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Euro Exit Is Ludicrous Idea for Any Country: Hannes Androsch
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Commentary by Hannes Androsch

June 2 (Bloomberg) -- The Greek sovereign-debt crisis and the attempts of the European Union to quell the simmering pot before it boils over is commanding the attention of the international community.

The sovereign-debt problem isn't in any sense the end of the euro zone; not even the beginning of the end. The foreign- exchange rate of the euro may fluctuate against other leading currencies, as is to be expected in a floating-rate regime, but Greece isn't going to withdraw from the euro zone, nor is it likely to be expelled by the other members.

Whatever the legal position, the view that Greece, or any other country in the throes of recession, should withdraw in order to benefit from devaluation of their currencies, is simply ludicrous. It is difficult to introduce a new currency at the best of times. But when the first item on the agenda of a new currency is likely to be a substantial devaluation, the mere suggestion might be sufficient to spark a civil war between creditors and debtors.

Given that all public as well as private-sector debts are denominated in euros, or other hard currencies, the introduction of a new drachma would provide little respite. It would probably cause the domestic banking system to collapse as its assets were devalued relative to its liabilities, and the government to default as the international community would hardly perceive such a move as being in its interests.

Long for Safety

The trend is actually going in the opposite direction as small countries, whose currencies lack credibility and stability in unregulated foreign-exchange markets, long for the safety of a major currency with deep reserves.

Nor is the euro zone likely to expel Greece, or any other aberrant member, notwithstanding the acknowledgement of cooked books as the latest addition to Greek fiscal cuisine.

A more pertinent question is whether the euro zone was wise to adopt measures to avert a Greek default. Two issues are pre- eminent here.

First, a bailout provides a classic case of moral hazard, both for other governments as well as for banks, which knowingly buy high-yielding, but risky assets.

Second, even after all the political grumbling and foot- dragging, the euro-zone governments had little option but to bail out Greece. Such is the involvement of German, French, Austrian and other banks in the Greek sovereign-debt market that the alternative would have been a rescue operation of domestic euro-zone banks. The motive was self-interest, not altruism.

Greatest Achievement

We need to consider that the European Union was conceived as a political entity, with the primary goal of eliminating warfare in Europe. The instruments of choice were closer integration of national economies, and political cooperation between national governments. Against this background, the single market has to be regarded as the greatest achievement of the EU to date.

Less well understood is that a single market, as a structure, can only work effectively and efficiently if supported by a number of complementary systems. One of these is undoubtedly the single currency and monetary union. Another is fiscal union: the public sector is too large a participant in the economy, creating incentives that may carry powerful externalities, to leave fiscal policy the autonomous concern of component member states. This piece of the jig-saw is missing.

Inevitable Phase

We need to view the current sovereign-debt problem as a second, inevitable phase of the international financial crisis, whose major eruption followed the collapse of Lehman Brothers Holdings Inc. in September 2008.

At that time, the interbank market was paralyzed due to increased credit risk and excessive leveraging, combined with an overextending of the maturity mismatch that lies at the heart of the financial system. The preceding decades of economic prosperity had been wasted; budget surpluses, inflated by the boom, became instruments of public largess or political adventurism. Cyclical correction was largely ignored; structural problems arising from demographic change, untenable pension systems and bloated public sectors, were confronted half- heartedly, if at all.

The stimulus packages to inflate economies sliding into recession, along with supportive monetary policies, were an unavoidable policy response. For reassurance, we need look no further than the decline in real income and the increase in unemployment in this crisis; painful as these have been, they pale into insignificance compared with the Great Depression.

This was achieved at a cost of growing budgetary deficits and spiraling debt ratios, but surely it is worth the price.

Market Verdict

So why are the markets unimpressed? Why is the market verdict unfavorable?

This is a clear vote of no confidence in the political management and fiscal administration of our economies. The wasted opportunities in the past; the delusion that deregulation was all that was required to ensure prosperity; the public promotion of an incentive structure that juxtaposed personal enrichment with the public good and the self-laudatory conceit during the good times, are all now coming home to roost.

It was always clear that the financial crisis couldn’t be confined to a single market, if only because of the close linkages between such markets when regulatory hurdles have been removed. Once more, we must confront the issue of “too big to fail,” but this time in relation to sovereign governments. Once more, we must consider to what extent the European Central Bank should pump public-sector liquidity into a market when private- sector liquidity has dried up.

Prosperity With Growth

As for fiscal policy, it is imperative to restructure public-sector revenue and expenditure, as soon as developments allow, in order to regain the long-term path of sustainability.
Prosperity can only come from economic growth, and this requires that we focus on investment in education, training and research.

We must be prepared to bite the bullet with regard to pensions and social services, something our governments have shown little appetite for to date. Sooner or later, we will have to stop trying to plug every leak in the dyke, permit some flooding if necessary, and be prepared to start again. The longer we wait, the more our economies are likely to underperform, relative to potential, for the foreseeable future.

(Hannes Androsch was Austria’s finance minister from 1970 to 1981. He is founder of AIC Androsch International Management Consulting in Vienna. The opinions expressed are his own.)

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