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Economic and Monetary Union crisis — reasons and existing solutions

The integration of the European Union (EU) Member States within the framework of the Economic and Monetary Union (EMU), as the forth out of five levels of economic integration developed by B. Balassa, is based on the irrevocable fixing of exchange rates and replacing national currencies with a single currency – the euro (see Balassa 1961). In consequence, the economic policy of the Member States is limited, because the monetary policy is controlled by the supranational institution of the European Central Bank. As a result, the EMU fundamentally represents the highest existing form of economic integration of the EU Member States.

Taking into account the theoretical assumptions of a monetary union based on the theory of optimum currency areas (OCA) by R.A. Mundell, P.B. Kenen and R.I. McKinnon (see Mundell 1961; Kenen 1969; McKinnon 1963), the theory of endogenous optimum currency area criteria by J.A. Frankiel and A.K. Rose (see Frankel, Rose 1996) and the theory of cost-benefit analysis of a monetary union by H.G. Grubel, P.R. Krugman and P. De Grauwe (see Grubel 1970; Krugman, Obstefeld 2000; De Grauwe 2000), resigning from the monetary policy in order to restore economic equilibrium might only be beneficial have the specific macroeconomic criteria been fulfilled. Due to the lack of economic regulation by means of floating exchange rate, any economic shocks have to be adjusted by means of other market-balance mechanisms, i.e. price and wage flexibility, input mobility, significant share in trade economic structure, similarities in fiscal and monetary policies, and significant convergence in goods markets and member states economies.

However, some economists claim that the analysis of co-dependencies and macroeconomic indicators of the EMU states does not corroborate the euro area as a full OCA (see Borowiec 2001; De Grauwe 2000). Fixing internal exchange rates along with maintaining the external rates' liquidity, and consequently introducing a single currency, does not lay the ground for the EMU area as an optimum currency area. In this context, the crucial problems the EU faces are growth disparities and low macroeconomic stability of the Member States, as well as varying vulnerability of national economies to asymmetric shocks.

Paradoxically, the number of the EMU members and the obligation to eventually join the eurozone by the EU member states with the opt-in status is an equally important issue. From the economic perspective, the enlargement of the EMU with other member states, apart from the UK, Denmark and Sweden, is disadvantageous. The increase in the number of the EMU members may lead to the increase of growth disparities within the framework of the EMU. Therefore, it is essential to ensure that the benefits outweigh the costs of economic and monetary union of the member states. According to P. De Grauwe, J.A. Frankiel and A.K. Rose (De Grauwe 2000; Frankel, Rose 1996), the crucial factors that guarantee the bridging of the negative effects of growth disparities on stability and functionality of OCA are trade, labour market flexibility and the correlation of the Member States' economic cycles. The authors claim that the higher the correlation of economic cycles, labour market flexibility and trade, the higher the benefits in comparison to the costs of operating an optimum currency area.

However, the major problem of the EMU is primarily the fiscal crisis which embraces mainly the so-called PIIGS countries (eng. Portugal, Italy, Ireland, Greece and Spain). The crisis results from the unsuccessful and irrational fiscal policy of the euro area members. The constant increase in expenditure in comparison to government revenue and financing existing obligations by selling government bonds have translated into the failure to meet the fiscal criteria which the Treaty on the European Union stipulates; thus, drawing nearer the vision of the bankruptcy of the state. The so far implemented solutions, i.e. partial remission of Greek debts, financial aid to Portugal, Ireland, or Greece in exchange for implementing economic reforms, are only provisional actions. Moreover, some of the adopted solutions may be regarded as a legitimization of an irrational fiscal policy of a member state, whose government is not held accountable. Therefore, it is of vital importance to launch and respect institutionalized forms of economic co-operation, macroeconomic stability, and member states' budgetary and fiscal control on the EU level. It should be also borne in mind that it is not Greece which is the EMU's direct problem, but Italy with a government debt of 2 billion euro.

The fiscal crisis is closely related to the EMU crisis and low macroeconomic stability of the Member States. It highlights the need to meet fiscal and monetary criteria included in convergence criteria not only by the Member States that want and have to access the EMU, but also by those states which have already adopted the euro. Simultaneously, the implementation of the fiscal pact provisions by the EMU members and opt-in countries should not result from the fear of the fiscal crisis, but rather from a rational and responsible fiscal policy of a country; thus, it should be a norm, rather than an action taken in response to a crisis.

On 8 and 9 December 2011 the European Council (EC) agreed on proposals, e.g. financial penalties, consolidation, budget control, and increase in the European Commission (EC) competencies in financial area, which are highly important, yet belated, solutions for the future of EMU and the European Union. Since the launch of the euro in non-cash circulation in 1999, the majority of the participating member states did not fulfil the fiscal criteria. In the light of this, a question should be asked as regards the importance of economic convergence criteria with a view to achieving EMU and the point of the euro launch in the Member States which had not been prepared from the macroeconomic perspective.

