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DOES MONETARY UNION MEAN THE EU SHOULD CO-ORDINATE FISCAL POLICY?

Let us begin by saying that the model that has been chosen by the EU for its Monetary Union is called the 'Mastricht model'. The Mastricht Treaty has been agreed at the Maastricht summit in December 1991 and includes four chapters relevant to the creation of European Monetary Union (EMU). These were provisions of the Maastricht Treaty, as well as the set of arrangements and agreements, the most important of which is the Stability Pact on fiscal policy, that will be mentioned later in this work. The Maastricht Treaty emerged thank to Delors Committee Report produced in April 1989, established to examine the way forward for the European Monetary System (EMS), and that called for a full Monetary Union to be set up in three stages. The Report welded two Intergovernmental Conferences (IGCs)[1]. They in turn prompted the Maastricht Treaty, which constitutes the current stage of the monetary integration in the European Union. It is important to mention that in the Article 3 of the Treaty guidelines for both the EMU member countries and other EU members for accomplishing aims of European Union have been outlined. They concern employing economic policy basing on strong co-ordination of the member countries' home policies and their domestic markets, as well as on outlining common aims in accordance with the principle of an open market economy with free competition. As far as monetary policy is concerned, the Article included setting rate exchange, leading to establishing one currency, defining and conducting one monetary policy and the rate exchange policy, whose primary objective will be to maintain price stability.

It is important that the member countries regard their economic policies as the common concern and co-ordinate them through Economic and Financial Affairs Council (Ecofin Council). Let us now focus on the three stages in which EMU had to be achieved and draw the attention to important aspect of convergence criteria.

The first stage (that lasted up until December 1993) was to consist of the completion of the single market as well as removing obstacles in free movement

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[1] Overturf S.F., *Monetary and European Union, Appendix 3*, Maastricht Treaty, St. Martin's Press 1997, s.241-265.

of capital[2]. Moreover, the EMS (European Monetary System) has been strengthened and the role of the European Currency Unit (ECU) has been extended.

In the second stage (1994-1998) institutional and law changes in the banking systems of the member countries have been introduced. They allowed the creation of the European System of Central Banks (ESCB), which is the independent body responsible for the conduct of monetary policy and the foreign exchange operations. ESCB comprises European Central Bank (ECB) and national central banks. In addition, ECB is modelled on the Bundesbank, which is beyond any political control and has fixed objectives such as low inflation (Article 3b). Furthermore, it replaces the transitional European Monetary Institute (EMI) and is the independent issuer of currency. Moreover, a number of guidelines for economic policies of member countries have been accepted. They include the need of fiscal consolidation of the member countries, establishing policies aiming to accomplish economic growth, convergence, as well as growth of employment. The earlier mentioned convergence criteria (conditions for adaptation of single currency for member states) from Maastricht are the following[3]:

- price stability (inflation criterion): a rate of inflation not more than 1,5% above the average of the three lowest inflation countries in the year before decision
- exchange rate criterion: no realignments within the ERM (European Exchange Rate Mechanism)
- interest rates criterion: long-term interest rates to be no more than 2% above the average of those in the three lowest-rate countries
- the following fiscal criteria of convergence concern key fields for counties' economy and finances: a maximum annual budget deficit of 3% GDP , a maximum total public sector debt of 60% of GDP

Jeremy Richardson notes that monetary union would be very problematic if not impossible at an acceptable economic and political cost without a considerable degree of economic convergence among EU states[4]. Convergence criteria have a double task. They should allow for easier currency unification by bringing nearer economic situations of the member countries. If the basic economic rates of those countries change in a similar way then their exchange rates will stabilize and it will be possible for them to accept single currency. In addition, if there was no restrains concerning public sector debt or budget deficit, countries could fall in debts and cause Union's rise of interest

[2] A. Nowak – Far, *Unia Gospodarcza i Walutowa w Europie*, C.H. BECK, Warszawa 2001, s101.

[3] De Grauwe P., *Economics of Monetary Union, Oxford University Press 2000*, s.130-131.

[4] Richardson J., *Power and Policy- making, Routhledge, London/New York 2001*.

rates. Employing by the countries a strong expansive budget policy could result in weakening of European currency[5]. In Monetary Union the policies of the member countries are tightly dependant on one another, therefore each decision taken in one country has its effects at the whole Union's territory.

Finally, the third stage for accomplishing EMU began in 1999 and it was significant because of the introduction of Euro as the single common currency. In 2002 Euro has been let into circulation in 12 countries, that complied with the objectives of EMU.

