The euro: a «success» story

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Is the euro a success story?

1. Yes, from the point of view of economic science (because it predicted the crisis accurately)
2. No, from the point of view of economics (because the profession managed the crisis badly)
3. No, from the point of view of politics (because its declared political goals were not achieved)
4. Yes, from a political point of view (because its undeclared political goals were achieved)

YES

Was the euro a SUCCESS story?

ECONOMIC RESEARCH told us so...

Rudiger Dornbusch (1996)
The most serious criticism of EMU is that by abandoning exchange rate adjustments it transfers to the labor market the task of adjusting for competitiveness and relative prices... losses in output and employment will predominate.
Euro fantasies, Foreign affairs, 75

ECONOMICS told us so...

Paul Krugman (1998)
The clear and present danger is, instead, that Europe will turn Japanese: that it will slip inexorably into deflation, that by the time the central bankers finally decide to loosen up it will be too late.
The euro: beware what you wish for, Fortune

ECONOMICS told us so...

Martin Feldstein (1997)
Instead of increasing intra-European harmony and global peace, the shift to EMU and the political integration that would follow would be more likely to lead to increased conflicts within Europe
EMU and international conflict, Foreign Affairs
Was the euro a SUCCESS STORY?

From an economic point of view: YES!

1. Everything went as the economic research had predicted
2. The burden of adjustment after the Lehman shock was beared by the labour market (Dornbusch)
3. This led to deflation (Krugman)
4. And to increased political conflicts (Feldstein)

Some BACKGROUND: economics /1

External shock (global recession) under flexible exchange rate

Less demand for domestic goods → Less demand for domestic currency → Currency depreciates → Domestic prices in foreign currency fall → More foreign demand for domestic goods

(and less domestic demand for foreign goods...)

Some BACKGROUND: economics /2

External shock (global recession) in a currency union

Exchange rate cannot adjust → Domestic prices in domestic currency must fall → Domestic demand for domestic goods falls → Unemployment must rise

Some BACKGROUND: economics /3

1. The EZ was particularly fragile because before the external shock the euro had caused a huge accumulation of private debt (Ecb, 2011)
2. Caused by a competitive devaluation of German wages (-6% in real terms) that altered competitiveness (German goods became cheaper); Bofinger (2015).
3. Favored by low interest rates in Southern countries (that made it easy to get indebted to buy cheaper German goods); Fernandez-Villaverde et al (2013).
4. Reinforced by the adverse effects on productivity of low interest rates (Gopinath et al. 2015) and labour market reforms (Daveri and Jona-Lasinio, 2006)

How the EUROZONE works

Germany moderates wages → The other countries’ wages do not adjust → Build up of external imbalances

Germany and CHINA

Italian economists and media blame unfair competition from China, but:

1. From 1999 to 2007 the market shares on Italian trade were 16% for Germany and 3% for China (OECD ITC database)
2. From 2003 (Hartz reforms) to 2009 real wages in Germany fell by 6% while in China they almost doubled over the same period (Ashenfelter, 2012; Yang et al. 2010)
3. Our «China» has been (and still is) Germany (Bagnai, 2012, 2016)
4. Is that a complete novelty?
If in the present situation of balance-of-payment surplus the German authorities are nevertheless going to use their monetary policy to prevent domestic inflation a greater use of the weapon of exchange-rate variations will have to be made.

The balance-of-payments problems of a European free-trade area, Economic Journal

Was the euro a SUCCESS story?

NO

The mainstream narrative

1. We (?) have lived above our means
2. Therefore, we must cut public debt
3. Austerity will restore growth (Alesina and Perotti, 1996; Reinhart and Rogoff, 2010)
4. External imbalances do not matter...
5. ...and hence the euro is not to blame: fiscal profligacy is the cause
6. This became the institutions’ policy stance

...not unexpected!
**THEY told us so...**

Mario Monti (2012)

We are gaining a better position in terms of competitiveness because of the structural reforms. We're actually destroying domestic demand through fiscal consolidation. Hence, there has to be a demand operation through Europe, a demand expansion.

Interview at the CNN, aired May 20, 2012

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**THE BIG QUESTION...**

Since mainstream economics had predicted the failure of the euro... ...and since the four words «I told you so» are so sweet to pronounce

Why are mainstream economists in Europe still advocating this project (and the related austerity policies)?

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**And a possible ANSWER: conflict of interest**

Helgadottir 2015

The «Bocconi boys» goes to Brussels

CEPR

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**What’s wrong with the MAINSTREAM?**

Let me state this point clearly

1. There is nothing wrong in being financed by an institution and endorsing its decisions (let’s say it’s a correlation)
2. However, this advice should not be presented in the media as unbiased (Halimi, 1997, 2005)
3. Never ask the barber if you need an haircut
4. Never ask an EC- or ECB-funded think tank if the euro is good
5. And: it is wrong to prevent pluralism, and this is what mainstream did (Manners and Whitman, 2015)

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**Was the euro a SUCCESS story?**

NO

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**The DECLARED political goal /1**

An «ever closer» union...

**TITLE I**

**COMMON PROVISIONS**

Article 1

(ex Article 1 TEU) [2]

By this Treaty, the HIGH CONTRACTING PARTIES establish among themselves a EUROPEAN UNION, hereinafter called “the Union”, on which the Member States confer competences to attain objectives they have in common.

This Treaty marks a new stage in the process of creating an ever closer union among the peoples of Europe, in which decisions are taken as openly as possible and as closely as possible to the citizen.
The DECLARED political goal /2

... to «withstand» globalization

1. Since nationalism caused last century’s world wars...
2. ...we must fight nationalism by creating a bigger nation...
3. ...that will allow us to better fight against China’s unfair competition (Majone, 2014)
4. The «oggi c’è la Cina» (today there is China) syndrome. My reaction usually is...

