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The European Monetary Union: Assessing the Positive Attributes

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*The European Monetary Union:
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By Sasha Machel

Introduction

The European integration process was initiated and developed in Western Europe, it was later extended to the central and Eastern Europe, but only after the key features of the European Union had been developed and established. In 2007, the organization commemorated 50 years of existence in different organizational forms. The organization began in 1957, when the Treaty of Rome was created, which gave way to The European Economic Community (EEC) also known as the Common Market. In the beginning, it was made up of France, Germany, Italy, Belgium, Luxembourg and the Netherlands. By 1996, it had adopted the name European Union (EU) and an additional 9 members: the United Kingdom, Denmark, Ireland, Greece, Portugal, Spain, Austria, Finland and Sweden¹.

The European Economic Community's initial design was similar to what the EU is today, to secure the benefits of large scale production by pooling together, human, financial, market and natural resources of its members, in a common interest of its member states. Tariffs were eliminated on goods moving from one member state to another, restriction on movement of labor and capital from one member state to another was eased, and monopolies that formerly restricted competition among member states were discouraged. Contrary to that, a common set of external tariffs were established for the entire area to regulate imports from the outside world, and a common system of price supports for agriculture replaced the applied individual systems in all member states. This was to promote trade within the member states in order to stimulate investments in mass production enterprises that could sell freely to all member states, regardless of where they were located. The founders expected this to encourage productive geographic specialization whereby, each member state would specialize in production of what was it was best suited in. Consequently, each member state would enhance their production, export capacities with lower cost to consumers, and create higher wages and a high standard of living that could be sustainable².

Let us consider the reminiscences of history at a time before the EEC was formed, and proposals of cooperation between European states were advanced but little came of them. This was due to the international climate, which was characterized by national rivalries, conflict of interest, and most of the leading advocates seemed to have selfish national interests. For example, Aristide Briand, the France prime minister supported the European cooperation but only to preserve the peace settlement that had been imposed on Germany by the 1919 Versailles Treaty. Gustav Stresemann, the German prime minister on the other hand, saw European cooperation as a way of Germany loosening the grip of the Versailles Treaty. The lack of real interest in European cooperation was revealed in the implementation of the League of Nations, which was established in 1919 to provide international collective security. It failed because of three main challenges: its policies were vague and mutilated by members, it depended on the

¹ Mark Gilbert, "European Integration: A Concise History". (London: Rowman & Littlefield, 2011), 1-7.

² Mark, 1-7.

decision of every member state before any decision on action was given, and thirdly, the selfish national interests held by the members as mentioned before. As soon as these members saw that interests were not being served by the cooperation, they left or sabotaged the union³. This failure inspired various changes in the initiation of the EEC. Indeed, the existence of the EU for over 55 years now is evidence that new policies and objectives in cooperation of the European states were not only adopted, but are still successfully applied in the EU.

Analysis and Discussion

Despite new policies, the matter of the monetary union in the EU has highlighted conflict of interest that was last witnessed in the League of Nations. Due to various misconceptions, most of the EU member states view the monetary union as a threat to their economic interests. The failure of the League of Nations is evidence, that this conflict of interest is a significant threat to the EU.

The common currency is typically promoted on the basis of various economic theories that suggest sharing a currency across the border has various advantages, which include: lower costs in transactions, reassurance of investors, promoting competition, and consistent pricing. This essay finds it appropriate and timely to assess the rational for, and impact of the monetary union in the EU. To achieve this objective, this paper will commit to an in-depth analysis of the relevant factors of the monetary union. These factors include, but are not limited to political, economic, and social factors. This assessment will validate the various theories that promote a common currency in the EU.

The European Union has been pursuing new steps towards unification under the provision of the Maastricht Treaty of the European Union that went into force in 1993. These steps include the removal of non-tariff trade barriers such as quality standards that exist between member countries. However, the most significant step has been in the implementation of a single EU currency. The euro was considered as the centerpiece of the European Economic and Monetary Union (EMU) in 1999. The Maastricht Treaty not only amends and extends the Treaty of Rome, but also extends the domain of the European Community (EC) in many directions. The EMU provides for the creation of the European System of Central Banks (ESCB), with the European Central Bank at its center. It also promotes the creation of a new currency, the ECU, to replace the national currencies of the EC countries⁴.

