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Europe's 'Trojan Horse'

BARRY EICHENGREEN |02 March 2010, 11:52

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This is going to allow the Greek authorities to meet their debt commitments. The markets are going to calm down. The long-term consequences are not going to be pleasant, but those problems can wait until another day.

Many people say the biggest mistake was letting Greece join the euro. It should have been clear that the country wasn't ready. Its budget policies were already out of control when the country joined the monetary union in 2001 and the unions pressured the government to raise wages to European levels, even though productivity was lower than the European average.

But this is a very simple answer, since these signs of dysfunction are not limited to Greece. Spain, with an unemployment rate of 20% and an explosive budget deficit sees Greece as an image of its own future. Or if it doesn't see it, the markets do. Portugal and Italy are a little better.

Just like Greece, these countries face drastic budget cuts. Just like Greece, they cannot devalue their currency to drive exports. Just like Greece, they face deep recessions. Just like Greece, they are going to feel tempted to ask for help.

All this leads to an obvious question: was the creation of the euro a mistake? Since I was one of the few Americans who supported the creation of a single European currency, it is fair to ask if I have changed my mind.

My answer is no. The creation of the euro was not a mistake, but it could still become one. The Greek crisis shows that Europe is only half way along the path to creating a viable monetary union. If it continues in this direction, the next crisis could make this one look like child's play.

In order to complete its monetary union, Europe needs to create a proper emergency funding mechanism. Currently, the member states can only help Greece if they circumvent the rules that stop them from helping other member states except in cases of natural disasters or in cases beyond the control of the country.

All of this increases the uncertainty. When the European leaders provide help, this leads public opinion and the markets to think they are being dishonest. If the Treaty of Lisbon is creating these problems, then it should be altered.

Apart from that, the help must be given, not only with conditions, but with a temporary control of the public accounts by a committee of "specialists" appointed by the European Union. History has taught us that the promises given by those who receive help are not enough.

There is no doubt that the countries these measures apply to are going to disagree. Nobody is going to make them take the money. Concerned about the moral risk? Here is your solution.

I'd also like to point out that this disciplinary measure would be much more effective than the defunct Stability and Growth Pact.

You may ask: how would Californians feel if they were made to temporarily place their budget deficit in the hands of a specialist appointed by the Administration of President Barack Obama? They probably wouldn't have a problem with this.

The specialist who was appointed wouldn't be a Californian but he would be a North American. The people would understand that he was acting in the benefit of the states and the country. Apart from this, they would feel comforted by the fact that California sends representatives to Washington D.C. from where this specialist would give his orders.

The Europeans don't do this because, firstly, they consider themselves Greeks or Germans. They don't interfere in the "sovereign prerogatives" of other member states. Germany is particularly reluctant, because of its memories of the Second World War. But if Europe takes its monetary union seriously it is going to have to get over the past. It doesn't just need greater economic ties, but political ones too. Whoever manages the emergency funding mechanism will have to be extremely responsible and answer to a strong European parliament.

German Chancellor Angela Merkel's voters hate the financial bailouts because they know it is them who are going to have to pay for them. They hate anything that sounds like European political integration.

But Germany is not blameless in this crisis. It demanded an extraordinarily independent and autonomous central bank that today applies a monetary policy that is too rigid, that exacerbates the problems of the PIIGS (Portugal, Ireland, Italy, Greece and Spain). Germany's huge current account surplus just makes the problems even worse.

Germany has done little in terms of budget stimulus to support the European economy.

Germany has benefitted enormously from the creation of the euro. It should return the favour, driving the creation of an emergency funding mechanism and making political integration possible. It should provide more budget support. And who is better placed to demand a more responsible European Central Bank?

The Greek crisis may be the 'Trojan horse' that leads Europe to deeper political integration. It doesn't cost anything to dream.

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