

The euro is 20 – time to grow up

By [Jérôme Creel](#) and [Francesco Saraceno](#) [1]

At age twenty, the euro has gone through a difficult adolescence. The [success of the euro](#) has not been aided by a series of problems: growing divergences; austerity policies with their real costs; the refusal in the centre to adopt expansionary policies to accompany austerity in the periphery countries, which would have minimized austerity's negative impact, while supporting activity in the euro zone as a whole; and finally, the belated recognition of the need for intervention through a quantitative easing monetary policy that was adopted much later in Europe than in other major countries; and a fiscal stimulus, the Juncker plan, that was too little, too late.

Furthermore, the problems facing the euro zone go beyond managing the crisis. The euro zone has been growing more slowly than the United States since at least 1992, the year the Maastricht Treaty was adopted. This is due in particular to the inertia of economic policy, which has its roots in the euro's institutional framework: a very limited and restrictive mandate for the European Central Bank, along with fiscal rules in the Stability and Growth Pact, and then in the 2012 Fiscal Compact, which leave insufficient room for stimulus policies. In fact, Europe's institutions and the policies adopted before and during the crisis are loaded down with the consensus that emerged in the late 1980s in macroeconomics which, under the assumption of efficient markets, advocated a "by the rules" economic policy that had a necessarily limited role. The management of the crisis, with its fiscal stimulus packages and increased central bank activism, posed a [real challenge to this consensus](#), to such an extent that the economists who were supporting it are now questioning the direction that the

discipline should take. Unfortunately, this questioning has only marginally and belatedly affected Europe's decision-makers.

On the contrary, we continue to hear a discourse that is meant to be reassuring, i.e. while it is true that, following the combination of austerity policies and structural reforms, some countries, such as Greece and Italy, have not even regained their pre-2008 level of GDP, this bitter potion was needed to ensure that they emerge from the crisis more competitive. This discourse is not convincing. [Recent literature](#) shows that deep recessions have a negative impact on potential income, with the conclusion that austerity in a period of crisis can have long-term negative effects. A glance at the World Economic Forum competitiveness index, as imperfect as it is, nevertheless shows that none of the countries that enacted austerity and reforms during the crisis saw its ranking improve. The conditional austerity imposed on the countries of the periphery was doubly harmful, in both the long and short terms.

In sum, a look at the policies carried out in the euro zone leads to an irrevocable judgment on the euro and on European integration. Has the time come to concede that the Exiters and populists are right? Should we prepare to manage European disintegration so as to minimize the damage?

There are several reasons why we don't accept this. First, we do not have a counterfactual analysis. While it is true that the policies implemented during the crisis have been calamitous, how certain can we be that Greece or Italy would have done better outside the euro zone? And can we say unhesitatingly that these countries would not have pursued free market policies anyway? Are we sure, in short, that Europe's leaders would have all adopted pragmatic economic policies if the euro had not existed? Second, as the result of two years of Brexit negotiations shows, the process of disintegration is anything but a stroll in the park. A

country's departure from the euro zone would not be merely a Brexit, with the attendant uncertainties about commercial, financial and fiscal relations between a 27 member zone and a departing country, but rather a major shock to all the European Union members. It is difficult to imagine the exit of one or two euro zone countries without the complete breakup of the zone; we would then witness an intra-European trade war and a race for a competitive devaluation that would leave every country a loser, to the benefit of the rest of the world. The costs of this kind of economic disorganization and the multiplication of uncoordinated policies would also hamper the development of a [socially and environmentally sustainable European policy](#), as the European Union is the only level commensurate with a credible and ambitious policy in this domain.

To say that abandoning the euro would be complicated and/or costly, is not, however, a solid argument in its favour. There is a stronger argument, one based on the rejection of the equation "euro = neoliberal policies". Admittedly, the policies pursued so far all fall within a neoliberal doctrinal framework. And the institutions for the European Union's economic governance are also of course designed to be consistent with this doctrinal framework. But the past does not constrain the present, nor the future. Even within the current institutional framework, different policies are possible, as shown by the (belated) activism of the ECB, as well as the exploitation of the flexibility of the Stability and Growth Pact. Moreover, institutions are not immutable. In 2012, six months sufficed to introduce a new fiscal treaty. It headed in the wrong direction, but its approval is proof that reform is possible. We have worked, and we are not alone, on two possible paths for reform, a [dual mandate](#) for the ECB, and a [golden rule for public finances](#). But other possibilities could be mentioned, such as a [European unemployment insurance](#), a [European budget](#) for managing the business cycle, or modification of the European fiscal rules. On this last point,

