

EURO – ADVANTAGES AND DISADVANTAGES

Gabriel MURSA*

Abstract: *The adoption of a single currency was considered one of the most important successes of the effort to unify the countries of the European Union. Obviously, a common currency has indisputable advantages, the most important being that of stimulating trade in countries that have joined the Eurozone. Meanwhile, the euro has several disadvantages, the most important being that the excessive centralization of monetary policy in the European Union. Moreover, the introduction of a single currency generated some disadvantages, which to some extent can be considered drawbacks in terms of efficiency of resource allocation in the European Union countries.*

Keywords: common currency; monetary policy; specialization; trade

JEL Classification: F360

INTRODUCTION

The euro was introduced in January 1999 as a logical and necessary step in the process of unifying the citizens of the European continent. The supporters of this political and economic partnership between the European countries considered that, in principle, the European Union must act as a supranational state with common institutions and rules governing an extended single market, through which the goods, the services, the capital and the labor force might move freely. One of the main ideas of the process of building the European Union has been the introduction of a single currency in order to facilitate the trade between companies and citizens from different countries. Thus, fifteen years ago, the single currency appeared, the euro, a device used nowadays only in 18 countries. The rationale behind the enactment of a common monetary policy was that a common Europe can not function properly in the absence of a common currency. Obviously, the use of a common currency in a single economic and political space generates a lot of advantages, absolutely necessary for the free cooperation of citizens of the member countries. However, the economic events of recent years have revealed that the single currency has many disadvantages.

* Associate professor in Economics at the Alexandru Ioan Cuza University of Iasi, Romania; e-mail: gabriel.mursa@gmail.com.

1. ADVANTAGES OF THE EURO

The efficiency of resource allocation is based on the ability of economic system to use the specialization and the exchange. People become more prosperous by expanding the benefits of peaceful cooperation and of division of labor. However, specialization is possible through the expansion of markets, i.e. by removing barriers to the free movement of goods, capital and labor force. This is one of the most important reasons for understand that the unification of countries in Europe is a way of increasing the prosperity of the citizens by the widespread use of the principle of specialization and unrestricted transfer of goods and services. In addition, there are reasons to believe that the extended economic systems tend to naturally select currency used by individuals to exchange goods and services in order to satisfy their needs. To fulfill its mission, a currency must be used by a great number of individuals. A wider acceptability of money reduces the unit costs of administering the currency, diminishing the transactional costs of exchanging goods and, ultimately, increasing the benefits created by specialization and free trade. From this point of view, the euro has been a way of reducing transaction costs arising from the exchange of goods and services in the European space, allowing a free and easy movement of goods, capital and labor within the European Union, especially in the territory composed by the 18 member states of the Eurozone. The use of a common currency has allowed a widespread integration of economic activities from various countries, which resulted in the exploitation of comparative advantages of individuals and of companies in member countries, as demonstrated by the sustainable growth of the trade.

An obvious advantage of the euro was to reduce exchange rate risks. In the system of floating exchange rates, the continuous changes in exchange relations inhibit the trade, creating difficulties for exporters and importers. For example, a 2% devaluation of a currency can embarrass a company specialized in foreign trade operations, working with a profit margin of 5%. Continuously fluctuating exchange relations between two or more currencies increases the uncertainty and the risk for the firms engaged in foreign exchange and discourage the transfer of goods and services across national borders. From this point of view, adopting euro created an enormous advantage. The deeper economic integration, an increased specialization and an increased trade volume made the Eurozone countries play an important role in the global economy, their GDP being the second largest in the world, accounting for 14.6 % of world GDP. Basically, the Eurozone has become the most important economic actor in the world, its imports and exports having the highest share in world trade (exports - 21.7 % of GDP , imports - 20.9 % of GDP) (IMF, 2013).

Enhancing trade between Eurozone countries and the significant growth of their economies was largely possible by suppressing the transaction costs generated by flexible exchange rates. The transition to a single European currency has allowed the establishment of fixed rates between the currencies of the Eurozone; since then the exchange rate between the German mark and the franc remained constant under the system of euro currency. The elimination of currencies fluctuations eliminated exchange rate risk. Obviously, the currency risk can be suppressed by other means, but, in principle, these increase the transaction costs and reduce the benefits from trade, discouraging the specialization and the trade.

