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RÉDACTION EN ANGLAIS D'UNE NOTE DE SYNTHÈSE
À PARTIR D'UN DOSSIER CONSTITUÉ DE TEXTES
À CARACTÈRE SPÉCIFIQUE OU SE RAPPORTANT
À DES FAITS POLITIQUES OU SOCIAUX CONTEMPORAINS,
RÉDIGÉS EN ANGLAIS

(Durée : 4 heures - Coefficient : 5)

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SUBJECT

Using only the attached documents, prepare a summary of about four pages, discussing future challenges for the euro and the role of the European Central Bank with regard to the economic and monetary problems facing Europe.

ATTACHED DOCUMENTS (22 pages)

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Text No. 1

http://www.guardian.co.uk/commentisfree/2010/may/05/reform-euro-or-bin-it-greece-germany/print

Reform the euro or bin it

The Greek crisis puts the currency's very survival at risk. Europe must now take long overdue action

Joseph Stiglitz

guardian.co.uk, Wednesday 5 May 2010 20.30 BST

The Greek financial crisis has put the very survival of the euro at stake. At the euro's creation, many worried about its long-term viability. When everything went well, these worries were forgotten. But the question of how adjustments would be made if part of the eurozone were hit by a strong adverse shock lingered. Fixing the exchange rate and delegating monetary policy to the European Central Bank eliminated two primary means by which national governments stimulate their economies to avoid recession. What could replace them?

The Nobel laureate Robert Mundell laid out the conditions under which a single currency could work. Europe didn't meet those conditions at the time; it still doesn't. The removal of legal barriers to the movement of workers created a single labour market, but linguistic and cultural differences make US-style labour mobility unachievable.

Moreover, Europe has no way of helping those countries facing severe problems. Consider Spain, which has an unemployment rate of 20% – and more than 40% among young people. It had a fiscal surplus before the crisis; after the crisis, its deficit increased to more than 11% of GDP. But, under EU rules, Spain must now cut its spending, which will likely exacerbate unemployment. As its economy slows, the improvement in its fiscal position may be minimal.

Some hoped the Greek tragedy would convince policymakers that the euro cannot succeed without greater co-operation (including fiscal assistance). But Germany (and its Constitutional Court), partly following popular opinion, opposed giving Greece the help that it needs.

To many, both in and outside of Greece, this stance was peculiar: billions had been spent saving big banks, but evidently saving a country of 11 million people was taboo. It was not even clear that the help Greece needed should be labelled a bailout: while the funds given to financial institutions like AIG were unlikely to be recouped, a loan to Greece at a reasonable interest rate would probably be repaid.

A series of half-offers and vague promises, intended to calm the market, failed. Just as the US had cobbled together assistance for Mexico 15 years ago by combining help from the International Monetary Fund and the G7, so too the EU put together an assistance programme with the IMF. The question was, what conditions would be imposed and how big would be the adverse impact?

For the EU's smaller countries, the lesson is clear: if they do not reduce their budget deficits there is a high risk of a speculative attack, with little hope for adequate assistance from their neighbours, at least not without painful and counterproductive pro-cyclical budgetary restraints. As European countries take these measures, their economies are likely to weaken – with unhappy consequences for the global recovery.

It may be useful to see the euro's problems from a global perspective. The US has complained about China's current account (trade) surpluses; but, as a percentage of GDP, Germany's surplus is even greater. Assume that the euro was set so that trade in the eurozone as a whole was roughly in balance. In that case, Germany's surplus means the rest of Europe is in deficit. And the fact that these countries are importing more than they are exporting contributes to their weak economies.

The US has been complaining about China's refusal to allow its exchange rate to appreciate relative to the dollar. But the euro system means Germany's exchange rate cannot increase relative to other eurozone members. If the exchange rate did increase, Germany would find it more difficult to export, and its economic model, based on strong exports, would face a challenge. At the same time, the rest of Europe would export more, GDP would increase, and unemployment would decrease.

