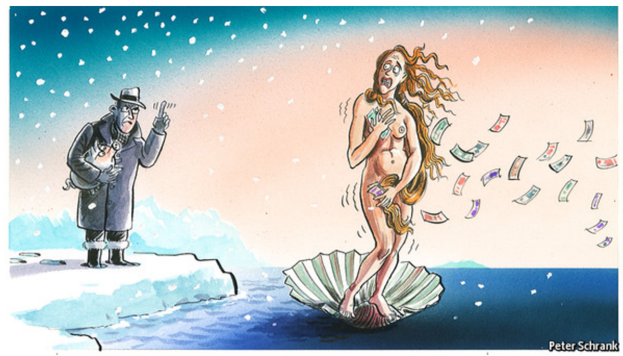
The Economist

Charlemagne

North is north

The euro zone’s exasperated north must do more than complain about the south’s troubles

Mar 30th 2013 | From the print edition



LAPLAND is just about as far from Cyprus as one can go in Europe. But on a spring day the sun reflected on an endless expanse of snow can be as bright as a Mediterranean beach. Russian pleasure-seekers and businessmen may flock to both countries. Yet in economic terms they are worlds apart. This week Cyprus became the fifth euro-zone country to negotiate a euro-zone bail-out; AAA-rated Finland, in its laconic way, is perhaps the most hardline of creditor states.

It is striking how the economies of EU countries on the Baltic Sea—from Scandinavia round to Germany, Poland and the ex-Soviet Baltic states—boast the union’s fastest-growing economies while many of those on the Mediterranean, from Greece to Spain, are shrinking fastest. The reasons are complex. For now, north and south are living up to stereotypes: Cyprus as the birthplace of the beautiful but fickle Aphrodite, who emerged from the surf at Paphos; Finland as the home of Vainamoinen, the wifeless old bard who, according to the “Kalevala”, a Finnish epic, surfaced from the primeval sea to plant the barren land.

Bitterness between north and south is intensifying. In Cyprus protesters took to the streets angrily to defend their bank deposits, decry their looming impoverishment and denounce Europe, especially Germany. At the same time in Finland the prime minister, Jyrki Katainen, summoned several European leaders for a retreat in a Lappish resort to discuss how to bring greater “fairness” to European affairs. Those who “follow the rules” (ie, northerners) must not always have to put up money for those who break them (ie, southerners), he declared.

The terms of the Cypriot rescue package reflect the exasperation of the creditor states. The era of the all-encompassing rescue is ending. Bail-outs must henceforth be accompanied by the bailing in of private investors. Cyprus was told its banks would not be helped by euro-zone taxpayers. So depositors have to take the hit for an oversized financial sector that had lived off questionable Russian business and had heavily exposed itself to Greece. The northerners' priority is to avoid the mistakes in Greece, where countries of the euro zone lent more money than Athens could ever repay (including to recapitalise banks). Creditor states later had to force private bondholders to take losses on Greek debt, and are now surreptitiously writing off official debt.

The Finns, the Dutch and the Germans want to shift the euro zone away from the idea of greater pooling of liabilities, advocated by Euro-federalists. Instead they want to strengthen the euro's basic framework as set out in the Maastricht treaty: each country must be responsible for its economic policies, within centrally imposed rules. Finland's hard stance stems, in part, from notions of national self-reliance: a small people in a vast land of forests and lakes fought alone against the Soviet Union in the Winter War of 1939-1940, then with Germany in the Continuation War of 1941-44, and against Germany in the Lapland War of 1944. In the cold war Finland was a semi-isolated buffer state between East and West.

The collapse of the Soviet Union and the bursting of a housing bubble pushed Finland into a severe recession and banking crisis: between 1990 and 1993 GDP fell by 10%, house prices fell by 40% and the Finnish markka lost 30% of its value. Finland did not seek outside assistance, and economists argue that crisis-era reforms laid the ground for strong recovery, best symbolised by the rise of Nokia, a mobile-phone maker. Having joined the euro, Finland's attitude to Club Med countries is blunt: stop moaning and get on with reforms. Just look across the sea at the Baltic states: they have gone through agonising recession, and internal devaluation within fixed currencies, but are now growing faster than anyone else in the EU. Many in the Club Med countries talk of leaving the euro. But Club Balt members are still lining up to join.

Estonia adopted the euro in 2011. Despite voters' qualms Latvia has applied to join next year. Poland and Lithuania are not far behind. To their leaders, tough fiscal rules are not an imposition but a guarantee against future instability. That Cyprus became a playground and piggy bank for Russian money hardly boosts its case among Finns. Internal politics is hardening the debate over Europe. The rise of the Eurosceptical True Finns, which became the third-largest party in the 2011 election, threatens Mr Katainen's awkward six-party coalition.

The twain must meet

The way Finland has liberalised its markets, and invested in education and technology while providing a generous welfare state and keeping tight finances, is admirable. Yet it risks falling prey to hubris. Any country can unexpectedly get into trouble and Finland is no exception. The once-mighty Nokia is in decline. Adjustment within a monetary union, where countries cannot devalue or relax monetary policy, is much more difficult, particularly when neighbouring economies are slowing down and even those with healthy budgets are retrenching. Had Finland gone through its recession within the euro, its pain would have been more intense. How much more support would the True Finns enjoy then? And how soon before Europe started talking of Finxit?

The greatest threat to the euro's survival is the increasingly poisonous politics of bail-outs in both north and south. Northerners have every right to demand responsibility from those they help. But they also have responsibilities of their own: they must show realism in designing bail-outs that do not inflict unnecessary pain; patience to delay austerity at home while others recover; and, above all, haste to rebuild the rickety financial structure of the euro zone. The first step to preventing another southern crisis is not hectoring from snowy forests, but creating a genuine banking union.

Economist.com/blogs/charlemagne (http://www.economist.com/blogs/charlemagne)

From the print edition: Europe