Law of the European Union

[10] Budget and Single Currency

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Budget of the EU

- 152 bilion (milliards) euro for year 2013.
- If compared with budgets of bigger and richer member states, the budget is small.
- EU distributes slightly more than 1% of gross domestic product of the EU.
- Member states distribute significantly more: 35-50% of their respective gross domestic product.
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Explanation of small budget

European Union is no (federal) state.

It does not take care for many state tasks and agendas.

It has no army and no police.

Most EU laws are enforced by member states, by their administrative authorities and their courts.

EU does not contribute significantly to welfare state policies.

There are small spendings on social security, healthcare or education in member states.

Revenues of the European Union

- Small budget is respected
- There are no European taxes.
- Only duties imposed on imports from non-member states within common customs policy are (after deduction of expenses) transferred to EU budget.
- The most important revenue are contributions of member states based on their GDP
- Part of value added tax revenue (tax harmonized by the EU) is another revenue.
- There are also significant agricultural levies.

Expenses of the European Union

Budget of the EU finances:

(1) institutions of the EU
(2) subsidies and interventions in common agricultural policy (40%)
(3) expenditures related to regional policy (35%)
(4) contribution to European research
(5) humanitarian aid provided by Europe to third countries.

Approval of budget and control

- Budget proceedings include the Commission (proposal), the Council and the European Parliament (with strong position).
- There are fixed deadlines for particular steps in preparation and approval of budget.
- The Court of Auditors controls use of EU money.
- European budget is bundled with budgets of member states. Various compensations for results of changes of EU policies are agreed from time to time for various reasons.

<u>**Single currency**</u>

Definition of money – roles

- 3 roles of money.
- Goods, services, labour and capital can be bartered by individuals and communities.
- Money makes this exchange easier.
- Money serves also for storage of wealth
- Units of money serve for measurement of value (price) of goods, services, labour, capital etc.

Traditional and modern money

- Many things can serve as money.
- Gold and silver served thanks to their scarceness, endurance and divisibility in many countries for centuries.
- Paper money – banknotes (backed and fiat money).
- Now, booked (including electronic) money exists.

Control by government

- Creation (emission) and circulation of money was and is under control of government.
- Monopoly of coinage.
- Monopoly of printing of banknotes.
- Prosecution of forgery.
- Control of creation of booked and electronic money.
- Management of mass of money.

Gold standard

- Many countries had „gold standard“ in the 19th century.
- Banknotes issued by national and other banks entitled their holders to exchange them for fixed amount of gold or silver held in their reserves.
- This system provided for fixed exchange rates.

Degradation of gold standard

- The system was compromised due to the first world war. Many countries issued exceed amount of banknotes. Change for gold has been stopped by laws or in practice.
- Several European currencies collapsed in hyperinflation.
- Only several states continued gold coverage of their currencies. Several other countries attempted to do it.

Brettonwood system (1944-71)

- US dollar was convertible to gold by fixed rate and exchange rates for other currencies were fixed in multilateral agreements
- These rates aintained with interventions on highly regulated currency markets.
- Loans of the International Monetary Fund should maintain this stability.
- It contributed to the development of international trade between 1945-1970. The system collapsed in 1971, the United States suspended convertibility of its currency for gold due to excess amount of dollars in circulation.

Free floating and European stabilization of exchange rates

- Since the collapse of Brettonwoods system, exchange rates fluctuate freely. There were sharply rising prices of oil and gold due to political instability in 1970-decade.
- Lability of exchange rates increases transaction costs. Therefore, integrated E(E)C and its member states established the European Exchange Rate System. The system was based on mutual obligation of central banks to intervene for fixed rates. There were, however, agreed appreciations and depreciations.

ECU for accounting

- Fiscal activities of the E(E)C have become so big to be conducted in one currency.
- The European Currency Unit (ECU) was based as „basket of currencies of all member states of the E(E)C.
- It was used as a neutral account unit of the E(E)C for management of common agricultural policy and other activities.
- ECU value was used as value of future euro when established in 1999.

The introduction of Euro – legal framework

- The Maastricht Treaty (1992) provided legal base for introduction of single currency.
- Every member state - with exception of „opt-out“ states: the United Kingdom, Denmark and unoficially Sweden - was expected and required to introduce the single currency.
- New member states are expected to introduce it.
- Nevertheless, there are doubts now about suitability of speed introduction of euro in new member states.

Convergence criteria in general + independence of central bank

- Maastricht Treaty (1993) has prescribed conditions for introduction of single currency.
- Member states were and are required to meet several demanding economic and lega criteria (convergence criteria).
- There shall be [1] national central bank independent from executive – it shall contribute to stability of national currency.

Convergence criteria II – monetary policies

Member states shall take manage their own currency to achieve following aims:

- [2] Exchange rate stability (two years within fixed limits +-15%). Legally described with participation in European exchange rate mechanism.
- [3] Low inflation (not more than 1.5% higher than inflation in three countries with the most stable currency)
- [4] Convergence of interest rates (within 2% range) of member states.

Convergence criteria III – fiscal policies

Member states shall have responsible fiskal policy on all levels of government (state, regional, local) and various public funds.

- [5] Budget deficit shall be less than 3% GDP (definition of public budgets necessary)
- [6] Public debt shall be less than 60% GDP.
- Fiscal criteria are applicable both before and after introduction of single currency.
- Many member states have troubles with these criteria, especially in contemporary period of economic slowdown and financial crisis.

