



Sociedad de Economía Mundial, XIII World Economy Meeting “Global Governance: Cooperation and Conflicts on the Global Economic System”

“Mercados, Especulación y Gobernanza: *El caso del Euro*”

San Sebastian, 27 Mayo de 2011

Josep Borrell, Presidente del'IUE



Structure Presentation

- 1) EMU and the eurozone: Structural weaknesses and the 2010/11 crisis
- 2) Initial EU reactions
- 3) Structural and ongoing reforms
- 4) Open issues and the way ahead
- 5) Conclusion



1) EMU and the eurozone: Structural weaknesses and the 2010/11 crisis



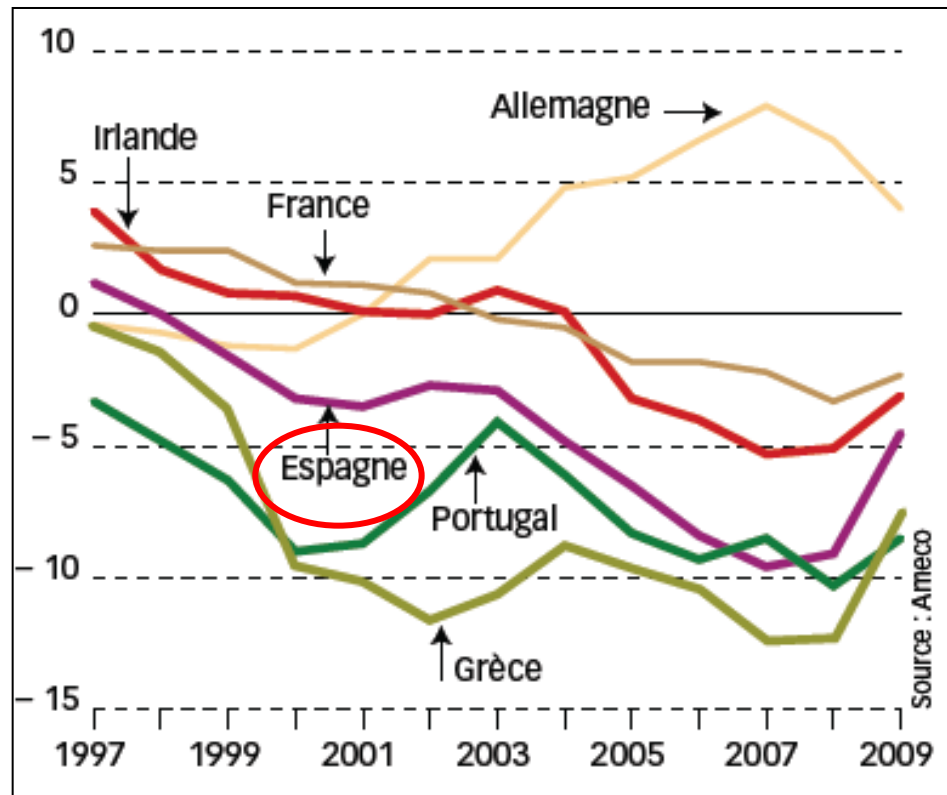


Structural problems of the European Monetary Union (EMU) and the eurozone

- Monetary union without economic and fiscal union
→ “Limping leg”
- No political union
- Political requirements overriding economic realities
- “Optimum currency area”?
- Diverse national economies and diverging competitiveness

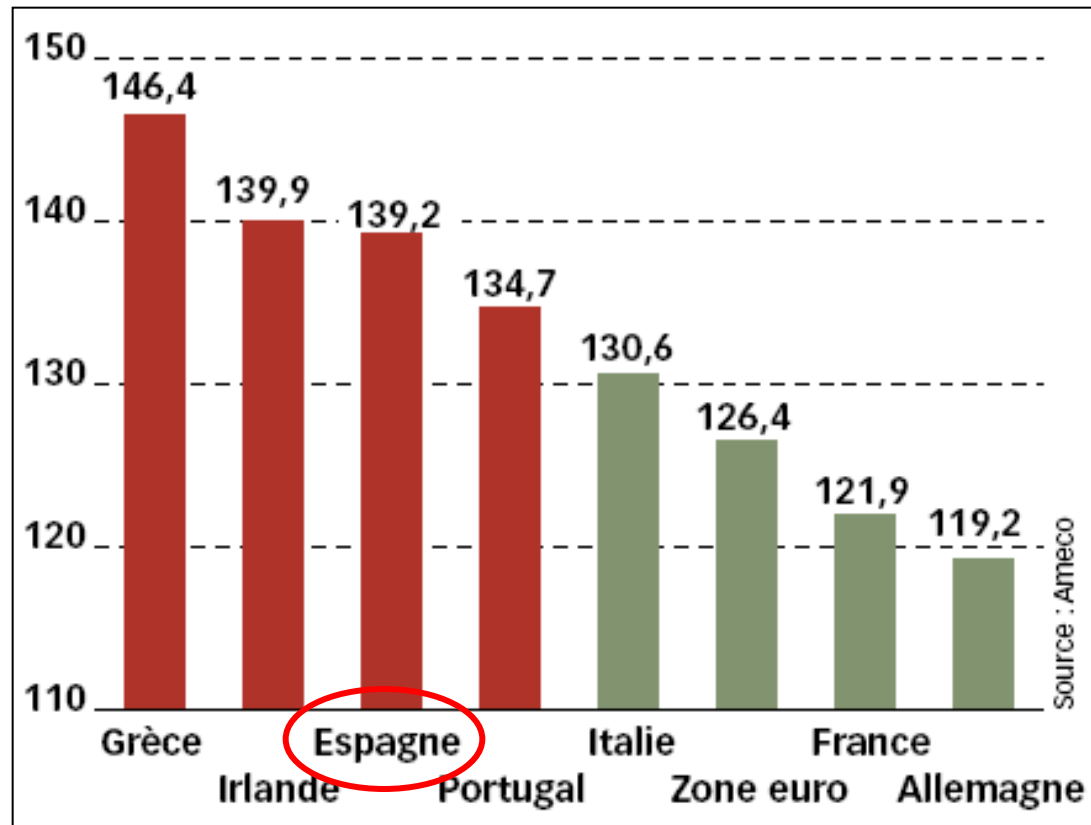


Balance of payments, selected countries (in % GDP)





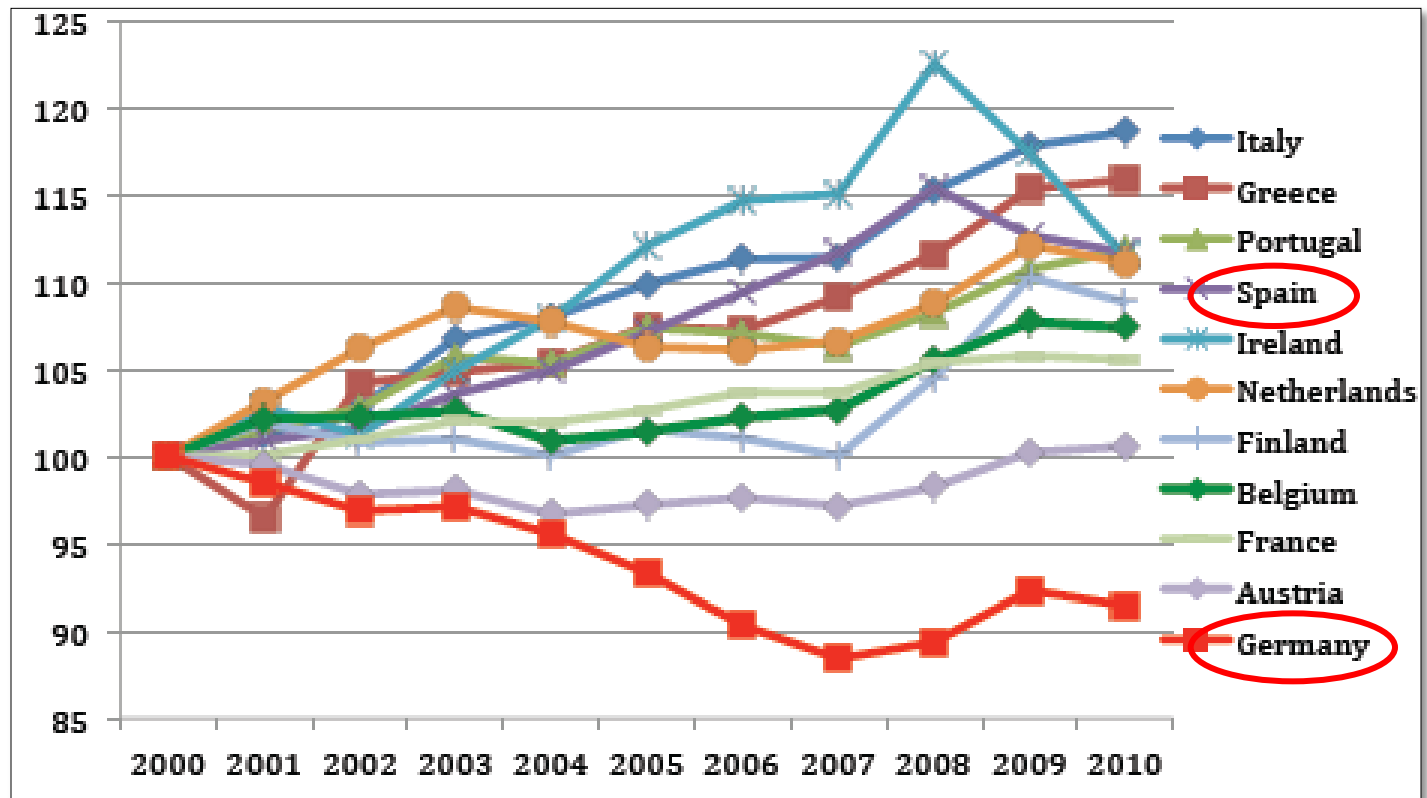
Harmonised consumption prices, 2009 (basis 100=1997)



Source: Alternatives Economiques



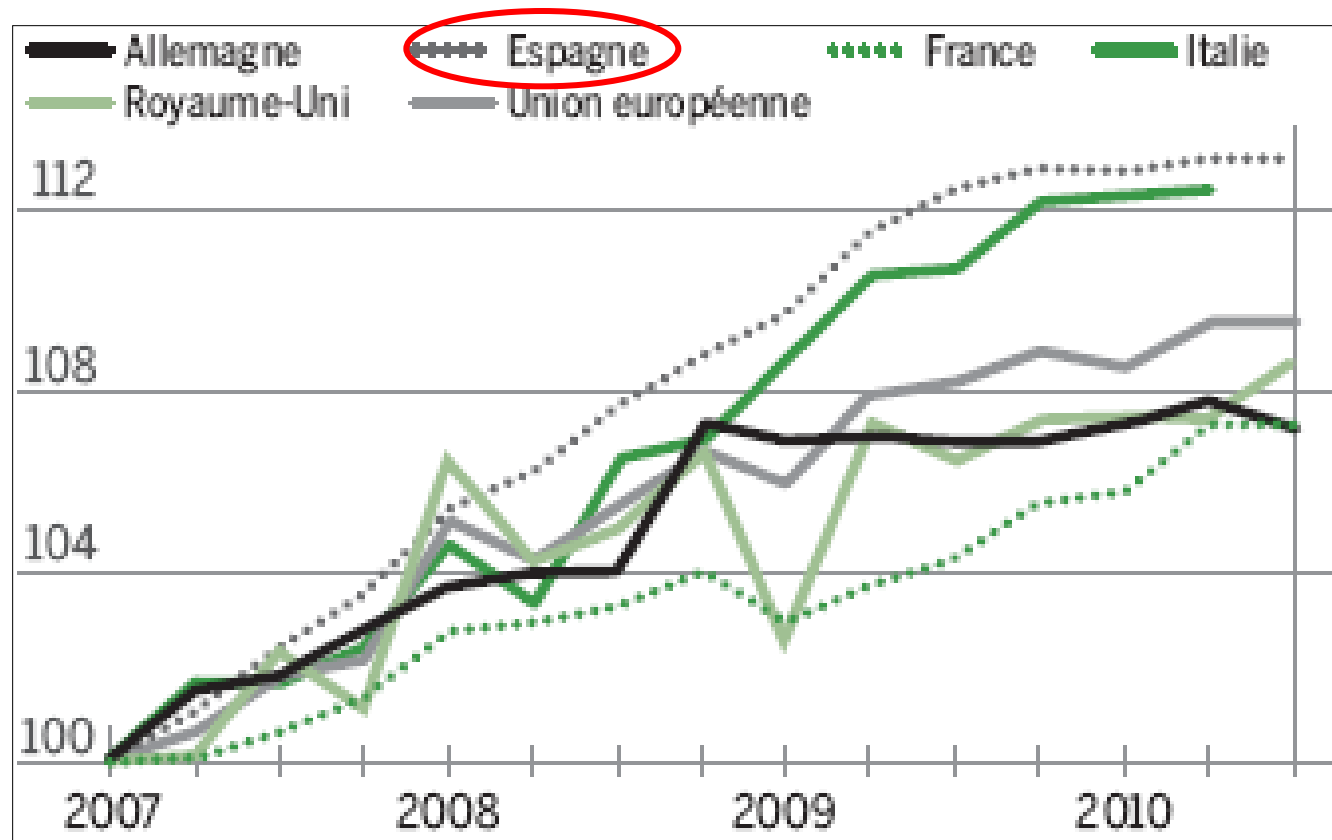
Relative unit labour cost (2000=100)



