

## THE EUROZONE WHERE TO?

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### 1. Introduction

Euro: to be or not to be a viable product and not a weak currency. But when and how? This is the question that is on everyone's lips, advised or less advised opinion and, naturally, because the single European currency is one of the complex problems of the contemporary world with implications for society at large, including the social mind.

### 2. The future of the Euro currency under the sign of the uncertainty

Optimistic position in papers in relation to the issue of the future of the euro was a dominant category of all specialists who have pronounced on this issue at the completion of 10 years from the launch of the euro. It is true that at that time, the end of 2009 the euro had made the financial crisis break out successfully in the summer of 2008, while Greece, Ireland, Portugal has not showed signs of major financial imbalances yet. But even without these major disorders, for another part of the specialists, the euro continued to be considered a monetary product without future.

As a result, during 2010, it has been shown, both from top politicians as well as from some experts that there were critics to the euro area or pessimistic forecasts for the future of the dollar. A first criticism was launched from European Union but outside the euro area by Polish Prime Minister Donald Tusk, who said in a press conference with Jose Manuel Barroso, European

Commission president, the followings: „As a country aspiring to the single currency, we hope to lead the euro area, but do not behave in an elitist manner the European Union”<sup>1</sup>. This statement, quite harsh, came from the fact that France has launched the idea of creating a new economic government of Eurozone, a proposal welcomed by EU President Herman Van Rompuy, but rejected by the EU executive based on the division of European states. Concerning this issue, Jose Manuel Barroso, was very definitely, saying at the Colloquium "European Integration and Democracy" held in Lisbon to celebrate the 25th anniversary of EU accession of Portugal and Spain, that: "In front of the external and internal challenges, Europe has the following options: disintegration or to continue to move forward together (...) the alternative for greater convergence is that even the largest country in Europe cannot compete, by itself, with U.S., Russia or China"<sup>2</sup>.

A bleak forecast transpires on our publication page "Newspaper", where under Dan Odagiu's signature appears the next story, unconfirmed by anyone else: "Germany and France could create Euro 2 currency." The new currency would be implemented only in rich countries in the euro area in order to keep them away from their poorer relatives in southern Greece, Spain, and Portugal. Problems in the euro area could be solved by creating a new single currency. Germany and France are considering more seriously the

<sup>1</sup> Revue "Capital", June 10, 2010

<sup>2</sup> <http://www.jurnalul.ro/stiri/externe>

implementation of a second EU single currency, in order to distance the northern states of Europe with a strong economy of the south states with major financial problems, reports telegraph.co.uk. So, Germany, France, Netherlands, Austria and Finland could adopt a new single currency besides the already existing one, while Spain, Portugal, Italy and even Greece, will remain only with the old currency. After taking such measures, the old strong euro will depreciate against the new currency, but both countries in northern Europe and the South will come to advantage: the first will get rid of the burden of the latter and they will avoid being given outside the euro area and thus they will not have to stand on their own economic difficulties<sup>3</sup>.

But perhaps the more critical and pessimistic opinion about the future position of making euro, and perhaps most taken into account in terms of scientific quality of the authors - even if they are known for their skepticism towards the European currency - belongs to Eliot Laurent and Jacques Le Cacheux, who, under the title "Euro: no future?"<sup>4</sup>, published a study in the journal of Science Research Center in Political Economy<sup>5</sup>. The article aroused great interest, but also some concern, and was taken into account by all the major news agencies. The study is preceded by a firm and clear warning: „*The euro is only a teenager and, unfortunately, a coin in suspension. It only disposes of a few years. If you do not take advantage of this period in order to achieve institutional*

*reforms, there is no doubt that the Eurozone will break up under its own contradictions, triggering a global crisis far more violent than in the fall of 2008. So we propose the establishment of a "sustainable federalism" structured on three pillars: increasing macroeconomic discipline, not only in terms of deficits, and public and private debt, penalizing states that do not follow common rules through a surcharge to be paid at Community budget, to a conversion plan economies in Southern and Eastern Europe to make them competitive*<sup>6</sup>.

The rigid tone of this study, especially coming from an area where the realities of economy and finance of the European countries seem to be well known and interpreted objectively, is likely to arouse concern. "At the time when the American financial crisis has caused an unprecedented European political crisis, when the very existence of the euro is not a certainty, the first step is to denounce the great lucid intellectual anesthesia of which European integration fell victim to the entry into force of the Treaty of Maastricht. No, the institutions of European economic policy, wrong constructed and used, are not effective! No, the performances of European countries are not good or converging? No, European response to the crisis, late, around and infirm cannot bring us peace! "- say the authors<sup>7</sup>. Greek crisis that nobody and nothing anticipated was the wave that brought economic good governance, covering reality and making Europeans feel they have overcome the crisis.

