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PRESS RELEASE

Lessons from the US for the institutional design of EMU

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This paper compares the euro area and the US in order to draw lessons for improving the Economic and Monetary Union. Although it is not perfect, the US comes closer to fulfilling the criteria of the Optimum Currency Area theory, and it did not experience the debt crisis that hit the euro area, partly because the US has federal institutions which are totally or partially lacking in the EU.

The stability of the euro area would improve if the Member States came closer to meeting the criteria of an optimum currency area. That requires more flexible markets in products and labour and an increase in the regional mobility of labour. Deepening of the single market could also make a contribution here, and could further enhance the benefits of the single currency by boosting trade. In addition, it is necessary to avoid economic imbalances which can generate contagion effects in other Member States. In the absence of a federal economic policy like that in the US, the existing rules on the coordination of national economic policies, translated annually by the Commission and the Council into the country-specific recommendations of the European Semester, must be actually implemented.

It is vital to avoid any repeat of the sudden reversal of capital flows such as that which occurred in 2010. That requires a Banking Union like the one in the US. In that respect, great progress has been achieved with the Single Supervisory Mechanism and the comprehensive assessment of the banks which come under it, and with the establishment of a Single Resolution Mechanism. The resolution mechanism needs further refinement by the addition of a fiscal backstop. The third pillar of the Banking Union, a Single Deposit Guarantee Scheme, could also help to prevent adverse financial shocks in the euro area. The development of alternatives to bank financing of the economy via a Capital Union is still necessary to ensure that the 'risk-sharing' between the Member States will take place to a greater extent via the financial markets, reducing the need for budget transfers.

For the residual risk-sharing need, the US has an important form of debt mutualisation and a federal budget that helps to cushion economic shocks. However, that has evolved over two centuries of political integration. The euro area implemented its common monetary policy immediately, and with success, but we cannot expect the 18 nation states of the euro area to take sufficient steps towards a political union within a relatively short time span, though that is necessary for the issuance of common debt and for an agreement on a significant budget for the euro area or another shock-absorbing fiscal mechanism.

The issuance of common debt is a panacea for multiple euro problems and would expand the range of monetary policy instruments, but – like transfers – it is accompanied by the moral hazard problem. Until a convincing solution has been found, we can expect such mechanisms to remain politically taboo. Monetary unions have a central budget because they are also political unions; the euro area is an exception to that historical rule. The euro area can survive without a federal budget; provided they are respected, the margins inherent in the European fiscal rules make it possible to absorb economic shocks via the national budgets, something that an efficient Banking and Capital Union will do much to assist.