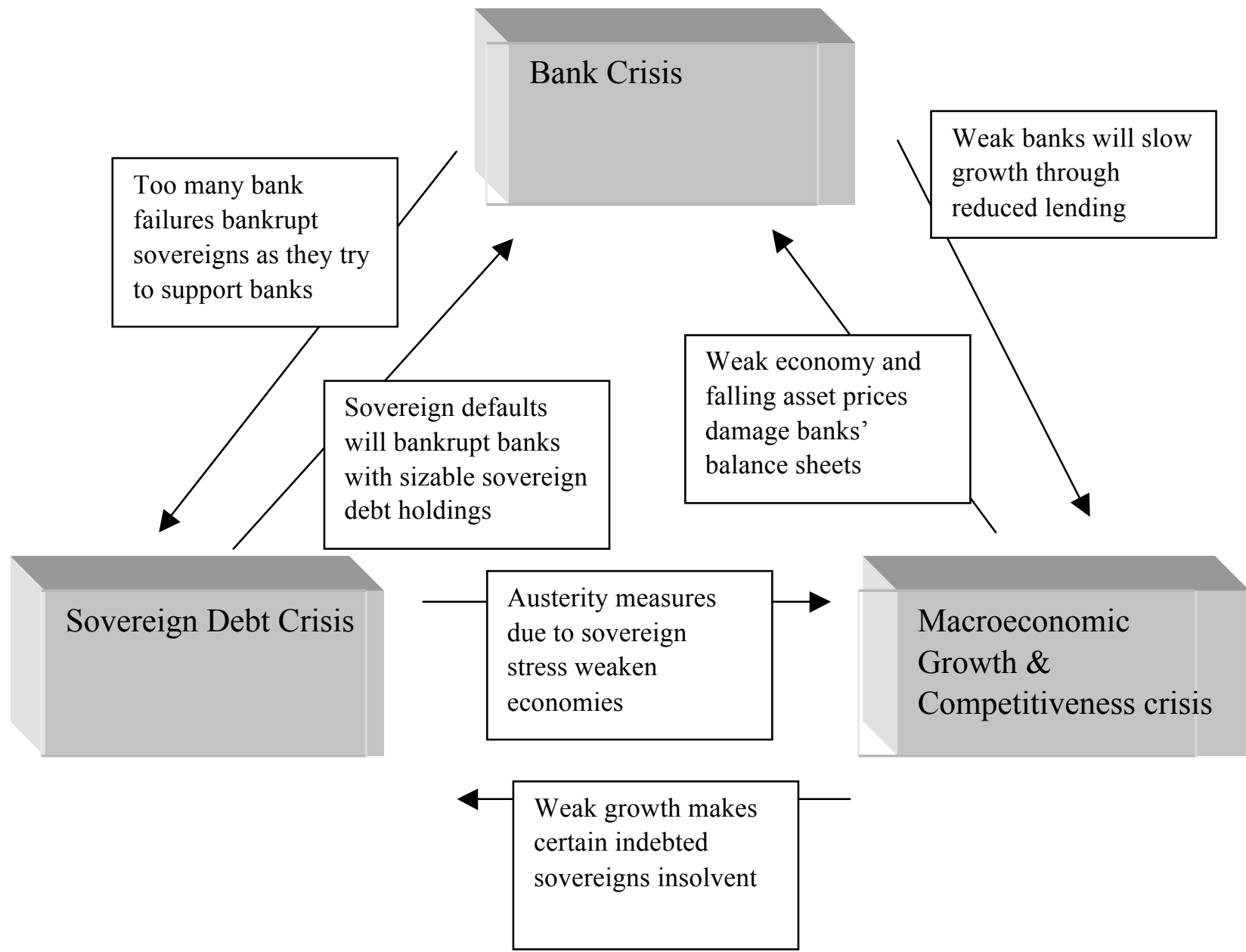


# The Euro's Three Crises by Jay Shambaugh

Ricardo Reis  
Columbia University

Brookings Papers on  
