

Report on Bachelor / Master Thesis

Institute of Economic Studies, Faculty of Social Sciences, Charles University in Prague

Student:	Krották, Viliam
Advisor:	prof. Ing. Dědek Oldřich CSc.
Title of the thesis:	The impact of the Euro on German economy

OVERALL ASSESSMENT (provided in English, Czech, or Slovak):

This thesis treats the interesting topic of the spillovers of the integration of a monetary union, for the leading economy. I particularly enjoyed the developments on the political shortages of the European union and hence of the euro zone. The introduction of the chapter on the wages was also challenging.

It is very good to quote articles (in particular up to date), but it has to be relevant and the basics must not be forgotten. The Literature review chapter would also have benefited from a thematic presentation, and not being a simple list of references. Regarding appropriate references, an example could be the 4 main pillars of the Banking Union, which were not set by Profesor Dedek but rather by the Commission/ECB/etc. The thesis could be enriched with a stronger theoretical background, for example a reference to the Taylor Curve in the part on wages/unemployment arbitrage (page 51) or a reference to Kennen on the Optimal Currency Area (together with Mundell and McKinnon) (page 24-27). Some references are missing, for example J. Frankel, A. Rose or P. Krugman (page 24).

The quality of the thesis would have gained from the student spending more time to check its text before publishing it, in terms of spelling, grammar and sentences (parts are missing which lead in the end to false affirmations, such as for example: "the share of the government public debt can not exceed the 60% of the GDP level, and needs to be lower than 3% of the GDP.") The thesis would also have benefited from more precision, in terms of definitions for example. What is meant by recession? Most commonly, 2 consecutive quarters of real GDP contraction? Because, if the student used this accepted definition, then he affirmed false things on German recession. In fact, on annual growth rate, there was only contractions of GDP in Germany in 2003, after a stagnation in 2002, and 2009 (source: eurostat).

The work would benefit from a deeper level of analysis. The student should not be over-simplistic, or too assertive, which can be particularly notable in the written form. You will see below a few example of paragraphs which „surprised“ me:

The objectives of the euro were much more complicated and ambitious than the student describes them as well as the tools put into place during the Great Recession.

- „This ambitious project was designed to deepen the integration of the EU countries and turn the Eurozone into the world's leading and most powerful economic entity.“ (page 22)
It was already the case. Part of the countries of the EU are part of the Euro Zone, subject to criteria and political willingness.
- „all decisions by ECB needs to be approved by all its members, which means, that nothing can be changed without the German approval.“ (page 26). The ECB is independent from all the governments, so in particular from Germany. The latter played a big role in the setting of the rule of functioning of the ECB and in particular in its mandate (inflation targetting), as a reaction to their hyperinflation trauma.
- „No purchase of the government bonds“, should be mitigated as history has proven that the ECB circumvented its mandate to do it anyway. (page 26)

Additionally, the current situation of the euro should not be too simplify. All the member states fought to defend the euro and the weakest members made masive sacrifices to remain part off. Of course, there are criticisms and some political parties claim to exit euro if elected, but we will see what happens in the future. If really euro was really „doomed to fail from the very first moments“, markets would have and still would price the EUR differently against strong currencies (USD, GBP, JPY for example). „However, due to the global financial crisis and the debt crisis in Europe, the perception has completely changed and within less than a decade there is only few of those left (who??), who would still believe in the bright future of the euro

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project. The project, which was established to guarantee an economic growth, wealth and prosperity has so far achieved the exact opposite of its noble goals." (page 22)

When presenting some key message, the student should try to mitigate his statements when needed, otherwise it can sound false. For example, „Justice and sanctions for breach of contracts.“ (page 26). There is a system of sanctions for not complying with the Maastricht criteria (Excessive Deficit Procedure, http://ec.europa.eu/economy_finance/economic_governance/sgp/corrective_arm/index_en.htm).

The situation (and in particular their relative performances) of Euro Zone countries is the result of many complex structural, economical and political parameters. Since joining the Euro Zone, a catching up of peripheral Europe took place, mixed with disequilibrium in their growth patterns (Spain with the building sector, Ireland with the financial industry).

Point 4.3 Conclusion oversimplistic, should have said „all other things being equal“.

Unfortunately, the relative failure of German neighbours on the export side cannot be explained as simply as the student claims (see the numerous in-depth reports on the comparison of France and Germany for example). Additionally, the student should bear in mind that there are probably some of the best central bankers gathered at the ECB, so it may not only be that they were blind...

