

**Economy**

# **New Opportunities for Polish-Japanese Cooperation: Diagnosis and Prospects**

edited by Jolanta Młodawska-Bronowska

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# Global economy knows no borders\*

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In order to describe the present situation of global economy, we should look at the International Monetary Fund, provider of economic forecasts for the entire world, which – over the past few quarters – has been constantly downgrading its predictions for the global growth. Quite recently, the rate of growth for the global economy was put at 3.3% for the next year. This is not a disaster and, as a matter of fact, if you compare this data historically, this rate of growth has been usually associated with periods of prosperity in the global economy. Why then was last year's meeting of the IMF and the World Bank in Washington rather gloomy? There are three reasons. The first reason is that 3.3% does not look bad, but the economy is slowing down, so we do not know how far we shall go in downgrading our forecasts. The second reason is linked with the global economy considered as an unbalanced structure, and we are examining a certain kind of realignment in different parts of the global economy. Every process of realignment or readjustment is dangerous and can end up maybe not in a crash landing, but rather in a bumpy process. Thirdly, we are clearly facing geopolitical tensions. Western Europeans usually concentrate their attention on the Middle East and the expansion of Islamic fundamentalism, whereas in Poland, we consider the east of Ukraine or Russia as a source of instability in the region. I think that our Japanese partners might point out other sources of geopolitical tensions located especially in Eastern Asia. This does not help the economy and adds to uncertainties in economic activity. As for the structural imbalances, we can see that different parts of the global economy grow at different speeds.

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\* Record of the speech delivered at the conference.

## **1. The United States seems to be in a relatively good shape**

What is frequently overlooked in the assessments of the American economy is that the US still remains demographically dynamic, which is mainly due to immigration. Another reason behind the such good shape of the United States economy lies in recent technological breakthroughs such as fuel extraction, mainly oil and shale gas. This adds optimism and gives Americans a very strong competitive edge over their competitors in other parts of the world. We should not forget about a very pragmatic macroeconomic policy in the United States. When needed, they have employed and pursued an extremely expansionary monetary policy, although now this period is coming to an end, causing some worries, especially in the emerging markets. As they are the recipients of the excessive flow of capital, with the end of quantitative easing in the US they might suffer from an excessive outflow of capital. These kinds of instabilities coming from that part of the world might hurt emerging markets. Nevertheless, the American economy is holding up very well when compared with other countries.

## **2. Transformation of the Chinese economy**

China's economy is in a very difficult and delicate process – on the one hand, it is slowing down, and on the other it is switching from being an export-oriented economy to a domestic demand-driven economy. This is a very difficult process because of the size of the Chinese economy and its interconnections with the world. The process of deceleration is not only expected, but also welcomed. After all, the world seems to be too small for China to grow at 10%, especially when the growth is export-driven. So this is another factor that worries the world, and Chinese trade partners in particular. In fact, everybody seems to be worried about how successful the Chinese will be in managing the process of switching their economic profile. The most recent issue we should be looking at is the way in which the Chinese government tackles economic slowdown and urban-rural tensions and inequalities, which are more visible every day and create a potentially dangerous social problem for the state.

