Bundesministerium
der Finanzen

The Eurocrisis: new challenges for the EU's economic policy

Thomas Westphal
Director General European Policy
German Federal Ministry of Finance
23th of February 2015

College of Europe, Bruges

Five points:

1. **Talking about EMU**
2. The crisis
3. Analysing the current situation
4. What needs to be done to come to a stable EMU
5. Next steps

MEETING OF THE HEADS OF STATE OR GOVERNMENT
THE HAGUE, 1-2 DECEMBER 1969

“They have reaffirmed their readiness to expedite the further action needed to strengthen the Community and promote its development into an economic union. … To this end they agreed … a plan in stages will be worked out during 1970 with a view to **the creation of an economic and monetary union**.”

Benefits of a Monetary Union

- No exchange rate risk
- Lower transaction cost
- Lower interest rates
- Lower public deficits
- Improvements for the international monetary system

Cost of a Monetary Union

Limits the number of policy instruments to deal with shocks:

- exchange rate policy
- Monetary policy
- commit to coordinate economic/fiscal policy

Optimal Currency Area

Ex-ante criteria:

- Flexible prices and wages
- Factor mobility
- Financial market integration
- Open economy

Optimal Currency Area

Ex-post criteria:

- Trade integration
- Commitment = stability FDI
- Institutional effects

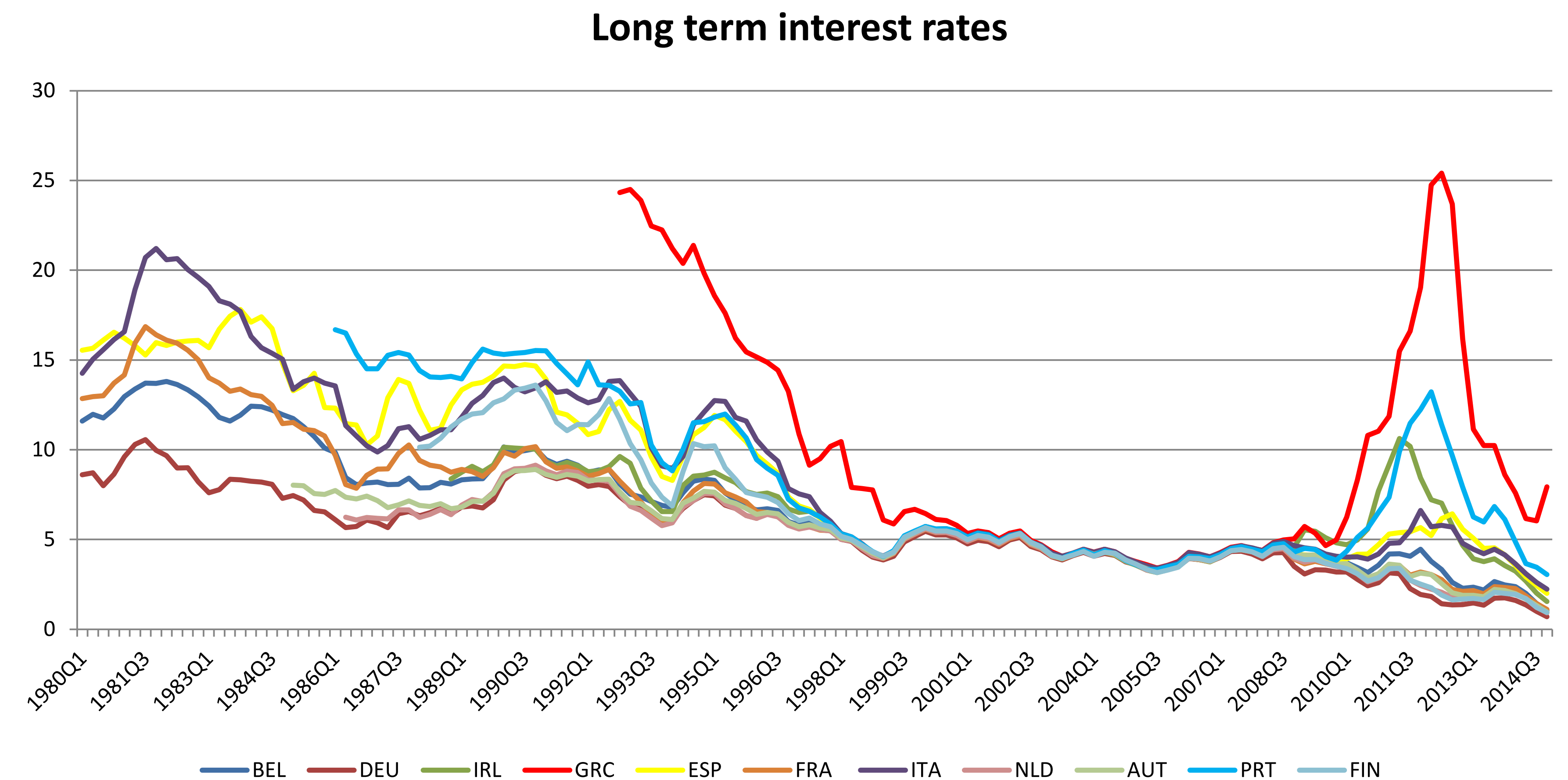
Five points:

1. Talking about EMU
2. **The crisis**
3. Analysing the current situation
4. What needs to be done to come to a stable EMU
5. Next steps

