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  ▪ Was outdated then (Buba’s legacy)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 heart of Eurosystem
  - A muddled hierarchy
- Appointment of Governing Board: totally political
  - A very serious, much under-rated concern
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
    • Took 38 years to reach the “Accord” a.k.a. “divorce”
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

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