Germany (like China) views its high savings and export prowess as virtues. But John Maynard Keynes pointed out that surpluses lead to weak global aggregate demand – countries running surpluses exert a "negative externality" on trading partners. Indeed, Keynes believed it was surplus countries, far more than those in deficit, that posed a threat to global prosperity; he went so far as to advocate a tax on surplus countries.

The social and economic consequences of the current arrangements should be unacceptable. Those countries whose deficits have soared as a result of the global recession should not be forced into a death spiral – as Argentina was a decade ago.

One proposed solution is for these countries to engineer the equivalent of a devaluation – a uniform decrease in wages. This, I believe, is unachievable, and its distributive consequences are unacceptable. The social tensions would be enormous. It is a fantasy.

There is a second solution: the exit of Germany from the eurozone or the division of the eurozone into two sub-regions. The euro was an interesting experiment, but, like the almost forgotten exchange rate mechanism that preceded it and fell apart when speculators attacked sterling in 1992, it lacks the institutional support required to make it work.

There is a third solution, which Europe may come to realise is the most promising for all: implement the institutional reforms, including the necessary fiscal framework, that should have been made when the euro was launched.

It is not too late for Europe to implement these reforms and thus live up to the ideals, based on solidarity, that underlay the euro's creation. But if Europe cannot do so, then perhaps it is better to admit failure and move on than to extract a high price in unemployment and human suffering in the name of a flawed economic model.

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Text No. 2

http://www.foreignaffairs.com/print/66483

August 10, 2010

SNAPSHOT

The Future of the Euro

Why the Greek Crisis Will Not Ruin Europe's Monetary Union

Lorenzo Bini Smaghi

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When the euro was conceived two decades ago, few people expected it to have to weather a storm as great as the recent global economic and financial crisis. And many observers now think the entire European construct -- its institutions and currency -- has been so damaged by the crisis that it might not survive. A careful analysis of the problems within individual eurozone economies, particularly Greece's, and in the architecture of the monetary union among them reveals what went wrong, how the EU has responded, and what the prospects of the euro really are.

Between 2008 and 2010, several things went wrong in Europe, the biggest of which was Greece's financial crisis. For years, Greek fiscal policy had been unsound. Although private debt had been rising, the country's overall debt-to-GDP ratio had not ballooned, because the Greek economy was growing. But that growth turned out to be unsustainable. When the global economic crisis hit, Greece's deficit more than doubled. The problem was compounded by revelations that the government had grossly falsified and padded its budget in the run up to the 2009 parliamentary elections.

Unlike countries with national currencies, Greece could not address its problems through monetary policy. It can neither print money to inflate its debt away nor depreciate its currency to recover the international competitiveness of Greek goods and grow the economy out of debt. And unlike a subnational federal region in trouble, Greece, as a sovereign unit itself, could not have its falling revenues and rising social expenditures offset through simple fiscal transfers from the rest of Europe. Its labor force, moreover, is not mobile enough for excess to be exported elsewhere in the eurozone.

As far as the euro's architects were concerned, this kind of problem should never have arisen. European financial markets should have put pressure on countries with excessive debt-to-GDP ratios, such as Greece, by charging them higher interest rates for loans. The European Central Bank (ECB) prohibits loaning money to service national debts, and its no-bail-out clause should similarly have discouraged overspending. Additionally, the eurozone's Stability and Growth Pact, which was meant to enforce fiscal discipline in member countries through rules against running high deficits and debts, should have constrained Greek politicians. Finally, the Lisbon process, a 2000 development plan for the eurozone, should have increased Greece's economic competitiveness and spurred real growth.

Unexpectedly, however, European financial markets accommodated Greece's public and private spending with relatively low interest rates. It was only when the global financial crisis gained momentum that the markets reacted and capital flows suddenly stopped. The Stability and Growth Pact was ineffective as well; member states proved unwilling to enforce restrictions against others for fear of being subject to restrictions

themselves. Finally, the Lisbon process underestimated the true differences in the member countries' economies and failed to adequately address them.

