

# The Challenges to the EUROpean Economy

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- What is the fiscal challenge?
- What is the monetary challenge?
- What is the institutional challenge?

- **What is the fiscal challenge?**
- What is the monetary challenge?
- What is the institutional challenge?

# SGP: what is the record?

YEARS WHEN A FISCAL MAASTRICHT CRITERIA WAS NOT ACCOMPLISHED BY EACH COUNTRY													
		2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	N Times
Finland	Deficit EDP	6,9	5,1	4,1	2,6	2,5	2,8	4,1	5,3	4,3	-2,5	-2,5	0
	Debt EDP	43,8	42,5	41,5	44,5	44,4	41,7	39,6	35,2	33,9	43,3	48,3	
Luxembourg	Deficit EDP	6,0	6,1	2,1	0,5	-1,1	0,0	1,4	3,7	3,0	-0,9	-1,1	0
	Debt EDP	6,2	6,3	6,3	6,1	6,3	6,1	6,7	6,7	13,7	14,8	19,1	
Spain	Deficit EDP	-0,9	-0,5	-0,2	-0,3	-0,1	1,3	2,4	1,9	-4,5	-11,2	-9,3	4
	Debt EDP	59,4	55,6	52,6	48,8	46,3	43,1	39,6	36,2	40,1	53,8	61,0	
Ireland	Deficit EDP	4,7	0,9	-0,4	0,4	1,4	1,7	2,9	0,1	-7,3	-14,2	-31,3	5
	Debt EDP	37,5	35,2	31,9	30,7	29,4	27,2	24,7	24,9	44,3	65,2	94,9	
Netherlands	Deficit EDP	2,0	-0,2	-2,1	-3,1	-1,7	-0,3	0,5	0,2	0,5	-5,6	-5,1	5
	Debt EDP	53,8	50,7	50,5	52,0	52,4	51,8	47,4	45,3	58,5	60,8	62,9	
Belgium	Deficit EDP	0,0	0,4	-0,1	-0,1	-0,3	-2,7	0,1	-0,3	-1,3	-5,8	-4,1	13
	Debt EDP	107,8	106,5	103,4	98,4	94,0	92,0	88,0	84,1	89,3	95,9	96,2	
Euro area	Deficit EDP	-0,1	-1,9	-2,6	-3,1	-2,9	-2,5	-1,3	-0,7	-2,1	-6,4	-6,2	14
	Debt EDP	69,2	68,1	67,9	69,1	69,5	70,1	68,5	66,3	70,1	79,8	85,4	
France	Deficit EDP	-1,5	-1,5	-3,1	-4,1	-3,6	-2,9	-2,3	-2,7	-3,3	-7,5	-7,1	14
	Debt EDP	57,3	56,9	58,8	62,9	64,9	66,4	63,7	64,2	68,2	79,0	82,3	
Austria	Deficit EDP	-1,7	0,0	-0,7	-1,5	-4,4	-1,7	-1,5	-0,9	-0,9	-4,1	-4,4	14
	Debt EDP	66,2	66,8	66,2	65,3	64,7	64,2	62,3	60,2	63,8	69,5	71,8	
Portugal	Deficit EDP	-2,9	-4,3	-2,9	-3,0	-3,4	-5,9	-4,1	-3,1	-3,6	-10,1	-9,8	14
	Debt EDP	48,5	51,2	53,8	55,9	57,6	62,8	63,9	68,3	71,6	83,0	93,3	
Germany	Deficit EDP	1,1	-3,1	-3,8	-4,2	-3,8	-3,3	-1,6	0,2	-0,1	-3,2	-4,3	17
	Debt EDP	60,2	59,1	60,7	64,4	66,3	68,6	68,1	65,2	66,7	74,4	83,2	
Italy	Deficit EDP	-0,8	-3,1	-3,1	-3,6	-3,5	-4,4	-3,4	-1,6	-2,7	-5,4	-4,6	19
	Debt EDP	108,5	108,2	105,1	103,9	103,4	105,4	106,1	103,1	105,8	115,5	118,4	
Greece	Deficit EDP	-3,7	-4,5	-4,8	-5,6	-7,5	-5,2	-5,7	-6,5	-9,8	-15,8	-10,6	22
	Debt EDP	103,4	103,7	101,7	97,4	98,6	100,0	106,1	107,4	113,0	129,3	144,9	