the proposals are proliferating, including for a rule on expenditures by [fourteen Franco-German economists](#), or the [replacement of the 3% rule by a coordination mechanism](#) between the euro zone members. Reasonable proposals are not lacking. What is lacking is the political will to implement them, as is shown by the slowness and low ambitions (especially about the euro zone budget) of the decisions taken at the [euro zone summit on 14 December 2018](#).

The various reforms that we have just mentioned, and there are others, indicate that a change of course is possible. While some policymakers in Europe have shown stubborn persistence, almost tantamount to bad faith, we remain convinced that neither European integration nor the euro is inevitably linked to the policies pursued so far.

[1] This post is an updated and revised version of the article “Le maintien de l’euro n’est pas synonyme de politiques néolibérales” [Maintaining the euro is not synonymous with neoliberal policy], which appeared in *Le Monde* on 8 April 2017.

Leave the euro?

By [Christophe Blot](#), [Jérôme Creel](#), [Bruno Ducoudré](#), [Paul Hubert](#), [Xavier Ragot](#), [Raul Sampognaro](#), [Francesco Saraceno](#), and [Xavier Timbeau](#)

Evaluating the impact of France leaving the euro zone (“Frexit”) is tricky, as many channels for doing this exist

and the effects are uncertain. However, given that this proposal is being advanced in the more general debate over the costs and benefits of membership in the European Union and the euro, it is useful to discuss and estimate what is involved.

There is little consensus about the many points involved in an analysis of the issue of membership in the euro. On the one hand, the benefits linked to the single currency 18 years after its creation are not viewed as completely obvious; on the other, it is not evident that the monetary zone has become less heterogeneous, and, possibly linked to that, the current account imbalances built up in the first decade of the euro zone's existence, which have grown since then due to the consequences of the 2008 global financial crisis, are putting constraints on economic policy.

The dissolution of Europe's monetary union would be an unprecedented event, not only for the member states but also from the point of view of the history of monetary unions. Not that there have been no experiences of dissolution – [Rose](#) (2007) counted 69 cases of withdrawal from a monetary union since the end of the Second World War – but in many respects these experiences offer little if any basis for comparison ([Blot & Saraceno, 2014](#)). Nor do they reveal any empirical patterns that could inform us about the possible misfortunes or chances of success that a break-up of the euro zone might have.

However, the reference to past episodes is not the only tool with which the economist can carry out an analysis of a break-up of the euro zone. It is indeed possible to highlight the mechanisms that would be at work if the monetary union project in Europe were to be wound up. There are numerous possible pathways to a break-up of the euro zone, and any analysis of the costs and benefits must be interpreted with the utmost caution, since in addition to uncertainty about any quantitative assessment of what is involved, there is also the issue of what scenario an exit would create. In these

circumstances, a departure from the euro zone cannot necessarily be understood solely from the point of view of its impact on exchange rates or its financial effects. It is very likely that an exit would be accompanied by the implementation of alternative economic policies. The analysis carried out here does not enter this territory, but merely explains the macroeconomic mechanisms at work in the event of a break-up of the euro zone, without detailing the reaction of economic policy or second-round effects.

The central hypothesis adopted here is that involving a complete break-up of the monetary union, and not the simple departure of France alone. Indeed, if France, the second-largest euro zone economy, were to exit, the very existence of the monetary zone would be called into question. The devaluation of the French franc against the southern Europe countries remaining in the euro zone would destabilize their economies and push them out of the scaled-down euro zone. We do not deal here with all the technical elements related to how a break-up would be organized [\[1\]](#) – launching the circulation of new currencies, liquidation of the ECB and termination of the TARGET system, etc. – but rather on an analysis of the macroeconomic effects [\[2\]](#). Two types of effects would then be at work. First, the dissolution of the European monetary union would de facto lead to a return to national currencies, and therefore to a devaluation or revaluation of the currencies of the euro zone countries vis-à-vis not only their euro zone partners but also non-euro zone countries. Second, the redenomination of assets and liabilities now denominated in euros and the prospect of exchange movements would have financial effects that we analyze in the light of past financial crises. Our scenario is therefore for a contained crisis.