Once the Greek financial crisis was under way, there were two options for tackling it. The first was for Greece to implement fiscal and structural reform that would bring its debt and deficit under control. Greece, the International Monetary Fund (IMF), the European Commission (EC), and the ECB negotiated just such a plan in June, with the goal of turning Greece's primary deficit of nine percent of GDP into a surplus of six percent by 2015. It rests on fairly standard IMF reforms: substantial expenditure cuts, increases in revenue creation, and improvements in tax collection. It also includes important structural reforms, such as pension reform and privatization, which are aimed at improving long-run debt sustainability and the performance of Greece's labor and manufacturing sectors.

The plan was accompanied by financing from the IMF and loans from the rest of the eurozone worth €110 billion -- or 46 percent of Greece's 2010 GDP. Because the Greek crisis spread to other countries -- Portugal and Spain, in particular -- member states agreed to create a special European Financial Stability Fund to support any eurozone country that decides to undertake economic reform.

Yet there is already widespread skepticism about the IMF plan among some academics, investors, and speculators. Many fear that it is too harsh, imposes too many restrictions, and would ultimately be politically unsustainable. Their alternatives, however, are no better. Some have called for Greece to undertake an "orderly" debt restructuring, including devaluing bonds to alleviate the country's debt burden. In its extreme form, this proposal also calls for the reinstatement of the drachma, because moving to the less valuable currency could restore Greece's economic competitiveness.

In truth, however, these measures would not work and would be much harsher for the people of Greece than the IMF plan. Debt restructuring is never orderly. Undertaken now, it would hammer Greece's domestic financial system and have serious repercussions for the rest of its economy. Greek access to eurozone capital markets would be impaired for years, stalling the public and private sectors. And if Greece did not fully repay the loans from other eurozone countries, it would suffer a major loss of political credibility.

In such an economically integrated area as the eurozone, leaving the currency union would not solve Greece's economic problems either. After Italy left the European Exchange Rate Mechanism (ERM) and devalued its currency in 1992, for example, it suffered from volatile swings in interest rates due to a lack of investor confidence. Inflation rapidly reappeared, and Italy had to tighten its monetary policy further than would have been necessary if it had stayed in the ERM.

The return to a national currency would also involve renegotiating business contracts, both within Greece and between Greeks and others. In the event of legal disputes, EU courts would likely be inclined to rule against Greece, the country that changed its currency. Greek citizens would probably try to maintain the euro as a unit of account and means of exchange, leading to parallel circulation of the drachma and the euro. And, having accepted billions in euro-denominated loans, the Greek debt burden would immediately increase if Greece reinstated the less valuable drachma.

The costs of restructuring debt or abandoning the euro would be too high for Greece to bear. The IMF plan is therefore Greece's best option. That said, it is ultimately quite tough and carries with it two types of risk. The first is if the reforms are not economically sustainable, they might create a debt spiral. The second is that if they are not politically sustainable, the government may adopt the other plan anyway.

A restrictive fiscal policy might well have a negative impact on Greece's growth in the short term, but many of the arguments about its recessionary effects are flawed. They use a baseline model that assumes a given growth rate and an unsustainable fiscal policy. When a restrictive budget is added, growth does indeed decrease at first, due to standard Keynesian principles. But financial markets are completely excluded from this model. It does not account for the fact that unsustainable fiscal policies inevitably provoke financial markets, which tend to react abruptly and generate terrible economic crises. At that point, much harsher measures are required to restore debt sustainability. A well-designed baseline model should include these effects and would show that over the long run uncontrolled fiscal policy is much more recessionary than timely budgetary adjustments.

Greece is a case in point. Due to fears about hindering future economic growth, for many months the Greek government refused to regain control of its budget. Now, even after emergency bailouts last spring, Greece is projected to lose four percent of its GDP in 2010. Had it taken action earlier and avoided the financial crisis, its economy probably would have shrunk more than what was projected before the crisis (in the fall of 2009, the EC projected a 0.3 percent loss for 2010), but it certainly would have fared better than it has now. The fiscal adjustment needed would have been milder, and the loss of political credibility would have been less devastating. Even now, a plan that does not include fiscal retrenchment will be much worse for long-term economic growth.