The advantages of the EMU include support of the single market, and major benefits for the consumer that involve market transparency and price harmonization. Theoretically, on a national level, a common currency can also minimize public spending, reduce debt, and tame inflation. In practical terms, consumer spending in euro currency members would be similar to the consumer spending of citizens of the United States. For example, a United States citizen living in Texas can buy a television screen in Louisiana due to its cheaper price because of a common currency. The same would happen in Europe, a citizen would be able to purchase goods with a competitive price from any member state of the EU. Additionally, all euro currency states have agreed to let the European Central Bank manage significant issues such as interest rates in order to ensure they are similar in all the euro using nations⁵.

³ Neill Nugent, "The Government And Politics of the European Union". (London: Duke University Press, 2006), 7.

⁴ Peter B. Kenen, "Economic and Monetary Union in Europe: Moving beyond Maastricht". (New York: Cambridge University Press, 2006), 157-171 .

⁵ Sarah Janes Cousins and Adrienne Muir, "Providing Information on Economic and Monetary Union." *A Case Study of the East Land Midlands European Information Relay*, 2002: 396-421.

In order for the European Commission (EC) to prepare themselves and the citizens for a single currency that aimed at helping small and medium enterprises, the EC constructed a communication strategy with two distinct parts. In the strategy, the European Commission stressed the importance of collaboration between the local and national government in the communication of the information about the Euro. It also insisted that other organizations such as banks, other financial institutions, and trade and consumer associations were included in this role. Furthermore, the EC viewed that for the communications to be effective they had to be structured in the culture, language and concerns of the citizens⁶.

Despite all these efforts by the EC, the perceptions of the Euro and the EU among citizens of various EU member states remain quite different. As stated by an author,

The Euro is not that popular; recent polls showed that only 48 percent of its users felt that the currency was 'advantageous overall'. There is a strong aversion to the euro, among the Swedes, Danes and British and they rejected the currency. Sweden feared a loss of financial and monetary independence. Danes expressed fears that the Euro would threaten their generous welfare benefits or even their national unity. Britain's economy has recently been stronger than the economies of Germany and France, suggesting to the British that they might as well shun the euro for now. The new eastern European members of the EU will have to make drastic economic reforms in order to meet the requirements of adopting the euro. Slovakia was the first to do so in 2007, raising the official number of the euro using nations to 13; these nations comprise of the so-called Eurozone⁷.

The matter of single currency seems to have highlighted the selfish national interests among EU member states which hinders the EMU efforts. A model that comes close to the EMU's ambitions in the EU is the single currency model adopted by the United States of America. The EMU created a new European Central Bank (ECB) to take control of monetary policy and exchange rate policy for the member countries. This central bank alone controls the supply of euros, sets the euro's interest rates, and maintains permanently fixed exchange rates for member countries. In this regard, the ECB performs similar functions to those of the Federal Reserve Banks in the United States⁸. The Communication Department of the European Commission, list of the EU member states (and year of entry) includes:

Austria (1995), Belgium (1952), Bulgaria (2007), Cyprus (2004), Czech Republic (2004), Denmark (1973), Estonia (2004), Finland (1995), France (1952), Germany (1952), Greece (1981), Hungary (2004), Ireland (1973), Italy (1952), Latvia (2004), Lithuania (2004), Luxembourg (1952), Malta (2004), Netherlands (1952), Poland (2004), Portugal (1986), Romania (2007), Slovakia (2004), Slovenia (2004), Spain (1986), Sweden (1995), and the United Kingdom (1973)⁹.

The eurozone comprises of those EU member states that have agreed to use the euro. According the European Commission, out of all EU member states, the eurozone members (and their year of entry) include:

⁶ Muir, 396-421.

⁷ Joseph Joe Hobbs, Andrew Dolan. *World Regional Geography*. (California: Cengage Learning, 2008), 91.

⁸ Robert J. Carbaugh, "Contemporary Economics: An Applications Approach". (Chicago: M.E. Sharpe, 2010), 1-5.

