

WILL THE Euro SURVIVE?

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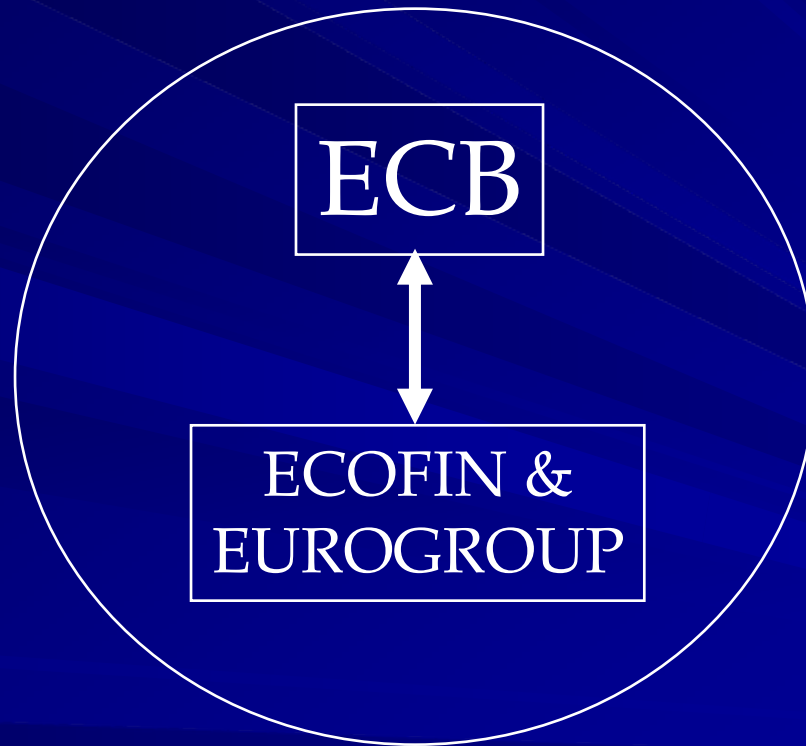
YES

But please don't leave yet...

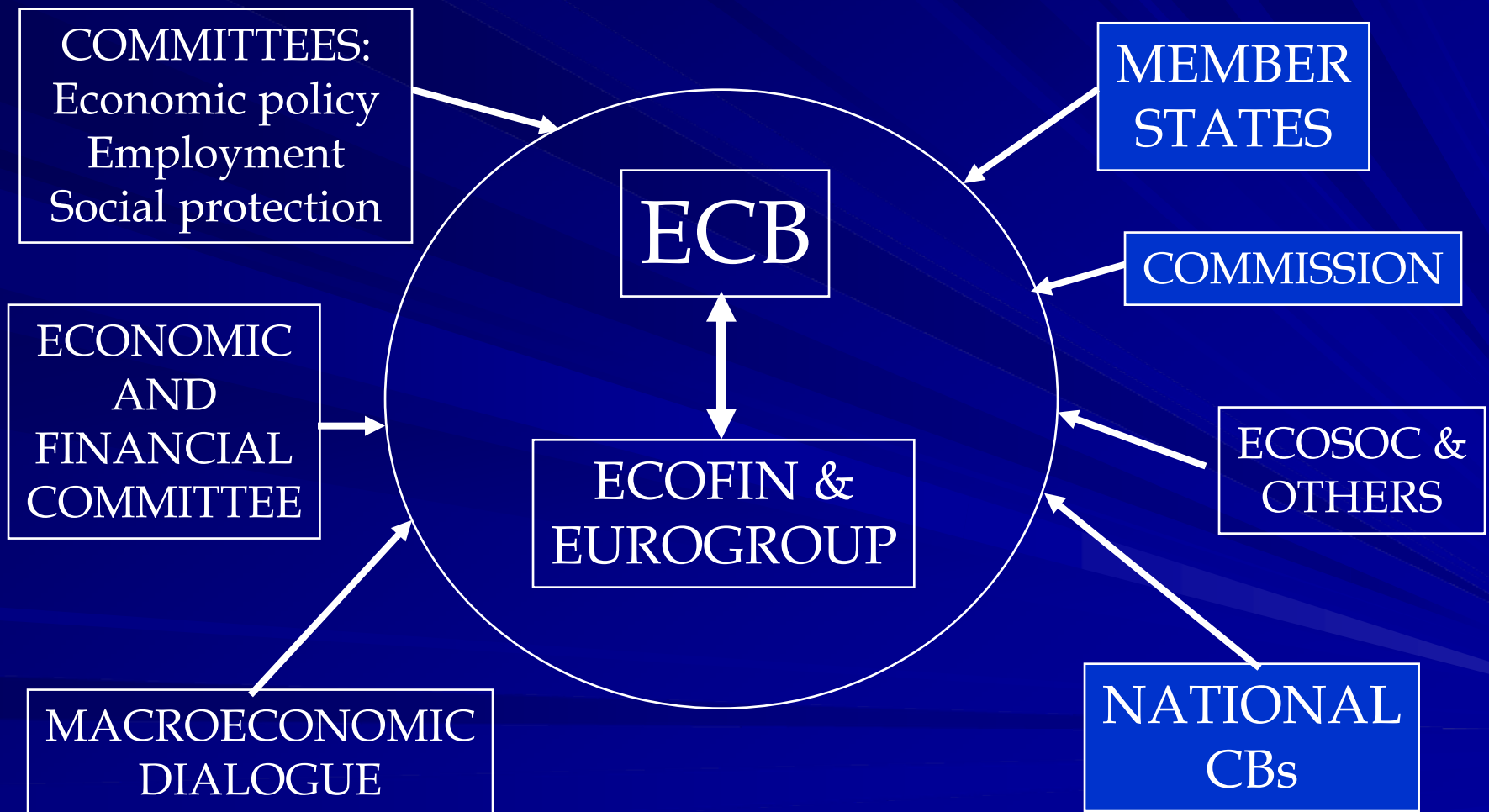
KEY FEATURES OF EURO AREA ECONOMIC GOVERNANCE

