THE EURO - HISTORY, CONCEPTS, CONVERGENCE CRITERIA

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History of euro

1957
The Treaty of Rome said a common European market could increase economic prosperity and help towards promoting closer ties among the people of Europe, twelve years later European summit at the Hague makes a single currency an official objective
1970s
The oil crises, economic divergence and a weak dollar meant only a "currency snake", tying the currencies of Germany, Denmark and the Benelux countries together, was achieved
1979
The European Monetary System (EMS) is created, with the exchange rate mechanism (ERM) defining rates in relation to the European Currency Unit (ECU), a quasi-currency representing an average of participating currencies.
1986
Single European Act The Single European Act, which modifies the Treaty of Rome is signed and comes into force the following year. It sets up a framework for the Single European Market by increasing the Commission's powers and introducing qualified majority voting for a number of issues.
1988
The European Council of Hanover sets up a committee chaired by Jacques Delors, the then President of the European Commission, to put forward plans leading to European Monetary Union
1989
After consideration of the Delors report, the European Council meeting in Madrid agrees the first of three stages of EMU will begin in July 1990
1990
Stage one of EMU begins with narrowing of bands under the Exchange Rate Mechanism and closer co-operation on economic policy and between banks.
1991
Plans for a single currency by the year 2000 are agreed under the Treaty of European Union Plans by the 15 members of the European Union in the Dutch town of Maastricht. In order to participate in the new currency, member states had to meet strict criteria such as a budget deficit of less than three per cent of their GDP, a debt ratio of less than sixty per cent of GDP, low inflation, and interest rates close to the EU average.The UK and Denmark exercise their opt outs from the stage three of EMU.
1994
Stage two of EMU begins with plans for creation of European Central Bank and convergence of member states' economic and monetary policies.
1995
The name "euro" is chosen for the new currency at the European Council in Madrid.
1998
The European Council agrees that 11 member states - Belgium, Germany, Spain, France, Italy, Ireland, Luxembourg, the Netherlands, Austria, Portugal and Finland - are ready to adopt the euro on 1 January 1999
European Central Bank established in Frankfurt to maintain price stability and set interest rates in the eurozone.
1999
Stage three of EMU: The euro is launched as an electronic currency used by banks, foreign exchange dealers, big firms and stock markets. the Euro becomes the currency of 11 of the member states of the European Union (Belgium, Germany, Spain, France, Ireland, Italy, Luxembourg, the Netherlands, Austria, Portugal and Finland).Exchange rates of the participating currencies are set and eurozone countries begin implementing a common monetary policy. Europe enters the 3rd millennium with a new currency.
2001
Greece joins the euro.
2002
New Euro coins and notes are introduced by the European Union. These replace the national coinages and banknotes of the countries which adopt the new single European currency.
2004
the 10 new EU member states (including Poland) had a currency other than the euro; however, those countries are required by their Accession Treaties to join the euro. Some of the following countries have already joined the European Exchange Rate Mechanism, ERM II. They and the others have set themselves the goal to join the euro (EMU III) as follows: 1.01.2007 for Slovenia, 1.01.2008 for Cyprus, Estonia, Latvia and Malta;1.01.2009 for Slovakia and Lithuania; 1.01. 2010 for Bulgaria and the Czech Republic; 2011 or later for Hungary, Poland and Romania

Currency

According to the definitions, CURRENCY can be described as:

- unit of exchange, facilitating the transfer of goods and services.
- form of money, where money is defined as a medium of exchange (rather than a store of value).

A CURRENCY ZONE is a country or region in which a specific currency is the dominant medium of exchange. To facilitate trade between currency zones, there are exchange rates i.e. prices at which currencies (and the goods and services of individual currency zones) can be exchanged against each other.

EXCHANGE RATE REGIME is the way a country manages its currency in respect to foreign currencies and the foreign exchange market.

Currencies can be classified as either floating currencies or fixed currencies based on their exchange rate regime.

