The Euro as a Guarantor for Stability and Prosperity – How Big the Crisis for Politics and Economy in Europe Really Is?

*M**r Roland Koch**, Chairman of the Executive Board of Bilfinger Berger SE, Germany, and former Premier of the state of Hessen, Germany, spoke on the topic, 'The Euro as a Guarantor for Stability and Prosperity – How Big the Crisis for Politics and Economy in Europe really is?' on 20th September 2012. He was introduced by **Tan Sri Sulaiman Mahbob**, Board Member of ISIS Malaysia and Chairman of Jambatan Kedua Sdn Bhd. ISIS Intern **Justin Lim** reports.*

The persisting instability in the Eurozone has led to a drop in confidence in the euro as a currency, and even threatens to break up the European Union. **Mr Roland Koch**, in defence of the European Union and the euro, said that concerted efforts are being made by all parties involved to ensure such an event will not come to pass.

This begs the question, `what is so crucial about the EU and the euro, in view of the extent to which the EU is defended and championed as a pivotal player in our globalized world, both economically and politically, today and in the future?

It is well known that the European continent was steeped in bloody violence over the last two thousand years of its history. The formation of the European Union was predominantly based on the idea that mutual interdependence would lead to disarmament. Running parallel was the philosophical heritage of individualistic identities, not of just individual persons but of cultures and nations too. Knitting people together makes war difficult; it is also simply impossible to pay two fighting armies with the same currency.

Germany, post-WWII, led the formation of the European Union and a common currency with this ideal in mind: a union that values interdependence as a means of regional security and stability, with its members at the same time proudly maintaining individual identities.

Roland Koch

The second reason for the formation of the EU was the economic and business opportunities it was expected to bring about. The elimination of intra-Euro trade barriers, tariffs, quotas, and excise and import duties have led to the disappearing of market boundaries in the region. This, coupled with the introduction of the euro currency led to a reduction in business and transaction costs and the free flow of goods and services within the EU — a truly 'Euro' market.

Lastly, the formation of the European Union was not only to promote intra-Euro co-operation and regional security: there was a strategic reason too. Koch believes that groups or regional blocs would emerge in the near future as a result of disparities in the global playing field. The EU would then be well placed to negotiate and coordinate effectively as a bloc with nations and regions that have substantial political and economic power.

Koch's reasoning was supported by a member of the floor, who agreed that the 'flat' Euro market was indeed a great asset, especially to Europeans and to the world.

Crisis of Confidence

Koch opined that the Euro crisis is in fact a crisis of confidence and has much less to do with an actual economic deterioration.

He cited the example of Italy. He considers the Italians reasonable competitors in markets all over the world and they are in fact wealthier than Germans on a per capita basis. Yet, despite the nation's good economic outlook, investors' confidence in the Italian government's ability to repay debt has been near zero. This was only rectified when Italy was forced to restructure its debt. He also stressed that the issues facing Spain and Italy are fundamentally different from those faced by Greece. Greece needs a longer period of time to restructure its debt while competing with its neighbour, Turkey, a relatively strong developing country with a relatively young population.

The reintroduction of the Fiscal Compact, or ensuring that prudent fiscal policies are undertaken, is the final step in completing European economic integration

He said that the crisis of confidence was the result of the decision of Hank Paulson, then US Secretary of Treasury, to allow the Lehman Brothers investment bank to go into administration. His action has had the effect of destroying confidence in and between banking institutions till today.

Secondly, investors' confidence has been further eroded by forcing private investors to participate in Greece's debt restructuring. As a result, the concept of risk-free sovereign debt (which does not require any capital backing) previously declared safe by law, has been challenged.

However, going forward, sovereign risks can now be priced correctly, allowing markets to function at 'correct' prices. It will take an extended period of time for markets to absorb this before confidence can be fully restored.

Question and answer session

How to Restore Confidence in the Euro: The EMS, ECB and the Fiscal Compact

Koch believes it is impossible for any single European country to refinance its debts on its own. Thus, the European Monetary System (EMS) has to step in to secure the states' financing. However the intervention of the European Central Bank (ECB) was needed as well, in the light of the crisis. The perceived limited firepower of the ECB however, was a problem.

It was only a recent agreement by the ECB, in early September, to buy unlimited bonds issued by heavily indebted countries, with strict conditions, to stabilize the Euro, that finally saved the day. While this is considered a normal function of a central bank, as lender of last resort with the necessary unlimited firepower to control a currency, it was difficult for the ECB as it was a central bank of a number of independent nations.

The reintroduction of the Fiscal Compact, or ensuring that prudent fiscal policies are undertaken, is the final step in completing European economic integration. It is a basic fiscal union that ensures compatibility of countries' levels of public debt in relation to their state-financed pension systems, affordable healthcare, social welfare, and insurance. This is such that countries would not be liable for another's debts. The Fiscal Compact was only possible through the unlimited firepower guaranteed by the ECB, and it firmly sealed the commitment of the European states to working towards further integration of the European Union and the stability of the euro.

Challenge for the Future

The key question for the future is, can the structural differences among the EU members support a common currency? Should the ECB pursue expansionary policies to address deflation in certain states while inflation is high in others? Pressure is put on political leaders who need to move in the right direction within such an environment.

Thus countries with large debts as a result of generous social welfare systems have to undertake austerity measures at the expense of economic competitiveness. Austerity is necessary so that financing will be private investor-led, constituting the proper and normal functioning of the market. This is in contrast to the Central Bank printing extra money, which leads to inflationary pressure and devalues the currency.

A member of the floor pointed out that the bailout provided thus far was largely at the expense of German taxpayers. Koch agreed. He said that while bailouts are necessary, they are harmful, as they create a moral hazard. It is a difficult balancing task, especially for the electorate.

Koch also said that restructuring public debt is a problem that can only be resolved in the medium-to-long-term. But adjustments to labour laws are equally important in that results may be apparent in the near-to-short-term. Liberalization of labour markets can help jump-start an economic recovery and spur mobilization of the labour force.

Conclusion

On the remaining issue of instability of the euro after necessary actions by both the EMS and ECB, we need to understand that it takes time for progress to be made. European integration is a step–by-step process which needs an extended period of time, denominated in years, before results become evident.

The euro has weathered heavy storms, but the worst has passed.

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