⁹ Communication department of the European Commission. *europa.eu*. June 23, 2007.
http://europa.eu/abouteuropa/index_en.htm (accessed December 05, 2012)

Belgium, Germany, Ireland, Spain, France, Italy, Luxembourg, the Netherlands, Austria, Portugal, Finland all who joined in 1999 and Greece (2001), Slovenia (2007), Cyprus, Malta (2008), Slovakia (2009), and Estonia (2011)¹⁰.

In order to gather sufficient insight on the difference between the competitive currency, and the common currency among the EU member states, we have to evaluate the performance of the different entities in one of the recent harsh economical climates, the 2008-2012 Global recession. The comparison will be between the European Union and the Eurozone.

In the year 2007, before the onset of the financial crisis, the EU and the eurozone had been in their strongest position for decades due to the favorable economic climate of the time. The global crisis that arised in 2008-2009, initially from subprime lending originating from the United States, had a lasting negative impact on the economy of the EU. However, other complex factors contributed to the European debt crisis; there was an enormous giant pull of money in the EU, leading to a significant increase in fixed income securities from approximately 36 trillion euros in year 2000, to 70 trillion euros by year 2007. The temptation offered by such readily available savings overwhelmed the policy and regulatory mechanism in every EU member state, and lenders aggressively put this money into use, generating a bubble across the globe. The inevitable bubble burst catalysed an assets price decline, while the investors (lenders) were left with full price debts. The manifestation of the debt crisis in each European country involved differs, for example Ireland's Banks lent the money to property developers, creating a massive real estate bubble. When the bubble burst, the developers defaulted leaving the Ireland government and the taxpayers to assume the private debts. In Greece, the government increased its commitment to workers in the form of increased wages and pensions, with the former doubling in real terms over 10 years. Furthermore, Greece hid its debt by deceiving the EU officials with the help of derivatives designed by major banks¹¹.

The magnitude of the crisis in the EU and the eurozone is mainly based on how many of the member states were involved in the crisis. This is because of the interconnection of the global financial system, which means that if one country defaults on its debts or enters into recession, the banking system of the creditors nation faces the loss. A good example of this is in year 2011, when Italian lenders owed the French Banks 366 Billion euros. If Italy is unable to refinance the debt, which is only part of Italy's growing debt of about 1, 964 billion euros¹², the French Banking system and economy will go under significant pressure as they will assume the debt. This is an illustration of financial contagion. Due to this factor, while the issue of sovereign debt has risen in only a few eurozone states, it is perceived as a problem of the entire area. Furthermore, the impact of the debt crisis on the EU economy was absorbed and spread through the EU member states via three channels: financial system contagion and connectivity, wealth and confidence effects on demand, and Global trade activities. Despite the subprime lending originating from the United States, Europe suffered the largest financial institutions write-downs. In 2009, Ernest & Young statistics revealed that 51% and 70% of the market recapitalization of the 10 largest European Banks and Insurers, had been swept away by the crisis. The GDP contracted by more than 4% in both the EU and the eurozone indicating that both areas were in a

¹⁰ Directorate General for Economic and Financial Affairs. *European Commission Economic and Financial Affairs*. August 09, 2012. http://ec.europa.eu/economy_finance/euro/index_en.htm (accessed December 05, 2012).

¹¹ eM Publications, "The Eurozone Debt Crisis". (Berlin: eM Publications, 2012), 2-10.

¹² "Default Italia" *Default Italia*. <http://www.defaultitalia.it/index.php> (accessed December 06, 2012)

recession. The recovery remained sluggish in both the EU and the eurozone with very low year on year quarterly performances¹³.

Due to the EU and eurozone diversity of policies, culture, and financial systems, the debt crisis proved to be challenging to mitigate. Unlike in the United States who have fully adopted a single currency economy, a harmonized solution could not be applied in Europe due to the sophistication created by the diversity of their economies. This was confirmed in the year 2010. As the financial crisis intensified, EU member states disengaged themselves from each other's problems to focus on their own economic problems. As a result, the crisis rapidly worsened, to an extent that the effects of the economic meltdown threatened to form a contagion and spill over to the rest of Europe. Therefore, the EU reached a consensus on a collaborative approach to the financial crisis in the eurozone and members outside the monetary union.

