Why we got here… and where we are headed

Ashoka Mody
October 27, 2018

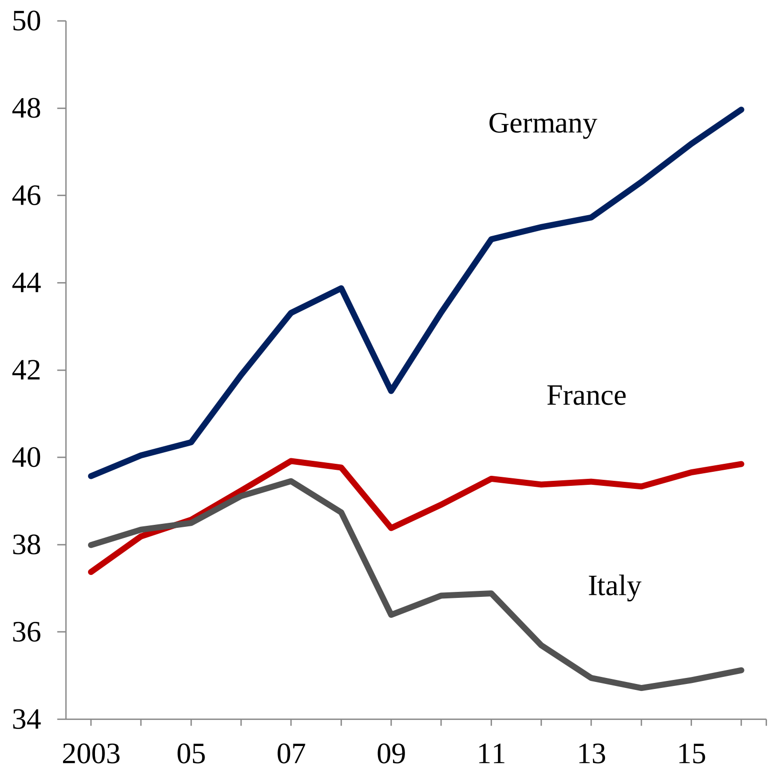
Based on *EuroTragedy: A Drama in Nine Acts*, New York: Oxford University Press, June 2018

Thesis: monetary union would lead Europe into political union.

- Early warnings: monetary union would increase political tensions and divisions—rather than foster political unity.
- **Nicholas Kaldor**, March 1971:
  - Single currency would *amplify* economic divergence, and
  - A house "**divided against itself cannot stand**."
- **Robert Marjolin,** crucial catalyst of Treaty of Rome, in the 1970s:
  - Political efforts to counteract economic divergence would be impeded by the **sovereignty barrier**:
  - European leaders "**obviously not ready**" to give up core sovereign functions;
  - Change required was "**too profound**."

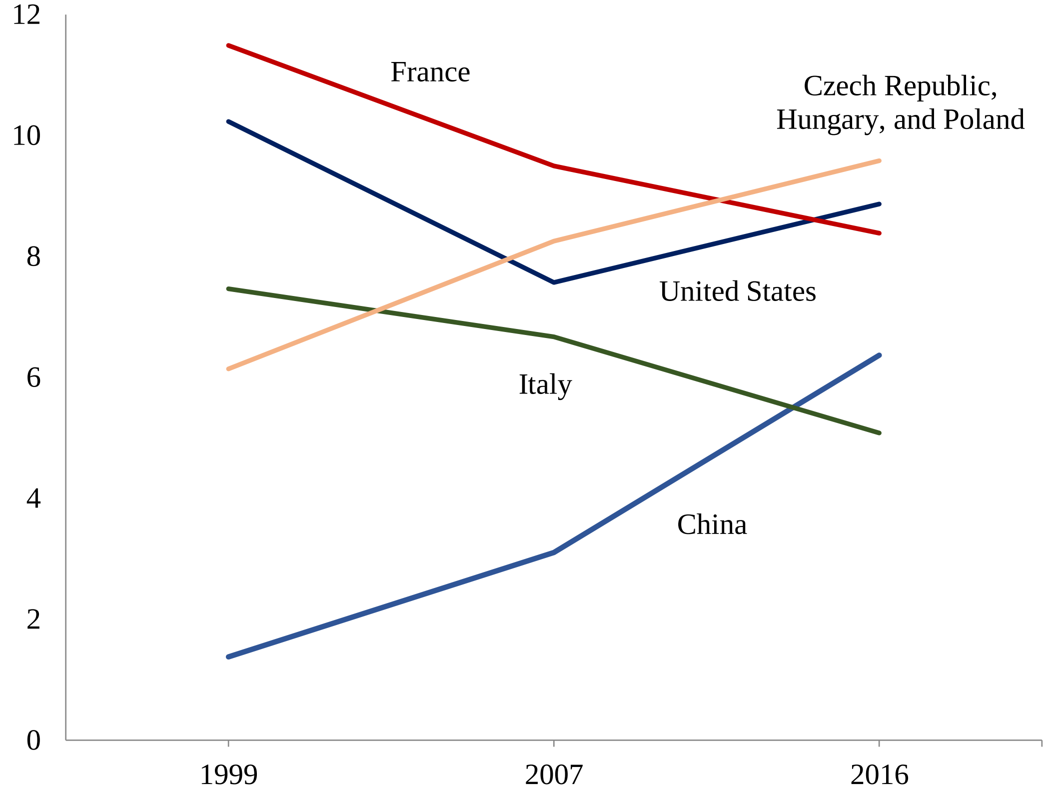
Kaldor's ghost stalks: the euro area's great divergence.