Source: European Commission, Ameco, De Grauwe

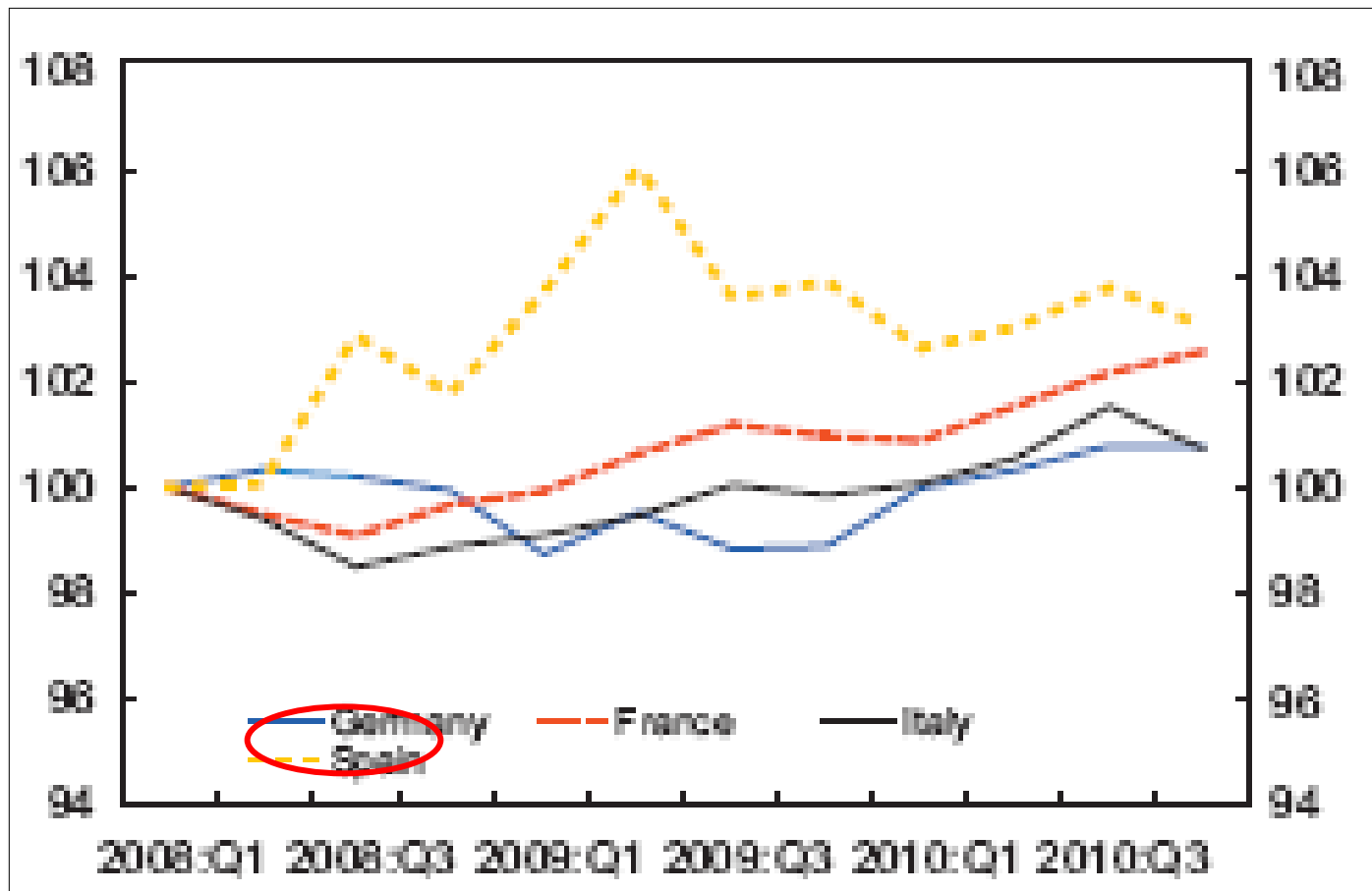


Development of hourly salaries in Europe, industry and merchant services (in %, 2007=100)





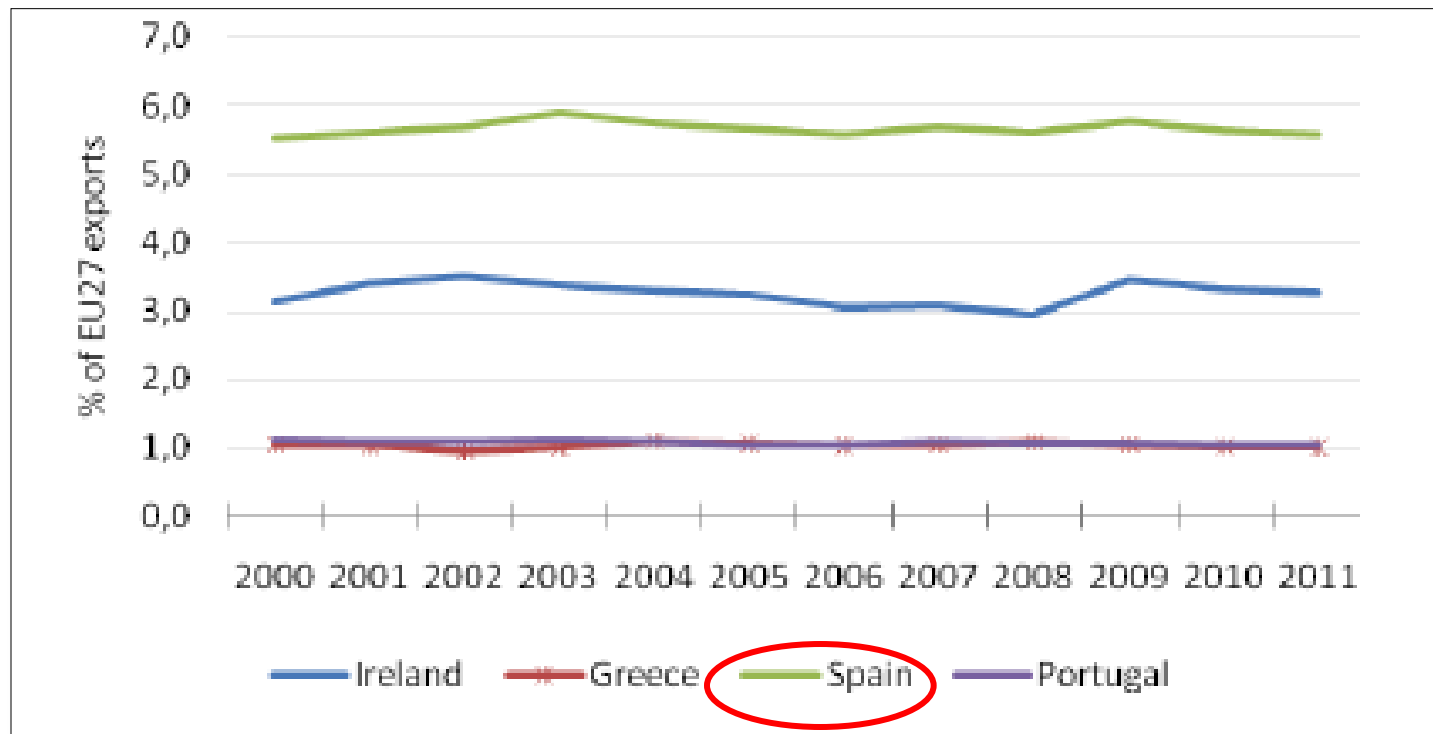
Real disposable income (2008, Q1=100)



Source: IMF



Exports of goods and services as % of EU27 exports





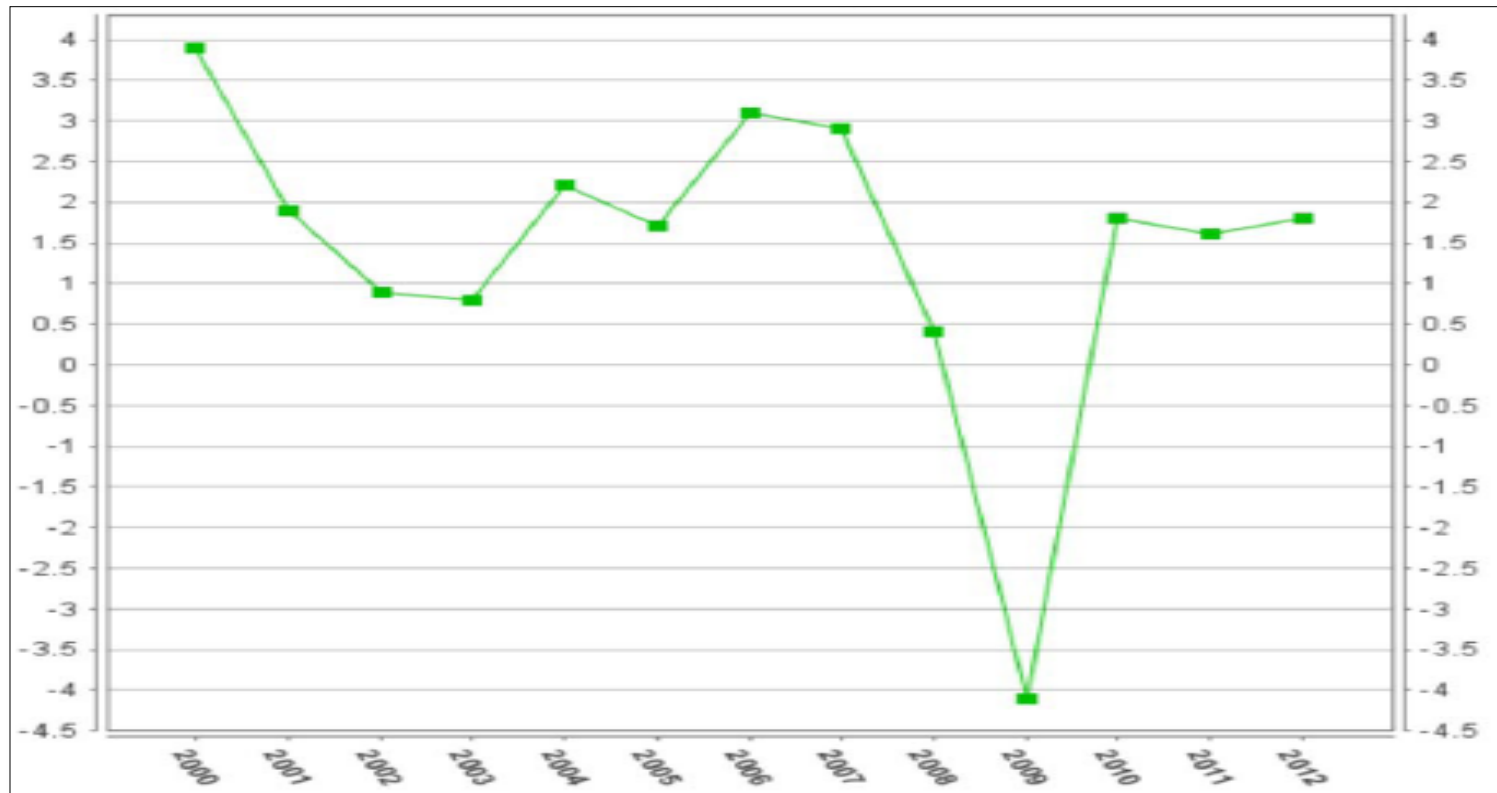
The 2010 crisis – What happened? (1/3)

