A gentle sceptic: Martin Feldstein and the euro

Radu ȘIMANDAN[*]

Abstract

This article traces the complex path that Martin Feldstein followed, for more than twenty years, in his principled critique of the European common currency project. Involved in the debate on the euro from its early stages to the tumultuous times of the sovereign debt crisis and the resulting recession, author of numerous articles in the academic and popular press, drawing his arguments from economics and political economy, he contributed to the development of an American vision on monetary unification in the EU. Studying this extended body of literature proves to be an interesting way to explore the sinuous discussion on the euro from the theoretical, applied and public-debate perspectives.

Keywords: euro, EMU, Martin Feldstein, US economists, monetary unification

Introduction

The prospects for monetary unification in Europe have been met with scepticism by academic economists, policymakers and commentators alike. American economists, in particular, have presented a pessimistic view of the euro project since its earliest stages (Frankel, 2000; Jonung and Drea, 2010). Although the far-reaching ambitions of the founding fathers of the EMU were generally admired and the significance of the moment was acknowledged – for instance, Bergsten (1997, p. 83) considered the introduction of the euro as "the most important development in the international monetary system since the adoption of flexible exchange rates", while Krugman (2000, p. 173) described this endeavour as being "the grand project of Europe" – the chances of success of the newly introduced European common currency were generally seen as quite trivial.

The American critique of monetary unification in Europe has been rooted in both economic and political economy arguments. Many US economists have argued that Europe is far from meeting the requirements derived from the optimal currency area (OCA) theory, at least compared to the United States (Eichengreen, 1992). Milton Friedman (1997) saw the EU as an area unsuited to a common currency due to its cultural, political and economic diversity and warned that forcing a monetary

[*] Radu ȘIMANDAN is Lecturer at the Polytechnic University of Bucharest, Romania; e-mail: radu.simandan@upb.ro.

unity in these adverse conditions could lead to an overt interstate political conflict. Eichengreen and Frieden (1993) laid the analytical foundation for the study of the political nature of the monetary integration in Europe by advancing a set of political considerations, such as interstate bargaining, intrastate political tradeoffs, and domestic distributional factors – whose interaction in Europe was quite detrimental to this process.

To be fair, the euro had a handful of notable American (moderate) friends. Leaving aside the fact that Robert Mundell, the Canadian theoretician of currency areas was an ardent supporter of the euro (Swoboda, 1999) and enjoyed a large audience in the US, several other economists pointed out the still unknown but potentially substantial role of the euro in the international monetary system (e.g., Frieden, 2000). The willingness of the euro to stay alive in the face of adversity has been particularly admired over the ocean. In a review of the euro's record for its twentieth anniversary, Jeffrey Frankel gave high marks to EMU leaders for their ability to accommodate the divergent interests of member states (Frankel, 2019). However, to reaffirm the observation that Frankel (2000) makes (but partially rejects), there seem to be two opposing camps following the euro game, one on each side of the Atlantic.

One way to explore this sizzling debate is to investigate the path followed by Martin Feldstein, a Harvard professor who has been at the forefront of the academic clash with the euro for more than twenty years. As an early principled opponent of the monetary unification in Europe, whose critique has gone beyond purely economic arguments to political economy considerations, Feldstein has helped to shape the views of the American academia further than the realm of Economics. His numerous popular press pieces on this matter, although more nuanced as time went on, made the straightforward case against the euro and suggested alternative policies to the European elite in charge of managing this intricate monetary reality.

To form a comprehensive image of Feldstein's view on the euro, we proceeded as follows. On his National Board of Economic Research (NBER)[1], we searched the list of academic publications, working papers and non-technical papers using the following search words to select the relevant publications: "Europe", "European", "Euro", "Eurozone", "EMU" and "ECB". We have thus arrived at a total of fifty articles (of which three academic papers, seven NBER working papers and forty popular press pieces) that formed the database for our analysis. We used the NBER working paper version in a few instances when the working paper was published later in an academic journal and the popular press article when the paper was published as an NBER working paper. We then performed a thematic analysis to identify patterns in this rich set of scholarly data. As we were familiar with the generally pessimistic tone of American economists regarding the euro and with the main reasons advanced to explain this pessimism (e.g. Jonung and Drea, 2010), we opted for a theoretical (or

[1] NBER homepage: http://www.nber.org/feldstein/.

