The ECB. The EMU. Advantages and Disadvantages of the Euro.

1BP570 Lecture 3.3.

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14 Apr. 2010
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 [Eurosistem],…

...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.”
Members of the ESCB

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 EUROSIGHT**

1. Nationale Bank van België / Banque Nationale de Belgique
2. Deutsche Bundesbank
3. Central Bank and Financial Services Authority of Ireland
4. Bank of Greece
5. Banco de España
6. Banque de France
7. Banca d’Italia
8. Central Bank of Cyprus
9. Banque centrale du Luxembourg
10. Bank Českého říše / Central Bank of Malta
11. De Nederlandsche Bank
12. Oesterreichische Nationalbank
13. Banco de Portugal
14. Banka Slovenije
15. 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
The Euro

**ESCB**

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

**Eurosystenm**

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

Who are these countries?

Belgium, Germany, Ireland, Greece, Spain, France, Italy, Cyprus, Luxembourg, Malta, Netherlands, Austria, Portugal, Slovenia, Finland, Monaco, San Marino, Vatican City
## Parallels between the FED and the Eurosystem

<table>
<thead>
<tr>
<th>The Fed</th>
<th>The Eurozone</th>
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</thead>
<tbody>
<tr>
<td>1. Who governs: BoG (7 members)</td>
<td>1. Who governs: Executive board (6 members)</td>
</tr>
<tr>
<td>2. Who makes policy: the FOMC (7 + 5)</td>
<td>2. Who makes policy: the Governing council (6 + 15)</td>
</tr>
<tr>
<td>3. Who are the members: the Federal Reserve banks</td>
<td>3. Who are the members: the national central banks</td>
</tr>
<tr>
<td>4. BoG members serve 14 years</td>
<td>4. EB members serve 8 years</td>
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14 Apr. 2010  
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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 (e.g. cannot devaluate the currency when needed - Greece in 2010)
- risk of asymmetric economic shocks