Current Account Imbalances in the Eurozone: Causes, Remedies and the Role of the ECB

Karlhans Sauernheimer

1 The European Monetary Union

1.1 History

The European Economic Community, starting in 1958, left monetary policy as a national responsibility. Art. 105 and 108 EEC Treaty only weakly restricted monetary autonomy by demanding the member states to treat their economic and exchange rate policy ‘as a matter of common interest’. At the time of the Bretton Woods Monetary Order, exchange rates were fixed to the US-$ with a small bandwidth of +/−1 per cent. EC founding member states agreed to narrow the bandwidth for their currencies to 0.75 per cent – a first small hint of ‘a common interest’.

After the breakdown of the Bretton Woods System and a period of general floating in the early seventies, the European Monetary System, EMS, was created in 1979. It was a fixed exchange rate system for the then nine EC member countries with a joint float vis-à-vis the currencies of third countries. The internal bandwidth was 2.25 per cent, allowing a little bit more flexibility than the Bretton Woods Regime, but establishing the idea of a joint currency block.

The system continued, notwithstanding numerous realignments due to differing monetary policies in the member countries, until 1998. Its anchor currency was the German Mark, which was the sole currency and was never devalued. In 1999, the EMS gave way to the European Monetary Union, EMU, and its common currency, the Euro.

1.2 The legal foundation of the EMU: The Maastricht Treaty

It was a big step to move from a de jure national monetary independence in the EMS to a loss of that independence in the EMU. No government
gives away easily the power to create its own money, to control interest rates and to set exchange rates. What must have happened was a kind of political earthquake, and it was, as is well known, the German unification in 1990. It leads to a mutual commitment: Germany abandoned its strong currency, the Mark, and with it the power to make the other EMS countries follow its monetary policy or to devalue. The other countries, especially France, accepted a central bank statute, which was, given their history, dissatisfactory: too narrowly committed to price stability, no responsibility for high employment, too indifferent to fiscal needs, technocratic and depoliticized. The statute became part of the Maastricht Treaty 1992. The treaty committed the 12 signatory states to start the European Monetary Union by 1 January 1999, at the latest.

The EMU was built on two pillars: The monetary pillar was the European Central Bank, ECB, and its statute. The fiscal pillar was the obligation for the member countries to ‘avoid excessive public deficits’. To enter the two-pillar building, applicants had to meet five convergence criteria: three monetary and two fiscal criteria.

The most important provisions of the Maastricht Treaty are the following:

1. Art. 105: The primary objective of the ECB is price stability.
2. Art. 105a: The ECB has the exclusive right to authorize the issue of bank notes inside the community.
3. Art. 107: The ECB and the members of its decision-making bodies are independent of political pressure.
4. Art. 109a: The Governing Council of the ECB is composed of the members of the Executive Board of the ECB and the Governors of the national central banks. According to Art.10 of the Protocol on the statutes of the ECB, decision making is made by the principle of ‘one man one vote’.
5. Art. 104: ECB credits to national authorities or community institutions are prohibited. The same is true for the direct purchase of government debt instruments by the ECB.
6. Art. 104b: No member state is liable for the commitments of other member states (No-Bail-Out Clause).
7. Art. 104c: The member states avoid excessive public deficits.
8. Art. 109j: Participating countries have to fulfil three monetary and two fiscal convergence criteria. The monetary criteria to be met are a sufficient degree of inflation and interest rate convergence to the inflation and interest rate of the three countries with the highest degree of price stability and no devaluation in the last two years