‘European challenges in a time of crisis’

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The Greek problem, as the world’s press has dubbed the issue confronting the European Union, has tuned the spotlight onto flaws that have marred the operation of the European Monetary Union. EMU led to monetary unification with strict rules to protect the common currency; however, with lax to non-existent regulations on economic unification, it is only partial economic union. Initially it boosted economic convergence among members, but later the gap between the North and the South of Europe gradually widened due to different levels of growth and competitiveness. In the South, the trade balance deficit ballooned. The Union had no provision for fiscal transfers between countries in favor of the competitively weaker members even though they supported the revenues of the competitively stronger members. Nevertheless, it should have been possible to control the repercussions.

The euro masked the fact that the economies of the South were lagging behind. When national currencies still existed, any deficit led to a fall in their value set the alarm bells ringing. No such warning signal exists now. On the contrary, the euphoria of unfettered access to loans led the South into greater deficits and serious fiscal imbalances. The countries of the North stated at the time that they were not responsible for the difficulties. They were not obliged to intervene nor could they. As they pointed out, the EMU Treaty prohibits member states from bailing out other members in a crisis. This rule ensures strict compliance with the agreed principles of EMU and cannot be overturned.

The crisis proved to be more powerful than the rule, however. It cast doubt on the rule and dented the credibility of the euro. It compelled the Union to seek a crisis resolution mechanism of the Treaty and the solidarity that it initially hesitated to demonstrate. The globalised financial market negated the protective mechanism that had been intended to stop a crisis in one EMU state from spreading to the others, and it transferred the crisis of the weak to the strong. Greece was the preeminent example. The euro zone at first made political declarations in support of Greece, but these declarations were not sufficient to ensure Greece’s creditworthiness. Eventually a temporary support mechanism to deal with the crisis was agreed upon and set up in May for Greece and for the other member states in June. The EMU members, together with the IMF, made
credit available to a member state that was unable to fund itself in capital markets. EMU members provide credits on a bilateral basis once a joint decision is reached. The interest rate for Greece was around 5 percent. The press commented on the developments, restating the same theme in different ways. The Economist noted: “The Greek crisis only confirms the folly of binding a group of disparate countries together in a currency zone with no mechanism, such as a central fiscal authority, to address its internal imbalances.”

This crisis seriously diminished the prospects of the euro becoming an international reserve currency to rival the dollar. The Union aspires to make the euro a reserve currency, since this contributes to its stability. Without a specific economic policy, without economic governance, the progress of the enterprise will lack stability and consistency. A strong euro demands the restriction of national autonomy in the area of economic policy. Without progress towards economic and political union, the EMU will possess no ideas and means with which to tackle global developments, make its voice heard in international dialogue and play a role in shaping the desired order of things.

In all countries of the European Union unprecedented sums were spent in support of the banking system, interest rates were slashed, liquidity rose sharply thanks to state guarantees, and private companies received funding. As a result, public deficits shot up to levels far in excess of the limit allowed by the Stability Pact.

Some analysts believe that as long as the effects of the crisis – failed businesses, rising unemployment – continue, state budget funds must be spent on reheating the economy. Others think that continued state funding runs the risk of fuelling inflation, squandering funds and burdening state budgets with additional high borrowing costs. In the eurozone states are avoiding any substantial stimulus now because of the current surge in deficit and public debt.

However there are some countries where continued state intervention is needed. In the absence of a common policy framework, the stability of the currency and prospects for the development of the Union are being harmed in both cases. A policy is needed that will reconcile different needs and improve the cohesion of the Union. There is no such policy nor will there be, as long as economic governance has not been instituted. Only economic governance can deal with imbalances and, in particular, the North-South gap in the Union.
Estimates by international organizations agree that once the crisis eases, the economy will grow more slowly than before. Due to the current uncertainty, new investments will be at a slower pace. Unemployment will remain at high levels. The rise of interest rates, the unavoidably restrictive fiscal policy – a necessary counterweight to large-scale state funding so as to deal with the crisis – and finally the drop in consumer spending will keep economic activity sluggish. At the global level, there will not be the demand that is conducive to rapid growth. USA and European consumers will rein in their spending due to high levels of household indebtedness. It has been estimated that the developed countries will need at least 2 years to make up for falling growth rates caused by the crisis. In the countries of the European South, which already had economic problems before the crisis, it is predicted that this period may exceed five years. The decrease in tax revenue, absorption of funds to pay interest on state loans, the necessary wage freeze, and social friction caused by government stability policies will have a negative effect on all countries. A common European economic policy could help overcome the consequences more rapidly. So far, however, it is doubtful whether such a policy will come into being.

The aim of steady growth necessitates turning the financial system towards strengthening the real economy. Practices that favoured quick, easy profits – huge fees for managers, traders’ bonuses, the non-transparent securitization of debt, stock market speculation, short selling and structured bonds – must be drastically curbed. The aim must be to increase long-term investments, promote productive activity, boost competitiveness and create jobs.

All that seems unattainable now. The expansion of the financial system has undermined long-term investments. New criteria now apply to capital investment. The key is no longer long-term performance but rapid, high level profitability. Such profitability is secured by buying stocks and profiteering in markets, not by investing to boost the productivity and competitiveness of a company. The pursuit of instant profit has sanctioned a shortsighted notion of what it beneficial. It deters investors from involvement in production and rewards greed in financial transactions. The recent crisis is the outcome of this transformation of capitalism. In order to strengthen productive activity and avoid a new crisis, there must be significant intervention to restore the priority of productive investments, job creation, social inclusion, the propagation of knowledge and the ecological balance of the planet. Supervisory regulations aimed at preventing excesses,
fraud and stock market speculation are also necessary, but they are not sufficient. What is needed is a significant step towards achieving growth.

