Completing the Monetary Union of Europe as mid-term solution of the Euro crisis

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Abstract

This research note discusses the Euro crisis in Greece in light of the referendum of July the 5th. It lays out the social and political costs of a GREXIT, but also of a continuing austerity policy. It proposes a reform policy fostering growth in Greece and discusses the role of conditionality. Finally, the important role of mid-left parties is highlighted.

Keywords: Europe, Euro, Greece, Germany, IMF, Monetary Union

JEL codes: E12, E62, F15, F16, F33, F55, H12, H50, H63, O42, O43

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Premise

The Greek leader, Alexis Tsipras, has won the referendum launched to ask the Greek people whether to accept or not the last agreement proposed by the creditors of Greece. Tsipras has asked the electorate to vote “No (oxi)” - some observers have argued that, in fact, he was worried to lose his face by accepting conditions with the EU credits, triggering an austerity policy, that during the last electoral campaign he promised to never accept. Then, in fact, he asked his people to vote “No”, hoping that a strong “oxi” would have strengthened his bargaining position with the EU so that he did not have to go against his electoral promises.

Now it is the European leaders who will have to decide whether to insist on their position and force Greece into the Grexit or to change the conditions such as restructuring the Greek debt and mitigating austerity measures, allowing Greece to return on a path of growth. The referendum, though, did not address the issue of future conditions with the EU that would be acceptable for the Greek people. It means that Tsipras’ victory in the referendum is important for domestic politics and symbolic, but not decisive or binding for future EU credits (Antonopoulos, 2015). It morally transfers the responsibility of the Grexit solution from himself as elected governor to the ordinary Greek people and the EU, which, at this very moment, should more reasonably establish an agreement with the Greek government that is more easily acceptable for ordinary Greeks compared to the current one.

A growth policy is strongly needed – for Greece and for Europe

Tsipras has long tried to convince the creditors and international partners of Greece that the only way for them to get their money back was to lead Greece on a path to grow. If Greece starts to grow again, it can repay its debt, otherwise it is true that Greece risks the default, but also that her creditors will loose their money.

Certainly, if one looks at the fiscal numbers alone, it appears that Greece will lose more than its creditors in case of a default and exit out of the Euro zone. After all, the Greek people will pay Greece's exit out of the Euro zone with blood and tears, with imports (food, drugs, sources) becoming prohibitively expensive, rising unemployment, and creating a social disaster as the Greek economy breaks down. At first sight, losses to the creditors, some 300 billion Euros, appear as a loss that can be borne economically, and thus appears rather small, at least in the short-run. However, if one looks beyond the fiscal numbers, if one considers political and social implications, things appear very different. The political losses of debtors and creditors will appear equally large, if not greater for creditors. Germany, France, Italy, and the other international financial institutions that are main creditors of the Greek debt could jeopardize the European construct and, together with it, the era of peace and stability that Europe has lived for many decades now. In this catastrophic scenario, all other European countries will lose more than Greece might do! The slump of stock exchanges of the last days are just a small signal of the hardship Europe could experience in the future if Greece were forced to exit the Euro and to repay its debt as scheduled.

The crisis: creating a dilemma for the EU

The mistake of the Greek right-wing government in the past was for many years tricking the public budget (it is not clear whether national accounting statistics is reliable in Greece) and accumulating foreign debt shamelessly. Corrupt political and economic elites have frittered public money away like no other EU country. Nevertheless, now, the Greek people has proven to wish a real change by voting for a completely new political solution, a new government, a left-wing government that had never run their country before. This new government, however, up to now has failed to deliver its promise of cleaning the administration from corruption and building up a new efficient one, which would have laid down a solid foundation for future economic growth.

The mainly European creditors of Greece are now facing two alternatives: either to completely lose their money now, or to support building up a Greece which grows and is hence, in the future, able to repay its debt. Restructuring the debt could imply a very low if not inexistent interest rate and a repayment over a very long time span, for example 50 years. The IMF head Ms Lagarde stated today on TV (8th of July) that also she views a debt restructuring as important for bringing Greece back on the path to growth (e.g. Rosenfeld 2015). Besides such restructuring, reforms of administration and institutions are necessary that make the country internationally competitive, attracting investors. This needs to be done in a socially balanced way.

