Challenges and Opportunities of the Global Economy
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Problems & Progress in the Euro Zone

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The Euro Zone

• Implementation mistakes “enabled” the crisis
• Political structure poorly suited to crisis management
Comparisons
Mexico: budget balance (% of GDP)

Source: EIU, CountryData
Mexico: GDP growth (%)
Greece: budget balance (% of GDP)

Source: EIU, CountryData
Greece: GDP growth (%)
## Two currency areas

<table>
<thead>
<tr>
<th>Common?</th>
<th>US</th>
<th>EU</th>
</tr>
</thead>
<tbody>
<tr>
<td>Currency</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Deposit insurance</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Bank regulation</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Fiscal policy</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Political authority</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Language</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Olympic teams</td>
<td>Yes</td>
<td>No</td>
</tr>
</tbody>
</table>
Problems
Problem #1

- Lack of fiscal discipline
- Fiscal criteria abandoned early on
- Not credible anyway?
- Would a US-like system have worked better?
Problem #2

- Leaks in the payments system
- “IMF without conditionality”
Target2 balances

Net Balance with the Eurosystem / Target [bn €]
Problem #3

• National bank regulation and deposit insurance
• A recipe for cross-border bank runs
Problem #4

- Regulators gave all member debt zero risk weight
- Greek debt less risky than British debt!
- Obvious play: buy Greek debt, use as collateral for ECB loan
Problem #5

• No exit strategy
• Gives weak countries excessive leverage
• Why give Greece a gun?
• Is Ecuador a better model?
Problem #6

- Cumbersome political process for fiscal coordination
- Why do we care what Finland thinks?
- The OMT/EFSF/EMS Rube Goldberg machine is on its way
Rube Goldberg machine
Progress?
Problems – and progress

• Problems
  – Common currency is hard to do right
  – Governance is slow and cumbersome, esp fiscal actions
  – Clear cost in terms of performance (Mexico v. Greece)

• Still: remarkable progress along many fronts
  – Fiscal discipline catching on in most places
  – OMT/EFSF/EMS shows coordination isn’t impossible
  – Common bank regulation under discussion
  – Odds of success? What would success look like?
Open questions

• Will mismatch between common currency and national political authority emerge in other ways?
• Do members want integration or sovereignty?
Lessons for others

• Common currency has great symbolic value
• But hard to do right
• Also a huge distraction from bigger issues
• Like productivity
Let’s end on a positive note
Extra slides
Mexico: current account (% of GDP)

Source: EIU, CountryData
Greece: current account (% of GDP)

Source: EIU, CountryData
Government debt (% of GDP)

Source: EIU, CountryData.
Rube Goldberg machine

Fish an Olive Out of a Long-Necked Bottle