The Euro Area:
Emerging from the Crisis

Presentation by David Anderson
Executive Vice-President
Working in Support of Education, New York

Florida Student Orientation,
Miami-Florida European Union Center of Excellence
Florida International University
December 7th, 2010

www.euro-challenge.org

The current economic situation in the euro area

Describe the current season of the Miami Dolphins

Imagine you had to describe the current season of the Miami Dolphins

You can summarize their season by focusing on different *indicators*

- **Games won, lost, tied**
- **Total yards, rushing, passing**
- **Touchdowns, sacks, field goals**

These are all indicators

They help to explain the Dolphins' season

Will the Dolphins go to the Superbowl?

EUROPEAN UNION
DELEGATION TO THE USA

GDP growth: a key economic indicator

Gross Domestic Product measures everything produced by an economy (both goods and services)

Gross Domestic Product **(GDP) is the total value of all the goods (e.g. cars, iPods) and services (e.g. haircuts, insurance policies) produced by an economy**

GDP growth **tells you by how much GDP has increased compared to the last year (or last quarter)**

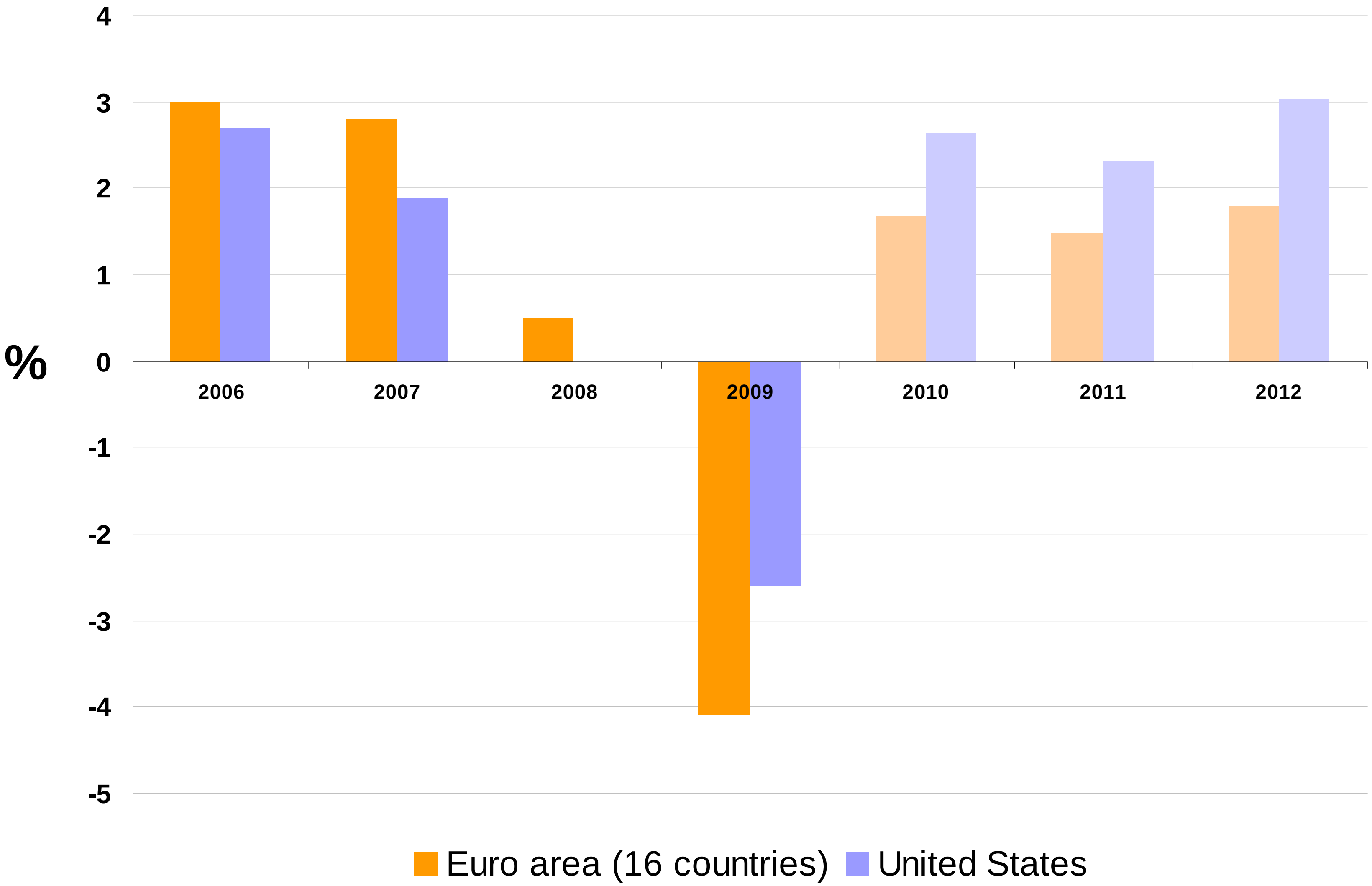
GDP growth is expressed as a *percentage*

