The Benefits and Challenges of Economic & Monetary Union

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Economic Monetary Union (EMU) is the end point of an ambitious and historic stage of integrated market changes[1] that not only challenge the structure and foundation of modern day liberal capitalism but also offer, if successful, a wealth of opportunity in the goods, labour and service industries of the European Union. A fiscal extension to the principles of the Schengen Agreement[2] of 1985 offered a financial breakthrough where multiple crises through the years during the latter part of the 1980's offered physical deficit in the sense that unemployment was on the rise and inflation was at a post war high. This long winded process required widespread policy integration over a spread of 40 years in order to achieve such monetary union, bringing Europe to both political strains at times but also a decade of growth and success. Something that started as a Single Market, which led to an unseen level of economic cooperation in its second stage then followed by full single currency implementation has been seen by many, including the former British Chancellor of the Exchequer and Prime Minister, Gordon Brown, as Europe's greatest political and economic achievement[3]. EMU would mean the European Community (EU) would be recognised as a global actor[4] in the financial markets but the single currency would have an international impact as an anchor for exchange rate stability in a 21st century global market desperate for growth, employment and low levels of inflation.

This exciting and somewhat slightly ambitious project[5] prides itself globally as a watershed in how union economics and fiscal federalism as a framework operates.[6] This is the first time in modern history that such a big convergence of monetary policy has taken place and it has come with many successes and advantages for its vibrant and dynamic economies. However, this has been at some cost and especially since 2008[7], a huge deal of suffering for some. This essay will aim to outline in economic and political detail the benefits and challenges of Economic & Monetary Union but also define it, it will look at its impact on the Eurozone community as a whole but also on the impacts it has on the wider EU and also specific states, both domestically and internationally.

EMU in Europe has seen consistent and significant progress since its establishment as nothing more than a European Community goal in 1969. However the most symbolic of these was its full validity into the international system via the setup of the Exchange Rate Mechanism (ERM) in 1979 through the first stage of the European Monetary System (EMS), and the Maastricht Treaty of 1992/1993. The treaty set down the criteria and final timetabling for full EMU in Europe by 1999/2002 as proposed by the 1988 Delors Commission Report[8]. This process had already begun its first stage on 1 July 1990 where exchange controls in the EEC were abolished, and this led to capital movements being completely liberalised in the community. This would prepare the community and its differing economies for the finalised technicalities[9] of the second and third stages set down in the treaties, the most important of which being the strict convergence criteria explained further on in this essay. The second stage, lasting for over 4 years began on 1 Jan 1994 with the establishment of the European Monetary Institute, the predecessor to the ECB. This Institute would enforce the original provisions of the ERM but it would also set up ERM II for the states that wished to join the single currency after its adoption but also to establish the Growth & Stability Pact which set down the strict convergence criteria required for full membership of the single currency and entry into stage 3 of the project. Finally in this second stage came the birth of the European Central Bank in 1998. It's function: to reduce exchange rate variability and achieve monetary stability in Europe[10], but also to set common interest rates and be the lender of last resort to the Eurozone states[11]. The third and final stage began in 1999 with the adoption of the single currency through the irrevocable fixing of conversion rates amongst the first wave states (11 of

17) of the Eurozone. This meant Eurozone member currencies such as the strong Deutschemark, the French Franc and Italian Lira, and the weaker Greek Drachma would cease to exist and the introduction of Euro notes and coinage would become the norm in Europe[12].

The Economic benefits of EMU are plentiful, and definitely outweigh the challenges in number. However, the risk factor of EMU on a general scale is what we're trying to assess and the first relevant benefit of EMU would be its optimistic but also responsible[13] convergence criteria for full EMU membership. This is seen by many[14] as setting a fantastic example of monetary discipline with penalties of up to 0.5% of GDP available to the Commission and the Central Bank for use against violating states. Whilst this convergence criteria anchors its legitimacy on the Integrity of the German Deutschemark as a pre euro currency, it only began as a strict guideline, it is only since the crisis of 2008 that a revised growth & stability pact is being proposed that makes these criterion binding. Under these rules, government debt cannot exceed 60% of GDP, and a government's current account deficit cannot exceed 3% in any fiscal year. This is seen as responsible budget economics but also very rigid[15] in its implementation and planning. Average nominal Interest paid cannot exceed 2% above the average of the top 3 financially performing states; this indicator is also used for Price stability, where inflation is limited to 1.5% above the top 3's average[16]. These rules, set down and audited by the ECB make good ground for the second benefit of EMU.

