At a glance

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Whatever it takes... for the euro to survive

EYE 2016 THE EUROPEAN YOUTH EVENT

Economic and Monetary Union (EMU) and the euro have come to symbolise both the opportunities and the challenges associated with European integration and its political and economic impact. While the Member States have supported each other during the ongoing economic crisis, further structural, monetary and fiscal policy measures are needed to preserve and strengthen the euro.

Background

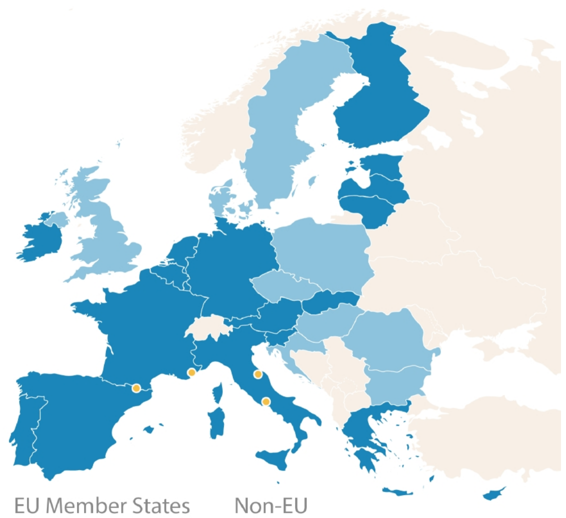
The euro as a physical currency was introduced on 1 January 2002. Today, 19 Member States of the European Union (EU), with a total population of 338 million, are part of the euro area (see Figure 1). In order to introduce and maintain the euro, the Member States are required to meet the convergence criteria (also known as the Maastricht criteria), which consist of monetary and fiscal benchmarks, e.g. the Stability and Growth Pact. EMU aims at coordinating and strengthening the economies of the Member States as well as ensuring their convergence, and the euro is an integral and important part of EMU. The European Central Bank (ECB) sets the monetary policy of the euro area. The main task of the ECB is price stability, through keeping inflation under control ('below, but close to 2%') over the medium term. Political or fiscal policy issues related to the euro are debated and decided in the Eurogroup. Although the euro has become a tangible sign of a European identity and brought many benefits to most Member States during its first years of introduction, the ongoing international economic and financial crisis fanned a debate on the usefulness and future of the single currency.

The benefits of the euro

According to the European Commission, the euro makes the single market more efficient and stronger. The benefits are interconnected and include, amongst others:

- Economic stability, growth and job creation;
- More choices and opportunities for consumers and businesses;
- Reduction in transaction costs;
- Attracting more investment from third countries;
- A stronger presence for the EU in the global economy.

Figure 1: The EU and the euro area



Source: EPRS

Indeed, several scholars confirm the positive impact of the euro for the Member States between its introduction and the global financial crisis. Mongelli and Wyplosz state that, between 1998 and 2007, foreign trade between the euro area Member States increased from 26% to 33% of GDP. The authors also observed that the single currency increased price stability. Baldwin et al. discovered that there has been 'some trade creation through EMU between participating and non-participating countries, which ranges between 15 and 19%'. There are, however, also less positive voices. Francesco Caselli, for instance, argues that, despite the single currency, GDP per capita in EMU countries increased in mid-2000 about 0.1% less than in other OECD countries (e.g. due to barriers still existing in the single market).

