

If You Insist on Keeping The Euro

It is irrational to establish or maintain a common currency in Europe. If, however, the decision was based on ideology, then the policies designed to hold together the cracked and bursting union are misguided. Many of the Eurozone's countries are insolvent to the extent that every bond they issue must be considered a PIK. These countries will surely face higher refinancing costs as investors flee and traders attack.

Each country has now been put on notice that some form of austerity and reform is necessary. Both austerity and reform are nice words for nasty things. Without a currency to make the price adjustments, domestic factor prices, such as wages, must bear the brunt.

As desperation and internal politics, not least an unruly public, drives countries to the brink, discipline needs to be instilled.

The Spanish bank bailout was ill advised. Any bailout is ill advised. At this point bailing any country out will only encourage solvent or marginal economies to seek a bailout or at best renege on their fiscal responsibilities.

An opportunity exist(ed) in Greece. Here is an economy which is not sufficiently integrated into the core Eurozone that its ejection would cause the minimum (of any other Eurozone country) of chaos.

A single exit is necessary (and may not be sufficient) to hold the union together. Greece is a convenient candidate. It should be forcibly removed from the union and denied any bailouts or transfers. The indictment of Greece will serve as a stern signal to Spain, Italy and Ireland, that non-compliance and fiscal irresponsibility has a high price. That price must be sufficiently high to compensate for the contagion risk associated with the ejection of a member state.

Following such drastic action, a more measured approach can be taken to cementing the union. Fiscal union or a banking union will need to be established. That is another long and painful discussion.