A GENERAL ASSESSMENT OF THE MONETARY INTEGRATION PROCESS IN EUROPE AFTER EURO ADOPTION

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Abstract

After more than five decades since the problem of the European monetary integration has been introduced into the arena of the politic debates and after almost two decades of changes towards a viable functioning of the Euro Area, it is interesting to make a review of this process and of its main challenges. The paper tries to provide an overall image of the European monetary integration process, evaluating it from the perspective of several elements that are important for this attempt. Besides the presentation of the historical facts from the Euro adoption, the paper also presents some challenges to the process of monetary integration in Europe, on the short-term.

Keywords: theory of monetary integration, economic convergence, political relations, international context, public opinion

JEL Classification: F15, F36

1. Introduction

The most often cited reason in the favour of the monetary unification refers to the economic factor (lowering the costs for currency transactions, reducing or eliminating the currency risk, increasing the trade integration between member states, increasing investments). The mutual and strong commercial relations, the symmetric exposure to the external shocks and business cycles synchronization increase the expected net benefits of a single currency and of the common monetary policy.

According to the classical theoretical model of the optimum currency areas, the process of integration of several economies

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within a common monetary space is done starting from the accomplishment of several economic criteria: the labour force mobility, the degree of economic openness, the degree of economic and commercial diversification and the incidence of asymmetric shocks. Several political conditions have been added afterwards: the fiscal transfers between the member countries, the homogenous preferences on common decisions of economic policy (see Criste, 2012).

Table 1 – The level of accomplishment of the theoretical criteria for optimum monetary conditions for the Euro Area

Criteria	Euro Area
Economic and financial integration	
Reciprocal economic openness	significant
Production and trade diversity	significant
Labour mobility	poor
Financial flows	significant
Integration of the financial markets	in progress
Political integration	
Single currency	supranational, newly-created currency
Fiscal policy	national policies limited by the PSC
Fiscal transfers	inexistent

Source: Criste, 2012

Applying the theoretical criteria of an optimum currency area to the Euro zone, we will notice that the adjusting instruments for a balanced functioning are not adequate (see Table 1): the labour mobility is structurally poor, while the fiscal transfers between the member countries have not been stipulated in the treaties underlying the operation of this monetary union. These facts show that the theoretical model of the optimum currency area is not the foundation for the monetary integration in Europe. The European Monetary Union (EMU) was formed by the political will of the authorities from the developed European countries to establish an economic area in order to be a competitive region in relation with other regions of the world. This monetary union was designed on the basis of the principles stated in the two European Treaties – the Maastricht Treaty, by which the acceptance into the third stage of the economic and monetary integration (the adoption of the single currency) is conditioned by a sustainable nominal convergence of the candidate countries, and the Amsterdam Treaty, which established the Growth and Stability Pact, a fiscal regulation for the functioning of the EMU.

The decision-making factors from the Euro zone member countries considered, even from its establishment, that a single currency will promote convergence in terms of economic growth, inflation and of the other macroeconomic elements. Such hypothesis was built on the assumption that after joining the EMU, there will be assimilations of the economic behaviour and synchronizations between macroeconomic indicators of different member countries, by the so-called “convergence process”.

The article aims to present a way to assess the overall process of the European monetary integration in the 15 years of existence of Euro Area given the contradictions existing between the theoretical and operational principles of this monetary union.

2. Methodology

Generally, the initiation and run of a worldwide economic or political process (adoption of a single currency, adhesion to an economic union, a change in the monetary policy strategy, etc.) must be analysed at least from four points of view: the **international context** (stats of worldwide political and economic stability or instability that may influence the particular process); the **main ideas and trends noticed in the literature on the particular topic** (underlying theory of the process, quantitative and qualitative analyses, empirical and critical observations on the particular process); the **political debates between the parties involved in that process** (for instance, between countries, in the case of the single currency, between the national institutions in the case of a domestic or national strategy); the **public attitude regarding this process** (perception of the citizens, which may provide valuable information since that particular process affects their lives).

