European imbalances
and the crisis
of the European Monetary Union

Draft

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Abstract
The paper explores the causes of European imbalances in the current accounts and the links from imbalances to the present crisis of the euro area. Special attention is given to the mainstream proposition that the core problem in the European Monetary Union (EMU) is a sovereign debt crisis due to profligate financial policy in the peripheral member countries. In contrast, the key problem is seen here in the polarized current account balances, which reflect divergent competitiveness of members. This is likely to lead in periods of recession to twin deficits in both budgets and current accounts. Greece is to some extent a special case. Among the non-mainstream interpretations special focus is given to the balance-sheet recession approach and to the notion of neo-mercantilism in surplus countries. Furthermore, the paper looks for criteria to distinguish “good” or tolerable and “bad” imbalances. It concludes that the EMU needs a thorough redesign to make it robust and beneficial for all members; exit or collapse would be historical setbacks.

1. Explaining European imbalances and exploring their problems

The European Union (EU27) and particularly the European Monetary Union (EMU) of 17 countries have built up since EMU inception strong and rising current account imbalances and corresponding financial imbalances. In this paper, I want to explore the driving forces for the imbalances, fathom their risks. Due to space I refrain from comparing these imbalances with those which are commonly called “global imbalances”. The latter are normally understood as the surpluses from emerging economies vis-à-vis the US as the main deficit country. Although the EU imbalances are often considered a regional phenomenon, as deficits and surpluses tend to balance, I consider them as intertwined with the global ones. Next, I develop the proposition that the present Euro crisis is a reflection of European imbalances, and that the diagnosis of a sovereign debt crisis of the GIIPS\(^1\) countries is misleading since the divergence of competitiveness of deficit and surplus countries is the prime problem. Although financial rescue efforts are urgently needed, they will be in vain as long as the underlying problems are not addressed and a workable strategy not found.

Despite a number of similarities between the US deficits and the EMU deficits, the EMU imbalances are quite different, much more explosive and have led EMU on the brink of collapse. It is not a Greek, Portuguese or Irish problem of budgetary profligacy but a fundamental flaw in the architecture of EMU. The epicentre of brinkmanship is in Berlin, the capital of the major surplus country.

2. Overview on European imbalances

Global imbalances in trade have been built up since the early 2000s, reached a record high prior to the financial crisis, shrank in the crisis and expanded anew in the recent upswing (see Fig. 1). The big surplus countries are China, Germany, Japan, plus a few newly industrialized countries, mainly in Asia, and the oil producers. The main deficit country is not only the US, but also the majority of the EU members and the CEEC group (Fig. 2), let alone some hundred low-income developing countries.

\(^1\) Greece, Ireland, Italy, Portugal, Spain
Although EU27 as well as the EMU have in the aggregate almost current account balance, they comprise independent nation states. To consider EMU and EU in balance, means relying on a statistical artefact and ignoring the imbalances. There are six EMU surplus countries (Germany, Netherlands, Austria,Finland, Luxembourg and Belgium) and Denmark and Sweden as EU members outside EMU. Germany accounts for 70-80% of the aggregated surplus, together with Netherlands more than 85%. The surplus economies, being highly globalized, run surpluses also with other countries outside Europe, across the globe.
accounts have ranged in the past between +9% and -15% at the margin. Imbalances have been built up to this magnitude since the EMU was launched until the eve of the financial crisis (Fig. 4), shrank in the crisis and picked-up somewhat in the recent recovery.

Current account deficits include private and public deficits, with private deficits embracing private households, financial and nonfinancial enterprises. In a recession, private deficits normally shrink along with fixed investment and faltering income, whereas budget deficits rise relative to GDP. Hence, in a recession deficits look like twin deficits: budget deficits cause corresponding current account deficits (see Fig. 5). However, this deceptive view camouflages that before the recession private sectors were in big deficits too, often paving the way into recession. This is true for Spain, Ireland, to a lesser extent also for
Portugal and Greece. In Greece, the public deficit was prior to the crisis unsustainably high, but more important is that it was and is mainly financed from abroad.

Fig. 5

![Fiscal deficits, % of GDP, forecasts for 2011-12 by EC](image)

Whatever the causes of current account imbalances are, there is a link to the price competitiveness, as indicated mainly by the performance of unit labour costs (Fig. 6). Japan encountered over a long spell clearly deflationary nominal unit labour cost changes, Germany has among all OECD countries the second lowest increases. This implies that wages fall short of productivity increase, and often not even compensate for inflation. In the peripheral EU countries, nominal wages rose considerably, pushing prices up, sometimes without any significant gain in real wages, thus contributing to the loss of competitiveness within EMU.

