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The Eurozone Economic Problems and the solutions ahead[1]

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1. Dynamics of the great recession: redistribution of world income and lack of a real global policy

This paper begins with the political, economic and social setting in which we are situated. In August 2013, we still find ourselves enduring the serious difficulties that began in 2007 on a world scale. Of course, with larger or smaller problems in the different countries, according to their respective circumstances; but in any case, without having yet encountered global solutions to our economic troubles.

Mission impossible, it could be said, since after a six-year period of problems, the discussion between neo-Keynesians, neo-classicalists, and pragmatics seems to be never-ending. Although it has to be accepted that international cooperation in the present circumstances is in better condition than during the Great Depression. When the World Economic Conference of London in 1933 signified that an idea of concord was not a common purpose, it opened the inevitable path to the Second World War (WWII).

Yet international cooperation has not achieved the necessary high level. At the G-20 and other international forums, the main-springs of the crisis have not been well analysed for the purpose of having a real diagnosis. In that sense, it has not yet been appreciated that the world economy is presently a complex made up of three *tectonic plates*:

- The *first plate* is made up of the *rich countries,* with a high level of consumption and low savings rate, slower growth than in the past, and gradually giving up their previous position of absolute protagonism, or leadership if you prefer. We are referring mainly to the US, the EU and Japan.

- The *second plate* consists of the *emerging countries*, with broad human and natural resources, strong savings, and rapid expansion of their GDPs. In the

[1] This briefing paper is based on a public lecture by Professor Tamames at the ANU Centre for European Studies on 29 August 2013.

group the BRICS (especially China) have crucial importance, since more than 50 per cent of world *growth* at present comes from them. And at the same time, the largest international reserves are kept and managed by their central banks, or their powerful sovereign wealth funds.

- The *third tectonic plate* belongs to the developing countries, which despite their difficult structural situation in so many cases, seem to be awakening from a long phase of stagnation. This is a new development that is not due to the official aid of the rich countries, but that comes from globalization. And by the way, we can recall the public demonstrations on streets and squares in the great cities of the advanced countries, from the 1960s to the 1990s of the 20th century, when the youngest and most generous people demanded the transfer of 0.7% of their GNP to the Third World, so that it could escape poverty. These public demonstrations are not seen anymore, since the protests evidenced since 2008 on, are mostly related to the budget cuts of the austerity policy especially in the rich countries.

What happened? It is simple: many countries that in the 1960s and the 1970s were developing very slowly are now real emerging powers. Not on account, as we said, of any special, generous North-South support, but because the then poor countries were able to profit from the great possibilities offered by globalization; above all on the basis of the comparative advantages of low wages.

And to quantify this fundamental transformation, we would say that in world trade in 2010, from a figure of 32 trillion US dollars, some four trillion were exports by emerging and developing countries; a multiple almost twelve times the 0.7 per cent demanded in the past for official aid. Furthermore, we can appreciate how the emerging and developing countries entered with full force into the so-called South/South trade. Thus fulfilling the *prophecy* made by Raul Prebisch on the occasion of the first UNCTAD, Geneva, 1964. Summing up, the joint effects of globalization and South-South trade resulted in a very significant redistribution of world wealth and income: actually, the best news linked to the most serious crisis we have been going through since 2007.

Although the world economy is divided into three different plates, we must emphasize their interdependence in the world scenario, since if the 30 wealthiest nations make up only 10% of the world population, their GDP represents 63% (2010). So that if more economic dynamism is not fully restored to the tectonic plate of the wealthiest part of the world, the other two could fall into a serious slowdown, due to the dynamics of international trade; for which considerable evidence is emerging in areas like India, East Asia and South America.

In other words: in a global economy, there must be some kind of global motor to countervail the trends of decline in the previously rich world. If we live in a globalized economy, we need more than ever *global institutions*, and truly global mentalities; thus overcoming the existing situation of a weak world institutional framework, incapable of dealing with great global issues.

2. The Eurozone crisis: is everything in such bad shape?

In the global context we have analysed previously, we cannot accept the idea that the single European currency will not survive. Against that perverse augury we must emphasize that the Eurosystem is creating its own federal tools to fight against auto-demolition. Something absolutely necessary, because as Martin Wolf has said:

> if countries face year after weary year of debt deflation and depression, the euro risks becoming a detested symbol of impoverishment. As a strong federal union, the US will bear the strain of such sustained disappointment. The far more fragile euro zone will not. Very simple: because the Eurozone would be dismantled with all catastrophic consequences.