After the collaboration of the EU and the eurozone, we are able to get a sense of monetary union throughout the EU member states. In the year 2010, the European Financial Ministers approved a rescue package worth 750 billion euros. This package aimed at ensuring stability across Europe by creating the European Financial Stability Facility (EFSF). Through 2011 to 2012, the European leaders agreed on more measures designed to prevent the collapse of member economies. This includes: banks accepting a 53.5% write-off of Greek debt owed to the private investors in order to minimize the contagion factor, boosting the EFSF to 1 trillion, and requiring all European banks to achieve 9% capitalization. Moreover, the EU leaders agreed to create a European Fiscal Compact including the commitment of each participating country to introduce a balanced budget amendment. This is to correct a structural contradiction within the euro system where by there is a monetary union without a fiscal union. This means that the eurozone countries share a common fiscal path (i.e common taxation, pension and treasury functions) but do not have a common treasury to enforce it. Thus, even though the member states are bound by an agreement via the European Central Bank (ECB), some members may choose not to follow it without any consequence. In the EU and eurozone collaboration efforts, the European policy makers have also proposed further integration of the EU banking management with euro wide deposit insurance, bank oversight, and joint means of the recapitalization of failing banks. As a result of these collaborations, the ECB can now better maintain money flows between European banks by lowering interests and providing weak banks with loans of up to 1 trillion euros. Additionally, to address the deeper roots of the economical crisis, most EU countries have agreed to adopt the Euro Plus Pact. This Pact consists of political reforms aimed to improve fiscal strength and competitiveness. This is expected to force weaker members to adopt further austerity measures, in order to reduce their national deficits. To minimize the negative effects of this Pact to the weaker nations, the European leaders have agreed to moderately increase the funds of the European Investment Fund, to promote infrastructure and provide loans to the private sector. Also, the EU members have agreed to lower their internal production costs in order to promote competitiveness, which will decrease current account imbalances among the member states, and hopefully put an end to the debt crisis¹⁴.

The result of this Collaboration measures are evident, the Turkish Weekly stated, In the 27-member EU the economy grew 0.1 percent in the period from July through September, after contracting 0.2 percent in the second quarter. Compared with a year earlier, Eurostat said the eurozone economy shrank 0.6 percent in the third quarter while the EU 27 was down 0.4 percent, after falls of 0.5 percent and 0.3 percent respectively in the second quarter. The EU's largest economy Germany, and France, both grew 0.2

¹³ Publications, 2.

¹⁴ I BAL, 6-12.

percent in the third quarter while Spain contracted 0.3 percent and Italy dropped 0.1 percent. Non-euro Britain posted a sharp gain of 1.0 percent.¹⁵

The EU results seems to raise a matter discussed by many scholars on monetary union, which are: in a monetary union, a country is unable to change money supply, devalue exchange rate, or determine short term exchange rates. The loss of this monetary independence leads to the loss of seignorage¹⁶. The 2012 performance economical data mentioned above conveys the support capacity of the weaker nations from their counterparts. In comparison to the loss of seignorage in a monetary union, the support available from the union seems much more significant. In the case of Greece, the debt crisis devastated its economy in late 2009, bringing down the government and sparking social unrest. Since this was a threat to the euro, Greece has been kept a float by its eurozone counterparts. Although Greece had to adhere to austerity measures set by France and Germany, it has received two massive bailouts amounting to 240 billion euros. Furthermore, the European officials helped Greece negotiate a landmark debt restructuring deal with a vast majority of its private sector lenders who agreed to swap 77 billion euros worth of debt for new bonds at 75% less. This deal cleared way for the Troika which includes the European Commission, European Central Bank, and the International Monetary Fund to release funds for the second bailout package worth 163.4 billion euros¹⁷. Considering Greece's default is the largest in history, if Greece was still on an independent currency, under the notion of preserving seignorage, the outcome would have been far more catastrophic.

The consequences of a lack of Union backing are better reflected on Spain when, the Prime Minister Mariano Rajoy, deferred from seeking help from a financial assistance program tailored by Europe officials especially for Spain. The results then were: Spain recording the highest unemployment record in the EU with 26.2 adults out of work, cement production hitting a record low since 1960, car sales going down to 37%, and the highest debt expansion pace in the world among other issues¹⁸. In response to alarming calls from the US and Europe, Spain accepted 125 billion euros offered by European Finance Ministers.

