

第8回 国際通貨論 I
International Monetary Study I
Medium- to Long-term Risks of the Euro

Professor MURASE Tetsuji
留学生センター教授 村瀬哲司
Autumn 2004

1. The Question of establishing confidence in the euro, euro economy and ECB

(1) The EMU as a political project faces a serious challenge — the economic downturn.

Economic trend of the euro area since its inauguration

| | 1999 | 2000 | 2001 | 2002 | 2003* |
|---------------------|----------|----------|----------|----------|----------|
| GDP growth % | 2.7 | 3.5 | 1.5 | 0.8 | 0.4 |
| Unemployment % | 9.5 | 8.5 | 8.0 | 8.4 | 8.8 |
| Inflation % | 1.1 | 2.1 | 2.8 | 2.2 | 2.1 |
| Current a/c (% GDP) | 0.5 | -0.2 | 0.5 | 1.3 | 0.5 |
| Euro/US\$ rate | 1.17 Jan | 0.91 Dec | 0.89 Nov | 1.00 Dec | 1.17 Oct |

*European Commission Economic Forecast, Spring 2004

Source of other figures: BTM main economic indicators

(2) The adaptability to external shocks is tested.

- >The impact of the US recession: the euro economy is not immune.
- >The impact of oil price hike
- >Can the Stability and Growth Pact survive this difficult time without easing its basic terms?
 - France and Germany breach the 3% deficit ceiling for three consecutive years (2002,03,04). Will they be sanctioned, or will the SGP be amended to avoid political embarrassment?

(3) The ECB is also tested.

- >The task of maintaining price stability (CPI up to 2%) avoiding the risk of deflation
- >The exchange rate of the euro recovered in 2003 to the initial level of euro 1=US\$ 1.17, when the euro was launched. (US\$1.22 as of 10 Sep 2004)
- >The president of the ECB changes in Nov 2003 from Wim Duisenberg to Jean Claude Trichet (Governor of Banque de France) before the term of 8 years is fulfilled. → the political intervention to the independence of ECB (secret political agreement about an appointment of its president in May 1998), a dark incident for the independence of the ECB

2. Structural problems and the theory of optimum currency area 構造問題と最適通貨圏の理論

(1) The structural reform is the key to the success of the EMU! [see Figure 3.1]

>Success scenario: single market + price stability + small government + flexible labor market = economic growth (more investment, more jobs)

>Risk scenario: discredited ECB + large government + rigid labor market = stagnation and regional discrepancies

→ Which scenario is the actual development of EMU following?

(2) The Theory of the optimum currency area (OCA)

Definition of an OCA: *an economic unit made up of regions that are affected by economic shocks symmetrically and production factors (labor & capital) move freely among them (Robert Mundell)*

In an OCA, a fixed exchange rate system or the introduction of a single currency realizes an optimal allocation of resources by eliminating uncertainties associated with the floating exchange rate system.

Is the euro area an OCA?

- (a) Homogeneity of economic structures → YES
- (b) Mutual economic openness between regions (high portion of tradable goods) → YES
- (c) Mobility of production factors → capital YES, labor NO

>If a region that shares the same currency is not an OCA, an income transfer system (an automatic stabilization function) between sub-regions becomes necessary to keep the integrity as a region.

3. The Balance between EU enlargement and deepening (or strengthening of integration)

(1) The Enlargement during the 20th century

>So far the EU has been a club of developed European countries.

>EEC 6 → EU 15 by mid 90s

>They share the same western European set of values, and the economic development stages are relatively close.

1958: France, W. Germany, Italy and Benelux (total EEC6)

1973: UK, Denmark and Ireland (total EC9)

1981: Greece (total EC10)

1986: Spain and Portugal (total EC12)

1995: Austria, Finland and Sweden (total EU15)

(2) The Enlargement during the 21st century

- >In 2004 the EU was enlarged by 10 countries, making the total membership 25.
- >Estonia, Latvia, Lithuania, Poland, Czech Republic, Slovakia, Hungary, Slovenia, Malta and Cyprus
- >Possible problems:
 - (a) Political: do they share the same foreign policy?
 - (b) Economic: dual structure of development levels [see Table 3.4]
 - Does a Single Market function smoothly?
 - © EU operations: difficulty in the decision-making
 - definition of qualified majority is 55% of the Member States representing 65% of the population (the Constitutional Treaty).
 - (d) How does the enlargement affect the euro value?