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Is the crisis of the euro nearly over?
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Last Monday, the Greek Treasury successfully raised five billion euro in seven-year bonds. Demand practically exceeded supply. Does this mean the Greek tragedy is over? Is the eurozone no longer at risk? That at least was the objective of the European heads of state and government for the European summit last week. A new mechanism was created that combines IMF payments with bilateral loans from the eurozone to help Greece if deemed necessary.

The financial markets did not seem to be very impressed. Standard & Poor's, the world's leading rating agency, for example decided not to alter the rating of the Greek government bonds despite the conclusions of the Council and the stock market barely brightened. Even though the Greek bonds that were issued this week sold like hot cakes, the interest the Greeks will have to pay, remains sky high, three hundred basis points more than the reference rate on the market, and more than double the interest set by the German Treasury. In short, the premium yield that investors are demanding for the Greek bonds has not decreased.

This insignificant effect is not surprising. The mechanism the Council established last week is rather complex.. It combines the intervention of the International Monetary Fund with one of the eurozone countries but an intervention of the latter is far from certain. The precondition for the bilateral loans is that market financing is insufficient**.** On top of that, a unanimous decision of all euro countries is required. Everyone who witnessed the German Chancellor these recent weeks knows that this unanimity is not a given. Furthermore, it's hard to say how one determines if market financing is "insufficient". It's easy for Greece to find or borrow money. This was proven on Monday. The question is what price will the Greeks pay for this money, in other words, what interest rates are we talking about? Will Greece be able to bare the burden of an even higher premium, when tens of billions in debt will have to be refinanced tomorrow and the day after tomorrow? That is the issue at stake. That is the question that the European Council has not been able or willing to answer.

The decisive role of the European Central Bank.

Furthermore, it is far from certain that the new mechanism will even work. It will probably only serve rather as a psychological weapon for the financial markets in the sense that one should not ask those poor Greeks for exorbitant interest rates, otherwise the European member states will start playing banker themselves. From that point of view, it was not the summit conclusions that determined the ‘successful’ issuance of the Greek bonds on Monday. It was the announcement of the President of the European Central Bank, Jean-Claude Trichet. He reported that, contrary to an earlier decision, the Greek government securities would continue to serve as collateral in order to ensure that banks had access to sufficient amounts of credit. Before the financial crisis, the threshold for acceptable paper was at least one A-'rating' for government securities to be eligible as collateral. During the crisis, the ECB cut its rating to BBB +. The ECB´s decision at the end of last year, within the framework of an exit-strategy, to end this policy and return to the A- rating standard, created a huge

problem for all holders of Greek government debt, as the Greek debt was already devaluated into BBB +. No wonder the Greek bonds were dumped in masse, which only worsened the crisis.

Nevertheless, the main merit of the Council conclusions of the March summit was not so much their content, but rather their actual existence. Though they will achieve little to solve the Greek crisis, they have at least ensured that the weeks of long discussion and cacophony of statements have come to an end. And right on time! There is after all a cold anti-European wind blowing across the old continent today, something of which until recently, only the most fervent Eurosceptics could only dream of. In fact this is not surprising. "*No euro for the Greeks*" is the perfect (populist) slogan, but it completely misses the point. Nobody will deny that the Greeks will have to take extreme measures and undergo tough reforms. Furthermore, the fact that they will have to do it themselves, is not a point of discussion; no one will tell the German chancellor she is wrong in that perspective. But in the end, what the Greeks truly need is a tool that allows their loans to be placed at a reasonable interest rate. If not, their hard work and efforts will only benefit banks and other financial institutions. This tool should be a European tool because only Europe has the necessary liquidity and credibility required. In short, what Greece needs, is neither compassion or money. Rather, it needs the possibility to use the good name and reputation of the euro for their government securities, while waiting for the recovery of their own credibility and credit-worthiness.

The need for three kinds of reforms:

The worst mistake we can make at this stage is to assume that such a tool will close the deal. The Greek crisis has demonstrated once again that in the long term a monetary union without an economic and political union is not sustainable. Reform is necessary with a threefold objective. First we need to make sure that the Stability and Growth Pact is enforceable. Secondly a competitive economic strategy needs to be elaborated to ensure that the economies of the Member States grow closer to one another, in other words, converge instead of diverge. Thirdly, we need to create a common bondmarket which will keep the cost of governments and business as low as possible. These three objectives should be translated into three radical reforms on which we should start working today, in order to be prepared when the next (monetary) thunderstorm announces itself.

The creation of a European Monetary Fund (EMF).

The first and most imperative task is no doubt the creation of a European Monetary Fund under the model described in the Gros/Mayer-proposal (*). If we do not want the Greek tragedy to repeat itself, and at the same time avert the contamination of the entire euro area, it is necessary to create a fund that supervises the financial stability of the euro area, and can finance and impose adjustment programs on Member States that fail to deliver.

The budget of 20 billion, necessary to launch this EMF, can be raised by the eurozone countries in respect to their GDP. Just like the IMF, the EMF can refinance itself through its borrowing business. However, in order to sanction non-compliance for the countries that do not adhere to the criteria of the Stability and Growth Pact, that is

either having an excessive deficit, or a heavy debt, or even both, there should be a supplementary annual contribution. These can amount up to 1 % of the stock of excess debt which is defined as the difference between the actual level of public debt (at the end of the previous year and the Maastricht limit of 60% of GDP) and 1% of the excessive deficit, i.e. the amount of the deficit for a given year that exceeds the Maastricht limit of 3% of GDP.

