro will reveal all institutional gaps existing in the national financial system. Without a well developed institutional and material infrastructure of financial sector it will be difficult to use the euro potential in order to acquire competition advantage over OECD states banks which are beyond the Eurosystem.

The material aspect of the euro as a financial innovation was very controversial at the initial project stage. The graphic design of the euro banknotes was criticised for its national identification of the bridge architecture, and the

\* Leokadia Oręziak, Kierunki zmian w systemach bankowych na obszarze euro, (Development directions in banking systems on the euro area) "Bank i Kredyt", July-August 1999, p. 16.

eurocash was criticised as being too difficult to recognise some coins for the blind. Poland will have to design national side of the eurocurrency, its reverse. It is generally known that there cannot appear religious symbols nor people. It seems that the National Mint will not renounce the attempt to win the tender for producing the eurocoins with a national reverse.

The issuance of electronic money by banks subsidiaries set up together with the issuers of electronic purses and cases will be a challenge for the domestic capital. They may be some airlines, supermarkets chains, parking enterprises and the like entities where clients make minor payments in mass. Adopting the EU regulations in this regard will open the national domestic market for the private initiative. The required 350 thousand euro of owner fund should not be a barrier to prove its efficiency by the domestic capital and technology.

The third plane of the analysis of the euro's impact on the national banks is its presenting in time. Most usually the analysts' attention focuses on the visible part of the euro consequences and on this part which is to occur in a short time. Then it turns out that despite frequent sceptical opinions – the euro has started normally without disturbances. And this is a success. It can be even regarded as a spectacular success on the capital and interbanks settlements markets.

**Table 3. The impact of the euro novelty on functioning of credit institutions**

Operational aspect of the innovation	Normalisation	Leaving the American dollar sphere	Privatisation of money policy
Intuitive aspect of the innovation	Continuity of the contract. Equivalent of the contract	Cross-border rendering of financial services	International co-ordination of economic policies
Material aspect of the innovation	Promotion of the euro	Withdrawing DM	Exchanging zlotys for the euro
Impact period	Short	Medium	Long

In Poland legal problems have also arisen which are related to a lack of congruence of the national monetary law with the common currency of several Eurosystem countries – and not a federal state. Sovereign courts in Poland must take position on the continuity of contracts concluded in ECU and national currencies of the EMU Member States. They should not question the fact that introducing the euro does not affect the validity of contracts concluded in the official ECU or expressed in currencies of the Eurosystem currencies. It is not known whether the contract parties will be always satisfied with ensuring the legal continuity of their contracts. In practice it may prove that economic

subject matter of the contract has turned unfavourable for one of the parties, or that it has lost its economic grounds for both of the parties. This is very much likely as regards contracts safeguarding against the exchange rate risk of transactions between currencies of the EMU Member States. Moreover, courts' choice of the interest rates counterpart to the ones recorded in the contract may undermine the economic interest of one of the parties. Then it may prove that the reference interest rates transferred from London to Frankfurt result in a different then originally assumed transaction profitability.

In the short period a lack of the euro promotion by the EU economic agents operating in Poland was revealed. Despite their membership in the Eurosystem they still use in their offer expressions saying about the exchange rate of their currencies to Polish zlotys. Polish partners to the EU business entities are not informed about a necessity to introduce changes in agreements beyond the date 1 January 2002 due to ultimate discontinuance of existing national currencies of the EMU Member States.

In the medium period it will be necessary to conduct a widespread action of withdrawing German marks commonly used for transaction settling by the economy sector which is not subject to taxation. The situation that should be avoided is direct exchanging German marks banknotes for eurocash in a cash desk in a bank in Poland.

For national banks the most important medium period consequence of introducing the euro will be spreading free cross-border trade in banking services. There are four cases of rendering cross-border services.

The first case is a situation when the service provider goes in person to the service taker. If it has internationally recognised rights for professional rendering services then it can compete with the residents in their internal market. The World Trade Organisation works for popularisation of this type open architecture of the financial system.

The second type of rendering cross border services requires business presence of the service provider in the country of the service taker. This may be in a form of teller machines installation, setting up a representative or a foreign division of a bank. Acquisition of a national bank or building from the start a bank joint stock company based on a local law, are other known forms of business presence in the country of the service taker. Despite the globalisation of the financial markets the foreign capital share in the banking sector is still limited as well as controversial in many opinions.

The third type of rendering cross border services is when the service taker itself comes to the service provider's country. In the holiday period this is the most common form of cross border rendering services.

In the European Union states there is a fourth type of cross border rendering financial services, when neither the service provider nor the service taker cross a border, and nevertheless a cross border service is rendered. This is possible when the agreement for rendering services for distance is free from provisions profitable for one party or not understandable for the common service taker, and the electronic signature is confirmed by a publicly trusted institution. This type of cross border rendering services revolutionises the architecture of financial systems, transforming it from the national into regional. For national banks this means an ultimate renouncement of attempts for treating bank's clients instrumentally.

The response for creating the euro are attempts to create an American dollar sphere in South America. American dollar replaces national currency not only in Panama but also in Argentina. The new architecture of the world financial system would therefore be bi-polar with a distinct division into the euro and dollar spheres. As long as there are no frictions between these two spheres, it may be considered that introducing the euro stabilises international financial markets.

Regardless of the fact whether the optimistic expectations regarding the euro's impact on the international financial markets come true or not, the Polish zloty will be exchanged for the euro. In a long run perspective it would not be possible to be stuck between the euro sphere and the dollar sphere. Then there appear groups of interest more strongly related to the United States than to the EU. The resistance towards the euro will therefore get stronger as it gets closer to the everyday practice.

Additional argument for the euro sceptics will be extensive co-ordination of economic policies of the EU states. For many of them this may be a return to a long time forgotten practices of the Council for Mutual Economic Aid. The rehabilitation of the medium period of economic programming in the conditions of market economy may generate resistance and fears against arbitrary solutions in economic policy. In the conditions of unprecedented development of American economy this kind of instruments for co-ordinating economic policies may seem as excessive interventionism which weakens the entrepreneurial spirit in Europe.

These are unjustified fears since the euro increases the role of private investors in the realisation of monetary policy of the European Central Bank. It is not possible to realise any efficient economic policy in global surrounding of states and economic entities in opposition to the interest of majority of institutional investors. Euro is not merely a political phenomenon, but this is primarily the response of European enterprises for the challenge of economic

globalisation. Further enhancing and expanding of the European integration would not be possible without the euro. Euro is a logical consequence of European integration processes rather than a cornerstone of a kind of united states of Europe.

Overall analysing of the three planes of the euro impact on functioning of banks in Poland well illustrates its complex and dynamic character. The euro is a natural element of the quality strategy in national banks. If the euro did not exist it would have to be invented.

## Conclusions

The systemic transformation defrosted the institutional structure of the country financial system. In these new conditions a new wave of changes generated by the euro is treated as a natural element of necessary transformations. All attempts to delay the exchange of the Polish zloty for the euro would only lead to increasing psycho-social costs of introducing this financial innovation. After freezing the institutional structure in economy and breaking inflationary expectations, introducing the euro would be treated as a limitation of the national sovereignty, and not as enhancement of chances for meeting global and cross border competition.

