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A Critical Evaluation of the Euro Currency Zone

Dr. Akwasi Adjei-Kuffour

KOFORIDUA POLYTECHNIC, DEPARTEMENT OF ACCOUNTANCY

Abstract: **The objective of the study is a critical evaluation of the euro currency zone. The study evaluates the benefits of the euro currency zone. The various costs associated with the euro zone were investigated. The implication of the currency zone was assessed. The methodology of the study-Data sources was mainly secondary. Data collection made use of both qualitative and quantitative. The population under study was drawn from member countries of the euro currency zone. The findings of the study assessed imports and exports of the 15 European countries and other European member countries as a percentage of Gross Domestic Product.**

Keywords: **European countries, U.S dollar, euro zone.**

1. BACKGROUND

In December 1991, EC members signed a treaty (the Maastricht Treaty) that committed them to adopting a common currency by January, 1999).The euro is now used by 12 of the 25 member states of the European Union. The euro is now used by 12 of the 23 members of what is often referred to as the euro zone.

The setting up of the euro has clearly been interpreted as an astonishing political drama with little historical process. Setting up the euro needs involvement of the national governments not only to surrender up their own currencies, however, also to give up control over monetary policy.

Reid(2004,p.85) wrote that ‘for Europeans, the dreams of gradeur,the hope of creating the weapon with which to fight back against the might of the U.S dollar are likely to come true”.

In a similar vein, (Hasler 2004, p.76), said that ‘so integrated and centralized is the money of the EU is that on monetary policy the union speaks with one voice and with a vengeance’.

For the Euro, it is the single currency use in transaction among the 27 member states of the European Union (EU). The emergence of the Euro was introduced in 1999 and seen as the major triumphant step towards European integration. More than 330 million EU nationals currently use the currency Euro as a means of transacting goods and services and are seen as the second most significant currency after the US dollar (European Commission 2012).

In a few months ago, investors were feeling highly optimistic concerning the Eurozone. In July, 2014, Greek Government could borrow money at an interest rate of 6%, a higher than expected projection of 40%. It was making a payment of first quarter of 2014 standing at 1.2% on annualized basis. The was a forecast worry that the Eurozone will wreck to a triple dip financial crisis.

‘’Confidence in a currency can be sustained by economic factors but also by the broader international security power of the issuing state or by a consistent conservative monetary policy that is credibly embedded within domestic problems’’(Helleiner,2008,p.358).

The primary purpose of the EU is to foster economic and political integration among member states and to permit the free trade movement of goods and persons and free border control and restrictions. The EU in furtherance of its noble objectives is to promoting peace, stability as well as prosperity across members of the European states. For that matter, the establishment of the single currency has facilitated trade market as well as the formulation in terms of the single currency. The Euro which is the geographical territory has made it possible to emerge as a key trading power within the globe.

Source: (http://europa.eu/about-eu).

The main objectives of the study are to determine:

-the benefits associated with the establishment of the euro

-the cost associated with the eurozone

-the implications of the euro to companies doing business in Europe.

A number of factors has influenced international currency.

Firstly, output and trade is a determinant. The currency of a country which has huge trade share in international l output, trade and finance played a natural importance. The US economies enjoy the greatest world output in that dimension.

A second factor influencing a currency status is the financial market. To attain international currency status, capital as well as money markets in the host state ought not only open and free in terms of control, however, also heavily and well organized. The financial marketplaces of New York and London in assets such as stocks, shares and bonds, that both have taken advantage of dollar-pound at the expense of the euro.

Thirdly, the confidences in the value of the currency have played a crucial role in influencing the currency status.

The establishment of the EU is seen as phenomenal in pursuit of economic and political partnership between 27 European states. It was formed prior to the Second World War and since then continued to grow dramatically.

The recent situations across the EU among others include public interest such as ongoing dispute, austerity measures which have engulfed the member states. There has been an implementation with the anticipation of arriving at a cut in the budget deficits. Instances of countries facing the full scale of the austerity measures are Greece, Italy, and Spain etc. Some states such as Ireland, Spain, Greece and Portugal have been bail out by the International Monetary Fund.

A number f EU States such as Ireland, Spain, Portugal and Greece has pocketed bailouts from IMF Fund. There seemed to be an anxiety with events that began in Greece having a serious repercussion on the Eurozone. Others include Spain with youth unemployment hitting at 25%. Italy facing similar problems of hardship in the Eurozone economy austerity (Mason 2011).