A crisis in different shapes

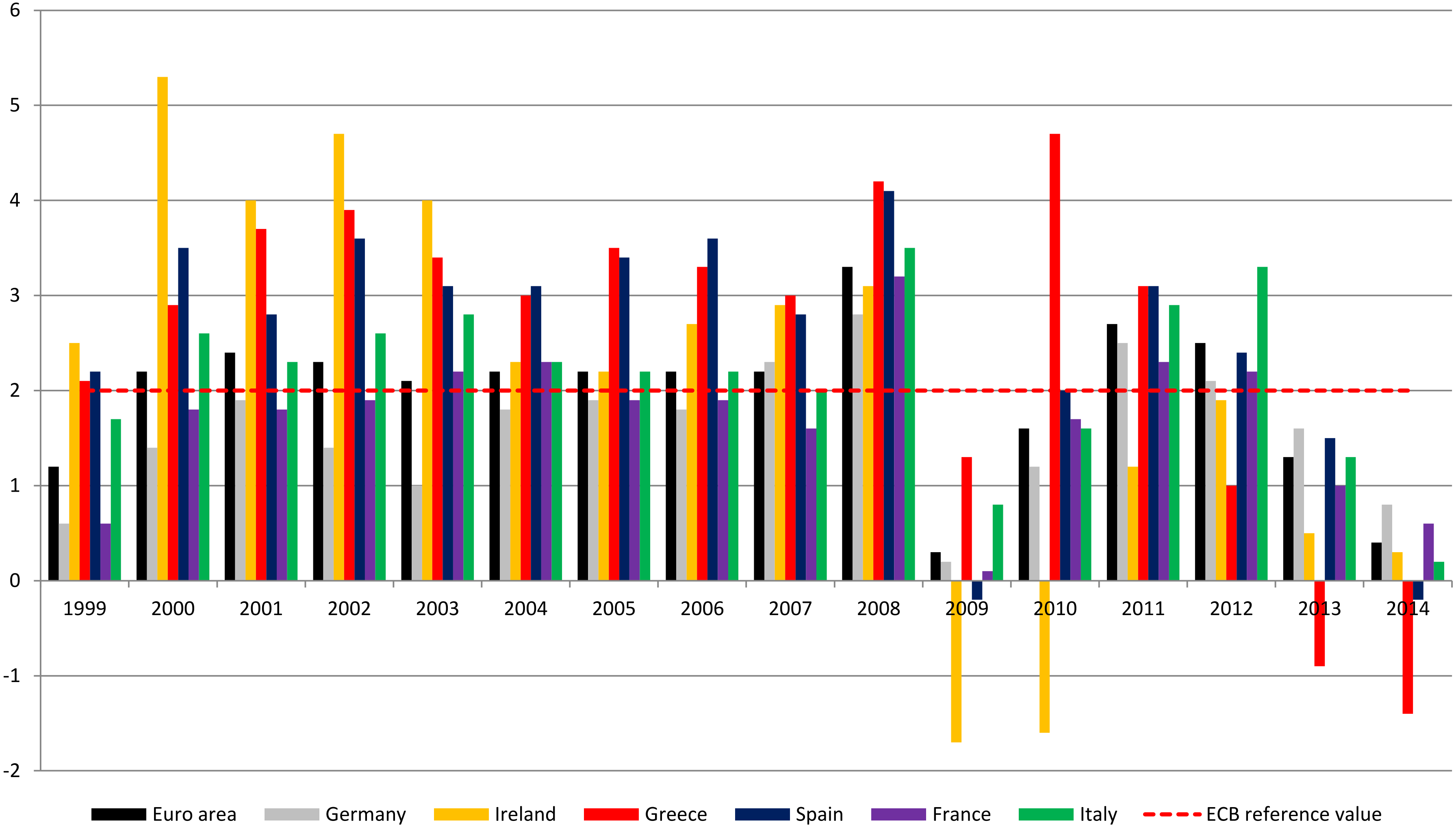
- US-subprime crisis (2007)
- Banking crisis (2008)
- Economic crisis (2009)
- Eurozone debt crisis (2010)
- Social and political crisis (current).