Introducing the euro in Poland is at a preliminary stage. According to the pendulum law of innovation it will be soon treated as a panacea for all ills of national economy. In the opinion of the euro pioneers the sooner it will be introduced the greater gains will be obtained from the common currency. For conservatives delaying introduction of the euro and dividing the process of integration with the EU into two long-term stages is a way for the integration which would ensure controlling national interests. They cannot acknowledge that the pace of introducing the euro will be decided by private investors. Since if investors notice their interest in accelerating the introduction of the euro in Poland nothing will stop its diffusion into Poland.

However, before investors prove the actual role of the euro in Poland it is necessary to adopt legislation enabling smooth withdrawal of 11 or more currencies of the eurostructure in Poland. It is necessary to improve the offer of products denominated in the euro. In the case of bank cards they are sometimes settled in American dollars with banks using licences of American organizations of their issuance and settlements. The information on this should be available for the client and this should facilitate understanding of the scale of the currency risk related to this situation.

There is a lack of information regarding a considerable reduction of the number of foreign correspondent banks, which indicates a very declarative



character of changes in national banks under the influence of introducing the euro. Therefore a strenuous effort is required in order to implement changes in practice and make them irreversible. The key role to perform in this regard pertains foreign banks operating in Poland as well as the National Bank of Poland.

**Eligiusz Przechodzki**

## **Euro and Its Impact on Financial and Banking Systems of Selected Countries in Central and Eastern Europe**

The subject matter of considerations mentioned in the title – very up-to-date, both in its pragmatic and cognitive meanings – is a new phenomenon in the world-wide practice and as such it is hard to be described in terms of assessments, conclusions and forecasts. Therefore, the observations and comments presented below, concerning mainly Ukraine, although based on the available empirical materials, are partly hypotheses and anticipations that will only be verified by and enriched with deeper substance through practice.

The single market of the European Union, embracing over 370 million inhabitants, is the largest of the world markets that count – it exceeds both American (260 million) and Japanese (125 million) markets. However, contrary to the USA and Japan, there are multiple currencies on European market, which obviously decreases the competitive position of the EU goods in comparison with those from Japan and America. It also complicates settlements inside the Union itself as well as with other countries, thus creating a considerable barrier for effective growth of foreign trade and progress in the EU integration. In these circumstances it seemed necessary to introduce – aside from other solutions – a single currency in the single market of the EU. This move entailed certain hazards, but also created some prerequisites to gain a series of benefits with regard both to financial and banking systems.

It seems that any attempt to evaluate the impact of euro, in particular on monetary and banking systems of the Central and Eastern Europe should be commenced with qualifying that currency into the category of significant financial innovations. Leaving aside closer definitions of that term, it is worth to draw attention to the euro as a turning-point which emerges from its most innovative features – it is a common currency and a legal medium of exchange in more than one emitting country. It has been the rule so far, that emission of a currency is a privilege of those ruling a certain territory.

Perception of euro as a financial innovation is also related to definition thereof as an international currency in a strict sense, because a currency is considered to be international if it is used by individuals and enterprises being residents of countries other than that emitting the currency, and performs the role of a medium of exchange, a settlement unit and a medium of thesaurization. The said functions are strictly intertwined.

A comparison of the scope of euro described above with ECU or transfer ruble allows for an ascertainment that euro certainly is both a crucial financial innovation and the first truly international currency in the modern economic history.

The turning point that creation of euro zone constituted was preceded by laborious and long-lasting preparations predefined in the European Union Treaty signed in Maastricht in 1992. The Treaty puts stress on complementary character of activities leading towards creation of the Economic and Monetary Union – EMU, and introduction of single currency. It also defines so called convergence criteria. Fulfilment thereof by the EU countries is a prerequisite for their admission to EMU.

The scope of actions undertaken by the EU countries on particular stages of approaching the EMU is widely known, similarly as the projected phases of the euro zone expansion. They show the magnitude of tasks faced by the countries of Central and Eastern Europe, not only those seeking prompt membership in the Union but also the remaining ones, like Ukraine or Russia.

From the formal point of view all countries of the EU are participants of the euro zone. Temporary adjournment was granted only to Denmark and the United Kingdom. The attitude of Denmark seems particularly symptomatic in the context of access to the zone of Central and East European countries. It is predominated by obstacles of psychological rather than economical nature, i.e. mainly by reluctance of the Danes to sell their land to foreigners. Reckoned among non-economical categories but strictly related to them – psychological barrier against access to euro zone, visible in the attitude of Denmark, has not, however, weakened its efforts to maintain the economy within the parameters

set out in the convergence criteria, which enables the country to make a political decision of exchanging the krone for euro in a suitable time.

At the present, a year after introduction of euro in a limited scope, both territorial and functional-wise, it is hard to forecast all the consequences of introduction of this financial innovation and international currency. That experience, however modest, allows for some forecasts regarding the directions of changes in the international financial system and on international financial markets.

First of all it should be stressed that changes will affect both levels of the markets – official and private, understood as the market of individual consumers. On the official level we can talk about the necessity of changing by the IMF of eleven national currencies for euro and changing the SDR basket, in which – prior to introduction of euro – European currencies represented 43%. Next issue is denomination of shares of eleven countries in the IMF, which constitute 22% of total shares, i.e. more than the USA (18,25%).

Important changes, already noticed in the use of currencies in international transactions, the scale of which continuously grow, include following:

1. growth of competitiveness of euro in comparison with American dollar and yen as a result of the on-going process of replacement of German mark by euro;
2. increase of the euro role as a currency used to invoice transactions, medium of payments and in the function of reserve or intervention currency (export and import of the EU countries are equal to 24% of their GDP and exceed the USA (11.5%) and Japan (9%). The share of the Eleven in the world trade (30%) doubles that of the USA and is four times bigger than that of Japan);
3. strengthening of the tendency to denominate securities, term deposits and international reserves in euro;
4. deepening of the European financial markets integration and, in consequence, the growth of their competitive abilities in relation to the American market.

As far as changes in banking sector of the Eleven initiated by euro are concerned, the already mentioned Maastricht Treaty includes precise regulations concerning the European Central Bank (ECB) and the European System of Central Banks (ESCB)<sup>\*</sup>. According to thereof ESCB will be composed of ECB as the central unit and eleven national banks as participants of ESBC. The most important tasks of ESBC – aside from maintenance of stable prices – are: creation and realisation of the Union's monetary policy, execution of currency

<sup>\*</sup> See Article 4a. Article 105–109 b and Protocol No. 3 on Statute of European Central Bank and European System of Central Banks.



operations, storage and management of member countries' currency reserves, improvement of settlement systems and co-operation with competent bodies in the scope of efficient carrying out of prudent banking supervision policy over banks and stability of the financial system.

The changes, as briefly outlined above, are of an organisational character that fits well into the process of changes in the West-European banking systems initiated in mid-eighties together with the progress of integration within the Union, and gaining a new dynamics and quality after the introduction of euro.

It is expected that in a longer term the changes in the Union's banking sector should cover:

1. rating of banks in connection with the new evaluation of securities;
2. consolidation of smaller banks forced by the shrinking of their market (operations with European currencies) and the necessity to bear enormous expenses connected with adaptation of IT systems, training of staff and providing of broad and comprehensive information to customers;
3. increase of independence of state-owned banks in order to let them compete with private institutions;
4. reduction of employment by, according to different estimates, 200 to 500 thousand people.

