Reforming the Eurozone

The EU cannot ignore economic growth and population decline in tackling its long-term debt crisis

By *per Concordiam* Staff
Photos by Agence France-Presse

In the heat of the debt crisis, German Chancellor Angela Merkel made an admission that clarified for many the stark choices facing Europe: Rolling government debt too far into the future was no longer an option for Germany because there was no guarantee the country's aging population could cover the bills once they came due. In a nutshell, Merkel illustrated the problems facing the European Union's "social market economy." Lavish retirement and welfare benefits begun during the vibrant years of the post-World War II boom may not be affordable in an era of declining population, slower economic growth and waning competitiveness.

"The new German problem is that the future of the eurozone and of Europe rests on the dominant German economy, but the long-term prospects of German demographics are daunting," a United Press International article said in 2011. "After three decades of dwindling birth rates there will simply not be enough Germans of working age to sustain the burden."

This analysis suggests that even if the eurozone emerges from the crisis that began in Greece and bled into countries such as Italy, the respite may only be temporary. To break the impasse, Europeans have floated possible longer-term solutions to the euro predicament, none of which will be easy to achieve in an EU built upon the principle of unanimous decision-making among its 27 members. Many EU leaders see the eurozone evolving into a fiscal union in which richer members such as Germany help pay the debts of other members, in some cases through "eurobonds" issued jointly by the EU. That would require structural reform to relatively unproductive EU economies that have used the euro to finance unsustainable spending. Once nations commit to spending discipline, economists view economic growth as the ideal way to shrink debt relative to the size of the economy. In Europe's case, however, such growth could be stymied by low birthrates and growing intolerance for mass immigration.

German Chancellor Angela Merkel and Italian Premier Mario Monti review an honor guard in Berlin during negotiations over the euro crisis in January 2012.

"Growth is undoubtedly the best way to get out of the debt trap. After World War II, the American economy grew at a faster rate than the national debt. As a result, the debt ratio was automatically reduced," *Der Spiegel* wrote in January 2012. "Nowadays, however, an aging and shrinking population makes it far more difficult to increase economic output. This means that slow-growing countries like Japan or Germany can hardly serve as the reliable borrowers of tomorrow. Rising economies like China, India, Indonesia, the Philippines or Vietnam offer more security."

Hurdles to fiscal union

The origin of the European debt crisis was the 2008 revelation that Greece could no longer meet its bond payments, money it had borrowed from domestic and international investors to finance government spending. Greece has since benefited from an EU bailout fund strengthened with hundreds of billions of euros from donors such as Germany. Greek leaders have also negotiated with bondholders to cancel or refinance most of the country's outstanding debt, which exceeds the country's gross domestic product. Though Greece's future as a member of the eurozone remains in doubt, a potentially greater danger is that the financial contagion could spread to the much larger economies of Italy and Spain. Even France, once perceived as an impeccable investment for creditors, had its bond rating downgraded in early 2012, suggesting the country will eventually have to pay higher interest rates to borrow money.

Many EU members have responded by calling for greater fiscal integration of a continent where national parliaments still control almost all budgeting. Despite pressure from France, Germany has rejected the concept of debt pooling until its taxpayers are assured they won't be picking up the tab for prodigal spending in the countries of the Mediterranean. But the price of such reassurance may be too high: EU members would have to cede

budgetary control, a critical part of national sovereignty, to Brussels. Achieving unanimity on that point among 27 different national electorates (17 electorates if the changes were confined to countries using the euro) could be difficult.

"Shared liability is something we will only be able to contemplate once the EU has achieved much greater integration. It will not do as a means to resolve this crisis," Merkel explained in an interview with the *Guardian* in January 2012. "That greater integration would involve the European court of justice enforcing controls for national budgets, for example, and much more besides. If we at some point have harmonized our financial and budgetary policy, that will be the time to try and find other forms of cooperation and shared liability."

Growth through reform

When facing similar financial crunches in the past couple of decades, countries such as Sweden and Finland reacted by deregulating and restructuring their economies, which they believed had grown too rigid and uncompetitive. Sweden experimented successfully with deregulation of its retail sector that allowed companies such as furniture seller IKEA to thrive. It partially privatized its government-guaranteed pension system on a model provided by Chile. As a result, the country outperformed most of the continent in terms of productivity and investment, and has weathered the recent crisis better than most.

