

Lammers, Konrad

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Spatial implications of the European Monetary Union: Overview and policy conclusions

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KONRAD LAMMERS

Spatial Implications of the European Monetary Union – Overview and Policy Conclusions

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1 Introduction

With the beginning of the year 1999, a further important step towards deeper integration of Europe took place: The European Monetary Union (EMU) was put into force. Undoubtedly, this step of European integration has had far reaching consequences within the monetary sphere of the economies in the member countries. But establishing a monetary union possibly has also considerable effects within the real sphere of the economies involved and that includes effects on the economic geography of the integrating area. Possible and probable spatial effects of EMU was the motive to establish a working group within the cooperation agreement of ARL (Academy for Spatial Research and Planning) and the DATAR (Délégation à l'Aménagement du Territoire et à l'Action Régionale) in order to shed some light on these effects. The present volume contains papers having been elaborated by members of the working group. This chapter provides a short introduction of the thematic issue, it summarises the main results of the papers in the light of the discussion of these papers within the working group, and it draws, based on these results, spatial orientated policy conclusions.

2 EMU and Economic Geography in Europe

If we want to get an answer to the question, whether and in which way EMU has a spatial impact on the EU we will need an idea of channels and mechanisms which could transfer the effects of introducing EMU and of running a European monetary policy as to the development of European regions. Two mechanisms are thinkable:

- The introduction of a common currency reduces the costs for trade of goods and services between countries belonging to the monetary union. It also lowers the costs for cross-border movements of production factors. Under the regime of a monetary union it will be cheaper to move a firm, to transfer capital or to migrate from one member country to another. Thus, it can be expected that the introduction of the European Monetary Union will change the national and regional pattern of trade and the location of firms and persons. The division of labour among European countries and regions will become deeper and nothing points to the fact that all countries and regions will be affected in the same manner. Thus, the economic landscape of Europe will change.

- The introduction of the single currency and the shift of competence in monetary policy from national central banks to the European Central Bank constitutes a big bang in the institutional environment for economic activities. This institutional change may lead to a different economic behaviour of firms, consumers, employed persons and their organisations as well as of national and regional politicians. Again, nothing points to the fact that – provided this mechanism is empirically relevant – the behaviour will change in all countries and regions in the same direction and to the same amount. Thus, the spatial pattern of economic activity under the regime of a single currency differs from the situation without this regime.

These are the two main channels or mechanisms which could, in principle, generate spatial effects by introducing the European Monetary Union. The next question is which spatial effects could occur: These possible effects are very similar to those which can be observed generally as a result of integration processes. They could be summarised as follows:

- In which way and to which extent will the spatial pattern of economic activity change? Can we expect more or less concentration of economic activity in the European area?
- Will convergence or divergence between regions and nations increase, for example in per capita income?
- Which countries and regions will be affected by spatial concentration/dispersion and convergence/divergence processes? Are these core, peripheral, border, or urban regions?
- Could we expect more or less specialisation of countries and regions in certain industries?

These are the key questions on a research agenda aiming at analysing spatial consequences of the European Monetary Union. Unfortunately, economic theory provides no clear answer to these questions. It is true, regional economic theory has made considerable progress in the last decade, especially in explaining spatial processes stemming from economic integration. Considering these processes is the main issue of the so called “New Economic Geography”.¹ Indeed, the respective models are able to convincingly explain the interdependence of important factors constituting a certain spatial pattern of economic activities, like transportation costs, economies of scale and the original distribution of industries including agriculture. However, the way in which these factors interact and which results concerning the spatial pattern of economic activities they create, depends essentially on the assumptions made in these models. Thus, it remains an empirical question which regional effects result from integration steps like the introduction of the single currency in the EU. The articles collected in this volume aim at providing some tentative results in the latter respect, although the authors choose quite different approaches.