Competitiveness and other issues seemed to be no problem for first 10 years, but then...:

- Global financial and economic crisis 2008/2009
- Strong recession
- Bank rescue plan
- PIIGS: fear of sovereign debt crises
- Account and fiscal deficits
- Rise in CDS prices / bond yields
- Crisis of confidence, market pressure



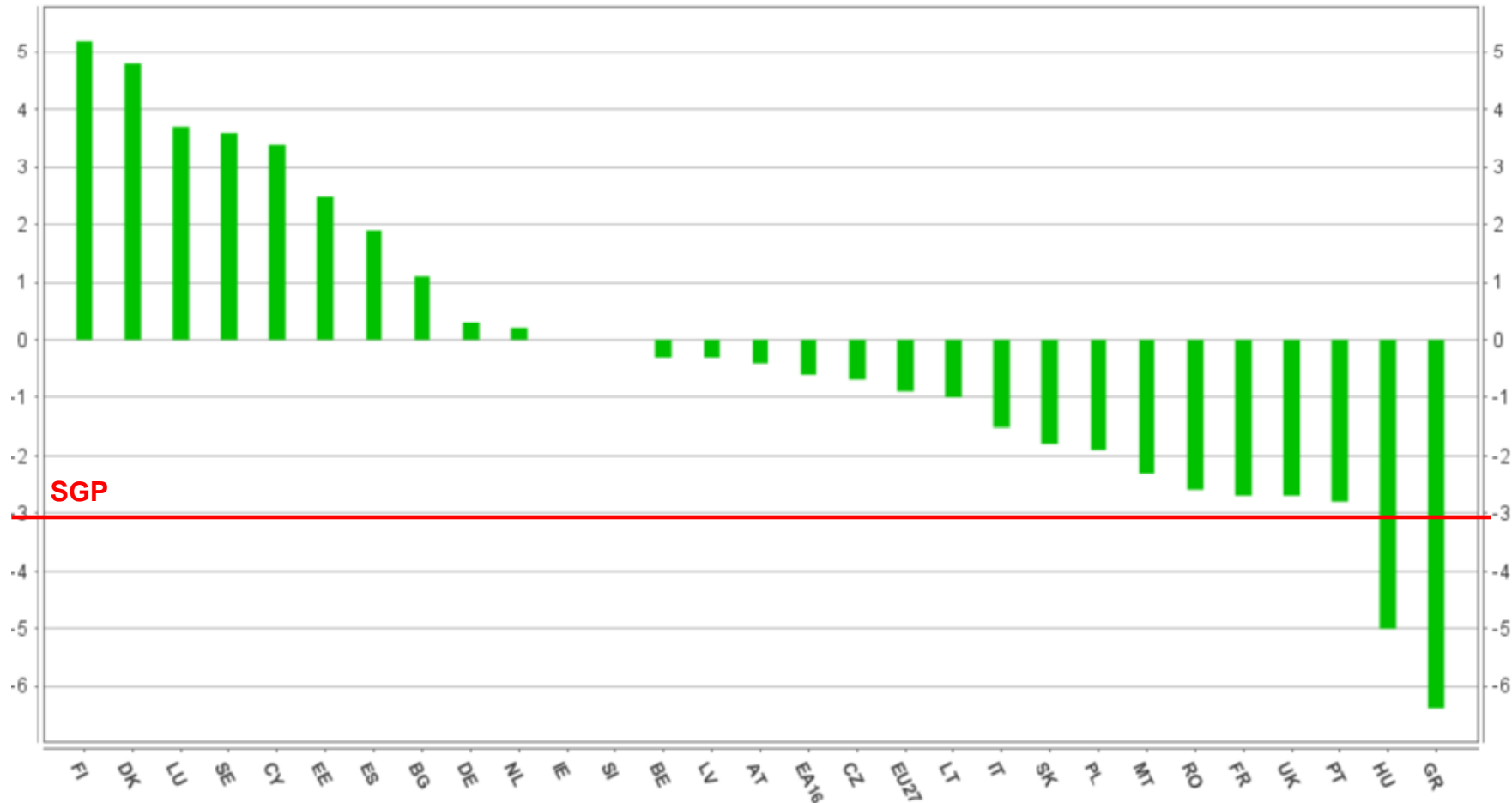
Real GDP growth rate euro area



Source: Eurostat



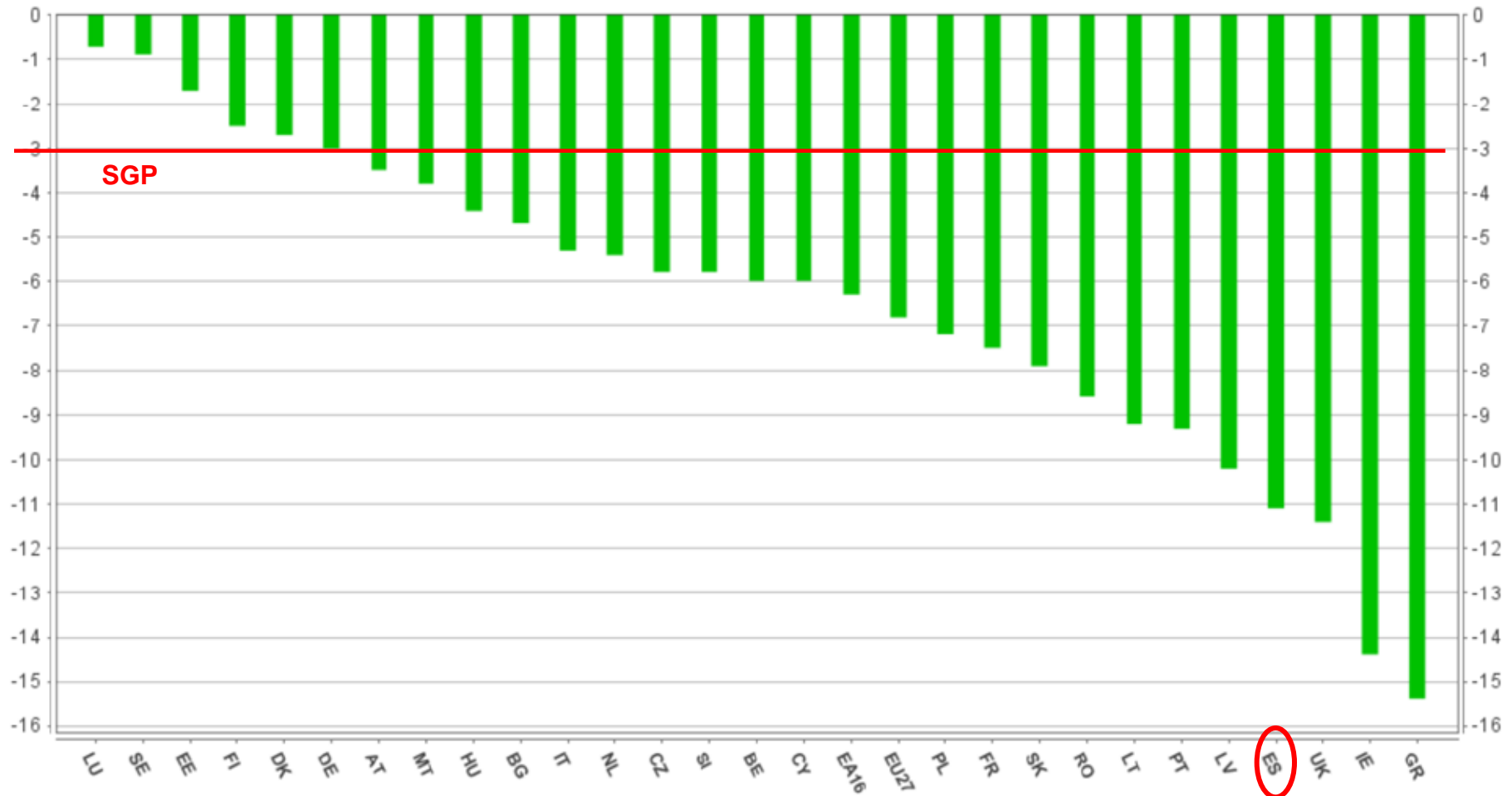
Public balance EU27 (2007)*



*Net borrowing/lending of consolidated general government sector as a percentage of GDP; Source: Eurostat



