



The Greek Fiscal Crisis and the Future of the Euro-zone - a German View

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1. Understanding German Concerns

- Because **Germany** was hit twice in the last century by big inflations the **aversion against inflation** is **especially high**.
- The **low German rates of inflation** in the post WW II era were due to this **aversion** and the **German monetary constitution** (independent central bank, no monetary financing of public debts and legal obligation of the Deutsche Bundesbank to keep prices stable)
- The **European monetary constitution** of the **Maastricht Treaty** mirrors this **German monetary constitution**:
- because it was considered to be the **best solution for the EMU** (Delors Committee) and
- to gain the **assent of German voters** in favor of the EMU

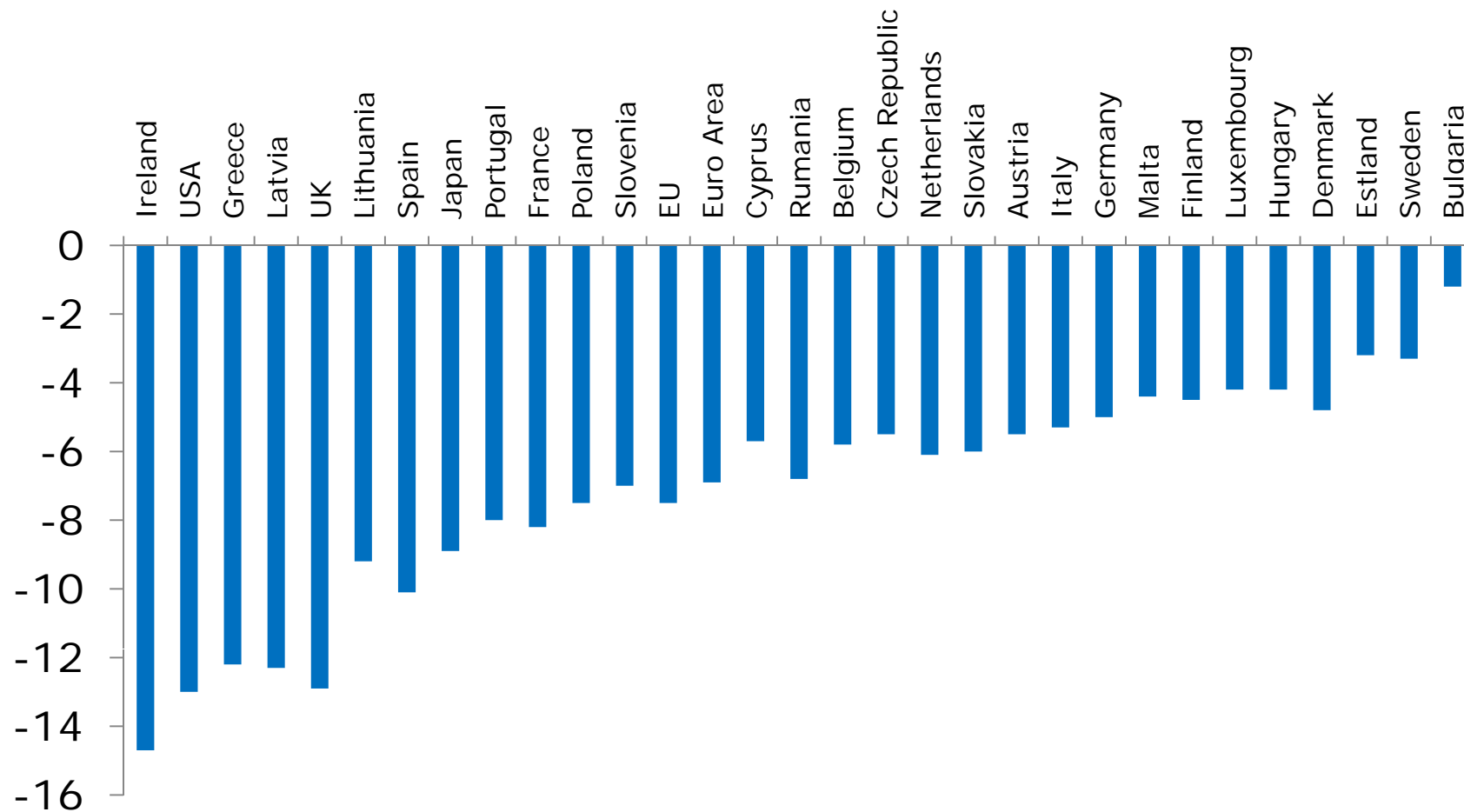
