

The Greek Crisis and the Future of the Eurozone

REVISITING SOME FUNDAMENTAL ECONOMIC PRINCIPLES OF THE EUROZONE

Andreas Theophanous

Professor of Political Economy, President of the Cyprus Center for European and International Affairs, University of Nicosia

The EU is facing its most serious economic crisis since the creation of the Common Market in the 1950's. The grand achievements that followed the completion of the Single Market, the Monetary Union and the Common Currency are under immediate threat. To get a sense of the magnitude of the challenge it is essential to understand the broader context of the crisis, including the debt crisis, the problem of unemployment and above all – under these difficult circumstances – how to take the debate on the future of Europe forward. These issues and challenges constitute the toughest test for the ability of the EU to sustain itself and thereafter to refocus on its future.

Not surprisingly the situation has resulted on the one hand in growing Euroscepticism and, on the other, in forces calling for closing the solidarity deficit. So far given the constraints and the rules of the game, the EU has been trying to contain the repercussions of the crisis. Much has been achieved but much more remains to be done.

The debt crisis and the overall economic crisis raise several issues including fiscal consolidation within and solidarity among the member states. But above all the EU may have to revisit some fundamental economic principles. Containing budget deficits and encouraging rationalization of public spending is one thing; trying to maintain the 3% deficit annually irrespective of the economic circumstances of a country would, most likely, create more problems that it could solve. Indeed during a recession such an approach is procyclical; in other words, it will likely worsen the recession. At times it may turn into a depression. The case of Greece may be indicative.

An alternative proposition is to have the 3% target as an average over time. It may be recalled that in the first post World War II years this was similar to the formal fiscal policy of Sweden (in this case the average over time was 0%) and it appeared in the literature as the Swedish Budget. Furthermore, it is of utmost importance to move forward with a fiscal union. That may also mean that spending of the EU will increase from 1% to about 5% of the total GDP of the Union. The suggested approach will enable the Union to support particular countries when in need with targeted spending patterns. Understandably, for the implementation of this policy option it is essential to reach a consensus for closer integration. This in turn may entail greater solidarity but also greater commitment of countries to move forward with the necessary reforms for fiscal consolidation.

It may be useful to recall that in the case of the US the political will and courage to address the structural fiscal problems of the country has not proved adequate so far. In fact the federal government has been in one way or another monetizing deficit. This has been associated with the relative weak exchange rate position of the dollar.

On the other hand the EU pursues a philosophy of strict fiscal discipline. This may be procyclical given that when a particular country is in a recession taking measures to balance public expenditures and revenues will certainly lead to a deepening of the recession. Indeed, it may result in a dangerous vicious circle.

It is therefore essential to revisit the overall theoretical framework of the euro. It is extremely difficult for a currency to exist in the long run in the absence of some form of fiscal union. Some analysts would take it further. A currency is not only a means of exchange and a store of value; it is also a flag. That means that for the sustainability of any monetary union some minimum form of political integration is necessary.

As demonstrated by the Greek experience, it is clear that the drastic increases of taxes and the reduction of spending have worsened the situation. What appears to be prevailing is an overall accounting logic instead of strategic economic thinking. The heart of the matter is that in addition to fiscal rationalization and consolidation Greece needs investments to create new jobs. Above all Greece requires a new economic structure as much as the EU requires a new economic approach. For example, it may be essential for Greece to take steps to enhance the credibility of state institutions and to revisit the role of trade unions including the circumstances under which a strike may be legitimate. And the EU must seriously consider the possibility of advancing a Fiscal Union.

At this stage the EU does not seem certain about which way to go. Interestingly the current Trio Presidency consists of two countries which joined the EU in 2004 (Poland and Cyprus) and an old member (Denmark) which opted not to enter the Eurozone. Out of the first two countries only one (Cyprus) has entered the Eurozone. This is indicative of the nature and structure of the EU today; a set up that cannot adequately address the depth and the magnitude of the problems today.

It is important to acknowledge that the issues under consideration require a new paradigm. As things stand the EU is acting on norms and guidelines which are an outcome of older paradigms and political and economic realities. This severe crisis caught stakeholders and players by surprise. Indeed, it is questionable whether in the long run there can be a monetary union without a fiscal union. Some analysts go even further to claim that a common currency can only exist within the framework of a political union. These issues deserve to be addressed seriously and with an open mind. Hopefully, the crises will abate sufficiently to allow this to happen.