

BÖLL LUNCH DEBATE

Is There a Future for the Eurozone? Part II¹

In February we asked a panel of experts whether there was a future for the eurozone. The tenor was one of moderate optimism. In the meantime the situation has gone from bad to worse. A default of Greece, 'orderly' or not, and an exit of the country from the eurozone is no longer unthinkable. The consequences would be harsh – for Greece, the eurozone, the European Union at large and contagion to the wider world economy is feared. A European Bank study warned that the entire eurozone project was at risk. Fundamental decisions over the direction of the monetary union need to be taken rapidly and those taken at the meeting of the eurozone finance ministers in Wroclaw on 16 September are widely regarded inadequate. Eight months after we raised the issue of the future of the eurozone we will ask a new panel of experts the same questions. Will the Euro(zone) survive? What measures have to be taken to save it from collapse? What is at stake if the crisis cannot be solved?

A Future for the Eurozone?

If one thing has become clear in the face of the crisis and the numerous futile attempts to rescue Greece and other countries, it is that what's at stake for Europe is nothing less than the survival of the eurozone itself. The second event of the HBS concerning the future of the eurozone has made it very clear that experts from all sorts of backgrounds agree on the fact that Europe now is at a crossroads. Will the Monetary Union finally get a worthy counterweight in the form of an Economic Union (the "E" in "EMU") or will Europe's Nation States continue to hang on to their petty competences and risk the downfall of Europe as we know it? For some, this conflict carries the unique possibility to deepen integration and take a huge step forward on the way to a Unites States of Europe while others fear that any more competences surrendered to Brussels will soon amount to the complete dismissal of the Nation State itself.

The questions behind this rather overstated dichotomy are very complex and the answers even more so. But before we jump to a hasty conclusion, let us first consider what is at stake, what the goals were when the EMU was first laid out and which instruments Europe does or should possess to be able to deal with the crisis.

¹ **Guest speakers** were: **Carsten Brzeski**, Eurozone Economist ING; **Sven Giegold**, Member of European Parliament (Greens); **Dr. Sotiria Theodoropoulou**, Senior Researcher European Trade Union Institute. The meeting was moderated by **Marianne Ebertowski**, Director Common Foreign and Security Policy Heinrich-Böll-Stiftung European Union. The event was held under Chatham House Rule. The opinions expressed do not necessarily represent the opinions of the Heinrich-Böll-Stiftung.

Origins and Problems of the Crisis

As much as experts agree that the eurozone is waist-deep into trouble, it is also widely acknowledged that a breakup – at least for the time being – seems unlikely. There is, however, a deep divide between the wealthier countries in Europe's North and the not so wealthy ones in the South. The first ten years of EMU brought prosperity and solid growth to Europe's South but by now, the lagging-behind in competitiveness has turned into a structural deficit. As much as we're holding our breath right now, waiting for the situation to deescalate, it might be worth spending a minute or two thinking about Europe after the crisis. The peripheral countries' economies are stagnating, if not shrinking, and even if the current crisis is finally solved one day, it will take a long time for them to catch up with the core countries again. If some sort of Transfer Union is to be avoided, a deep economical split will be running through Europe's middle and the disparate distribution of wealth will likely lead to political unrest. Already now, populist movements are rallying around their leaders all over the continent, sometimes with frightening success. As pointless as it is from an economic point of view – some day those political movements might result in single countries leaving the EU or even to a break-up of the whole thing into pieces.

But what are the causes for the crisis and how can they be solved? The answer to this question cannot be a simple one and yet the popular media seems to focus on the public debt levels only. What might be even more worrying are the current account deficits of the states in crisis. In a situation of deep economic recession, one would normally expect the current account deficits to rebalance after a prior maladjustment of trade balances. Some countries, like Portugal and Ireland, have indeed managed to reduce their deficits, although by much less than you would expect considering the circumstances. Other countries, like France, have in fact worsened over the past couple of months and even Greece doesn't seem to find a balance here. The common currency was obviously built on assumptions that do not exist in reality. The infamous Stability and Growth Pact alone has been violated 68 times without any sanctions and a simple restating of its purpose and specifications yields little hope for success to resolve the crisis at hand.

Besides the financial and political aspects, there's also a social dimension to the problem. Recession in Greece and Spain has led to unemployment figures well above the EU average and youth-unemployment peaking at over 40%. Obviously, this puts the social safety net under a lot of pressure and in turn radicalises political opinions as the moderate parties in power are unable to solve the crisis on their own. This is a democracy issue: On the one hand, the Troika of IMF, ECB and EU Commission dictates the measures to be taken to the Greek government and then it's sink or swim. If the criteria are not met, the country simply won't receive the next disbursement of financial aid. At the other end of the spectrum, the German Chancellor literally has to force her party's MPs to vote for measures that are clearly not favoured in the political mainstream opinion. Ultimately, these issues will not remain the only aftermath of the crisis, but will in turn lead to many other problems as budget cuts restrain governments all over Europe. Battling climate change, for instance, might soon be realised to be a luxury that only rich states can afford.

What Will Happen Next?

