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Opinion

The Importance of Monetary Union in the Integration of Financial Markets

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Currency zones have been created in various regions of the world for centuries. Such aspirations took place in both capitalist and socialist economies. However, the reasons for their formation were completely different. In the era of colonialism, they were created through coercion, and now they are created as a result of sovereign decisions of independent states. Integration is the process of merging a group of elements, which takes place within individual sectors of the economy, regions, as well as entire national economies and their groups. As a result of this combination, a synergy effect is achieved. The new organism becomes more effective than the mere sum of its individual parts. Monetary integration should be seen as a process that first means full convertibility between the currencies of member countries and achieving harmonization of fiscal systems and economic policy coordination, and then replacing national currencies with a common currency. This process is accompanied by the transfer of their national powers by the states belonging to the integrating community to the level of community bodies. An integrated financial market is an essential element for the smooth functioning of the monetary union. It supports the adjustment processes necessary in the event of asymmetric economic shocks. For example, if one of the countries in the monetary union suffers a negative economic shock, as a result of which demand decreases, companies operating in its territory generate a loss, which results in a decline in their share prices. In the case of an integrated financial market, the shares of these companies are also in the investment portfolios of citizens of another country or other member states of the monetary union, therefore, the consequences of the deterioration of economic activity in a country affected by a negative economic shock are also borne by the economies of these countries. However, during a period of prosperity in another country or countries, the country affected by the shock also benefits from it. In these countries, there is an increase in demand, companies achieve good financial results, which affects the increase in the prices of their shares, which are also in the investment portfolios of citizens of the country affected by the negative shock. A similar mechanism operates not only through the integrated stock market but also through the integrated bond market and the banking system. Integration of financial markets of countries belonging to the monetary union is a way to share risks among all member states. The risk of a negative shock in the monetary union is therefore shared among all its members. An integrated financial market allows citizens of a country affected by a negative shock to maintain their income at a higher level than without membership in the monetary union. In the absence of a common fiscal policy in the euro area, one of the important mechanisms for reducing the risk of economic shocks is the integrated financial market.

The problem of the benefits and costs of creating a monetary union should be considered on two levels of time - in the short and long term. The most visible benefits achieved in the short term include the elimination of transaction costs of currency exchange, the disappearance of exchange rate risk in settlements between member countries and a reduction in the value of foreign exchange reserves necessary to handle foreign trade. The benefits of eliminating currency exchange costs can only be achieved if national currencies are fully replaced by a common currency. When the exchange rates of national currencies are fixed and at the same time these currencies are still the main means of payment in their countries, transaction costs still occur. Eliminating exchange rate risk eliminates uncertainty that negatively affects the development of mutual trade and the integration of financial markets. The lack of exchange rate risk becomes particularly important in the case of small and medium-sized business entities that do not have appropriate financial and human resources to effectively protect themselves against this risk. An important cost of establishing a monetary union in the short term may be an increase in unemployment resulting from asymmetric economic shocks, which may translate into an increase in inflation and a reduction in the GDP growth rate, adjustment costs (e.g. accounting) incurred by economic entities and price increases resulting from the so-called "rounding up" (cappuccino effect).

The most important long-term benefit of establishing a monetary union is an increase in the level of real GDP. It results from the elimination of uncertainty regarding price formation, increasing the potential sales market, expanding and deepening the financial market and achieving economies of scale. Another benefit is the transparency of prices on the goods and services market and asset prices on financial markets. The common currency provides a simple platform for comparing prices throughout the monetary union, although it does not eliminate price differences. Maintaining low inflation and low interest rates are also important benefits obtained in the long term. They are particularly important for countries that have greater difficulties in maintaining inflation at a stable, low level. It is also worth noting the positive impact of the introduction of the common currency on investment growth. This applies to both domestic and foreign investments. If the new currency becomes an international currency and its importance outside the EU is greater than the sum of national currencies, this creates additional benefits from integration. Firstly, income from seigniorage, and secondly, increased activity on the local financial market. If the common currency becomes international money, it creates new opportunities for financial institutions from the countries of the monetary union. In the long term, the most important costs of monetary union result from the need to adapt economies to the criteria of an optimal currency area. The higher level of inflation resulting from supply shocks cannot be reduced by national monetary policy, but only by restrictive fiscal policy, which may result in a long-term decline in the economic growth rate. The efficiency of stabilization mechanisms and the absorption of economic shocks in member countries will influence the importance of the costs incurred and benefits achieved from the monetary union.

To sum up, membership in a currency area does not only bring benefits. There are also costs associated with it, even with low inflation in the area. The mentioned costs result from the abandonment of the use of exchange rate policy (which is a condition for membership in the currency area) to achieve stabilization of production and employment in the event of economic shocks. By losing the use of its currency, the state gives up a strong instrument regulating the economy. Members of the monetary union are deprived of such opportunities, which, in the event of possible shocks occurring in the economy on a regional scale, may lead to an increase in inflation, unemployment and budget disruption. It should be noted that a high degree of economic integration between the accession country and the area characterized by a fixed exchange rate reduces the negative effects of imbalance resulting from economic shocks.