Beyond economic sustainability, critics cast doubt on the IMF plan's political feasibility, arguing that it is impossible for Greece to retrench if it means that the country must do away with entitlements that the population has come to view as fundamental rights, such as generous unemployment and retirement pensions. Such retrenchment would stir public unrest, they say, and leaders would have no option but to default to devaluation.

It is true that, as is often noted, there is no constituency for budget discipline. And Greece's ruling political class may not have had the ability, or will, to convince Greek citizens of the need for restrictive fiscal measures in advance of the crisis. The current economic situation has shown, however, that politicians can build consensus for unpleasant fiscal action during a crisis. Governments in the eurozone used the threat that the Greek problem could spread to build support for an expensive rescue package, for example. And the governments of Portugal, Spain, Ireland, and others used the dire state of European financial markets to justify budgetary restraint and major reforms to labor and financial markets.

Citizens do not take fiscal reform lightly, but they are more easily convinced of its necessity if persuaded that something even worse looms as the alternative. This is why public support should coalesce around IMF-style economic reform, not debt restructuring or devaluation. Citizens of countries where those occurred remember their devastating effects. In countries where there is no recent memory of financial crisis, some may harbor the illusion that the current one will pass easily. But in today's world of densely networked economic systems, that is indeed an illusion.

Just as the economic crisis exposed problems in the Greek economy, it also exposed weaknesses in the euro's institutional framework. Restoring confidence will require strengthening that framework. A task force headed by EU President Herman Van Rompuy is scheduled to offer concrete proposals to do so by the end of this year. And in June, the ECB released its own recommendations: stronger independent surveillance of the budgetary policies of the member states with more automatic implementation of sanctions; improved surveillance of country competitiveness to ensure that member states continue to converge economically; and a crisis management structure with strong conditionality to support countries that implement adjustment

programs. We acknowledge that it will not be possible to expel member states that fail to comply with EU budgetary guidelines, so such a threat would ultimately not be credible.

The EC and the European Parliament have also called for the creation of three financial supervisory authorities (the European Banking Authority, the European Insurance and Occupational Pensions Authority, and the European Securities and Markets Authority) and a regulatory authority (the European Systemic Risk Board). Because the economies of the eurozone are so interconnected, eurozone-wide supervisory and regulatory authorities are necessary. They would have the discretion to press national governments to remedy problems and would be independent enough to act preemptively, without having to wait for a crisis to galvanize politicians to action. Some may dislike the idea of giving international bodies the power to constrain national economic policy. But financial contagion spreads too quickly, and European taxpayers have had to pay for the failures of other countries too often, for the current system to remain.

Forecasting the euro's demise was premature. The EU and eurozone countries were able to respond to the financial crisis with appropriate corrective measures: many countries adopted strong fiscal adjustment packages; eurozone countries have announced, and in some cases already implemented, unprecedented structural reforms, not least of which was their joint decision to coordinate and publish the results of their bank stress tests; the new European Financial Stability Fund has been established and can be used to support other eurozone countries in distress, and a task force on reform will offer and approve concrete proposals to strengthen eurozone governance by the end of the year.

One might criticize these measures for having been taken only after a crisis was eminent, but this is ultimately how democracies work in the face of difficulties. Problems in the economies of eurozone countries and in the framework of the monetary union will need to be addressed, but all the constituent countries will emerge stronger if they continue to pursue the right adjustment policies. Europe will need to find the right mix of cooperation, in defending its common interests at the global level, and competition in incentivizing growth. It will need to rely both on the center, which must ensure strong fiscal policy, and on the member states, which control much of the rest of economic policy. But one should take inspiration from the EU's history. Finding these balances has historically been one of Europe's key strengths.

