OPTIMALITY OF THE EURO CURRENCY AREA UNDER THE CIRCUMSTANCES OF THE EUROPEAN CRISIS

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Abstract: - This paper proposes an analysis of the euro currency area optimality. There are discussed the main criteria used in the literature for the assessment of the optimum currency areas: three classical economic criteria and three criteria of a political nature. Based on statistical data and results of various studies in the field the conclusion is that the eurozone is not an optimum currency area because there does not exist labor flexibility and efforts must be made in the field of taxation and political integration.

Key-Words: - optimum currency area, criteria of optimality, labor flexibility, fiscal transfers, diversification of production

1 Introduction

The economic and monetary union is the result of political decisions based on a strong economic component. With the advent of monetary unification, joining the European Union to new countries involved automatically joining the EMU, even if at a later date. The main consequences for the new EU member countries wishing to join EMU refers to the adoption of a monetary policy to facilitate the transition to monetary policy community and to ensure the fulfillment of the criteria on inflation, adopting an exchange rate regime compatible with EMS II, a financial sector development and the modernization of payment systems.

Any EU member state which meets the convergence criteria can join the euro area and there is no predetermined limit on the number of countries that can be integrated.

The economic advantages of euro coins replaced due to a single currency of the Member States aimed at eliminating the risk related to exchange rate, reducing transaction costs, increased price transparency and deepen financial markets. However, the euro also offers a number of indirect economic benefits such as macroeconomic stability, low interest rates, structural reform, the status of reserve currency and economic growth. The precious advantages of the euro are overshadowed by risks and uncertainties of the single currency. The main problems the economists have identified about the future single currency are related by the lost of sovereignty inherent in transition costs, costs incurred, economic shocks and the possibility of differences at the political level.

Transition costs include the inherent amounts spent to modify forms, price lists, labels, printed office documents, bank documents, databases, software, cash registers, ATMs and even computerized banking counters. Economic shocks refer to unexpected changes in the macroeconomic environment of a country or region that destroy the balance of production, consumption, investment, government spending and trade.

Member of a group or those joining a group can both win possession of a common currency only when they are part of an optimum currency area, when their economic structures are similar and there is no risk of asymmetric shocks affecting only some of these countries [1].

2 Criteria of optimality of currency areas

In terms of theory, Economic and Monetary Union is based on optimum currency area theory. This theory is based on the contribution of Robert Mundell, further developed by other economists like R. Mc Kinnon, Kenen. Although Mundell examined the criteria underlying the smooth functioning of a monetary union since 1961 when EMU was only in draft form, it has been proved that he sensed great challenges faced by countries
wishing to form EMU. Among the issues that generated the greatest interest in the optimum currency area criteria was the one on which a monetary area must meet to be an optimum currency area.

Robert Mundell has identified a number of criteria that a country must meet to be part of an optimum currency area: the symmetry of external shocks, the degree of labor mobility, openness of the economy, the level of economic diversification. Thus, optimum currency area is that area which allows certain properties that make asymmetric shocks to be absorbed without having to use the exchange rate or monetary policy instruments. The role of optimum currency areas theory is to identify whether it is good for two or more states to create a monetary union.

In his works he describes the money as a space where inputs, especially labor, are perfectly mobile. From this set we can see that the optimal monetary circulation of a coin is determined by using geographical landmarks or according to political criteria of territorial states, but by reference to economic criteria of the degree of internal and external mobility of production factors. Mundell has made two conclusions:

1. In the case that in various regions there are manifested symmetric shocks, whose impact is similar, it is appropriate to adopt a regime of fixed exchange rates or monetary union achievement between regions, the single monetary policy adjustment is a good mechanism for these shocks.

2. In the case that the impact of the shocks is asymmetric, there comes the question of the existence of other adjustment mechanisms than exchange rates and the irrevocable fixing them or making a monetary union requires in advance a strong labor mobility between regions affected and / or flexibility wages.

An additional criterion to define optimality of currency areas is the degree of diversification of production, identified by Peter Kenen. It showed that states in a reduced range of specialized products are more likely victims of shock. Economies with a diversified production structure does not deal with demand shocks exported goods, diversification of production structure making negative shock produced by a drop in demand for a property to have little impact. Asymmetric shocks have a moderate effect on the economies with high degree of diversification of their production structure, the information more easily achieving monetary union.

