THE STUMBLING EMU (EUROPEAN MONETARY UNION) : A BUMPY ECONOMIC INTEGRATION IN EUROPE

Will it be possible to have a single currency in Europe by 1999? The answer depends on how much the European Union (EU) wants monetary integration in spite of the current stormy weather. The EU became a single market at the end of 1992 to allow the free movement of labor, capital, goods and services within Europe, and a single currency system would mean increased efficiency. First, a European Monetary Union (EMU) would eliminate the cost of foreign exchange transactions and exchange rate hedging. Second, the citizens of the EMU would not have to exchange currencies. And last, the single European currency would be more competitive in the world currency market. However, the formation of a single currency system will not be easy. To avoid potential free-riders, the members of EMU need to eliminate their economic disparities before such a monetary integration.

The Original Plan

At Maastricht in December 1991, the desire for a more closer union among the peoples of Europe and a smooth integration was quite obvious. The leaders of the 12 member countries of the EU agreed that a single currency was a necessary part of the EU and would complete the final stage of the economic monetary unification. The Maastricht criteria were intended to eliminate economic disparities within the EMU. The key points of the criteria are:

(1) exchange rates must be stable within the exchange rate mechanism (ERM) for at least two years before selection for EMU membership is made;

(2) long-term interest rates must be within 2 percentage points and inflation within 1.5 percentage points of those of the three best-performing member countries in terms of price stability;

(3) public deficits must be no more than 3% of the GDP and the gross government debt must be no more than 60% of the GDP.

At Maastricht, the leaders of Europe declared that the single currency system (more precisely, the fixed exchange regime within the EMU) would be fully formed by the end of 1997, or at the latest, by the end of 1999. However, the 1997 target has already been abandoned. Originally, a majority of the EU's 15 members were required to meet the strict criteria of monetary integration, but as the deadline drew closer, it became clear that some of them were not ready for it. Britain and Denmark have already opted out of the EMU, and Italy is skeptical. According to the most recent plans, after the different currencies are linked in 1999, new European notes and coins, called the "euro," will be issued in 2002.

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The Burden of Budget Deficits

The biggest problem for the member countries of the EMU has been reducing their budget deficits. As of now, only Germany and Luxemburg meet the Maastricht criteria in full, and most members of the EU have a long way to go in meeting the criteria in general. Under the present Madrid agreement, on December 15, 1999, only those who qualify for the criteria will be able to join the EMU automatically; otherwise, countries with excessive budget deficits will have to pay fines of 0.25% of their GDP.

There is a deep conflict over the reduction of budget deficits. Lower deficits mean more investment and more jobs. The increased tax revenue will, in turn, further lower deficits and help pay off

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the accumulated debt in the long run. On the other hand, lower deficits will only come about by raising taxes or reducing public spending, meaning fewer jobs in the short run. The cycle of unemployment and the budget deficit is spreading everywhere.

Across the EU, one-tenth of the workforce is without jobs. The unemployment rate is 9.3% in Germany, 17% in Finland, and nearly 25% in Spain. Of course, lowering the budget deficit is not the only factor which is causing high unemployment. Many worry that lowering budget deficits and maintaining currency parities for the sake of the Maastricht criteria are accelerating the current recession in Europe. Germany, the biggest economy in the EU, is facing this dilemma right now. GDP growth stopped in the third quarter of 1995, and most forecasts for GDP growth are less than 2% in 1996. With higher unemployment, wages are still rising. Even though Germany will not need to make big cuts in government spending, the current stagnation may pose political obstacles toward the strong coalition of EMU.

How Many Will Qualify for the EMU by 1999?

Along with the economic problems among the EU members, there are also political problems. One concerns the date on which countries qualify for the EMU. All except France, especially Germany, agree that the selection should be made in early 1998 on the basis of the most recent, reliable and actual data for 1997. France, which faces elections in March 1998, wants selection done by the end of 1997, even if the final economic figures for that year are not available. France fears that its qualification for the EMU will become a divisive election issue. At the EU's Madrid summit on December 15, 1995, it was decided that the selection will be made as early as possible in 1998. According to EU estimates, eight of the EU's 15 members could qualify to join the EMU by 1999, but others think that the number could be as few as five.

What All This Will Mean

On January 1, 1999, the exchange rates of those who qualify for the EMU will be fixed. From that same day, the euro will exist in the European banking system, and new negotiable public debt will be issued in terms of euros. During the period from now until 1999, Germany will keep the Deutschmark lower to reduce burden on the other EMU countries in meeting the Maastricht criteria. On January 1, 2002, the euro will be used by the peoples of the EMU, and the national currencies of EMU members will cease to be circulated. At that time, the influence of the euro in the world exchange market will be much stronger than that of today's mark.

What does this all mean to Korea in particular? Korean exports to Europe have increased year after year, despite the relatively higher trade barriers after the formation of the EU. Korean investment in Europe has also been rising, which will increase the importance of the won versus euro exchange rate. All of these things will combine to cause the interdependency between Korea and the EU to become much greater. Today if the United States coughs, Korea catches a cold. In 2002, if the EMU coughs, Korea may have to go to the hospital. VIP

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