A NOT VERY COMMON SINGLE CURRENCY

PAST, PRESENT, AND FUTURE OF THE EURO

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Presentation Plan

1. An quick overview of European monetary integration
2. The economic rationale for a successful currency area
3. The launching of the euro and the global financial crisis
4. The euro under strain
5. Alternative proposals
6. Looking at the crystal ball

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- The attributes of the sovereign: to declare war, to levy taxes, and to mint coins [Jean Bodin, The six books of the Republic, 1576]
- Monetary unions within European nation states: Switzerland (1848), Italy (1861), Spain (1868), Germany (1871 and 1873)
- Monetary unions between European nation states
  - The Austro-German Monetary Union (1857-1867)
  - The Latin Monetary Union (1865-1926)
  - The Scandinavian Monetary Union (1873-1931)
- The period of the European “Bilateralism triumphant” R.Triffin (1945-47)
- Agreements for intra-European payments and compensations (1948-50)
- The European Payments Union: first steps towards convertibility (1950-56)

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- Early plans for European monetary union:
  - 1st and 2nd Barre Plan, and the Schiller Plan
  - Werner Plan
  - 22 March 1971 Council Resolution

- Some attempts towards exchange rate stability:
  - European snake (1972-78)
  - ERM of the EMS

- The Delors Report on the Economic and Monetary Union (1988)

- Some fiscal rules:
  - The Stability Pact (1990s Waigel's Pact)
  - The Stability and Growth Pact and the Excessive Deficit Procedure

- The Maastricht Treaty (1992)

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- Is the Eurozone an *optimal* currency area? Which is the characteristic that a country has to fulfil to consider its exchange rate either useless or inefficient?
- Mundell: factor mobility, namely labour mobility
- McKinnon: degree of openness, the vicious circle hypothesis
- Kennen: product diversification
- Magnifico: national propensity to inflate, historical and social factors
- Ingram: degree of financial integration
- Vaubel: real exchange rate stability

- Which is the policy response to face asymmetric shocks?
- A centralised EU budget would provide automatic (free of charge) transfers of resources between Member States [MacDougall Report 1977]
- Whereas, within decentralised national budgets, savings from the surplus countries are channelled, through the financial systems, as loans to the deficit countries
- This borrowing increases debts in the deficit countries, and reduce their margin of manoeuvre of both fiscal and monetary policies
- Furthermore, when debt becomes not sustainable in one country this can spill over negatively on other Member States

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- It rises the interest rates and, thus, increases the interest burden on other Member States, and narrows the margin of manoeuvre of the ECB monetary policy
- This calls for stringent fiscal rules to stop irresponsible (free riding) policy behaviour [Delors Report 1988]
- Deficit countries, however, could always be funded if financial markets are efficient
- If financial markets manage the financial risks properly they would attribute different risk premia to Member States, thus, avoiding moral hazard
- Yet, financial markets could still fear the contagion effect of a declaration of insolvency in one country

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- To avoid this fear the Maastricht Treaty prohibited the monetary funding of public deficits (art. 104 Maastricht Treaty, 123 Lisbon Treaty)

- Today, this makes the payment of the debt burden more difficult for Member States in the Eurozone

- To avoid the threat of bankruptcy of one country, the EU established the non-bail out clause (art. 104b Maastricht Treaty, 125 Lisbon Treaty)

- To avoid the threat of non implementation of the previous article 104b, the EU established the Excessive Deficit Procedure (art. 104c Maastricht Treaty, 126 Lisbon Treaty)

- Which, together with the Stability and Growth Pact helps monitor and contain Member States deficits

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- After careful preparation, the ECB was created and the euro was launched in January 2002
- The *one-size-fits all* type of EU-wide monetary policy obliges the ECB to look more attentively at the economic needs of the core countries than to those of the peripheral partners
- In early 2000s, Germany and France desperately needed to kick-off their stagnating economies, and exerted mounting pressure on the ECB to loose its stance
- The ECB policy flooded the peripherals with a liquidity glut and fuelled speculative housing bubbles
- Further, households and companies became over-indebted, and created perverse incentives for wages to grow above productivity

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- As in the 1986-92 episode, domestic spending outpaced output in peripherals and translated into higher current account deficits and accelerating ULCs and prices