The crisis: loss of confidence

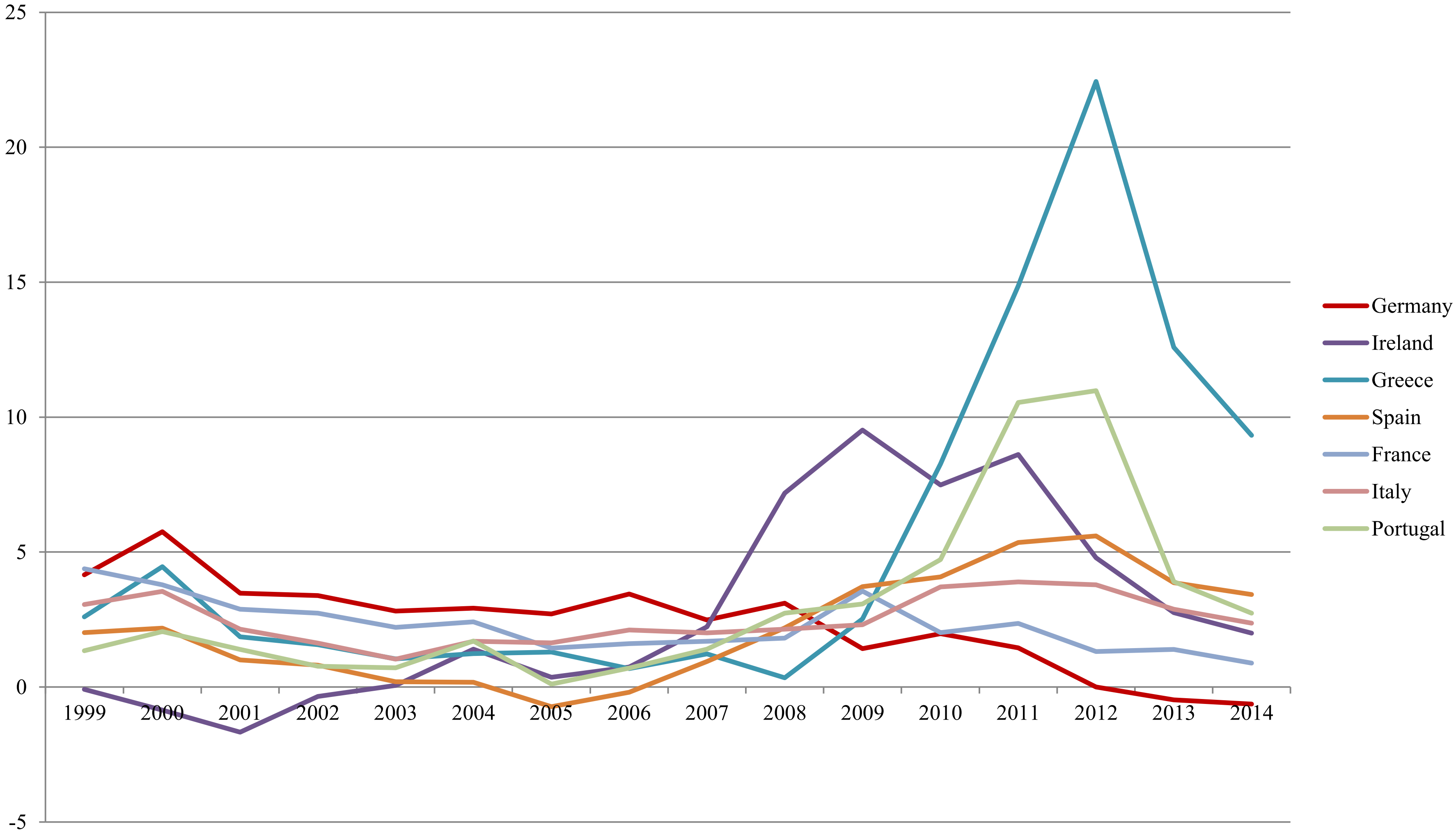


Quelle: Eurostat

Euro area inflation rates

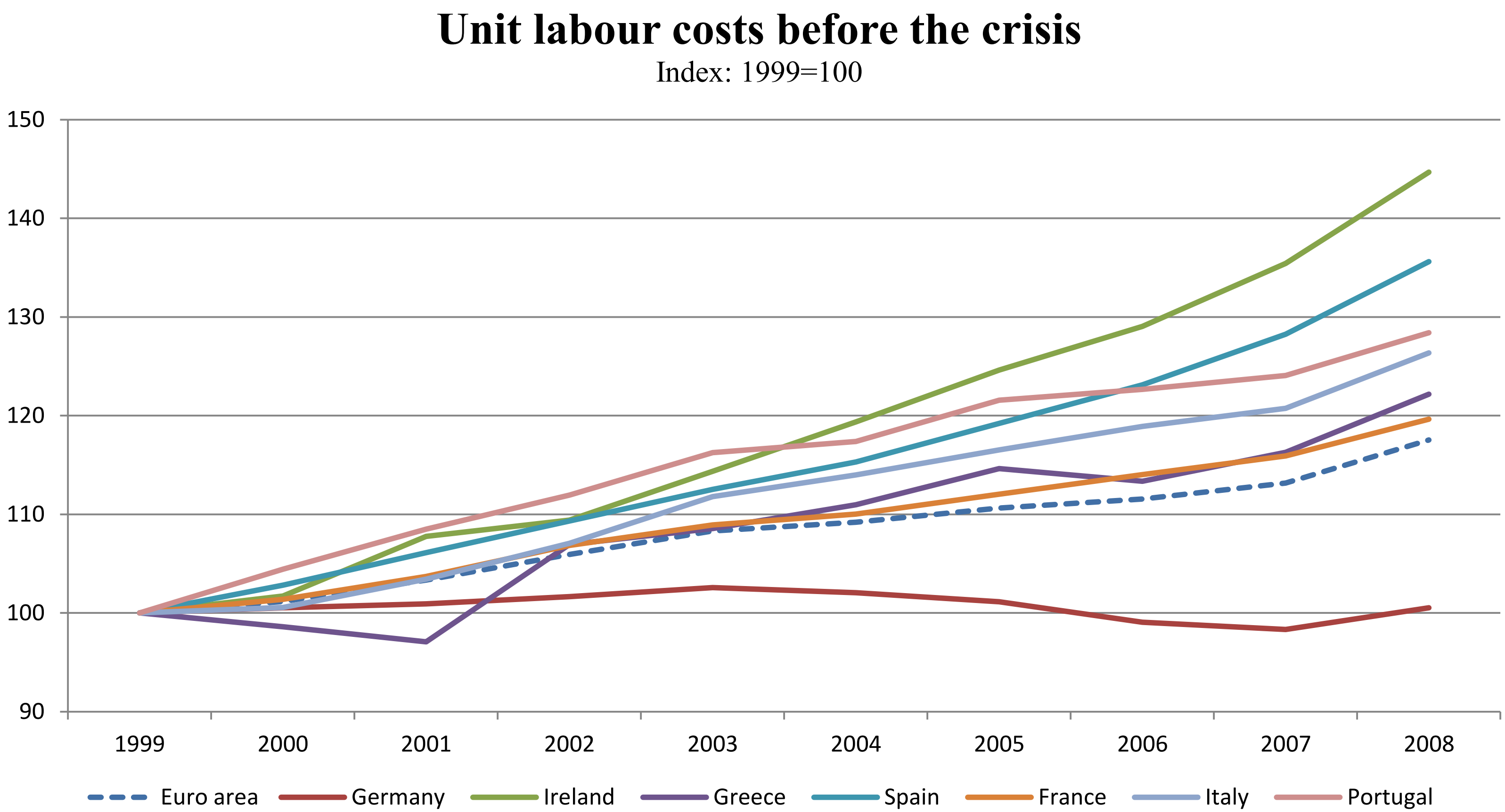


Real long-term interest rates



Bundesministerium der Finanzen
Berlin

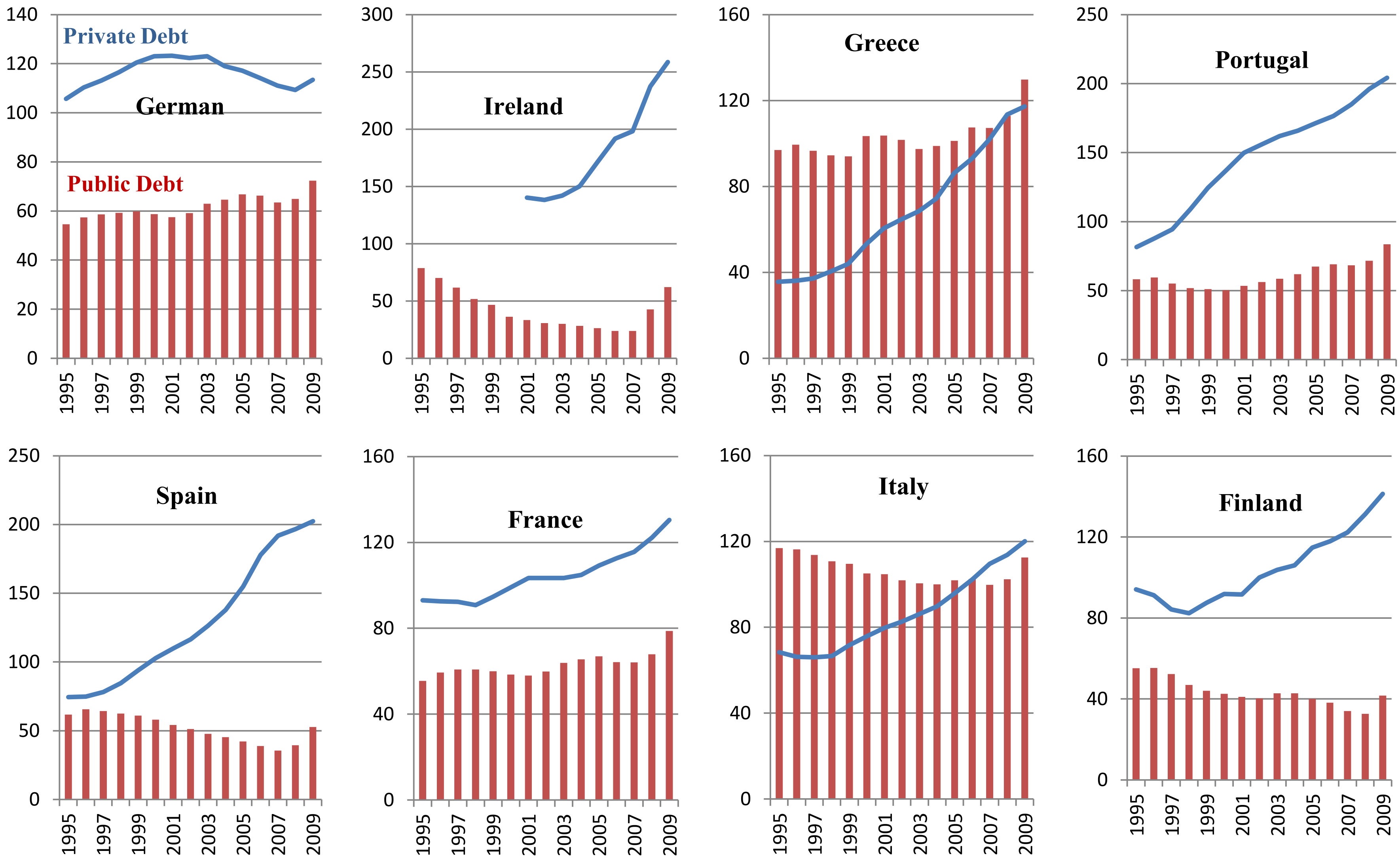
Building-up of imbalances



Bundesministerium der Finanzen
Berlin

Public and private sector debt

in % of GDP



Bundesministerium der Finanzen
Berlin

What to do?