1. Understanding German Concerns

- German voters had to be convinced to **give up** the **Deutsche Mark** (DM)
- which was the **anchor currency** of the EMS “German monetary hegemony” at that time and
- which was in the eyes of German the **symbol** of a **successful economic recovery** after WW II
- The **fear of many Germans** is that they will get a **weak Euro** in exchange for their **stable DM** because the **rules of the Maastricht Treaty** and the **Stability and Growth Pact (SGP)** will **not be kept**
- and in addition they will **have to pay** for those who get in trouble because they did not keep the rules

2. Nature of the Crisis

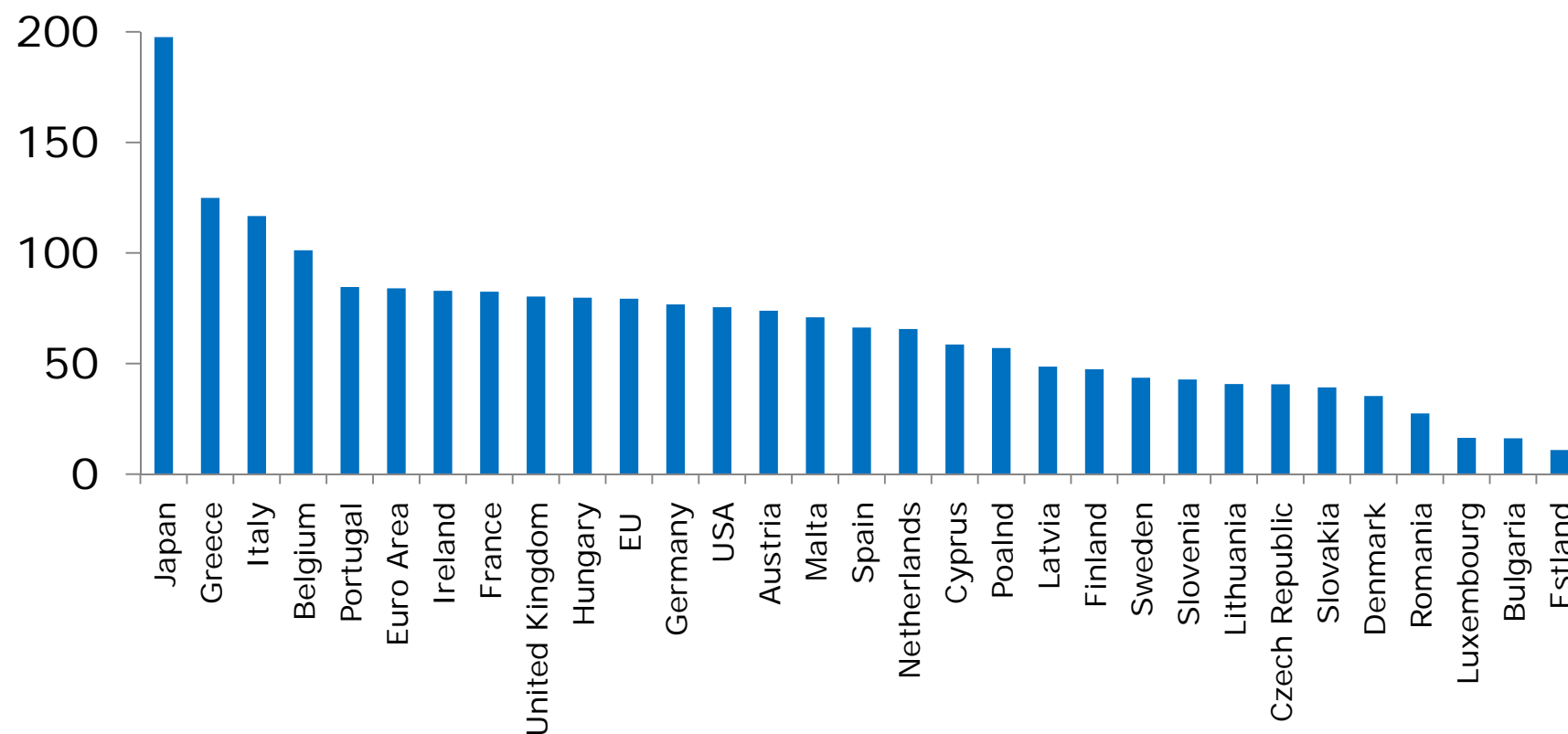
- The **present Greek crisis** is **not only** a **fiscal crisis**
- although the Greek **public budget deficit** and **public debt** are among the **highest** in the Euro Area (EA)

