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Responsibility rests with member states

by Michael Heise

The decisions taken by the EU Council last week are aimed at improving the foundations for sustained growth in the EU and a crisis-proof euro. This entails not only ensuring sound state finances but also the elimination of macroeconomic imbalances which have built up over years, particularly on the periphery. Steep cost increases and excessive credit-fueled demand have eroded competitiveness in some countries and spawned yawning current account deficits. It is vital to pay more attention to these developments and to confront them at an early stage. However, identifying a procedure to achieve this is anything but straightforward. It must not only pay heed to economic principles, it also has to be politically acceptable for all member states.

The current debate about macroeconomic imbalances – also, by the way, at the G20 level – tends to center on the current account. However, this focus is too narrow as it ignores the various drivers at play. Surpluses can stem from productivity gains and a competitive corporate sector. Moreover, they are a form of savings which can cushion the foreseeable impact of demographic trends – as in Germany or Japan, although weak domestic and import demand did also contribute to the trade surplus. However, in Germany that is now changing gradually. Net wages and salaries are rising significantly again, more is being consumed and imports of late were 18% up on a year earlier. A general penalization of surpluses, as proposed by US Treasury Secretary Geithner, makes no economic sense. Trade deficits are not always a bad thing either, attributable to ballooning wage growth or untenable mountains of public and private debt. Catch-up countries, for instance, can by all means record “healthy” current account deficits, with capital flowing in for lucrative long-term investment and fostering the economic convergence process.

Balanced financial and trade accounts on their own do not signal a balanced, sustainable growth path. This also requires a productive, competitive economy, a healthy labor market along with sustainable private and foreign debt. In these areas it is not only the member states on the periphery of the euro area which still have homework to do.

With regard to preventive, as far as possible de-politicized and automatic sanctions, the reform of the Stability and Growth Pact made only marginal headway. However, if in the framework of the processes now launched, a concept to monitor and prevent macroeconomic imbalances can be realized, this would represent a major step forward.

Clear rules create an incentive for sound economic policy in the member states. At the end of the day, however, the responsibility remains with national governments. It is up to them to place the monetary union back on a more stable foundation and thus underpin the credibility of the euro in the long term.