# ASHOKA MODY

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Since I am the most controversial person on this panel, I would like to show some pictures. The main point is that the warnings came very early, in March 1971, very soon after the original proposal on monetary union in October 1970. Nicholas Kaldor, who was one of the great economists of the 20th century, was the first to say that the single currency would amplify economic divergence among member countries. Basic economics says that a single monetary policy will be too tight for some countries, too weak for others, that the weaker countries will be further set back and the stronger countries will have added benefit, therefore increasing the divergence.

There was a proposition at that time that although the architecture was incomplete, eventually there would be a political union and fiscal transfers would be created of the type you have in the US, where Connecticut transfers funds to Alabama. Kaldor countered that he doubted such this would ever happen, because it would require permanent transfers, not just temporary ones. He said, on the other hand, that economic divergences would deepen political divisions, and a house divided against itself cannot stand. This is in March 1971.

Through the rest of the 1970s, Robert Marjolin, a name known to this audience, one of the great Eurocrats of the post-war era, a key catalyst of the Treaty of Rome, was very opposed to monetary union because he said that the nation-state was still alive. Because the nation-state was still alive, the idea that there would be compromises that would allow the creation of some kind of political structure within which compromises could be made and a political union created was simply not going to happen. Therefore, he opposed the monetary union even though he was deeply pro-European.

Indeed, the rest of the story is that Kaldor's ghost and Marjolin's ghost have been stalking the Eurozone. You see this great divergence that occurs – Italian per capita income today is marginally lower than it was in 1999, at the time of the start of the monetary union. France, since the start of the crisis in 2008, has barely grown, whereas Germany has continued to grow. This is exactly what Kaldor had predicted, that the divergence would increase, and because the divergence has increased, Germany is trading less with France and Italy, one of its principal trading partners at the time of the Euro, and has increased its trade with China in particular, but also with non-Euro European countries like the Czech Republic, Hungary and Poland.

This undercuts one of the fundamental premises, that the Euro would increase trade between Eurozone countries and therefore would be a spur for growth, so it undercuts the essential argument that the Euro does something good in terms of growth effects. The risks, however, remain profound. Regarding the Italian situation, Italian per capita income has fallen, young college-educated Italians are leaving Italy in growing numbers, and because young educated Italians are leaving, that further reinforces Italy's low growth trap.

Kaldor's political forecast is also being confirmed, that economic divergence would deepen political divisions. Loss of trust in Italy is greater than in France and greater than in Germany. During 2012, in the crucible of the crisis, you had the formation of the AFD Party, Alternative for Deutschland, in Germany, and the Five Star Movement in Italy. They were an exact consequence of the political divisions. The AFD felt that Chancellor Merkel was doing too much for Europe, the Five Star Movement felt that Merkel was dictating to Europe.

Looking ahead, my theme is that the ECB has reached the political limits of its actions and therefore is rapidly losing credibility. We saw that for the first time in 2012 and 2013, when the Eurozone was descending into what people called 'lowflation' or deflationary tendencies. Normally low inflation is considered to be good, but when it becomes too low, there is a worry that people, anticipating the low inflation, will tend to postpone consumption, which will reduce growth and then make debt burdens harder to bear.

The Americans were much quicker in responding to the lowflation risk, so the Eurozone is stuck at 1%, and within that Germany is 1.6%, Italy even lower. The ECB continues to predict that inflation will go up, but the gap between its actions and what it delivers remains vast. We may well have a crisis in the next few months – Italian growth is rapidly slowing, and as world trade slows, European countries slow down, and the Italian slowdown is the most pronounced. Italian interest rates are rising rapidly, bank stock prices are falling, and the combination of weak growth, rising interest rates and falling stock prices is a potent combination that could push Italy into an unmanageable crisis.

There always remains the hope of a saviour, and when Macron became President in 2017, he was quickly anointed as one, but here is where Marjolin continues to stalk. The sovereignty barrier is stronger than ever before and the divergence between Germany and France remains important. The last time a French initiative led to a constructive European outcome was in May 1950 at the time of the Schuman Declaration. Since then, interests have diverged and it has been extraordinarily difficult to come together.

I will end by saying that the Euro has been a source of division and will continue to be so, because the interests are naturally different, incentives toward completion of the architecture will always be stymied, there will be technocratic solutions which will lack political legitimacy, and because they lack political legitimacy, they will either be half-measures or, in the worst circumstance, they will fail when most needed.

I will stop there, and Jean-Claude can say why I am completely wrong.

**Jean PISANI-FERRY**

Before that, let me ask you one question. Why do you ascribe the difficulties in Italy to the Euro?

**Ashoka MODY**

I am glad you asked me that question. I do not do that. What I say is that a weak country will be disadvantaged in a zone that has a single monetary policy.

**Jean PISANI-FERRY**

You mentioned Kaldor, who said that, so you used that as a basis and then presented the evidence, suggesting that the Euro was the reason or one of the reasons, why Italy has weakened.

**Ashoka MODY**

No, what I say is that the Italian problems are Italy's problems. The fact that Italy cannot generate productivity growth is an Italian problem, but the fact that it cannot devalue its currency is a Eurozone problem, and when you bring the two together, a country that has negative productivity growth and cannot devalue, you have an Italian problem. That is the point I am making.