The End of Maastricht and the last Euro: Will the EU Survive the Euro Crisis?

https://www.e-ir.info/2012/07/19/the-end-of-maastricht-and-the-last-euro-will-the-eu-survive-the-euro-crisis/

JOHN WEEKS, JUL 19 2012

In May 2010 the government of Greece faced a debt service problem. In the context of the euro zone as a whole, this should have been a minor issue, equivalent to a US state government unable to balance its budget. The obvious solution was for the European Central Bank to buy part or all of the Greek debt, ending the problem in a stroke. With the purely financial difficulty eliminated, political discussions could have begun to correct the underlying cause of the short term problem, which was the massive trade surplus of Germany manifested in Greece as an unsustainable deficit. The policy changes for Greece would have included reform of the public revenue structure such that the rich paid their taxes and adjustments in public expenditure, which could have been phased over several years. The phasing would have allowed for economic growth to make the adjustments relatively easy.

In place of this rational approach, the non-elected officials in the European Commission and the International Monetary Fund, zealously encouraged by the German Chancellor, imposed a deficit reduction program on the government of Greece, then Italy, Spain and Portugal that makes the 1980s Washington Consensus policies for the Latin American debt crisis appear benign in retrospect. When the elected government of Greece proved unequal to the task of implementing economic madness, the lords and ladies of the eurozone took the austerity to its logical conclusion. If an elected Greek government would not do the dirty work, establish an un-elected one. It is rather bad luck for the European Commission and the Chancellor that unlike in Italy with another unelected government, the Greek constitution required an election to be held this year. The anti-austerity vote proved too large for financial market comfort, perhaps signalling more democratic objections to come.

Against all rationality, the overlords/ladies of the euro zone managed to achieve what would seem a difficult to impossible task, converting the debt service problem of a country with less than eleven million people into an imminent catastrophe for a entire continent. In May 2010 when the Greek problem could have been easily solved, the growth rates of France, Germany, Portugal, Italy, Ireland, Greece and Spain) were all positive. This is despite the latter four countries often being labelled as part of the so-called PIIGS. In a new version of economic "convergence", they are now all negative. Even the mighty "power house" of Germany fell into decline in the final quarter of 2011.

Few outside of Europe (and not all within) understand the profoundly undemocratic nature of European Union governance that created the current disaster. In retrospect it is clear that the long-term effect of the Maastricht Treaty and its infamous "criteria" were to remove economic policy from democratic oversight and burden it with irrational restrictions. Worse than undemocratic, the criteria are foolish. The notorious limit to national fiscal balances of minus three percent of GDP refers to the overall budget balance, total revenue minus total expenditures. The overall balance includes payments on the public debt, which a government cannot reduce unless it plans to default on its creditors.

As a result of this, the International Monetary Fund, supported by all public finance experts, specifies its fiscal adjustment programs in terms of the *primary* balance, the overall minus interest payments. In 2011 with near hysteria in Brussels and Berlin about unsustainable public finances in Europe, only three governments were in breach of the technically sound measure, Slovenia (-4.8%), Ireland (-10.1) and Spain (-6.5). The last two were clear cases of "no good deed goes unpunished", because the primary deficits provoking financial instability were the result of recapitalizing ("bailing out") the same banks that speculate on public bonds.[i]

Even more absurd than the overall deficit target is the rule that public debt should not exceed sixty percent of GDP, defined for a government's gross debt. The designers of this rule may have been unaware that in addition to liabilities, governments also have assets. The relevant outstanding obligations of a government (in this case, like a household or business) are its net debt, liabilities minus assets. A glance at Eurostat or OECD statistics shows the difference between gross and net debt is far from trivial. At the end of 2011, the cross country average gross debt for euro countries was ninety-five percent of GDP, while the average for net debt was 61 percent.

If the Maastricht criterion were competently defined, the euro countries would on average be in virtual compliance. By the correct measure, the net debt as a share of national income, euro countries in breech at the end of 2011 were Belgium (82%), Portugal (74%), Italy (94%) and Greece (135%). Lest one become excessively concerned, the statistics for Belgium and Italy are considerably lower than they were during the entire 1990s, and the Portuguese "breach" is the result of national income being several percentage points lower in 2011 than in 2008.

