European Integration: Historical Aspects and Current Problems

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Abstract

The article presents the process of European integration from the end of the World War II until the estabilishment of the European Monetary Union, emphasizing the main moments of this process. The assumptions of the integration process are discussed in the article. It is emphasized that both the political and economic reasons were behind the European integration process. The European system of Central banks and principles of its monetary policy are discussed in the article. The international role of Euro, its increasing international weight during the pre-crisis period is analysed. The present situation in the Euro zone, its problems and perspectives of the European Union and a single currency are discussed. The analysis shows that the European Monetary Union and a single currency will have long-term perspectives only if specific radical measures, especially in the spheres of monetary and fiscal policy of European Union, and closer integration between the countries are taken.

Keywords: Euro, European integration, European Union, European Monetary Union, debt crisis in Euro zone .

1. Introduction

The integration process of Europe, the result of which is foundation of European Union (EU), is one of the most significant processes, in the political and economic sense, during the whole history of Europe. If the economic aspect was stressed at the initial stage of European integration, after establishing the European Union the establishment of the European Monetary Union (EMU) becomes the most important task. Formally EMU exist since January 1, 1999, and Euro as cash started functioning in twelve states of EU since January 1, 2002. Adoption of Euro ended the 50 year lasting money integration process. Euro became the key axis of integration. In the contest of the international monetary system, formation of EMU is perhaps the most important event since the failure of the world monetary system that functioned on the basis of the Bretton Woods treaty. The experience of the first Euro functioning years has shown that it became a factor that stabilized the fluctuation of interest, price, and exchange courses in a complicated economics globalization environment. The fact that EMU is based on new ideas should be stressed. The essence of these ideas is that the monetary policy of EMU gives preference not to stimulation of economic growth by the classical monetary policy means, but to ensurance of long-lasting price stability.

When evaluating in the context of other monetary unions, the Euro project is a particular event in monetary history. Never before did it happen that a group of independent states would refuse their national money of their own will and would concurrently retain political independence. This act determines quite a new combination of macroeconomic policy, based on general values and following the subsidizing principles. The policy based only on the national interests can be neither productive, nor stable enough. The policy based on the common currency, has an effect on all the spheres of economics: allocation of resources and revenues, economic growth, as well as labour, product, service, and finance markets.

Euro introduction is of significance not only in economic, political, but also psychological terms. National money is an important symbol of national sovereignty. A voluntary change of national currency into Euro indicates that the general European identity is strengthening. As early as 1956, the idea of EMU was already discussed in the negotiations the Rome treaty, and the monetary union formation plan was approved by the Maastricht treaty, signed on February 7, 1992. As the main moments when creating EMU, we should mention Werner's report in which he offered to create this union until 1980, onthe currency system consisting of the currency basket (ecu) and the exchange rate mechanism, as well as Delors report that lay on the basis of the plan for creating the EMU, defined by the Maastricht treaty.At present there are 17 EU members of the EMU. Since the experience of functioning of the monetary union in Europe is not so rich, we can expect that there will be more discussions on this point in future.

2. Historical Assumptions of the European Economic Integration

The European Union is, in a sense, quite a unique construct of countries having no analogues so far. A group of independent countries of Europe, which created a common internal market with a single currency, managed to preserve the political independence thereby. The creation of the common internal market of the EU, which has its prehistory, is a part of further integration of the European countries. Such a creation of EU was stimulated both by political and economic reasons – after the end of the World War II the Western European countries agreed on Europe's becoming a democratic region of prosperous economy that would never give rise to war. However, Europe could have become a region of developed economy ensuring high living standards only if it were in a successful competition with the other world regions and, firstly, the USA and Japan. This goal was impossible to achieve employing the efforts of separate countries only and that forced the European countries to organise into a closer union. It was indispensable to coordinate the macroeconomic and, especially, monetary and fiscal policies of the European countries, to ensure an effective distribution of resources (manpower, capital) or that of the goods and services, as well as the free movement at the regional level. Thus, the globalisation of economic processes, increase in the world competition, application of high technologies and their rapid development impelled the European countries to deal with economic tasks firstly. Perception of common tasks and the outcome of adequate efforts was the creation of the European Economic and Monetary Union, though not immediately, but in consecutive phases.