There is another issue of conflicts of interests between EU Members. The absence of confidence across the Eurozone resulting in increased cost of borrowing. Germany has come out boldly to urge member countries to be self financing as result of the financial crisis by implementing austerity measures.

In a study, Krugman (1984) demonstrated how there is the existence of multiple equilibra in the utilization of the international currency. In his analysis, the side-effects were that little variations in the determinants is not likely to generate into a corresponding variations within the reserve currency numbers at the short run.

Economic of scale suggested that despite the long run, measures in terms of the international currency application may not be linear within the determinants.

Chinn and Frankel (2008, p.51), the primary reason is that the euro now exists as more serious potential rival than mark and yen were. A second reason is that the U.S.by now has a 25 year history of chronic current account deficits and the dollar has a 35-year history of trend depreciation''

2. BENEFITS OF THE EURO

Europeans made up their mind to form a single currency within the EU for number of motives. In the first place, they perceive that businesses as well as individuals will realize significant savings from having to handle one currency, instead of many.

Secondly, the adoption of a common currency will make it softer to compare prices within Europe. This should raise competition for the reason being that it will be much simpler for consumers to patronize the manufactured goods in the shop. The argument is that it assumes that transparency within prices which leads to a common currency will result to arbitrage in products within the common currency zone, people will buy goods that seemed to be most affordable and cut their demand for goods which seemed to highly expensive

Thirdly, confronted with lower prices, European producers will be compelled to explore for ways to cut their production costs to maintain their profit margins. The introduction of a common currency, by raising competition, should ultimately generate long-run inroads in the economic efficiency of European companies..

Fourthly, the introduction of a common currency should provide a solid stimulus to the development of a vibrant liquid Pan-European capital market. The development of such a capital market should lower the cost of capital and bring about rise in both the level of investment and the efficiency with which investment funds are allocated.

Further argument relates to cut in foreign exchange variability and the resultant cut in uncertainty which leads to having a single currency. Exchange rate can hurt hugely every day. The reduction in uncertainty emerging from the eradication of exchange rate fluctuations is likely to influence investment within the economy. This would obviously be the matter for firms which export a huge scale of stock of their output to other Eurobond nations, since low uncertainty about receipts from its exports imply that is in the capacity to plan in the foreseeable future across low risk. In that vein, investment projects for instance, building fresh factories show low risky. A rise in investment will benefit the entire economy for the reason being that it may result in greater growth of the economy.

Another clear and direct advantage of a common currency is that it facilitates trade simpler between members and, in specifically, there is a cut in transaction costs included in trade between members of the common currency zone.

(Caleo, 1999, p.6), for his part said that the Euro's success will push the EU towards providing out its commercial and financial power with more effective and autonomous collective diplomatic and military power"

Goldman Sachs considers EMU ' as a remarkable success so far for weathering widespread regional skepticism as well as a series of shocks including 9/11 and the present market dislocations-while contributing to good and relatively stable growth throughout the Euro zone' (Goldman Sach,2008,p.7).

3. COST ASSOCIATTED WITH THE EURO

The limitation, for some, of a single currency is that national authorities have lost control over monetary policy. That is, it significant to facilitate that the EU monetary policy is well-managed. The Maastricht Treaty demand for the setting up of the independent European Central bank, similar in some respects to the US Federal Reserve, with an obvious mandate to manage monetary policy in order to facilitate price stability.

Another disadvantage of the euro is that EU is not what economists would call an optimal currency zone; similarities in the underlying structure of economic operation make it viable to adopt a single currency and used a single exchange rate as a tool of macroeconomic policy. Many of the European economies within euro area, however, are dissimilar, for instance, Portugal and Finland have varying wage rates, tax régimes, and business cycles, and they may react differently to external economic shocks. A variation within the euro exchange rate that assists Finland is likely to frustrate Portugal. Clearly, such variations worsen macroeconomic policy. For, instance, when euro states are not consolidated common monetary policy is likely to imply that interest rates are raised for frustrated states. It will be exciting to see how EU manages with the strains caused by such divergent economic performance.

One approach of coping with such divergent repercussions across the euro area might be for the EU to involve in fiscal transfers, taking money from successful states and injecting it into less-endowed states. Such initiative, however, would open a political sort of issues. The question is, would Germany forgo their share of EU funds to set up employment avenues for under-employed Romanian and Bulgarian workers.

4. OPTIMAL CURRENCY AREA

Optimum currency area theory tries explain asset of requirements in respect of group of states such that, if the mechanism are acceptable, then it would be known as optimal imply the capacity of each of the states to limit the underlying costs of monetary union and uplift the advantages. Some of the features that minimize the cost of single currency are labour mobility, capital mobility, real wage flexibility and symmetric macroeconomic shocks.