Had the convergence criteria been fulfilled during the establishment of the EMU, fiscal stability of the Eurozone would have been maintained and the fiscal crisis would have probably been avoided. It is not hard to foresee that weak macroeconomic stability and increasing public debt in relation to GDP may lead to the destabilization of the Eurozone and cause problems with debt management among some EU member states. It should also be noted that introducing the existing solutions with a view to improving the situation in the euro area, either based on the intergovernmental agreement or modifications to the Lisbon Treaty, is a belated attempt.

It does not mean, however, that the European Council proposals from 8 and 9 December 2011 are not a significant response to the fiscal and Eurozone crisis. The intergovernmental treaty specifying budgetary regulations and strengthening economic coordination may deepen the integration and lead to a convergence in growth within the EMU and the EU. The most important arrangements of the summit include actions aimed at bridging the debt and deficit by means of strengthening the financial framework based on growth and stability pact and intense macroeconomic surveillance. Also, an immensely important proposal is to include, in the national constitutional framework, records about state fiscal security and coordination of budgetary plans on an EU level with substantial partnership with the European Commission. Another important decision is the setting up of the European Stability Mechanism, coming in force in July 2012, which includes the private sector in the programme of reducing debt in Greece, contributes 200 billion euro to the International

Monetary Fund (IMF) with a view to providing debt relief for EMU members and allows for decision-making by qualified majority voting within the framework of the European Stability Mechanism.

As a result of the fiscal crisis, investors and financial markets have lost confidence in the fiscal policy of the euro area Member States. Another significant factor is also the vulnerability of the financial sector and the world trade downturn. Therefore, it is essential to rebuild the confidence and take actions aimed at intensified economic integration among not only the Euro area members, but also all the EU Member States. Stronger economic integration will allow the EU Member States to closely coordinate reactions to economic shocks and effectively support the efforts concerning the economic growth. These actions may give fresh impetus for the European Union and counterbalance the increasing debt. In this context, an important solution seems to be the obligation to mutually control the Member States' budgets on the EU level with regard to their deficits and surpluses. The European Commission will play a key role in monitoring the recovery plans for national budgets of the states which exceed the deficit ceiling of 0.5% GDP. Equally importantly, 6 legislative acts were adopted and came into force on 13 December 2011 with a view to improving budget monitoring and enforcing control over the public debt (see COM(2010) 522 final; COM(2010) 526 final; COM(2010)527 final; COM(2010) 523; COM(2010) 524 final; COM(2010) 525 final), launching a six-month cycle of economic reports (so-called the European semester), according to which the EU member states formulate and coordinate economic and budgetary policies at an EU level. Another objective in bridging the effects of the fiscal crisis should involve actions aimed at the strengthening and the recovery of economic growth in the EU Member States. In this context, creating new work places and implementing deep structural reforms, i.e. rising the retirement age, seem to be crucial. Strategy for Growth issued by the European Commission invites the Member States to pursue differentiated growth-friendly fiscal consolidation, facilitate banks and enterprises from the SME sector in accessing financial resources, promoting growth and competitiveness, tackling unemployment and the social consequences of the crisis, and the modernisation of public administration [COM(2011) 815 final].

In order to improve the situation in the euro area, it is also essential to implement reforms aimed at improving functioning of financial markets and increase investor protection. In this context, it is crucial to strengthen the surveillance of rating agencies to make them more responsible for their rating forecasts. Therefore, European Securities and Market Authorities have been established in order to increase the supervisory powers in relation to credit rating agencies and possibly to charge fines should any legal standards be breached. These actions are aimed at maintaining stability and increasing the predictability of actions on financial markets, which are the key factors in fighting the fiscal crisis and safeguarding against financial crises. The solutions proposed by the European Commission will allow for decreasing excessive confidence in rating agencies, more frequent assessments of the Member States' debts, increasing independence of rating grades and laying responsibility on the agency in the event of a breach of the Union law.

Although the existing solutions are belated, they are vital in bridging the negative effects of excessive government debts on the euro area stability. The fiscal crisis and the EMU's problems might provide impetus for the further intensification of economic integration of the euro area and the European Union, which might lead to dismissing the vision of the collapse of the EMU. Nonetheless, the level of economic cooperation of the EU Member States and co-responsibility for the future of a united Europe should be increased. The euro area crisis has shown that the EU Member States should take any action and measures aimed at strengthening economic integration. In order to achieve it, all the European Union Member States need to work out a common political will, cooperate in the common interest and reliably fulfil the obligations regarding fiscal stability and economic cooperation.

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