

Economic problems essay sample



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Once the euro has been adopted, adjustments to economic problems, external shocks and changes in competitive positions need to be made other than via domestically set short-term interest rates and fluctuations in the exchange rate. Each country consequently needs to assess the likelihood of being exposed to country-specific shocks to which a euro area-wide monetary policy will not be able to react. In particular, it is important to avoid home-made competitiveness problems, for instance through too high wage increases in relation to productivity gains. At present, the business cycles of the euro area and most EU countries are highly correlated, and the correlation can be expected to increase further given the growing trade integration and the pursuit of stability-oriented economic policies.

Some differences between countries will, however, always exist and are a natural feature in all currency areas, reflecting regional adjustments to changes in demand and supply. As long as markets are free to adjust to the changing economic conditions, country differentials should largely be of a transitory nature. This underlines the importance of efficient and flexible labour and product markets which react in a timely manner and thereby moderate the impact of divergent developments on growth and employment. This is also why there is a strong focus in the EU and the euro area on structural reforms, as reflected for instance in the Lisbon process, and on prudent fiscal policies which are sufficiently flexible to provide buffers for bad times. The pressure to reform and improve the working of the domestic economy does not end with the convergence process for euro area entry.

Let me briefly also touch upon the challenges related to the adoption of the euro. As you are aware, the Treaty establishing the European Community

specifies a number of nominal convergence criteria which must be fulfilled, including the need to deliver both price and exchange rate stability. This may be complicated in countries which are also undergoing a process of real convergence, which tends to put upward pressure on either inflation or the exchange rate. This suggests that the timing of euro area entry needs to be carefully considered, also in view of the fact that a key challenge relates to the sustainability of convergence. Only when a country is certain to be able to maintain simultaneously an environment of low inflation and a stable exchange rate can it be confident of functioning smoothly within Monetary Union.

These challenges relate to the country as a whole; the challenge for individual citizens is to adapt to a whole new monetary reference system. While this may take time for older generations, who are used to what is cheap and expensive in the terms of the old currency, it is striking how fast the changeover goes for the younger generations. Unfamiliarity can lead to situations where companies try to take advantage of the euro cash changeover by raising prices. We have had this debate in many countries, and it remains a challenge for public authorities and consumers to scrutinise price-setting behaviour closely and act against obvious attempts to take advantage of the situation.

Finally, a key challenge for all countries lies in an open and transparent debate with the general public on the implications of euro area participation and the necessary steps to be taken towards this goal.. Surveys show that there is a small majority of citizens in the new EU Member States (53%; and 52% in Poland) believe that adopting the euro will have positive

consequences for their countries. Fewer people feel happy about the prospect of a future changeover (48%; and 46% in Poland). Sometimes, participation in Monetary Union is viewed by sceptics in terms of a loss of sovereignty. However, the room for manoeuvre for independent national policy-making in a highly integrated world economy is debatable in any case. For instance, it is clear that there are limits to the scope for national monetary policy to deliver both price and exchange rate stability in a world with free capital movements.

Drawbacks of the Euro:

- The weakness of an asymmetrical monetary target: Having an asymmetrical inflation target means that the ECB must only intervene if the rate is exceeded, and not if inflation falls below the target rate. Critics argue that, as a result, there is a built-in deflationary bias. The euro area has certainly experienced deflationary pressures in recent years.
- End's a nations ability to conduct its own economic policy
- Interest rates are specific to a currency and membership of the EMB incurs a single rate of interest and would therefor be too inflexible(this can be seen in Britain's economic crisis of 1991)
- If one member of the EU country suffers a boom or bust, the EMU could be caught in a dilemma of whether to let an economy collapse or hyper inflate
- The 15 country Eurozone makes problems even more pronounce. Not taking into consideration for Europe's smaller economies such as Ireland and Spain and Portugal – often comes down to the old question

of micro vs macro and what is good for the economy as a whole may not be good for every sector and region.

- The lack of transparency may be their biggest fault- council argues that this is done to prevent any political pressure and so all proceedings are kept secret. This can make financial markets nervous and may led to expected e. c. t.
- Who controls the monetary union?? The ECB is independent and yet politicians will have an influence in the banks decisions. For example, Oskar Lafontaine, Germany's Finance Minister told the ECB leadership to lower the Eurozone's interest rates. Government politicians from France and Italy ascertained Lafontaine's position and central bankers from around the world supported the ECB's independence.
- With regards to spending and stability, the ECB's main problem is that is has to deal with not one or two but with 15 different governments, each of which can run up huge deficits and could force the ECB to raise interest rates which could be harmful to other countries. To try and tackle this the members have signed a stability pact, pledging that they will adhere to strict spending limits or face financial fines

Potential Conclusions:

- Current main arguments supporting economic and monetary union centre around the benefits for the manufacturing sector, which would be shared put evenly and coupled with the monetary stability that is generated would enable stable economic growth for everyone.
- Often exaggerated the benefits which would only be felt by the bigger businesses that are in a position to export their goods and reap the

rewards of cheaper exportation costs. A single rate of inflation is too inflexible for the very divergent economics and the structure of the ECB is far too problematic. This one size fits all approach to economics is too idealistic and doesn't take into account that each of the member states would solely be pursuing their own interests.