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Hobbling behind America

The euro zone's long road to recovery—or decline

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EUROPEANS like to blame America for their crisis. But look at the numbers, and it is plain the euro zone has mishandled its response. Take growth: output in America has surpassed its pre-crisis peak and is growing; the euro zone has yet to make up the lost ground and is shrinking. Or joblessness: it stood at 10% on both sides of the Atlantic in 2009, but it has now fallen below 8% in America whereas it has shot above 12% in the euro zone. In sum, the euro zone was poorly designed and European austerity has been too harsh.

Were the European economy a hospital patient, the doctors might be sued for malpractice. In Europe, the price of incompetence is being paid by the young unemployed. Bombastic talk of the euro rivalling the dollar is gone. The aim is now simply to arrest the decline. As some in Berlin put it, Europe otherwise risks becoming like Latin America in the 1980s.

At this week's summit European Union leaders were taken with the sort of issues that typically concern poorer countries: finding money stashed in secret bank accounts and getting multinationals to pay their taxes. EU leaders for the most part ignored their wish to lead the world in reducing greenhouse-gas emissions. Instead, they fretted about bringing down the price of energy now that America is benefiting from shale gas. The next steps in repairing the euro must wait until another summit in June or, more likely, until Germany's election in September.

In Berlin these days, the obsession with fiscal discipline is being tempered by a focus on economic reforms. It is surreal to hear senior figures blaming the IMF, for agreeing to overly harsh bail-out programmes, or the European Commission for failing to respond quickly enough to youth unemployment and to the credit-crunch harming smaller firms in southern Europe. Angela Merkel, the German chancellor, is particularly fond of some charts that Mario Draghi, the ECB president, brandished before leaders at their summit in March. They show that wages in deficit countries have risen since 1999 far ahead of productivity. In Italy productivity has been static, yet wages have failed to adjust as in Spain or Portugal. And France looks worryingly like a southern European debtor, despite its German-like borrowing costs.

The proper response is structural reform to raise productivity and bring down wages. But the first is hard in the short term. And the second inflicts economic pain and could stir up social strife. Structural reforms involve changing the social contract that countries have developed over decades.

Some troubled countries, including Greece, are adjusting nevertheless—either because bail-out programmes require the liberalisation of labour and product markets, or because unemployment is brutally forcing down wages. France presents a bigger conundrum. It is not under pressure from markets. It is too big to be bossed around by Eurocrats. And it is too important for Germany to criticise loudly.

The decline of France could sink the euro. When the commission issues country-specific recommendations next week France will get two extra years to meet its deficit target, in the hope that it uses the time to enact structural reforms. François Hollande recognises the need for France to regain competitiveness. Yet his recent proposal for euro-zone reform betrays a desire for an easy way out. He called for the creation of an “economic government” with a full-time leader (the EU already has many “presidents”). Its task would include harmonising taxes and encouraging welfare systems to converge upwards. In brief, part of the answer to France’s competitiveness problem is for everyone else to raise their labour and welfare costs.

It is a mindset that infuriates Germany, which wants France to embrace globalisation as an opportunity, not a threat. For Mrs Merkel, the issue is not how to help struggling countries catch up with Germany, but how Europe can compete with the rest of the world. How will Europe make a living in future? Why do European firms struggle to be globally successful? The view in Berlin is that if recession is causing high unemployment in the periphery, blame rigid labour markets. Rising anti-German sentiment may be unpleasant, but it is a price worth paying to get change.

The infernal machine

Like so much in the euro crisis, the emphasis on structural reforms has come late. Governments have spent so much political capital on austerity that they may be too enfeebled to liberalise their economies. The reform of the euro zone as a whole is just as important. The European Central Bank has stepped in as lender of last resort for sovereigns, up to a point. The financial sector is being stabilised by the slow creation of a banking union.

Some of the delay is due to Germany's desire to limit its liabilities. But it is also down to the reluctance of France and others to modify the treaties, for fear of losing referendums. Britain's demand for a renegotiation of its membership makes this prospect even less palatable. Yet it would be a mistake to pretend that the euro can survive without greater risk-sharing. The hapless Mr Hollande has tried to take up Mrs Merkel's challenge of greater political union as the price of more solidarity. He said he was ready to see it within two years. "If Europe doesn't move it falls over or, rather, it disappears from the map of the world," he added. The indifference that greeted this call says much about lost French influence. Mr Hollande may be manoeuvring ahead of the German election, but few expect German policy to change.

European officials argue that Europe "is not a state", so cannot respond quickly—certainly not as decisively as America. For one canny observer in Berlin, the euro has become an "infernal machine that nobody can stop". Now that countries are trapped in it, they have a duty to fix it.

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