Course: <u>Law of the European Union</u>

[08] Single Currency, Budget, Agriculture and Cohesion

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Definition of money, and government control

- Goods, services, labour and capital can be bartered by individuals and communities.
- Money makes this exchange easier.
- Money serves for exchange, storage of wealth and measurement of value (price)
- Many items can serve as money.
- Gold and silver served thanks to their scarceness and endurance in many countries for centuries.
- Coinage was often monopolized by government.
- Now, booked (including electronic) money exists. It is not easy to define mass (M) of money. Different methods are used for this purpose.

Gold standard

- Many countries had „gold standard“ in the 19th century.
- Banknotes issued by national and other banks entitled their holders to exchange them for fixed amount of gold or silver held in their reserves.
- This system provided for fix exchange rates.
- The system was compromised due to the first world war. Countries issued exceed amount of banknotes. Exchange for gold was ceased by laws or in practice.
- Several European currencies collapsed in hyperinflation.
- Only few states continued gold backing of their currencies. Several other countries attempted to do it.

Brettonwood system

- Since the second world war, the Brettonwood system was system for stabilization of exchange rates.
- It used the US dollar which was convertible to gold by fixed rate and exchange rates for other currencies were fixed in multilateral agreement and stabilized with interventions on regulated currency markets.
- Loans of the International Monetary Fund were expected to contribute to it.
- The system contributed to the development of international trade between 1945-1970. It collapsed in 1971, the United States suspended convertibility of dollar for gold due to excess amount of dollars in circulation.

Situation before introduction of single currency

- Exchange rates fluctuate freely. There were sharply rising prices of oil and gold due to political instability.
- Lability of exchange rates increases transaction costs. It is necessary to create reserves for changes of exchange rates for enterprises engaged in international trade in goods and services.
- Therefore, integrated E(E)C and its member states established the European Exchange Rate System. The system was based on mutual obligation of central banks to intervene for fixed rates. There were, however, agreed appreciations and depreciations.

ECU for accounting

- Budget of the E(E)C have become so big to be conducted in one currency.
- The European Currency Unit (ECU) was based as „basket of currencies of all member states of the E(E)C.“
- It was used as a neutral unit of the E(E)C for management of common agricultural policy and other activities.
- ECU price was used as price of euro when established in 1999.

Legal framework for introduction of single currency

- The Maastricht Treaty (1992) provided legal base for introduction of single currency.
- Every member state - with exception of „opt-out“ states: the United Kingdom, Denmark and unoficially Sweden - was expected and required to introduce the single currency.
- New member states are expected to follow.

Convergence criteria I – in general + independence of central bank

- Maastricht Treaty (1992-3) has prescribed requirements for introduction of single currency.
- Member states were and are required to meet several (convergence) criteria.
- [1] national central bank shall be independent from national executive power and thus contribute to stability of national currency.

Convergence criteria II – monetary policies

Member states shall take manage their own currency to achieve following aims:

- [2] Exchange rate stability (two years within fixed limits +-15%). Legally described with participation in European exchange rate mechanism.
- [3] Low inflation (not more than 1.5% higher than inflation in three countries with the most stable currency)
- [4] Convergence of interest rates (within 2% span) of member states.

Convergence criteria III – fiscal policies

Member states shall have responsible fiskal policy on all levels of government (state, regional, local) and various public funds.

- [5] Budget deficit shall be less than 3% GDP (definition of public budgets necessary)
- [6] Public debt shall be less than 60% GDP.
- Fiscal criteria are applicable both before and after introduction of single currency.
- Many member states do not meet these criteria, especially in contemporary period of economic slowdown and financial crisis.

Preparation of introduction

- 1993-1998: convergence criteria should be meet.
- In 1998 the European Council decided on the issue. Greece only was blocked to enter the „eurozone“. Greece joined fraudulently two years later.Other failing (requirements 5 and 6) member states (Italy, Belgium) were admitted.

Introduction

- 1999-2001. Legally, old currencies ceased to exist. Immaterial euro replaced them. Nevertheless, coins and banknotes of former currencies represented it transitionally .
- Conversion rates were established with regulation 2866/98. Exchange rates were based on exchange rates for former ECU
- Introduction of cash: first two months of 2002.
- Euro banknotes and coins were introduced into circulation and cash of former currencies was withdrawn.

Name, banknotes and coins

- Euro – neutral name adopted in 1995, ECU (ecu) was abandoned. Fraction unit – cent is similarly neutral.
- Banknotes are uniform for all Member States. Coins have single metal, shape, weight and averse side, their reverse side is national.
- Banknotes and coins of old currencies were quickly withdrawn. However, it is and it will be possible to exchange them in national central banks.
- Nature of EU is revealed with banknotes: no inscriptions, no European personalities.

Continuity of required payments

- All payments required with laws (taxes, fees, fines), decisions (related to tax debts, social security etc.), judgements (damages etc.) and contracts (delivery of goods and services, loans, labor) were converted to euro.
- The introduction of single currency cannot cause frustration of any obligation to pay agreed or imposed amount of money.
- For member states, continuity is prescribed by EU law. Such continuity was acknowledged also in other countries.

Pros of single currency

The purpose is suport of interstate commerce.

