Trichet: welcome to my great big fat Euro fiasco

Post categories: Eurozone

Paul Mason | 19:02 UK time, Thursday, 7 April 2011

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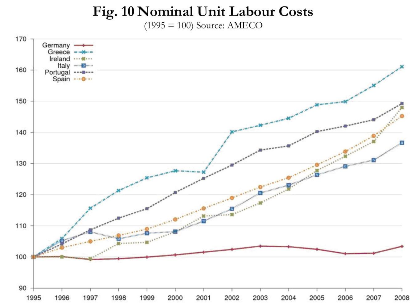

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It's Vorsprung Durch Technik versus "manyana", cold efficiency versus laid-back Mediterranean sloth, it's the Europe of no motorcyle helmets versus the Europe of precise train timetables. It is every cultural stereotype you've ever heard about the two kinds of people who inhabit this continent.

And for now, economically, it's valid: there are two Europes and they are diverging.

It's no longer a two speed Europe: it's a two tier Europe with the bottom half spiralling into low growth, penury and social crisis - and the top tier is booming. German industrial output, up 15% year on year today, stands in contrast to a slump in Ireland, Greece and now - once the austerity kicks in for real - Portugal.

Portugal last night joined the club of countries needing a bailout. It'll probably take E80bn to sort out - but that's not the problem. The problem is the conditions attached will be further austerity: the very austerity the Portugese parliament rejected; and - from an objective standpoint more important - which will make it difficult for Portugal ever to grow its way out of crisis.

Onto this two tier Europe - Greece's economy has shrunk by 6% over two years, Ireland's by 11% - the ECB today heaped more pain. To combat aggregate inflation at 2.6% it has raised interest rates. To the cries of pain that this will weaken the recovery in the stricken countries it has plugged its iPod in and listened to its same old mix of theme tunes: independence; price stability; the belief that the current crisis can be solved by cheap, rolling loans, their terms loosened ever onwards as the real economies doing the borrowing shrivel up and starve.

What's the source of this great divergence? It starts with the design of the Eurozone itself: many economists believe Germany was allowed to join at a devalued rate, obtaining a permanent trade advantage with the south. Then, just as the periphery glutted itself on unsustainable private debt - the credit cards, the four-wheel drives, the extra villas by the shining Med - Germany enacted labour laws and welfare reforms entitled Agenda 2010, which, as its critics write, allowed German bosses to squeeze their workers just as bosses in Ireland and southern Europe were doling out extra pay and benefits to their.

The graph at the top of this post shows the results (thanks to Costas Lapavitsas at Research on Money and Finance).

There is a huge competitiveness mismatch and a resulting huge trade mismatch. The south became an export market for north-European manufactured goods, and a credit market for the north-European banks - which may have been technically constrained to be dour and presbyterian by domestic law but nevertheless piled into the Irish and Spanish property bonanza with gusto.

Everybody benefited from the credit bubble; but Germany has above all benefited from the Eurozone's structural imbalance.

We are now in the process of picking up the pieces but it's not easy.

In the first place, the level of austerity being demanded in southern Europe and Ireland is starting to challenge these populations' very concept of the social deal they thought they had. I am not talking about the Euro, the social chapter: it's what they thought they'd achieved by throwing off fascism, military dictatorship or in the case of Ireland decades of isolation and backwardness.

What the new fiscal reality says to them - and the new reality of having the ECB tell them

About this blog

I'm Paul Mason, Newsnight's economics editor, a job that takes me from Kenyan shanty towns to Russian hedge funds and Chinese factories. My blog is called Idle Scrawl. It veers wildly across the subject: from house prices, to global poverty; from deconstructing glib terminology to devastating critiques of the England football management. It is occasionally meant to be funny. Follow me on Twitter

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their interest rates have to go up even as their economies go down the pan - is that the social deal was an illusion.

There is now growing traction for the idea of a controlled, voluntary default by the three stricken countries. That is, they restructure their debts and banks and pension funds in France, Germany and Britain take the hit. The longer this can be postponed, the better the shape the banking systems of these countries could be in to take the hit. But there are growing calls for example among unions and left wing parties in Ireland, Greece and Portugal to declare the debts "odious" and repudiate them.

