

**Challenges and Opportunities of the Global Economy**

**G20 Seminar, Mexico City, September 21, 2012**

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# **Problems & Progress in the Euro Zone**

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# The Euro Zone

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- Implementation mistakes “enabled” the crisis
- Political structure poorly suited to crisis management

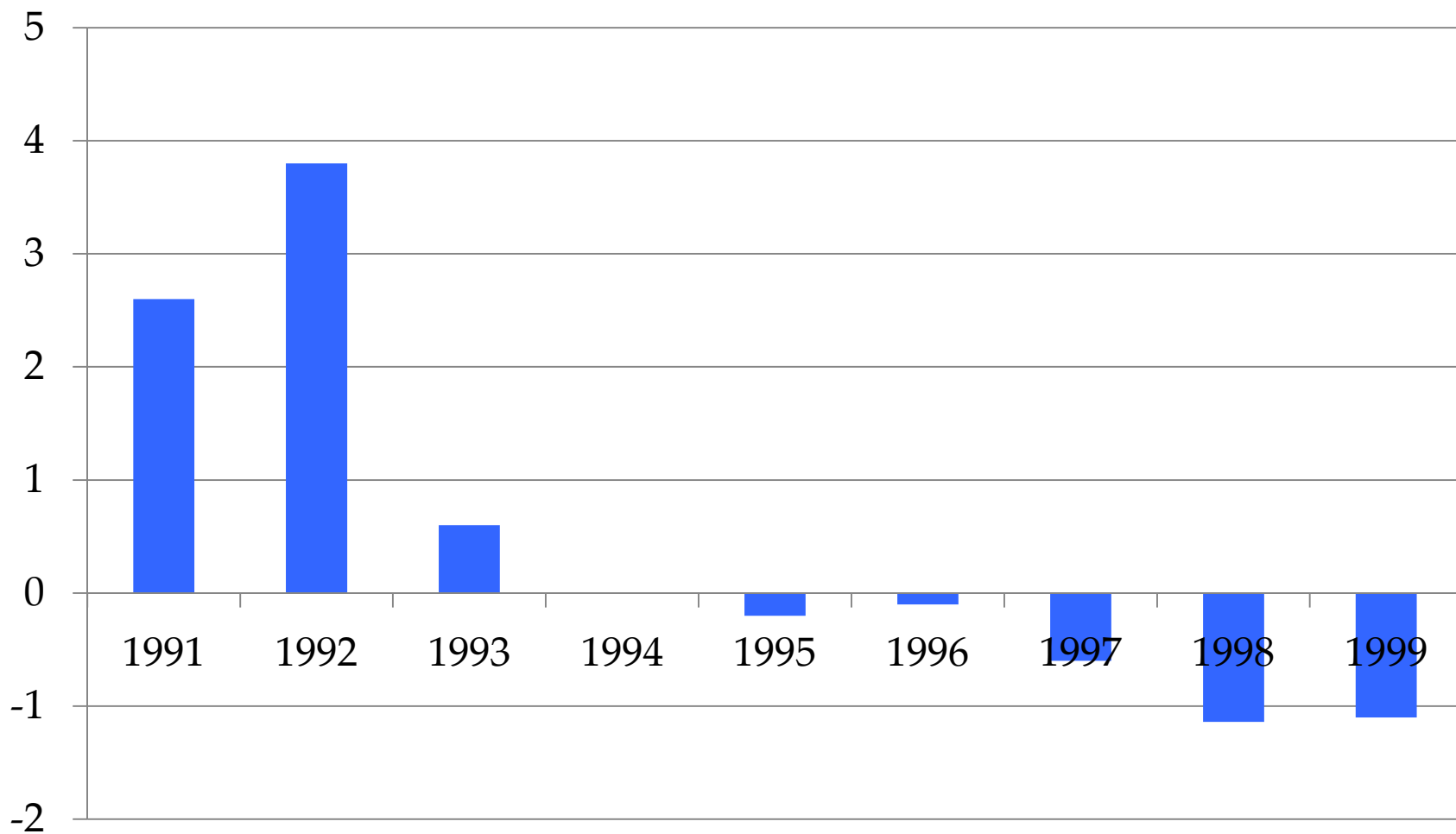
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# *Comparisons*