- Primary imperative for ECB: price stability
 - Fiscal policy remains with the Member State
 - As does supply-side policy
 - Caught in trap of 16/27 membership
 - Hence confusion in responsibilities of different actors
 - Necessitates extensive resort to coordination
- >> The EU is **NOT** a United States of Europe,
but more a united Europe of states

THE INSTITUTIONAL MIX



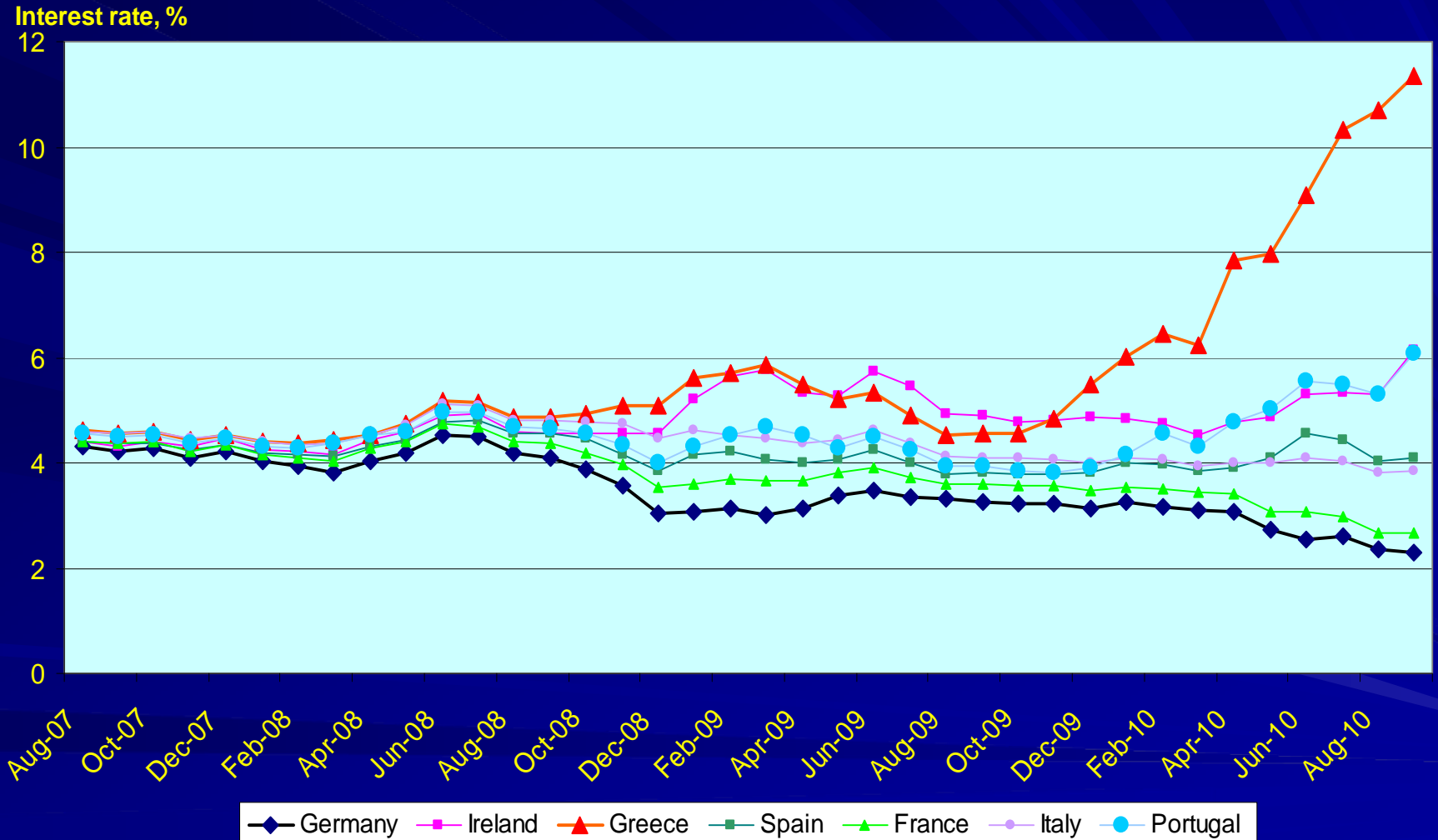
THE INSTITUTIONAL MIX



