LABOUR EURO-SAFEGUARDS CAMPAIGN

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MORE QUESTIONS AND ANSWERS

ON THE FUTURE OF THE EURO

1. **What has recently happened to Greece?**

After long and tortuous negotiations, the Eurozone countries have agreed that Greece should be supported with a further huge bail out. €130bn is being made available to enable the Greek government to meet its commitments to bond holders and banks. Almost none is going directly to help the Greek economy. The price paid by Greece to obtain this funding is, however, extremely high. There are to be further major rounds of cuts in government expenditure, which will inevitably further depress the Greek economy which has already contracted by some 15% over the last four years. Drastic reforms of the labour market are to be implemented. The minimum wage has already been reduced by 22% for those over 25 and 32% for those younger than this, leaving large numbers of people who are still working struggling to make ends meet. Meanwhile unemployment is steadily increasing, making another large section of the population even worse off – over 20% as a whole and 50% for those between 16 and 24. To secure the loan, Greek politicians were made to sign declarations that the austerity policies insisted upon by the EU would be implemented whatever the results of the elections which were originally due to take place in April and which have now been put back to May 2012. Hardly surprisingly, the hardship imposed on Greece has resulted in widespread rioting and arson.

2. **What is happening elsewhere in the Eurozone?**

While Greece has been the headline news the situation elsewhere in the Eurozone continues to be poor. Most Eurozone countries are now expected to see little or no growth in 2012. Even the more prosperous countries such as Germany and Holland are experiencing output drops as their main export markets in the EU go into decline. Across the Eurozone, governments are failing to balance their books, with no growth to finance their increasing indebtedness. Some easing has been brought about by a change of policy by the

European Central Bank (ECB), which is now lending very large sums of money to banks across the Eurozone to keep them solvent. This has reduced somewhat the interest rates which the weaker economies such as Portugal, Spain and Italy have to pay, but at the price of the ECB running up huge amounts of money which it is owed and which may never be repaid. Provided that the Single Currency avoids breaking up, these debts due to the ECB may remain on the ECB's books at full value, but if the Eurozone collapses the enormous losses which the ECB would then have to book would leave its liabilities much larger than its assets. Whether there would then be sufficient creditworthiness anywhere in the Eurozone to bail out the ECB in these circumstances remains to be seen.

3. What will happen if Greece defaults?

A large amount therefore rests on whether the Greek economy will manage to stay in the euro. The omens are not good. The degree of hardship imposed on the Greeks looks as though it may be unbearable, leading to the politicians and parties who have signed the recent agreements being unable to hold the line following the forthcoming elections. There are still unresolved problems about how long the bail out funds which are currently being released are going to last and increasing numbers of politicians – reflected in public polls – who believe that good money is being thrown after bad. The markets are clearly nervous and distrustful. If the current projections for the Greek economy turn out to be too optimistic – which on past performance seems to be very likely – the bail out which has just been negotiated may well unravel, as the terms imposed upon Greece turn out to be undeliverable.

4. What will happen to the Greek economy if it defaults?

There is no doubt that, if Greece does default, this will be, for at least in the immediate short term, a disaster for Greece. It will also be a catastrophe for the leading EU politicians and for the EU project as a whole. If the medium term projections are as bad for Greece as they appear to be, and the EU political class realises this, it is hard to avoid the conclusion that the politicians involved, many of whom face elections fairly soon, are just hoping to put off the time when Greece does default until their elections are over. This is because the immediate impact of a Greek default would be to plunge Greece into an even deeper economic crisis. All the evidence from other countries which have faced similar problems – such as Argentina at the beginning of 2002 – is, however, that once the default has taken place and the Greek currency has fallen to a competitive level, the economy would rapidly start picking up again. In Argentina, the national income fell 11% in 2002, but by 2003 the economy was growing again, inflation fell right back and unemployment went down. For the next few years, the economy grew at an astonishing 9% per annum. Industrial output doubled between 2003 and 2010. The same trends would very probably materialise in Greece.