'top-down') thematic analysis rather than an inductive (or 'bottom-up') one, considering both semantic and latent themes (Braun and Clarke, 2006).

Any theoretical or analytical statement that captures something important vis-à-vis the positioning towards the euro was considered to represent a theme. As such, we were guided by several well-established statements commonly found in the popular press and academic literature on the euro (Table 1). For each statement, we have used the earliest source that, to our knowledge, clearly articulates the specified idea. The analytical objectives were to identify the specificities of Feldstein's arguments and see how these arguments relate to those of other scholars, American or not. To this latter end, we identified and selected several scholarly articles that cite Martin Feldstein's publications using the *Cited by* facility offered by Google Scholar.

Table 1. Common statements in economists' views on the euro

Countries in the EU are too heterogeneous to form an optimal currency area (Glick, 1991).
For EMU countries, the costs of renouncing control over their monetary policies outweigh the benefits (Bordo and Jonung, 1999).
Interregional fiscal transfers are a key condition for the success of the eurozone (Eichengreen, 1992).
Monetary unification in the EU increases the chances of political conflict within the EU (Friedman, 1997).
The main drive for the EMU is political rather than economic (Eichengreen and Frieden, 1993).
A weaker euro would help ease the sovereign debt crisis (Frankel, 2015).
The EMU is not the US (Tobin, 2001).
Two-speed Europe is a hazardous institutional choice (Chryssogelos, 2017).

Source: author's representation

We have divided the time frame into three periods: the first period, which begins with the publication of the article in *The Economist* in 1992, is devoted to describing how Feldstein laid his own analytical basis for the debate on the euro; the second period covers the euro crisis and begins with the first article on this issue which was published in 2008 (Feldstein, 2008); the final period begins in 2012 with the publication of his article on Spain's problems following the euro crisis (Feldstein, 2012i) and focuses mainly on the analysis of the economic, fiscal and monetary consequences of the crisis. The following three sections analyse each period in detail, while the last section concludes.

1. Building the core arguments against the euro

After graduating from Harvard College in 1961, Martin Feldstein was determined to become a physician (Loungani, 2004). Instead, he embraced a career in Economics and, after spending six years studying and researching at Oxford

University, he began teaching at Harvard in 1967. Interested in a wide range of topics in the field of public economics, from taxation to social security and health economics, in 1982, professor Feldstein was appointed Chairman of the Council of Economic Advisers and chief economic adviser of President Ronald Reagan, continuing to advise Presidents Bush and Obama in various positions. Promoting collaborative effort as a leader of the NBER for more than thirty years (Summers, 2019) and popularizing economic thinking as author of articles and comments dedicated to a large audience, he left a lasting mark in the economics profession. At his death in June 2019, *The Economist* printed a deferential title under the headline *An Economic Institution*: "Martin Feldstein was a pillar of American economics" (The Economist, 2019).

A prolific author, Martin Feldstein published nearly four hundred academic articles and countless non-technical papers and comments throughout his long career. The process of monetary unification of the EU figured prominently in Feldstein's publications, both in academic journals and popular press comments. Several general themes can be distilled from this extended body of literature, from the cost-benefit analysis to the political economy of EU's monetary unification, to fiscal and monetary policies in the Eurozone and, of course, to how the sovereign debt crisis has turned the whole matter upside down (Table 2).

Table 2. Main themes in Martin Feldstein's articles on the euro

Theme	Article	Theme	Article
Cost - benefit analysis	2017a, 2012c, d, 2011c, d, g, h, i, l, 2010e, 2009b, 2000a, 1992	The euro vs. the dollar	2014, 2013a, 2012b, 2011a, 2010c, 1999, 1998
Political economy of the Eurozone	2013c, 1997a, b	Eurozone crisis; policies in response to the Eurozone crisis	2016, 2015a, 2010a, b, 2009a, 2008
Fiscal issues	2013b, 2012e, h, 2005	Individual country analyses	2017b, 2013d, 2012a, g, i, 2011b, e, f, j, 2010d, f, 2001
The ECB, monetary policy	2015b, 2012f, 2011k, 2000b, Feldstein and Feldstein 1998		

Source: author's representation

As early as 1992, Feldstein has expressed an unenthusiastic view of the prospects for monetary unification in Europe and suggested that the European Community should abandon its monetary union plans. Writing for *The Economist,* he warned EU political leaders of several challenges that their monetary strategy

would bring (Feldstein, 1992). As one of the oldest exposure of the case against the euro, the arguments presented in this source deserve closer examination.