# Fiscal Consolidation: What is the challenge

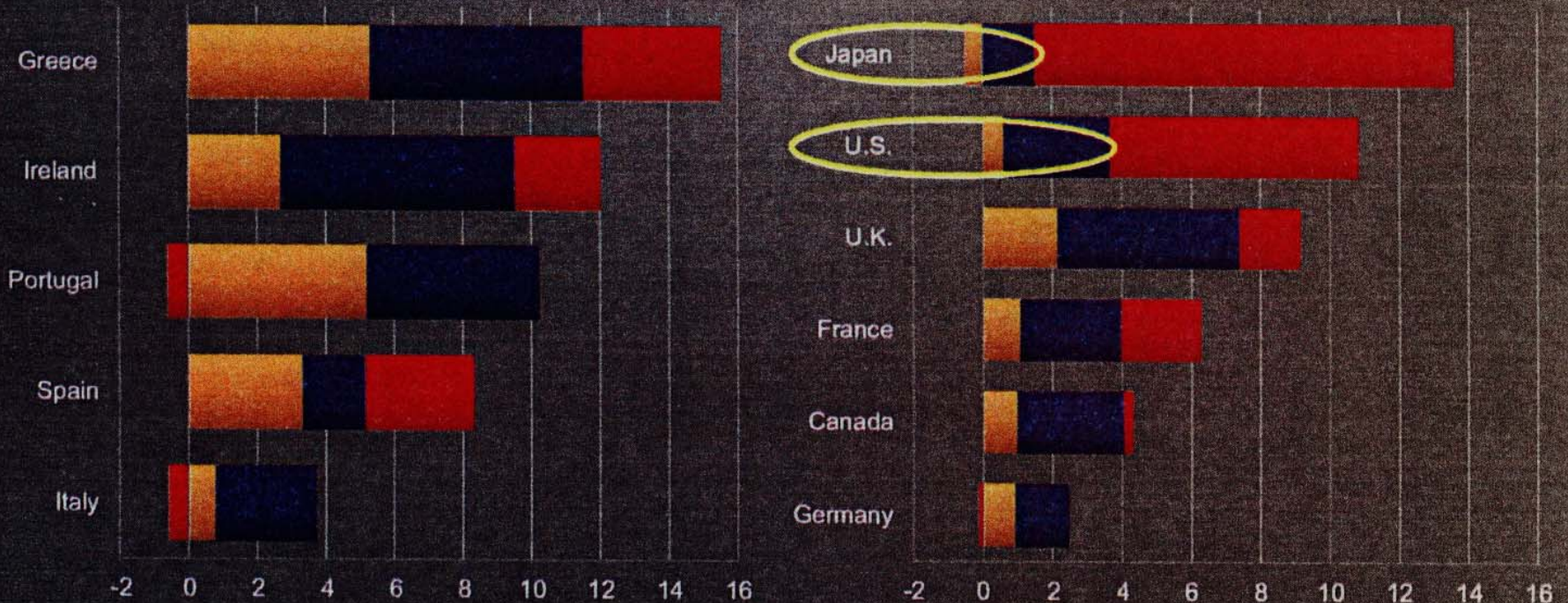
	GOVERNMENT BUDGET DEFICITS						Difference from September Forecast		
	2008	2009	2010	2011	2012	2013	2011	2012	2013
Euro Area	-2.2	-6.5	-6.3	-4.3	-3.4	-2.9	-0.1	-0.3	-0.4
France	-3.3	-7.6	-7.1	-5.7	-4.8	-4.4	0.1	-0.2	-0.5
Germany	-0.1	-3.2	-4.3	-1.1	-0.7	-0.1	0.6	0.4	0.7
Italy	-2.7	-5.3	-4.5	-3.9	-2.8	-2.3	0.2	-0.4	-1.1
Spain	-4.2	-11.2	-9.3	-8.0	-6.8	-6.3	-1.8	-1.7	-1.9
United States	-6.7	-13.0	-10.5	-9.5	-8.0	-6.4	0.1	-0.1	-0.2
Japan	-4.7	-10.8	-9.3	-10.1	-10.2	-8.8	0.2	-1.0	-1.0
United Kingdom	-4.9	-10.4	-9.9	-8.6	-7.8	-6.5	-0.1	-0.8	-1.4
Canada	0.1	-4.9	-5.6	-4.9	-4.4	-3.6	-0.6	-1.2	-1.7

