Advantages and disadvantages of joining a currency union economics essay

Currency Union are a group of countries that share a single currency. There is a misconception that currency unions are a product of the 20th century globalization, but it is not true. They have existed since the times of Roman, but still they haven't been adopted as a global financial system. The reason being despite it having many advantages it has few disadvantages as well. I will discuss these advantages and the disadvantages in the first part of my essay. While in the second part I will show some light on the current heated debate about UK joining the Euro Zone.

Transaction cost:- The most essential advantage connected with changing to a single currency was the removal of the need to change currency . Savings are very large because of the elimination of the transaction cost connected to the exchanging currency, the taxes for countries that have most of the exports to the European counties only. The significant decrease in the cost of exports will be most useful for small scale business to achieve economies of scale. " By switching to the euro, members of the EMU were expected to save as much as $30 billion a year (The Euro, the European, pp. 154)", :- Daniel Portone.

Investment:- As there is low transaction cost there is large amount of investment because companies now this is one of the most important decreases in the cross border investment. This has lead to large cross border investment like in France the foreign direct investment has increased from 12% to 18%. The disappearance of the cost of transaction and the introduction of the common currency makes the money market deeper and integrated. The major financial institutes are being listed in the Euro, which in turn attracts potential investors to gain confidence in different EU financial markets . The market combination provides various links to dilute the risk in the EMU.

“ If we assume that the French and German bond and equity markets are fully integrated, it will facilitate the adjustment to asymmetric shocks (see Figure 1). When France is hit by a negative shock, companies there make losses and that drives down stock prices of these companies.”- – Jean Monnet. which bring the profit to germen investors , thus the boom in germany brings profit to French . ” A very similar mechanism also works through the fully integrated bond market”, – Jean Monnet

Exchange rate stability (Common Currency):- Common currency generates a platform to judge the price relationship, “ make price difference more noticeable and helps to equalise it across borders.”- Jean Monnet . Along with the removal of the need to change currency, there is also problem with the volatility of the exchange rates also. When the rate fluctuates it also affects the profitability of the company and increasing the risk which in turn decreases the net investment into the country. Thus to stabilise the situation it is useful for a company to enter in a currency union. “.. having the same currency can boost trade by a factor of three. Canada again provides the example : inspire of close proximity to the US and similarities in culture , Canadian provinces trade twelve to twenty times more amongst themselves than with the US states” The common currency provides the member nation to compare the prices efficiently . “ The poor regions would never become richer simply by devaluing its currency repeatedly. On the contrary the associated high inflation would introduce economic distortion and reduce its average real income”, :- Professor Alec Chrystal

Free movement of workers :- Free mobility area of the labour helps the countries to prevent from an asymmetric shock which is the result of inflation in one country A and a recession in country B . If there is mobility of labour ie they can move freely this will lead to release the inflation in A and increasing employment of the people in B. “ For example, workers from Indonesia, Malaysia, Philippines, and Thailand account for 10 percent of the employment in Singapore. Emigration has been as much as 2 percent of the labor force of the sending countries”- (http://www. adb. org/Documents/ERD/Working_Papers/WP012. pdf)

The prevention of competitive devaluations and speculation:- The Monetary unions protect the member countries damaging effect of competitive devaluation of the currency which may lead to steeling the business of the other . But is any country which try to do this with the monetary unions has an adverse effect of high inflation.

Other advantages of joining the currency union are as follows. The country gets an access to larger markets and thus increasing the overall income of the country. It also reduces the effect of shocks from exterior instability to an individual country. Joining the currency union is very important for those countries which lack internal control . This allows free movement of goods and sevices without any obstacles. This also keeps peace between the nation as they now that they are all interdependent on each other . the one of the most important advantage is it it will increase the tourism in the countries as there is easy movement and no currency changes .