The widespread hope that eliminating currency fluctuation facilitates trade and investment has little chance to become a reality, and in fact, the intra-European trade may even decline as specialization makes a country more vulnerable to changes in demand and therefore unwilling to make full use of international specialisation. Unable to manipulate the real exchange rate of their currencies, countries with a common medium of exchange may find it particularly strenuous to remain internationally competitive. Then, there are political economy arguments. Apart from Germany, few countries are willing to renounce an independent monetary policy in exchange for a promise of a German-style anti-inflationary oriented central bank. Indeed, there is reason to believe that few countries are attracted to the low inflation outlook. Regarding the broader institutional design of the EU, it is clear that those with federalist views would be better served by the introduction of the euro, while the rest have no reason to pursue such a goal. Those countries that are not members of the EMU would see themselves as political outsiders and pose a threat to Europe's future peace and prosperity, as they would be tempted to block constructive political initiatives – therefore, the euro would worsen the inherent problems of the 'two-speed Europe' institutional arrangement (Feldstein, 1992).

Like many US scholars, Feldstein recognizes the historical significance of the moment. He unequivocally states, "[t]he introduction of the European economic and monetary union (EMU) could be the most far-reaching European political event of the twentieth century" (Feldstein, 1997b, p. 23), and "[t]he EMU is the most significant political event since the end of the cold war" (Feldstein, 1999, p. 2). Nonetheless, this appreciation should not be confused with approval. In an influential article published in *The Journal of Economic Perspectives*, Feldstein goes over the main points that he recognizes as defining his pessimistic view (Feldstein, 1997b). After reviewing the politics (the objectives to prevent a new internal war and to project force externally, the prevalence of national interests over the interests of the union, and the disregard of the European political elite for the popular sentiment against adopting a common currency) and the economics of EMU (its effects on the cost of trade among EMU member states, cyclical and structural unemployment, inflation, the likelihood of protectionist policies), he concludes that the overall consequences are likely to be negative. At this point, however, he acknowledges that European political leaders seemed determined to adopt the common currency until January 1999, although the unceasing conflict between Germany and France could still interfere with the attainment of this goal.

Martin Feldstein was among the first economists to approach the monetary unification in Europe from a political economy perspective. His main arguments may be summarized as follows. An independent monetary policy in a bloc of sovereign states leads to international political conflict, with Germany and France at the forefront of this battle in the case of the EMU (Feldstein, 1997a). The main points

of contention stem from the proclivity of national governments to control monetary policy and from the related question of the proper objective of this policy instrument. Given the classical trade-off depicted by the Phillips curve and the fact that, in the EU, some countries are more concerned about inflation while others are worried about unemployment, it is plausible to expect that the internal public will voice their frustration and that national governments will take this battle to the EU level. Furthermore, lacking a discretionary monetary policy tool, some countries would be tempted to use fiscal transfers to offset a drop in aggregate demand, but the fiscal deficit and public debt limits, agreed as part of the Stability Pact, preclude this possibility. The result is yet another source of political tension between countries with high and low (cyclical) unemployment – or, to put it differently, countries that are at different points in their respective business cycles. This problem would certainly be mitigated or eliminated if member states enjoyed greater business cycle synchronization, but Feldstein does not consider this possibility.

The high probability assigned to the euro to act as a catalyst for conflict in the EU is a common theme in the early literature that takes a political economy perspective. Friedman (1997) points out that a monetary union in Europe precludes the use of the exchange rate as a policy tool in the likely case of one group of countries being affected by a negative shock that would require lower wages relative to another group of countries. The result of these divergent economic interests is the accumulation of political tensions within the EU. The disturbing history of conflict among European nations lends more weight to this argument (Frieden, 2000). As detailed below, Feldstein (1998) expands on this topic and analyzes how the euro can lead to a deterioration of the EU-US relations.

