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BENEFITS AND CHALLENGES OF THE EURO

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Benefits and challenges of the euro

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Introduction

In this opinion we aim to weigh the actual benefits and potential challenges of the euro as a common currency for 20 European Union (EU) countries. First of all, a single currency offers many advantages: it makes it easier for companies to conduct cross-border trade, the economy becomes more stable, and consumers have more choices and opportunities. However, a variety of political and economic obstacles barred the way for an EU single currency: weak political commitment, divisions over economic priorities, and turbulences on international markets. These developments led to a frustrating progress towards the Economic and Monetary Union. All the EU member states are in principle obliged to introduce the euro once they fulfil the convergence criteria. The EU countries that have not negotiated a currency opt-out clause are Poland, the Czech Republic, Hungary, Romania and Sweden (Hampl, 2023). The only exception is Denmark, which has an 'opt-out clause' in the EU treaties, exempting the country from the obligation to adopt the euro. Denmark may nevertheless apply for membership of the Euro area, if it decides so.

A brief history of euro's creation

Creating an Economic and Monetary Union (EMU) was a recurring ambition for the European Union from the late 1960s onwards. The international currency stability that reigned in the immediate post-war period did not last long enough to maintain the economic predictability. At the Hague Summit in 1969, a decision was taken to explore the possibilities of progress towards an economic and monetary union. An *ad hoc* committee of experts was set up and, at the request of the EC Council, Pierre Werner (Prime Minister and Finance Minister of Luxembourg) was chosen as its chairman. The work of this committee began on the 20th of March 1970 and resulted in the Werner Plan or the Werner Report, which offered a full definition of the EMU. The Werner Plan was supposed to be implemented in three stages over a decade (1971–80). The ultimate aim was to achieve irreversible convertibility between the currencies of the member states, the complete liberalization of capital movements, the irrevocable fixing of exchange rates, and even potentially the replacement of national currencies by a single currency as a natural and desirable further development of the monetary union. From an institutional point of view, the report called for the creation of two new steering bodies: a 'centre of decision for economic policy', independent of governments and placed under the democratic control of the European Parliament, to be elected by universal suffrage; and a 'Community system for the central banks'. Also, the EMU would serve as a 'leaven' for the

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development of a political union. Two main principles underpinned the Werner Report: gradual realization of the EMU (a step-by-step approach); and parallelism between economic convergence and transfer of powers to the supranational level. The Werner Report ran into a series of international crises, culminating with its *de facto* suspension in 1974 (Danescu, 2017).

Further turmoil in international currency markets threatened the common price system of the common agricultural policy, a main pillar of what was then the European Economic Community. Also, later attempts to achieve stable exchange rates were hit by the oil crises and other shocks until, in 1979, the European Monetary System (EMS) was launched (European Parliament, 2024). This led to the creation of the European currency unit (ECU), adopted on the 13th of March 1979 and used until it was replaced by the euro on the 1st of January 1999[2]. The ECU was composed of a basket of currencies of the European Communities' Member States[3].

Following this step,

> "In June 1988 the European Council confirmed the objective of the progressive realisation of Economic and Monetary Union (EMU). It mandated a committee chaired by Jacques Delors, the then President of the European Commission, to study and propose concrete stages leading to this union. […] On the basis of the Delors Report, the European Council decided in June 1989 that the first stage of economic and monetary union should begin on 1 July 1990. On this date, in principle, all restrictions on the movement of capital between Member States were abolished. […] The establishment of the European Monetary Institute (EMI) on 1 January 1994 marked the start of the second stage of the EMU and with this the Committee of Governors ceased to exist. The EMI's transitory existence also mirrored the state of monetary integration within the Community. The EMI had no responsibility for the conduct of monetary policy of the member countries in the European Union – this remained the preserve of the national authorities – nor had it any competence for carrying out foreign exchange intervention"[4].

The Maastricht criteria were established in the Maastricht treaty, signed by the members of the European Union in 1992. They were defined in Article 121 of the Treaty establishing the European Community, based on economic indicators that member states must fulfil to enter the Eurozone. In 1995, the European Council agreed to name the European currency unit (to be introduced at the start of Stage 3) the 'euro', and confirmed that Stage Three of EMU would start on the 1st of January 1999. A chronological sequence of events was pre-announced for the changeover to the euro. This scenario was mainly based on detailed proposals elaborated by the EMI (ECB, 2024). The euro (EUR) replaced the ECU at parity on January 1, 1999. We should also keep in mind that the European Union's ability to accept new members, while advancing the European integration, was an important goal[5].

