# The euro crisis : Where do we stand ?

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# Introduction to the special issue of Brussels Economic Review / Cahiers Économiques de Bruxelles:

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The Great Recession sheds lights on several flaws in the architecture of the European Monetary Union (EMU, hereafter). Excessive risk taking in quiet/good times in both the public and private sectors underlines the need to improve risk prevention. Without a doubt, the sharp increase of financial instability within the eurozone (market failures, insufficient monitoring and enforcement tools, contagion between sovereign indebtedness and bank indebtedness, financial fragmentation) highlight the need to improve crisis resolution mechanisms.

Consequently, several changes have occurred since 2009 to correct the shortcomings in the EMU governance. A large range of tools has been created and imposed or proposed to Member States (MS, hereafter). Adjustment programs providing financial assistance under conditionality have been created with the European Financial Stability Facility (EFSF) and the European Stability Mechanism (ESM). New fiscal rules have been implemented with the Six Pack, the Two Pack and the Fiscal Compact of the Treaty on Stability, Coordination and Governance in the EU (TSCG). They aim at strengthening the two major objectives for fiscal policy in the EMU: sound fiscal policy and balanced public finance in the medium run. National reforms promoting growth, improving adjustment capacities and restoring fiscal sustainability are encouraged. The European Semester has been established to enable a better coordination of national policies. The Europe 2020 Strategy has been relaunched especially thanks to the Juncker's Investment Plan for Europe. In addition, on-going debates over further steps to strengthen EMU governance are in progress.

This special issue of Brussels Economic Review / Cahiers Économiques de Bruxelles aims at providing some theoretical and empirical perspectives on the euro crisis from a macroeconomic viewpoint. The contributions have been selected after the Macroeconomics Workshop: "The euro crisis: Where do we stand?" organized by the University of Strasbourg, the Bureau of Economic Theory and Applications (BETA-CNRS) and the ERMEES research team[1]. The ERMEES research team is an informal group of macroeconomist created in November 2013 and interested by European macroeconomics in Strasbourg[2]. The workshop took place in mid-October 2015 at the European Doctoral College in Strasbourg. We have received more than sixty submissions from around twenty different countries and international institutions. Some thirty researchers were gathered to explore and analyze the underlying macroeconomic causes of the first major crisis in the nascent history of the EMU.

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[1] More information on the Macroeconomics Workshop: http://www.jamelsaadaoui.com/?page_id=914

[2] More information on the ERMEES research team can be found here: https://udsermees.wordpress.com/

First of all, we would like to thank the University of Strasbourg and the Bureau of Economic Theory and Applications (BETA-CNRS) for their financial and logistical support[3]. We are very grateful to the keynote speakers, Ansgar Belke from the University of Duisburg-Essen and Gunther Schnabl from the University of Leipzig for their invaluable contributions to the workshop. We also want to thank all the participants of the workshop for their implications during the sessions and for the quality of the debates. We thank Sile O'Dorchai, the managing editor of Brussels Economic Review / Cahiers Économiques de Bruxelles, for providing to us the opportunity to publish this special issue on the euro crisis. We are grateful to Thierry Burger-Helmchen, the dean of the Faculty of Economics and Management Sciences, to Bertrand Koebel, the director of the Bureau of Economic Theory and Applications, to Géraldine Del Fabbro and to Pierre-Guillaume Méon. We thank the anonymous referees for their critical comments and remarks. Finally, we thank all the members of the ERMEES research team (Moïse Sidiropoulos, Francesco de Palma, Giuseppe Diana, Thierry Betti, Thomas Coudert, Nicolas Mazuy, Marine André) for their implication during the organization of the workshop.