Forecasts of European Monetary Institute in Bangor conform to the above expectations. They are as follows:

1. there will be improvement in capital strength of banks emerging from better risk management;
2. the profits of banks on trading financial instruments will grow;
3. the profits on fees and commissions will become more important;
4. new savings products will be developed and the importance of mortgage loans will grow;
5. accomplishment of high profitability measured by return on equity (ROE) will become the main objective for banks, as a result of which less attention will be paid to growth of assets and, in longer time perspective, decrease in tendencies to consolidate banks and more active search by smaller banks for highly specialised market niches\*.

An inherent factor concurrent with introduction of any financial innovation – and euro as it has been proven above, is such – is risk. Different categories of risk and the degree to which respective types of banking are influenced by it are summarised in the table below\*\*:

Potential impact of introduction of euro on different types of banking with category of risk						
Type of banking	Technological	Euroland break-up	Competitiveness	Loss of demand	Loss of revenues	Regulative
Investment	medium	high	high	high	high	high
Retail	high	high	high	high	high	high
Trust	medium	high	high	medium	medium	medium
Corporate	medium	high	medium	low	medium	low

As it can be seen, the highest impact of euro should be felt in retail banking, while the lowest impact should be felt by corporate banking.

Some deeper consideration, in the context of influence of euro on countries of the Central and Eastern Europe, should be given to analysis of the political risk (break-up of Euroland), which – as seen in the table – is high in relation to each type of banking in countries of the Eleven, and has already been realistic when Italy was not able to maintain some parameters set out in Maastricht.

Experiences of first months after introduction of euro allow for identification of the following aspects of the political risk:

1. strong relationships between national currency and national identity;
2. lack of tradition of euro as a stable currency;
3. lack of external stability in value of euro\*.

Despite of the mentioned risk, breaking or postponing of euro introduction process would bring – aside from measurable economic loss – a decrease of confidence in Euroland countries, which would inevitably lead to a stop or even a break up of the European integration process.

The changes that have been presented above, related to introduction of euro and opportunities and risks emerging from the process gather new vividness and meaning in relation to third countries from outside the euro zone. It seems that among those a division should be made as from one side there are countries like the USA and Japan, and from the other – countries of the Central and Eastern Europe, which, as it is widely known, remain in very different stages of market reforms and have different concepts of integration with Western European structures.

First months of functioning of euro showed that the results thereof were promptly felt by banking sectors of Poland, Czech Republic and Hungary – which can be explained by the fact that accelerated process of political transformation in these countries overleap with economical and political integration with West European structures. In case of the Polish banking sector an

\* Quote from: Konopielko, Euro coraz bliżej, "Bank" 08/1998, p. 35.

\*\* Based upon Economic and Monetary Union: Perspectives for Business and Finance, Euromoney books, London 1997, p. 29.

\* L. Layard-Lirsching, European Monetary Disunion, "Treasury Management International" 4/1998, p. 10-12.

additional factor determining the specific influence of euro is that a high share of the sector is owned by foreign investors, most of whom come from countries of the Eleven. As a consequence, the American dollar represented in the capital of Polish banks, which prior to the introduction of euro competed even with the Deutsch Mark, will significantly diminish the strength of its influence.

Specialist analyses of current changes in the Polish banking system related to introduction of euro and expert forecasts of the trends in the future show numerous aspects of banking activities where changes are inevitable.

First of all – as experts emphasise – the measure of how advanced are Polish banks in preparations to face new circumstances will be development of strategy of strengthening their market position or at least surviving, taking into account the following:

- learning how to perform accurate analysis of loan credibility allowing for entry to areas of higher risk (e.g. in the territorial aspect – to the countries of former USSR that western banks are afraid of);
- creating historical customer data bases, that will make it possible to determine their needs and to make accurate decision in new realities;
- improvement of quality management.

The actions listed above concern – as already mentioned – the strategic categories and, though taken successively, their results will be fully visible in future. The Polish banking sector, however, has already gone through some changes related to introduction of euro which concern mainly:

- correspondent relationships;
- interest rates;
- cross-border settlements.

The increase in value of payment orders in euro, as a consequence of reduction of the number of currencies in Euroland countries from eleven to one, as well as the transformation of euro into a fully legal transaction currency forced Polish banks to redefine their correspondent banking policies. The possibility of considerable reduction in number of correspondent banks in the European countries directly translates into reduction of costs of foreign currency operations on nostro accounts and other benefits.

Another quick change, that can bring painful results to banks and their customers, is the change of reference interest rates. As a result thereof loan agreements concluded between Polish banks and their customers, based on widely accepted LIBOR or FIBOR rates will be amended and the EuroLIBOR

\* See also: Niepełna lista przemian, "Bank" 12/1998, p. 23–25; Czy euro zmieni świat? "Bank" 09/1997, p. 27–29; E. Chraboniszewska, Euro a rynki finansowe, "Bank i Kredyt" 12/1998, p. 4–16; J. Zombirt, Praktyczne implikacje euro dla polskiego sektora bankowego, "Bank i Kredyt" 12/1998, p. 66–70.

and EURIBOR will be introduced. That fact was taken into consideration neither by the borrowers nor by the banks, which opens a field for potential conflict between them.

Another challenge faced by Polish banks, connected with the offer of settlements in euro addressed to Polish enterprises are cross-border settlements which are one of the most important areas of competition between Polish banks and foreign banks located in Poland. That brings a serious threat for Polish banks, as they are forced to make a deliberate, based on economic calculation, choice of system of settlements in euro.

When speaking about consequences that emerge for Poland from the fact of introduction of euro, one should take into consideration not only our banking sector but also enterprises and financial market.

A considerable impact on the shape of financial market in its different segments was made by the decreasing tendency of EURO/USD exchange rate. As it is known, the currency basket on which the National Bank of Poland (NBP) bases the daily exchange rate of zloty is composed in 55% of euro and in 45% of dollar. Hence, Polish currency is exposed to fluctuations of the common European currency, which is reflected in profitability of securities (including treasury bonds). The change in this scope can be brought by floating of zloty exchange rate.

As can be seen from the above summary of the most important opportunities and threats for Poland related to introduction of euro, the new currency can become a factor of stable growth for this economy (including banking and financial systems) but it also brings considerable difficulties and a set of real threats.

Awareness of threats and their specific nature with regard to respective countries seeking membership in the Union was expressed in statements of heads of central banks of Poland, Czech Republic and Hungary\*. Some differences were revealed in setting the date of accession of these countries to the monetary union. The President of the NBP stressed that Poland should access the union in the shortest possible time and zloty would be soon incorporated into ERM2 exchange rate system (its rate will then be fixed in relation to euro). The heads of central banks of Czech Republic and Hungary, however, pointed to differences between economic circumstances in their countries and in Western Europe, which – according to them – requires some long term actions adjusting the economies to criteria set out in Maastricht, prior to the accession.

\* Conference on 75<sup>th</sup> Anniversary of the National Bank of Poland, "Rzeczpospolita", 21 May 1999, p. 12.