Fig. 6
The risks of the widening imbalances within EMU comprise mainly the following: (i) progressively increasing polarization of competitiveness, (ii) as a mirror image, polarization of net debt and net creditor positions with risks of private or sovereign debt failure; risk of over-indebtedness of banks in deficit countries as they can take on too much leverage via strong refinancing via the European system of Central Banks; (iii) restricted long-term growth in both deficit and surplus countries, (iv) risks of asset inflation in deficit countries, (v) reduced effectiveness of monetary policy of ECB as one-size nominal interest rates fit neither the deficit nor the surplus countries, and the same is true for the exchange rate which is overvalued and undervalued for the deficit respectively the surplus group.

Now, how could these imbalances emerge?

3. Alternative explanations

3.1 Overview and mainstream interpretations

There are a number of explanatory approaches for the European imbalances which are not all necessarily exclusive. I will briefly comment on them one by one.

<table>
<thead>
<tr>
<th>#</th>
<th>Name</th>
<th>Main causes</th>
<th>Main remedies</th>
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<tbody>
<tr>
<td>1</td>
<td>Non-optimal currency union</td>
<td>Lack of exchange rate adjustment to macro imbalances</td>
<td>Abandon EMU or kick some members out</td>
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<td>2</td>
<td>Fiscal and wage indiscipline in GIIPS-members</td>
<td>Excessive budget deficits and debt ratio; lack of labour market flexibility; implicit bail-out rule causing moral hazard</td>
<td>In deficit countries: Fiscal austerity; downward wage flexibility replaces real depreciation</td>
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<tr>
<td>3</td>
<td>Too high wages in surplus countries</td>
<td>Too high wages &amp; low profitability expulse capital to peripheral countries</td>
<td>Wage restraint in surplus countries, supply-side policy</td>
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<td>4</td>
<td>Shortcomings in design of EMU</td>
<td>Too lax fiscal rules; no replacement mechanism for current account imbalances; no common European economic “governance”; too little political inte-</td>
<td>Hardening of SGP; monitoring/control imbalances (symmetrically?); establish EFSF or ESF</td>
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<tr>
<td>5</td>
<td>Balance sheet recession</td>
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<td>Imbalances reflect asset price bubbles and their bursting in PIIS, but fiscal profligacy in GR; Germany over-saved domestically and over-lent to overseas PIIS+UK are in balance sheet recession, must counter with big fiscal deficits; GR needs rescue; abandon 3% deficit cap</td>
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<tr>
<td>6</td>
<td>EMU design adjusted to neomercantilism</td>
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<td></td>
<td>Disparity in competitiveness also due to surplus countries, abusing EMU for export-led growth with wage/fiscal restraint; unrestricted capital mobility is risky; neglect of BoP management; ECB as insufficient LLR</td>
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<td></td>
<td>Revision of EMU-design: establish incomes policy; caps for CA imbalances; regional/industrial policies in GIIPS; economic government in EMU; ESF as “European Monetary Fund”</td>
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</table>

#1 is the view of the opponents to EMU often drawing on the original optimum currency area theory. In principle this view disregards all the problems with full-fledged flexible exchange rate arrangements which had led to the European Exchange Rate Mechanism (ERM) which, however, was too weak to be effectively maintained. EMU is clearly not an optimum currency union, mainly because of limited labour mobility and absence of fiscal federalism which is normally conditional on political unification.

#2 reflects the mainstream opinion in European economics, tilted towards neoclassical theory. The present crisis is (mis)understood as primarily a sovereign debt crisis. It is assumed, often implicitly, that the problem of lacking competitiveness can be solved during a fiscal austerity crisis which would facilitate wage deflation and hence adjustment of the implicit real exchange rate. That the bonds markets did not detect country risks at an early stage is occasionally interpreted as a proof that in case of emergency the official bail-out clause would not be enforced so that massive moral hazard could divulge.