An important advantage of enacting euro was the elimination of exchange rate differences. In the absence of a single currency, a Romanian firm exporting in Germany receive DM but pays wages in RON. Most times, it is put in a position to sell and buy German marks or other foreign currencies. In addition to the risk associated with floating exchange rates, the Romanian firm loses difference between the price of purchase and the sale price. Banks buy currencies at a low price and sell them at a higher price. Therefore, the firms involved in foreign exchange lose that margin when selling and buying foreign currency. Thus, a system of floating exchange rates can generate losses both from a modified exchange rate of the national currency and from the difference of value between the sale price and the purchase of foreign currencies in the forex market. However, these potential losses can be considered transaction costs that discourage the foreign trade, inhibit exploitation of comparative advantage and the creation of a common market. The introduction was made at a fixed exchange ratio of national currencies, which had the advantage of eliminating these drawbacks. A fixed exchange rate has the great advantage of a more efficient allocation of resources at the international level, in this case, for the member countries of the Eurozone. Virtually, a fixed exchange rate eliminates the possibility of using monetary nationalism as a means of artificially increasing the competitiveness of national economies through the periodic devaluations of the national currency (Hayek, 1998). Under a system of floating courses, the national governments intentionally use the currency devaluation in order to stimulate exports in the short run. However, such a measure has limited and short-term effects, favoring a particular group of interest (exporters) and disfavoring the importers and the consumers, generating an overall increase in domestic prices. Under a system of fixed exchange rates, the external competitiveness of the goods and services produced within the country has a real base, not a monetary or a illusory one, created by a devaluation of the national currency. When it operates with fixed exchange rates, a economy can ensure its competitiveness in international trade through structural reforms, not manipulating the exchange rate of the national currency, which benefits short small group of exporters.

A huge advantage of the adoption of the euro was to eliminate the possibility that the national governments use a discretionary monetary policy to induce some artificial booms by credit expansion (Huerta de Soto, 2012). With a single currency, the governments can not imprint fiat currency and resorting populist policies. The democratic governments use monetary policy as a means to satisfy political interests without resorting to harsh measures, such as increasing taxes. In the second half of the twentieth century, a significant increase in government spending led to huge budget deficits covered by monetary instruments. In general, the governments have preferred to create inflation and not to increase budget revenues by raising taxes because, in a democratic political system, the voters rejects tax increases. Thus, they preferred to rely on the hidden tax of inflation, which distorts the functioning of relative prices and therefore the allocation of scarce resources. The adoption of the single currency and the transfer monetary policy prerogatives made the governments accustomed to cover the budget deficits through monetary instruments to be deprived of one of the most used tools of economic policy. This particularly favored citizens of countries whose governments often resorted to monetization of deficits at the expense of strengthening fiscal discipline. This was quite evident in recent years, when many of the Eurozone countries, once followers of inflationism were put in a position to take precautionary measures in order to reform the economy. From this perspective , the euro has acted, even if imperfect, like the gold standard because of the limited possibilities of politicians to devalue the national currencies to solve short-term economic problems of their own nation. The economic crisis of recent years has forced politicians to resort to limiting budget deficits, to adjust public spending, to deregulate of economic activity, to encourage the labor market flexibility etc. Without the euro, the existence of national currencies with flexible exchange rate would give the possibility of governments of different countries to abandon austerity policies and to resort to inflation and devaluation as a means of solving their temporary economic difficulties caused by the economic crisis. But as we pointed out, the inflation acts as a tax that allows the governments to finance the excessive spending by a hidden confiscation of the purchasing power of currency users. Moreover, it decreases the overall productivity of the process of resource allocation because the erroneous signals transmitted by the price system directs the scarce resources to marginal uses.

With the single currency, the governments of Euro area have very limited opportunities to use inflation as a method of financing the budget deficit. In fact, their only option is to control the public expenditure, taking into account that a high level can not be easily financed by increasing taxes. From this perspective, the limited the powers of national governments acts as a safety belt for the economies of the southern flank of the European Union, which traditionally are not accustomed with the budgetary discipline imposed by a common monetary policy, designed and applied in the Eurozone.

This was evident when countries like Greece and Italy showed their intention to give up the single European currency.

