SINGLE CURRENCY – ADVANTAGE OR CHALLENGE?

A CONTRIBUTION TO THE DISCUSSION

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The expansion of the European Union is now within sight. It is a welcome fact that Slovakia finally joined the ranks of countries forming the next round of European Union's expansion and our expected accession in 2004 will come into increasingly sharper focus. In this respect, there arises the question of selecting an appropriate economic policy with regard to the future implementation of the single currency – the euro.

The single currency of the EU member states is a significant change in the economic, political and social life of all of them. It is important that the countries get ready for this change and their citizens understand its importance. In order that they recognised the advantages ensuing from implementing the single-currency, but on other hand equally recognised the challenges presented by this process and realised also the possible partial disadvantages.

European Central Bank (ECB)

Responsibility for formulating and carrying out monetary policy in the eurozone lies with the ECB, which is an "extended arm" of the European System of Central Banks (ESCB). The ECB has a high degree of institutional independence, i.e. it is independent of intervention from national or European institutions. The monetary policy of the ECB takes into consideration the eurozone as a whole and does not react individually to specific developments or the needs of an individual regional state. The primary aim of the ECB's monetary policy is to maintain price stability, defined by yearly growth of the harmonised consumer price index for the eurozone at a level lower than two per cent. Price stability should contribute to the efficient redistribution of resources between consumption and investment and increasing the transparency of the price creation mechanism. The basic instrument of the ECB's monetary policy are interest rates, which it tries to influence via its own financial operations.

A pressing problem in the framework of formulating the ECB's monetary policy arises in the insufficient convergence in the structure of economies and price movements between EU member states. This could lead to the emergence of asymmetric shocks, where different countries or regions require different interest rate levels. The loss of the opportunity to influence the exchange rate and the loss of autonomy in the field of exchange rates, which ensued from EMU membership, can be the main "cost" for a country needing to use these instruments in the process of adjusting its monetary development

It is important in connection with the mentioned method of formulating the currency and monetary policy of the ECB, which views the eurozone as a whole, not as a sum of the specific situations of individual countries. These problems can easily give rise to the impression that the ECB's monetary policy may suit more the needs of the three most advanced EU countries rather than all the other countries.

Synchronising the development of member countries

Implementing the single currency can however lead only to the further synchronisation of the macroeconomic development of eurozone countries thanks to increased trade growth within the Union. On the other hand growth in trade will lead to growth in competition, which clearly results in increasing specialisation and diversification of production, which can again give rise to a different ability of member states to face up to economic changes.

The solution to these situations lies clearly in price and wage flexibility and in mobility of factors of production. Despite certain advances made in this field, it is clear that the eurozone needs further reform measures. Evidence of this may be seen in the persistently high rates of unemployment in certain regions of the eurozone and the existence of unfilled jobs in other regions. Improving labour-market flexibility is possible only through reducing protective measures in the field of employment, reducing unemployment benefits and simplifying the movement of working capital, as well as the strength of trade unions in collective bargaining. This can mean a significant downsizing of social systems in many fields of the eurozone in the case of clearly high political and social costs.

Social aspects

The aims of currency integration and prudent macro-economic policies aimed at long-term development can have also a social impact and may be at variance with the aims of short-term oriented social policies. This applies especially for weaker countries of the Union.

Prices and EMU

Currency union to a significant extent supports the development of trade and investment, since it eliminates exchange rate risk, reduces transaction costs and increases transparency of price information. This overall leads to increased competition, in consequence of which production efficiency grows along with total production. The reduction of costs and the introduction of innovations in production will enable the production of higher quality goods, thereby supporting economic growth and reducing unemployment. Moreover, a more efficient and flexible market economy is able to react much better to emerging economic changes.

Prices in the framework of the eurozone are different. The main factors influencing the current state are in particular the various levels of economic growth in individual member countries as well as differences in economic policy, differences in direct and indirect taxes, transport costs and the national interests of individual member countries. The persistent differences in prices of tradable goods and services within the eurozone may be proven by the existence of certain barriers preventing increased competition and market integration.

The process of complete integration into the Monetary Union

The vision of joining the single currency has to a significant extent already influenced candidate countries in the pre-accession stage. These countries are endeavouring to make the necessary steps to prepare for introducing the euro, which can be seen in their choice of exchange rate system, in administering government debt, in foreign trade policy, in measures on the money and capital market, as well as in creating the institutional framework for accession to the EU.

The effect of the euro on candidate countries will changed according to the phase at which the candidate countries are in the integration process. Three degrees exist in the process of integrating into the Monetary Union:

- The pre-accession stage,
- Partial integration stage, covering the period from the country's acceptance as a member of the European Union up until introduction of the euro,
- Complete integration into the Monetary Union.

Candidate countries will be accepted into the EU as members with an exception (being without the introduction of the euro as the national currency), but several requirements will be placed upon them.

First of all, they will have to maintain exchange rate stability of their national currency, and at the same time will have to co-ordinate their economic policy in accordance with the Treaty on the EU and will still have to fulfil the Maastricht Criteria. Following EU accession the candidate countries prior to introducing the euro must pass through a two-year period of membership in the ERM 2 exchange rate system.

If we look at the individual candidate countries, not all have created equally good bases for complete integration into monetary union. In the countries there are various levels of mobility of the factors of production, a differing degree of openness and last but not least they have a different rate as well as structure of economic activity.

Despite this, even if the candidate countries managed to fulfil all the nominal criteria stated in the Maastricht treaty and become full members of the EU, there still arises the question of real convergence. Nominal convergence creates only the economic framework in order that the economies of the candidate countries may maintain positive economic development. Even if fulfilling the Maastricht criteria is a demanding task, the candidate countries still face the much more burdensome task of real convergence.

The candidate countries, including Slovakia, must face up to problems ensuing from the substantially higher standard of living of the population in EU member-states. Despite the fact that the transformation process is underway in candidate countries, the level of labour productivity and average wages are still substantially lower than the EU average. Achieving real convergence, balancing out standards of living and economic growth comparable with EU countries will therefore be a long term process.

The single currency and candidate countries

The main benefits of introducing a single currency are considered to be growth in efficiency at the micro-economic level and increasing stability at the macro-economic level. Together with the necessary structural reforms these are the main stimulus for economic growth in countries that have introduced the euro. This can have a positive influence also on candidate countries, mainly on their economic growth. These countries can benefit from the positive development in the eurozone, since increased demand in this field can bring about increased export from candidate countries into the eurozone.

The high mobility of capital in the eurozone can influence greatly also the movement of capital from the eurozone towards candidate countries in particular in the form of foreign direct investment.

A further advantage for candidate countries are also the relatively low rates of inflation in eurozone countries, which can affect inflation also in the candidate countries. The extent of this process will depend on the exchange rate system in each of the candidate countries. Moreover, the low interest rates in eurozone countries can affect also interest rates in candidate countries, the result of which will be a reduction in debt costs. This process reduces the costs of economic restructuring as a result of the reduction in interest rates and the improvement in the candidate countries' access to European capital markets.

In connection with introducing the single currency there can also arise a range of certain fears that in particular the effort for accelerating the introduction of the single currency following the candidate country's accession to the EU may bring about several negative effects. First and foremost there could arise pressure for creating comparable wage levels, which could negatively affect fiscal policy. Candidate countries will, moreover, have to face up to the already mentioned shocks caused in consequence of full integration into the EU internal single market at the early stages of the integration process.

The real costs for physically introducing the euro as a single currency can also be significant, even if from the long-term aspect they will certainly be only a fraction of the benefits that introduction of the single currency will bring.