Eurozone 2013: Is the Existential Crisis really Over?[1]

The eurozone has survived the year 2012. The Grexit did not happen; Eurogeddon could be avoided – just about. But is the "existential crisis" really over as Commission President Barroso claimed in the beginning of this year? Complacency seems to be a little premature. Certainly, the eurozone leaders have taken first steps to make the architecture more sustainable and to develop effective tools to deal with urgent problems. The ECB's outright monetary transactions (OTM) bond-buying programme, even though it has not yet been used, has helped to reduce the risks of a collapse of the eurozone, and the operational start of the European Stability Mechanism has been successful. But we should not forget that the eurozone still suffers from a double–dip recession. There is no noteworthy economic growth and unemployment is still rising. Recovery for most of the eurozone cannot be expected until the second half of 2013; according to the Organisation for Economic Co-operation and Development growth will not occur until 2015. Unemployment in the eurozone has reached a record high of 11.7% with worrying differences between northern and southern member states; youth unemployment has risen to 23.9% with a hair-raising 56% in Spain. Also, the year will start and end with elections in two important eurozone countries. Italy went to the ballot box on the 24th of February; the Germans will elect a new parliament in September. In Italy, Mario Monti in his role as caretaker prime minister, had helped to stabilise the situation, but the outcome of the Italian elections could easily send the country back into turmoil with serious implications for the rest of the eurozone. In Germany, Angela Merkel cannot be sure to be re-elected. Whether this would be good or bad for the eurozone is very much in the eye of the beholder. Where the old French-German motor known as Merkozy ran smoothly, but not necessarily in the direction preferred by man and, its Horkel-version spluttered to a halt, a brand-new Holbrück-variant run on green fuel could perhaps do miracles for the eurozone. But, in the meantime, much work needs to be done and fast. The banking union is a top priority, but can only be the beginning of further economic and political integration. Will the eurozone under the leadership of its new president, Dutch Minister of Finance Jeroen Dijsselbloem, survive 2013 and what steps have to be taken to close the dangerous north-south divide?

To say that we have gone through the worst of the crisis is, from the perspective of countries with 50 to 60% youth unemployment as is the case in some member countries, would be simply cynical. However, there are signs of economic stabilisation. The interest rate spreads for government bonds came down, though mainly because of the bold intervention of the European Central Bank, which means that it cannot be considered as a dividend of true stability. Also, looking at all the crisis countries, not only in Ireland, but also in Portugal, Spain and Greece, the need for public or private borrowing to finance a negative current account has decreased. Italy has seen a total turn-around with the policies of Mario Monti who succeeded in bringing deeply negative current account into the positive. The only country with a continuing problem in this respect is France, which is really worrying, because it is a core country. The source for this improvement was not only the depressed internal demand and therefore down going imports, but all countries, including Greece, had successes in export of

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goods (even though as in the case of Portugal the export only went to the outside of the eurozone and a reverse trend has already set in) even if they were not yet able to recapitalise on their services strength. There is still a lot of potential, even to go into surplus. (On the other hand, it needs to be said that the improvement of current accounts is often linked to impoverishment and decrease in demand.)

These are certainly developments which are behind the stabilisation of the interest rates for states. What is still worrying from an economic point of view are two points. First, the balance sheets of banks. In spite of the fact that growth is so low and countries are in depression, we still see in most countries worsening ratios of bad loans. That is why it is so crucial to move fast on the issue of the banking union. Unfortunately, this is the only of the Barroso and Van Rompuy issues for deeper integration where we have real progress. It is very important to make progress here as we still have high risks in the system and nobody really knows how big the problem really is.

The second point of worry the global aspect. Economists from the periphery often say: let's do exchange-rate policies, the question is: with whom? Europe as a whole has more or less a balanced trade account. If we moved into exchange-rate policies this would be responded to by our partners very negatively and quite rightly so. We have an internal problem in Europe: we have regions with surpluses and regions with deficits; it cannot be solved by doing exchange rate policies, because the external partners would resist paying. It is bad advice to externalise this problem. Still, if this problem cannot be solved, it will become impossible for the peripheral countries to stay in the eurozone.

What is needed are new sources of growth. Without growth there will be no stabilisation of the debt ratio. Here the situation is still worrying, but a lot of the effect is because of the denominator. If the denominator is shrinking you have immediately a mechanical increase of the ratio. Unfortunately, in this respect very little has happened. The real actions for growth are just old recipes which in crisis do not work. In the short run, it's the macro economy which makes everything very difficult. Where shall the growth come from? We cannot all export at the same time. We need a strong growth strategy, one which reduces the dependency on foreign oil on foreign gas, foreign resources, one which invests into social services when this is needed etc.

But the biggest risk in the crisis beyond the economic issues, is the social one linked to the political risk as the example of the elections in Italy has shown: if 50% of the voters in one of the most pro-European countries voted for parties which either from a populist or right-wing perspective criticise the European integration then we know what could happen in the next country in this situation. This demonstrates that it is not a solution to shout for more European intervention when people feel that they lose control over their lives by decisions taken in Brussels. Therefore, if we – for good reasons – need to move to common fiscal and economic policy on the level of the eurozone and the European Union, we need at the same time have a decentralisation agenda; we need to support the very understandable need for local control.

Deeper integration through reforms on a national level?