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[2] Eurostat, *European currency unit (ECU)*, https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Glossary:European_currency_unit_(ECU) (22.02.2024).

[3] *Idem.*

[4] European Central Bank, *Economic and Monetary Union (EMU)*, https://www.ecb.europa.eu/ecb/history/emu/html/index.en.html (22.02.2024).

[5] Council of the EU and the European Council, *EU enlargement policy*, https://www.consilium.europa.eu/en/policies/enlargement/ (22.02.2024).

Almost a quarter of century of the euro functioning *via* challenges

Joining the euro area remained a political goal for almost all the member states. While the euro area had started with only 11 members, Greece soon joined in 2001, Slovenia in 2004, Cyprus and Malta in 2008, Slovakia in 2009, Estonia in 2011, Latvia in 2014, Lithuania in 2015, and Croatia in 2023.

Despite the many challenges that the Eurozone faced in the last decades: the Global Financial Crisis (GFC), the sovereign debt crisis and 'lowflation', the role of the euro as a global reserve currency remained broadly stable, with a share of about 20% of the total stock. The geopolitical relevance of such a move would prove its value years later, in the midst of the Russian war of aggression against Ukraine (Buti and Corsetti, 2024).

Especially in the last two years, we saw that:

> "The euro area economy is strongly integrated in global markets. Europe represented about 16% of the world's trade in 2022. The euro area trade-to-GDP ratio is significantly higher in 2023 than in 2000. Conversely, trade is a critical contributor to growth in the euro area, with trade flows between the euro area and the rest of the world reached more than 60% of euro area output"[6].

Thus, "despite a succession of new shocks, the international role of the euro remained resilient in 2022. This was a year that saw the onset of Russia's war in Ukraine, a rise in economic sanctions and a substantial increase in geopolitical risks – all with potential repercussions for the international monetary system. (...) The euro remained the second most important currency globally", even though its share is growing[7]. The share of the euro in global official holdings of foreign exchange reserves increased by 0.5 percentage points to 20.5% in 2022 when measured at constant exchange rates. (ECB, 2023)

Despite this success, the beginning of the currency has been more complex. According to a recent analysis (Buti and Corsetti, 2024, pg. 3):

> "The path to the political decision to introduce the new currency was marked by intense and passionate debates. Views were rather polarised. Predictions that an ill-designed and ill-timed monetary unification would have deepened contrasts and attritions in the continent up to generating a "war" (Feldstein, 1997, *apud* Buti and Corsetti, 2024, pg. 3) coexisted with scenarios of "nirvana" for Europe (echoing European Commission, 1990). Among economists, the debate revolved around the body of models/reflections collectively known as 'optimum currency area' (OCA) theory and weighed on the side of pessimism, with some notable exceptions stressing the possibility that an evolution towards OCA could be endogenous (Frankel and Rose, 1998, *apud* Buti and Corsetti, 2024, pg. 3). […] At the political level, there was diffused awareness that the EMU architecture was 'incomplete'. Implicitly or explicitly, two views on how to complete the architecture of the euro area coexisted: a 'French' and a 'German' view. Roughly, the former envisioned a 'top-down' approach where the initial minimal economic constitution of the euro would be supplemented by a euro area budget. This was seen as the key missing pillar to ensure an adequate aggregate fiscal stance at union-wide level and address, when needed, national/regional shocks. The German view envisioned a 'bottom-up' approach, where euro area members were held responsible for 'putting and keeping their houses in order'. This required each state to implement the necessary structural reforms and fiscal adjustment, to be able to fend off shocks by national means alone. During the summit in Madrid, the high

[6] European Commission, *2024 Euro Area Report*, (Institutional Paper 259, November 2023), pg. 30 https://economy-finance.ec.europa.eu/system/files/2023-11/ip259_en.pdf (22.02.2024).

[7] European Central Bank, *The international role of the euro*, (June 2023), pg. 3, https://www.ecb.europa.eu/pub/pdf/ire/ecb.ire202306~d334007ede.en.pdf (22.02.2024).

political capital invested by national authorities on the euro project prevailed over economists' overall scepticism. This does not mean that economists were not heard. The eclectic construction, with a single fiercely independent monetary policy and decentralised fiscal policies subject to rules, reflected an emerging line of thinking at the time – in Europe, presented in ordo-liberal clothes (Buti and Corsetti, 2024, pg. 3)".