Public Deficits ratio to GDP



Federal Ministry of Finance, Monthly Report March 2010 (status quo: November 2009)

Public Debt ratio to GDP

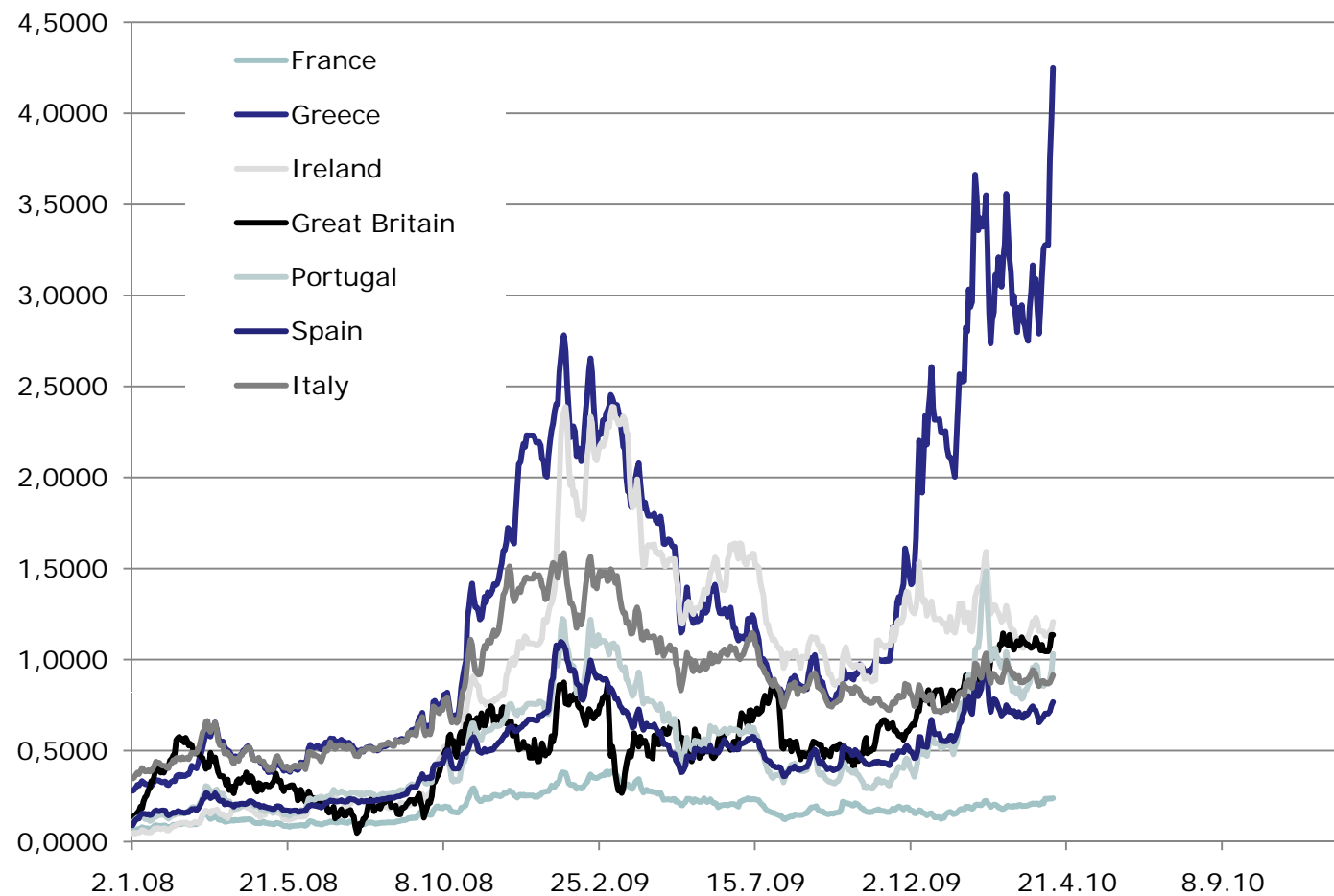


Federal Ministry of Finance; Monthly Report March 2010 (status quo: November 2009)