Per capita incomes
(In thousands of US dollars, corrected for purchasing power parity)



Predictably, German exporters shift their sights away from the euro area.

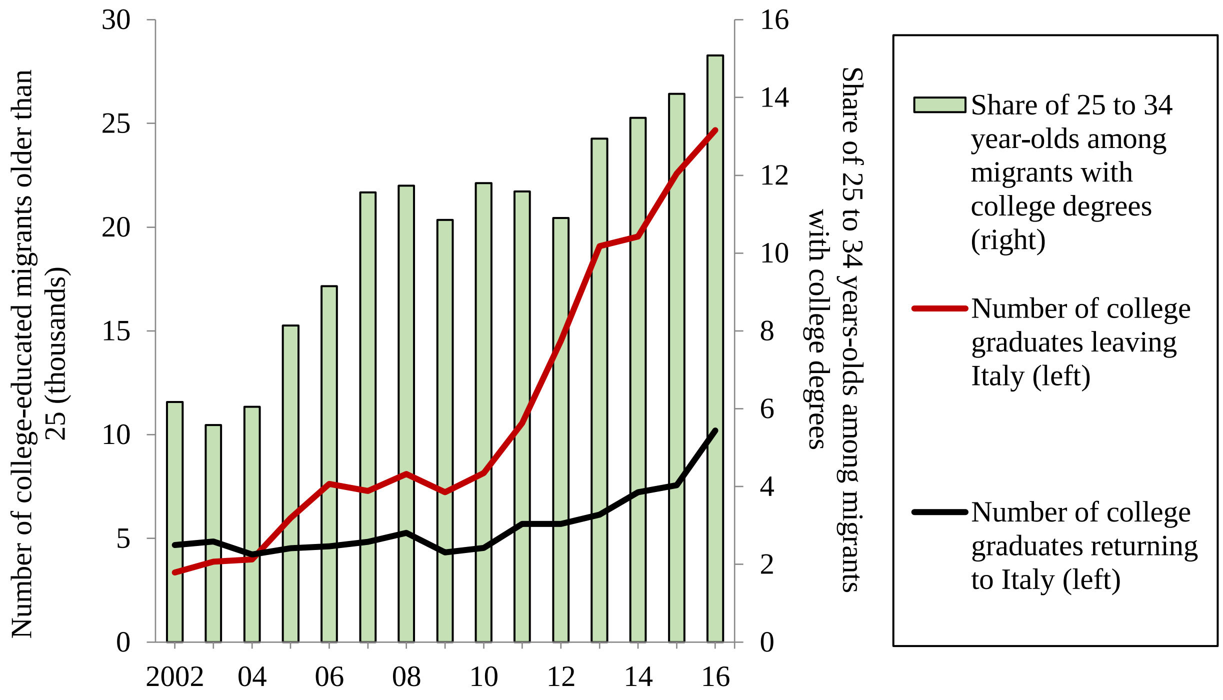
(Percent of total German exports to the various countries)



Source: IMF Data, http://data.imf.org/regular.aspx?key=61013712.

Undercuts the core claim that the euro promotes economic growth.

Young college-educated Italians leave Italy in growing numbers.

