

# President Trichet, Greece and the Euro

**Paul GOLDSCHMIDT**



Former director at Goldman Sachs International, former director at the European Commission (1993-2002), member of the Advisory Board of the Thomas More Institute.

President Trichet delivered yesterday, during his monthly press briefing, a masterful display of financial orthodoxy. In his introductory remarks he recalled in turn: that the Governing Council judged "convincing" the austerity measures presented by the Greek Government; that Member States should continue their efforts of budgetary discipline; that banks were invited to continue to fulfil their obligation of providing credit to the "real economy"; that the progressive phasing out of exceptional support measures for the banking sector and the unchanged level of ECB interest rates were fully justified by the Economic growth in line with expectations and a balanced outlook for the risk of inflation/deflation; that the ECB had earned its credibility to fulfil its mandate of keeping inflation close to or slightly below 2% p.a. as demonstrated by the 10 year inflation average of 2,1%, due to decline to 1,9% by the end of 2010.

In his answers to the press he further mentioned: that the possibility of a Greek exit from the Eurozone was an "absurd scenario"; that he considered any modification of the mandate on price stability as very dangerous. It would lead to uncertainties in the future, make the management of inflationary expectations more difficult and thus lead to impairing the ECB's credibility; that he would not comment on measures regarding the role of rating agencies or specific institutions in connection with market volatility, limiting his remarks to the wish of a rapid implementation of financial reform.

It is most welcome that President Trichet discarded out of hand any possibility of an exit of Greece from the Eurozone, thus weighing in heavily and appropriately to counter the insane scenarios being voiced by many - sometimes eminent - economists (probably wishing to justify their erstwhile scepticism on the viability of the Euro) and euro sceptic politicians (for whom the crisis is a godsend) and which are being spread indiscriminately by the media in quest of "sensationalism" and "scoops".

However, the orthodoxy of the ECB's position, which remains totally confined within its prerogatives defined by the Treaty, raises, nevertheless, several questions.

To what extent, for instance, does the judgement of the Governing Council concerning the "convincing" character of the measures proposed by Greece, take into account the "fairness" character of the burden imposed on the various segments of the population and consequently the possibility of social unrest? If, in the common interest, no specific group can hope to escape participating in the necessary effort required, the absence of measures (other than fighting tax evasion) specifically aimed at the classes who most benefitted from the prosperity of the last decades, risks to upset the whole program. The absence of a social component in managing the Greek crisis strengthens considerably the impact of the caricature opposing "the cold soulless world of finance" (largely discredited by its responsibility in triggering the crisis) and "the hard daily realities faced by the population at large" (innocent victims of the excesses that were perpetrated). Even if unfairly, the ECB shares in the overall poor image of those responsible for the financial crisis

and should take this into account. To counteract the influence of those who blithely recommend – for others – a strict adherence to the rules by Greece, the EU should mobilise – in the name of the solidarity expressed during the informal Brussels summit - budgetary funds earmarked for such purposes in order to provide temporary support to the most vulnerable such as the beneficiaries of the lowest pensions or of the low paid civil service jobs. Such measures would dampen social discontent, encourage economic recovery and, by initiating a virtuous process of exiting the crisis, calm market volatility. If such action is clearly outside the purview of the ECB, there is nothing to prevent it from recommending it rather than ignoring the subject.

A second question regarding President Trichet's presentation concerns his analysis of a balanced probability between inflationary and deflationary risks. First one should commend the ECB for its past action in meeting so accurately, since its inception, its price stability target "over the medium term". Let us not forget, however that this does not "guarantee" future performance. Second, based on the ECB's own growth projections (1,2 to 1,8% through 2011), should one not conclude that there is no prospect of falling unemployment – quite to the contrary? If so, is it reasonable to require further budgetary restraint from Member States that can only be achieved by measures that would tip the "balance of risk" towards the deflationary scenario, which is unanimously considered as the worst possible outcome? An austerity program that would impinge on the "social welfare protection", that has served the EU so well in limiting to date the impact of the crisis, is unthinkable at European level (contrary to the specific Greek situation where EU solidarity must be brought to bear to allow for recovery). One can see here very clearly that the limits have been reached in trying to reconcile within the Eurozone a single shared monetary policy with an economic and fiscal decentralised one.