But a default would break the rules of the Eurozone (they're being flouted anyway). And what is not often understood, meanwhile, is the amount of support being effectively given to the periphery by Germany's central bank, via the ECB's liquidity operations (put simply, the ECB issues short term loans to countries on terms that put at greater risk the money that's supposed to be risk free supplied by the Bundesbank).

The two, logical, technically elegant solutions are these:
a) the periphery leaves the Eurozone
b) the north takes control of the whole system but pays the price through a fiscal union in which taxpayer Euros in Hamburg and Helsinki pay for benefits in Athens and Athlone.

It will be noted that b) is unpalatable to the electorates of north Europe, and anything approaching it is proving so unpopular that it is altering the electoral landscape - in Germany and Finland and probably soon in France (Belgium doesn't have an electoral landscape and the Netherlands, with the rise of the right, was already well and truly altered).

However (a) is becoming very palatable: not just to the leftish plebeian masses in the stricken countries but also to the electorate of north Europe.

A way between these two extremes could be negotiated if there were skilled, authoritative, charismatic leaders but... I don't even need to finish the sentence. The EU is not very good at leadership and vision right now: it's good at fiascos.

And in his justifications for the rate rise - technically correct and defensible - ECB boss Jean-Claude Trichet just welcomed us all to a great big fat fiasco, no less mesmerising than a tacky reality show, but of considerably greater import.

Comments

1. At 11:13 8th abr 2011, **Sasha Clarkson** wrote:

Paul - the monetarist revolution has made politicians too afraid to use fiscal policy to tackle inflation. I remember Denis Healey threatening to respond to inflationary wage increases by increasing taxes. So long as he increased spending by less than he increased taxes this would have achieved his aim of matching the money supply to the available goods.

A Central Bank increase in interest rates tells the banks to levy (an increased) private tax on debt. However, the effects are more uneven than a general tax increase, and more difficult to target to achieve socially and economically desirable ends.

If there is excess liquidity in the system, increasing interest rates will remove some of it by encouraging the repayment of debt – or so the theory goes. The problem is that if north Europe is overheating, and has excess liquidity, south Europe is on its knees because of a dearth of it. So Euro politicians, be honest. Reduce the inflationary pressures of the north by appropriate and and fair increases in taxes, and use the proceeds to tackle the southern economic problem by paying off their debt. Then look at future mechanisms to rebalance the European economy. That way you could save the Euro. Otherwise increased interest rates and southern default will achieve the rebalancing, but the Euro will be dead and cooperation will weaken leaving everyone worse off.

Who is both economically literate AND brave enough to tell it as it is.

Remember – increasing interest rates is equivalent to increasing taxes, but a blunter instrument and less conducive to the public good.

Those who think that high interest rates are good because they reward savers should realise that money saved does no good for the economy unless it is invested – in something real, not in short term market trade gambling. An increase in interest rates by the central bank actually reduces the incentive to invest in real enterprise.

complain about this comment

2. At 11:26 8th abr 2011, **Jericoa** wrote:

You mention the 'disconnect' between the North and 'peripheral' Europe.

Looked at from a perspective of the people themselves I actually disagree with this on reflection. The disconnect seems manufactured somehow.

Amongst the peoples of Europe there is little disconnect if any and what most people want is entirely achievable and sustainable and all within their cultural context if they so wish, the only thing that would need to be controlled would be population across cultural barriers.

The real disconnect is between the EU leaders, the leadership apparatus, connections to big business and 'the people'.

The scale of that disconnect is hard to reconcile with the term 'democracy' and is increasingly dangerous.

The incumbents could be 'voted out' eventually via democracy as austerity bites, but that will almost certainly be too late in the current climate.

The current democratic process moves too slowly to keep up with events in a world where billions can be made by locating your office at a fibre optic junction in the middle of the ocean to take advantage of the speed of light between global financial hubs, enabling them to 'cream off' a profit from price differences between those two centres.

http://www.bbc.co.uk/news/science-environment-12827752

All such activities bring no value to society and should be banned, it is like 'value theft' ..should be a new crime I reckon....

In contrast, the best timescale the people can hope for in order to improve their lives via the political process is, realistically, two parliamentary terms …8 years… at least.

