

My neighbour's doubts on the crisis measures

The [strong approach that 'Super Mario' announced on 6 September](#) to make the speculators betting on the demise of the euro feel that they are wrong, raised doubts in my neighbour's mind, which he expressed during a birthday party. Below, my response to his doubts. First, a brief overview of the measures.

The ECB is responsible for the monetary policy of the European Union or, rather, of the euro area. The ECB is to maintain price stability. Its further responsibilities include the promotion of the stability of the financial system. Following [the agreement of the Euro Area Summit](#) at the end of June, this function is to be expanded: on 12 September, the European Commission unveiled the implementation of this decision in [its legislative proposals](#) for a role of the ECB in the supervision of banks. [Vice-President Vítor Constâncio](#) set out the ECB's stance on this matter during [a lecture in Amsterdam](#) on 7 September.

Since the beginning of the combined banking and sovereign debt crisis, financial markets do not only include credit risk in their calculations (they distinguish between exposures vis-à-vis German, Dutch, French and Finnish governments and peripheral Member States) but they also bet on the euro area's demise. The interest rates that Greek, Spanish, Italian, Irish and Portuguese banks and governments have to pay include a top-up reflecting the fear that these debtors will in the future not pay back in euro. In case these States were to give up the euro, creditors would face long legal battles concerning their exposure. This means the interest rate level is not only a true measure of debtor risk but also an expression of speculation on the end of the euro.

The euro is meant to be irreversible. After national currencies had been abolished, the euro took their place. This irreversibility has now been [confirmed by the ECB President](#). The central bank is unable to obtain the effects it aims at in the interest of price stability throughout the euro area. Its instruments are distorted by waves of speculation.

The ECB intends to break these waves with outright monetary transactions (OMTs), i.e. purchases of sovereign bonds issued by Member States with an adjustment programme. Through buying these bonds with a maturity of up to three years, the ECB can push interest rates down to levels which are closer to normal market rates. Thus, the ECB restores the European money market so that the central bank can, once again, apply its monetary policy instruments with effects in the entire euro area.

Now, my neighbour's doubts.

1. Is this monetary financing, i.e. financial support to governments that central banks are forbidden to give? No, OMTs are purchases of sovereign bonds on secondary markets, so after a sovereign has sold bonds to other interested parties. These kind of purchases are expressly permitted. Their side effect is, of course, that the relevant sovereigns borrow more cheaply.
2. Don't OMTs put a premium on bad behaviour by governments? No, only governments with an adjustment programme will be eligible for OMTs. These programmes include strict demands in terms of government budget reductions and economic reforms. The [IMF](#) is to be involved. Ask the Greek, the Irish or the Portuguese. The latter have just seen [a major cut in their purchasing power](#) executed with a 50% increase of social security contributions for wage earners (from 11% to 18% of their salary).
3. But didn't these southern governments overstep the budgetary rules? Yes, they did, just like [almost all 27 Member States](#), as a consequence of the financial crisis, since 2008. [Ireland](#) was the best pupil in class with low governments deficits and public debt until, in October 2008, the crisis forced the Irish Government to guarantee the banking system. This was many times larger than Ireland's national income and the guarantees suddenly pushed up sky-high the budget deficit and the public debt. (If we had acted in unison as EU at that time, the crisis would not have gone out of control the way it did, but Germany was opposed to joint action then.) [Spain](#) had its government's finances in order from the start of the euro but, like Ireland, was confronted with a housing bubble. When this burst, Spanish banks suffered huge losses. [Portugal](#) which, indeed, has a less competitive economy and suffered excessive budget deficits several times, had just restored order to its public finances when the crisis broke out. [Greece](#) is a case apart. But even there, enormous adjustments have been carried out. These blunt adjustments already led to a remarkable improvement of competitiveness of peripheral Member States. And to low interest rates in the North of Europe.
4. But don't we cut down on government spending here in order to help Greece? No, the loans to Greece, Ireland and Portugal are for a large part loans extended by a joint vehicle, the [EFSF](#), which the euro area Member States only guarantee. Through this fund, the 17 euro area States borrow on the financial markets against tariffs that are far lower than peripheral States have to cough up. The loan proceeds are sluiced to Athens, Dublin and Lisbon, applying a top-up. Now that the [German Constitutional Court](#) in Karlsruhe has allowed this, the EFSF is to be replaced by the [ESM](#). Only in the case of Greece there are bilateral loans of the other 16

EU States that have the euro as their currency. The peripheral Member States pay interest on these loans which thus constitute a monetary flow from South to North. At the same time, the crisis led to negative interest rates for the core Member States: we enjoy an interest rate advantage and, thus, are until now winners in the current situation even though we run the risk to have to pay under the guarantees or, in the case of Greece, not to be repaid under the loans. All the more reason to counter the crisis with strong measures that restore confidence, to bring order to government finances and to reinforce the resilience of our economies.

5. These debts rekindle extreme sentiments, don't they? Yes, they certainly do. The crisis makes Europe susceptible for extreme political viewpoints, for xenophobia and narrow nationalism. Apart from the carving up of the financial markets, a division among citizens is taking shape who, more than in the past, tend to think in prejudices and clichés. Politicians and business leaders failed to explain what is really going on. They succumbed to populist babble. They failed to tell the story of Europe in clear terms. This has to change. It is [only through European cooperation](#) that we can overcome the crisis jointly.

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(The English translation acknowledges events after the original column was written)