

# **Political Economy of European Monetary Integration I**

Europe in World Economy 2017

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# Schedule and readings I

- **26. 4. Political Economy of European Monetary Integration I**
  - Goodhart, Ch. 1998. „The Two Concepts of Money.“ European Journal of Political Economy. Vol. 14, no. 3. Pages 407-432 (26 pp.).
  - Krugman, P.; Obstfeld, M.; Melitz, M.: International Economics. Boston. 2001. Pages 293-319 (27 pp.)
  - Cohen, B.: “The Macfoundations of Monetary Power” in: Andrews, D. (ed.): International Monetary Power. Ithaca. 2006. Pages 31-50 (20 pp.).
  - Godley, W. 1992. „Maastricht and All That.“ London Review of Books. Vol. 14, no. 19. Pages 3-4 (2 pp.). On-line text (<http://www.lrb.co.uk/v14/n19/wynne-godley/maastricht-and-all-that>).
- **3. 5. Political Economy of European Monetary Integration I**
  - El-Agraa, A.: The European Union – Economics and Politics. Cambridge. 2011. Pages 147-193 (47 pp.)

# Schedule and readings II

- **10. 5. Euro in the international monetary system**
  - Bibow, J. 2013. “On the Franco-German Euro Contradiction and Ultimate Euro Battleground.” *Contributions to Political Economy*. Vol. 31, no. 1. Pages 127-149 (22 pp.).
  - Fields, D.; Vernengo, M. 2012. “Hegemonic currencies during the crisis: The dollar versus the euro in a Cartalist perspective.” *Review of International Political Economy*. Vol. 20, no. 4. Pages 740-759 (20 pp.).
- **17. 5. The Contemporary Euro Crisis (by Ales Chmelar, the Office of the Government of the Czech Republic)**
  - TBA





# Money and society

- What is money?
- How is money produced?
- How does it get/lose value?

# The standard economic story (metallist)

- Carl Menger (1892), methodological individualism
- Problems of **rational actors** engaged in economic **exchange**
  - Double coincidence of wants
- Type of an evolutionary explanation – increasing effectiveness of the economic exchange
  - Precious metals (gold, silver) were selected due to their properties, particularly their high exchangeability
  - Paper and later electronic money were introduced as a transaction cost saving device, originally they were to represent the „real money“ deposited in vaults
- With this theory, money is first and foremost a **means of exchange**, its other functions (unit of account, store of value) are secondary
- Barter -> money -> credit

# Problems with the standard approach

- The questionable role of a state
  - It is considered unnecessary for monetary system to operate
  - States have a tendency to destabilize their monetary systems
  - But in some cases it's recognized that states have some important role to play (prevents counterfeiting, guarantees quality)
- Theoretical problems
  - Hoarding of money makes it more scarce and thus less like to be used as money
  - Unstated presuppositions (economic exchange, property rights)
- Empirical issues – anthropological surveys are at odds with the barter story, money predate coins by millennia



# State/credit theory of money

- Money is firstly a **unit of account** for recording debts
- It is an **IOU** and is created when an IOU is issued
- Its value depends on the **credibility** of the promise
- Money is an institution – a generalized and formalized type of an obligation (debt)
- Anyone can issue money (obligations) and almost anything can represent it (cattle, salt, wood, paper)
- The crucial problem is: **How to make people accept it?** How to make it generally recognized? (only then a generalized means of Exchange is possible)
- **Hierarchy of money** (government > banks > firms > households)
- Problems (role of the private sector, legitimacy issues)

# Essence of money

- What is money?
  - **measure of value**
  - It's vital to differentiate between money and money things (what represents money)
  - People coordinate their economic behavior in various ways, the most common in-group coordination mechanism is some form of credit -> money usually measures debts (credits)
  - credit -> money (-> barter)
- How is money produced?
  - By issuing an IOU (× destruction of money)
- How does it get/lose value?
  - Credibility × quantity theory of money (but it's complicated)

# Money and states

- A state is able to **determine its money** (unit of account) once it enforces **taxes/fees** in it
- Governments use money to **mobilize resources** for public purpose
- Money is **accepted** for several reasons: trust, habit, authority, but the ultimate reason is power
- The fact that a state issues its money and declares that it will accept it back in the form of taxes is an expression of **power** (+legal tender)
- Governments can buy anything that is for sale in its currency and is in theory able to **overbid** anyone
- Money has **distributional consequences** and is therefore prone to be abused for **political gains**
- Debtor × creditor interests

