The crisis of the eurozone: a view from Slovakia

Richard Sulik, MP

Former Speaker of the Slovak Parliament

Rule-breaking and the genesis of the euro crisis

In order for the European common currency to function in countries with different economies, it was necessary to establish certain rules. These rules were known as the Maastricht criteria. Since, however, politicians are generally irresponsible, the rules pertaining to the euro were not followed. In the first decade of the singe currency, the Maastricht criteria were breached 97 times. The rule prohibiting countries with a public debt larger than 60 percent of the GDP from entering the eurozone, for example, was ignored from the beginning. Greece and Italy entered the eurozone anyway. At the time of joining of the single currency, the public debt of Italy was 105 percent and Greece 92 percent. Yet no country was held to account. In 2004, even Germany and France publicly declared that they will no follow the Maastricht criteria.

In the years following the launch of the euro, many countries have fallen further in debt. Much of the borrowed money artificially stimulated consumption - not least government consumption, or “buying of votes.” Vote buying is among the most important shortcomings of the democratic system. It works like this: at an election time, politicians tell the electorate, “if you elect us, we will increase your pensions, and give you free healthcare and free internet.” Such promises sound very attractive and bring in the votes.

What politicians do not say is that most of the “free” stuff will be bought with new debt. After years of unbridled borrowing and ignoring of the Maastricht criteria, Greece became the first country to face financial problems as the financial markets refused to lend the Greeks more money at a low interest rate.

Never-ending bailouts begin

Under normal circumstances, a heavily-indebted country that has lost the confidence of the financial markets would be obliged to save and, if that proved to be impossible, declare bankruptcy. Not so with Greece! When the troubles started, the European politicians and the European Central Bank have declared their intention to save the Greeks from default. At first, they claimed that the Greeks could pay their creditors without a need for foreign aid. Then they said that the Greeks would need 30 billion euros; then 60 billion euros. Later they extended the Greeks a loan of 110 billion euros - in spite of a high probability that Greece would not be able to pay back. When extending that 110 billion euros loan, European politicians assured us that the Greek troubles would be solved by 2012. They also told us that Greece would return to the financial markets by that same year. Today we are in the middle of a second Greek bailout worth some 145 billion euros! If the first loan was non-sensical, because Greece was en-route to bankruptcy, the second loan is pure madness because Greece already is bankrupt. Put differently, helping the Greek state is a waste of taxpayers’ money.

It later became apparent that other highly indebted countries - like Portugal, Spain and Italy - needed help. So what did the brilliant politicians in Brussels come up with? They created the European Financial Stability Facility, or EFSF, which is supposed to rescue financially irresponsible countries in the eurozone with money from financially responsible members of the eurozone. In 2010, Ms Angela Merkel, the German Chancellor, gave an “iron-clad” promise that the European bailout mechanism would be temporary, last only three years, and exclusively consist of loan guarantees.

Now we are being told that in addition to the temporary bailout mechanism, Europe will have a permanent one. We have also learned that the European Central Bank is supplying commercial banks with unlimited loans at an interest of one percent and that it is buying sovereign bonds of most heavily indebted eurozone member states. So far, the ECB has done that in the secondary markets, but after the permanent bailout mechanism becomes law, the ECB will be able to buy sovereign bonds in the primary markets. The European politicians have created a de-facto transfer union - the exact opposite, in other words, of what the eurozone was supposed to be.

All the above contradicts the understanding reached before the approval of the temporary bailout mechanism; is in contradiction of the Lisbon Treaty and in contradiction of the rules governing the ECB. I believe that the failure to follow the rules and the subsequent loss of credibility is a serious transgression on the part of the European political elite. The sums involved are staggeringly high. Yet, the national parliaments of the eurozone countries, who are mandated by law and by the electorate to oversee national budgets, are abrogating that responsibility to unelected bureaucrats in Brussels. That goes against the very essence of democracy.

Private gains, public losses

Consider also the moral hazard associated with the creation of the permanent bailout mechanism. First, the eurozone members will no longer have to convince the financial markets that they are credible borrowers. Second, interest will fall to a uniform level of 3.5 percent for all sovereign borrowers. Third, countries that receive a loan will no longer need to extend financial guarantees to other eurozone members. In other words, European bureaucrats have managed to develop a system that will encourage countries to borrow as much as possible! Europe is like heroine addicts who think that they can solve their addiction by increasing the daily intake of heroin. I have no doubt that the bailout will worsen the euro-crisis.

Let us also not forget the responsibility of the creditors. For decades, French and German banks that lent to the Greek state enjoyed higher returns on investment. They did not share those profits with anyone. The gains, in other words, were private. Now that the French and German banks are faced with a possible Greek default, their losses are being socialized. All the while, we are being bamboozled with the false concept of European "solidarity." Yet, inability to pay off excessive debts caused by government over-borrowing and over-spending is not the same as an economic emergency caused by an earthquake or a tsunami.