Preconditions for the integration of European countries appeared immediately after the World War II when the plan for reconstruction of the destroyed European economy, nicknamed as the Marshall Plan, was prepared. In pursuance of its implementation and administration, the Organisation for European Economic Co-operation was set up in Paris in 1948, later reorganised into the Organisation for Economic Co-operation and Development, known as OECD. Despite the successful activity of the Organisation for European Economic Co-operation, it was realised that the European economic development needed the creation of a common market and the coordination of monetary and fiscal policies of the European countries or even centralised coordination.

The essential step towards the economic integration of Europe was the establishment of the European Community, the birth of which was given after the creation of the European Coal and Steel Community. The French Minister of Foreign Affairs R. Schuman proposed merging together one of the most important industries of the continent – production of coal and steel. This idea was implemented in 1951 in Paris when six European countries – Belgium, Italy, Luxembourg, Holland, France, and Western Germany – signed the agreement on establishing the European Coal and Steel Community. In 1957, at the Rome Conference the six countries of the European Coal and Steel Community signed two treaties whereby establishing the other two new organisations: the European Economic Community and the European Atomic Energy Community ("EURATOM"). Upon the establishment of the managing authorities, common to all the three communities, in 1967 they were fused together into one system and called the European Communities (later the European Community).

In 1960 seven European countries – Austria, Denmark, Great Britain, Norway, Portugal, Sweden, and Switzerland - signed the convention in Stockholm whereby establishing the European Free Trade Association (EFTA). Despite the importance of the European Free Trade Association for the creation of the common market of the European Union, its contribution to the process was far away from being on top. Formation of the common market of the European Union was predetermined namely by the development of the European Communities.

The new integration phase of the European Communities started in 1987 upon the enforcement of the new agreement named the Single European Act that replaced and supplemented the Treaties of Paris and Rome establishing the European Communities. The Single European Act establishes a clause for the creation of a common market over a period that would conclude on 31 December 1992, which would compromise, a free movement of goods, services, capitals, and people. Creation of the common internal market was grounded on the principles laid out in the so-called White Paper, prepared in 1985 by the European Commission, presided by Jacques Delors. Basically, the programme was implemented. It was established by the Treaty of Maastricht in 1992 in Maastricht, Holland. This Treaty, known as the Treaty on European Union, formally established the EU and declared the new European economic integration phase – creation of the EMU. The present Treaty lays down the clauses for the participation in EMU, known as Maastricht convergence criteria, to be met by the states willing to join the EMU. The Treaty of Maastricht was later modified and amended by signing the other two treaties – the Treaty of Amsterdam in 1997 (Amsterdam) and the Treaty of Nice in 2001 (Nice). These treaties deal with the issues related to the EU institutional reform, required for the EU expansion, as well as human rights and freedoms and other issues, but did not consider the basis of the EU common market.

3. Creation of the Economic and Monetary Union

Already at the beginning of integration it has been realised that economic integration of European countries would not be effective unless the monetary systems of these countries were unified and common currency introduced. Nevertheless, the creation of the European Monetary System has been far from an easy task. It took a lot of time and efforts to establish the European Monetary Union with its single monetary policy and single currency unit – ECU.

