Postscript

On November 29th, 2012, this report was published in the Netherlands. Many commentaries judged that the report is independent, well-founded and well-balanced. Below, I will summarize some critical responses to the report and give a short response to each of them.

In response to an interviewer, Van Wijnbergen states that a Grexit and the resulting devaluation of the Greek drachma will increase the debt burden and cause hyperinflation in Greece. Van Wijnbergen argues that the economic policy should aim at raising productivity rather than wage cost reduction. Van Wijnbergen is an excellent economist and his views on economic policy are often very relevant, but it seems that Van Wijnbergen did not have the opportunity to read the report himself before responding to the journalist, because his remarks are discussed at several places in the report. Given the uncertainties, it is indeed possible to defend Van Wijnbergen's view. He basically repeats the views of Buiter (2011) described in the report. But these views neglect the empirical evidence that indicate that inflation will probably not fully redress the positive effects of the devaluation. Consequently, he also ignores the possibility that a country with large foreign debts may be more able to repay its debts in the long run if the economy recovers after the devaluation. Furthermore, I agree that raising labour productivity would be the first best solution. I have referred to the case of Portugal to illustrate this point. However, as discussed in the report, it will take many years (decades) before the gap in labour productivity between Greece and northern European countries will be bridged. Moreover, it is highly uncertain to what extent policy reforms that aim at productivity growth will really succeed. This shows one basic feature of the debate on the euro, namely that the proponents of one or another policy option often stress certain risks (which are certainly present), but neglect other risks that would cast doubt on their view.

Another response is from Mathijs Bouman. He qualifies the report as a rational and balanced report. But still Bouman believes that the report misses the crucial issues. First, he criticizes the method used. I use the prevailing economic theory of optimal currency area and apply it to different options of the euro zone. On the basis of this theory, I conclude that a preference for maintaining the current policy of the current euro zone is ambiguous. Bouman argues that we already knew that the EMU is not an optimal currency area. But that is not, according to him, the cause of the current problems. Rather, the euro crisis has been caused by the financial crisis. My response to this criticism is that the theory of optimal currency union is definitely of great importance to assess the conditions under which the euro zone constitutes a stable currency area. Indeed, currently the crisis in the banking system is the direct cause for the divergence within the euro zone. But in the future, another shock could put pressure on the euro. The report shows that it is not likely that all countries in the current euro zone will meet the OCA criteria in the short or medium term. That means that economic shocks in the future will cause quite different economic developments in different countries and will again be very costly. We live in a world full of economic crises. From 2001 to 2008 is only seven years. It is too optimistic too believe that the probability that between now and ten years, no other major shock will occur in the world economy that will lead to divergence in the euro zone again. Think of a war in the Middle East with great implications for the oil price; a conflict between China and Japan or possibly the US; or a dollar crisis if the US cannot control its high debts anymore. That is why it is so important for the euro zone to meet the conditions of the OCA theory in the next ten years. As stated in the introduction of my report, the report aims to analyze the long-term trade-offs: is the long-term goal where the current policy strives at really sustainable? To answer this question, the theory of the optimal currency area is the most appropriate instrument of analysis.

The second criticism of Bouman is that the report does not indicate how the transition to another euro zone should take place. For example, how do you avoid capital flight? Bouman acknowledges that the report does describe these problems and that it calls for a good management of the exit as an important precondition for this. But the report does not go into details with regard to the management process. On the one hand, Bouman is right. But I do not consider this as a serious problem, as the report refers to (among other things) the comprehensive and award-winning study of Capital Economics 'Leaving The Euro: A Practical Guide', which focuses precisely on this question. If Bouman does not agree with the analysis of Capital Economics, he should criticize this report (which he does not).

A final serious criticism is that the report too easily ignores the biggest risk of an exit of Greece, namely the risk of contagion. Although the report certainly mentions this danger and warns that this might happen, a solution to prevent the contagion effect is not given. I think this is a valid and serious criticism on the report. Actually, in an earlier version, I did formulate some guidelines on how to deal with this danger. But since this topic is also an element of good exit management, I did not expand on this analysis. But in the (unpublished) section on this issue, I stressed that a good timing of the exit is crucial. For example, I think that, if the economy develops in a way that makes a Grexit more politically preferable, one should implement a Grexit when confidence in other southern European countries is already recovering. As soon as financial markets have changed their expectations for the economic development in Italy or Spain, a Grexit will probably cause much less turmoil in financial markets than right now. At that time, it will be no longer necessary that the ESM is enormously extended to fully protect Spain or Italy or that the ECB extends its safety net beyond reasonable limits to neutralize contagion of these large countries.