First of all, there are no provisions in the treaties for countries to leave the eurozone. In effect, an exit of the eurozone would probably amount to an exit of the EU as a whole. And while the technicalities would be negotiated in bilateral meetings between the Member State (MS) and the EU, everyone can imagine what would happen to the exiting MS in the meantime. It would probably take months to figure out all the details of the exit and as long as that isn't taken care of, nobody would be willing to lend any money to the concerned MS. Furthermore, it is debatable whether or not an actual exit by either Greece or Germany is desirable at all. With a currency of its own, Greece could adjust its nominal exchange rate to help its economy back on track – but it was exactly the fact that in a world of ever-larger degrees of international trading, the nominal exchange rate hadn't been effective as a macroeconomic policy instrument anymore why the EMU was created in the first place. Germany, on the other hand, would soon see a strong appreciation of its own currency if it was to exit the euro-system. No one knows how long the German industry would be able to uphold its growth-rates under these circumstances.

So will the measures taken now be enough to solve the crisis for good? Right now, we're hurrying from summit to summit and the solutions presented to the public normally becalm the markets for just a couple of days before everyone realises that the big problems still haven't been taken care of. The spreads that countries like Italy and Spain have to pay in order to roll over their debts is increasing weekly and if France's banks would suffer a few more downgradings by the Rating Agencies, then the French government would get into trouble, too. In the event of a French downgrading, the whole EFSF system would collapse with France as a major contributor relying on its AAA rating.

It is difficult to foresee what will happen next, because right now, the EU is missing a greater vision. Politicians from all MS are busy keeping pace with the markets and so politics in the EU today is much more about reacting to external events than formulating goals of its own. This lacking of a vision might be the largest deficits and the greatest hindrance on the road back to normality. If there isn't a vision for a united Europe, how could you expect the citizens of Greece to put up with all the austerity measures just for the sake of it? Politicians will have to stop describing the EMU as a strait jacket and proceed to a much more positive dialogue. Whatever way the EU will handle the crisis: There are difficult years ahead and without a positive attitude towards the EU, the chances for success are lowered considerably.

The Current Solutions

Today it seems that the hopes of most Europeans rest with the EFSF. Over the last couple of months of the crisis, politicians on the highest levels have continually equipped this instrument to be the last resort for countries on the brink. But even the enormous sums of money that have been compiled during the most recent summits don't appear to be able to calm the markets. The truth is that it would take trillions of Euros to save countries like Spain or Italy from collapsing and although the EFSF now has been equipped to use

leveraging to its advantage, it still couldn't raise near enough money to take up the challenge. As simple as it sounds – to really perform the way that politicians promised the EFSF would do, it would need much more cash. Considering the pains that politicians in all MS had to take to convince their MPs and the population that the most recent expansion of the EFSF was unavoidable, it is an unlikely scenario that this would happen again any time soon.

Another of the problems with the EFSF is that right now, the decision of whether or not the EFSF intervenes if a country gets in to trouble relies on the unanimous vote of the 17 MS involved in the institution. This concept isn't very likely to convince many investors, as help to troubled countries is issued on a case-by-case basis. The policies of the EFSF still try to defend all the national prerogatives but in the end, we might end up having no prerogatives at all because a failure of the Euro would be too costly for anyone to bear. For the EFSF to work effectively it will need to become an unconditional lender of last resort and this requires some sort of automation. There will have to be a mechanism that steps in as soon as certain preconditions are fulfilled by any one country.

In addition to the problematic case of the EFSF, the question of how Europe is going to tackle its structural problems hasn't been mentioned at all. As clear as it is that the EU needs instruments like the EFSF, it is also obvious that this cannot be a day-to-day solution to Europe's more fundamental problems, namely the huge differences in the MS' competitiveness. As there has been no coordination whatsoever in terms of fiscal policy over the past decade, the differences between MS in this area are enormous. The current situation is that every MS is to increase its competitiveness on its own, which, in a worst case scenario, could mean that prices and wages grow at zero or less percent and that demand is stagnating, if not decreasing. It will have to be determined in a concentrated effort, to what extent the risk of a recession of that format outweighs the benefits of global leadership in export. Whatever the result of this process may be – it is certain by now that a united stance of the EU is essential for a sustained success in this matter.

The austerity measures imposed on Greece cannot be the only answer to its current account deficit. It is true that Greece needs to lower its public spending, that it must work on the hurdles set up by too much bureaucracy and that a reform of the public insurance and tax system is long overdue. But with austerity alone, this crisis cannot be solved, because without growth, Greece will never be able to lower its public debt. Most of the country's turnover is created in the agricultural and the tourism sector – nothing that is likely to produce the much needed drive in the coming years. Huge investments are necessary to set Greece back on the map and a whole country needs to be “re-industrialised”. An example that has been mentioned many times in this context is the large-scale deployment of solar plants, but for this, the country would first need to increase its attractiveness to investors.