Based on these elements, we will evaluate the progress of the monetary integration in Europe, from 1998 to 2012, presenting the main characteristics of the four conjunctural elements, on three-year intervals. The splitting of this period in short, even intervals, aimed both to capture the most important features of these periods (the start of the EMU, the period of recession in some European countries, the period previous to the global financial crisis, the acute period of the crisis, which also includes the European crisis), and to provide for a temporal balance.

Methodologically, the evaluation is done marking as minuses (-1) those identified characteristics which reflect the situations unfavourable to integration, and pluses (+1) those characteristics which favour the monetary integration. If any of the four criteria has the same number of pluses and minuses, it is scored with 0. Based on the possible results, cumulating the scores for each criterion, the possible scores range from -4 to +4. A minimal value of -4 signifies a negative evaluation of the process of monetary integration in Europe, showing that all four elements describe a “hostile” attitude towards this process: an unfavourable international context; the existence of epistemological criticisms regarding the monetary integration or the predominance of ideas against this process; political tensions between the European countries and a generally hostile attitude of the public against this project. At the opposite end, a maximal value of +4, shows an absolutely favourable evaluation of the monetary integration process in Europe. This refers to the convergence of the attitudes from the four criteria, which are in favour of the project of European monetary integration: international stability, positive relations between countries and between great powers, dominance of the current in favour of the monetary integration, both in terms of ideas and of the internal and foreign policy, as well as a positive attitude of the public.

3. Understanding the realities of the monetary integration process in Europe

During the first period that we approached (1998-2000), the **international context** was dominated by the effects of the Asian crisis, which amplified the concern of the countries to rethink the global financial system; however, this circumstances didn’t affect in any way the process of European monetary integration. Since it was assumed that worldwide the Euro will give Europe the strength to become a competitive region compared to other regions, we may say that overall, the adverse effects of the financial crisis were offset by the “fever” of adopting the Euro. As the Euro zone was established and became operational, the **sphere of the theoretical knowledge** expanded with the experimental field, the reality of the European monetary union becoming the research support for the process of monetary integration. Many case studies reveal the existence of divergences between the European countries (even those outside the Euro zone) regarding the cyclic position: on the one hand, the UK, Denmark, Finland, Netherlands, Ireland and Norway had positive economic growth and low inflation, while Germany, France and Italy had a poor economic growth and higher unemployment rates. These divergences were presumed to adjust in time by the functioning of the monetary union. According to the endogeneity hypothesis, which supported this trend, the monetary integration creates processes of convergence within a currency area. The studies, such as Frankel and Rose (1997 and 2000), Rose (2000), highlight a direct connection between reciprocal trade (commercial integration) and income correlation, and these estimations show a very strong connection between these two indicators (the so-called "Rose effect"). According to these estimations, the process of monetary integration is considered to be positive. Despite of the structural difficulties of the Euro Area (the differences between European countries regarding the cyclical position of the economy, the rigidity of the products and labour markets), the **political climate** was in favour of the euro adoption. Such attitude is explained by the fact that they rely on the process of economic convergence, highlighting particularly the potential benefits of the common currency: *fostering the adoption of measures in favour of employment, developing of the single market* (by a higher price transparency, lower transaction costs, elimination of the currency risk, which would boost competitiveness and the trade flows), *more important international role of the euro currency*. During this period, the **public expectations** were optimistic. The information from the *Eurobarometer*, show that, during this period, in average, about 66% of the member states citizens were favourable to the monetary integration process, perceiving mainly the benefits of adopting the common currency.

