THE EURO CRISIS

The crisis in Europe is about political opportunism and complacency rather than just debt, says **Steve Wood**

Many factors have contributed to the European Union's debt crisis: turbo-capitalism, deficient regulation, policy errors, imprudent banks, and remote technocratic 'elites,' among others. Commentators and angry publics readily point to these factors because they appear more immediately connected to the current malaise. Less obvious but more profound are historical, sociological, psychological, opportunist and criminal influences—and tiring economies with large state sectors, *dirigiste* controls, high taxation, expensive social security provisions, and extensive redistribution. These features derive from and are the responsibility of national populations and their political classes. They indicate that the crisis is about more than debt alone. Western European electorates assumed (and even demanded) that their lifestyles, and the circumstances that supported them, would continue more or less as they had since the post-World War II boom raised living standards to levels not previously experienced. Politicians obliged. There were jobs for life, six or more weeks of holidays for some, universal health care that included convalescences, generous pensions at 55 to 60, increased government spending when elections had to be won, and not so much concern about current or future costs. All this was fine as long as they could afford it.

Integration and the development of a 'European social model' were among the principal reasons credited for the widespread bounty. As a Carolingian club plus Italy, the European Union's forerunners (the European Coal and Steel Community, the European Economic Community, and the European Community) were reasonably coherent. The French establishment operated them as a system of international financial transfers, or 'side payments,' whereby more productive societies subsidised others that were less productive and also privileged sectors like agriculture. (West) Germany and the Netherlands were the main net payers. As membership increased, smaller states (Ireland, Greece and Portugal) and larger ones (Spain) did not present insurmountable problems. Protected against competitive external forces, the policy of convergence aimed to draw the communal budget's net receivers steadily closer in per capita terms to the richer members. The arrangement functioned more or less effectively for a generation and acceptably for another decade or so, underpinned (if not always acknowledged) with wealth created and military security provided by the United States. While structural deficits firmed and demographic time bombs ticked, people came to believe this was the natural and permanent state of affairs, a generalised condition of which today's predicament is a symptom.

Almost overnight, some of the certainties that held this world together disappeared. The Cold War ended and German reunification reanimated submerged rivalries. To prevent the European project from unravelling, it had to be transformed from a 'community' into a 'union.'

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This involved a rapid deepening of integration and the overcoming of incompatibilities. Though the economic component is necessarily liberal—free movement of goods, capital, citizens, and services—most EU members are instinctively statist. After selective integration in Europe, politicians and citizens then thought a selective globalisation was possible: accepting favourable elements, compromising on some less favourable, and rejecting the rest, all the while maintaining the living standards they had become habituated to.

A key divergence existed over the understanding of what central banks were there to do and how to do it. The French 'political bank' existed to print money at the behest of politicians (not least for their own interests). It contrasted with the German 'independent bank,' which was more concerned with price stability and balanced budgets, and sought to exclude political interference. These varied conceptions reflected the broader French and German macro-economic cultures. Their struggle was about defining the new Europe. It was French governments that had wanted Greece, Spain and Portugal in the European Commission to help counterbalance Germany. Having replaced the deutschmark with the euro and the Bundesbank with the European Central Bank (ECB)—the political and financial price that Germany had to pay for its reunification—France was compelled to at least move in the German direction on monetary and fiscal policy (displeasing some of its *classe politique*). Conversely, there are qualifications about Germany's adherence to its own archetype. Germany insisted on financial rectitude at the European level mainly to constrain other less fiscally responsible states and societies for which it could be liable. However, German governments will also exceed prescribed debt and deficit levels if deemed requisite in the national context.

How EMUs fly

Economic and Monetary Union (EMU) is a quasi-supranational, quasi-sovereign assemblage of 17 states and the ECB. It was formalised in the Treaty on European Union (TEU), signed at Maastricht in 1992. Qualifying criteria for the imminent common currency included specifications regarding national interest, inflation and exchange rates; a 60% debt-to-GDP ratio; and a 3% annual deficit. These budgetary limits were to continue after that currency, named the euro in 1995, was introduced and then replaced national currencies. A Stability and Growth Pact (SGP) was incorporated in the 1997 Amsterdam Treaty to bolster what had been agreed to in the TEU. It included reporting procedures and a compliance mechanism, the Excessive Deficit Procedure.