The idea to integrate monetary systems has already been expressed in the Treaty of Rome, where it was stated that "each Member State considers its own policy on the change of the exchange rate as a common matter". However, more precise actions were taken up only after the report in 1970 by the Luxembourg's Prime Minister Pierre Werner where the plan for the establishment of the European Monetary System before 1980 was introduced. The prime aim of this plan, which was pursued by the Member States of the European Community, was to limit the fluctuations of currency exchange rates. The maximum permitted currency fluctuation margin of 2.25 % was set, as compared to the US dollar. Upon the implementation of this plan, the European Monetary Cooperation Fund was founded in 1973, which granted loans to the central banks of the Member States necessary for the execution of the currency exchange stabilisation policy. The then situation though prevented from the implementation of this part of the Werner plan, was figuratively named "the snake in the tunnel".

Despite the failure of the Werner Plan, in 1978 the European Council adopted that plan for the creation of the European Monetary System that came into effect as of 1979. The principal elements of the system were as follows: the currency exchange rate mechanism, European Monetary Cooperation Fund and the European currency unit – ECU. The basis for the European Monetary System was the exchange rate mechanism. The participating member states had to set and maintain their exchange rates within the limits set in terms of other currencies. The permitted fluctuation margin was 2.25 % against ECU; however, for several countries (Great Britain, Spain) these limits were extended for some currencies up to 6 %. ECU as an accounting unit of the European Community was introduced in 1978. It forms the currency portfolio of the European Monetary System, composed of currencies of each country are included into the portfolio with an established weight. The composition of ECU used to be reviewed every 5 years. Currency weights could have been changed even earlier in case their weight varied by more than 25 %. ECU was widely used by the national countries and the European Community institutions for settlement of accounts and payments but not common for commercial transactions.

With reference to the above, the European Monetary System has not become the monetary union yet in its full sense, whereas ECU was not the common currency of the European Community. In 1989, in Madrid Jacques Delors, the President of the European Commission, proposed the plan for implementing the Economic and Monetary Union. The establishment of the union had to happen gradually, namely in three stages. The first stage had to mark the final completion of the creation of the common market and economic stabilisation based on convergence criteria. The second phase had to focus on the establishment of institutions that would prepare the countries for the adoption of a common currency and become a basis for the foundation of the European Central Bank. The third phase would end up with the adoption of a common currency. Such Delors Plan was specified in the Treaty of European Union.

The Treaty of the European Union laid down the following convergence (also known as Maastricht) criteria that had to be met by the countries – the Member States of the Economic and Monetary Union:price stability,strict control over the budget of the country, exchange rate stability andstability of the stock market.

As the implementation of Delors Plan, the European Monetary Institute was established in 1994 that replaced the European Monetary Cooperation Fund overtaking and expanding its functions thereof. The European Monetary Institute was held responsible for the coordination of monetary policy of the EU countries and consulting of the national central banks for monetary policy-related issues. The activity of the European Monetary Institute served as a basis for establishing conditions for the set-up of the European Central Bank in 1998 that took over the functions of the European Central Bank and developed insofar as to ensure the comprehensive operation of the central bank. Since 1999 the European System of Central Banks also came into effect, being composed of the European Central Bank and the national central banks of the EU countries.

4. European system of Central banks and the principles of its Monetary Policy

The European System of Central Banks is a unique construct having no analogues so far, formed for the implementation of the EU monetary policy. The European System of Central Banks is composed of the European Central Bank and the national central banks of the EU countries. A part of the European System of Central Banks, composed of the European Central Bank and the national central banks of the countries that introduced euro, is also known as the Eurosystem. It goes without saying that banks under the Eurosystem have a closer cooperation because their monetary policy is based on the common currency – euro. The major goal of the European System of Central Banks is the maintenance of price stability. In case there is no violation of such a goal, the European System of Central Banks supports the common economic policy of the European Union.

The European System of Central Banks is a subordinate system, the European Central Bank being at the highest level. The resolution adoption under this system falls on the European Central Bank, whereas the implementation thereof normally takes places through the national central banks under the decentralised procedure. Decisions for centralised implementation are determined by the management bodies of the European Central Bank in accordance with the subsidiary and effectiveness principles. Decisions of the European Central Bank are of binding character to all the banks falling into the European System of Central Banks.