The period between 2001 and 2003, although didn't lack in major events which marked the world, may be regarded as neutral for the process of monetary integration. One of the important effects of the shock of the terrorist strike of September 11, 2001, was the lower trust in the **global plan**, as reflected by the "quality flight" phenomenon, both in the developed countries, and in the emerging countries, as well as the deterioration of the financial conditions from the emerging countries. These effects didn't affect though, directly, the economic and politic climate of Euro Area, the economic and politic relations between the countries being rather stable. The

knowledge area is dominated by concerns for the potential integration, flexibility and symmetry generated by the establishment of a monetary union. The studies published in this period show that the Rose effect was overestimated. However, the idea that the establishment of a monetary union stimulates the economic integration between the member countries still persists. There are different opinions regarding the effect of the monetary integration on the flexibility of economies: some say that the monetary union tends to increase the labour flexibility (Blanchard and Giavazzi, 2003), while others say the contrary (Iversen and Soskice, 2001). The problem of a political union is increasingly mentioned in the debates, by the persistent concerns about the governance of the Euro Area, highlighting that the absence of a political union might affect the progress of the monetary union. These observations decreased, at least conceptually, the level of support for the monetary integration within the Euro Area. **Politically,** the process of the European monetary integration is rather seen as optimistic, although there is an insufficient level of the real economic convergence of the member countries and the deficiencies generated by the lack of a political union. For instance, the burden of the macroeconomic “management” of the recession in the Euro Area (in 2001) was transferred to the European Central Bank which cannot have all the necessary instruments for such activity. During this period, the **public expectations** are optimistic, the trend of support for the process of monetary integration increasing by about 4 percentage points, compared to the previous period.

Between 2004 and 2006, there was a higher level of concern for the build-up of imbalances **worldwide**, which affected even the situation within the Euro Area. On the one hand, the current account deficit of the US balance of payments reached historic peaks due to the deterioration of the trade balance. On the other hand, the Asian countries had a surplus of the current account. This situation yielded academic concerns about the potential consequences of a correction of this imbalance: higher distrust of the investors for the loans in US dollars, depreciation of the US dollar and the consequent effects on the wealth. Although this conjuncture generated concerns, they were neutralized by the political stability of Europe and by the process of EU enlargement. Hence, the international conjuncture during this period may be considered to be neutral for the process of European monetary integration. In the **field of the ideas debates**, there were more concerns regarding the existence of macroeconomic divergences between European countries. The appreciation of the real exchange rate, with the competitiveness deterioration of the countries from the Euro Area periphery amplified the concerns about the functioning of a “two speeds” monetary union, with consequences arising from this. The experience proved not only that the Euro Area functioning is just a learning process, but also that the nominal economic convergence is not enough to support a sustainable integration of a member country. However, no major tensions exist **between countries**, because they are timely adjusted. For instance, the potential conflicts concerning the excess of the budget deficit and public debt are settles by reviewing the Pact of Stability and Growth (in 2005), bringing a more flexible interpretation of these limits, taking into account the cyclical position of the economy. During this period, the **public expectations** remain optimistic, although the support for the monetary integration process is, averagely, slightly lower than the previous period: about 68% of the Euro Area citizens support the new currency. According to the *Eurobarometer* data, in average, 53% of the Euro Area citizens consider that the monetary integration project is beneficial for their country, but many criticise the fact that the adoption the single currency meant higher prices and that it didn’t determine price convergence.

After 2007, the **international context** has deeply changed following the global financial crisis. The “subprime” shock, in 2007, whose propagation determined turbulences on the international financial markets, affected directly the developed countries, and the Lehman Brothers shock, in September 2008, deepened the financial crisis in the European countries. The higher uncertainty from the financial markets determined the “quality flight” phenomenon as the investors went to countries which provided more stability (like Germany). The differential treatment of the sovereign debts from the Euro Area widened the already existing gaps between European countries, being a triggering factor of the sovereign debt crisis in the next period. Therefore, the process of monetary integration was significantly affected by the conjuncture of the international relations, being, thus, negatively rated. In the **field of knowledge**, for this period, it has been published analyses regarding the alternatives to the initial project of the European monetary union, proposing to narrow or even to break the monetary area, which means an opposing process of the monetary integration. The Euro Area difficulties, determined inter alia by the widening gaps between countries in terms of the interest rates, intensified the distrust about the viable functioning of the Euro Area. However, the stronger Eurosceptic current and the intensifying political tensions between countries were offset by the **political statements** supporting the further functioning of the Euro Area. In average, the support for the monetary integration project was still high in the Euro Area (about 68%), but it displayed trends of decrease. There also was heterogeneity between the member countries about this matter. Thus, according to the Standard Eurobarometer 70 (European Commission, 2008), 90% of the Slovenian citizens were supporting the Euro project, while only 53% of the Portuguese citizens did the same thing. Such situation might be considered neutral (neither positive, nor negative): on the one hand, the support for the Euro currency is higher, in average, within the Euro Area, but there are significant differences between the member states, on the other hand.

