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THE EURO AS A SINGLE CURRENCY IN THE EUROZONE

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EURO AS A SINGLE CURRENCY IN THE EUROZONE

EXECUTIVE SUMMARY

This research discusses and analyzes arguments from academic sources for and against having a common currency and monetary policy throughout the EU. Its purpose is to demonstrate that the most reasonable thing to do for the European countries is to continue expanding the currency area and optimizing their institutions to become more efficient and boost welfare in the least economically powerful countries. This will be achieved by gathering several strong arguments proven by experimentation from reliable sources, while also explaining some of the strongest arguments against this position. The paper will be developed with a short introduction, a literary overview of the previous research, the main analysis, and a brief personal conclusion.

Among the most important findings against my position, we researched that the main critics of the common currency were the difficulty of having a “one size fits all” monetary policy, the idea that the euro prioritizes Germany and other main powers in Europe, and the fact that European economies have been having a very low growth and their current economic policies have a lot to do with this.

The main arguments supporting my position were that the use of the euro by itself is slowly but undeniably helping to solve the lack of European nationalism, it has increased insiders' and outsiders’ investment by reducing transaction costs, trade between the common

currency area has significantly increased thus improving product´s quality, tourism is increasing, and it is a great way to keep Europe in peace.

All these arguments will be further analyzed in the paper to provide a bigger perspective on how a common currency area is the way to go for the EU.

INTRODUCTION

Whether adopting a single currency or not between several sovereign states has been a topic of great discussion for many European leaders throughout history. The creation of the euro came to reality in the year 1999 and was used by 11 European member states as an overarching currency used for exchange between countries within the Union. However, three years later it became the domestic currency of many member states and now, more than 20 years later, is used by 19 out of the 27 member states of the European Union. The idea of a single currency with a unique monetary policy was driven by the ambition to promote growth, economic integration, and stability in the European community. Today, still young, the euro, which is controlled by the European Central Bank, the euro is already being utilized by more than 340 million people. Expectations on the growth of the euro as the only currency in the EU are high as, according to Eurobarometer, popular support for the euro is at a historical height. (Miguel Otero-Iglesias, 2019)

The use of the euro has been seen in different ways, even though many important accomplishments have been achieved in terms of popular support, price stability, resilience, and credibility. The stability and resilience of the euro have been proved by the fact that the average inflation in the euro area has been 1.75% and that the exchange rate between the

euro and the US dollar has been at the same level during the whole euro´s lifetime. On the other way, it is often claimed that the euro as a unique currency between the European Union is not a good idea, as a monetary union, in the absence of a political union that oversees establishing a common political process to determine the distribution of fiscal costs, is impossible. Many renowned scholars have stated their opinion on the matter as something economically irrational. Paul de Grauwe stated, “The euro is a currency without a country. To make it sustainable, a European country must be created”. (Harold James, 2019)

The purpose of this essay is to identify and describe the main arguments against and in favor of the use of a single currency throughout the European Union. The body of the essay will be composed by the negative statements and aspects of this matter followed by the arguments in favor of the use and expansion of this currency zone. All the information gathered will be evaluated and put into perspective, so that the strongest arguments for each trench are identified and later used to build a position. After taking a position, clear arguments gathered in an extensive analysis supported by facts, up-to-date data, and empirical examples will be used to defend our main thought. The last part of the essay will be a critical personal conclusion, which summarizes our arguments and a coherent overview of the main findings and thoughts on the euro as a single European currency.

LITERATURE REVIEW

This literature review is about several different academic sources on whether the euro as a single currency within the European Union is something that would benefit the general well-being or if it would do the exact same opposite. It relates to my academic paper as I

want to state important arguments in favor and against this being a good idea. As the final objective of my paper is to encourage the use of one single currency across the European member states, I looked for keywords such as “single currency”, “euro as a unique European currency”, “euro and the exchange rate”, “euro and free trade”, etcetera and found some important papers.