A unilateral exit from the euro zone by France and the ensuing break-up of the euro zone exclude a scenario for a common currency where strong cooperation between the old member

states would help to maintain a high level of exchange stability and effectively continue the economic status quo. There is little likelihood of a scenario like this, since it would lead to not using the margins of maneuver opened up by the exit and to maintaining the much-denounced and presumed straitjacket. The crisis would be contained in that the most violent effects would be reduced by coordinated policies. This would mean exchange movements that are rapid and substantial, but which stabilize over a time horizon of a few quarters [\[3\]](#). We assume, furthermore, that each country pursues its own interest without special co-operation.

I – A summary of the economic mechanisms at work

The gains expected from leaving the euro zone

In the first place, leaving the euro zone would mean that the exchange rates between the currencies of the countries that compose it could once again vary against each other. Given this, the question arises of the value at which the exchange rates of these currencies will tend to converge. The expected gains would be, on the one hand, an improvement in competitiveness due to the devaluation of the franc. A devaluation would lead to imported inflation in the short term, before increasing purchasing power and spurring growth. The second gain involves the possibility of defining a monetary and fiscal policy that is differentiated by country, and therefore more appropriate to France's situation.

An exit from the euro zone would also make it possible to set tariffs less favorable to imports from other countries, and thus more favorable to producers on the national territory, but which would also affect consumer prices and thus consumer purchasing power [\[4\]](#).

The costs of leaving the euro zone

France's exit from the euro zone would lead to the departure of other countries, which would see their currencies

depreciate against the franc, especially the southern European countries. The net effect on competitiveness may prove ambiguous.

A Frexit would lead to currency movements, which would translate into a return of transaction costs on currency exchanges between euro zone countries. Moreover, the break-up of the euro zone would also lead to a redenomination of assets and debts in the national currency. Beyond the legal aspects, these balance sheet effects would impoverish agents who hold assets denominated in a depreciating currency or debts redenominated in an appreciating currency (and enrich those in the reverse situation). Uncertainties about balance sheet effects, particularly for financial intermediaries and banks, could be expected to lead to a period experiencing a sharp downturn in lending.

How much additional autonomy would be acquired for monetary policy is uncertain at present. Indeed, it is difficult to conceive of a monetary policy that is much more expansionary than the ECB's policy of negative rates and security redemptions [\[5\]](#). The Banque de France could, of course, buy back the national public debt by creating money, but, in light of the low current interest rates on French sovereign debt, it is not clear that this would lead to significant gains [\[6\]](#). It should be noted that a persistent current account deficit would need to be financed by external savings and that this external constraint could affect monetary policy, for example by requiring an increase in short-term and long-term interest rates that could impose capital controls by the government.

Finally, the introduction of trade protectionism would obviously lead to retaliation by the aggrieved partners, which would hurt French exports. The overall net effect on world trade would be negative, with no gain at the national level.

II – The impact on exchange rates and competitiveness

A Frexit would not lead to strong gains in competitiveness. We simulated the effect of a Frexit in the following way:

1. We assume that a Frexit would lead to a rapid disintegration of the euro zone;
1. We then use our estimates of long-run equilibrium exchange rates presented in Chapter 4 of the *2017 iAGS Report*. It appears that the equilibrium parity for the new franc would correspond to an actual effective devaluation of 3.6% compared to the current level of the euro. This is a real change, once it has been corrected for the effects of inflation and is effective, that is, taking into account exchange rate fluctuations in relation to different trading partners, possibly in the opposite direction. The new franc would be devalued relative to the German currency, but would appreciate relative to the Spanish currency;
2. Using the empirical estimates of exchange rate adjustments (Cavallo et al., 2005), we determine a short-term exchange rate trajectory. Our estimate is for a 13.7% depreciation of France's effective exchange rate with respect to the other euro zone countries, and an appreciation of 8.6% with respect to the countries that do not belong to the euro zone.