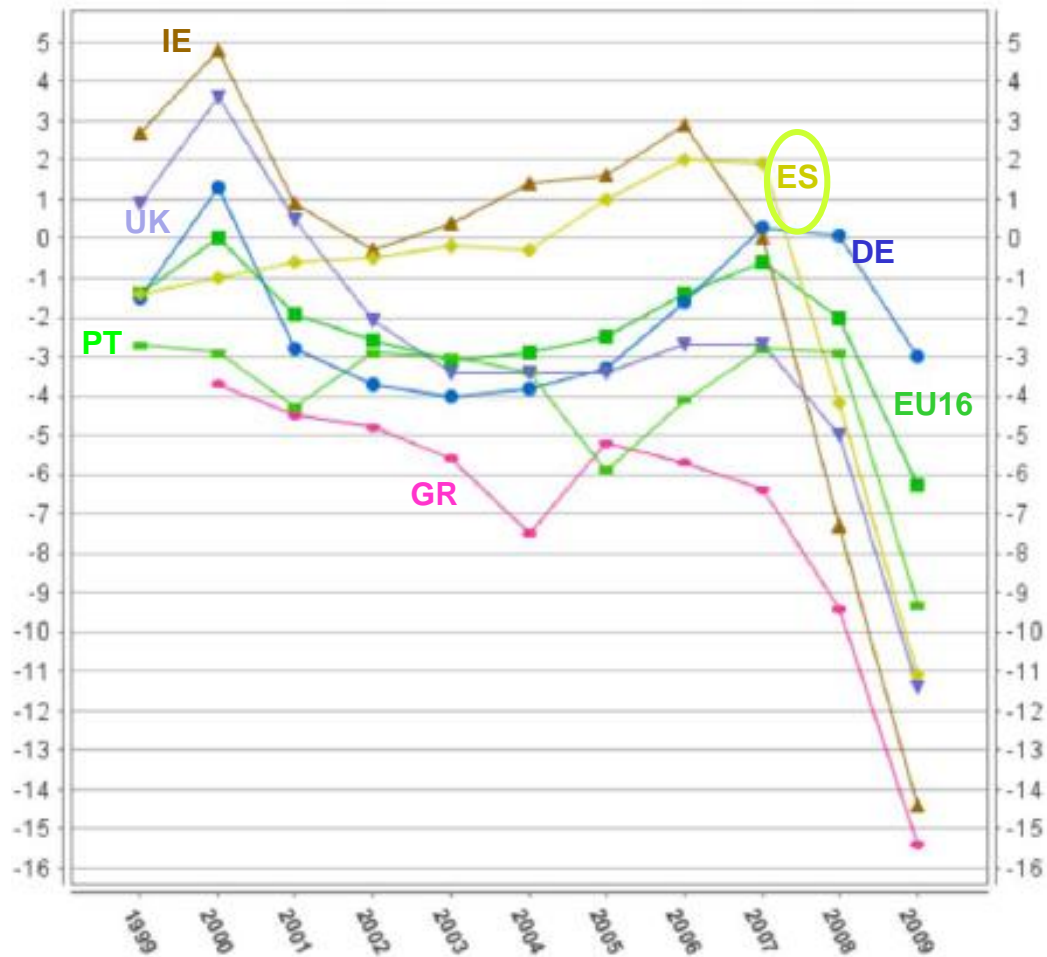
Public balance EU27 (2009)*



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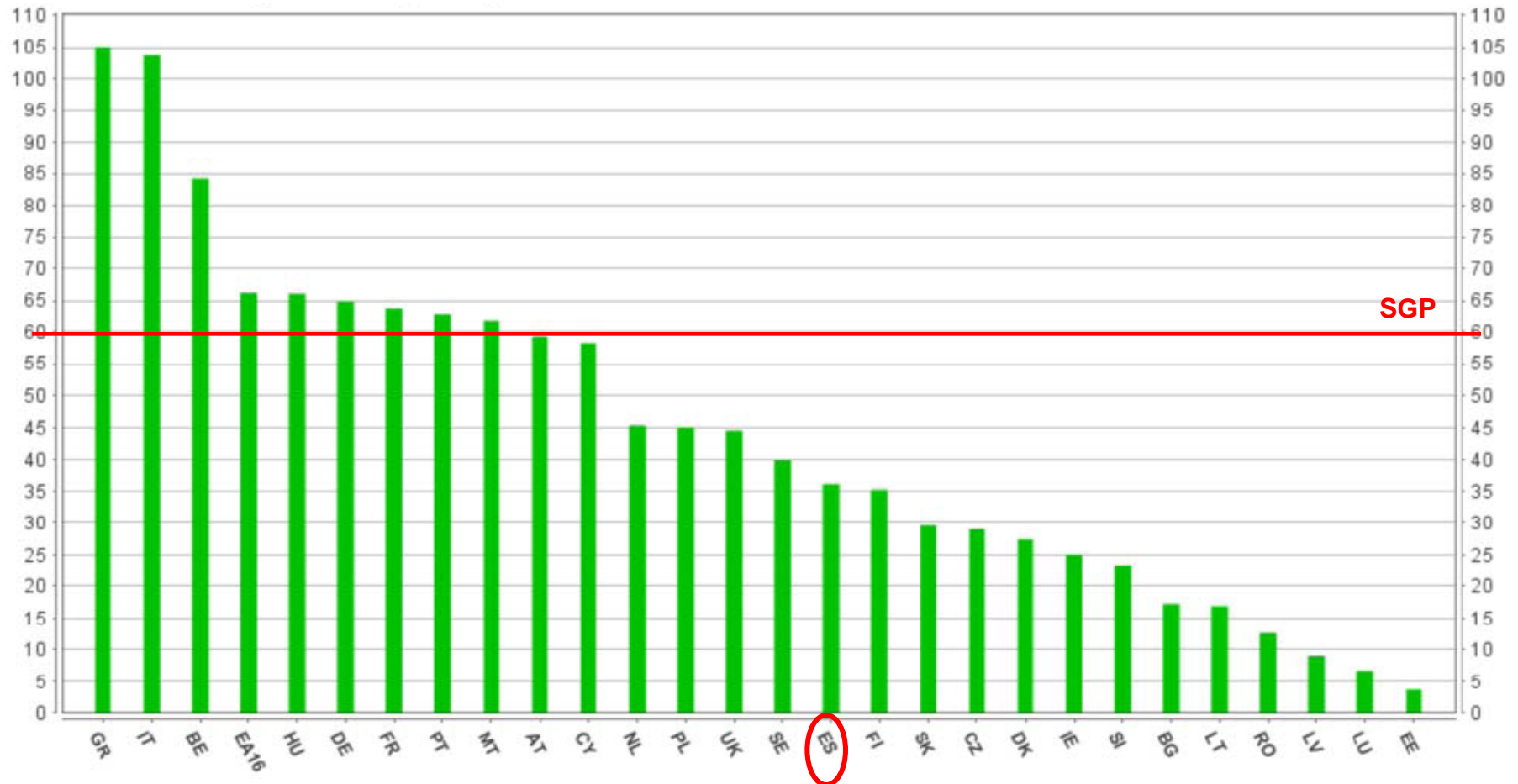
Public balance, selected countries *



* Net borrowing/lending of consolidated general government sector as a percentage of GDP; Source: Eurostat



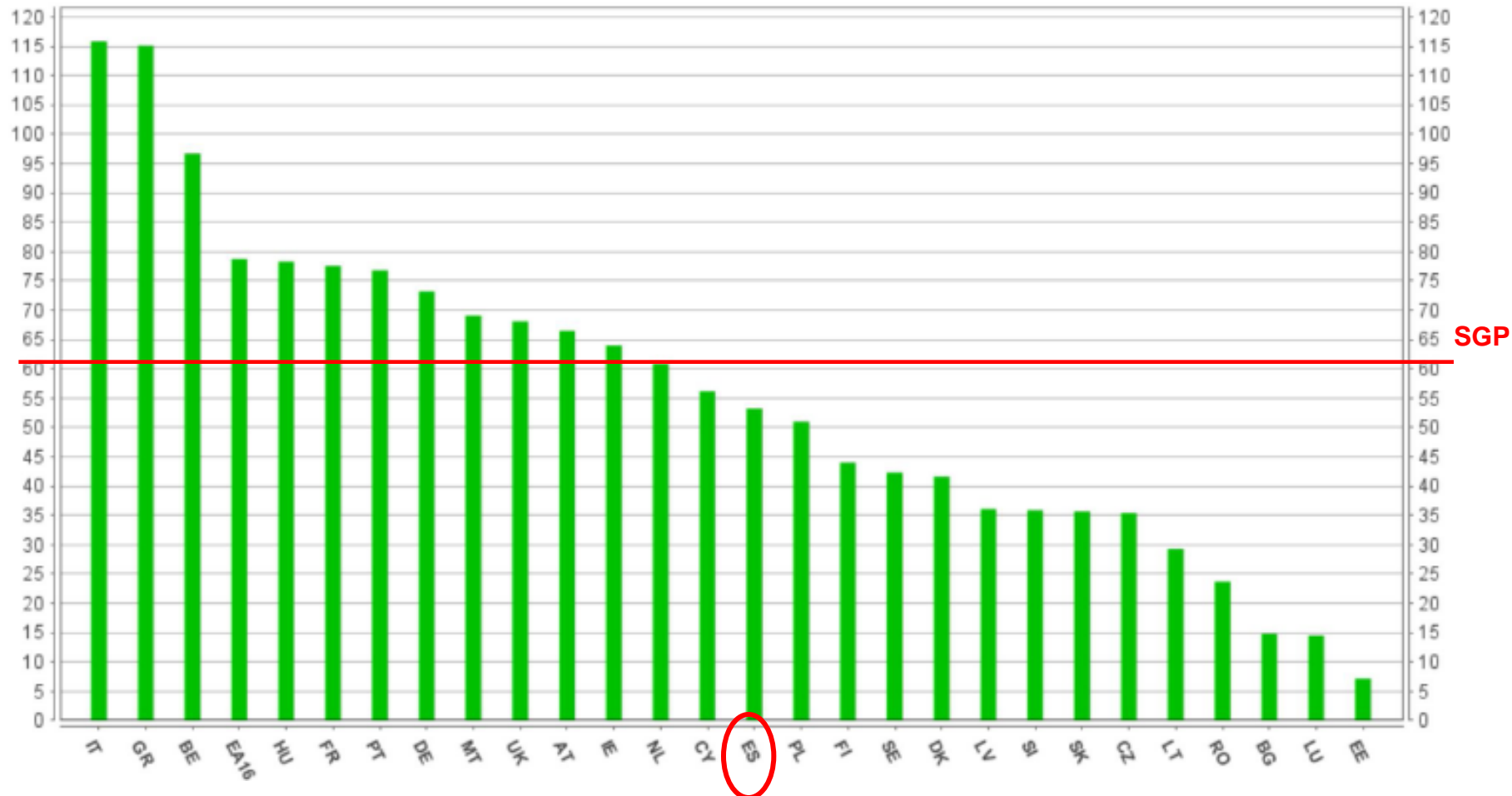
General government debt EU 27 (2007)*



* General government consolidated gross debt as a percentage of GDP; Source: Eurostat