Another criteria defining optimality of currency areas was introduced by Ronald McKinnon and refers to the openness of the economy. Economist showed that an increase in the openness of the economy reduces the usefulness of changing exchange rates as a means of restoring external competitiveness and void the effectiveness of monetary policy as autonomous, in the case of an open economy, depreciation is rapidly convey internal prices. McKinnon is the one who gave a clear definition of the concept of optimum currency area "an area where a single currency, which has flexible exchange rates against other currencies of the world, is the best solution to achieve three important objectives for any economics: full employment of labor, price stability and external balance. "[2]

The three criteria presented, considered classical, plus three other criteria are policies that are in charge of the extent to which different states should assist each other if they will face asymmetric shocks. This category frames criterion according to which a transfer of optimum currency area states agree to help each other if they are affected by asymmetric shocks. Another criterion is the homogeneity of a political preferences according to which EU member states must demonstrate that they have a common understanding of the reaction to shocks. It is considered therefore that the asymmetric shocks do not pose problems as long as each state responds to shocks in the same way. If member states do not share the same currency area regarding those preference on the agreement, each common central bank will want to follow different policies, leading to controversy and will affect the entire monetary union.

A final criterion is that of solidarity implies a degree of solidarity among citizens. When the common monetary policy generates conflicts of national interests, states that form a monetary area must accept the costs on behalf of a common destiny. This is one essential criterion in the current crisis facing the economic and monetary union, an idea supported by renowned researchers' , "common solidarity can not be avoided in a monetary union, even if this involves sitting at table with sinners. "[3]

3 Analysis of Economic and Monetary Union from the perspective of optimum currency area theory

After we have structured based on extensive professional literature on which criteria can be appreciated as an optimal currency area in terms of
research, we consider it properly to study these criteria of Economic and Monetary Union.

Between member countries of the Economic and Monetary Union there are differences in point of the legislation, differences in rates of growth between tax systems, etc. The problem seems to be to what extent these differences are relevant, so their presence to prevent the achievement of monetary union, because differences may exist in an optimal monetary union.

To analyze the Economic and Monetary Union from the perspective of Mundell's criterion we have to turn to labor flexibility, which in most literature and studies it is quantified by the flexibility of labor legislation, active labor market efficient as a percentage of GDP, the degree of fiscal memory and the degree of unionized labor.

Table 1: Hierarchy of European countries as members of the OECD EPL index

<table>
<thead>
<tr>
<th>Rank</th>
<th>Country</th>
<th>Protection of permanent employees against individual dismissals</th>
<th>Regulation of temporary employment</th>
<th>Specific regulations for collective dismissals</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>United Kingdom</td>
<td>0.46</td>
<td>0.17</td>
<td>0.48</td>
<td>1.11</td>
</tr>
<tr>
<td>2</td>
<td>Ireland</td>
<td>0.67</td>
<td>0.25</td>
<td>0.40</td>
<td>1.32</td>
</tr>
<tr>
<td>3</td>
<td>Hungary</td>
<td>0.79</td>
<td>0.46</td>
<td>0.48</td>
<td>1.73</td>
</tr>
<tr>
<td>4</td>
<td>Denmark</td>
<td>0.63</td>
<td>0.58</td>
<td>0.65</td>
<td>1.86</td>
</tr>
<tr>
<td>5</td>
<td>Czech Republic</td>
<td>1.38</td>
<td>0.21</td>
<td>0.35</td>
<td>1.94</td>
</tr>
<tr>
<td>6</td>
<td>Slovakia</td>
<td>1.46</td>
<td>0.17</td>
<td>0.42</td>
<td>2.05</td>
</tr>
<tr>
<td>7</td>
<td>Finland</td>
<td>0.92</td>
<td>0.79</td>
<td>0.43</td>
<td>2.14</td>
</tr>
<tr>
<td>8</td>
<td>Poland</td>
<td>0.92</td>
<td>0.54</td>
<td>0.68</td>
<td>2.14</td>
</tr>
<tr>
<td>9</td>
<td>Austria</td>
<td>1.00</td>
<td>0.63</td>
<td>0.55</td>
<td>2.18</td>
</tr>
<tr>
<td>10</td>
<td>Netherlands</td>
<td>1.29</td>
<td>0.50</td>
<td>0.50</td>
<td>2.29</td>
</tr>
<tr>
<td>11</td>
<td>Italy</td>
<td>0.75</td>
<td>0.88</td>
<td>0.82</td>
<td>2.45</td>
</tr>
<tr>
<td>12</td>
<td>Belgium</td>
<td>0.71</td>
<td>1.08</td>
<td>0.68</td>
<td>2.47</td>
</tr>
<tr>
<td>13</td>
<td>Germany</td>
<td>1.13</td>
<td>0.75</td>
<td>0.63</td>
<td>2.51</td>
</tr>
<tr>
<td>14</td>
<td>Sweden</td>
<td>1.21</td>
<td>0.67</td>
<td>0.75</td>
<td>2.63</td>
</tr>
<tr>
<td>15</td>
<td>Romania</td>
<td>0.83</td>
<td>1.20</td>
<td>0.73</td>
<td>2.80</td>
</tr>
</tbody>
</table>
EPL index reflects aspects of labor market regulations in order to distinguish and to compare between inflexible countries and flexible countries. EPL composite indices used in the analysis include individual protection against dismissal, temporary employment contracts and collective dismissals protection.