Using simulations with the *emod.fr* model, we estimate a modest increase in competitiveness. The effect on GDP would be close to 0 in the first year and 0.4% after three years. These figures are low and refer to a scenario without any readjustment within the euro zone. If we consider the possibility of a gradual adjustment within the euro zone (based on the mechanisms, for example, referred to in *iAGS 2016*), the potential gain would be even lower. Once again it is possible to envisage that the monetary policy conducted by the Banque de France would seek to devalue the French currency more strongly than that of its competitors. But in such a scheme, it is very likely that the latter will in turn wish to

preserve their competitiveness and engage in a policy of competitive devaluations.

III – The financial impact: The effects of the banking crises

The dissolution of the euro zone and the return to national currencies would have significant repercussions for the national banking and financial systems through their international business, and it would bring about a return of exchange rate risk within the euro zone. We first assess the risks that the collapse of the euro zone would have for the banking system. The mechanisms at work are likely to provoke a banking crisis, which could have a high cost for economic activity.

The return to national currencies in a financially integrated space would necessarily entail a major upheaval for the financial system. These effects would not be comparable to those observed at the time the euro was adopted. Indeed, as [Villemot et Durand \(2017\)](#) have shown, potentially the balance sheet effects would be significant for a low coordination scenario.

The balance sheet effects could be reduced if there were international coordination when leaving the euro. Such coordination would make it possible to distribute the ECB's assets and liabilities in a coherent way, notably within the framework of TARGET 2. However, it's difficult to assume a significant level of coordination when leaving the eurozone, and it is illusory to believe that the difficulties in achieving coordination will lessen. On the contrary, they are likely to increase in a climate of instability instead of one with a shared destiny. As a result, the scenario we use for leaving the euro zone excludes the establishment of a new financial or monetary architecture.

The risk of a banking or financial crisis is central to understanding the impact of the break-up of the euro zone. The

impacts would pass through three main channels. The first involves a flight of deposits and savings and the distress liquidation of financial assets. The second is related to the effects of currency misalignments on banks' balance sheets and insurers. The third concerns the sovereign risk that would affect either the public debt and its financing, or if this debt were subject to uncontrolled monetization, the return of intense external pressure. The economic literature includes recent efforts (notably Rogoff and Reinhart, Borio, Schularik, the IMF) to try to evaluate banking or financial crises. It should be clarified at the outset that this literature does not deal with the dissolutions of monetary unions. In the various banking crises recorded since the 1970s by Laeven and Valencia (2010 and 2012), there is no mention of a crisis linked to the dissolution of a monetary union. Nevertheless, the financial dynamics in play in the event of the break-up of the euro zone would be, as mentioned above, risk factors for a banking or financial crisis.

Moreover, the economic literature on currency crises has pointed to the link with banking crises (Kaminsky and Reinhart, 1999). The collapse of a monetary union in reality reflects a crisis situation for the exchange rate system, which leads to revaluations and devaluations with the over-adjustment of exchange rates, as highlighted in the previous section. The reference to the cost of banking crises thus illustrates the potentially negative effects of exiting the euro zone. However, it should be remembered that these costs correspond to an overall assessment of banking crises that does not make it possible to identify precisely the mechanisms through which the financial shock is propagated into the real economy – an assessment that would involve identifying the impact of rising risk premiums and the effect of credit rationing, where it is much more difficult to determine the uncertainty. An analysis by Bricongne et al. (2010) of the various channels through which the 2007-2008 financial crisis was transmitted suggests that a significant amount remains

unexplained. Also, in the absence of a more detailed analysis, we make the assumption that the historical experiences of banking crisis are the main quantitative element that can be used to get close to the eventual negative impact – via the financial effects – of a break-up of the euro zone.

Laeven and Valencia (2012) analysed 147 banking crises in developed and emerging countries over the last few decades (1970-2011). They calculated the losses in production as the three-year cumulative loss of actual GDP relative to trend GDP [\[7\]](#). For the developed countries, the cumulative loss of growth was on average 33 GDP points. During these three crisis years, the public debt increased on average by 21 GDP points (partly due to bank recapitalizations), the central bank's balance sheet increased by 8 GDP points, and the level of non-performing loans increased by 4 percentage points. It should be noted that there was a high degree of heterogeneity in the cost of the crises, depending on the crisis and country in question. For example, the authors' assessment of the cost of the 2008 banking crisis in terms of growth following the bankruptcy of Lehman Brothers was 31 GDP points for the United States and 23 GDP points for the euro zone as a whole. Hoggarth, Reis and Saporta (2002) conducted a similar study and sought to provide robust assessments of trend GDP. They noted cumulative production losses during crisis periods ranging from 13 to 20 GDP points, depending on the indicator chosen. However, these estimates of the cost of banking crises are to be taken with caution, since they are based on numerous assumptions, in particular on the trajectories that countries would have followed in the absence of a crisis.

