LABOUR EURO-SAFEGUARDS CAMPAIGN

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MORE QUESTIONS AND ANSWERS ON THE EURO AND ITS FUTURE

1. **Why is the Eurozone in such dire straits?**

The fundamental reason why the Eurozone is now in a state of perpetual crisis is not because of lack of liquidity or solvency among either Eurozone banks or the EU's sovereign states. These are merely symptoms of the basic malaise, which is that the weaker euro economies are now hopelessly uncompetitive. They cannot pay their way in the world. They have huge balance of payments deficits which both suck demand out of their economies and leave them with no alternative but more borrowing to fill the gap. In the past, the solution to problems of this sort was devaluation. Within the Single Currency regime, however, devaluation by depreciating the currency's external value is impossible. The only way out is "internal devaluation" which means squeezing down costs to make the economy more competitive. This is, however, a ruinously difficult strategy to pursue successfully. As can be seen only too clearly in Greece, Spain and elsewhere, it involves drastically falling living standards and desperately high unemployment. In these conditions, business investment inevitably falls away, making future prospects for competitiveness ever less likely to be achieved. The result is mounting austerity as hope for a better future evaporates and mainstream politicians fall further and further into disrepute.

2. **What could tip the Single Currency into breaking up?**

The EU political class is desperate to stop the euro fragmenting. There are, however, such wide differences of opinion between the solvent nations – primarily Germany – and those which cannot compete with German standards of efficiency and competitiveness, that no agreement has been reached about how to tackle the euro's problems. Nor is there any serious prospect of one being forthcoming in the near future. In these circumstances there are at least three different ways in which a break up of the euro might be triggered. One is refusal by the Germans to make available sufficient funding and guarantees to enable insolvent banks and sovereign states within the Eurozone to meet their liabilities. A second is political developments among nations with more and more austerity being forced upon them, making them unwilling to continue with policies compatible with euro membership. A third is wholesale withdrawal from the market by private lenders, unwilling any longer to take the risks involved in lending money to banks and sovereign states which, increasingly clearly, are never going to be able either to service or to pay back the loans made to them. The chances of one of these three developments manifesting themselves appear to be becoming greater almost by the day as the Eurozone drifts from one short-term crisis to another.

3. What is likely to happen the Single Currency if one or more countries leave the euro?

Clearly, some Eurozone countries are in even worse shape than others, with Greece at the top of the list. The hope among EU leaders is that, if one country such as Greece leaves the euro, it will be possible to insulate this development from the rest of the Eurozone. There are several good reasons, however, why this is very unlikely to be the outcome. First, once one country leaves, it will be clear that the Single Currency is not inviolable and that others may therefore follow the exit route. Second, market and internal political pressures are building up all the time, so that the conditions which led the first country to leave are very likely to materialise in other countries. Third, the defences against default in the form of loans and guarantees are being used up all the time, making the financial resources still left to deal with each new crisis look increasingly inadequate. Fourth, after a period of a year or so, all historical experience suggests that any countries which do leave the euro and revert to their old currencies will start recovering strongly, providing a sharper and sharper contrast with those still mired in austerity in the Single Currency. Thus, even if the Eurozone authorities do manage to hold the line as the Eurozone begins to break up, it seems very unlikely that they will be able to do so indefinitely.

4. What would be the impact on the European economy if the euro implodes?

If the Eurozone, as seems increasingly likely, does eventually break up what will the consequences be for both the Single Currency countries, and ones like the UK which are in the EU but not in the euro? In the short term they are likely to be highly disruptive, leading to further falls in output and more unemployument. The main reasons for this are the huge amount of debt which has been run up in the Eurozone which is ever more likely to cripple national economies with the huge costs of servicing and repayment, combined with the massive problems involved in reverting the highly complex Eurozone economy back into national currencies. Once each country leaves the Single Currency, it will have immediately to re-establish its own central bank, capable of creating virtually unlimited amounts of local currency. Money creation on a huge scale – and thus likely to come with a heavy inflationary price tag - will be necessary to stop its banks collapsing and the state being unable to meet its obligations. The history of many devaluations in the past, however, some of them precipitated in conditions as calamitous as those now prevailing in Greece, is that within a year or so there is a strong recovery. Exports pick up; unemployment starts to fall; inflation rapidly subsides; and the economy begins to grow rapidly. The impact on the economy of Europe from a Eurozone collapse is thus likely to be a period of substantial disruption, rising inflation and unemployment for a relatively short period, followed by a strong recovery.

