

The Euro Under Construction

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Maastricht: an incomplete Treaty

- Quite precise on monetary policy and institutions
- Less precise on fiscal discipline
- Nothing on financial stability
- Nothing on crisis management



Monetary policy

- Quite clear on “price stability”
 - But target left to ECB
- Less clear on instruments
 - Interest rate or money growth
 - Answer was “two pillars”
 - Was outdated then (Buba’s legacy)
 - Better adapted to new world after crisis
- No room for lending in last resort
 - Needs agreement with governments about potential losses

Monetary institutions

- Totally clear on central bank independence
- Need to keep and involve national central banks
 - A small parliament
 - ECB at the head of the ECB
 - A muddled
- Appointment
 - A very seri



Fiscal discipline

- Key requirement, clearly identified early on and in Treaty
 - Artificial deficit and debt limits
 - Excessive deficit procedure
 - Formalized in 1997 in the Stability and Growth Pact
- Incompatibility between national sovereignty and obligations under the Pact
 - Political “solutions”
 - Many revisions, lack of result
- Hard part: the no-bailout clause
 - Effectively out of order (Pringle case)

Financial stability

- Gaping hole
 - Not assigned to ECB
 - Left to national supervision and resolution authorities
 - Conflicts of interest
 - Unworkable “Colleges”
 - Reason: fear of backlash
- Banking Union: a major step forward, still incomplete
 - No adequate resources
 - Resolution fund, deposit insurance
 - Resolution partly in national hands
- ECB as lender in last resort
 - Not unanimously accepted

Crisis management

- Crises not foreseen
- De facto intergovernmental management
 - A political issue, no adequate attention to technical details
 - The “Deauville walk”
 - De facto German leadership
 - European Stability Mechanism
- ECB in front line
 - Hugely controversial
 - Independence under stress
 - No risk sharing
 - “Doom loop”

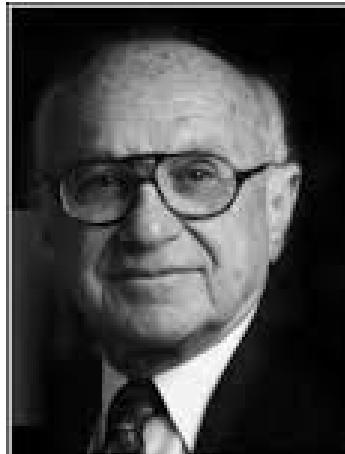
Looking ahead

- Limited expectations for June Summit
 - North vs. South, debtors vs. creditors
- Eurozone unprepared for next crisis
 - ECB can use precedent
 - But divisions not forgotten
 - Bad news for Switzerland
- Nothing out of the ordinary
 - US Fed: created in 1913 (137 years after independence)
 - Took 20 years to set up FOMC After Wall Street krach
 - Took 38 years to reach the "Accord" a.k.a. "divorce"
 After postwar inflation

Conclusions

- Eurozone architecture wasn't right on first attempt
 - Good reasons
 - Understanding of financial stability has improved
 - Fiscal discipline arrangements better understood now
 - Bad reasons
 - Lobbying power of banks
 - Defense of national interest
- Further reforms will occur
 - Usually requires a crisis

Conclusions



The Great Depression in the United States was caused - I won't say caused, was enormously intensified and made far worse than it would have been by bad monetary policy.

— Milton Friedman —

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People only accept change when they are faced with necessity, and only recognize necessity when a crisis is upon them.

The future of the Eurozone?

— Jean Monnet —

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