Eurobonds

growth

debt

competiti-
veness

reforms

banks

exchange
rates

bazooka

solidarity

ECB

Crisis response

Member States	Financial markets	EMU-Governance	Crisis mechanism:
Reforms to improve competi-tiveness; fiscal con-solidation	Banking union: European Supervision; serious regulation	Re-enforcing SGP; Macro imbalances procedure	EFSM; EFSF; ESM

Policy coordination
“boldly go where no man has gone before”

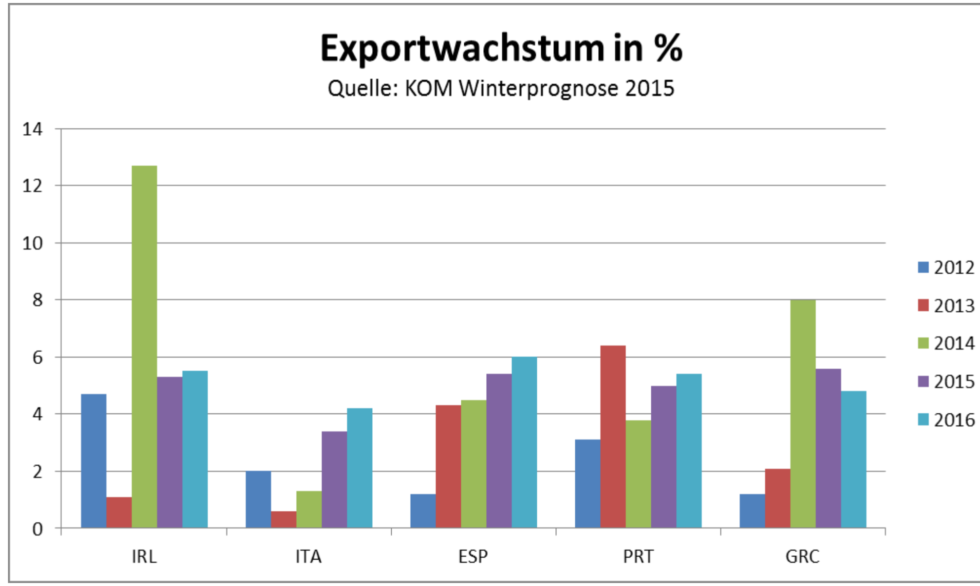
A dynamic system

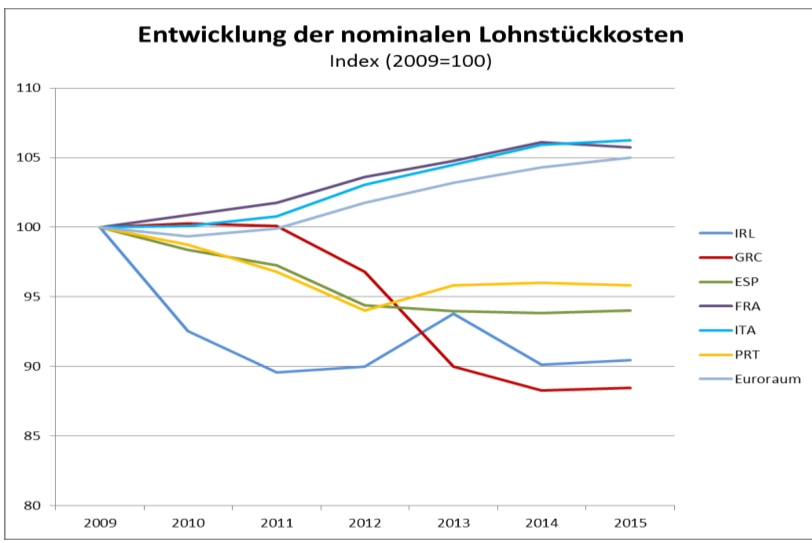
Five points:

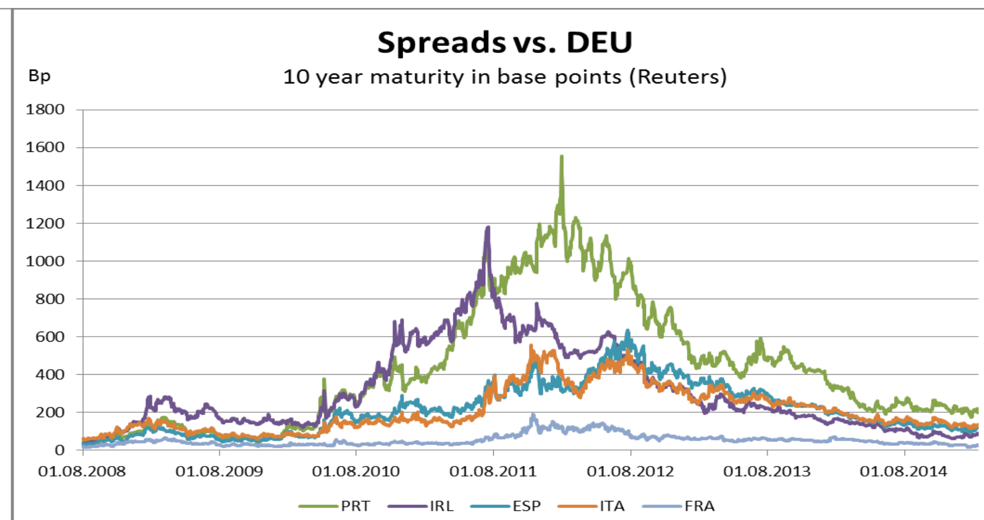
1. Talking about EMU
2. The crisis
3. **Analysing the current situation**
4. What needs to be done to come to a stable EMU
5. Next steps