5. THE IMPLICATIONS OF THE EURO

The establishment of a single market within the process of regional economic integration provides useful opportunities for the fact that markets which were formerly safeguarded from external competition are opened.

Secondly, a growing proportion of U.S firms have long had subsidiaries in Europe. Those that did not would be recommended to consider setting up them now, lest they run the risk of being close down by the EU by nontariff barriers. On-EU firms have quickly raised their direct investment in the EU in anticipation of the setting up of a single market.

Even after the removal of barriers to trade and investment, enduring variations in culture as well as competitive practices frequently limit the capacity of companies to realize cost economies by centralizing production in major locations and producing a standardized product for a single multicounty market.

The emergence of single markets creates opportunities for business. It also displays a number a. For one thing, the business terrain across each grouping will become highly competitive. The reduction of barriers to trade and investment between states may result in price rise competition across the EU.

Another threat to firms external to the underlying trade blocks from the likely long-term improvement in the competitive position of many firms across the zones. This is specifically necessary within the EU, where many firms have historically been limited by a rising cost structure in their capacity to compete in the world stage with North American and Asian firms. The setting up of a single market and the negative impact raised competition within the EU is starting to generate serious trials by many EU firms to minimize their cost structure by rationalizing production. This is advancing and positioning many EU firms into efficient world competitors. The messages for non—EU businesses is that they required to be better-organized for the emergence of a more capable European competitive by cutting their own cost structures.

A further threat to companies outside of trading zones is the threat of being close The internationalization of the Euro can be approached from the alternative perspectives of the private and the official uses of the currency. First, the Euro has been used increasingly by private agents across the world, especially in international debt and bank transactions. The share of Euro-denominated debt has kept pace with the growth of debt markets while USD-denominated debt has contracted. The share of Euro-denominated bonds issued by non-residents has increased from less than 20 per cent prior to the launch of the Euro9to more than 30 per cent by mid-2003. 10 Meanwhile, the Bank of International Settlements (2007) estimates that total Euro-denominated cross-border claims of banks have increased by approximately 75 per cent between 2001 and 2003 while the corresponding dollar-denominated claims remained nearly constant. The modest abatement in the private use of the Euro as vehicle currency may reflect the fact that intra-European trade no longer requires the use of a vehicle currency.

Finally, function of the European Commission in competition policy proposes the EU is seriously willing and able to intervene and impose conditions on companies suggesting mergers and acquisitions. This a threat insofar as it limits the capacity of firms to carry out the corporate strategy of their choice.

6. METHODOLOGY

Data Sources: The study was mainly secondary sources of information drawn from journals, finance textbooks, reports and author's own contribution. The advantages of secondary sources include-may have fewer resource requirements; can offer comprehensive and contextual data, permanency of data, can lead into unforeseen discoveries. The disadvantages such as: likely to gathered for a purpose which does not match your need, access is likely to be cumbersome and totals and definitions likely to be inappropriate etc.

Data collection: The study made use of both qualitative methods- that is; data which cannot be statistically analyzed and are difficult to measure in numbers. One key problem in analyzing qualitative data is that, on one hand, the number of observation is too low and, on the other hand, the information on the case is so in-depth that it is very easy for the researcher to be drawn into the sheer volume of cases. And quantitative data-when they are statistically analyze and expressed, presented or measure in numbers.

The population under study was the European Union Currency zone among member countries.

Sample Size: The study sampled fifteen (15) countries between 1995-2004. However, currently the EU has 27 members and UK has opted out leaving membership to 26.

Imports Plus Exports of 15 European Countries From and to Other European Union Countries as a Percentage of GDP