The European Central Bank, as said before, has a very rigid and ordered system of governance similar to that of the Bundesbank. This means that when it comes to its implementation of the common interest rate and price stability, every provision of the Growth & Stability Pact is taken into consideration and the bank works for the benefit of all 17 member states. This model was proven to have worked in Germany in the 90's and had similar results in the Euro's first decade[17]. Further success includes the reduction in transaction costs between member states because of the same exchange rate and Rate of Interest (ROI). This, if the UK was to be a member of EMU, may have seen savings of between £50-100 per annum for the average citizen[18]. This successful theory is mirrored throughout Europe, with the European Commission suggesting that elimination of transaction costs could boost the GDP of the countries concerned by an average of 0.4% by 2015[19], and the cost of transporting goods and services between the common market using the single currency are significantly lower since 2001. This also allows for a great deal of price transparency for large business from both Europe and around the world but in conjunction with reduced exchange rate uncertainty, the increase in Foreign Direct Investment (FDI) has allowed for more business looking to come and invest in Europe. This not only gives the Eurozone states an incentive to compete with each other for a healthier domestic private sector but it also gives the incentive for strengthened intra-MEU trade, meaning states, whilst competing with each other, also trade with each other much more easily. In this respect, EMU has removed the possibility of devaluation of the single currency, which countries have used in the past and has increased inflationary pressure. The ECB prides itself in its policy of keeping Interest rates low on average. This would cater for an economy capable of expanding rapidly in the global markets because of its flexibility through a lower ROI.

EMU's economic challenges however make for much harder reading, especially since the Eurozone crisis emerged from the ashes of the global downturn.[20] Firstly, the Eurozone states have seen a loss of power to choose different short term inflation vs. unemployment trade-offs to the ECB, this is one of a huge string of national sovereignty issues[21]. In the long term there is no trade-off between inflation and unemployment, but in the short term the ECB can choose an interest rate which reduces inflation slowly, giving time for the unemployed to find jobs, this however results in the realisation that countries which join the single currency will lose the ability to make these choices independently. This also affects a member states autonomy in reacting to sudden economic shock. This is mostly apparent now in the case of the PIIGS states (Portugal, Ireland, Italy, Greece & Spain) where unemployment is a direct factor of this challenge. A reduction in demand is likely to lead to a reduction in prices, but this in turn means redundancies and businesses filing for administration. The ECB is unlikely to dictate drastic change to the Growth & Stability pact unless all the states are affected equally. This would mean that Germany and France would have to suffer the same deep recession as Greece for something like the 3% deficit threshold to be altered[22]. Furthermore, the ECB is made up of representation from all 17 national Central Banks, they all have different systems of governance and they aren't all as rigid in their auditing of monetary affairs as the ECB is. This has led to decisions coming down to the last few votes on European monetary affairs and since 2007 has led to the ECB not publishing minutes from committee meetings because of the risk of market destabilisation and loss of confidence in the single currency[23]. This market shake up might also be at further risk because of the impact of a generic ROI in all 17 states, this ‘one size fits all policy’ may work for the stronger economies but the weaker economies have major teething problems as can be seen by states such as Greece who is currently having to pay a 17.9% ROI on its standard 10yr Bond[24]. The ECB’s target inflation rate of 2% may also be deemed as too deflationary and this has aided the tragic rise of unemployment to numbers of over 20% in states like Spain and Greece[25]. The sad reality is that this rigidity may instil a disciplined, sustainable and organised mechanism for the implementation of full EMU in the European and World markets but some nations require longer to catch up to this programmes many benefits. This, since 2008 has begun to lead to a two tiered Eurozone within an ever emerging two tiered European Union. The strong would have their own system, and the emerging would run off another, more flexible framework to suit their needs.