### **3. Abenomics as a life buoy for Japan**

As for Japan, the new economic policy engineered by Japanese Prime Minister Shinzō Abe, called Abenomics, is being pursued nowadays in an attempt to revive the economy. The chairman of the Bank of Japan and my colleague, Haruhiko Kuroda, is at the centre of all the action. Quantitative easing and the ultra-soft monetary policy of the BOJ are pulling Japan out of years of deflation. American and European commentators used to describe the immense public debt as the main problem in Japan, but the Japanese totally disagree, saying that 90% of that debt is held domestically. This might be true, but the Japanese themselves do not think that 250% of GDP public debt is sustainable, therefore making Japan vulnerable to various disturbances. That is why the second arrow of Abenomics is concentrated on reducing the size of the budget deficit by increasing sales tax. Increasing sales tax, as I might presume, is a shock to the Japanese economy and society. Nevertheless, it is pursued and in the nearest future we will see how efficient it is going to be. The third arrow, described as structural changes, is very important. It usually occurs when an economic policy does not work and specialists say that we need to turn to the structural economy or structural reforms, which might mean everything. The term “structural”, however, in case of Japan, means that the current pattern of employment is completely different from American or European ones in such aspects as: lifetime employment, almost eternal affiliation with the same employer, loyalty, security, small mobility and no chances of introducing a wage policy which would help the BOJ Chairman fight deflation. As a matter of fact, his predecessor, Masaaki Shirakawa, who was much more conservative in his monetary policy, once said that “as long as we have this model of lifetime employment, no matter what we do with quantitative easing, we will not fight and we will not be able to overcome deflation.” Why is deflation so important? If you are overly in debt, deflation increases the real value of the debt compared to your current income and current wealth, which may be a dead end for the economic system of a country.

## **4. Economic manoeuvres of the European Central Bank**

In many aspects, Europe is the weak spot of the global economy. Firstly, it has problems with functioning as a one-currency area when individual parts of the Eurozone are so different. The problem of Europe is in the divergence between the so-called North and South, or peripheries as they are frequently called. Despite not being a part of the Eurozone, Poland is in fact a part of the North. Analysing the situation in Europe, we must underline that the current problem in this region is retaining a common currency when economies are moving in different directions. As a result of this, the overall growth rate of the economy is very modest and now, after a very rapid recovery, there is a movement towards something close to stagnation.

Why is this so important? Inflation has always been the best way to do away with excessive debt. This has happened many times in the history of advanced economies, like in the aftermath of the Second World War, when European countries and the United States came out from the war with massive public debt. Somehow it was massaged out, by fast growth and inflation. Now, we have almost zero growth and a situation close to deflation. How can we do away with the existing excessive, unsustainable debt? Leaders of European countries have turned to public policy and what can be done with it. The easiest and fastest way to engage was an easy monetary policy with zero interest rates.

There is also talk about quantitative easing and the European Central Bank has engaged in this policy, following the Bank of Japan, the Bank of England and the Federal Reserve. The problem is that the mandate of the ECB, at least as it is interpreted by the Germans, does not allow this institution to engage in the same kind of monetary quantitative easing by unconditionally buying unlimited quantities of government securities, as was done in those three cases mentioned before. Quantitative easing must accordingly take into account other types of debt instruments. You may have heard that the ECB started buying the so-called asset-backed securities issued on the basis of existing loans, mainly for small and medium-sized companies. Other assets are also to be purchased by the ECB with the expectancy that if more liquidity and more money is in the hands of economic agents, more credit will be extended and more economic activity will be stimulated.

## 5. Infrastructural projects as an improvement for the European Union

However, the universe of asset-backed securities and other instruments like covered bonds is very small in Europe, estimated at only one billion Euro (if we want to describe it in the American terms – one trillion Euro), which stands for around 6–7% of the Eurozone GDP. Taking this into account, the ECB's plan to buy out all assets of this type from European commercial banks will have much smaller effect than in the three cases mentioned before, as this operation would represent only a fraction of the value of the Eurozone's GDP. This will only compensate for the decrease of the balance sheet of the ECB that happened last year. There was much talk about quantitative easing, but in reality, it was about engineering quantitative tightening. Using the everyday language, they were not printing money, but destroying it. In order to reverse this destruction process, “every moving thing” in the European economy had to be bought. And this is impossible.

Mario Draghi, the President of the ECB, said that he “will do whatever it takes to save the Euro”, adding that it will be enough to improve the situation. So, after monetary policy, the second big instrument is fiscal policy, and it was taken on. If we think that economy is lingering on at a very slow pace, we could stimulate it by further expenditure. What happened in Europe in the last few years was fiscal austerity, the reverse of fiscal stimulation, which was triggered by the situation in the so-called peripheral countries, or more precisely in those that have the Euro as their currency (Greece, Portugal and Italy). This was necessary because many countries found their debt unsustainable, and the markets were denied access to capital, and thus to rolling over the existing debt. Therefore, fiscal policy did not play a stimulative role in the past, but rather the contrary.