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The SGP was an attempt to ameliorate EMU's disconnect between monetary policy, officially run by the ECB, and economic and fiscal policies, which remain the purview of national governments, all with particular circumstances, preferences and imperatives. The current crisis has confirmed the improbability of these policy fields remaining under separate authorities, and that the SGP is a chimera. Its credibility was ruined when the two prime movers, Germany and France, exceeded the debt and/or deficit criteria from 2002 and used their political weight to avoid censure. That gave a green light to others, whether they needed it or not, to deepen the hole that the European Union was digging itself into. The parameters and nuances of the EU composite economy are more complex than those of the United States or Japan. Prospective bond buyers and market analysts evaluate individual states. Should one or more emerge as potential defaulters, others in the Eurozone, which provide the ECB with its regular and emergency funds, and the International Monetary Fund (IMF), are appealed to. That scenario was realised in 2010 and 2011. The most despairing case, Greece, was granted two bailout packages: €110 billion and then another €109 billion, the latter accompanied by a further €50 billion in 'voluntary' funding (or write-downs) by private institutions. That is almost €100 billion short of

total Greek public debt of €363 billion in 2011. Raoul Ruparel calculates that by 2014, every household in the Eurozone will be financing €1,450 of Greek public debt.[1] It could go higher as negotiations on the terms of agreements and their actual implementation continue.

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It is not credit agencies or global markets that caused this. Their familiar diagnoses, attributions and prescriptions aside, Marxist analyses also show that fiscal and broader economic crises are nothing new in Greece. The font of Europe is a 3,000-year-old late developer and still has no competitive production base.[2] Since it entered the European Commission in 1981, and having received pre-accession assistance before that, the Greek economy has grown from about 58% of the then 10-member average per capita GDP to about 90% of the 27-state European Union. That is after 30 years as a net recipient and the lowering of the average by the inclusion of 10 poorer ex-communist countries, most of which have done much better despite their relative historical disadvantage. In 2010, Greece was ranked 97 out of 183 countries on the World Bank's Ease of Doing Business Index. In 2011, it was ranked 109. Its rating in protecting investors was 154.[3] Exacerbating, or exemplifying, this dismal performance were revelations that for several years, Greek 'statistical authorities' had falsified the accounts they were reporting to the European Commission.[4]

Greece has been living at 20% to 30% beyond its means. Portugal and Spain are not quite so profligate, though they have also been beneficiaries of the EC/EU for more than 25 years. They have not used this time and money to adequately transform their economies. Particularly in Spain, downturns have been accompanied by skyrocketing (official) unemployment. In the same period, fuelled by the same sources and a low tax rate for investment, Ireland made a meteoric rise from a European backwater to experience a couple of rarefied decades as the Celtic Tiger, before crashing to earth, bankrupt. Hubris was its main flaw. Recent productivity figures suggest, however, a positive trend. Italy is characterised more by stagnation. It has public debt of more than €1,900 billion or 125% of GDP, a 4% deficit, near zero growth, unemployment approaching 9%, an ageing population, and considerable exposure to Greek debt. It is not as if there were no early warning signals. Italy was not even close to the EMU debt criteria when the euro appeared and has not been since. Neither has Belgium. They were accepted into EMU for political reasons: as two of the original six, they could hardly be left out.

The criteria have been flaunted by almost all signatories at some time and by some almost all the time. The main problem states may be 'peripheral,' but injuries to extremities, if they are serious enough, eventually reach core organs. France has escaped the intense attention that Greece and others have attracted. Its debt has been over 60% of GDP since 2002 and is now over 80%. The deficit was over 7% in 2009 and 2010.[5] Germany's debt has also distended above 60% since 2002 and is about 83% (€2 trillion) in 2012. Germany can produce and sell enough to manage its own debt but not that of everyone else as well.[6] Balanced budgets and low debt might be criticised as obsessive goals, but if most or all states are spendthrifts it results in the undesirable situation that Europe is in today. Proclamations of solidarity are ironic in a context where many are living beyond their means.