Furtheremore, it is important to note that Monetary Union offers advantages but it also brings certain costs. Advantages are mainly associated with making the common market work more effectively. EMU reduces transaction costs as well as uncertainty and risk for trade and capital movements. It also increases the transparency of prices since all values and prices are denominated in the same currency, which should make economic decisions more rational. The main cost of introducing Euro is the fact that member countries will lose important instruments of the economic policy. The single currency means no possibility of carrying out monetary policy within one country. In addition, all the functions concerning currency and the level of interest rates were taken over by ECB.

Let us now move to the second key issue in this work, namely fiscal policy. Stability and Growth Pact (SGP) is the most notable of the agreements made in order to complete the model of EMU[6]. It seeks to control post-EMU fiscal policy by projecting the Maastricht fiscal criteria into the future. Main features of SGP were agreed at the Dublin Summit in December 1996 and were included in the Amsterdam Treaty of 1997.

The Pact aims to ensure fiscal rectitude in EMU by codifying the Excessive Deficit Procedure, that was outlined in the Maastricht Treaty. Countries conduct their own fiscal policy, but national budgets are to be controlled by limiting government borrowings to the Maastricht level of 3% of GDP per annum, with a maximum public debt of 60% of GDP. In fact countries can spend more but in order to do so they have to raise taxes, severely limiting public spending in the context of free movement of labour and capital.

Countries, which deviate from this position are subjected to fines. Germany and France did exceed the budget deficit of 3% but after being brought by the Commissions to the European Court of Human Justice they avoided the penalty[7]. This in turn gave rise to the discussion about modification of SGP, as well as about the size of budget deficit and public sector debt.

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[5] *General Report on the Activities of the European Union1997. European Commission*, Office for Official Publications of the European Union Brussels, Luxemburg 1998

[6] Barkin N., Cox A., *EMU Explained. The Impact of the Euro, Appendix 4*, Stability and Growth Pact, Kogan Page, London 1998, s. 209-214

[7] J. Blitz, Fazio calls for spending cuts, „*Financial Times*," London, 23 April 1998

Last but not least, the rule of subsidiarity concerns the division of competences between the Union and national institutions. According to this rule, there are policies that are conducted on the central level (like for example monetary policy) and those conducted at the national level. In addition, the majority of economic policies in the Union are conducted by support not by replacing actions of the national level. Therefore there is no need for unification but merely co-operation and co-ordination, keeping in mind the common interest like in the case of macroenomic policies (Maastricht criteria). In addition, convergence rule states that different levels of economies become similar in the Union. Common patterns e.g. in production or management started to form. Needless to say, similar economies mean similar governmental actions (regulating, intervening) [8]. Furthermore, Economic and Monetary Union are based on the convergence programme concerning general level of prices and public finances. Primary objective of the monetary integration is price and interest rates stability. Whether it is effective or not depends on the budget discipline. In other words, it depends whether countries are able to keep low level of budget deficit in public debt.

To summarise, together with the establishment of Monetary Union, member countries have passed only their financial policy over onto the supernational level. Each member country of EMU is free to conduct their own fiscal policy, which is precisely the reason why it should be coordinated. The body that does this function is, as mention at the beginning, Ecofin Council. It has power to co-ordinate macroeconomic policy of the Euro zone countries including fiscal policy, but it also coordinates their policy with the policy of EU countries, that are beyond Monetary Union. If we take into consideration the fact that the policy in EMU is decentralised, there is a risk that countries will conduct too loose fiscal policy creating a danger of inflation. The European System of Central Banks is there to eliminate this danger. The additional protection for ensuring fiscal rectitude (apart from Maastricht Treaty) is Stability and Growth Pact. It contains detailed procedures concerning coordination of economic policies and surveillance over the fiscal policy. It requires the Euro zone countries to aim to achieve balanced budget to achieve an excess in the budget.

To emphasize once more, membership in Monetary Union disables countries to conduct their independent financial policy. The fiscal policy is merely a way to react for a sudden fall in the economic performance and unemployment growth. It also plays a major role in balancing economic development of individual countries.

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[8] J.D. Hansen (red) *Ekonomiczne aspekty integracji europejskiej*, Oficyna Wydawnicza, Kraków 2003, s. 201-209.

Lastly, the EMU member countries are aware that today's solutions concerning fiscal policy are not perfect. If we moved the fiscal policy onto the supernational level there would be a radical change in the situation. It would cause centralizing countries' budgets as well as enlarging financial transfers in favour of the economically weak countries. That for some nation states would be difficult to accept. There is no evidence, however, that making better use of all the chances that Monetary Union gives one should limit fiscal autonomy for precise regulating, so that equal interest rate was appropriate for everyone.

Summary

Monetary Union has caused a full harmonisation of the financial policy. Country's accession to the Monetary Union means that it needs to conduct its economic and fiscal policy complying with the public finance's discipline. In addition, it is a meaningful factor of the country's economic growth.

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