The above thoughts may lead to conclusion that the balance between benefits and threats related to introduction of euro is, in case of Poland, Czech Republic and Hungary, maintained. In longer perspective though, the benefits should positively predominate. As Europe moves towards the East, however, the fulfilment of challenges seems more and more difficult for the states there, and the potential profits – at least from the point of view of governments and central banks' authorities – are distant and unspecified. This hardly concerns the Baltic States as their governments follow consistent political and economic programs of reforms and do not disguise their European ambitions. However, it fully concerns Russia and Ukraine – two most powerful countries in territorial, demographic and economic sense that emerged after the collapse of the Soviet Union.

From the Polish point of view it is particularly interesting to scrutinize events in the context of euro in Ukraine as that country is our biggest neighbour in the East and second, after Russia, trade partner in the area. There is also a significant number of Polish investments in that country and a dynamics of Polish-Ukrainian co-operation on many fields, including banking (Polish capital owns shares in several Ukrainian banks, and Bank Pekao SA is the sole owner of Bank Depozytowo-Kredytowy (Ukraine) Ltd. in Luck).

In order to better understand the scale of problems faced by Ukraine resulting from the introduction of euro, the factors mentioned with relation to Poland, Czech Republic and Hungary should be supplemented with the political factor – practically unimportant in those countries but crucial for Ukraine. The follow-up of regaining independence by Ukraine was not only – as it is widely thought – the economic crisis inherited from the Soviet economy and magnified by breaking co-operation and trading ties with Soviet and foreign partners, but also the unusual growth of national awareness expressed through increased will of building the national identity also in the field of economy. A very important factor in the political and economic autonomy is having an own currency. Introduction thereof in September 1996 became a real success of the young Ukrainian state.

The attempts to carry out political and economical reforms noticed in the first years of Ukrainian independence, which – interesting from the point of this paper – assumed development of a modern banking system almost from the scratch, allowing for free business activities and competition, and opening the economy, collided with heritage of Soviet period: still high economic dependence on Russia, populist tendencies in the society, obstacles of economical and mental nature in privatisation and restructuring of industry, overdeveloped social sphere, and others. The troubles were made up by the Russian

crises of August 1998, which affected Ukraine mostly through decrease of all economic indicators, including the drop of GDP to 98.3% compared to 1997, decrease in exports (to 86.6% compared to 1997) and imports (86.0% compared to 1997), breakdown on the money and securities markets, withdrawal of capital (mainly portfolio capital) by foreign investors and significant deterioration of condition of the banking sector (since mid-1998 the National Bank of Ukraine has carried out remedy programs in 13 banks, and taken away or suspended licenses of 40 commercial banks).

A serious problem for Ukraine is so called "grey sphere" of economy, estimated by experts to be as high as 60% of GDP and the "black sphere" i.e. organised crime. Introduction of euro will undoubtedly cause significant disturbances in the system of settlements connected with illegal activities. So far, however, there are no premises for assessment of attractiveness of Ukrainian banking sector from the point of view of criminal organisations willing to erase the source of financial means. Nevertheless, the balance of unclassified trade shows the potential scale of the problem.

The phenomena described above are the background for Ukrainian preparations related to introduction of euro. In that context, opinions of financial and economic experts from that country since the end of 1998 in which emotional motives interlace with attempts to analyse economic effects of euro appearance on the Ukrainian market and with the information on actual preparations to that fact are not surprising.

Misgivings about the acceptance of the change from hryvna to euro by the Ukrainian society seem – in the context of lack of Ukraine's declaration concerning its integration with the EU structures – to be somewhat exaggerated. However, they are justified from the point of dolarisation of not only foreign settlements made by Ukrainian enterprises, but also of the entire system of internal payments, which despite of its informal character is functioning according to the rules well known to economies of countries suffering from inflation and lack of legal stability. Therefore, the change from dollar to euro, even in official settlements between Ukrainian enterprises and their West-European partners, will require not only – as it is in case of Poland, Czech Republic, Hungary and the Baltic States – appropriate logistic preparations done by banks and companies, but also breaking of certain stereotypes of bankers and businessmen who consider dollar to be the only currency for settlements in international transactions.

Starting from comparison of preparations for settlements in euro made by banking systems of Poland and Ukraine and bearing in mind some specific factors in Ukrainian environment mentioned above, we can notice some

concurrent actions. They mainly concern technical preparation of banks to new realities: review of correspondent relationships and selection of systems to follow international settlements. The further we go, though, the more differences we see. They are mostly visible in the scale of undertaken actions and their nature which – as mentioned before – are determined by political and economic factors.

As a background for presentation of those actions we can use the statement of a well known local financial market analyst – astonishing from the Polish point of view, but not rare in Ukraine – that “... in short-term perspective the consequences of introduction of euro are for Ukraine equal to zero and any change of that situation can take place no sooner than in several years”<sup>\*</sup>. Some enlargement of the quoted opinion can be found in an article written by another specialist in which he points out on multiplying by the EU countries of artificial barriers stemming the inflow of Ukrainian merchandise to the Union, and Ukrainian retaliatory actions. The author is convinced that introduction of euro will not suppress these policies and therefore the meaning of new currency for Ukraine will be minor<sup>\*\*</sup>.

This kind of opinions is supported, though from a different side, by statements – filled with prudence and worries – of high functionaries of National bank of Ukraine. It clearly appears therefrom that, for example, in the nearest future the institution is not going to change the structure of its currency reserves and will maintain the mechanism of fixing the hryvna-euro exchange rate in the same manner as it was done for ECU.

Some analysts of the Ukrainian financial market and the NBU experts are making distressing forecasts regarding the development of situation at local money market. They worry that euro will cause a substantial shrink of speculative currency operations transmission in the EU countries. That, as a consequence, can cause a displacement of those operations into Ukrainian market. It will be – according to them – a simple undertaking due to the weaknesses of Ukrainian financial system and mistakes in macroeconomic policy. That problem became the subject of special letter directed by the NBU to commercial banks. In the letter, the central bank warns about the possibility of the phenomenon and recommends steps that are to counteract it, e.g. “review of correspondent relationships with countries of the Eleven” and “paying special attention to services in the scope of payments on the territory of Europe and their influence on variety of banks’ functions”<sup>\*\*\*</sup>.

\* D. Weisband, *Posledstviya Jewro dla Ukrainy*, “Biznes” No. 51(310)/1998, p. 21.

\*\* W. Wowczak, *Perspektywy switowej ekonomiki u kontekstie zaprowadzeniya Jewro*, “Wisnyk NBU”, 01/99, p. 18–19.

\*\*\* “Biznes” No. 1–2 (312–313)/1999, p. 25.

The atmosphere of worry and uncertainty are accompanied by statements completely unlike. Their authors, without denying the complexity of political and economic situation in Ukraine, try to indicate some necessary steps to be made, which, if successful, would let Ukraine derive measurable profits from the introduction of euro.

The most substantial stipulations are addressed to Ukrainian enterprises – present and potential exporters. They point out that the introduction of euro will inevitably annihilate a protective umbrella spread over ineffective actions in the economy. Ukrainian enterprises will be exposed to international competition and will either prove to be capable to compete or face the failure.

