A pile of euro coins. ACN

PENNIES FROM HEAVEN

TRIBUNE
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Of all the indictments ever hurled against the Euro perhaps the sharpest was made by Margaret Thatcher thirty years ago. Her memoirs describe a conversation in summer 1990 where she tried to convince John Major (who would become her successor as British Premier) that, in a monetary union, "Germany and France would finish up paying all the regional subventions that the poorer countries would insist upon if they were going to lose their ability to compete on the basis of a currency that reflected their economic performance." Hence, she thought, "we had arguments which might persuade both the Germans - who would be worried about the weakening of anti-inflation policies – and the poorer countries – who must be told that they would not be bailed out of the consequences of a single currency, which would therefore devastate their inefficient economies."

Her predictions were not far off. When the Eurozone crisis burst in 2010, the usual suspects (those unflatteringly known as PIGS: Portugal, Italy, Greece, Spain) had indeed lost competitiveness during the boom years and, within the Euro, could not regain it through devaluation. Others also got into trouble: Ireland even required a bailout when its government assumed its banks' liabilities, and Finland's output dropped sharply too – but both were fundamentally healthy economies and rebound in due course. Ireland in particular proved to be an exemplary pupil, carrying out almost from day one, with impressive results, the reforms demanded by the so-called "Troika" (European Commission, ECB and IMF). The PIGS' low institutional quality, conversely, made them incapable of taking the measures required, and the Troika, after adopting a tough stance in the first years, from mid-2012 gradually relented and became increasingly lenient.

Why? For two reasons. First, it became apparent that the financial malaise was too widespread, and several large economies (Spain, Italy and potentially France) were tottering near the pit, so the ECB had to set to work the money-printing press to pay for everyone's way out of trouble (remember Mario Draghi's famous "whatever it takes"). Second, and more insidiously, because the inflation that, analysts feared, monetary expansion would bring never came, so money printing became a costless boon, a theft without victims… Inflation did not appear because globalisation brought cheap products from emerging economies while undermining local trade union's negotiating power, and also because the fears of banks, consumers and investors made them reluctant to give or take credit, thus limiting money's impact on prices… When something works, it is tempting to keep using it, so the ECB's daring reached unheard-of heights, like setting negative interest rates – i.e., paying borrowers for borrowing (!). It was also a useful political tool: on October 2, 2017, for example, the Catalan independence referendum's success raised Spanish debt's risk premium sharply – yet, almost immediately, the ECB made massive purchases to bring it down.

Then the pandemic came, and the money-printing machine was put to work like never before: today, for example, the sum of Spanish government and banks' debt the ECB holds represents 68% of Spain's GDP (who says the ECB is stingy?!). Yet the exceptional circumstances that enabled such profligacy must eventually come to an end.As Milton Friedman wrote half a century ago, "inflation is always and everywhere a monetary phenomenon." When inflation finally takes off, its first victims will be Europe's "frugal" economies – Germany, Netherlands, Finland... Will they then still be happy to finance those Mediterranean economies that are never able to get their act together? If not, expect major shake-ups in countries that, like Spain, systematically rely on European generosity to keep their elites fat and popular discontent at bay.