European economists were not late to react to the American wave of criticism led by such academics as Martin Feldstein and Milton Friedman: "It is possible that the opinions of Feld[stein] and Friedman are not entirely impartial, and this possibility illustrates one aspect of politics in a monetary union. Feld[stein]'s and Friedman's opinions – as well as the opinion of many other USAmerican economists – may be biased in accordance with the national interests of the US"[2] (Minkkinen and Patomäki, 1997, p. 8). As these authors go on to note, the reasons for this bias have to do with the frustration of the American economists in the face of the euro's success and the prospects for the US to lose its 'hegemony'. The transatlantic battle of ideas over the euro was now open.

However, this does not suggest that European economists have acted as a tight group united in their unconditional support for the euro. As Bagus (2010) observes, two opposing views of Europe have collided from the beginning of the unification process in the post-war era: the classical liberal view and the socialist view. The conflict of visions over the most appropriate monetary arrangement for the EU can be

[2] Feldstein's name is misspelled as Feldman, but it is clear from the context that the authors refer to Martin Feldstein.

understood as a unique battle fought in the context of this more widespread ideological war. As a rule, free-market-oriented economists are more likely to oppose a centralized monetary system such as EMU in which monetary experts wield great powers over ordinary citizens, while those favourable to state intervention in the economy are more likely to support it. This ideological divide may explain both the difference in support for the euro between commentators in the US versus the EU and the divergence between economists in each of the two common currency areas.

In January 1999, the euro becomes a reality. Eleven EU countries, out of a total of fifteen, irrevocably fix their exchange rates and unify their monetary policies under the European Central Bank (ECB). Marking the first anniversary of the euro, Feldstein reiterates his grim assessment, pointing to the verdict of the markets (Feldstein, 2000b). Indeed, the euro fell by around 15 per cent against the dollar and even more against the yen in its first year of existence. Feldstein blamed the structural problems of the European economy for this cheerless outcome and argued that the ultimate source lies in bad policies: generous welfare benefits, excessive regulation and anti-business policies promoted by EU governments, especially those of France and Germany. Concerning the monetary policy of the newly established ECB, Feldstein's analysis is unambiguous: the one-size-fits-all course of action, unavoidable in a monetary union, is not suitable for an area with large differences in inflation and business cycle stages, as the euro area was at the time (Feldstein, 2000a; 2000b). Overall, to use the title of an article he wrote for The Wall Street Journal in 2000, Feldstein's verdict was ruthless: *Europe can't* handle the euro (Feldstein, 2000a).

Even before the launch of the euro, the EU common currency project sparked a polarizing debate on the role of the euro against the US dollar, with several renowned economists (including US economists) predicting that the euro would radically transform the international monetary system and outperform the dollar (Otero-Iglesias and Steinberg, 2013). Although the force of inertia specific to international trade practices may initially play on the dollar side, the euro is likely to narrow the gap in terms of market share, given that the ECB has a clear mandate to ensure price stability, its predictable preference for euro appreciation and the fiscal policy conditions likely to work in favour of a tight monetary policy (Bergsten, 1997). Political economy aspects are once again key: short and long-term policy in the eurozone is the fundamental determinant of the attractiveness of the euro since it affects its expected evolution and the stability of the domestic financial system – a political factor seen as a weak point in Europe given its history of conflicts of interests among national states (Frieden, 2000). However, after the first few years of existence, the euro seemed to have been a success as an international player given the boom in euro cross-border financial transactions, but less so as a currency in which to invest given its loss of value (Frankel, 2000).

