The ECB. The EMU. Advantages and Disadvantages of the Euro.
FIN 204 Lecture 11.2.

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Outline

1 The European System of Central Bank (The ESCB)

2 The European Monetary Union (EMU)

3 Advantages and Disadvantages of the Euro
The ESCB is independent of any government or parliament in Europe.
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Main Goal of any bank within the ESCB: Maintain medium-term price stability (2% CPI). How:

- deposit and lending facilities
- repo agreements (1-Week and 3-Months)
- reserve ratio (2%)
Article 108 of the Treaty establishing the European Community:

“When exercising the powers and carrying out the tasks and duties conferred upon them by this Treaty and the Statute of the ESCB [Eurosysterm], ....

...neither the ECB, nor a national central bank, nor any member of their decision-making bodies

shall seek or take instructions from Community institutions or bodies, from any government of a Member State or from any other body.”
THE EUROPEAN SYSTEM OF CENTRAL BANKS (ESCB)

1. Nationale Bank van Belgie / Banque Nationale de Belgique
2. Българска народна банка (Bulgarian National Bank)
3. Česká národní banka
4. Danmarks Nationalbank
5. Deutsche Bundesbank
6. Eesti Pank
7. Central Bank and Financial Services Authority of Ireland
8. Bank of Greece
9. Banco de España
10. Banque de France
11. Banca d’Italia
12. Central Bank of Cyprus
13. Latvijas Banka
14. Lietuvos bankas
15. Banque centrale du Luxembourg
16. Magyar Nemzeti Bank
17. Bank Čentrali ta’ Malta / Central Bank of Malta
18. De Nederlandsche Bank
19. Oesterreichische Nationalbank
20. Narodowy Bank Polski
21. Banco de Portugal
22. Banca Națională a României
23. Banka Slovenije
24. Národná banka Slovenska
25. Suomen Pankki – Finlands Bank
26. Sveriges Riksbank
27. Bank of England
Members of the Eurozone

THE EUROSYSTEM

1. European Central Bank
2. Nationale Bank van Belgie / Banque Nationale de Belgique
3. Deutsche Bundesbank
4. Central Bank and Financial Services Authority of Ireland
5. Bank of Greece
6. Banco de España
7. Banque de France
8. Banca d’Italia
9. Central Bank of Cyprus
10. Banque centrale du Luxembourg
11. Bank Čentralni za Malte / Central Bank of Malta
12. De Nederlandsche Bank
13. Österreichische Nationalbank
14. Banco de Portugal
15. Banka Slovenije
16. Suomen Pankki – Finlands Bank
The Euro

**ESCB**

**ESCB**: A system involving the central banks of the EU members + the ECB

**Eurosystem**

**Eurosystem**: ECB + the central banks of the *countries using the €* as their official currency
**ESCB**

**ESCB**: A system involving the central banks of the EU members + the ECB

**Eurosysterm**

**Eurosysterm**: ECB + the central banks of the *countries using the €* as their official currency

Who are these countries?

![List of Eurozone countries](image-url)
Parallels between the FED and the Eurosystem

The Fed

1. Who governs: BoG (7 members)
2. Who makes policy: the FOMC (7 + 5)
3. Who are the members: the Federal Reserve banks
4. BoG members serve 14 years

The Eurozone

1. Who governs: Executive board (6 members)
2. Who makes policy: the Governing council (6 + 15)
3. Who are the members: the national central banks
4. EB members serve 8 years
The European Monetary Union (EMU)
How does a country become a member of the Eurosystem?

The Maastricht criteria:

1. **Price stability**: at most 1.5% higher CPI than the average for the 3 best countries in inflation
2. **Exchange rate stability**:
   - ± 15% around the parity vs. the € for 2 years
   - no devaluation of the currency 2 years before joining
3. **Interest rate convergence**: main interest rates not higher than 2% more than the 3 best countries in inflation
4. **Fiscal stability**:
   - Government deficit \( \leq 3\% \) of GDP
   - Gross government debt \( \leq 60\% \) of GDP
Advantages and Disadvantages of Joining the EMU

**Advantages**
- ↓ in transaction costs: incentives to go international for the local firms
- reduces currency risk
- overall stability of the economic environment

**Disadvantages**
- loss of independence of monetary policy
- monetary policy no longer tailored according to local needs, inflexible
- risk of asymmetric economic shocks