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A gloomy anniversary

The euro has been in our pockets for five years and citizens aren't happy. True, a majority of them still regard the common currency as advantageous. But according to a recent Eurobarometer survey (http://ec.europa.eu/public_opinion/flash/fl193_en.pdf), support has been dropping for five years now and in Italy, the Netherlands and Greece, a majority of the citizens express a negative opinion.

When asked what the effects of the euro has been, citizens in the euro area are virtually unanimous: they recognise that the euro facilitates price comparisons and has made travelling easier, and even think that it has made the EU stronger in the world economy. But an astonishing 93% of them are convinced that it has provoked an increase in prices. And they do not think it has had any significant effect on interest rates, growth, employment and public finances. Even in Greece, which ten years ago had 8% inflation and bond rates above 10%, 97% of the respondents say that prices have increased and only 1% that interest rates have dropped!

Economists are puzzled. Inflation over the last five years (2002-2006) did exceed inflation over the previous five years (1997-2001) but by half a percentage point only, a modest increase mostly attributable to a doubling of the price of oil and other raw materials. In a careful analysis of microdata, Ignazio Angeloni and co-authors have confirmed that a price jump did occur in the first quarter of 2002 at the time of the introduction of the new currency at retail level, because the changeover offered a unique opportunity for simultaneous price hikes*. But they find that this was a once-and-for-all jump, concentrated in the service sector, whose overall effect on the consumer price index was comprised between 0.2 and 0.5 percent. Even acknowledging that consumer have been particularly sensitive to those service price increases (because they concerned items they buy frequently, because services prices change less often than good prices, and because you observe the price of a cup of coffee each time you pay for your cup of coffee, while you pay at once for all the items in your supermarket caddy), it is hard to understand why they remain concerned five years later.

This is, as academic say, a topic for further research. In the meantime the fact is that citizens throughout the euro area are concerned, and this is bad news for the future.

Unlike established central banks like the Fed or, in the old times, the Bundesbank, the European Central Bank, as a young institution, does not derive its legitimacy from history. Nor does legitimacy stem from the process leading to the appointment of its board members or from its accountability vis-à-vis the people and parliamentary chambers. While such processes can confer legitimacy in well-functioning democracies, this is not the situation in

Europe. The majority of ECB executive board members were appointed because their (big) home country is de facto entitled to a permanent seat. And while there is some accountability vis-à-vis the European parliament, the role of that parliament, itself a distant institution, is limited to asking questions.

The legitimacy of the ECB therefore derives primarily if not exclusively from its performance. It is what political scientists call output legitimacy. If the central bank does a good job and is perceived as having done so, it gains legitimacy. If it does not, it loses it. This is why the near-unanimous perception that the euro is responsible for price increases and a loss of purchasing power is a worrying one. It means lower legitimacy for the currency and the institution in charge of it.

So far, the ECB has not had to take any particularly unpopular decision. Interest rates have risen, but their level remains low. Now imagine what would happen in the case the ECB would need to take away the punch bowl just as the party is getting good, as former US Federal Reserve chairman Arthur Burns used to say. Imagine, what is worse, that it would mistakenly do it at the time the economy has already started slowing down. Or imagine that it would do it as part of the euro area is already in a near-recession. There would quickly be an outcry and all sorts of criticisms would concentrate on the central bank.

Those risks should be a matter for concern for the ECB, but also for the ministers of Finance, the Eurogroup and for the heads of states, who after all bear ultimate political responsibility for the creation of the single currency. They should all regard the euro as their young and still fragile child. Unfortunately, they all seem more preoccupied with posturing. In recent months, we have seen a fair amount of blame game, repeated statements of independence, some childish disputes, and a few utterly irresponsible statements, but hardly the type of collectively responsible behaviour we should be entitled to expect from all those in charge of that extraordinarily ambitious project: the creation of a currency for Europe.

* Ignazio Angeloni, Luc Aucremanne and Matteo Ciccarelli, « Price setting and inflation persistence : Did EMU matter ?, Economic Policy, April 2006.