The political benefits of EMU mirror the aspirations and pride of the European dream. EMU has united Europe[26] but it has also shown it to the world[27], the European Union is now recognised as one, single joint source of GDP in calculated global income, scoring 4th place with a 21% share in global nominal GDP[28]. There’s much more transparency between states not only on the obvious monetary affairs side but also on the political, with political allegiances becoming ever more strengthened by EU monetary policy[29]. States have to work together on common policy where one might be left wing and the other right. This shared capitalism through fiscal federalism has seen and proved that political relationships and diplomacy are much more subject to flexibility for the advantage of the wider community than they are for domestic national interest. The norm is that in the long term, this scheme will help everyone. But the challenges of this political and economic union dictate that in order for this plan to be realised in the near future, states have to cede sovereignty and fiscal independence to some extent. Whilst this may be for the good of the common market and the currency in General, historical and cultural icons of European history such as the Drachma have been scrapped entirely simply to move forward with the implementation of EMU. When a state goes through financial and Asymmetric shock in its economy, it relies on the governance of the ECB to take the necessary course of action, this may sometimes mean leaving the state to weather the storm[30] and this principle has seen various bailouts offered over the past 5 years to states that simply can’t take the rigidity and pressure anymore. In political circles, this has led to increased resentment of the European project, states are willing to participate as much as ever but there is now frustration at the fact this crisis is lasting so long in some countries as opposed to its current state in others.

To conclude, EMU has its advantageous benefits and its sometimes crippling challenges, and it is important to remember that the Euro, as a result of the stages of EMU such as ERM and the Growth & Stability Pact, is still in deep teething mode. It is a young currency and most of the issues concerning EMU revolve around the flexibility of the ECB in dealing with situations such as the Eurozone Crisis. Any Eurosceptic can argue that EMU may damage national sovereignty and integrity of a national currency but nobody can deny the awesome growth in government GDP and foreign investment paired with impressive drops in unemployment from 2000-2009[31]. And this in many respects has small influences such as the Athens Olympic Games in 2004 and the Green Energy Directives of 2001 to thank for.[32] Countries involved in EMU are ever investing in this multilateral venture, its successes could be greater than those seen in its first decade and its progress to date is more than admirable. However, speedy and effective reforms to the structure and workings of the ECB and the G&S Pacts are vital after this recession is over in order for the Euro to remain whole, sustainable and worthy of international trust and praise, because after such a tumultuous period in its history, it seems to be overcoming the first few hurdles and is on the path to a very successful future in the global markets.

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[1] (Gros & Thygesen, 1998) p.12

[2] (Spahn, 1993) p.2

[3] (Brown, 2010) p.57

[4] (Huhne, 2001) p.10

[5] (Gros & Thygesen, 1998) p.7

[6] (de Grauwe, 2009) p.83

[7] (Brown, 2010) p.3

[8] (European Central Bank, 2012)

[9] (Issing, 1996) p.5

[10] (European Central Bank, 2012)

[11] (McNamara, 1999) p.84

[12] (Crouch, 2000) p.28

[13] (Issing, 1996) p.3

[14] (Brown, 2010) p.9

[15] (Forder, 2001) p.33

[16] (European Central Bank, 2012)

[17] (Brown, 2010) p.2

[18] (Huhne, 2001) p.30

[19] (Crouch, 2000) p.72

[20] (Brown, 2010) p.27

[21] (Forder, 2001) p.39

[22] (de Grauwe, 2009) p.112

[23] (de Grauwe, 2009) p.97

[24] (European Central Bank, 2012)

[25] (Brown, 2010) p.102

[26] (Huhne, 2001) p.1

[27] (Brown, 2010) p.3

[28] (de Grauwe, 2009) p.94

[29] (Issing, 1996) p.4

[30] (Crouch, 2000) p.72

[31] (Huhne, 2001) p.22

[32] (de Grauwe, 2009) p.142

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