# "IT CAN'T HAPPEN, IT'S A BAD IDEA, IT WON'T LAST". US ECONOMISTS AND THE EURO; A REAPPRAISAL

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**Abstract**

*Soon before the euro started to circulate among European citizens, Rudiger Dornbusch (2001) wrote, about the new currency: "It can't happen, it's a bad idea, it won't last". Although not unanimously shared, this strongly pessimistic vision was behind most of the contributions that economists from the US gave to the debate on the euro since it was first publicly announced, with the publication of the Delors report in 1989. Krugman, Feldstein, Dornbusch, Bayoumi, Kenen, Eichengreen, McKinnon, Tobin and many others provided a vast literature on the (many) risks and (scarce) opportunities of the European single currency. The untimely defence of the euro by Jonung and Drea (2009) and Issing (2012) provided new material for critique to a structure of economic governance in the Eurozone manifestly unsuccessful.*

*The aim of the paper is to illustrate the (critical) contributions that US economists gave to the debate on the EMU and the euro, attempting a new assessment of their role. Some of them may be seen as merely instrumental to hinder a project that might jeopardize the dollar hegemony in the international monetary system, and many of them rely too much on a static concept of Optimum Currency Area's criteria (as Jonung and Drea suggested). But most, further critiques should have been (and should now be) considered more seriously, in an attempt to build a framework for the long-term sustainability and success of the euro.*

**Keywords: Euro, Political integration, US economists, EU economic governance**

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## Introduction

From the very beginning, the worldwide debate on European monetary union was characterized by a sharp contrast between euro-skeptics and euro-supporters. This debate also underwent significant changes in relation to both the technicalities of monetary integration and to the evolving overall view of the European integration project.

US economists contributed significantly to this debate, mainly with a strongly pessimistic attitude. Soon before the euro started to circulate, Rudiger Dornbusch (2001) wrote, about the new currency: “It can’t happen, it’s a bad idea, it won’t last”. Although not unanimously shared (Bersgten 1997a, b, 1999 and Mundell 1997, 1998, 1999 represent a few authoritative exceptions), this approach was the leading feature of US economists’ approach to the euro since it was first publicly announced, with the publication of the *Delors Report* in 1989. Sala-i-Martin and Sachs (1991), Bayoumi and Eighengreen (1992), Kenen (1992, 2010), Krugman (1993), Feldstein (1997; 2009), Dornbusch (2001), McKinnon (2002) are only some of the many authors that argued on the (many) risks and (scarce) opportunities of the European single currency.

Despite a harsh criticism from Jonung and Drea (2009), who claimed that the sceptical attitude of US economists was instrumental to weaken the euro on the international markets, and depended on an excessive (and distorted) use of the theory of optimum currency areas (OCA), US theories against the sustainability of the euro governance can hardly be attributed only to the OCA issues. In 2012 Otmar Issing (2012), in response to Dornbusch's essay, wrote *The euro: It has happened, it is a challenging idea, it will last*. Nevertheless, as the recent turmoil in the Eurozone shows, some critiques should have been taken more seriously, in an attempt to build a more effective institutional framework for the long-term success of the euro.

The paper by Jonung and Drea, and the explosion of the sovereign debt crises in the Eurozone since late 2009, further revitalized the debate on the euro among US economists, who provided new insights on the question of European political, economic and monetary integration. In the recent years, many authoritative and intellectually diverse US economists such as Greenspan (2015), Krugman (2015), and Stiglitz (2016) – just to provide some

examples – claimed against the sustainability of the euro in the context of its current system of economic governance.

We know now that also the *Architects of the Euro* (Dyson and Maes 2016), those who actually built it, were (at least partially) aware of the flaws of the general framework of economic and political governance around the euro; this poses serious questions as concerns the role and extent of political issues in the making of the single currency. In any case, a reconsideration of the role US economists (from academics and policymaking, especially the Fed) had in the debate on European monetary union is necessary, in order to highlight theoretical and policy contributions that might nowadays be seen with a more empathic feeling in Europe. The aim of the paper is to attempt such reassessment, especially in view of the recent events that struck the euro area. Given the evolving nature of relevant sources involved in this debate, especially in the most recent years, we largely had to rely also on (authoritative) blogs, not only on journal papers, which have a higher reactiveness to everyday facts and policymaking.

We shall first show how the discussions on European monetary integration emerged in the US since the early 90s, mainly motivated by the desire to predict what might be the implications - for the dollar and the US economy - of the single European currency. In the second section, starting from the mid-nineties, the judgment turns severe, and the euro is dismissed as *a bad idea*; we shall dwell on the reasons for this judgment and try to stress the relevance of neglected important aspects of that debate. When the euro start circulating among European citizens, the (negative) judgment turns towards its long-term sustainability (third section), which is currently still a key argument and challenge for European integration (fourth section).