Now, the situation has become dire and some countries face pressure coming from the Eurozone to stimulate the economy. But the only country which could help to conduct this plan (Germany) took a different path, in which the main goal was a balanced budget. But if not them, then who? There are not too many candidates that have fiscal space to continue and increase their deficit. Even “the hawk of the hawks”, Valdis Dombrovskis, former Prime Minister of Latvia, after having been nominated the Deputy President of the European Commission, was forced to admit that austerity was over. At the same time, a tough question was raised about who was going to turn to fiscal loosening, especially when there were not so many candidates? Some plans appeared to set up a European

Growth Fund (EGF) for Strategic Investments worth 315 billion Euro, from which infrastructural projects would be financed to help stimulate the economy.

There are two problems though. First, what projects are we talking about? This is the “defence line” of Germany’s Federal Minister of Finance, Wolfgang Schäuble, used during a discussion with his Polish counterpart Mateusz Szczurek, who is in fact a supporter of this fund. The Polish government’s representative often asked the same question, saying that if there were a specific project, then the money could be found. Poland is a very active participant in promoting the idea of the EGF, and we have a moral high ground on this. Mainly, this is not about our country, as we have a similar fund which is in fact a European Structural Fund flowing to Poland from Brussels at the rate of net 2.5% of GDP. We have our own program of infrastructural improvement that the city of Lodz is already taking full advantage of.

The Europeans, though, have not yet prepared a roster of infrastructural projects that would make sense from the point of view of the global European economy. I can name some examples like the modern European bridge system or the network of gas and oil pipelines. Meanwhile, the Germans could also take care of the run-down highways in the west leading from Brussels or Paris to Poland. A difference can be seen between the quality of highways in the east (former German Democratic Republic) and those in the west which are jammed. As far as this initiative is concerned, there is the problem of financing it. Putting on an additional tax makes no sense. However, an additional debt might be a solution, but the real question is: which country will incur it? None – the idea is to borrow money from the market in the name of the European community. This would be the first case of having a community debt, something that all the proponents of the fiscal union are very happy with, except the Germans (and the Finns, the Dutch and others), the paymasters, who fear it the most.

## 6. Structural policy as a problem

This idea of creating a European Fund for Strategic Investments is quite interesting from the perspective of further evolution of the European integration. We have underlined the problems of fiscal stimulation. When the economists see that monetary policy does not work, and that fiscal policy is not that clear of an option, they start talking about structural policies. Poland is a very good example of how structural policies helped

in the process of the European integration. Now, we are reaping the benefits of positive structural changes engineered in the first 15–20 years of transition. Structural policy is nevertheless troublesome because we do not know precisely what it is, how it works, how much time it takes to start influencing the economy, and sometimes in which direction it moves. This is a patchwork, so we have to do different things in different countries in different periods.

We know that the French have to limit or even run down their overgrown and very generous social state, but every time French politicians mention this, one million people appear on the streets of Paris. The main difference between managing Poland and France is the following: when the Prime Minister of Poland Donald Tusk increased the retirement age for men from 65 to 67 and for women from 60 to 67, we had “massive” protests on the streets of Warsaw of about thirty thousand people. If the French were to be put in a similar situation, then there might be even two million demonstrators on the Champs-Élysées. That is the difference. The problem in Europe, or should we say in the Eurozone, is that policy options are really scarce and we really do not know what to do exactly.

## **7. Poland as a future member of the Eurozone**

There are two main issues about Poland, one in the internal and one in the external scale. The internal issue is about convergence, which is closing the civilizational gap with the most advanced countries, continuing in the same way that we have done in the last 25 years. A part of our society still doubts whether the last 25 years have been a huge success, but we cannot stop and hesitate as further stages of our development, perhaps even more demanding, are still ahead of us. We have not found out yet whether we are able to proceed economically in the same fashion as before.

