EURO ADOPTION: IS IT REVERSIBLE?

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Abstract: *Starting from 1999 sixteen countries have adopted euro as a single currency. Considering that the Maastricht Treaty stipulates that all the European Union countries must adopt euro once they meet the requirements stipulated it is not a question of "if to join the euro area", but rather of "when". Therefore adopting euro currency is not and it should not be a reversible process. The decision to participate the monetary union represents the expression of a decision to move forward, while leaving it would be nothing else but a step back.*

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My answer is: no. Three years ago, when I have done my first research on euro area, this question would have seemed inappropriate. Now, taking into consideration the fact that important economists foresee the end of euro, this subject stirred my interest. The result of multiple lectures only strengthen my belief that euro exit is not a desirable option.

Considering their complexity, I can say that currency unions are mysterious phenomena. For many years, countries have made sustainable efforts to participate to such a union, participation that promised many benefits. Thus it has been developed a vast literature regarding the reasons for joining a currency area. Less interest has been given to causes that made the countries leave currency unions. And the number of countries that acted so after the World War II was not quite negligible.

Recently, the issue of exiting a currency union and even the total disintegration of it came back, right after the current financial crisis strongly affected the euro area.

Opinions regarding the viability of European Monetary Union had been formulated even before the introduction of the single currency. Before 1999, many economists sustained the fact that the stability and viability of a currency area can be fulfilled only if they are joined by greater economic flexibility and deep political unification.

Despite the critics, on 1 January 1999, eleven countries abandoned their national currencies and adopted euro as the single currency. Ten years later, this became the common currency of sixteen member countries of the European Union. According to the Maastricht Treaty, all the European Union countries must adopt euro once they meet the requirements stipulated. Thus, it is not a question of if to join the euro area, but rather of when.

The anniversary of ten years of euro led to the publishing of many working papers that showed that euro area proved to be a success. Monetary stability is the main advantage brought about by the monetary union, the inflation rate ranging across 2% in 1999-2007. The public finances situation has also improved, with the member countries being very close to the reference limits. Until the end of 2008, public deficit has been under the maximum value of 3 percent of GDP, while public debt had superior values, but close to the reference of 60 percent of GDP. Between 2005 and 2008, employment rate reduced significantly in euro area thanks to the numerous reforms implemented. Economic growth improved by the end of 2007.

Considering all this advantages, adopting euro became easily a desideratum for all the countries that were struggling to achieve the convergence criteria. Euro area promised to offer stability and economic development to the new member states.

The current financial crisis showed that there were problems inside the European Monetary Union, which fact determined the increase of uncertainties regarding euro's ability to survive. The main culpable country this is Greece, who's fiscal problems where intensely debated.

In October 2009, after the Greek elections, the public deficit announced by the new government was 12 percent of GDP, significantly higher than the one previously promised to the European Commission at the beginning of 2009, of 3.7 percent of GDP. The budgetary problems of Greece are mainly cause by the high entitlement and age related expenditure, the poor tax administration and a bloated public sector.

To confront the huge imbalances, the Greek state received a package worth of 110 billion euro from IFM and other countries from the union. In exchange, the government signed a severe program to reduce the expenses and increase the taxes.

By hiding the real situation of public deficit, Greece showed an irresponsible behavior. The fact that it belongs to a currency union forces it to make efforts for maintaining a discipline of public finances; otherwise a systemic risk might appear. Such a behavior was anticipated and preventing measures had been adopted by introducing clauses in the Maastricht Treaty. Thus, it appeared the "no bail out" clause that interdicts interventions from European Central Bank for helping a state facing bankruptcy and it was created the Growth and Stability Pact which has the role of supervising countries that have a budgetary and fiscal negligence.

Even so, it appears that the Hellenic state ignored the requirements that should have been respected; therefore it is easy to understand why some of the other member countries would want it leaving the euro area. But the question can be asked whether or not for a small economy like the Greek, being outside the union would be better. Again, the answer is no. And that is because, for a country with fiscal weaknesses inside the union is better than outside of it.

The only argument for exiting the euro area would be that introducing a new national currency can lead to a nominal and real depreciation and, indirectly, to an increase of competitiveness, that is more than welcomed. But this favorable situation has weak chances of lasting. Rigidities from small economies like Greece are real, not nominal as it would be needed in order for a depreciation of exchange rate to have a durable impact on real competitiveness.

It is important to mention that depreciation will lead to an increase in real terms of public debt which would mean an impossibility to refund the debt; both options being costly for the government and population.

The argument for leaving the euro area omits the fact that the financial environment changed drastically in the last two decades. In a regime where capitals are free, abandoning euro will trigger massive capital withdrawal that will undermine the stability of the economy. The new currency will be under a speculative pressure, generated by financial markets. The authorities will have to increase interest rates or to let the currency depreciate.

At the same time, repercussions of euro exit on the relations with other EU partner countries will be countless. Besides the potential protectionist reactions and the destabilizing impact on single market, a euro exit can be seen as sign to leave the European Union. A country that unilaterally abandons the single currency to benefit from a competitive advantage will jeopardize its status as a member of the European Union. Lisbon Treaty contains a clause about EU exiting but none referring to euro.

