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Olivier, you are not a centrist, but there is a lot of space between the two, so it is easy to do.

Olivier BLANCHARD

The Euro has real problems that Jean-Claude Trichet did not emphasise but Ashoka Mody over-emphasised. They can be alleviated but not eliminated.

For most members, although perhaps not all, the Euro is the least bad of monetary and exchange rate arrangements.

The basic problem of the Euro is the original sin. Robert Mundell stated conditions for an optimal currency area, and it is clear that the Euro just does not satisfy those conditions. Countries have different shocks. Labor mobility across countries is low. Wage and price adjustments are too slow.

Little can be done about the first two. The focus should be on improving the third. This requires improvement on three fronts.

At the euro level, higher average inflation, to allow countries which need to depreciate to do it without requiring decreases in nominal wages. This is the job of the ECB.

At the euro level, respect of the macroeconomic rules of the game. Countries with current account deficits must depreciate, i.e. have lower inflation than the average. But also, countries with current account surpluses must appreciate, i.e. have higher inflation than the average. Germany is not playing by these rules.

At the national level, more trust between social partners to allow for a faster, less painful adjustment of wages and prices. While trust is not built in a day, and there is no magic recipe, trilateral discussions at the national level can improve the outcome.

The Euro has real problems that Jean-Claude did not emphasise but Ashoka over-emphasised. They can be alleviated but not eliminated.

I have seven points.

The first point. Remember the remark about democracy being the best of all bad systems. It is the same with the Euro – for most of the members, maybe not all, the Euro is the least bad of monetary and exchange rate arrangements; as a footnote, some members might be better off outside, but let us leave that aside.

The reason I say this is that we tried the other ways before – we tried the soft peg, we tried the hard peg, and they did not work so well… So what is left is floating, which would be difficult to manage given the depth of economic and financial integration between some of the members. Floating between Germany and France seems like a non-starter; I just do not see it. We have to accept the fact that there is no perfect monetary system or exchange rate arrangement, and this is probably the best we can get, so we had better make the best of it.

The second point. Why is the Euro not functioning well? It is due to the original sin – Robert Mundell stated conditions for an optimal currency area, and it is fairly clear that the Euro just does not satisfy those conditions. Either you need all the countries to have the same shocks, which we found not to be the case, or you need high labor mobility, so that when one country does poorly, people move to another; it is clear that there are sharp limits to mobility across Euro countries, especially when people do not speak the same language.

So, when you have a shock, you need to adjust competitiveness and thus relative prices, and that is what is not working well. Europe has many other problems, and they interact with this, but this one is the implication of the Euro itself.

The third point. This lack of adjustment is a critical issue. We saw it in two waves. First, we saw the very large current account deficits of the countries in the South, be it Greece, Portugal or Spain, and how dangerous they were. When you cannot adjust your relative price and run very large current account deficits, then you risk running into trouble, and this is what happened.

Now we are seeing the opposite problem. We are seeing an enormous German current account surplus. It is a different beast, because you can sustain a surplus more or less forever, but it is not a good idea from the Euro point of view. The current account surplus in Germany is leading to Euro appreciation, which is clearly affecting other countries, and has all kinds of other effects. The lack of adjustment in prices and wages has major implications, and we know these can determine politics, which we are seeing.

The fourth point. Why is the price adjustment so slow and difficult? The first reason is not all countries play by the rules. Germany is not playing by the rules of the Euro, and that is important. The second reason is that, even when countries play by the rules, there is a very slow response of prices and wages to the labor market, and as a result you have a long period, in the case of current account deficits, of high unemployment. This is very costly, in human, and as we see now, in political terms. Let me take both reasons in turn.

The fifth point, on rules. In a common currency area, countries which have current account deficits should depreciate, i.e. increase prices less than the average, and countries that have surpluses should appreciate, i.e. increase prices faster than the Euro average. If countries with large current account surpluses do not do so, whether by relying on contractionary fiscal policy or other means to limit demand and, as a result, inflation, then the other countries just cannot adjust. That is exactly what we see in Germany, where there is great reluctance to let inflation exceed the Euro average. But, as a matter of basic arithmetic, if some countries need to decrease their prices relative to the average, the others have to accept to increase theirs relative to the average. Otherwise, the adjustment cannot take place.

The sixth point, on the slow adjustment of wages and prices. When the average inflation rate in the Euro is low, a country that needs to depreciate, and thus have lower inflation, may need cuts in nominal wages, and this is extremely difficult to achieve. People do not like cuts in nominal wages, it does not happen, so you do not get the adjustment. Average Euro inflation should be higher, an issue for the ECB to handle.

Another reason why wage and price adjustment is so difficult to achieve is the lack of trust between social partners in many countries. What is needed in a country with a current account deficit is a parallel decrease in wages and prices. The important word is parallel. To the extent that some goods are imported, the real consumption wage needs to decrease, but not by much. The issue is coordination of wage and price adjustments. If social partners trusted each other, this could be achieved quickly, rather than through a long period of unemployment, leading to the same outcome but with five or 10 years of hardship. The level of discussions between the social partners in countries – and I am thinking of my own, France – is extremely poor. It used to be much better under what was called indicative planning in the old days. Social partners would sit down and see what could be done, and then they either agreed or not, but at least they discussed the issues. It is not happening.

Bottom line. What would I do to improve the Euro architecture? I would want higher inflation at the Euro level, not because I like inflation, but because low inflation makes the required relative price adjustments much harder. I would like more than 2%, but I want 2% at least. I would want respect for the macroeconomic rules of adjustment, at this stage, a relevant issue in the case of Germany. I would work hard to improving labor relations at the national level. I will end by mentioning one issue I did not discuss because, while it is on most people's wish list, I am not sure it is of the essence, namely fiscal union. I fully agree with Jean-Claude about the banking union, the capital markets union, being an essential component of the Euro architecture. I am not sure that the fiscal union is of the essence. It would be good to have it, but, even in the US, which is often mentioned as the reference because of the pre-eminence of the Federal budget, it plays a limited role in facilitating adjustment to state specific shocks. But this is a discussion for another time.