The Eurozone monetary system is a obstacle to extending social security system of the European Union. Due to electoral reasons, all European countries support a huge public spending in order to finance the welfare state system, a tool used by all political parties to buy votes and to stay in power. With a single currency, it is more difficult to do this. Obviously, the euro adoption has not led to the disappearance of this populist system, but it put obstacles in the way of its expansion. With an autonomous monetary policy, any government can finance a portion of these expenses by the monetization of public deficits. In order to avoid raising taxes, the governments resorted to the hidden tax of inflation to cover costly social programs promoted by political parties. Today, the governments of the euro area have limited opportunities for spending more because they have lost the right to imprint fiat money. Of course, the euro has not led to the disappearance of the welfare state system, but made more transparent its financing. Since they can not use anymore the occult financing of social spending through inflation, the governments can expand such programs by increasing the official taxes, a transparent and democratic method to use the taxpayers incomes. But as we have seen, the tax increasings have negative effects not only on the economy but also on political parties who promote such a policy. Therefore, it is difficult to use such an instrument in a democratic political system. Therefore, the euro introduced a natural barrier to the expansion of social security programs because it have inhibited the political authorities to use inflation as a hidden way of financing public expenditures.

Finally, the euro has had the advantage of being determined the Eurozone countries to meet some convergence criteria. Thus, in order to enjoy the benefits of specialization and cooperation through a single and wider market, the national governments were seen gradually forced to abandon lax monetary and fiscal policies being constrained to promote the price stability, to keep under strict control the money printing, to restructure public spending and to eliminate chronic budget deficits. These criteria aimed at introducing a strong discipline in countries that typically were trained to use the technique of inflation to delay indefinitely the solve of real economic problems.

2. DISADVANTAGES OF THE EURO

The euro has boosted trade in the euro area, it has permitted the division of labor and has represented a way of disciplining the national governments, who, before entering the Eurozone, used fiscal policy and monetary policy to achieve populist objectives.

But the euro is not a perfect instrument. Its main drawback is that it is a fiduciary currency. Or, the fiat currencies are not based on a real standard, but on the simply trust of people. The major disadvantage of the euro is that the European Central Bank may use discretionary monetary issues, which would allow the application of policies similar to those used by national governments with their own currencies. Being deprived of a real base or standard, the European authorities can devalue the euro and can finance the budget deficits of the Eurozone countries. This is not just a theoretical possibility, but a fact that has happened in recent years, when the European Central Bank resorted to monetary emissions, accepting as collateral the junk bonds of Greek government. Basically, it behaved like a national government which, faced with the impossibility to finance the excessive public expenditures, used the method of deficit monetization. By doing this, the European Central Bank itself violated fundamental principles of euro convergence criteria. Thus, the euro can not be a strong guarantee of the application of efficient long-term economic policies (Booth et al., 2013). The euro has partially avoided the dangers arising from fiduciary nature of former national currencies like peseta, drachma, or escudo, but did not remove all the dangers of discretionary monetary issues and of a lax fiscal policy.

The second major disadvantage of the euro is that it limits freedom of choice for citizens. Given the existence of national currencies, there was a money market through which these coins are competing each other. In fact, there was a competition between the central banks to have a fiable money; the national central banks were obliged to be very cautious about monetary issues. In these circumstances, EU citizens can made transactions or they could keep wealth in a currency which they considered best suited for personal purposes. Today, the adoption of the euro currency freedom of choice has been significantly reduced. Taking into account that the euro is legal tender, every citizen is forced to accept and to use the currency imposed by the European authorities. However, the lack of freedom in the choice of currency is contrary to European principles of safeguarding individual freedom and the desire of individuals to improve their own welfare. By introducing the single currency, the EU money market depends on a monopolist. The national monopolies held by national central banks have been replaced by a stronger monopoly, a supranational one, held by the European Central Bank. Obviously, the most negative effects derived from the forced concentration of production applies also for the production of money. Consequently, in the absence of competition between national currencies, the existence of a single currency, provided by a monopoly, may involve any specific adverse effects of any monopoly (Mises, 1998). The losses resulting from the new monopoly held by the European Central Bank could be offset by imposing specific standards of the best currencies existing before 1999, which would have led to the imposition of a monetary policy

similar to that applied by countries such as Germany and the Netherlands. If this would happen, the citizens of any part of the Eurozone would have benefited from a solid, stable currency like the German mark. But the political opportunism gave the euro a value representing rather an average value of former currencies. The European currency users lost the opportunity to choose the best currency from a basket of competing currencies. The adoption of low monetary standards has disadvantaged countries with prudent monetary policy and created the incentives induced by the adoption of a lax monetary policy, a policy with an unstable money. However, given the disappearance of national currencies, the European citizens have lost the ability to create pressure on central banks in their own countries, choosing the currencies of other countries. The difficulties faced by the European Union since 2008 support this view. In addition, the suppression of freedom of choice of currency made it impossible to discover the preference of the citizens (Hayek, 2007).