When the economy is growing, GDP growth is a *positive number*

In a recession, GDP growth is *negative* (GDP shrinks)

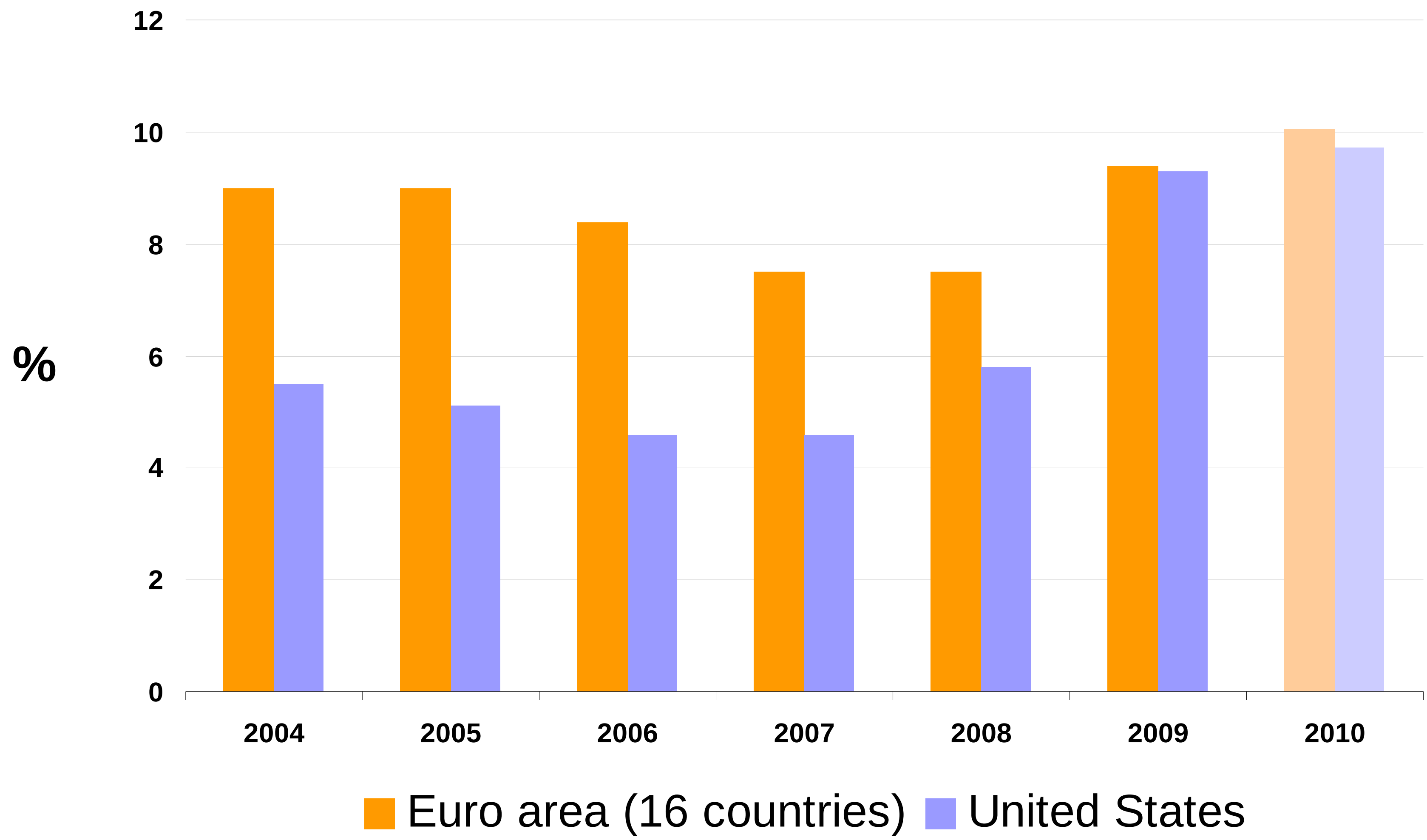
EUROPEAN UNION
DELEGATION TO THE USA