Feldstein entered this debate on the side of the economists who doubted the triumph of the euro on the international stage. To be sure, the new monetary developments in the EU pose some risks to the United States, but these are not as

straightforward as commonly thought. Since Feldstein had the absolute conviction that the arrival of the euro would provoke an intra-European conflict that would cause the EU to move in unpredictable directions, he posited that the chances of a EU-US conflict on foreign policy and military issues increased (Feldstein, 1998). So the US would be better advised to keep its long-standing political and military ally under scrutiny. The danger that some European countries seeking a common enemy would begin to see the United States as their common enemy was real. Therefore, Washington should develop a strategy to reduce the risks of conflict with the EU (Feldstein, 1999). Yes, the US should take the euro seriously, but only if the European common currency is viewed fairly as a device that upsets the balance. As for the prospect of the euro becoming a prime player on the global stage, the structural problems of the EU economy (at the time, unemployment in the EU was more than double the level in the US) would prevent this from happening (Feldstein, 2000).

The 2009 meeting of the American Economic Association allows Feldstein to reaffirm his well-known arguments and to point to the ongoing euro crisis in support of his position. At the time, he described his point of view at the time with the following three statements: monetary unification in the EU is driven by politics, not economics; economic benefits (in the form of increased trade and competitiveness) are likely to be outweighed by economic disadvantages (higher unemployment and long-term inflation); the creation of the euro heightened the potential for conflict within Europe and with the US (Feldstein, 2009b). The suggestion here is that all these risks had manifested themselves since the launch of the euro. At this point, Feldstein was taking on a new battle: he was determined to prove that EMU was fundamentally different from the US from an optimal currency area perspective (the 'EMU is not the US' theme). In his mind, three conditions made the US more likely to meet the requirements for an optimal currency area: increased labour mobility, greater wage flexibility, and a centralised fiscal policy (Feldstein, 2009b; 2011c). Political union – the overarching idea that the EU leadership has supported from the beginning – is of no help in this matter.

2. A renewed pessimism: the sovereign debt crisis

In light of the above discussion, we argue that Martin Feldstein should be recognized as one of the leading scholars who contributed to the development of an American framework for analysing the monetary unification of the EU. His general pessimism, clearly expressed in his early articles, remained unchanged throughout the period.

The advent of the euro crisis offered Feldstein a new set of arguments in support of his distrustful views. Ten years into its existence, the euro area may have reached a turning point: despite all the legal and technical difficulties in doing so, some countries may choose to withdraw. A key reason for this temptation is identified in the desire to escape the constraints of the Stability Pact in order to be

able to adopt old-style Keynesian fiscal stimulus programs to combat the downturn (Feldstein, 2008). An asymmetry is once again present: some countries need fiscal stimulus more than others do, and this adds to the level of potential conflict in the EMU. On the positive side, however, Feldstein is quick to admit that the ECB deserves credit for sticking to its mandate and delivering a low inflation rate. Coming from a key contributor to Reaganomics, Martin Feldstein's accent on price stability as the sole responsibility of the ECB is hardly surprising.

It is now a matter of life or death: the survival of the Eurozone is at stake in the harsh circumstances brought about by the crisis. More likely, some countries will be tempted to leave the EMU and depreciate their reacquired sovereign currencies to improve competitiveness, boost exports, and reverse the downturn. Given its high level of unemployment (more than twice the level of Germany at the time), the case of Spain is discussed in more detail to illustrate the logic behind these predictions (Feldstein, 2009a). One way to overcome the problem of setting the proper exchange rate for the newly re-established (old) currency would be to start with a parity (1 unit of the new currency = 1 euro) and then let the markets set the exchange rate.

It is worth noting that Feldstein discusses the scenario of some countries leaving the Eurozone only as a possibility; nowhere in his articles can be found clear predictions that a country *will* exit or the idea that *it would be desirable* to do so. To be sure, the foundations of the euro are unequivocally flawed, but "[d]espite its problems, the euro is very likely to survive the current crisis. But not all of the Eurozone's current members may be there a year from now" (Feldstein, 2010e, p. 12). His tone remains quite unemotional. Among American euro sceptics, many renowned economists have expressed mistrust in the euro and voiced their attitude in harsh language. Joseph Stiglitz also paints a grim picture of the common currency, but his approach is more radical, as the euro is seen as a *threat* to the future of Europe and the main contributor to its *dismal performance* in promoting growth (Stiglitz, 2016). Nouriel Roubini's style is equally firm: Greece *should* default on its public debt and (permanently) *abandon* the euro (Roubini, 2011).