## 1. The euro can't happen

Tracing back the history of the euro, the first phase of the US debate can be identified in the period of time that ranges between the early Nineties and the Madrid Summit in December 1995. During this initial stage the leading view of US economists can be summarized by the expression: *the euro can't happen*.

Most assessments were carried out on the basis of the core criteria of the standard OCA theory (Mundell 1961, McKninnon 1963, Kenen 1969), especially in comparison with the American experience of economic and monetary integration (Eichengreen 1991a; Sala-i-Martin and Sachs, 1991; Frankel, 1992; Krugman, 1993). In those contributions, the main problems of a single currency in Europe were identified as: the low mobility of labor; a lower (than in the US) correlation to economic shocks; slow adjustment mechanisms after economic shocks; the lack of a fiscal redistribution system; and the lack of political institutions that would help tackle problems of credibility in facing economic downturns.

Recognizing the OCA theory as “a central intellectual question”, Krugman (1993: 4) observed that a single currency and a single market tend to increase the degree of specialization in production and this, in turn, is likely to increase the vulnerability of the whole system to asymmetric shocks: if the process of specialization takes place in national terms, due to positive externalities of agglomeration (what Krugman calls “geographical concentration”, 1991: 484), a shock affecting an industry becomes country specific and, without an adjustment mechanism such as the exchange rate or redistributive mechanisms (fiscal transfers), the currency union becomes unstable. Meade (1953: 38-43) – and even Kenen (1969) – had already stressed the importance of a fiscal central authority to make a common currency sustainable; Krugman (1993: 20) only stressed the relevance also of this trade-off: “we know that fixed rates cost least when trade is large, when labor mobility is high, when shocks are symmetric, and when there are compensating fiscal transfers”. This suggests that a redistributive mechanism should be designed at the supranational level. Of course, this would dramatically impact on the division and allocation of competences (ultimately, of sovereignty) at different layers of government (from local, to national and supranational). Nevertheless, most US economists underlined a major shortcoming in the structure of European institutions, neither accountable to citizens nor fully to member States (only through the exercise of the veto power), thus lacking a coherent multilayer democracy and an effective way to tackle problems of collective action.

The lack of a credible political commitment to change the institutional structure of governance in the EU made it week. A stronger and more integrated core of euro countries within the EU could and should be imagined: Dornbusch (1990), for example, argued in favor

of a multi-speed approach (different areas with different degrees of integration); an idea shared by many others (Kenen 1992; Pollard 1995; Bayoumi and Eichengreen 1992). Jeffry Frieden (1994) took an even more radical stance, envisaging the creation of a “mini EMU”, only including Germany, France and some smaller northern European countries, in order to ease convergence and common political strategies.

Indeed, comparing the performances of the EU States from 1990 to 1994, the Federal Reserve economist Patricia Pollard (1995) showed a worsening (rather than an improvement) in economic convergence; indeed, according to the data of 1994, only two countries - Germany and Luxembourg - met all the five Maastricht criteria. The slow (and tricky) ratification of the Maastricht Treaty and the turmoil on exchange rates markets in 1992-93, were recognized as further elements of weakness. It must be stressed that, although the study was conducted too early to test the ability of expectations concerning the single currency to work (1995), we still nowadays have negative results, underlining that there was an overall macroeconomic convergence until 1999 and divergence after the euro (auf dem Brinke et al. 2015: 12); and only convergence of inflation rates until 2007 (Gough 2012). We will later come back on the issue of macroeconomic convergence.

Some uncertainties obviously reflected the very early stage at which monetary integration was in those years. Eichengreen (1991b) pointed at the need to reduce the time span considered in stage 2 of monetary union (during which convergence was required within the European Monetary System framework). The risks of a long transition to irrevocably fixed exchange rates might cause problems of asymmetric shock absorption in cases of (country-specific) financial collapses (or stress), therefore suggesting the need of budgetary and liquidity mechanisms of redistribution (Eichengreen 1991b: 24-26), in particular through fiscal federalism. From this point of view, it should be noted that the speculative attacks that asymmetrically hit European currencies in 1992 where a testimony that his prediction was very plausible.

Another point concerning the transition to later phases of monetary integration came from Kenen, who was concerned on how stage three (single monetary policy and transfer of reserves to the ESCB) would be managed (Kenen 1992: 473-4): how to decide the external value of the single currency; if and how to involve non-euro EU countries (not qualifying for,

or unwilling to join the single currency) in choices of (monetary) policy that would presumably impact on them too.

A further point of uncertainty behind the success of the EMU was the meaning and effectiveness of the Maastricht criteria, given their nature of mere constraints. Most US economists underlined their negative contribution as to the impact on macroeconomic performances, and the likely worsening of the European economy: again, lacking any redistributive mechanisms, tightening policy stances to strict rules would have prevented from absorbing exogenous shocks, thus making the costs-benefit balance of EMU unstable. The most controversial out of the five criteria were the fiscal ones (budget deficit under 3% and government debt under 60% of GDP). What troubled US economists about these parameters were their economic rationale, their effectiveness, and their desirability (Eichengreen 1992; Frankel 1992; Pollard 1995).