Giving below the veil, the authors make a critical analysis of the measures which have been taken so far to protect the area and the euro. Thus, The European Stability Fund (ESF), was following the Eurogroup meeting on 7 June, and could constitute a guarantee for the debt of a Member State in case of need and to avoid situations of lack of

<sup>3</sup> <http://www.cotidianul.ro>

<sup>4</sup> **ÉLOI Laurent, LE CACHEUX Jacques** – "Zone EURO: no future?", in „Lettre de L'OFCE", **Centre de recherche en économie de Sciences Politiques**, nr. 320, 14 iunie, 2010.

<sup>5</sup> *Centre de recherche en économie de Sciences Politiques* is an university institute for projections and policy assessments. Here operates 40 French and foreign researchers, which are added, as a "research associate", several specialists in France and abroad, of which three are Nobel laureates. The institution is led by Jean-Paul Fitoussi, Professor at the Institute of Political Studies in Paris.

<sup>6</sup> Op. cit. par. 1.

<sup>7</sup> Idem, pag. 1

liquidity. Under pressure from Germany, each state is not employed only for its share of participation in guarantees offered by ESF. "*What kind of European solidarity is this?*" - asks the authors. It seems that they are right, because, according to this model, each euro area state is jointly with itself ... and, moreover, to express "solidarity", the IMF agreement is necessary. In addition, the authors believe that ESF cannot solve the problem of the euro area countries experiencing imbalances, but it might only solve the immediate problems related to liquidity, and only provide a reserve of time that eventually can be translated into practice by genuine reforms. In fact, the ESF is intended to be available for a lifetime of 3 years, time horizon in which the Commission concluded that Member States may return to a limit of less than 3% of GDP deficit, as envisaged in the Stability Pact.

Another issue of European solidarity, analyzed by the authors, is related to the fact that financial markets, but also a large number of commentators have divided euro area countries in crickets and ants. Ants States whose economic fundamentals are sound gives them credible prospect of a return to normality, while crickets whose savings were, until recently, an object of admiration, now suffer all the economic evils so profound that only a draconian regime could put them up. But, just belonging to an integrated currency area may encourage national governments of the member countries to greater relaxation of the budget, threatening the stability and soundness of all money belonging to them. This community of economic and monetary destiny, invoked to impose budgetary rules to national governments, is ignored when it comes to exit strategies and to make order in public finances. In these situations, each is firmly surrounded or bound by financial markets as well as the European courts; to "clean" its own "yard". Therefore, Eurozone undertakes a costly coordinated depression. Consolidation

policies taken by all countries simultaneously generate a backdrop of economic growth, which contributes to distrust on the financial markets. On the other hand, the austerity policies lead to lower domestic demand in the euro area, thus threatening public debt stabilization. Thus, countries that are trying, each for himself, to acquire an increase of credibility, they only record a split, this time in the group, from such a goal.

Structural weakness of the euro area is not limited to issues of public accounts. The crisis has brought persistent divergences between national economies of Member States in terms of competitiveness. Thus, while Germany, in early 2000, had a policy of modernization and restructuring of the apparatus or manufacturing, but also of keeping wage costs in the 2000s, other euro area countries, not just those in the south, but also Ireland have seen the degradation of their competitiveness in a real "wage drift" of increasing support without a real increase of labor productivity. This trend, present since the beginning of the euro, was reflected in the current balance with surplus for Germany, the Netherlands, and Austria and for the other countries being deficitary, particularly in Greece, Spain and Portugal. These are the problems that a possible "economic government of the euro area", which to be worthy of the name, should resolve. The authors consider that this is absolutely impossible to have the "economic governance" developed at Maastricht (1992) and Amsterdam (1997). Supported by France, but received with hostility by Germany, the idea of "economic governance of the euro area" is now on everybody's lips, including Angela Merkel, but the meanings assigned to it are different. On the other hand, some countries see in "economic government" the strengthening of budgetary discipline and the rapid consolidation of public finances. On the other hand, the most important thing is to strengthen the existing principles, the adoption of new

rules and sanctions for deviations from the rules that could discourage deviant behavior. In the latter optics falls the constitutionalisation of national budgetary rules proposal, inspired by Germany's decision to enroll in the Constitution the obligation of a balance between public accounts, but also to strengthen the Stability Pact, mentioned with insistence at the last meetings of the Euro group. In the same spirit came also the Commission's proposal, approved by the Euro group, that before being submitted for approval to national parliaments, budgets must be first examined by the Commission and the Council.