Economic Activity  
23<sup>rd</sup> of March, 2012



# Evaluation of policies

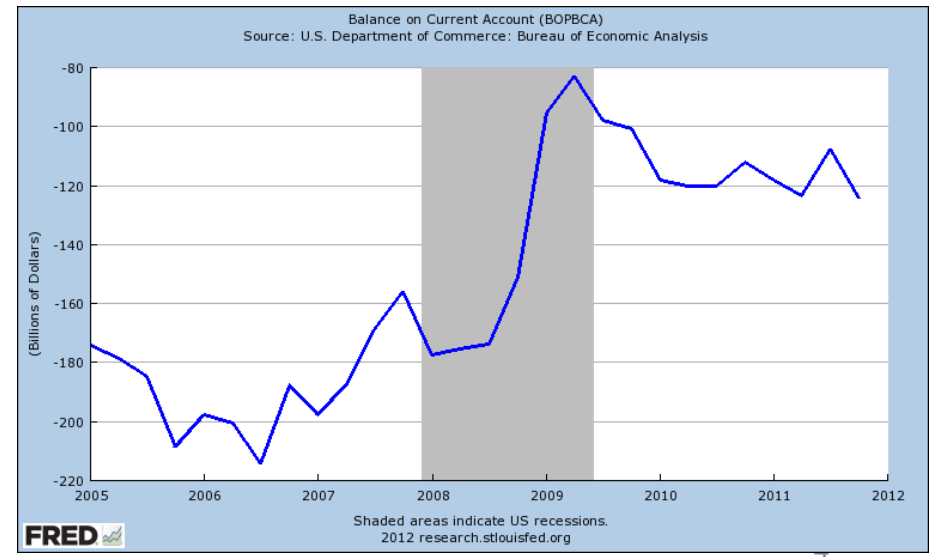