5. **What will the impact be on the rest of the world?**

Economies in the rest of the world are already suffering in varying degrees from the lack of growth in the Eurozone. For them the countries in the euro are at present a stagnant market, offering them little prospect of expanding exports. Furthermore, they are at risk, as is everyone else, from the inter-connectedness between banks which means that any defaults in Europe could easily lead to heavy contractions in credit availability, at least in the short term, across the world. Propping up the Eurozone as it is at present, however, is no solution to either of these problems. As long as continuing austerity is the policy being pursued in Europe, there will be no demand recovery, while the more debt which is accumulated to try to keep the euro in place, the bigger the eventual crash, affecting the whole world's banking system, is likely to be.

6. **What should the Eurozone's leaders now do?**

Faced with the conditions which now prevail in the Eurozone, with every prospect that these could worsen, what strategy should its leaders now adopt? Surely, what they ought to do is to recognise that the establishment of the Single Currency without a co-ordinating fiscal union already in place was a huge mistake. It needs to be rectified by unwinding the euro as rapidly as possible, with most of the current Eurozone economies reverting back to having their own currencies. This is not, however, at least overtly, anywhere on the current agenda. Instead, all the proposals currently being negotiated at one euro summit after the next involve more and more loans being made, combined with more and more austerity among all the weaker Eurozone economies, in a vain attempt to reduce their borrowing requirements, but without full fiscal and monetary union. This is because there simply does not exist in the European Union, the willingness - exemplified within all nation states - to transfer funds from richer to poorer regions and people on a sufficient scale to make fiscal union possible, exemplified, not least by German unwillingness to underwrite Eurozone wide borrowing. The result is a larger and larger overhang of debt, which makes the consequences of delaying dismantling the Single Currency the likely cause of bigger and bigger sovereign debt defaults and a worse and worse banking crisis when eventually the euro house of cards collapses.

7. What should Britain's stance be?

At present, the stance of the British government has been to support the establishment of whatever integrationist measures among the Eurozone members seem to be required to keep the Single Currency in being. While Britain – thankfully – is not a Eurozone member, and is not therefore directly involved in the detailed discussions about how to try to keep the euro in being, this policy has two very major drawbacks. The first is that, as an EU Member State, we are left on the periphery of discussions, with changes being contemplated to the relationship between Member States which could be extremely important to us largely in the hands of people who may have a very different agenda from ours and over which we have relatively little influence. The second, however, may well turn out to be much more important. By supporting the efforts of the current Eurozone leaders to keep the euro going, the British government is likely to find itself having backed entirely the wrong strategy. If the EU's real best interests lie in winding up the Single Currency as soon as possible, surely the British government should not be prolonging the agony by offering up more loans and guarantees. On the contrary, if it is true that the interests of both the UK and the rest of the EU would really be best served by the early demise of the Eurozone, it may be far better for the stance the British government to take to be the opposite to what it is at the moment. Instead of supporting all the current efforts at keeping the Single Currency alive, it should be to indicate that the British view was that the best way ahead would be for the Eurozone, as it is at the moment, to be wound up as soon as possible in the least damaging way available. Nor should this be simply a matter of what is said to Eurozone leaders. It should also be followed up by practical measures including, wherever possible, avoiding new financial commitments designed to support the euro being put in place. Instead, these resources should be safeguarded for when the end comes. It does Greece, Spain and all the other countries currently suffering from massive deflation no favours to prolong the agony by keeping the existing euro structure in being. All these countries will, however, need help when the Eurozone collapses. We would be far better to do whatever we can to help them then, with whatever resources we have managed by then to keep intact, then than to squander them now on a hopeless quest to stop the Single Currency disintegrating.

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