SMU

Publication: The Business Times, p 23
Date: 20 November 2013
Headline: Eurozone policies are working

Eurozone policies are working

Economic figures show that on the whole, performance of the eurozone countries has improved

By **JOERGEN OERSTROEM MOELLER**

THE eurozone is emerging from a major crisis, but that does not prevent *Financial Times* columnist, Martin Wolf, from labelling it a horror story. *The International New York Times* ran a front page story with the headline: "Euro trouble puts hopes for unity to the test". So why not look at the figures and evaluate its performance.

◆ **Growth:** The eurozone is not scoring well. Over the period 2001-2014 total growth is forecast at 1.5 per cent; 8.8 per cent for the US and 4.6 per cent for Britain.

◆ **Employment:** Since its inception in 1999, the eurozone has created 600,000 more jobs than the US.

◆ **Unemployment:** The unemployment rate in the eurozone is about 12.2 per cent and 7.3 per cent for the US. This is due to an increase of the workforce, not falling employment in the eurozone which, as mentioned earlier, has gone up compared to the US. If we freeze the participation rate – the share of the population seeking employment – to its level in 2001 – the unemployment rate would be about 6 per cent for the eurozone and 12.5 per cent for the US – a completely different picture, actually a reversal of rankings.

Total debt measured as share of GDP is about the same for the eurozone and the US – running at around 260 per cent with Britain at around 285 per cent. There are, however, differences in its composition. In the US government debt and private debt account for a higher share than corporate debt compared to the eurozone, but the differences are not that big.

The main divergence is found when looking at the development of primary government deficits (excluding net interest payments on existing debt and therefore better as a yardstick for a long term outlook). The eurozone shows a surplus even for weak countries such as Italy and Greece. The deficits in the US and Britain are estimated at 3.1 and 4.1 per cent of GDP respectively.

The real worry is an analysis by the Bank for International Settlements sketching out how much fiscal tightening is necessary to bring the government deficit down to 60 per cent of GDP in 2040, taking age related spending into account.

This analysis comes to the conclusion that the US needs a fiscal tightening of 16 per cent, Britain 14.1 per cent. The comparative figures for the four major eurozone countries are much lower – with Germany at 3.3 per cent, France at 5.1 per cent, and Italy at 1.9 per cent and Spain at 7.3 per cent.

The overall performance of the eurozone is quite good except for growth. Still, the eurozone will grow over the four years 2011-2014. It is noteworthy that this has been achieved while running a substantial surplus on the current account (1.9 per cent for 2013 forecast to be unchanged in 2014 even with growth picking up). The US has a deficit of 2.5 per cent also forecast to be unchanged in 2014. Britain sports a deficit of 3.4 per cent falling to 2.7 per cent in 2014.

Inflation, once the ghost everyone wanted to get rid of, is under control in the eurozone at 1.4 per cent forecast to fall to 1.3 per cent in 2014 compared to 2.5 per cent for the US in both years and 3.4 per cent and 2.7 per cent respectively for Britain.

There is no accounting for tastes and it is up to any individual to choose and evaluate these figures, but it is a hard one to argue that they represent a horror story.

Let us turn to some of the arguments put forward against the single currency.

It is often heard that there is no geographical mobility, condemning people without employment to stay where they are and suffer while mobility ensures that a single currency works in the US. A recent OECD report discloses that the truth is more complicated than such a simplistic view.

Outflows from countries most affected by the crisis, particularly southern European ones, have accelerated, by 45 per cent from 2009 to 2011. In the US, *Time* magazine revealed, about one out of five workers moved every year in the 1980s; now only one of 10 does. Residents who have changed their address in the past year for 1950: 19 per cent. For 2009: 12 per cent.

Social mobility in the US is below most European countries; actually at the same level as Britain and Italy.

We also hear that there are no fiscal transfers in the eurozone while in the US the federal government steps in to smooth out cycles. This is simply not true. The share of the federal budget in the US eligible for this kind of policy is very small. It is also difficult to measure. In any event, the difference will not be significant. It is overlooked that balanced budget provisions are in force through states' constitutions for most US states, implying that the US economic and monetary union functions pro-cyclically – reinforcing instead of smoothing business cycles. This is exactly the opposite of what is prescribed according to established theories.

Reuters published an analysis (Dec 18, 2012) which said that "the federal government has emerged as one of the most potent factors driving income inequality in the United States", disclosing that since 1989 inequality has increased in 49 of 50 states and the poverty rate increased in 43 states.

I do not know how many times I have heard that it is impossible for Greece and Germany to be in the same economic and monetary union; their economies are too disparate and they do not converge. Really? Have you ever looked at Mississippi compared to Maryland with a ratio of 1:2.2 in income per capita? Greece versus Germany is 1:1.6. Portugal versus The Netherlands 1:1.8 – according to the CIA factbook.

A comment heard again and again is that Greece and other weak countries should have kept their own currency or left the eurozone to devalue the national currency. Devaluation means that you make yourself poorer, not richer, changing the terms of trade against you, forcing people to work more to acquire the same amount of foreign goods.

It switches distribution of national income in favour of profits, eroding purchasing power of wages. In reality devaluation shifts the burden of adjusting almost exclusively to workers. Five years ago, Britain devalued about 18 per cent; today real wages has declined by 8.9 per cent – in the eurozone real wages have gone up by 1.9 per cent. Devaluation is supposed to boost exports.

From deficit to surplus

The British experience over the preceding five years shows an export performance worse than for the eurozone and producing a larger deficit on the current account measured as a percentage of GDP than for eurozone countries.

If we disaggregate eurozone figures for current account, the picture is surprising. In 2008 all five weak eurozone countries (PIIGS) had disturbingly high deficits: Italy and Ireland at 3 per cent of GDP, Greece at 16 per cent, and Spain plus Portugal in the middle showing 8 and 12 per cent respectively. By end 2013, all five countries have turned into surplus – without devaluation (Britain having devalued went from a deficit slightly below 2 per cent of GDP in 2008 to an estimated 3.4 per cent in 2013).

It was their luck that they joined the single currency. If not, they would probably have heeded the advice to devalue. That would have given them a couple of years of better figures after which they would have been back to square one – only poorer by changing the terms of trade against themselves.

Belonging to the single currency have forced them to restructure, reform, and retool, which they should have done years ago to modernise and make themselves competitive. This is what they have done now and they have reaped surpluses both on the current account and the primary government balance.

The figures do not lie. They can be interpreted in various ways, but they speak for themselves. The policies adopted by the eurozone work. Growth, employment, inflation, government deficits and debt, and current account – all essential figures bring good news.

United we stand: *Belonging to the eurozone has forced the weaker members such as Portugal and Greece to restructure, reform and retool, resulting in surpluses in their current accounts.* PHOTO: REUTERS

The writer is visiting senior research fellow, Institute of South-east Asian Studies and Adjunct Professor, Singapore Management University & Copenhagen Business School

Source: The Business Times © Singapore Press Holdings Limited. Permission required for reproduction.