Lacking other supranational viable adjustment mechanism, the major question was: how could a major crisis be coped by European monetary authorities? The cost resulting from the loss of national monetary independence is much larger when the currency area is hit by a negative asymmetric shock and the exchange rate cannot act as a stabilizer, but also when there is a shortage of fiscal policy instruments to compensate for the lack of monetary intervention capacity. US economists noticed the lack of all these conditions, therefore concluding that the costs outweighed the benefits, unless Europeans would decide to use transfer mechanisms to absorb shocks, such as fiscal federalism.

As Dornbusch suggested in 1996: “EMU has gone from being an improbable and bad idea to a bad idea that is about to come true” (Dornbusch 1996: 113). Notwithstanding these negative predictions, the euro was created; and it was expected to acquire an important status, thanks to the fact that it was backed by a strong political commitment by the most important national countries that US economists underestimated, neglecting its role in forcing macroeconomic convergence and stabilizing market expectations.

## 2. The euro is a bad idea

Approaching the critical date of December 31, 1998 – when exchange rates would be

irrevocably fixed (they actually were already since July 1998) and the euro *de facto* be born – the assessment of the single currency from the US turned definitely harsh.

During this starting period, US pessimism was reinforced by the disappointing (from the dollar perspective) initial performance of the euro: since it started being traded on financial markets, it began depreciating steadily against the dollar, inducing US economists to argue that such negative performance was a symptom of the European problems, facing a strong U.S. economic growth and a sharp rise in European unemployment.

We have seen that most ex-ante negative expectations on the viability of the euro project where based on the lack of compliance of Europe to any of the standard criteria for OCA optimality. In the second half of the Nineties, a new, challenging theory had been provided, arguing about the endogeneity of the optimum currency area criteria (Frankel and Rose 1996; 1998). According to them, making an ex-ante assessment of optimality criteria does not make sense, because things evolve and change quite rapidly when a currency area is created, making most conditions of optimality of the new currency area satisfied in the short-medium term.

Notwithstanding this theoretical suggestion, the largest majority of US economists rejected it, confirming that the euro would not be able to create ex-post the conditions of optimality that were lacking ex-ante. Friedman (1997), for example, expressed skepticism (other than his usual argument that adjustments are easier when implemented via the exchange rate) in terms of culture and identity: "Europe's common market exemplifies a situation that is unfavorable to a common currency. It is composed of separate nations, whose residents speak different languages, have different customs and have far greater loyalty and attachment to their own country than to the common market or to the idea of 'Europe'". And Feldstein (1997: 60-61), in an article published in *Foreign Affairs*, claimed:

"Monnet was mistaken... If EMU does come into existence, as now seems increasingly likely, it will change the political character of Europe in ways that could lead to conflicts in Europe...What are the reasons for such conflicts? In the beginning there would be important disagreements among the EMU member countries about the goals and methods of monetary policy. These would be exacerbated whenever the business cycle raised

unemployment in a particular country or group of countries. These economic disagreements could contribute to a more general distrust among the European nations."

The main general point of the discussion was that Europe does not possess the institutional framework that allowed the US dollar to work effectively. For two fundamental reasons: a) the structure and functioning of the ECB; and b) the fiscal issue.

As concerns the central banking issue, US distrust arose again from the comparison between the US Fed and the ECB, mainly due to the Fed acting as a lender of last resort, with a full range of available policy instruments, while the ECB is constrained to inflation targeting only, without the constitutional (statutory) mandate by the European Council to intervene against other macroeconomic flaws.

In that period, nevertheless, the accusation was mainly expressed in terms of the ECB shadowing the inflation targeting of the Bundesbank (Eichengreen 1991b; Friedman 2000; Orizio 1996; Wynne 1999). This resemblance of the ECB to the German Central Bank, especially regarding its targeting inflation, led many Us economists to cast doubts about its ability to fulfill even its functions of prices stabilization, especially in times of crisis, making a response to major shocks difficult, and eventually increasing tensions among participating countries (as we have seen, this was the major point of Feldstein 1997). As Jordan (1997) argued: "divergent debt-servicing costs would worsen the relative fiscal positions of the high-debt nations"; a prediction that would nowadays probably be seen with much less skepticism from the euro side.

A missing issue concerning the banking question is worth dwelling upon here. Leaving aside the problematic aspect of the lender of last resort (one of the elements of divergence between the Fed and the ECB), it seems strange that the banking question was neglected (or underestimated) by economists, including the American ones (with the exception of the Federal Reserve economist Jerry Jordan), because in the case of the Eurozone the general principles of regulation and supervision of the banking system were set out in the framework of an EU directive (the Second Banking Directive of 1989) prior to the signing of the Maastricht Treaty; and even then it was possible to detect the strong peculiarity of the system.