Achievements

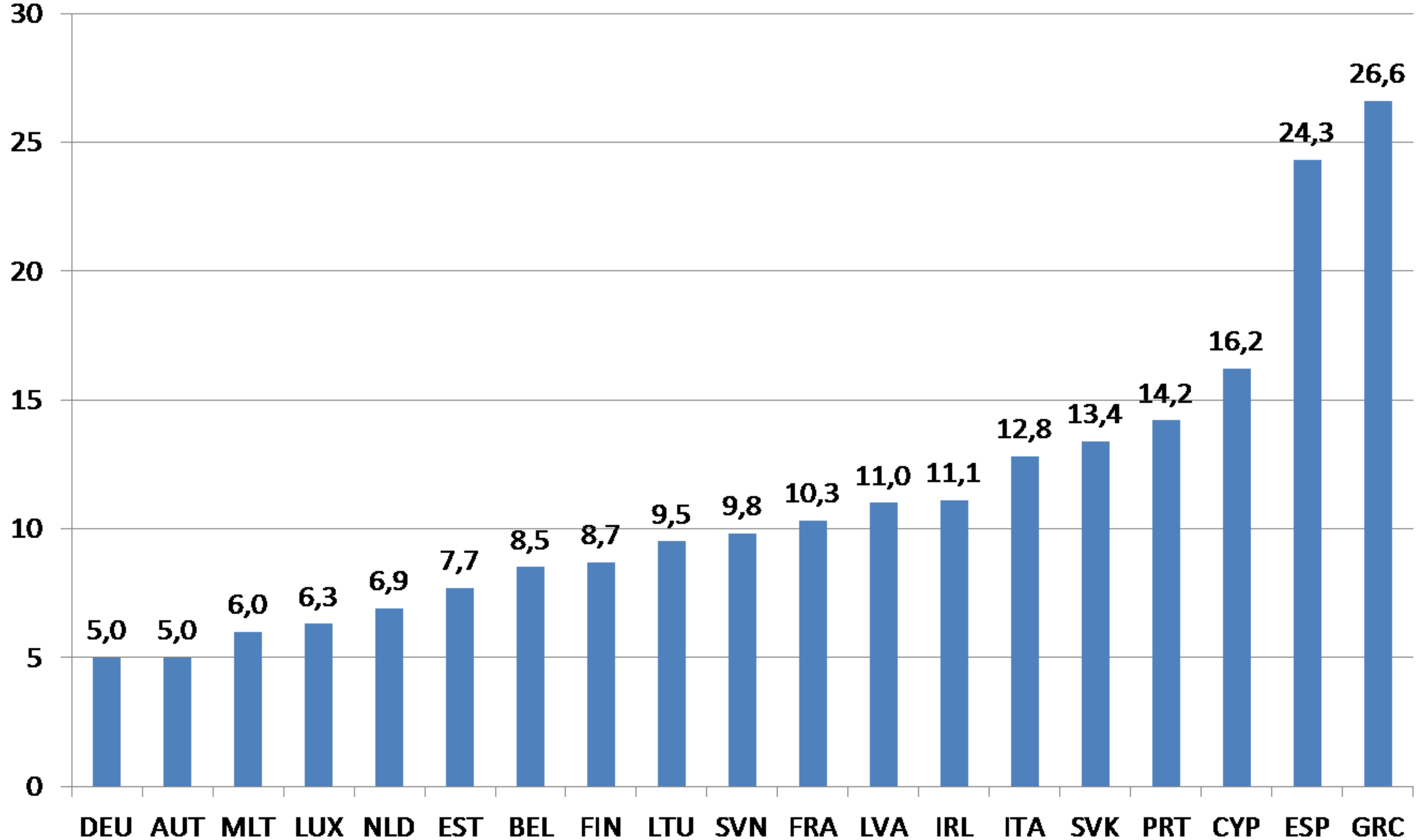
- Market confidence has returned
- 3 programmes completed (IRL, PRT, ESP)
- Ex-programme countries growing again
- Recession behind us







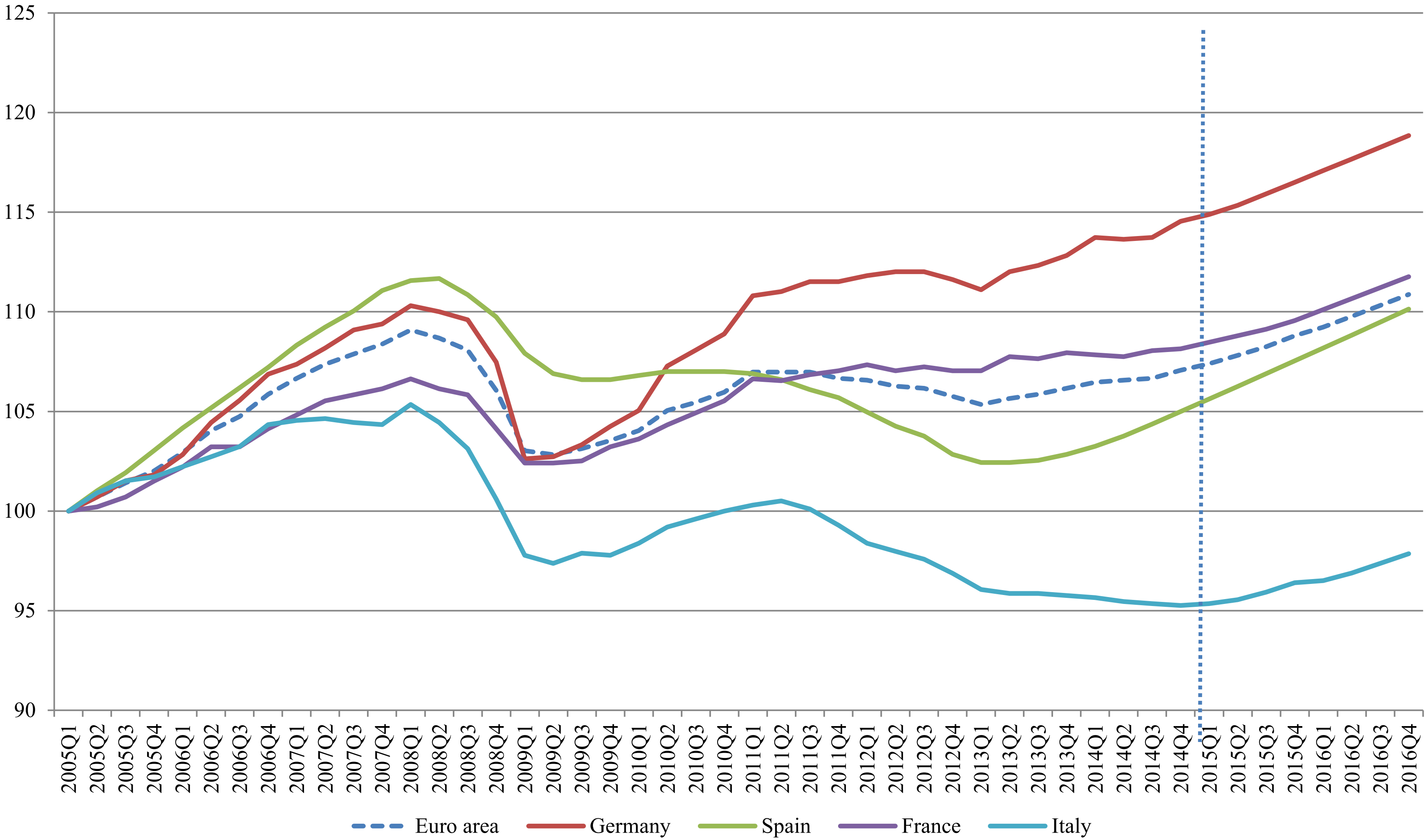
Unemployment rates in 2014 (in %)

