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NEW OCCASIONAL PAPER:

Money Mischief in the Eurozone: Reforming the European Monetary Union

Fredrik Erixon in a [new ECIPE Occasional Paper](#) analyzes the role of the European Central Bank in the current Eurozone crisis. He asks how should the actions of the European Central Bank (ECB) – before and during the Eurozone crisis – be judged? And now that central banks across the developed world are undergoing profound changes, what does its past tell us about the future of European monetary policy? How should it change to increase macroeconomic stability?

The European Central Bank has been a source of monetary disorder in the Eurozone. It was complicit in creating a huge asset bubble and growing current account imbalances in the Eurozone in the pre-crisis years. And it has been complicit in creating the drawn-out recession in the Eurozone in the past years. Its failure stems from a misguided monetary policy based on pure inflation targeting and a progressive downgrade of the role of money in monetary policy. For the ECB to become a source of macroeconomic stability, its policy, targets an operation of instruments should be changed. It does not mean that price stability should be ditched, or that a new mandate needs to be created. Yet it means that it should explore alternatives to the current monetary policy regime.

In this paper, Erixon states that the Eurozone is in such a difficult situation that no monetary policy will do wonders, since all monetary alternatives are also associated with significant risks. Central banks could certainly do more to stimulate demand, but such actions are difficult to engineer without increasing the risks for higher inflation. It is clear that overall policy, targets, and the operation of instruments need to change. It is less clear how they should change. In the conclusion, the author presents six steps that should be taken in order to make monetary policy more responsive to current economic crisis.

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