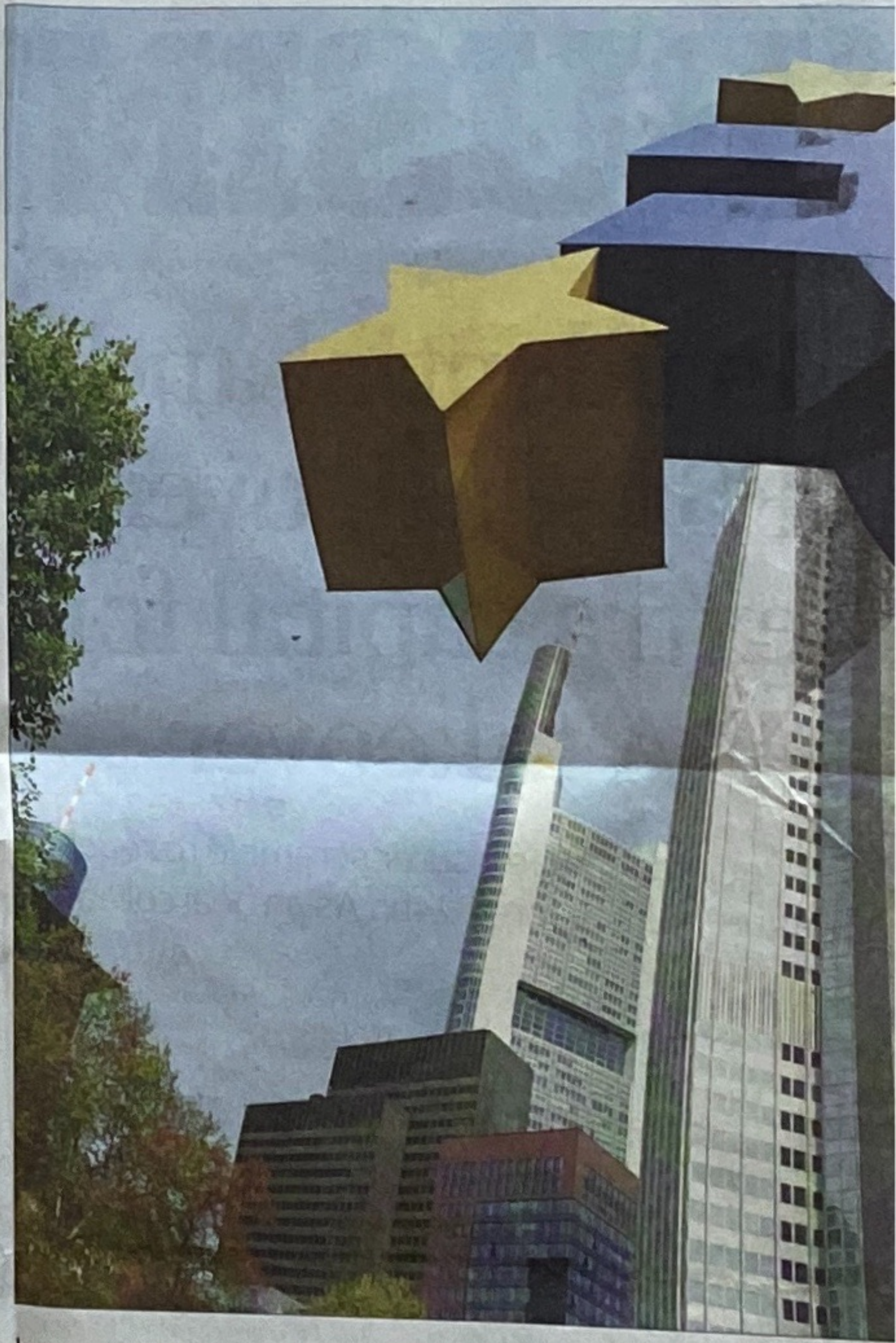
Eurozone's future in the balance

Despite last week's rescue plan for Greece's debt-ridden economy, the storm has not yet passed. As the world waits to see whether the crisis will spread to other European economies, a range of experts give Richard Wachman and Katie Allen their views on how events will play out



The eurozone faces the biggest test since its inception in 1999, amid fears that the Greek debt crisis could spread to other European countries and imperil the future of the euro.

Nervous stock markets have plunged around the world as worries intensify that banks will lose confidence at the ability of heavily indebted governments to repay their loans. A loss of confidence could lead to a second leg of the credit crunch if banks refuse to lend to each other because of concern about their exposure to nations that have borrowed to the hilt.

In particular, markets are fretting that weak European economies such as Portugal, Spain and Italy could follow Greece, and seek international and EU aid. When German chancellor Angela Merkel urged the German parliament to back the EU's emergency loan package for Greece, she said: "Quite simply Europe's future is at stake. Nothing more, nothing less."