IV – The gains from monetary autonomy

The gains from an alternative monetary policy would depend on the new direction taken by a monetary policy that remains to be defined and that will determine the conditions for financing the economy. Such a policy would probably be ultra-accommodative due to the financial and banking instability

generated by the balance sheet effects.

Evaluations of the contribution of financial conditions in France from 2014 to 2018, however, suggest that these are not the most important factor explaining the sluggishness of economic activity. Over this period, the contribution of financial and monetary conditions to GDP growth is between -0.1 and 0.2 points [\[8\]](#). There is thus little gain to be expected from a new ultra-accommodative monetary policy (independently of the effects on exchange rates discussed in the first section or the impact of external pressure).

Conclusion

This text has attempted to outline the possible consequences of a Frexit, without going into too detailed and therefore perilous quantification.

1. Contrary to what is sometimes advanced, there is little to be expected in terms of competitiveness or manoeuvring room for short-term monetary policy;
2. The main cost would come from the banking or financial crisis arising from balance sheet effects, particularly given the context of a disorderly exit.

At this stage of the analysis, it is difficult to identify the potential positive economic effects of a Frexit, while the risks of a negative impact due to financial effects seem to be very significant.

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[\[1\]](#) These points are to a large extent discussed in *Capital Economics* (2012).

[\[2\]](#) It is difficult to develop a long-term counterfactual scenario in the case of exiting the euro. We therefore focus on the short- and medium-term effects of possible transitions.

[\[3\]](#) We implicitly eliminate the scenario of a currency war where each country would try to gain competitiveness by devaluations that would permanently lead us away from convergence towards a real equilibrium exchange rate.

[\[4\]](#) The introduction of tariffs like this calls for leaving the European Union. Without developing this analysis here, it is very likely that leaving the euro zone would lead to

leaving the European Union. There have been assessments of the EU's contribution to intra-European trade and growth that we are not using here in our short-term approach.

[5] Through its quantitative easing program, the ECB essentially purchases sovereign debt bonds, including French debt securities. In February 2017, the outstanding securities held by the ECB under this programme ([PSPP](#)) amounted to € 1,457.6 billion. Breaking down the purchases based on the share of the ECB's capital subscribed by the central banks of the member states, the fraction of French debt securities exceeds 200 billion euros.

[6] Getting free from the constraints of the Stability and Growth Pact could be a gain in itself. This assumes that the constraints of the SGP go beyond simply the sustainability of the public debt demand.

[7] These evaluations show, however, that there is a high degree of heterogeneity in the assessed costs depending on the country in question.

[8] <https://www.ofce.sciences-po.fr/pdf/documents/prev/prev1016/france.pdf>

Decline of the euro and competitive disinflation: who's going to gain the most?

By [Bruno Ducoudré](#) and [Eric Heyer](#)

For nearly two years, between mid-2012 and mid-2014, the euro appreciated against the world's major currencies. Having

reached a level of USD 1.39 in May 2014, the euro had increased in value since July 2012 by more than 12% against the dollar. During the same period, the euro appreciated by 44% against the yen and more than 3% against the pound sterling.

Since May 2014, this trend has reversed: after rising by nearly 10% between mid-2012 and mid-2014, the real effective exchange rate for the euro, which weights the different exchange rates based on the structure of euro zone trade, has depreciated by 5.2% over the last six months (Figure 1). In fact, within a few months, the euro has lost nearly 10% against the dollar, more than 3% against the yen and 4% against the British pound. The weakening against the pound sterling actually began in August 2013, and has reached over 9% today. We expect the euro to continue to depreciate up to the beginning of 2015, with the single currency's exchange rate falling to 1.20 dollars in the second quarter of 2015.

Figure 1. Effective exchange rate of the euro



Source: Datastream.