# Modern money

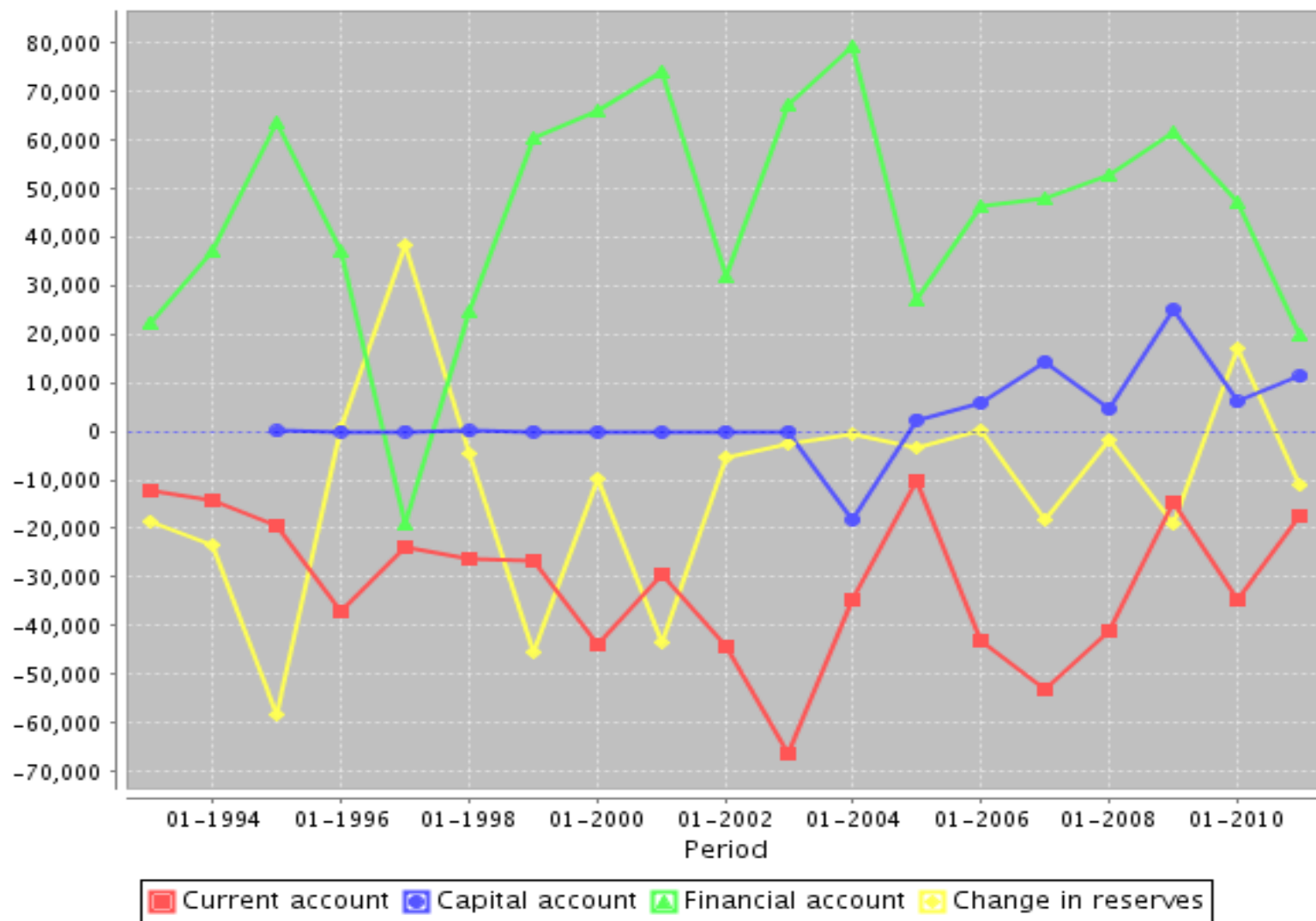
- Usually one state – one currency rule
- Governments owing in their **own currency can't be forced to go bankrupt** but they can decide to do so
- **Fallacy of composition** – what is true for a part (an individual) doesn't have to be true for the whole
  - Individuals  $\times$  states
  - Expenditure = income
- Governments are for historical and political reasons **limited** in their power to exploit their monetary systems
- Most money today is issued by **private commercial banks**
  - Exogenous money – money multiplier
  - Endogenous money – credit creation ex-nihilo

# Limits of domestic monetary power

- Political and institutional constraints
  - Central bank independence
  - Deficit limit
  - Debt ceiling
  - Limited money supply (metal standard, currency peg)
- Inflation and real constraints (output level)
- International constraints
  - Balance of payments constraints
  - Debt in a foreign currency

