Not Out of the Woods Yet:
Economic Growth and the Future of the Eurozone

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Last month, the Viessmann Centre, along with the Laurier Centre for Economic Research and Policy and the Lazaridis School of Business and Economics welcomed Dr. Jeffry Frieden, Professor of Government at Harvard University, to campus as the 2015 Economist-in-Residence. Dr. Frieden delivered a thoughtful and engaging talk on the "The Future of International Finance" to a packed audience of students, faculty and special guests.

Frieden has published widely on such topics as the international monetary system, the political economy of exchange rate regimes and European currency and integration. His recent book, *Currency Politics: The Political Economy of Exchange Rate Policy*, explores political and distributional motivations for explaining exchange rate regime preferences. A combination of historical narrative and empirical analysis, the analysis is not only informative and persuasive, but also thoroughly enjoyable to read.

Maxine LeBreton, a Masters of Arts in Business Economics student, and Dr. Tracy Snoddon, Associate Professor of Economics, sat down with Dr. Frieden and asked him to share his insights on the ongoing process of European integration and current challenges to the Eurozone.

MAXINE LEBRETON: Most people are well aware of the big problems faced by Greece and other heavily indebted European countries over the past 2 years or so. There was a lot of speculation that Greece would have to "leave" the Euro or perhaps Germany and other more stable members might strike out on their own. Can you bring us up to speed on what has happened since then to forestall these dramatic predictions –with particular emphasis on the monetary policy?

DR. JEFFREY FRIEDEN: A number of things have happened to make the Euro look a little more stable that it has in the last few years and to ease macroeconomic pressures in the European economies. First, the European Central Bank has committed itself to more stimulative economic policies and has been undertaking some really very extraordinary monetary measures to stabilize the financial system in Europe. This has in turn alleviated some of the pressure on the slowly growing European economy. While many countries are not growing rapidly and some are still in recession, most are faring better than a few years ago.

Second, the agreement between Greece and its Eurozone partners on a bail-out package for Greece has helped to reduce uncertainty and stabilize the Euro. Six to eight months ago, after years of difficult negotiations had failed to produce an agreement, there was considerable uncertainty about whether an agreement was possible and it looked like Greece might default on its debts. This raised the question of whether being in default on your debt was inconsistent with being a member of the Euro zone or the EU. Once the agreement on a bailout package was reached this past August, this uncertainty was resolved.

That being said, Europe is not out of the woods yet. Other heavily indebted countries such as Portugal and Spain will still likely have difficulty servicing their debts and may resist austerity measures. In Portugal, a left wing alliance ousted the pro-austerity minority government and the new Prime Minister wants to turn the page on austerity. And political forces opposed to austerity measures are gaining momentum in Spain. We can anticipate more controversial negotiations before we can say that the Eurozone crisis is over.

MAXINE LEBRETON: How solid is the situation going forward? Have the changes you described provided a more stable and permanent foundation for the Euro?

DR. JEFFREY FRIEDEN: Well, the situation depends a lot on the success of the processes I've outlined already. The future of Eurozone solidarity depends on how good Eurozone economic growth is. I think economic growth can paper over a lot of disagreements. As the economy begins to recover, the constraints on economic policy makers will be less severe and the tensions between the Eurozone partners will likely dissipate. And if inflation starts to rise, the real debt burden will be lowered on firms and countries. So the prospects for solidarity moving forward are fairly good, if the economy cooperates.

MAXINE LEBRETON: Are there still big reforms that need to happen?

DR. JEFFREY FRIEDEN: Currently, there have been steps in the right direction. Eurozone partners are implementing banking union in the Eurozone which is a critical step in solidifying financial regulation in Europe. Some of the fiscal policy reforms in the Eurozone countries have set a good fiscal foundation. Reforms that have taken place so far have focused on the long-term rather than the short-term. But Europe's problems are much more immediate and policymakers need to focus on spurring on economic recovery. Right now the most important task for Eurozone members is to rekindle economic growth. Once the economy is growing, Europe can turn its attention to more long term, structural reforms. Without economic growth, there won't be any appetite for structural reforms.

MAXINE LEBRETON: Canada just elected a new Liberal majority government with a wide variety of policies that differ from its predecessor, particularly on fiscal policy. To what extent do you see a need for innovation on monetary policy in Canada? What do you think are the key challenges going forward for this country?

DR. JEFFREY FRIEDEN: Among the challenges that Canada faces are those associated with being a commodity based economy. Canada is diversified but its economy is pulled forward or back largely by developments in commodity markets. Canada is a master when it comes to flexible exchange rates. Given the external shocks particularly from commodity prices that the country faces, it makes sense for the Canadian dollar to be relatively weak. It may not be good from the perspective of the average consumer but it probably is good for economic growth.

We would like to thank Dr. Frieden for sharing his views on economic growth and the future of the Eurozone.