Debt restructuring is a solution that John Maynard Keynes (1920) had proposed in his famous pamphlet on *The Economic Consequences of the Peace* to the winning countries who wanted to humiliate Germany in the aftermath of World War I (sic!). Keynes warned the European leaders that the only way to make it possible for Germany to repay its debt was to allow Germany to grow, not to drown it. In the case of Germany, such restrictive debt policy lead directly to WW II. Insisting on a fast repayment of debts in the case of Greece with tight and inflexible deadlines would equally drown this country, and such 'punitive' behavior has always been a perfect fertilizer for the growing influence of nationalist parties in other European, but also one's own countries. It is not for this that the European Union was created; the EU was founded not to favor, but to destroy nationalisms that have caused wars for two millennia in Europe.

The Euro zone is composed of sovereign countries. Any condition attached to a credit imposes a de facto restriction on domestic policy making and national sovereignty. So do the rules of the European Monetary Union laid down in the treaty of Maastricht. In the case of Greece where a young, weak government is fighting a war against long-established corrupt elites and administrations, the conditionality of credits and fiscal transfers can help the government realize its reform plans. The conditionality set out in the ESM takes into account the specific economic, political and social situation a country is in, and thus is in line with what economists like e.g. Joseph Stiglitz (2015) demand. In that light, such disciplining conditionality is not only able to protect creditors' interests, but it also serves the Greek people that suffers from the elites' mismanagement.

The inconsistencies of the European monetary union

Also other Eurozone countries have problems of sovereign debt because of the crisis above all, but, let's face it, also because of the Euro or the way the Euro has been managed until now. Contrary to what the ideologists of the Maastricht Treaty hypothesized (see, for an empirical early assessment, Frankel and Rose, 1998; Rose, 2000; Karam et al. 2008), monetary convergence is neither a sufficient nor a necessary condition for convergence in the real economies of its member states [1]. In the following we discuss some shortcomings in the construction of the Eurozone.

Germany is gaining a lot from the introduction of the Euro, while the Mediterranean countries experienced growing disadvantages. In Germany, the expanding export industry profits from the fact that the Euro is weaker then the German Mark combined with a natural insurance against the exchange rate risk, also absorbing most part of the capital flows and making Germany a dominating creditor to other European countries. In contrast, the Mediterranean countries have seen their industries destroyed within few years (Krugman, 2015). In truth, this

[1] De Grauwe (2007) shows that nominal convergence is not driving real convergence as assumed in the framework laid down by Eischengreen (1993). In their seminal paper. Alesina et al. (2011) argue that one reason why real convergence was not achieved is that liberalization of goods' market did not proceed in Mediterranean countries with liberalization of labor markets.

was perfectly foreseeable before the Euro was introduced and we cannot forget the strong words used, perfectly unheard, by the Italian Nobel laureate, Franco Modigliani, who warned Italy not to enter the Euro zone[2]. But there was and still is no willingness for a coordinated industrial and monetary policy at the EU level that was sufficiently well organized to ace the situation and smooth the ineluctable dramatic process of structural change.

The EU fiscal policy has had no sufficient resources to help the countries which are lagging behind after the introduction of the Euro, a currency that is stronger than their former domestic ones. As economics handbooks show, any monetary union should have an adequate regional policy, but as long as the EU budget can count only on 1.27% of the GDP of member countries, regional and cohesion policy will be insufficient. No matter how many empirical studies are done to assess its impact: the money is so little that the EU regional and cohesion policy is simply systemically irrelevant.

The EU monetary policy is exclusively aimed at maintaining monetary stability, also during this current financial and economic crisis, with apparent deflationary effects which have especially hit Mediterranean countries (De Grauwe and Yuemey, 2014). This has not changed even in light of that the youth unemployment rates in these countries reached up to 50%. Other geographical macro-areas of the world are implementing massively expansionary monetary policies to deal with the crisis and relaunch economic growth. For example, in the United States, Barak Obama nominated as head of the Federal Reserve Bank Ms. Janet Yellen, a committed Keynesian. In Japan, Mr. Shinzo Abe is implementing the so-called Abenomics, which is as much (or maybe even more) than what Yellen is doing in the United States of America. Another example is China which

[2] Modigliani and Baldassari (1997) were in favor of the European Monetary Union, which they saw as a counterbalancing force against the fixed exchange rate. They imagined a strong role of the European Central Bank to support those Southern European countries facing structural difficulties in their economies which would have followed the introduction of the Euro. Nonetheless, when Modigliani saw the way the ECB was constructed he became critical against the Euro, a position which he maintained in many public speeches until his death in 2003.

maintains an extremely low exchange rate and throws massive amounts of money into its economy continuously. Many Latin America countries are following the same road. The Protestant-dominated Eurozone, however, is the only monetary area of the world where there is no expansionary monetary policy during a time of economic crisis. The growth potential of the European continent is far from being reached - no wonder why given that Europe is doing the opposite of her competitors.