2. Nature of the Crisis

- and the **financial markets** demand ever **higher interest rates** (last week more than 5 percentage points higher than for German government bonds)

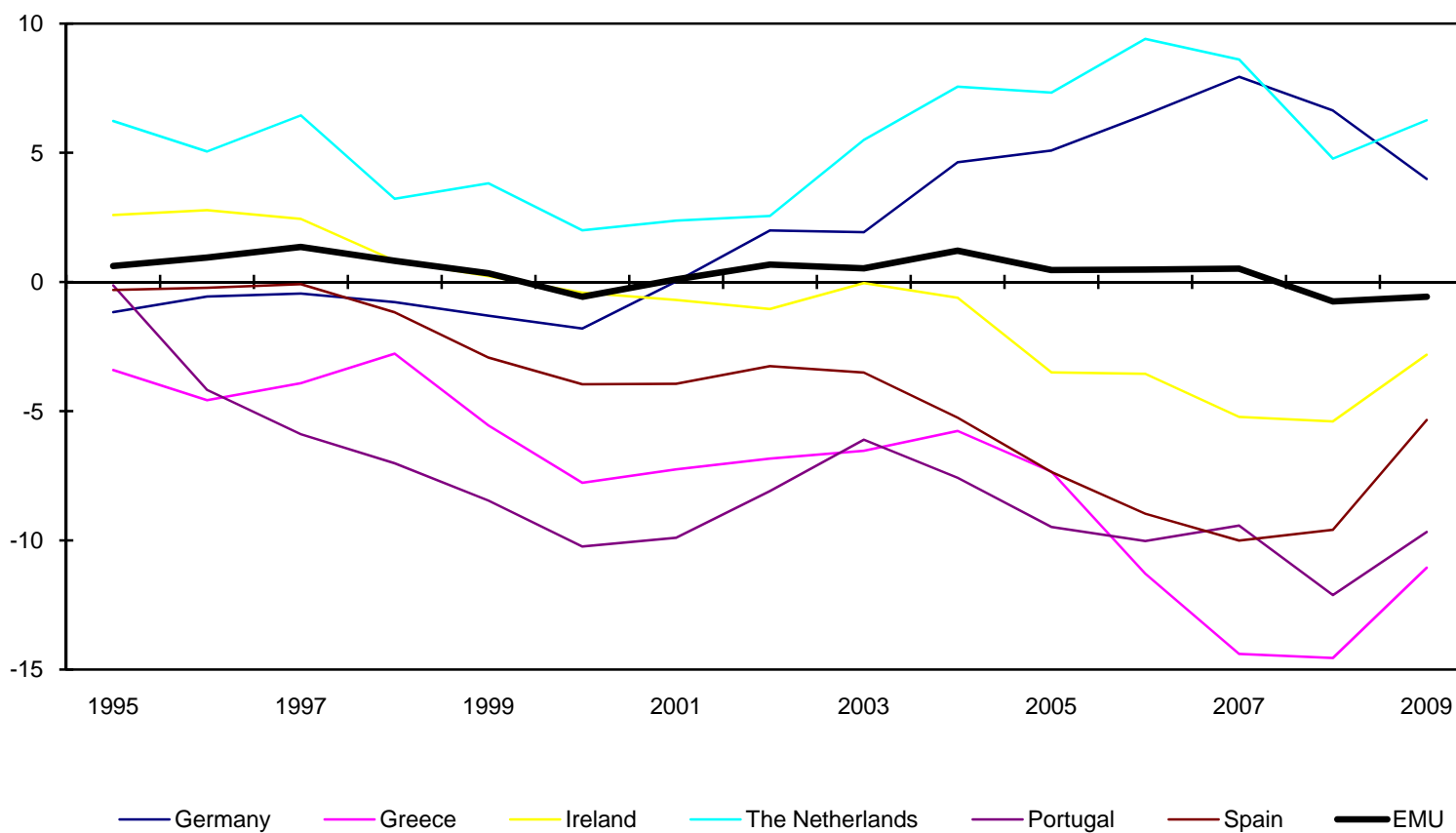
Interest-Spreads of Government Bonds Compared to German Government Bonds



