

THE EURO AREA MUST LEARN THE LESSONS FROM PYGMALION

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The story of Prometheus warns of the dangers of excessive ambition. For critics of the euro area, the architects of monetary union were guilty of such excessive ambition. Critics might even draw on Mary Shelley's classic *Frankenstein*, the subtitle of which is "The Modern Prometheus", as a warning against the kind of dysfunctional creation that can result from misguided ambition.

George Bernard Shaw drew on a different tale, Pygmalion, to describe someone falling in love with their own creation. The sculptor Pygmalion was able to see his beautiful creation brought to life by wishing it to be true. Critics of monetary union would accuse the architects of monetary union of being prone to this flaw too.

In sociology, the Pygmalion story is used to define a 'Pygmalion effect' as a self-fulfilling prophecy where a person's behaviour improves once expectations of their behaviour are raised. In the play by GBS, Eliza Doolittle only behaved acceptably for high society once Mr Higgins altered her expectations.

One tale warns of the dangers of ambition, the other highlights its benefits. Which is the correct metaphor for where the Euro area stands today? To resolve the current crisis, the euro area must look to the story of Pygmalion. Europe must strive to create a self-reinforcing dynamic that rewards 'good' behaviour.

Yet sociology also teaches that the 'Pygmalion effect' can operate in a negative way. If the poorly-behaved - or the unlucky - are treated harshly, they can lower expectations of their own behaviour. This is a risk if austerity goes too far or the stigma is too much and Spain or Italy feel they have little stake in their own good behaviour.

How can the euro area generate a positive Pygmalion effect that makes good behaviour easier? Notwithstanding weak activity in peripheral economies, some fiscal restraint is needed now to re-establish trust between the different parts of Europe. And lasting good behaviour requires all to understand that rules are enforced.

Enacting difficult but worthwhile structural reforms can, however, also build trust while being more growth-friendly than austerity. The euro area should, therefore,

continue to shift its emphasis, where possible, from fiscal restraint to structural reform in peripheral economies.

Europe also needs to work at convincing the people of Spain, Italy and elsewhere that policy advice comes from wanting a durable union that benefits all - not from wanting to impose arbitrary norms of behaviour. George Bernard Shaw mocked 'high' society's pretensions of respectability based on little more than affectations. That genuinely good behaviour cannot be enforced at the expense of another's identity is one important message from *Pygmalion*. Mr Higgins's attempt to persuade Ms Doolittle to conform to his prejudices ultimately failed - she instead opted to go her own way.

In the euro area, some substituting of austerity for structural reforms, as well as establishing clear rules for the ECB to lend its support would make genuinely good behaviour both less costly and more likely to endure. Such initiatives would also draw the correct lessons from *Pygmalion*.