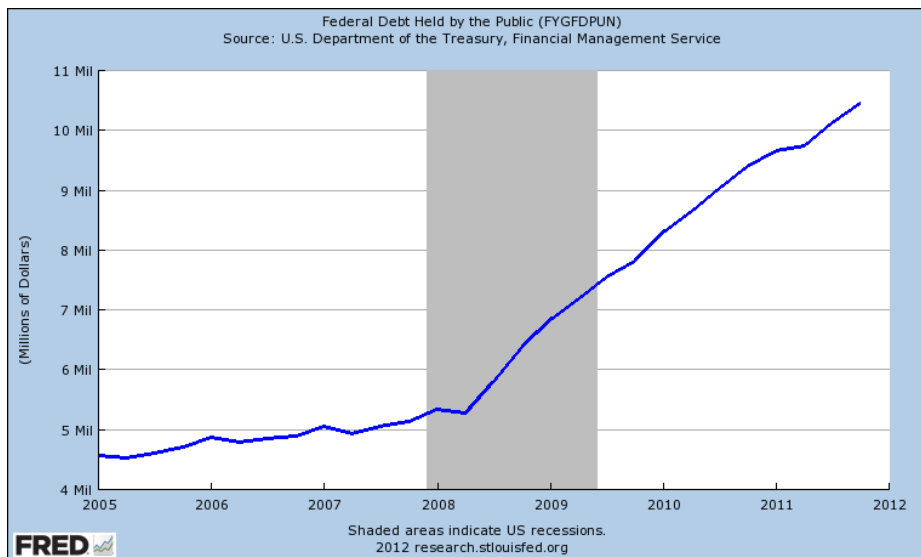
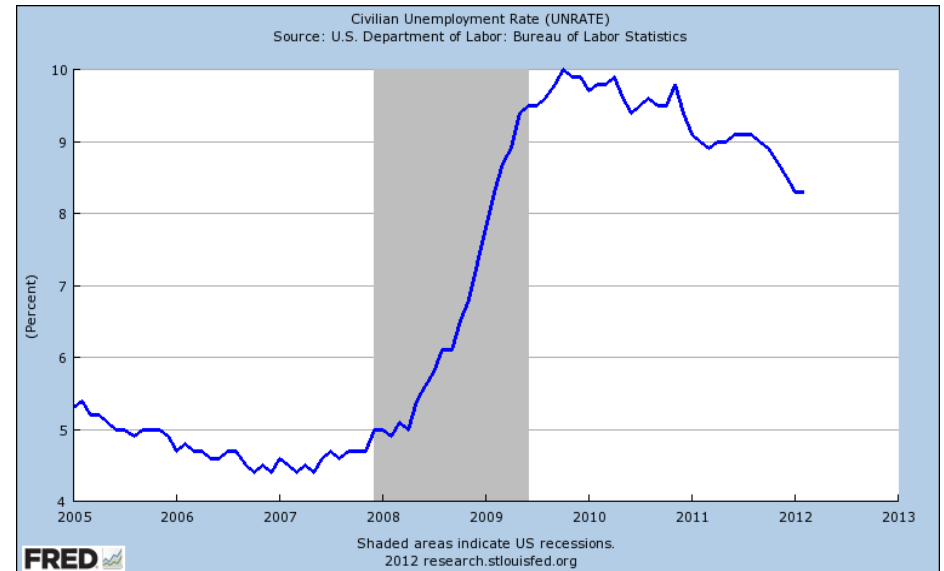
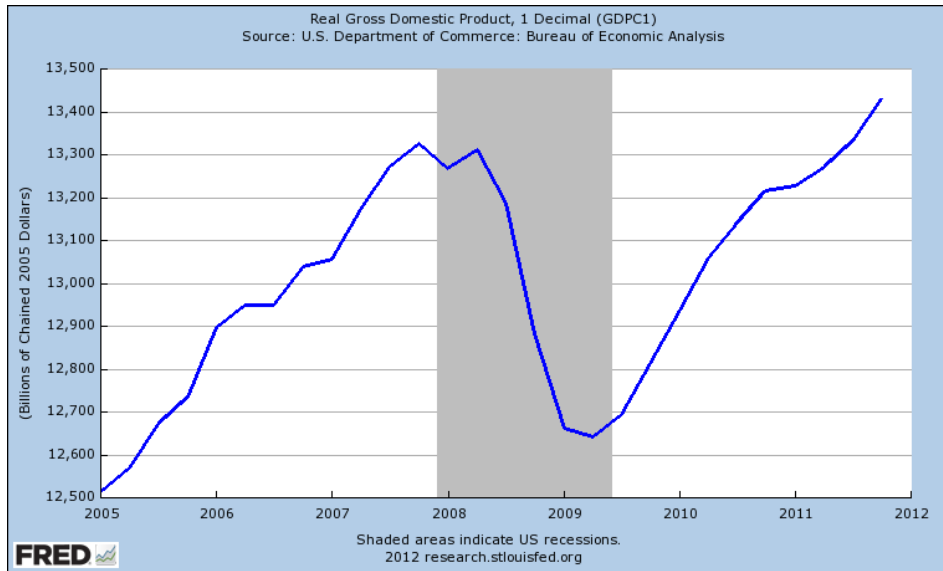
## *Incomplete approaches*

