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How to Create a New European Plan for Investment

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1. Introduction

The Greek crisis which began six years ago, is an extreme case that has brought to light deficiencies of the euro area. It was characterized by a series of untimely and vainly punitive decisions on the part of the other member states of the European Economic and Monetary Union (EMU), unbearable and unattainable requests to make macroeconomic adjustments and reforms on the part of European institutions, and encouraging but eventually fruitless commitments on the part of the Greek government.

These circumstances ended up maximizing the economic and social costs linked to the preexisting structural fragility of Greece, causing the financial size of the aid programs promoted by EMU members and European institutions to balloon, and resulting in partial and distorted adjustments of the Greek economy. Those adjustments pointed out that the expectations of growth and well-being characterizing Greece at the beginning of the new century were misleading, but they also contributed to lead the Greek economy to depression and Greek society to a state of emergency.

2. The Legacy of the 2010 Greek Crisis

The situation described above was already fed by the first European aid intervention that came into existence in April 2010 in the form of five-year bilateral loans to Greece (totaling €110 billion), which were funded by all the other EMU members states and the International Monetary Fund (IMF). The interest rates on these loans were too high and the aid program required macroeconomic adjustments that were too ambitious for the very fragile Greek economic institutions, including overly severe measures to reduce government deficit and debt, €50 billion in planned privatizations, and radical structural reforms to improve competitiveness. As a result, despite the parallel purchase of Greek government bonds by the European Central Bank (ECB) on secondary financial markets through the "Security Market

Program" (SMP), there was a covert restructuring of bilateral loans in March 2011, accomplished by way of a maturity extension and decrease in interest rates due. Moreover, in October 2011, the Eurogroup was forced to admit the impossibility of financing Greek government debt through the issuing of bonds and their sale on the market until the end of 2014. Consequently, these debt maturities had to be matched by means of a second European loan totaling €130 billion.

This new European aid program was implemented in March 2012, with the involvement of private holders of Greek government bonds who had to accept a cut equal to more than half the nominal value of the aforementioned holdings. On the flipside, Greek policy makers had to commit to the implementation of previous, unrealized policy initiatives and the introduction of a number of additional restrictive economic measures. The aim was to reduce Greece's ratio of public debt to GDP to 120.5% by 2020. In actuality, these measures dramatically increased the insolvency risk of government bonds issued by other peripheral member states of the EMU as assessed by the market; moreover, they corroded the trust European citizens had in European institutions. Meanwhile, structural problems within the Greek economy remained unaffected. As early as June 2012, the Eurogroup had to admit the failure of its new program. In December 2012, it became necessary to start a new phase of Greek loan-restructuring, with a simultaneous re-purchase of residual public debt from private investors by the Greek government.

3. The New Iteration of the Greek Crisis

The framework above, among other factors, explains the mid-2015 expiration of the European aid program to Greece and formed the basis for negotiations between European institutions and the new Greek government led by PM Alexis Tsipras, which took place in the early months of 2015. The various phases of these dramatic negotiations cannot be analyzed in detail here. Let me just emphasize that they led to four findings which are crucial for understanding why the most recent developments in the Greek crisis produced a legacy that looms menacingly over the future of the EMU.

Above all, for the first time in the history of the euro, the *mésalliance* between a group of "central" countries (specifically, Germany) and the Greek delegation risked to determine the "exit" of a member state. This exit would have brought with it the potential to transform the monetary union into a fixed exchange rate system, thus exposing the euro currency to financial speculation (as witnessed during the recurring monetary crises between 1973 and 1992). The eventual end of the euro would have reduced the European Union to a trade agreement, turning back the clock by at least half a century.

Secondly, the decision made by Tsipras at the end of June 2015 to call a referendum on a previous potential agreement that was no longer on the table, can be interpreted as a desperate move to liberate himself from the more extreme elements of the Syriza party. Here it matters that this move also caused a situation that had no precedent in the EMU, that is a situation without technical solutions and just entrusted to political choices. The decision to call a referendum required, in fact, Greece to leave the old European aid program and declare its insolvency with respect to the IMF, thus preventing the ECB from providing emergency financing to the Greek banking sector, and thereby causing a collapse of the banking system and the entire economy.

Thirdly, the purely political agreement reached mid-July at the "twenty-fifth hour" between European governments and Tsipras that gave rise to the draft of a €86bn aid plan, matured in a rancorous climate. The latter eliminated much of the residual trust between member states and between the institutions of EMU and its citizens.

The fourth point stands on a pure economic ground. The new drafted plan reiterated previous, unrealistic requests for adjustments and reforms imposed on the Greek government in the prior failed aid program, earmarking much of the €86 billion toward payments for past debts and rescuing the banking sector; moreover, it was still more punitive towards any short term expansionary policy. As such, the terms of the actual new aid program approved by the Eurogroup in mid-August is unlikely to spark economic growth and overcome the Greek crisis. As has been indirectly demonstrated by the political instability in Greece (with new elections scheduled for these days of September), the "Greek issue" will present itself once more in due course, in the form of a need to restructure public debt.

