



PRESS RELEASE

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WILL THE EUROZONE CRACK?

By Simon Tilford

Europeans often refer to EMU and enlargement as two of the EU's greatest successes. Unfortunately, diverging trends in competitiveness within the eurozone threaten its stability. If they persist, there is a risk the eurozone will break-up. Italy is most likely to trigger a crisis. If Italy fails to improve its competitiveness, it will eventually be forced to leave the eurozone. The consequences would be hugely damaging, not just for EMU, but for Europe more broadly. It could easily force other countries to quit and even threaten the single market.

There is no mystery over what is needed:

- ★ **Market reforms:** The completion of the single market – crucially the removal of barriers to the trade in services – and implementation of the Lisbon Agenda would do much to increase the flexibility of labour and product markets.
- ★ **Stronger wage growth in Germany:** EMU was supposed to put an end to competitive currency devaluations, but that is effectively what Germany is doing by relying on exceptional wage restraint to boost its competitiveness.
- ★ **More expansionary monetary policies:** A less restrictive definition of price stability would increase flexibility within the eurozone by making it easier for members to regain competitiveness without running the risk of deflation.
- ★ **Greater financial market discipline:** To encourage investors to differentiate more between the debts of the members, the ECB should announce that in five years' time it will stop accepting debt that is rated below 'AA' as collateral.
- ★ **Reform of the stability and growth pact (SGP):** The SGP needs to differentiate between current and investment spending, in order to prevent further cuts in public investment hitting growth prospects.

Unfortunately, membership of EMU has, if anything, reduced pressure on governments to undertake the necessary reforms. It is not too late to ensure that EMU is a success, but governments have to act quickly. They must convince their voters that the reforms needed to ensure the success of the euro – liberalisation of labour markets, more competition and sound management of public finances – are also those that will boost economic growth and safeguard public services and welfare states.

Notes for editors:

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