Despite the fact that the European System of Central Banks applies the classical monetary policy instruments, the implementation of monetary policy in the whole euro area is far more complex considering the case of one country only. In such a case the monetary policy is based on the evaluation of economic prospects of the entire euro zone rather than the national development trends only. The monetary policy is affected by various factors and processes. Thus, the evaluation of the impact of monetary policy instruments on the whole euro area is much more complicated as compared to a separate country.

In addition, obviously, the effectiveness of the monetary policy for the euro area will be present only after sufficient coordination, clear strategic direction and efficient control. Though the objectives set by the monetary policy of all the central banks of the euro area countries seem to be the same, the implementation of the policy is of decentralised character. Therefore, the coordination role, undertaken by the European Central Bank, shall be of prime importance. It shall, moreover, consider the fact that the actions of an individual national bank will inevitably bear effect on the situation in other euro area countries too.

5. International role of the Euro

Adoption of the Euro on January 1, 1999 was of great significance not only to EU, but also to all the states of the world. Having changed the national money of most EU states, the euro was continuously gaming strength and became one of the most important international currencies in the world. In this period the Euro can be regarded as the second world currency, successfully competing with the USA dollar. The role of Euro as a basic and reserve currency is also increasing. Using Euro as the basic currency, a wide spectrum of currency regimes is possible. One way or another, about 30 non Euro zone states have associated their currency with the Euro, though they make up rather a small part of the general gross world product (Benjamin, 2007). Some countries use the Euro as local money (e.g., territories under the jurisdiction of France), money of other countries is directly related with the Euro (e.g. Lithuania), another group of countries linked their national money with a currency basket, one component of which is the Euro or its national denomination (e.g., Hungary, Ireland).

One more group of countries (Czechia, Poland, Slovakia) keeps to the policy of the controlled exchange rate mode, where the Euro plays the role of an introduction. This, one of the outcomes of originating (EMU) is Euro internationalization. An obstacle for a more rapid spread of Euro is the so-called "snitching cots", i.e., expenditure of time and money in the transition to another currency. Adoption of the Euro was a powerful stimulus for the development of finance markets. During the first three years since the introduction of the Euro,the turnover of financial means in the Euro zone countries has grown more than twice as compared with that of national money. The common currency made it possible to optimally distribute the capital in the Euro zone. Due to that, more participants could make use of a larger number of financial means, because in smaller states with different money there is no possibility to form the sufficient critical mass of using certain financial means.

Though the US dollar remains the principal investment currency, its significance is declining, while that of the Euro is increasing. The part of bonds and money market means expressed by the Euros has grown from 18% in 1998 to 31% in 2004 in the international market, while that expressed in USA dollars has decreased from 48% to 42%. The Eurobond market is one of the target ones in the world. According to bank data, the part of international settlements in Euro bonds issued in 2004 made up 48% of the whole international bonds, while in USA dollars - 34%. Bond markets of ES and USA governments are similar, but the bond market of corporations of the latter is much larger. The main aspects that determine international attractiveness of the Euro as an investment currency are as follows: the integrated, so-called deep market in which a large amount of financial means can be purchased and sold without any influence on their price, developed secondary market, a great variety of financial means, and a high degree of market liquidity. After adoption of the Euro, the risk of the exchange rate has disappeared and the competition increased which stimulates a further integration of finance markets and increases their efficiency.

Tendencies of integration and competition in international finance markets have evidently been observed, because the world finance centers are competing for influence in international finance markets. The monetary union and the Euro precondition the strengthening of positions of EU as the international center of finance in the competitive fight against the USA and Japan. Introduction of the Euro also had an effect on the domestic finance market of the monetary union (Galati, Tsatsaronis, 2003). After introducing the common currency, transactions in national currencies have disappeared in the states of the monetary union, and so did the necessity of transactions for insuring against the exchange rate risk. Thus, the Euro integrated and consolidated financial markets of EMU states. The effect of Euro introduction on financial markets is much stronger and faster than on the other fields of economy (Gaspar, 2004). After adoption of the Euro, the fastest changes took place in the markets of short-term financial means, i.e. money. The Euro stimulated integration of the money market and a technological progress of settlements. As a consequence, there are no great differences in interest norms. Integration of long-term financial means markets required more time. Naturally, there also were some changes in the markets of shares and bonds, but not as fast as in the exchange markets.