That the diagnosis of too high sovereign debt, relative to GDP, in the EMU is flawed can be seen when the GIIPS-countries are compared with other advanced economies, e.g. Japan, US and UK. Why does Japan enjoy so low interest rates, and Greece so high, despite a higher debt ratio in Japan? Why is Britain’s debt as well as US debt higher than Spain’s or Portugal’s but their interest rates on sovereign bonds so much lower? The answer is: Japan and UK are mainly indebted domestically, they have the option for depreciation of their currency, and they have central banks that actively defend sovereign bonds if necessary, similarly the US, indebted externally but in own currency. GIIPS countries are also indebted in local currency, but they don’t really own their currency. And the US benefit from the privileged status of having the prime reserve currency. GIIPS countries are obviously in a special situation, they are trapped in EMU with adverse conditions.
This mainstream view holds that adjustments take place asymmetrically in the deficit countries, that wage deflation can restore competitiveness and does not incite a debt crisis. Presently we observe in Greece, as if it were out of chapter of a Post-Keynesian textbook, how deeply flawed this view is. Greece falls into depression; indebtedness increases (“debt paradox”), leads to default, hampers growth and inflicts losses on the creditors, triggers contagion and shatters the financial system stability. Even if all debt of Greece or other countries were cancelled, they most likely could not run a balanced budget and a balanced current account, but would likely be ousted from bonds markets.

#3 reflects a view held some time ago by Hans-Werner Sinn from ifo-institute, in international context somewhat quirky so that I will not comment on this here.

#4 might describe in brief the viewpoint of the European Commission, interpreting EMU as overall beneficial but in need of crucial reforms. Most importantly, the hardening of the fiscal rules for debt and deficits is proposed, meaning tight austerity, whereas the CA imbalances are recognized as a problem which should be mitigated by intensive surveillance without special tools that can bite if necessary.

### 3.2 Contrasting interpretations

There are two strongly contrasting interpretations of the European imbalances.

#5 is the viewpoint of Richard C. Koo who developed the idea of a balance sheet recession (BSR) for the case of Japan. BSRs arise because of bursting asset price bubbles which damage the balance sheets of corporations, household and banks. Despite very low interest rates, investment does not pick up since firms have to clean their battered balance sheets, i.e. they pay back debt, replenish equity and may fall in a sentiment of general debt aversion. In a flow-of-funds analysis, one can see that in this type of recession private households and firms run surpluses, which would be increased if the government would cut deficits. Hence in a BSR high budget deficits are necessary to avoid a breakdown of aggregate demand or extreme capital outflows through excessive lending to the rest of the world, thereby causing big imbalances. The bottom-line is that a BSR requires huge fiscal deficits, as monetary policy is paralyzed, in contrast to a normal recession.

Koo’s story on the EMU crisis starts with the bursting of the dotcom-bubble which hit Germany strongly. Germany fell in a BSR with low growth, supported by low interest rates of ECB. However monetary policy is ineffective in a BSR, but expansionary fiscal
policy was more or less refused in Germany, due to the 3%-cap regulation. This led to sector saving surpluses for corporations and private households, and banks searched for borrowers abroad. This lending at low interest rates sparked asset price bubbles in PIIGS countries, with house price increases in the period 1999-2008 similar to the US. Greece is a special case since budget deficits increased prior to the financial crisis, but the point is, following Koo, that the fiscal deficit was financed by borrowing abroad to the tune of 80% (before EMU, Greece borrowed 85% domestically). Germany supported over-borrowing in the PIIGS countries actively and is thus part of the problem. Koo warns against a strong fiscal austerity in the countries hit by BSR as well as against austerity in Germany, obsessed by private and public debt aversion. All this will likely cause a double-dip recession. Koo proposes to abolish the 3% deficit cap in the Maastricht treaty and to replace it by prohibition of government borrowing abroad. The 3% rule ignores the possibility of BSR and can make things worse, similar to flawed fiscal restriction in 1997 and 2001 in Japan.

In large parts Koo’s story is convincing. However, he simply ignores all issues of income distribution and wage restraint in the surplus countries. High corporate saving and corporate debt aversion is not only a German sentiment. Besides, excessive export-led growth is not only caused by the restrictive 3% cap. Finally, the long-term problem of high debt due to huge fiscal deficits in BSR-ridden countries like Japan is not sufficiently addressed.