The second issue raised quite often is the following: will Poland join the Eurozone? We are obliged to do it, committed to join the Euro in our accession treaty and in the referendum that took place in 2003. Poles might not realise that, because this was not an issue at that time. Nonetheless, Polish authorities consider entering the Euro area as a strategic goal, but as for now we are not yet prepared to do it and we are not rushing. This makes perfect sense as the political argument goes two ways. Those who fear European integration, creation of a European state or some kind of federation, fear that Poland will lose or will be watered down in the Eu-



ropean melting pot. Critics usually argue that being outside the Eurozone leaves us on the margin of the integration, and we will not be sitting at the table where the most important political decisions are taken, instead figuring only on the menu.

Well then, shouldn't we join the Euro? But then the economic argument comes: we are not prepared yet. So when will we be prepared? To be a little sarcastic, we can say that if we could be as competitive as the Swiss, have a labour market as modern as the Danes and a fiscal policy in such a splendid state as the Estonians, then we would easily and safely compete with the Germans in the one-currency area. But of course we will never become at once Switzerland, Estonia and Denmark, so the question becomes why that is so. I think that the real reason behind our delay could be the uncertainty about the future of the Euro area. Just a few years ago, maybe as recently as two years ago, the European companies were contemplating what the legal implications of contracts' redenomination would be.

What does this mean? It means we were asking what would happen if the Euro disappeared and we did business with companies which reintroduced national currencies such as the Italian Lira or the German Mark? How would we repay our debts? This was a real issue for chief financial officers of major European companies. If this was such a concern, it meant that the Euro was doomed. At that time, the most important decision-makers in the private sectors had already factored in the collapse of the Euro. After this kind of behaviour was detected on the market, Mario Draghi said: "I'll do whatever it takes to save the Euro and, believe me, it will be enough." The private sector and investors still believe that. The danger of the collapse of the Euro has been eliminated for the time being, but can the Eurozone function like this when countries still accumulate excessive debt and when economies basically move in different directions? Without some grand bargain between the main Eurozone countries, there is a reasonable doubt that the Euro will function as a successful project.

As long as it is not obvious to us that it's a good bet to join the Euro, why should we rush? The problem is not with us, but with them. Poland has a very balanced economy. We do not realize that the usual themes that are being discussed in Europe, to a certain extent even in Japan, do not occur in our country. We are not an advanced, state-of-the-art country; the technology frontier is not in Poland. However, we do not have problems with excessive debt, either in the private or the public sector. Even if Leszek Balcerowicz arduously protests against this statement, he is simply exaggerating. Only our wages are too low and if this trend continues, we will be stuck with price-dependant competitiveness, and our best people will keep emigrating to London or Dublin. This is the main problem for Poland today.

Question:

Mr Miura Tomoyuki:

My name is Miura and I am a former employee of a Japanese trade company. I am not a specialist in economics, but if Poland adopts the Euro currency, then there might come a boom in the Japanese investment, as the majority of big companies have offices in countries that belong to the Eurozone. They want to settle accounts in the same currency. I know that inside the Eurozone different problems exist; therefore I want to ask Prof. Belka, as an influential person, a question about what we can expect in the nearest future regarding Poland adopting the Euro currency. If it happened, what benefits might not only the Japanese companies get? And another question: does President Belka think there is a concern for the deflation in the longer period in Poland, as it is happening in Japan now?

Answer:

Prof. Marek Belka:

Before the crisis, economists were basically enthusiastic about almost immediate adoption of the Euro. Among benefits to be accrued was the access to inexpensive capital. Still, the interest rates in Poland are higher than in the Eurozone, so with the acceptance of lower Eurozone interest rates, Poland will have cheaper financing of its public debt, but not only this – Polish companies will also have access to cheaper capital. The problem is, and that is one of the lessons that we have learned in recent years, that interest rates are lower than natural rates, unnaturally low if you wish, and this can be a trap. If the interest rates are too low, we can trigger an unsustainable credit boom leading to higher prices, or even lower natural interest rates. The natural interest rate is subtracted from the nominal interest rate, the rate of inflation.

