

# 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  - Was outdated then (Buba’s legacy)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 top of the system
  - A muddled system
- Appointment of the president
  - A very serious political process



# 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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