There is no more currency risk in the Euro zone, therefore investors can pay more attention to the loan risk and its evaluation. The wider and more liquid market of Eurobonds becomes more and more attractive to investors even beyond the limits of the Euro zone. The former national markets were small, non liquid and therefore unattractive for large international investments. The effect of Euro on stock markets is weaker than on other segments of the financial market: the experience shows that issuers are disposed to concentrate issues in the national markets that most frequently become most liquid. Selection of a market is determined not so much by currency as by other factors, e.g. geographical spread of issuer's kinds of activity. Liquidation removal of the currency risk has not essentially changed the relations set among the issues and their national markets. Adoption of the Euro determined structural changes in the European markets of derived financial means and their expansion. The Euro has a double effect on the markets of derived financial means. First the common currency diminished the variety of derived means, since some kinds of transactions have disappeared. On the other hand, with a decrease in the member of transactions, the competition of EU derived financial means trading intensities.

Adoption of the Euro has also invoked changes in the international monetary system stimulating the currency integration in other regions of the world. The Euro became the second currency in the world according to the size of economics in which are used. It stimulated world trade as well as the size and liquidity of capital markets (Greenspan, 2001). One of the major advantages of entry into EMU is a positive effect of trade expansion on the entering country, i.e. the so-called Rose effect (Frenkel, Rose, 2002; Rose, Engel, 2001; Chintrakarn, 2008). It is of utmost importance that trade growth stimulates the economic growth as well.

It has been established that the trade increase in the country by 1% determines an increase of the gross domestic product by 0.33 %. (Shalder at all, 2005). By eliminating the exchange rate indetermination, the common currency diminishes risk and determines thereby a lower rate of real interest. The decreasing rate of interest, in its turn, stimulates the economic growth, too.

6. Present problems of the EMU and its perspectives

We have demonstrated above that the Euro as a currency was gradually becoming stronger and stronger, at the same time strengthening the economic power of EU member states until the very beginning of the world economic crisis. The global crisis changed the situation in the Euro zone and weakened the Euro. The Eurocrisishas sooneruptedintothe eurozonedebt crisis.The SouthernEuropean countries - Greece, Spain, Portugal, Italy, Cyprus, and Ireland were becoming problematiccountries of the eurozonedebt crisis.The situation, determined by the latter, has revealed serious flaws of the Euro as a single currency as well. It appeared that the structure of the monetary union itself and measures concerning the financial status within the union were not thoroughly considered. The situation in Greece has showed a number of serious problems that a single currency might face in the case of force majeure. Here the act of saving Greece basically turned out into the rescue of the Euro as a currency.

The EuropeanUnion institutions reacted to thesituation inthe Eurozone and in the whole EU.It should be notedthatmuch earlier,even beforesigning the Maastricht Treaty,measures wereprovided that couldensure a sustainableeconomic growth ofthe Eurozone states.In June1997, the European Council hassignedthe Stabilityand GrowthPact,which was designed toensure the budgetarydiscipline inEMUand theimplementation ofthe Maastrichtcriteria. Since the Eurozonedebt crisisthreatened thesurvival ofthe Euro zoneitself, the European Commission has takenadditional measures.In May 2010the European FinancialStability Fundwas set up.When it becameclear that theEuropean FinancialStabilityFundwas aninsufficientmeasure,in February 2,2012ambassadors ofthe Eurozonein Brusselsigned a newcontract.The European StabilityMechanismwascreated by this newcontract. The European Commission proposed to establisha EuropeanBankingUnionand to set up an overall bankrescuefund.Allof the proposedmeasureswould strengthen the financial stabilityand positively influencethe financial markets. These measures can be effective for solving the current problems, but they do not solve essential structural problems of EU, which are significant for the future of the Union.