I will analyze viewpoints #6 in more detail as it reflects my own opinion if combined with #5. The driver for imbalances is, from this angle, the neo-mercantilist export-led growth strategy in the leading EMU countries, particularly in Germany. Instead of managed real undervaluation of the currency in China, in Germany lower unit labour cost growth grants competitive advantages. This is supplemented with structural change and intra-sector modernization, supported by R&D, human capital formation and globalization of key industrial corporations. Real wages are de-linked from productivity growth, domestic demand more or less stagnates since long thus leading to sluggish import dynamics. It is both a price and a quantity effect that follow out of below average dynamics of unit labour costs. Consumption out of wages is constrained, as well as tax revenues and social security contributions which constrain in tandem with fiscal austerity domestic demand. German aggregate demand in the past decade came on average almost solely from net exports. In contrast, several (though not all) deficit countries enjoyed higher growth, fuelled with higher private and public debt, as well as with higher wage increases. Improving industrial competitiveness in the periphery economies against low benchmark prices from surplus
countries inside and outside EMU stalled, structural change towards modern sectors and diversification of manufacturing was thrown back. Catching up with advanced countries in EMU was reversed towards a widening price and technology gap.

What had happened to the German economy since the late 1990s when wages started to fall behind productivity? A complex set of factors drove towards continuous wage restraint, whereas productivity kept moving upward. East German wages remained lower than West German wages, wage competition increased. The unification raised the level of debt, fiscal constraints led to a freeze of public sector wages. Furthermore, after the unification unemployment reached 12.7%\(^2\) 1997, approaching 4.5 mn. The coalition government of Social Democrats and Green Party (1998-2005) opted for a package of measures to flexibilize the labour market which led to a booming low wage sector. Wage constraints hit mainly wages in service sectors. Average real wages per employee did not rise from 2000 until 2010 in Germany. Trade unions lost a great deal of bargaining power. Hartz reforms I-IV, mini and midi job reforms giving tax preference to low pay work, time-work, strong increase in part-time work, etc. paved the way to institutional reforms that hollowed out the traditional wage bargaining, unemployment insurance system and labour market regulations. In the course of reforms, the wage share in aggregate income fell considerably. Germany as a comparatively large economy depends much more on domestic demand than smaller economies with a higher share of exports in GDP. Overall, the neoliberal agenda led to de facto neo-mercantilism. Exports to GDP rose in Germany from 33% 2000 to 45% 2010.

Without abolition of exchange rates in the EMU, the currency of the surplus countries would likely have appreciated, sooner or later. Within the EMU, the deficit countries could run even high deficits without exchange rate risk and in common currency, among other channels also by borrowing from the local banks via the ESCB. Naturally, money and credit creation in the ESCB\(^3\) is not regionalised. In addition to this, deficits had been financed to some extent by FDI from the surplus countries, often praised as engine of growth and modernization. This system of neo-mercantilism served the interest of export industries and banks in surplus countries, and had led to higher growth and easy finance for the deficits in the periphery countries. The average performance indicators for EMU pleased ECB and the European Commission. It was then the financial crisis which shat-

\(^2\) According to German statistics, which is equivalent to 9.4% following ILO measurement.

\(^3\) European System of Central Banks
tered this system and triggered the Euro crisis, with Greece as a scapegoat and as the peak of the iceberg.

How could the architects of EMU neglect the balance of payment of its members? It was the notion that unfettered capital mobility is always welfare enhancing. Deficits occur only if they can be financed, and if they can be financed they must be good – unless they are twin deficits. This doctrine had once been coined Lawson doctrine (Nigel Lawson was in the 1980s the British Chancellor of the Exchequer under Margaret Thatcher), and was already proven wrong in the Asian crisis, especially in Thailand 1997. Following this doctrine capital account management is unnecessary, with the exception of fiscal policy. Private capital flows are seen like free trade, capable to enhance intertemporal consumption smoothing and to improve international capital allocation. If this doctrine is flawed, some sort of balance of payment management, be it in the current or in the capital account, are unavoidable, irrespective in what exchange rate regime a country is. Under a system of fiscal federalism, the management is done with fiscal transfers. As the EMU is a heterogeneous union of member states with diverse income levels, this option was categorically ruled out. Hence other forms of capital account management are indispensable.

A special feature of the present EMU design was recognized quite recently. The ECB is a central bank that is independent from the respective governments. Hence the currency of this central bank is independent from the member states of EMU. The euro is by name the common currency, but it is owned only by a quasi-external central bank. The member economies are euroized, analogous to dollarization in a number of countries which abandon their own currency. Members have lost their old lender of last resort (LLR). Some hold that indebted members of EMU are in a status similar to countries with “original sin”. Sovereign bonds are not backed by ECB, or only occasionally and not reliably. The argument that ECB should only serve as LLR only in case of liquidity crisis, not in solvency crisis, ignores that ex ante both crises can seldom be clearly distinguished. In contrast to most other central banks in advanced economies, ECB purchases sovereign bonds from indebted countries only to a limited and not predictable extent.