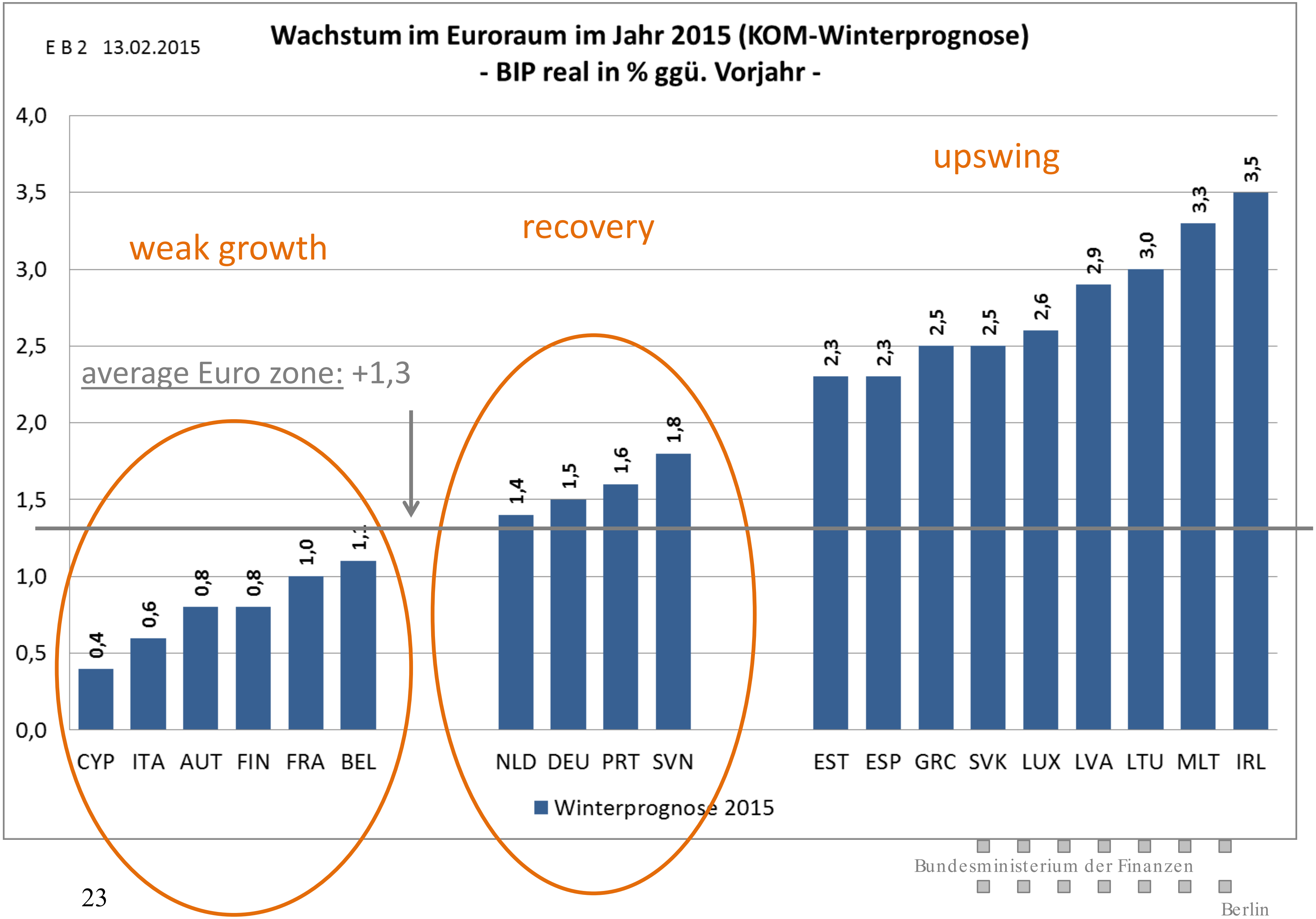


n

Real GDP in the euro area

(Index: 2005Q1=100, Commission forecast as of Q1 2015)

