

Advantages and disadvantages of adopting the euro



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A Study of the Benefits and Costs which Might Result for UK-based Firms Should the UK Adopt the Euro

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Introduction

The euro is the single currency established in 1999, currently shared by 18 countries of the European Union's Member States (Ec. europa. eu, 2014). Due to the number of advantages such as the stimulation of trade and disadvantages such as economic instability, the decision for the UK to adopt the euro is a big economic and political debate at present which will affect businesses and the public in many ways. The following report will look at the advantages and disadvantages for businesses and answer the question as to whether the UK government should proceed with the decision.

Objectives

- Assess the benefits of the UK adopting the EURO
- Assess the drawbacks associated with the UK adopting the EURO
- How businesses can utilise these benefits and survive in the international market
- Look at the political, economic, social and environmental factors
- Provide workplace and personal experience

Methodology

In order to achieve the goals identified above, a variety of different sources have to be explored. The core text; International business by Wall, S., Minocha, S. and Rees, B. and Macroeconomics By Edward Gamber and David <https://assignbuster.com/advantages-and-disadvantages-of-adopting-the-euro/>

C Colander are good places to start as they give a good background on international business and the different factors that effect businesses looking to expand on an international level.

To fully assess and answer the posed question the following sources will be useful;

- Adopting the Euro in Central Europe, Challenges of the Next Step in European Integration: Occasional Paper. 234 (IMF's Occasional Papers) by Susan Schadler;
- Britain and the European Union – Frequently Asked Questions By Stuart Notholt;
- Britain, the Euro and Beyond by Baimbridge and Whyman
- European Economic and Monetary Integration, and the Optimum Currency Area Theory by Mongelli, F. P.

These sources give good background on the problem and also give different opinions as to the pros and cons associated with adopting the euro. They also provide links to various other sources and explain why this has been an on-going debate for the UK since the European Union formed.

As the debate about the UK adopting the euro is consistently in the news and is a much talked about issue due to the economic and political implications, there will be a number of web based sources that will be explored such as;

- Ec. europa. eu 2014; The euro – European Commission
- S-cool. co. uk. 2014: A-level Economics The Euro Revision – Should the UK Join the Single Currency?

- News. bbc. co. uk. 1997: BBC News | Single currency | Pros and Cons.
- Wei, L. 2009: Your portal to the world: Pro & Cons For UK When Adopting Euro.
- European Commission – Europa. 2011. How the euro benefit us all.
- Econ. economicshelp. org. 2007. Economics Essays: Why the UK will never join the EURO

These amongst other online sources will also give different opinions on the question asked and will be useful as a source before further reading or research is carried out. With the various forums online and the above sources, there will be a large amount of information

Main Body

Advantages of the Euro

The Economic and Monetary Union (EMU) was established to allow the European economy to function well bringing more jobs and greater prosperity for Europeans (European Commission – Europa, 2011). There are many benefits to adopting the euro for the UK and for businesses alike which include eliminating risks and cutting costs.

The main benefit for businesses is that due to the single currency there will be no costs in exchanging currencies with EU countries which will result in the uncertainty for businesses being reduced. This will help to improve economic welfare and also remove the risk of unforeseen exchange rate revaluations or devaluations (Historylearningsite. co. uk, 2013; Irons and Colander, 2002). Due to the fluctuating exchange rates, businesses would

have to take into consideration either export prices being higher or companies being discouraged from exporting within a single market. Therefore by adopting the euro the UK will have more opportunities for cross-border trade (Ec. europa. eu, 2013; CenuÅŸe and DrigÄf, 2010). This would be more beneficial to medium sized UK businesses as they cannot currently take advantage of operating in the euro-zone and gaining profit like Shell and Vodafone and other larger companies.

The interest rate of the Bank of England and other central banks is known to be volatile. With a single currency the European Central Bank will focus on economic conditions across the board helping to lower the interest rate. This will be beneficial for investment and growth as the strength of the currency will improve (Ec. europa. eu, 2013). By keeping the interest rate low or stable, this can improve profitability of exports and more businesses will want to invest in UK firms. Also less volatile interest rates will allow businesses to borrow at cheaper rates and also invest more confidently in the long term (Ec. europa. eu, 2013; Irons and Colander, 2002). For this reason the Japanese company Mitsubishi Corporation is keen for the switch and the

By joining the EU, UK businesses will be open to price transparency and reduction of information costs. The single currency will also allow consumers and businesses to compare prices which will help reduce the costs of raw materials and further make their customers happy with lower prices (Baimbridge and Whyman, 2008; Ec. europa. eu, 2013). For example new cars in Europe cost less than new cars in the UK, a single currency will remove this price differential. Also the euro will allow better access as <https://assignbuster.com/advantages-and-disadvantages-of-adopting-the-euro/>

investors will no longer be limited to a local market and investors can move capital to areas where it will be used more effectively (Baimbridge and Whyman, 2008; Ec. europa. eu, 2013).