Now, we are looking at ultra-low interest rates, both from the point of view of the potential benefits and cheaper financing, and the risk of interest rates being too low, leading to the development of unsustainable credit booms. Then, what we thought in the run-up to the crisis was that if we entered the Eurozone, we would do away with exchange rate volatility, and this is exactly what you are hinting at.

While doing business with Poland in Polish zloty, you are exposed to an exchange rate risk. This means, both for the foreign company and domestic companies, that in normal times exchange rate volatility is a nuisance to hedge against it, and this is costly. However, there is another lesson learned during the crisis: if times become abnormal or extreme, then

you may benefit from a domestic currency which serves as a cushion for domestic exporters against the collapse of trade. This is exactly what happened in 2008/2009, when the zloty depreciated, providing a buffer, in terms of this currency, for exporters to the Eurozone, thus preventing labour shedding and all kinds of fire sales. So, again we learned that what may be a benefit in normal times, could be a trap in abnormal times.

However, I am not against joining the Euro. In my public pronouncements, I point out the structural weaknesses of the Polish economy, and sometimes I realize that I am not really fair to myself. I think that Poland is probably better prepared to function in the Euro than many actual Eurozone countries. But this only shows how weak the Eurozone is, because it is full of countries that should have never entered it. This was the conclusion of my statement on the Polish Eurozone membership – that the problem is not with us, but with them. And so it will be as long as they do not sort things out, as long as the Germans and the French do not strike a “grand bargain”. In short, the French should be more German and the Germans should be more French. If they do not do this, then we cannot be sure whether it is safe to enter the Eurozone. Of course, if we see that the Eurozone is growing in a sustainable way, then I would see very little reason to procrastinate.

Deflation is a problem, but not everybody in Poland shares this view. In fact, when you ask the libertarians or the ultra-liberal economists, they will tell you that deflation is alright. It increases the purchasing power of consumers and stimulates savings. That is fine. Deflation poses a threat to a country that is overly in debt. When I say ‘country’, I do not just mean the public sector, but also the private sector. In contrast to the pronouncements of the Polish media, Polish households are basically debt-free if you compare them to Western Europe. One exception is, of course, those foreign currency- denominated mortgage loans, but this is 9% of GDP. When you look macroeconomically, it is a manageable social problem.

The same is with the public debt, but of course every country has to deleverage, which means it has to wind down the mountain of debt. For this deflation is deadly. But there is another dimension to this. We have gotten used, as households, as businesses, to live in an inflationary environment, so when you make your business plan in a company, you normally assume that the prices will grow. Well, if you are conservative, in the Polish economy it was only 2% annual growth rate, for example. But in the times of deflation, this may turn out to be exorbitantly optimistic, because the prices for many businesses are declining. I mean, the only part of production costs luckily not falling are wage costs. That is why we are not alarmed by deflation yet, because wages are growing at

a healthy rate of 3.5%, at least from what we see in the statistics. Statistics always distort the reality, but still they show what is important in terms of macroeconomic proportions. Other production costs are falling, the PPI (Producer Price Index) captures most of other costs of production, and they were in the negative territory for the last two years. This means that, for many businesses, it is a completely different universe when it comes to doing business now. I am not one of those who underestimates the dangers of deflation. Besides, if I see everybody complaining or being afraid of deflation in the world, it cannot be that everybody is wrong and we alone are right. I think that this is something that we should be worried about. That is why we have recently cut interest rates. This is a symptom of our concerns, so yes, I do agree this is not neutral for our economy, and for those indebted economies, it may be deadly.

## Streszczenie

Artykuł naukowy „Global economy knows no borders” jest podsumowaniem wystąpienia profesora Marka Belki podczas konferencji naukowej “2014 – New Opportunities for Japan – V-4 Cooperation” zorganizowanej przez Wydział Socjologiczno-Ekonomiczny Uniwersytetu Łódzkiego. Głównym tematem niniejszego opracowania są rozważania nad stanem gospodarki światowej oraz perspektywami jej rozwoju. Autor rozpoczyna swój wywód od prezentacji prognoz Banku Światowego i Międzynarodowego Funduszu Walutowego dotyczących globalnego wzrostu, a następnie płynnie przechodzi do analizy czynników (zarówno ekonomicznych, jak i politycznych), które w ocenie wielu ekspertów mogą postawić te oczekiwania pod znakiem zapytania.