With the help of academic resources search engines such as google scholar or science direct and even newspapers such as the *Dubrovnik times*, an extensive search for important and somehow proven information was made focusing mainly on recent studies, not more than 3 years old, was made. As this is a topical issue and is continuously being discussed by political figures and other interested professionals, there is plenty of debate and work around the topic. This fact allowed me to look for research that is closely related to my main argumentation, but as it is a topic that involves so many stakeholders in varied ways, it has a lot of material researched with different perspectives and experimentation. To decide on which papers to focus on and use I analyzed how related and important their findings were and looked at their number of citations, usually the more citations a work has, the more relevant it is.

Only papers that discussed the euro and its effects as a single currency in Europe or a specific EU member state were selected. Twelve comprehensive bibliographies have previously been compiled on the use of euros as a unique European Union currency. The first was by the *International Monetary Fund* (2005) which supports the euro usage as it brings long-term benefits. The second is by Negri, Nicoli, and Kuhn (2020) a European journal that experiments on how the euro usage promotes people's identification as part of the European Union. The third is by Cerulli, Nenci, Salvatici, and Zinilli (2021) which is an

Italian economic journal that explains the impact of the euro as value-added in the Italian exports. The fourth is research made by the ECB (2021) that explains how Bulgaria and Croatia will adopt the euro after some preparations that were possible due to the previous experiences with the other countries that joined the group of European euro users. The fifth by Penchev (2020) explains a few things that could be homogenized in the eurozone by having a single currency. The sixth by Otero-Iglesias (2019) is an academic paper that contradicts Mody´s opinion about the euro and how it is not convenient. The seventh is a journal of economic psychology by Mussweiler and Strack (2004) that states that the use of the euro would ease the comparison between product prices across different states in the EU. The eighth is a Croatian newspaper that applauds the Croatian state using the euro and even states that even though they had their own currency, the Kuna, the euro has for a long time been the main currency for them. The ninth academic source is a paper from a Hungarian bank that explains the changes that the adoption of the euro would bring to Hungary by Csajbok and Csermely (2002). The tenth by James (2019) explains some of the challenges the euro has found on its way. The eleventh is an analysis by Lanchester (2016) of why the euro has been a failure. The twelfth discusses how the euro has contributed to tourism flow increase and was written by Febrer (2016). More academic sources may be cited and used to better complete my paper´s purpose.

The literary review has shown that there is plenty of experimentation and research that supports my main position that can be summarized as the euro adoption by the European Union member states will bring major long-term benefits for the adopting country´s economic situation. The analysis of this paper will explain why this statement is true and explain a few reasons why some critics have arisen from this situation. After reading this

paper the reader should be able to generate his own opinion about the euro situation and understand some key arguments that suggest that a common currency area in Europe is a good idea.

ANALYSIS/DISCUSSION

We have already made the necessary research to have a decent extension of knowledge on the subject to discuss. As stated in the introduction of this paper, the first part of the analysis will be the recompilation and examination of some of the strongest arguments against my thesis. To start strong, I need to address one of the biggest critics on the matter, which is that a single monetary policy cannot solve every country´s needs. Around the member states of the European Union, different economic situations are happening that must be treated with different monetary strategies. Some of the European countries are prospering, with high growth and low unemployment, such as Germany and the Netherlands. There are also European states that from prolonged economic downturns and unemployment, such as Italy and Spain. These two types of countries require different sorts of monetary policies, the high growth countries' main priority may be to prevent inflation, so maintaining high-interest rates is the best idea for them. The second case requires economic stimulation, which is obtained by lowering interest rates thus increasing borrowing from banks. The problem is that, in a single currency area such as the euro area, interest rates cannot be simultaneously high in one country and low in the other.

As these different environments are indeed present in the EU and they all use the euro, some problems have been increasing in countries, such as Italy and Greece. During the European sovereign debt crisis, growth slowed, unemployment increased, investors feared

for their solvency and the euro economic policy response was to drive up interest rates. The issue here is that solvency fears may not have been present if each country was able to print money and inject it into their economy, but as the ECB is in charge of deciding for the whole eurozone, this was not an option. These events ultimately led to more unemployment, deflation, and even negative economic growth in some states. This chain of events is why some experts believe that the euro as a single currency was the main factor in Greece´s economic depression.