For many business people and economics experts, this decline in the euro represents an opportunity to escape the deflation trap currently threatening the euro zone. Faced with sluggish growth in the zone and an inflation rate that is falling dangerously low, the announcement by the European Central Bank

of a quantitative easing programme indicates its willingness to devalue the euro against other currencies in order to support Europe's growth and meet its inflation target.^[1] The French government also expects a great deal from the euro's depreciation.^[2] The Treasury Department believes^[3] that a 10% decrease in the effective exchange rate of the euro (against all currencies) would increase our GDP in the first year by 0.6 percentage point, creating 30,000 jobs, reducing the public deficit by 0.2 GDP point and pushing up consumer prices by 0.5%.

The revival of short-term growth in the euro zone through a depreciation of the euro's effective exchange rate would also limit the non-cooperative policy of competitive disinflation being implemented in southern Europe (Greece, Spain, Portugal). While European countries trade mostly with each other and compete sharply for export markets, the effort to improve competitiveness through a disinflation policy is bound to fail in the euro zone if all the members adopt the same strategy. This is, however, the strategy chosen by the European Commission, *i.e.* by pushing the countries in crisis to reform their labour markets and cut labour costs. In this light, the depreciation of the euro is needed to support structural reform in Europe and support demand ^[4] even as fiscal austerity policies are further undermining it.

[In a recent study](#), we attempted to assess the effects expected from the depreciation of the euro. We are interested not in the reasons for the variations in the euro (differential performance, behaviour of central banks) but in its macroeconomic implications (in particular its impact on GDP, prices and employment). To assess the sensitivity of exports to price competitiveness for six major OECD countries (France, Germany, Italy, Spain, United States, United Kingdom), we made estimates using new foreign trade equations that distinguish, within the euro zone, intra-zone trade and extra-zone trade. The elasticities obtained are consistent with the existing

literature on this subject. It is necessary to make a joint estimation of the equations for export volumes and import prices: this provides a feedback loop in partial equilibrium for a change in the effective exchange rate on import volumes and export volumes. Taking into account the marginal behaviour of importers and exporters tends to limit the effect of a change in the effective exchange rate on the volumes of imports and exports when these have little market power. Simulations show that, in the euro zone, Spain would have the most to gain from a depreciation in the euro's exchange rate against other currencies, but also from a policy of competitive disinflation (case where Spain's export prices grow more slowly than the export prices of its euro zone rivals) (Table 1).

Table 1. Breakdown for the euro zone of a 10% depreciation of the nominal effective exchange rate

Long-term Impact ...				
... of a 10% depreciation of the euro against other currencies (ln %)				
	DEU	FRA	ITA	ESP
Exports	1.3	1.1	1.1	1.7
Imports	-3.2	-2.1	-1.1	-2.3
Export prices	1.4	2.1	1.5	2.0
Import prices	4.3	2.9	2.0	2.9
... of a 10% rise in the prices of competitors in the euro zone (%)				
	DEU	FRA	ITA	ESP
Exports	1.6	1.6	2.1	2.8
Imports	-2.8	-3.3	-1.3	-4.0
Export prices	1.7	3.1	2.9	3.4
Import prices	3.4	4.3	2.3	4.7

Source : OFCE.

For the French economy, we also carried out a more detailed analysis using the OFCE's macroeconomic model *emod.fr*, with the goal of comparing our results with those obtained by the French DG Treasury with the *Mésange* model.

Our results show that a 10% depreciation of the euro against

all currencies leads to a gain in price competitiveness for export to France vis-à-vis the rest of the world. The other euro zone countries experience the same gain in competitiveness across all export markets. In this case, the effect on activity would be +0.2% the first year, and +0.5% after three years. Excluding the effect due to the change in price competitiveness, the increased demand resulting from the pick-up in activity among our European partners would be broadly offset by lower demand addressed to France from the rest of the world. On the labour market, the depreciation would create 20,000 jobs in the first year, and 77,000 jobs after three years. The public deficit would improve by 0.3 GDP point in three years (Table 2).

Table 2. Impact on the French economy of a 10% depreciation in the exchange rate of the euro against all currencies

(% difference from level in reference scenario)	n	n+1	n+2	n+7
GDP	0.2	0.5	0.5	0.1
Total salaried employment (in 1000s)	20	53	77	43
Household consumption prices	0.9	1.4	1.8	3.6
Public financing capacity (in % of GDP)	0.0	0.2	0.3	0.2

Note: A depreciation of the euro would be favourable to short-term activity via an improvement in France's price competitiveness vis-à-vis non euro zone countries. The positive effect of the euro's depreciation on the activity of our euro zone partners and the negative effect on our non euro zone partners is taken into account.

