

The future of the Euro



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Recently Mr Draghi, the outgoing President of the European Central Bank, gave a good lecture on the past and future of the currency he has defended and developed in recent years. He gave an honest account of the successes and failures of ECB policy and wider Euro policy by the EU since the foundation of the currency. He admitted that the EU had a bad banking crisis just like the USA and UK in 2008-9, but were slower to tackle the underlying weaknesses of their banks. He accepted that in its wish to be tough on inflation the ECB had been less helpful to output and jobs in the zone, with a measure of overdoing it. He rightly drew attention to the way unconventional measures including creating money to buy up government bonds saved the currency. He did not mention the Greek and Cypriot crises which are also an important part of the story.

The interesting thing he argued for the future was the need to create a "common fiscal stabilization instrument" as he thinks the overall fiscal stance of the Eurozone is too tight. His problem is that the countries that want fiscal expansion to boost their economies including Greece and Italy have very high levels of indebtedness which they cannot expand under EU rules. Mr Draghi recognises he cannot change these rules and maybe does not want to anyway. Meanwhile Germany with capacity to expand its spending, cut its taxes and borrow a bit more, does not want to.

It appears that Mr Draghi is proposing a bigger budget at EU level with borrowing at EU level as well. If the EU had a balance sheet that can be expanded by borrowing to offset overall fiscal tightness across the zone as a whole, that would deal with Mr Draghi's worries about policy stance. There would, of course, be arguments about whether the zone should do any such thing, and if it did where the money should be spent and on what. A suitable scheme might for example allow the EU to borrow substantial sums for infrastructure investment, and then to orient them to the states in a weaker financial position or with lower incomes. This would provide a new mechanism to route some of the German surplus directly into the deficit states.

This is a big question for the incoming European Parliament and Commission. How far away are we from a bigger common EU budget, and a common EU balance sheet expanded to provide more demand and activity in the zone? Isn't it a backdoor way to a transfer union?