5. **What will then happen to the other weak euro economies?**

A crucial question is whether, if Greece does default, it will be possible to stop the subsequent contagion spreading to other Eurozone countries. Whether this will be possible in the short term will depend largely on whether there is still sufficient borrowing power, and the political will to use it, to avoid further defaults. For a period, it is possible that this will happen, although the strains involved in attempting to do so will be enormous and may be unbearable. In the longer term, however, it is very unlikely that this policy will be successful. This is because the root cause of the euro crisis is not the lack of solvency or access to liquidity of the weaker EU economies. It is the enormous gulf in competitiveness between the weaker and the stronger members of the Eurozone.

6. **Will austerity solve the euro problem?**

The gamble being taken by the Eurozone authorities is that the Eurozone crisis will force the weaker economies to restructure and improve their competitiveness so rapidly that they will be able not only to match the German rate of improved efficiency, which is likely to take place over the coming years, but hugely to exceed it. As costs in the weaker Eurozone economies are now some 30% higher than those in Germany, than they were when the Eurozone was established in 1998, as a result of higher inflation, this is a mammoth task. It therefore involves goals which are very unlikely to be achieved even if the political will required is available. This is because it is extremely difficult to get productivity and efficiency up in conditions of severe economic depression. Some results can be achieved by forcing down wages, as has happened in Greece and Ireland, but other vital components of increased competitiveness are all too likely to be absent, especially high levels of investment in the sorts of projects which are most likely to increase productivity and competitiveness. The medium term prospect of countries such as Spain, Italy and Portugal being able to regain the capacity to compete successfully with Germany are thus vanishingly small. If, however, at the same time as they go through years of austerity, high unemployment and stagnant living standards, people in these countries see the Greeks suddenly doing very much better than they were previously, as their economy picks up having been through the trauma of leaving the Single Currency, it will then become even harder to avoid more countries leaving the euro.

7. **What then seems most likely to happen?**

The most likely outturn, if Greece defaults, is therefore likely to be the Single Currency unravelling, perhaps rapidly but possibly more slowly. Every time a country leaves the euro, however, there will be a very damaging impact on both the economy of the leaving economy and the rest of Europe as the loans which have so rashly been made available to prop the euro up for too long drop massively in value, leaving the lenders insolvent and potentially bankrupt. National incomes will fall before they start to recover and austerity will get worse before it begins to get better. It seems probable that those countries eventually leaving the euro will include Greece, Ireland, Portugal, Cyprus, Spain and Italy, and very probably Belgium and France as well. This may leave a northern tier of countries, including Germany, Holland, Austria, Finland and possibly one or two others who want to stay with what will then be left of the euro.

8. Where will this leave the European Union?

It is always hard to tell what reactions there might be to events of this sort unfolding but it seems certain that they will be very damaging to the EU. Once the economies previously locked into the euro escape from it, they will be unlikely to want to submit to any more of the economic control from Brussels which the Single Currency entails. It also seems probable that the power of the EU to control its constituent Members more generally would be significantly diminished. A decade of backsliding economically in the Eurozone at the same time as countries in the East forge ahead, is bound to lead to a huge diminution in the power and influence exercised in the world by European countries. More worryingly, there also seems to be a significant risk that years of austerity may poison the political atmosphere, leading to extremism, xenophobia, racism and a retreat from the liberal world economic order.

9. What will be the legacy of the Single Currency?

The establishment of the Single Currency was always a very high risk project. The chances of it ever being successful were never good. There were plenty of people before it came into being who warned that the concept was flawed. The EU political class chose to ignore all these warnings and to press ahead with what was essentially a political and not an economic decision to bring the Eurozone into being. It was a terrible misjudgement. The result is that the collapse of the Eurozone is likely to transform the EU into being a very different sort of organisation than its leaders expected it to be – much weaker and much less self-confident. The cost of getting to this point is going to be enormous, however, not only for Eurozone members but for Britain too as we get sucked into the vortex. We will be saved the worst because we are not in the euro, but we will suffer badly enough, nevertheless, from the catastrophes which the collapsing euro is only too likely to bring in train.

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