# Fiscal Consolidation: Who is doing it?

## Fiscal Consolidation: Proceeding, But a Long Way to Go

### Change in Cyclically-Adjusted Primary Balances (percent of GDP)

■ Projected adjustment (2010-11)   
 ■ Projected adjustment (2011-15)   
 ■ Remaining adjustment until 2020 to achieve illustrative debt targets 1/



Source: IMF staff estimates.

1/ Total required adjustment to reduce the gross debt ratio to 60 percent by 2030 (net debt target of 80 percent for Japan). After 2020, the primary balance must be maintained constant at the prevailing level until 2030.

- What is the fiscal challenge?
- **What is the monetary challenge?**
- What is the institutional challenge?

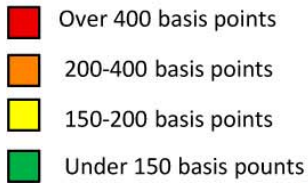
# Fiscal/Monetary Consolidation:

## What is the challenge

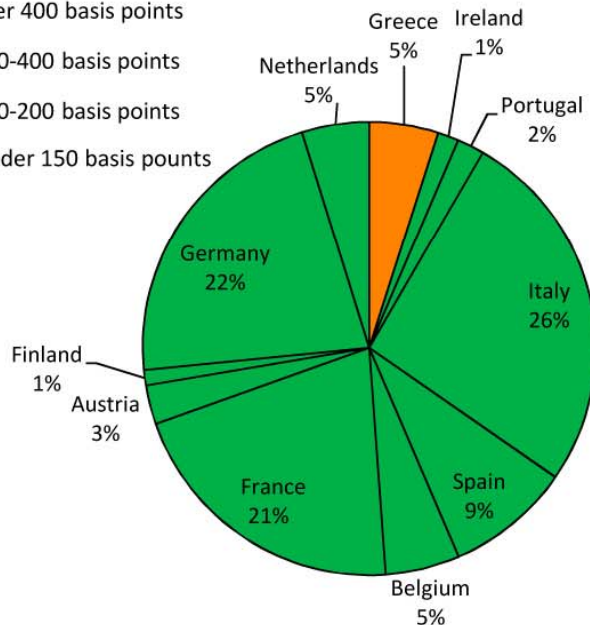
### Size of High-Spread Euro Area Government Bond Markets

(In percent of total euro-area government debt)

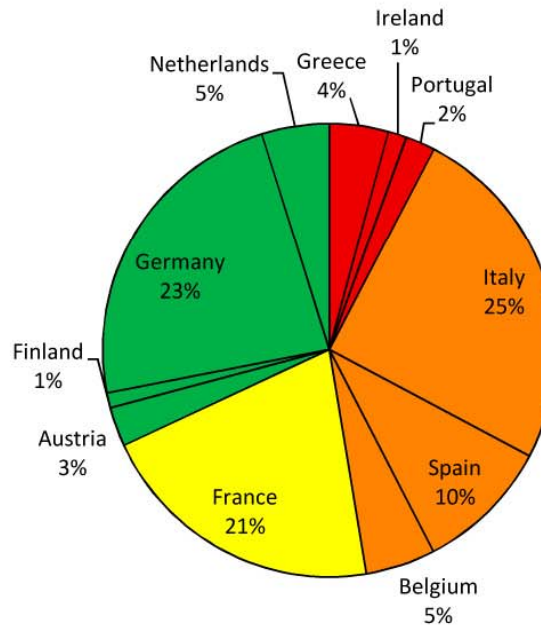
Sovereign CDS spreads:



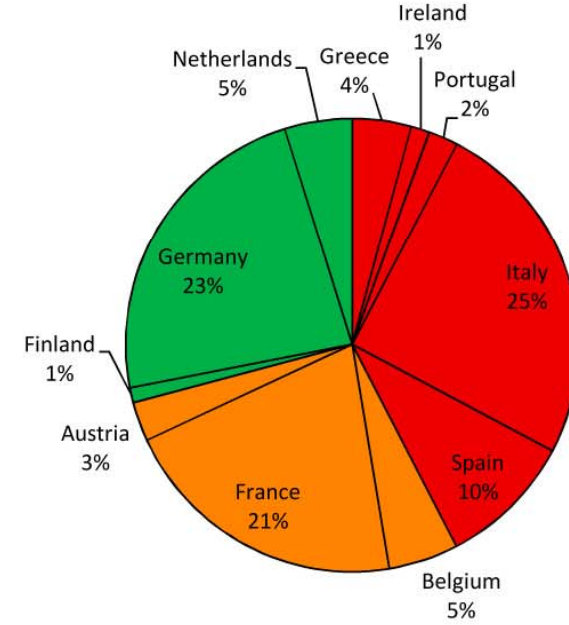
**Spreads as of April 2010**  
(Q1 2010 debt of €6.2 trillion)



**Spreads as of September 2011**  
(Q2 2011 debt of €6.9 trillion)



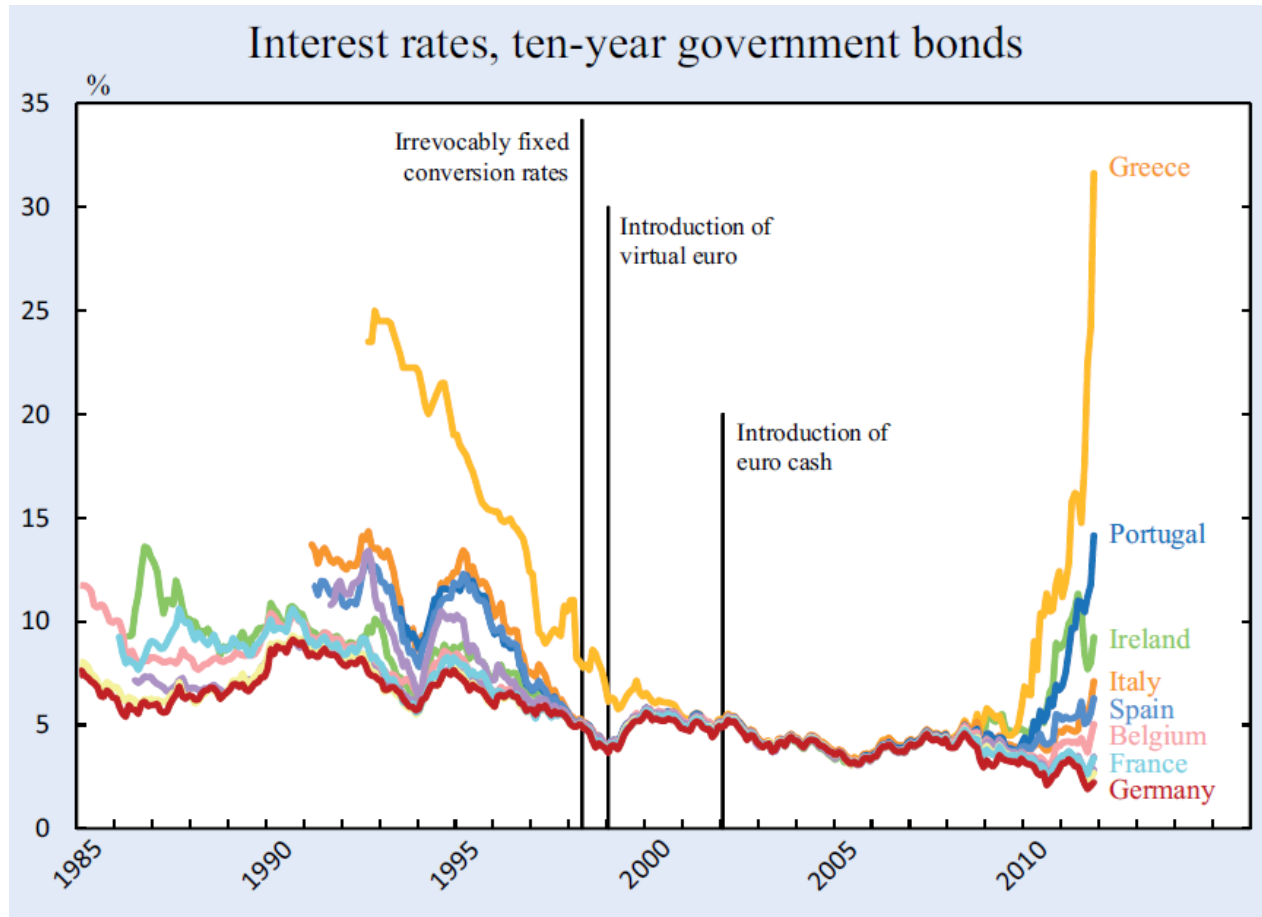
**Spreads as of January 2012**  
(Q2 2011 debt of €6.9 trillion)