GDP growth: deep recession, fragile recovery



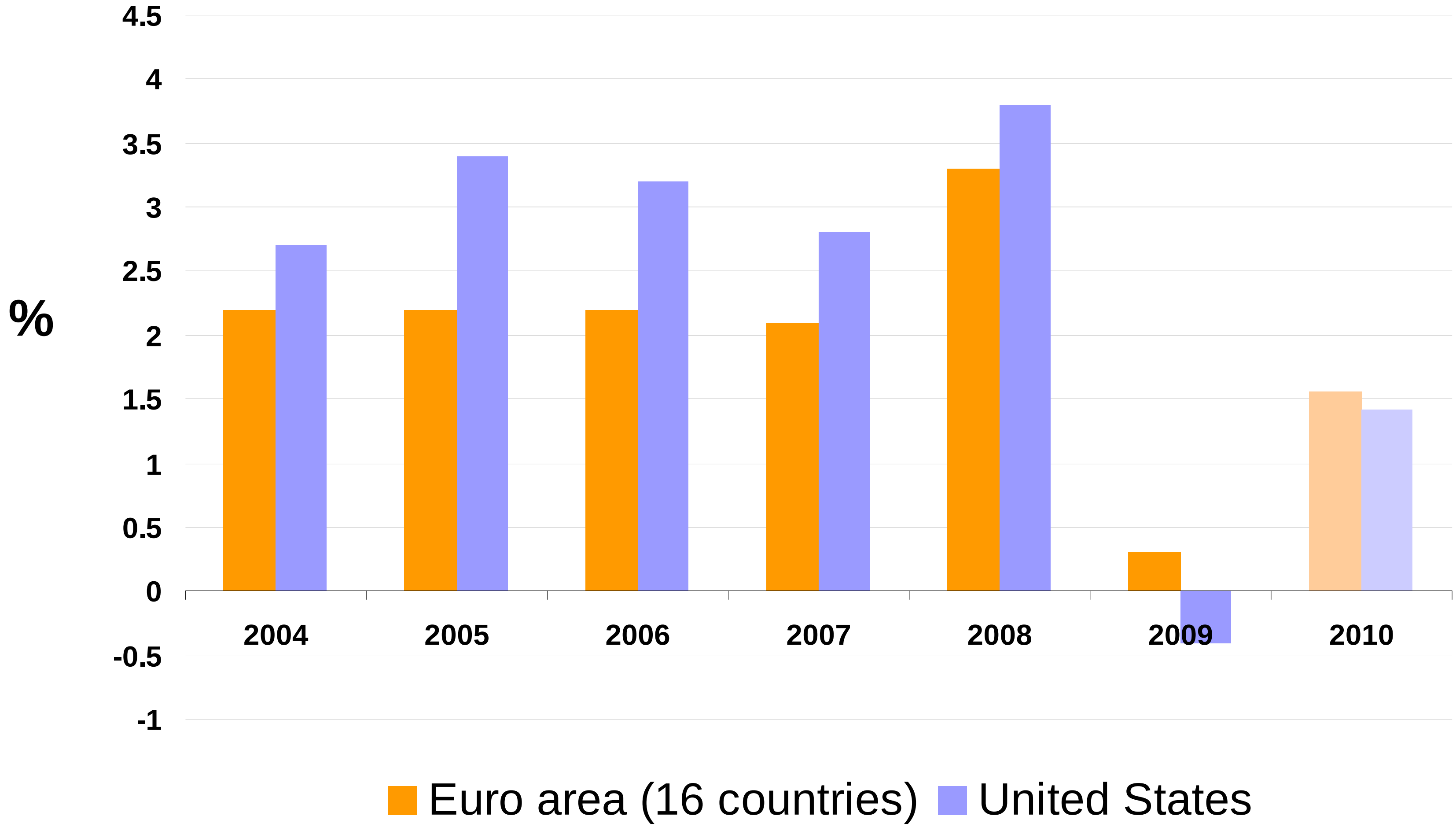
Source: OECD, IMF

Unemployment: stable, but still too high



Source: Eurostat, IMF

Inflation: if anything, too low?



