

Comments:
Lessons From the United States
For the Functioning of the EMU

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Themes

- When/how did the US complete monetary, fiscal, and banking union?
 - Great Depression banking regulation and New Deal
 - World War II fiscal centralization
 - 1990s and beyond for banking union
- What would make the union more complete?
 - Fiscal centralization
 - Risk pooling
- What are key sticking points?
 - Doom loops
 - Regional economic differences
 - Political integration

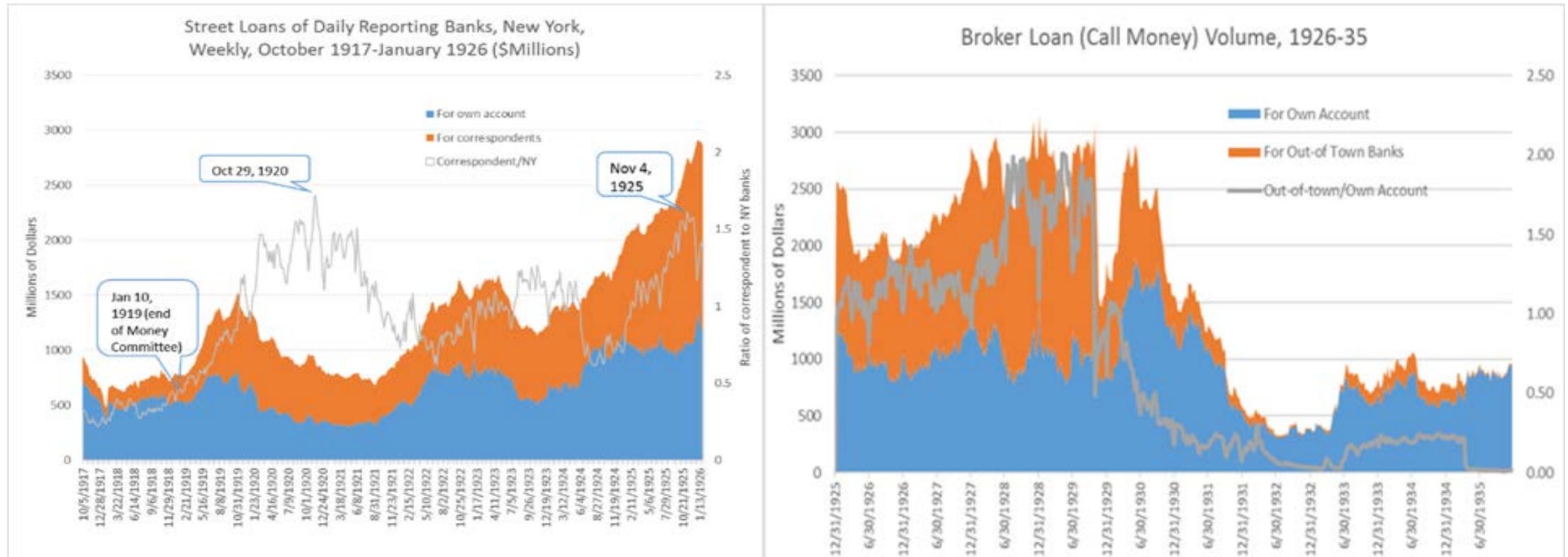
Reflections

- Issues that resonate
 - The long and winding road to US union
 - The episodic nature of US monetary regimes and regulation
 - Anomalies of the US banking industry
- Some additional evidence to consider
 - Capital markets and banking integration
 - Emergency currency and the proto-LOLR
 - Significant changes due to Depression-era regulation
- Lingering doubts
 - Has the US solved its banking problems ('doom loop')?
 - Does the US really compare?
 - Would Europe be better off if it were more like the US?