Even more important than choosing the correct measure is whether there should be a debt criterion. As any mortgage holder knows, the "burden" of a debt is not its absolute size or even its size relatively to income. The financial issue for a household, business or government is the cost of servicing the debt, determined by the interest rate on that debt. The speculation on the public bonds of Portugal, Italy, Greece and Spain created the debt burden problem now plaguing the euro. This is a problem that could easily be solved by a rationally designed European Central Bank that had the authority to serve as "bond buyer of last resort", as the Federal Reserve Banks are for the United States government. Using this authority, the central bank could stand ready to purchase any country's bonds at a specified maximum rate, for example, five percent. This policy would eliminate sovereign bond speculation in a stroke.

But the design of the European Central Bank is not rational. It is not even designed to be subject to meaningful democratic oversight. Its anti-democratic nature is not an accident of the law of unintended consequences. It is the conscious fulfilment of the central political principle of neo-liberalism, that economic policy is the preserve of experts, and should not be subject to the "populism" of democratic politics. It is an irony that the European Union is frequently assailed by right wing politicians in the United States as a haven of socialism. In reality it is exactly the end of democratic oversight that the Tea Party Republicans crave.

As disaster gathers on the European continent, one can imagine two paths of avoidance. The essential problem of the euro zone is the extreme internal trade imbalances: Germany with a huge surplus mirrored by the deficits of the other countries. The obviously rational approach would be for a German fiscal expansion combined with an end to the implicit and explicit export promotion subsidies that generated the surplus. These national policies would coordinate with temporary export subsidies and import restrictions in the deficit countries. The European Central Bank would provide transitory finance of trade deficits. The trade subsidies and restrictions would be combined with longer-term productivity improving investment policies for what might be termed "competition convergence". The probability of this sensible policy approach occurring is zero.

At the time of the Latin American debt crisis of the 1980s, many commentators (I was among them) argued that if two or more of the heavily indebted countries joined in a debt renegotiation pact, the onerously debilitating Washington Consensus policies could have been avoided. Similarly, today in Europe a pact among the governments of Greece, Ireland, Italy, Portugal and Spain to coordinate a simultaneous withdrawal from the eurozone would offer a viable alternative to the imposed austerity programs. Together the output of these five countries is almost forty percent larger than Germany's. The probability of this radical, but feasible alternative may be as high as one in a million.

This leaves the two most likely outcomes: eurozone depression with no defectors, or eurozone depression with a chaotic defection process. It is most likely to be depression with defectors, Greece being the first, and quite soon, under the feckless watch of the present right-wing government.

How far we have fallen! The famous Schuman Declaration of May 1950 by the foreign minister of France set forth a glowing vision of a cooperative Europe at peace with itself:

The solidarity in production thus established [by European Coal and Steel Community] will make it plain that any war between France and Germany becomes not merely unthinkable, but materially impossible. The setting up of this powerful productive unit, open to all countries willing to take part and bound ultimately to provide all the member countries with the basic elements of industrial production on the same terms, will lay a true foundation for their economic unification.

The vision of a cooperative Europe has now degenerated into a collection of weak and strong countries caught in a spiral of beggar-thy-neighbor trade and austerity policies, in which the 99% are the losers (even in Germany). The authoritarian governance of the EU has reached its fullest expression in this debt disaster of the 21st Century, bringing on a continental depression. The ideology that justified this consciously-created and unnecessary depression was and is pure neo-liberal economics wedded to great country nationalism.

Of all the bitter ironies of European unity gone viral, one stands out from all the others. The original motivation to form what has become the European Union was explicitly political, a project designed for a lasting peace in Europe, in which no country would dominate the continent. From that benign intent, the euro and large country nationalism have changed the EU into the vehicle to achieve that domination.

—

John Weeks *is Professor Emeritus of Development Economics and an Associate at the Centre for Development Policy and Research at the School of Oriental & African Studies, University of London – where he also serves as a Senior Researcher at the Research on Money and Finance Group. He is also Senior Researcher at the Institute for African Economic Studies, Addis Ababa University, Ethiopia.*

[i] OECD [online available at] www.oecd.org or EUROSTAT [online available at] http://epp.eurostat.ec.europa.eu/portal/page/portal/eurostat/home/).