Preparatory phase

- 1993-1998: convergence criteria should be meet.
- In 1998 the European Council decided on the issue. Greece only was blocked to enter the „eurozone“.
- Greece joined fraudulently two years later.
- Other failing (points 5 and 6) member states (Italy, Belgium) were admitted.

Introductory phase

- Phase of introduction: 1999-2001. Legally, old currencies ceased to exist. Immaterial euro replaced them. Nevertheless, coins and banknotes of former currencies represented it transitionally .
- Cash: first two months of 2002. Banknotes and coins of old currencies were quickly withdrawn. However, it is and it will be possible to exchange them in national central banks.

Conversion of money

- Conversion rates were established with regulation 2866/98.
- Conversion rates were based on exchange rates for former ECU
- Conversion rates are permanent
- Former currencies „melted together“ and „changed“ into Euros.

Name, banknotes and coins

- Euro – neutral name adopted in 1995, ECU (ecu) was abandoned. Fraction – cent is similarly neutral.
- Banknotes are uniform for all Member States.
- Coins have single metal, shape, weight and averse side, their reverse side is national.
- Nature of EU is revealed with banknotes: no inscriptions (multilingualism versus graphics) and no European celebrities. There is European nation. Therefore, no state is possible!

Continuity of required payments

- All payments set by laws (fees, fines), decisions (related to tax debts, social security etc.), judgements (damages etc.) and contracts (delivery of goods and services, loans) were converted to euro.
- The introduction of single currency cannot cause frustration of any obligation to pay agreed or imposed amount of money.
- Continuity is prescribed by EU law.
- Continuity was recognized in other countries.

The Eurosystem and the European System of Central Banks

The European Central Bank is responsible for monetary policy in Eurozone.

- The European Central Bank (Frankfurt am Main, Germany) The key decision-making body is the Council and Directorium.
- These central banks have become part of the Eurosystem.
- Central banks of member states without euro retain their independence.

Eurozone monetary policy

- The most important principle for monetary policy is stability. Low inflation is demanded.
- High level of employment and exchange rate stability are secondary aims of European monetary policy.
- The European Central Bank uses similar tools for steering of the currency as other central banks do: money stock management (expansion, or reduction of „M“ indicators).
- Euro banknotes are issued by the European Central Bank. Coins are issued by national central banks of member states of Eurozone.

Pros: removal of transaction costs

The most important aim is suport of interstate commerce.

In integrated areas – EU with its four basic economic freedoms is good example - savings are quite important due to frequency of necessary cross-border payments.

- Single currency removes exchange of currencies and cost of it.
- This removal is permanent. Euro has reduced prices slightly. However, nobody has recognised it, occassional increases of prices were observed.

Pros: exchange rate stability and transparency

- Single currrency removes costs resulting from exchange rate instability for trade partners.
- Single currency enhances transparency of prices for goods and services, wages and profits.

Cons of single currency

- Single currency requires single monetary policy.
- It is impossible to meet different needs of economies of member states of eurozone.
- Is eurozone optimal monetary area? Do phases of economic cycle synchronize in member states and their regions? If not, single currency results in bigger inflation or bigger unemployment than necessary in some parts of eurozone.
- Together with lack of fiscal discipline of many member states, it can cause disintegration of eurozone in future.

Single currency as symbol?

- Many people think that currency is expression of statehood and sovereignty.
- Such opinion is false. For centuries, gold and silver were used as money. Coins normally circulated abroad.
- There are groups of countries sharing one currency. Several countries use currency of other country, there are countries with more currencies (China).
- Therefore, euro shall not be percieved as principal step in transformation of EU into federation.

Origins of debt crisis

- Limits for budget debts were not respected for decade.
- Economic slowdown emerging in the USA became worldwide since 2007.
- Several member states (Greece, Portugal, Ireland, Cyprus, Italy, Spain) suffer from high public and private debts.
- Some of these countries faced severe financial (banking) crisis.

Crisis of heavily indebted member states

- Greece has practically went bankrupt.
- Cyprus now faces imminent debt crisis.
- Nobody wanted and wanted to lend money to these countries.
- Ireland, Portugal faced also lack of confidence in financial markets.
- Even Italy, Spain and now Slovenia face problems.

Rescue measures

- Hair-cut (relief) of part of excessive Greek public debt.
- Bilateral loans.
- Transitional emergency funds EFSF and EFSM provided loans on
- European Stabilization Mechanism started to provide emergency loans.
- International Monetary Fund is also involved.

Involvement of ECB and central banks in Eurosystem

- ECB launched expansionary policy.
- It refinances banks in member states affected with financial crisis.
- It buys government bonds of the member states facing distrust on financial markets.
- Significant imbalances emerged in TARGET2 reflecting imbalances of payments. Money are created exclusively in south countries.

Deviation from existing rules

- Financial assistance to indebted member states is not expected by founding treaties.
- Expansionary policy of ECB can be questioned whether in compliance with principles of founding treaties.

Disciplining measures

- Existing rules for control of the member states were strenghtened.
- Attention was reoriented also to private debt and balance of payments and trade.
- Fiscal Compact is treaty concluded among 25 of 27 member states – it requires consitutional amendments requiring balanced public budget.

Possible collapse of Euro?

- Many are convinced that threatening default of any member state would require introduction of national currency.
- Many started to fear collapse of Euro.
- Partial or even general breakdown of Eurozone would trigger severe consequences for European economic integration.
- However, Euro does not face loss of value. Other big countries have also expansive monetary policy.