

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

FIN 204 Lecture 11.2.

Petar Stankov

`petar.stankov@gmail.com`

15 Apr. 2010

- 1 The European System of Central Bank (The ESCB)
- 2 The European Monetary Union (EMU)
- 3 Advantages and Disadvantages of the Euro

# Statute and Main Goals of the ESCB

The ESCB is independent of any government or parliament in Europe.

# Statute and Main Goals of the ESCB

The ESCB is independent of any government or parliament in Europe. It was established with the Maastricht treaty in 1992, began operation in Jan. 1999.

# Statute and Main Goals of the ESCB

The ESCB is independent of any government or parliament in Europe. It was established with the Maastricht treaty in 1992, began operation in Jan. 1999.

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%)

# ECB Independence

**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 [Eurosystem],...



**shall seek or take instructions** from Community institutions or bodies, from any government of a Member State or from any other body.”

© EUROPEAN CENTRAL BANK

08.007 01/08

# Members of the ESCB

## THE EUROPEAN SYSTEM OF CENTRAL BANKS (ESCB)



ORGANISATION



# Members of the Eurozone

## THE EUROSISTEM



ORGANISATION

€ European Central Bank

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 Ċentrali ta' Malta/  
Central Bank of Malta

11 De Nederlandsche Bank

12 Oesterreichische Nationalbank

13 Banco de Portugal

14 Banka Slovenije

15 Suomen Pankki – Finlands Bank



© EUROPEAN CENTRAL BANK

OR.002 01/00



# 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

## Eurosystem

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

Who are these countries?



# 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:**
  - $\pm 15\%$  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