

The EMU at 20: Current Status and the Way Forward

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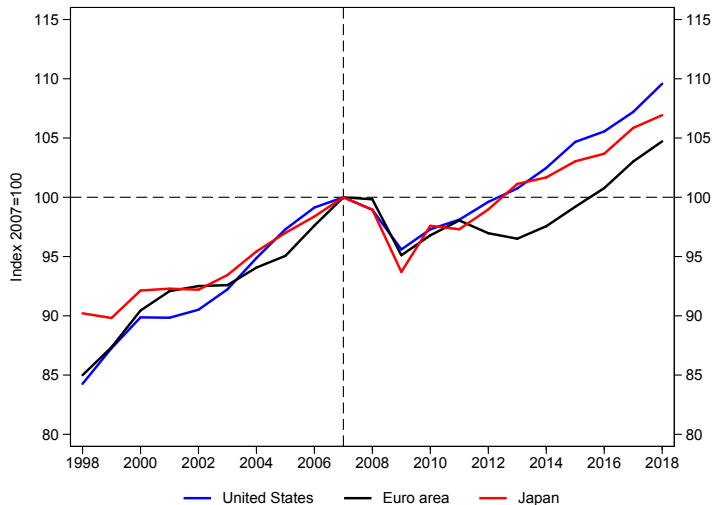
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The euro and the silver tetradrachm



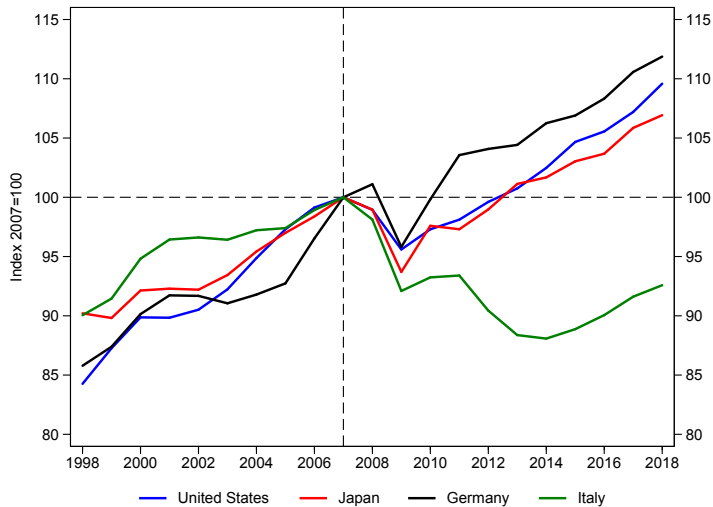
The ongoing euro crisis: What ails the euro area?



Real GDP per person. IMF WEO, April 2019. Index 2007=100



The ongoing euro crisis: Winners and loses?



Real GDP per person. IMF WEO, April 2019. Index 2007=100



Causes?

- ▶ Random and accidental?
- ▶ Euro malfunction?



Politics over economics: Federation vs confederation

- ▶ Federation
 - ▶ Common government protecting common interest.
 - ▶ Common government accountable to all citizens of all states.
- ▶ Confederation
 - ▶ Competing interests among member states.
 - ▶ Leaders in each state accountable only to citizens in their state.



The fragility of confederations

- ▶ United States (under the Articles of Confederation, until 1789).
- ▶ Delian League.



Lessons from the Delian League

- Founded: 478 BCE
- Dissolved: 404 BCE



Avoiding the fate of the Delian League

- ▶ The EU Treaty
- ▶ The role of independent European institutions



The role of independent institutions

- ▶ How are common policies decided when the interests of individual Member States diverge?
- ▶ The success of the Union rests on the ability of Europe's independent institutions to protect the common good over the interests of any individual Member State.
- ▶ Individual Member States that manage to exert undue influence on these institutions can distort policy to benefit their own citizens at the expense of others and the euro area overall.



A closer look at the ECB

- ▶ Europe's unique central bank—the most independent and least accountable central bank ever created in history.
- ▶ The most appropriate crisis management for the euro area as a whole is not best for all Member States.
- ▶ The most appropriate monetary policy for the euro area as a whole is not best for all Member States.
- ▶ Success in influencing ECB policy can disproportionately benefit a Member State at the expense of the common good.



