Lasting euro success requires bolder proposals

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As the euro nears its 10th anniversary, the celebration season started this week with the publication of a report by the European Commission that combines hype, critical assessment and cautious recommendations. We share much of its assessment, but we think that its prescriptions should go further. Here is why.

The Commission is right to claim that the euro is a resounding success: the transition to the new currency was astonishingly smooth and, for all the talks about break-up, the reality is one of a steady increase in membership of the eurozone. Citizens have admittedly been disgruntled by price rises in energy, food and some services, but these have clearly more to do with global conditions and the lack of competition in sheltered sectors than with the introduction of the new currency.

The Commission is also right to admit that the euro has fallen short of some initial expectations. It points out that potential European economic growth remains too low and that incentives for growth-enhancing reforms have been too weak. It implicitly recognises that the initial obsession with fiscal rectitude, although understandable given the poor budgetary record of several member countries, has deflected policymakers' attention from the need to correct big macroeconomic divergences. Spain and Ireland, where unsustainable property booms have recently come to an abrupt end, are strong reminders that it may not be enough to put one's own fiscal house in order to achieve stability.

The Commission also acknowledges (though in an oblique way) that enlarging the euro area to include new European Union members is a significant challenge. Finally, it bluntly admits that, in spite of having created the world's second most important currency, the euro area still lacks a clear international strategy. These are frank and useful assessments; the Commission should be praised for making them.

However, the recommendations do not measure up to the challenges identified. To start with, they do not touch upon the monetary strategy of the European Central Bank. Institutional constraints are real. But, although there is much to commend in the performance of the ECB, any serious discussion of the euro area record should include monetary policy.

The Commission rightly calls for a more focused co-ordination and surveillance of national policies but is not candid enough on what has worked and what has not in the current system. Ten years into the euro it is time to be lucid: detailed procedures that aim at fine-tuning national policies cannot and do not work. Governments are accountable to their citizens. They find it useful to share information, benchmark their performances and consult each other on priorities, but they will not abide by detailed guidelines drafted in Brussels. As we and our colleagues pointed out in a recent report, Coming of Age (Bruegel, 2008), the euro area needs fewer routine procedures and more ability to act in times of real crises or to prevent them. The role of the euro area system is to create the right incentives and to allow individual governments to pursue their own goals within that framework, while providing the means for joint action when the stability or the functioning of the common good – monetary union – is in danger. The wisdom of this philosophy – with less frequent attempts to co-ordinate and a greater emphasis on watching the big picture – will only grow stronger as the euro area enlarges further and becomes even more diverse.

The Commission is embarrassed on enlargement. This is unfortunate because the overly legalistic approach to joining the euro area that has prevailed until now risks creating a lasting divide inside the EU.

A country that is catching up – with fast growth in output and prices – may, for a while, need to retain a flexible exchange rate regime, which provides a better way to control inflation than joining a monetary union where the interest rate is set in relation to the situation of a large group of mature countries with slow growth and low inflation. But when the country that is catching up decides that it wants to join the euro, its ability to do so should be assessed on the basis of criteria that take into account its specificity. At the moment the EU acts incoherently: it insists that new member countries have a duty to join, but that their readiness should be assessed on the basis of criteria designed for mature economies at a time when the euro did not exist. The Commission goes some way towards recognising the challenge but fails to draw the consequences.

Finally, the Commission is too shy on the external dimension. The fragmented representation does not allow the euro area to play its full global role. This contributes to making the US and emerging countries unhappy about Europe's continuing over-representation in institutions, such as the International Monetary Fund, and complicates global governance, which the EU proclaims it wants to strengthen. Yet procrastination prevails because no euro area country is in a hurry to relinquish its international standing. The euro area now needs a roadmap. If there is one player that should dare to propose it, it is the Commission.

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