Role of Capital Markets

- Capital market integration very early in the US. long before officially banking union.
- Country banks tied to capital market via correspondent system and call money market

Call Money Volume 1917-1935 (Weekly)



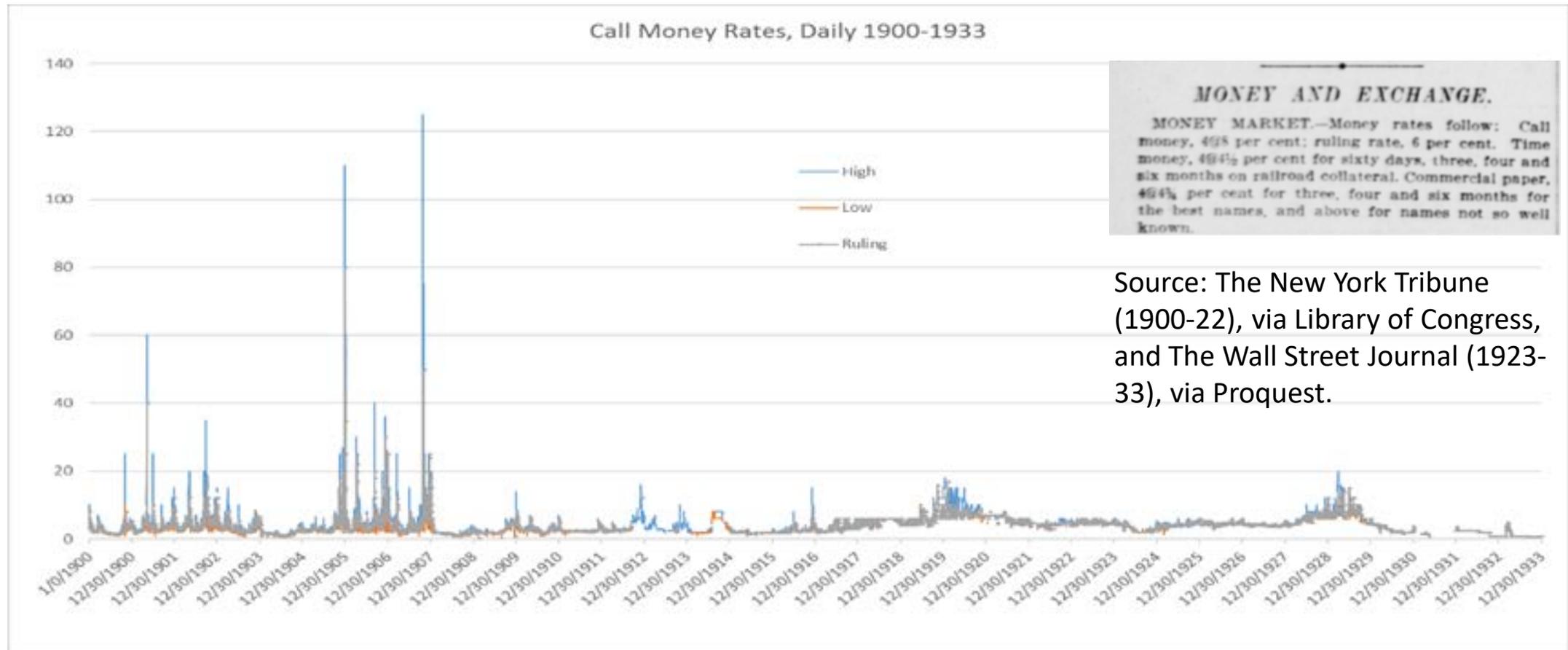
Source: Federal Reserve (1941)

Banking regulation and monetary policy regimes connected

- National banking era from Civil War to 1908—many panics
 - No central bank or official LOLR; private and ad hoc interventions
- June 1908-November 1914: Aldrich-Vreeland era ←
 - Emergency currency/LOLR but no central bank key turning point in LOLR facility and crisis response. Dramatic reduction in volatility of money market; successfully nipped the 1914 panic in the bud.
- November 1914 – 1933: Federal Reserve 1.0
 - Central bank with LOLR facility
- After 1933-5: Federal Reserve 2.0
 - Central bank with centralized fiscal backing