Unlike the scenario of some countries abandoning the euro, Feldstein's bet on default is unequivocal: *Greece will default on its national debt* (Feldstein, 2010f). To convince domestic and foreign investors to fund its deficit spending, the Greek government would have to enact drastic cuts in the budget deficit and increase tax revenue, but both measures are politically unworkable under the given circumstances. Once again, the euro is seen as guilty: if it had not been part of EMU, Greece could have evaded default. By devaluing its currency and putting its public finances in order, Greece could have increased its exports and grown enough to boost its tax revenues and avoid losing investor confidence. In the absence of a Greek national currency, a key market signal was missing: investors had no effective means of conveying to the Greek government their dissatisfaction with its excessively large debt, a message typically transmitted via currency depreciation resulting from capital flights. From a political perspective, given the potential for contagion to other

peripheral countries (such as Portugal, Ireland or even Spain), the temptation of the EMU elite to *postpone* the default of Greece is understandable (Feldstein, 2011f).

After discussing the prime causes of the inevitable Greek default and making things clear about the role the euro played in the mess, Feldstein presents a solution that he portrays as both politically feasible and economically sound: the Eurozone holiday (Feldstein, 2010d; 2011b). In this scenario, Greece would temporarily leave the Eurozone and return to the drachma with the obligation to re-enter a few years later at a devalued exchange rate. This boost to international competitiveness would be enough to offset the contraction and reinstate growth. As the argument goes, this institutional arrangement would be preferable to the then-current strategy of harsh budgetary adjustments that would condemn the Greek public to many years of high unemployment.

Feldstein's 'euro holiday' solution for Greece was met with much interest but little approval. It is quite rare for a popular press article to be cited in academic journals, but Feldstein's original piece in *The Financial Times* received a fair amount of attention from scholars. His idea was heavily criticized for purely economic reasons (suspending the euro would lead to capital flights, a banking crisis and exchange controls, suggesting the notion that once established, a currency union is forever) and for political economy reasons (EU politicians should be seen as rational agents in the best position to judge the net costs of breaking up the euro area versus keeping it) (Eichengreen, 2014). Fears have also been expressed that the Greek holiday option would wipe out the Eurozone through materialized moral hazard, together with the more or less veiled suggestion that this might have been Feldstein's hidden intention all along (Baldwin and Wyplosz, 2010).

Surprisingly, some crucial issues are missing from Feldstein's investigation into Greece's predicament. Long-established conditions of Greek policymaking, such as government waste, the unholy alliance between private interests of big economic players and elected officials, overly powerful bureaucracy, tolerating tax evasion (Katsimi and Moutos, 2010), although key elements for the success of the drop - devalue - reinstate cycle, are nowhere to be found in Feldstein's analyses. Nor does he discuss the practice of 'window dressing' the public finance data in the context of the holiday solution. Coming from an economist that applied a political economy framework to advise against the euro, this absence is even more striking. Furthermore, Feldstein seems to rest his case excessively on the stimulating effect of currency devaluation, a policy that he would later prescribe to all EMU countries as a means to overcome the recession. Indeed, it can be argued that given the low diversification of Greece's export basket and its little opportunity to expand to new products, the room for growth via increased exports due to a devalued currency is small (Bahar and Kransdorff, 2015).

By the end of 2011, unable to agree on a blueprint for political union (as a means to reduce uncertainty) and on the issuance of euro bonds (to move towards

greater fiscal centralization), the political elite in charge of the euro not only failed (Vittori, 2013), it double failed (Feldstein, 2011i).

3. A ray of hope?

In spite of all predictions to the contrary, European leaders showed their determination and managed to keep the common currency in the face of the debt crisis. At this point, a faded optimistic case for the euro seemed appropriate (Feldstein, 2012c). Here, the Harvard professor appears to appreciate the unprecedented efforts of the ECB to lend a helping hand. The ECB's pledge to buy Italian and Spanish sovereign bonds in exchange for fiscal reforms seemed to succeed in bringing down their interest rates. This trend was likely to continue, given the prospects of these countries for growth and declining debt to GDP ratios. Prospects for peripheral countries like Greece and Portugal to abandon the euro remain high, but at least the big players could now enjoy more room to decide. For Feldstein, it is still worth carrying out a counterfactual analysis for Italy and Spain of having their own currencies and devaluing in order to escape problems. However, as these countries do have the euro, a policy of depreciation of the euro at EMU level would continue to benefit them, as well as other countries with current account imbalances.