The crisis in 2013 seems to be not so much economic crisis as political. Where do the eurozone and the European Union stand politically in 2013? And where do we want them to stand? Barroso presented in his speech a vision of a deeper integrated union with a separate and bigger EU-budget, the Commission as the EU-government and a stronger vote for the EP. In the Netherlands for example this scenario is seen as a nightmare. Also in many other member countries the opinions stand in strong opposition to the new proposal for a deeper integration agenda. That will only end up in referendums and probably stop there. The federalisation agenda which makes the public in many EU countries rather afraid responds to problems at the macro level of the EU. We all know the debate about the EMU which is a monetary union without an economic and political union, which is why we need a central bank and social stability buffers in order to fill in the gaps or so it is said.

But is there also an alternative agenda, a third way between Barroso's vision and Cameron's idea of Europe? Maybe deeper integration should happen on the national level. After all, the crisis started in 1999 on the national level when it turned out that national statistics were unreliable. National control offices do not even exist in some Member States or do not function properly, economic councils function in some countries but not in others. There is a whole list of national institutions which have not been working properly. As long as Member States are 'semi-failing' or 'failing states' no monetary union will work. In the discussion about deeper integration it is important to make sure that national institutions function effectively. However, to criticise each other's national administration and institutions is a taboo. Countries prefer to criticise each other's policies. This should be put on the agenda, though probably it will not happen. Still, even if we are searching for growth, this is the problem which has to be looked into. These national institutional reforms should happen under an umbrella of EU-legislation. The reform on the national level leads also to a rethinking of the organisation, the procedures and roles of the European Commission and the European Parliament.

Maybe the solution lies in a programme for flexible integration with different kinds of cooperation which is doubted by those who say that flexible integration in the European Union is problematic and prefer to establish a common set of rules for the common market. Considering this, the British idea of being part of a common market, but not of a common regulatory framework is unacceptable.

The structural economic long-term perspective

Besides the institutional aspect, the structural economic long-term perspective explains the upcoming of the crisis and the prospects for the future development. The division into periphery and core is not only geographical but more essential concerning the pattern of productive specialisation of the countries included in the eurozone. It ranges from countries specialising from ubiquitous, very common and not complex products to countries exporting very complex and exclusive products. Considering the degree of complexity of exports, Germany is with 40% at the top, whereas Portugal (16%) and Greece (3%) can be considered peripheral countries. The differences in the degree of complexity create the conditions for extreme heterogeneity in the eurozone, which is not optimal.

On top of the structural differences, there is a series of events that affected the countries asymmetrically. Firstly, consequences of the Maastricht Treaty with the nominal convergence criteria till the entering of the Euro led to a loss of monetary and exchange rate policies autonomy on which the peripheral countries relied to provide protection for their industries. As a second asymmetric shock the lifting of the trade barriers (like the EU-Morocco free trade agreement, China's WTO accession, the EU Eastern enlargement) drastically increased the competition in the least complex product segments which hit the peripheral countries more than the core countries. Additionally the wage compression in the core, e.g. in Germany, had negative effects on the peripheral economies. Last named the general process of overvaluation, a strong euro, made it much more difficult for the peripheral economies to compete in the low complexity segment.

Thus the crisis was already latent in the current account in the periphery, although it was disguised by the inflow of capital as a consequence of the monetary union, which was not used in a sustainable manner but was distributed and used irresponsibly. There was a turn-away from tradable to non-tradable goods because these were the once which were obviously profitable. So the underlying latent crisis broke out as consequence of the "global" crisis [2] 2007/2008 which is still going on. It first surfaced as a recession that brought on the public debt crisis via a number of channels: automatic stabilisers, counter-cyclical measures which were in the very early stages encouraged at EU level and bank bail-outs and speculation about sovereign debt as a self-fulfilling prophecy in so far as it raised the interest rates and created an additional burden on the budgets. The Portuguese case shows that the government debt only started to go through the roof as the crisis started. But austerity measures are counterproductive in this respect; the rescue package is just temporarily avoiding the fold. Public debt is only the epiphenomenal form of the crisis; the actual crisis is a crisis of competitiveness, an economic crisis which was lying dormant for ten or fifteen years. The consequences of the austerity measures are that government debts keep escalating, making it inevitable that recurrent haircuts even in disguise will have to be made with as consequence widespread and increasing unemployment, falling wages in the periphery, record numbers of bankruptcy, increasing poverty etc. The welfare state is being dismantled. There is a massive redistribution of income from labour to capital and increasing inequality. All this is a result of the fact that one has treated the symptoms while ignoring the root causes and in reality the measures worsened both, the causes and the symptoms until there is nothing to treat any more, not even the symptoms. Instead of stimulating the economy, the economy has been depressed.

So what has to be done? A required measure to treat not only the symptoms but the causes would be that debt service is tied to the economic performance. The use of a secondary currency could be considered as well as a method of facing the crisis. Furthermore an external depreciation of the euro, a greater inter-European transfer as well as enhanced policy autonomy in the periphery would help to go for an industrial upgrade. Economically this is realistic, politically obviously not. On the short term the eurozone is not at risk of breaking apart. The current conservative peripheral governments do not have an interest in leaving, mostly because of domestic agenda's for which they can use the crisis as a pretext and 'disguised' creditor-led haircuts will keep occurring. But in the long run it definitely is, as the constraints upon competitiveness in the least complex product segments and the impossibility of actively undertaking industrial upgrading condemn peripheral economies to inexorable decline and sooner or later electorates will vote into office governments elected on an 'exit' platform.

[2] In fact the so-called global crisis hits the advanced economies with the emerging economies making up for it to a great deal.

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