Populist challenges to the Euro

By JOHNREDWOOD | *Published:* JUNE 2, 2018

There are waves of voters on the continent wanting substantial change to the Euro scheme which lies at the heart of Project EU. The endless austerity policies designed by Germany to avoid the need for substantial transfer payments from the richer parts of the zone to the poorer parts are universally unpopular in the south and west of the EU. Voters swept aside the two traditional main parties in Greece, only to see their chosen champions Syriza blown away by a resolute EU defence of austerity. In Italy now a populist government has been formed, as 5 Star and Lega have almost destroyed the two traditional centre left and centre right parties of that country. In Spain Cuidadanos and Podemos are on the march again and poised to do well from any early election. Even in fortress Germany herself, the home of Euro orthodoxy, a growing impatience with just how much Germany is nonetheless committed to has led to the worst ever result for the two traditional parties in the last general election.

All of these pressures go back to the Maastricht rules and criteria. These rules still have some sway in the UK, a non Euro member. The UK Treasury has used the budget discipline rules to require progressive reduction of our deficit, with the aim of starting to reduce the debt as a proportion of our national income. I often support the policy of controlling public spending and debt, and agree it should not be allowed to get out of control. I do not support our subservience to an inflexible EU rule that pays little attention to the state of the cycle, the level of unemployment and none to the tightness of monetary policy. Today tight fiscal policy in the UK is reinforcing tight monetary policy with the inevitable slowing of the economy we saw in Quarter 1. I think we need to look at all of these things together to get the right policy trade offs between inflation, output and future debt levels. A lot of Maastricht thinking is based on the pre crisis European economies. Today with mass migrations affecting wage inflation, and the liberal global supply of goods and services keeping down prices, the old identities that full capacity automatically led to high inflation do not work.

Much more serious than our position is the impact these disciplines have had on the south and west of the Euro area. Far from creating stability, the Euro scheme gave Ireland and Spain a wild ride. First it led to a massive boom, with asset inflation on a big scale, over development of property and over extension of bank credit. Then it gave them a big bust, where all of that reversed. In Italy's case it has given them more than a decade of pitifully low growth and high unemployment. In Greece it has led to a major slump with large falls in living standards. In Cyprus a banking crash led to people not being able to withdraw their Euros from some banks, and suffering losses on larger deposits.

Today the voters of Italy and Spain are saying they want reform of the Euro. They want more latitude to spend more, tax less and borrow more to try to accelerate growth and job creation. It is important how the EU responds. If they seek to do to Italy what they did to Greece, we are all in for a very bumpy ride. What they need to do is to move more rapidly to complete their political union, and to put into it a system of transfers of cash from rich to poor and from surplus to deficit areas. In the UK large sums are moved to the areas that need it via the nationwide benefits system and the Council revenue support grants. That is why the sterling single currency area does not have these periodic crises we see in the Eurozone. If they are not prepared to do this then they need an orderly break up of the zone so deficit countries can devalue against Germany and price themselves back into markets. When they broke up the rouble zone the countries that got out and established their own currencies soon did well out of that reform.