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## **The Design Faults of the Economic and Monetary Union**

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**Abstract:** The basic proposition of this paper is that the economic problems which have threatened the existence of the euro have not arisen in the main through 'bad' behaviour of some member states. They rather come from 'design faults' in the construction of the euro project. These faults can be seen as present in the nature of the convergence criteria which focus on nominal rather than real variables; pay no attention to the validity of the exchange rates at which countries enter the EMU, or to the prevailing current account deficits and surpluses; nor to the differences in inflation mechanisms between countries. These 'design faults' continue with the inadequacy of a fiscal policy based on numerical targets operating at the national level. The design of the 'independent' European Central Bank has largely precluded the necessary co-ordination of fiscal and monetary policy, and has also disabled the central banking system from providing sufficient support to national governments and their budget deficits. It is concluded that a complete re-design of the Stability and Growth Pact and related policies is required.

**Keywords:** Economic and Monetary Union, Stability and Growth Pact, EMU Monetary Policy

**JEL Classification:** E58, E61, E63

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## **1. Introduction**

The financial crisis of 2007/09 and the associated 'great recession' have revealed a whole host of problems in the Economic and Monetary Union (EMU), with the future of the euro itself being widely questioned. In this paper it is argued that the economic problems, which confront the EMU, have not arisen, in the main, through 'bad' behaviour (e.g. profligate governments) of some member states but rather from 'design faults' in the construction of the euro project. Elements of these faults were present from the beginning in the nature of the convergence criteria which focused on nominal rather than real variables, but crucially paid no attention to the appropriateness of the exchange rates at which countries entered the EMU, to the prevailing current account deficits and surpluses, nor to the differences in inflation mechanisms between countries. These 'design faults' continued with the inadequacy of a fiscal policy based on numerical targets operating at the national level which were unable to cope with a major recession and its aftermath. The design of the European System of Central Banks with an 'independent' European Central Bank at its centre has largely precluded the necessary co-ordination of fiscal and monetary policy, and has also precluded the central banking system providing sufficient support to national governments and their budget deficits (e.g. by always being prepared to act as 'purchaser of last resort' to the bonds of national government).

## **2. Optimal currency area and all that**

Debates over currency and monetary unions often draw heavily on the ideas associated with the Optimal Currency Area (OCA) literature (for example, Mundell, 1961). The question posed by Mundell and others can be seen as arising from the observation that when a country has its own currency, adjustments to 'shocks' can be effected through an appropriate change in its exchange rate. A 'shock', which has the effect of reducing the demand for its exports or reducing its supply potential to meet demand for exports, can be met by devaluation to stimulate the demand for exports by lowering the price in the foreign currency. In the absence of such an adjustment, the shock could be expected to reduce exports and thereby domestic employment. Although the OCA was much discussed in the academic literature and in studies on the desirability of otherwise for the formation of the euro, it appears to have had no impact on the design of the euro or of the convergence criteria. The OCA literature postulated that in the absence of the variation of the exchange rate possibility, which is clearly the case for a country in a currency union there could be alternative adjustment processes: those of price flexibility, of factor mobility and of fiscal transfers. It is clear that the convergence criteria made no reference as to whether a country possessed sufficient price flexibility. The price

flexibility, which is meant here, is that when the demand for a range of products produced by a country falls, then there is a response of prices of those product in the country concerned declining. It is a change in relative prices which would be called for. As the statistics in Table 1 reveal (and further discussed below), there has been price flexibility between countries, but it is not clear that this has been of the relevant form, that is prices have tended to rise in countries with deficits relatively to prices in countries with surpluses. Labour mobility was relatively low, using the United States as a benchmark. The absence of significant fiscal transfers in the context of an EU budget, set to be balanced and to amount to little more than 1 per cent of GDP is well known, and the issues on fiscal transfers are more extensively discussed below.