During the period from 2010 to 2012, the **international context** didn't change further compared to the previous period; the effects of the global financial crisis (the global economic slowdown) persisted; tensions developed between different regions of the world (geopolitical issues), but they didn't affect directly the process of monetary integration. Because this conjuncture didn't produce changes in the European monetary integration process we may consider it to be neutral. The **sphere of ideas** was increasingly filled by concerns about the financial stability, the role of the central banks in the management of the on-going crisis and the resulting risks. Though, no clear opinion in favour or against the monetary integration could be determined, in this field. Again, the burden of administrating the problems generated by the crisis is transferred to the ECB which cannot have all the instruments and means necessary for such endeavour. Although it managed, nevertheless, to manage the financial instability, there still are risks that its independence is affected. Despite the higher tensions between the European countries determined by the deepening budget deficits and by the onset of the sovereign debts crisis, there is an increasing interest to solve the crisis and to maintain the Euro Area operational. Thus, besides the **political declarations** of supporting the functioning of the EMU, there were several other institutional proposals regarding a better governance of the monetary union: establishment of a European mechanism for financial stabilization (in May 2010); financial assistance by the international organisations to support the countries from the periphery in building a new architecture for financial surveillance and consolidation of the cooperation between EU member states regarding the economic competitiveness and convergence, through Euro Plus Pact (in 2011); functioning of a permanent European mechanism for stability (as of October 2012). The chronicization of the problems challenging the Euro Area made the governments of the new EU member states (Poland, Czech Republic, Hungary, Bulgaria and Romania) to become circumspect about adopting the single currency. These evolutions can be rated negatively overall, because although there is some political stability left in the EMU after the start of the crisis, the structural problems maintain a vulnerable political climate. The problem of the sovereign debts from the Euro Area and the implementation of the austerity programs to correct the budget deficits in the countries from the periphery aggravated the social tensions. The higher unemployment rate, persistent phenomenon of this crisis, fuelled the pessimism and euro-scepticism among the **population**, although the decrease of popularity is rather low: according to the Eurobarometer data, 65% of the people from the Euro Area support this project, just 3% less than in 2007-2009. Such level shows a rather stable perception of the process of European monetary integration during the period after the financial crisis outbreak.

Table 2 below shows the evaluation of the process of monetary integration from the perspective of the four criteria.

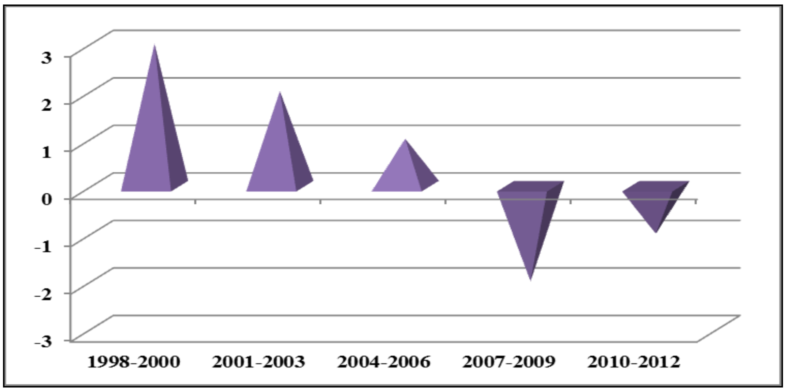
Table 2 - Evaluation of the monetary integration process in Europe