Sources: Bank for International Settlements; Bloomberg L.P.; and IMF staff estimates.

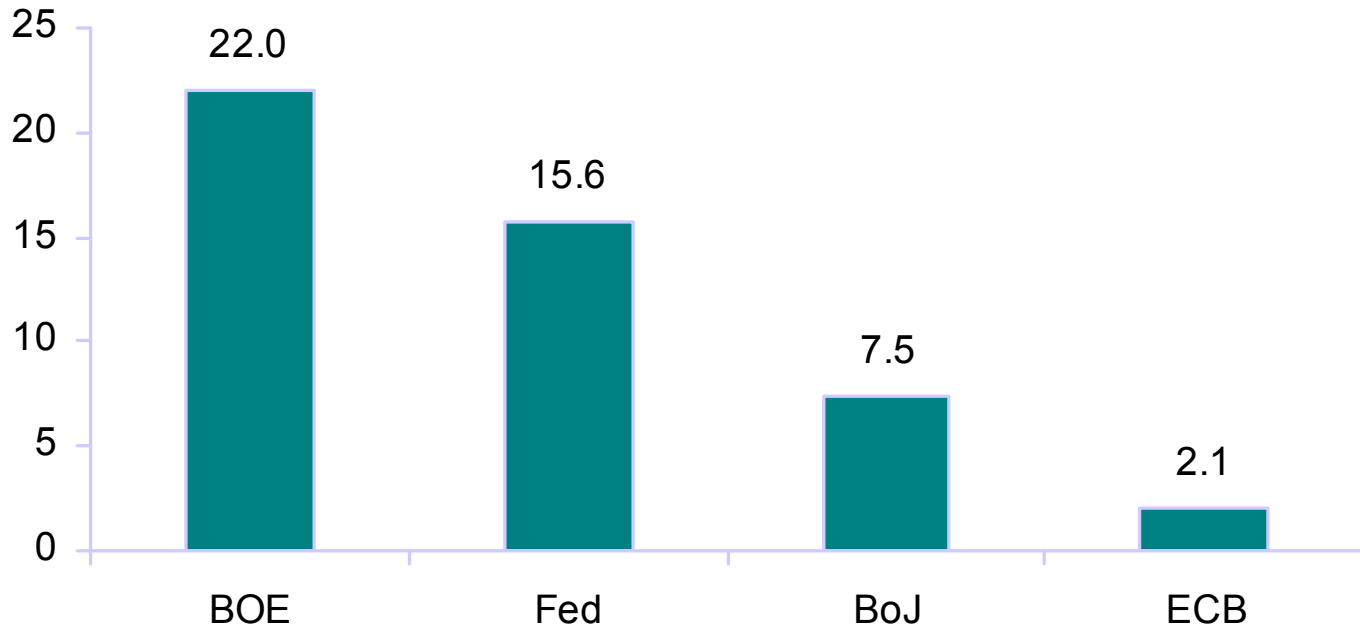


# Fiscal/Monetary Consolidation: What is the future?



