

## Europe after the doomsayers

*The EU's hole plugging leaders will avoid collapse; but we are sleep walking into a tragic lost decade if politics continues on its current lifeless trajectory*

BY OLAF CRAMME

The doomsayers are wrong. We have all read their pieces: throughout the second half of 2011, barely a single week passed by without an army of economists and would-be economists – predominantly in the Anglo-Saxon world, but also in other parts of the EU – proclaiming in no uncertain terms that the eurozone is doomed and its collapse imminent. They made their predictions based on what they thought the EU's leaders would, or more importantly, would not do: no big 'bazooka' in the trillions; no introduction of eurobonds or other forms of debt mutualisation; no proper lender of the last resort that can step in to finance sovereign debts; not even a roadmap to a genuine fiscal union worthy of its name.

Well, the leaders did what everyone more or less expected and what some indeed feared; a bit of extra cash here, a bit of institutional tinkering there – and the euro is still with us. In fact, it has been remarkably strong and stable in the recent past. Its value against other benchmark currencies, in particular the Dollar and Pound sterling, remains within accustomed margins. Trade within the eurozone has so far continued at reasonable levels despite major economic uncertainty. After all stock markets speak a clear language: over the last six months the German DAX went up a staggering 11.92%, the French CAC40 up 4.96% and the British FTSE100 up 9.93%. A collapse looks somewhat different from this perspective.

Unfortunately, this is where the problem begins. The discrepancy between what supposedly should have happened and what actually happened will only fuel the suspicions of those policymakers who do not buy the mainstream view and scholarly wisdom on how the eurozone crisis must be resolved. Worse, it will reinforce the illusion that European leaders – most notably Germany's Angela Merkel – like to entertain; that any existential threat to the eurozone (see excellent summary, in German, by Wolfgang Münchau) can be dealt with in a piecemeal, half-hearted fashion.

Take the fragile state of the banking sector in the euro area. The liquidity crisis that has led to a severe credit crunch is seriously destabilising the entire financial system. The ECB has finally stepped in and offered a cheap credit line which permits Europe's banks to help re-finance the debt of troubled eurozone countries, such as Italy and Spain. But this operation, closely monitored by a suspicious Bundesbank, carries its own risks and increases the dependency on short-term lending. It simply does not amount to a lasting solution.

Take Greece's debt problem. The strategy of delaying default may have helped to prepare Europe's financial system for the looming "credit event". Indeed, financial players and markets already seemed to have priced in such a development, making the landing slightly more predictable. Yet no one really believes that bringing down Greek debt to 120% of GDP – as envisaged in current negotiations – can offer a credible way out amidst the adverse economic dynamics. And of course, all this brings little relief to a human tragedy in the making. Greece may be a truly special case, but the ramifications will continue to be felt across Europe.

Take the situation in Spain. Despite being a eurozone role model for fiscal prudence before the financial crash, the country now finds itself in a dangerous debt trap. When both the public and the private sector are deleveraging, the downward spiral is unstoppable, as the experience of Japan in the nineties has shown. Against this background, the EU's new 'Fiscal Compact' may prove poisonous, making it almost impossible for Spain to escape the trap. To be sure, through the

redeployment of unused structural funds and other growth-enhancing gimmicks, the EU will surely find a way to avoid catastrophe. But on its current trajectory, long-term pain is guaranteed.

Or take the eurozone's economic imbalances. Contrary to the hopes of the architects of monetary union, competitiveness positions between eurozone countries are steadily diverging. Banks have basically stopped financing these divergences, affecting the infrastructure of cross-border euro payments. Again, central banks are providing a temporary solution but the money market remains seriously distorted with the obvious adverse effects hitting hard in the real economy. How long the system can carry on if imbalances continue to worsen is an open question. But a suitable remedy is far from evident.

As it appears, the EU's leading policymakers have some kind of response to all these problems. They know very well how to keep the show going and plug the dangerous holes that might cause incalculable damage to the euro area. What they just don't know, however, is how to make the kind of leap forward which is required to put an end to the ever-recurring crises: the move towards a political union in which the inevitable trade-offs between national sovereignty and economic, fiscal and monetary integration are clearly recognised, shared with an enlightened electorate, and finally accepted by them through strengthened democratic procedures.

Many economists moan about Europe's rulers, the German chancellery in particular, being economically illiterate. They miss the point. Fundamentally, there exists no economic deficit, but rather insufficient political impetus. We are sleepwalking into a lost decade, not a total collapse, because our leaders do not possess the political mandate, courage and confidence to fundamentally change the dynamics of the Eurozone crisis. To disprove the pessimists, we need to create a wider political space in which the necessary changes can happen. Depoliticisation is the bigger threat.

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