"Europe's governments have been remarkably timid, compared with the Nordics, in exploiting another avenue to growth – structural reform," *The Economist* noted in January 2012. "… it is in Europe where the potential gains from structural reforms are greatest and where the policy focus has nonetheless been overwhelmingly on austerity."

As the recent crisis took hold, Spain and Italy have both promised to loosen labor rules that have locked older workers into jobs and deprived young aspirants of access to those same fields. Stories proliferate about trucking licenses in Greece passing from generation to generation like treasured inheritances unavailable to outsiders. Italian labor rules fill 2,700 pages and are so murky that businesses can't fire incompetent workers without stiff penalties or labor strife, *Bloomberg Businessweek* wrote in late 2011. The country ranks near the bottom of the world in labor market efficiency.

"Italy's economy can no longer afford the generous benefits it showered on its workers in the 1960s, when the country grew 5 percent to 6 percent a year," the magazine noted. "Measures put in place years ago to protect workers aren't just slowing down the economy now, they're perversely hurting the very workers they're meant to protect."

Stopping population decline

Few doubt anymore that European infertility correlates to the euro crisis. In a January 2012 article, *Der Spiegel* suggested governments re-evaluate government debt in

Far left: A store in Magdeburg, Germany, advertises longer Saturday shopping hours after Germany liberalized rules that had forced businesses to close earlier than many customers preferred. Such deregulation is credited with helping countries such as Germany and Sweden achieve better economic growth.

Left: A protester burns copies of euro notes in front of the Bank of Greece in Athens in 2011. An economic downturn has created unrest in the country, which is trying to extricate itself from a debt crisis.

light of demographic change. Sovereign debt was once deemed necessary for war fighting and investment in projects such as dams, bridges and airports. But these days almost every finance ministry piles debt upon debt simply to pay for ongoing expenses such as government salaries and pensions. Such a bargain is workable if a country's working age population rises compared with the number of retirees. But that's not the case in almost all of Europe. Fewer workers will be available to be taxed to finance the retirements of a growing pool of elderly pensioners. Long-term bondholders asked to wait 30 years to redeem their investments are worried about the EU's financial viability by the time 2042 rolls around.

Many of the problems revealed during the euro crisis were outlined in "Project Europe 2030: Challenges and Opportunities," a report produced for the European Commission in 2010. The 46-page document starkly laid out problems needing the coordinated attention of EU member states lest they slide into irrelevance on the world stage. At the current average birthrate of about 1.3 children per woman — the replacement rate is nearly 2.1 children per woman — the EU would face massive worker shortages requiring tens of millions of immigrants to fill.

"Too often immigration is perceived as a burden to be shouldered rather than an opportunity to be seized. Europe has much to learn in this regard from Australia, Canada and the United States, with which it is in direct competition for talented and skilled immigrants," the report said. "Yet Europe will only become an attractive destination for skilled immigrants if the latter feel accepted, have full access to formal labour markets and the possibility to set up their own businesses."

The opening of EU labor markets in 2011 to recently admitted member states such as Poland and the Czech Republic promises to help improve the situation. But EU officials believe the continent will need to look farther abroad to fill its need for scientists, researchers and doctors. A "blue card" program giving preferential immigration treatment to highly educated arrivals from Asia, Africa and North America would help. "Project Europe" says as much.

Attempts by governments such as Germany's to encourage families to breed have largely failed, stymied by changing cultural attitudes that government bureaucrats struggle to recognize. Germany has already spent 15 billion euros ($21 billion) on *Elterngeld* to subsidize child rearing. "But no matter how much money the state throws at the problem, it won't go away," *Der Spiegel* concluded in August 2011.

Reasons for hope

The EU remains the world's largest economic bloc packed with 500 million citizens living in democracy and freedom. The continent will eventually emerge from its debt crisis, either with a more compact eurozone or a recommitment to stronger fiscal union, but the bigger challenge will be declining European competitiveness and addiction to unaffordable government spending. What EU leader wants to preside over a shrinking, less influential Europe lacking even the means to defend itself? As Italian Prime Minister Mario Monti phrased it in January 2012: "Overcoming the economic, financial and social crisis that is gnawing at Europe depends on structural reforms that are in the hands of, and in the decision-making capacity of, the member states." □