

Better in than out? Economic performance inside and outside the European Monetary Union

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1. Better in than out: Short vs. Long-run Perspectives

- Need to distinguish between short-run and long-run
- In the short-run leaving the euro could also bring 'flow' benefits (e.g. competitiveness via nominal exchange rate depreciation) which, of course, would have to be weighed against the 'stock' costs (e.g. redenomination and cost of debt)
- But those benefits would disappear soon (e.g. inflation)
- Moreover, abandoning the euro would likely mean abandoning the EU as we know it: This would make the outgoing countries extremely vulnerable and would weaken the entire EU (not to mention the geopolitical threats!)

2. EMU: virtuous convergence vs. growing divergence

- Evidence suggests the view that the introduction of the euro would automatically induce a virtuous convergence was naïve
- Rather, the Eurozone experienced growing divergence
- Can the lagging reforms in some countries explain it all? Probably not: Need to think of disciplining not only the borrowers but also the lenders to prevent ephemeral interest rate convergence and the resulting bubbles
- In the absence of political/fiscal union, various types of moral hazard are bound to emerge
- The Stability and Growth Pact clearly didn't work
- The Fiscal Compact and the 'fiscal austerity' approach haven't worked either
- NOCAs can become OCAs only if adjustments are programmed & facilitated → again, lack of political union

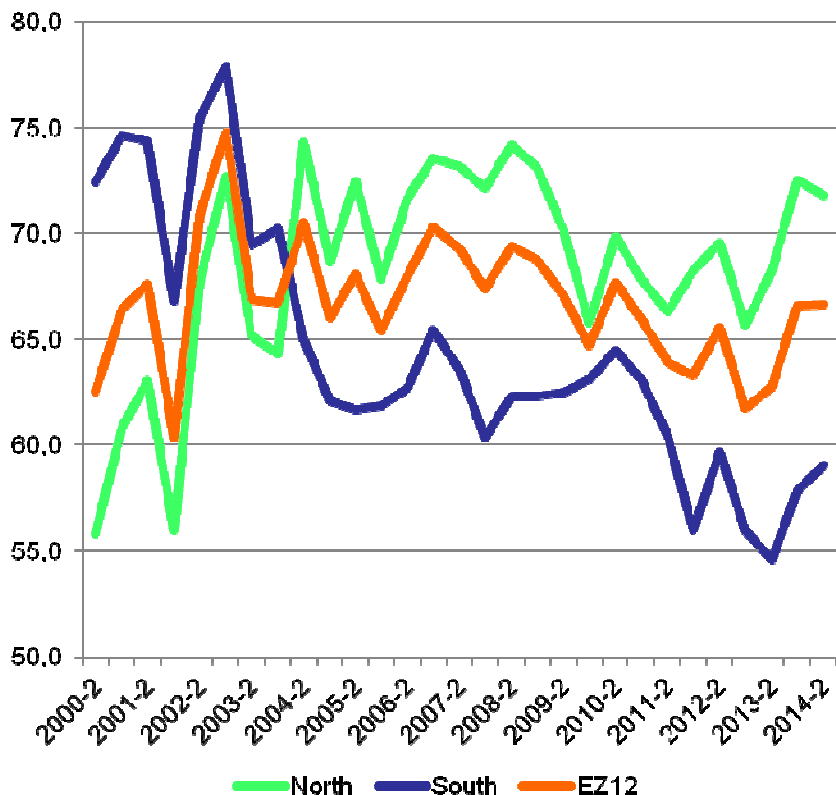
3. Eurozone institution build-up (esp. ECB) gave some respite

- The Eurozone managed to curb the self-fulfilling sovereign debt crises
- The institution build-up especially at the ECB (both in terms of new monetary policy/LLOR instruments and the Banking Union) succeeded in stopping the negative spiral since 2012
- But, as Mario Draghi said repeatedly, the ECB cannot solve the underlying problems, it can only buy time
- That time should be used to carry out the needed reforms
- Some of those reforms had to be achieved at the national level and the process has been lagging, though moving on
- Other, less frequently mentioned, reforms had to be carried out in Brussels to introduce the missing macro adjustment-facilitating measures but not much happened there either

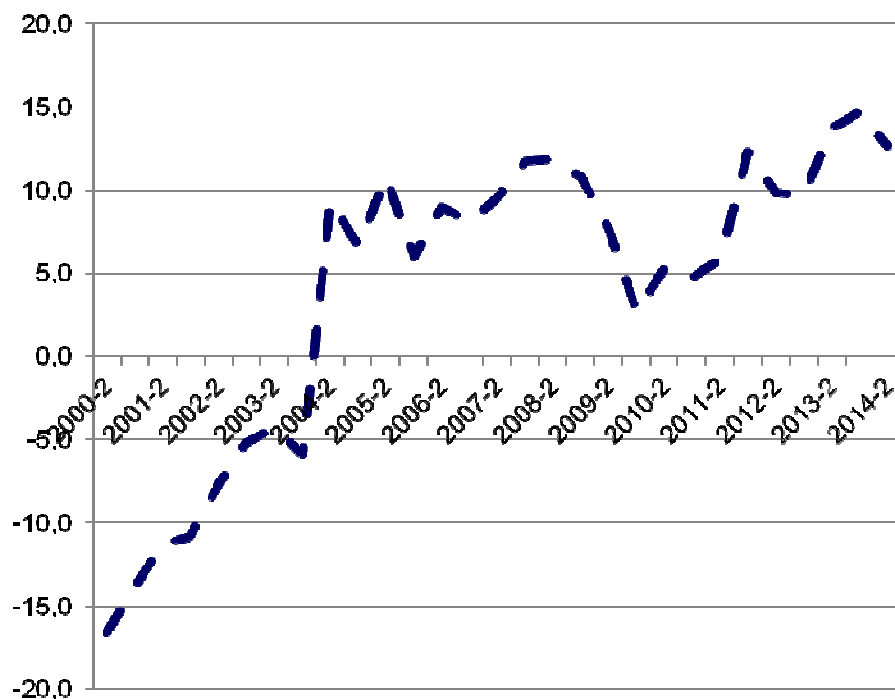
4. But social uneasiness keeps a wide North-South divide

- Considering the EZ12, support for the euro is dwindling in the South (Greece, Italy, Portugal, Spain) vis-à-vis the North (source: Eurobarometer)

Support for the euro (%)



Support for the euro (%): North - South



5. *Is there a New Deal around?*

- Only lately a 'stingy' Junker program for investment did surface

- Can anyone see a New Deal to save the euro?