The OCA literature relates to ‘shocks’ and makes an implicit assumption that the initial conditions are satisfactory and then focuses on adjustments to ‘shocks’ to the initial equilibrium position. But, as we discuss in section 5, there were initial imbalances (that is initial at the time the EMU was being formed). These include a pattern of current account deficits and surpluses (and correspondingly a pattern of capital account inflows and outflows) and major differences in unemployment. The unemployment position in many countries at the time of joining EMU (see Table 1) was far from satisfactory and could in no way be described as one of full employment or indeed equilibrium in the labour market. The structure of the EMU did not provide for adjustment processes which could rectify the initial (and largely worsening) imbalances between EMU countries.

Table 1 near here

### **3. The convergence criteria**

A country’s membership was in principle conditional on meeting the convergence criteria. The criteria referred to inflation and interest rates, achievement of budget deficit and public debt requirements and independence of Central Bank. In the outturn (Arestis, Brown and Sawyer, 2001), the conditions were fudged. The issues surrounding budget deficits and independence of Central Banks are returned to below.

The considerations, which were omitted from the convergence criteria (and as far as one can tell from serious thought in respect of the formation of the monetary union), were notable for what they indicate was relevant and significant and what was irrelevant and insignificant. And it was many of those omissions, which were sources of many of the difficulties that have since emerged. There was no mention of convergence of the business cycle that was significant in relation to EMU macroeconomic policy, which was in effect monetary policy (and the differences in country’s position in the cycle could be judged by the output gap

figures cited in Table 1). Monetary policy is of necessity an undifferentiated policy and inevitably runs into a 'one size fits all' problem. There was also a lack of concern over the level of unemployment in terms of a lack of any reference to low levels of unemployment being an objective of monetary policy (or any other policy). There was a lack of concern over differences between countries over unemployment on entry into a fixed exchange rate regime. This constrains high unemployment countries in their ability to draw level with fellow euro area member countries with relatively low unemployment. A country with high unemployment would have to find additional sources of demand for their output if their unemployment record is to improve, and to do so without a serious deterioration in their current account position.

The convergence criteria required convergence of inflation rates at the time of admission into the EMU, with a country's inflation rate (in March 1998) being within 1.5 per cent of the average of the rate in the three countries with the lowest inflation. This was a reasonable requirement given that a common inflation rate after union would be a requirement for its sustainability, though as indicated in Table 1 a common inflation rate was not achieved. The inflation rate requirement was for a moment in time, and as Table 1 indicates inflation rate divergences had re-appeared by 2001. It is well-known that the constituent members of EMU had previously experienced different inflation patterns (for example, compare Germany and Italy). But there was little concern as to whether there was a similarity in inflationary conditions. Thus, whether there was any tendency for one country to inflate faster than another or whether inflationary expectations were similar were ignored despite the marked differences in inflation experience in the preceding decades. There was also no regard paid to differences in the inflationary barrier between countries, that is differences in the unemployment rate which may be consistent with constant inflation. The creation of the single currency may have generated some conditions, which would be conducive to less divergence in inflation experience (e.g. trade between countries in a common currency placing pressure on prices). But crucially there was no criteria on inflationary conditions being similar. In that we would include any underlying tendencies on the rate of inflation, the wage and price determination mechanisms, the responsiveness of domestic prices to foreign price changes and the effects of fluctuations in demand and economic activity on wage and price inflation.

There was also rather surprisingly little attention given as to whether the exchange rate at which a country entered the euro was a sustainable one – the only regard paid in that respect was that prior to entry the currency concerned had been within the Exchange Rate

Mechanism (ERM); and hence that the exchange rate of the currency had remained relatively close to the central value. But no regard appears to have been paid to whether the current account was in deficit or surplus, and hence whether the corresponding capital account position would prove sustainable. The mixture of the dissimilarities of inflationary conditions and the lack of regard to the sustainability of the current account position on entry has now come to haunt the EMU. The competitiveness of some countries has deteriorated adding to their current account deficits, and the need to borrow from abroad to meet the deficit.