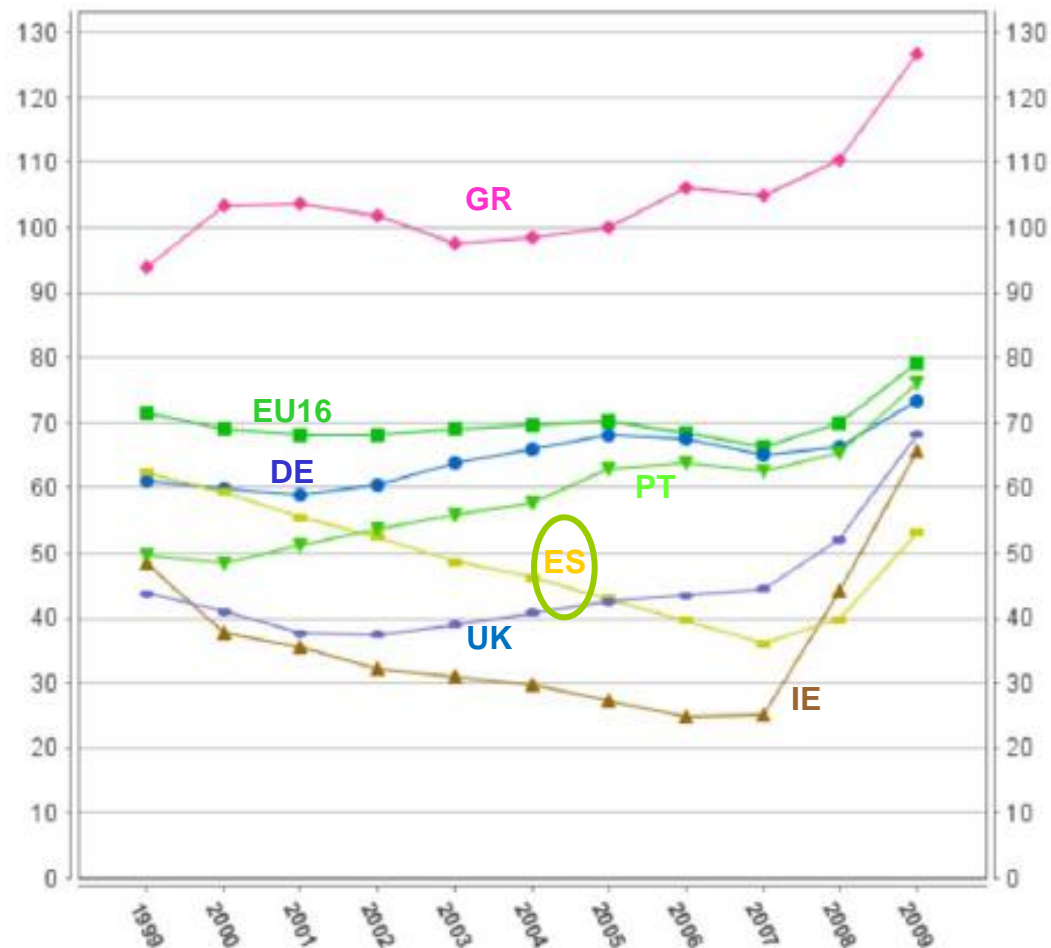
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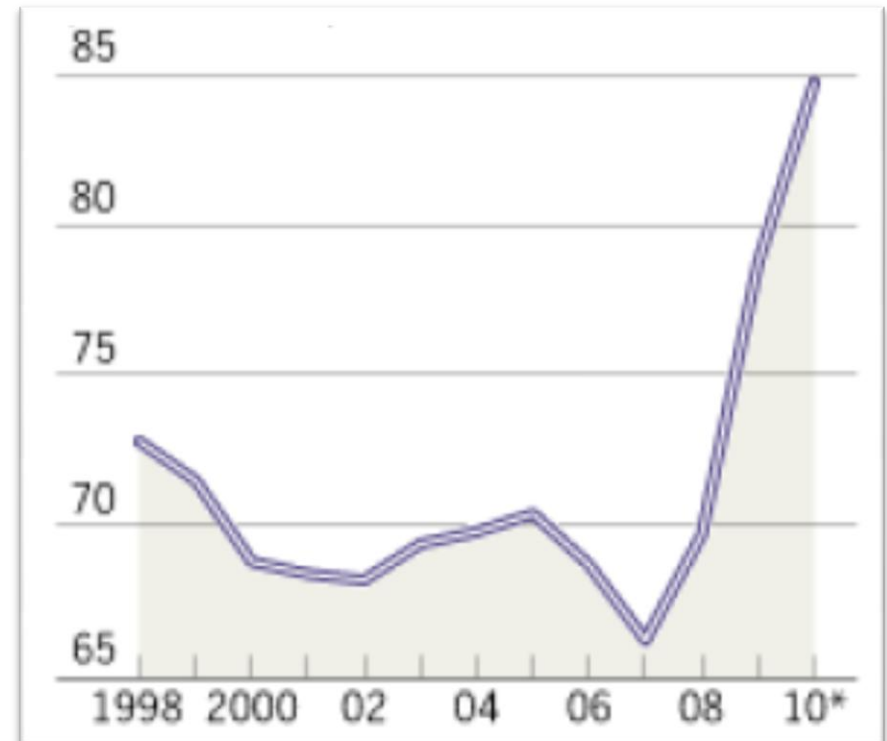
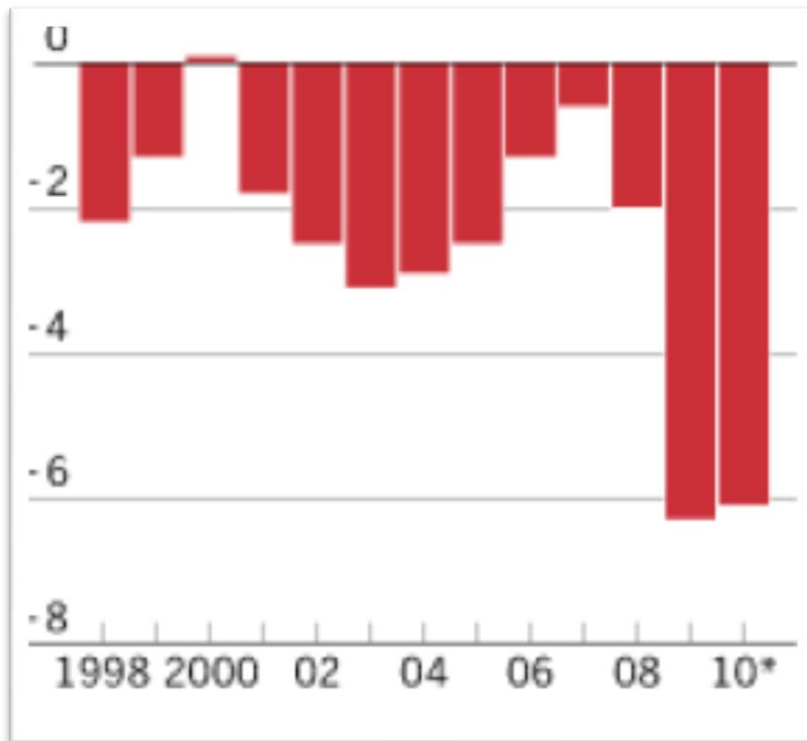
General government debt, selected countries (2009)*



* General government consolidated gross debt as a percentage of GDP; Source: Eurostat

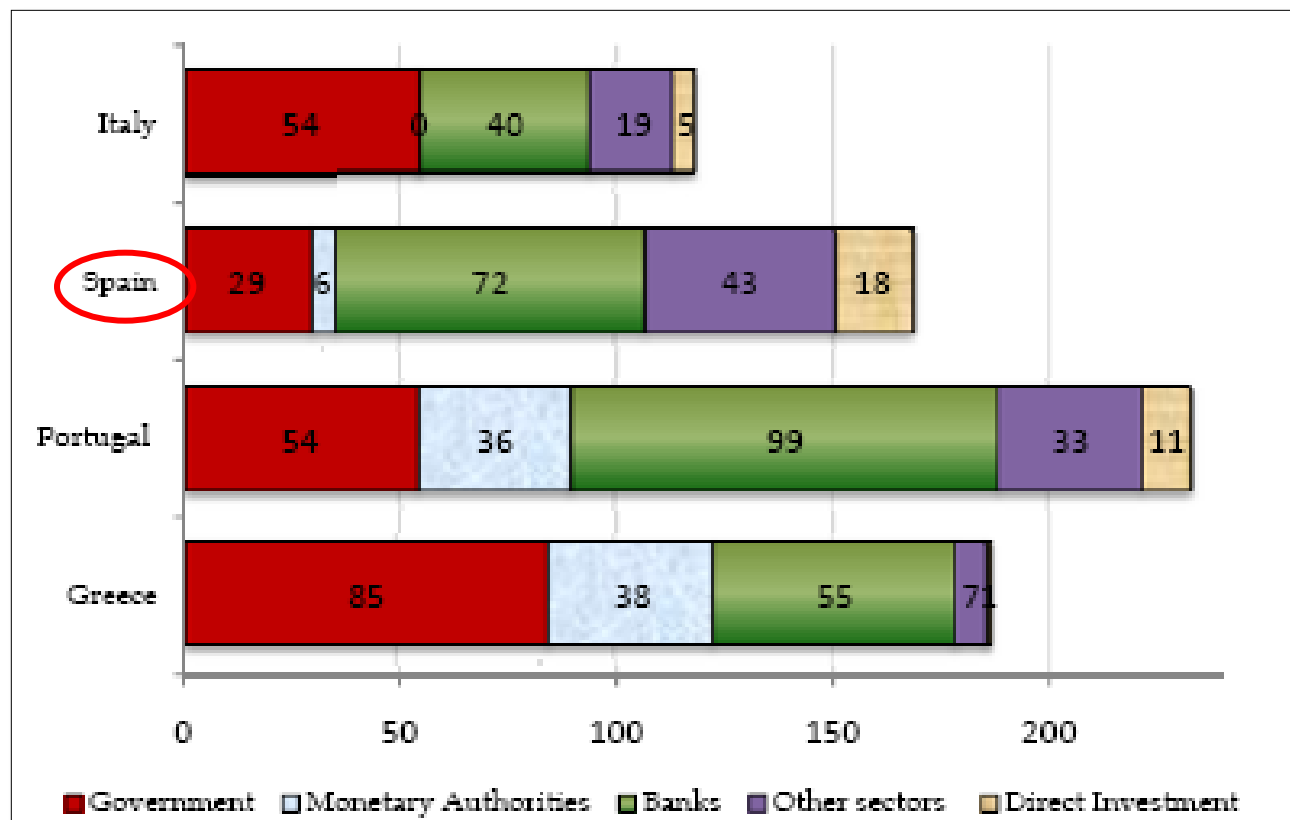


Eurozone budget balance / Gross government debt (% of GDP)





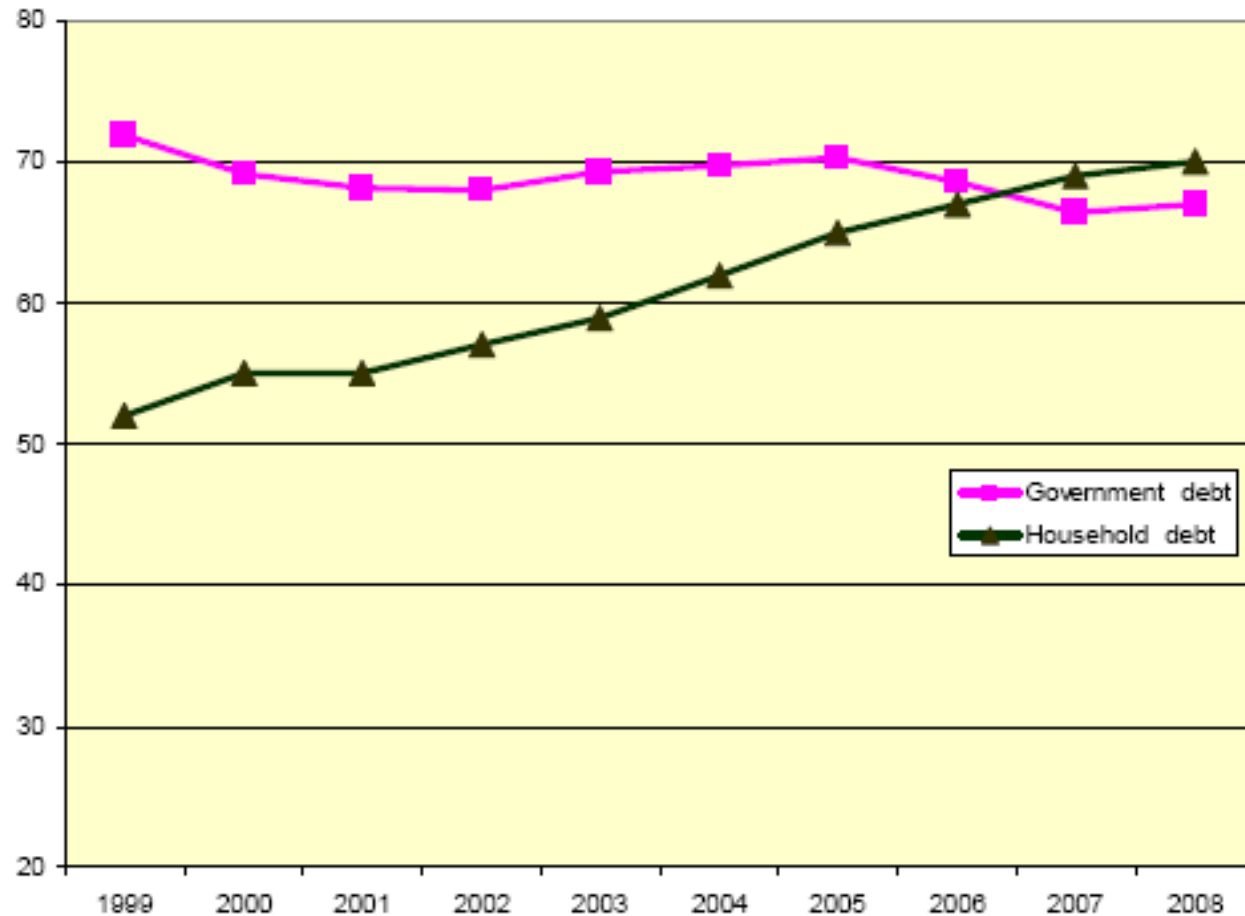
Gross external debt (% of GDP), breakdown by sector



Source: D. Gros



Household and government debt in eurozone (% of GDP)



Source: De Grauwe



The 2010 crisis – What happened? (2/3)

- Greek “falls” in Spring 2010
- Relatively small country’s debt degenerate into generalised government debt crisis in eurozone
- Looking into the abyss
- Weaknesses in initial EMU construction made obvious by crisis