Efficient use by Ukrainian enterprises of mechanisms brought by euro, already now allows for an increase of their competitiveness on international markets and for taking advantage of co-operation with international financial markets in order to gain relatively inexpensive capital. This arises from decrease of currency exchange costs by Ukrainian exporters and reduction of exchange rate risk. Means saved in this way can be used to cover the needs of exporters. Moreover the best companies will have a possibility to place their securities denominated in euro on the EU markets and outside them. It is estimated that means gained in this way will be less expensive than in case of other sources (e.g. international loans).

Generally, euro should make Ukrainian economy and financial market more transparent, which doubtless will not remain without some impact on growth of foreign both direct and portfolio investments in that country.

Very symptomatic from the point of further development of Polish-Ukrainian relations and Ukrainian attitude to European integration processes are also forecasts made by Ukrainian experts concerning economic growth of countries currently remaining outside the monetary union but realising its beneficial consequences. That mainly concerns traditional partners of Ukraine – Poland, Czech Republic and Hungary. It is estimated that business outlook in these countries together with the right use by Ukraine of its former trade relations with them will bring an additional opportunity to not only develop Ukrainian export but mainly to take advantage of these countries as intermediaries in the process of closer integration of Ukraine with political and economic structures of Western Europe.

Opinions similar to the ones mentioned can be summarised in the statement that their authors do not deny the possibility of administratively maintaining Ukraine away from euro, however, they are convinced that in longer perspective it is not possible to keep euro out and the earlier proper preparatory steps

are made (as the political situation after the presidential elections is favourable) the better the chance to take full advantage of the process.

The introduction of euro – a milestone financial innovation and truly international currency – has started the process of deep changes in not only banking systems and financial markets of countries within the European Monetary Union but also has brought measurable consequences to other countries – European and from outside Europe – those seeking the membership in the Union as well as those – meanwhile – suspending their decisions in that respect.

Less than a year of experience with the new currency put a question mark over the question of accuracy of forecasts concerning further development of situation in countries of Central and Eastern Europe since it is hard to balance costs and benefits and identify all the threats related to the new currency.

It is sure, however, that countries of this region, that have made the biggest progress in political reforms and adjustment of their economies to the EU standards (e.g. Poland, Czech Republic, Hungary and Slovenia) are, in a degree comparable to the EU countries, exposed to possibly negative consequences and threats brought by the new currency to banking systems, financial markets and enterprises. It will be just those countries, however, and the Baltic States that will benefit from the positive changes that – according to plans of euro architects – are already initiated and will be initiated in the future by this instrument.

In two biggest post-Soviet states – Russia and Ukraine – the mentioned threats and risks seem to be smaller because of the distance between their financial and economic systems and those of the rest of Europe. But consequently, the possible benefits from the introduction of euro will be smaller for those countries. One can say that the new European money brings for those countries an additional opportunity and impulse to choose the strategies of their further political and economic development. It will depend on determination of political and economic authorities and on the will of societies, to what degree and when the advantage of the chances will be taken.

Jerzy Kleer

## Summary and conclusions

Each summary of the discussion – especially concerning the discussion abounding in polemic accents – is a considerable simplification of this discussion; it is also its serious impoverishment. Unfortunately, each person who is going to summarise the discussion, is trying to select and show such threads, which could be treated as the most important or most controversial.

The mentioned assumption concerns also this discussion. Before I will start the more detailed specification of discussed problems (both these issues where appears the conformity of views as well as these issues represented by such participants of discussion who keep up their positions regarding the issues), I would like to present the three following statements.

The first statement – and probably the most important – is that both the presented papers as well as the extremely fascinating discussion were performed on high scientific level. It was an advantage of discussion that some questions were subject to fierce disputes full of emotions. This made the discussion peculiarly “coloured” not diminishing the scientific features of discussion. The topics of presented papers and discussed then, first of all are the relatively new ones (at least inside our environment) and so much important for the Poland’s economic perspectives, that it would be very strange to discuss these topics without emotional tone.

The next statement: the choice regarding the topic of conference – “Euro and its impact on banking and financial system in Central- and Eastern Europe” was not only correct, but also very needed. It does not matter that in many

discussed questions did not come to the rapprochement of positions. However, it is important that this made everybody aware of the fact, that both Poland and other Central-Eastern European countries have not only to get used to new European currency, but also they should find a solutions how to associate domestic currencies with Euro. The significant stake of Polish trade turnovers as well as foreign investments is already associated with 'Euroland'. It seems that such process will intensify regardless on the date of Poland's incorporation to the European Union.

Last but not least, the third statement: the discussion on Euro and all the consequences of its implementation (especially for the countries being the applicants to the EU) will (or would) be the starting point of serious discussions on real chances of applicants and barriers related to their incorporation into the EU. Until now the debate concerning country incorporation to the EU (especially regarding Poland) was dominated by the political aspects as well as – partially – by the legal aspects (resulting from negotiations with representatives of the European Commission; this aspect concerns the adjustment procedure). Discussion on Euro shows numerous areas of threat, but also shows the chances and opportunities related to the joining firstly the EU and next to the European Monetary System.

Unquestionably the incorporation to the EU is for Poland the important goal. Nobody from participants of discussion has challenged this question. The same situation is regarding the joining – sooner or later – the Euro monetary system. The divergencies regarding this matter concerned rather the date of incorporation to the EU and relationship between Euro and Polish Zloty as well as currencies of other Central- and Eastern Europe. In this context there should be emphasised two important aspects being a subject to discussion (and even hot dispute) regarding the costs of shift from Polish Zloty to Euro currency – when it will be done? The first aspect: what will be the costs of this operation? The second aspect was as follows: Who will cover these costs (this mean: who will finance this operation)? There is a question: will Poland be only charged for these costs, or will we receive support from European Union or European Central Bank? It is hard to determine the expected financial support destined for currency change procedures in Poland and other countries. It is unquestionable that the several simulations are necessary to estimate the cost requirements not only in the economic aspect but also in the psychological one. The discussions in countries – applicants to the EU show that the attachment to the domestic currency is always remarkable. In one of presented papers and in the discussion there was conclusion concerning high importance attached by Ukrainian community to their newly created currency. Our discussion empha-

sised more general problem associated with the general Poland's costs of incorporation Poland and other countries – applicants to the EU. I have the impression that until now such general and reliable calculation of adjustment costs of joining the EU has not been made. Of course, there are several simulations of adjustment costs, but these simulations deal rather with specific areas (e.g. agriculture). But, is this any total costs simulation made? If yes, should they be publically presented or should they stay in closed cabinets? I have the impression that first of all the direct and immediate benefits resulting for Poland from taking a part in numerous EU funds are very much stressed, whereas the costs and expenses which will be borne due to incorporation to the integrative structures are kept somewhat in the shadow.

Considering the propaganda point of view the above policy is correct. It is good to remember that the main charges bear the country joining the European Union. Every economist or politician, who understand the reality and does not consider the unreal ideas, will agree with that conclusion. There were no controversies concerning our perspectives to irrevocable joining the EU, and thereafter we will join 'Euroland'. But considering the knowledge about the incorporation costs and the specific dates (which we should not to set) – we should absolutely retain the realistic thinking.