2. Nature of the Crisis

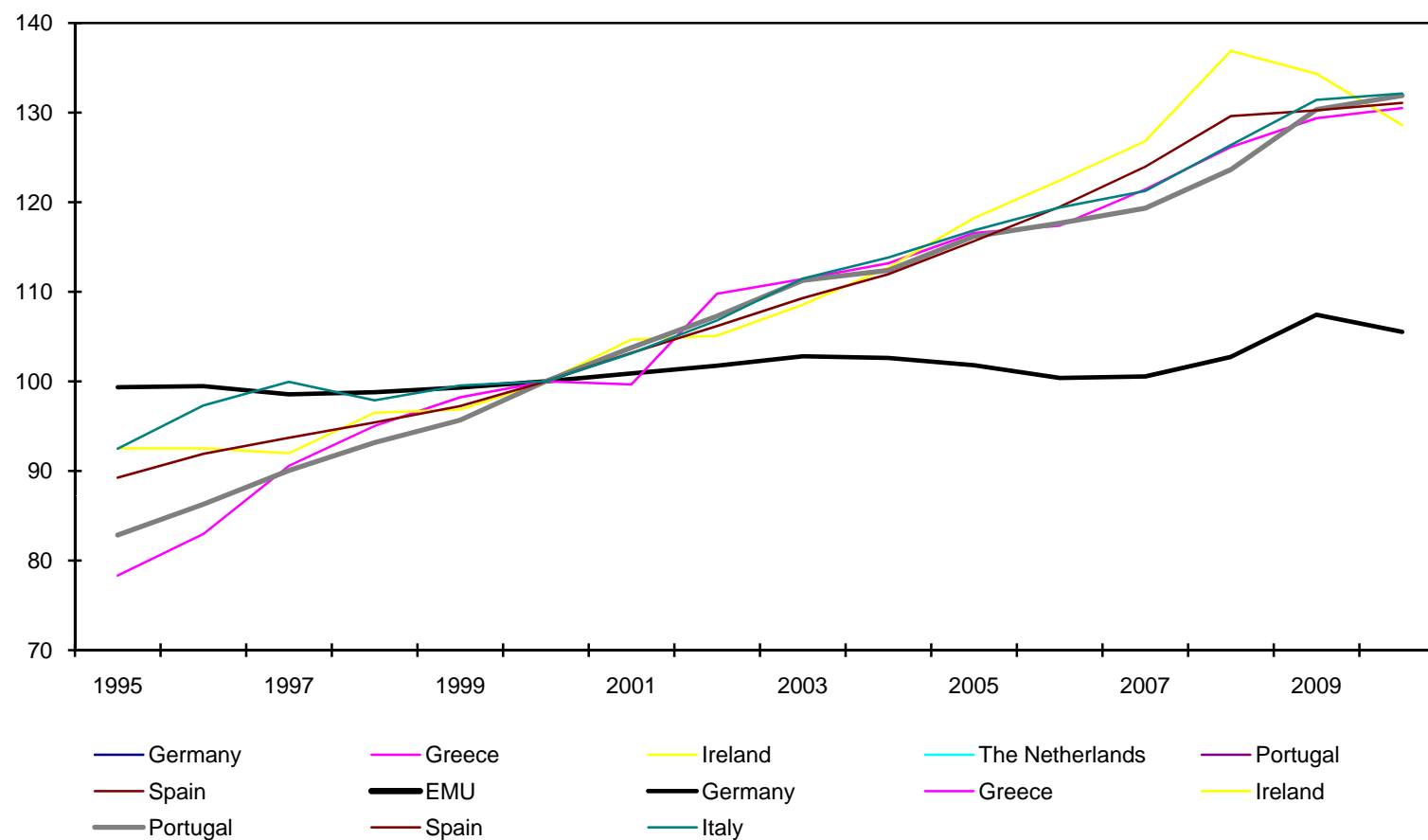
- It is also very much a **crisis of international competitiveness**
- This is indicated by a **high current account deficit of Greece** which rose from 7% of GDP to 14% after joining EMU and is presently about 10%