In particular, it should have been clear by the two general principles of banking regulation and supervision - the *Home Country Control* and the *Principle of the responsibility of the host country* - that if the monetary policy was entrusted to the ECB, and the responsibility for banking supervision remained a prerogative of nation-States, major problems might arise; as they actually recently did, when the banking union started being implemented. Until the national banking systems were segmented, this lack of supranational supervision didn't create problems. During the late Nineties and early 2000, when the European banking systems greatly internationalized, the organization of such a surveillance not only became inadequate but was no longer able to work, making the whole banking system more fragile. As Tommaso Padoa Schioppa recalled since the early 90s, the European supervision system is a fundamental prerequisite for the smooth operation of the Eurozone banking system, in turn crucial to the survival of the euro. Despite their experience in this, Us economists completely neglected this aspect: no comparison was made with the Us experience, showing how the US are equipped with an independent federal agency (SEC, Securities and Exchange Commission) that performs general functions of supervision and regulation of the financial stock markets.

The other issue was the fiscal one, already underlined in the previous period, which is now seen as a twofold problem: on the one side, European States are constrained by the provisions of the Maastricht criteria (the *Stability and Growth Pact*), which is very different from the Philadelphia Constitution of 1787 (Tobin 2001); on the other, there is no redistributive and stabilizing mechanism as fiscal federalism in Europe (again, see Tobin 2001). This device, absent in Europe, plays in the United States a vital role in the absorption of negative economic shocks. Not only such a system would be necessary in Europe, but inter-State transfers might even be significantly higher than in the U.S., because of the greater gaps and imperfections in the European economic and monetary union (Sala-i-Martin and Sachs 1991). Generally speaking, US economists warned Europeans that they were neglecting some of US most important criticism, and that this would lead to nothing good (Danilo 1998, Friedman 2000).

In conclusion, in that period US skepticism stemmed from the fact that the lack of a solidarity and redistributive mechanisms, whether due to structural/political flaws or to a lack

of desirability to most European countries, would dramatically impact member-States economies in the event of a major asymmetric crisis (Eichengreen 1991a; Jordan 1997).

And even irrespective of dramatic shocks, as Krugman (1993) suggested, the increasing specialization of production would tend to expose European economies to unpredictable behaviors (Midelfart-Knarvik et al. 2003), hardly leading to any macroeconomic convergence, and requiring a deep institutional change (Tobin 2001). As Jordan (1997) suggested:

"The debate does not revolve around whether monetary union is achievable, or even sustainable; it centers on whether people understand the potential economic consequences of monetary union and whether they are prepared to meet its challenges. The cost–benefit calculation becomes particularly difficult because, ultimately, European political integration is a necessary condition for a successful monetary union".

A suggestion that would have required major changes of the Treaties; and that the European Governments were not ready to accept.

On the other hand, it was also underlined that also the disruption of the euro (mostly considered unlikely at that time) might lead to serious problem. As suggested by Eichengreen (2007: 3): "A widespread presumption is that departure from the euro area would be associated with a significant rise in spreads and debt-servicing costs". Which is exactly what happened when the mere hypothesis of exit, in the recent crisis, started making its way in the market.

**3. The euro won't last**

Despite the US criticism and skepticism, the euro gathered momentum in the global economy during its first years. As expected by Mundell ("The euro should stand up very well", 1998: 80), it seemed to work plainly and successfully. It appreciated against the dollar by almost 100% until 2008 (from 0,81 to 1,57), following the oil shock striking the global economy (the price increased by 800% in a few years, from 18$ in 2001 to 144$ in 2008), thus sheltering European economies from part of its negative impact.

US economists seemed to acknowledge such temporary success, avoiding any debate on the euro until the crisis struck the Eurozone since late 2009. They also had to accept the

strong critique by Jonung and Drea in early 2009, who defended the euro against US skeptical claims towards Emu and the euro. A critique that proved definitely untimely! Presented at the American Economic Association session dedicated to the tenth anniversary of the euro, their paper tried to identify explanation for US criticism, detecting three main reasons: a) an overwhelming influence of the theory of optimum currency areas; b) the use of a static and ahistorical approach to the study the European Monetary Union; c) the belief that the EMU was first and foremost a political project.

Apart from the last claim, which is manifestly erroneous (the euro *is* a political project), the first two observations were fundamentally correct. US economists have systematically assessed the euro in terms of lack of the in Europe of the optimality (exogenous) criteria. Doing so, they underestimated the relevance of the staring political commitment to the euro by its founding members, and its capacity to stabilize markets expectations and ignite a virtuous circle in the logic of Frankel and Rose (1998). According to Jonung and Drea, US economists made the mistake of comparing the process of monetary integration in Europe, characterized by shocks, crises, political and economic tensions, with the mature and stable status of US monetary and financial integration (a result, however, of a much longer process of political, economic and financial unification). Inevitably, the evaluation of the fulfillment of the OCA criteria before the full implementation of European monetary union produced the general idea that the attempt to implement the European Monetary Union was inadequate and inconclusive. Basically, Jonung and Drea (2009) accused US economists to show the limits of what they called a "backward-looking approach", which should be replaced by a "forward-looking approach".