All this real "arsenal of rules" designed to prevent future "budget shortfalls" is perfectly justified. But it cannot guarantee that the euro area is able to return to a better economic situation, because the European authorities commit the same mistakes as those that led to the Maastricht Treaty: on one hand, they focus only on the rules of construction budgets and the annually budget, without paying attention to other forms for coordination of economic policy, and, on the other hand, they polarize public attention to the public balance, in the detriment of public debt stock, as well as other macroeconomic indicators, such as private debt and competitiveness. However, Ireland and Spain's experience shows that economic weakness may be caused not only by an unhealthy management of public finance. Furthermore, the credibility of budgetary rules cannot be reinforced by strengthening the sanctions, since those have a highly political character, as the relaxation of Stability Pact proved back in 2005. As about the approval of national budgets by the Commission and the Council, this will play the role of a "discharging of responsibility" for national governments in the eventuality that these problems occur. *"Without a mechanism for mutual cooperation that is advantageous for each other,*

*strengthening discipline lacks credibility."*<sup>8</sup> - say the authors.

The current policy of the Eurogroup is based on two arguments. The first has a historical nature and refers to the cases of Ireland and Denmark, in 1980, Sweden and Finland, in 1990, and Canada, in 1995, when the proper management of Public Finance generated the end of the crisis situation and the local economic growth. But the authors say that the situation is not similar because there was the case of relatively small and open national economies. The second argument highlights the potential benefit of depreciation of the euro by stimulating exports. But, having in mind that only 16% of commercial exchanges of euro zone countries are made with non-euro countries, the depreciation should be considerable in order to obtain an economic growth generated by exports. In the same time, a devaluation of the euro, given the differences in competitiveness of euro area economies would be an advantage for Germany five times more than for Greece and three times more than for Spain.

The situation in the euro area expresses a compromise between the establishments of strict budgetary rules and tends to create an informal court to coordinate economic policies. Attitude of rejection of Germans from expanding such cooperation has now conferred legitimacy of the Constitutional Court in Karlsruhe, June 2009, which severely limits the ability of the executive to engage in coordination of European economies.

What is still to be done? The two authors are not limited to demonstrate the inability to preserve of the euro area, but they are also trying to provide the solution that could redress the situation and that could be expressed in three words: "a sustainable federalism." Intermediate objectives that have to follow the European economic policy in

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<sup>8</sup> Ibidem, pag.3.

the coming years should be the following: financial sustainability of debt and restore the competitiveness of those countries that have lost it, which is gaining economic sustainability. Financial sustainability requires setting a maximum rate of public debt at a certain level, which did not have anything to do with that 60% of GDP threshold set, arbitrarily, at Maastricht. Perhaps a threshold of 100% of GDP would be more realistic, but only if the difference between the interest rate at public debt and growth rate is negative. The ratio of financial and economic sustainability should be: to ensure financial sustainability, economic sustainability should be ensured because only monetary policy, although it could influence the public sector financing, it cannot directly control interest rates. This is the solution for countries with problems of competitiveness, disabled by unit labor costs too high and which found the only solution for increasing labor productivity in ambitious policies aimed at education, increase innovation, etc. This is exactly what these countries are not doing now because they are now focusing almost exclusively on cost reduction programs and to reduce deficits.

As for the penalties to be imposed on member states that does not follow the rules established, they are very important as long as we talk of sovereign states and therefore their nature should be carefully and responsibly established. According to the Stability Pact, sanctions consist of financial penalties and fines. But they only get hit in the state's finances that are so poor and so they are less likely to materialize. The new sanctions that have been raised recently, referring to exclusion from the euro area, suspending the voting rights, the withdrawal of EU structural funds, are even more inappropriate, because they are contrary to the authors' objectives and even offered them the monetary union. To be effective, sanctions must be both penalties and incentives and, in any

case should not lead to clear prospect of a return to steady growth and credibility.

