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Brookings Survey on Eurozone Progress:

A presentation

Since 2010, developments in the Eurozone have invariably been described as a "crisis". Public opinion, as well as most journalists, follow wild cycles of optimism and pessimism driven by last-chance summits, market reactions, street demonstrations, and other dramatic developments, with the assumption that the main question is whether and when the currency union will unravel. What they miss, however, is the other important part of the story: how European leaders, at the same time as they are battling difficult economic conditions (or, to use a metaphor, "putting out the fire in the house"), are painfully building more solid foundations for the Eurozone to make it a viable currency union (or "remodeling the house"). In other words, while the Eurozone crisis is about destruction, its other side is about construction, or the completion of a construction started in the 1990s – at a time when there was no crisis and little market pressure, hence insufficient incentive for member states to make the painful reforms and sharing of sovereignty required to build a functioning, sustainable currency union.

It is that part of the story that the Brookings Survey on Eurozone Progress, meant to be updated quarterly, is tracking. While it is quite possible that an accident will precipitate the collapse of the Eurozone, the objective of this survey is to offer the best estimate, by Brookings scholars, of the progress made by European leaders in building a more solid and resilient currency union, sometimes dubbed "Eurozone 2.0" or "EMU 2.0" (for Economic and Monetary Union). There are of course several challenges in doing so, first and foremost the definition of "Eurozone 2.0". Various experts and European government officials have very different explanations for the origins of the crisis, so it is not surprising that they also have very different recommendations about the ultimate shape of the revamped Eurozone.

In order to reach a minimal consensus on what a sustainable Eurozone would look like -- what broad attributes it needs to acquire -- we draw from several sources: the existing economic and political science literature, the diagnostics and plans put forward by experts and policy-makers, and the aspirations of markets and investors. In our eyes, the goal for the Eurozone must be to reach a point where the adjustment mechanisms within the monetary union are sufficient to handle periods of extreme stress, such as the current period. The balance can be achieved by minimizing the sources of stress, which usually relate to differences between the national economies, or by maximizing the ability to adjust to the stresses, or a combination.

Serious imbalances can manifest as debt problems, unsustainable current account imbalances, excessively high or low inflation, severe unemployment, or indicators of future performance such as the

rate of new business formation or productivity trends. Financial crises can also be an important indicator, but principally matter because of their effects on the real economy, which should manifest in the broader indicators. These economic problems can then create serious political turmoil.

There are multiple configurations of political, economic, and financial arrangements that would theoretically produce a sustainable system for adjustments to compensate for stresses. In other words, there are many possible roads to Eurozone 2.0. At one extreme for example, there would be the fabled United States of Europe. But we are open to giving credit to a move towards any truly sustainable system, and it is very likely that the *sui generis* nature of the Eurozone will persist in the future. However, we also take the view that the answer will need to include certain features and exclude others, often for long-term political reasons. For instance, a Europe that closely resembles the United States politically is infeasible in the next decade or two. On the other hand, we deem a banking union to be necessary, probably in fairly strong form.

Thus, based on a consensus of Brookings experts, we have drawn a list of 6 broad objectives where progress is needed in the coming years if the Eurozone is to become self-sustaining and resilient: 1. creating a political union, 2. creating a fiscal union, 3. creating a banking union, 4. enhancing the role of the ECB in ensuring liquidity and market access, 5. creating sovereign crisis resolution tools, 6. improving competitiveness and economic adjustment.

We asked 14 Brookings experts, both resident and non-resident scholars from three different departments (Foreign Policy, Economic Studies, Global Economy and Development), to give us their best assessment of the degree of progress made by European leaders in reaching these six objectives. Some scholars have given their estimate for all six objectives, while others have focused on one or several objectives only, depending on their areas of expertise. All have also offered a few sentences to explain their judgment: their commentaries are accessible online. It should also be noted that the Brookings Survey is not a report card for any official exercise currently under way, like the road map being written by the "Group of Four" (the four presidents of European institutions: Herman von Rompuy, Jose Manuel Barroso, Mario Draghi and Jean-Claude Juncker) to define the next steps of European integration, or the objectives set by the European summit of June 29, 2012, laying out the general shape of the banking union to be constructed. Indeed, even if the objectives of that summit are fulfilled, it does not necessarily follow that Brookings scholars will consider the objective of a sufficiently robust banking union to have been satisfied.

We offer the result as a range of expert opinions, with all the necessary caveats, presented in a visually engaging format. "Progress" on several of the objectives is obviously difficult to quantify and hard to put on the same scale as the others, and it is often hard to determine what the "right" or "sufficient" level of progress is, especially as there are multiple stable configurations. We have nonetheless decided to ask scholars to put a judgmental value on the approximate level of progress in each objective, as well as a composite evaluation of "overall progress", while warning the user about the fragility of this judgment and of the conception of the survey as a whole.