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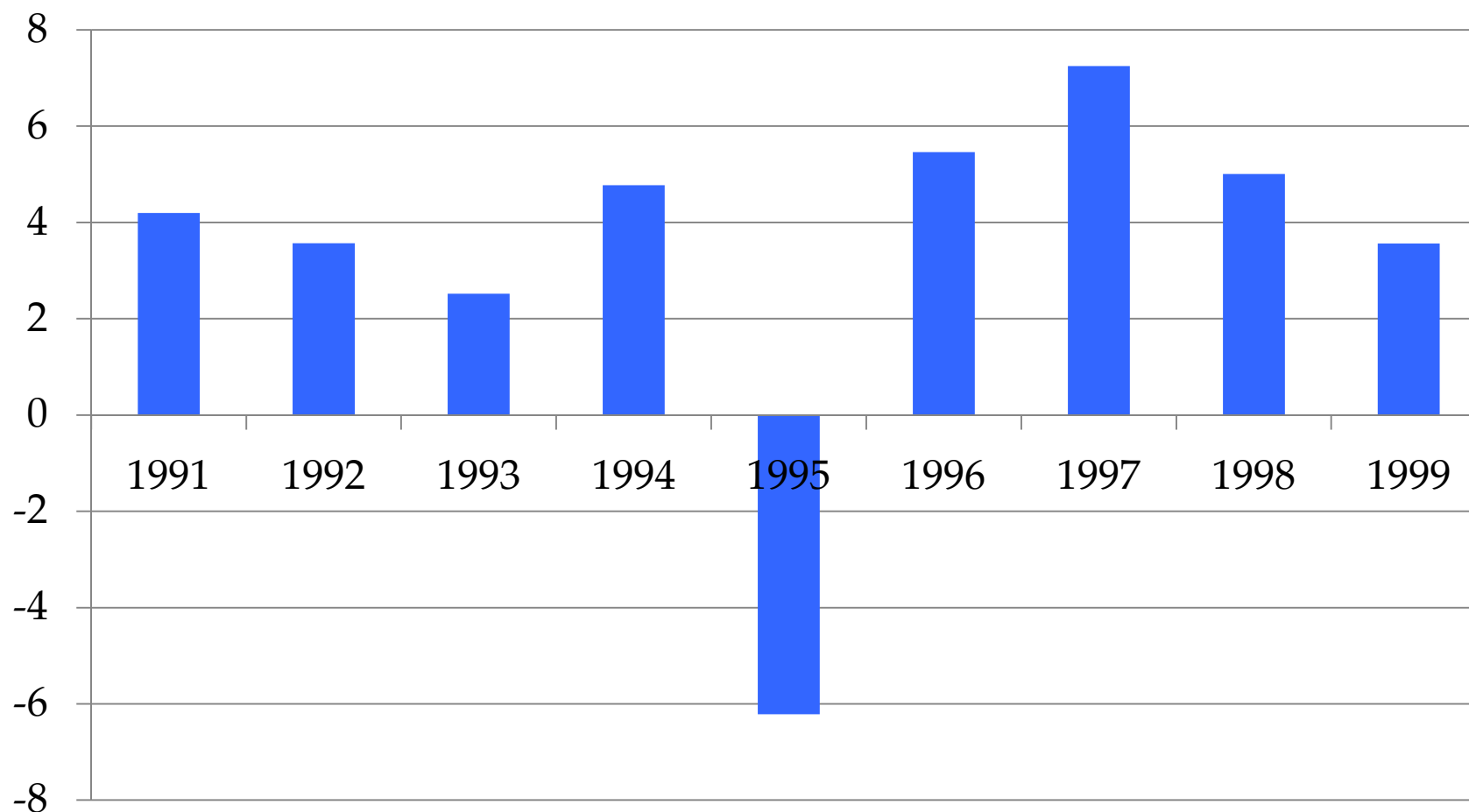
# Mexico: budget balance (% of GDP)