Labor market rigidities lead to an increase or to maintain long-term unemployment, as it results from the literature made by central banks or by international bodies. Labor market rigidity affects mainly the young employees and those with low levels of training. United States (0.85) and UK (1.11) recorded the lowest levels of labor market rigidities, and Portugal, Spain and Greece registered high levels of labor market rigidity, which creates pressure on the economy especially in periods of crisis and which may explain some of the current serious difficulties adapting to changing market work its drastic austerity plan imposed by that which implements it.

United States and United Kingdom recorded the lowest levels of labor market rigidities in the labor on indefinitely period of time contracts.

The dismissal (the legal process of impeachment can begin) is of one day in the U.S. and 20 days in Portugal. According to OECD calculations, Italy recorded the largest decrease in stiffness in temporary work contracts, but notable developments were registered by Denmark, the Netherlands, Belgium and Sweden. France in turn has seen an increase in rigidity of the labor market. Labor market flexibility has a significant impact on decreasing frictional unemployment (composed of people in transition between jobs). Countries that have adopted measures of labor market flexibility have seen the best results on employment growth. Stringent conditions of employment protection is an additional cost to the employer, which discourages investment. Active labor market interventions (LMP) refers to the participants in the labor market whose main activity is actively seeking a job and ends by changing their status on the labor market.

PML government intervention measures aimed at providing temporary financial support for disadvantaged groups in the labor market. Most measures are aimed at activating the unemployed, support for people moving from inactivity (involuntary) to employment or maintaining employment for people threatened by unemployment.

As you can see from the chart, the share of expenditures for active labor market policies in GDP is not changed like in the EU in 2009 facing 2004. Thus, in countries such as Belgium, Czech Republic, Estonia, Ireland, Greece, Spain, Italy, Latvia, Lithuania, Hungary, Poland, Portugal, Slovenia and Slovakia increased their share, because the other countries, including Romania and its share reduced. At the highest level of 2009 is recorded in Belgium 3.791% 37, followed by Spain with 3.747% and
lowest in Romania 0.455% for the EU 27 average to be at 2.174%.

In terms of labor taxation it can be seen in the year 2009 the highest level of tax burden of work was recorded in Belgium 49.4%, and lowest in Malta 17.7%, while the EU average 27 was 39.3%. In terms of evolution 2009 compared to 2004 levels of labor taxation in most countries we can notice see that it sank, except France, Italy and Hungary.

![Fig2. Tax wedge on Labor Costs 2004-2009][6]

The degree of syndication, the last indicator based on which appreciates the flexibility of labor is determined by dividing the number of union members and employed population. According to a study conducted by FedEE in 8 of the 27 European Union member states more than half of the employed population belong to unions. Moreover, countries with the largest population in the EU have low levels of syndication as Italy 30% UK 29% Germany 27% and France with 9% [7]. As a result three of four employees of the European Union are not members of a union.