- **FLOATING CURRENCY** is a currency that uses a floating exchange rate as its exchange rate regime. A floating currency is contrasted with a fixed currency. In the modern world, the majority of the world's currencies are floating, including the most widely traded currencies: the United States dollar, the Japanese yen, the euro, the British pound and the Australian dollar. A floating currency is one where targets other than the exchange rate itself are used to administer monetary policy. The market dictates the movements of the exchange rate. It is the most common exchange rate regime today. However, since central banks frequently intervene to avoid excessive appreciation/depreciation, these regimes are often called managed float.
- **FIXED CURRENCY** (less commonly called a pegged currency) is a currency that uses a fixed exchange rate as its exchange rate regime. In the modern world, fixed currencies form a minority of the world's currencies. Prior to the 1970s, the Bretton Woods system made fixed currencies the norm; however, in 1973, the United States government abandoned the gold standard, so that the US dollar was no longer a fixed currency, and most of the world's currencies followed suit. It ties the currency to another currency, mostly more widespread currencies such as the U.S. dollar or the euro. Fixing a currency represents a particular type of monetary policy. Most currencies with currently fixed exchange rates are pegged to either the U.S. dollar (the dollar standard) or the euro (the euro standard).

Currency characteristics

In common usage, currency sometimes refers to only paper money, as in "coins and currency", but this is misleading. Coins and paper money are both forms of currency.
In most cases, each country has monopoly control over the supply and production of its own currency. Member countries of the European Monetary Union are a notable exception to this rule, as they have limited control of monetary policy to the European Central Bank.

In cases where a country does have control of its own currency, that control is exercised either by a central bank or by a Ministry of Finance. In either case, the institution that has control of monetary policy is referred to as the monetary authority. Monetary authorities have various degrees of autonomy from the governments that create them. In the United States, the Federal Reserve operates without direct interference (zakłócenia) from the legislature or executive. It is important to note that a monetary authority is created and supported by its sponsoring government, so independence can be reduced or canceled by the legislative or executive authority that creates it. However, in practical terms, the cancellation of authority is not likely since those who have the power to do so are generally beholden (obserwowani) to the Fed (urzędnik federalny) for their positions. In almost all Western countries, the monetary authority is largely independent from the government.
Several countries can use the same name, each for their own currency (e.g. Canadian dollars and US dollars), several countries can use the same currency (e.g. the euro), or a country can declare the currency of another country to be legal tender. For example, Panama and El Salvador have declared US currency to be legal tender.
Each currency typically has one fractional currency, often valued at 1⁄100 of the main currency: for ex. : 100 cents = 1 dollar, 100 centimes = 1 franc, 100 pence = 1 pound. Units of 1⁄10 or 1⁄1000 are also common, but some currencies do not have any smaller units.

These are the major currencies used in trading

- Australia - Australian Dollar (AUD)
- Canada - Canadian Dollar (CAD)

- European Monetary Union (EUR-12) - Euro (EUR)
- Hong Kong - Hong Kong Dollar (HKD)
- Japan - Japanese Yen (JPY)
- Switzerland - Swiss Franc (CHF)
- United Kingdom - Pound Sterling (GBP)
- United States - US Dollar (USD)

Economic and Monetary Union

There were three stages of monetary systems:

Stage I
European Monetary System (EMS) was an arrangement established in 1979 under the Jenkins European Commission where most nations of the European Economic Community (EEC) linked their currencies to prevent large fluctuations relative to one another. After the collapse of the Bretton Woods system in 1971, the EEC countries agreed in 1972 to maintain stable exchange rates by preventing exchange fluctuations of more than 2.25% (the European "currency snake"). In March 1979, this system was replaced by the European Monetary System, and the European Currency Unit (ECU) was defined.

The basic elements of the arrangement were:
- The ECU: A basket of currencies, preventing movements above 2.25% (6% for Italy) around parity in bilateral exchange rates with other member countries.
- An Exchange Rate Mechanism (ERM)
- An extension of european credit facilities.
- The European Monetary Cooperation Fund: created in October 1972 and allocates ECUs to members' central banks in exchange for gold and US dollar deposits.

Periodic adjustments raised the values of strong currencies and lowered those of weaker ones, but after 1986 changes in national interest rates were used to keep the currencies within a narrow range. In the early 1990s the European Monetary System was strained by the differing economic policies and conditions of its members, especially the newly reunified Germany, and Britain permanently withdrew from the system. This led to the so-called Brussels Compromise in August 1993 which established a new fluctuation band of +15%.

Stage II
The European Monetary System was no longer a functional arrangement in May 1998 as the member countries fixed their mutual exchange rates when participating in the euro. Its successor however, the ERM-II, was launched on January 1, 1999. In ERM-II the ECU basket is being discarded and the new single currency Euro has become an anchor for the other currencies participating in the ERM 2. Participation in the ERM 2 is voluntary and the fluctuation bands remain the same as in the original ERM, i.e. +15 percent, once again with the possibility of individually setting a narrower band with respect to the euro. New members became Denmark and Greece.