Eight years to vote someone in with sufficient clout to ban valueless profiteering when those who rape the system we all depend on can change their lives in a fraction of a fraction of a second by manipulating numbers on an island somewhere in the Atlantic.

Says it all really, I, like Merv, don't understand why people arn't much more angry.

I suppose the truth is very few people understand it thanks to the media who are doing a great job of covering their friends and owner's backs.

complain about this comment

3. At 11:29 8th abr 2011, **BobRocket** wrote:

At the heart of the problems are the banks and bean counters who don't seem to understand capitalism.
Forcing down the wages of German workers to make them more 'competitive' also makes them less enthusiastic consumers.
Only the banks and Financiers get rich in the race to the bottom, everyone else becomes impoverished.

As for the EuroZone
Option B was always the plan, now all it needs is some kind of crisis to make it the only viable option.

complain about this comment

4. At 11:32 8th abr 2011, **tawse57** wrote:

How much longer can the BOE continue the charade of the UK not having inflation?

Our inflation, correct me if I am wrong, is higher than the EU so shouldn't our interest rates rise also?

I

complain about this comment

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5. At 12:06 8th abr 2011, **jauntycyclist** wrote:

4

no because its imported inflation not wage inflation. real wages and incomes are shrinking as is the economy. in such a situation growth is more important.

the imported inflation is just the yearly oligarch tax on poor people which is created by creating asset bubbles in commodities from wheat to oil. If you wanted to stop that then you would have to curb speculation in essential commodities and limit trading to those who actually use the stuff which some countries have done. the uk hasn't and won't given who funds the tory party. So the massive wealth transfers will continue as oligarchs seek to retain the value of their wealth at the expense of everyone else.

Mervy is watching employment and not worried about the oligarch tax.

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6. At 12:22 8th abr 2011, **Jericoa** wrote:

#5

There should be a new law on the books of the crimes against humanity court in the hague.

'Value theft'

Def: The generation of value credits (money) by manipulation of the global financial architecture with no return value to that system.

Gambling should be kept to horses, football matches and casinos for entertainment.

complain about this comment

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7. At 12:41 8th abr 2011, **jauntycyclist** wrote:

6

running a shop is a gamble. all free trade is a gamble. so gambling is not the problem. its on what is the gamble.

I do agree the practise of creating artificial price increases in essential commodities merely for extortion by those who can monopolise such markets should be illegal. But if we believe the political class then free markets are about having the freedom to create monopolies in a Darwinian way. A process which is called 'good'.

food is vat zero rated but its not oligarch tax zero rated. funds looking for a fast return can drive the price of wheat, oats, corn, sugar beet whatever till the pips squeak. Which is not wealth creation but wealth extraction and wealth transfer from the many to the few.

complain about this comment

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8. At 12:45 8th abr 2011, **tonyparksrun** wrote:

It seems to me, the problem is not just one of liquidity or even solvency.
In S Flanders blog yesterday, she observed..."The sad thing for Portugal is that it did not even get the boom that other "Club Med" (or Celtic Tiger) countries got. Growth between 2001 and 2007 averaged only 1.1%, making it the slowest growing country in the entire Eurozone during this period. Growth in Portugal's GDP per head was even slower - only 0.6% a year. But that was then and this is now. The problem for Portugal and the rest - in many ways the root cause of the entire crisis - is not that these countries are insignificant. It's that they're different."

This suggests that there are inherent barriers to growth in say Portugal (or Greece or Ireland) whether that be slothful or uneducated populations, undeveloped capital markets, no indigenous industry having a comptitive advantage or some other factors specific to each country. The country is simply not being productive enough to sustain its economic needs/model.
This will not be solved by keeping them in the EZ, through the ECB tiding them over with short term funding. When the cheap/expensive ECB loans run out, Portugal will still grow at a low level in future without structural, cultural or social change. Chucking money at them doesn't make economies inherent growth capability change, it merely puts off the day of reckoning.
As Martin Wolf (FT) has observed, the imbalances in the EU are a reflection of the imbalances in the global economy.

To me, this is a longer problem which will only be solved by actually addressing the underlying problems. Imposing a Eurowide political or economic tax structure will not help either, as this doesn't change anything fundamentally for individual countries and will suit the powerful law giving core at the expense of the periphery.