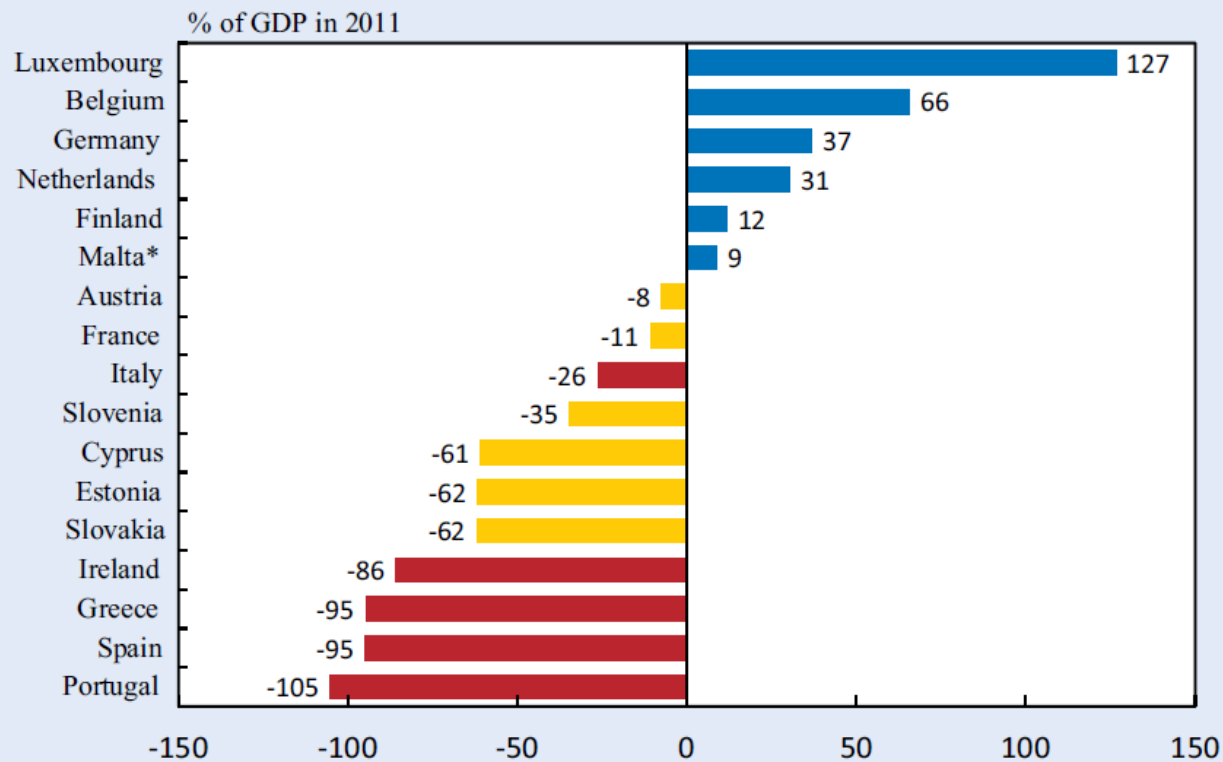
Source: EEAG(2012): *Report on the European Economy*, "The European Balance-of-Payments Problem", CESifo, Munich 2012, pp. 57-81.