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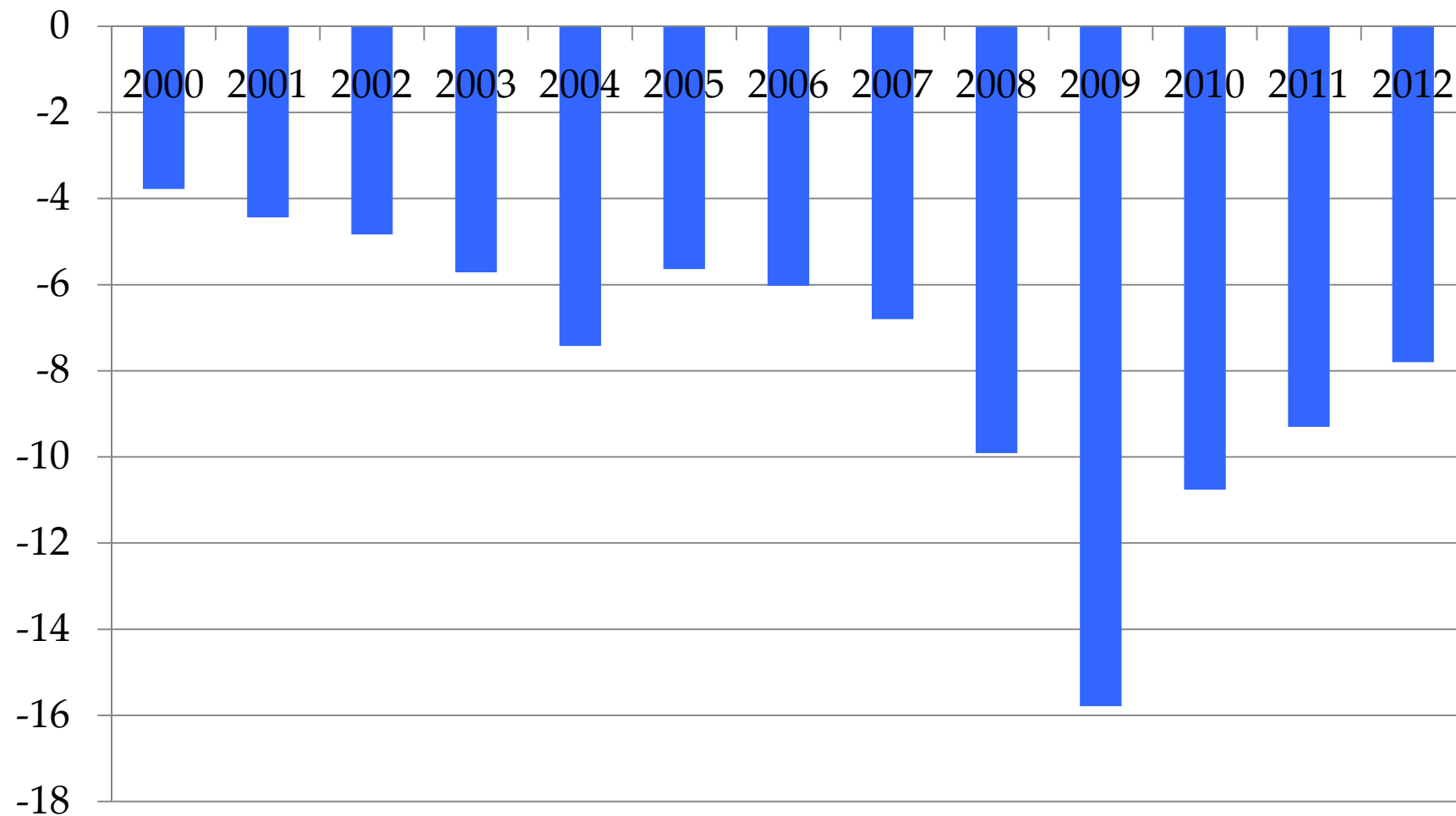
# Mexico: GDP growth (%)