- Internal devaluation
- Structural growth policies
- Stress tests
- Liquidity provision
- National bank support
- Austerity
- Bailouts
- Raise capital requirements

## *Unified package:*

- Fiscal devaluations
- Higher inflation target
- ECB liquidity for sovereigns
- EFSF capital for banks
- Fiscal expansion in countries that can afford it

# 1. But, shock vs. propagation



# Impact on policy evaluation

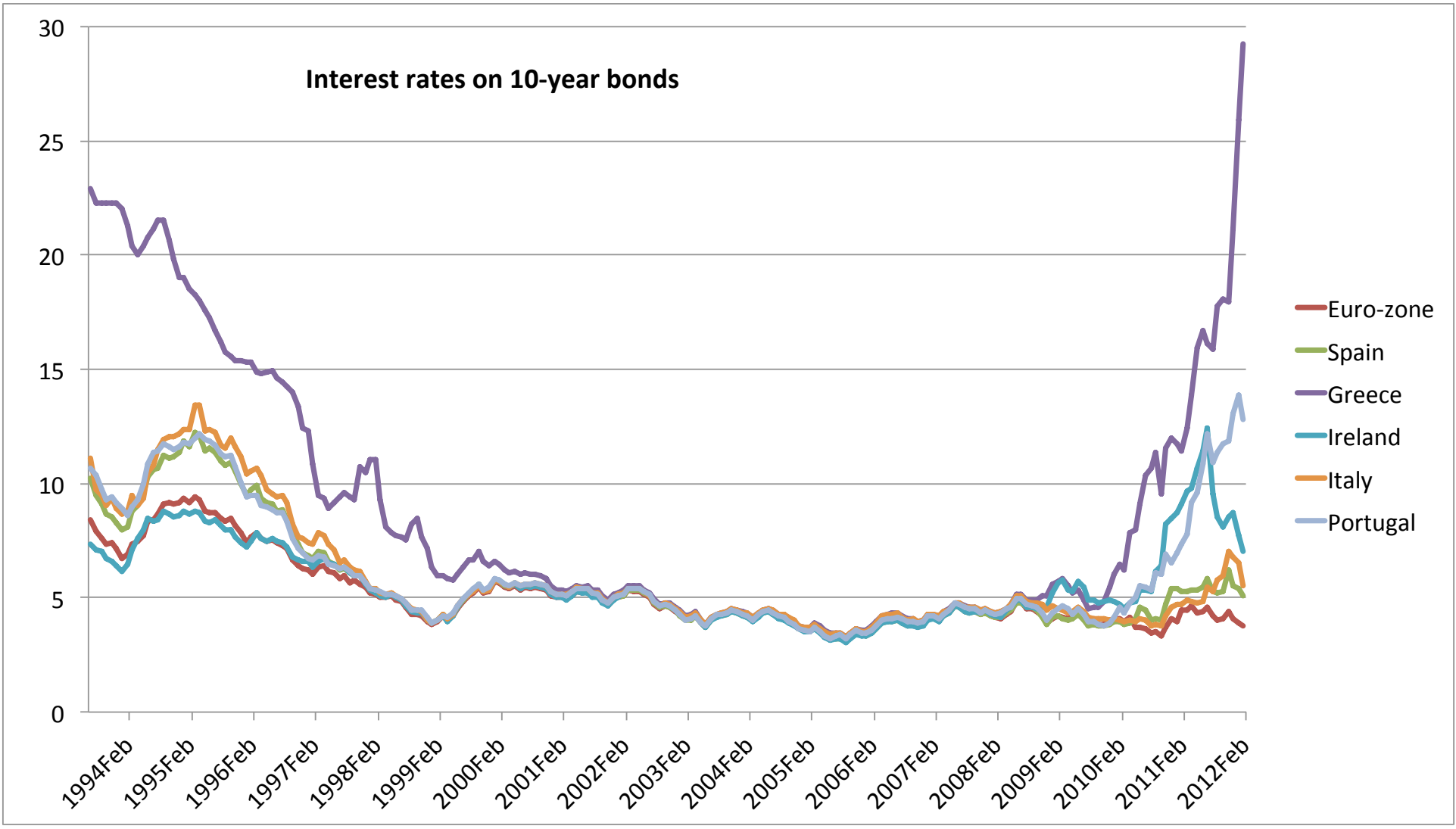
- US analogy: is deficit spending an incomplete approach?
- Crisis resolution versus first-best economics.
- State building.
- Europe and competitiveness: structural funds, the Lisbon agenda, new “Marshall” plans, ...

## 2. On the competitiveness problems

Trade flows versus capital flows.

Alternative narrative:

- Euro removes currency risk, perhaps optimism
- Northern Europeans diversify savings abroad, capital flows south. Key date is 2002-03, not 1999.
- Financial crisis, risk perceptions rise, sudden stop
- Global imbalances, not trade
- Post-Lehman fear of default, sovereign bailout of banks, back to the financial sector.



