

Professor and Nobel Prize winner Joseph Stiglitz has been touring Europe to promote his new book, and I have been following his trip with interest.

In the book Professor Stiglitz argues that the EU will collapse if we keep pursuing our present policy on the common currency. I think his analysis is incomplete, and as a result, his conclusions are unsound. I would certainly not claim that everything is going smoothly in Europe, but the solution is not to abolish the euro to preserve the EU. Rather, the solution is to deal with Europe's economic problems so our countries continue their recovery.

It's true that the decision to establish the euro was ultimately a political one. This was entirely understandable, given the need for political unity after the fall of the Berlin Wall, but the introduction of a common currency did entail certain economic risks.

Many regard the loss of an exchange rate mechanism as the main risk of a currency union. I don't share this view. The exchange rate is a useful buffer for absorbing cyclical shocks between countries. Yet studies have shown that the economic cycles of the eurozone countries are broadly aligned. Moreover, currency devaluation does little to address the structural shortcomings in these countries' economies. And if there is any effect, it is short-term.

If we return to the introduction of the euro, we can see that the problem did not stem from the loss of exchange rate levers. The problem was that financial markets made no distinction between the member states with regard to risk, even though there were enormous differences in growth potential from country to country. For example, the availability of cheap credit led to real estate bubbles in places like Ireland and Spain. In Greece and Portugal, too, credit and consumption increased sharply, and wages rose faster than productivity. Interest rate differences disappeared, while differences in competitiveness increased. The low interest rates led to a surfeit of credit, of which very little was invested in productive sectors. When the financial crisis hit, interest rates exploded. Government had to step in and save the banks.

Professor Stiglitz sees the favourable economic development of Sweden, a non-euro country, as proof of his assertion that the euro inhibits growth. The Swedish economy has done well, to be sure, but the economic performance of a non-euro country like Norway has been comparable to that of the eurozone since 1999, while Denmark's economy has actually underperformed that of the euro area.

Sweden is an interesting example for another reason: it shows that debt-driven growth of the kind witnessed in the eurozone prior to the crisis is not confined to currency unions. In the early 1990s Sweden also experienced a housing bubble, followed by a major financial crisis. At the time the government intervened to save the Swedish banks. This shows that financial imbalances can also accumulate outside a currency union.

It is also instructive to compare the Czech Republic and Slovakia, two similar economies that previously shared a currency. Since introducing the euro in 2009, Slovakia has grown faster than the Czech Republic, which does not use the euro.

My conclusion therefore is that it is not the common currency but rather national economic circumstances and institutions that make the difference when it comes to limiting the build-up of financial imbalances.

The currency union did not have the authority to rein in bad national policy, and it was not prepared for a serious crisis. Oversight of the banking sector was inadequate, and there was no effective framework in place for dealing with banking and debt crises. When banks got into trouble, they were bailed out with public funds, driving up national debt in various countries.

Since the crisis a number of major steps have been taken. First the creation of Europe's rescue funds, followed by the establishment of the banking union, which tightens oversight to guard against the proliferation of vulnerabilities. In addition a framework has been set up for the recovery and resolution of troubled banks. Since the banking crisis in Cyprus, 'bail-in' has become the norm: when a bank gets into trouble, it is the investors who must pay the bill. This way, they have an incentive to price risks accurately, and in the event of a bail-out taxpayers are not left to pick up the tab.

Furthermore, member states have made progress on structural reforms that enhance their capacity for growth and adaptability. Spain, for example, has implemented labour market reforms that have resulted in 25,000 new jobs a month, according to the OECD. On the World Bank's Doing Business Index, Greece has risen from 190th place in 2010 to 60th place in 2016. This year, its government deficit has been further reduced to 1.6%. To ensure that budgets are also sound over the long term and to establish buffers against future economic shocks, budgetary rules have been tightened.

So is all the criticism of the EMU unfounded? Of course not. Our approach to the crisis had its flaws. We did not deal effectively with problems in the financial sector. In the midst of a financial hurricane, policymakers were understandably greatly concerned about the danger of contagion on the financial markets. But even so, we should have dealt more aggressively with the financial sector. While banks in the US were forced to recapitalise on the market, in Europe the recovery of the banking sector was not enough of a priority. And in Greece the public debt in private hands could have been restructured back in 2010, rather than waiting until 2012.

Lessons have been learned; defects in the currency union have been recognised, and the eurozone is in much better shape than it was before the crisis.

All the same, the crisis has left scars. Although unemployment in the eurozone has declined over the past few years, it is still much too high in many countries.

There is still a lot of work to be done to stabilise the currency union and improve conditions for growth and employment. In the banking sector more measures are needed to reduce risks. We need to enhance access to finance for businesses and eliminate barriers to investment. Government expenditure must foster growth, especially in those areas where we can promote equal opportunity for all, such as education. And we need to put our budgets in order and keep them that way.

In this way we can preserve our unique European social model, so we can maintain affordable healthcare and pension systems in the future. There is a great deal of work ahead. Nevertheless, Professor Stiglitz has good cause to continue his journey through Europe in a more optimistic frame of mind.

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