

## **‘SHARING THE BURDEN OF ADJUSTMENT TO THE CRISIS’**

### **Remarks by David Begg to EU Economic Forum on Governance**

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The theme of this conference is Economic Governance in Europe. If we are honest we are dealing with the inevitable consequences arising from failure to resolve the so called ‘Monetarists’ and Economists’ debate in the 1960s and 1970s. The original 1969 Werner blueprint for EMU contained proposals for institutions to manage both economic and monetary policy. The Delors report in 1989 recommended only the creation of a European system of Central Banks (Verdun, 2010: chapter 20). Thus any long term solution which seeks to preserve the Euro will have to address this gap in the institutional architecture. I suspect that paradoxically the measures now being taken to address the immediate impact of the crisis will militate against the deeper European integration this implies.

It is hardly surprising that this should be so. In the peripheral countries – my own in particular – an enormous sum of public and private debt has accumulated. To deal with public debt we need to generate a sufficient level of primary surplus. This depends on growth but there is no growth because deflationary budgetary policy has collapsed domestic demand.

For most people the consequence is a loss of personal economic security. People are afraid of losing their jobs, afraid of losing their homes, afraid of losing their pensions now because the Government has raided private pension funds to finance a Jobs Initiative that the ‘Troika’ will not let them otherwise finance. If they work in low wage sectors they are afraid that the EU will dismantle the minimum wage protection that exists. They are right to be afraid.

And despite the hardship they are enduring they see little by way of real reform of the European financial system. The hedge funds remain unregulated, there has been no

reinstatement of the equivalent of the Glass-Steagall Act to separate retail and investment banking and, of course, the bonus culture operates as it always did.

Let there be no mistake but there were very serious policy failures in Ireland and the last Government paid a high electoral price for that. A party which had governed for 80 per cent of the lifetime of the State was reduced to a quarter of its former size. But the policy failures were not exclusively domestic in origin.

Economic and Monetary Union was based on the idea of an optimal currency area. Monetary policy dominated and the ECB operated an interest rate policy that suited France and Germany but was pro cyclical for Ireland and unsuitable. Moreover, deregulation of financial markets combined with low interest rates was irresistible to the Irish banks and at least facilitated the orgy of lending.

I make this point because the people from the EU and the ECB who are dictating the terms of our existence are not without responsibility nor are they disinterested actors in determining who bears the burden of austerity.

So what is to be done? There is a very animated debate taking place in Ireland at the moment reflecting extreme dissatisfaction with the agreement. Some respected academic economists and the political opposition are openly advocating a unilateral default.

The Trade Union Congress remains cautious about default and the type of shock economic adjustment that it might precipitate. We have studied the empirical evidence of default but rarely has it occurred without the facility to devalue the currency.

Moreover, by some metrics the country is paying its way. Exports are performing robustly and we are running a balance of payments surplus. It makes no sense to persist with a policy which is pushing the country towards default in circumstances, which if they could be separated from debt, are manageable.

We prefer the suggestion of Professor Paul DeGrauwe of Leuven University for the creation of a European Bond market in which up to 60 per cent of a country's debt could be covered by Eurobonds (Blue Bonds) at a low rate of interest and a higher tier of Red Bonds to cover the remainder. This would provide a huge incentive for countries to bring down their debt to below 60 per cent. It would also create a European Government bond market in which investors would have confidence and which would make available ample liquidity (DeGrauwe, 2011).

Remember that Europe as a whole does not have an acute debt problem. What it does have is a systemic fault to rectify.

There are two main arguments against DeGrauwe's proposals which, in fairness, he addresses head on in his paper.

The first is that pooling debt in this way would erode the advantages currently enjoyed by countries with high credit ratings. Indeed it might for a period but balanced against the systemic risks it might be worth it. As DeGrauwe puts it:

‘A Monetary Union creates collective problems. When one Government faces a debt crisis this is likely to lead to major financial repercussions in other member countries. This is so because a monetary union leads to intense financial integration’.

(DeGrauwe, 2011:26)

The second concerns moral hazard. But here again DeGrauwe points out that countries entering a Monetary Union lose more than a instrument of economic policy; they also lose their capacity to issue debt in a currency over which they have control. As a result, loss of confidence by investors can in a self fulfilling way drive the country into default.

The point is that judgements about moral hazard can be very subjective.

DeGrauwe's (ibid) key message is that current thinking about a new governance structure (ESM) does not sufficiently recognise the fragility of countries in a currency union. Some of the features of the new financial assistance are likely to increase this fragility. In addition it is likely to deprive member countries of their ability to use automatic stabilisers during a recession.

As he puts it, 'This is surely a step backward in the long history of social progress in Europe' (ibid:1).

### **Bibliography:**

DeGrauwe, Paul (2011) 'The Governance of a Fragile Eurozone'. University of Leuven.

Verdun, Amy (2010) 'Economic and Monetary Union' in Michelle Cini and Nieves Pez-Solorzano Borrigan (eds) *European Union Politics*. Oxford University Press.