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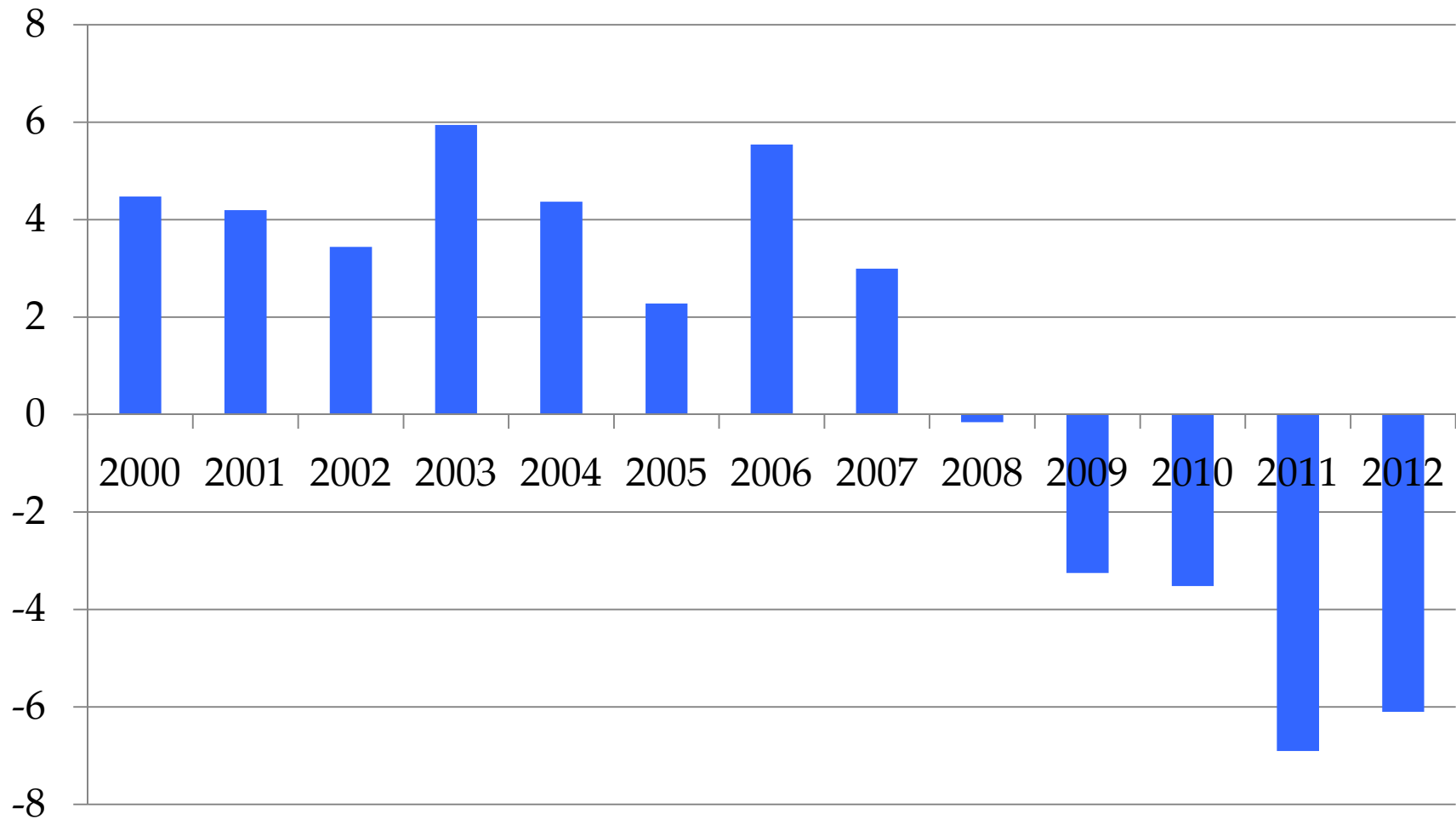
# Greece: budget balance (% of GDP)

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# Greece: GDP growth (%)

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# Two currency areas

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<b>Common?</b>	<b>US</b>	<b>EU</b>
Currency	Yes	Yes
Deposit insurance	Yes	No
Bank regulation	Yes	No
Fiscal policy	Yes	No
Political authority	Yes	No
Language	Yes	No
Olympic teams	Yes	No



