The introduction of a common european currency economics essay

Economics

The common European currency has many different advantages and disadvantages. Some of the advantages include: 1. Currency Instability Reduced – The common European currency will be more stable than other currencies around the world. As it operates in a large currency area, it will be much more stable than other currencies at the moment. If the instability of the currency is reduced, that will allow the exporters and traders to be able to predict what will happen next and hence be able to plan their future actions and future projects while having a greater certainty that the market will not suddenly change. 2. Less Currency exchange – The average European citizen will be able to travel around the Euro zone and will have a reduced need to change his money while travelling, as well as having fewer problems when bringing large sums of money across the border. 3. Less Currency fluctuations for Businesses – Business will not need to insure themselves against the threat of having currency changing around. Also, administrative costs will be reduced and the time that is spent on the currency exchange process will be minimised as well. 4. Lower Interest Rates – Single currency will enable the interest rates to be lowered as all countries from the Euro zone will be dependent on the credibility of the German financial system. Some of the disadvantages for the average European citizen include: 1. Barriers – When countries in the European community are trying to form a monetary union, there will be certain problems encountered along the way. Language barrier is the main problem when it comes to the mobility of the workforce across Europe. This issue can lead to areas which will be deeply depressed as people will be unable to find work and areas which at the same time will have a flourishing economy with larger wages

available. 2. Impact on the National Sovereignty – The loss of national sovereignty is one of the main disadvantages of forming a single European currency as well as a monetary union. The transfer of money from the national to community level would mean that more powerful countries or more developed countries would have to operate with other less developed countries which are more prone to higher inflation. 3. Central Bank – One central bank will be unable to create a set level of inflation for every single member state and this will mean few issues when it comes to the monetary union. References:*BBC. (1997). Single Currency Pros and Cons . Available: http://news. bbc. co. uk/2/hi/special_report/single_currency/25081. stm. Last accessed 5th May 2013.

Question 2. Describe the development of the exchange rate of the Euro compared with the US dollar and the impact which this had on the European Economy.

Before 2001, the Euro currency has had historically low exchange rate levels comparing to other currencies. Between the years 2001 and 2008, there has been an increased value in the exchange rate between the Euro and the United States dollars, where the Euro has peaked against the United States dollar in 2008 and had a value of €1 = $1. 599. However, when looking at the way the exchange rate has been developing between the Euro and the Dollar, the developments are slightly complex. The value of €1 fell during 2010 to a low of $1. 1942. After this, there has been an increase in the Euro currency with the Euro raising to the equivalence of $1. 488 during 2011. After 2011, the Euro has had a mixed development against the dollar exchange rate, mainly falling downwards, however the most recent low point

being considered on the 24th July 2012, when the €1 was equivalent of $1. 2089. This has had a great impact on the European Economy, as the constant mixture of exchange rate developments was creating instability on the markets and project directors and businesses could not predict what the future will bring. This meant that business all around the European Community had to make their predictions and most of the decisions very quickly and on short notice, which means that losses were made.

References:*European Commission. (2012). Exchange Rates and interest rates. Available: http://epp. eurostat. ec. europa. eu/statistics_explained/index. php/Exchange_rates_and_interest_rates. Last accessed 5th May 2013.

Question 3 . Explain the convergence criteria and the reason why they were introduced.

The convergence criteria is a term which is used to describe the entry acceptance criteria into the single European currency, also known as the euro and it is the criteria which must be met before a country is allowed to be integrated into the single currency zone. They were introduced in order to ensure that the country that's applying to become a part of the single European currency is prepared and has met all of the criteria which will ensure a stabilized running of the currency in the long term and will not bring any issues to any other countries that are presently in the single monetary union. The convergence criteria are all set out in the European Community Treaty. There is four parts to the convergence criteria which must be met and they are as follows: 1. Price stability – A country must achieve a high level of price stability in itself, and is usually compared with

the rate of inflation that’s selected from the three most performing states. The normal rule is that the inflation rate of a country must not go past 1. 5 percent than that of the three most well performing European states during the year before the inspection is taking place. 2. Government finances – when the Commission is producing a recommendation to the Council of Finance, it will ensure that the budgetary discipline is followed as regarding the two subpoints:* The ratio of the deficit of the government during the year comparing to the Gross Domestic Product must not exceed 3%.*The ratio of the gross debt of the government in comparison to the Gross Domestic Product must not exceed 60%. 3. Exchange Rates – The country that is applying to become a part of the single currency zone, must have taken part in the exchange rate system of the European monetary policy for minimum of two years in advance and must not have devalued against any other currency of another European state member. 4. Long- term interest rates: The primary long-term interest rate of the country that is applying for the single European currency must not exceed by two percent the three most well performing countries in the European Community in regards to their long-term interest rates. References:*Europa. (2006). Introducing the Euro: Convergence Criteria. Available: http://europa. eu/legislation_summaries/other/l25014_en. htm. Last accessed 5th May 2013.

Question 4. What are the political and economic motivators in the creation of the EMU?

The EMU is an abbreviation for the European Monetary Union which had a majority of political motivations rather than economic motivations in the

creation of the EMU. The people that make the policy tend to observe it as a major milestone for a bigger political integration and overlooking the economic part of it. The development of the EMU in Europe has been a well-developed political process. The first time the EMU was introduced was 1969 when the Werner Report came out however it did not make a greater difference until 1989 when major steps and details were introduced for this objective. There has been a controversy surrounding the EMU when a set of criteria has been decided on as to who can join the said union, which was laid out in the treaty of Maastricht. Some of the criteria included restrictions set out on the level of the fiscal debt and a requirement for the level of exchange. References:*Paul Bergin. (2008). Monetary Union. Available: http://www. econlib. org/library/Enc/MonetaryUnion. html. Last accessed 5th May 2013.