Being $15 trillion in debt itself, the United States is not a great example for favourable comparisons with anyone. Yet the United States is not asking others for money. Rather, it is the largest donor to the IMF, which is also disbursing funds to Eurozone states. Despite its own problems, the United States will recover quicker, and be relied on by the European Union to drag it out of recession, because of its greater flexibility, dynamism and productivity.[7]

Unity and diversity

Better times camouflaged another untested aspect of the European integration project: its motto of 'unity in diversity.' It may reflect noble sentiments, but sustaining the motto in practice is altogether different, especially when confronted by immense challenges. Neither positivist nor reflectivist approaches alone explain everything in the EU environment; together, they indicate the limits to how much unity and diversity can co-exist. Common currency blocs have an optimal size: behind the econometrics are heterogeneous mentalities and politics. Europe's grander cultural features do not cancel out the variance in more mundane, everyday manifestations. There is not one 'European social model' but several, with different industrial, commercial, productivity and entitlement cultures.[8]

All models, including the British-Irish, have demonstrated shortcomings. None is so urgently in need of reform as the Mediterranean version and the politics that perpetuates it. Greece, for example, has a huge disparity between productivity levels (low) and pension payments (high).[9] Takis Fotopoulos presciently noted:

> In case debt-led growth is precluded in the nineties, within the context of EEC's Economic and Monetary Union, the country faces the prospect of stabilising at a low growth long-term equilibrium that would constantly increase the gap between Greece and the rest of EEC. [Moreover] whether regions in the South European semi-periphery (Greece, Portugal, Spain, S. Italy) should continue the process of their integration within an EEC dominated by the Northern metropoles, or whether, instead, they should pursue a programme of regional integration within a Mediterranean sub-Community of regions at similar levels of development (that could now include the Balkans as well) will probably become an important issue in the eve of the new millennium.[10]

This does not negate the need for adapting the continental model, of which Germany and France are representative. An important difference between the Mediterranean and Germany or France is that the latter two supply high value-added goods and services that other populations want to buy. Germany has a sound reputation among world markets and governments. Nordic countries also have high taxes and big spending governments, but they are better organised, produce quality goods with external demand, do not close for *siesta*, and have (with New Zealand) the world's lowest corruption levels. On a scale with 10 as the best score, Transparency International's Corruption Perceptions Index for 2011 rated Denmark and Finland at 9.4; Sweden at 9.3; the Netherlands at 8.9; Germany at 8.0; France at 7.0; Spain and Portugal at 6.2 and 6.1; Italy at 3.9; and Greece at 3.4. Rwanda was rated 5.0.[11] A real 'union' of states and nations is only possible with enduring economic, social and political convergence. That presumes a substantial measure of cultural convergence.

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Nation-states and Europe

European integration had the central motivation of binding Germany within institutions. Concurrently, the construction could not be built or maintained unless Germany paid a disproportionate share of the costs. In the Cold War decades, Germans tolerated payments to others and a degree of extravagance by them because of the good economic times. Since 1990, Germany has been paying for its own expensive reunification and is also the largest net contributor to the EU budget. Germans are asking why the system needs to continue as it has. So are the Dutch, the Danes, and the Swedes. Germany's bankers, business, politicians and the public are generally averse to accumulating large deficits or debt, but will accept them if they are considered necessary, for Germany. Underwriting Greek, Italian, Irish,

Portuguese and Spanish debt is something else. Only 20% of Germans support state aid for Greece.[12] Problems with international dimensions can easily become situations of 'us' and 'them.' Reminders of wartime atrocities, accusations of profligacy and freeloading, complaints about a lack of solidarity, demands for ejection from the Eurozone, and so on did not take long to rise to the surface.[13] A continuation of reduced visitor numbers for tourism-dependent Greece would worsen its situation.