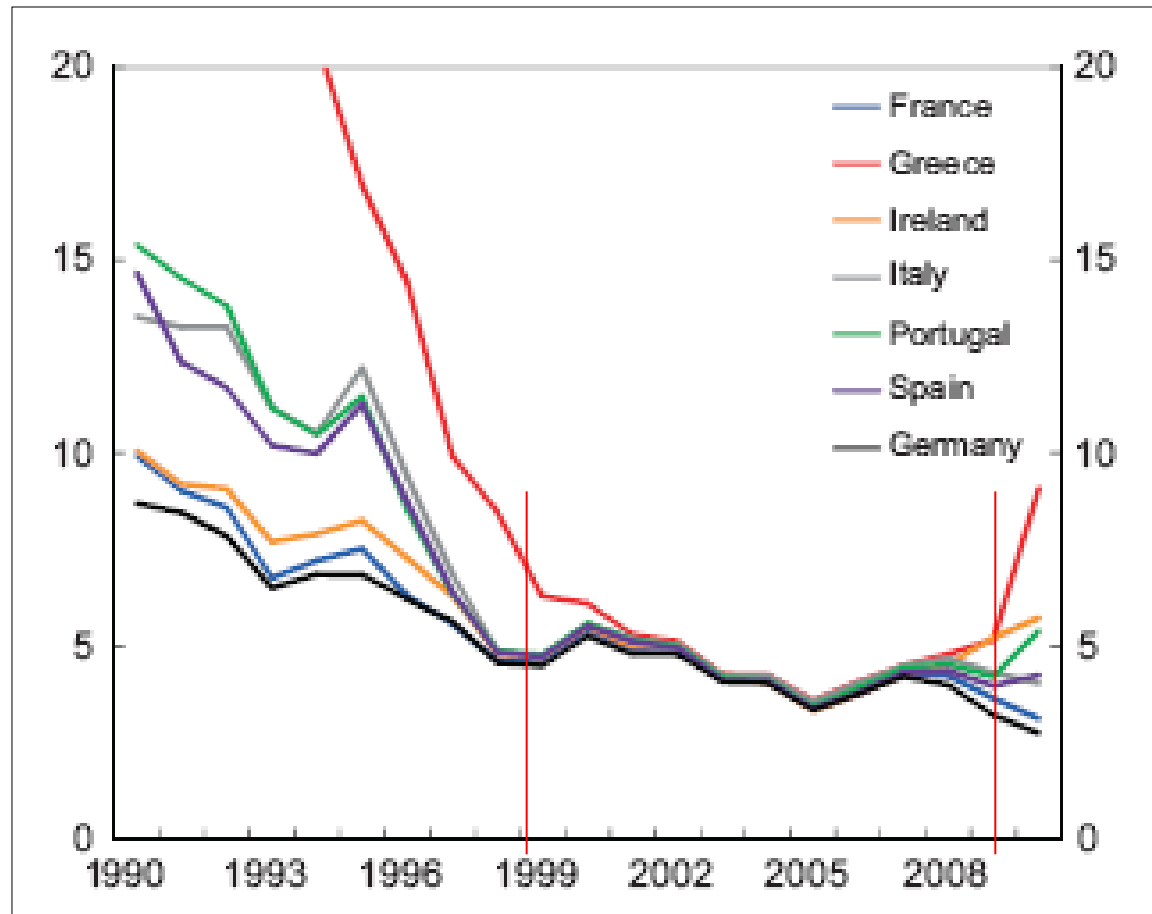


The 2010 crisis – What happened? (3/3)

- Core weaknesses/problems:
 - Money and finance fully integrated, but different tax, fiscal, spending... policies
 - One-dimensional focus on SGP
 - Excessive lending
 - Greece disaster with huge government debt
 - Explosion of private debt (Ireland/Spain)



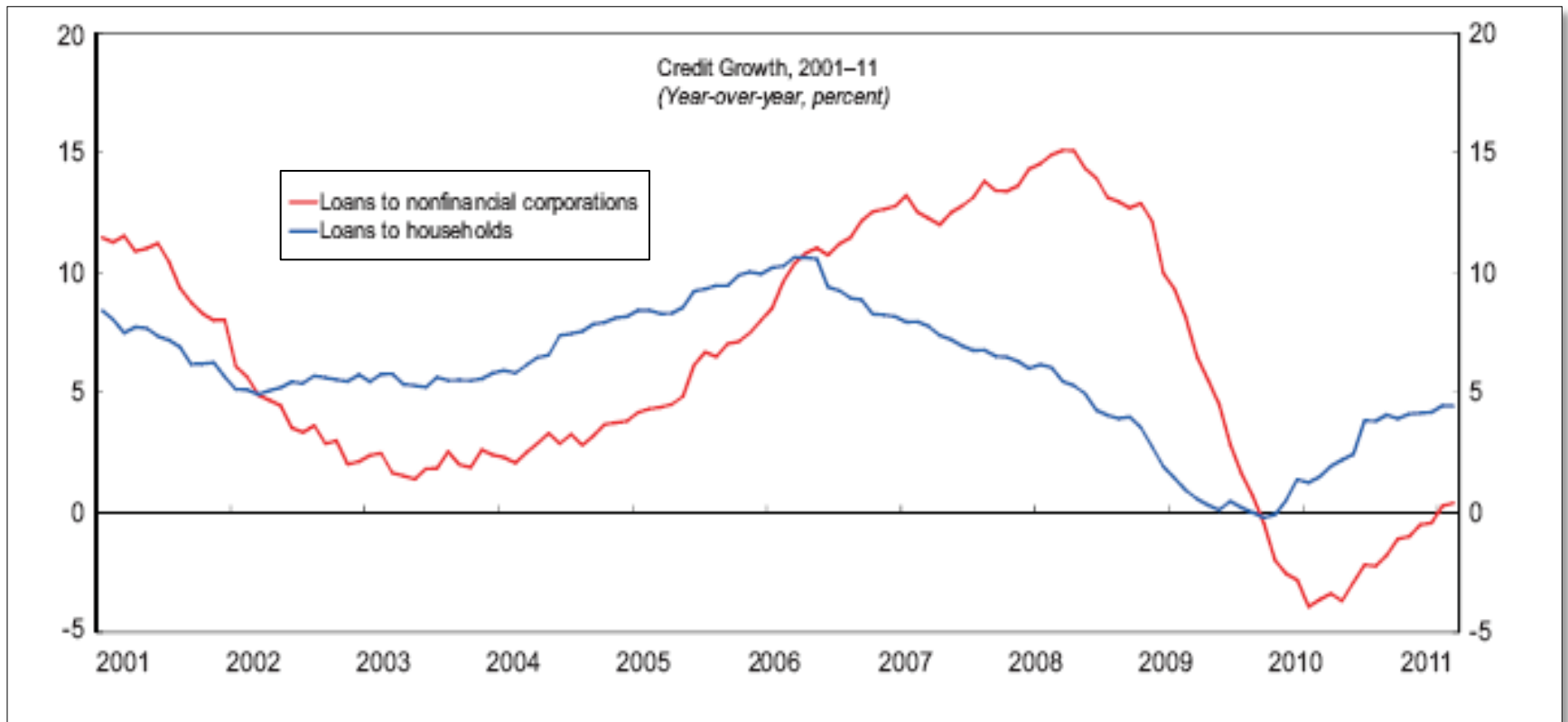
Convergence of long-term government bond rates 1990-2010



Source: IMF



Credit developments euro area



Source: IMF



2) Initial EU reactions



Reactions to the crisis (1/2)

- Reactions first rather uncoordinated and confusing
- Then: Three step ‘bail-out’-mechanisms/safety nets:
 - 1) April/May 2010: Immediate loan for Greece
 - 2) May 2010: Temporary European Financial Stability Facility (EFSF)
 - 3) March 2011: Permanent European Stability Mechanism (ESM, from 2013)

Reactions to the crisis (2/2)

- Apart from loan mechanisms, various propositions for general overhaul (Taskforce Council, ECB, EP, Commission)
- “European semester”
- October 2010 Council: Permanent mechanism, Change of SGP, Treaty adaptation
- Important steps, but again:
Focus on budgetary discipline and household/fiscal control



3) Structural and ongoing reforms



Councils and decisions in March 2011 (1/2)

- Serious of Councils and meetings in March 2011
- “To do whatever it takes”/”Grand bargain”
- Most important decisions:
 - Better deal for Greece
 - Allows haircuts on sovereign debt
 - EFSF becomes permanent from 2013 onwards as European Stability Mechanism (ESM)
 - Fund to buy bonds on primary market



EFSF/ESM

Eurozone safety nets

European Financial Stability Facility

A temporary bail-out fund created by the 17 eurozone states in June 2010

European Stability Mechanism

A permanent bail-out mechanism that will replace the EFSF in mid-2013

Capital

€440bn €700bn

€250bn

Current lending capacity, but an agreement has been made in principle to boost it to €440bn

Eurozone states provide varying guarantees:

3.5% Belgium

27.1% Germany

Has a triple-A credit rating by Standard & Poor's and Fitch Ratings

Cannot be used to buy sovereign bonds on the primary or secondary market

€500bn

Lending capacity

Requires €80bn in cash as well as €620bn in guarantees and callable capital

Eurozone members will provide guarantees plus €16bn of cash every year for five years, starting in 2013

Eurozone countries will speed up their payments into the fund if a large country requires a bail-out and the mechanism has insufficient funds

Can be used to buy bonds on the primary market when a borrower agrees to a bail-out and austerity programme

Source: FT research

Source: Financial Times



Councils and decisions in March 2011 (2/2)

- Euro Plus Pact (DE/F: “Competitiveness Pact”/”Euro Pact) to:
 - Increase competitiveness
 - Budgetary and macro-economic surveillance
 - Council to monitor developments



4) Open issues and the way ahead





Open issues and the way ahead (1/3)

On the positive side:

- EU went through difficult but at the same time creative and crucial period – Crisis as opportunity
- Much reached that was unimaginable a while ago
- New dimension of EMU and EU



Open issues and the way ahead (2/3)

On the negative side:

- Details of ESM still unclear
- Euro Plus Pact still far from proper economic governance
- Only emergency facility
- Many grave problems not tackled
- Solutions simply bought time

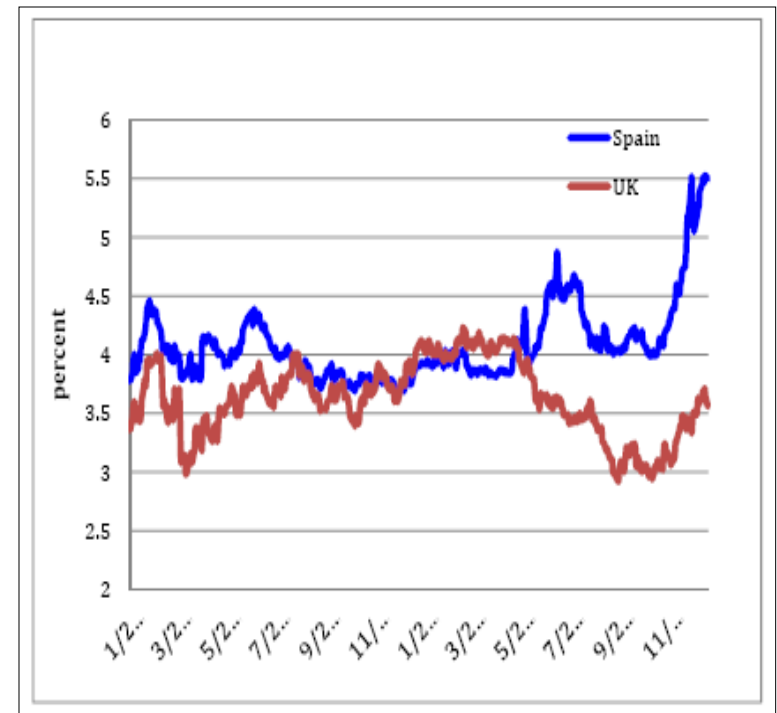
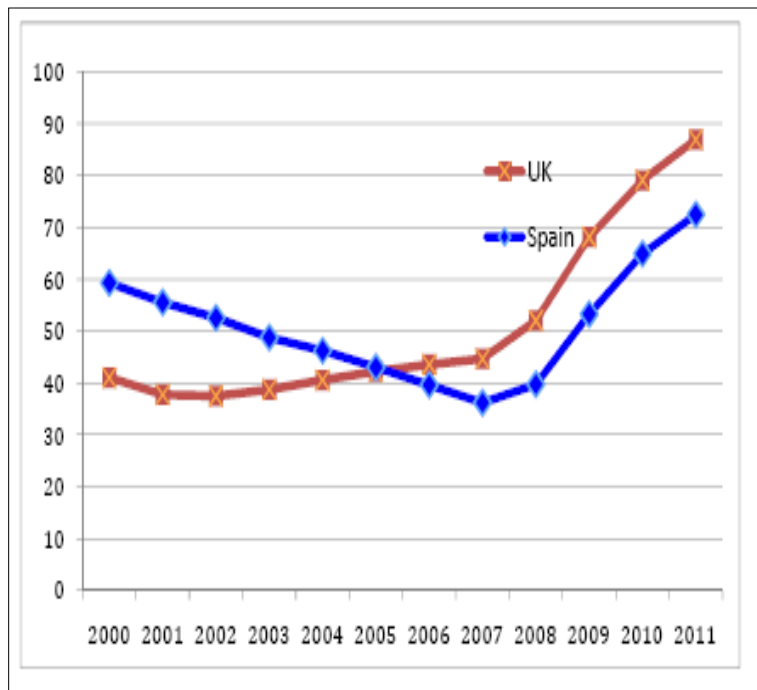