The present-day operation of the Union does not facilitate the needed intervention. The Stability and Development Pact is oriented almost exclusively towards achieving monetary stability. It does not acknowledge the importance of growth in securing better living conditions, more jobs and greater opportunities for progress. The underlying assumption is that once adjustments are made, the economy will continue again much along the path it had for a quarter century. This optimism is not justified. This recovery is different from previous ones. Consumers drove record levels of debt. Business investment is slow. In line with a modernized Stability Pact, member states must undertake obligations to promote investment, expand knowledge, reform administration and improve social support systems. The response to these targets must be monitored regularly, the results published and funding for member states be specified.

Member states that do invest in achieving high rates of growth while implementing programmes to rationalize expenditure should be able to exceed the 3 percent of GDP deficit limit set by the Stability Pact. The choice we have is between sluggish growth that limits the potential for many people to improve their living conditions, and ongoing investment to ensure a permanently productive environment with better chances of work and income. The latter choice demands consistency in pursuing goals and discipline in managing resources. Economic policy should not be influenced by election cycles and clientilist considerations.

Apart from the investments made by member states, the entire Union requires an investment program framework. Investment is needed in areas such as transport and telecommunications infrastructure, renewable energy sources, research and cooperation among institutes of advanced education.

The Union’s budget funds obviously do not suffice for such initiatives. The member states have limited ability to increase their contributions. The Union must examine the expediency of raising money by issuing European bonds in order to carry out investments and also fund activities that will facilitate growth and employment.
The greatest obstacle to common economic governance is the principle of intergovernmental co-operation. It obliges the various governments to wait for long drawn out consultation that frequently comes up against the interests of the major member states. For instance, the Union was not able to get uniform guidelines on tax issues, because Great Britain always opposed them. In 2004, these difficulties were added to by the negative stance of a majority of governments in the European Council. They opposed initiatives that would have bolstered the Union’s powers and expanded the responsibilities of the European Commission. They wanted to put the brakes on the unification process and stop the flurry of activity that had marked the previous decade in the Union. The European Commission led by a majority of members belonging to the European Popular Party accepted this view.

In February 2010, European Council President Herman Van Rompuy proposed that the Council agree on a common procedure for formulating European strategy on growth and employment, saying: “we must above all move on from what we plan to do to how we will actually do it. Governance is key here.”

In that spirit, heads of state and euro zone prime ministers made a joint declaration on March 25 2010, underlining their determination to “enhance co-ordination of economic policies in Europe”. For this reason they deemed that “the European Council must improve economic policy governance in the European Union.”

In December 2020, the European Council decided after brief deliberation “that the Treaty should be amended in order for a permanent mechanism to be established by the Member States of the euro area to safeguard the financial stability of the euro area as a whole (European Stability Mechanism).” The permanent mechanism will replace the temporary rescue package that currently provides assistance to indebted countries. Starting in 2013, it will permit the provision of assistance on new, stricter terms, such as activating the mechanism only after case-by-case evaluation. It sets conditions for restructuring a country’s debt and envisages that private creditors will also bear losses if a country becomes insolvent. The economy ministers of the euro zone members will specify the terms of operation in the coming months.

The permanent stability mechanism was presented as a significant step towards economic governance. Little progress has been made, however, and a great many
problems remain to be solved. The slow pace of decision-making after the summit incurs the risk that the Union may not be ready in time to deal with sudden new market shifts. And the model of economic governance will not be formulated as long as the EMU member states pay no attention to bridging the competition divide between the North and the South, which is the most serious problem confronting a joint economic trajectory.

The majority of Union members wish to retain the intergovernmental style of decision-making. They oppose the Union’s assuming the form of a federation where uniform polices would replace inter-governmental agreement. But they also see the need to expand the cycle of joint policies, in particular those relating to the economy and strengthening the common currency, the euro. In the majority view, what matters is to set an acceptable limit to the transfer of responsibilities from the member states to the Union. Views differ, however, on the extent to which the Union needs new responsibilities. Will there be a joint tax policy? Will the Union be able to shape an economic policy aimed at balancing the benefits and burdens from the operation of the common market and the euro? Will it be possible to transfer funds from the more economically robust countries to those that are less economically robust?

The European Council’s recent decisions confirmed an inability to create substantive economic governance. And the proposals of the working group set up under the presidency of the Union and the European Commission will not suffice to overcome the current impasse. Shared determination is needed to achieve results in exacting, methodical negotiation, but no such determination exists. The leaders of Europe do not want to acknowledge the problem and solve it; they do not wish to change the way in which the Union functions.

The conclusion to be drawn from these developments is that issues of economic governance will remain unresolved. As long as the countries of the North focus exclusively on declaring that the countries of the South have broken the rules of fiscal discipline, the discussion will continue to be narrowed down to the matter of preventing members from defaulting.

Economic governance demands a broader approach, a plan with political and economic goals for the next decade: development for the Union and new impetus for projects, technologies and exchanges that will benefit all. Development must be the focal point of efforts to reverse the present situation. For instance, by
creating euro bonds, not to make up deficits, which the countries of the North reject, but so as to invest in development.

In early 2010, the European Commission presented a new tenyear plan called Europe 2020. The plan provides for initiatives to increase employment, boost research, improve education and reduce carbon emissions. Though the European Council accepted the proposals last spring, they have not yet been put into effect.

This is yet another indication that ideas do exist, that many states recognize the need for change in the way the Union operates, but also that steps forward are hesitant and the pace of implementing proposals is extremely slow. A shared determination to advance rapidly and effectively is the most important challenge we must tackle if we want to accommodate the Union to the demands of the new era.