The Eurocrisis: What Now?

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European Union—a United States of Europe?

- From six original members to 27 today

The European Union Flag

Treaty of Rome, 1957


Candidate Countries
Iceland
FRANCE
Guadeloupe
Martinique
Réunion
French Guiana
PORTUGAL
SPAIN
Azores
Madeira
Canary Islands
SWEDEN
FINLAND
Norway
ESTONIA
Russia
LATVIA
LITHUANIA
(Rus.)
DENMARK
Belarus
IRELAND
UNITED KINGDOM
NETHER-LANDS
POLAND
GERMANY
BELGIUM
LUXEMBOURG
CZECH REP.
Ukraine
SLOVAKIA
Moldova
HUNGARY
AUSTRIA
FRANCE
Georgia
ROMANIA
Switzerland
SLOVENIA
Armenia
CROATIA
Bosnia & Herzegovina
Serbia & Montenegro
BULGARIA
Macedonia
TURKEY
PORTUGAL
SPAIN
ITALY
Albania
GREECE
CYPRUS
MALTA

European achievements as of 2007

- A single market without tariffs for manufactured, agriculture, and services
- Labor visa-free mobility—Schengen agreement
- Record GNP per capita--$32,000.
- Generous unemployment and welfare provisions
- A peaceful and united Europe from the Atlantic to Russia’s borders

The Euro bloc today

- 17 EU members, including Germany, France, Spain, Italy, Greece, and Portugal.
- All use the euro currency, now valued at about $1.31 per €, acceptable worldwide.
- All have access to the European Central Bank, which sets the basic interest rate and influences the exchange rate.
- About 25% of worldwide reserves in €.

- Euro currency notes and coins

Advantages of a single currency

- Eliminates conversion expense within bloc.
- Sharpens price competition.
- Eases inter-European investments.
- Stable prices for all.
- Avoids competitive devaluations.
- Centralizes monetary policy for banks with a common interest rate.

Rules of prudence for all

- Maastricht rule: max. 3% deficits, max. 60% sovereign debt; low inflation.
- Enforced by European Commission.
- Exception for downturns and France and Germany violate 2000 Stability and Growth Pact
- 2005 SGP revision equally weak in practice

Others signs of “Eurosclerosis”

- Weak growth compared to USA, NICs
- Labor hours per year less than USA, Japan
- Few technological achievements
- General complacency

Causes of the crisis

- Easy loans for all.
- Private and public overspending.
- Wages and price rises without increases in productivity.
- Basic law of economics: if investment > saving, an import surplus and rising foreign debt is inevitable. Dissaving = public deficits and private borrowing.

Possible solutions

- Austerity—makes things worse!
- ECB acting as lender of last resort.
- Contagion and panic in the bond markets—EFSF, IMF, the Fed, and China to the rescue!
- Debt deflation and “internal devaluation”
- slow and painful.
- Devalue the € and inflate prices—likely political consequences

The two alternatives now

Breakup of the euro zone <u>or</u>

Internal devaluation, bailouts, and treaty revisions

My fearless prediction?

Thanks for your attention!

Questions?