

QUESTION: "DO THE ADVANTAGES OF MEMBERSHIP OF THE EUROZONE OUTWEIGH THOSE OF RETAINING A NATIONAL CURRENCY IN EUROPE?"

YES!

NO!

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In May '98, European leaders decided to launch the euro in 11 countries beginning in 1999. At that point, economic and monetary union (EMU) had begun with a single exchange rate and monetary policy operated by the ECB. Only in 2002 were banknotes and coins introduced. Since then, the eurozone has been extended to include 17 members. The euro sovereign debt crisis that began in April 2010 has certainly revealed the complexities of maintaining a common currency but membership of the eurozone still outweighs any perceived advantages of retaining national currencies.

Perhaps the strongest benefit of a common currency is that currency fluctuations are negated which leads to cost and time efficiencies. Businesses gain through savings from losses of currency swings, transaction costs in performing currency exchanges and also hedging techniques that counter such volatility. Thus, time gained from efforts used to mitigate this risk and extra funds saved can then be more productively put to use within a corporation. Private consumption will also benefit through transaction cost efficiencies and a resulting higher marginal propensity to consume. Foreign direct investment (FDI) is boosted as investors are more likely to direct projects to stable currency environments. Further, trade within the EU is also improved as the elimination of exchange rate uncertainty facilitates dealings between exporters and importers. (Trade is also enhanced as competitive currency devaluation to unfairly benefit trade is eliminated).

Second, a common currency is a key dynamic for the governing ECB to efficiently implement a unified macroeconomic policy. The significance of the sub-prime crisis has had a global economic implication. As such, a uniform macroeconomic policy can have a more influential impact in tackling such severe financial phenomena.

Third, the implementation of the euro promoted efficient industry players through price optimizations within the EU. Respective counterparties have a single platform as a price comparison which makes price differentials more noticeable and helps equalize them across borders boosting the most competitive market participants.

Finally, currency speculation focused on a single currency becomes more difficult and within the EU it is negated. Speculative currency trades concerned with disparate economies of a group of member states vs. a national economy are more complicated to formulate as there are varying outlooks on unparalleled economic situations, i.e. in '92 George Soros's famous lucrative bet against the sterling was successful as the trade was targeted at macroeconomic factors specific to a single economy, the UK.

The main disadvantage of the euro vs. a national currency is currency devaluation when economically necessary. Where a member of the EU is faced with an adverse economic impact such as the sovereign debt crisis currently plaguing the PIGS, currency devaluation can prove advantageous.

National currency devaluation can promote domestic growth by increasing competitiveness relative to peers. Exports increase through cheaper domestic products whilst imports decrease via more expensive foreign goods. As a result, domestic companies widen their market share beyond the domestic periphery and the trade balance deficit narrows. Although currency devaluation increases the value of the national debt, interest payments may become more manageable following such growth. Further, FDI is lured as prices of domestic assets become more attractive to foreign investors. After the sub-prime crisis, sterling depreciation boosted FDI into asset classes which included real estate, the stock market and others.

Second, the ECB sets interest rate levels and regulates the money supply in order to combat unemployment, inflation and other macroeconomic targets. A common currency abolishes the management of interest rate levels on a national level and it thus becomes difficult to implement a single strategy to combat disparate economic statuses and financial infrastructures. For example, in the light of inflationary levels surpassing the ECB's target of 2%, interest rates in April 2011 were increased from 1.00% to 1.25% for the first time since the financial crisis. However, this move could be detrimental for indebted periphery countries.

Third, there is a significant sunk cost in adopting a common currency that must be considered. An investment is undertaken to transition infrastructure associated with the national currency and there also is a cost tagged with the abolishment of old banknotes and coins and the change to new ones. Fourth, the Stability and Growth Pact (SGP), aimed at ensuring that the eurozone meets the Maastricht convergence criteria, requires that annual budget deficits and national debt levels are kept in check. This prevents the utilization of fiscal measures such as targeted government spending to counter unfavourable national economic cycles. Finally, the success of the implementation of the euro in the eurozone is often compared to that of the common currency (USD) in the United States. However, the US is in an advantageous position due to the common language factor and the transferability of pensions. In effect, mobility of labour is easily facilitated whereby workers from economically depressed states can relocate to more prosperous ones.

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