In fact, there is no actually efficient financial regulation mechanism in the EU tocontrol how the member states keep to the Maastricht Treaty criteria. According to Eurostat, at the time of economic crisis most EU member states just waved these criteria aside. Still, even if such a regulatory mechanism with the function of exercising control over the national budgets were put in place, it would barely be sufficient. If all these problems are not dealt with and no mechanism to facilitate the implementation of effective measures at the EU level in emergency cases is put into operation, the future of both the Euro as a currency and EMU as a whole will stay vague as it presently is. Thus, the use of huge monetary support funds and the obligation placed on the part of the European Central Bank to buy in government bonds of countries in a serious financial situation might bring about uncontrollable inflation with hardly predictable consequences.

Where the monetary policy in EMU undergoes the centralised procedure, with reference to the economic growth prospects of the whole Community rather than separate member states, the fiscal policy is carried out by the national governments independently. On the other hand, the Treaty of Maastricht establishes the requirements for the fiscal policy to be satisfied both by the Euro system member states and the countries pursuing the adoption of the Euro. These requirements are presented in detail in the Stability and Growth Pact that ensures the fiscal policy discipline in EMU, as well as expresses the principle of sustainability. The latter shall mean that each member state of the Union must maintain a balanced budget over the economic cycle. The permissible national budget deficit of 3 % is allowed during economic recession only. The approval of regulations, established in the Stability and Growth Pact as the basis for the official fiscal policy of EU, shall mean that the monetary and fiscal policies of the European Union are based on the monetary “fixed-rule” principle, renouncing the Keynesian attitude. Even though such a fiscal policy is based on the operation of automatic stabilisers, it shall not imply that, for instance, in reply to unexpected economic changes, which occur as a result of extraordinary situations, instruments of the discretionary fiscal policy allow for the restoration and maintenance of sustainability of public finances. The fiscal policy might be more effective if it was more centralized and the EU budget was used for this purpose.

It seems sound to presume that, given the presence of a single currency, we should consider not only the coordination of the monetary policy, but also the enforcement of a single fiscal policy, which, in its turn, requires to have one single treasury, uniform markets for products and services, labour, capital, and other resources, uniform revenue and finance system, as well as one common regulatory mechanism. Such a unitary economic system ought to ensure equal social guarantees for all inhabitants of its member states. Furthermore, the consolidation of markets would also necessitate a closer political integration between countries. Thus, in fact this would be quite a radical solution subsequently leading to a unitary European state. However, a question might arise whether rich countries would consent to sharing their wealth with poorer ones. Maybe they would prefer providing some financial support to the countries in trouble and introducing strict regulatory regime in such cases, because such a scenario is more convenient for them? Anyway, the present situation clearly demonstrates that the specific cardinal measures in the economic policy are needed to restore and strengthen the economy of EU.

In contrast to doubtful considerations of famous economists and pessimistic forecasts about the Euro, we are of the opinion that, if all the necessary decisions are taken, EMU with a single currency will survive and continue developing further on because that would bring economic benefits to all the countries of EU.

Conclusions

The following conclusions can be drawn from this analysis. The international role of the Euro and its international weightwas increased with the increase of economy in EMU and the whole EUduring the pre-crisis period. However, the present situation in the Euro zonehas shown that the principles relating to the formation of EMU have not been duly finalised yet and, in order to guarantee future for this union, a number of radical and well thought-out decisions are needed.EMUwith the single currency will have long-term perspectives only if specific radical measures, especially in the spheres of monetary and fiscal policy of EU and closer integration between the countries are taken.

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