- Peripheral's authorities were irresponsible to conduct pro-cyclical overheating fiscal policies, while core's authorities were irresponsible to allow for heavy indebtedness of their banks in the peripherals

- Savings and productivity imbalances within the Eurozone reflected the deterioration of both the current account and the external competitiveness between core and peripheral countries

- Improvements in core countries showed in larger external surpluses, subdued ULCs, and restrained fiscal budgets

- Peripherals required bail-out packages and applied internal devaluations, but core countries still show external surpluses

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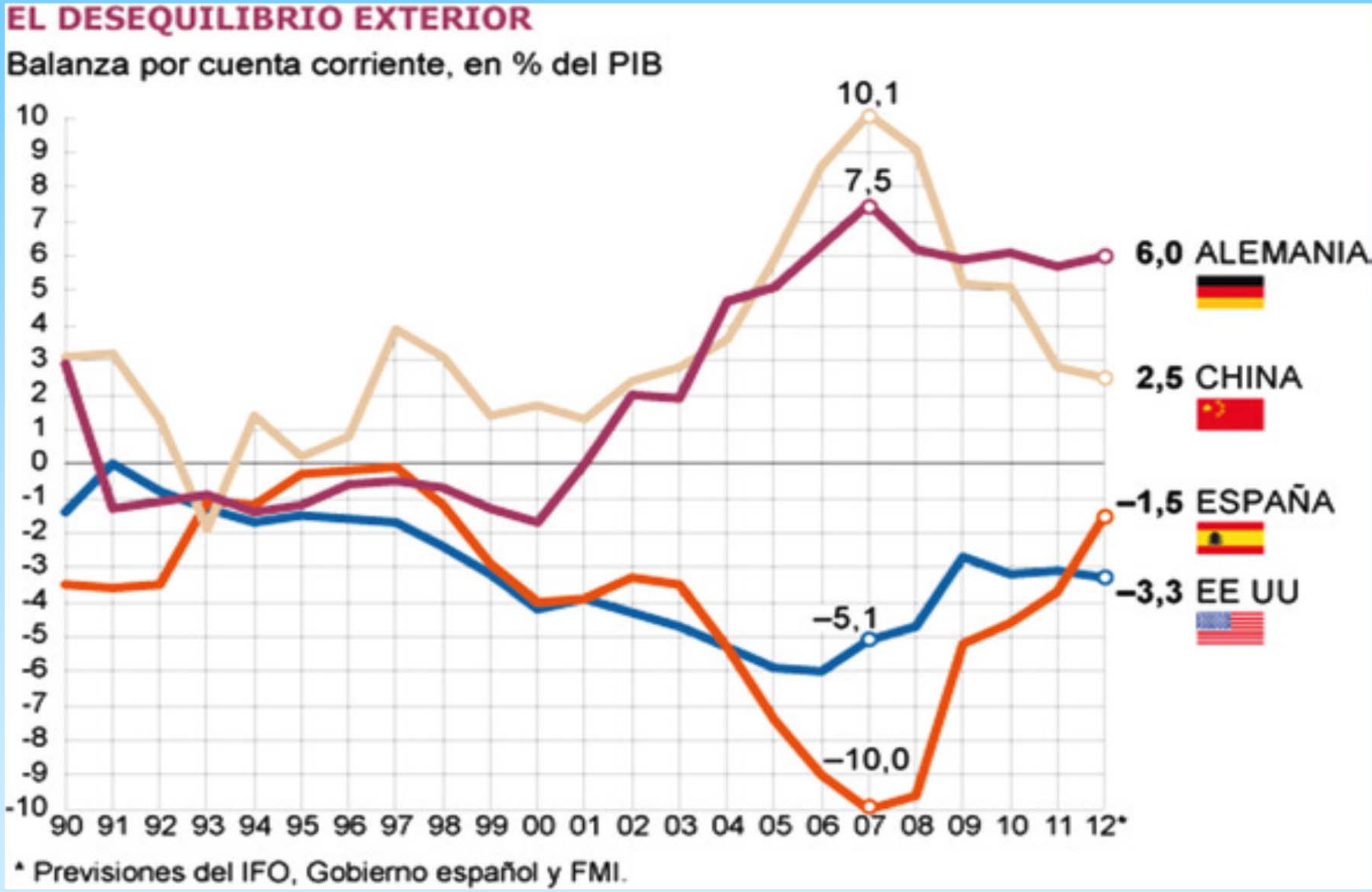
External Imbalances worldwide
(% of GDP)