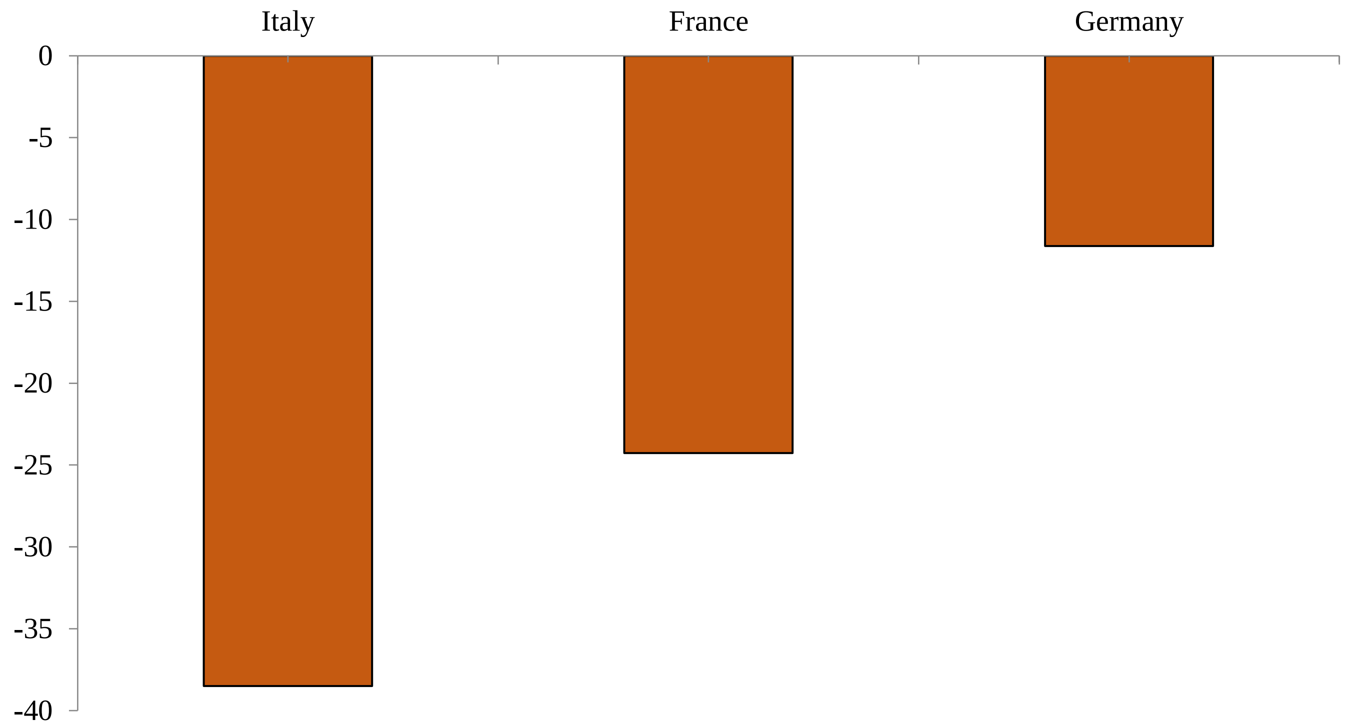


Source: Italian National Institute of Statistics.

Italy's low growth trap: poor opportunities, the educated leave, R&D remains weak, and opportunities remain poor.

Per Kaldor's political forecast: economic wounds left political scars.

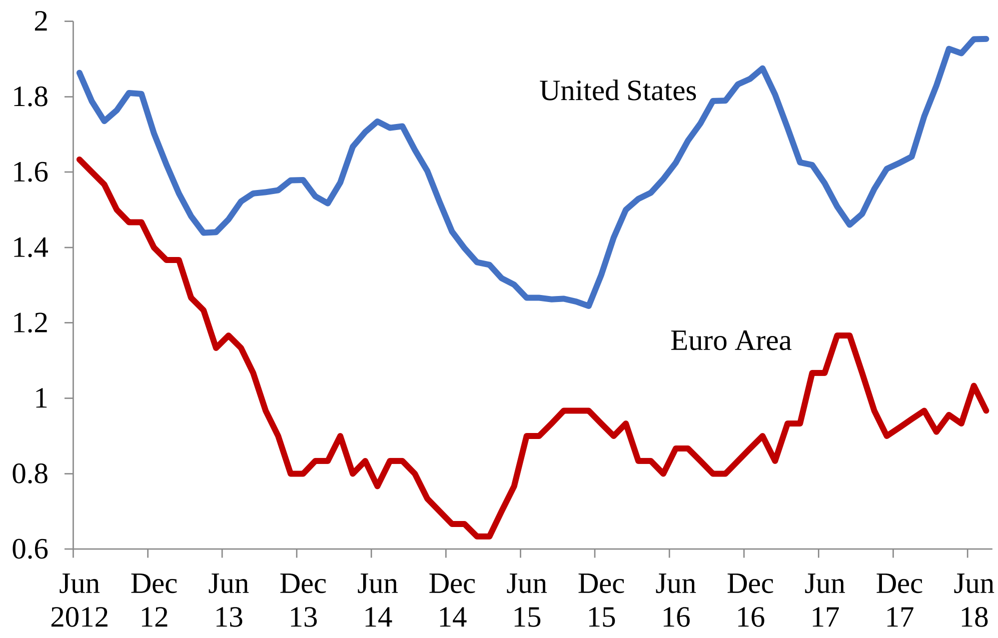
(Decrease in percentage of respondents who trust the European Union, 2016 relative to 2001)