As reported by Buti and Corsetti (2024, pg. 12):

"The importance of the institutional and policy developments in these years cannot be overemphasised. The euro area could hardly have survived (at least in its present form) without them – it was close to breaking point with the crisis of 2011, and 'Grexit' in 2010 and 2015. These developments, however, did not and could not undo the damage of the crisis. The crisis fragmented the euro area's economic and financial space, well beyond the heterogeneity that one can expect to characterise a monetary union among countries with different structural and institutional features (Schnabel, 2022, *apud* Buti and Corsetti, 2024, pg. 12)".

Therefore, the challenges that we emphasized in the previous section – GFC, the Greek crisis, Brexit and COVID-19, have led to more concrete policies, able to increase the Eurozone's capacity to respond to crises and become more resilient. In an article for New York Times, Neil Irwin said that:

"From Lisbon to Latvia, from creditor countries to debtors, among some left-wing leaders as well as conservative governments, the response to Greece reflected a deep aversion to government spending as a tool to fight economic slumps and faith in deregulated labour markets. It is a vision of austere, market-based policies that are a break with Europe's past.

Germany persuaded European leaders to rally more firmly around what might be called the Berlin consensus by a combination of patient diplomacy and clever brinkmanship and by exploiting alarm over the antics of Greece's leaders, numerous participants in the crisis talks recounted in interviews" (Irwin, 2015).

Germany has played a major role in the discussions concerning Greece's debt crisis. A key issue has been the benefits it enjoyed throughout the crisis. These included falling borrowing rates (as Germany, along with other strong Western economies, was seen as a safe haven by investors during the crisis), the investment influx, and the exports boost thanks to the Euro's depreciation (with profits that may have reached 100bn Euros, according to some estimates), as well as other profits made through loans.

According to Buti and Corsetti (2024, pg. 14):

"The response to COVID-19 was radically different from the response to the GFC. Why? Clearly, the lessons from handling of the GFC, when EU countries declared victory and withdrew the fiscal support too early, played a role. However, other factors are arguably more relevant. We bring forward a 'benign coincidence' hypothesis: the simultaneous presence of circumstances that reduce political resistance to act at European level. The first and probably the most important of these circumstances was the nature of the shock (Buti and Papaconstantinou, 2021, *apud* Buti and Corsetti, 2024)".

Hungary and the Euro

Hungary joined the European Union in May 2004.

"As part of the "*acquis communautaire*", participation in the new version of the exchange rate mechanism (ERM II), and subsequently in the European Monetary Union (EMU) is obligatory for all new EU members (no opt-out clause is available). Therefore, the question since then for Hungary and other new member countries has been no longer whether or not to enter the eurozone but rather the time horizon when Hungary's entry should

happen. More specifically, as a condition for EMU membership, a country must be prepared to adopt the euro as the single currency and be able to meet the obligations arising from the Stability and Growth Pact. The formal condition for a country's preparedness to adopt the single currency is the fulfilment of a set of nominal convergence criteria, the so-called Maastricht criteria (Jankovics, 2004)".

At the same time:

"Accession to the Economic and Monetary Union is one of the most important steps in Hungary's European integration, which will entail abandoning the national currency and adopting the euro as domestic legal tender. For Hungary as a new member state in the EU, introduction of the euro will not be an option but an obligation. Nevertheless, new EU members will have some leeway to set the date of adopting the euro. Therefore, it is useful to analyse the likely costs and benefits of joining the euro area for Hungary and to define the choice of medium-term economic policy strategy in the light of the results of this analysis. […] This analysis is confined strictly to the economic benefits and costs of introducing the euro and is not intended to examine its other possible impacts, including, for example, the implications for politics and national security. Adopting the euro will likely have a permanent impact on Hungarian economic growth. This impact will become evident through numerous channels. Bank staff have attempted to quantify and sum up the extent of this impact transmitted through the various channels. The findings of this analysis suggest that the introduction of the euro will bring about significant net gains in growth. However, welfare is influenced not only by the level and rate of GDP growth, but their stability as well. A widely fluctuating national income will produce lower welfare than a more stable one, even if on average the two income levels are identical. For this reason, it is important to examine whether joining the euro area will increase or mitigate the volatility of business cycles. In other words, the key question is whether Hungary and the euro area form an optimum currency area, that is whether the monetary policy of the euro area is capable of adequately substituting independent Hungarian monetary policy in smoothing out cyclical fluctuations. In the findings of this analysis, the euro area seems to be in most respects at least as optimal a currency area for Hungary as for less developed euro area member countries (Csajbók and Csermely, 2002)".

While the Hungarian government has been planning since 2003 to replace the Hungarian forint with the euro, as of 2024, there is no target date and the forint is not part of the European Exchange Rate Mechanism (ERM II).