Period	Criteria				Total
	International context	Literature on the monetary integration	Political debates on the monetary integration	Attitude of the public towards the monetary integration	
1998-2000	0	+1	+1	+1	+3
2001-2003	0	0	+1	+1	+2
2004-2006	0	-1	+1	+1	+1
2007-2009	-1	-1	0	0	-2
2010-2012	0	0	-1	0	-1

Source: Prepared by the author

Figure 1 shows graphically the evolution of the perception regarding the process of European monetary integration.

Figure 1 - Evolution of the perception regarding the monetary integration process in Europe



Source: Prepared by the author

It can be noticed that the poorest level was recorded in 2007-2009, during the first stage of the financial crisis, while the best one was noticed in the early days of the Euro. The positive assessment weakened gradually and the global financial crisis imprinted a negative trend in this direction, too. The positive assessment was due to the positive perception both of the political relations between member states and of the public (see Table 2), the key elements that might return the evaluation on the positive side for the next period.

4. Short-term outlooks

Although in 2010-2012 a slight revival of the positive perception on this process was noticed, overall it is not relevant, because one important criterion, the political relations between the European countries, was evaluated negatively, and the perception of the public from the Euro Area is neutral. Nevertheless, it is not sure whether, subsequently, the assessment will continue to improve, given the persistence of the risks for the European integration process. These are not related only to the rather turbulent international context, but mainly to the operational political framework of the European Union, which is the foundation for the Euro Area stability.

According to the latest data published by the *Standard Eurobarometer 80* (European Commission, 2013), the average proportion of the people from the Euro Area which support the process of monetary integration remains stable (66%), but there are still differences between the individual countries in this respect. The lowest proportions are recorded in the countries from the Euro Area periphery, reflecting the negative effects of the financial crisis, which have been felt stronger in this region.

Politically, the relations between the EMU countries remained at the same level as during the previous period. Conventionally, the Euro Area has political stability for the governance initiatives agreed by the countries, but actually there are some tensions because of the polarized structure of this monetary union (centre-periphery; north-south), the preferences regarding the measures aiming to adjust the national imbalances not being homogenous. For instance, there are two divergent conceptions: on the one hand, the economically and financially stronger countries (Germany) consider that the economies which had an unsustainable development (Greece, Portugal and Spain) should bear the debt burden by implementing austerity measures; on the other hand, the countries which are more powerfully affected by the crisis consider that the stronger economies should continue supporting the loans, although the default risk increased.

Another risk factor regarding the political relations between countries refers to the fact that the implementation of the national fiscal measures and the announced initiatives aiming to strengthen the fiscal governance at the European level are yet to be finalised. Moreover, the social tensions, built-up over the recent years because of the implemented austerity measures, and the delayed economic growth, undermine the capacity of the governments to implement the policies necessary to administrate the financial system, thus maintaining vulnerable the political climate in the Euro Area.

5. Conclusions

The originality of the paper is that it doesn’t aim to reiterate the macroeconomic evolutions within the Euro Area and the nominal convergence process of the member countries, but to asses the process of European monetary integration in terms of its context after the euro adoption. Having a different approach, the paper is not a review of the literature, but it uses the literature to show the characteristics of the European monetary integration process.

The European monetary integration process of was assessed differently in time, but the favourable perception is on a decreasing trend. From the view of the four elements that we considered, the political relations between countries and the public perception regarding the consolidation of the monetary integration process are determinative for assessing the integration process in Europe. The latter is influenced, in turn, by the political evolutions and by the perspectives of the economic development of the European countries.

Although the direct adverse effects of the global financial crisis have mitigated, the political risks still remain, and they may maintain or aggravate the unfavourable perception of the process of monetary integration.

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