PRINCIPAL SHORTCOMINGS

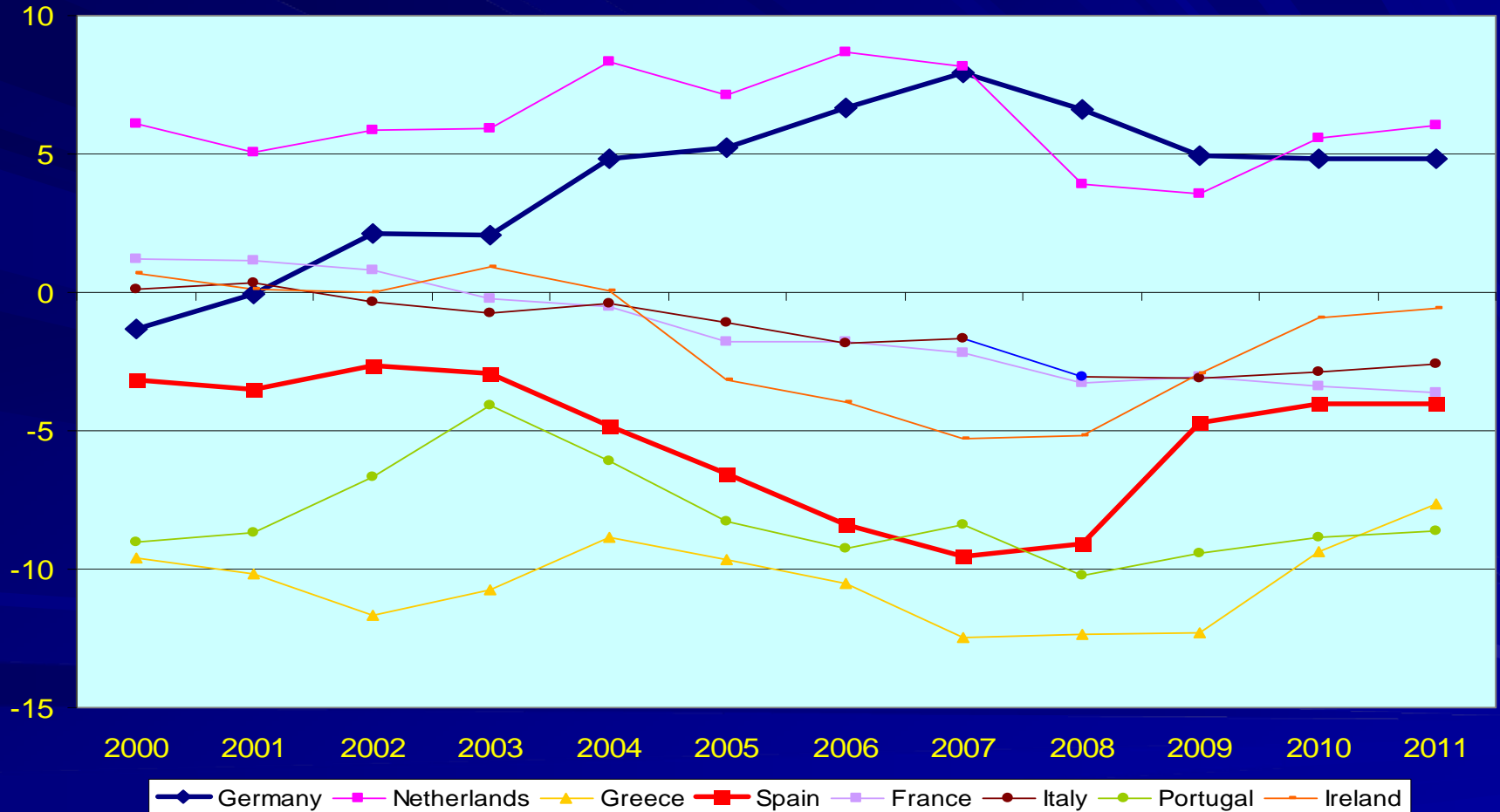
- ECB as sole, EU level economic actor
- Aggregation of national policies: policy mix
 - Certainly fiscal, but also supply-side
- Wrong focus of surveillance
 - Especially, neglect of imbalances and their causes
- No explicit crisis resolution mechanism
 - Tricky wording of ‘no bail-out’ clause in Treaty
- Political economy of implementation
 - The ‘why comply?’ Catch-22s – legitimacy

