

**ARGUMENTS TO JUSTIFY EURO - ADVANTAGES AND LIMITATIONS**

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**Abstract**

*Euro single currency was often used as an excuse to justify the worsening economic situation in some member countries, the European Central Bank being attacked several times; but we must not forget that for over 8/9 years euro gained against the dollar struggle, being the most used banknote in the world.*

**Keywords:** *euro; EU; European Central Bank.*

**JEL Classification:** *O1*

**I. INTRODUCTION**

The reasons that may justify a Member State joining the European Union in the Eurozone and therefore the adoption of common monetary policy are represented by:

- a) holding a coin that is linked to currencies of countries strongly developed economically contribute to a more stable monetary system;
- b) a strong currency obliges operators to become more efficient and more competitive internationally, unable to count on depreciations (recorded in previous years of the eurointroduction);
- c) a common currency in an enlarged economic zone is more defended in front of the financial turmoil;
- d) a strong currency speculators protects against attacks.

**II. THE BENEFITS OF THE SINGLE CURRENCY**

Achieving Economic and Monetary Union is a great project of economic policy causing micro and macroeconomic effects on national economies of the participating countries and the European economy as a whole.

These effects may be classified as:

- a) direct or indirect effects, such as defined according to their data transmission channel. Direct effects are the immediate ones and depend on the single currency, such as for example reducing transaction costs. Indirect effects are the subject of monetary policy.
- b) the static or dynamic effects are defined as temporary due to their appearance. Static effects are of "on-off", or effects that are generally carried out early in the process of monetary integration, such as the elimination of transaction costs of trade. Dynamic effects are those that are done gradually over time and are defined by a greater potential for growth. These are identified, for example, in greater competition due to price transparency expressed in the same European currency. All of these effects determines the benefits and costs for all economic operators. Throughout the paper will try to detail the different types of costs and benefits, given that they are distributed asymmetrically between operators, regions and countries, and what can be considered a benefit for some can prove to be a cost for others. In terms of benefits, the economic consequences of monetary unification process can be sorted by classical objectives of economic policy, the major benefits of efficiency, benefits of regional equity and external benefits(De Grauwe P. 2009).

**III. BENEFITS FOR GREATER EFFICIENCY**

By using the single currency, the market becomes more transparent, the place of greater competition, which allows better allocation of resources that are transferred from subjects less efficient (companies producing at very high prices) the most effective (businesses innovative, better organized, etc.). Assets turnover increase efficiency within the system, because:

- a) the elimination of the transaction costs (that is a direct benefit of the single currency). The cost of currency conversion transaction was estimated (EEC Commission, 1990) to 15 billion euros per year, meaning 0.4% of EU GDP, being distributed asymmetrically because they were favored especially small countries that are much more open and using foreign currencies proportionately and small businesses that support heavier "fixed" component of the banking costs;
- b) the elimination of exchange rates, which make disappearing hedging costs and facilitate trade flows and foreign direct investments (it is the indirect effect of the euro). In the absence of exchange risk, operators are

determined to make trade and investments with the outside, especially with countries that in the past have suffered internal currency devaluations. Removing uncertainty reduces interest rate on the exchange because it eliminates the risk premium that companies pay for loans, thus encouraging the investments. Each company investment creates macroeconomic foundations of economic expansion, which certainly favors the employment;

c) greater price transparency that determines perfect comparability of prices in EMU countries, increasing competition between manufacturers, but also among consumers by understanding customers both individuals and companies or the state.

As can be seen, on the efficiency benefits are essentially microeconomic phenomena of nature, the same kind of effects examined in the Europe '92, which allowed the birth of the Single Market.

#### **IV. BENEFITS FOR A GREATER ECONOMIC STABILITY**

By introducing the single currency, countries manage to achieve greater economic stability because they respected the Maastricht criteria and thanks to better coordination of economic policies that the Stability Pact and Growth requires (with the goal of a balanced budget on a medium term).

Macroeconomic stability is determined by low inflation and low interest rates, factors that facilitate a steady and sustained over time. In reality it is necessary to specify that the greatest stability is blocked by use of economic policy instruments, alternated with depreciation. This shows that while symmetric shocks (those that hit equally all partner countries) can easily be absorbed by amending the common monetary policy (such as, for example, the value of the euro against the currencies of non-European), asymmetric shocks must be absorbed by changes in the quantities and prices of production factors in the country affected by the crisis to reduce production costs and a recovery in exports (Vinconi Mondavi, 1996).

To achieve greater stability of prices, every country and every citizen or company therefore claimed costs, so-called costs of disinflation determined by the shape of economic policy the government chose to reduce inflation. These costs are even lower as the government is more involved in the fight against inflation, which results credible market. Given that macroeconomic stability means inflation, income, occupancy workforce, an analysis of these indicators will be continued in the last part of the paper.