Adopting the euro has enabled the introduction of a stronger monetary and fiscal discipline in countries that traditionally were characterized by populism and lack of seriousness, but brought disservice to the citizens of countries like Germany and the Netherlands, accustomed to stable currencies. In fact, the adoption of the euro has led to arbitrary transfers of wealth from low inflation countries to high inflation countries, through the excessive imports covered by government bonds. To avoid these transfers, the countries that previously had prudent fiscal and monetary policies would have to adopt the same standards, which would lead to a generalization of budget deficits and a significant devaluation of the euro in all parts of the Eurozone.

A third major drawback of the single currency is a massive centralization of decisions at EU level and a significant concentration of powers in the hands of a small group of individuals, which may endanger one of the fundamental principles of the European Union, the individual liberty. A concentrated decision-making power significantly increases the probability of committing errors because decision making is based on fewer minds than in a decentralized system. In addition, the impact of erroneous decisions can be huge, because concerns directly on all 300 million citizens of the Eurozone. Obviously, by the introduction of a single currency, the national governments can not exert a direct pressure on their own national central banks in order to monetize their budget deficits, but the advantage of the common monetary policy can be destroyed by the concentration of powers in the hands of a small group of technocrats, managed by the most influential politicians of the EU countries.

These drawbacks lead to the conclusion that, in fact, the euro has been designed to be a political tool used by politicians in order to realize an excessive centralization of European Union (Bagus, 2012). The possible unification of fiscal policy, which is discussed in recent years to strengthen the

common monetary policy, gives us the argument to believe that, in fact the euro has not been introduced especially for its economic benefits (Schwartz, 2004).

CONCLUSIONS

Adopting the euro has both negative and positive effects. In principle, a common currency facilitates specialization, exchange and integration of national markets into a supranational, wider market. It allows the reduction of transaction costs induced by currency risk, increasing benefits from international trade. From a certain point of view, the euro generate some of the advantages of the gold standard, because it reduces the possibilities of national governments to finance deficits by creating and issuing currency. By switching to the euro, the Eurozone countries had to meet convergence criteria relatively hard to achieve, to accept fixed exchange rates, which prevents artificial devaluation of national currencies as a instrument to increase competitiveness. Meanwhile, the adoption of the euro has many disadvantages: fiduciary character of this currency, the creation of a supranational monopoly of the European Central Bank, an excessive centralization of decision-making in the European Union, the suppress of freedom of choice of the the Europeans citizens in monetary affairs. Therefore, the euro rather serves the interests of political centralization of Europe, than the desire to stimulate trade and the free movement of goods, capital and labor.

REFERENCES

- Bagus, P. (2012) *The Tragedy of the Euro*, Auburn, USA: Mises Institute.
- Booth, P. (ed.) (2013) *The Euro – the Beginning, the Middle and the End?*, London, England: Institute of Economic Affairs.
- Hayek, F. A. (2007a) *Denationalisation of Money*, London, England: Institute of Economic Affairs.
- Hayek, F. A. (1998b) *Monetary Nationalism and International Stability*, Fairfield, USA: Augustus M. Kelly Publihshers.
- Huerta de Soto, J. (2012) *En defense del euro: un enfoque austriaco*, accessed on April 2014 at <http://www.libertaddigital.com/documentos/jesus-huerta-de-soto---en-defensa-del-euro-un-enfoque-austriaco-41912626.html>.
- IMF (2013), *World Economic Outlook*, Washington, USA: International Monetary Fund.
- Mises, L. (1998) *Human Action. A Treatise on Economics*, Auburn, USA: Mises Institute.
- Schwartz, P. (2004) *The Euro as Politics*, London, England: Institute of Economic Affairs.