In integrated areas – EU with its four basic economic freedoms is good example - savings are quite important due to frequency of cross-border payments.

- Single currency removes exchange of currencies.
- Single currrency removes costs resulting from exchange rate instability for trade partners.
- Both savings are permanent. Euro has reduced prices slightly. However, nobody has recognised it, occassional increases of prices were observed.
- The single currency enhances transparency of prices for goods and services, wages and profits.

Cons of single currency

- Single currency requires single monetary policy.
- It is impossible to meet different needs of economies of member states of eurozone.
- Is eurozone optimal monetary area? Do phases of economic cycle synchronize in member states and their regions? If not, single currency results in bigger inflation or bigger unemployment than necessary in some parts of eurozone.
- Together with lack of fiscal discipline of many member states, it can cause disintegration of eurozone in future.

Single currency as symbol?

- Many people think that currency is expression of statehood and sovereignty.
- Nevertheless, for centuries, gold and silver were used as money. Coins circulated frequently abroad.
- There are groups of countries sharing one currency. Several countries use currency of other country (for exampe, US dollar), there are countries with more currencies (China).
- Euro is also used in several other countries.
- Therefore, euro shall not be percieved as principal step in transformation of EU into federation.

European Central Banking

The European Central Bank is responsible for monetary policy in eurozone.

- The Bank (Frankfurt am Main, Germany) The key decision-making body is the Council and Directorium.
- The central banks of member states of eurozone have not ceased to exist. They have become part of the Eurosystem.
- Central banks of member states without euro retain their independence, they are partially involved in the EU monetary policy.

Principles of European monetary policy

- The most important principle for monetary policy is stability. Low inflation is demanded.
- High level of employment and exchange rate stability are secondary aims of European monetary policy.
- The European Central Bank uses similar tools for steering of the currency as other central banks do: money stock management (expansion, or reduction of „M“ indicators).
- Euro banknotes are issued by the European Central Bank. Coins are issued by national central banks of member states of Eurozone.

Single Currency Endangered

- Many member states permanently fail to meet fiscal criteria.
- EU law did not expect redistribution.
- Greece and Ireland face imminent collapse due to sharply increasing budget deficits and sovereign debts.
- System of guarantees and loans among member states of eurozone has been established in last months.

Budget of the European Union

- 116 bilion (milliards) euro for year 2009.
- If compared with budgets of bigger and richer member states, the budget is small.
- EU distributes slightly more than 1% of gross domestic product of the EU.
- The member states distribute significantly more: 35-55% of their gross domestic product.

Explanation of little budget

European Union is no (federal) state.

It does not finance many state tasks and agendas.

It has no army and no police.

Most EU laws are enforced by member states, by their administrative authorities and their courts.

There are negligent European spendings on social security, healthcare or education.

Member states remain to be welfare states. EU integrates them. However, is not a social union.

Revenues of the European Union

- There are no European taxes.
- Only customs duties imposed on imports from non-member states within common customs policy are (after deduction of expenses) transferred to EU budget.
- The most important revenue are contributions of member states based on their GDP
- Part of value added tax revenue (the tax harmonized by the EU) is another revenue.
- There are also significant agricultural levies.

Expenses of the European Union

Budget of the EU finances:

(1) institutions of the EU

(2) subsidies and interventions in common agricultural policy (35%)

(3) expenditures on regional cohesion (40%)

(4) contribution to European research

(5) humanitarian aid provided by Europe to third countries.

Approval of budget and control

- Budget proceedings include the Commission (proposal), the Council and the European Parliament (with strong position).
- There are fixed deadlines for particular steps in preparation and approval of budget.
- The Court of Auditors controls spendings.
- European budget is bundled with budgets of member states. Various compensations for results of changes of EU policies are agreed from time to time for various reasons.

Common Agricultural policy I

- It is expensive and controversial policy.
- Agricultural lobby is influential.
- Huge money flows in European agriculture through subsidies, market interventions and compensations for changes required by EU.
- Common agricultural policy is set in most regulations and several directives of the EU.
- It is enforced directly by authorities of member states. The Commission only supervises and coordinates this enforcement.

Common agricultural policy II

- EU support contributed to chronic surplus of agricultural commodities.
- Therefore, EU has introduced restrictions of production (quotas for milk, sugar etc.) and prohibition of use of instruments of production (no new vineyards, mandatory unused fields)
- EU pursues protectionist external trade policy for agricultural products for decades. It heavily subsidizes exports. Nevertheless, commitments within WTO reduce this protectionism for future.

Regional Cohesion I

- Significant EU money are spent for regional policy.
- They shall contribute to economic and social cohesion of member states and their underdevelopped regions.
- Differences among member states in GDP per capita are quite high, especially since last enlargements.
- Regions with poor economic performance are identified within special EU classification (NUTS).
- European money are used for support of various infrastructure projects: roads, railways, facilities for protection of environment and for economic development including education and reasearch in poorer regions.

Regional cohesion II

- Distribution of subsidies is organized jointly by the Commission, and by authorities of member states within progagreed with the Commission.
- Special legal framework combines public and private law instruments for realization of particular projects agreed within priorities set for period of several years.
- After last two enlargements, direction of flow of EU money for regional policy was diverted.
- Most regions in post-socialist member states qualify for European money.