¹ The main ideas of the „New Economic Geography“ were laid down in PAUL KRUGMAN’S often cited book „Geography and Trade“ (KRUGMAN 1991). In the meantime the „New Economic Geography“ has reached a textbook state. See FUJITA, KRUGMAN, VENABLES (1999).

3 Main results

IAN ROBINS considers in his article differences the single currency might bring to the regions within the euro-zone under three main headings:

- consequences for the regions of a changed relationship in which countries being members of the euro-zone stand to each other;
- macroeconomic consequences for regions of their being a member of EMU;
- effects of the possible concentration of industrial activities in regions and of trends towards specialisation of regions in certain industries.

IAN ROBINS points out, like many other authors do, that under the regime of a single currency a country has lost the opportunity to choose exchange and interest rates which may be appropriate to the economic performance of certain regions. To overcome regional employment problems and to recover regional competitiveness other mechanisms of adjustment have to be at work. Prices for production factors, especially wages have to be flexible and the mobility of production factors, especially of human labour, has to be high. In addition, fiscal transfers could, in principle, compensate for losses in regional competitiveness or regional employment problems, but the European competition policy and fiscal constraints in the national as well as in the EU-Budget limit this possibility. As far as macroeconomic consequences are concerned, ROBINS argues that EMU membership favours peripheral countries more than core countries. This is concluded from the fact that before introducing EMU, the exchange rate risk was considerably higher for peripheral countries than for core countries, especially Germany and countries which had fixed their currency to the Deutsche Mark. Under these circumstances, peripheral countries had a location disadvantage which might have discouraged companies to invest there. Under the regime of the single currency this disadvantage does no longer exist with the consequence that more companies choose now more locations in peripheral countries than before. Finally, ROBINS discusses the possible effects of EMU on the concentration of industrial activities in regions and on the specialisation of regions in certain industries. He expects some changes in the location pattern, based on other empirical studies investigating the changes in the spatial industry pattern during the process of European Integration in the last 25 years. But these changes are not significant in terms of an increase (or decrease) in the existing core-periphery structure of the continent.

JOHANNES BRÖCKER'S paper studies effects of EMU using a multiregional general equilibrium model. The model is applied in a comparative-static way comparing a situation with and without EMU. The difference between these two situations is represented by savings of transactions costs, due to a common currency for traded goods. The main results of BRÖCKER'S analysis are:

- taking all member countries together, the welfare gain of EMU is approximately 1% of the European gross domestic product.
- EMU turns out to be neutral with regard to the per capita position of regions. There is no (positive) correlation between the level of per capita income of European regions and their gains by introducing the common currency.
- Within the countries, those regions benefit mostly which are close to borders of other EURO-zone countries. This result is the outcome of the implicit assumption of the model that border regions have the highest trade intensities with partner countries and, therefore, gain mostly from a reduction in transaction costs by the common currency.

MARTIN HALLET distinguishes between static and dynamic effects of the Euro in his paper. Static effects are those showing the magnitude in the reduction of trade costs generated by the introduction of the common currency. Dynamic effects are defined by him as the changes in economic growth, employment, welfare and production structures of regions which are induced by the reduction of trade costs in a middle- and long-term perspective.

According to HALLET'S analysis, there is no clear core-periphery pattern regarding the exchange cost savings by introducing the Euro, neither on the country nor on the regional level. Thus, in a static view, the Euro is more or less neutral with regard to the geographical location of regions and countries in Europe. As far as the dynamic effects are concerned, HALLET points out that the period since introducing the common currency in 1999 is too short to expect any empirical evidence in the middle- and long-term perspective. He argues that, nevertheless, some lessons can be drawn from analyses on the regional impact of previous steps of the European integration process. A main result of these analyses is, that there is a visible trend of industrial concentration in regions and of regional specialisation in certain industries. But these processes are of a slow nature and do not support the fear that poor and peripheral regions are affected in a negative way. Moreover, the general trend of structural change from manufacturing into services tends to make regions more similar regarding their specialisation. This would mean that the probability of region-specific shocks are getting smaller. As far as border regions are concerned, HALLET shows that they performed rather well within the EU integration process.

