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Course: Law of the European Union

[08] Euro, Budget, Agriculture and Cohesion

Single Currency

Pre-Euro history

Important European countries and the the United States had „gold standard“ in the 19th century. It replaced use of gold and silver coins.

Banknotes issued by national banks entitled their holders to exchange them for fixed amount of gold or silver by these banks held in their reserves.

This system provided for fixed exchange rates among these European and American currencies.

The gold standard was severely affected by the first world war (1914-1918). Many European countries and their central banks issued exceed amount of banknotes and guaranted possibility to change them for gold has been stopped by national laws or administrative practices. Furthermore, several European currencies collapsed in hyperinflation.

Only several states continued gold coverage of their currencies. Several other countries attempted to do it with partial success only (including Czechoslovakia).

Since the second world war (1939-1945), the Brettonwood system was international law – based system for stabilization of exchange rates among most currencies of countries which started economic liberalization with the General Agreement on Trade and Tariffs.

The system used the United States dollar which was convertible to gold with fixed rate (35$ for ounce) and exchange rates for other currencies were fixed by multilateral agreement. The system was balanced with practice of interventions of contral banks. Imbalancies were bridged by loans of the International Monetary Fund. There were, however, numerous obstacles to movement of capital and payments even among the most developped countries.

Stabilized exchange rates have significantly contributed to the development of international trade between 1945 - 1970.

The system, however, collapsed in 1971. The United States suspended convertibility of its currency for gold due to excess amount of „greenbacks“ in world circulation which returned quickly to the United States due to mistrust related to American economy and politics affected by unhappy development of Vietnam war.

Price for gold increased sharply since breakdown of Brettonwood system. Since the collapse of the system, exchange rates are not stabilized among existing trading countries and blocks. There were also sharply rising prices of oil due to political instability in 1970-decade.

Lability of exchange rates, however, increase transaction costs. It is necessary to create reserves for sudden changes of rates for enterprises engaged in international trade in goods and services.

Therefore, highly integrated European Communities and its member states decided to establish the European Exchange Rate System (European Monetary System). The system was based on mutual obligation of central banks to intervene for fixed rates agreed by central banks of member states. There were, however, several appreciations and numerous depreciations in the system because it was impossible to maintain it.

The European Currency Unit (ECU) was introduced. It was based on „basket of currencies“. It was used as a neutral account unit of the European Communities for management of common agricultural policy and other activities.

The introduction of Euro

The Maastricht Treaty (1992) provided legal base for introduction of single currency (name Euro, however, was adopted later, in 1995 due to lack of satisfaction with abreviation ECU).

Every member state - with exception of so-called „opt-out“ states: the United Kingdom, Denmark and unoficially Sweden after its accession to the European Union - was expected and required to introduce the single currency. New member states – including the Czech Republic are expected to introduce it too.

Member states were and are required to meet several – sometimes severe economic and legal – criteria (so called convergence criteria or Maastricht criteria).

These criteria are the following:

[1] Independent national central bank

[2] Exchange rate stability (two years within fixed limits). Legally described, participation in European exchange rate mechanism.

[3] Low inflation (not more than 1.5% higher than inflation in the most successful three member states)

[4] Convergence of interest rates (within 2% range)

[5] Budget deficit less than 3% gross domestic product of particular member states (definition of public budgets necessary)

[6] Public debt (definition of public budget shall be also taken into consideration) shall be lowever than 60% GCP.

There was period of qualification in 1993-1998. The Maastricht criteria should be met in this period.

However, several above mentioned criteria have not been enforced rigorously. The European Council decided on the issue in spring 1998.

Greece only was blocked to enter the „Eurozone“ due to higher inflation and interest rates. Other failing (criteria 5 and 6) member states (especially Italy, Belgium) were, nevertheless, admitted. Greece joined (a little bit fraudulently) two years later.

Period of introduction of euro started in 1999 and ended in 2001. Member states currencies ceased to exist from legal point of view. Nevertheless, their coins and banknotes represented temoporarily single currency. Immaterial euro was

introduced instead of them. Fixed conversion rates were established by regulation no. 2866/98.

„Hot period“ of introduction of single currency covered two first months of 2002. Euro banknotes and coins were introduced into circulation and banknotes and coins of replaced currencies of member states of „Eurozone“were withdrawn from circulation.

Banknotes are uniform for all Member States. Coins have national reverse side, adverse side, metal, shape and weight are same for all member states. Both banknotes and coins circulate freely in Eurozone.