The choice for Europe is whether to allow the intra zone debt transfers to ease the human costs of the change process within a maintained broad EZ or to detach the periphery and let the markets sort out the change process, which will have grave social, cultural and political consequences that risk setting the clock back 70-80 years to an age of political extremism.

In summary, if Portugal is to really solve its problems of low growth then it needs rapid and drastic structural change. It is now outside its own control to dictate the pace of change. Either the change happens on Euro terms, mollified by a period sponsorship from ECB or outside the EZ at a pace dictated by the markets and IMF post default.
A

complain about this comment

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9. At 12:59 8th abr 2011, **stevie** wrote:

one day, one far off day, they will have to give us a vote on continued membership of Europe and then all the food mountains, sleazy expense accounts, mind boggling subsidies, lax immigration controls, refusal to publish audited accounts and legions more of madcap schemes...then maybe, just maybe we may all get our sanity back....but don't hold your breath as Ireland found out....

complain about this comment

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10. At 13:05 8th abr 2011, **Jericoa** wrote:

#7 I agree and that was my intent. Gambling was a poor choice of words on my part for they risk nothing personally unlike shop keepers, heck even parasites have to take a chance of being injured in the process of latching onto their hosts vital systems, these guys ..... ah it has all been said before.

Worse than parasites..... there you go I said it anyway.

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11. At 13:20 8th abr 2011, **Sasha Clarkson** wrote:

@7 Running a shop may be a risk, but it is not a gamble in the sense of Casino capitalism, in that the shopkeeper is attempting to give something of real value in exchange for any income he makes.

complain about this comment

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12. At 15:23 8th abr 2011, **jauntycyclist** wrote:

11

unless you are fulfilling existing orders then buying stock is speculation that you can sell it for more than you bought it. risk determines the amount you are prepared to lose.
value is merely in the mind of the purchaser regardless of if there is any real value or not which is why so much is spent on advertising for brands. A branded good may cost the same to make as an unbranded good but sell for much more. the value in the branded clothing etc is merely perception.

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13. At 16:08 8th abr 2011, **robertwaldmann** wrote:

I'd mention one other possible cause of the Eurowoes. I think that German unification created problems for the European currency union. I know it was a long time ago, but unification was a huge, gigantic, very large challenge. Following re-unification Germany had a long spell of high unemployment. We lazy slackers in Southern Europe* were asked to compete with former East Germans who were working with outdated capital etc.

Now that Germany is economically as well as politically united, it is a much tougher competitor. So the DM should appreciate. But the German Euro can't appreciate.

Now 1989 was a long time ago, but it sure seems to me that the allignment was missed long before Agenda 2010 could have had any effect.

*I live in Rome and am lazy as dirt -- I am in no way asserting that any significant fraction of my fellow residents of Italy are as lazy as I am.

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14. At 16:29 8th abr 2011, **jauntycyclist** wrote:

13
'the northern work ethic'

if the weather is mainly cold and wet [as in northern europe] one might as well work. if its sunny one tends to sit outside and think manyana?

complain about this comment

15. At 08:01 9th abr 2011, **BobRocket** wrote:

#14

'manyana' in Spain (warm and sunny), the phrase in Ireland is 'ahh, there are seven days next week' (cool and damp)

I think the equivalent UK phrase is 'I just can't be #####!'

complain about this comment

16. At 21:07 9th abr 2011, **stevie** wrote:

the Germans are grafters and they are supporting the rest of us, soon they will be pissed off about that, but now they haven't sussed.....

complain about this comment

17. At 09:44 19th abr 2011, **u2you2** wrote:

I'm a private investor in the stock market.
All the time this Euro crisis is at the back of my mind, so I have several questions to ask of you please:
What is stopping any member from just leaving the Euro currency on their own accord ?
Could various members just be expelled from the Euro ?
If there was a two tier Euro, hard and soft / north and south, would the hard Euro become so strong as to serious effect German exports for example, to the degree that it created unemployment and a recession ?
Would it be in various countries interests to opt into the soft south Euro to gain an export currency advantage, I'm thinking here of France and Italy ?
Finally to go back to what existed before, single currencies, what would the cost be for every European member ?

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