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THE ROAD TO MONETARY UNION

Richard Pomfret
University of Adelaide

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Richard Pomfret
University of Adelaide

Author for correspondence: Richard Pomfret, richard.pomfret@adelaide.edu.au

Abstract: The Road to Monetary Union analyzes, in non-technical language, the process leading to adoption of a common currency for the European Union. The monetary union process involved different issues at different times and the contemporary global background mattered. The Element explains why monetary union was attempted and failed in the 1970s, and why the process was restarted in 1979, accelerated after 1992 and completed for a core group of EU members in 1999. It asks why euro membership expanded in the 2000s, but still does not include all EU members. It analyzes connections between eurozone membership and Greece's sovereign debt crisis. It concludes with analysis of how the eurozone works today and with discussion of its prospects for the 2020s. The approach is primarily economic, while acknowledging the role of politics (timing) and history (path dependence). A theme is to challenge simplistic ideas (e.g. that the euro has failed) with fuller analysis of competing pressures to shape the nature of monetary union.

Keywords: monetary union, Eurozone, European Union

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Preface

Monetary union has been one of the most dramatic components of European economic integration. It was attempted by the then-nine members of the European Economic Community in the 1970s and failed dismally. The project was relaunched in the 1980s and 1990s. The euro was introduced for financial transactions in 1999 and on 1 January 2002 euro bank notes became the common currency in twelve EU member countries. By January 2020, nineteen EU members were using the euro.

Monetary union among such a large and varied group of independent countries was unprecedented. Economists could easily explain the failure of the 1970s and many predicted in the 1990s that monetary union would not happen and, if it did happen, it would not last. By 2020, both predictions had been disproven, although many critics continue to predict the currency's doom.

This contribution to the **Cambridge Elements**: **Economics of European Integration** series describes and analyzes the road to monetary union. It is essentially an economics story with steps along the road being accelerated or delayed by political developments. European monetary union is a unique story because it is associated with a unique process of deep integration among independent countries.

Fixed exchange rates among independent countries – and the extreme case of currency union – are difficult because they involve acceptance of either restrictions on capital mobility or on monetary policy. Small open economies such as Luxembourg may join a currency union because they have little monetary policy independence anyway, but larger economies will be more cautious. In the early stages of European integration, the large member countries were unwilling to accept these restrictions, especially in the unstable global economic conditions of the 1970s when the large European countries had differing monetary policy priorities. By the 1990s, following creation of the Single Market and general agreement that moderating inflation should be the principal target of monetary policy, most of the EU member countries were willing to accept the need for a common currency. This story is told in Sections 3–6.

The last two sections consider the operation and future of the eurozone. After a relatively calm first decade, the eurozone faced a major shock as several members experienced sovereign debt crises, of which Greece's was the most challenging. The crises raised the fundamental question of the extent to which financial crises in a common currency area were national or eurozone-wide problems. If all members are required to help in resolving a debt crisis, what are the implications for common policies towards the financial system?

A second systemic issue concerns the relationship between the EU members in the eurozone and those members not using the common currency. To what extent will financial and economic policies, and their ramifications, be determined by the former group, leaving the non-users as a second-class periphery outside mainstream EU policy discussions? Following Brexit in January 2020, the balance between euro and non-euro countries within the EU has shifted dramatically: of the 446 million people in the EU27, 341 million live in the eurozone and 105 million outside the eurozone.

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Material in this Element is related to sections of my book on European Economic Integration (Harvard University Press, forthcoming), which provides deeper analysis of the broader economic integration process in Europe. The Element was written while I held the Jean Monnet Chair in the Economics of European Integration (2017–20), co-funded by the European Union and the University of Adelaide.

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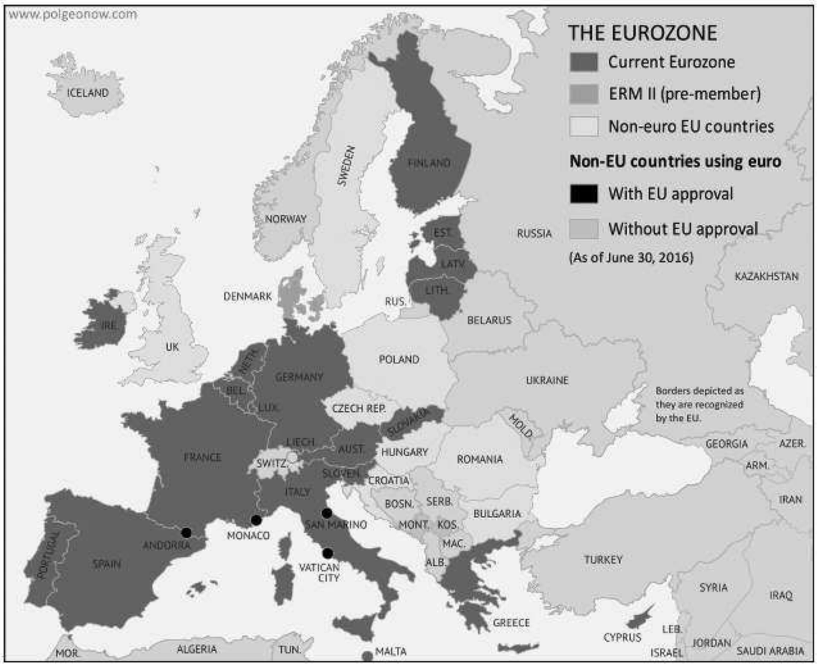

Map Countries using the Euro, January 2020
Source: www.polgeonow.com/2014/08/map-which-countries-use-euro-plus-this.html (accessed 11 January 2020), covered by Creative Commons license https://creativecommons.org/licenses/by-sa/3.0/legalcode

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