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# *Problems*

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# Problem #1

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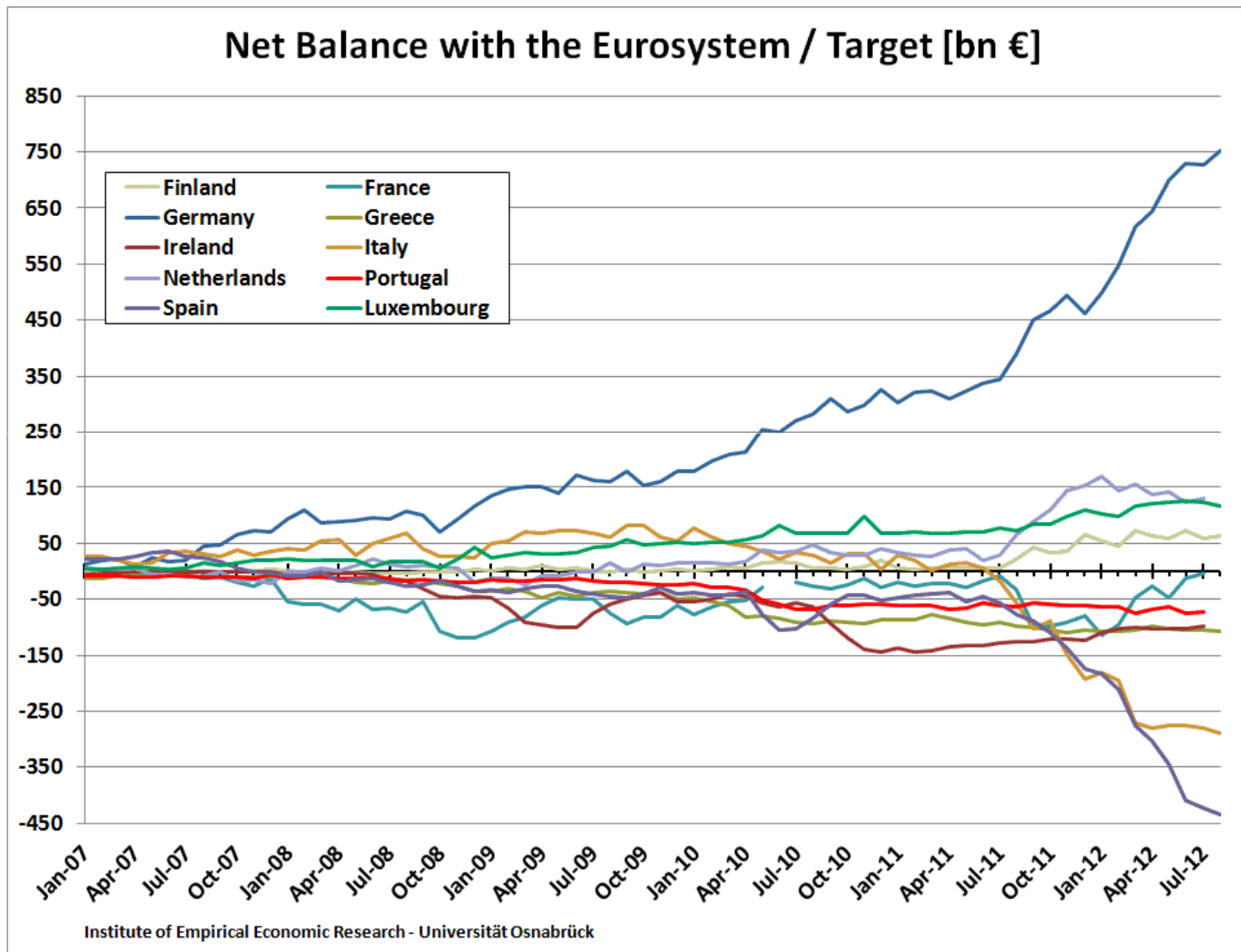
- **Lack of fiscal discipline**
- Fiscal criteria abandoned early on
- Not credible anyway?
- Would a US-like system have worked better?

# Problem #2

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

# Target2 balances



# Problem #3

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- **National bank regulation and deposit insurance**