Source: Eurostat, IMF

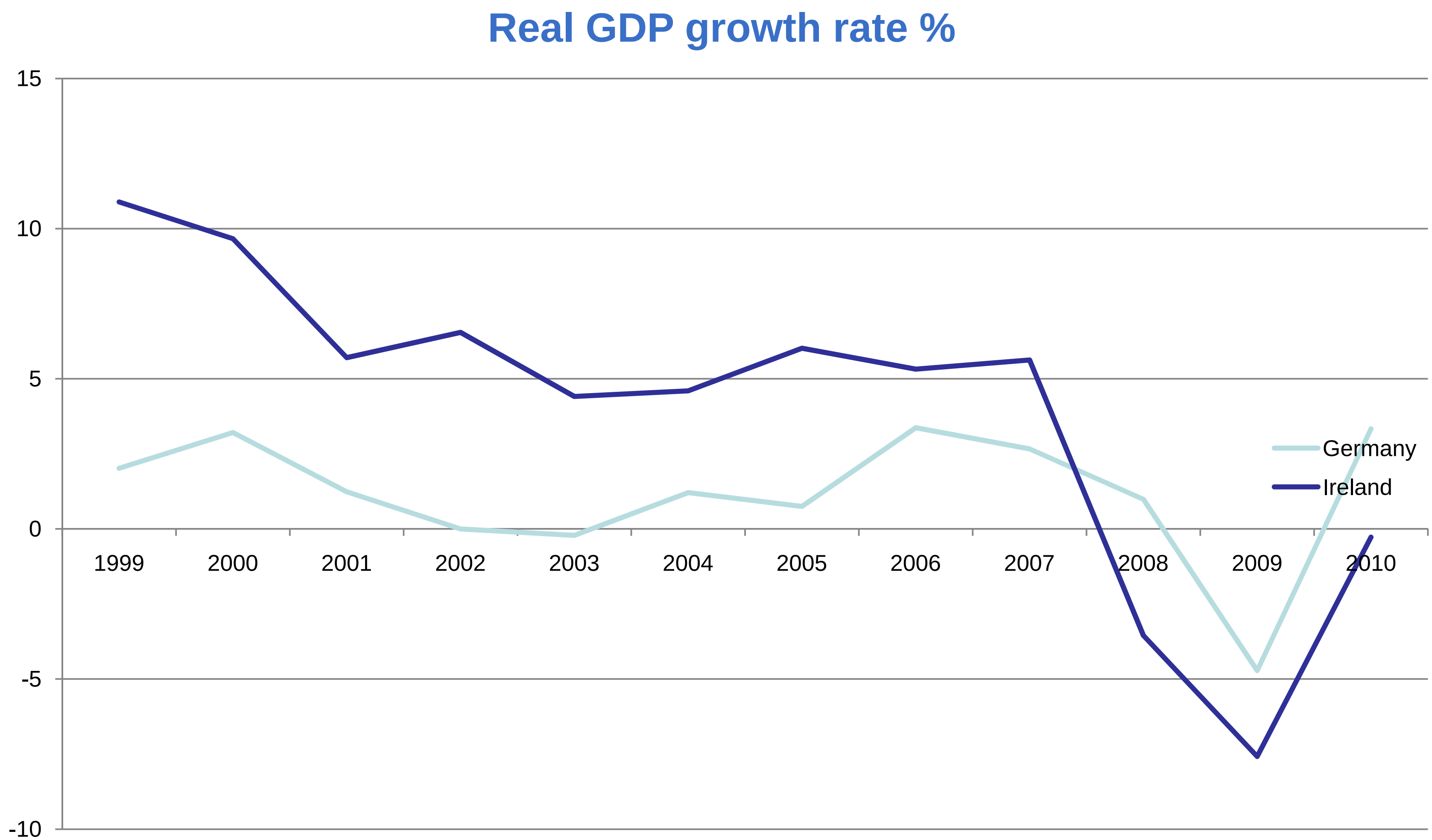
The European sovereign debt crisis

The euro area: core and periphery countries

Core countries:
Germany, France, Netherlands, Austria, etc.