Another constantly mentioned problem about the euro is the idea of it being in favor of Germany. In case you were not aware before the euro was established as a single currency, there was another way of stabilizing exchange rates in the EU called the ERM (European exchange rate mechanism). The ERM was a mechanism in which different European currencies fixed their exchange rates to the German mark. As Germany has the largest economy in the eurozone and has had a working monetary policy since World War 2, this idea was the one that made the most sense, but this still generates doubts of favoritism of the euro towards Germany.

The fact that a single monetary currency cannot be the answer in different economic situations and that Germany seems to be ECB´s top priority can be seen in the year 2012, in this moment the European monetary policy was too tight, even though many countries such as Portugal, Italy, Spain, Greece, and Ireland were struggling with high debt, high-interest rates, and high unemployment and needed a looser monetary policy. This was not the only time the European monetary policy benefitted the Germans over another nationality, a similar thing happened when after dealing with the burdens of reunification, Germany pursued a looser monetary policy, which led to the U.K.'s strong economy facing serious

inflation problems. In 1992, on an event caused by this reason called Black Wednesday, the U.K. had to raise interest rates and eventually pushed out of the ERM. (Andrew Beattie, 2021)

The European growth expectations were low even before the global financial crisis because of a mixture of demographic and organizational reasons, but as the economic historian Robert Fogel predicted in 2007, welfare spending and high taxes would end up dimming economic growth in the euro countries. This along with the lack of new European company giants, which were something that thrive in the US and China, stopped growth and innovation within the old continent. This absence of big enterprises is due to the poorer development of the venture sector as well as by markets that were still segmented by national politics and national regulation. (Harold James, 2019)

Even after being in a constant economic crisis, some bankers and other insiders believe that the European governments just need to “buy time”, so that the economy starts correcting and growing, while debts shrink, and the banking system goes back to its normal self. The problem is that the situation has already got to a low or no growth phase with high unemployment and this causes popular anger and disaffection. The only way to fix the eurozone problem seems to be an increased sharing of economic burdens between creditor and debtor countries. This would mean the richer countries to burden some of the costs of the poorer countries and this is what happens in a real currency union, such as the United State. (John Lanchester, 2016) The thing is that this event is not probable to happen, as even when people have some sense of nationality between each other, they are not always so happy to sacrifice themselves for the greater good.

Now that we have established some of the biggest flaws of using a single currency in a zone with so many differences in culture, language, weather, etc. It is time to state why the implementation of this monetary policy and system will be beneficial when it is optimized. Several studies show that the many benefits of the euro are interesting and promising. These benefits cover a wide range of subjects from tourism to trade to consumer's sake.

The euro as a single currency along with the European institutions within the EU helps to create a single European state. The work by Negri, Nicoli, and Kuhn (2020) strongly supports their hypothesis that states that the introduction of the euro has a modest magnitude, but a significant and robust effect on the European identity as the share of people who identify exclusively with their nation decreased about 3% after the currency changeover. They concluded this by using parametric model specifications on 26 EU countries observed from 1996 to 2017. This fact is important because collective identity is essential in politics.

