The Single Currency –the €

Specification requirements The Single European Currency – the benefits and drawbacks to UK businesses of not being part of the euro zone.

The Single Currency—European Monetary Union.

EMU (European Monetary Union) involves the establishment of irrevocably fixed exchange rates between the member currencies , and the implementation of a single monetary policy (interest rates), operated by the European Central Bank.

The single currency known as the Euro €, came into existence on the 1st of January 1999. Initially the € existed in tandem with the currencies of the member states, (this means that members currencies were still be used for everyday transactions and purchases, but commercial goods and services can be priced in Euros). In Jan 2001 the Euro was issued for everyday use in member states, for a while each country had two currencies, it's own and the Euro, but as soon as people got used to using the new currency the € fully replaced member currencies, and is now used for all forms of exchange.

The Euro consists of a weighted basket of member states currencies. At the time of establishment of the currency the relationships between each member states currency (the exchange rates), and the Euro were fixed. All these member currencies now are no more, If the £ were to join the €, then we would go through the same process, of fixing the currency rate and then in stages adopting the € as our currency.

To be able to enter the currency, members of the EU had to meet certain macro economic performance standards as laid down in the Maastricht treaty These standards are known as Convergence Criteria. The idea behind the convergence criteria is that member economies should be as similar as possible (allowing for size), before joining EMU. This convergence of economies will reduce pressures within the system, minimise economic conflict between member states, and make monetary policy, as set by the European Central Bank, relevant to the economic circumstances present in of each of the member state's economies.

The Convergence criteria were :

- Inflation. To be no more than 1.5% higher than the 3 countries with the lowest rates of inflation.
- Long Term Interest Rates. To be no more than 2% higher than the 3 countries with the lowest interest rates.
- Government Deficit. To be no more than 3% of GDP.
- National Debt. To be no more than 60% of GDP.
- Currency Fluctuation. Stability within the normal band of ERM for the previous 2 years. (This was later amended to give more leeway).

11 countries qualified under the Maastrict convergence criteria, and joined the €, 2 countries qualified but declined to join (Denmark and the UK), and one country failed to meet the criteria (Greece).

Which countries have adopted the euro – and when?

1999	Belgium, Germany, Ireland, Spain, France, Italy, Luxembourg, the Netherlands, Austria, Portugal and Finland
2001	Greece
2007	Slovenia
2008	Cyprus, Malta
2009	Slovakia

Benefits of joining the Single Currency.

Those that argue for UK membership of EMU, and the replacement of the £ with the Euro, normally use the following benefits to boost their case.

Removal of Transaction Costs. That is the costs of changing one currency into another.

Removal of Exchange Rate Volatility. This would end much of the uncertainty in business transactions involving cross border trade. A great deal of the profitability and competitiveness of businesses and industries can depend on movements in exchange rates.

Lower Long Term Interest Rates. The expectation is that interest rates will fall to those levels seen in the strongest European countries, notably Germany. Typically these have been around 2% lower than UK rates. This fall in interest rates will encourage investment and reduce business costs. In 2009 UK interest rates fell below those of the Eurozone.

Maintain Competitive Advantage of the City. London is the main financial centre of Europe. Other financial centres such as Frankfurt are trying to take a larger share of London's business. Outside the Euro we will find it much harder to retain this business. (Note. After 7 years of the Euro, and with the UK outside, London has increased its market share of European financial services markets).

Easier Trade with Europe. Because of price transparency and fixed exchange rates UK firms will find it easier to win business in the Eurozone.

Increased Flows of Labour. The single currency will encourage labour flows throughout Europe, allowing firms access to potentially lower cost labour.

Disadvantages of joining the Single Currency.

Those that argue against Membership of EMU use the following arguments.

Transitional Costs. These are the costs involved in changing accounting and pricing systems to the €, that will have to be borne by UK businesses. The estimated cost to UK industry is around £5 billion.

Inflation Potential. The costs of transition, passed onto the consumer, will cause an inflationary blip (temporary jump).

Regional Unemployment will worsen. Because macro economic monetary policy is now Europe wide and controlled by the European Central

Bank, when the main industrial and financial centres are booming little heed can be paid to regions that are depressed. This lack of national flexibility in the setting of interest rates can only increase the economic differences between the richest and poorest areas in Europe.

Recessions cannot be managed effectively. Again because macro economic monetary policy is now Europe wide, countries that are entering recessions ahead of others who are later leaving recovery or boom periods, will not be able to use appropriate monetary policy such as reduction in interest rates. It is of course expected (hoped), that economic cycles of member states will run in tandem. (Italy Spain and Ireland suffering from recessionary problems, which are harder to resolve with a fixed currency).

Forced Flexibility of Labour Market. It will no longer be a matter of getting on your bike to look for a job, but getting on Eurostar to find work in Hamburg, Barcelona, Paris, or whichever region is booming!

We see then that there are arguments for and against UK membership of the single currency.

The current government stance (May 2009)is that we will enter the € when the time is right. The time will be right only when and if, 5 standards of UK and European economic performance, as laid down by the Chancellor are attained. Even if the UK and Europe meets these standards, entry is dependant upon a referendum.

The Chancellors Five Tests

- Whether there can be sustainable convergence between Britain and the economies of a single currency.
- Whether there is sufficient flexibility to cope with economic change.
- The effect on investment.
- The impact on our financial services industry.
- Whether it is good for employment.

Conclusion.
At the moment is seems very unlikely that the UK can or will join the single currency. We currently (May 2009) fail to meet the Maastrict criteria (so do many of the € members!), and the government is not in a strong enough political position to push for membership. From British firms point of view the fall in the value of the £ over 2008 /2009 has encouraged exports, and decreased the competitiveness of imported goods—something that would not have occurred if we were in the € zone.

Notes