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Euro area										
Belgium	73.7%	73.8%	81.4%	88.0%	86.5%	87.3%	90.9%	90.8%	105.3%	105.%
Germany	21.1	18.9	20.9	22.9	22.6	23.5	24.7	25.6	29.2	29.5
Greece	19.4	16.4	15.7	17.4	16.4	16.7	17.5	17.5	18.3	13.1
Spain	18.7	16.3	18.7	21.0	21.8	20.3	23.1	21.5	25.6	24.9
France	21.8	19.5	21.8	22.5	22.5	23.0	24.3	25.1	28.9	27.8
Ireland	57.8	52.3	49.9	53.1	50.4	52.1	55.0	55.6	64.8	65.3
Italy	21.0	16.3	17.4	18.5	19.0	19.7	20.2	20.3	22.4	22.1
Luxembourg	-	-	-	-	-	-	-	66.5	74.0	79.0
Netherlands	52.2	50.0	55.2	60.8	59.9	60.5	58.7	60.6	70.3	69.3
Austria	28.7	27.5	30.6	35.3	34.8	35.8	38.2	39.6	43.7	44.8
Portugal	35.5	29.4	30.7	32.3	34.0	35.2	36.7	37.7	41.1	40.7
Finland	21.9	20.1	23.1	28.1	28.2	28.7	30.4	30.4	35.5	32.8
Non-euro area										
Denmark	29.0	27.6	29.8	33.2	32.1	33.0	32.9	33.9	37.8	37.3
Sweden	26.9	22.5	16.3	32.0	31.5	30.7	35.1	35.1	38.7	33.2
UK	20.8	19.5	17.6	17.1	17.5	18.1	18.4	18.8	22.7	21.1

Source: Euro Zone

Table 1 demonstrates the aggregate in terms of intra-union imports as well as exports for fifteen EU states, involving the twelve nations that consists of the euro zone, thus from the period 1995 -2004,as a % of GDP.Culminating collectively intra-union imports as well as exports is suitable in that transaction costs within trade between stats are sustained on both imports as well as exports. The study perceive of this percentage as index of trade integration within states with the rest of Continental Europe.

The study witnessed that in 2004,Belgium’s intra-EU exports as well as imports stood above 100% in terms of its GDP.In the case of Ireland, Luxembourg and the Netherlands further took advantage hugely from transaction cost accompanied with the single currency, because the aggregate of intra-union exports and imports with the underlying states ranged from nearly 65% to approximately 80% of their GDP.Austria and Portugal accounting for 65% and 80% respectively of GDP in respect to indices of trade integration both nearly 40% in terms of GDP .In France,Germany,Spain and Finland, the percentages stood between nearly 25% and 30%.The trade integration index for Italy stood at just above 20%,while Greece showed to have some inroads from monetary union with combined exports as well as imports accounting for just 13% during the period under review (2004).

Among the three non-euro zone nations, Denmark and Sweden trade integration accounted for 37.3 and 33.2 respectively, while United Kingdom’s trade integration within Europe was only above 21% in 2004.

The study evaluates that the level of trade integration within Europe is very variable, however on average, is on the increase with the exception of Greece. Another significance of the study is that the level of trade integration shows an upward trend in almost every nation-In comparison of the index in terms of trade integration in 1995 to that of 2004,it went up as the table shows, but the case of Greece is exceptional. The study indicated that states such as: Austria stood at 16%, while countries such as: Italy and the United Kingdom, the increase in terms of the ten-year period is just negligible.

Findings from the study indicated that trade integration above the ten years, notwithstanding had seen a jump over the last 5 years period under review. For Germany, the index went up by just 1.5% scores from 1995 -1999,however then increases by just 6% scores from 2000 -2004.InIreland, the index normally falls by approximately 7.5% scores within the first 5 years and then rises by nearly 13% scores within the last 5 years.

Generally, the study propose that a growing proportion –if not entire European states have been advantageous from the cut in cost of transaction as seen in international trade due to the single currency.

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7. CONCLUSION

Economic integration entails acceptance among nations to set up connections through the shifts of goods as well as services, and factors of production within frontiers. This connection is likely be fragile or vibrant depending on the stage or degree of integration.

The euro zones foster economic and political integration among member states and to permit the free trade movement.

The key factors of euro zone currency such as: output and trade being a deterimental, financial market, value of the currency, pursuit of economic and policy partnership between member states were discussed in the study.

The benefits derived from the euro currency zone involves significant savings, prices comparison, cut in production cost, stimulus to the development of a vibrant Pan-European Capital Market, reduction of foreign-exchange and improved trade, removal of barriers to trade and investment and cost economies among others was analyzed in the study. However, a number of costs also prevail. Most importantly, euro currency zone is likely to operate to the associated cost such as national authorities have lost control over monetary policy; the issue of divergent performance was assessed in the study. The study evaluates the underlying implication such as: protection from open competition, the setting up of a single market, opportunities for business and rising cost structure took a centre stage in the analysis of the summary and most importantly the detrimental repercussions such as emergent competition policy on the issue of market addressed and question of internalization of the euro addressed.

The theory of the optimum currency areas as well as existence of the multiple equilibrium in the utilization of the international currency was discussed in the study.

In the methodology, the study adopted secondary sources of information. The data collection method made use of both qualitative and quantitative data respectively.

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