

How to fix the Eurozone: Views of leading economists

Richard Baldwin, Francesco Giavazzi 12 February 2016

Important progress has been made in repairing the design faults that the EZ Crisis revealed. This column introduces a new VoxEU eBook which argues that fixing the Eurozone is a job half done. The eBook, which presents 18 chapters by leading economists that hail from a broad range of nations and schools of thought, is surely the most comprehensive collection of solutions that has ever been assembled.

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The Eurozone was from rocked by turmoil and high drama from 2010 to 2015. Compared to those tumultuous times, it is easy to think that the worse of the Crisis is behind us. This is a mistake.

The Eurozone remains a damaged vessel. It has been made seaworthy with makeshift solutions and half-measures. The ECB's resolve and the gradually improving macroeconomic performance is keeping the euro afloat for now. But this is accomplished by something akin to bailing the water out of the boat as fast as it leaks in.

European leaders must very soon find permanent and coherent solutions to the Eurozone's shortcomings. It is time to cast aside national and ideological prejudices and engage in an open-minded discussion of what more needs to be done to restore stability and prosperity in Europe. The time to start is now. Millions of Europeans – above all Europe's young – are paying an unconscionable price for EZ leaders' failure to finish the job of fixing the Eurozone.

This column introduces a new VoxEU.org eBook:

[How to fix Europe's monetary union: Views of leading economists](#) ^[3]

that we hope will foster the development of solutions that can fix the Eurozone before the

next crisis strikes Europe's monetary union. Each chapter presents solutions to one or more of the main challenges facing the Eurozone.

The Rebooting Europe project

The first eBook in the Rebooting Europe project collected essays from a wide range of leading economists on a simple question: "What caused the EZ Crisis?" (Baldwin and Giavazzi 2015). This second eBook in the series collects essays on an equally simple question: "What more needs to be done to fix the Eurozone?"

To provide a common base for answering the how-to-fix-it question, we started a process that extracted a 'consensus narrative' on what caused the EZ Crisis. The idea was that it would be easier to find agreement on how the monetary union should be fixed, if we first found agreement on how and why things went wrong during the EZ Crisis. The result was an essay ([published in November 2015](#) ^[1]). Although not all the authors of the first eBook were willing to put their name to it, the document "Rebooting Europe: Step 1 – agreeing a crisis narrative" was ultimately signed by 16 leading economists hailing from a broad range of views. It has garnered support from more than 90 other eminent economists and been viewed almost 50,000 times on VoxEU.org.

The 2nd eBook: What more is needed to fix the Eurozone?

The new eBook has 18 chapters and many of these present multiple reform proposals, or packages of reforms. We cannot possibly do justice to all of these in this short Vox column (see the list of columns at the end of this Vox column). What we can say is that all the authors agree that more needs to be done.

As Agnès Bénassy-Quéré writes in her chapter, "The Eurozone was conceived as a monetary union without a sovereign. It was just an arrangement between several member states to share monetary sovereignty, provided they commit not to abuse the system through fiscal profligacy. This arrangement failed."

The same has been recognised by the so-called Five Presidents' Report: "Europe's Economic and Monetary Union (EMU) today is like a house that was built over decades but only partially finished. ... we will need to take further steps to complete EMU" (European Commission 2015). It proposes the completion, in the long run, of three unions to match the Monetary Union: Economic Union (including Banking Union and Capital Market Union), Fiscal Union, and Political Union.

While the Five Presidents' Report was an important step in getting the debate going, it seems to be unrealistically ambitious in the long run – essentially pushing all the way to something like a United States of Europe. At the same time, it is insufficiently ambitious in the short run – shying away from reforms that would require a Treaty change.

Our authors almost all start from the perspective that fixing the Eurozone will require changes in the Treaty. Half-measures and muddling through will not do the job. They take a fresh look at the problems and potential solutions using clear economic reasoning and the best available evidence. Most authors question some or all of the ideas in the Five Presidents' Report.

The full range of coherent solutions

This eBook is surely the most comprehensive collection of solutions that has ever been assembled. The chapters gives readers a full overview of virtually all the problems and all the serious proposed solutions (including a number of proposals that have not appeared elsewhere).

Although they disagree on solutions, our authors broadly agree on the list of things that needed to be fixed. These include:

- Completing the Banking Union;
- Breaking the 'doom loop' between banks and their sovereigns;
- Ensuring EZ-wide risk sharing for Europe-wide shocks;
- Cleaning up the legacy debt problem;
- Coordinating EZ-level fiscal policy while tightening national-level discipline;
- Advancing structural reforms for a better functioning monetary union.

Each chapter presents solutions to one or more of these challenges, and several of the chapters view solutions to one problem as inexorably linked with the solution to one or more of the other problems.

Lessons learned and progress to date on fixing the Eurozone

At the outset, we must acknowledge that there is nothing novel about the notion that the Eurozone needs completing. Most of our authors have published on this topic since the EZ Crisis struck (see their individual chapters for references). The basic shortcomings have been known and discussed by economists since the euro was launched. This may be seen as reassuring in the sense that the realisation that the Eurozone has shortcomings does not depend on elaborate new theories, empirical findings, or controversial interpretations of the EZ Crisis. Based on nothing more than simple economic logic and basic economic facts, many flaws were obvious from the start.

For example, a CEPR report wrote: "The ECB suffers serious faults in its design that sooner or later will surface. This is likely to happen when large shocks [Editors' note: the Report refers to the 1997 Asian Crisis], hit euroland. ... The lack of centralized banking supervision, together with the absence of clear responsibilities in crisis management, risk making the financial system in euroland fragile. No secure mechanism exists for creating liquidity in a crisis, and there remain flaws in proposals for dealing with insolvency during a large banking collapse." (Begg et al 1998).

These problems were swept under the rug during the halcyon days of the Eurozone's first decade.

Concluding remarks

Fixing the Eurozone is a job half done. As one of the authors in this eBook, Nobel Prize winner Chris Pissarides, writes: "There are certain conditions needed to make a common currency across diverse economies a success and the Eurozone is clearly not satisfying them."

Given the wide range of shocks arising from the current situation in Europe and beyond,

now is not the time to relax. The job of fixing the Eurozone must be completed sooner rather than later. At their summit next week, EU leaders should find the time to restart the process of repairing Europe's monetary union.

List of chapters and authors

Part 1: Complete reform plans

Minimal conditions for the survival of the euro

Barry Eichengreen and Charles Wyplosz

Maastricht 2.0: Safeguarding the future of the Eurozone

Lars P. Feld, Christoph M. Schmidt, Isabel Schnabel and Volker Wieland

A sovereignless currency

Agnès Bénassy-Quéré

The Eurozone's Zeno paradox – and how to solve it

Jean Pisani-Ferry

Part 2: Focusing on completing the Banking Union, and financial markets

Completing the Banking Union

Daniel Gros

Safeguarding the euro – balancing market discipline with certainty

Thorsten Beck

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Sebnem Kalemli-Ozcan

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Rebooting Europe: Closer fiscal cooperation needed

Christopher Pissarides

How to reboot the Eurozone and ensure its long-term survival

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Policies and institutions for managing the aggregate macroeconomic stance of the Eurozone

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Asymmetries and Eurozone policymaking

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The way forward: Coping with the insolvency risk of member states and giving teeth to the European Semester

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How the Euro Crisis was successfully resolved

Barry Eichengreen and Charles Wyplosz

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