Amongst the thirty communications of the Macroeconomics Workshop, we have retained six papers. The first two papers, by Ansgar Belke and by Catherine Mathieu and Henry Sterdyniak, give an analytic view of the euro crisis and offer different perspectives on the future of the euro. The next two papers, by Thierry Betti and by Paolo D'Imperio, particularly focus on fiscal issues: the sign and the size of fiscal multipliers in the EMU for the first one, the relevance of a fiscal transfer scheme to improve risk sharing in the eurozone for the second one. Finally, the two last papers deal more specifically with monetary issues. The first one of Thomas Coudert introduces a theoretical model to explain inflation persistence. The last one of Vivien Djiambou is an empirical investigation on the link between public debt and public bond spread during episodes of financial stress.

Ansgar Belke provides a useful analytic framework to address several aspect of the specter of a "Grexit". To this end, he first assesses critically the work of the Troika in Greece. He stresses that Greece is not a case of a textbook small open economy but a rare case small semi closed economy in which macroeconomic adjustments are more complex to analyze especially during fiscal consolidations. He also mentions that the notion of "Grexit" is nothing more than a "red herring" since its economic relevance is rather limited. Finally, he draws some perspectives to reduce competitiveness gaps between the German Ruhrgebiet and the Greek region of Central Macedonia.

Catherine Mathieu and Henry Sterdyniak demonstrate that the strong rise in public debts since 2008 crisis has been accompanied by low inflation and low interest rates (in contradiction with the "crowding-out" theory) thus they conclude that public debts are currently Keynesian and required macroeconomic stabilization. They also criticize the European fiscal rules and present the eight original sins of the single currency. Besides, they analyze different and more unconventional proposals to solve euro's current woes, especially for public debt governance. Finally, they question the survival of the euro if an intelligent and precise cooperation between MS is not implemented.

Thierry Betti uses a New-Keynesian DSGE model with a micro-founded labor market and a SVAR specification for the eurozone in order to give an assessment of fiscal multipliers (on output and unemployment) depending on the nature of public spending (consumption or

[3] This event has been supported by a grant from the University of Strasbourg: Initiative d'Excellence (IdEx) - attractivité 2014.

investment). He concludes that both public consumption and public investment trigger a significant decrease of unemployment but the effect is stronger in the case of public consumption. The empirical results partially confirm his conclusions since public consumption and public investment reduce unemployment but here the effect of public investment is stronger.

Paolo D'Imperio estimates a two-country DSGE for the eurozone core and periphery to assess the potential effects of a fiscal stabilization scheme in the EMU to strengthen risk sharing between MS. The paper uses Bayesian time series econometric techniques and found that the implementation of fiscal transfers between MS could lead to an absorption of seventy percent of asymmetric shock in the eurozone after a positive productivity shock in the eurozone core. Symmetrically, a negative productivity shock will lead to transfers to the core countries. He rightly underlines that the institution of a cyclical fiscal transfer mechanism is just one of the several reforms needed for the eurozone to be sustainable in the long run. His conclusions are particularly important since the question of fiscal federalism between MS remains open.

Thomas Coudert introduces a New-Keynesian DSGE model with a micro-founded labor market to explain inflation persistence in the eurozone. He analyzes with attention severance pay and bargained firing costs. Thus, he introduces a new source of rigidity in the wage dynamics which increases inflation persistence. He stresses that the implications of his results are twofold. Firstly, since there is a huge labor market heterogeneity in the eurozone, the unique monetary policy must take into account these differences. Secondly, a harmonization of labor markets in the eurozone could possibly improve the efficiency of the monetary policy.

Vivien Djiambou focuses on the impact of public debt on government bond spreads. More precisely, he investigates a nonlinear relationship between public debt and public bond spread during episodes of financial stress. Using dynamic panel threshold regressions, he found that high levels of public debt does not *per se* induces an explosive dynamic on bond spreads. This kind of "vicious circle" can be triggered by an increase of financial stress. In high regime of financial stress, an increase of level public indebtedness could lead to an increase of public bond spreads. He also underlines that the effects can be significantly different for core European countries and periphery European countries.

As a final point, we want to express our pleasure for having contributed to the Brussels Economic Review / Cahiers Économiques de Bruxelles. We sincerely hope that this special issue will contribute to the debates on the future of the euro.