Open issues and the way ahead (3/3)

- Politics vs. economics
- Role of the markets and expectations
- Banking sector
- Plan A (conditional loans, austerity,...) has failed



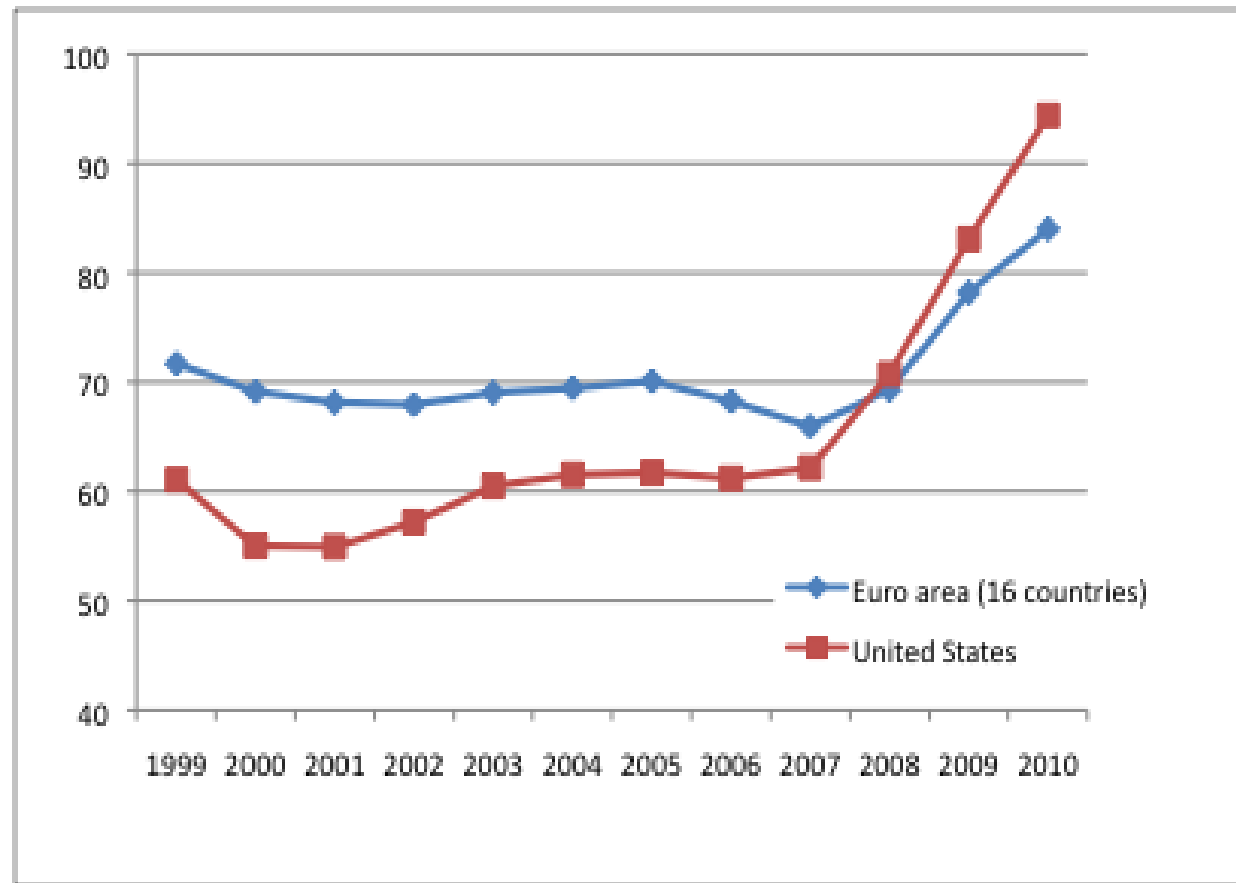
Gross government debt (% GDP) vs. 10-year government bond rates, UK vs. ES



Source: P. De Grauwe



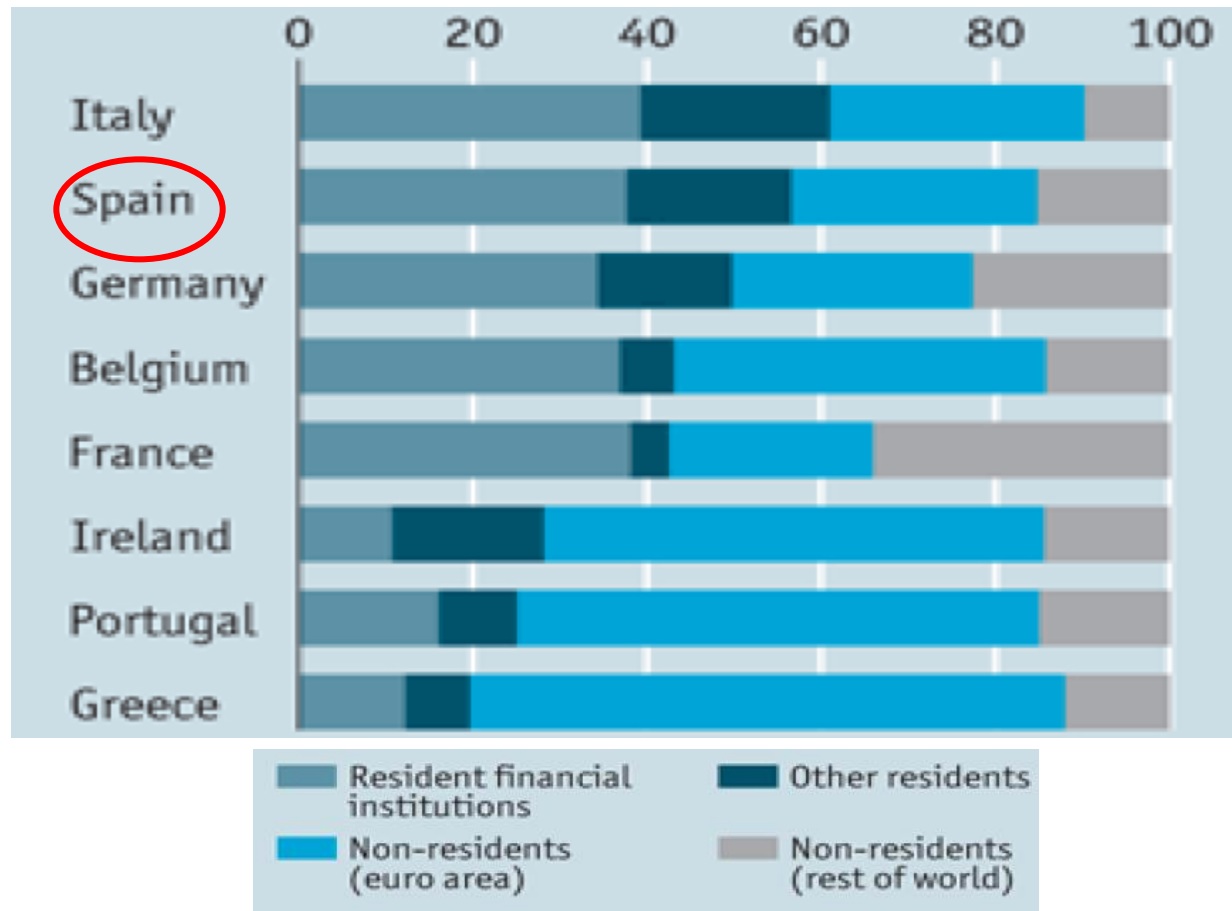
Government debt ratio , US vs. eurozone



Source: European Commission, Ameco, De Grauwe



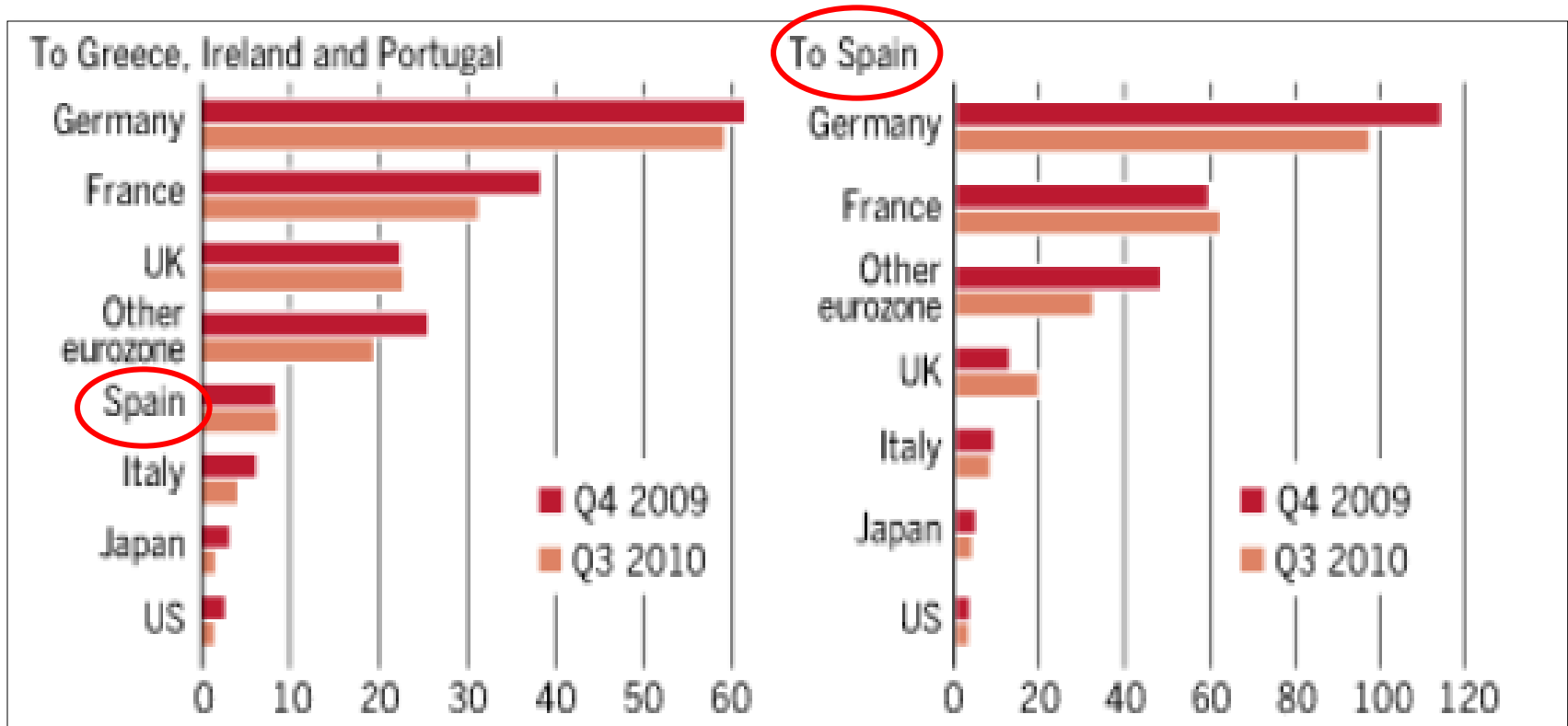
Government debt holders, % of total, 2010