Feldstein extends his recommendation for currency depreciation to the entire EU in the context of the Great Recession and calls for a weakening of the euro in quite a few high-impact articles (Feldstein, 2011a; 2012a; 2012b; 2013a; 2014). The objective of this policy is to increase external competitiveness in trade with countries outside the Eurozone, thus contributing to recovery. He is quick to point out that this policy cannot be a permanent solution, but at the very least, it would give authorities time to implement measures to improve productivity (Feldstein, 2011a). Surely, the decline of the euro was already taking place due to scepticism from international investors, but what Feldstein recommends is a deliberate action by the ECB that would accelerate this process. Regarding the effects of this policy on the exports of other countries and the prospects of a currency war, Feldstein only discusses the American case: the US economy would be only marginally affected given the small proportion of trade with EU member states, and no policy reaction from Washington would be expected to prevent a weaker euro (Feldstein, 2012a).

As in other cases, Feldstein's wide-audience, non-technical articles suggesting the depreciation policy of the euro have been discussed in scholarly articles but, this time, it generally received positive reactions. More economists, including European economists, began to view the depreciation of the euro as an indispensable course of action for recovery (e.g., Frankel, 2015; Kawalec and Pytlarczyk, 2013). This solution seemed to gain popularity even among decision-makers:

> In recent weeks I have discussed the case for a declining euro with current and former Eurozone officials. I expected that they would just say that I am a long-

> time "eurosceptic" who is always critical of the euro. But the opposite happened. These Eurozone experts all agreed that a lower value of the euro is necessary for the survival of the single currency (Feldstein, 2012a, p. 1).

What Feldstein does not consider, however, are the initial trading conditions that are key to the success of the weaker euro policy, such as the initial export structure of peripheral countries (those that this policy was designed to help the most) and the likelihood for them to conquer new external markets. Surely, the depreciation of the euro would come with its own set of problems. While this may be an effective way to restore competitiveness in the short run, it also brings a distorted set of incentives for policymakers, as they may be tempted to avoid the difficult structural reforms needed to improve competitiveness in the long run and expect the noticeable gains in external performance to become permanent (Kawalec and Pytlarczyk, 2013). Furthermore, inflation may be an intended or unintended consequence of this policy, but surprisingly Feldstein does not discuss the broader implications of this by-product, in line with the then-common notion that inflation in the EMU was not a cause for concern as it was low and expected to stay low – a level sometimes considered too low. As several observers point out, an irrational and pernicious fear of deflation seemed to be the norm among EMU policymakers (e.g. Bagus, 2010). In fact, Feldstein would explicitly recommend that the ECB conduct a looser monetary policy aimed at eliminating a so-called deflation, as the (positive) rate of inflation at the time was below the target rate by one percentage point (Feldstein, 2013a).

The ECB has enacted a large-scale asset purchase program and slashed short-term interest rates, a policy very similar to Feldstein's weaker euro suggestion. Although not specifically aimed at this goal, this quantitative easing (QE) drove the value of the euro down by 25% in the fall of 2015 relative to the summer of 2014 and Mario Draghi announced a new expansionary monetary policy as a key ingredient of his anti-crisis strategy. However, the impact of this policy on Eurozone members' exports and production has been limited: the main transmission channel of Feldstein's proposal linking the exchange rate with production appears to have operated at low capacity. Feldstein attributes this disappointing result to the structure of exports, as EMU members mainly trade with each other and use US dollars as the reference currency when trading with the rest of the world (Feldstein, 2016).

