



Paul Krugman, Euro and the stimulus debate

Dear Reader,

The single union concept was formed in the year 1969, while Euro, as a unified currency, came into existence in the year 1999. With the commissioning of this new currency, the European Union heralded the beginning of a single monetary policy which provided a new financial framework for Europe. The policy made authorities shift from every nation's central bank to The European Central Bank and this shaped the interest rate movement across the borders.

A recent article by Paul Krugman on 'What the matter is with Europe' has raised some interesting questions. Considering Krugman stature, it is not surprising that his comments on economic matters are widely read and debated. His take on why Europe's response to the current crisis has not been swifter and more decisive are based on his view that the adoption of single currency by diverse governments has weakened the economical structure. His views, though not explicitly, indicate that the cracks in the economy are a result of the creation of a single economic zone and the creation of Euro as the common currency. The debate on the merit and demerit of this economic structure continues in the world economic forum. Like any other economic debate, I don't see any of the parties persuading us decisively in favour of their point of view.

Though I find merit in Krugman's views, about how the use of single currency across different governments in Europe has created inbuilt contradictions, and have made it challenging for governments to be swifter and be more decisive in addressing a crisis of this magnitude, I beg to differ on his view about Euro being a sub-optimal solution. For Europe, the creation of a unified economic block and the policy of single currency have certainly helped removing inefficiencies of the system. It increased Europe's bargaining power while trading with the rest of the world. The world economy has also benefited from the availability of two important currencies to trade with. It has helped the free movement of goods and services between the markets within the Euro zone. It has made labour movement possible and has helped to distribute wealth among nations which are part of this European economic block.

However, Krugman's views on the pressure that European economies bear today are not without merit. These economies are weak today. And he suggests that this weakness has its origins in the adoption of EURO as the common currency as it has become a significant obstacle in building a reliable structure of a bailout plan and the proportion of contribution by each nation. On the contrary

I believe this structural weakness is deeply rooted in the high tax regime and the lack of sufficient labour reforms. I believe the leakages in the system will help Europe recover faster from the situation we are all in today. Though the high tax regime helped maintain a certain level of income at the hands of the household, in the longer run it will prove to be a leakage from the same household sector. Therefore it restricts the ability of the family to spend on goods and services. Though Krugman argues that the high tax structure has an inbuilt mechanism to propel or hold a certain level of spending, it has always been a dampener to the efficient allocation of capital and labour.

The fear that a country will not be able to stimulate its economy by devaluing its currency to shore up the exports appears very real. Since there is limited scope for a nation to initiate changes reflecting its economic structure of production and consumption, it is argued that Euro may rather constrain the efforts to choose the right policy tools to address the current crisis. However a combined policy mechanism which influences the host of nations can be considered more effective. In that context it is too early to give the final verdict on this matter. I believe collective wisdom of the political leaders will prove Krugman's predictions inaccurate. In the light of this, current financial crisis may offer an opportunity to the European leaders to address the much needed reforms in the high tax and labour law regime.

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