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What should we expect from the euro-area summit?

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Bruegel hosted a lunchtalk with Zsolt Darvas (Research Fellow at Bruegel) and André Sapir (Senior Fellow at Bruegel and Professor of Economics at ULB) who was also the chair of the event.

André Sapir started his talk by stating that Europe is facing a debt crisis which has different effects across the Euro Area (EA) countries. He highlighted that it is more a crisis of peripheral economies. Moreover, if one looks at some fundamentals like inflation, unemployment, public accounts, etc…the general picture in EA countries is better than other major economies in the world, he stated.

At least two more elements, he continued, characterize the crisis: fiscal discipline and inappropriate governance. Europe has done much on the reactive side (i.e. in designing the response to the virulence of events) but has to do much more on the proactive one (i.e. on the prevention), he affirmed. He added that the EA-Summit should propose an ambitious comprehensive approach that allows countries to exit the current crisis and, at the same time, avoids them to repeat the same mistakes in the future. Even if there seems to be a relatively broad consensus on what to do, the EA-summit outcome could be undermined by country-specific factors (i.e. different political and economic domestic situations), he claimed.

He also said that despite what has been done already, more has to come both on prevention and resolution mechanisms. First, prevention instruments in place were clearly insufficient, he said. He suggested to strengthen the role of ISRB as well as to put more emphasis on the interconnections between financial markets movements and the real economy. Second, banks should receive more attention and stress-tests should be run in a credible way if one wants markets and operators to believe in their results, he concluded.

Zsolt Darvas claimed that the current crisis is of the state members and not of the EA (he suggested to look, for instance, at the Euro/Dollar equilibrium exchange rate to have a clear indication of the truthfulness of his statement). EA is clearly not an optimal currency area and divergences exist within and across core and peripheral economies, he commented. In terms of competitiveness, for instance, Germany is different from Greece (core vs. periphery) but Greece is different from Spain (divergence within the periphery), he further stated. Nevertheless, he claimed that those differences should not be

perceived as insurmountable limits since other common currency areas (e.g. the USA) show similar differences within members. Finally, he believes, the lack of fiscal federalism in the EA should not be seen as big problem since it is not a sufficient condition to generate economic growth.

Looking at the EA-Summit, Mr. Darvas noted that probably a lot of emphasis has been put on competitiveness tough the package to be discussed contains much more (e.g. pension reforms). Germany will play a big role in the resolution of the current crisis as well as in the implementation of prevention tools. For this reason, he said, it is important not to give the idea that "Germany is paying for everybody". The competitiveness package is very important for Germany but Mr. Darvas pointed out that it is more as an instrument that can prevent future crises than a tool to departure from the current one.

The audience repeatedly asked why leaders are reluctant to talk about what they believed to be the real problem of the current crisis: the banking sector. Speakers answered that politicians hesitate to do it because they are sometimes afraid of creating a sort of Lehman Brothers panic situation and then be blamed for that. Moreover, both the panelists lamented the lack of reliable banking-sector data to propose a clear policy. Some attendees drew the attention of the speakers on the possibility to impose sectorial sanctions. Prof. Sapir showed his favor for an approach that combines market discipline as a prevention tool and sanctions to be used when markets overreact. Mr. Darvas, instead, suggested market discipline as an ex-ante preventing tool but also as an ex-post effective sanction. The magnitude of markets punishment and the consequent fiscal adjustment countries will have to make will be larger than any sanctions imposed by EU institutions, he said. He finally added that EU-level sanctions can give politicians the occasion to blame Brussels for domestic problems.