#### **V. THE BENEFITS OF REGIONAL CONVERGENCE**

The single currency allows businesses operate in the same way in any Community country or region. This may favor less developed regions that can attract flows of capital that can be invested in various activities, leading to an increase in employment, given the low costs of production which generally developed areas do not have. For example, the cost of labor in such regions appears to be an attractive factor on industrial sectors that require a high volume of labor (Labour intensive). This promotes ongoing convergence between European regions which assist in reducing in time the disparities of initial development (Krugman P. R. 2001).

However, the single currency may favor less developed countries because transaction costs are higher for countries with financial markets less developed, while the benefits of economic stability are higher for countries less advanced in public finance, which usually include peripheral countries. Greater equity in income distribution between regions can only be achieved provided to increase the efficiency of revenue sharing mechanisms based on funds. Therefore appear two contrary phenomena, whose effect is difficult to measure: on the one hand the central regions of Europe are encouraged by the single currency, because their economies of scale is the distributive type (Krugman, 1991), the cost of distributing production operator with headquarters located in the center of Europe is lower (such as Alsace or German Lander Southern) than a productive technology located at the periphery (regions of Portugal, Greece and Southern Italy); on the other hand, peripheral regions are favored because they have lower costs of labor. The impact on each region is, therefore, depending on the type of economic investments, which is trying to be localized: if there is a high intensity labor (skilled or unskilled) or capital; if there is an economy of scale production and / or distribution rate; whether there is a high intensity of research and development (Balcet, 1997).

#### **VI. EXTERNAL BENEFITS**

Benefits mentioned in the previous sections are added the external ones, the effects due to the importance of the EURO as an exchange currency extra-EU relations and as the motto portfolio to international investments. Insofar as the euro becomes a so-called reserve currency, a currency held value and stability outside the Economic and Monetary Union, European Central Bank obtained a benefit of "seigniorage" equal to the Economic Union and monetary inflation.

In the presence of high values of EURO worldwide it is important to analyze the effects that occur in the political sphere, because the European Union would have more power to the table of the international negotiations, based on its economic and financial strength (Audretsch D. B., Welfens 2000).

These benefits were evidenced especially at major world economic crisis. After the tragic attack on September 11, 2001, instability in the world that has hit the currency markets and economic growth were partly

mitigated within the Eurozone due to the force of the euro, increasing use of the euro as a means of international payment, that the euro has become an important backup currency (eg in China) that there are energy resources prices expressed in euros not dollars, as was done until recently.

The same argument also applies to the financial crisis on September 2008, which in the absence of euro could turn into a currency crisis and more exposed to European countries.

## VII. THE COSTS OF THE SINGLE CURRENCY

Costs on the introduction of the euro can be identified mainly in loss of national sovereignty over monetary policy and the decisions that Economic and Monetary Union imposes on budgetary and fiscal policy every country that wants to join it.

### *Loss of national sovereignty over monetary policy*

Loss of national sovereignty over monetary policy generates different costs in each member country based on "political value" that is given by the role of inflation, currency exchange rates, the level of interest rates. It is about the intervention instruments of economic policy (fixing the interest rate) or objectives that are to be achieved (inflation and exchange rate) over which each state would continue to maintain control. If we start from the assumption that the European Central Bank has restrictive policies, characterized by sufficiently high interest rates to control inflation, loss of national power is a cost that will be characterized as follows:

a) high for the countries most sensitive to economic growth, by means of maneuvers on interest rates or through depreciation, which favors exports is less sensitive to inflation. A typical example is Italy '80s, where interest rates were very low in order to encourage productive investments;

b) low for countries pursuing traditionally restrictive monetary policy and which find in the status of the European Central Bank a bulwark against inflation. A typical example is Germany '80s; worth to mention strong attention given by the political authorities and the German monetary phenomenon of inflation, which have been an important objective of monetary policy of the Bundesbank, given the historical legacy of the Republic of Weimar.

With the entry into EMU, countries with high inflation (as Spain and Italy) improve their own reputation because they substitute national monetary policies, not necessarily adverse to the inflation phenomenon, with the monetary policy of the European Central Bank which has in price stability a statutory target; In contrast, Germany's entry into Economic and Monetary Union and other countries with low inflation have failed to bring a contribution of confidence in terms of reputation in these countries, inflation is quite high in EMU (Barro R., Gordon D., 1983). To overcome a possible disincentive to countries with low inflation, it was trying to impose European Central Bank to pursue a policy extremely restrictive, with an obligation to insert in the statute price stability. Since this has not been well explained and determined, it is considered that the ECB should follow the objective of maintaining an inflation rate of around 2% over the medium term.

Regarding the absence of impairment, this will represent a cost felt especially by countries which in the past have been registered frequent devaluations to improve price competitiveness to their products (such as countries in Europe Mediterranean), but not the countries where monetary depreciation it was almost negligible since the 80s. If the first countries was necessary instrument depreciation substitution with other instruments of economic policy favoring business competitiveness; the other countries, reducing the possibilities of impairment do not represent any cost. But it is important to clarify that devaluation is not the same impairment and may represent a cost only if he could demonstrate that changes in nominal exchange rate (devaluation) fail to permanently alter the real exchange rate of the national currency; he must succeed to prove that devaluation has a structural and permanent effect on a country's external accounts and not a simple effect of time and circumstances.

