The EU in the International Monetary and Financial Regime

Europe in World Economy 2015

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History

Gold standard

- Fixed exchange rate system
- Most important currencies pegged to gold
- Europe-led system, Bank of England as the most important element
- Governments sacrificed internal balance to maintain an external one

Interwar system

- Attempts to restore gold standard
- Problems with parities (undervalued×overvalued)
- Great depression – beggar thy neighbor policy (competitive devaluations)

Bretton Woods system

- Fixed but adjustable exchange rate system
- Currencies pegged to US dollar that was convertible to gold at $35 per ounce
- Provided stability for the post wwii world
- Mounting instability since the end of 1960s

First attempt at establishing EMU

- 1969 The Haague summit
- The Werner report
- Snake in the tunnel
- Nixon shock, first oil shock, enlargement

The European Monetary System

- Since 1979
- New accounting unit – European Currency Unit (ECU) – the basket of all EC currencies
- Exchange rate mechanism (ERM) – allowed exchange rate variation 2,25% from the ECU
- Qualified success
- 1992 crisis

EMU

- Delors report
- Three-stage timetable
  - First stage – intensify economic cooperation, all countries in ERM
  - Second stage – European Monetary institute (later European Central Bank), convergence tests, permanent peg
  - Third stage – the transition to full EMU, introduction of the euro
- Treaty on European Union
  - Opt out for United Kingdom and Denmark
  - All other countries have to join when they are ready