Disadvantages of currency union

Loss of sovereignty: – This means that country adopting the Common currency has to give up the Monetary policies to the body who is controlling the union . like in the case of European union all the 12 countries had to give up their monetary rights to the European central bank with decides the monetary policies for all the nation . Its most biggest disadvantages come during the crisis when the situation are different in all the different countries and cannot be handled in the same way. Like in a case of sudden increase in the unemployment the governments income will decrease as taxes are not paid so the government will have to increase the taxes which will lead to further disaster decrease in the interest rates during the crisis will help some but will adversely affect the other . So it is very difficult to be in an currency union . “ In the United States, Texas could not avoid a recession in the wake of the 1986 oil price fall, whereas demand for Sterling changed in the light of the new oil price, adjusting the exchange rate downwards.”- http://news. bbc. co. uk/1/hi/special_report/single_currency/25081. stm

Cost of adopting the new currency: – The adopting of new currency will have a very huge cost to the economy. These are like “ Such changes include educating customers, changing labels, and training staff, changing computer software and adjusting tills.”- http://news. bbc. co. uk/1/hi/special_report/single_currency/25081. stm “ Lower inflation and reduced transactions costs of trade provide gains, while the inability to respond to idiosyncratic asymmetric shocks generate losses”.:- Andrew K. Rose1

New negative cross-border spillovers of fiscal policy:- “ a national fiscal expansion raises the demand for savings, ceteris paribus pushing up the long-run interest rate and discouraging investment. In an integrated capital market strengthened by monetary unification, this effect will spread to other countries, imposing a negative externality. A monetary union may also generate new negative spillovers. An increase in domestic government purchases, in affecting the demand for domestic products, raises local inflation, thereby pushing up average euro-area inflation and forcing the ECB to contract monetary policy for the entire area. Further, a national fiscal expansion may cause an appreciation of the euro, thereby undermining the external competitive position of all union members.”- (http://www. voxeu. org/index. php? q= node/4305)

The other disadvantages of the Monetary unions are as follows, the one of the biggest disadvantage is the difference in languages with in turn leads to the decrease in the mobility of labour “ Language in Europe is a huge barrier to labour force mobility. This may lead to pockets of deeply depressed areas in which people cannot find work” (http://news. bbc. co. uk/1/hi/special_report/single_currency/25081. stm.). The countries in the currency union also lose the ability to cope with the external shocks. It have to leave it on itself so be rectified with in today’s time is very difficult.

Should Britain join euro

Britain is one of the biggest financial hub in the world, which is also the worlds largest hub for currency trading . Britain does the maximum currency trading . Britain from the beginning has been independent and has been flourishing . But it was a real shock to the Britain when EMU was formed and the biggest threat . After reading the list of journals , it is very difficult to say whether or not Britain should join the Euro or not . There are many arguments and thoughts over it and would like to bring them forward to you .

I would first like to bring forward all the positive aspects of the Britain joining the euro with the real facts about it . There has been a significant decrease in foreign direct investment in Britain after the formation of the EMU . " Britain's share of the foreign direct investment coming into Europe has fallen by a half (see Table 3). In 2001 the Netherlands received more of this investment than Britain.":- Richard Layard, Willem Buiter, Christopher Huhne, Will Hutton,

London as mentioned is a important financial hub, but " the pound has little to do with it". Where most of the trading is done mostly in dollars in most of the transaction , but the euro outranked the pound , where euro was involved in 41% and pound in just 24 % of the transactions (as seen in the table 1). The other thing is that this financial centre employ about 1, 50, 000 people creating £10-£15billion annual invisible exports . " If the UK exercises its opt-out, long-term damage would be inflicted on the City, which will ultimately lose its pre-eminence to Frankfurt or even Paris, in part because trading in the Euro will be focused within its area of operation":- Brian Burkitt

The continues increase in the instability will decrease the attractiveness of Britain has as a destination of capital flow. " The stock of euro-denominated corporate bonds nearly tripled between 1998 and 2001, to 1. 2 trillion Euros". This clearly shows the euro-zone has reconstructed its business which has increased the annual cross border foreign direct investment by 4 fold. Britain almost has its 50% of its trade with the EMU, which is shown in table 2, so it would be better for the UK to join the euro and thus reduce its cost of import and exports .” During November 2002 the Chief Executive of Ford UK specifically stated that euro/sterling exchange rates were damaging the profits of the company”:- http://www. fpma. scot. nhs. uk/euro_pros_cons. pdf

The British consumers will be now able to compare prices all over Europe . “ This will end the phenomenon of rip-off Britain that allowed coca-cola to charge double here what it charges in Spain, or Ford to charge 43% more for a focus than in Denmark.” :- Christopher Huhne . From long time the MNCs new that Britain is the “ Treasure Island” and the consumer are willing to pay high price. Britain chance to exploit the Asia and the America is by joining the bigger currency that’s the Euro