## 2. On the competitiveness problems

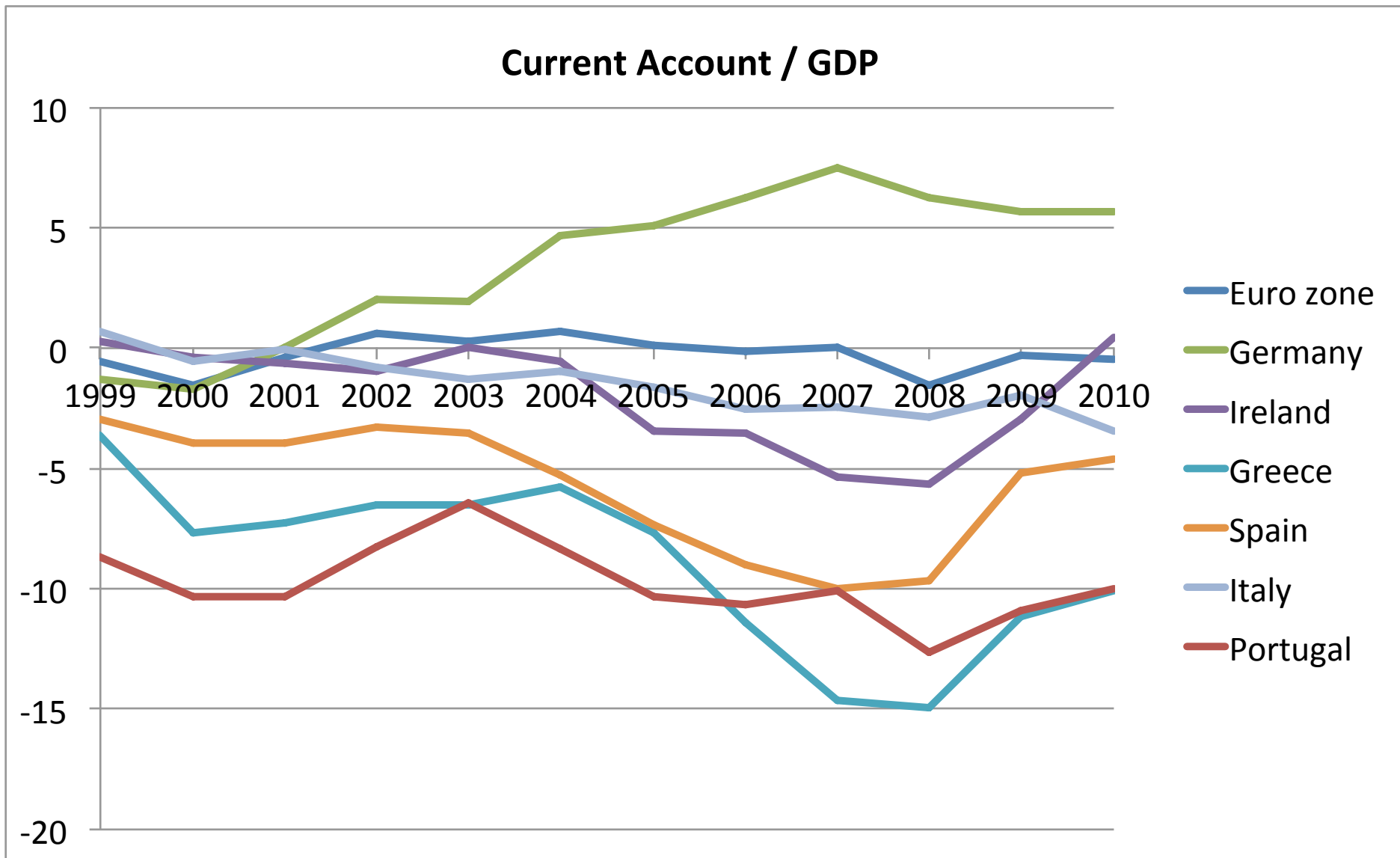
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# Flows and 99 versus 03