**Central Bank holdings of own region's  
Government Bonds, Oct-2011  
(% of Total Public Debt)**



## Net foreign position relative to GDP

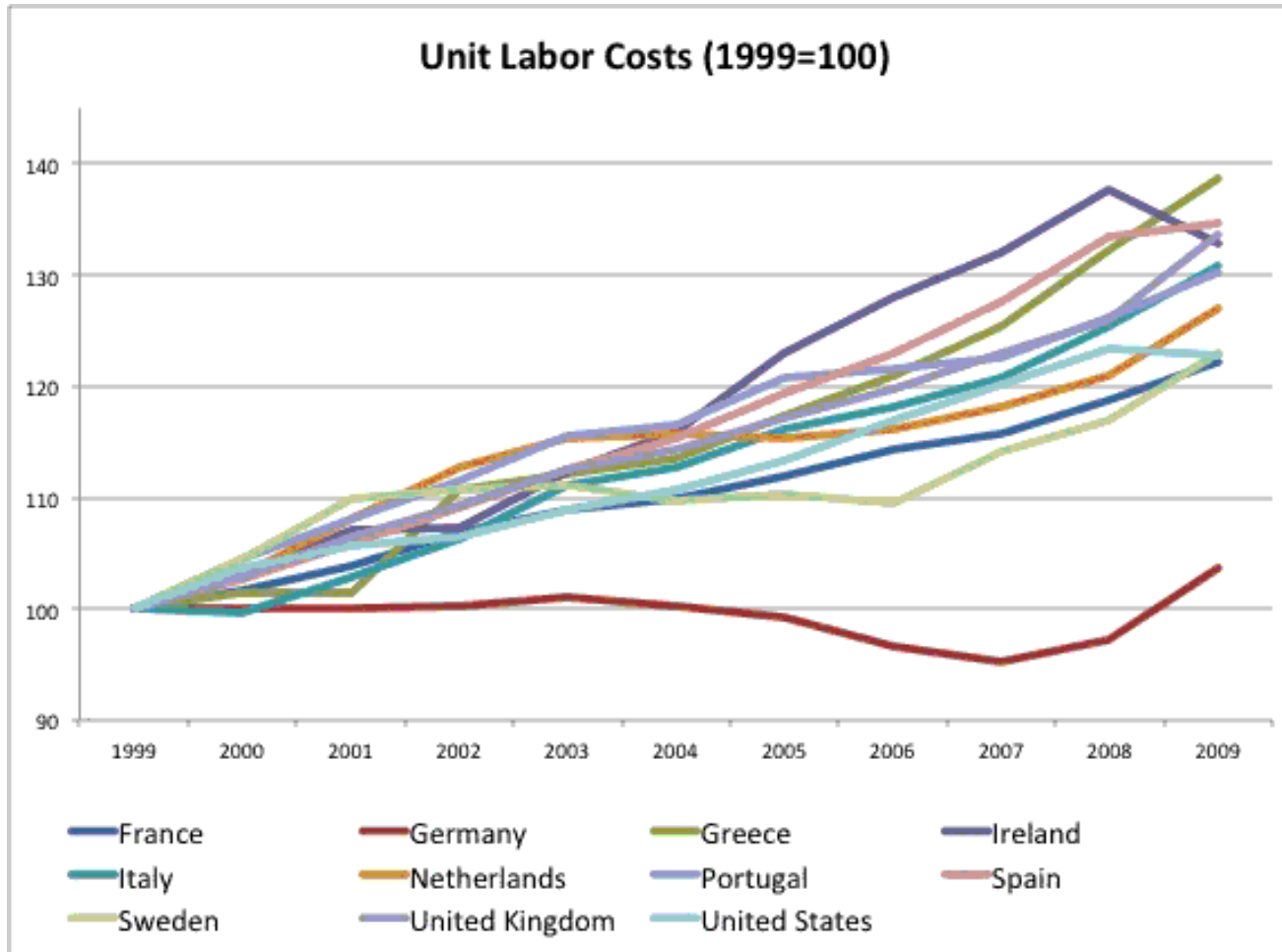
End of June 2011



\*End of December 2010.