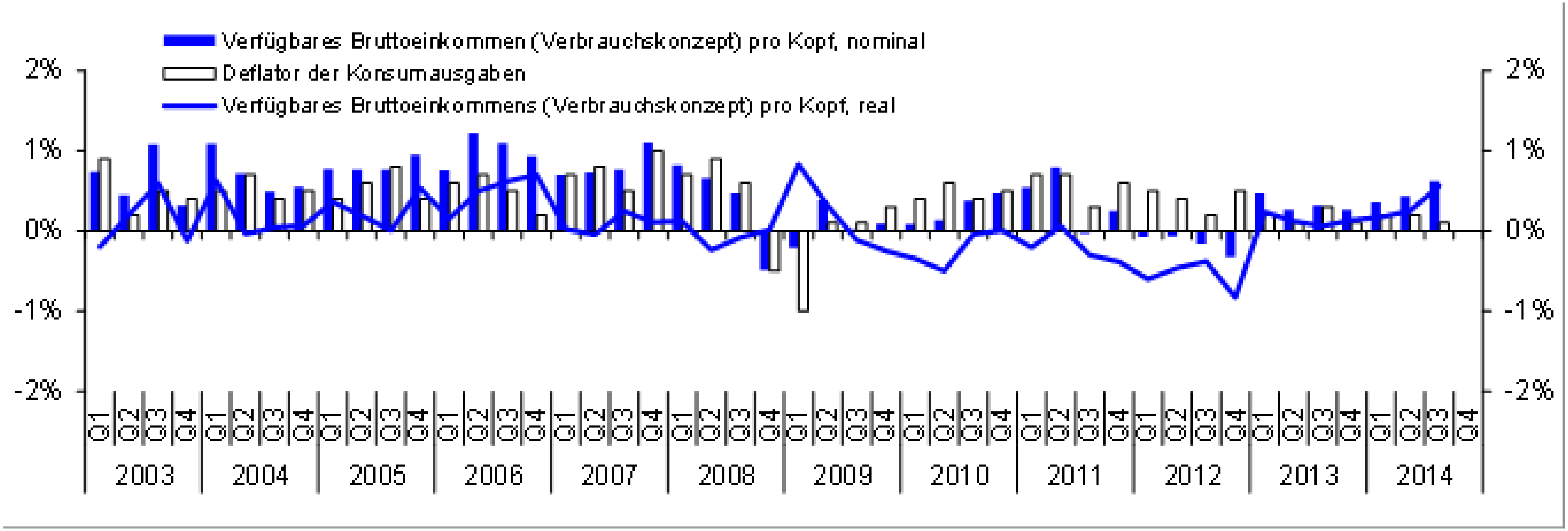




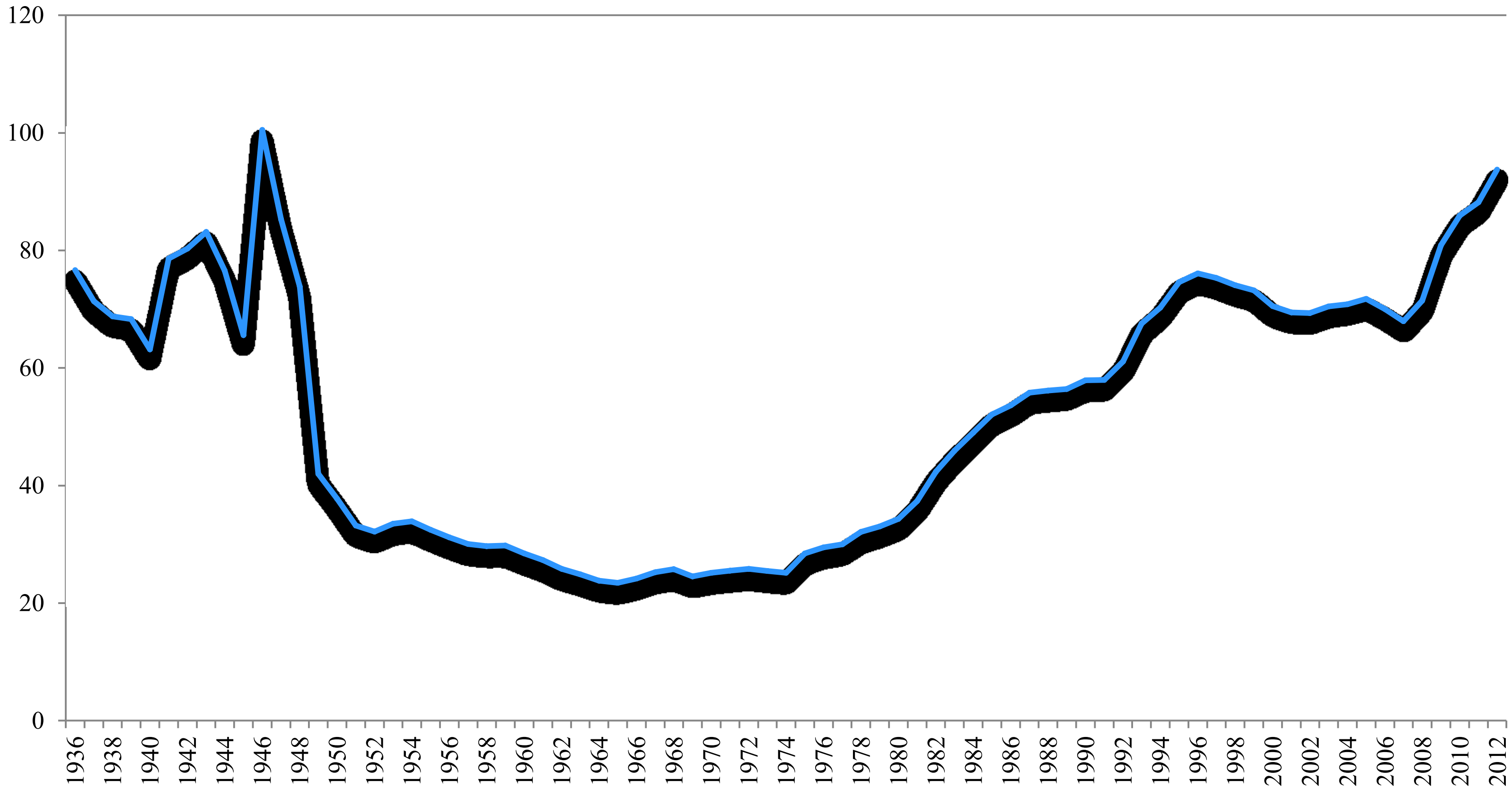
Bundesministerium der Finanzen

Berlin

Effects of low inflation



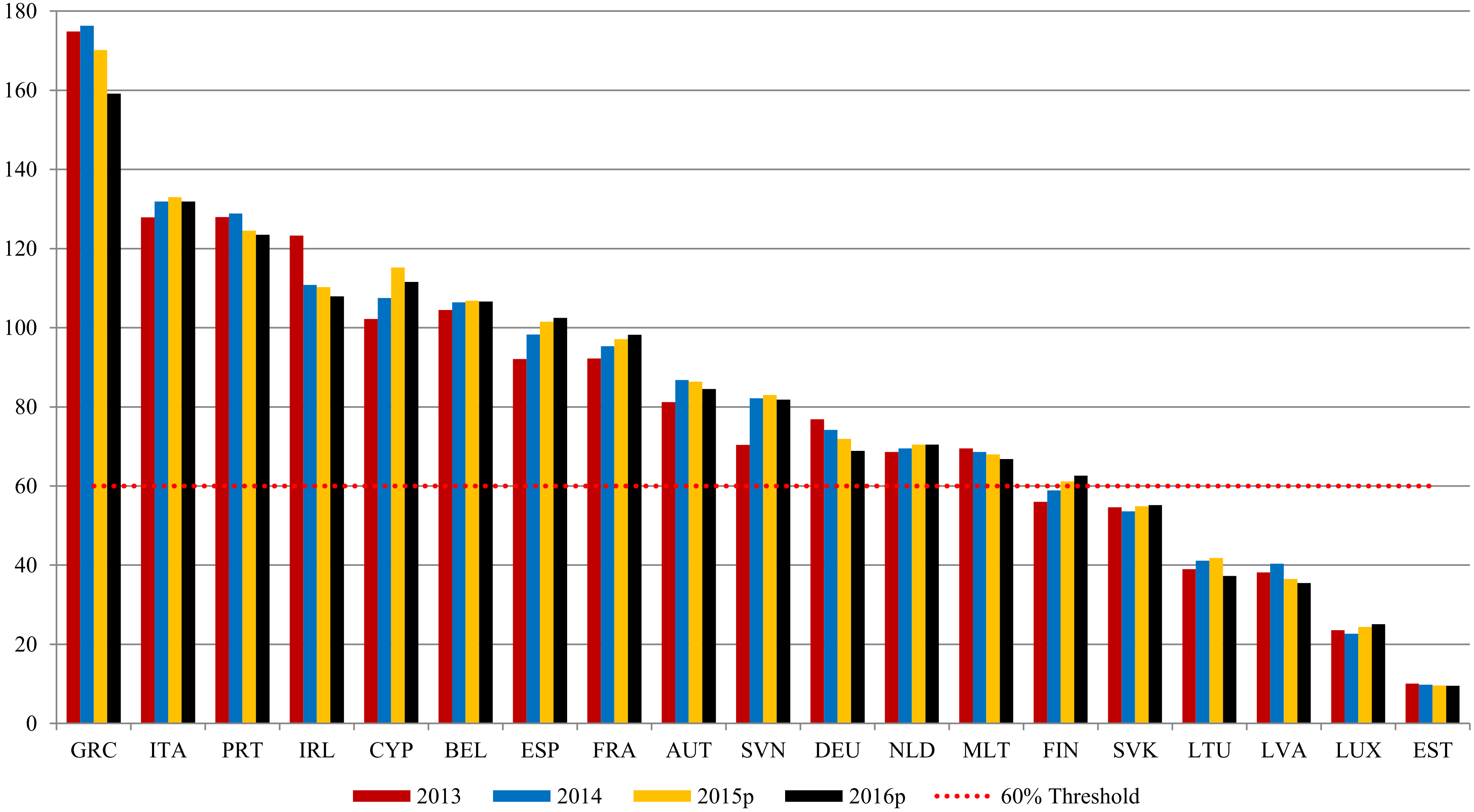
Debt ratio in the Eurozone (% BIP)