This brings us also to judge the second point of their criticism to US economists as basically correct. The European monetary union should be understood in dynamical terms, as the last step of the original project of sharing sovereignty among European States. If one looks at the euro in these terms, it is not difficult to understand that it of course creates increasing contradictions in the system, but also that – provided the political commitment is strong and constantly reaffirmed – it is only one step further towards a supranational democracy, a federal system of multilayered governments, very similar to what the USA look like.

On the third point, therefore, Joung and Drea were wrong. US claims that the euro is basically a political project is correct or, put in a different way, the political and institutional commitment is crucial to the sustainability of a monetary integration project. Indeed, the political commitment needed to make the European monetary union work properly during and after the crisis proved insufficient, highlighting its shortcomings and faults, therefore weakening the credibility of the euro itself. Of course, we cannot blame Jonung and Drea for this: their paper was published soon after the sovereign debt crisis exploded in Europe, letting all the critical aspects of European economic governance emerge with all its force. Nevertheless, the point remains that Jonung and Drea (2009: 30-31) fundamentally neglected the critical role of political commitment to build a sound monetary framework, which was the issue on which US economists would strike hard in the following years.

Unfortunately, as we anticipated, Jonung and Drea (2009) contribution came untimely, making all good points in their criticism disappear in the violent counter attack from the US in the following years. As suggested by Krugman, not without some satisfaction:

"as David Beckworth [2015] rightly points out, many American economists warned about exactly the flaws in the euro that are now the source of so much suffering. Beckworth reminds us of a January 2010 [Krugman is quoting from the journal version] article by Jonung and Drea that has become an accidental classic. Their intent was to mock U.S. economists who were negative on the euro and were made to look foolish by its success; to that end they provided an impressive bibliography and literature review of academic euroskepticism — and in so doing provided us with a sort of honor roll, because all the dire warnings from those ugly Americans came to pass within months of their article's publication. So why were the ugly Americans right? Because the theory of optimum currency areas turns out to be basically right." (Krugman 2015a)

Instead of providing a conclusive defense of the arguments in favor of the single market, their paper actually became the occasion for a parade of US economists who had anticipated its faults.

We all know what happened. In 2008, the global financial crisis, ignited by the subprime loans bubble in the US, quickly spread throughout the globe, requiring concerted action by governments and central bankers. The resulting flood of liquidity into the global

economy did not reduce uncertainties on the capacity of the European economy to recover as the others, its economic governance structure raising questions and doubts regarding its effectiveness. With a supranational budget constrained to less than 1% of European GDP, and national budgets constrained by the subsequent sovereign debt crisis (since the end of 2009), it was objectively critical to implement anti-cyclical policies in Europe. When the Greek crisis burst out, the widespread feeling in the US (shared by market expectations) was that the euro would not last, thus starting the third phase of Dornbusch's (2001) predictions.

As Krugman (2011) claims:

"Europe lacked the institutions needed to make a common currency workable. Instead, they engaged in magical thinking, acting as if the nobility of their mission transcended such concerns. […] The result is a tragedy not only for Europe but also for the world, for which Europe is a crucial role model. The Europeans have shown us that peace and unity can be brought to a region with a history of violence, and in the process they have created perhaps the most decent societies in human history, combining democracy and human rights with a level of individual economic security that America comes nowhere close to matching. These achievements are now in the process of being tarnished, as the European dream turns into a nightmare for all too many people. How did that happen?"

The path followed by European integration stopped somehow before turning into a full-fledged federation as the US: "In the 1980s and '90s this 'widening' was accompanied by 'deepening', as Europe set about removing many of the remaining obstacles to full economic integration. […] The creation of the euro was proclaimed the logical next step in this process. Once again, economic growth would be fostered with actions that also reinforced European unity" (Krugman 2011).

A comparison between the federal structure of the US and the confederative structure of the EU may help understand better the divergence; let's take the example of Nevada (US) and Ireland (EU), as he does:

"Nevada's situation is much less desperate than Ireland's. First of all, the fiscal side of the crisis is less serious in Nevada. It's true that budgets in both Ireland and Nevada have been hit extremely hard by the slump. But much of the spending Nevada residents depend on comes from federal, not state, programs. That the state's reduced tax take will endanger their

social security checks or their Medicare coverage. In Ireland, by contrast, both pensions and health spending are on the cutting block" (Krugman 2011).

Why is this reasoning crucial to understand the euro case?

