A euro parable: the young couple with a joint account

By Kenneth Rogoff

Perhaps the following parable is not entirely fair to the euro, but nevertheless the parallels seem striking.

Consider a young couple who is contemplating marriage, but unsure whether to take the big step. So instead they decide to test things out by opening a joint bank account. At first things go remarkably smoothly. Heady with success, they get the inspiration of extending the arrangement to her brother and his sister. Not only do they hope to show their siblings how well they can cooperate, but with four people, the total size of the account reaches the critical threshold needed to receive exorbitant privileges normally accorded to the bank's larger customers.

Thanks to a cleverly designed constraint to limit imbalances between each sibling's contributions and withdrawals, the innovative experiment continues to flourish. There is no real enforcement mechanism, but the two sets of siblings are determined to make the arrangement succeed. Forced to interact routinely, the couple and their siblings start becoming closer. They even start having dinners together on a routine basis.

Eventually, the quartet decides that dinners will be even more fun, and the bank will give them an even better deal, if they expand the arrangement. So the siblings persuade a few cousins to join. Pretty soon, their phones are ringing off the hook with family members they have not seen in years. Cousin Kendra, a marginally employed chef with precarious finances, is nevertheless welcomed in hopes she will employ her culinary skills to enrich group meals.

Life is not without its problems. Everyone is irritated at first cousin Nigel, who lives just across the river yet insists on managing his own finances. He is still invited to meals, though his cooking skills are hardly up to Cousin Kendra's. She, in turn, exhibits little enthusiasm for balancing her chequebook, and the bank sends ever more frequent warnings that her overdrafts would have to be covered by the others. Shortly after joining, a couple other cousins have taken advantage of their new prime customer bank
status to buy extravagant apartments with jumbo loans at far lower interest rates than they were ever afforded in the past.

The whole complex scheme seems to survive against all odds until one day things suddenly start to collapse. Despite informal personal imbalance limits, several cousins significantly overdraw their accounts. Others fall behind on mortgage repayments. Panicked, the founding siblings ask themselves whether it might be best simply to kick out the group’s worst behaving members. Unfortunately, the bank informs them this will be very difficult to do without first closing the entire account, wreaking havoc with everyone’s finances.

Desperate, the family brings in a well-regarded outside financial advisor. She comes up with the seemingly brilliant idea of a joint credit card, with payments guaranteed unconditionally by all, including the wealthiest cousins. This would allow the impecunious members to pay off bad cheques and mortgages, effectively borrowing against the resources of the others. And it wouldn’t be a gift, the advisor promised. Borrowers would pledge to skip meals. Any savings on ingredients would be used to make loan repayments. This works for a while until cousin Kendra starts to look pale from her diet. She begins missing work and the imbalance between her occasional deposits and frequent withdrawals gets worse. The richest cousins soon find they have to mortgage their houses in order to pledge enough cash to the bank to prevent an immediate collapse.

Of course, this grand experiment ends catastrophically. I will have to leave the reader in suspense as to whether the couple gets married. No doubt, in the film version of this parable, the studio would tape alternate endings and test which one sample audiences liked best.

Perhaps the parable overstates the risks fully independent countries face when sharing the same currency, but then again, maybe not by so much.

Economists have long understood that significant labour mobility is not nearly enough. A sustainable currency union requires other country-like features including a centralised fiscal authority that has as at least as much power to collect taxes as the constituent states. A central financial regulator is also essential, at least absent an adequate global regulator. And the centre cannot be endowed with so much power without the legitimacy that can only come from political union. Currency union without political union is an unstable halfway house.
This is not to say that a future United States of Europe, or part of Europe, needs to take any particular narrowly defined form. There is no one-size-fits-all formula for marriages or currency unions, although a loose bond that is easily broken is obviously not enough.

The real lesson of the euro’s grand experiment is that, given the weak state of global governance, the optimal single currency area is probably still a country, at least when two or more large countries are involved. A pre-nuptial joint bank account is a very unstable route to marriage.

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