We can be sure that we are not going to experience that catastrophe: a dismantling like the one that occurred with the *Latin Monetary Union* (whose members were France, Belgium, Switzerland, Italy, Greece and in some way also Spain), promoted by Napoleon III which *de facto* disappeared when the French Emperor was defeated in the Franco-Prussian War (1870). The Eurosystem has not been created by any autocracy, but by the 11 sovereign countries, signatories of the Maastricht Treaty, and now, the Euro is the common currency of 17 European states, which are integrated through intra-European trade.

In other words, it has to be understood that the best business for all Europeans is to push the Monetary Union forward; instead of dropping it, to go back in history, to the age of small national currencies. In that sense, instead of a powerful IV Reich, what we need at present is a real *European Germany* to help the single currency and the solidarity.

3. Inevitability and feedback of the austerity policy

Before entering the discussion about how to reinforce European economic institutions, we must analyse what happened after the explosion of the financial bubble which emerged from 2001-2007, as a result of the previous *credit bang*. Banks, after lending so much, were affected by a lack of new funds entering their balances, and also by a very high level of defaulting by borrowers.

In that difficult context, and to prevent a complete collapse, a series of measures were taken by the economic authorities all around the Eurozone. Through different means, and mainly through aid to private banks by central national banks; and even with a few nationalisations in the worst cases.

The banking system had to be saved; otherwise the situation could have developed most catastrophically. And that was done by most of the member states of the EU, though in the most serious circumstances, four countries –Greece, Portugal, Ireland and Cyprus— had to be helped with special communitarian aid schemes – bailouts; implemented by the Eurogroup, combining credits of the newly created *European Fund for Financial Stability* and the IMF.

In the case of Spain, there was not a full bailout, that is true, but a special programme of 40 billion Euros had to be devised to balance out the banking balances. Especially the saving banks (*cajas de ahorro*), which had suffered extremely serious difficulties on account of their excessive activity in the field of mortgage credits. All that policy was necessary. Otherwise a systemic crisis could have taken place, thus collapsing the whole economic system of the above-mentioned countries, and even of the stronger EU nations, through some kind of *domino effect*.

But the situation regarding banking difficulties resulted in more complications for some state members, since they had to issue an enormous amount of Public Debt to substitute the dramatic fall of normal fiscal receipts with money borrowed in international capital markets all due to the decline of economic activity in so many sectors.

In that scenario, red lines had to be settled to go over certain levels of maximum deficits, fixed on terms that generally were qualified as very severe. And at the same time it was necessary to quantify maximum targets to the public debt stock related to the GDP. Those measures together were the main tools of the so-called *austerity policy* to put a brake on what is considered excessive state spending.

Austerity and bailouts were the policy of last resort, to maintain the Eurosystem and not permit the exit of certain states out of the Euro. It was a real need to avoid that option because of its consequences in terms of strong devaluations that could have followed after re-adopting their previous national currencies.

The target of the austerity measures is a new fiscal equilibrium, reducing the size of public administrations through employee dismissals, wage cuts, public organism dismantling. But of course, the austerity measures also fed back into the process of recession. And that is why so many request a new common European policy, to jointly grow again. This is a subject that we shall deal with further, after appreciating what has changed so far in the Eurosystem's main institutions.

4. Reinforcing European institutions in the Eurozone

The Euro scheme provided by the Maastricht Treaty was not immediately developed, mainly because throughout the creation of the Eurosystem (1998) and until 2007, a cycle of bonanza prevailed all over the world economy. But when the cycle changed abruptly in 2008, everybody realised that the institutionalisation of the Euro was not strong enough. Therefore, in the declining region of the cycle (2009 and after) new Euro-institutions had to be created to ameliorate the performance of the single currency. In that direction, the principal changes introduced were the following:

- *Fiscal Union,* so that the Eurogroup supervises national budgets of the state members, to ensure a certain common discipline regarding public expenditure. It includes obliging *recommendations* contained in the *Memoranda of Understanding*, which are real contracts between the Eurozone and each of their countries.
- *Golden fiscal rule,* to achieve zero budget deficits in all the Euro state members by 2020, for which constitutional amendments were introduced in a few countries, based on the previous German model.
- *Banking Union,* so that all the credit systems inside the Eurozone perform on the same patterns, according to the agreement achieved at the Bank for International Settlements (Basel-III).
- *Single banking supervisor* to assure banking disciplines, a feature still with many doubts on its future setting, because of the delay in a series of reforms to be

introduced in the German savings banks, which are not in such good shape: *es ist nicht Gold alles Gold was glänz.*