Source: Barclays Capital, Economist, De Grauwe



Banking sector exposure*

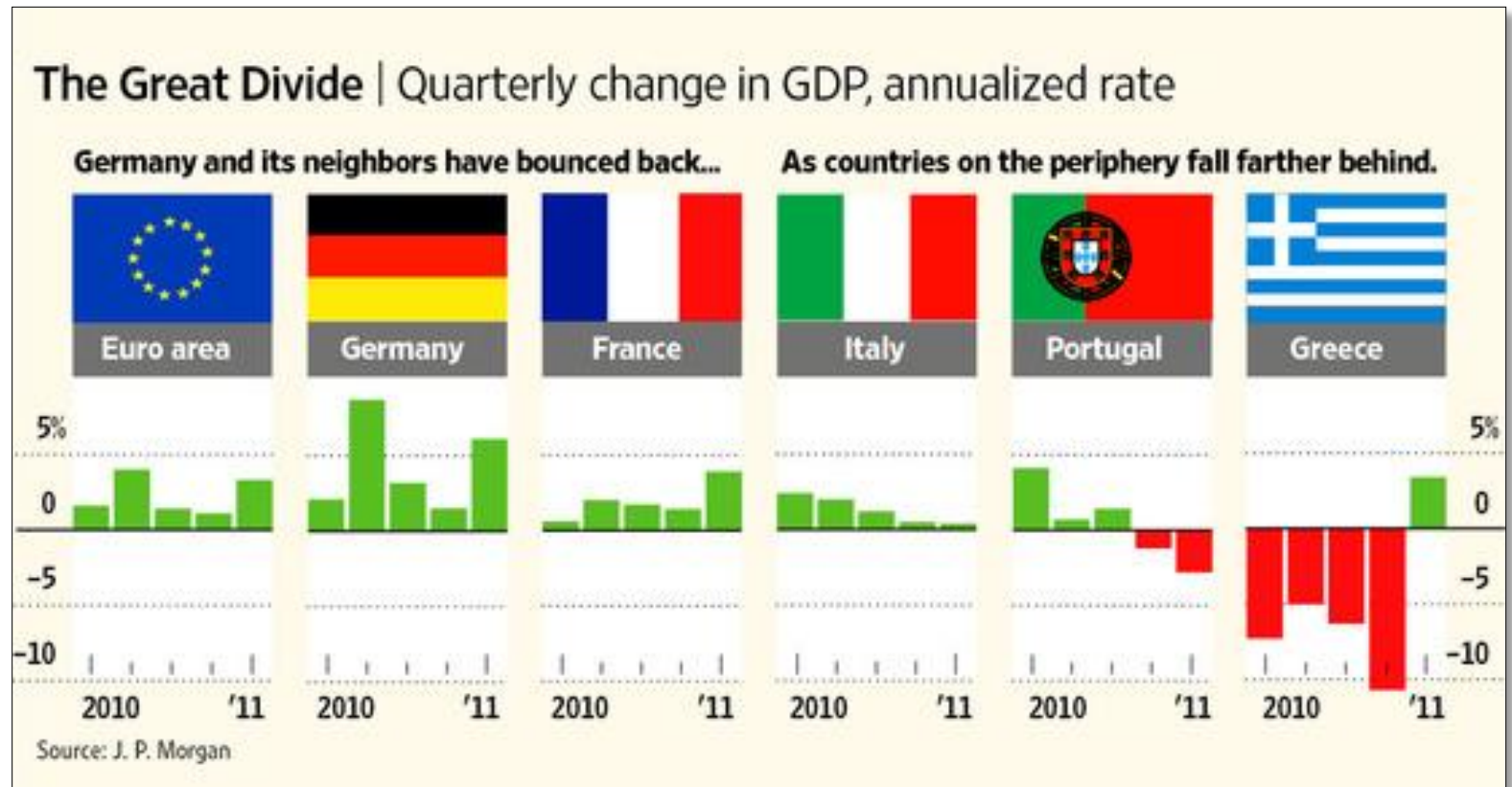


*Claims on domestic banks and public sector, % of equity of banks with foreign exposure

Source: IMF, Financial Times

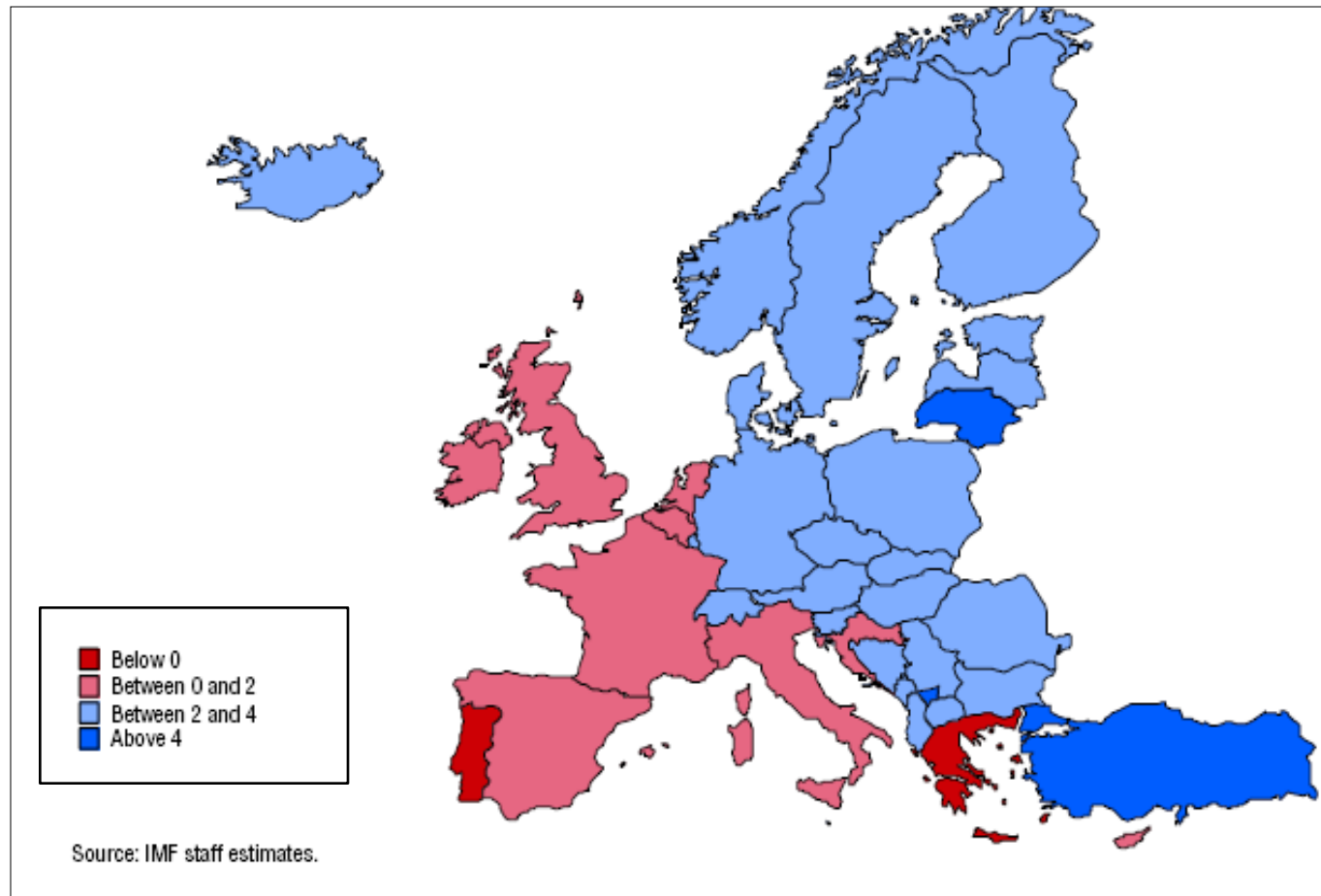


GDP change (%)



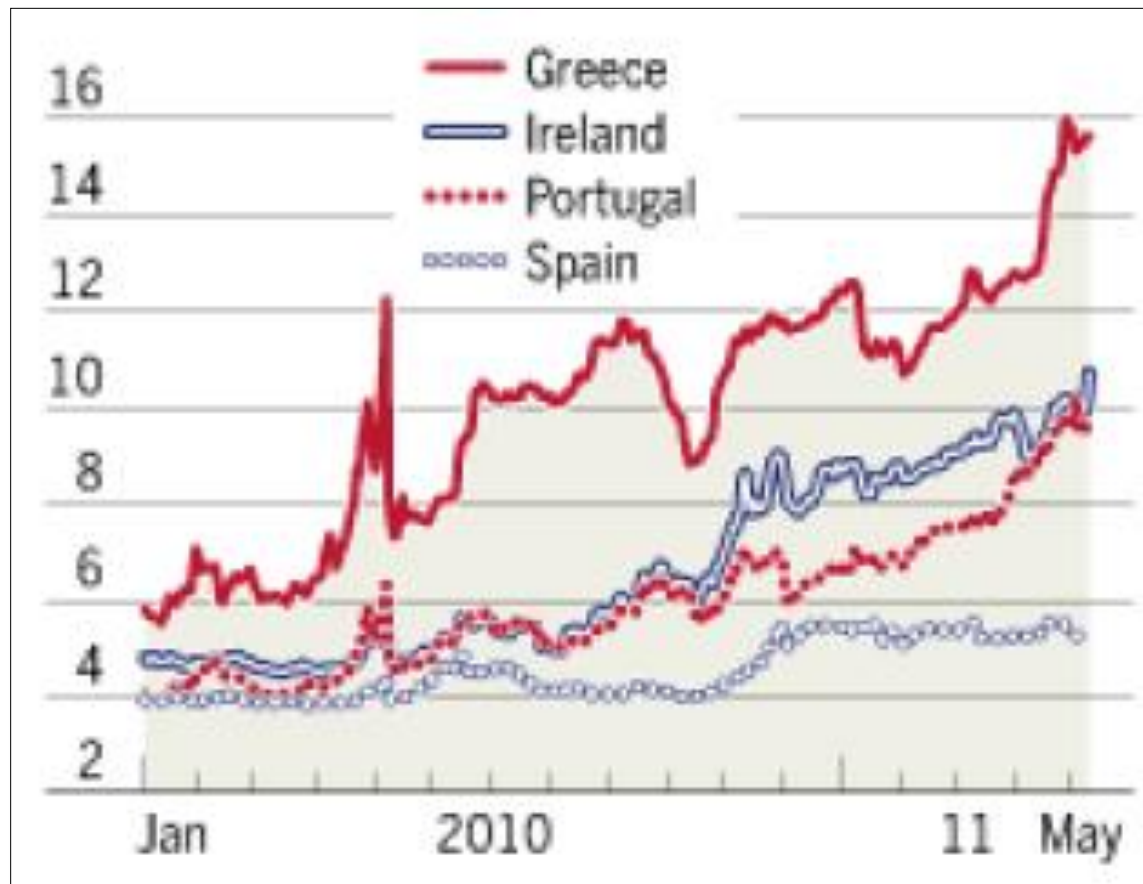


Projected real GDP growth 2011-12





Government 10-year bond yields



Source: Financial Times



Open issues and the way ahead (3/3)

- After Plan A failing, what could be elements of Plan B?
 - Carry on and pile debt on debt
 - Debt restructuring and default mechanism
 - Euro bonds
 - Fiscal union



5) Conclusions



Conclusions

- Options: serious change or break-up
- Implications for European integration process / Institutional dimension
- Missing political will and “vision”
- Basic problem: No political union
- Eurozone lesson/implications for economic global governance and its reform?