Despite the EU support of the weak member states, we have to ask ourselves how the EU got to this crisis in the first place. In the year 2004, while studying on the impact of the enlargement of the external policies of the EU, Francesc Granell of the University of Barcelona asserted that; the enlargement could have detrimental effects on EU cooperation due to various elements such as, need for new members to increase their low levels of present aid in favor of developing countries¹⁹. However, after an indepth analysis of variouse factors, the study concludes that the EU-enlargement is creating a larger, and powerful economic region in the global economy. Moreover, the study asserts that, in future, Europeanization of social policy will

¹⁵ International Strategic Research Organization . *TURKISH WEEKLY*. December 07, 2012.
<http://www.turkishweekly.net/news/145494/recession-back-in-euro-area-crisis-going-deep.html> (accessed December 08, 2012).

¹⁶ Christian Sorgenfrei, "Optimum Currency Areas: A Monetary Union for Southern Africa". (Berlin: Diplomica Verlag, 2011), 102.

¹⁷ The New York Times Company, "The New York Times". (December 08, 2012).
<http://topics.nytimes.com/top/news/international/countriesandterritories/greece/index.html> (accessed December 08, 2012).

¹⁸ Jr., Landon Thomas, "Global Business." *The New York Times*". (October 15, 2012).
<http://www.nytimes.com/2012/10/16/business/global/spain-may-pay-price-for-delaying-aid-request.html?pagewanted=all> (accessed December 05, 2012).

¹⁹ Joaquin Roy and Robert Dominguez (eds). *Towards the Completion of Europe: Analysis and Perspectives to the New European Union Enlargement. Towards the Completion of Europe*. (Miami: Thompson-Shore, Inc., 2006), 9.

be more complex, following new methods of coordination²⁰. The current activities in the EU validates this study.

Conclusion

The eurozone debt crisis is unique primarily due to the existent diversity in the memberstate financial systems. According to our comparison of the eurozone and the EU economic models in the crisis, the yearly performance of both entities in the recession and recovery was similar. The level of financial contagion, which is the main reason monetary union is rejected, seems to be equal in both the EU and the eurozone states. On the contrary, during the height of the crisis, when EU member states attempted to isolate themselves from each other for their own economic woes, the crisis worsened drastically.

However, when the both the EU and eurozone states decided to collaborate in dealing with the crisis, some significant improvements were achieved. While the monetary union exposes a nation to a crisis and denies it other independent currency advantages, it offers a nation with the shelter during a poor economical climate. Likewise, just as a country is exposed to a crisis, during a good economical climate, the country benefits from positive exposure from other member states.

Skeptics are under the misconception that the debt crisis in the EU is evidence of its monetary union failure. However, the EMU has been a success in that it has strengthened cooperation among its participants on budgetary policies and has facilitated progress toward the creation of an integrated European capital market²¹. We view the euro debt crisis as a evolutionary step for the EU area. The debt crisis has highlighted weakpoints and at the same time forced the necessary collaborative efforts among EU members to fix the weak points. As a result, the following objectives have been achieved in the EU: the formation of the EFSF, creation of the European Fiscal Compact (including the commitment of each participating country to introduce a balanced budget ammendment), EU members have agreed to the Euro Plus Pact, and there has been further intergration of EU banking management. As observed, these measures are already effective in mitigating the crisis. This is because they are effective in eliminating previous factors in the EU that enabled the crisis. These factors are:

- Tightened credit conditions across the eurozone
- High risk premiums on growing numbers of eurozone sovereigns
- Disagreement among European policy makers on how to deal with longterm and shorterterm economical crisis
- High level government and household debts
- Rising risk of recession in the eurozone

After the crisis is over, the measures established by the EU officials to deal with this crisis will most likely act as the foundation of a monetary union throughout the EU.

²⁰ Roy and Dominguez, 208.

²¹ Steven Everts, "Economic and Monetary Union: A Test for US-European Relations." *Instituto Affari Internazionali*. http://www.iai.it/pdf/articles/everts_1.pdf (accessed December 6, 2012)

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The New York Times Company. *The New York Times*. December 08, 2012.
<http://topics.nytimes.com/top/news/international/countriesandterritories/greece/index.html>
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