Abandoning the single currency by Greece has multiple negative effects on it, but it can't lead to the total disintegration of the euro area. In my opinion, a stronger threat comes from the countries with a good fiscal position, like Germany, which might decide to leave the union, unwilling to become the rescuer for those countries that are fiscally insolvent.

Problems faced by Greece represented a good opportunity for Professor Martin Feldstein from Harvard University, one euro-skeptic, to bring up the fragility of euro area. Thus, analyzing the imbalances in Greece, he proposed the solution of euro exiting. He was contradicted by his former student, Charles Wyplosz who rejects this idea, considering that abandoning euro will bring a total collapse to the Greek economy. Taking into consideration the reasons mentioned in the previous paragraphs, I tend to agree with Wyplosz's opinion.

I consider that the best argued opinion regarding euro's future is that of Barry Eichengreen, who argues that joining euro is irreversible, invoking the numerous costs imposed by leaving it. A first factor supporting the idea is represented by the economic costs involved by the single currency abandon. A second reason for which members should not leave the euro area is the one related to political costs. The country that revokes its commitment risks disputes with the partners.

Nevertheless, the most important cost is not economical, nor political, is procedural. Reintroducing national currencies makes necessary the redenomination of all contracts in national currency. To assure a well functioning system, the euro abandon must be joined by a detailed planning, a planning very similar to the one that took place before the physical introduction of euro. Computers will have to be reprogrammed; vending machines will have to be modified and the list could such go on.

I agree with the arguments formulated by Eichengreen, because the introduction of a new currency is costly regarding time and trust. This would begin with the inevitable and complex political discussions that would join any decision to make such a move which would affect negatively the trust and ultimately, the real economy. A new currency would need to be printed and brought into circulation, an action which could not be completed overnight.

The future of euro was also analyzed by the Nobel laureate, Paul Krugman, who agrees with Eichengreen opinion. Even though he considers that the fundamental problem of European monetary integration is the belief that Europe can maintain the currency functional despite the strong reasons that showed that it was not prepared, he upholds that reintroducing national currency would do nothing else but trigger the most difficult of all financial crises. To make the future functioning of euro currency possible, what Europe needs is a stronger political integration, bringing the member states closer to the American model.

I therefore consider Krugman's argument to be adequate taking into consideration the fact that, while the negative effects of the financial crises on euro area are known and there are numerous solutions for them, the consequences of abandoning euro still remain under uncertainty, bearing the risk of being much higher.

The irreversibility of adopting euro is further sustained by yet another Nobel laureate, the economist Joseph Stiglitz, who considers that the countries in the euro area have all the chances of surpassing the crisis. Accordingly, the euro will survive, regardless the fact that economic development will be affected by the reduction of public expenses and by taxes growth.

The previous opinions only emphasize the idea that, similar to the period before euro introduction, there are economists who sustain the monetary union and economist who continue to have a dose of skepticism about its future. Launching an idea such as renouncing the euro represents, in my vision, a forced action driven rather by an impulsive reaction than being a result of logical reasoning.

But what is the ECB opinion regarding euro exit? As you may assume, this opinion has a strong note of subjectivism. ECB considers euro adoption to be an irreversible process, which would require a careful preparation. Creating a monetary union in Europe was a historical moment, when all members of the euro area took the commitment to communicate and to take the best measures for their individual and common good.

Under a legal approach, according to Maastricht Treaty, euro adoption was and it is an irreversible step. Article 4(2) refers to the irrevocable fixing of exchange rates that leads to the introduction of a single currency and article 123(4) refers to the exchange rates to which the currencies will be irrevocably settled.

The president of ECB, Jean Claude Trichet, has the mission of finding solutions for assuring the euro area's stability, fact that has been achieved from the beginning of the first negative effects of the crisis. Firmly, he always qualified as absurd the speculations regarding euro abandoning.

The decision of leaving the euro area can be regarded through a cost-benefit analysis. The most important reason for exiting euro area is given by the belief that it will trigger the depreciation of the new created currency as an attempt to regain the lost competitiveness. However, for many reasons, such a move would have unwanted results, different from its own political interests. Thus, while the main advantage is questioned, there is no doubt regarding the significant costs that returning to the national currency will bring.

In my opinion, European monetary union should be regarded as a "club" where the members are equal and work for a common goal: monetary stability. I admit the fact that the ideal of such a "club" might have been unbalanced by the financial crisis, but we should not forget the enormous efforts that had been implied by the creation of such a monetary union in Europe. Membership to such a "club" promised protection against financial problems which should be obtained by rigorous behavior and mutual help. Even though the treaty specifies that members are not responsible for others public debt, there is an implicit commitment to offer urgency help. Leaving euro area can lead only to marginalization of the state because, unlike the joining process, this is not sustained by the other member states.

Adopting euro currency is not and it should not be a reversible process. The decision to participate the monetary union represents the expression of a decision to move forward, while leaving it would be nothing else but a step back.