1) “From an economic perspective, it would be beneficial for the EU to have more than one currency.” Discuss. (30 points)

The Monetary Union is a long standing tool of inducing economic and institutional convergence both within the EU and with respect to prospective members. A large portion of economic convergence and overall development comes in the form of introducing innovations, macroeconomic and financial stability which create the right environment for investment to take place. While short-term issues may certainly affect members of the Monetary Union, particularly instances of asymmetric shocks, the long-term incentives and benefits of a single currency outweigh the alternative.

Joining the MU is conditional on satisfying a number of macroeconomic, financial, and institutional criteria. This creates pressure on prospective members to converge institutionally which lays the groundwork for easier cooperation with older member states as well as boosts the process of integration. Frankel and Rose (1998) suggest that the maintenance of a MU in countries which do not strictly fulfill Optimal Currency Area criteria accelerates integration, which in longer term prompts economic changes which translate into satisfying the conditions of an OCA. Moreover, while there is some evidence suggesting that a MU decreases the frequency of asymmetric shocks, what is more certain is that a MU typically leads to financial integration, which facilitates the emergence of insurance mechanisms. These insurance mechanisms, in turn can reduce the damage and costs of asymmetric shocks to the MU. Furthermore, as EU requires, among others, low inflation, relatively low deficits and government debt with respect to prospective member’s GDP the developments towards fulfilling these requirements generate more stable macroeconomic conditions. This is particularly important when considering the importance of investment in a newer member state to its further economic development and consequently convergence with the EU average.

With a single currency comes simplification to transactions and trade. Namely, greater price transparency as all prices become directly comparable between all members of the Monetary Union, elimination of exchange rate risk and costs of hedging against fluctuations of the exchange rate, and reduction in overall transaction which span more than one country. Direct comparability of prices under one currency improves market efficiency and allows for more informed decisions, while also proliferating trade. Less negotiation around currency choice in a transaction or hedging against fluctuation implies lesser fees, and therefore greater accessibility and ultimately volume of transactions occurring in the economy. It is particularly important to note that smaller entities which without a single currency would face additional costs of international transaction, which may prohibit them from engaging in such operations, under one currency are relieved of these costs and therefore can contribute economically and grow faster. Furthermore, high price transparency under one currency is an additional positive factor which eases expanding trade and increasing the number of transactions as less costly analysis needs to be employed.

Convergence towards a single currency is a powerful driver of economic synergy and institutional convergence, which are long-term guarantees of prosperity and growth of the EU. Moreover, the combined benefits of a single currency with the necessary criteria to enter into the MU are healthy requisites which stand to ensure a stable macroeconomic environment. Lastly, the monetary union implies trade proliferation and resistance to asymmetric shocks.