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Winners and Losers in the European Economic and Monetary Union: Is Unity a Way-Out for Europe?

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Abstract: This paper explores the economic and political impact of the European Monetary Union (EMU) on its member states and analyzes whether deeper unity is the solution for Europe. The paper begins by tracing the history of EMU through its three stages, reiterating the fundamental goals of economic integration and stability. Then, through a specific case study on the different experiences of countries such as the United Kingdom, Italy, Germany, and Greece, the paper shows the "winners" and "losers" shaped by the constraints and benefits of the single currency. The paper also discusses potential solutions for the improvement of EMU, such as fiscal integration, enhanced economic governance, and a more flexible framework, while talking about their possible economic and political impacts. The conclusion reflects on the need for a balance between deeper integration with flexibility to adjust different economic conditions and political realities of member states. The paper believes that finding a sustainable path that can reach the goals of economic stability, growth, and political cohesion will determine the future of EMU.

Keywords: European Monetary Union (EMU), Eurozone, Fiscal Integration, European Integration, Monetary Policy.

1. Introduction

Under the framework of the European Union (EU), the Economic and Monetary Union (EMU) has been one of its most important projects of regional economic integration, established in 1999. Since then, the EMU has played an important role in fostering economic stability, encouraging free trade, strengthening the relationship between the member states, and integrating member states more closely with the EU. This goal has been further promoted by introducing a unified currency—the euro.

The EMU was first believed to be a hope to boost the European economy. However, the crucial fact has significantly challenged the confidence of the member states. As the nightmare shrouded the whole world in a sudden in 2008, starting from the United States, the international economy had experienced a severe “earthquake”. What’s worse, the EMU’s "one-size-fits-all" monetary policy, which does not account for the diverse economic conditions of its members, further exacerbate the situation of the member states [1]. The state members had been struggling in huge amount of debt, and this continued result in their austerity measures and long-term stagnation.

Although the recovery after the crisis is successful, the cracks of confidence expand in silence. A widespread debate on whether the benefits of a common currency outweigh the costs and whether deeper integration or a potential disintegration of the Eurozone would be more beneficial for Europe's future has started, and even till now, the result is still unknown [2]. While the supporters believe that a more integrated fiscal and political union is needed to stabilize Europe and increase the influence of Europe on the international stage, the opponents have raised their concerns about the potential conflict inside the union driven by various factors, such as the differing economic philosophies, historical backgrounds, and national interests.

Thus, considering the ahead information and debates, this paper will offer a critical view of the winners and losers in the EMU framework based on data analysis, examine the root causes that lead to those differences by detailed case studies, and discuss whether a move towards greater unity could provide a way out for Europe.

2. The History of the EMU and Euro

After WWI, facing the increasing states in Europe, a sense of insecurity and instability of the European economy grew in people's hearts, and Gustav Stresemann soon raised the idea of setting a united European currency in the League of Nations in 1929 [3]. And as unity seemed to be a way out at that time, the idea of establishing the EMU had been raised. Finally, in 1988, with the debates on establishing EMU continuing heated, the President of the European Commission, Jacques Delors, decided to launch the project of EMU to create a stronger economic and monetary union at the Hannover Summit. As the EMU was established, the history of its development can be mainly divided into three periods, which also reflect the stages that the EU gradually integrated in the fiscal part.

The first stage was from 1990 to 1993, during which the union mainly focused on the free movements of capital between the member states. On this stage, the member states tried to enhance economic convergence and cooperation by eliminating exchange rate fluctuations and facilitating capital flows inside Europe. In 1992, the most important document, the Maastricht Treaty, was enacted and soon put into use. According to the treaty, convergence standards related to inflation, public debt, budget deficits, exchange rate stability, and long-term interest rates were established, requiring every member state to reach these criteria to join the union [4]. This treaty had helped to establish essentially similar economic conditions in member states, paving the way for the subsequent introduction of a unified currency.

During the second stage, which was 1994–1998, the European Monetary Institution (EMI) was established. The EMI was responsible for strengthening cooperation among national central banks and preparing for the creation of the European Central Bank (ECB) and the Euro. At the same time, the Stability and Growth Pact was adopted to enforce the member states to meet the standards set out in the Maastricht Treaty. In 1995, Austria, Finland, and Sweden joined the European Union, which constantly increased the status of the EU. As the process had been gradually promoted, in May 1998, Euro was finally introduced, and the ECB soon replaced the EMI. These changes symbolized significant achievements of the EU' s fiscal integration, promoted the economic recovery and growth in the Eurozone, and indeed enhanced the power and voice of European countries on the international stage as a united force.

Finally, the third stage started in 1999, when the euro was introduced as an electronic currency for eleven EU member states, representing the official establishment of the EMU. On this stage, the power of the central bank in every single member state was delegated to the ECB, and the exchange rates between the euro and national currencies were locked down. In 2002, the Euro was finally introduced in physical form, becoming the only legal currency in member states. Till then, the member states of the EU increased to eighteen, which included Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia, and Spain.