Profesor Belka zwraca uwagę na brak strukturalnej równowagi w światowej ekonomii oraz występowanie zjawiska nierównomiernego rozłożenia wzrostu gospodarczego pomiędzy różnymi rejonami globu. W celu lepszego zobrazowania tego problemu podejmuje się oceny bieżącej sytuacji makroekonomicznej głównych światowych gospodarek. W części poświęconej USA odnosi się do nowych rozwiązań technologicznych w dziedzinie pozyskiwania energii, kwestii migracji siły roboczej oraz ekspansywnej polityki monetarnej stosowanej przez amerykański Bank Rezerw Federalnych. Omawia następnie skomplikowaną sytuację Chin, które odnotowały znaczący spadek dynamiki wzrostu, co nie pozostaje bez wpływu na narastające napięcia społeczne i nierówności ekonomiczne w „Państwie Środka”.

W odniesieniu do Japonii autor przybliży starania rządu oraz banku centralnego do wyprowadzenia kraju z „deflacyjnej pułapki”, ograniczenia ogromnego długu publicznego oraz ponownego wprowadzenia gospodarki na ścieżkę wzrostu. Kolejną częścią pracy jest przedstawienie wyzwań stojących przed Europejskim Bankiem Centralnym, którego celem jest utrzymanie unii walutowej oraz pobudzenie wzrostu w deflacyjnym otoczeniu gospodarczym przy nadal nierozwiązanym problemie zadłużenia części członków Unii. W tym kontekście zostaje zaprezentowana polityka „luzowania ilościowego” (QE – Quantitative Easing), a także rozważania nad planem inwestycji infrastrukturalnych, które mogłyby dodatkowo pobudzić wzrost gospodarczy Unii Europejskiej. Autor zwraca jednak uwagę na brak myślenia wspólnotowego zarówno w kwestii planowania inwestycji, jak i dzielenia się odpowiedzialnością za zadłużenie. To z kolei prowadzi go do rozważań nad przyszłością integracji europejskiej i jej zasięgu, a także wskazania trudności w stosowaniu polityki reform strukturalnych.

Ostatnia część pracy jest poświęcona rozważaniom nad wstąpieniem Polski do strefy euro. Problem ten jest omówiony z różnych perspektyw: roli, jaką Polska chce odgrywać w ramach Unii Europejskiej, naszej gotowości do spełnienia kryteriów ekonomicznych, polskiej polityki wewnętrznej oraz nierozwiązanych problemów, które trapią samą Eurostrefę. Praca została również rozszerzona o zapis sesji pytań i odpowiedzi, podczas której autor ustosunkował się do zagadnień wpływu potencjalnego przyjęcia przez Polskę waluty euro na wymianę handlową z Japonią oraz konsekwencji dla polskiej gospodarki w związku z pojawieniem się zjawiska deflacji.

This monograph covers the output of the conference titled “2014 – New Opportunities for Japan and V-4 Cooperation” and contains Japanese and Polish contributions. It offers reflections on the *statu nascendi* of economic and cultural relations between the two nations. Viewpoints and research results mirror the various interests and arguments of the scholars (mainly economists, sociologists, and japanologists), businessmen, and representatives of administrative bodies (central and local governments) who participated in the conference, all of whom are searching for common solutions.

The presented papers are very much diversified with respect to their content and writing styles. The book itself reflects an eclectic approach. The multifaceted approach to the discussed issues facilitates the comparison of expectations against real life activities. The most important goal of the book is to identify the potential for collaboration and crucial fields in which there exist challenges and a need for changes, all in the interest of leading to a new stage of reciprocally profitable relations between Poland and Japan in today’s globalised world.



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