With high external debt, deficit countries are indebted in “common”, though not “own” currency, are not backed by a committed central bank or some institution which can bail them out; they have neither an option for depreciation nor for exit out of EMU. In such a debt trap, a sovereign bond crisis is an Achilles heel for the EMU as a whole since the crisis can backfire on the creditors and hence the financial system stability of the union. The
sovereign bonds market is the second Achilles heel of the EMU, besides the missing replacement mechanism for abandoned exchange rates.

With this diagnosis, fundamental reforms of the EMU deem necessary which should comprise to following ingredients: (i) basic incomes policy guidelines for EMU members along the idea of productivity-led wage increases, (ii) capital account management with caps on excessive deficits and surpluses, (iii) an EMU economic government in charge of clearly defined common issues, among them policies for rebalancing in a symmetric approach to avoid outright wage deflation and subsequent financial stress; (iv) special regional and industrial policies to resume competitiveness of the deficit countries; (v) and a rescue mechanism for over-indebted countries in the form of the EFSF or ESM, a kind of European Monetary Fund, financed by all members.

4. Good and bad imbalances

When are imbalances excessive, when are they good or bad? Very often the following answers are given, representative for decades long debates, summarized in the table. I will comment on #6 in more detail as it reflects my own opinion.

<table>
<thead>
<tr>
<th>Alternative concepts to identify excessive current account deficits</th>
<th>CA imbalances caused by fiscal deficits, private imbalances are good</th>
<th>Imbalance by “productive” inflows are good, speculative inflows bad</th>
<th>Good imbalances if capital inflows are used growth enhancing, no matter whether for private or public objectives</th>
<th>CA deficit (surplus) caused by above (below) average growth is tolerable</th>
<th>Higher inflation in catching-up countries could impact competitiveness negatively, causing bad deficits</th>
<th>CA imbalances are tolerable if they are sustainable, i.e. external debt/GDP constant in the long run</th>
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</thead>
<tbody>
<tr>
<td>#1 Lawson doctrine</td>
<td>#2 Composition of capital inflows</td>
<td>#3 Usage of inflows</td>
<td>#4 Growth differentials</td>
<td>#5 Negative impact of Balassa-Samuelson effects</td>
<td>#6 Size of CA deficits matters</td>
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</tbody>
</table>

Concept #1: All imbalances are good as long as they express private utility maximizing decisions, i.e. only excessive budget deficits financed externally are of concern, as mentioned above.

Concept #2: The composition of capital flows matters: FDI is per se good, considered as “productive”, and risks are borne by the external investor. Hot money, short-term inflows and inflows attracted by asset price increases are speculative and have little impact on the real economy in the deficit country. In contrast, experience with FDI in many countries is
sobering. Crowding-out of domestic investment can take place without increase of aggregate investment.

Concept #3: The usage of inflows in the receiving country matters, be it for productive investment or for private or government consumption. Only productive inflows are acceptable, not debt-financed consumption. The difficulty remains how to detect “productive” capital inflows. Many inflows in current account deficit countries are used directly or indirectly for private or government consumption.

A special case is the often proposed concept that aging economies should save in young-age economies to repatriate the returns later for the investors’ pensions. Here it is ignored whether the receiving country is really investing the inflows to create a bigger capital stock and able to earn and transfer the proceeds. This concept could push emerging economies in a risky deficit status.

Concept #4: Growth differentials between catching-up and advanced economies lead to increasing deficits in emerging economies if import-income ratios are constant. If the burden of external debt relative to GDP remains stable, the deficits are tolerable. However, all too often it is ignored that catching-up requires structural change in exports and imports and very often exchange-rate realignments.

Concept #5: According to the Balassa-Samuelson effect catching-up countries tend to have higher inflation than advanced countries, especially because of higher inflation in the nontradable sector. This can be interpreted as real appreciation, particularly if nontradables are inputs for exports. Deficits caused by such effects are risky and require exchange rate adjustments or wage adjustments in case of constant exchange rates.