An important lesson can be drawn from the German unification where the smaller weak-currency Eastern Germany and the larger strong-currency Western Germany merged. Helmut Kohl, being a great statesman, well understood that such monetary union between East and West could turn East Germans into losers and West German into winners, and that therefore East Germany needed help, not little help, but really big help, strong, decisive (official goal of Solidarpakt II is to build up East German infrastructure and to support innovation and investment for achieving a sustainable self-sufficient local economy, see Bundesregierung (2010)). He gave away to East Germany the exchange rate parity, an unprecedented monetary policy, which was then matched with an impressive growth in public spending in support of the Eastern Lander. No matter how many scientific studies conclude that much money was wasted, we cannot neglect that East Germany has undergone a dramatic process of real convergence with the rest of the country. This convergence did take some 20 years – a similar time frame for credits should also be given to Greece (in 2000, ten years after the unification, the East German GNP had reached 66% of the West German one, and in 2009 it reached 79%, since then stagnating at this level, see Kuehl (2014)).

Overcoming the euro-no-euro dialectics

Do we want nationalism to be reborn again in Europe and maybe even prevail? For the first time, many recent national political elections in EU countries can be interpreted as referendum pro or against the Euro, in place of a referendum for the center-right or center-left parties. It is very important that center-right and center-left parties do both their bit to save Europe.

We need European elections with a clear option between center-right and center-left parties. It is time to get rid of the Troika, which seems to represent the interest of creditors and non-European countries too strongly (given that Ms Lagarde is now less willing to give up the IMF's neo-liberal position and make a compromise than EU officials are, it might be wise for the EU to bail out the IMF credits given to Greece, as was reported on July the 2nd,see e.g. the Guardian (2015)). Neo-fascist and populist parties of all nationalist rights are lurking, playing a destructive "the worse-the better" game (in the recent elections of the EU parliament, euro-skeptic ad nationalist parties gained a percentage between 6% to 12% of all voters in the EU, see European Parliament 2014).

The EU needs, like one needs water in the desert, the re-emergence of a dialectics between center-right and center-left, rather than between rich and poor countries. The EU has always overcome crises like this one by relaunching itself, not by reducing its spaces! We need to rewrite the Maastricht Treaty. We need a new EU. We need a Political and Social Union and a fully developed Monetary Union with a fiscal transfer mechanism!

The role of the ESDP and other leftist parties

It is the task of the Leftist parties in Europe to show that the Greek case should be addressed in a very different way from the current one, moving away from austerity policy to a policy of socially balanced and sustainable growth. The European Socialist and Democratic Party (ESDP) of Italy and his current leader, Gianni Pittella, gave a strong argument supporting that direction and could take on the role of leadership in the European parliament. Also the German SPD should do its bit. Only this way Angela Merkel can be freed, in the long-run, from the pressures of her own conservative Christian-democratic party, her ministers, and other forces who still favor an 'austerity-policy-only'. In the long-run, true, but "the sooner the better". It is necessary to arrive at European political elections with clear policy options: on the one hand, the socialist and social-democratic parties and, on the other hand, the conservative and neo-liberalist parties.

Be there policy struggle, so to clarify the existing policy options. On the one hand, a punitive vision of Europe, which can lead to a nationalist escalation and at the end of an era of peace, having lasted many decades in Europe; on the other hand, a solution which meets the interest of the creditors of Greece, but does not destroy the European construct.

There cannot be any more the dialectics that has been seen up to now, namely the Troika against the sovereign people in Mediterranean countries. We need to find a different solution and it appears to us that only the ESDP is able to find it, preventing the triumph of Eurosceptic and neo-fascist parties who are not able or willing to go beyond the immediate interest of their electorate. It is high time for the ESDP to take initiative and start putting into reality the European Monetary, Economic and Social Union.

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