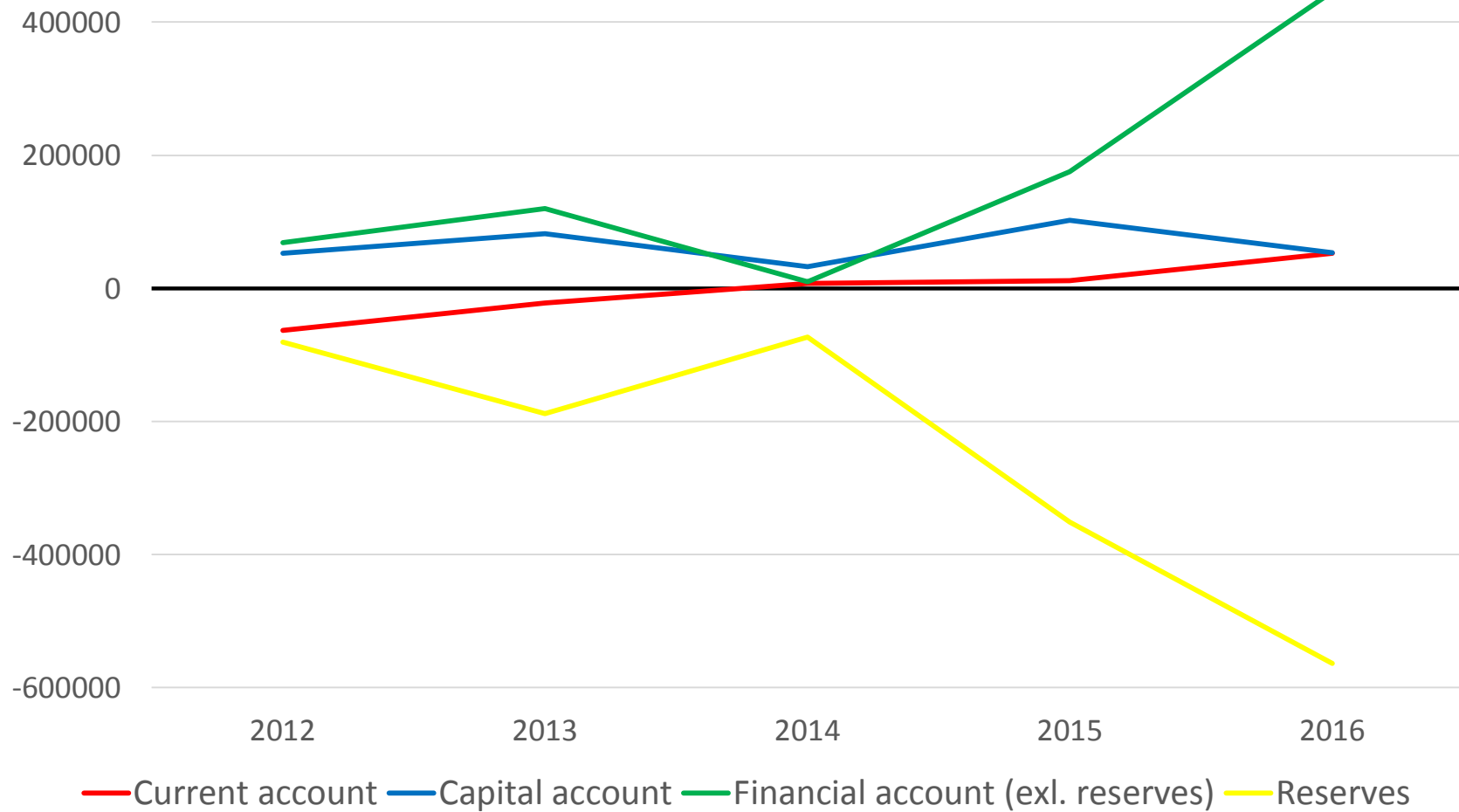
- **Balance of payments**
  - Accounting accord of all monetary transactions between a country and the rest of the world
  - The sum of all accounts has to be equal 0 by definition
- **Composition (IMF × USA!)**
  - Current account – trade + factor income
  - Financial (capital) account (including the reserve account) – net change of ownership of international assets
  - Balancing item (statistical errors)
- **Relations between individual accounts**
- **Net international investment position**
  - Accumulated CA, asset price changes, currency moves

Balance of payment statistics (in millions of CZK)



Source: The Czech National Bank

## Balance of Payments of the Czech Republic 2012-2016



Source: The Czech National Bank



# Net international investment position (% of GDP in 2014)

Switzerland	119,6	United States	-39,7
Japan	74,8	Slovakia	-70
Germany	36,4	Spain	-94,5
China	17,1	Ireland	-106,7
Russia	16,7	Portugal	-111,6
CZ	-35,6	Greece	-121,9

Source: IMF

# Balance of payments adjustment

- Most countries can't run CA deficits for prolonged periods of time
- Relationship to government deficits and debts
- Balancing mechanisms
  - Exchange rate adjustment
  - Internal prices adjustment
  - Various others (debt forgiving, war, emigration)
- Adjustment cost
  - Transitional cost
  - Continuing cost

# Monetary power

- **Autonomy × influence**
- **Power to delay**
  - Liquidity
  - Borrowing capacity
  - Special cases
- **Power to deflect**
  - Sensitivity (openness)
  - Vulnerability (adaptability)
- **Who adjusts?**
  - Deficit × surplus countries
- **Distributional consequences**