

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

ECO 420 Lecture 9.2.

Petar Stankov

`petar.stankov@gmail.com`

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- 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

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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%)

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],...

...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.”

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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



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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

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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