Per l’ Unione europea la Cina produce troppo

La bulla del sistema produttivo cinese non ha fine, né sembra trovare niudi effetti. È denso di pessimismo l’ultimo rapporto sull’eversaparity cinesi della Camera di commercio europea a Pechino: dal 2009, data della precedente edizione, la situazione, nonostante gli sforzi, è peggiore. L’eversaparity è un ostacolo allo rilancio, già il titolo della generalizzazione è risaputo.

«Non possiamo più importare i problemi della Cina – taglia, vecio, il presidente della Camera Europea Waller - l’eversaparity cinese si trasforma inevitabilmente in dumping, il che attesta chiaramente che il Piese non ha ancora adeguato agli impegni presi 15 anni fa quando aderì all’Unione. Dimostrare, noi fatti, che si sarebbe preparati a diventare una economia di mercato».

It’s your fault because you grow too little but also because you produce too much!

Was the euro a POLITICAL success story?

From a political point of view: NO!

1. It did not really contribute to reinforce a common European identity.
2. It caused instead a climate of social unrest both in “loser” and in “winner” countries.
3. It caused an outburst of nationalistic resentment (mostly directed against Germany)
4. It is against economic rationality

...and its FAILURE in Greece (bottom-up)

Greek, German Tensions Turn to Open Resentment as Referendum Looms

Anti-German rhetoric from some Greek politicians is met by mounting frustration in Berlin

Die Mitte. OXI
...and Italy (top-down)

Prodi a In mezz’ora: “Germania? Potere troppo arrogante. Mi preoccupa lavoro”

...and Germany.

ECONOMIC RESEARCH told us so…

Nicholas Kaldor (1971)

It is a dangerous error to believe that monetary and economic union can precede a political union. For if the creation of a monetary union and Community control over national budgets generates pressures which lead to a breakdown of the whole system it will prevent the development of a political union, not promote it.

The New Statesman

...and within Germany.

ECONOMIC RESEARCH told us so…

Alberto Alesina (1997)

Large countries have several advantages, including insurance against shocks, and market size. However, as world trade becomes more open, one of the main benefits of a large country becomes much less important. A country does not have to be big to be open.

Comment on M. Obstfeld «Europe’s gamble», Brookings Papers

What’s WRONG with austerity?

A monetary union destroys the benefits of an economic union

1. The whole point of an economic union is to enjoy a larger domestic market that acts as a buffer against external shocks (Alesina, 1997)

2. If intra-zone adjustment in response to a shock occurs through «demand destruction», this benefit gets lost
A monetary union is useful only to the extent that it is harmful

1. If macroeconomic fundamentals are aligned, there will be no major shifts in intra-zone exchange rates, and hence the MU is useless: no need to reduce small transaction costs.
2. If instead there are structural differences across member countries, exchange rate swings can be large, and a MU is potentially useful. However, preventing nominal flexibility through a MU costs more in social terms than hedging against it.

The euro and EUROPEAN FEDERALISM

A more nuanced view on the political failure...

Deliberate use of crises as a governance tool

THEY told us so...

Romano Prodi (2001)

I am sure the euro will oblige us to introduce a new set of economic policy instruments. It is politically impossible to propose that now. But some day there will be a crisis and new instruments will be created.


The political philosophy of FEDERALISM

Monetary union and political union (Castaldi, 2012)

1. People do not want of «Europe» (an abstraction)
2. So let us put people in a situation where they are forced to want it
3. A disfunctional monetary union calls for more political union...
4. ...because once the crisis arrives, fiscal integration (a federal budget) is needed to compensate for the shocks
5. And what if people understand we are affecting the democratic process?

The political philosophy of EC

Brussel’s republic (Juncker’s method)

We decide something, we make our decision public, then we wait and see. If there aren’t any big complaints or upheavals, because the majority does not understand at all what we decided, then we go on, step by step, until a point of no return is achieved.

1. J.-C. Juncker, current president of the EC
2. It is not completely democratic
3. But it is completely naive: history does not know any «point of no return» (Roman empire, Soviet Union,...)
4. And: why to conceal the logic of the decisions taken?
The UNDECLARED political goals

Affecting income distribution by restricting the perimeter of the State

Monetary union as a tool for enforcing a «neoliberal» agenda.
1. The euro was not about reducing transaction costs in trade (this would have been silly; Eichengreen, 1993)...
2. ...it was about affecting income distribution by lowering wages and the provision of public services
3. European integration was not about bringing the decisions closer to the citizens...
4. ...it was about bringing them to Brussels, where they are sheltered from the national democratic processes.

TOMMASO PADOA SCHIOPPA (2002)

In continental Europe a comprehensive program of structural reforms must encompass the fields of pensions, health, labour market, education, and many more. But it must be guided by a single principle: to weaken the system of protections that during the 20th century has separated the individual from the direct contact with the hardness of life." Il Corriere della Sera, 2003

THEY declared their goals...

THEY declared their goals...

Mario Monti (1998)

After all, the European institution were interested in consolidation policies. And they accepted the burden of unpopularity because they were farther away, they were sheltered from the electoral process.

Interview on Italy in Europe, Laterza.

The UNDECLARED political goals

Use the «vincolo esterno» to enforce a «domestic» agenda (Featherstone, 2001)

1. The economist’s point of view: tying one’s hands to virtuous countries in order to «do the right thing» by compressing democracy at home (Giavazzi e Pagano, 1988)

2. The political scientist’s point of view: the «paradox of weakness»: give up sovereignty in order to getting stronger (because the blame of unpopular policies is shifted to supranational, democratically unaccountable institutions; Grande, 1995).

Was the euro a SUCCESS story?

Thank you!