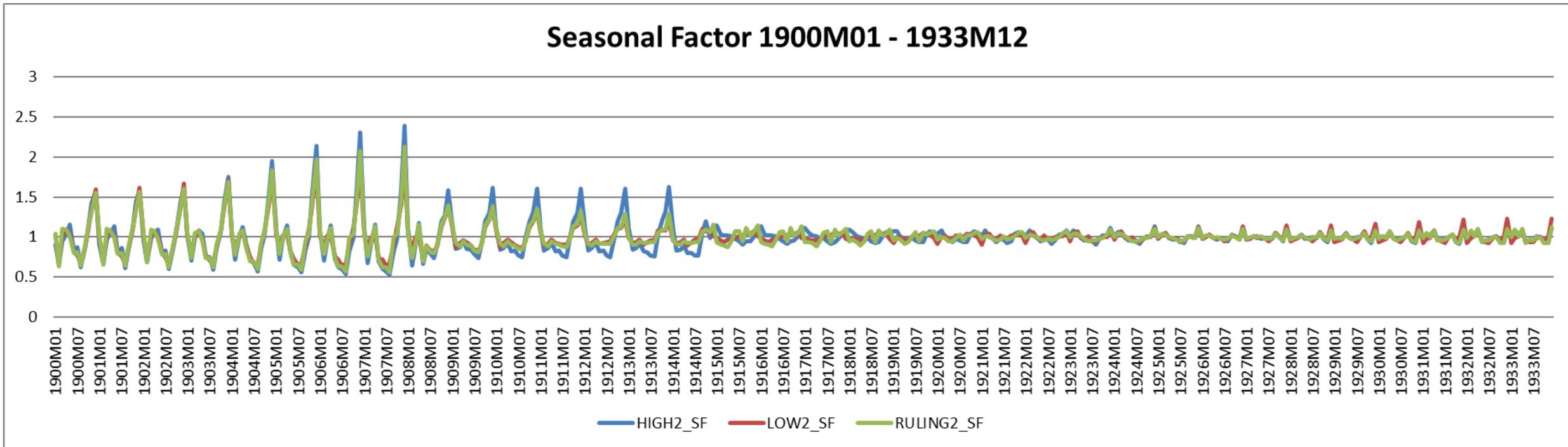
New Data on Call Money Rates, 1900-33 (Daily)

Creating of the Fed system in 1914 had little impact on the money market.
More dramatic reduction in rates and volatility came in 1908 and 1933.