Younger people are justifiably angry. Those not protesting in Greece are leaving it.[14] It was their forebears, not a German *Diktat*, who placed them in this position. Funds disbursed to Greece by the ECB do not come from an independent source; they derive mainly from the taxpayers of net payer EU member states that are also part of the Eurozone. These people are being burdened with a debt that is both intergenerational and internationalised, and will last a few decades. 'Pooled sovereignty' has become 'pooled debt.' A bigger problem will emerge if the German *Mittelstand* (small and medium-sized enterprises) take to the streets as the Greeks, Italians and Spaniards have.

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The nation-state is often portrayed as an artificial construct, and a united Europe as natural or necessary. But governments are voted in or out by national, not pan-EU, electorates. They are averse to riots. National imperatives are hard to resist. Moreover, there is no powerful central authority that can effectively censure EU member states. The ECB or European Court of Justice (ECJ) can hardly fine a reprobate if that state does not have any money. Nor can they sentence ministers or bureaucrats to terms in a EU prison.

Former European Commission President Jacques Delors recently said the euro 'would still be strong if it had been built to my plan.' That entailed more extensive and deeper cooperation in economic and social policy fields and vigilant policing of convergence by the Council of Ministers, an institution of member state representatives. Now 'populism in certain countries' is undermining the currency and the wider integration project, which comprised deeper philosophical and normative concerns. The 'crisis of the euro' is 'all part of a crisis of the Western way of doing things':

> We are part of the West, and the West could possibly lose its leadership … it is important that we preserve the values that matter not only to Europe, but to Britain and the United States—the values that are Judeo-Christian in origin—Greek philosophy and Greek democracy and Roman law, and the Age of Enlightenment and the French Revolution.
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> At the same time, we cannot tell the President of China what to do. Other peoples want to preserve their values, and we want to preserve ours. This is the great challenge.[15]

Europe's magnificent civilisation, imposing history, and the achievements of post-War integration are not sufficient to ensure continued prosperity, even if some seem to think otherwise. Europe has overcome worse traumas, though each recovery encompassed change, usually of a radical kind.

Conclusion

In response to the question 'What is the problem we wish to solve when we try to construct a rational economic order?' Friedrich Hayek remarked:

> Knowledge … never exists in concentrated or integrated form but solely as dispersed bits of incomplete and frequently contradictory knowledge which all the individuals possess … It is rather a problem of how to secure

> the best use of resources known to any of the members of society, for ends whose relative importance only these individuals know.[16]

There is an allegory here of the European Union as a disparate collection of states, nations and societal segments that do not share the same body of knowledge (culture). Hayek's observations also reveal the limits of quantifying risk based on a corpus of imperfect information.[17] As academic disciplines or professional practice, economics and law do not capture or control the more mercurial phenomena of politics, cultural proclivities, and social expectations that the European Union is also imbued with. Far from a lack of politics, the present crisis demonstrates its primacy and contingency. Any number of factors influence decision-making and public behaviour: electoral cycles and their manipulation, scandals, whim, opportunism, pork barrelling, incompetence, corruption, fraud, endemic tax evasion, ignoring or reinterpreting of rules to suit, moral hazards, international tensions, and natural disasters. Most of that selection transpired in one or more EU states in the past decade. While they will occur again, we don't know precisely which, when, where, who, how much, or what the consequences will be. Participants in the EU's crisis summitry do not know either. They are just trying to buy time: on credit.

Endnotes

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15 Charles Moore, 'Jacques Delors: "Euro would still be strong if it had been built to my plan,"' *The Telegraph* (2 December 2011).

16 Friedrich Hayek, 'The Use of Knowledge in Society,' *American Economic Review* 35:4 (1945), 519–530.

17 Cf. Bartholomew Paudyn, 'The Uncertain (Re) politicisation of Fiscal Relations in Europe: A Shift in EMU's Modes of Governance,' *Review of International Studies* 37:5 (2011), 2201–2220.