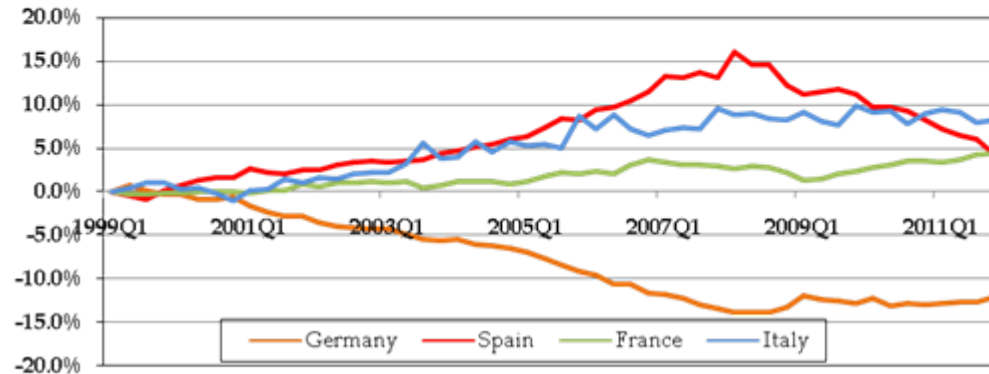
Source: Eurostat, Ifo Institute calculations.

# Growth & Competitiveness: Divergence or Convergence

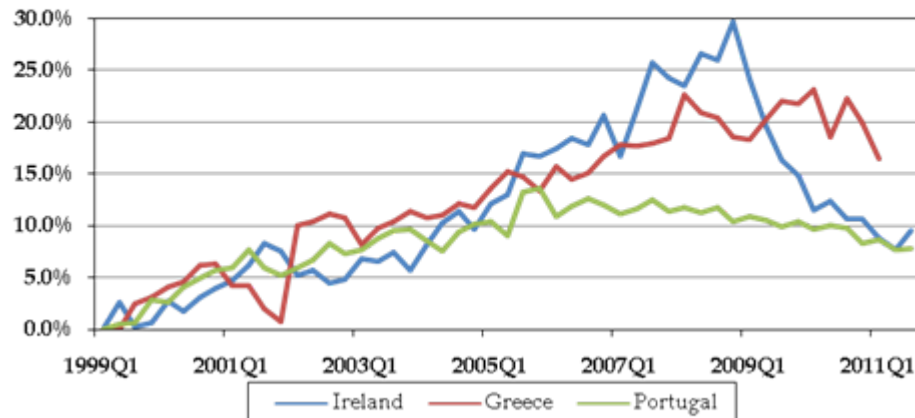


# Competitiveness: Who is Correcting?

UNIT LABOR COSTS IN THE EURO AREA  
(Big Countries)  
Percent deviation from Euro Area average



UNIT LABOR COSTS IN THE EURO AREA  
(Countries under program)  
Percent deviation from Euro Area average



- What is the fiscal challenge?
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- **What is the institutional challenge?**

# Institutional Challenge:

## Excess of activity – lack of action?

- **Emergency mechanisms:**
  - EFSF, EFSM, leveraging,
  - ESM
- **Enhanced governance:**
  - Six-pack: enhanced SGP (sanctions), european semester, macro imbalances (January 2011)
  - Europlus pact (march 2011)
  - Fiscal Compact (december 2011)

# Institutional Challenge:

## Excess of activity – lack of action?

- **Expected Measures:**
  - SMP vs. LTRO
  - Enhanced firewall: €1 trillion vs. EFSF/ESM
  - Financial Sector:
    - integrated supervision/resolution
    - Mutualization - EFSF
  - Fiscal Integration:
    - Euro...(bonds/bills/issuance)
    - Taxation vs fiscal transfers
  - Growth enhancing: S/R vs L/R



# Institutional Challenge

- Democratic legitimacy – national, supranational
- Decision making process – unanimity
- Economic legitimacy – taxation and expenditures
- Economic Integration:
  - Mutualization
  - Growth

# The Challenges to the EUROpean Economy

***THANK YOU!***