Concept #6: The size of deficits matters as it determines the sustainability of external debt. A current account deficit is the increment of total external debt of a country in a period. A too high external debt to GDP ratio could require a high primary surplus, meaning trade surplus. The sustainability of external debt, no matter of private or sovereign, requires a primary surplus when the long-term real interest rate exceeds real growth. Too high debt service to foreign creditors, even if stable relative to GDP, may not be acceptable and creditors might envisage risks that lead to risk premiums in interest rates. Hence it is the ratio of g and i that matters. With realistic values for growth (g) and interest rates (i), only small deficits satisfy sustainability conditions.

The latter concept seems to incorporate several others mentioned before. Productive use of capital inflows is likely to increase the growth-interest rate ratio, in contrast to debt-
financed consumption. The sustainability guideline could explain the traditional home-bias in funding domestic investment primarily with domestic saving. It is also in line with much empirical evidence for the likely failure of external debt based development strategies for countries that strive to catch-up with rich economies. High CA deficits regularly are prone to default.

Another way to approach the problem of tolerable current account imbalances is to explore the drivers for net capital exports, respectively net exports of goods. Surplus countries save more than they invest. Net capital exports are excess saving, relative to domestic investment. In terms of the real economy, excess saving is the flip side of overproduction and lack of aggregate demand for the domestic production. However, the excess saving alias net capital exports materialize only ex post, i.e. when net exports transactions have been realized. If not, domestic production, income and saving shrink due to lack of demand and domestic saving and investment equilibrate. Hence, rebalancing international imbalances is solving the problem of rebalancing domestic aggregate supply and aggregate demand. Excessive and continuous current account surpluses reflect a lack of domestic aggregate demand, relative to output; the neighbours are beggared to provide the lacking demand, in exchange for debt. The term “beggar-thy-neighbour” is misleading – “pressure both thy neighbours and thy own citizens” might be more appropriate. The macroeconomic downside is that deficit countries tend to fall in too much external debt, or adopt also neo-mercantilist strategies which could trigger international deflation.

5. Why the EMU should be rescued

When looking at the immense difficulties of rescuing EMU and redesign it efficiently and in a democratic manner, many economist tend to resign and follow populist sentiments against further European integration. Should we let EMU collapse? Weren’t the critics of EMU, especially from Anglo-Saxon countries right? Shouldn’t we return to the old OCA-theory and admit: it was an unsound experiment, as we hear presently from some British Tories with unmistakable Schadenfreude?

It is not only the immense costs of exit that prohibit a return to square one. What are the potential benefits of a re-designed EMU?

First, it is the opportunity to have lower inflation and lower real interest rates with a stronger currency for those members which had weak currencies. Complementing incomes policy towards productivity-led wages could support price stability, aggregate demand and employment.
Second, exchange rate volatility and concomitant uncertainty in a world of floating is avoided. The impossible trinity is circumvented or at least mitigated. Stable exchange rate, monetary policy autonomy and capital mobility can be reaped simultaneously, however with some capital account management as mentioned above. A return to fully floating exchange rates, as between DM and US$ with 50% ups and downs takes hostage of the real economy. The former European Exchange Rate Mechanism proved to be too weak, not resilient against strong shocks.

Third, a well-designed monetary union should give catching-up countries better chances to do so and hence also advanced economies better chances for their growth and employment by cooperating with the less advanced economies.

Fourth, from a Keynesian view counter-cyclical fiscal policy to smooth business cycles and weather external shocks is less efficient in solo attempts of highly integrated countries. Likewise, financial system stability and banking supervision require unified action globally or at least regionally.

Fifth, EMU embedded in partial political integration should warrant more democracy. Presently, economic interdependencies between EMU members are immense, but economic policy making lags behind. In a confederation everyone must agree, there is no majority rule. De facto, the biggest and strongest decide alone. Presently the crucial decisions are taken by two members, represented by two persons. The rest, even the parliaments of the two nations, have to follow. This is a caricature of democracy. Without a monetary union political integration would be set back too, but the necessity to coordinate and interact in policies were given as well and tends to increase. Thus the only alternative to a big step backward is a giant step forward towards a monetary union with more political integration in the field of economic policies. As a number of critics of OCA theory have held, a currency area requires some degree of political integration. Money is essentially attached to state. Common money needs a common state, at least in the field of economic policies.

Lastly, a redesigned EMU could be an alternative to unfettered laissez faire in the global economy, making European regionalization a counterweight to neo-liberal globalization.