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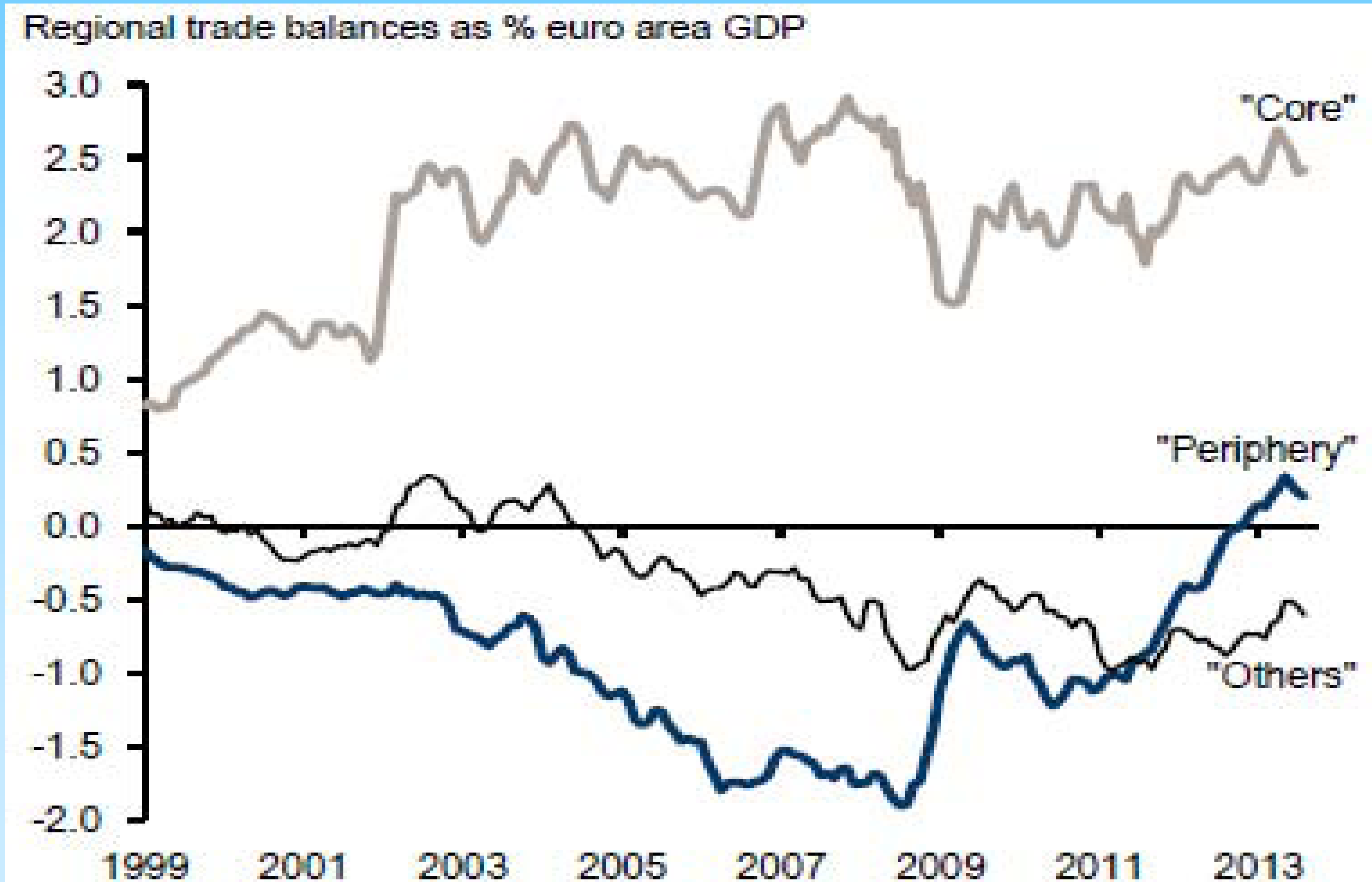

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Emergency Aid for the Periphery