LSE Government Department
The HotSeat Videocast

Professor Simon Hix discussing the recent bailout of Greece and the future of the European Union.
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Ariane Sparks: I'm Ariane Sparks. Welcome to the HotSeat, With us today to discuss the recent bailout in Greece and the future of the European Union is Professor Simon Hix. Thanks for being with us, Simon.

Can you tell us about the current situation in Greece?

Simon Hix: ell, the current situation is that Greece has run up unsustainable debts and this has an effect on the value of the euro because Greece shares a currency with thirteen other EU member states and the debt value of Greek debts affects the debt value for the other member states and so the other member states as part of the euro worry about what will happen to Greece because if Greece defaults this has real pressure on the value of the euro and the value of their bonds that they sell as governments and destabilises the euro in general so there is pressure on the other states in the eurozone to come up with some money to help bail out Greece. The problem is, legally in the way the euro works, it was set up originally with what's called a no bail out clause, so in the Maastricht Treaty it says that the whole point of the euro was that it wasn't allowed to bail out states that defaulted within the eurozone because this would be what economists called moral hazard, if you don't say beforehand we're going to bail you out then people look at it and say hey, a state could run up big debts and the others would have to bail them out. So that's why they put it in the treaty in the first place but that's exactly what's happened. So they've come up with a very peculiar way of bailing out Greece without bailing out Greece. So they've put up financial loans to Greece with the expectation that Greece will pay them back and then they can call that, legally, that this is not a bailout so there won't be challenges, for example, in the German constitutional court because they can say we're not bailing them out, we're loaning them the money. The problem with loaning them the money is the markets don't believe that Greece is going to pay back the loans so they're putting even more pressure on Greece and the expectation right now is that one of two things will happen. Either Greece will default because they will not be able to pay back these debts. If Greece defaults, that's a real pressure for the euro and there's a possibility that Greece will be forced out of the euro and then there could be a domino effect. If the pressure is then on Greece, what happens next to Portugal and then to Ireland and then to Spain. So that's one option. The other option is there will be genuine fiscal union within the monetary union so the EU would have to set up a proper fiscal federal structure to have common rules governing public finances, common rules governing the sort of transfer of funds from one state to another state, and German taxpayers, for example, are saying if we're going to have this fiscal union then Greece has to buy up to certain things that Germany wants to impose on Greece. For example, a common retirement age, they'd have to raise their retirement age, they'd have to raise their tax revenue, they'd have to basically do things the German way and this raises big problems for democratic accountability in Greece where Greece is essentially handing over sovereignty to Germany. So either of the two potential outcomes that people are looking at right now are not really palatable and this is the problem we face right now.

Ariane Sparks: Can you have monetary union without full-scale fiscal cooperation?

Simon Hix: Yeah, this is exactly the problem. Right at the beginning, people said this. Can you have monetary union without a common budget. Back when they first started talking about monetary union in the 1970's there was a report written called the Verner Report that said that the EU would have to have 5% of it's GDP in taxation at the EU level if there was going to be a common currency. Now, economic and political thought moved on since then and they said well, actually we can make monetary union work if we just converge in economic models to minimise the possibility that we would have this big variance in economic performance or the potential of default so we'd have to converge on our level of public debt, we'd have to converge on our annual budget deficit, we'd have to converge, generally, in our economic performance and if we could do that, we wouldn't necessarily have to have this large fiscal union. But they did that as part of the Maastricht criteria but they sort of fudged membership of the euro. So the euro would have been fine if it had been Germany and some of the core states around Europe like the Benelux, France, Austria, Finland and perhaps some of the Scandinavian states if they wanted to join. But letting Italy join and Portugal and Greece; at the time a lot of economists said their economies just too different; their productivity levels are just too different; their public debt is too big. This is a recipe for disaster and this is the disaster we're in now. So I don't think the euro can survive as it is currently without their being some kind of fiscal union. How they do that; or whether or not politically they'll be able to do that is a separate question.

Ariane Sparks: How does this crisis affect the future of the European Union?

Simon Hix: It has a big effect. If we go for scenario one where Greece gets kicked out of the euro and then there's a domino effect and that leads to pressure on Portugal and other member states, we could start to see the emergence of a core and a periphery EU. A core of the EU made up of Germany, France, the Benelux and a few other states around that and the periphery of the EU, the southern European states, Scandinavia, Eastern Europe, Britain who then have to renegotiate the terms of their relationship with the core eurozone. So we can imagine some kind of fiscal union within the euro as a core, heart of the EU and then a single market which is a broader single market so that is one sort of scenario. The other scenario is the EU does move generally to a broader fiscal, political union. Now, that's less likely and that would require much more of a democratic mandate so the big question there is how could they possibly legitimise that given current public concerns, public opposition to the EU in a lot of states, particularly in net contributor states like Finland and Holland and Germany, and so I think the only way to do that would be if you have, for example, a contest for the commission of presidency in 2014 and the emergence of a democratic mandate for a particular vision at the European level. Now, that's unlikely so right now I think the former scenario is probably more likely.

Ariane Sparks: Alright, we'll leave it there. Professor Hix you are off the HotSeat. Thank you for being with us.