Thus, the QE policy that worked well in the US and attracted praise from Feldstein has performed less than optimally in the EU, at least as a device to boost exports outside of the Eurozone. This outcome did not cause Feldstein to reconsider his position on the weaker euro policy that he had been advocating for the previous few years. Given that it was obvious that QE was not enough and old-style Keynesian stimulus programs were not available due to the already excessively large debt of member states, the solution lies in fiscal policy measures at country level that do not lead to an increase in the fiscal deficit, such as stimulating business investment through tax credits, accelerated depreciation of fixed assets, allowing individuals to

deduct mortgage interest payments, or announcing a commitment to increase the value-added tax annually for the following five years (Feldstein, 2015b).

Feldstein had previously advanced state-level solutions for the EU. The prevention of large national budget deficits is an essential requirement in a currency area, but the fear of member states of losing their national sovereignty in fiscal matters can interfere with a centralised solution. The decision-makers must operate within the constraints of a multinational area: "The problem for the EMU leadership is therefore to find a way to prevent excessive deficits while leaving member states free to shape their own spending and tax policies" (Feldstein, 2010b). National deficit rules should be considered a solution, given their success in the US: although each state government can set its own spending and tax policies, state-level debt remains low as required by state constitutional provisions.

A slight change of heart can be detected at some point throughout this troubled period, as Feldstein seems to understand that an inevitable feature of a currency area is that, once in place, it becomes politically unfeasible to let it fall apart. This political reality, however, does not magically turn an expedient into an economic stroke of luck. "But while the creation of the Eurozone was an economic mistake, allowing it to dissolve now would be very costly to governments, investors and citizens" (Feldstein, 2012a). Given that the scenario of a complete dissolution has become unrealistic, the debate should now focus on the best policies for the Eurozone to overcome the crisis.

Conclusions

Martin Feldstein's path, with its wide variety of interests, themes, shifting accents, and apparent contradictions, can be considered as the embodiment of the American way of looking at the European monetary unification. This American professor and educator has been involved in a long principled debate on the pros and cons of the *one money, many countries* proposal for Europe.

The OCA theory has been the framework of choice for US critics of the euro, at least in its early stages (Bordo and Jonung, 1999; Jonung and Drea, 2010). Martin Feldstein does not follow this beaten path. Although some themes inspired by the OCA theory (such as the high economic costs for EMU members to abandon national monetary policies and the need for centralised fiscal transfer mechanisms) are found in Feldstein's argumentation, his foundational structure against the euro better fits the political economy framework. This strategy allowed the Harvard professor to focus his line of attack on some traits of the EU monetary unification that would most likely lead to its demise, such as the build-up of international and intra-national political conflict and the hazardous consequences of a two-speed Europe. The surprising determination of the EU political leaders to bear the economic costs of maintaining the currency union in the face of the crisis may point to the fruitfulness of this argumentative strategy. However, a limitation in the context of EMU can be

identified in the scarcity of empirical investigation, as this approach tends to be limited to identifying the biases that rational agents, especially politicians, manifest in different institutional settings.

The way that Feldstein treated inflation in the Eurozone speaks to his shifting focus over time. The ECB deserves praise for having managed to keep the price level stable for the first few years of its existence. But later, Feldstein recommends euro inflation as a means to overcome the recessionary effects of the crisis. This strategy has certainly been the weapon of choice for many governments confronted with the crisis and sluggish recovery, but Feldstein has gone beyond that to suggest a monetary expansion substantial enough to produce a depreciation of the euro. The costs of losing the purchasing power that ordinary euro holders would have to bear are nowhere taken into account in Feldstein's comments.

Feldstein was not so radical as to recommend that a country leave the Eurozone irrevocably in the turmoil resulting from the crisis. Accepting the ultimate political nature of monetary unification, his advice aimed to alleviate the problems associated with EMU membership, given that the exit option has become politically unavailable. His famous 'euro holiday' solution is a case in point. This sets him apart from other American academics that had no second thoughts in recommending various EMU withdrawals or the dismantlement of the Eurozone. As for the extension of the euro area, we can only infer that, since the euro is an economic mistake in his mind, the political gains for the new members cannot outweigh the economic costs they would bear because of this political decision.

Following the traditional American way of looking at the euro and further consolidating it, Martin Feldstein was a Eurosceptic. His later advice, however, seems to be given from the position of someone who wanted the euro to succeed.

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