"Well, when the single European currency was first proposed, an obvious question was whether it would work as well as the dollar does here in America. And the answer, clearly, was no — for exactly the reasons the Ireland-Nevada comparison illustrates. Europe isn't fiscally integrated: German taxpayers don't automatically pick up part of the tab for Greek pensions or Irish bank bailouts. And while Europeans have the legal right to move freely in search of jobs, in practice imperfect cultural integration — above all, the lack of a common language — makes workers less geographically mobile than their American counterparts" (Krugman 2011).

Again, it is the distance between a federal (US) and a confederative (EU) system that makes the difference. The crucial point for Krugman is to make the EU a transfer union, where redistributive powers are centralized at the level of the supranational power:

"The Germans are adamant that Europe must not become a 'transfer union', in which stronger governments and nations routinely provide aid to weaker. Yet as the earlier Ireland-Nevada comparison shows, the United States works as a currency union in large part precisely because it is also a transfer union, in which states that haven't gone bust support those that have. And it's hard to see how the euro can work unless Europe finds a way to accomplish something similar. Nobody is yet proposing that Europe move to anything resembling U.S. fiscal integration" (Krugman 2011)

Some US economists showed to believe in political union (Zumbrun 2011 and Ellyhat 2013); others as Krugman 2013 (Weisenthal 2012) could not see a positive outcome of the crisis simply because political union is not realistic. The blame is on the very European politicians, according to Krugman (2015b), who have "spent a quarter-century trying to run Europe on the basis of fantasy economics": i.e. to impose "a single currency on a very heterogeneous group of countries" (Feldstein 2011: 1).

The reason why US economists stressed so much the institutional difference between the US and the EU is that most of them considered the EU a potential threat to economic recovery worldwide and/or a source of further destabilization for the global economy. US

economists insisted on the European Union to reflate its economy; recognizing that this could only be done with a higher degree of integration in the fiscal and economic field. Only at a supranational, federal level Europe could accomplish this task. As reported by Zugman (2011): "Greenspan said Aug. 7 on NBC's 'Meet the Press' that the chance of a return to recession 'depends on Europe, not the United States'". This concern was reflected in the strong claim in favor of demand-support policies from Europe, which nevertheless could not be implemented within the current governance of the euro-area, thus suggesting pessimistic predictions about the survival of the euro. For this reason there was a rather broad consensus in the US on the conclusion expressed by Martin Feldstein in a debate organized on June 2, 2010 by *The Economist*: "Although the European Monetary Union has now survived for 11 years, the current strains within the euro zone show why it may not last for another decade without at least some of its members leaving"[14].

### 4. Recent debates

This critique towards the institutional structure and constitutional nature of the EU was a leading feature before July 2012, when the ECB started intervening in the market and changing the nature of the euro problem. The situation of the euro-area imbalances, reflected in high and increasing spreads with the German *Bund* and within the Target 2 system of payments, became hardly tenable in June 2012, leading to a major political decision of the European Council to (implicitly) support the Central Bank to use unconventional monetary policy instrument to avoid the collapse of the euro. Consequently, on July 26, 2012 the President of the European Central Bank Mario Draghi, at the *Global Investment Conference* in London, firmly announced that the ECB was ready "to do whatever it takes to save the euro"; adding "and believe me, it will me enough". The spread on national treasury bonds immediately sunk at a few basis points, thus loosening the threat on Grexit, Italexit, etc.

Reforms are nevertheless necessary, and monetary policy can only assist this process. Stiglitz, on March 6, 2014 at the World Economic Forum called for an explicit change of the ECB mandate[15], suggesting it to abandon mere inflation targeting. But this requires a vote in

[14] http://www.nber.org/feldstein/economist_debate60210.html, last access 10/October/2017

[15] https://euobserver.com/news/123388, last access 10/October/2017

the European Council, deciding upon unanimity. What the ECB did in the last few years was to buy time for the governments to make the necessary change in the European economic governance, required to sustain the euro. As Stiglitz (2013) had already claimed in 2013, underlining the preeminent role of Germany in taking the necessary and urgent political steps:

"The euro was supposed to bring growth, prosperity, and a sense of unity to Europe. Instead, it has brought stagnation, instability, and divisiveness. It does not have to be this way. The euro can be saved, but it will take more than fine speeches asserting a commitment to Europe. If Germany and others are not willing to do what it takes – if there is not enough solidarity to make the politics work – then the euro may have to be abandoned for the sake of salvaging the European project".

The most important document of economic policy ad constitutional design nevertheless did not come from single European governments, nor from inter-governmental initiatives, but from the leaders of the European institutions.