Completing EMU has therefore become a high and inescapable priority. It should be carried out on two levels: internal and external.

On the internal side, one should, as fast as possible, implement the mechanisms of "mandatory" coordination of economic and fiscal policies. Ideally, this would lead to the creation of a "federal budget" at Eurozone level that would be entrusted with a sufficiently significant share of the overall tax revenue (let us say 30%) so as to be able to carry out a robust redistribution policy. The vast majority of tax revenue (70%) would remain within the purview of Member States and local authorities, allowing for a broad range of policies adapted to the needs and preferences of the populations concerned. (The Greek case could have been easily managed within such a framework).

On the external level one should question whether time has not come to integrate all Member States into EMU (in line with the Treaty). I had already made such a suggestion in March 2009 as part of my comments on the de Larosière Report when I wrote:

"A parallel debate, being carried out this week end by the European Council, on the impact of the crisis on intra European solidarity raises the question of the accelerated admission of new Members into the Eurozone on more flexible criteria, which could, in turn, have far reaching implications on the subject of the Report. Indeed, one should compare the cost of support by the Union of countries experiencing difficulties - each retaining their monetary sovereignty - with the alternative cost of their integration into the Eurozone. It is not forbidden to believe that this latter option might prove more advantageous for all parties concerned. Accelerated integration would be reminiscent of the bold proposal of Chancellor Kohl to recommend parity between the East and West German Mark at the time of reunification; in present circumstances it is precisely boldness that Europe needs. To the expected outcry that such a proposal would generate from orthodox monetarists, one can oppose the following arguments:

- Depreciation of the Euro versus the US dollar might be considered positively in these difficult times (cfr. The British Pound).
- The economic weight of Eastern European countries is relatively small (in relative terms far less than the weight of the GDR compared to the FRG).
- The current benign inflationary climate limits immediate risks, allowing further economic convergence within rather than from outside EMU
- That budgetary discipline will be all the more taken into account that the tools of monetary sovereignty have been transferred to the ECB.
- That such an enlargement might encourage the last recalcitrant Member States to join EMU, giving considerably increased power to the Union on the international political economic and financial scene.

A refusal of Union solidarity, or the imposition of excessively onerous conditions for joining the Eurozone, would carry the risk of a break up of the Union, just at the very time when the single currency could prove itself to be a most efficient tool in the fight against protectionism.”

Recent events, including the candidacy of Iceland to join the EU, considerably reinforce these arguments. There is little doubt that an extension of EMU to the whole of the EU would have many advantages including: the possibility of implementing a reform of the architecture of the financial system encompassing one currency – one monetary policy and a single regulatory/supervisory framework; the reinforcement of EU’s voice on the international scene at all levels; far greater flexibility in the policy mix between economic, fiscal and monetary options which could take better into account conditions prevailing on world markets. It would restore to the EU the full use of its “exchange rate” weapon and allow, as our main competitors do, to better defend the vital interests of European citizens in matters such as employment and competition.

It is only under such conditions that it might be appropriate to reconsider the flat refusal of President Trichet to contemplate a change in the “price stability” norm imposed on the ECB. Indeed, one will then be faced with making a judgment whether the unavoidable deleveraging of the over indebted financial system, that still lies ahead, should be addressed partially through the depreciation of the value of outstanding debts (inflation), preferably in a controlled manner, or alternatively to impose such deleveraging within a tight price stability regime that would ultimately lead to deflation.

Short of an ambitious political agreement the solution will ultimately not be one of choice but rather one which is imposed, and once again “markets” and “speculators” will be singled out as the villains. It would then be the entire European construction that would be at risk despite the fact that the implosion of the EU would clearly be catastrophic for the great majority of its citizens.

Paul GOLDSCHMIDT

---