Course: Law of the European Union

[08] Single Currency, Budget, Agriculture and Cohesion

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Definition of money, traditional money and control by government

- Goods, services, labour and capital can be bartered by individuals and communities.
- Money makes this exchange easier.
- Money serves for exchange, storage of wealth and measurement of value (price)
- Many things can serve as money.
- Gold and silver served thanks to their scarceness and endurance in many countries for centuries.
- Coinage was often monopolized by government.
- Now, booked (including electronic) money exists. It is not easy to define mass (M) of money. Different methods are used for this purpose.

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.
- The system was severely compromised due to the first world war. Many countries issued exceed amount of banknotes. Guaranted 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

- Since the second world war, the Brettonwood system was system for stabilization of exchange rates.
- It used the United States dollar which was convertible to gold by fixed rate and exchange rates for other currencies were fixed in multilateral agreement and maintained 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.

Situation before introduction of single currency

- 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. It is necessary to create reserves for changes of exchange rates for enterprises engaged in international trade in goods and services.
- Therefore, highly 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 I – in general + independence of central bank

- Maastricht Treaty (1992-3) has prescribed conditions for introduction of single currency.
- Member states were and are required to meet several – sometime demanding economic and legal – 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

- Other criteria areapplicable before introduction of single currency affect 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.

Phases of introduction

- 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.
- 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 .
- Conversion rates were established with regulation 2866/98. Exchange rates were based on exchange rates for former ECU
- Phase of introduction of cash: first two months of 2002.
- Euro banknotes and coins were introduced into circulation and cash of former currencies was withdrawn.

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.
- Banknotes and coins of old currencies were quickly withdrawn. However, it is and it will be possible to exchange them in national central banks.
- 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.
- For member states, continuity is prescribed by EU law.
- Such continuity was acknowledged also in other countries.

Pros of single currency

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.
- Single currrency removes costs resulting from exchange rate instability for trade partners.
- The 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 (for exampe, US dollar), there are countries with more currencies (China).
- Euro is used in several other countries.
- Therefore, euro shall not be percieved as principal step in transformation of EU into federation.

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 of member states of eurozone have not ceased to exist. They have become part of the European System of Central Banks.
- Central banks of member states without euro retain their independence, they are partially involved in the policy of the European Central Bank.

Principles of European 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.

Budget of the European Community

- 116 bilion (milliards) euro for year 2009.
- 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.

The European Union does not contribute significantly to welfare state policies.

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

Member states remain to be welfare states. EU integrates them. However, is not social union.

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.

Common Agricultural policy I

- It is expensive and controversial policy.
- Agricultural lobby is influential. There are, however, several justifications of involvement on national or European level.
- Huge money flows in European agriculture through subsidies, market interventions and compensations for changes required by EU.
- Common agricultural policy is set in most regulations and several directives of the EU.
- It is enforced directly by authorities of member states. The Commission only supervises and coordinates this enforcement.

Common agricultural policy II

- EU support contributed to chronic surplus of agricultural commodities.
- Therefore, E(E)C and EU have introduced restrictions of production (quotas for milk, sugar etc.) and prohibition of use of instruments of production (no new vineyards, mandatory unused fields)
- EU has protectionist external trade policy for agricultural products for decades. It heavily subsidizes exports. Nevertheless, commitments within WTO reduce this protectionism for future.

Regional (cohesion) Policy

- Significant EU money are spent for regional policy.
- They shall contribute to economic and social cohesion of member states and their underdevelopped regions.
- Differences among member states in GDP per capita are quite high, especially since last enlargements.
- Regions with poor economic performance are identified within special EU classification (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.

Regional policy II

- Distribution of subsidies is organized partly by the Commission, partly by authorities of member states within programs agreed with the Commission.
- Special legal framework combines public and private law instruments for realization of particular projects agreed within priorities set for period of several years.
- After last two enlargements, direction of flow of EU money for regional policy was diverted.
- Most regions in post-socialist member states qualify for European money.