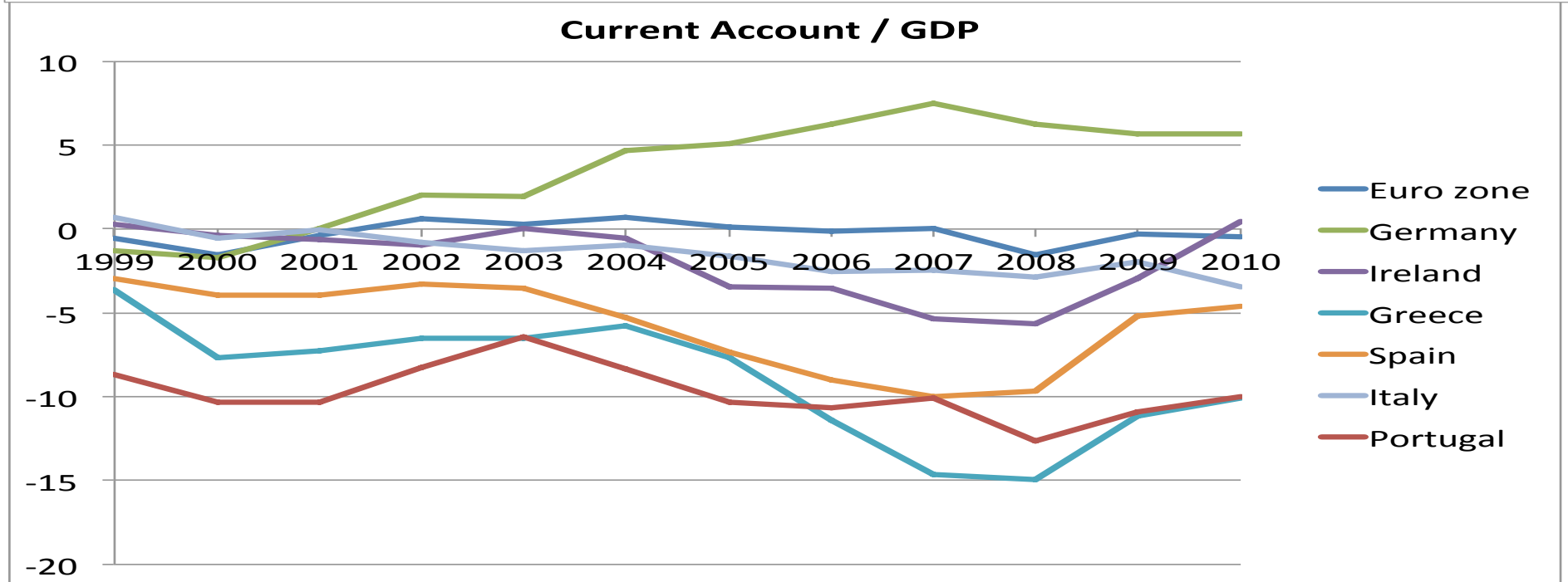
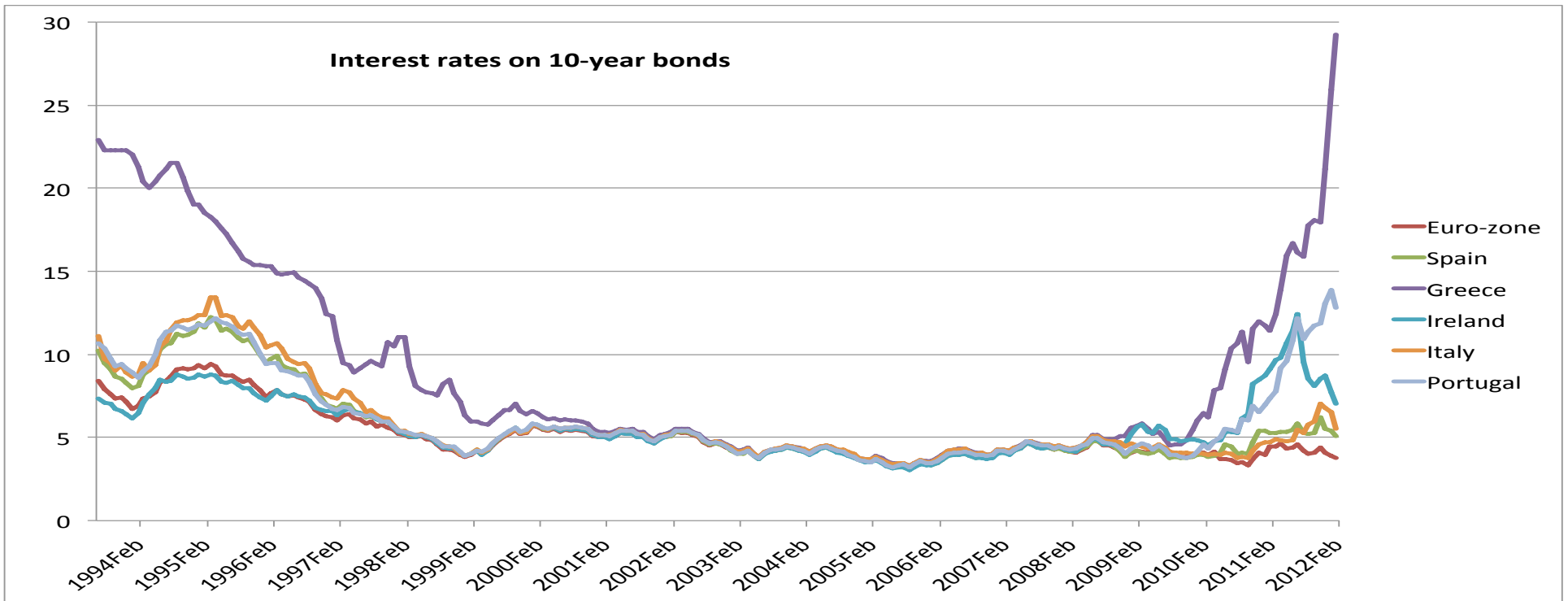