Banknotes and coins of member states elder currencies were quickly withdrawn. However, it is and it will be possible to exchange them in national central banks.

All payments established by laws, decisions, judgements and contracts were converted to euro according to freezed exchange rates.

The introduction cannot cause frustration of any obligation to pay sum of money.

All new member states are expected to introduce the euro in next decade (2007-2011). Slovenia has already introduced it. Several other new member states prepare it for next few years. Other new member states, however, hesitate to introduce it for several different reasons.

The above mentioned criteria are enforced more rigorously on new member states. There are examples of member states refused to adopt euro.

<u>Pros and cons of the single currency</u>

Many politicians perceive single currency as tool for closer integration of the Member States (currency as symbol of statehood).

However, the most important aim of the single currency is stable environment for interstate commerce.

The single currency removes costs for exchange of currencies. This removal is permanent. In deeply economically integrated areas – the European Community with its four freedoms is an excellent example – these savings are quite important.

Euro has reduced prices slightly. However, nobody recognised it. On the other hand, people realized particular rises in prices instead of it.

Single currrency removes also all costs resulting from exchange rate instability for trade partners of all transaction which are not instant.

The single currency also establishes greater transparency of prices for goods and services, wages and profits.

The single currency contributes to integration of capital markets.

Single currency requires unified monetary policy. However the European Central Bank can set only single monetary policy and is uncapable to meet different needs of member states economies

The question is whether Eurozone is optimal monetary area?

Institutions for common monetary policy

The European Central Bank (Frankfurt am Main, Germany) is part of federal system of central banks of member states.

These central banks have not ceased to exist. They have become part of the European System of Central Banks. The key decision-making body is the Council of the European Central Bank.

Central banks of member states without Euro retain their independence, they are partially involved in the policy of the European Central Bank.

The most important principle governing monetary policy is principle of stable currency. 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. It is money stock management (expansion and reduction of it).

Euro banknotes are issued by the European Central Bank. Euro (and euro-cent) coins are issued by national central banks of member states of Eurozone according to plans agreed on European level.

Budget of the European Community

The European Communities and the European Union are no (federal) state. They do not take care for many state tasks and agendas.

Both organizations have no army and no police. Most European Community and European Union laws are enforced by member states, by their administrative authorities and by their courts.

The European Community and the European Union do not contribute significantly to welfare state policies of member states. There are little European spendings on social security, healthcare or education in member states. Member states remain to be welfare states. The European Union and the European Community are not, however, social union.

Therefore the structure has limited budget (approx 1% of gross domestic product of the European Union, 116 bilion Euro in 2007), especially if compared with member states (33-50% of gross domestic product).

There are no European taxes. Only custom duties imposed on imports from non-member states imposed according to single tariffs are transferred to European budget.

Other important sources are contributions of member states based on their gross domestic product, part of value added tax revenues (tax harmonized by the European Community) and agricultural levies.

Main European budget expenses are: (1) administrative expenses, (2) common agricultural policy, (3) regional policy and cohesion, (4) contribution to European research, (5) humanitarian aid provided by Europe to third countries.

Budget proceedings include the Commission (proposal), the Council and the European Parliament (with strong position). There are fixed deadlines for particular steps.

The Court of Auditors checks use of European money. There are chronic allegations of misuse.

European budget is closely connected with state budgets. Various compensations are agreed from time to time for various reasons.

Common Agricultural policy

Common agricultural policy of the European Community is the most expensive policy (35% of European Community / European Union expenditures).

Common agricultural policy is based on public interventions set by many regulations and directives of the EC. However, it is enforced directly by authorities of member states. The Commission supervises this enforcement only.

Numerous interventions in agriculture production and in markets of agriculture products include big subsidies, market involvement of state funds for maintaining sufficient prices, restrictions of production (quotas on milk, sugar etc.), prohibition of use of instruments of production (no new vineyards) and protectionist external trade policy in agricultural products, subsidized exports included.

Regional (cohesion) Policy

Approx. 40% Expenditures of the European Community and the European Union is spent on regional policy.

These expenses serves economic and social cohesion of member states and their underdevelopped regions. Regions with poor economic performance are identified on various levels (NUTS).

European money are used for support of various infrastructure projects: roads, railways, facilities for protection of environment and for economic development including education and reasearch in poorer regions.

Distribution of subsidies is organized partly by the Commission, partly by authorities of member states.

After last two enlargements, direction of European money is diverted. Most regions in post-socialist member states qualify for European money.