FONDATION ROBERT SCHUMAN

INTERVIEW WITH JEAN-PAUL BETBÈZE

European interview
n°65
29th May 2012

«We must avoid Greece leaving the euro zone»

Interview with Jean-Paul Betbèze, chief economist and director of economic studies at Crédit Agricole SA, member of the Economic Analysis board. He is also a member of the Scientific Committee at the Robert Schuman Foundation.

1. How do we avoid – and should we avoid? – Greece leaving the euro? What would be the consequences? For Greece? For the euro zone? For the European Union?

Yes, we must avoid Greece leaving the euro zone, not just for Greece, but for the euro zone itself. For Greece it's obvious: exit would in fact mean massive devaluation of the drachma, by say 50%, with the immediate effect of increasing the price of imported goods, but without being at all sure that Greece could export as much, and as quickly, in view of its markets. Tourism could of course bounce back quickly, because the fall in the currency could to a large part be translated into a fall in prices, but the country should not, of course, present any kind of risk in the eyes of holidaymakers. As for export capacities, these indeed would presume that since Greek products became less expensive, they would find buyers, but beforehand that businesses would have to be able to resist the shock. And this is not necessarily be the case in view of the weakness of the industrial fabric and the weakness of the banks. The risk in fact is that of a very strong depression, stronger than the «usual» play of devaluation, which "normally" presupposes gains at export that are higher than the extra cost of imported products and legitimates the devaluation.

But it should be added that this Greek shock, in addition to its direct cost for other members of the zone, linked to guarantees and loans, is above all a cost in terms of credibility. The euro zone has in fact regrouped around Greece; yes, it has taken its time, it has done so insufficiently, but all the same it has regrouped. And it has committed itself. How can we be assured that tomorrow, or the day after, it will be more efficient in protecting another economy, should it be found to be under pressure, another economy that will surely be less fragile, but which will be larger?

2. What are the possible scenarios and what should be done to avoid the worst?

In a general way, Greece is suffering because the euro zone is suffering. We should therefore of course be dealing with Greece but we should also be reinforcing the euro zone as a whole. To do so the crisis exit strategy that is being suggested must be affirmed and fine-tuned still further.

Affirmed first and foremost, since this is a crisis exit through and with growth, with deep restructuring of the industrial fabric in each country, highlighting the benefits offered by the single market. At the same time, these growth strategies must go alongside reductions in budgetary deficits, all of which taking place at the same time. Presented in this way, this is a dangerous strategy because it does not offer any space for freedom. When a given economy, for example, has to deal with a public debt shock or a banking crisis, or even a crisis in terms of competitiveness, it generally devalues its currency. The increase in growth that it gains in doing so (supposing of course that the economic context is buoyant, i.e. that we were not entering an exchange war phase, and that salaries follow only after a delay, and partially) enables a reduction in the cost of banking and/or public adjustments. What is happening in the euro zone is that each country, with the exception of Germany, has its own budgetary problem, plus a banking problem, plus a problem with competitiveness. They are not all of equal seriousness, depending on the country, but they are all present, in the knowledge that individual devaluation is impossible and that the economic environment is not buoyant.

Within this context, only a combined adjustment, by country and between countries, which extends the duration of the adjustment, which organises a weakening of the currency and which allows, subject to certain conditions, further debt but debt which would carry growth with it, opens the way ahead.
Fine-tuning must follow because it is a highly integrated strategy that is required, combining public modernisation and wage moderation by country and between countries, spreading it out over time with the support of specific finance. Debt to reduce debt? Yes, if and only if it increases potential production. Whence the idea of project bonds, specifically linked to a given project, a project whose creation would enable, precisely, the reimbursement of the bond.
These general programmes must therefore be supported by better coordinated policies, with a clearer commitment by partners in the zone, within the context of greater integration. In short, a bit more of everything. One may find this way to be too «intermediate», too «centrist», too «one size fits all»! But let us not forget that, in order to work, it is essential for certain lines to move more definitely. In addition to the parity of the euro, specifically set out as being a major part of the solution, the euro zone must also express its feelings in terms of the banking models. Thus, if one understands the importance of equity as a buffer for banks, it is counterproductive to want to increase it at the very time when one wants the banks to play a greater part in financing the economy… when the economy is so weak. The same goes for insurance company ratios which are pushing the latter to get rid of shares, thus contributing to the falls in stock markets.
But more profoundly, whilst highlighting this intermediate scenario, which uses all the levers and therefore requires an effort by everyone, nothing is possible without a real explanation of the stakes involved. Europe and the euro zone is indeed well liked, but our fellow citizens do not properly understand the efforts they need to make in order to get through these trials. They thought that it was protecting them and that is precisely what happened, the euro zone protected from adjustments, enabling debt at rates that were too low, and therefore enabling too much debt, up until the truth came out. To «avoid the worst» we must begin a global strategy and explain it, as never before, guarding against the populisms that always emerge in times of crisis.

3. Does the state of Spanish banks represent a threat in the short term? Or in the medium term?

Spanish banks are actually highly diverse, from major international banks down to regional savings banks, victims of the property bubble. It is with these banks that the problem lies, in other words the problems of valuing of their assets, sell-offs to discharge debt, at a loss of course, followed by the necessary concentrations and recapitalisations. Confidence, which is so decisive, will only return on these conditions. Otherwise the sector as a whole will remain under pressure, with the effects of these questions on growth and private employment. The important and positive point is that wage adjustment (downwards) has supported exports by Spanish businesses. This has not yet been sufficiently taken into account by the markets, which are polarised on the question of the savings banks.

4. Does the «support for growth» called for by the new French President represent a real route for getting out of the austerity/recession spiral?

Again, everyone wants growth but not everyone defines it in the same way. In the current situation we should be speaking of potential growth, of the capacity to produce more, profitably, in order to benefit more from world growth and thus support private growth and reimburse public debt. Support for growth is therefore mainly private, involving the competitiveness of businesses, which needs further reinforcement, along with a social dialogue which must be developed. When one compares growth through demand with growth through offer, it is clear that they are actually linked, because it is growth through offer that must be sufficiently powerful to support employment and thus demand. The «great works» have no meaning unless they work towards this increase in potential growth. It is offer which creates demand. It is profitable offer which creates solvent, profitable demand. It is profitable offer which legitimises possible further debt.

5. In you opinion what should be (could be) the components of a growth pact for the European Union?

Clearly the lines will have to move and adjustments will have to be found. Restoration of confidence is decisive and therefore the politicians must intervene, alongside the European Central Bank. Financial commitments must already be implemented to serve the banking and financial systems, the funds collected by States must, under restructuring conditions, enable recapitalisation of banks that are currently under pressure, notably in Spain. The ECB must bring its rates down and send the message that it is ready, if necessary, for another LTRO [1]. But it must be clear that this new structure to be created involves stronger integration of the economies, with commitments to be made, combined with stricter verification conditions. The «growth pact» is, in reality, a pact of joint responsibility.

Jean-Paul Betbèze

Chief economist and director of economic studies at Crédit Agricole SA, member of the Economic Analysis board. He is also a member of the Scientific Committee at the Robert Schuman Foundation.

1. LTRO: Long Term Refinancing Operation. The author is referring here to an operation that would be similar to the two loans granted by the ECB to several hundreds of European banks, in December 2011 and February 2012, representing a total amount of almost € 1000 billion, with a 3 year term.

See all of our publications on our site:
www.robert-schuman.eu

Publishing director : Pascale JOANNIN