#### **4. Fiscal transfers and the Stability and Growth Pact**

The EMU has been notable for the lack of fiscal transfers between the component national states affected by some Federal authority. The role of such transfers (as is undertaken for example in the USA) would combine a transfer of spending power from the relatively rich area to the relatively poor area and would serve to limit the effects on an area from an asymmetric shock. A Federal level fiscal policy would also serve to operate across the piece as an automatic stabiliser. But a Federal fiscal policy would need the ability to run significant budget deficits and not to be constrained by any necessity to balance the budget over some time horizon. The significant advantage of a Federal fiscal policy of this type would have been that a region particularly hard hit by recession would have received fiscal assistance rather than having to rely on its own borrowing to operate a budget deficit sufficient to contain the worst effects of the recession. The strength of the EMU would have permitted necessary borrowing at more conducive interest rates than a country left to itself. EMU would have the major advantage in this regard (further discussed below) that it would be borrowing in its own currency, and as such there would be no risk of default on the debt simply because EMU (through the European Central Bank) would in effect always be able to create sufficient money to pay any debts. The significant issue for national governments within EMU is that their borrowing is in effect in a foreign currency in the sense that the euro was a currency where the national government had no control over the volume of the currency.

The key features of the Stability and Growth Pact (SGP) are that member countries should maintain budget deficit at less than 3 per cent of GDP (with minor exceptions for severe recession) with a budget in balance or small surplus over the cycle, and with government debt less than 60 per cent of GDP. The budget deficit requirements have generally not been met (data in Table 2) with an average eurozone budget deficit of 2.2 per cent of GDP over the period 2002-08. The 3 per cent limit has been breached on many occasion – using figures from OECD, Economic Outlook, there were 26 times when a country exceeded the 3 per cent limit on an annual basis.

Table 2 near here

The SGP limits suffer from a number of shortcomings. First, a zero budget deficit as recorded would be a surplus of around 1 per cent of GDP in real terms (the fall in the value of the public debt due to inflation is equivalent to 1.2 per cent of GDP for a 2 per cent rate of inflation and a 60 per cent debt to GDP ratio). Second, a 60 per cent debt ratio is consistent with a 3 per cent budget deficit on a sustainable basis since the relationship between deficit and debt on a sustainable basis is public debt = deficit divided by nominal growth rate, and here a 5 per cent nominal growth rate is taken. Third, and more significantly, the requirements of the SGP are asymmetrical in the deflationary conditions – there is an upper limit on deficits but no upper limit on surpluses. Fourth, a numerical target is introduced for budget deficits without any rationale, other than to proclaim an overall zero budget deficit. An alternative rationale for the size of a budget deficit, drawing on the ‘functional finance’ view (Arestis and Sawyer, 2007), would be to use the budget deficit to ensure a high level of economic activity. Then, for the target budget deficit to be in line with private savings minus investment plus current account deficit, which would be forthcoming at that high level of economic activity. On that basis, the appropriate scale of the budget deficit depends on a range of factors including the average propensities to save, propensity to invest, to import and the scale of exports. Countries vary in their savings and investment behaviour and in their net export position, and hence the appropriate budget deficit would vary from country to country. The SGP fiscal policy then also suffers from a rather severe ‘one size fits all’ problem.

The SGP imposes a general deflationary bias in two related ways. First, those countries where the appropriate budget position (for a high level of economic activity) was in surplus would not be subject to any constraints from the SGP; those whose appropriate budget position was one of deficit would be, and the constraint would act in the deflationary direction. Second, the general experience of most EMU countries has been one of significant budget deficits – indeed countries would not have been entering the euro with debt ratios to GDP in the range 60 to 100+ per cent unless they had been generally running budget deficits. Recall here that an average budget deficit ratio (to GDP) of  $d$  would lead to a debt ratio (to GDP) of  $b = d/g$  where  $g$  is the nominal growth rate so that with a nominal growth rate of 5 per cent a 60 per cent debt ratio corresponds with a 3 per cent deficit, and 100 per cent with 5 per cent. The current push towards tighter observance of the deficit requirements, particularly in the context where those pressures are being applied to many countries at the same time, can only exacerbate the deflationary climate.

The approach to fiscal policy within the EMU has contained, by design and by institutional arrangements, pressures towards deflation. It has been based on a pre-Keynesian perspective in that there is the belief that budget deficits are, on average, not required, and hence that private aggregate demand will, on average, be sufficient for the maintenance of high level of economic activity.