The UK is also known to have a very successful labour market and within a single currency this would be highly beneficial not only in that the inflation rate will go down but also as competitiveness will be sustained (Mongelli, 2008). This could also be very useful for SMEs as well as large organisations due to prices going down and hopefully competitiveness will promote more business.

Arguments against adopting the Euro

Although the arguments for adopting the euro seem strong, some of the positives can be changed into points to support the UK keeping the sterling.

By adopting the euro, the UK may be open to instability, lower growth, higher unemployment and economic decline due to not being able to set their own interest rates based on the national economy (Kern, 2002). Although devaluations can be detrimental in some cases, it has been demonstrated in the past that well-chosen devaluations can help an economy out of difficulties. For example during the economic downturn in 2008, many economies of countries within the euro, such as Spain, could not stimulate their own economy by devaluing their currency and therefore increasing exports, this saw their businesses and economies failing and finding it difficult to recover (Historylearningsite. co. uk, 2013; Baimbridge and Whyman, 2008).

The physical conversion from sterling to euros will have many costs for banks and retailers which the UK Government is unlikely to cover, such as training staff, changing computer software, creating open euro bank accounts and educating customers. The British Retailing Consortium estimates that British retailers will have to pay between £1.7 billion and £3.5 billion to make the changes necessary (Baimbridge and Whyman, 2008). This will affect SMEs, which will not benefit directly from the adoption of the euro and they could potentially force marginal firms out of business and give countries that are not in the euro a competitive advantage. According to the KPMG report, an estimated 3,000 firms face total costs of up to €56.5 million (£35.8 million) (Baimbridge and Whyman, 2008).

UK Businesses may also have to drive down prices due to the combination of improved availability of information and price transparency. This will be especially troublesome for products that are accessible to cross border trade and will be reinforced by internet shopping (Baimbridge and Whyman, 2008). Inefficient firms will suffer mostly from this and profits will be reduced due to higher levels of competition.

Joining the euro would mean that the UK would have to adhere to new labour rules which in some cases govern how employees are hired and fired (Baimbridge and Whyman, 2008; Econ. economicshelp.org, 2007)). As the labour market is more flexible in the UK than it is in others in the euro and UK firms have more independence with employment, joining would be detrimental for the firms as the cost of production would increase and unions would have more power (S-cool.co.uk, 2014; Brugesgroup.com, 2014).

Results and Conclusions

Based on the findings above the general benefits for the UK businesses adopting the euro are as follows;

- Lower transaction costs
- Reducing the uncertainty affecting the profitability of international transactions
- Lower cost of capital
- Improved allocation of capital
- Better use of the common monetary reserves
- Reducing losses due to different rates of inflation within EMU member countries
- Improving macroeconomic management and cooperation
- Improving macroeconomic stabilisation within EU Member States

The costs for UK businesses on the other hand are as follows;

- Deflation and economic instability
- Costs of change
- Loss of income resulting from issuing currency
- Increase of costs necessary to make “ shock” adjustments;
- Lower economic growth rates
- Less flexible labour market

Comparing the two lists, it would seem that it would be best for the UK to adopt euro as businesses would benefit from the lower transaction costs, lower cost of capital and better price transparency which could lower invoices and costs of raw materials. This as discussed would benefit

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customers and could help to boost business. So ultimately it seems that the higher capital costs and an overvalued exchange rate are the results of not joining the euro as well as receiving fewer European visitors (Rickard, S 2002).

The costs of the UK adopting the euro seem short term, such as the costs of change and the loss of income due to issuing the new currency. However the less flexible labour market, deflation and the lower economic growth seem to be major factors that have caused the UK to delay the decision to adopt the euro. Those who support the single currency must consider that loss of control over monetary and exchange rate policy may weaken national economic management which, looking at previously strong economies like Germany will have a large impact on trade and business (CenuÅŸe, M, & DrigÅŸf, 2010; Baimbridge and Whyman, 2008)

Ultimately there are many factors that need to be considered should the UK decide to adopt the euro or stick with the sterling. The fact that there are political and economic arguments makes it harder to come to a simple decision, and although it appears that the benefits are great, the costs need to be carefully considered as businesses need a strong economy to survive and flourish. Baimbridge and Whyman (2008) quote Healey (2000: 19-20) who states that ' while the beneïƒ ts are signiïƒ cant, cumulative over time and reasonably uncontroversial, the costs are much more uncertain, widely exaggerated and almost certain to diminish with the passage of time'

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