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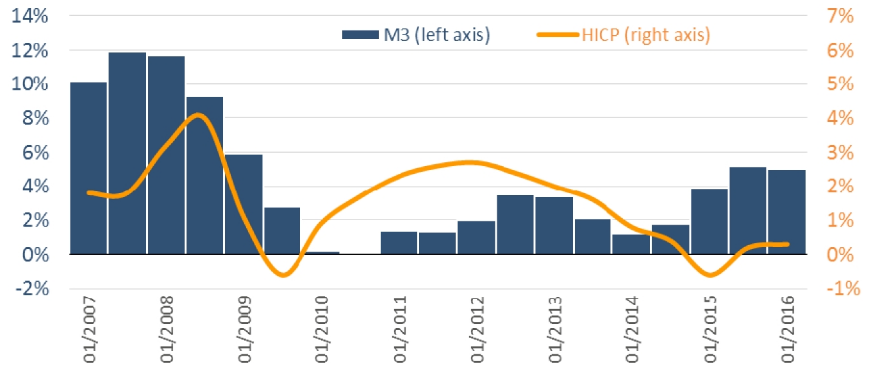
The crisis and its impact on the euro area

The euro area has not yet recovered from the 'Great Recession' which started in 2008, and its recovery has been uneven, with Member States such as Germany, Austria and The Netherlands being hit less by the crisis than Spain, Ireland, Greece and Portugal for example. Some experts even see the threat of secular stagnation. According to Eurostat, the global financial crisis has resulted in a decline in investment (ratio relative to GDP) in the euro area of about 15%, from 23.44% (2007) to 19.88% (2014). Despite near-term forecasts looking a bit brighter for the euro area – several forecasts predict GDP growth of 1.6% (2016) to 1.9% (2017) – many Member States are still facing high unemployment. In January 2016, the unemployment rate was 10.35% compared to 7.29% in January 2008. Moreover, the rate of young people without perspectives of finding a job remains high. In January 2016, the youth unemployment rate was 22.0% in the euro area, compared with 15.5% in 2007.

The responses of the EU and the ECB to the crisis

Economic theory proposes different approaches to tackle an economic slump. One suggestion to boost the economy is to stimulate the demand side. In this context, the European Commission has, amongst other measures, launched the European Fund for Strategic Investments (EFSI). It aims to mobilise investments in the real economy of at least €315 billion over three years (2015-2017). At the same time it is also important to improve the supply side, which shapes the investment environment. That would encourage innovation, improve efficiency and boost employment. According to a Commission paper, vulnerable countries in the euro area might consider shifting activities from non-tradable to tradable sectors, and creditor countries could remove the structural obstacles (for example through fiscal reforms or strengthening employability) to stronger domestic demand, in order to further balanced growth in the euro area. In addition, controlled migratory flows might alleviate the pressures from worrying demographic developments and a shrinking workforce.

Figure 2: Development of the broad money aggregate (M3) and inflation rate (HICP) in the euro area (2007-16), annual growth rate in percentage



Data source: ECB.

While EFSI is widely seen as positive among politicians and scholars, the monetary policy of the ECB is contested – and in particular the famous words of the ECB's President, Mario Draghi, to preserve the euro 'whatever it takes'. In this context, the ECB not only lowered its main interest rate to a historically low 0.0% in March 2016 (low interest rates should increase consumption and investment, and decrease savings), but also extended, in December 2015, its quantitative easing programme – in particular its expanded Asset Purchase Programme (APP) – in order to provide further liquidity and stability to EU markets. The monthly purchases of €60 billion under the APP are now intended to run until the end of March 2017, 'or beyond, if necessary', according to Mario Draghi. The aim of the ECB's standard and non-standard monetary policy measures is to expand monetary liquidity and to combat deflation. Inflation has fallen from around 3% in 2011 to 0.3% in January 2016 (see Figure 2) and an estimated -0.3% in February 2016. In addition, the purchase of government bonds of several EMU Member States from secondary markets remains disputed within the ECB and among Member States, as it could delay structural reforms and create new economic bubbles (e.g. stock market, housing), but has shortened the maturity of the respective government debts and their liquidation costs.

Outlook

EMU and the euro have brought many benefits to Member States. However, due to the global economic crisis and imprudent fiscal policies, some Member States face difficult re-adjustment processes. Despite diverging views on the 'right' economic and monetary policy, the Member States nevertheless have supported each other. EMU is still a 'work in progress' and its future will depend not only on economic, but also on political factors.