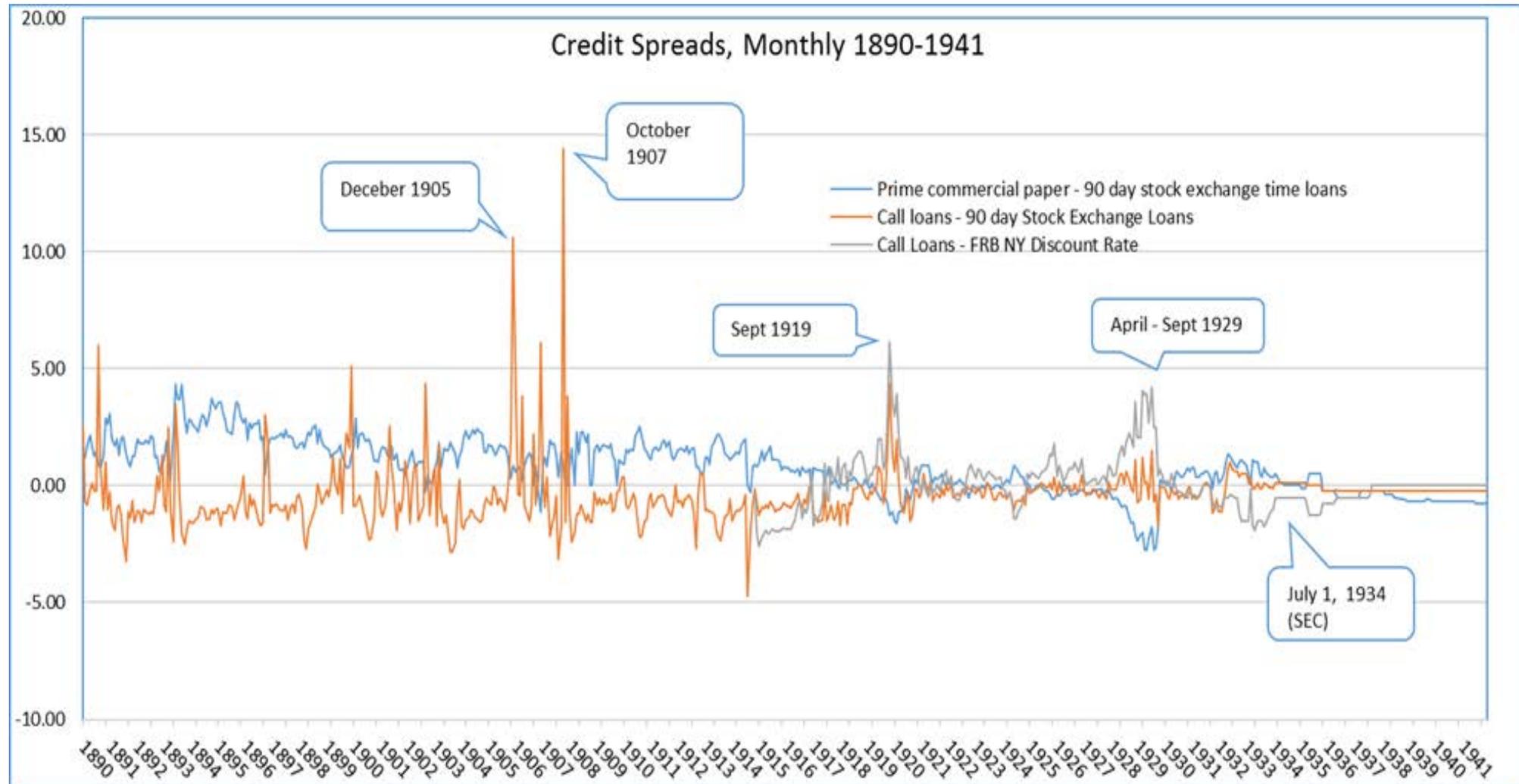


Seasonality in Call Money Rates

More active monetary policy reduced seasonality of capital flows due to harvest cycles.



Credit Spreads



Has the US solved its doom loops?

- Connecting government finances with banking stability
 - Bloomberg editorial 2017: “There are two sides to the linkage between governments and lenders. When investors believe that a government will bail out a weak bank, troubles in the financial system can cause sovereign bond yields to spike. Conversely, when lenders hold too much government debt, doubts over a country’s fiscal health can spill over to the banks.”
- Have we fixed this in the US?
 - S&L crisis
 - TARP
 - AIG bailout
 - SIFIs

Recurring theme of unification + centralization

- Bloomberg: “What’s needed is a grand bargain between more vulnerable countries such as Italy and stronger economies such as Germany.”
- Comparing Europe to the US
 - Can Europe *ever* hope to come together as a true fiscal and political union?
 - Current political state of affairs looks dismal
 - Greece
 - Brexit
 - Spain/Catalonia
 - Right wing parties gaining ground in “liberal” democracies of the West.
 - Eastern Europe (Hungary...)
- More accurate comparison?
 - North America: imagine a union among the US, Canada, Mexico + 20 other states?

Has the US system given it an edge?

- Does risk pooling make all states/countries better off?
- Who benefits from further integration and unification?
- Is the US outperforming?
 - <https://data.oecd.org/chart/54LT>