The US economists anticipated in their critical arguments most of the steps of the 4/5 *Presidents Reports* of December 2012 and June 2015, where they suggested the European Union, in particular the Eurozone, should build: a) a banking union, b) a fiscal union, c) an economic union, and d) a political union. Fred Bergsten, emeritus founding Director of the influential *Peterson Institute for International Economics* of Washington, in an interview of December 2011 claimed (a bit too optimistically):

"they [Europeans] have to create an economic union, and I'm convinced that all the steps that they're taking now — the EFSF, the successor mechanism, the economic governing systems they're setting up, Merkel's calls for a political union — I think all that's leading toward a full economic union. And five years from now — I think it will take years and it it'll take key Constitutional amendments — they'll have it." (Bergsten 2011)

Five years later, none of these steps is in sight. Apart from a minority of them (Bergsten is of course one of them), most non-European economists showed a manifest pessimism concerning the destiny of the euro after the sovereign-debt crisis. As was perfectly synthetized:

"Observers outside the eurozone have long had a dark view of the euro's prospects. Five years ago, in January 2012, the American economist Martin Feldstein—who argued in 1997 that the single currency would bring conflict to Europe—wrote in *Foreign Affairs* that "the euro should now be recognized as an experiment that failed." A few months later, Paul Krugman wrote that the euro could fall apart "in a matter of months." The list of prominent scholars who have either predicted or called for the breakup of the eurozone has lengthened since then. In 2016, Mervyn King, the former governor of the Bank of England, argued that "leaving the euro area may be the only way to plot a route back to economic growth," and Joseph Stiglitz claimed that "Europe may have to abandon the euro to save … the European project." (Otero-Iglesias 2017).

In an interview to the *BBC News* of February 2015, titled *Alan Greenspan predicts exit from euro inevitable*, Greenspan claimed: "The problem is that there is no way that I can conceive of the euro of continuing, unless and until all of the members of Eurozone become politically integrated - actually even just fiscally integrated won't do it"[16].

Again, it was all left to the monetary policy. When the ECB started its OMT (Outright Monetary Transactions) and later the QE (Quantitative Easing) program, it was welcomed with cool enthusiasm: as a long awaited but too late a tool, and as a dangerous instrument that might simply lead Europe into a money trap: "Something had to be done, and last week the E.C.B. cut interest rates. As policy decisions go, this had the distinction of being both obviously appropriate and obviously inadequate: Europe's economy clearly needs a boost, but the E.C.B.'s action will surely make, at best, a marginal difference. Still, it was a move in the right direction" (Krugman 2013).

Krugman's (2015c) main critique is, as a few years earlier, actually focused on the austerity stance of economic policy in the EU, complaining that neither nation States are left to intervene in the support to demand, nor can the European institutions do it, lacking any credible institutional setting.

A stance that had force recession on weaker countries. In terms of policy prescriptions, in the most dramatic moments of the Greek crisis, stellar US academic

[16] http://www.bbc.com/news/business-31249907, last access 10/October/2017

economists such as Krugman (2015), Stiglitz (2013; 2016), Galbraith (2015), Sachs (2015) suggested (and even made detailed studies on) Grexit, receiving harsh criticism (Palaiologos 2015). It is therefore not a misunderstanding (as they sometimes pretend) that some of them were also taken as a reference guide from many *euro-exiters*.

The recent book by Stiglitz (2016) strongly claims against the euro, accusing it to be a neoliberal construction, not serving "the wellbeing of ordinary citizens" which would require major transformations that might imply even a different monetary arrangement. Comparing the euro to a wedding, he wonders: "The costs of dissolution – both financial and emotional – may be very high. But the costs of staying together may be even higher" (*ibid*.: 26).

The main point here is that decentralized monetary adjustments is necessary in the absence of any other adjustment mechanism and that it would be therefore much better to come back to national currencies and some sort of exchange system such as the European Monetary System. In other words, it would be desirable, and sufficient, to bring back the clock to thirty years ago: a very fashionable and widespread viewpoint, in very recent times.

Also Feldstein (2017) makes a similar case concerning Italy, on the basis that an economy used to adjusting to external shocks of decreasing competitiveness with devaluations cannot change pattern (we may argue that Italy had some decades to change pattern, though). But he recognizes that once in the euro, the costs of quitting may prove huge.

A major concern derives from the fact that all these harsh critiques to the euro risk being self-fulfilling. Here, the endogeneity criterion works perfectly: once you create expectations that a currency is untenable, this will activate all the mechanisms that will lead it to become untenable, or more and more costly. It is hard to believe that US economists *were* and *are* unaware of this.

**Concluding remarks**

As Dornbusch (1996: 118) wrote: "Whatever persuaded European leaders in 1991 to single out as the key vehicle of political integration, it is a poor choice", concluding: "If there was ever a bad idea, EMU is it" (Dornbusch 1996: 124). The euro maybe should not happen, at least not before other steps were implemented in terms of banking, fiscal, economic and

political union; but it did. It was probably a bad idea, but it created contradictions that have made further pushes towards greater sovereignty sharing in Europe unavoidable, which was the aim of the founding fathers of European integration. It was expected not to last, with very good reasons. But, until now at least, it is struggling to last. It seems therefore, after all, that US economists made wrong claims about the euro destiny. Should we be content with what sounds like a simplistic (and wrong) conclusion?