Like Greece, Italy too lived beyond its means. Given the level of its debt, Italy should not have been allowed to enter the eurozone. Today, Italy is the second most indebted country in the eurozone. Logically, it is facing higher interest rates than, for example, Germany. As such, the purchase of the Italian debt by the ECB – that lowers Italy's borrowing costs – is an outrage. The ECB had no right to do so. The ECB's sole goal should be to maintain price stability - as we were promised that the ECB would do at the time of the creation of the euro. Purchase of the Italian bonds - simply because the interest rate on those bonds is increasing - harms price stability in the eurozone.

The only thing that can save Italy is to start saving money. Here are a few money saving ideas. The net pay of the Italian members of parliament is 15,000 euros per month and the annual transport costs of the Italian political class amount to 1 billion euros. Also, it would not hurt if the Italian government sold some of the state-owned companies or some of the 2,500 tons of gold in the Italian vaults. There was no reason why the ECB should have bought one cent worth of Italian bonds. Now of course there is no reason for the Italians really to save. All they have to do is to pass the begging bowl.

<u>Thoughts on Greece and Slovakia</u>

Over the last 200 years, Greece went bankrupt 5 times. For 90 out of those 200 years, Greece was unable to pay its creditors. The last year that happened was 1964. Then, in 1981, Greece entered the European Union, or the European Economic Community as the EU was then called. That same year, a socialist politician named Andreas Papandreou became the Greek Prime Minister (Andreas' father, Georgios, was also Greek Prime Minister and so was Andreas' son George). In 1981, the Greek national debt was 27 percent. The membership of the EEC gave Greece more credibility to borrow and after eight years of Andreas' premiership, the Greek debt rose to 90 percent of the GDP.

No doubt, Greece would have gone bankrupt much sooner - except that the membership of the eurozone once again increased the Greek credibility in the eyes of the financial markets and allowed the Greeks to postpone the inevitable. The Greeks have also employed some creative accounting - like including the proceeds from prostitution in the Greek GDP figures. By the way, the man who was chiefly responsible for this creative accounting, the former head of the Greek Central Bank, is now the new Greek Prime Minister. Mr. Lucas Papademos is tasked with fixing the mess that he himself helped to create.

In essence, the eurozone membership allowed the Greek politicians to feed the massive state apparatus of some 1.2 to 1.5 million bureaucrats, who amount to a quarter of the working population, and a massive military of 134,000 soldiers, for another decade. Today, the Greek wages and prices are much higher than Greek productivity. As such, the Greeks have only three options:

- Continuation of the financial transfers - like loans and eurofunds to Greece - which will be financed by the entire eurozone.

- Reduction of wages and prices by some 30percent, which would make Greece more competitive.
- Withdrawal from the eurozone and a return to the drachma.

Since the first option will be - sooner or later - refused by the eurozone and the second option will be refused by the Greek public, only a return to the drachma remains as a feasible option. If that happened two years ago - when the Greek crisis started - the Greeks would have been much better off.

From the Slovak perspective, helping the Greeks is utterly absurd. Slovakia is the poorest country in the eurozone. Our average monthly income is 780 euros, or 1050 euros when the employer's payroll contributions are include. Average pension is less than 400 euros per month. We have a GDP of 70 billion euros and collect 30 percent of the GDP in taxes.

The average wage in Greece is twice as high as that in Slovakia. The average pension is three times as high. Thanks to my party, which promised to oppose the Greek bailout at the election in 2010, Slovakia did not participate in the first Greek bailout. As a consequence, we have saved the Slovak taxpayers 820 million euros. But, Slovak politicians have, in spite of my party's opposition, agreed to join the temporary European Financial Stability Facility. As a consequence, Slovakia has agreed to guarantee loans worth some 7.7 billion euros.

Moreover, Slovak politicians have agreed to join the permanent European Stability Mechanism. As such, Slovakia will have to guarantee further 5 billion euros - and transfer 650 million euros up front as cash. All in all, Slovak politicians have agreed to guarantee 13.4 billion euros, which is 112 percent of the annual tax intake of the Slovak government. Slovakia's share of the guarantees will be the highest in the eurozone in terms of the public expenditure.

We cannot afford to be this generous. We do not have a highway between Slovakia two largest cities; we have a sub-standard education and healthcare; we have the lowest wages and pensions. Yet, nobody seems to care. What is important to our political elite is that we appear to be "good Europeans."

Conclusion

In conclusion, let me say that I agree that the current problems in Europe go beyond Greece. It is important to recognize that under the guise of the rescue of the euro, a European government is being born. This new, centrally-government Europe will have a common currency, common debts, common taxes and, in the medium to long term, minimal competences at the national or state level.

What is being currently contemplated in Brussels is more controlling than the former Comecon (or the Council for Mutual Economic Assistance that existed among the countries of the former Soviet bloc during the Cold War). The rules under which

Slovakia has joined the EU have changed. The character of the EU has changed and is changing. Yet, the people are not being consulted. I am sorry to say that Slovakia - perhaps more so than other EU countries - is finding itself on the road to economic enslavement. This is not the European Union that we have signed up for!

Based on Mr Sulik's speech at the Cato Institute on February 21, 2012.