## **5. European Central Bank**

The European Central Bank (ECB) was established as an 'independent' institution, where independence means no interference from any other institution or individual at all. The national central banks, which form along with the ECB, the European System of Central Banks (ESCB), are also independent, as required according to one of the convergence criteria for euro membership. The price stability objective of the ECB is interpreted as inflation below but close to 2 per cent. The independence of the ECB and the objective of price stability fit with the idea of inflation targeting but not precisely so in view of the 'reference value' for the M4 definition of the money supply, the latter being 4.5 percent. The decisions on interest rates made by the ECB could be discussed in detail and whether those decisions may have been over cautious. But it is not the details of those decisions which is central here. It is rather the framework within which monetary policy has been set.

It can first be noted that the ECB has largely failed to meet the price stability target with inflation within the eurozone being over 2 per cent every year from 1999 until the onset of the 'great recession' in 2007. Albeit the margin by which the target was missed was small (much less than 1 per cent in general) until 2008 when the eurozone inflation rate peaked at 4 per cent in July 2008. The case for an independent Central Bank is often made on the basis of the credibility in terms of achieving the inflation target. Yet the credibility of the ECB appears not to have suffered from this persistent failure.

It is in the nature of monetary policy that it can suffer from the 'one size fits all' problem – monetary policy has to be uniform across a currency union, yet the economic issues and problems, which are being addressed by monetary policy, vary across the currency union, e.g. by region or in the EMU by country and by region. The severity of the 'one size fits all' problem is much reduced if the conditions in the member regions are closely correlated (e.g. over the movements of output, inflation) and if the responses of economic variables of relevance to the policy instruments (interest rate) are similar between member regions.

The influences on the rate of inflation are numerous, but here it is useful to mention the demand-pull approach (Phillips curve) and the cost-related approach. Inflation targeting is closely related with the former with the transmission mechanism running from interest rate to



the level of demand and thereby onto the rate of inflation (Arestis and Sawyer, 2008). Yet inflation will be influenced by costs of imports notably of commodity prices and by wage determination. The former are likely to be rather similar across countries of EMU, with relatively minor differences arising from the composition of their imports. The latter have differed significantly between countries (see Table 1) reflecting differences in wage policies and in wage determination processes. Monetary policy cannot address those differences since it is not only undifferentiated across countries but has little impact on wage determination.

When there are differences in countries' inflation rates, a 'perversity' arises, namely that a common nominal policy rate set by the ECB translates into a lower real interest rate in a country with a higher rate of inflation, yet the theory of inflation targeting is that higher inflation should be addressed by a higher nominal and a higher real rate of interest. Thus on this theory, differences in inflation rates are exacerbated by the common monetary policy, in effect stoking up demand in a country with higher inflation.

Although inflation targeting is focused on the interest rate/inflation dimension via demand linkages, it has become widely acknowledged (particularly since the financial crisis) that interest rate can have effects on asset prices and on exchange rates. The 'one size fits all' issue feeds into aspects of the financial crisis. An example: Spain's economy boomed as a construction boom developed, which in retrospect was unsustainable. This construction boom no doubt had a range of causes but low real interest rates would be supportive of such a boom. If the Spanish authorities had wished to dampen down the boom or to have coped with the bust through the use of interest rates and monetary policy more generally it was powerless to do so.

The operations of a Central Bank in many (but not all) countries involve the Central Bank acting as a lender of last resort to the banking system. Further the government does not directly issue money and budget deficits have to be covered by borrowing. However, the Central Bank accepts government paper from banks as collateral for provision of reserves (at the policy rate of interest) and through that route the budget deficit could be said to be partially money financed. If the balance sheet of central government and Central Bank (as a public owned institution) are consolidated, the relationship  $G - T = \Delta B + \Delta M$ , where  $G$  is government expenditure,  $T$  taxes,  $\Delta B$  denotes changes in borrowing and  $\Delta M$  changes in the stock of money, holds. The Central Bank would always accept government bonds from banks – at the price which it has set. There would not be a question on the acceptability of those bonds. The Central Bank may accept other 'paper' (as a number have in the aftermath of the financial crisis).