- „There can be no doubt, however, that Germany's extraordinary success on the external front is due to the numbness of Germany's neighbours and the blindness of the institutions created to guide and to oversee the Eurozone's proper functioning, in particular the ECB and the European Commission. A more vigilant central bank or a more attentive Commission would have intervened early on, warning Germany about the risks of its strategy and alerting its neighbours. The failure to do so is the direct result of the ideological pillars on which EMU has been built“. (page 51)
- „As the result, the German taxpayer subsidize the export economy and no jobs are being created in reality.“ (page 53)
- The conclusion... for example: „To repeat the conclusions from the previous chapters, it can be said, that the inability to devalue in the southern countries has resulted into vast German surpluses. The Euro has not diminished Germany's massive superiority, but it has even boosted it.“ In contradiction with what you said on the poor state of Germany before joining the Euro zone („sick man of Europe“).

Regarding exports, from 1999 until 2007, German exports to the rest of the world grew at the same pace as those to the Euro area, which reversed since then, in favor of the rest of the world (see page 49). Even in real terms, the driver of German exports after the crisis has been exports to the rest of the world (outside European Union).

Regarding the econometrical part, the presentation of the methodologies could have been deepened, in particular given the particularly ambitious task of the study: create an alternative economic scenario for the major European country without the euro, in a context of exceptional economic crisis... I am not very familiar to the SCM methodology, but I do not understand why the alternative scenario to the Euro creation does not start after the creation of the Euro (after 1999)? What is the point of rewriting the past?

How did the student choose the pool of countries? To what extent are they similar to Germany? Iceland, UK, Sweden, Denmark, Norway, Australia, Canada, Japan, South Korea and USA. Is there a reference in the literature to a similar pool of countries?

Additionally, the student could have explained the reasoning behind the choice of the predictors/explanatory variables: why explaining exports of goods and services with GDP per capita, high technology exports and final consumption expenditure? What do you mean by final consumption expenditure (households, public)? Why explaining GDP level by exports and goods and services and consumption? In level? To my knowledge, households' consumption is not a major contributor to growth in Germany.

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Regarding the model on the labor market, did the student test for the multicollinearity of the predictors, as consumption and exports of goods and services are 2 major contributors to the 3rd variable, GDP. Unfortunately, the student did not comment the graph 5.5. Why would Germany be better off without the euro when taking into account the world and not the euro zone in terms of GDP, whereas it would have benefited from it in terms of exports, which is a key contributor to its growth as the student describes it?

Suggestions for future work:

- Use EUR and not USD when analyzing European countries as well as Eurostat data as much as possible, as it is the reference for European statistics (and also the most comparable source in between European countries). It is particularly damageable to the statistical part, as the FX impact (USD against EUR fluctuations) will be added to the explanatory variables. All the more that the EUR/USD variations impact the price competitiveness of exports, which is the dependent variable. And it would have been possible to use all these variables in EUR from Eurostat.
- Use up to date statistics. For example, according to the WTO, since 2014, Germany the 3rd exporter and importer (after China and the USA).
- Always state the dates and sources for figures. You can do your own calculations (for example the % of exports to the Euro area, as % of total, based on Eurostat statistic), and hence having the precise date illustrating your argument.
- Some key characteristics of the German industry are missing: the role plaid by trade unions in wage negotiations, a key characteristic is the Mittelstand, the access to financing by SMEs, the dynamic patent activity, etc.

Suggested question for the defense is:

Echoing the first chapters of the thesis, why do you think there is a link between the cost of the reunification of Germany and the „crisis“ of the euro nowadays?

In the case of successful defense, I recommend **“dobře” (satisfactory, 3)**

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SUMMARY OF POINTS AWARDED (for details, see below):

CATEGORY	POINTS
<i>Literature</i> (max. 20 points)	10
<i>Methods</i> (max. 30 points)	15
<i>Contribution</i> (max. 30 points)	15
<i>Manuscript Form</i> (max. 20 points)	10
TOTAL POINTS (max. 100 points)	50
GRADE (1 – 2 – 3 – 4)	3

NAME OF THE REFEREE: *Laure de BATZ*

DATE OF EVALUATION: 30/01/2017

Laure de Batz
Referee Signature

