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Saving the Euro: No Exit for Greece ?

Regardless of who is to blame, Commission or ECB should have issued warning long ago

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The financial mess in Greece is far from over, and the jitters around the Eurozone and the EU are unprecedented. While the construction of Europe has seen ebbs and flows over the past 60 or so years with approximate decennial cycles, the present crisis appears particularly severe.

As a vicarious European, I find it hard to see the immense progress made in the EU being reversed to the extent that one of its greater achievements, the establishment of a common currency for 16 nations and counting, may be undone. My sense is that the European institutions will eventually weather the storm. Once they have, the EU will be stronger than ever. The question is: what does it take to accelerate the recovery?

The diagnosis is key. My lawyer's answer to the economic conundrum is the need to establish an exit mechanism from the Euro. In the draft Constitution of the EU, then in Lisbon, a major institutional hole was filled: until the 21st century, there were mechanisms to join the EEC (then EC then EU), but no mechanism to leave it, or indeed to be excluded. This has now been remedied, and the Lisbon treaty, which is effective since December 2009, has a section about how a country could leave the EU. It is cumbersome, but at least there is an acknowledgment that a particular member-state could leave, although it could not be forced to leave.

With the onset of the crisis in the Eurozone, it is suddenly plain for the member-states, including Greece, that such exit mechanism is not available. So either the EU bails out Greece, or the currency of the 15 other members of the Eurozone gets dragged down by a nation with a population of a mere 10 million people, out of a huge Eurozone of 375 million and far stronger GDPs elsewhere. So instead of finding a way to reestablish a safer Eurozone without Greece, as it was indeed before Greece adopted the euro, the whole system is put to existential danger.

In contrast the conditions for Greece joining the Eurozone in the first place were clear, even if twisted to facilitate the country's entry on account of the excitement over the then young euro and the emotional debt to the cradle of democracy. To join, the conditions were clearly delineated. These "convergence criteria," established by treaty for the precursor of the Euro, the EMS (European Monetary System), had proven their worth to keep the currencies in the EMS in line. They are four: a low inflation rate, a stable exchange rate, a low long-term interest rate, and healthy public finances defined by reasonable government deficits and government debts. Metrics were associated with each criterion, and those metrics needed to be respected over a number of years before a country could join the EMS originally, and the euro in 1999. Greece joined the euro in 2001.

Two criteria, low inflation and stable currency, are automatically moot upon joining the euro. But the long-term interest rates and the government debt and deficit ratios continue to fluctuate, since they remain governed in large part by each member-state government. In Greece, the long-term interest rate started to get out of step with other EU nations in 2009. Instead of a government deficit ratio to GDP not exceeding 3 percent, the figure rose to 12.7 percent. The government debt, where the ratio under the convergence criteria could not be over 60 percent of the GDP, was twice the figure in 2009: it stands at 113 percent of Greek GDP.

This data should have been closely monitored by the ECB, with enough warnings and corrective policies forced upon Athens to get its act together on these criteria. Only when default started to loom over the external part of Greece's debt did European politicians and bankers wake up to the problem. It is too late on two accounts.

One is conjectural, i.e. political. The ECB was caught napping. Or was it the Commission, which continues to publish convergence criteria annual reports for nations that would like to join the Eurozone but do not meet the criteria? Regardless of who is most to blame (and there should have been resignations …), either the Commission or ECB should have stepped in long ago to tell the Greeks, and the rest of the Europeans, that something was seriously wrong in Athens' public finances. The ECB, or the Commission, should have also offered ways to correct it, lest … Well here is the structural problem which either institution could do little about. For "lest" means lest Greece is asked to leave the Eurozone, as it would have in the EMS system. But there is no exit from the euro and so the ECB and/or the Commission are hamstrung structurally.

In a Spiegel interview published Saturday, ECB governor Jean-Claude Trichet sought to shift the blame on a number of other actors, while hiding behind a quote of former German Chancellor Schmidt that "ECB policy is flawless." Flawless seems an odd qualification considering the current mess, but one should concede the structural point: if Greece had been warned in good time by the ECB and/or the Commission, and did not set its public finances on healthier keel, then what? Since there is no legal mechanism to get out of the Eurozone, the whole 375 million Europeans who use the euro to buy their bread daily are trapped in the financial equivalent of Sartre's claustrophobic play, "No Exit."

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