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Text No. 3

http://www.ecb.int/press/key/date/2010/html/sp100910.en.html

Interview with Jean-Claude Trichet, President of the ECB, conducted by Lionel Barber and Ralph Atkins on Wednesday, 8 September 2010

Financial Times: After the events of the past few years, are you confident that the euro can survive, and if so, why?

Jean-Claude Trichet: Yes, I am confident, of course! You know how much scepticism there was in the run-up to the setting-up of the euro. The best way to measure how much has been done is to conduct a thought experiment and place ourselves at the beginning of 1998 or, perhaps even more boldly, in 1994, and imagine hearing somebody say the euro would be launched on time in January 1999, that it would start with 11 countries, that very rapidly there would be 16 countries. And that after 11 ½ years, for these 16 countries and more than 330m people, not only would the stability of the euro be in line with our definition of price stability – below but close to 2 per cent - but that the level of price stability would be better than that obtained in the previous 50 years by major currencies before the euro. Over the 11 ½ years, euro area inflation has averaged 1.97 per cent.

That would certainly have been considered much too bold, much too optimistic, perhaps totally unrealistic - but that is what we've been doing. So 'yes, sir', the euro is there. The euro area faces a lot of challenges, as is the case for all major advanced economies. All their central banks have a lot of challenges today, and this is no time for complacency for any of us, but the success of the euro, measured as I just suggested, is obvious.

Financial Times: What would you describe as the main challenges facing the euro today?

Jean-Claude Trichet: I would say that we have all the challenges of major central banks in the advanced world. There is the challenge of coping, in terms of our own responsibility, with the 'turbulent episode' in which we find ourselves since three years. We have to cope with the challenge of globalisation. We have to cope with the challenges of science and technology, which is developing so rapidly that it creates for the central bankers a lot of additional challenges, in particular in terms of assessing correctly productivity and the impact of IT on the financial sector. Population ageing is also a big challenge for all central banks.

We have two other challenges that other major central banks do not have. One is the deepening and overall implementation of the single market with a single currency, which has been Europe's ambition since the very beginning. We are the only central bank which is transforming, by virtue of its own activity, the economy under its jurisdiction.

The second challenge is enlargement. We were 11 countries at the beginning. Next January we will be 17, with Estonia joining. This highlights the challenge of permanently strengthening and deepening the governance of the euro area, with new economies coming in.

Financial Times: Before we talk about governance, let me ask you some specific questions about the crisis management measures. How are you going to reduce the dependence of the likes of Greece, Portugal, Spain, Ireland on extra liquidity provided by the ECB?

Jean-Claude Trichet: As you know, the European economy relies very much in terms of financing on commercial banks. So it's not surprising that our own 'non-standard measures' concentrate much more on bank refinancing than on intervening in markets, in comparison with the Fed. As markets gradually stabilise, our non-standard measures, which are fully consistent with our mandate and, by construction, temporary in nature, will continue to be progressively phased out. So we are accompanying the market as it progressively goes back to normal. But, as I said already, it is a process which takes time.

Financial Times: Do you have in mind, though, a need to phase out 'non-standard' refinancing and do you have a sort of time horizon for this?

Jean-Claude Trichet: We of course have to consider all those measures as transitory. They are there to cope with a situation which is abnormal - to help correct those markets that are dysfunctional and thereby help restore a more normal transmission mechanism for our monetary policy.

We have eliminated one-year liquidity, and we have also phased out six-months liquidity. The decisions we took last week take precisely into account, through three fine tuning operations in the last quarter, this progressive phasing out and its impact on liquidity.

Financial Times: Where do you think we are in this crisis? It's a difficult question. I mean, if I'd asked Roosevelt in 1935 he would have had a hard time answering the question too...

Jean-Claude Trichet: I guess so, yes. I would say that the correct response is that we are in a situation where central banks in particular, and also other authorities, have to remain alert and have to know that we are in an uncertain universe. We always have to be prepared for new challenges that can not necessarily be foreseen and that might be in some respect unpredictable. We have permanently to be in a state which I call credible alertness.

Financial Times: How close did the euro area come to disaster in May?

