OPINION

A new future for the eurozone

'We're now feeling the full effects of conservative policy responses to the crisis.'

By MARIA JOÃO RODRIGUES | 2/14/16, 6:00 AM CET

Average households struggle to meet basic social needs like housing, childcare, healthcare or education. | Aris Messinis/AFP/Getty Images

Europe is full of breakaway sentiment. French and Spanish voters are fed up with the old elites. Border checks are cropping up across the eastern and northern parts of Schengen. The Italians are fed up with the euro, and British, Polish and Hungarian governments are playing the "Reform the EU, strengthen sovereignty" game. The Germans are becoming increasingly anxious about migration and public safety. To many member countries, the EU is either part of the problem or unable to provide solutions.

Their anger would be less intense if the economy were in better shape. And "We will manage" would sound a whole lot more convincing if ordinary people had brighter economic prospects of their own.

But Europe's economic crisis has been long and job growth is precarious. Average households struggle to meet basic social needs like housing, childcare, healthcare or education.

> Lots of effort has rightly been invested in defining and implementing structural reforms. But Europe's longer-term growth potential has been eroded by years of underinvestment.

As Jean Pisani-Ferry, head of France Stratégie, put it recently, "failure to restore growth, bring inflation back on track and address major labor market imbalances and inequality in the distribution of income is making a joke of traditional parties' pretence to economic competence."

We're now feeling the full effects of conservative policy responses to the eurozone crisis.

Abrupt fiscal consolidation in 2010-2012 brought a double-dip recession. Mild recovery came only when austerity was eased and the European Central Bank launched unconventional measures. Still, fixed investment in the EU has fallen from the 21.4 percent GDP average in 2001-2010 to 19.5 percent GDP in 2015.

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Lots of effort has rightly been invested in defining and implementing structural reforms. But Europe's longer-term growth potential has been eroded by years of underinvestment. In turn, as the ECB has shown, low domestic demand is the main reason for small and medium-sized enterprises' reluctance to invest.

More social democratic policies are needed now to prevent a ruinous back-slide to nationalism. But there is a tragic lack of in-depth political discussion on economic policy at the European level. The eurozone is extremely interdependent and national governments have almost no macroeconomic tools left. Yet finance ministers rarely speak about the economic policy of the eurozone as a whole. Keeping Stability and Growth Pact rules is very important for mutual trust, but what if the current policy mix actually hinders growth?

The Commission has rightly deepened the analysis of the eurozone's overall budgetary position and of its high current account surplus. It tabled its recommendation on the euro area's economic policy in November, and the European Parliament has debated it with Presidents Juncker and Dijsselbloem. The Parliament report on 2016 economic policy priorities should be finalized in February, well before the spring summit.

Yet the Council's preparatory bodies work much faster, without public scrutiny, and they push the discussion back to questions of national fiscal discipline and structural reforms. The

Eurogroup and Ecofin approved the euro area recommendation in January without much debate, let alone real coordination among countries.

Jean Pisani-Ferry, Commisioner-General of the French General Commission for Strategy and Economic Foresight | Eric Piermont/AFP/Getty

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Heads of the Bundesbank and Banque de France have recently joined the ranks of those advocating the creation of a eurozone treasury, reinforcing control over national budgets. But would such a treasury only enforce rules or actually steer the eurozone toward balanced growth? The latter requires deeper coordination, with clarity on which countries need to consolidate budgets more and which should consolidate less, or even expand, in the interest of the whole.

Eurozone economic policy should be more than the sum of its 19 national parts. The euro area as a whole generates a massive excess of savings over investment: At 3.7 percent GDP, or nearly €400 billion, its current account surplus represents the biggest imbalance in the world. We export all this money instead of consuming or investing it at home.

> It may sound paradoxical, but a reduced current account surplus would make the vast majority of eurozone citizens better off.

If global growth is slowing down, how can we adapt? How do we strengthen domestic demand and boost investment for stronger recovery and solid long-term growth?

Even if all eurozone governments do their structural reforms homework and maintain fiscal responsibility, we won't solve this problem. Real coordination would require clearer division of tasks: If the eurozone periphery must keep prices down and budgets tighter according to the rules, then high-surplus countries in the core should provide a demand boost. Otherwise, the eurozone will continue to stagnate, with inflation much below the ECB target, and bitter social anxieties continue to brew.

For proper recovering, the eurozone needs faster wage increases, greater public and private investment and above 2 percent inflation in high-surplus countries. Peripheral countries need to continue reforming and try to strengthen investment.

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A demand stimulus led by high-surplus countries would initially create new jobs mainly in these countries, but the rest of the eurozone also stands to benefit, thanks to higher overall inflation and less pressure on the euro to appreciate. The periphery would not need to undergo deflation in its effort to regain competitiveness. And there would be less need for the ECB to flood the market with €60 billion every month.

It may sound paradoxical, but a reduced current account surplus would make the vast majority of eurozone citizens better off. It would mean higher investment in productive capacity and public goods, supporting reform efforts, and higher wages for some.

Conversely, continuing to blindly rack up excess savings and lend them to the rest of the world will only keep Europe in stagnation and expose the continent to the growing risk that these savings will lose value.

This is what eurozone policymakers should be talking about. Deeper coordination doesn't mean letting national governments off the hook. It means keeping the big picture in mind and finally get our act together.

Maria João Rodrigues is vice-president of the Socialists & Democrats Group in the European Parliament and the Parliament's rapporteur on the 2016 Annual Growth Survey.