Periphery countries:
Portugal, Ireland, Greece, Spain

Monetary policy: one size fits all



Source: IMF

The origins of the Greek crisis

Greece's euro membership marked by spending boom

Wages rise really fast

Low interest rates spur borrowing

Government finances badly managed

Problems with budget statistics

Over-generous pension, health systems

Greece and the EU rise to the challenge

May 2010: Greece adopts €110bn program supported by the EU and IMF

Program aims to shore up government budget and boost competitiveness

Key structural reforms being adopted (e.g. landmark pension reform)

Drastic cuts in government spending across all areas

Increases in taxes

Aims to solve debt crisis

The origins of the Irish crisis

Ireland experienced strong growth in recent decades

Transformation from agricultural economy to “Celtic Tiger”

Strong presence of multinational companies, skilled workforce

But reckless lending by banks to commercial property developers

Bad debt of banks causes problems for whole economy

Deep recession – 14% unemployment

EUROPEAN UNION
DELEGATION TO THE USA

Ireland and the EU rise to the challenge

Government already taking drastic measures over last several years

November 2010: Ireland adopts €85bn program supported by the EU and IMF

Program aims to cut budget deficit and repair the damage caused by the banking crisis

Fixing problems in banking sector

Drastic cuts in public expenditure across all levels of government

EUROPEAN UNION
DELEGATION TO THE USA

The great debate: will the euro survive?

EUROPEAN UNION
DELEGATION TO THE USA

The euro-skeptic view: euro break-up inevitable?

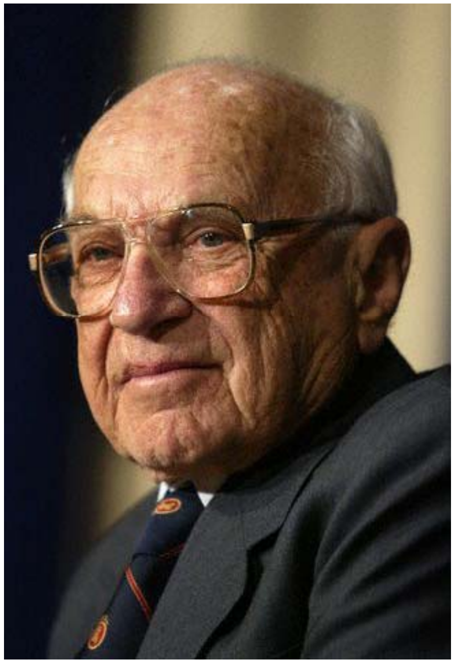
Doomed from the start?

European countries too different?

Public debt levels are not sustainable?

Austerity measures are too severe?

Leaving the euro would help?



"The euro will not survive the first major European recession."

Professor Milton Friedman, 1912-2006

EUROPEAN UNION
DELEGATION TO THE USA

The case for the euro

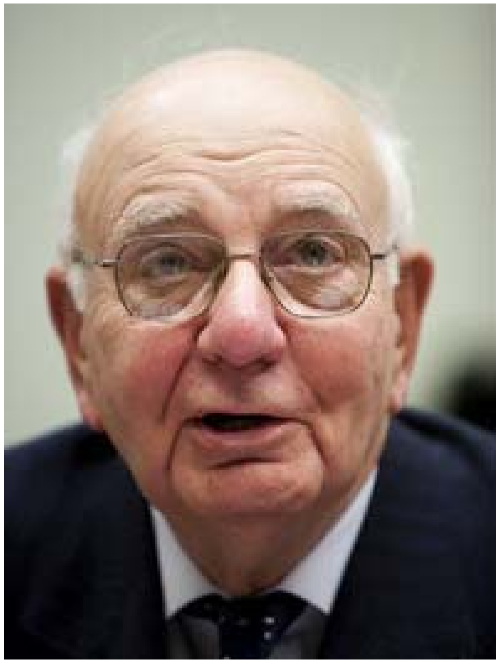
EMU will evolve (US monetary union also did so)

Political commitment of leaders to defend the euro

Governance of euro area will be strengthened

More sustainable public finances will help countries

Leaving the euro would involve huge costs, make it harder for countries to borrow