For recovery and strengthening of the euro area, the economic and financial sustainability, with the inevitable sanctions, must be accompanied by common economic policy, discretionary by nature, designed to promote economic growth throughout the euro area and at the same time, reducing the competitiveness disability for the most vulnerable countries. The authors suggest these economic policies coupled with "climate – energy package"<sup>9</sup>, which is meant to lead to environmental pollution and reduce dependence on fossil energy sources, developing alternative energy technologies. Firmly directing budgetary resources and, eventually, the European Investment Bank loans, in order to support conversion of European economies, especially from the South (less developed) – say the authors - towards ways of production and ways of life based less on non-renewable resources, will solve all the problems of sustainability and financial and economic but also environmental sustainability. In this way, the southern states may cancel the differences in competitiveness, and become true European and world centers of renewable energy production and the euro area will be able to reconnect to the future - concludes Eloi Laurent and Jacques Le Cacheux.

Pessimistic view on the evolution and appreciation of the euro and the euro area continued to be expressed in early 2011. They come from some independent expert appreciated for the

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<sup>9</sup> "Climate-energy package" includes a package called "3 times 20" work based on the outcome of the United Nations Framework Convention on Climate Change held in Bali in 2007, aims for 2020, compared with 2009, 20% reduction in exhaust emissions in the atmosphere, increase energy efficiency by 20% and 20% increase in the share of nuclear power in total energy production. After a year of negotiations, "package" was adopted on 28 December 2008. By this package, the EU has said that a world leader in the fight against climate change."

quality of the assessments achieved so far. Thus, Douglas McWilliams, general manager of CEBR<sup>10</sup> said earlier this year (2011) that there is a chance to five of surviving for the euro area over 10 years in the current formula. Moreover, he said, on short term, if the euro doesn't collapse this year, then surely it will depreciate considerably in relation to dollar<sup>11</sup>.

In this forecast, another personality joins McWilliams, one who is very present in the evolution of the global economic outlook, Nouriel Roubini, teacher at the New York University's Stern School of Business<sup>12</sup>. He said, neither more nor less that the current approach to problems in the euro area, will make the weaker members out of the euro area.

John Taylor, president of FX Concepts, one of the biggest hedge funds<sup>13</sup>, another pessimistic analyst made the same statement: "Some countries could abandon the euro currency"<sup>14</sup>.

"The prophecy" of Roubini and Taylor received a quasi-confirmation, even faster than anyone would have imagined. On 14 November 2010, foreign

minister in Lisbon, Luis Amaso, told L'Espresso weekly that: *"The country needs a broad coalition to pass the current situation. Otherwise, the alternative would be, ultimately, surrender to the euro"*<sup>15</sup>. Portuguese official statement is a premiere, at least until writing these lines, and its importance is not the consequences that it had or not, but that it was seen as an alternative to overcome the crisis.

While it is difficult to predict the future of the euro with a high degree of accuracy, one phrase seems to have a truth value, because it was said by the current leader of the most powerful country in the euro area, Angela Merkel: *"If euro fails, Europe will fail"*<sup>16</sup>. As long as Germany's position is the one written above, (it belongs to other states, but no leader has expressed it with such clarity and force) EU and euro seem to have a common future.

### 3. Conclusions

It is in the human nature to fear change and the uncertainty following the transition. It is fear because we don't know the rules, the evolution and the final state. If, however, we understand the mechanisms, stages and requirements, the change is transformed from an experiment in an exercise of knowledge, action and will. Our belief is that the changeover has been and is still a great challenge that has to be completed with success.

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<sup>10</sup> CEBR consulting is an independent company, founded in 1992, which provides consulting services to companies, financial institutions, government departments. Douglas is the authorized McWilliams "voice" and decides on all important issues in macroeconomic and macro financial.

<sup>11</sup> **Toreanik, Alexander** - "The euro area has only 20% chance of survival"

<sup>12</sup> idem

<sup>13</sup> Hedge funds are investment trusts that are different from the ordinary with the following features: participation in the fund is starting to considerable amounts (usually from \$ 1 million and up) usually funds are not regulated which allows managers to use a variety of investment techniques that are not allowed in other types of funds, making the risk level of these funds to be considerably higher, and earnings, besides the commission to administer, usually - 2%, its fund managers can assign at least 20% of the profit gains over the previous set, which makes these people to be among the rich world. The first hedging fund was established in 1945 by an American sociologist - Alfred W. Jones, but who was also a financial journalist.

<sup>14</sup> www.mediafax.ro, December 3rd, 2010.

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<sup>15</sup> **Dinu, Carla** – "Portugal might abandon euro", www.HotNews.ro, November 15, 2010.

<sup>16</sup> **Bătcă, Ana** – "Eurozone, a club where few are feeling good", in Evenimentul Zilei Journal, December 14, 2010.

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