The scholars

1	Carlo	Bastasin	Visiting Fellow, Center on the US and Europe, Foreign Policy and Global Economy and Development	Assessing objectives 1 to 6
2	Douglas	Elliott	Fellow, Initiative on Business and Public Policy, Economic Studies	Assessing objectives 1 to 6
3	Donald	Kohn	Senior Fellow, Economic Studies	Assessing objectives 1 to 6
4	Domenico	Lombardi	Senior Fellow, Global Economy and Development	Assessing objectives 1 to 6
5	Cesare	Merlini	Nonresident Senior Fellow, Center on the US and Europe, Foreign Policy	Assessing objectives 1, 2 , and 4 to 6
6	Jacques	Mistral	Nonresident Senior Fellow, Global Economy and Development	Assessing objectives 1 to 6
7	Andrew	Moravcsik	Nonresident Senior Fellow, Center on the US and Europe, Foreign Policy	Assessing objectives 1 to 6
8	Theodore	Pelagidis	Nonresident Senior Fellow, Global Economy and Development	Assessing objectives 1 to 6
9	Eswar	Prasad	Senior Fellow, Global Economy and Development	Assessing objectives 1 to 6
10	Javier	Solana	Distinguished Fellow, Foreign Policy	Assessing objectives 2 to 3
11	Daniel	Speckhard	Nonresident Senior Fellow, Center on the US and Europe, Foreign Policy	Assessing objectives 1 to 6
12	Ernesto	Talvi	Director, Latin America Initiative, Foreign Policy	Assessing objectives 2 to 4
13	Justin	Vaïsse	Senior Fellow, Center on the US and Europe, Foreign Policy	Assessing objectives 1 to 6
14	Thomas	Wright	Fellow, Managing Global Order, Foreign Policy	Assessing objectives 1 to 6

Brookings Survey on Eurozone Progress: Objectives and questions to scholars

Note on the scale: The scale goes from 0 to 100%.

- 0% represents the least solid and resilient union consistent with the formal existence of such a union.
- 100% represents the ability to withstand the pressures of a severe, low-probability scenario with no more likelihood of a Eurozone breakup than strong national governments face of their own unraveling.
- Estimates below 50% represent a level of progress insufficient to be confident that the Eurozone would survive internal and external tensions, crises and shocks in the long term, and all estimates below 25% indicate that the objective in question might be a source of potentially fatal weakness for the Eurozone when confronted by internal or external shocks.
- Estimates between 50% and 75% indicate a level of progress sufficient to inspire confidence in the long-term survival of the Eurozone, but with risks still present and a sub-optimal arrangement, which can be detrimental to growth as well as stability.
- Estimates above 75% reflect a level of progress where the objective under consideration has been sufficiently fulfilled to make survival of the Eurozone very likely but not certain, thereby creating confidence and favorable conditions conducive to growth.

Note on the subpoints: The subpoints listed below with '+' next to them will be visible on screen and are meant to offer details on the objective under consideration; they are not meant to be evaluated separately.

1. Creating a political union

- + *Ensuring accountability of decisions*
- + *Creating robust executive governance for the Eurozone*

Question to scholars: In order to make the Eurozone a viable currency union in the long term, European leaders need to make progress towards political union, both to strengthen its governance and remedy its executive deficit, and to ensure democratic accountability. On a scale from 0 to 100%, how far along do you estimate the Eurozone to be in achieving the necessary level of political union to be consistent with a very resilient Eurozone?

2. Creating a fiscal union

- + *Fiscal convergence*
- + *Surveillance and enforcement*
- + *Mutualization of debt*
- + *Common budget and fiscal transfers*

Question to scholars: In order to make the Eurozone a viable currency union in the long term, European leaders need to make progress towards fiscal union, an objective that includes fiscal convergence among national budgets, a regime of centralized surveillance and enforcement of budget rules, It could include, as well, two even more controversial features: mutualization of

debt and fiscal transfers in the form of a common budget. On a scale from 0 to 100%, how far along do you estimate the Eurozone to be in achieving the desirable level of fiscal union?

3. Creating a banking union

- + *Zone-wide bank regulation*
- + *Zone-wide bank supervision*
- + *Zone-wide deposit guarantee fund*
- + *Zone-wide bank resolution mechanism*

Question to scholars: In order to make the Eurozone a viable currency union in the long term, European leaders need to make progress towards a banking union. The four features such a banking union should include, according to most analysts, are Eurozone-wide: regulation, supervision, deposit guarantee fund, and bank resolution mechanism. On a scale from 0 to 100%, how far along do you estimate the Eurozone to be in building a banking union?

4. Enhancing ECB role in ensuring liquidity and market access

- + *ECB capability to act as lender of last resort to solvent banks*
- + *ECB easing market access by solvent sovereigns in case of market disruptions*
- + *ECB cooperation with other funding arrangements like IMF or ESM [OMT]*

Question to scholars: In order to make the Eurozone a viable currency union in the long term, there needs to be an effective lender of last resort, almost certainly the ECB, for solvent banks, and to ensure the provision of liquidity for solvent but illiquid countries, so that they can address crises and reassure investors. This includes the possibility of ECB direct intervention in the bond markets. On a scale from 0 to 100%, how far along do you estimate the Eurozone to be in acquiring these tools?

5. Creating sovereign crisis resolution tools

- + *Funding with conditionality and surveillance for insolvent countries*
- + *Loss-sharing between Eurozone governments, European institutions and investors*

Question to scholars: In order to make the Eurozone a viable currency union in the long term, European leaders need to have emergency tools for aiding insolvent countries. These tools include official funding with conditionality and mechanisms to apportion losses when restructuring is needed. On a scale from 0 to 100%, how far along do you estimate the Eurozone to be in acquiring these emergency tools?

6. Improving competitiveness and economic adjustment

- + *Encouraging labor mobility in the Eurozone*
- + *Accommodating inflation differentials*
- + *Filling competitiveness gaps*
- + *Promoting structural reforms and improving the single market*

Question to scholars: In order to make the Eurozone a viable currency union in the long term, and avoid damaging disparities in competitiveness and economic conditions, European leaders need to improve internal adjustments mechanisms. That includes facilitating labor mobility, accommodating inflation differentials and promoting structural reforms in the countries where

they are needed. On a scale from 0 to 100%, how far along do you estimate the Eurozone to be in featuring these adjustment mechanisms?

Overall completion

Question to scholars: On a scale from 0 to 100%, how far along do you estimate the Eurozone to be in reforming itself in order to be a viable currency union in the long term?