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However, under the hope brought by the unify, potential threats and problems still exist. It is believed that while the third stage solidified the Eurozone, it also highlighted the structural challenges of a single monetary policy without a centralized fiscal union [1]. The outbreak of the fiscal and economic crisis later revealed the limitations of the EMU, showing its inability to address shocks arising from differences in economic fundamentals and national circumstances among member states.

3. The Economic and Political Impact

After Euro and the EMU were introduced, the impacts brought by the introduction are complex and varied. It’s obvious that the unification of a single currency, the Euro, has constantly decreased the transaction cost in the Eurozone, increased trade between the member states, and enhanced the investment flows. This has significantly contributed to economic growth and stability in the region. In contrast, the unify also results in the problem that member states have lost their flexibility in designing their own fiscal monetary policies and exchange rates. Due to the different national circumstances, the debts of some member states have increased and experienced severe economic crises. To be specific, this section will take Germany, Greece, the United Kingdom (UK), and Italy as examples to analyze the impacts of the EMU.

As one of the most successful countries in the EMU, Germany has seen significant growth in its economy in recent years. As the Euro has been widely used, it provides Germany with great opportunity to export its goods across Europe without the risk of currency fluctuations, which increased the substantial trade surplus. Since the Euro was relative undervalued compared to national currencies like the Deutsche Mark, Germany's export competitiveness has greatly enhanced, benefiting its manufacturing sector and overall economic growth [5]. Besides, the Gross Domestic Product (GDP) of Germany has gradually grown from 2564.4 billion euros to 3867.05 billion euros from 2010 to 2022, which has been one of the largest economies in Europe [6]. However, the development of its economy also brought more responsibility toward Germany on an international political aspect. Germany has been responsible for supporting financially weaker members in the Eurozone through bailout packages and debt restructuring agreements, which result in the dissatisfaction of politics and occasionally debates inside Germany [7].

Greece, however, has been suffering from substantial debts and an economic crisis since joining the EMU. With the vulnerable economic structures and the crash of the global financial crisis of 2008, the public debt levels of Greece triggered a sovereign debt crisis, driving the whole country into severe problems. At the same time, as the currency became depreciate quickly, the Greek government had no choice but to tighten the fiscal policy, which led the society to fall into a greater recession, high unemployment, and severe social and political instability. Its experience reveals the risks of economic divergence within the EMU and the limitations of a "one-size-fits-all" monetary policy that cannot address economic and financial crises effectively [1].

When it comes to the UK, it appears to be the unique one. The UK was the minority of the member states that chose to leave the EMU and not adopt the Euro, which helps to retain Britain’s own monetary sovereignty and control over economic policy. This decision ensured its flexibility in setting interest rates and exchange rates, which became especially important during the economic crisis. For example, the Bank of England was able to implement a series of measures, such as promoting a significant devaluation of the pound, that helped stabilize the economy during the financial crisis in 2008. Additionally, it also protected the UK from the severe debt crisis of the early 2010s in the Eurozone. However, this also decreased its connections with the EU, and as soon as Brexit took place, the free trade of the UK inside the Eurozone became even harder. As the UK highly depends on its exports, this has constantly brought difficulties to the economy of the country. Meanwhile, it also caused a crisis of confidence in the government and shaken the UK's international status, which will have negative effects on its long-term stable development in politics and society. More and more debates took place, where concerns about economic control, migration, and sovereignty were central to them [8].

Italy's experience with the EMU is totally different from that of the UK. As one of the founders of the Eurozone, Italy started to use Euro since 1999. Unfortunately, Italy has struggled with stagflation, high public debt, and structural inefficiencies. And the loss of independent monetary policy and exchange rate flexibility has exacerbated Italy's situation since Italy is unable to devalue its currency to regain competitiveness against other economies, such as Germany. The long-term stagflation will soon result in the dissatisfaction of the public, pushing populist and Eurosceptic sentiments toward their peak. Some parties, such as the Five Star Movement and the League, have gained more and more power, enhancing their political status. This has not only resulted in the continued questions on whether Italy should continue to participate in the Eurozone but also led to the political instability of Italy [9].

In conclusion, the influence of introducing the EMU and Euro shows differences among different countries due to their special national circumstances, in which countries such as Germany seem to be the winners and others such as Greece and Italy seem to be losers. To be specific, on one hand, the EMU and Euro have significantly lowered the international trade barriers and increased the fluency of investment in the Eurozone, which became beneficial for those high-competitive economies in Northern Europe, such as Germany, and increased their trade surplus. On the other hand, it also comes with a loss of a country’s own sovereignty in proposing their own fiscal policy and interest rate flexibly. Combining with the weak economic basis of the Southern European countries, such as Greece, the unity has exacerbated their situation. And this leads to an enlargement of the economic gap in the Eurozone, which leads to a rise in populist movements across Europe, challenging the notion of "ever closer union" and questioning the viability of a one-size-fits-all approach to European integration [2]. Thus, here comes the question we discuss today in this paper: Is unity still a way-out for Europe?