If we consider a devaluation implemented to correct asymmetric shocks on the demand, a minor demand compared to goods produced in a country: at first, the devaluation changes exchange nominal, increasing exports and reducing imports, with strong gains for commercial balance; but subsequently reduced purchasing power of the currency, increases the price of imported goods and therefore products which incorporate these goods. The increase in import prices is a cause of inflation (the so-called "imported inflation") generating an inflationary cycle if there are not reduced input costs reasonable. If the latter are rigid, the depreciation on competitiveness, the real exchange is valid only in the short term, while in the medium term it is eroded by the increase in domestic prices. In conclusion, the costs of the changeover are limited to short-term effects of impairment and therefore does not represent a real cost to reduce structural opportunities for countries in the Economic and Monetary Union (Krugman, 1991).

### *Constraints on fiscal policy: Stability and Growth Pact*

Growth and Stability Pact defined by the European Council in Dublin in 1996 was rectified in the Amsterdam European Council in June 1997 and requires member states of the euro area to set their objective as a balanced budget by 2003. To achieve this objective every six months Member States shall submit their own

budgets and projected examination declared by the Commission to avoid excessive imbalances (those in excess of 3% of GDP, and public debt above 60% of GDP).

If a registered imbalance appears to be very high, Growth and Stability Pact impose these countries, preceded by an "early warning" (early warning) and followed by a "recommendation" for exceeding the budget. The first "early warning" was proposed by the European Commission and endorsed by the ECOFIN Council in 2001, against Ireland for too high inflation and too expansive fiscal policy and "pro-cyclical". In theory, countries that do not meet the criteria for financial soundness must pay a bearing deposit an amount comprised of a fixed set at 0.2% of GDP and a variable part, the equivalent of 1/10 the difference between the deficit and the 3% limit set by the Treaty, for a total amount but not exceeding 0.50% of the GDP. This amount is refunded only if within 2 years from the date of registration of the deficit, it is corrected. The sanctions do not apply if the deficit derived from a country's severe recession (reduction in GDP should be at least 2%), while if the recession is mild (a drop in GDP of between 0.75% and 2%) country concerned must demonstrate that the deficit derived from exceptional circumstances.

The purpose of the Stability and Growth Pact is to ensure greater effectiveness of fiscal policy. This effectively exists only if there is solid and balanced public budget (Nobay A. R., Peel D. A., 1998). In addition, the report Pact of Stability and Growth stems from the same concept of Economic and Monetary Union: a country might increase without limit its budget deficit, thinking that sooner or later, other member countries will help out of the crisis, but this would lead to the collapse of the entire economic and monetary union. This opportunistic behavior, the "free rider" appears to be impossible if the country is being monitored at every half semester of its national budget. These budgetary constraints have given rise to many heated debates among economists, with pros and cons. If those "pro" arguments highlights the negative externalities that can penalize all countries where one country would demonstrate undisciplined in financial terms, militants opinions "against" Pact of Stability and Growth Assuming that only the financial markets are able to regulate the behavior of governments (and any other time), and in case of economic crisis, the upper limits of the budget deficit - 3% of GDP - could be too low to allow an economic recovery shaken to the public expense (Ken Safir, 1998).

Following these discussions, the European Council of Finance Ministers (ECOFIN) showed ambiguous behavior (according to the Stability Pact and Growth in the event of global economic crisis upper limit of the budget deficit can be overcome; what actually happened as a result of the attack of 11 September 2001 and the financial crisis of 2008-2010).

In fact, according to ECOFIN in June 2002, the goal of balancing the national budget by 2003, it became a simple "close to balance", an approximate balance in that deciding and accepting a deficit of 0.5% , postponing the balance for next year. It claimed at the time that the Covenant is "healthy", but with that hint of ambiguity necessary to make public accounts into the red float in three of the largest euro area countries: France, Germany and Italy. On the one hand a recommendation Portugal Commission launch excessive deficit (2002), Germany (2003), France (2003) and ECOFIN suspended the excessive deficit procedure against France and Germany (2003) by amending the Regulation Covenant. In July 2004 the European Court of Justice in Luxembourg ruled in favor of the appeal presented by the Commission and annulled from the ECOFIN decisions regarding blocking procedure against countries with deficit budget. In the coming years, continued monitoring of national budgets by "moral session" of the Commission and the economy growth in 2005-2007 allows recovery of several negative values.

## VIII. CONCLUSION

With the start of the 2008 financial crisis, once again emerges the same strategy of flexibility in maintaining the Stability Pact and Growth: the presence of a global economic crisis compliance with the Stability and Growth has been diluted over time, and in 2009 and 2010 European countries have been allowed temporary expansion of the deficit budget with the promise of achieving consistent recovery plans in the coming years. Currently, it sits at the negotiating table on this return route the parameters of the Maastricht Treaty, not only on the budget deficit (3%), and the level of lending (60%). This last parameter is the most difficult to meet for many countries in the Euro-zone, holding Italy in 2010 indebtedness highest across the European Union (G. Vitali, 2011).

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