Question 5. Explain the difference between EMS and ERM.

EMS stands for the European Monetary System and it’s the system that has been used before the introduction of the European Monetary Union. The EMS was a set of policies and rules which had as its main aim to create a stability of the currencies throughout the European Union. The way that the EMS worked was that it would encourage countries to have co-ordinated the monetary policies between them and to ensure a smooth running of it. ERM stands for the Exchange Rate Mechanism which was used by the European Monetary System and had as its main aim creating exchange rates that were stable and this would encourage trade between countries in the EU. References:*Civitas . (2012). EU Facts: European Monetary System.

Available: http://www. civitas. org. uk/eufacts/FSECON/EC9. htm. Last accessed 5th May 2013.

Question 6 . Explain the idea and role of " Margins of Fluctuation"

The idea of Margins of fluctuation was to ensure that for any country that wished to join the single currency zone or were willing to be a part of the European Monetary System had to ensure that their currencies stayed within a certain predefined limit and all the time had to follow the concept of fixed, but also adjustable exchange rates. The main rates of the European Monetary system was set against the European Currency Unit also known as ECU, which consisted of an average from participating currencies. The currency fluctuations had to be kept within a margin of +- 2. 25% and this margin has then been extended to +- 15%. References:*Eurostat. (2009). ERM fluctuations. Available: http://epp. eurostat. ec. europa. eu/cache/ITY_SDDS/en/ert_erm_esms. htm. Last accessed 5th May 2013.

Question 7. What is the principle of Mutual Support within ERM?

The principle of Mutual Support within the Exchange Rate Mechanism included as one of it's main features exchange market intervention. Mutual support has been unlimited which meant that the exchange market interventions were unlimited as well. Market interventions are all based on the principle that at the worst time, when the situation looks bleak, the government will intervene and help out in any way in order to make sure that there is a correct running of the scheme and it's doing so in the interest of the public. Another aspect of the Mutual Support within the Exchange Rate

Mechanism was short-term loans. This meant that when necessary, all participating member states were able to avail of short term loan in order to ensure that there is a smooth running of the scheme and the loans had to be repaid after a short term period. References:*Baldwin & Wyplosz . (2010). European Economy. Available: http://willmann. com/~gerald/euroecon-07/slides12. pdf. Last accessed 5th May 2013.

Week 7 [c] – Macroeconomic Policies & Fiscal Policy

Question 1 – Explain the concept of externalities or spillovers and their role in fiscal policy

Externalities are the phenomenon where the behaviour of certain people is affecting the cost of a subsidy or it modifies the revenues that are available from a certain tax. An example of such externality would be alcohol and the way it creates a cost for the taxpayers because of the existence of a medical care system that is subsidized by the government. The spillovers which are the externalities of the fiscal policy are the issues present in the fiscal policy that will not be able to adjust them using one single policy from the government. It will require more than just one policy in order to influence how these issues are monitored. Also, the externalities in the fiscal policy will mean that countries can support each other, discuss ideas together and also come to conclusions about policies and make sure they are organised, co-ordinated and agreed on. References:* Edgar Browning . (2012). The Myth of Fiscal Externalities . Available: http://pfr. sagepub. com/content/27/1/3. abstract. Last accessed 5th May 2013.

Question 2 . Discuss the potential advantages and disadvantages if the EU were to have a common fiscal policy to match its common monetary policy.

Fiscal Policy is all about government spending and bringing in the profits. If the demand on the economy is miniscule, then the government has the potential ability to step in and to try modify the demand with it’s actions such as lowering taxes and disposable income can be increased. Monetary policy is all about the supply that is associated with money, and is adjusted by aspects such as interest rates and margins of fluctuation. A good example being the control of high inflation, and the fact that in order to combat that, the people responsible for making the policy can increase the rates of interest. The potential advantages of having a common fiscal policy to match the common monetary policy would be the fact that this could create a potentially powerful policy which would be responsible for controlling of the major monetary issues and the fact that it would have a total control. However, there are also potential disadvantages that the creation of such policy could imply and that would be that both policies are needed on their own merit and if they were to be shared, then this could mean that one of them would become obsolete. References:* ETSU Faculty. (2010). Fiscal Policy vs. Monetary Policy. Available: http://faculty. etsu. edu/hipples/fpvsmp. htm. Last accessed 5th May 2013.

Question 3. How did the EU solve the problem with Greece - describe all the measures taken and why was this a new approach !!

The ministers from the European Community have come to a decision that they will cut Greece’s debt by an increased 40 billion euros as well as

attempting to raise an additional 44 billion euro in aid and money from bailing out. The EC has also agreed to provide the government of Greece with an extra two years in order to stabilise their overspending. The Greece government has agreed on a budget which includes cuts worth of 9. 4 billion euro and the reason all of this has started is the fact that Greece for a very long period of time has been living beyond their available means, considering the times it all began before they embarked on a journey with the Euro. A great example being the fact the public sector wages have risen by over 50% in an 8 year period and the Athen Olympics have added to an already existing large debt. The European Union will constantly increase the way Greece repays their debts, helping them out in every possible way and making sure that social and economic cohesion is constantly upkept.

References:* BBC. (2012). Eurozone Crisis Explained . Available: http://www. bbc. co. uk/news/business-13798000. Last accessed 5th May 2013.