LONG-TERM INTEREST RATES SINCE START OF FINANCIAL 'CRISIS'



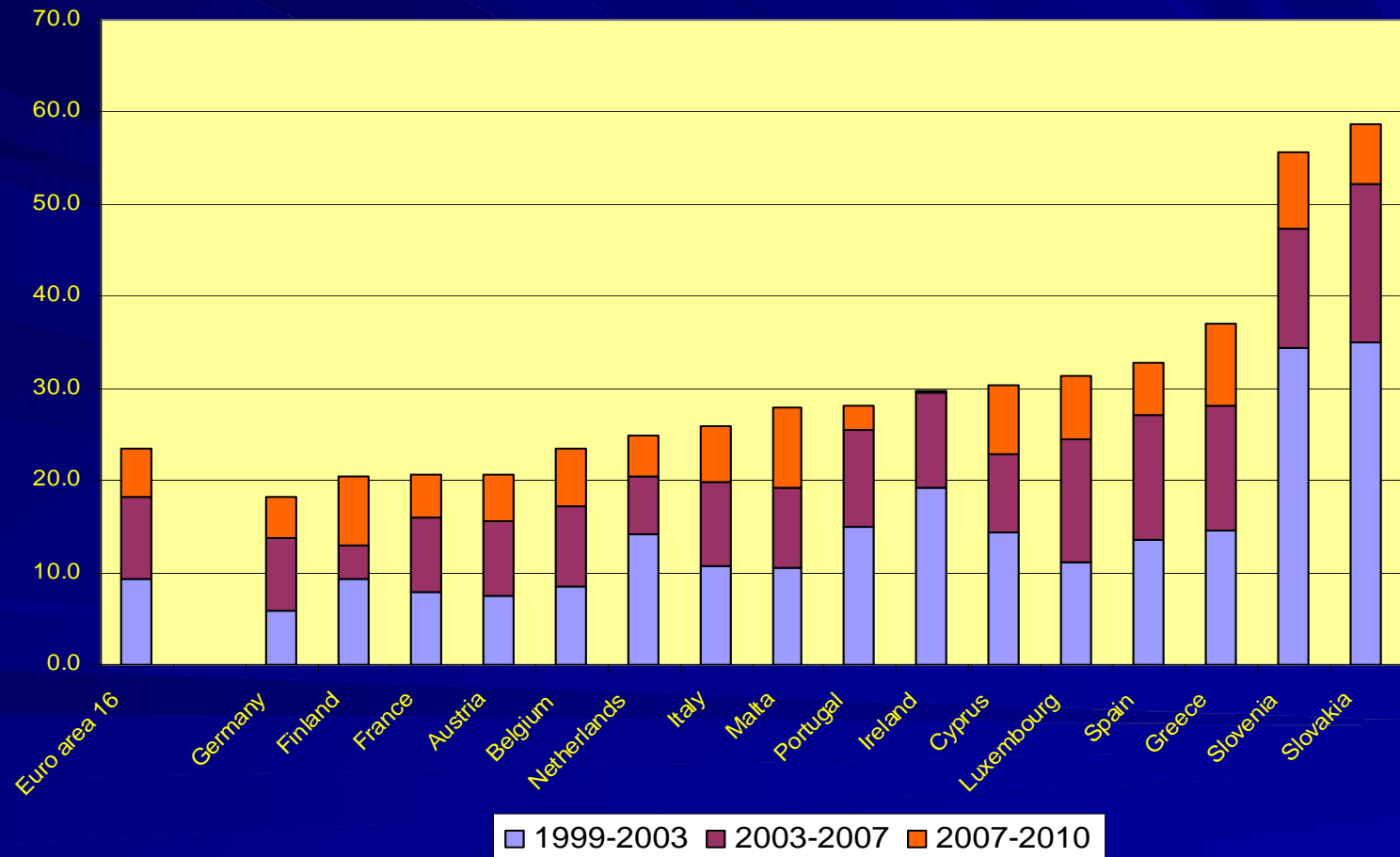
GROWING DIVERGENCE IN CURRENT ACCOUNT OF BoP