When a government issues bonds in its own currency, then there is no risk of it being unable to meet its obligations on those bonds, whether in terms of interest or repayment of principal. The government possesses powers of taxation. But more significantly, it is the Central Bank which has the ability to create money. Provided that the Central Bank creates the money, the bonds can always be repaid in the national currency. The Central Bank, if necessary under orders from its owners, the government, ensures that the bonds are repaid: in that way there is no risk of default on government bonds when they are denominated in the national currency.

The arrangements within the EMU raise problems in this regard. On the one hand there is no fiscal policy and no budget deficit at the level of EMU. On the other hand, national governments do run budget deficits and have outstanding debts, but have to do so in a 'foreign' currency, the euro: 'foreign' in the sense that the national government and the national central bank are not able to create the currency in which the debt is denominated. It is further the case that the ECB does not have to accept the 'paper' of the national governments, and indeed had adopted a general policy of only accepting 'paper' which has achieved a 'high' credit rating. This type of policy was suspended with the onset of the 'great recession' and when it became apparent that the role of the credit rating agencies was rather suspect.

The ECB can, but does not have to, operate as lender of last resort. It is prohibited from monetising government debt, but in that regard differs little from many Central Banks in not directly monetising public debt though there is the indirect monetisation referred to above. The ECB has at times been slow to react to issues and problems, notably in the first weeks of the global financial crisis of Autumn 2007. The issue here is not that mistakes were made but how far the ideology and policy making framework could be held responsible. The desire to establish credibility and the focus on price stability only, and at the expense of real variables point in the direction of a likely deflationary bias in their decision making.

Although the ECB was established as 'independent' this has not precluded it from pronouncing on macroeconomic policy and to pushing a particular agenda (along the lines of fiscal consolidation and labour market 'flexibility'; see, for example, the monthly press conferences of the President of the ECB on this matter). But that very independence comes at the expense of limits on co-ordination of economic policy with the other institutions of EMU and the EU. Further, the focus on price stability has meant that the effects of interest rates on exchange rate and asset prices are largely ignored. The authorities have been left virtually powerless to address problems such as rapidly rising house prices, construction booms and the like, which contributed to the evolution of the financial crisis. The policy of

inflation targeting (as we have argue elsewhere; see, for example, Arestis and Sawyer, 2008; Arestis, 2009) has not been the success story often portrayed and, as indicated above cannot address the significant problem of inflation rates differing across member countries. The EMU is left bereft of an effective inflation policy. The emphasis of monetary policy should shift to much more concern with financial stability. The focus of financial stability should be on proper control of the financial sector so that it becomes socially and economically useful to the economy as a whole and to the productive economy in particular. Banks should serve the needs of their customers rather than provide short-term gains for shareholders and huge profits for themselves. IMF (2010) suggests a macro-prudential approach to contain systemic effects of ‘too-important-to-fail’ institutions, including now non-bank institutions. Also, Bean et al. (2010) suggest that macro prudential policy is a better policy to prevent asset and credit bubbles than monetary policy; the latter “seems too weak an instrument reliably to moderate a credit/asset price boom without inflicting unacceptable collateral damage on activity” (p. 32). Macro prudential policy acts more directly on the source of the problem. At the same time, though, monetary and financial stability policies should be coordinated. We go even further and suggest that it is vital for full coordination of both policies with fiscal policy, along with discretion in applying them. Financial stability has attracted renewed interest and focus as an instrument of monetary policy. King (2009), for example, argues that “the instruments used to pursue financial stability are in need of sharpening and refining” (p. 5).

## **6. Current account deficits and surpluses**

The statistics in Table 1 indicate that countries entered the EMU with deficits and surpluses. In 2001, for example, deficits of over 4 per cent of GDP arose in Greece and Portugal, and surpluses of over 5 per cent in Finland and Luxembourg. Whilst Germany moved from deficit to surplus over the period, the pattern of deficits and surpluses tended to persist, and in a number of cases the deficits tended to grow. There has been significant changes in competitiveness between countries (at least as measured by unit labour costs), and some illustrative figures are given in Table 2.

