

LABOUR EURO-SAFEGUARDS CAMPAIGN

BULLETIN

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MORE QUESTIONS AND ANSWERS

ON THE EURO

1. **What is the latest state of play on the Eurozone?**

The Eurozone crisis – now no closer to resolution than it was when the spread in interest rates between German and Greek debt began to widen around 2009 – is now threatening the whole world with a major economic downturn. The prospects for the Eurozone itself, however, are much worse. The enormous imbalances between the northern and southern tiers of the Single Currency area have left the Eurozone leaders with a stark choice. They either keep the Eurozone together at the cost of years of years of austerity, nil or negative growth, high unemployment, mounting inequality and relative decline, or the Single Currency collapses, triggering massive disruption and economic – and political – turmoil. Worse still, the most probable future for the euro may be a combination of both these outcomes. There may well be a protracted period while more and more debts are accumulated while desperate efforts are still being made to keep the Single Currency in being, followed by an eventual crash as the euro's defences are eventually overwhelmed. If this happens, the outcome for the Eurozone – and everyone else – will have been made much worse than it otherwise needs to have been as a result of all the additional liabilities run up while trying to keep the Single Currency in being.

2. **What steps are being taken by the Eurozone leaders to try to avoid this future?**

The official EU line, of course, is that the Eurozone crisis is containable with funds being put in place – in particular via the European Stability Mechanism – which will be sufficient to deal with the enveloping banking crisis which the Single Currency area faces. This will then contain the huge disparities in competitiveness between the weaker and the stronger Eurozone economies, it is hoped, for long enough for them to adjust to the disciplines of the Single Currency. The aim is to

force down wages and to cut expenditure in the weaker countries to an extent where the requirement for further loan support disappears. If the European Union was capable of changing very rapidly into the United States of Europe which many EU leaders want, complete with the pooling of all debts and massive increases in Europe wide tax and expenditure, there is just a chance – albeit probably after a lost decade – that some measure of stability might be restored. The chances of this happening, however, look extremely remote. There is no appetite for much tighter integration among the vast majority of the people in the EU. As a result, the future of the euro looks highly vulnerable to at least three essentially separate threats. One is that the Germans cease to be willing to act as paymasters and debt guarantors on the scale which is certainly going to be required of them. The second is that the government of one or more of the austerity countries – Greece being the most probable first case – becomes unwilling or unable to deliver the ever increasing reduction in living standards and public services required by the stronger countries. The third is that the markets cease to believe that the euro has a credible future, making it impossible for the weaker countries to borrow at viable rates of interest – or eventually at all. In the absence of the huge sacrifices in national sovereignty which much closer integration entails, it seems all too likely that sooner or later one of these three eventualities will materialise.

3. **What is the fundamental reason why the Eurozone is in such dire straits?**

It is easy to point to the increasing insolvency of both banks and sovereign states in the Eurozone and therefore to conclude that the basic problem is one of liquidity – that money is draining out of the weaker Eurozone members – so that if sufficient cash was provided by the stronger countries, the problem would be solved. The insolvency and liquidity problems of Greece, Italy, Spain, Portugal and Ireland, however, are really only symptoms of a much deeper malaise, the consequences of which from the beginning always made the Single Currency a hugely risky undertaking. The fundamental problem is not one of liquidity or solvency among the weaker Eurozone economies. It is that they have become massively uncompetitive with the stronger ones and it is their inability to pay their way in the world which has precipitated their financial problems. This has happened because the rates of inflation, especially for goods and services for export, have been far higher in the now insolvent countries than those, like Germany, with big surpluses. Partly as a result of booms fed on low euro interest rates, the cost base – all the internal domestic costs which have been charged out to foreign customers – has risen in the austerity countries by 30% to 40% more than it has in Germany. The result is that exports in these countries have withered. In the short term, the balance of payments can be shored up by cutting back on imports, but this can only be done by cutting living standards and disposable incomes. In the medium to long term, with a fixed exchange rate, the only way to regain competitiveness is by massive cuts in labour costs. Getting them down a little may be possible, as Ireland has shown, but reducing them by 30% or 40% is an altogether different proposition. It

seems extremely unlikely that it will be feasible to get this done with the consent required in countries which continue to have democratic constitutions.