% of GDP



TRENDS IN CONSUMER PRICES OF EURO AREA COUNTRIES, 1999-2010

Change in price level
over period, %



EXTENT OF ULC SHIFTSpre-crisis!

Member State	Change 2000-08, %
Spain	29.3
Italy	26.1
Greece	25.0
Portugal	21.8
Belgium	17.2
France	17.1
Germany	-0.2
Euro area	14.8
UK	22.8
Poland	6.8

**“THINGS THAT CAN'T GO ON
FOREVER... DON'T”**

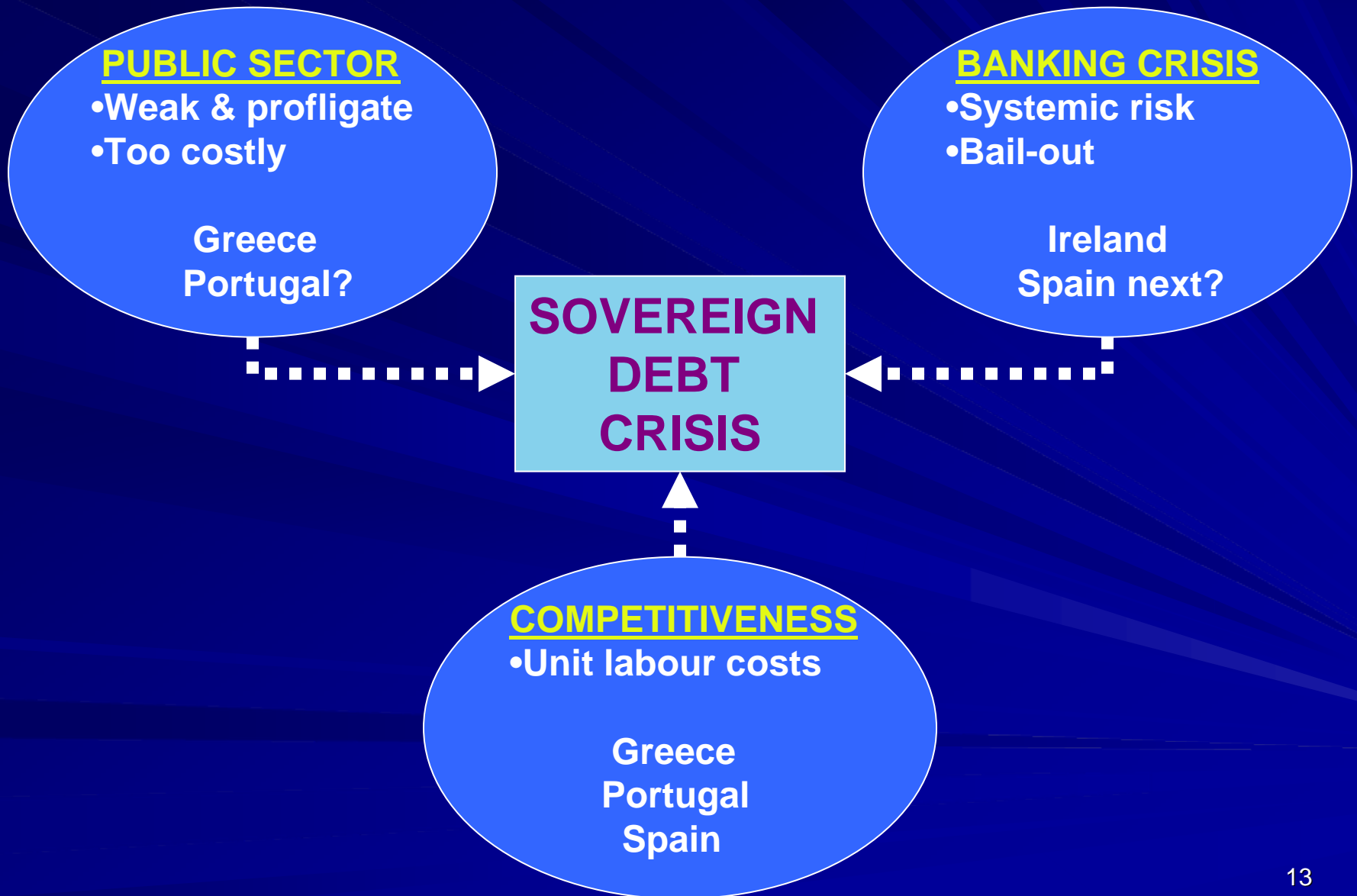
Herb Stein [Nixon's economic adviser]

.....THEN CAME MAY 2010



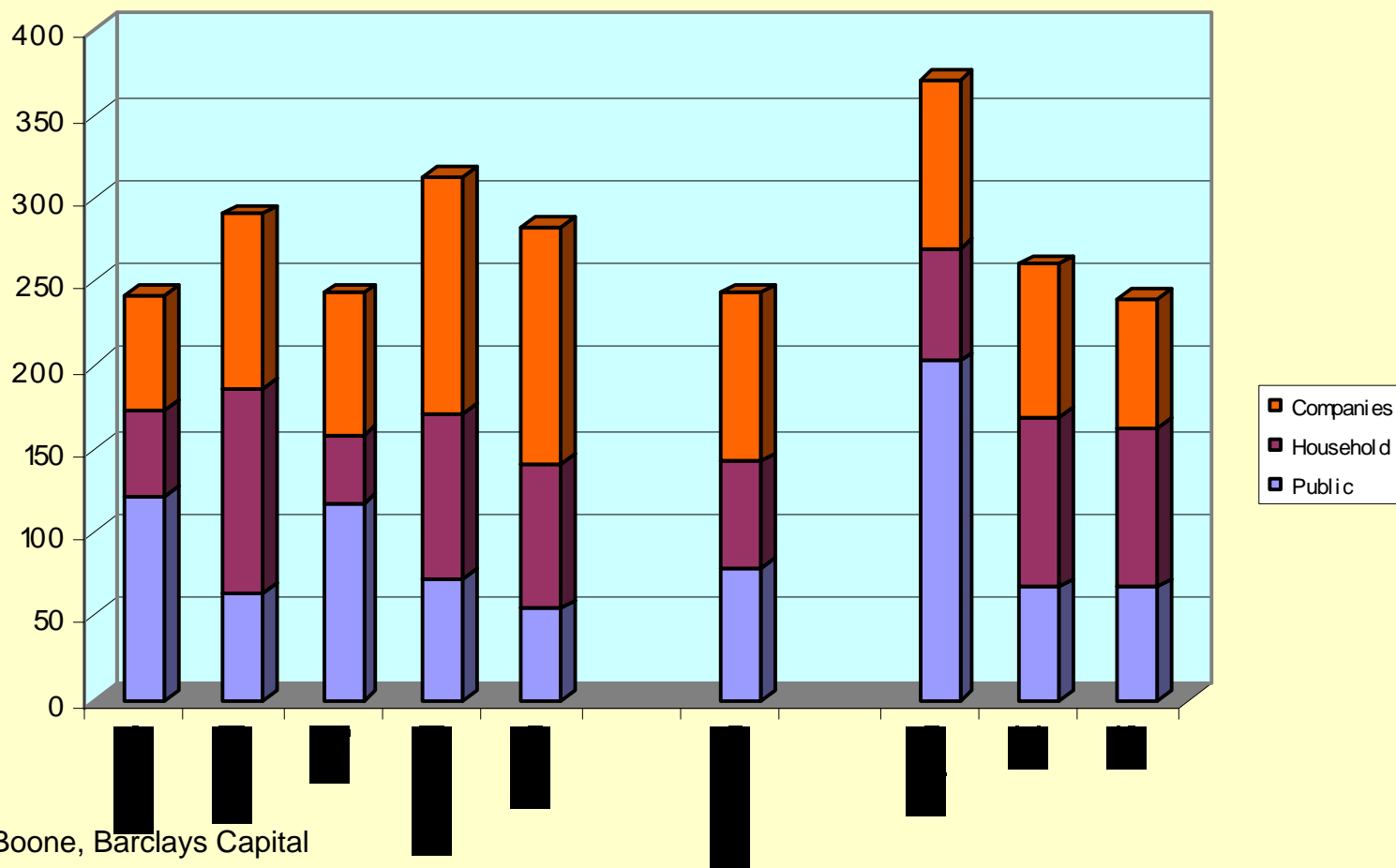
AND NOVEMBER 2010...AND?

