10

20 January 2011

Tassos Giannitsis

I will focus on three policy issues concerning the future of the euro, which in my view have to be *debated*.

1. These years learned us three lessons:
   a) that the present crisis is much more than a crisis of individual countries. The crisis affected more members of the Eurozone but also the euro itself,
   b) that during all this period nobody was ready to accept the discipline of the S&G pact and even more that within a common currency the rules and the instruments of economic policy making had to be drastically changed ,
   c) the crisis was not only a question of discipline of the public or the private sector, of the profligacy of the banks or of housing bubbles. In fact, the case is, that besides such developments the governance mechanisms of the eurozone failed. The S & G Pact failed as a coordination mechanism and the weakening of the political credibility of Eurozone's governance triggered serious imbalances and strains,

   More than that, the present crisis reflects two other phenomena:

   a) a broader rebalancing between the major world players concerning their position in the unfolding new architecture between the West and the East, and

b) a struggle between markets and governments as to the rules and the shape of the world financial markets.

This means that what is at stake today in the eurozone includes but goes beyond the fiscal and financial discipline of the one or another country. It includes also a more general discipline concerning any major factor that can destabilize the eurozone. In fact, the problem is par excellence a political one and the crisis is the expression of a broader questioning of the zone's political capability to defend its currency and its sovereign solvency.

In view of that, my question is whether the discussed policy options can deal with all these aspects and can act a) as a short-term preventive and defensive strategy restoring confidence and a return to more stable and sustainable conditions, and b) as a long-term offensive strategy rendering the euro more credible and efficient as an engine for long term growth in the Eurozone. In simpler words: a) at least today, are the governments ready to create institutions and enhance more efficient political governance mechanisms of the eurozone and b) are the discussed solutions appropriate to prevent a further round of potential and deeper imbalances?

2. The present debate is focused nearly exclusively on fiscal and financial issues and makes abstraction of structural factors. It is as if the exchange rate of a currency is unrelated to the real economy and the economic and social structures of the participant countries.

However, the long-term stability and functionality of the Eurozone depends on both, macro and structural factors. Fiscal discipline eventually could be achieved across border for some years, but with severe implications. However, the more the gap in productivity, inflation, competitiveness and growth increases the divergences within the zone, the less the exchange rate of the euro will correspond to the reality of its economies and the more its stability will be challenged. Such structural divergences will also create a two-tier division within the eurozone, whereby weaker countries although members of the zone, in fact will face interest rates and restrictions as if they were in a pre-euro or out-of-euro situation.

In such a case, the common currency will act as a brake on growth of some countries and as a leverage of periodical cycles of instability. From a longer-term perspective this cannot be a viable option for the eurozone.

[Obviously, structural differences exist within any state. But in these cases they are smoothed either by financial transfers or because of the much higher human and capital internal mobility. This brings through the back door the question of structural convergence and its implications for a currency area.]

In view of that, the question is: how besides the goal of macro-balance, production patterns can also be enhanced and targeted in Southern Europe, in the aim to replace growth based on fiscal deficits and debt, or on low and uncompetitive wages or on housing babbles by new growth drivers. No doubt, there is a serious problem of discipline and deep adjustment to new rules of policy making within a currency zone. Finally, however, the question of stable macro-balances and competitiveness of these countries is much more than a question of discipline and depends also on their capability:

- to increase in the medium term structural productivity,
- to be innovative, and
- to produce growth.

Hence, the question is: a) can global solutions and institutional framework which are discussed today enable countries of the eurozone to overcome their present deep imbalances and achieve sustainable growth? and b) Can eurozone policies generate a transition path based on a successful mix of stability, discipline, solidarity and growth?

3. Third issue: In my view the crisis is inter alia an expression of the broader repositioning concerning the evolution and the perspectives of the major world players (USA, China, Europe) in the West and in Asia. Behind the many forms of this crisis such as the subprime titles, the housing bubbles, the fiscal or the credit crisis, the question is: <u>why all this</u>, <u>why mostly in the West</u> and <u>why so intense</u>? The case is whether we are faced not just with the typical consequences of a destabilized financial and fiscal system, but with a more serious problem whereby the West attempts to counterbalance its weakness to generate welfare through real investment, saving, or innovation by

favoring growth based on low interest rates, lax banking supervision and, in general, by substituting more and more the financial industry and financial innovations in the place of the real economy. In such a case a cyclical destabilization will continue to be a major risk for both South Europe and the euro as well.

The competitiveness of the eurozone countries cannot be made the residuum of inappropriate volatility of the exchange rate of the euro due to unilateral policy choices. What happened looks like the opposite of Argentina's crisis. The euro appreciated to nearly 1.4 to 1.5 $ and the competitiveness of the countries producing low to medium technology goods and services, characterized by high price elasticity, slumped. As it was said, a national virtuous policy, even more a rational from a short-sight policy (the German one) proved to become a collective vice. The question is that the participation in the eurozone requires more coordinated national policy approaches which will avoid to become harmful for the other countries. The weakening of the euro these months has already led to substantial increase of Greek exports and an improvement of our competitiveness.

True, Europe has to strike a balance between two partly conflicting goals: how to be a winner in the global race by succeeding a big change of its technological, knowledge and productive structures. And how to ensure goals and governance structures which will ensure a more symmetrical evolution between members with very different internal macro and structural conditions. This means a governance scheme which will target at least the following package of goals:

- Discipline: Fiscal, financial, economic,
- Competitiveness and growth via innovation, productivity
- Sustainable convergence via Solidarity
- Trust and confidence
- Control of financial risks and destabilization, and
- Structural reforms to increase productivity.