4. **What choices do the Eurozone leaders now have?**

The problem now faced by Europe is one which looks as though there is no outcome in prospect for the Single currency which is going to avoid a catastrophic downturn in the EU's fortunes perhaps both in absolute terms and certainly in relation to what is happening elsewhere in the world. The acute dilemma faced by the Eurozone leaders is that the steps which need to be taken to keep the Single Currency in being are ones which are all too likely to condemn the Eurozone countries to economic stagnation as long as the euro remains intact. This is because the austerity which is being imposed on all the weaker economies undermines the export and growth prospects for all the stronger Eurozone members. The result is that there is going to be little or no growth for the foreseeable future in the Single Currency area as long as the policies needed to keep the euro intact are being implemented. It is exactly this collapse of growth which brought to grief both the previous attempts to lock the currencies of EU Member States – the Snake between 1969 and 1975 and the Exchange Rate Mechanism, which lasted in various forms between 1979 and 1993. As long as national currencies remained in being, however, the currency adjustments required – devaluations and revaluations - to get growth going again were still available and comparatively easy to implement. The problem now is that, with all the Eurozone using the same currency, these longstanding remedies no longer exist without massively much greater problems being incurred as the Single Currency is abandoned. Currency adjustments now mean breaking up the euro and in the short term the consequences of the Single Currency collapsing are dire, with the prospect of both banks and sovereign states defaulting, leaving European economies in unprecedented disarray. This why the choice now faced by the EU is so unenviable. It is either years of stagnation while the euro is kept going or a very steep economic downturn as the Single Currency breaks up – which is very likely to be the eventual outcome in any case.

5. **Where is this leading to politically?**

The EU has just been awarded the 2012 Nobel prize for its role in keeping peace in Europe. It may well be that the timing of this award will look singularly inappropriate with the benefit of future hindsight. This is because the huge misjudgement by the EU's leaders in establishing the Single Currency is likely to have far reaching adverse political consequences. The euro did not come into being for any valid economic reasons. It was created by politicians who thought that the establishment of the Single Currency would force all the participating countries to move rapidly towards political integration. This was always a huge gamble, made much more risky by the unwillingness and consequent failure of EU leaders to ensure that they had the support of their electorates behind them. Because this vital

requirement has never been anywhere near being fulfilled, and there is no willingness among the EU electorate to create a United States of Europe in the form of a fully fledged nation state like the USA, the conditions necessary to make the Single Currency viable have never existed. Without the taxation and public expenditure levels which only nation states make possible, the prospect for the degree of political integration necessary to make the Single Currency workable in the medium to long term were never there. The result is that the EU leaders are not just looking at a huge economic problem with the euro. There is also a massive political problem looming up. What is going to happen to political institutions in much of Europe if all that politicians can deliver is a choice between unending austerity to keep the Single Currency in being or economic collapse if they fail to do so? The danger is that support for centrist political parties will drain away, leaving their previous supporters moving towards extremist or single issue parties which then become incapable of forming coherent governments. The prosperity which nearly all of Europe has enjoyed for the last nearly seventy years has rested heavily on rising living standards, reasonably full employment, and governments capable of governing. What is the future going to look like if all these props for stability are removed at once?

6. **Where might this have left the UK?**

Perhaps it is worth reflecting on how close the UK was a few years ago to joining the Single Currency. Around 2002, when there was probably the broadest consensus among the political elite in the UK that we ought be part of the Eurozone, the exchange rate between the pound and the euro hovered round £1.00 = €1.60 – nearly 30% higher than it is at present. If we had joined at this rate, not only would we be far more deeply caught up in the euro's travails than we are now but we would also have been in the Single Currency with as desperately uncompetitive rate of exchange as Greece suffers from at present. Against the background of the large government deficit that existed throughout the 2000s in the UK, combined with the very heavy exposure we had to the banking crisis, our situation would now have been at least as bad, if not worse, than it is in any of the Eurozone's weakest economies. We were only really saved from this catastrophe by the promise of a referendum on joining the Single Currency having been given which those who wanted to join did not think they could win. Then, as now, it seems that the British electorate as a whole were much better judges of the situation than our political leaders.