- A recipe for cross-border bank runs

# Problem #4

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- 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

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- **No exit strategy**
- Gives weak countries excessive leverage
- Why give Greece a gun?
- Is Ecuador a better model?

# Problem #6

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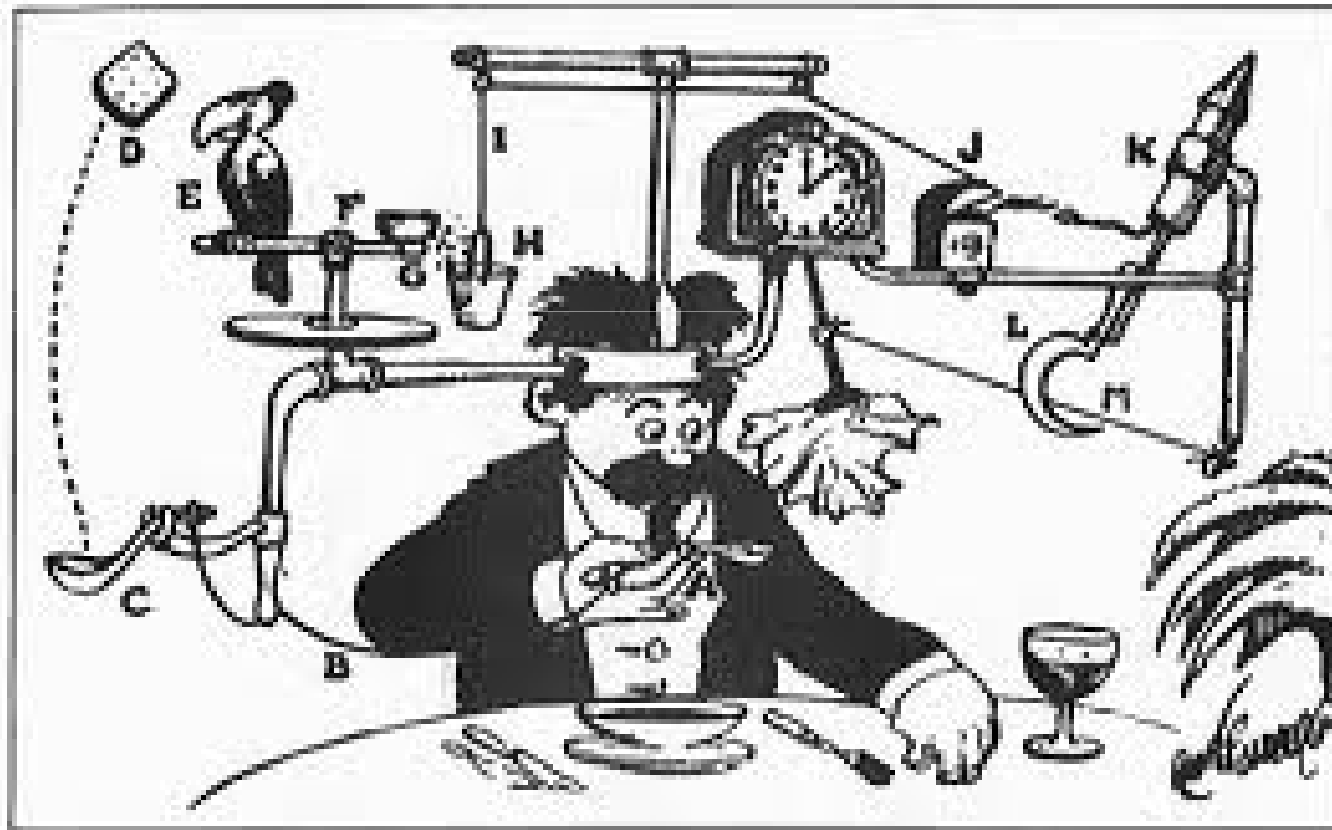
- **Cumbersome political process for fiscal coordination**
- Why do we care what Finland thinks?
- The OMT/EFSS/EMS Rube Goldberg machine is on its way