The aspect related to the time schedul triggered off several controversies during the conference. On the other hand it was formulated the postulate that the date of Poland's joining the EU should be set as the fixed parameter. The same postulate was formulated concerning European Monetary Union (EMU). Such postulates were formulated because of the opinion, that Poland should know the schedule of EU joining to be prepared to these processes as good as possible. But there were some alternative opinions – that setting of any time schedules is a premature action, because it is not known when the European Union will be ready to incorporate new members. This regards the situation which has arisen after the Summit in Helsinki when it has been decided to start negotiations with next six countries – applicants to the EU. We also do not know when Poland will be really ready to not only to adjust its legal regulations to the EU standards, but also concerning the EU economic realities.

The conference (especially opinions of the discussion participants) proved that it is up-to-date question regarding the meaning of Euro currency and its influence not only on banking and financial system in Central- and Eastern Europe. But this question requires the examination of many existing problems: both the basic ones as well as the detailed ones. It was obvious for the conference's organisers. But the discussion showed that there was no consensus in many general questions. That was because the participants of discussion



were representing different political points of view; they were the followers of different economic ideas, and – last but not least – because the real economic process till now is unable to prove the legitimacy just of one from the existing economic- or organisational solutions.

The result of conference treated as the way to consensus, to an agreement – can be considered in two areas. The first one is the group of questions to which the full (or almost full) consensus appeared. The second area is the group of questions touched by significant differences. Considering the theoretical point of view, both these areas are important, because it was deep identity of the areas of conformity and areas of disagreement. Both areas are important for further scientific discussions.

### The areas of conformity

1. The appearance of Euro currency is certainly (or even revolutionary) change in world economy. The importance of Euro currency will undoubtedly appear in the starting period mainly inside the 'Euroland' (the 11 incorporated countries), then the expansion will be continued in Europe as well as worldwide. Presently it is hard to determine the promptness of such processes. But, sooner or later, the foreign trade of incorporated countries (15) will be invoiced in Euro currency. The next step will be as follows: the majority of transactions executed between European countries and the remaining countries of the world will follow this process too. But this is a sound of the future. It can be taken for granted, that Euro is primarily destined to strengthen and to develop the economies of monetary union members. This should be also a support for the economies of the applicants to the European Monetary Union. In the first period of Euro existence, this currency is focused on internal affairs of the EU; the target for new currency is to strengthen this group of countries. It is very important task, because up to now the integration process could not secure all such benefits for economic integration without the existence of common currency.

2. The participants of discussion have agreed that Euro appearance will finally lead – rather sooner than later – to smoother fluctuations of business cycle. Considering the point of view based on long-term development, this task is very important, because – as it was proved by past development – it was no close convergence of business cycle inside European Union.

Thanks to the integration, the huge internal market appeared. On this market the group members can offer majority of their products and services. Before the appearance of Euro currency on this market were present several currencies, the fluctuation of their exchange rates was different. This fact led to increased

fluctuations of business cycle. The appearance of Euro is equivalent to implementation of the uniform monetary policy based on some universal rigours concerning the given area, subject to European Central Bank's supervision. The already collected practice of European Central Bank proves that its reaction is immediate and consistent regarding all fluctuations based on inflation and budget problems. Undoubtedly this will have the positive influence on smoothening the business cycle. In any case, such conclusions come from the theoretical prerequisites. It will be possible to comment these conclusions after the 2–3 years period of Euro existing, when the theoretical conclusions will be comparable to real experience. The national currencies will be in this period totally withdrawn from circulation. Considering these circumstances, in the discussion appeared the following question related at least to the initial period. How the common currency can constraint the economic policy of the individual countries, being still independent countries – members of EMU? The main opportunities of economic policy are still realised by the national monetary policy. Too short period of Euro existence does not allow answering this question anyway.

3. The participants of conference have agreed that Euro should contribute to economic growth in the European Union. This growth is a problem for long time – at least for 10 years. When the growth rate of the UE would be calculated correctly, we can notice that in the long period the economic growth was not on the satisfactory level not only in comparison with the world average rate, but also especially in comparison with the USA and Southern-East Asia (including China) growth rates. The factors which should dynamise growth may be divided for the long-term, medium-term and short-term ones. The first group includes the well known factors, which are related to reduction or to the total elimination of the significant volume of transactions' costs, or to the speculative transactions on foreign currency exchange, or to increase of economy's transparency, or especially to the increase of competitiveness of European enterprises. The medium-term factors are more debatable, generally because that they require fulfilment of several conditions in the future. Nobody could be sure that such conditions would be definitely fulfilled. The opinion mentioned in discussion – that has never been a subject to polemic – was the opinion that Euro will enhance long-term growth of employment (more exactly: will contribute to the reduction of unemployment). Assuming that acceleration of growth will appear (it was a subject to dispute how will be the average amount of this rate: would it be between 2,5 and 3%, or more?), the level of unemployment will decrease; however, on condition that unit costs of labour will grow up not excessively, as well as the social oriented government policy

will be reduced. It is hard to settle this question whether such situation will happen or not. But it is unquestionable that Euro will act towards this end. During the discussion the optimistic view prevailed that Euro will exert an impact on growth acceleration in the area of monetary union or – considering the broad aspect – inside the European Union.

4. There was also a consensus concerning the opinion that Euro can be helpful for stabilisation of Polish economy, by the active influence on financial stability – or in the broad aspect – on the adjustment to the EU processes. The hearts of the matter were real adjustment processes related to particular economic areas. There was a following reasoning conducted: the support for stabilisation will be based not only on the take-over the costs (financing the expenses) by European Union – considering at least the significant part of these costs (such scenario has been practically excluded). The support will therefore concern the strengthening of banking systems and financial institutions being subject to several risks. It should be stressed that fortunately Polish financial system avoided the troubles similar not only to the Russian-styled troubles, but also the Czech- or Hungarian ones. But it was also pointed out that Poland will be charged for the costs of adjustment processes – this question is very important not only for the academic or banking and financial circles, but also for the political classes. Support coming from the EU will be at best the supplementary factor; the special role of such support will appear mainly in the institutional and organisational questions, in the suggestions how to avoid the fundamental mistakes. Considering this point of view, the European Union and also the EMU, have already gained enough experience.

5. The opinion was widely shared that Euro can have a positive influence on the general development of Polish economy. This is not only because the majority of Polish foreign trade transactions concerns the regions of very low inflation rate, and the exchange rate fluctuations could be considered as totally eliminated – but also like a factor motivating to further changes. The profound transformation of Polish economy from the centrally managed economic system to the market oriented and also when the country is going to join the EU – so in that situation is necessary a peculiar stimulation like a 'Big Push', which will motivate the community of this country. Such stimulation will also positively motivate the elite of authorities and business activity to the increased efforts, or – sometimes efforts modified in comparison with the previous practice. This is not excluded that Euro can be such driving factor. But, there is one condition to fulfil – the decision elite, which is determining the directions of further economic development, could take the decisions having the long and clear enough perspectives. Regardless of the importance we assign to the

market forces regarding the allocation of production factors, so considering the general development we cannot relinquish the clear economic policy – especially in such areas which determine the success on joining the integration group.

### The areas of disagreement

During the conference – especially in discussions – many controversial problems arise (please note that there were stormy controversies regarding some problems). For many differences there was no theoretical consensus found. But this is not a tragedy, and it does not show that the conference was inefficient. One of the important goals of such type of discussions is disclosure of the differences based on theory as well as on practice. There were many such questions, and for the sake of brevity, only the selected questions will be mentioned here.