Any member state could call on the EMF funds up to the amount it has deposited in the past (including interest). Should a country, however, need additional resources or guarantees, it shall have to accept a tailor made reform program which the European Commission would supervise. If a member state does not wish to comply, it would be excluded from the structural funds within the EU.

The launch of a "Euro Bond Market" (EBM).

As imperative as the creation of the EMF, is the launch of a common eurobond market (EBM) within the eurozone. It is perhaps the only way to reduce the so-called bond spreads to pre-crisis levels and to simplify the way Member States have access to funds. One must ensure however that the EBM does not remove the incentives in many countries to put their house in order. Moreover, should one prevent such a joint issuance of bonds, it will result in making countries with sound public finances pay for member States with unsound budgetary policies or questionable budget control.

To prevent this, we need to choose a two-step approach. The first stage follows roughly the De Grauwe / Moesen model (**). The issuing is done in a common way, according to the share of each country in the EIB. The interest rate on the bond would be a weighed average of the yields observed in each government bond market at the moment of issue. The proceeds of the issue would be channelled to each government, but each government would pay the yearly interest rate on its part of the bond, using the same national interest rates used to compute the average rate on the bond. The advantage for smaller Member States would be easier access to international funding. The overall advantage would be the creation of a bond market with sufficient size to attract large investors, such as China, leading to a liquidity premium that would benefit all Member States.

Once the spreads have been reduced to the pre-crisis level (and that means less than thirty basis points for bonds with a period of ten years), the second phase can be implemented. In this phase, 40% of the total public debt or the allowed public debt according to the Treaty of Maastricht (60% of GDP) can be brought together in one common bond market. This common debt should be legally superior to all other debts issued by a country, while the European Commission has the possibility to deny access to the common eurobond market, to member states that don't take the Maastricht criteria seriously

The main advantage of this dual approach is that it creates the certainty that Germany will receive more for its bonds than they do now. Moreover, it ensures that countries will benefit from a reduction of their interest rates because of the increased liquidity that the EBD will create.

The development of economic governance in the eurozone.

However necessary, the creation of a European Monetary Fund (EMF) and a euro bond (EBM) are, they are still insufficient. Besides the monetary pillar, the eurozone lacks a real economic political pillar, that is a body that determines economic policy and makes sure member states adhere to this policy. Unfortunately, that is not what the European Council has in mind. What is said to be the 'Europe 2020' strategy is nothing more than a new shiny rap around the old "Lisbon Strategy", a strategy that has failed miserably during last ten years. 'Europe 2020' did not abandon the open method of coordination in which an exchange of best practices and peer pressure should encourage Member States to adapt and adjust their economic and social policies. However, there is little reason to believe that this approach will be more successful under the name Europe 2020, than it has under the old "Lisbon Strategy". Moreover, the current proposal gives the control over the implementation of the new strategy into the hands of the European Council. It is truly nonsense to think that the European Council can play that role. The past has proven repeatedly that Member States will not supervise and rebuke one another.

Hence the need to get rid of this 'open method' of coordination and launch a new strategy, a true "economic governance" that puts the European Commission in charge. This is absolutely necessary because the failure or success of the new strategy depends on the existence of an impartial actor to steer the Member States in the right direction. More over should the Commission receive the assignment to come forward with a common European economic orientation policy, based on reform projects for individual countries. The new strategy should also be linked to the budget and the allocation of structural funds. In other wors, the strategy should foresee 'sticks and carrots'. This means additional structural funds for Member States who deliver credible action plan and results, but at the same time financial penalties for Member States that do not comply with the strategy.

This new economic strategy should not be based on the lowest common denominator. On the contrary, the strategy should encourage Member States to form groups of countries to spearhead progress in the Internal Market. New instruments, such as 'sunrise clauses' should ensure that the internal market laws of the Union enter automatically into force in the case where Member States do not transpose them in time. Finally one single European supervisor is necessary if financial supervision is to be strengthened.

A binding assignment for the European Commission.

It is true that most countries have shown little or no enthusiasm for such reform. This is unfortunate, but not insurmountable. It is after all the European Commission who has the right of initiative. It is up to the Commission and no one else to judge the usefulness and desirability of these reforms. Once the EC has put forth such a proposal to the European Council, there is not a single head of government who can neglect it and at least partially accept it. It is the strategy Jacques Delors used when he successfully created the single market and introduced the euro.

One objection that the Member States cannot make is that these reforms are not in compliance with the Treaty. The new Lisbon Treaty in this respect is crystal clear. While Art. 121 describes the role of the European Council in this area, it appropriates,

in addition with Articles 122, 136, 172, 173 and 194, the European Commission with the task of coordinating economic reform and action plans, and of forging a common strategy. For the creation of a common bond market or a European Monetary Fund, there are hardly any legal obstacles to be found. Article 352 of the Treaty allows the Council to take up any new initiative not foreseen in the Treaty. And if the Council does not find the required unanimity for such an initiative, there is always the possibility of enhanced collaboration within the provisions of the Convention (art.20) or beyond.

In any case, the European Union and the eurozone needs to act swiftly and concretely! It's no longer sufficient to make minor changes. On the contrary, it´s time to be courageous and draw conclusions from the financial, economic and Greek crisis. It is five to midnight!. If we don't act now, we will end up playing second league, and no longer with the big boys like the US and Asian countries, just as Dominique Strauss Kahn expressed recently.

(*) Gros, Daniel / Mayer, Thomas, "How to deal with sovereign default in Europe", CEPS Policy Brief No.202, February 2010

(**) De Grauwe, Paul / Moesen, Wim, "Gains for all: a proposal for a common Euro bond", International Economics, May / June 2009