Stage III
The EMS-2 is sometimes described as "waiting room" for joining the Economic and Monetary Union of the European Union. In the EMU (stage III) the actual currencies in the participating member states are replaced by Euro banknotes and coins.

Convergence criteria

Before adopting the Euro, several criteria must be fulfilled. The aim of that process is to maintain stability of the price even after inclusion of new members.

These criteria, known as Convergence criteria or Maastricht criteria, include:

1. inflation rate must be not higher than 1.5 percent above three best performing countries of the EU (based on inflation)
2. the ratio of annual government deficit to GDP must be lower than 3% at the end of previous year (in exceptional cases this ratio can be slightly higher than 3%)
3. the ratio of gross government debt must be lower than 60% at the end of previous year.
4. exchange rate in a period of two preceding years must be stable. Applicants must not devaluate or revaluate its currency in that period of time

5. the nominal long-term interest rate must not be more than 2 percentage points higher than the 3 best-performing members (based on inflation)

Also, sometimes independence of the central bank is mentioned as another condition (which is actually quite obvious).

Different countries fulfil those criteria in different ways, with Poland in the middle of them:

CONVERGENCE CRITERIA					
COUNTRY	INFLATION RATE	GOVERNMENT FINANCE		ERM II MEMBERSHIP	INTEREST RATE
		ANNUAL GOVERNEMNT DEFICIT TO GDP	GROSS GOVERNEMNT DEBT TO GDP		
Reference value	**max 2.6%**	**min. -3%**	**max. 60%**	**min. 2 years**	**max 7.9%**
United Kingdom	2.2%			0 years	4.44%
Denmark	2.1%			Joined ERM II on 1 January 1999	3.79%
Sweden	0.5%			0 years	3.70%
Slovenia	2.3%	-1.9%	29.4%	Joined ERM II on 28 June 2004	3.98%
Estonia	1.3%	+1.8%	4.9%	Joined ERM II on 28 June 2004	4.38%
Cyprus	2.4%	-4.1%	71.9%	Joined ERM II on 2 May 2005	4.28%
Malta	0.4%	-5.2%	75%	Joined ERM II on 2 May 2005	4.34%
Latvia	2.9%	-0.7%	14.3%	Joined ERM II on 2 May 2005	4.38%
Lithuania	-1.2%	-2.5%	19.7%	Joined ERM II on 28 June 2004	4.28%
Slovakia	2.7%	-3.3%	43.6%	Joined ERM II on 28 November 2005	4.79%
Bulgaria	4.6%	3.1%	29.9%	0 years	3.8%
Czech Republic	2.9%	-3%	37.4%	0 years	3.90%
Hungary	4.7%	-5.4%	60.4%	0 years	7.58%
Poland	2.1%	-6.8%	47.7%	0 years	5.48%
Romania	15.3%			0 years	
Croatia	1.8%			0 years	
Macedonia	1.2%			0 years	
Turkey	7.7%			0 years	
Albania	2.4%			0 years	
Bosnia and Herzegovina	0.9%			0 years	
Serbia				0 years	
Montenegro				unilaterally adopted	

sources: http://www.ecb.int/stats/money/long/html/index.en.html
http://wikipedia.org/wiki/convergence_criteria

Advantages and disadvantages of Euro

A common currency must brings benefits – if else, it wouldn't probably be adapted. Since 1950. when a French minister Robert Schuman proposed creation of European Coal and Steel Community it was sure, that this is not only about integration of people, but also making the economy of European countries stronger.

The following table consist advantages and benefits of Euro as an common currency, as well as arguments against and threats:

Pros	Cons
• easier flow of money and services • more competition between banks • no cost for exchanging money • easier price comparisons between countries • no risk of changing rate • it makes harder for companies to get away with charging artificially high prices for goods and services • holidaymakers and travellers can no longer incur the costs of currency conversion when travelling between countries • improved competition between companies across the eurozone area. This will ultimately lead to leaner, more competitive industries and to lower prices and better value for consumers.	• the concept of greater price transparency leading to lower prices is a fallacy, since even if consumers become more aware of price differences they are still more likely to buy in their local high street rather than make the effort to buy from another country • the theory that a single currency will lead to the harmonisation and lowering of prices across Europe seems hard to support. Regional differences in prices are a result of differences in levels of taxation as well as variations in labour, property and transportation costs. The cost of living in different parts of the UK varies considerably, even though all regions share the same currency. • less scrupulous retailers would use the introduction of the euro to round-up prices • before accepting euro many criteria (see convergence criteria) must be fullfiled • time and money consuming process

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