# Rube Goldberg machine

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Self-Operating Napkin



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*Progress?*

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# Problems – and progress

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- 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

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

# Lessons for others

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- 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

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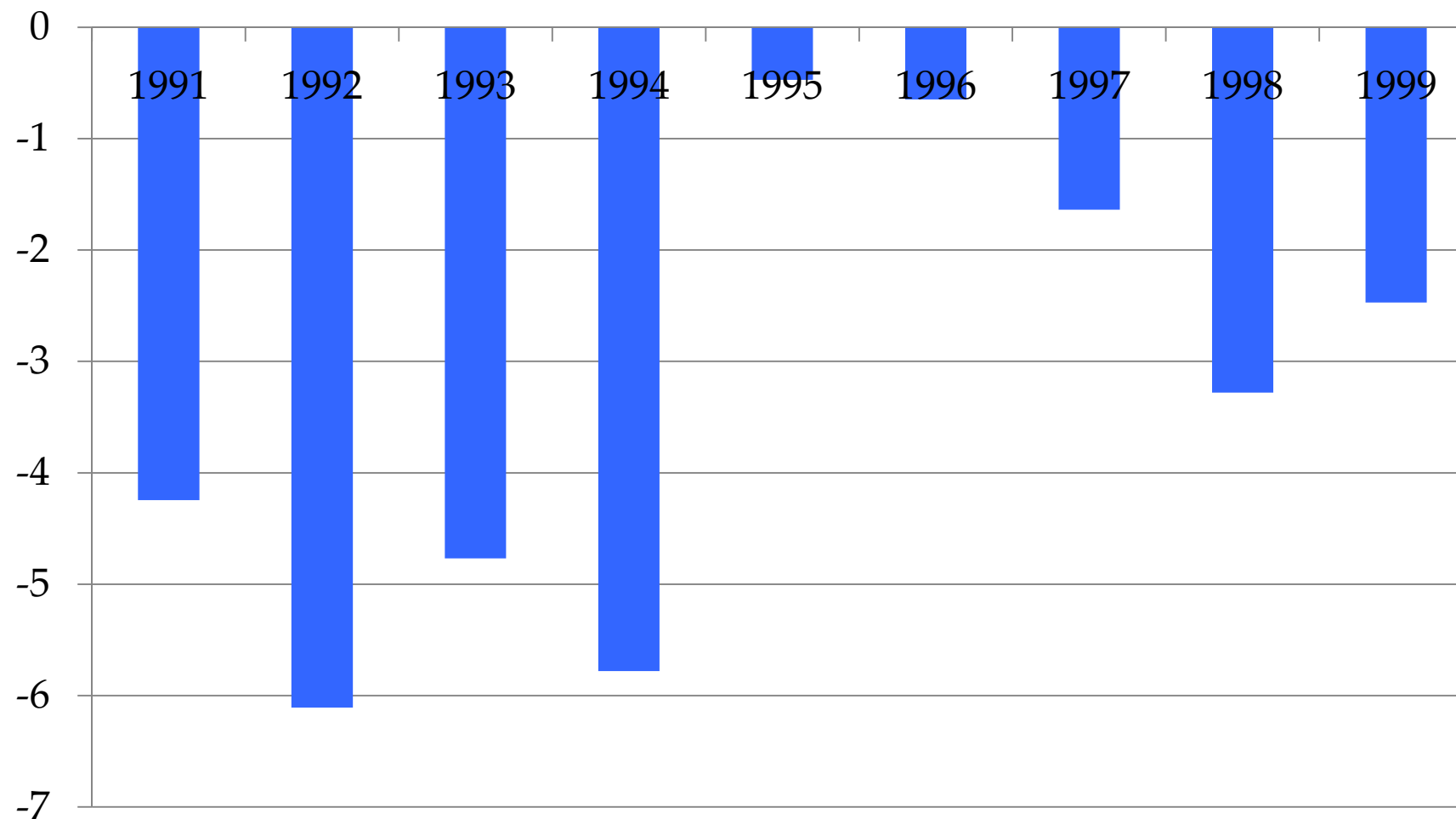
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*Extra slides*