4. The Proposed Paths

It would be wrong to equate the four points detailed above with some of the various stages of the Greek crisis between 2010 and 2012. There are at least three notable differences: the lengthy recession in the EMU (2011-13) reduced the macroeconomic imbalances in the short term inside the area while sharpening structural gaps in competitiveness between "central" and "peripheral" countries; the exit of a member state from the euro became a possibility, and therefore the EMU can now be perceived as a reversible union; the European institutions' scope for action is today limited by the declining trust between member states and an insufficient level of representation legitimacy, particularly when the constituency of each of these members is taken into account. The interaction between each of these new negative developments created an explosive combination, requiring changes that had deeply uncertain outcomes.

A few actors of European policies are conscious that the situation at hand is a matter of great moment. However their proposals lead to two diverging directions which strengthen cross vetoes, and thus hinder the search for stable solutions. Some genuine Europeanists in the "central" countries (above all, German Minister of Finance Schäuble) sustain that overcoming the difficulties facing the EMU requires more drastic reductions in the deficits and debts of public finances. This touches upon creating a fiscal authority for the EMU with the power to compel member states to meet the agreed fiscal rules. Only this way, in the opinion of Mr. Schäuble and his allies, would it be possible to overcome excessive gaps in competitiveness and lack of trust, the only path through which fiscal unification and political federalism can be achieved. On the flipside, many Europeanists in the "peripheral" countries retain that the solution to the current impasse in the EMU requires political and institutional discontinuities, a move to reinforce the European method (versus the intergovernmental one) as well as the role and representation of the European Parliament in order to limit the power of the European bureaucracy. This could open the path toward a federal union, similar to the United States, in which the disjointed competitive and fiscal environment between member states would no longer be an unmanageable element of instability.

Both these proposals do not appear capable of resolving the EMU's actual problems. The first assumes that the lack of trust will be resolvable through rigorous controls over the risk of opportunistic behaviors on the side of "peripheral" countries, without asking if the choices made by "central" countries are shared by others. Additionally, it also assumes a causality link between fiscal tightening and economic growth, something which the extended recession in Europe has put into serious doubt. The second proposal assumes transfers of national sovereignty and institutional cohesion can be achieved without reciprocal trust between member states. Moreover, it forgets that the historical and institutional peculiarities of each country belonging to the EMU (path dependence) would make creating a union akin to the United States impossible, so that the competitive and fiscal gaps between members states cannot be managed in the same way in these two areas.

5. The Way Ahead

The changes in economic and institutional setting of the EMU must be as profound as those evoked by the two just mentioned and opposite proposals, but their implementation must be more gradual. First, short and medium-long term measures must be put in place to re-launch economic growth in the euro area. In this regard, the principal role would be entrusted to a European plan for investment that takes cues from the Juncker plan, but one that is financially more robust and that can favor "peripheral" countries. This new plan would be an ideal bridge between a short term support of aggregate demand in the EMU and a medium-long term recovery of competitiveness in "peripheral" countries. Moreover, the attainment of the 2008 economic values with respect to the percentage of investment on GDP and the renewal of a stable path for growth are both requisite conditions, even if they may not be sufficient, because each member state of the EMU can have room to implement the fiscal adjustments and reforms deemed necessary for reducing macroeconomic imbalances to a given threshold compatible with the stability of the euro area. It is, in fact, easier to implement reforms, which always bring social costs, in the presence of an increase in employment and income than during a recession.

For these national reforms to coincide with those necessary for strengthening the EMU, each member state would have to agree upon their content and the consequent policy measures with European institutions by means of "contractual" agreements (relating to the "contractual arrangements"). The latter can also facilitate the compliance of these same measures with specific public balance constraints; and this could help begin efficient coordination in the fiscal field inside the EMU. This coordination could be built, in its turn, upon a form of European insurance (e.g. by making recourse to the European Stability Mechanism). The resulting virtuous circle between adjustments and national reforms, on the one hand, and European insurance schemes, on the other, would naturally blend into the creation of risk-sharing relationships between member states. This could help to build up a solid base for creating a "European minister of finance" and for moving financial resources from national public balance sheets to an EMU-wide one.

The creation of an EMU balance sheet, however, requires a European fiscal capacity. Due to the irrevocable principle of "no taxation without representation," this fiscal capacity could become an economic lever for giving representation legitimacy to European institutions, and thus for renewing a trust relationship between these institutions and citizens of the EMU. The unification of fiscal policy and that of federal policy would become two components of the same process.