Jean-Claude Trichet: No, I don't think that the euro area was close to disaster at all - seen from inside. I know how Europe functions. I know how the constellation of authorities functions, at the level of the various nations and at the level of the European institutions, Seen from the outside, I would say that it's always difficult for external observers to judge and analyse correctly the capacity of Europe to face up to exceptional difficulties. There is no other model to which we can refer – either in history or in a fully fledged political federation such as the US, and certainly not in comparison with centralised states such as Japan or the UK. But I'm always confident. In May we had additional proof of the capacity of Europe to cope with new challenges.

Financial Times: Can you explain why [in May] the ECB changed its mind on government bond purchases? There was a lot of criticism in Germany especially.

Jean-Claude Trichet: When I talk of 'credible alertness' I really mean it. When we decided on 9 August 2007 that it was appropriate to embark in an unlimited supply of liquidity in our own money market, and we supplied 95 billion euros for 24 hours, that was not a decision that was in the textbooks. We were criticised a little bit at the time, and then, after a while, it was recognised that this decision had been wise and lucid.

So in May this year I would say that we were in a situation where it was considered appropriate by the governing council of the ECB to take the decision, as I said earlier, to help restore a more normal functioning of our own monetary policy transmission mechanism. We had previously purchased covered bonds and we had not excluded intervening in other markets.

Financial Times: What lessons do you draw in terms of euro governance from this crisis to date?

Jean-Claude Trichet: First of all, we are on the record as having always asked for full and decisive implementation of the governance measures that already exist. We combated very fiercely the position of the heads of government of the three major countries in the euro area when they wanted to weaken formidably the stability and growth pact, back in 2004 and 2005. It was a very, very fierce battle. They wanted to really unravel the pact.

What I would sum up as our position today is very simple. We call for 'a quantum leap' in the reinforcement of fiscal surveillance, with, in particular, what I would call the reversal of the burden of the proof. We have called for the 'quasi-automaticity' of procedures and sanctions. We have called for a reinforced independent way of assessing the fiscal situation and we have also called for a quantum leap as regard the surveillance of competitiveness and imbalances in euro area member countries. And, finally, we have called for decisive measures to enhance the quality of statistics.

As regards the methodology, we consider that a change of the treaty would be appropriate, but we accept that this would involve a long or very long procedure at the level of 27 EU countries. That's why we have called for the maximum use of secondary legislation as a first step, to exploit all the possibilities that secondary legislation can offer to go in the direction of the necessary goals. That's the idea.

Financial Times: And what about temporary suspension of membership or even expulsion of a member that is systematically breaching this...?

Jean-Claude Trichet: No, I don't call for expelling members, but a temporary suspension of voting rights is something that should be explored.

Financial Times: In retrospect, shouldn't Europe have undertaken bank stress test earlier?

Jean-Claude Trichet: I think so. The ECB and the Bank of England were very much in favour of this stress test. Of course, we have a very complex institutional environment, involving cooperation in real time among 27 EU capitals. It was really essential to have this exercise undertaken on a unified basis, simultaneously. You know that we particularly welcomed the detailed publication of the results for the 91 banks involved.

Financial Times: Are you worried about deflation in Europe?

Jean-Claude Trichet: No, I do not see the materialisation of a risk of deflation, or either of inflation, at present. We went through the heat of the crisis without any materialisation of deflationary risks. Our successful and solid anchoring of inflation expectations has protected us, I trust, very well against the materialisation of inflation risks - but also against the materialisation of deflation risks.

Financial Times: And what about deflation in the United States, is that different?

Jean-Claude Trichet: I fully rely upon the analysis of the Federal Reserve.

Financial Times: But how serious do you think is the present weakness of the American economy?

Jean-Claude Trichet: I would say, again, that I rely very much upon the Fed's analysis, which I have to say over the crisis has been wise and pertinent. There was a level of hype at certain moments, when we were getting out of the crisis, which perhaps did not fully reflect the situation of the real economy. And now there is a mood which seems to me too negative. That's my own personal feeling.