DISTINCT 'PATHOLOGIES'



STRUCTURE OF DEBT, EXCLUDING FINANCIAL SECTOR

% of GDP, 2009



Source: Laurence Boone, Barclays Capital

EXPLAINING RECENT PROBLEMS

- Germany's changed role in Europe
 - Traditionally the 'good European'
 - But new generation of leaders and new times
 - Awkward domestic constraints
 - The constitutional court – most trusted institution
 - Public opinion, articulated by *Bild Zeitung*
- Unintended consequences of Deauville
 - Correct for long-term
 - But threw petrol on the flames
 - Burning Ireland and igniting Portugal

EMERGING SOLUTIONS: OUTCOME OF van ROMPUY TASK FORCE

- Better macroeconomic surveillance
 - Macroeconomic, with focus on risky imbalances
 - Internal, but with ramifications for external
 - Structural indicators
- Fiscal frameworks and/or rules at national level
- Changes in the Stability and Growth Pact
 - Debt indicator to complement 3% deficit limit
- A new sanctions regime
- Preferably, to be achieved *within* existing Treaty

THE MEANS

Dark arts of rules & persuasion

- Better prevention along with coordination
 - The two semester approach
- New excessive imbalances procedure 'EIP'
 - A scorecard with 'alert' indicators
 - But leavened by judgement
 - In-depth reviews: is action needed?
 - If the latter, recommendations will be issued
- Sanctions for euro area members
 - Only euro area members vote
- National rules consistent with SGP

UNFINISHED...OR TOO HARD

- Crisis resolution mechanism
 - Unease about involvement of IMF
 - Need for mini-Treaty change
 - Avoiding case before German Constitutional Court
 - Concerns about moral hazard
- Nature and scope of possible EMF
- Euro-bonds as a means of pooling risk
 - Moral hazard concerns again; adverse incentives
- The spectre of 'fiscal' union
 - If only we knew what it meant

CONCLUDING REMARKS

- Many political economy issues
 - Subsidiarity: who controls?
 - Winners and losers: who is really being rescued?
 - Germany is pivotal
 - Usually does the right thing ... eventually
 - Progress towards financial stability
 - Yet there is, effectively, no ‘European tax-payer’
 - New realism about costs of non-compliance
 - Doubts nevertheless persist about delivery
- >> Political will, that elusive ingredient

SO, IS THE EURO IN PERIL?

My answer:

It remains part of the solution,
but is at a tricky crossroads