Notwithstanding Jonung and Drea (2009) and Issing (2012), defending the euro from US criticism, the flaws of the euro-area they have been constantly underlining during the last three decades are (mostly) theoretically robust, and dramatically pressing nowadays. Considering the crisis that Europe is still facing compared to other areas of the world, both the predictions of the past and the main concerns expressed by US economists about the Eurozone governance proved to be correct.

In particular, the lack of adjustment mechanisms in the event of asymmetric negative shocks is recognized by European institutions themselves as a major problem to be addressed in the coming future, as the Reports of the 4/5 Presidents of December 2012 and June 2015 and the latest documents issued by the European Commission in late Spring 2017 demonstrate.

The endogenous theory of optimum currency areas criteria proved wrong. Or at least it worked only until a major crisis hit the Eurozone. We can debate whether the crisis hit too soon, i.e. before the virtuous mechanisms envisaged by that theory could effectively take place. But we cannot deny that the euro area is much more asymmetric now than it was twenty years ago. And this is not a good result.

We should avoid making the mistake not to consider US critiques seriously, just because the euro is still existing. After all, its existence is still under scrutiny and attack. So, what should we do with all that criticism? Should we just brush it out as Jonung and Drea pretended to do? And, if not, how should we handle it? Is there any useful message we Europeans should draw from the critiques US economists cast in the debate concerning the euro? And, more difficult to single out, is there any suggestion that can be considered genuine, irrespective of possible instrumental goals?

Of course it can be argued that, for instance, the insistence on the need of a fiscal stimulus in Europe, crucial for recovery after the financial crisis, can be considered a way to support the export-led recovery of the United States. It can be argued that all the criticism against the external value of the euro in the first years of existence were instrumental to preserve the competitiveness of the dollar and of US goods.

But it is difficult to imagine any *instrumental criticism* concerning the architecture of the economic and political governance in the EU: financial redistributive mechanisms, political union, a different role for the ECB, a different concept of economic convergence and its indicators.

The most radical critique is also the most difficult to address: a change in the constitutional nature of the EU (or the Eurozone): from a loose intergovernmental association to a fully-fledged federal supranational union. As suggested by EU Commission President Romano Prodi in an interview at CNN on January 1st, 2002 commenting on the newly born euro: "It (the introduction of the euro) is not economic at all. It is a completely political step. The historical significance of the euro is to construct a bipolar economy in the world. The two poles are the dollar and the euro. This is the political meaning of the single European currency. It is a step, beyond which there will be others. The euro is just an antipasto"[17]. The problem is that after the antipasto there was no main course.

The European constitution, convened to provide a solid supranational structure to the Old Continent, failed both in mandate and communication, and it was rejected by the referenda in the Netherland and France, thus putting a halt on the integration project. A halt that, given the upcoming financial and economic crisis, was never mended.

The euro remained the only supranational symbol of a far more reaching project of legitimated economic and political governance that was left unfinished. Our feeling, in brief, is that Cochrane claim is absolutely true: "Objections to 'the euro' are not objections to a common currency per se, but objections to the rest of the legal, regulatory, banking, fiscal, and policy framework that accompanies the euro." (Cochrane 2017)

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[17] https://nationalplatform.wordpress.com/2005/09/25/25092005-what-leading-eu-politicians-actually-say/, last access 10/October/2017

In brief, there is one major claim we should not neglect coming from US side: the role of politics in designing a currency union. The main problem *has been* and *is* that there was a weakening of the political commitment backing the euro. If in the very beginning (late Nineties) it proved to be strong, and bound to reinforce (fostering greater degrees of economic and political integration), presumably leading to some budgetary sharing and/or redistributive measures, in the recent years the crisis has shown that such political commitment faded away.

Both the enlargement (without strengthening and democratizing the decision making process of European institutions) of the European Union, and the lack of a specific political direction after the failure of the European constitution, have impacted negatively upon the credibility of the political will to go further on European integration, both in economic and political terms.

As correctly recognized by Mankiw (2015), a currency is mainly a political issue, not a merely technical, economic one. If the political commitment behind a currency is weak, as is the European commitment to further integration among sovereign States, then the currency is weak, and speculative attacks may accelerate its collapse or rise the cost of its survival (the quantitative easing of the ECB). Unless these limits are acknowledged and corrected, there will be no euro in the future to discuss about.

The election of Donald Trump to US Presidency might be changing the nature of US governmental support to the European integration project (turning into the negative), paradoxically making economists weaken their criticism and underlining the constructive questions to be solved to make it sustainable, as the recent open letter of 25 Nobel Prize winner in economics against the euro-skeptic Marine Le Pen might demonstrate. Maybe a new phase of judgment on the euro is on its way from the US, which may be labeled "the euro needs to last". In any case, the euro challenge lies in the hands of European governments, in bad (as has been the case for the last decades) or good.

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