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# Europe's Trojan Horse

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BERKELEY – Europe is now moving ineluctably toward a bailout for Greece. There will be emergency financing. There will be conditions. There will be the obligatory promises by the government in Athens.

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This will make it possible for the Greek government to service its debt. The markets will settle down. The longer-term consequences will not be savory, but they will be problems for another day.

Some will say that the fatal mistake was allowing Greece to adopt the euro in the first place. That the country was unprepared should have been clear. Its fiscal policies were already out of control when it joined the monetary union in 2001, and its trade unions were agitating to push wages up to European levels, despite lagging productivity.

But this answer is too simple, given that such signs of dysfunction are not limited to Greece. Spain, with its 20% unemployment rate and exploding budget deficit, sees in Greece an image of its own future. Or, if it doesn't, the markets do. Portugal and Italy are little better.

Like Greece, these countries now face sharp budget cuts. Like Greece, they can't devalue to encourage exports. Like Greece, they face deep recessions. Like Greece, they will be tempted to ask for help.

All of this raises the obvious question: Was the real mistake creating the euro in the first place? Since I was one of the few Americans to advocate a single European currency, you would be justified in asking: Am I having second thoughts?

My answer is no, creating the euro was not a mistake, but it could still be a mistake in the making. The Greek crisis shows that Europe is still only halfway toward creating a viable monetary union. If it stays put, the next crisis will make this one look like a walk in the park.

Completing its monetary union requires Europe to create a proper emergency financing mechanism. Currently, other member states can provide assistance to Greece only by bending the rules, which prevent them from lending except in response to natural disasters or circumstances beyond a country's control. This heightens uncertainty. When Europe's leaders do help, it makes the public and markets think that they are being dishonest. If it is the Lisbon Treaty that creates these problems, then the Lisbon Treaty should be changed.

Moreover, assistance should come not just with conditions, but with temporary control of the national budget by a committee of "special masters" appointed by the European Union. Mere promises by the recipient, history tells us, are not enough.

No doubt, countries to which these measures are applied will express outrage. Well, no one is forcing them to take the money. Worried about moral hazard? Here's your solution. Note also that this would also be a much more effective disciplining mechanism than the defunct Stability and Growth Pact.

You might well ask: how would Californians feel if their state was forced to turn over its budget temporarily to a special master appointed by President Barack Obama's administration? Actually, they would probably feel okay.

The special master would not be a fellow Californian, but he would be a fellow American. People would understand that he was acting in the interest of the state as well as the country. They would also be reassured by the fact that California sends representatives to Washington, D.C., where the special master's marching orders would be issued.

Europeans don't do these things because they see themselves as Greeks and Germans first. They don't interfere in the "sovereign prerogatives" of other member states. Germany is especially reluctant, given memories of its World War II conduct, not least in Greece.

Well, if Europe is serious about its monetary union, it will have to get over its past. It needs not just closer economic ties, but also closer political ties. Those running a strong emergency financing mechanism will have to be strongly accountable. They will have to answer to a strong European Parliament.

German Chancellor Angela Merkel's constituents hate bailouts, because they know that it is they who will be doing the bailing. They oppose anything that smacks of European political integration.

But Germany is not innocent of responsibility for this crisis. It demanded an extraordinarily independent and unaccountable central bank that is now running an excessively tight monetary policy, aggravating the plight of the PIIGS (Portugal, Ireland, Italy, Greece, and Spain). Germany's enormous current-account surplus aggravates their problems further. Germany has also done too little in terms of fiscal stimulus to support the European economy.

Germany has benefited enormously from the creation of the euro. It should repay the favor. It should push for the creation of an emergency lending facility, and for political integration to make that feasible. It should provide more fiscal support. And who better to press for a more accountable European Central Bank?

The Greek crisis could be the Trojan horse that leads Europe toward deeper political integration. One can only hope.

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dtnowak 10:15 18 Feb 10

There's historical precedent within Europe for a country with crippled credibility to hand economic management to a pan-European authority: Austria, following hyperinflation in the 1920's, gave up control of the treasury / central bank to the League of Nations. Greece should do likewise: only by committing unconditionally will it emerge from the crisis like Korea or Mexico in the 1990's -- rather than an economic failure like Argentina.

I'd take issue with the idea that Greece belongs in EMU. None of the countries it borders were even in the EU when it joined. Bulgaria, Turkey, Albania, Macedonia... next Romania, Croatia, Serbia... still no euros in sight. No reading of Mundell's theory on optimal currency areas could argue for Greece's being in the Euro. The UK, Sweden, Switzerland, are all suffering, but they are thanking their stars for their shock-absorbers: they have been able to devalue and have lower interest rates than the Eurozone.

But, what's done is done, and having encouraged/allowed Greece to join their club before it was ready and thus fueled the predictable boom from inappropriately low rates for the periphery, Europe's political elite should help the PIIGS adjust within the rigid structure of currency union.

Demonthenis 06:58 19 Feb 10

Why do people wish to torment the Greek government & electorate with German style frugality and hard work? Or for the Greeks to declare bankruptcy and hand over control to foreigners? Let the Greeks have access to what all other economies outside the Euro can do: devalue.

Issue drachma notes at a substantial discount to the Euro. The monetary illusion then takes hold. Neither labor unions, pensioners or consumers would strike against a nationalistic position, even though real living standards, wages and consumption take a big hit, disguised through a drachma devaluation. Then call in the IMF and a stand-by loan and preserve the essential aspects of the social safety net.

Did I mention a moratorium on payments on \$/€ debt service to resume when the economic health is restored? That's why a Paris Club mechanism is still around.

You have been quoted as saying this route is too complicated -- i.e., 'the sky would fall'; nonsense. This is what US banks claimed in order to get a Fed bailout. Onto a full blown application of Keynesian common sense to an economic crises.

alexferro 12:45 25 Feb 10

Maybe the rest of Europe can boot Germany off the Euro and change the rules and behavior of the ECU.  
AF

stevenla 11:50 04 Mar 10

"You might well ask: how would Californians feel if their state was forced to turn over its budget temporarily to a special master appointed by President Barack Obama's administration?"

It's shameful that a man of your education and exposure to the world doesn't understand that the EU is an organisation of nation states not the states of one nation. Change "California" to Canada and you might be asking a question that would get you a valid answer.

It's the E.U. not the U.S of E.