4 THE EMU AND SOCIAL EFFICIENCY

Social efficiency requires that the available resources are fully utilised and that the resources employed are used efficiently. This chapter focuses on the latter aspect. The question is to what extent the monetary union could contribute toward more efficient use of the resources employed.

Section 4.1 estimates the resource savings that are likely to be made in economic transactions through the use of a single currency. Section 4.2 analyses the effects of a single currency on trade, investment, and interest rates. Section 4.3 discusses how competition in the single market will be affected. Section 4.4 analyses the economic gains that may be made if membership in the monetary union leads to lower inflation. Section 4.5 discusses seignorage revenues, and section 4.6 summarises the chapter.

4.1 Reduced transaction costs

The use of 14 different currencies within the EU gives rise to costs in connection with international payments. The balance-of-payments statistics show the different kinds of transactions involved. These can be roughly divided into two categories: those that are included in the current account, mainly trade in goods and services and interest-rate payments, and those that are included in the capital account, mainly capital flows in connection with direct and financial investments (portfolio investments). The transaction costs mainly consist of bank charges for exchanging currencies and for handling exchange-rate risks, and costs that companies incur due to the use of different currencies, such as the cost of personnel employed to reduce currency risks.

These transaction costs will be reduced for those countries that participate in the monetary union. How large the reduction will be for a country depends on what proportion of its international transactions takes place with other member countries.

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1 Although Belgium and Luxembourg have their own currencies, the exchange rate is 1:1 and has so been for several decades. Banks do not impose a charge on exchanges between Belgian and Luxembourg francs by applying different rates for buying and selling. In a calculation of how transaction costs will be affected by the creation of EU’s monetary union, the Belgian and Luxembourg currencies may be regarded as one currency.
The breakdown of foreign trade, by country, can give some indication on this point, even though only a couple of per cent of foreign-exchange transactions derive from trade in goods and services (see section 3.3). In Sweden’s case, about 60 per cent of its exports go to the 14 other EU countries. About 35 per cent of Sweden’s exports go to the eight EU countries considered most likely to join the monetary union from the start in 1999, viz. Austria, Belgium, Finland, France, Germany, Ireland, Luxembourg, and the Netherlands.2

The use of resources in the financial sector for exchanging currencies and hedging in connection with transactions between EU countries can be estimated in two ways. The simplest thing is to add together the financial sector’s revenue from exchanging currencies and hedging activities and use this as a measure of the resource cost to the economy. In practice, this is difficult to do, because detailed information on the revenue structure in individual companies is not available or is confidential.

Using confidential information from a few banks, the Commission has estimated that less than 5 per cent of the financial sector’s revenue in the 12 countries that were members of the EU before 1995 (the EU 12) were generated by foreign-currency transactions among these countries.3 The banking sector’s share of total GDP for the EU 12 is less than 6 per cent. This means that transaction costs in the financial sector deriving from the use of different currencies within the EU 12 can be estimated to account for about 0.3 per cent (5 per cent of 6 per cent) of the GDP of these countries.

An alternative method is to estimate the banks’ revenues indirectly. This can be done based on data on various foreign-exchange transactions, assessments of the shares generated by customers in EU countries, and estimates of the various transaction costs to the banking sector’s customers. The Commission’s estimate for the banking sector in EU-12 countries indicated savings amounting to between 0.17 and 0.27 per cent of GDP. The estimate would probably be only marginally affected if the three new EU members - Austria, Finland, and Sweden - were included.

So both calculation methods give about the same result. But the estimates represent an average for the 12 countries. Smaller countries, especially Greece and Portugal,