Source: Standard Eurobarometer survey, available at http://zacat.gesis.org. Note: Respondents answered the following question: "I would like to ask you a question about how much trust you have in certain institutions. For each of the following institutions, please tell me if you (Tend to trust it; Tend not to trust it): The European Union." The chart presents the change in share of people who said they trusted the EU. For each year, 2001 and 2016, responses for the two available quarters are averaged.

Looking ahead: the ECB has reached its political limits: ECB delay in bond purchases delivered the lowflation wound.

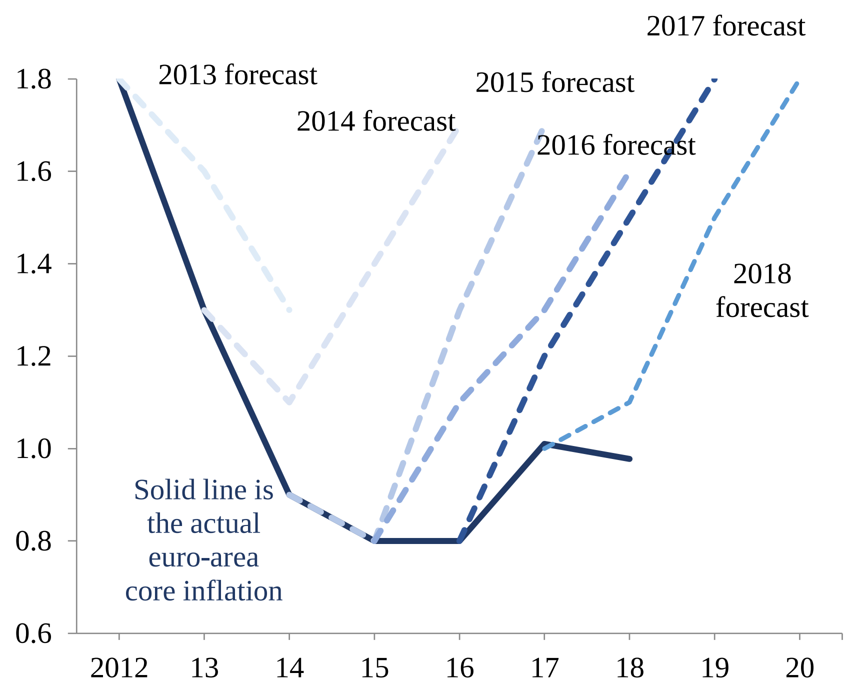
(Three-month moving average of "core" annual inflation rates, percent)



Source: Eurostat: "HICP—All Items Excluding Energy and Food"; St. Louis Fed, FRED: "Personal Consumption Expenditures Excluding Food and Energy (Chain-Type Price Index)."

The ECB keeps forecasting a rise in inflation:

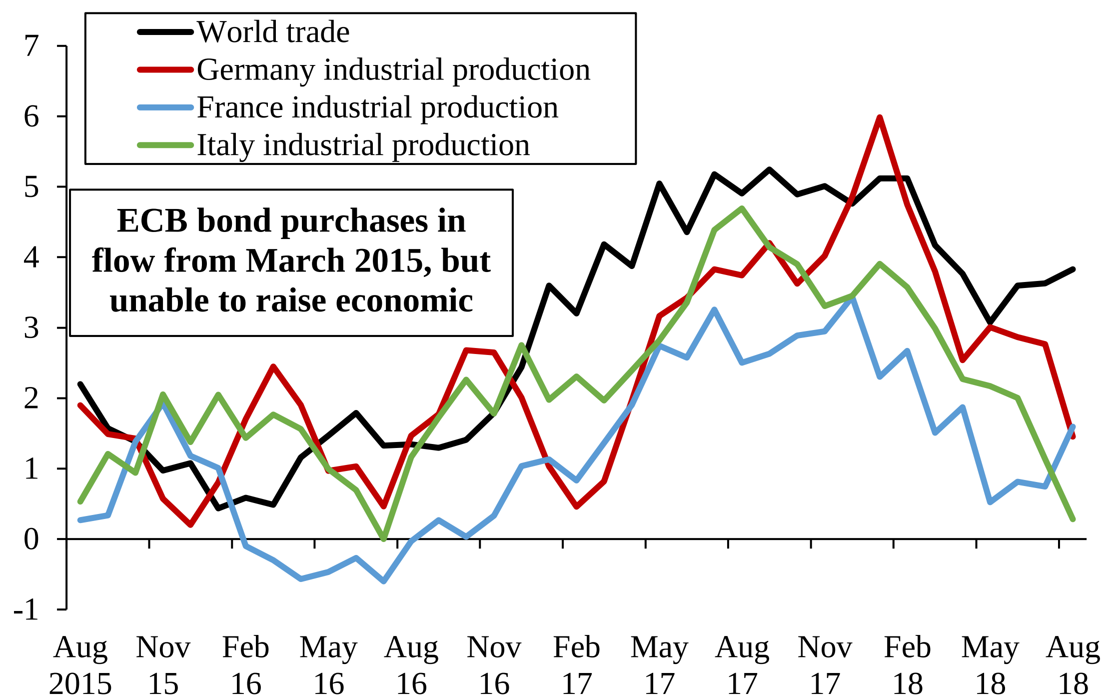
Inflation remains stubbornly low.



Sources: ECB's Macroeconomic Projections made in March of the year, https://www.ecb.europa.eu/pub/projections/html/index.en.html.
Note: 2018 core inflation is the average of months January to September 2018.

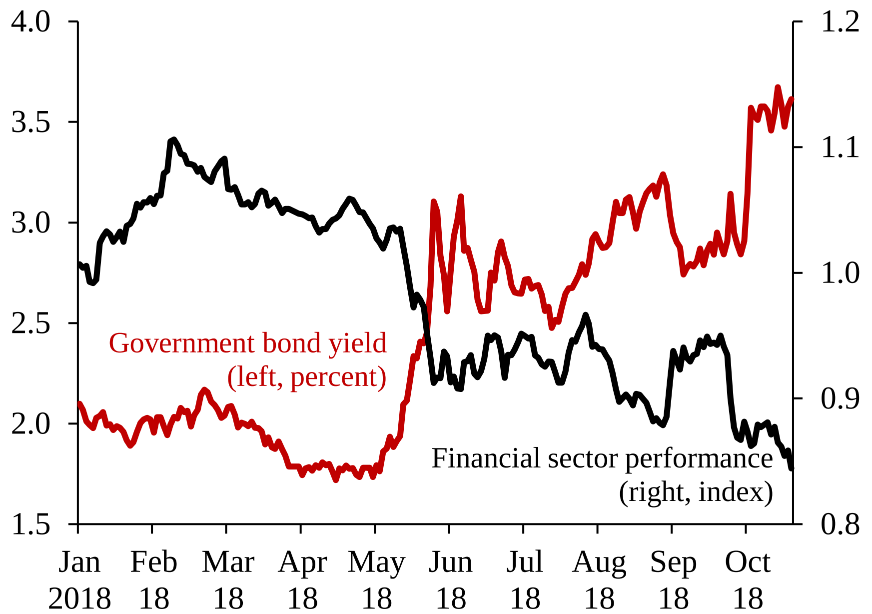
World trade rather than ECB's bond purchases moves eurozone growth.

(Annual growth rates, percent; three-quarter moving averages)



Source: For world trade growth data World Trade Monitor, https://www.cpb.nl/en/data; for the industrial production of Germany, France and Italy Eurostat, code [sts_inpr_m]. Note: The three-month average of growth over the same three months in the previous year.

Italy's financial problems:
The government-bank "doom loop," always latent, has remerged.



Sources: FTSE Italia All-Share Financial Index: Global Financial Data, ticker IT8300 Index; FTSE Italia All-Share Index: Global Financial Data, ticker FTSEMIB Index; Italy ten-year bond yield: Datastream International, code S310DT. Notes: The graph presents the relative performance of financial stocks and the Italian 10-year bond yield from 2 January 2015 to 18 September 2012. The relative performance of financial stocks for Italy is the ratio between the FTSE Italia All-Share Financial Index and FTSE Italia All-Share Index.

The search for a savior.

Marjolin’s ghost stalks:
Sovereignty barrier is stronger than ever.


WE HAVE MET THE ENEMY AND HE IS US.
© 1971 WALT KELLY