The first question concerns the significance of foreign capital in the banking system and in the national economy. Probably it is not the most important question, but this problem triggered off the most emotions, most controversies, and – what is important here – did not lead to any consensus among the participants. There were different opinions regarding the position of foreign capital in the economy, especially in banking sector. The first group of participants opted for the following conclusions: considering the significance of foreign capital in the transformation processes of economy, as well as considering its significance in restructuring of the economy (especially in accelerating its growth) – some economic sectors – especially the banking system and other financial institutions in the initial period of transformation – should be owned by domestic capital or finally should be owned by State. There were following arguments for such conclusion: this is a danger for domestic financial system that the funds based on domestic savings could be transferred abroad; foreign banks are not interested in the promotion of Polish export opportunities; also that there is a danger for public interest if the banking system is (or could be) seriously threaten due to domination of foreign capital in Polish banking system, and the banking system risk is increased. These arguments were illustrated by numerous examples from Eastern European countries, including the examples from the European Union. These examples show that until the domestic banking system is not consolidated, there was a selective admittance of foreign capital to the domestic banking system. The example countries were Germany, Spain, France and Portugal. The second group of participants took opposite side. There were opinions formulated that the volume of foreign capital incoming is too weak; that Poland – in contrast

to the existing opinions – is not a country in which the foreign capital will be excessively invested. What concerns the promotions of Polish export by banking sector being a subject to significant foreign investments – there is another reality than it is mostly performed. It is good to remember that the example countries of most increased export are Hungary (last year export growth: 17%) and Czech Republic (export growth: 11%). In the same time the growth of Polish export amounted only 7%. In the above mentioned countries the share of foreign capital engaged into banking sector is higher than in Poland. It is also false conclusion that along with the increase of foreign capital share in banking system, the risk of banking security is also growing up. In the banks owned by foreign strategic investor, the awareness of banking risk is higher and – what should be pointed out – such type of risk is much better managed and controlled.

This dispute has not been settled because the period of assessment is too short to decide which option is the right one. It seems that the question will be controversial for the long time yet. Especially that the policy of government is not sufficiently clear, and it is subject to changes.

**The second question** concerned the term 'public- or national good'. This term appears in almost all Acts of Parliament or the regulation – some action or activity could be ordered or forbidden because of 'public or national interest'. It was shown that this term could be treated as the keyword coming from socialist system; not enough correctly defined. This means that in the economic reality (especially in the banking and financial system) this term could be freely interpreted. This conclusion has got an influence on the arbitrariness of decisions taken by bureaucracy. This is such question that requires a new definition not only in the economic development interest, but also it is necessary for stabilisation of 'rules of the game' concerning both Polish and foreign investors. The foreign investments require the stable and clear rules of the game; otherwise the influx of foreign funds to the economy will be limited. It is good to consider that without such investments supply – the resumption of growth acceleration would be impossible.

**The third question** concerned the relationship between Polish currency system and Euro system. Regarding this question there were many detailed views presented. But these views have not been a subject of detailed analysis, neither have been generally approved. Without going into details of this discussion, it is worth mentioning the majority of contentious issues. First of all, it was pointed out that regardless of the role, which could play Euro in stabilisation of Polish system of currency exchange rates, Zloty is still stronger associated with US Dollar than with Euro. The reasons of such situation are

the structure of Polish public debt, the debt issued by private investors as well as the invoicing of Polish foreign trade. It is the contentious issue whether this relationship could change in a short time. The 'sentimental' attachment of Polish people to the US Dollar should be also considered. In such context arise the problem of the Euro-Dollar competition. It was an attention paid in this context for the following circumstances. First, this is still a future related question; secondly, this problem will depend on internal strength of Euro currency inside EMU. Next question is that nobody knows how fast the British Pound will (or will not) be incorporated to EMU; last, but not least, it is hard to assess the successes of the European Union within the next years. There were two following postulates issued. The first one is that it is necessary to set the exact date of establishing the relation between Zloty and Euro, since Poland should be adequately prepared for such operation (costs and expenses, logistics etc.). The second conclusion concerned that it would be very useful to connect Polish Zloty with Euro before joining the EU and also to prepare the scenarios how to execute such connection of currencies. Such conclusions caused the questions (especially addressed to the speaker from Brussels) concerning the status of preparations regarding the relationship and possible agreements between central banks of the countries-applicants to the EU and European Central Bank located in Frankfurt. With regard to this question, the attention was pointed at the necessary needs to create the scenarios regarding these relations, regardless of the date of Zloty-Euro association. In the discussion appeared also the questions regarding the relationship between Euro and the currencies of other Central- and Eastern European countries through the Polish Zloty. This problem mainly regards the Ukrainian currency (Hryvna).

**The fourth question** concerned the Euro-Dollar rivalry. Although I mentioned this problem previously, but it is worth developing this thread in detail. The United States dominates Europe more than the macroeconomic indexes show. This is very important goal of Euro existence to compensate such domination. There was a significant consensus regarding one question: the domination will not be compensated within short time. On the contrary, due to some historical reasons, due to its operational range as well as due to some psychological reasons, US Dollar will play the leading role in world currency system. If the competition of Euro would appear, so it will concern the limited area and with a relatively big delay. For the time being, the Euro/Dollar rivalry seems to be apparent. But the problem is still existing, especially in the long-term perspective. Therefore could be asked the two justified questions (although up to now there are no answer for these questions). The questions are following: would the co-existence of two world currencies be favourable

for world economy? Would it be better to keep only one dominant currency instead of two currencies? Well, if the competition is a desirable phenomenon, so the co-existence of two world currencies is indisputable.

**The fifth question** concerned the internal functions of Euro inside EMU or – broadly speaking – inside the European Union. Should Euro be only a common currency, or should it deeply concern the integration processes? Thus, the Euro implementation scenarios are not sufficiently clear, especially those published. It is clear that the implementation of common currency brings many advantages previously described here. The general question is following: should the functions of Euro amount to these advantages only? Or – is there a long-term scenario assuming that the members of EMU will be deprived of the independence regarding the monetary policy (what can lead to the future similarity of taxation, social security and – probably – also the wages systems)? It means that in the field of activity of common currency system, the European Union will become a unitary market with all its consequences. During the discussion there were expressed the opinions, that such long-term attitude towards the consequences of implementation of common currency is a utopian view, which will stay unrealised within the present as well as the next generations' life. Probably, such situation could happen, nevertheless – in my opinion – if such scenario would have take place, the benefits brought by Euro implementation would be limited.

Of course, it is necessary to be fully aware, that if such scenario (described as utopian) was executed, the independence of member countries would be seriously limited. Different flags and emblems would eventually remain, but maybe there is such logic of globalized economic development. But Euro is not competitive to the globalisation processes, but rather it is a complementary factor. Such eventual situation is related to the future. Probably Euro will lead to the real unification of Europe or its dominant part.

