

## The Euro Party's Over. What Now?

Пише: Irwin Stelzer  
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"The party's over. It's time to call it a day. They've burst your pretty balloon, and taken the moon away."

So wrote Betty Comden and Adolph Green over fifty years ago, when they couldn't possibly have realized they were creating a lyric that would some day describe the euro zone.

No need retelling the well-reported slide of Greece into what will likely be an eventual default. Or the trials and tribulations of the euro zone's other periphery countries. What is worth noting is that it is one thing for healthy nations to be the unfortunate victims of "contagion," quite another for them to pick up the infection by embracing the diseased country.

Which is what euro-zone countries have done.

They have in effect welcomed the disease-weakened balance sheets of Greece and other countries onto their until-now healthy, stronger balance sheets, wiping out decades of good, prudent living in the case of Germany, and calling attention to thirty years of deficits, in the case of France.

Worse still, the spread of the fiscal disease is not confined to the euro zone, which it can be said by the querulous should have seen it coming. Britain, with a fiscal deficit of Grecian proportions—12% of GDP—and the U.S., in similar circumstances, find themselves not immune to the disease.

The rating agencies are increasingly nervous about leaving unchanged the triple-A ratings of the U.K. and the U.S. And the Obama administration is sufficiently fearful of the effect on America's recovery of the euro zone's problems, that the president called Spanish president José Luis Rodríguez Zapatero to urge him to take "resolute action" to get Spain's fiscal house in

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order—rather like the pot calling the kettle black, since the president has shown no inclination to cut his own spending programs, even though the government's debt is headed to 110% of GRP by 2015, compared with 90% at the end of World War II.

The good news is that the message from the markets seems to have gotten through. The eurocracy managed to cobble together a plan to prevent a complete seizing up of the banking system by promising to inject liquidity into the system. But nervousness about counterparty viability already has returned, driving up measures of bank credit risks to nine-month highs.

Better still, Spain's socialist government, reneging on its pledge not to reduce public sector salaries, cut them by 5%, ended its €2,500 (\$3,100) childbirth allowance, cut foreign aid, and announced other economies—with new taxes on the "rich" soon to follow. Portugal's socialist government also has stepped up its austerity program, combining spending cuts with a one-percentage-point VAT increase to 21% on most goods, and a 2.5% tax increase on corporate profits in excess of €2 million. Other governments across Europe are discovering the virtues of prudence. But the markets remain skeptical, and the International Monetary Fund is demanding still more spending cuts and tax increases, even of wealthy countries.

The bad news is that the outburst of fiscal virtue is likely to strangle in its infancy the anemic European recovery—the EU and euro zone grew at an annual rate of only 0.2% in the first quarter, Spain's economy grew a tiny 0.1%, and Portugal's growth rate of 1% was the highest in the EU. Unlike Germany, with an export machine that will be helped by the falling euro, the drop in the euro will provide no such stimulus to the non-competitive economies on the euro zone periphery to offset fiscal tightening.

So cuts in spending and increases in taxes are likely to throw those economies back into recession. That will reduce tax receipts, further widening the fiscal deficits. Even worse, prices have already begun to fall in Ireland and Portugal, which might cause consumers, already hard hit, to rein in spending even more in anticipation of further falls in prices.

It is difficult to predict whether the euro can withstand the social tensions created by this deleveraging of public sector finances. My guess is that it will: the ruling classes have too big a stake in the European "project" to allow the euro to pass into history as an interesting experiment.

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But the euro zone will be forever changed. France has scored a major victory over Germany in its battle to push European integration further by subjecting individual nation's fiscal policies to increased central control, a move it might come to regret when its own budget, running a deficit equal to 8% of GDP, is reviewed. The IMF is now a major player in the euro zone, an area previously verboten to it. And the credibility of the European Central Bank as an inflation fighter has been weakened by its active participation in the bail-out.

As the Comden-Green opus concludes, "Now you must wake up, all dreams must end. Take off your makeup. The party's over. It's all over, my friend."

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