Source : emod.fr.

Finally, we simulated the effect of a 10% increase in the prices of our competitors in the euro zone on the whole of France's export markets. This 10% improvement in price competitiveness vis-à-vis the other euro zone countries would have a positive effect on activity via an increase in exports, investment and employment (Table 3). The impact on activity would be +0.4% in the first year and +0.9% after three years. It would be zero after 10 years. Nearly 130,000 jobs would be created in a period of 3 years and the government deficit would improve by 0.5 GDP point over this period.

Table 3. Impact on the French economy of a 10% improvement in France's price competitiveness relative to the euro zone countries

(% difference from level in reference scenario)	n	n+1	n+2	n+7
GDP	0.4	0.8	0.9	0.2
Total salaried employment (in 1000s)	33	90	129	82
Household consumption prices	1.0	1.7	2.3	5.2
Public financing capacity (in % of GDP)	0.0	0.3	0.5	0.5

Note: A 10% deterioration in France's price competitiveness relative to the rest of the world is understood to mean a 10% decline in the prices of all France's rivals on its export markets.
Source : *emod.fr*

[1] See C. Blot and F. Labondance, "[Why a negative interest rate?](#)", *Blog de l'OFCE*, 23 June 2014.

[2] See the [speech by Prime Minister F. Hollande on 5 February 2013 to the European Parliament](#).

[3] Economic and Social Report of France's 2014 draft budget bill.

[4] See the [speech by M. Draghi "Unemployment in the euro area"](#), Jackson Hole, 22 August 2014.

What do we know about the end of monetary unions?

By [Christophe Blot](#) and [Francesco Saraceno](#)

The European elections were marked by low turnouts and increasing support for Eurosceptic parties. These two elements reflect a wave of mistrust vis-à-vis European institutions, which can also be seen in confidence surveys and in the increasingly loud debate about a return to national

currencies. The controversy over a country leaving the euro zone or even the breakup of the monetary union itself started with the Greek crisis in 2010. It then grew more strident as the euro zone sank into crisis. The issue of leaving the euro is no longer taboo. If the creation of the euro was unprecedented in monetary history, its collapse would be none the less so. Indeed, an analysis of historical precedents in this field shows that they cannot serve as a point of comparison for the euro zone.

Although there seem to be a number of cases where monetary unions split apart, few are comparable to the European Monetary Union. Between 1865 and 1927, the Latin Monetary Union laid the foundations for closer monetary cooperation among its member states. This monetary arrangement involved a gold standard regime that established a principle of monetary uniformity with a guarantee that the currencies set up by each member state could move freely within the area. Given the absence of a single currency created *ex nihilo* as is the case today with the euro, the dissolution of the Union that occurred in 1927 holds little interest for the current debate. In fact, experts in monetary unions instead characterise this type of experience as “areas of common standards”. A study in 2007 by Andrew Rose (see [here](#)) assesses 69 cases of exits from a currency union since the Second World War, which would indicate that there is nothing unique about the break-up of the euro zone. However, this sample of countries that have left a currency union cannot really be used to draw meaningful lessons. A large number of these cases involve countries that gained their political independence in the process of decolonization. These were also small developing economies whose macroeconomic and financial situations are very different from those of France or Greece in 2014. The most recent experience was the break-up of the rouble zone, following the collapse of the USSR, and of Yugoslavia, both of which involved economies that were not very open commercially or financially to the rest of the world. In these

circumstances, the impact on a country's competitiveness or financial stability of a return to the national currency and any subsequent exchange rate adjustments are not commensurate with what would happen in the case of a return to the franc, the peseta or the lira. The relatively untroubled separation of the Czech Republic and Slovakia in 1993 also involved economies that were not very open. Finally, the experience most like that of the EMU undoubtedly involves the Austro-Hungarian Union, which lasted from 1867 to 1918. It had a common central bank in charge of monetary control but no fiscal union [\[1\]](#), with each State enjoying full budgetary prerogatives except with regard to expenditure on defence and foreign policy. It should be added that this Union as such could not go into debt, as the common budget had to be balanced. While the Union established trade and financial relations with many other countries, it is important to note that its break-up occurred in the very specific context of the First World War. It was thus on the ruins of the Austro-Hungarian Empire that new nations and new currencies were formed.

