

## **Euro mind games**

By Michael Heise

Should Germany reintroduce the DM or would it be better if Greece was to leave the eurozone or do we in fact need a Northern Union and a Southern Union, the first with a somewhat harder, the other with a somewhat softer euro? These are just some of the ideas currently being tossed around. Scant attention is given to the difficulties involved in replacing one currency with another, with new notes having to be printed, coins minted and all IT systems adapted. Above all, however, little importance is attached to the economic and political costs of dismantling the eurozone.

True, the euro has not yet led to the degree of political integration required by a single currency in the long term. But the successes which have been achieved – from the uniform money market, through cheaper cross-border payment systems to political cohesion in the Euro Group – would be jeopardized were the single currency to be broken up. Countries would branch off on their own again, using exchange rates to gain competitive advantage. .... Exchange rate uncertainty would curb flows of investment capital and goods between the countries. For Germany, where 43.3% of exports are destined for the eurozone, the consequences could only be damaging.

Two main arguments are put forward for a breakup of the eurozone. The first is that a monetary union without adequate political union is a “lopsided construction” (Karl Otto Pöhl) and cannot work in the long term. Of course, the obvious conclusion from that is to push ahead with political integration where necessary. Above all, this should include political instances to ensure that the fiscal rules agreed by all member states are indeed implemented and that events such as those seen in Greece are not repeated.

The proposals put forward to date in this context do not go far enough. A modest tightening of the sanctions for fiscal miscreants or the establishment of an independent council of experts to monitor fiscal policy is certainly not enough. What is needed is an institution with the right to intervene when countries persistently breach the rules and which, in an extreme case, can wield the threat of expulsion from the single currency.

The eurozone’s second fundamental problem often quoted is that the countries are far too diverse to sit snugly under the roof of a common currency and a single monetary policy. Differences in competitiveness among the individual countries were bound to lead to hefty current account

deficits and surpluses in the eurozone. There's no denying that such imbalances exist but they are not the inevitable result of monetary union, rather they stem from the fact that the rules were not adhered to. Those countries now groaning under large deficits allowed wages to race ahead of productivity gains, they failed to use the years of economic expansion to rein in their budget deficits and they did not confront the credit boom triggered by low eurozone interest rates. Such behavior is bound to spawn large deficits once the devaluation option is no longer available. The countries affected are now likely to have learned this lesson from bitter experience. But to be absolutely sure that fiscal aberrations in particular are not seen again, the Stability Pact rules and implementation mechanisms need to be improved. The efforts currently evident on the economic policy front are going in this direction and will strengthen the euro in the long term. It is therefore premature to launch into the swansong for the euro.