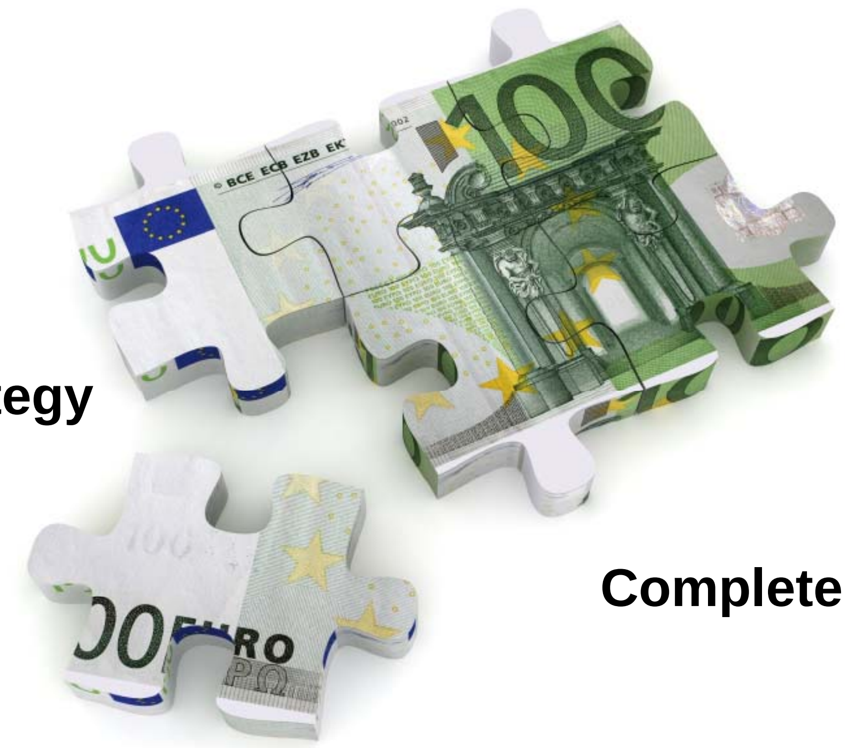
"If you didn't have that common currency in Europe, they would have bigger problems than they have now."

Paul Volcker, former Federal Reserve Chairman

Completing the Economic and Monetary Union

Make more effective fiscal rules

Bring down debt and deficit levels



Boost growth: 'Europe 2020' strategy

Complete the Single Market

Increase competition

Europe 2020: smart, sustainable, balanced growth

- Economic reform program developed at EU level
- Each country adopts own measures
- Aims to spur more knowledge-intensive, innovation-based growth
- Raise employment rate to 75%
- R&D spending should be 3%
- Prepare for longer-term challenges: aging, globalization
- An agenda for growth and jobs

The crisis and the challenges

High debt and deficits

- Deficit and debt levels rose sharply due to the crisis
- But already too high in several countries
- Countries now facing much higher borrowing costs
- Greece and Ireland forced to seek assistance
- Too high a debt level reduces economic growth

Aging Population

- There are currently four people of **working age** for every retired person
- By 2050 there will be only two people of working age for every retired person
- As populations age, economic growth slows, tax revenue falls (fewer workers)
- Increased 'age-related' spending on healthcare, pensions
- Crisis makes it even more urgent to have low debt levels

Sustaining the Social Welfare System

Europe’s Next Top Model: Who Will You Vote For?

Scandinavian: high employment, low inequality

Rhineland: low employment, low inequality

English-speaking: high employment, high inequality

Mediterranean: low employment, high inequality

high

unemployment benefits

low

employment protection

weak

strong

Productivity – a measure of how much each worker produces

Marie-Claude

- Marie-Claude designed 5 web sites
- Karl-Heinz designed 8 web sites
- Who is more productive?

Karl-Heinz

Productivity – a measure of how much each worker produces

Marie-Claude

Karl-Heinz

- Marie-Claude designed 5 web sites
- Karl-Heinz designed 8 web sites
- Who is more productive?

- Marie-Claude worked 200 hours
- Karl-Heinz worked 400 hours
- Now who is more productive?

Web sites designed per hour: Marie-Claude: 0.025
Karl Heinz: 0.020

➔ **Marie-Claude has a higher hourly productivity than Karl-Heinz**

Slow growth

Sluggish growth due to:

- Higher unemployment
- Poor productivity
- Structural problems

Boost growth by:

- Stimulating competition?
- Fostering innovation?
- Education and training?