

## **In defence of Europe**

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***The Straits Times***, 15 December 2011

THE financial crisis, which began in the United States in 2008, has moved across the Atlantic. It is now centred on Europe, especially the euro zone. In recent months, readers of this newspaper have had a steady diet of negative reports and commentaries by mainly British and American sources on the euro, the euro zone and the European Union (EU). There is very little empathy with or understanding of the European integration project in those two countries. We wish to give a more balanced and positive view of the situation. We will do so by answering a number of frequently asked questions.

### **What is the historical significance of the European Union?**

The European Union may be seen by many today as mainly an economic and monetary union, but in fact, it had its origins first and foremost as a peace project.

Europe in the first half of the 20th century was the killing fields of the world. Conflict between European nations led to World Wars I and II, the most destructive in human history.

Following World War II, visionary leaders such as Jean Monnet, Robert Schuman and Konrad Adenauer decided to put an end to war and took the first steps towards peace by launching the European integration project. They proceeded step by step beginning with the creation of the European Coal and Steel Community in 1952. The success of this experiment led to bolder attempts to create the European Economic Community in 1958, with the signing of the Treaty of Rome. In 1967, the customs union binding the original six member states was completed.

The community became a Union in 1993 when the Maastricht Treaty (formally known as the Treaty of the European Union) came into force in 1993. With the admission of new members, the membership gradually increased from the original six to 27 today. What is remarkable in the past 60 years is that no member of the EU has gone to war with another.

### **Has the EU's economic integration been a success?**

The EU's economic integration is a success story. In 1993, a single market was created by abolishing all internal barriers to trade in goods and services. The four freedoms - freedom of movement of goods, services, capital and people - are guaranteed.

The EU is the world's largest economy and biggest investor. It has a combined population of 501 million and a combined gross domestic product (GDP) of ?12.268 trillion (S\$21 trillion) accounting for 28 per cent of the world's GDP and 21 per cent of world trade.

The EU is China's and India's top trading partner and Singapore's second-largest trading partner. The importance of the EU to the global economy and Asia cannot be underestimated.

## **What led the EU to create the euro?**

The completion of the single market in 1993 created the conditions necessary for the European leaders to embrace the goal of monetary union. A single currency would ensure macroeconomic stability, avoid the volatility of exchange rates, reduce transaction cost and act as a catalyst for the integration of European financial markets, which benefit European businesses.

To give up a country's national currency is to give up an important symbol of that country's sovereignty. This must have been an especially difficult decision for the Germans because the deutschemark was such a strong currency.

Germany joined the other EU countries in adopting the Maastricht Treaty in 1993, which contains the Stability and Growth Pact as an informal institution to guarantee responsible fiscal behaviour.

Under the treaty, a country had to comply with the following five criteria in order to join the euro zone:

- a) Low inflation;
- b) Low long-term interest rates;
- c) Stable exchange rates;
- d) Government budget deficit of less than 3 per cent of GDP; and
- e) Total public debt of less than 60 per cent of GDP.

In the run-up to the launch of the euro, the original 11 members of the euro zone accepted extraordinary macroeconomic and fiscal discipline to qualify for membership in the euro zone. The euro was launched on Jan 1, 1999.

## **Who sets monetary policy in the euro zone?**

There are three institutions which together shape policy in the euro zone. First, the European Central Bank (ECB), which sets monetary policy for the 17 countries within the euro zone.

Second, the ECB works with the national central banks within what is called the European System of Central Banks (ESCB). The ESCB is analogous to the US Federal Reserve System. Decisions are taken by the Governing Council of the ECB.

National central banks participate actively in the preparation and implementation of the decisions. The Governing Council of the ECB consists of the president of the ECB, the heads of the central banks of the 17 euro zone countries and five other full-time members of the Executive Council.

Third, the Stability and Growth Pact, an institution for close mutual surveillance and coordination to ensure fiscal responsibility. It, however, lacks teeth and failed to sanction the countries which violated the Pact, including Germany and France. From the very start, the target of not having public debt above the 60 per cent limit has not been strictly enforced. The public deficit target (the condition that the budget deficit should not exceed 3 per cent of GDP) has also been violated early on not only by Greece, Italy and Portugal but also by Germany between 2002 and 2005, France in 2003 to 2004, Austria between 2004 and 2006 and The Netherlands in 2003.

### **What caused the current crisis in the euro zone?**

The crisis was in part an indirect outcome of the success of the euro. The introduction of the euro, which is accepted as a safe and stable currency, allowed countries in the euro zone to borrow at very low interest rates. This led to excessive borrowing by some euro zone countries and failure to comply with the criteria of the Stability and Growth Pact, in respect of the limits set on budget deficit and total public debt.

Sanctions were not imposed against these violations. The result is that countries such as Greece, Portugal and Italy are carrying enormous sovereign debt. The market has responded by refusing to continue extending loans to those countries or is charging them exorbitant rates for such loans.

### **Will the recent decisions taken by the EU leaders solve the problem?**

The recent decisions taken by the EU leaders do address the fundamental weakness of the system, that is, how to enforce fiscal discipline. Except for Britain, all the EU leaders agreed on a new inter-governmental 'fiscal compact', which allows for automatic sanctions on budget rule-breakers, and calls on governments to amend their national Constitutions to prevent profligacy and ensure budgets that are balanced.

They also agreed that draft national budgets will be submitted to the EU before they are adopted by their national parliaments.

These proposals agreed in the summit in Brussels, if adopted and faithfully implemented, will ensure that the euro zone's fiscal house will be in order.

### **Will national legislatures and voters accept the fiscal compact?**

It is a little hard to predict if all the national legislatures will accept the fiscal compact. There are several elections coming up early next year in countries such as France, and this may inject partisan politics into the process. The voters' mood may also be soured by the various austerity measures already in place.

However, by opting for an inter-governmental pact rather than treaty changes, governments may be able to avoid holding referenda to approve it. The prospect of approval by national parliaments is reasonably good. The proponents of the pact will emphasise that national parliaments are still primarily responsible for drawing up the rules and procedures that would then be monitored by a euro-watchdog for consistency and implementation.

### **Will the euro survive and continue to be a strong currency?**

The euro is and will continue to be a strong currency. Launched on Jan 1, 1999, on a par with the US dollar, the euro is, today, trading at one euro to US\$1.30. It is, therefore, a stronger currency than the US dollar. We have no doubt that the euro will survive the current turmoil. The 17 countries of the euro zone, led by Germany and France, are determined to ensure that the euro succeeds and they will do whatever it takes to prevent its failure.

We have faith in the future of the euro, of the euro zone countries and of the EU. The EU will restore its fiscal house to order and unleash the energies of its creative

people and businesses to generate growth, create jobs and reduce unemployment. Further structural reforms will ensure a return to competitiveness and confidence.

We must not forget that 10 out of the top 20 most competitive economies in the World Economic Forum Global Competitiveness Index 2010-2011 are EU member states. The EU will emerge from this crisis more disciplined and more competitive.

Asia, with strong trade and investment ties with the European Union, has a stake in the success of the euro and the EU.

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