Current account deficits in selected countries of the Euro Area in % of GDP



Unit Labour Costs in selected countries of the Euro Area

2000 = 100



3. Causes of the Crisis

- Foremost, **Greece did not take its EMU membership serious**
- It **forged budget figures** in order to be **admitted in 2001**
- As an **EMU member** it **continued** to do so year after year
- By this it **deceived** the **other EMU members** as well as **itself** and created **uncertainty on the true economic situation** of the country up to now
- It first **enjoyed the benefits of its EMU membership** by financing **government debt** at much **lower interest rates** than before
- The rapidly extended government debt was **used to preserve existing economic structures** which made the country **less competitive internationally**
- As it seems, **Greek politicians did not understand** that **EMU membership** means **significantly more systems competition** making **a policy adjustment necessary** in order to benefit in the medium to long run

3. Causes of the Crisis

- But **not Greece alone** caused the crisis
- The **European Commission** did not demand a **strict keeping** of the **convergence criteria** and the **rules of the SGP**
- This was already true for the **start of EMU in 1999**
- **In 2002**, one year after the admittance of Greece to the EMU in the second round, the then **president of the European Commission**, Romano Prodi, called the **SGP stupid**.
- After that, **could there still be expected a strict monitoring of the rules by the Commission?**
- When **Germany violated** the **deficit criterion** in **2003** the **early warning** of the European Commission **was rejected** by the **Schröder government**
- **Germany** and **France** did **not accept** the **deficit procedure of the SGP** but instead put through a **dilution of the rules**
- In the last **presidential election campaign in France** all candidates demanded changes of the European monetary constitution

3. Causes of the Crisis

- In sum, the **basic rules of the European monetary constitution** agreed upon in the Maastricht Treaty were **not respected**, neither by many member countries nor by the European Commission
- After all, neither the **European Commission** nor **member states stopped the game**, but the **financial markets did!**
- The results of this **bad governance in the past** show up now and let **EMU enter a state of deep crisis**

4. Future of the Euro-zone

- At the moment, the **future of the Euro-zone** is very **uncertain**
- The present crisis demonstrates to the world that **Europe is unable to manage the EMU properly**
- The **IMF** had to be **called for help**
- **Financial assistance** of the EU to Greece means that the **rules of the Maastricht Treaty** and the **SGP** have to be **broken** (no bail out clause)
- By this, the **credibility** of the EU is seriously **damaged** and **moral hazard problems** are created
- Which **rules** will be **broken next**, which **country is the next** to ask for **financial assistance**?
- After all it is **very doubtful**, whether the **financial rescue program for Greece** will **stabilize Greece** and **the Euro-zone**
- First, it is **not sure** that the **Greek government** can **put through** its **ambitious consolidation program**

4. Future of the Euro-zone

- Second, what will happen to the mainly home driven **Greek growth rate** in the next years if the **public budget deficit quota** will be cut by more than 10% and the **wages** even more
- Therefore, many observers expect that in a **few months Greece** will have **to ask for even more help** above the presently envisaged 45 bill. Euros
- **Greece** needs a **devaluation** to become **internationally competitive** again.
- **Within EMU** only **real depreciation** is possible but **hard to realize**
- In the end, it could turn out to be **better for Greece** or it could be forced by the financial markets to **leave EMU** and solve its debt problem by **“haircuts”** and give **international banks** a share in the costs
- Since not only **Greece** but also **other EMU members** might demand **financial assistance** the **EMU** could turn into a **transfer union**

4. Future of the Euro-zone

- It is **hard to imagine** that this could be a **sustainable solution**
- Other **proposals for stabilization**, e.g. **European Monetary Fund (EMF)**, **common Euro bonds**, **economic government** and **more coordination** in my view do not solve the **governance problems of EMU** convincingly
- They would **lower the pressure** that the rules of the **Maastricht Treaty** were intended to put on **all EMU member states** to care for policy **adjustment** and **higher international competitiveness**
- Only by this, a **higher welfare in Europe** will be brought about which **guarantees** the **assent** of people to **European integration**
- For the **future of the Euro-zone**, therefore, a **recollection of the original rules** of the Maastricht Treaty is of **utmost importance**
- As soon as possible a **credible agreement** and **self commitment** of all EMU members to **fully respect** and **keep** the **Maastricht Treaty** and the **SGP** is urgently needed
- **BACK TO THE RULES!**