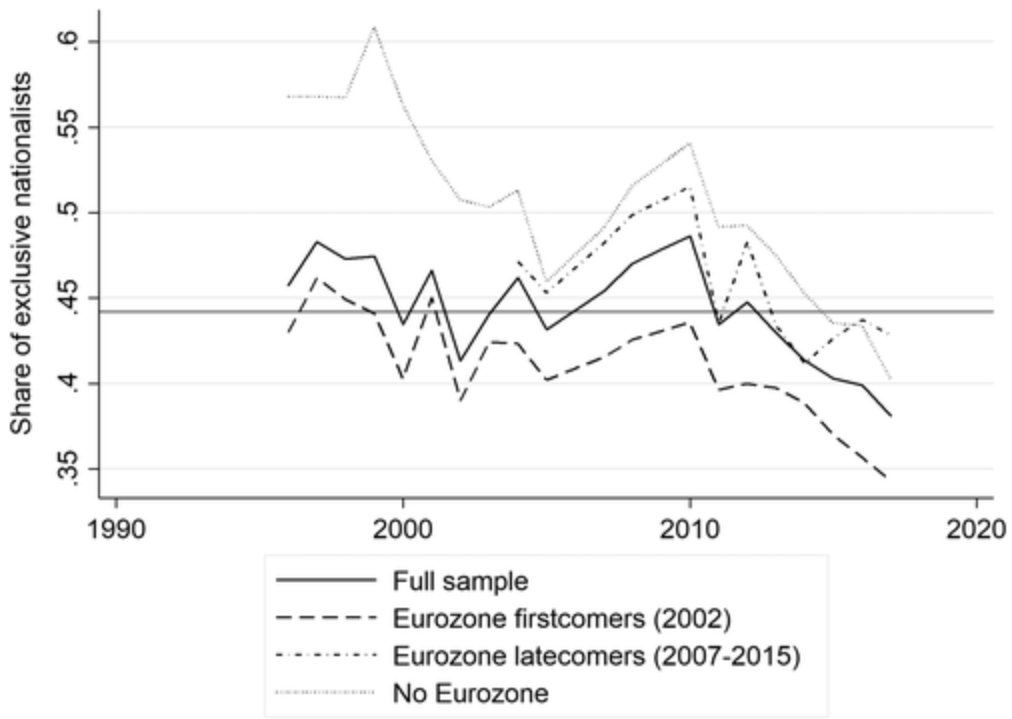

Figure 1. Share of people with exclusive national identity by country group over time.

Note: Mannheim Trend File (1996–2002) and Eurobarometer waves (2003–2017). Unweighted by population.

Collective identities refer to the responsibility individuals belonging to a group feel towards each other and are therefore considered fundamental components in the formation of the nation-state. Institutions are then formed to formalize this sense of belonging and responsibility. These institutions should exert collective sovereignty and ensure compliance with social norms. When the EU controls in a better way core resources such as trade, internal free movement, taxation, labor market and social policies, diplomacy, and defense the benefits of being one single nation will become a clearer reality. Nowadays only the CJEU, the EU Customs Union, internal free movement, and the single currency are powers that belong to the EU, the other key resources are still being mainly controlled by each country.

The euro fostering a common identity is important because, without this, a country cannot exist. If supranational institutions work together to look for the EU welfare, more Europeans will start to recognize themselves as a group and this would create cooperation between the states which would ultimately bring many benefits.

Much research on how trade will be benefitted from the euro has been done and they mostly indicate positive and significant gains from trade. Even though the size of the benefits varies widely, Rose (2002) examined 24 different studies and found a pooled estimate that currency unions double trade between union partners, and even in the worst case, a 15% increase was shown. In the same work by Frankel and Rose (2002), high and low estimates for growth in trade and GDP for countries such as the Czech Republic, Hungary, Poland, Slovak Republic, and Slovenia. The results are shown in the graph below.

The introduction of the euro as a single currency has provided a boost to the Italian role as a provider of inputs to “factory Europe” state Cerulli, Nenci, Salvatici, and Zinilli (2021). A common currency should foster deeper and more liquid financial markets, increasing cross-border investment because of the lower transaction costs and the FX risk disappearance. Evidence shows that the introduction of the euro has increased inflows into the monetary union, both among EU countries and investors outside the union.

CECs: Potential Long-Run Increases in Trade and Per Capita Output Following Euro Adoption[1]

(In percent)

	Trade[2]	GDP[3]	Trade[4]	GDP[3]
	High estimate[2]		Low estimate[4]	
Czech Republic	60	20	7	2
Hungary	55	18	6	2
Poland	25	8	3	1
Slovak Republic	59	20	7	2
Slovenia	53	18	6	2

Sources: Frankel and Rose (2002); Rose (2002); IMF, *World Economic Outlook;* IMF, *Direction of Trade Statistics;* and IMF staff calculations.

[1]Based on 2002 trade and GDP data.

[2]Percent change in ratio of total trade to GDP. Assumes currency union increases trade (the sum of exports and imports) with current euro-area members and the other accession countries by 85 percent over 20 years. Based on Rose's fixed-effect meta estimates (Rose, 2002). Assumes trade with other countries rises in line with GDP.

[3]Assumes a 1 percent increase in total trade/GDP increases real GDP per capita by 0.33 percent. Estimate drawn from Frankel and Rose (2002).

[4]Assumes currency union increases trade with current euro-area members and the other accession countries by 10 percent. Estimate drawn from analysis of average five-year gain from EMU experience.

