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The four big dilemmas of the European Union

European leaders are fiercely debating a possible agreement in their efforts to save the euro and prevent the Union from falling back into recession. Although the issues that the EU faces seem complex and are disguised in overlap, they can be summarized by the following main arguments: borrowers vs lenders; austerity vs growth; discipline vs solidarity; Europe vs the nations.

Borrowers vs Lenders

The European Union, like the US, has a large amount of accrued debt, held by the government and the private sector, which has in large part become impossible to repay. The real issue then is what gets written off and who takes the hit. Although the eurozone is heavily exposed, it would be far more manageable if the debt was equally distributed; this is not the case. Southern states, such as Greece, have been near collapse. Private sector lenders in October had agreed to write down their Greek debt holdings by half. It will be hard to repeat this in the future, although Portugal, Ireland, and Spain may follow suit. This has led to a loss of confidence in the European banking system. Banks have been called to increase their capital by more than 100bn euro, which may not be possible without government intervention. Germany and other less indebted countries may have to bear the costs and bail out the failing institutions and governments.

Austerity vs growth

Most European governments have rapidly increased their borrowing during this recession, but due to fears over the southern governments' ability to repay, the cost of borrowing has increased dramatically. Pressured by Germany and the European Central Bank, painful austerity measures have been implemented by these governments. Germany has said it will eliminate its own small deficit by 2013, but this push for austerity is destroying any potential for growth. This decrease in revenue has made it harder for government to cut their borrowing and get on a sustainable path. The ECB will most likely cut interest rates, below their current 1.5%, and buy up more Italian and Spanish debt to decrease borrowing costs. Germany as the host of the ECB do not agree with such a move. Though highly unlikely due

to cultural differences, another option is for Germany and the other countries that markets will still lend to ncrease their borrowing and thus spending to offset the cuts in the South.

Diverging fortunes - 10-year government bond yields	
Germany	2.05%
France	2.83%
Spain	4.95%
Italy	5.56%
Ireland	7.41%
Portugal	10.80%
Greece	22.14%

Discipline vs Solidarity

Germany's position in this crisis is obvious: the reckless borrowing by the Southern countries during times of cheap interest rates led to the enormity of the crisis. They want to impose strict budget rules to avoid such irresponsibility in the future by ingraining it into Member state constitutions. This seems doomed to fail. This "stability pact", already proposed with the euro's creation, was quickly broken by Germany herself. It also misses the key issue: the Southern states differ. Greece had lied to gain entry into the euro, which may justify Germany's position; but not for Spain. Pre-crisis Spain had lower debt than Germany and even had higher revenue than spending. When the property bubble burst, it caused major consequences for the entire economy: uncompetitive wages and 20% unemployment and because of the euro, they could not devalue to gain a competitive advantage. These localized problems could be dealt with if there was a centralised fiscal authority, more akin to a federation like the US. Although in that system, Germany would still foot the larger part of the bill.

Europe vs the Nations

The argument seems to boil down to one of Germany versus the Southern states. German voters simply do not understand why the South cannot keep its finances under control as they were able to achieve large growth after the turmoil of the Second World War with prudent finances. The problem is that if Germany does not come to the South's aid, its own economy would be at a loss. Not only does it hold much of their debt, as do the French, but their export driven economy would falter; not to mention the possibility of states leaving the Eurozone causing unknown consequences. The Southern states would be at an ever greater loss.

The major problem is that since the European project's inception, nobody has spoken for Europe. Seemingly competing national interests and back room deals have hampered progress, which is only worse at a time of crisis. Any changes to the Treaty would need to be agreed by the 17 eurozone governments and then ratified by the 17 parliaments; a slow process, during which markets lose even more confidence, undermining any chance of finding a solution. The European Commission president, Jose Manuel Barroso, has attempted to bring unity and leadership, advocating for a greater role for the European Commission. As a political appointee, he can and has been largely ignored by the leaders of

the Member States. Perhaps as an elected leader he could have more sway with the public, who could then pressure national governments to agree to a common European solution. As it stands now though, this is not the case. Ultimately, there may not exist a workable solution to this political, rather than economic, dilemma.

Relevant links

- Bloomberg - Government bond yields

<http://www.bloomberg.com/markets/rates-bonds/government-bonds/uk/>

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