The Banking Sector

The regulation of the banking sector remains a major point of disagreement among MS. A further bailout of some of the more problematic banks in Europe is at hand and while

some politicians would like to proceed exactly like they did last time, others insist that this time, the states will have to become real shareholders in order to have their say in the still pending regulation of the sector. Democratically, the latter one certainly seems to be the only viable way, as no one could explain to tax payers why the banks are yet again being rescued with state money without the state being able to intervene in their practices. The memories of the last bailout are not too far away and not much seems to have changed in terms of bank behaviour so far. In our economic system banks have the privilege of providing a public good, but if they can't provide for this anymore because they aren't properly capitalised, the state must be allowed to step in and try to rearrange things. So if the state has to bail out the banks again, it would this time have to behave like a normal shareholder and make actual use of its voting shares instead of just giving money to the banks and let them return to business as usual. In the end, there might even be a profit to be made when the shares are sold to the market again.

Of course, this doesn't discharge the MS or the EU of adopting further legislation to regulate the banking sector. The exemption of government bond in the risk ratings will have to be reconsidered and the new capitalisation requirement of 9% also is a step in the right direction, but the details are too blurred to allow for a forecast of the effects. There is a concern that the banks might capitalise mainly through deleveraging, which would in turn kill the recent pick-up of economic activities because Europe's real economy is to a large degree dependent on credit. On the other hand, if you take state money to recapitalise, we will soon see another downgrading of some MS. Undoubtedly, the issue of how the banks will recapitalise cannot be left to the banks alone but calls for a common EU legislation.

A Glass-Steagall² approach to the reshaping of the banking sector has experienced support in different political fractions. As it is right now, it is difficult to regulate the banking sector adequately, because the people selling the financial products live on the commissions they receive from the ones who created the product. Regulating the commissions wouldn't help either because the whole process is still dealt with in the same house. A separation of investment and commercial banking could allow for proper regulation of both sectors and it would (at least to some degree) separate the risks that investment banks have to take from the customer's own risk. That said, the banks which really are waist-deep into trouble are not the ones that would usually be described as the typical investment bank but are rather the ones which followed much more "conservative" approaches, like the German Landesbanken, Dexia and others. But maybe it is exactly the fact that they only were active to a small degree in investment banking that earned them the renown of being some of the biggest black holes for state money so far: Maybe they just lacked the expertise on this field of activity and were tempted to try nevertheless.

² The Glass-Steagall Act of 1933 obliged US banks to separate commercial and investment banking with the intent of removing the conflict of interest arising from the integration of both banking types. It was repealed in 1999 and has recently provoked arguments whether or not this repeal led to the renewed occurrence of „too big to fail“ types of banks that resulted in anewed bank-bailouts after the collapse of Lehman Brothers Holding Inc. in 2008.

Improved Political Coordination

It is clear that the EU cannot remain as it is today, some dramatic changes will have to come about if we don't want it to fall apart. These changes don't have to be negative, some people have even spotted the unique chance to change things in Europe that have been criticised for a long time. On the forefront of these proposals is the call for an improved political coordination and leadership that has been so sorely missed over the last decade. Now the markets force EU leaders to either make a commitment or to let the EU fall apart. So instead of mending all the bigger or smaller problems that are appearing all over the Union, we should maybe concentrate on the more structural issues and come to terms with the core problems.

Some say that for a short- and mid-term solution, there will probably be now way around some sort of transfer union. If we don't want to risk the peripheral countries falling way behind and eventually breaking off, the EU will need some sort of mechanism that will transfer money from the rich states to the poor ones. Another approach would be some form of investment programme to help countries like Greece back on track, but these investments will only be credible if they are backed by a political union with a common future. Whatever way we choose, there will have to be more social justice and the regulation of the banking sector will finally have to be taken seriously so that a crisis like the current one doesn't reoccur easily. If there is a clear sign that states take decisions for the greater good again, there will also be more legitimacy.

For a long-term solution, the monetary union will finally have to be concluded by an economic union, too. To date, we are totally missing a social dimension to all our rescue programmes. EU MS are competing over ever lower wages, employment standards, social insurance, etc.. The age of retirement, for instance, is different in every single EU country and countries where employees have to work longer might have to bail out countries where employees are on pension much earlier. As a side effect, standardisation in those areas would of course also allow for an improved single market.

Conclusion

It has been a long way from the roots of the EU in the 1950s to the financial crisis that hit the continent in 2008. The purpose of this unique structure has shifted from a guarantor of peace to a means for enormous prosperity and growth. But the sovereign debt crisis has brought to light issues and concerns that had been rumbling deep down in the very structures of the EU for quite a while. The supremacy of economic concerns that has ruled EU politics for years is now finally questioned by the obvious absence of democracy that has been established over the course of time. Maybe now is the time to pause for a moment and reconsider what the EU was build for, where it has steered to since its establishment and whether this is the way we wanted it to be. From that perspective, the financial crisis really does do us a huge favour because it forces us to rethink our priorities. In a couple of years we may look back and finally realise what

huge decisions were taken in these troublesome times and only then may we truly value what the EU is or what it once was.

For more information about how to act on the crisis from a Green perspective, see <http://www.gruene-europa.de/cms/default/dok/393/393641.schuldenkrise@en.htm>
(German only)



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