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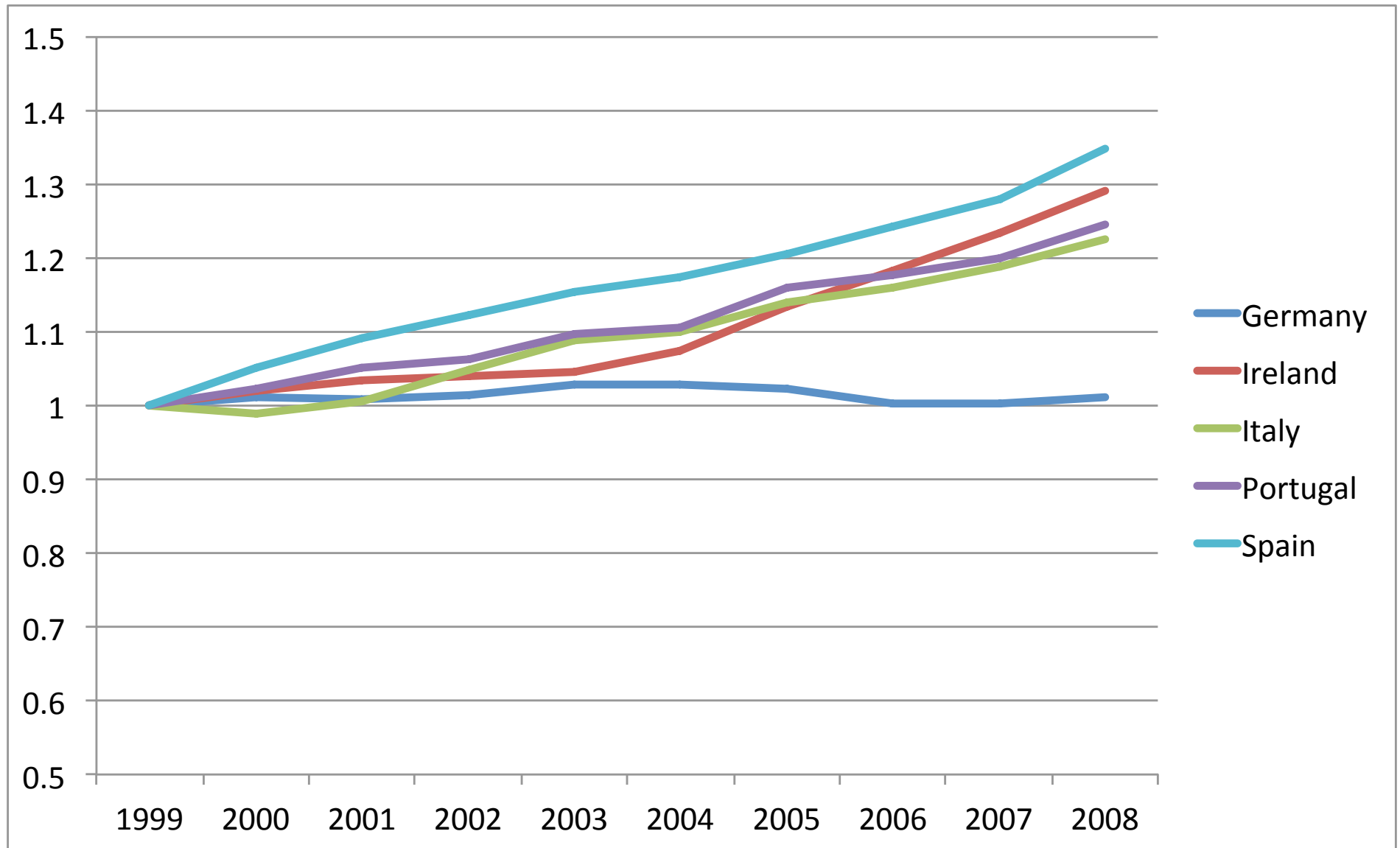
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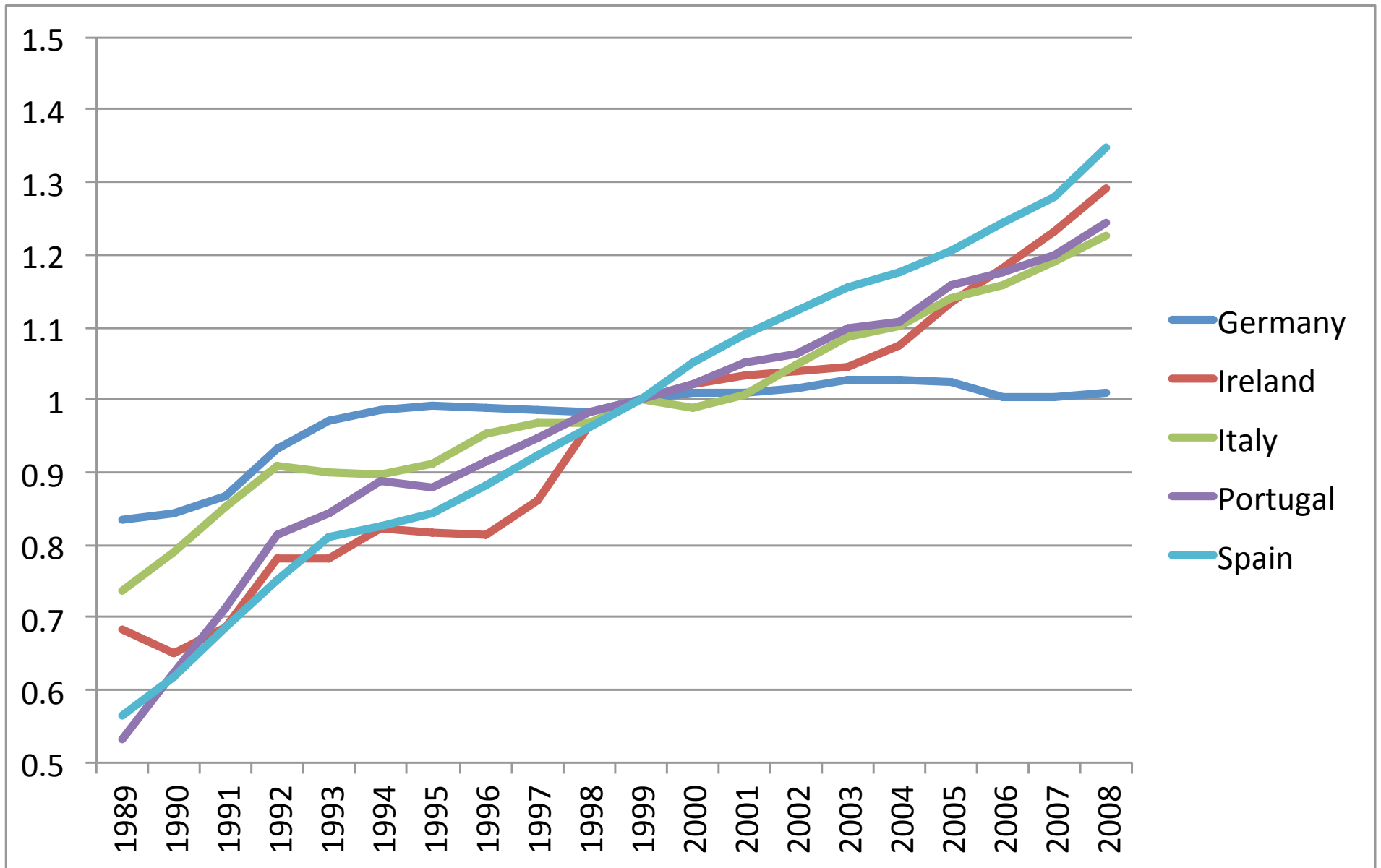
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# Unit labor costs, the great divergence



# But look also before the euro



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### 3. A focused alternative

If the problem is:

- Diabolic loop between banks and countries.
- Capital flows, sudden stops, flight to safety.
- Too much leverage.

A direct attack would be to:

- Give banks safe bonds not tied to sovereign state.
- Divorce flight to safety from CA and geography.
- Price risks adequately.

*What we need is a European safe asset*



# Euro-nomics.com



- European debt agency (EDA) buys sovereign bonds from each EZ member.
  - Fixed proportions (60%) relative to lagged GDP.
  - In secondary market!! (uses market prices)
- It issues senior bond (ESBies) and junior bond (EJB).
  - ESBies are fixed fraction of total collateral (70%).
- Large market: Esbies around 4tn.
- Pass-through: No joint guarantees!