On Friday, Merkel obtained parliamentary approval for the EU and IMF to start disbursing the €110bn Greek bailout. But the crisis is far from over, because there are doubts that Greece will be able to implement massive cuts in public spending in the face of widespread public opposition that last week led to riots and three deaths.

Now questions are being asked about whether Britain could face the same problems as Greece, despite the country being outside the eurozone. Below we speak to experts and leading figures to gauge their views on whether the euro can survive and about Britain's ability to weather the storm. •

Richard Lambert
Director general of the CBI

This is a very risky time for the eurozone, but I think the euro is more a political project than an economic one. The European political elite is very committed to the single currency. If the euro fell apart, it would be potentially disastrous for the member nations, ushering in a period of deflation, not to mention extreme political and economic uncertainty.

Turmoil in Europe is not in Britain's interest. But we are not, currently, in the same boat, as we have a flexible exchange rate. Nor is our indebtedness as serious. According to the IMF, we have a modest current account deficit of 1.7%, against 8.9% for Greece. And the average maturity of UK government debt is longer than for other European economies.

Of course we have to deal with our deficit. Failure to do so would mean that Britain too would be in trouble in a few years. But we have a credible record in managing our public finances; we are in a very different place to Greece.

Gerard Lyons
Chief economist at Standard Chartered

In terms of the euro, all this should not be a surprise. All the arguments against the UK joining the euro have been vindicated. Not all the members who are currently in the euro should be in it.

The euro may have better protected some of its members compared with what may have happened if they had been outside during the crisis, and some countries, like Iceland, still want to join. Despite all this, the euro system is not sustainable in its present form.

At some stage, the euro area would have had to come to a fork in the decision-making road. This may be that fork. The euro area needs to decide whether it wants political union. The nations which accept a political union will have to go down one route – and those that don't will have to leave the euro.

History shows that monetary unions of large sovereign nations cannot survive unless they become a political union. Monetary union requires labour mobility and fiscal flexibility in the form of a single treasury. Rich regions need to bail out poor areas when needed. This is easier to implement if they are part of the same country and much harder to justify across a monetary union.

The basic problem with the euro was that one interest rate does not suit all the countries. In economic jargon, the euro is not an "optimal currency area". In other terms, the economies are so different they need their own interest rates. One size does not fit all.

So, ahead of the recent financial crisis, the euro contributed to an even bigger boom in the smaller European economies. Hence they have seen a bigger bust. All this demonstrates the fragile underpinning of the euro area.

Anton Börner
President of BGA, the Federation of German Wholesale and Foreign Trade

We need the euro! The current developments show that it's no longer just about Greece but about the euro as a whole. We need the euro, so everything must be done to stop it going under.

Why? Because the euro is as beneficial to Germany as to other countries in Europe. In the past, volatile exchange rates made long-term planning very hard for export-dependent companies. Expensive currency hedges and exchange fees – such as those still common in US or Asian trade – are no longer something firms within Europe have to contend with. That saves billions of euros every year and safeguards jobs.

The fact other euro member states have benefited from low interest rates does not mean that Germany is worse off. In fact the opposite is true: we have benefited from having more stable and faster-growing trading partners. Germany has also gained by no longer having to grapple with devaluation in other countries.

Leaving aside Germans' historical sensitivities, a weak euro bluntly means less credibility for the eurozone. That means less investment, less wealth, less security for pensioners and savers and means drastically rising interest rates with the knock-on effect of more countries being at risk of bankruptcy. The long-term stability of Europe and basic order itself would be under threat.

Germany should get strongly involved in the framework of an IMF solution. Above all though, Germany must make sure that such a crisis is never repeated. The no-bailout clause in the Maastricht Treaty was introduced at the insistence of Germany and is indispensable. That's something we must insist on.

John FitzGerald
Economist at Economic Social Research Institute, Dublin

I don't think we will see the break-up of European monetary union. Each European country has the ability to deal with the economic problems that lie ahead.

Take Ireland as an example. No one suggested that we seek a bailout from the IMF or Europe. We got on with it ourselves and have come up with a very good fiscal package. Wages are expected to fall on average by up to 7% over the next three years, which will bring down the price of goods and services.

The underlying structural deficit before the government began taking action in 2009 was around 8%; we now think it is probably in the 3-4% range. The Irish government still needs to do more. A tough budget next year will probably complete the bulk of the adjustment, so when the economy recovers fully the country will no longer be in deficit.

Admittedly, the rescue package for Greece has raised expectations that other countries with problems can rely on outside help. But Spain's problems are not of the same order as Greece's.

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