4. Potential Solutions and Reform

We cannot deny the effort of the EMU during the recovery period; however, more and more questions come to stage as it develops. The problem of disparities caused by the uneven development of the EMU is growing. If unification is no longer the so-called answer and a new way remains unclear, then the trust of the allies will continue to break down, causing even greater shocks to the situation in Europe as a whole. But still, apart from the pessimism on the future of the EMU, some experts argue an idea that deeper integration or significant reforms are necessary to address the structural flaws of the EMU, which will change the current situation and reach the potential goals. This paper will focus on the three primary pathways to improve the EMU: fiscal integration, enhanced economic governance, and more flexible EMU structures.

To start with, further fiscal integration has always been a controversial solution to the problem. It’s suggested that the EU should create a centralized fiscal authority capable of conducting fiscal policy across the Eurozone. Thus, a common Eurozone budget, a shared fiscal policy framework, or mechanisms such as a European unemployment insurance scheme could take place, serving as an automatic stabilizer when facing accidentally economic shocks. Since it highly centralized the authorities of the member states on their fiscal aspect and shared the risks over regions, it is believed to be helpful to reduce the aftereffects of the previous unification system, which repatriated the freedom of the member states on policymaking and eliminated the ability of member states to face the economic challenges. Other supporters of fiscal integration also argue that it would help reduce the economic gap between member states by providing financial support during downturns and promoting economic convergence. For example, a Eurozone budget could fund investments in

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infrastructure, education, and innovation, boosting growth in weaker economies [10]. However, since the shared financial risks increased due to the integration, countries like Germany and the Netherlands, which have benefited from this system before, have been cautious about the further fiscal integration due to their worries about the permanent transfers and moral hazard led by the integration [11]. Thus, leading to a long-term debate on this potential solution.

Another idea to solve the problem is to enhance the economic governance of the EMU. This focus is on improving the current EMU framework in order to better coordinate economic policies and enforce fiscal discipline. Proposals such as creating a European Finance Minister, further enforcing the Stability and Growth Pact (SGP), and promoting structural reforms to increase productivity and competitiveness have been raised in this solution. And as the great tragedy of Greece's economy was mainly driven by its poor fiscal management and lack of structural reforms, this idea is suggested to be a great way to avoid those structural crises taking place once again [12]. However, critics hold the opinion that simply tightening the rules without offering investment to help the long-term growth of the economies will only exacerbate the division and inequality between the countries and result in the dissatisfaction of the society. Therefore, the enhancement of governance must be coordinated with the promotion of economic growth and balanced with social policies.

Last but not least, some experts suggest that establishing a more flexible EMU structure that can adjust the diverse economic conditions and preferences of its member states will be a better choice. This idea involves creating mechanisms for orderly exit or temporary suspension from the Eurozone for member states that are facing severe economic difficulties. And it also allows differentiated integration, so some countries can move toward deeper integration while others remain at a more basic level of cooperation [13]. In this way, it provides countries, such as Italy and Greece, which have been struggling with severe economic crises due to the constraints of the Euro, more flexibility and opportunities to recover and develop their economies. It also allows them to adjust themselves without breaking the stability of the whole Eurozone. Meanwhile, it provides countries, such as the UK, to further cooperate inside the EU while satisfying its need to maintain its strong sovereignty in the economic area. However, the main problem of this solution is that a more flexible EMU could eliminate the credibility and cohesion of the Euro, which may potentially lead to an increase in financial instability.

In brief, among all the solutions that have been raised nowadays, the same message that has been conveyed is that we must find a balance between further integration while maintaining enough flexibility. None of the solutions could be perfect; thus, more negotiations must be promoted. A combination of enhanced fiscal integration, economic governance, and flexibility is necessary to solve the challenges the Eurozone has faced. With the legacy of the Eurozone crisis remaining and the rise of populist movements, finding a sustainable path for the EMU for the future of European integration is in urgent need.

5. Conclusion

Standing on the crossroads of future development, the EMU has faced complex economic and political challenges. As the populism movements and Euroscepticism gradually increase and spread over Europe, its sustainability and effectiveness have been questioned, and its credibility has been challenged. A fundamental problem in EMU is dealing with the need for economic integration and solidarity versus the importance of maintaining national sovereignty and economic flexibility. Through the analysis of the history of EMU, the experiences of its member states and possible solutions show us that while the euro has brought significant economic benefits and promoted integration in the past, the member states call for more flexibility nowadays. The potential solutions lie within the cooperation of fiscal integration, improved economic governance, and more flexible EMU structures. Each of them offers ways to address the Euro area's challenges, but they also involve

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trade-offs between the two. Thus, when it comes back to our topic today: Is unity still a way out for Europe? It has to be said that the way forward for the EMU is likely to be a combination of these solutions and balance deeper integration with flexibility to adjust to the diverse needs of different economies. There's no specific winner and losers in the EMU; every member state has faced their own need, and cooperating is the way for all. However, the flexibility of the policy must be ensured during the further unity. Only with careful and well-coordinated fiscal integration, enhanced governance, and the capacity for differentiated integration can a more sustainable EMU be established, and only by addressing both economic and political challenges can the EMU hope to evolve into a more resilient framework that supports the long-term stability and prosperity of all its member states.

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