From the table we can see that the syndication is very different between countries in the euro area, from values between 10% -19% in Slovakia and pain to more than 90% in Finland EU now promoting flexicurity: that labor market flexibility with security workers. Spain to more than 90% in Finland EU now promoting flexicurity: that labor market flexibility with security workers. When the EU took into account only flexible "labor market had no benefit from the increase in short-term employment contracts." Rather, flexibility had a negative impact on the market to create long term jobs and market segmentation - that is its polarization between well paying, secure and accompanied by benefits, respectively, low-paid jobs, no security and no social protection - has increased.

### Table no. 2 degrees of syndication in the EU

<table>
<thead>
<tr>
<th>More than 90%</th>
<th>Finland</th>
</tr>
</thead>
<tbody>
<tr>
<td>80%-89%</td>
<td>Belgia</td>
</tr>
<tr>
<td>60%-69%</td>
<td>Italia</td>
</tr>
<tr>
<td>50%-59%</td>
<td>Cipru, Luxemburg</td>
</tr>
<tr>
<td>30%-39%</td>
<td>Austria, Irlanda, Slovenia</td>
</tr>
<tr>
<td>20%-29%</td>
<td>Germania, Grecia, Olanda, Portugalia</td>
</tr>
<tr>
<td>10%-19%</td>
<td>Slovacia si Spania</td>
</tr>
</tbody>
</table>


Ten Member States (Belgium, Germany, Austria, Ireland, France, Italy, Luxembourg, United Kingdom, Malta and the Netherlands) still maintain restrictions on employment in Romania and Bulgaria, a right which they have until 2014 Under the Accession Treaty as happened in countries that joined in 2004. Europeans do not yet know the potential benefits of mobility and what is more important, also continues to face practical obstacles, legal and administrative, such as high rents and poor housing supply, difficulty in finding a job for spouses and partners, lack of information on the portability of pensions, linguistic barriers and difficulties to be recognized overseas qualifications.
In the euro area does not exist workforce mobility, which means that in the event that an asymmetric competitiveness. This has happened to the unemployment rate that has increased dramatically during the crisis, ranging from 6.8% (in 2008) to 9.6% (in 2010).

Another criterion of optimality of a monetary zone is on the openness of the economy of member countries. Opening the economy is defined as part of economic activity devoted to international trade, so the ratio between the sum of imports and exports and GDP. Recent studies [8] shows that this criterion is met in open economies in the euro area. Most countries in the euro area are very open, especially the smaller. Luxembourg is the country with the highest values of openness over 100%, unlike Spain, heavyweights, France and Italy where the values are ratios below 25%.

Criteria related to the diversification of production can be considered as fulfilled by any of the countries in the euro area which is not exclusively dependent on one product, which is likely to result in mitigation of asymmetric shock.

Regarding the criterion on fiscal transfers the Community budget, representing about 1.1% of EU GDP, is clearly insufficient for fiscal redistribution activities. A special effort should be made by politicians in netto-donor states to persuade the public that such transfers are made and with interest, including the phenomenon of migration to stabilize the new member countries. On the other hand, fiscal transfers, capped at a maximum of 4% of GDP recipient countries appear to be sufficient at this time (even excessive, given the limited capacity of absorption). Moreover, the countries of Eastern Europe can attract quasi-fiscal transfers more important, both by private remittances of workers abroad, and through services like tourism.

4 Conclusions

Analysis of the euro area in terms of optimality show that only some of the criteria are met. According to Mundell's criteria can not be a European Union optimum currency area because of labor immobility. Analyzed in all the criteria of optimum currency areas, the EU characterized by high capital mobility, a degree of integration of capital markets, diversification of production, trade openness and similarity of inflation rates and a low mobility of labor and little flexibility in prices and wages.

Although not optimum currency area criteria are met, we can appreciate that this is possible in the future because the scale of history, the European

References:
[1] EIR, the European Union: Economic and Monetary Union, 2005, page 6