Evaluating ECB policy: Core inflation in euro area

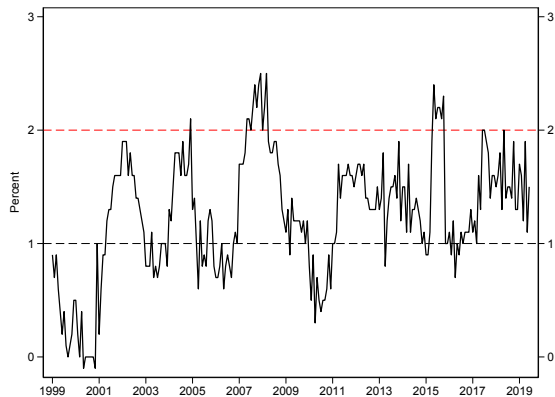


ECB policy: Too loose or too tight?



Evaluating ECB policy: Core inflation

Germany



Italy

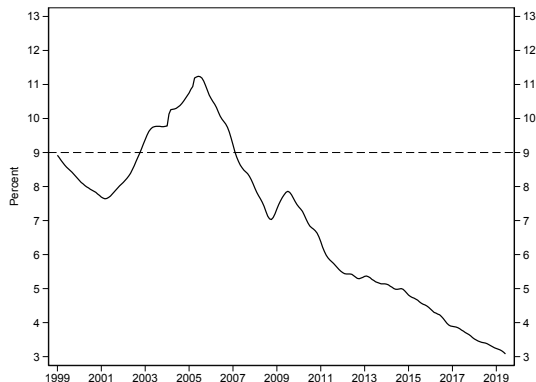


ECB policy: Too loose or too tight?

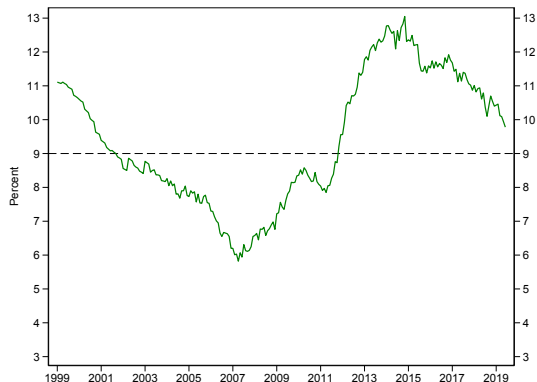


Evaluating ECB policy: Unemployment rate

Germany



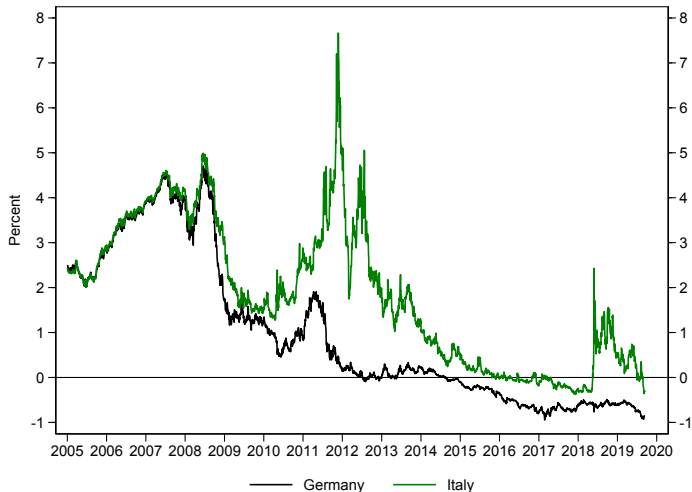
Italy



ECB policy: Too loose or too tight?



What is the cause of the continuing fragility of the euro area?