Eurozone aggregated historic debt/GDP for selected countries: Austria, Belgium, France, Germany, Italy, Netherlands, Portugal, Spain.
Sources: IMF historical public debt database, Angus Maddison Project, BMF staff calculations

Public debt in the euro area

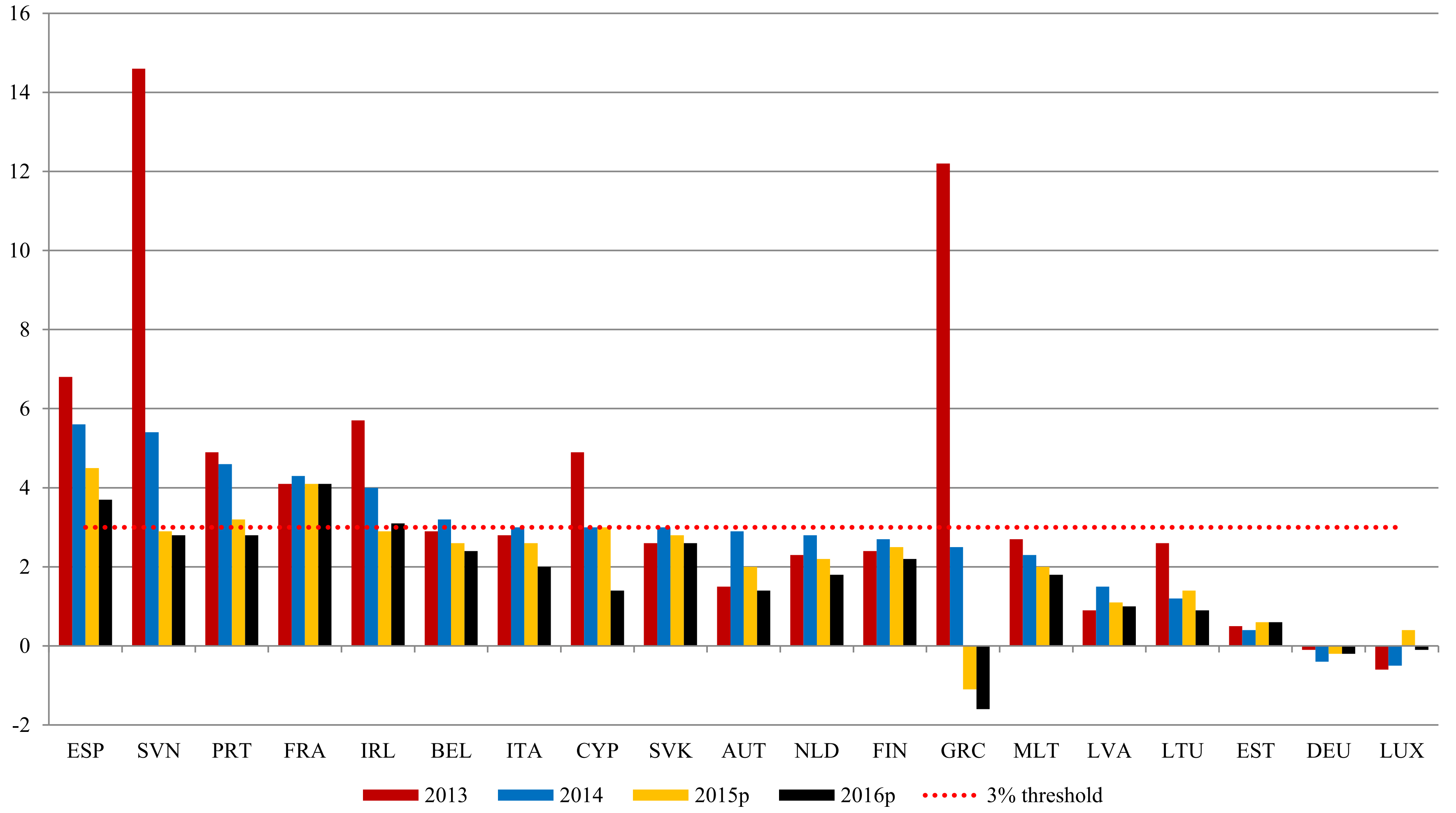
in % of GDP



Bundesministerium der Finanzen
Berlin

General government deficit in the euro area

in % of GDP



Five points:

1. Talking about EMU
2. The crisis
3. Analysing the current situation
4. **What needs to be done to come to a stable EMU**
5. Next steps

A stable EMU: substance

- In absence of political and fiscal union:

  CONFIDENCE
- Community vs. Intergouvernemental rules
- Set of (simple) rules (common sence, ownership)
- Fiscal policy: lowering debt ratios, MTO allows stabilisation via automatic stabilisers
- Policy coordination (forward looking)
- Agreement on debt reduction, structural reforms, how to support growth
- Internal market, incl complete banking union, budget (*put the money where your mouth is*) tax rules?

A stable EMU: institutional

- Commission: Guardian of the Treaty or political institution?
- EP: grand coalition? Eurozone chamber?
- Council: ability to shape policy?
- National parliaments: how to ensure national support for European ideas and policies?

Challenges remain

- <u>Geopolitical</u>
- <u>Political</u>: support for European idea
- <u>Social</u>: unacceptably high unemployment in some countries
- <u>Fiscal</u>: legacy of high public debt limits policy space
- <u>Economic</u>: growth fragile; still need for structural reform
- <u>Institutional</u>: new Commission, new Parliament
- <u>Confidence</u>: need to implement our rules

Five points:

1. Talking about EMU
2. The crisis
3. Analysing the current situation
4. What needs to be done to come to a stable EMU
5. **Next steps**

Juncker Plan

Connect policies

Policy coordination identifies challenges

Policy recommendation address challenges

Member States act accordingly

EU-budget finances

Create space for shock absorbtion

Member States reach MTO

Lower debt ratios = room for lower taxes

debt ratios reduced = room for lower taxes

automatic stabilisers can work

THE EUROPEAN REPUBLIC

IS UNDER CONSTRUCTION

Thank you for your attention

Thomas Westphal
Director General European Policy
German Federal Ministry of Finance
23th of February 2015

College of Europe, Bruges