It must therefore be concluded that monetary history does not tell us much about what happens at the end of a monetary union. Given this, attempts to evaluate a scenario involving an exit from the euro are subject to a level of uncertainty that we would call "radical". While it might be possible to identify certain positive or negative results of exiting the euro, going beyond this to give specific calculations of the costs and benefits of a break-up comes closer to writing fiction than to robust scientific analysis. As for the positive side, it can always be argued that the effects on competitiveness of a devaluation can be quantified. [Eric Heyer and Bruno Ducoudré](#) have performed such an exercise for a possible fall in the euro. But who can say how much the franc would depreciate in the case of an exit from the euro zone? How would other countries react if France left the euro zone? Would Spain leave too? In which case, how much would the

peseta fall in value? The number of these variables and their potential interactions lead to such a multiplicity of scenarios that no economist can foresee the result in good faith, let alone calculate it. The exchange rates between the new European currencies would once again be determined by the markets. This could result in a panic comparable to the currency crisis experienced by the countries in the European Monetary System (EMS) in 1992.

And what about the debt of the private and public agents of the country (or countries) pulling out? The legal experts are divided about what share would be converted by force of law into the new currency (or currencies) and what would remain denominated in euros, which would add to agents' debt burden. So it is likely that an exit would be followed by a proliferation of litigation, with unpredictable outcomes. After the Mexican crisis in 1994, and again during the Asian crisis in 1998, both of which were followed by devaluations, there was an increase in agents' debt, including government debt. Devaluation could therefore increase the problems facing the public finances while also creating difficulties for the banking system, as a significant share of the debt of private agents is held abroad (see [Anne-Laure Delatte](#)). The risk of numerous private defaults could therefore be added to the risk of default on the public debt. How would one measure the magnitude of such impacts? Or the increase in the default rate? What about the risk that all or part of the banking system might collapse? How would depositors respond to a bank panic? What if they seek to prop up the value of their assets by keeping deposits in euros and opening accounts in countries that they consider safer? A wave of runs on deposits would follow, threatening the very stability of the banking system. It might be argued that, upon regaining autonomy for our monetary policy, the central bank would implement an ultra-expansionary policy, the State would gain some financial leeway, put an end to austerity and protect the banking system and French industry, and capital controls would be re-

established in order to avoid a bank run ... But once again, predicting how such a complex process would unfold amounts to astrology ... And if the example of Argentina [\[2\]](#) in late 2001 is cited to argue that it is possible to recover from a currency crisis, the context in which the end of the “currency board” took place there should not be forgotten[\[3\]](#): a deep financial, social and political crisis that does not really have a point of comparison, except perhaps Greece.

In these circumstances, we believe that attempting to assess the cost and benefits of leaving the euro leads to a sterile debate. The only question worth asking concerns the political and economic European project. The creation of the euro was a political choice – as would be its end. We must break with a sclerotic vision of a European debate that opposes proponents of leaving the euro to those who endlessly tout the success of European integration. There are many avenues open for reform, as has been demonstrated by some recent initiatives ([Manifesto for a euro political union](#)) as well as by the contributions collected in issue 134 of the *Revue de l'OFCE* entitled [“Réformer l'Europe”](#). It is urgent that all European institutions (the new European Commission, the European Council, the European Parliament, but also the Eurogroup) take up these questions and rekindle the debate about the European project.

[\[1\]](#) For a more detailed analysis of comparisons that can be drawn between the European Monetary Union and Austro-Hungary, see Christophe Blot and Fabien Labondance (2013): “Réformer la zone euro: un retour d'expériences”, *Revue du Marché Commun et de l'Union européenne*, no. 566.

[\[2\]](#) Note that Argentina was not in a monetary union but rather under what was called a “currency board”. [See here](#) for a classification and description of various exchange rate regimes.

[\[3\]](#) See Jérôme Sgard (2002): “L’Argentine un an après: de la crise monétaire à la crise financière”, *Lettre du Cepii*, no. 218.