

Euro Crisis or Crisis of Euro Countries? Weaknesses and Lessons from “Deep Integration”

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Euro Crisis or Crisis of Euro? Countries Weaknesses and Lessons from “Deep Integration”

- I. Starting Point
- II. The Way into the Crisis
- III. Possible Ways to fix the Crisis
- IV. The Present Situation: Playing for Time is an Unstable Equilibrium
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I. Starting Point

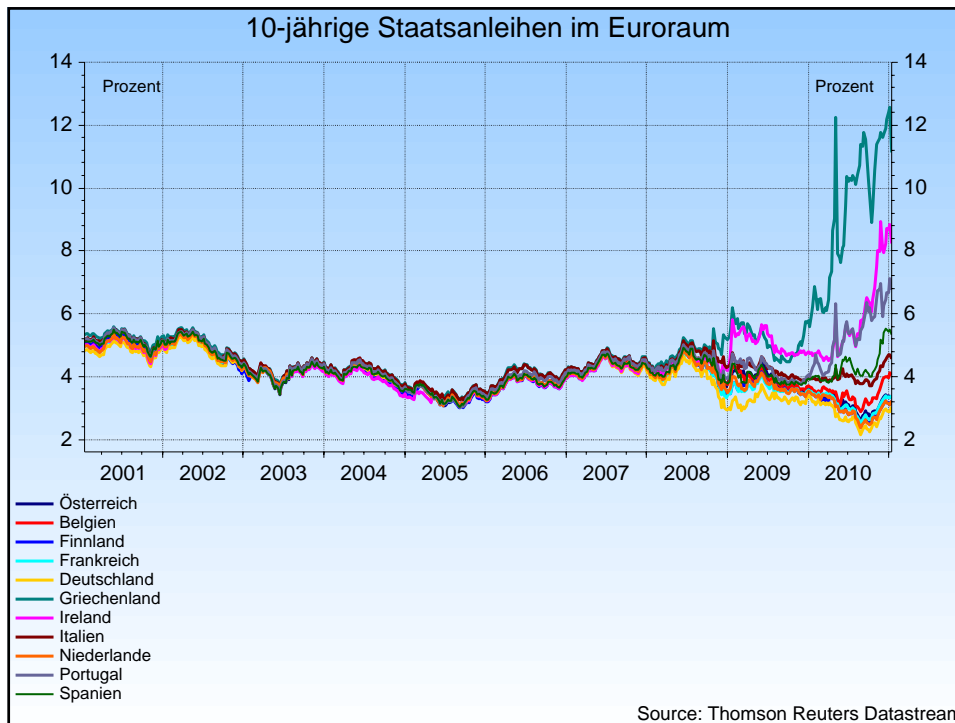
- Disputes over the sequence of EU regional integration: monetary integration as a coronation of real sector integration (Mundell I, optimum currency area) vs. vehicle of further integration (Mundell II),) German Bundesbank view (DM block: coronation; periphery view: vehicle)
- Entry conditions (convergence and stability prerequisites) were “generously” defined (Italy: pre-entry membership in the narrow ECU exchange rate band)
- Admission to membership was granted under static assumptions (once and for all fulfilment of entry conditions) and under the belief that periphery countries would use the interest rate windfall for investment rather than for consumption



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- Financial markets implicitly assumed bail-outs and intra-Euro transfers by fixing zero spreads for government bonds of Euro countries (Figure 1: Ten years government bonds)
- All border cases (Italy, later Greece, Portugal etc) were admitted to the “Club”





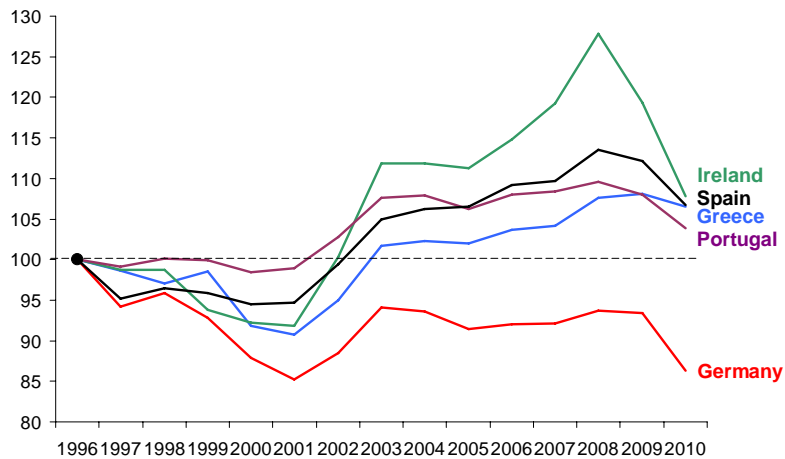
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II. The Way into the Crisis

- Periphery countries consumed the interest rate windfall
- Unlike other, Euro countries and Germany experienced wage moderation since mid 90s Euro countries and undertook serious labour market reforms after the burst of the dot-com bubble: effect: real exchange rate depreciation against other Euro countries (Figure 2)
- Brussels was helpless against “cheating” practices of Greece concerning debt and deficit data
- Stability rules were outrightedly violated by Germany and France (around 2005) without sanctions: Sanctions never had teeth; sinners rule over sinners

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Real Effective Exchange Rates of Selected Euro Member States 1996-2010 (June 1996=100)



Source: Bank of International Settlements, Basle.

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- The wedge in real competitiveness between Euro-Med and Euro-North opened dramatically when Germany (not burdened by real estate or other asset bubbles) recovered rapidly due to high demand from emerging markets for its export goods
- In the aftermath of the 2008/2009 financial crisis, financial markets overshot in extremely widening the spread between government bonds while being overly myopic before
- Markets expected defaults (insolvency assumptions) while politics first assumed temporary illiquidity of Greece; this discrepancy turned out costly

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III. Possible Ways to fix the Crisis

- A European Monetary Fund with orderly haircut procedures
- The introduction of Eurobonds
- Informal Paris Club/London Club default procedures with debt restructuring (buy back arrangements, debt swaps, debt for equity swaps, better collateralized debt) like in the Polish case (early 90s,) and Brady initiative late 80s)
- Tightening the Stability Pact with automatic sanctions including waiving voting rights



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- Widening and extending the EFSF (European Financial Stability Facility) 750 Bill € plus (Barroso Plan)
- Dismissing Greece and other PIIGS from the Euro Area
- Super-competitive Germany leaves the Euro Area
- Germany raises nominal wages to fuel domestic consumption

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https://www.yunbaogao.cn/report/index/report?reportId=5_6510