The counterpart of current account deficits and surpluses is, of course, capital account surpluses and deficits. Much of the lending and borrowing involved was between the member countries of EMU, reflecting the ease of borrowing and lending in a common currency, and that the EMU as a whole was close to being in current account balance. The cumulative (and largely private) borrowing has been a significant factor in the financial crisis and its transmission. The ‘great recession’ has highlighted in a big way that banks in a number of Northern European countries (notably France and Germany) have become substantial lenders

to so-called periphery countries. The pattern of borrowing and lending may well have contributed to the development of asset price bubbles and unsustainable construction booms in some countries. It also meant that liabilities, both public and private, of the residents of country A appear as assets of banks and others in country B. The support for country A through bail-out and other programmes become in effect the bail out of the banks of country B which would otherwise suffer losses on their assets.

The pattern of current account deficits and surpluses of countries within the EMU poses major problems for the continuation of the EMU. The EMU does not contain mechanisms by which the pattern of deficits and surpluses can be resolved. Simply countries with current account deficits would have to generate through price and wage reductions what would amount to a devaluation and/or develop industrial and other policies which over time would drastically improve its competitiveness. Countries with surpluses have then to be willing to accept the reduction in those surpluses and not seek to match the reductions in prices and wages. There would have to be some agreement amongst the member countries on the resolution of the pattern of deficits and surpluses. With the present patterns of competitiveness and current account positions, those with deficits will find growth and an acceptable level of economic activity difficult to attain simply because they would likely find difficulties in continuing to borrow for outside their country.

These problems with current account deficits and surpluses arise mainly from a combination of the neglect of current account positions in the convergence criteria. Also from other factors, such as the entry of countries into the euro at exchange rates, which corresponded to current account deficits; and to the evolution of competitiveness between member countries. In effect these arise from design mistakes over the convergence criteria and the absence of mechanisms to address differential movements in competitiveness.

## **7. Can the euro project be saved?**

The EMU project could be seen to be based on two pillars. The first was an essentially neo-liberal policy framework (Arestis and Sawyer, 2006). The second was to see the single currency as the final stage of economic integration in removing what could be seen as the final barrier to free trade (different currencies and the associated costs) after the removal of non-tariff barriers under the Single European Act.

The first was embedded in the Treaty of European Union in its various forms and now cemented in the Treaty of Lisbon, more precisely 'The Treaty on the Functioning of the European Union'. Changes to the Treaty of Lisbon require the unanimous agreement of the 27 member countries, and since the changes required to support the euro involve policies,

which could be seen as moves towards political union, the possibilities of making those changes is close to zero. This indicates not only the ‘stupidity’ of the policy framework, but also that of embedding economic policies into a constitution, which is virtually impossible to change. It would also have to be recognized that the dominant macroeconomic institutions in the EMU, notably the ECB and the Directorate General (D-G) for Economic and Financial Affairs (European Commission), appear to be fully signed up to the neo-liberal agenda.

With regard to the second pillar, it was recognised by some advocates of the euro, that there were many ways in which there was insufficient economic integration to support a single currency, but that in the presence of a single currency, integration would continue to a stage, which did support a single currency. The conditions indicated by the OCA literature could be seen as the nature of the integration in terms of generating movements in relative prices and permitting factor mobility.

The political limits (including those arising from the nature of the Treaty of Lisbon) and the ideological constraints (associated with the neo-liberal agenda) on serious reforms are discussed below, from which the general conclusion is that the needed reforms will not be carried through. This discussion also includes consideration of the possible role for a substantial EU-level fiscal policy and some other aspects of political union.

The policy agenda for a sustainable euro and EMU would include:

- (i) the development of fiscal policy arrangements including the development of a substantial EU (or EMU) level fiscal policy (with significant levels of tax revenue and expenditures and the ability to run budget deficits), and coordination of national fiscal policies designed to support a high level of economic activity. The scale of budget deficits, which may be required, would need to be fully supported by the ECB in the sense of always accepting EMU/EU bonds and national government bonds ;
- (ii) the end of independence of the ECB and its incorporation into the economic policy making framework, and the key objective of the ECB becoming financial stability rather than price stability;
- (iii) policies at the EMU level to resolve the current account deficits through appropriate changes in relative prices and competitiveness;
- (iv) policies at the EMU level, which address the overall level of inflation within the area and the tendencies to inflationary differentials between countries.

