
FOREWORD

The global financial crisis has now turned into a European sovereign debt crisis, abruptly putting an end to a decade of soft budget constraints for the countries in Europe's periphery. Interest spreads are rising once again, awakening memories of pre-euro times. The European Union has intervened with hastily constructed rescue packages and is bracing for a major reform of the European economic governance system, attempting to blend solidarity with market discipline.

In its 10th Report on the European Economy, the European Economic Advisory Group contributes to the debate by presenting a master blueprint for such a governance system. It specifies a three-step procedure that starts off with liquidity support as a first line of defence, followed by a plan to help in the case of impending insolvency and a full-insolvency procedure for the worst case. This system would make the European Central Bank bailout policy superfluous and could in the near future be applied to Greece, whose perilous situation is analyzed in a separate chapter. A chapter on Spain and one on the supervision and possible taxation of the banking sector complete the set of topical issues that the Group examines in depth in this year's report. As always, we start with an assessment of the current economic situation and a set of forecasts prepared by the Ifo Institute and complemented by the Group.

Owing to its truly pan-European, non-partisan nature, the EEAG can offer fresh, unconventional views based on sound economic reasoning for policy-makers, business leaders and academics. Over 10 years, it correctly anticipated the problems arising from the enforcement weaknesses of the Stability and Growth Pact (2002); questioned the euro-area's institutional arrangements in terms of their adequacy for reducing the risk of financial crises (2003); provided a "primer" on the 10 countries that joined the European Union in 2004; voiced a premonitory concern about a possible collapse in real-estate prices in some European countries (2005); warned about the potentially disastrous effects of global imbalances (2006); cautioned about necessary macroeconomic adjustments in Ireland and Italy, being the first to raise a red flag regarding then-booming Ireland (2007); was the first to address the neglected supply side in fighting global warming (2008); put the finger on some of the key factors behind the financial crisis (2009); and anticipated the problems arising from excessive indebtedness (2010).

The EEAG, which is collectively responsible for each chapter in this report, consists of a team of seven economists from seven European countries. This year, the Group is chaired by Jan-Egbert Sturm (KOF Swiss Economic Institute, ETH Zurich) and includes Giancarlo Corsetti (University of Cambridge), Michael Devereux (University of Oxford), John Hassler (Stockholm University), Gilles Saint-Paul (University of Toulouse), Xavier

Vives (IESE Business School, Barcelona) and myself (Ifo Institute and University of Munich). Thomas Moutos (Athens University of Economics and Business) supported the Group with valuable comments and expertise. The members participate on a personal basis and do not necessarily represent the views of the organisations they are affiliated with.

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