**The sixth question** concerned the fact, that it was a general unanimity related to the consequences of asymmetrical shocks being the result of Euro implementation. On the other hand, it was no agreement concerning the assessments of dangers related to such implementation, as well as concerning the assessments of individual measures related to moderation of such shocks. Discussion was focused rather on identification of dangers and the remedial measures. The participants were trying to make some distinction in this context; how are the differences between the dangers threatening the developed countries and the dangers threatening less developed countries (especially the Central- and Eastern European countries) which are going to join the European Union. It was a subject of consideration, how benefits can be received and how

will be the charges for the country joining the EU (afterwards EMU), if the GDP per capita amounts one third of the EU average (calculated on the basis of purchasing power). What can be treated as benefit or a cost in such case? Could the stabilisation of foreign exchange rate and the reduction of inflation rate be always treated as a benefit (assuming the given conditions and the given incomes level). Should it be treated like a benefit or not?

**The seventh question** concerned two of more general theoretical topics, which – I think so – were insufficiently considered during the discussion. Probably it was caused by the fact, that the participants were dominated by theoreticians as well as by people experienced in monetary and financial questions. The first question is related to the following circumstances: despite of considerable progress towards market oriented economy, there is a still significant domination of real economy, which is poorly covered by the monetary systems. Such areas like e.g. agriculture, mining, defensive industry and other – are located rather on the edge of market- and monetary systems. To these sectors the market principles could be applicable only partially. Regarding such areas, the economic decisions are not based on the cost-benefit account, but rather on the political decisions. Money is not an exclusive measure of assessment. In our discussions regarding the associations with Euro, such questions absolutely cannot be omitted. The assessment of Poland's readiness to join the EU in such situation would be rather unrealistic.

In this context has been mentioned the question of theory concerning transformation of domestic currency into the common one (currency of the community). Until now we have no such theory of currency transformation. As far as the justification of such circumstance is concerned, I would like to refer to the experience related to transformation processes started 10 years ago and executed in other countries changing their economy from centrally managed to the market based one. In this period there were no theory of transformation too. The process of trial and error has created the theory. Although it is still questionable (many people have such doubts till now) whether we have already such theory. Regarding this question I do not want to take a floor, but concerning the transformation theory let me say, that such theory should not be based on the monetary aspect only. The common currency – as I told it in the opening statement to the conference – could be treated as revolution regarding the European economic relationships. This is a revolution with the long-term, perspective consequences – not only the economic, political and social – but also regarding the thinking and working philosophy. Between the countries having its own history or fighting with each other in the past, will be undoubtedly created the new behaviour systems. The common currency should

be a joining factor. Would it be possible without any conflicts or not – it is hard to assess now. It is necessary to consider that these behaviour systems will not cause the wide conflicts, and this will be not an excessive obstacle for the European economic development.

## **Hermann Bünz**

### **Closing statement**

Experienced specialists from the Central and Eastern Europe as well as professionals from the Western Europe and the European Commission coped in a masterly way with the presentation of the complex problems of the "Common European Currency". The conference, headed expertly by Professor Jerzy Kleer, was a source of a comprehensive information for all the participants and created a possibility of understanding the problems in question. Our task now is to introduce the gained knowledge to the every-day work. In this context, however, one should say additionally about a few aspects that go beyond the scope of the mentioned subject matter.

On one hand, the matter concerns the traditionally perceived national state. During the conference, fears were expressly articulated that a common currency could pose a threat to the national state, destroy its identity and in effect lead to a growing uncertainty which in turn could be transformed into a clear enmity towards the united Europe. It should be emphasized, however, that we are now in the phase of the world economy development in which a process of divergence from the classic industrial state takes place as well as the classic 19<sup>th</sup>-century perception of a nation.

For the first time the limits of growth were set out, which has so far been perceived as unlimited and which seemed to be a foundation of the welfare of nations. If we do not want to destroy the basis that our welfare is conditioned by, we have to ask the question whether – also from the economic point of view – there are other development criteria apart from the traditional concept of

growth. And here, one should bid farewell to the concept of growth stemming from the past as well as to the concept of a sovereign national state, such as our ancestors dreamed of.

The concept of the welfare state dating to the second half of the 20<sup>th</sup> century raises more and more doubts as well. Will it be possible to finance it in the hitherto form in a longer term? Or, are there other ways to ensure welfare to societies? From the point of view of many persons the list could be supplemented with some other "bids of farewell". For example, a farewell to the national currency. Some of those farewells have, however, become less painful thanks to new processes. One of them has taken the shape of European integration and its political form – the European Union.

And here, questions of quite a different character begin. Many states seeking membership in the EU are not fully aware of the meaning of that move. They lack a vision of a united Europe. It still seems to them that all that is a rather administrative and technical problem. What has the European Union been dealing with during its over 40-year old existence? Where does the path embarked on by the more and more strongly integrating Europe lead to? If someone maintained 10 years ago that a common currency would exist in year 2000, it would only cause an astonishment with the unusual boldness of that person. And nobody would believe that Germans would ever part with the Deutsch Mark. And today, the astonishment is caused by persons who doubt that there is a need to introduce Euro, and don't believe in its effectiveness.

And of course, there appears the question of what place would a country like Poland take in the European Union in the future. What are perspectives of that country?

I would like to say a few words about that country, which has the biggest significance in the context of those problems. A country whose accession to the EU is being vigorously prepared and in which there still exist fears connected therewith. However, as regards the Poland and EU problem, I am an optimist. Poland is in the very centre of the transformation process. The question of how and how quickly the process will be carried out, and when the country is going to be prepared for accession to the EU must be answered by the Poles themselves. Undoubtedly, Poland has not got 40 years for collecting of experience, making mistakes and drawing appropriate conclusions, such as in the case of most of the states that presently are members of the Union. It can certainly be a burden, but may prove to be beneficial as Poland has a great opportunity to draw on the experience of her neighbours. And being the biggest and the most important of all the candidates will have to play an important role in the process of the European integration of new members to the EU.

The question when and in what way Poland will become a member of EURO Club does not play a decisive role now, because at the beginning it will be a problem of financial, technical and economical character. The will to pursue that purpose and the political determination exist, however, in all the political circles of the country. Unfortunately, that principally positive premise is not always properly appreciated by the present Member States of the EU. Therefore, I would like to encourage scientists and specialists to even more intensively take up the problems connected with the degree of preparation of Poland to accession to the EU. It may be a critical approach, but it should be clear and well pronounced, first of all to the EU.

Many views and opinions expressed at the conference implies that there exists certain skepticism with regard to the membership of Poland in the EU. That is well understandable, as the conference was attended by scientists to whom skepticism and critical estimates are natural tools of their work. From the political point of view, however, it would be advisable for those critical tones and reservations of an emotional character to translate into a support for an accelerated accession of Poland to the EU. Here I believe, for example – that based on the experience gained at the conference, showing the authority of the Polish science – the expert of the European Commission of Brussels will play a role in the capital city of the European Union in the future, that will be beneficial to Poland.

I believe that both this conference and the resultant publication will not be the only events organized by Friedrich Ebert Foundation with regard to the problems in question. They should encourage further intensive work on all the issues concerning the monetary policy, also, or perhaps first of all, with participation of the neighbours of Poland in the East, South and North.

And finally, I would like to express my personal thanks and sincere esteem to Professor Jerzy Kleer, who supported by his young scientific staff from the Higher School of Banking, Finance and Management, ensured the unquestioned success of the conference both on the substantial and organizational side. That can be a basis for an effective and fruitful debate on the EURO currency and the European Union itself. And that is what we need – so that we can shape our common future.