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# Mexico: current account (% of GDP)

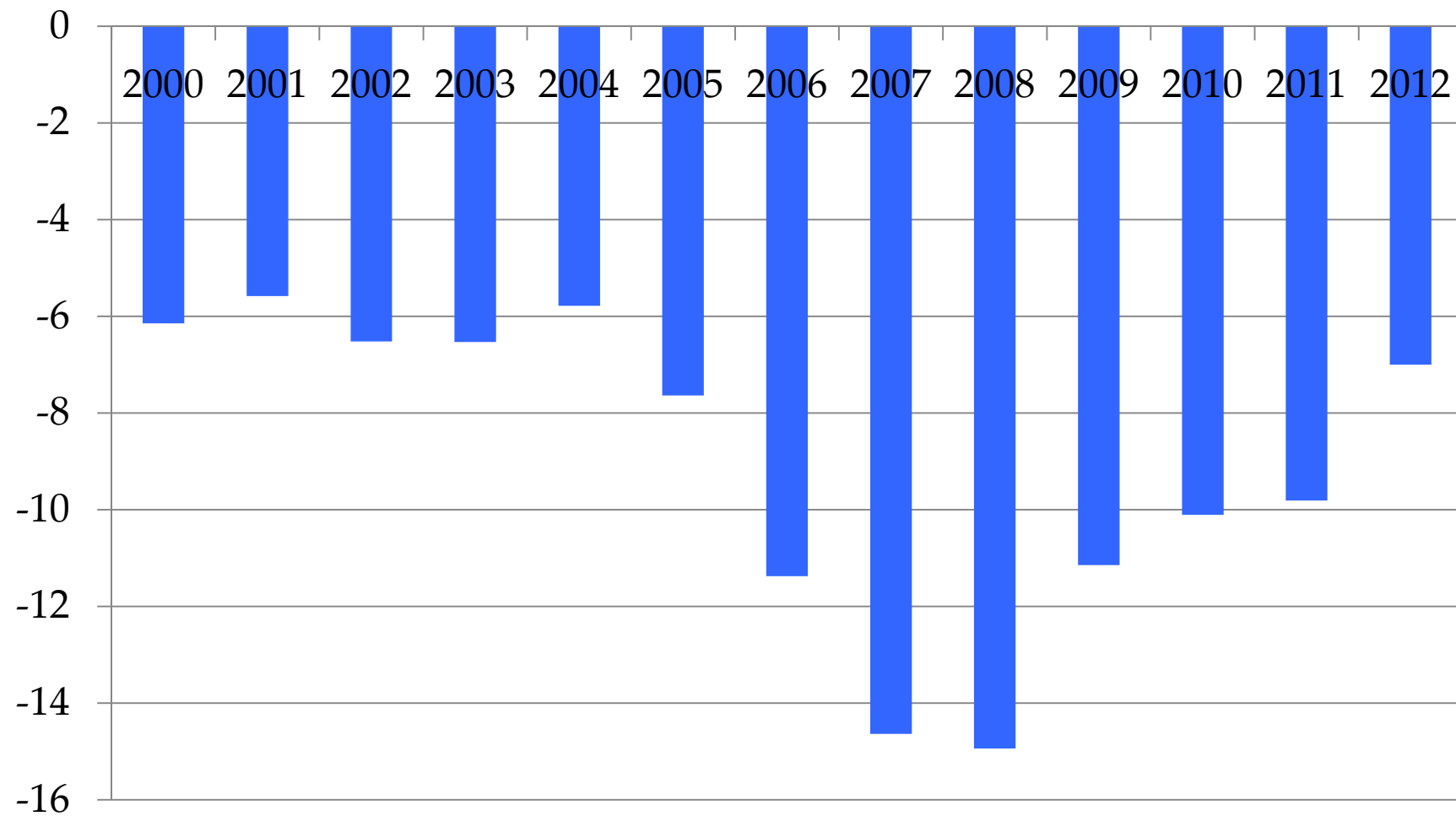
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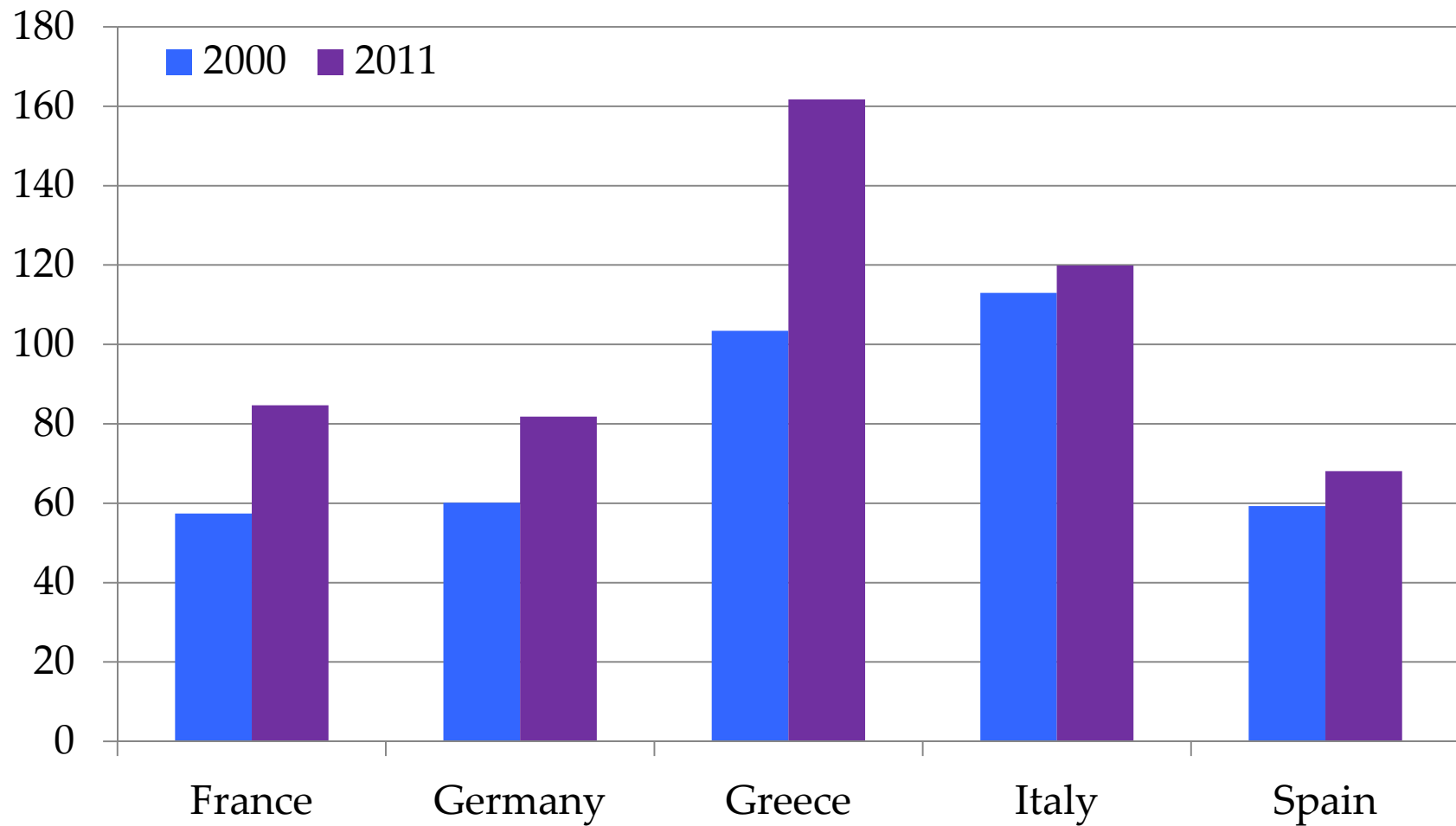
# Greece: current account (% of GDP)

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# Government debt (% of GDP)

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# Rube Goldberg machine

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Fish an Olive Out of a Long-Necked Bottle

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