
FOREWORD

Recent developments in the euro crisis have cast a long shadow over Europe's future. The emergence of large intra-euro area imbalances and the loss of competitiveness by some euro area countries has resulted in exorbitant private and public foreign indebtedness. Spiralling deficits have triggered major cross-border capital flights from debtor countries, reflecting a loss of investor confidence in the sustainability of the euro area.

In its 11th annual Report on the European Economy, the European Economic Advisory Group at CESifo contributes to public debate over the crisis by analysing intra-European balance-of-payments imbalances as measured by the Target accounts. It discusses the difficult trade-off between short- and long-term risks faced by policymakers, and argues that the euro area cannot avoid a painful process of internal price level realignment to compensate for the missing possibility of external exchange rate adjustments. The Group advocates short-term liquidity help but rules out Eurobonds and other measures undermining investor liability, which would lead the euro area back to a system of excessive capital flows and current account imbalances. The Group reiterates its recommendation to policymakers to introduce the three-stage-crisis procedure described in last year's report.

As always, the report begins with an assessment of the current economic situation and a set of forecasts prepared by the Ifo Institute and complemented by the Group. Two chapters of the 2012 report focus on the current situation in individual euro area countries. In last year's report we analysed Greece; this year we focus on Sweden and Hungary. Sweden, on the one hand, offers a prime example of sound fiscal policies. Hungary, on the other hand, represents a country with deep structural and economic problems that remain largely unresolved. We include a chapter on the regulation of the banking sector, which also summarises the recommendations made in our earlier reports. These recommendations are now more pertinent than ever. The chapter on European energy and climate policy argues that a uniform price signal for carbon emissions is needed in the euro area.

The EEAG, which is collectively responsible for each chapter in this report, consists of a team of eight economists from seven European countries. This year, the Group is chaired by Jan-Egbert Sturm (KOF Swiss Economic Institute, ETH Zurich) and includes Lars Calmfors (Stockholm University), Giancarlo Corsetti (University of Cambridge), John Hassler (Stockholm University), Gilles Saint-Paul (University of Toulouse), Akos Valentinyi (Cardiff University), Xavier Vives (IESE Business School, Barcelona) and myself (Ifo Institute and University of Munich). The members participate on a personal basis and do not represent the views of the organisations they are affiliated with.

I wish to express my gratitude for the valuable assistance provided by all of the scholars and staff at CES and Ifo who helped to prepare the report. This year's participants were Darko Jus and Florian Buck (research assistants), Tim Oliver Berg, Benjamin Born and Nikolay Hristov (economic forecast), Lisa Giani Contini and Julio Saavedra (editing), Christoph Zeiner (graphics), and Jasmin Tschauth and Elisabeth Will (typesetting and layout). Finally, I would like to thank Swiss Re for hosting our autumn meeting.

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