FD reporter and ex-Brussels correspondent Martin Visser judges that the report is pleasant to read, because it is very nuanced. In his view, all arguments are presented in a clear way. But a big disadvantage of the report is that it gives no quantitative underpinning. All figures are retrieved from other sources, of which some are lacking scientific status (like The Economist). I partly agree with this criticism. Although the report presents some original empirical analyses, most figures are indeed based on different other sources. A more systematic empirical analysis is definitely possible and warranted. Given the small budget available to the ChristenUnie, it was however not feasible to dig deeper into the quantitative analysis. Moreover, as stated in the report, one should be aware that the factors that are crucial for the policy evaluation are inherently highly uncertain. Even if one would employ a larger research team and have more data available, it would still be very hard to narrow down the kind of uncertainties discussed in the report.

ND editor Peter Bergwerff also doubts the feasibility of a Grexit, because it should be well managed, very speedy and secretly prepared, allowing no democratic control in order to prevent financial disorder. In the report, I acknowledge that democratic legitimacy of a Grexit will be absent. But when deciding on such an exit, one could certainly make a good assessment of how the Greek people will perceive an exit and take this into account. Moreover, currently many fundamental financial decisions are taken in the EU that also lack a good democratic legitimacy for exact the same reason, namely to prevent financial disorder. If one would take Bergwerff's argument literally, the euro zone would be a kind of Hotel California: once in, one can never leave. This may deter other countries that are currently outside the euro zone, to become part of it.

This brings me to another, more fundamental, point. Namely, that my analysis implies that the sustainability of the euro zone requires a design of exit conditions. Exit conditions will discipline the euro countries in the future (Eijffinger and Mujagic, 2012). However, exit conditions can only function properly if the possibility of an exit is seriously considered. Obviously, this would be an important change in the current commitment to the euro zone. Because once one is convinced that a design of exit conditions is required to make the euro zone sustainable in the long term, one admits that the current euro zone must not be maintained at all costs.

Next, if policymakers do, for the sake of the stability of the EMU, formulate exit conditions, my report indicates that it is not plausible that all countries of the current euro zone will meet the conditions of staying in the EMU in the medium or even long term. The political implication is that policymakers should keep other options than the integration of the current euro zone in mind. This means, for example, that it is sensible to amortize Greek debts, because that is inevitable anyway, even if Greece stays in the euro zone. But it also keeps open the option of a Grexit, if the economy develops in a way that makes this option more likely.

According to the economist Beetsma, the report rightly states that continuing the current policy is untenable, because then Greece's economy will fail to recover. Nevertheless, Beetsma thinks that keeping Greece within the euro zone is better than a Grexit. Because a Grexit will not help the Greek economy, which is barely competitive, ahead. Before Greece entered the euro zone, it regularly devaluated its drachma to be cheaper and be able to compete with foreign countries. However, at that time, the Greek economy did not become stronger. According to Beetsma, that is what Europe is doing right now, by forcing Greece to sound public finances and privatisations.

This criticism is similar to Van Wijnbergen's point that a Grexit is not a first best policy, which I agree on. The reason why a Grexit should, nevertheless, be taken serious is that one can doubt whether Europe can continue to take over the management of the economic policy in Greece forever. Beetsma does not address the issue of cultural differences in Europe. But in the long term, these cultural differences may have a decisive influence on what is politically feasible.

Beetsma and Bovenberg also criticize the evaluation of the exit of more southern European countries from the euro zone, basically for the same reasons as expressed by Peter Bergwerff that it is not feasible to keep an exit secret. Consequently, financial disorder effects may set in, as described in the report. According to Bovenberg, an exit of Spain and Portugal would make investors doubt that Italy and France can be maintained within the euro zone. And then the whole euro zone will collapse. Moreover, the debts of these large countries are too big for writing off. I do agree with this criticism. I already noted this danger myself by describing it as the major threat for this policy option (see conclusion 9 of the summary). But I refrained from judging that this risk would dominate the advantage that if Greece, Cyprus, Spain and Portugal leave the euro zone, the remaining euro zone will gain in convergence and stability. Beetsma and Bovenberg may be right about this. However, again much depends on the timing of the exit as well as on how Italy and France will develop. If Italy and France are able to improve their competitiveness and government budgets in the nearby future and the euro zone stabilizes, an exit of other southern countries than only Greece will not be as dangerous anymore for the remaining euro zone.

Furthermore, Bovenberg repeats the criticism of Bouman that the report ignores the role of the financial sector in the euro crisis. According to Bovenberg, Spain got into trouble, because Spanish banks lent too much to the real estate sector. As I already stated above, I think this is true, but only partially. Because in the future, other large shocks may occur that will cause divergence in the euro zone, if countries do not meet the conditions for a common currency area. Moreover, as described in Chapter 2, Spain would have been better able to prevent the bubble in its real estate market, if it was not a member of the euro zone. Because then, its central bank would have probably applied a more strict monetary policy with consequently higher real interest rates.