Benefits from a single currency zone in Europe go far beyond trade increases. Another important effect would be the elimination of FX risk, this should by default lower real interest rates. Using a general equilibrium model, MNB (2002) estimates that lower risk due to the euro changeover would raise growth by about 0.1% per year over the long term via lower real interest rates. Estimates done by other similar papers suggest a similar effect, of about 0.2% per year. By eliminating FX risk, European countries should become more attractive for foreign direct investment, particularly in sectors open to trade. This effect

might be one of the best reasons for the EU to adopt a single currency, as many opportunities arise from privatization and deregulation. The U.K. Treasury has acknowledged the potential for higher FDI but does not detect a clear effect so far in the EMU countries. (IMF, 2005)

Sharing a common currency can be expected to reduce transaction costs. In 1990, the European Commission estimated the potential savings on transaction costs through the elimination of national currencies at around 0.4% of EU GDP. This benefit would be more significant in the GDP of countries with smaller economies than for those whose currencies are heavily traded. Estimations of these savings were 0.2 percent of GDP for the bigger economies compared to 1% for the smaller ones.

Joining the euro area creates a clear framework for macroeconomic policy discipline, thus enhancing credibility and lowering inflation expectations. The problem with this benefit stated by Currie (1997) is that Frankel and Rose (2002) found that growth benefits from improved monetary credibility and stability of using the euro are not as clear-cut as benefits coming through trade.

Working together as a single currency zone is a great way of keeping peace around Europe, as looking at your neighbors as a team is much better than considering them the competition. Let us remember that the establishment of the euro in the first place had a lot to do with stabilizing and pacifying the tension between countries such as Germany and France. (Miguel Otero-Iglesias, 2019) If we start to look for ways to separate Europe or suggest that every country should care more about themselves, we may be resurging the old tensions that existed along with Europe and probably be looking at future unnecessary

conflicts. Besides Europe needs each other more than ever before, as individually each country is not as great as they were before. Acting as a supranational is the best way of joining strengths and providing a better life for Europeans.

As the last important benefits of a common currency zone mentioned in this paper, we have the increase in tourism due to many factors such as the free movement between Schengen countries, the reduction of transaction costs, and the price transparency. (Antoni Febrer, 2016) The use of a single Visa or Passport (in case you were born in any Schengen country) eases travel stress and necessary time spent making tourists much eager to visit as many places as they can afford. While the reduction of costs is so significant that an estimation made by the Ministere de l´Interieur (1997) revealed that only because of transaction costs did a traveler crossing Europe lost half of his purchasing power. Finally, the price transparency is a benefit for the tourists because in this way they feel they have more control over what is worth their money and it promotes quality products, hotels, restaurants, etc. Before the adaptation of the euro as a single currency, the countries could just devaluate their currency to attract tourists, and this does not mean that their products or services were worth what they cost.

CONCLUSION

We have now reached the final part of this paper after reviewing valuable arguments for and against the use of a common currency between the European Union. Indeed, the idea of having a single currency and a single monetary policy throughout such an extensive and diverse area requires a lot of cooperation and effort. This makes it easy to criticize and

point out all the flaws that this system has arisen, but we have seen that it is also true that the euro has important short-term and long-term benefits.

The United States was not always together as a single currency area, for them to get where they are, many years passed. About 150 years had to go by to build the stability, structure, and success achieved by the biggest international economy. Besides, the biggest difference in the challenge between Europe and the USA being a common currency area I believe is the difference in language and nationalism. Things such as culture, weather, geographic conditions, and other key differences were also different in each state of the US, but now they have mixed and seem more homogenous.

The implementation of such a movement needs time and patience, and I believe that the research made for this paper shows that Europe is going forward and becoming more of a single state step by step. Croatia and Bulgaria are on their way to joining the countries that use the euro by filling the requirements necessary in the Maastricht treaty. So even though the eurozone is still not an OCA, the trend seems to be directed toward that end. The deciding factor is that the biggest economies understand that sacrificing for a while to help the poorer countries will result in a much stronger European bond thus creating the strongest Europe overall to be able to compete against big international economies such as China, the USA, or Russia.

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