Although the approaches of the considered papers are rather different, their conclusions are very similar or at least compatible. With regard to the effects of the Euro in a spatial and regional context, the main results are:

- The positive welfare effect for the European Union as a whole is probably small.
- The Euro will not affect the aim of regional cohesion in a negative way. Rather, the opposite seems to be true: the poor (in terms of per capita income) and peripheral regions and countries will probably benefit more than those which are rich or belong to the geographical core of the Euro-zone.
- Regions bordering those of other member countries of the Euro-zone will be affected positively.
- The fear is not justified that the probability of region-specific shocks will increase because the Euro will lead to more industrial concentration and regional specialisation.

4 Spatial Orientated Policy Conclusions

In the run-up to the introduction of the common currency, the fear was often expressed that this would lead to more regional divergence in Europe. This fear seems to be unfounded. The papers under consideration do not provide any evidence that the aim of territorial cohesion in the EU is touched systematically by the common currency in a negative way. Rather the opposite is true. Regions with a low per capita income, regions located at the European periphery and regions bordering other member states tend to be favoured more than other regions. Thus, EMU does not provide any reason to extend regional policy measures to those regions being already subject of EU regional policy today and to legitimate this by the argument otherwise the aims of national or regional cohesion would be in danger.

It has often also been argued that the introduction of the common currency has to be accompanied by establishing an interregional transfer system in order to absorb region-specific shocks. In a monetary union, so the argument, this transfer system has to take over the role which the national exchange rate had played under the regime of national monetary policy. If a region lost its competitiveness by a region-specific shock, financial transfers from other regions, the national states, or the EU would have to stabilise the economic performance of the respective region in terms of income and employment. Establishing such a transfer system would be especially necessary because under the regime of a monetary union the regions would become more specialised and industries would get more concentrated in a geographical sense. Although it could not be completely precluded, the general fear that region-specific shocks will increase is, according to our results, not justified. Thus establishing an interregional transfer system compensating automatically for region-specific shocks does not seem to be necessary.

To conclude, there seems to be no need to introduce new or to extend already existing regional orientated instruments or policy regimes on EU level in order to avoid unwanted spatial effects by EMU. The reason is simple because such effects are not presumable. Moreover, it would not be meaningful to implement policy measures for the specific purpose to balance precisely these effects. The EMU is only one important step of European integration with possible spatial effects; others are the completion of the internal market and the Eastern enlargement. All steps of European integration decrease the transaction costs for economic activities across national borders with the consequence of possible changes in trade between regions and in the location of people, firms, and production. It would be an impossible task to separate the effects of EMU from those of other steps of European integration. But even if it were possible and provided there were any undesired effects, from the regions' point of view it would be of no relevance which step of European integration would generate them. Only for this reason, it would make no sense to implement spatial orientated policy measures for the purpose to meet undesired, but unlikely regional effects of EMU.

Moreover, it would hardly be possible to design policy measures in a way that they could rapidly and precisely recover losses in regional competitiveness. As far as interregional transfer systems are concerned, in principle, they could compensate for losses, but only in a financial sense. The regions' economic recovery in competitiveness after a region-specific shock will only be possible, if adjustments in the real sphere take place, that means adjustments in relative prices and/or quantities on product and factor markets. Generally, the introduction of the Euro as well as the other steps of European integration require more flexibility on product and factor markets in the whole integration area and not only in specific regions. The Euro increases the competition among all regions in attracting firms and production factors and it creates higher adjustment needs in regions regardless of their income position and geographical location. For these reasons it is important to strengthen the market forces by liberalisation, deregulation and decentralisation in all countries of the Euro-zone. This would raise the capability of regions to cope with adjustment pressures stemming from intensified competition among them.

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