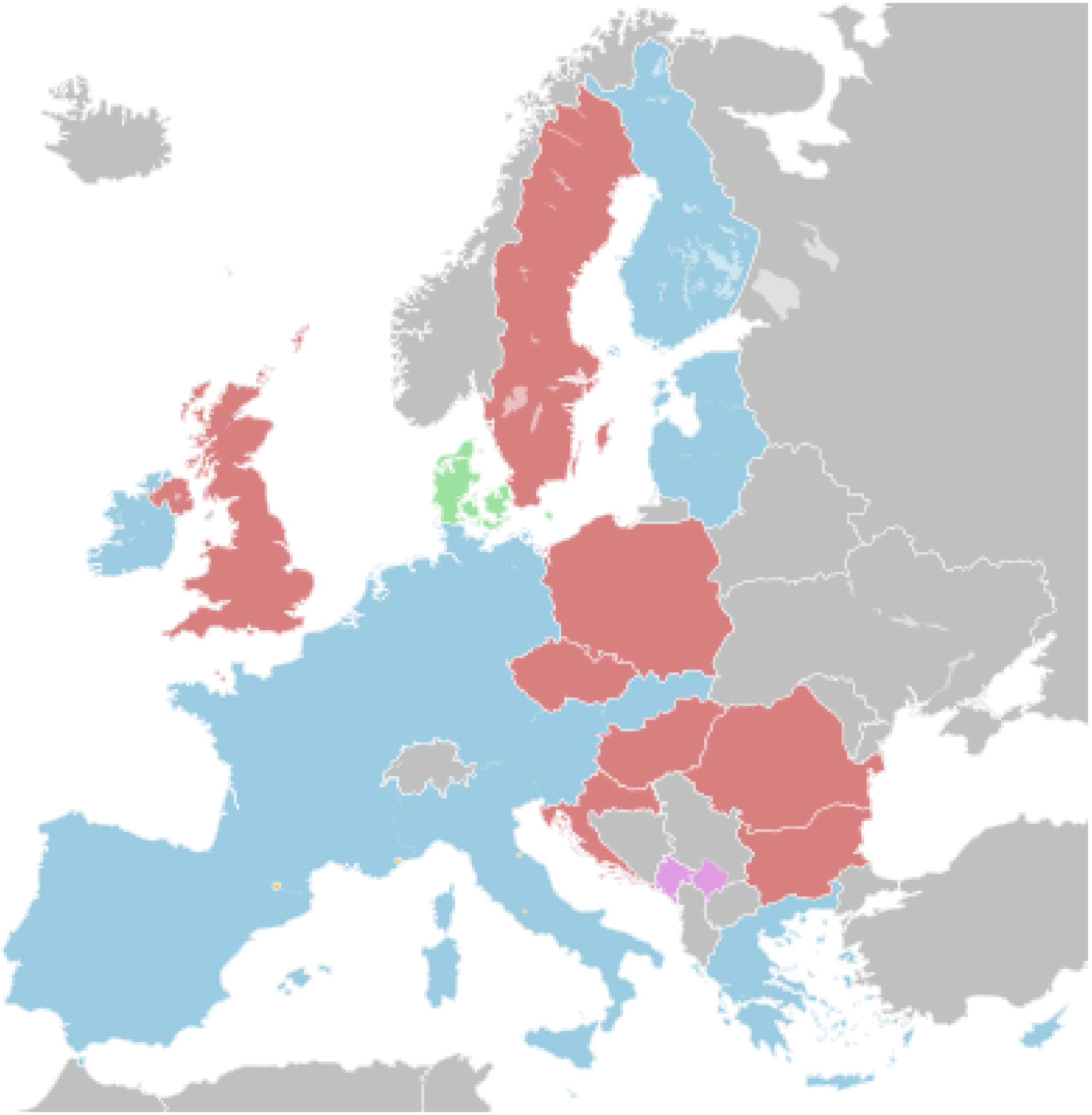
Maastricht criteria

- Government deficit: the ratio of the annual government deficit to gross domestic product (GDP) must not exceed 3% at the end of the preceding financial year
- Government debt: the ratio of gross government debt to GDP must not exceed 60% at the end of the preceding financial year
- Exchange rates: participation in the exchange-rate mechanism of the European monetary system without any break during the two years preceding the examination of the situation and without severe tensions
- Price stability: the inflation rate of a given Member State must not exceed by more than 1½ percentage points that of the three best-performing Member States in terms of price stability
- Long-term interest rates: the nominal long-term interest rate must not exceed by more than 2 percentage points that of, at most, the three best-performing Member States in terms of price stability

EU member states' performance with regard to the convergence criteria

	deficit 95	deficit 96	deficit 97	debt 95	debt 97
Belgium	4,1	3,3	2,1	133,7	122,2
Denmark	1,6	1,4	+ 0,7	71,9	65,1
Finland	5,2	3,3	0,9	59,2	55,8
France	4,8	4,0	3,0	52,8	58,0
Ireland	2,0	1,6	+ 0,9	81,6	66,3
Italy	7,1	6,6	2,7	124,9	121,6
Luxembourg	+ 1,5	+0,9	+ 1,7	6,0	6,7
Germany	3,5	4,0	2,7	58,1	61,3
Netherlands	4,0	2,6	1,4	79,7	72,1
Portugal	5,1	4,0	2,5	71,7	62,0
Austria	5,9	4,3	2,5	69,0	66,1
Greece	9,1	7,9	4,0	111,8	108,7
Spain	6,6	4,4	2,6	65,7	68,8
Sweden	8,1	3,9	0,8	78,7	76,6
Great Britain	5,8	4,6	1,9	54,1	53,4

Eurozone member states



Monetary Policy

- European System of Central Banks
  - European Central Bank + national CB
  - **Governing Council**, Executive Board, General Council
  - Independence (term, secrecy, no monetization)
- Policy
  - Maintaining price stability, other goals subordinate
  - Inflation less but close to 2%

Economic Policy Coordination

- Eurogroup
  - Finance ministers of the eurozone
  - political control over the currency
- Real coordination is reactive and rather haphazard – open method of coordination
- Neoclassical approach
  - maintain price stability
  - provide credibility (CB independence + fiscal rules)
  - other monetary a fiscal policies are ineffective in the long run, lack of coordination should not matter much
  - structural policies are responsible for long term economic growth

Stability and Growth Pact

- The most important instrument of coordinated economic policy
- Adopted in Amsterdam, 1997; in force since 1999
- Reason: fiscal discipline in the EMU as the stability factor of single currency
- Criteria:
  - an annual budget deficit lower than 3 % of GDP
  - a public debt lower than 60 % of GDP or approaching that value
- Excessive budget procedure–proposal of Commission, decision by Council (including sanctions)
- Problems: Germany, France (no sanctions against them in the Council)→changes in the rules since 2005 (moderation of rules)

Position in financial institutions

- International Monetary Fund
  - over 32% of votes, 7-8 seats on executive board
  - SCIMF (subcommittee on IMF matters under Economic and Financial Committee)
  - EURIMF – EU members states' representatives at IMF
- World Bank
  - over 32% of votes, 7-8 seats on executive board
  - meetings, information exchange
- Bank for International Settlements
  - 11 out of 19 seats on board of directors (CB governors)
- G7
  - GB, Fr, Ger, It
  - ECB on selected issues, president of Eurogroup
- G20
  - GB, Fr, Ger, It, EU