- A new attitude inside the ECB, which probably would require a reform of the Maastricht Treaty: to make the ECB closer to the way of working of the Federal Reserve System in the US. In that direction, new means and methods will be formulated:
    - Larger acceptance of state bonds by the ECB, in certain conditions, to make the public debt issue easier.
    - Direct help from the ECB to private banks, not going through public debt issued by the states.
    - More expansive policies to make possible lower exchange rates for the euro and thus to make European exports more competitive.
    - Probably some kind of European *quantitative easing* (QE) on the style of the Fed Reserve System regarding big enterprises and other institutions.
    - An enlargement of the *European Mechanism for Financial Stability*, as a real federal reserve of the ECB. Until now, Germany has blocked a more expansive policy on the side of the ECB. Especially looking forward to the so-called *Eurobonds,* that could mean a real mutualisation of public debt inside the Euro-zone to promote public investments.

5. What is Happening in Spain?

Let me say a few words about what is cooking in my own country. I can say straight away that Spain – after a real economic nightmare between 2008 and 2011 – is improving at present in its economic situation. Among the different indicators in favour of that thesis we can select a few:

- The strong reduction of the risk premium; that is the differential of interest rates of the Spanish long term bond issues related to the German *Bund*. That indicator has gone down from 550 in the middle of 2012 to 240 points in September 2013.

- The increase of exports, especially to the non-EU areas, with *superavit* in the combined commercial and services balance, most important if we remember that in 2007 that deficit was more than 10 per cent of GDP.
- The improvement of tourism, with a great increase of Russian and Chinese citizens, who come to Spain not only to visit, but also to purchase a lot of expensive items.
- The trend in the reduction in the rate of increase of unemployment, as a real effect of the labour reform which permits higher productivity; and therefore, better competition regarding foreign markets.
- The much better behaviour of the stock exchange, as reflects the Ibex-35 Index, in parallel to a clear comeback of international capital.

In spite of all these indicators, it can be said that the Government has not yet done all its homework, since many reforms have been postponed or only half implemented. Especially the Public Administration, where there are, still, too many employees with low productivity. In addition, there are further issues to be solved: namely the broad margin of fiscal fraud; the financing of the autonomous communities; and the high level of public debt.

6. Global reforms required

The improvement of the economic situation in the Eurozone countries also depends on the general trends in the international economy. It is clear that the favourable current forecasts are no assurance that a final solution to the crisis has been attained. Some would even argue that a new crisis is looming in the economic horizon. However, we can state here that any national economy – if they still can be thus called – depends on the future adjustment of international institutions and behaviours. And only as a preliminary *repertoire*, we can mention the main cases to be reformed:

- The Group of Twenty, the G-20, has to be more empowered. Otherwise, its world summits – from Washington 1998 to Saint Petersburg 2013 — are going to be remembered as more or less useless for real international cooperation.
- Almost the same can be said about the World Trade Organisation, with its delayed Doha Round, started in 2011 and now in serious danger of a fiasco. Something has to be done

to overcome the unsolved difficulties, with the aim of a more globalised international economy.

- Reconstruction of an international monetary system (IMS). This is a real need as was the case between 1944 and 1971, thanks to the Bretton Woods agreements. And we could say that some ambitious goal had to be fixed, which the BRICS countries are already clamouring for. We could even say that the Keynesian idea of a global currency (remember the *Bancor*), must be fully recovered.
- A new programme against poverty is also absolutely necessary, after the lack of success of so many items belonging to the Millennium Development Goals. As has been assessed, the best business that can be done is to give to the poor of the world the opportunity of overcoming their painful situation.
- Military expenses have to be reduced, which is not a chimeric goal. Utopia is possible if the leaders of the superpowers assume more universal goals instead of their obsolete hegemonic ones. In that sense, it could be possible to fix a maximum level of 1 per cent of GDP dedicated to Defence, as is already the case of Japan, and also the recommendation by NATO, in certain conditions, to the non-hegemonic countries.
- We have to emphasise too, the increasing role of the BRICS, as a new growth motor for the whole international economy. This is not to create any exclusive blocks, but to reinforce the role of those countries which still have broad growth possibilities (of course, in a more sustainable framework).

7. The global framework

I conclude by underscoring the increased interdependence in the present international economic scenario. If we have more and more globalisation, we need to push the idea that globalized institutions are also needed. Besides that, we should try to formulate some kind of new theory regarding what in previous times was referred to as comparative costs trade advantages. In this sense globalisation means fewer barriers to interchange, productivity, quality and sustainability. All of them have to be considered as principal targets in all kinds of production systems without forgetting the fundamental solidarities, regarding peace, nature conservation and the struggle against underdevelopment.

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