## **8. Summary and Conclusions**

We have argued in this paper that the economic problems which have threatened the existence of the euro have not emanated from the wrong application of the relevant economic policies of some member states. They rather come from the fact of 'design faults' in the original and subsequent changes to the euro project. We have paid a great deal of attention to the following problems: the nature of the convergence criteria, which focus on nominal rather than real variables; paying no attention at all to the variability of the exchange rates at which countries enter the EMU; paying very little attention, if at all, to the prevailing current account deficits and surpluses, a major factor in the promotion of the degree of the seriousness of the 'great recession' within the euro area; and not worrying sufficiently about the differences in inflation mechanisms between countries. These problems are not helped by the inadequacy of a fiscal policy that is heavily based on the 'faulty' stability and growth pact operating at the national level. The 'independent' European Central Bank, which has largely precluded the necessary co-ordination of fiscal and monetary policy, and has also disabled the central banking system from providing sufficient support to national governments and their budget deficits. Abandoning the Stability and Growth Pact and the way the ECB is currently operating are important conclusions along with the suggestion that financial stability should be the main focus of the 'revised' ECB model, along with coordination of it with monetary and fiscal policies.

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**Table 1 Economic Statistics for EMU 12 Original Members for 1998 to 2001**

	Current account position as percent of GDP		Inflation rate		Unemployment rate		Output gap	
	1998	2001	1998	2001	1998	2001	1998	2001
Austria	-2.5	-0.2	0.8	2.3	4.3	3.7	0.6	0.4
Belgium	-1	0.4	0.9	2.4	9.3	6.6	-0.9	-0.3
Finland	1.6	5	1.3	2.7	11.4	9.1	0.0	0.1
France	-2.6	-1.6	0.7	1.8	10.3	7.8	0.1	1.0
Germany	-2.2	-2.8	0.6	1.9	8.9	7.5	-0.4	1.0
Greece	-3.8	-4.4	4.5	3.7	11.2	10.8	-1.5	-1.6
Ireland	2.3	0.9	2.1	4.0	7.6	3.9	1.6	2.9
Italy	-3.1	-3.1	2.0	2.3	11.5	9.2	-2.7	0.8
Luxembourg	3.4	6.1	1.0	2.4	3.1	2.5	1.4	1.5
Netherlands	-0.9	-0.3	1.8	5.1	3.9	2.2	1.4	2.1
Portugal	-3.4	-4.3	2.2	4.4	4.4	5.0	-0.1	2.6
Spain	-3.2	-0.7	1.8	2.8	14.6	11.0	-1.0	1.7

Source: Calculated from OECD, Economic Outlook, 2010/1, no. 87



**Table 2 Economic Statistics for Eurozone 12: Experiences under the Euro**

	Annual average growth rate 2002-08	Cumulative inflation rate (1999-2008)	Unit labour costs 2008 compared with 2001	Budget deficit as percent of GDP average	Government debt as percent of GDP 2008 (Maastricht definition)	Current account surplus as percent of GDP 2008
Austria	2.37	20.7	100.95	1.66	62.7	3.2
Belgium	1.34	24.6	112.78	0.69	90.0	-2.5
Finland	3.07	19.3	89.60	-3.54	34.2	2.8
France	1.20	20.9	108.54	3.19	67.5	-2.3
Germany	1.20	18.2	96.56	2.30	66.0	6.6
Greece	3.87	38.3	111.73	5.46	99.2	-14.6
Ireland	4.30	39.2	113.86	0.11	43.9	-5.4
Italy	0.71	27.0	133.83	3.14	106.1	-3.4
Luxembourg	3.93	32.5	118.24	-1.29	13.7	5.5
Netherlands	1.94	26.6	113.89	0.86	58.2	4.8
Portugal	0.81	33.2	104.06	3.54	66.3	-12.1
Spain	3.03	32.7	128.84	0.04	39.7	-9.6

Source: Calculated from OECD, Economic Outlook, 2010/1, no. 87