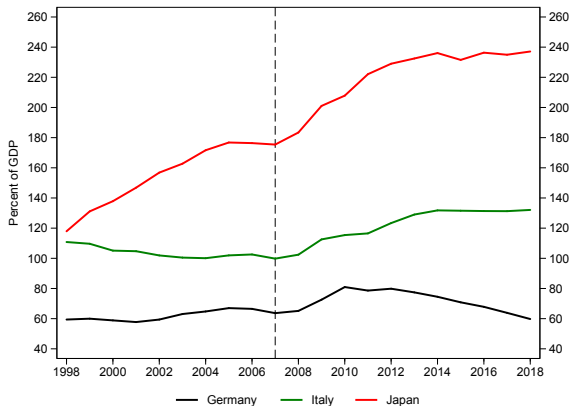


Yields on two-year sovereign debt.

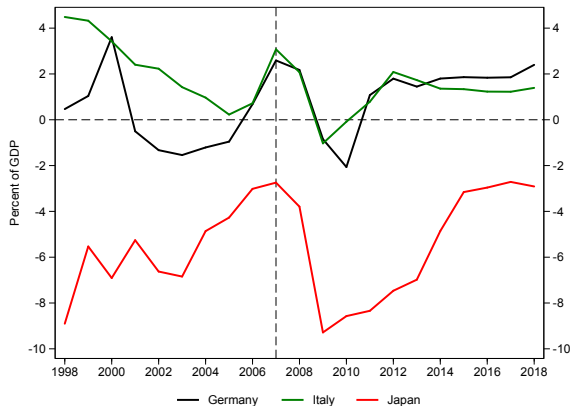


Japanese frugality vs Italian profligacy?

Gross debt



Primary fiscal balance



Debt and primary fiscal balance as a percent of GDP. IMF WEO, April 2019.
Negative fiscal balance corresponds to fiscal deficit.



Adverse expectational equilibria in sovereign debt markets

- ▶ Use of ECB's collateral framework “as a sanction to exert fiscal discipline”?
- ▶ Reliance on rating agencies for determining collateral eligibility of government debt?
- ▶ Reliance on market rates for DSA?
- ▶ Disciplining “misbehaving” governments?



Disciplining governments?

“Dear Prime Minister,

The Governing Council of the European Central Bank discussed on 4 August the situation in Italy’s government bond markets. The Governing Council considers that pressing action by the Italian authorities is essential to restore the confidence of investors. . . .

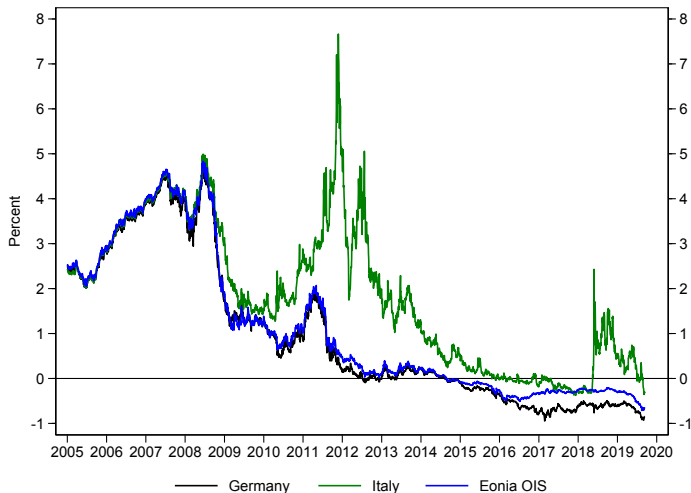
In view of the severity of the current financial market situation, we regard as crucial that all actions listed in section 1 and 2 above be taken as soon as possible with decree-laws, followed by Parliamentary ratification by end September 2011. A constitutional reform tightening fiscal rules would also be appropriate. . . .

We trust that the Government will take all the appropriate actions.”

(Letter by Mario Draghi and Jean-Claude Trichet sent to Silvio Berlusconi on August 5, 2011.)



Distributional consequences of ECB policy



Two-year government bond yields and euro OIS rate



The EMU at 20: Current Status and the Way Forward

- ▶ At present, the euro is a threat to Europe.
- ▶ To overcome the crisis, Europe's common independent institutions must assert their independence and act in accordance to the Treaties.
- ▶ In accordance to the Treaties, common institutions must use their independence to effectively counterbalance narrow national interests.
- ▶ Policy must protect and promote the common good.
- ▶ The key to EMU success is **shared prosperity**.