Hungary originally planned to adopt the euro as its official currency in 2007 or 2008. Later, 2010 became the target date, but that date was abandoned due to an excessively high budget deficit, inflation, and public debt. For years, Hungary could not meet any of the Maastricht criteria.

In February 2011, Prime Minister Viktor Orbán made it clear that he does not expect the euro to be adopted in Hungary before 2020[8]. Under Prime Minister Viktor Orban, Hungary amended its constitution[9], which now says that the forint is the country's currency. The fundamental law must be amended again if the euro is to be adopted. Orbán said the country was not yet ready to adopt the currency and they would not discuss the possibility until the public debt reached a 50% threshold. In April 2013, Viktor Orbán proclaimed the euro adoption would not happen until the Hungarian purchasing power parity weighted by GDP per capita had reached 90% of the eurozone average[10]. In June 2015, Orbán declared that his government

[8] *Hungary and the euro*, https://www.euractiv.com/section/central-europe/news/hungary-moves-closer-to-eurozone-opt-out/ (22.02.2024).

[9] The Hungarian constitution states that "the official currency of Hungary shall be the forint" (Fundamental Law, 2011).

[10] Politics.hu, "Orbán: Hungary will keep forint until its GDP reaches 90% of eurozone average". https://web.archive.org/web/20150119115544/http://www.politics.hu/20130426/orban-hungary-will-keep-forint-until-its-gdp-reaches-90-of-eurozone-average/ (22.02.2024).

would no longer entertain the idea of replacing the forint with the euro in 2020, as previously suggested, and instead expected the forint to remain "stable and strong for the next several decades"[11]. However, in July 2016, the National Economy Minister, Mihály Varga, suggested the country could adopt the euro by the "end of the decade", but only if economic trends continue to improve and the common currency becomes more stable[12].

According to Neményi and Oblath (2012, pg. 1): "Irrespective of the timing of accession, it is in Hungary's interest to meet the conditions for joining the euro as soon as possible. However, these conditions include not only the Maastricht criteria, but also "internal" requirements, such as stabilising inflation expectations at low levels and putting in place institutions and mechanisms to ensure sustained consistency between wage and productivity developments. Steps to demonstrate the will to create the conditions for accession would increase international confidence in domestic economic policy and improve the prospects for economic catching-up".

There are not many polls measuring the levels of support among Hungarians for adopting the euro. Yet, a Eurobarometer study puts the percentage of Hungarians who would like to replace the forint with the euro at 72% in 2023, in contrast to 56% in 2003 (Eurobarometer, 2023).

Conclusion - Future members of the Eurozone

After discussing the relation between Hungary and the Eurozone, it would be useful for our assessment to see how the other countries in the region plan to accommodate themselves to the Eurozone requirements for gaining full access to the area. Bulgaria is not yet a member of the euro area. The lev is, however, part of the exchange rate mechanism (ERM II) since July 10, 2020. It must participate in the mechanism without severe tensions and without devaluing its central rate against the euro for at least two years before it can qualify to adopt the euro. The participation in the Exchange Rate Mechanism is supposed to help non-euro area countries prepare themselves for becoming part of the euro area. It is an important milestone towards adopting the euro. The lev observes a central rate of 1.95583 to the euro. Bulgaria also committed unilaterally to continue its currency board arrangement within the ERM II.

Czechia, Romania and Poland are not yet members of the euro area. The Czech koruna, the Romanian leu, and the Polish zloty have not yet joined the Exchange Rate Mechanism (ERM II). Neither Czechia nor Poland has a target date to adopt the euro, but Poland aims to do it as soon as possible, since adopting the euro is one of the top priorities of the current Polish government. Romania has initially set 2024 as its target year to adopt the euro. By contrast, adopting the euro is not a priority of the Hungarian government. Whether to join the ERM or not is both a political and an economic question. Thus, the Hungarian government prefers to

[11] Christopher Adam, "Orbán: Hungary will not adopt the euro for many decades to come" (03.06.2015), *Hungarian Free Press*, https://hungarianfreepress.com/2015/06/03/orban-hungary-will-not-adopt-the-euro-for-many-decades-to-come/ (22.02.2024).

[12] Hungary's economy minister sees possibility for adopting euro by 2020 – UPDATE, (19.07.2016), *Daily News Hungary*, https://dailynewshungary.com/hungarys-economy-minister-sees-possibility-for-adopting-euro-by-2020/ (22.02.2024).

face the risk of remaining outside the Eurozone. The current government's interpretation of "national sovereignty" seems to override any other European priority.

In this opinion piece, we presented the recent challenges and benefits of the euro currency, with a special focus on the future potential members of the Eurozone.

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