

Resolving Europe's economic dilemma will require more than sleight of hand

[Agenda]

BY IRWIN STELZER



U.S. President Harry Truman, weary of hearing his economists conclude "on the one hand, but then on the other hand," famously asked for a one-armed economist. He's fortunate he never found one. For any economist who feels certain about his reading of the economic tea leaves, who sees no "other hand," is, to put it mildly, more than a little overconfident.

All by way of excuse for this attempt to figure out just what is going on in the European Union and euroland.

On the one hand, things are brighter than they were last year, when the areas' economies were contracting at a rapid rate. No one is expecting that dismal performance to be repeated this year or next. But on the other, neither is anyone expecting anything like satisfactory growth. The Economist Intelligence Unit is guessing that growth will be at an annual rate of 1.0% and 1.1%, this year and in 2011, respectively.

The move out of recession is the result of an increase in exports. On the one hand that's good news: Otherwise, the EU economies would continue to shrink. But on the other hand, some of the increased exports, especially those from Germany to other euro-zone countries, are exacerbating serious imbalances. Germany's trade surplus with its EU partners is causing serious problems, especially for the struggling periphery countries.

"Germany's...trading partners cannot sustain deficits forever," notes the Economist.

Germany's surplus is its EU partners' deficits, which they have to finance by borrowing. And



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borrowing is precisely what Greece and similarly situated countries need less of. Europe needs Germany to base more of its growth on domestic demand, its consumers to start spending and stop paying down debt, neither of which they show signs of doing.

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As Jefferies, the securities and investment-banking firm, points out in its latest report, consumption in Germany comes to only 57% of gross domestic product, compared with closer to 70% in the U.S. and the U.K.

Then there is the news coming out of Berlin, Athens and Brussels. Greece won't cut spending unless it is guaranteed that its euro-zone partners will somehow enable it to borrow at lower interest rates. Otherwise, argues Greek Prime Minister George Papandreou, the

property loans. Of those, somewhere between \$220 billion and \$330 billion (estimates vary) are loans to property developers, many of which are in no position to repay. The government says one-third of the cajas are insolvent, and is hoping to solve the problem by organizing mergers with healthy institutions, but is running into opposition from regional politicians, who would much prefer some sort of bailout. If the IMF rescue team heads to Europe it might just as well visit Madrid as Athens, pain-averse Spanish politicians might decide.

All of these problems have driven the euro down from its November peak of around \$1.50 to about \$1.37. With the U.S. economy recovering at a more rapid rate than Europe's, and with the Federal Reserve likely to raise interest rates sooner than the European Central Bank, experts are expecting the euro to continue to weaken against the dollar. On the one hand, this is good news. Europe's exporters now find their goods more competitive in world markets, even against those made in China, which pegs its yuan to the strengthening dollar.

On the other hand, a weaker euro raises the price of imports, especially those, like oil, that are denominated in dollars. That increases the possibility that when the EU economies do start to recover, inflationary pressures will force the European Central Bank to tighten sooner than it might otherwise want to do. On the one hand, that is good news: It would contain inflation. On the other hand, it's bad news: It would slow the recovery.

All proof that Harry Truman was wishing for something that just doesn't exist.

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