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Financial crisis will force EU nations closer than ever

Editor's Note:
The eurozone was rocked by the impact of the 2008 financial crisis, which left the economies of three EU nations, Portugal, Greece, and Ireland, in disarray, and others struggling to cope with the aftermath. Will the crisis push the EU closer together, or drive it apart? What measures can it take to avoid future catastrophes? London-based Global Times (**GT**)reporter Sun Wei talked to Iain Begg (**Begg**), a professorial research fellow at the European Institute of the LSE, Tanja A. Börzel (**Börzel**), Jean Monnet chair and director of the Center for European Integration at the Freie Universität Berlin, and Graham Bishop (**Bishop**), a leading independent financial analyst who has advised the UK and European parliaments, and author of *The EU Fiscal Crisis: Forcing Eurozone Political Union in 2011?* on these issues.

Graham Bishop

Tanja A. Börzel

Iain Begg

DIALOGUE

GT: At the initial phase of the current financial crisis, it was widely held that the crisis proved the necessity of European integration because of the joint bailout plan. However, with the sovereignty debt crisis deepening, there are more worries about the future of integration. How do you view the prospect of further European integration?
Börzel: The crisis has clearly shown that there is a need for further political integration, which is widely acknowledged.

The problem is that the political will to transfer further sovereignty rights from the member states to the EU is limited when it comes to fiscal, economic, and budgetary issues. The member states will try to work within the Lisbon treaty to strengthen and enhance cooperation and coordination on these issues.
Bishop: In 2010, we saw a series of reviews of the role of the single market during the period of extreme financial turbulence. At one level, it could have been argued that the single market in both money and financial services had allowed financial shocks to be transmitted from one country to another.

However, the comparison with the economic shocks, after, for instance, the oil crisis of 1974 showed clearly that shocks would be transmitted one way or another. Then, it was sharp currency devaluations and dramatic changes in interest rates as well as budgets.

This time round, there was not even any discussion about the relative merits of maintaining the single market, and the collective decision of the member states was to proceed rapidly in 2011 to deepen it, in many and detailed ways. This process will steadily cement the collective influence of Europe as a whole.

GT: How can the conflicts between the EU's monetary policy and fiscal policy be solved, and sovereign debt crises avoided?
Börzel: The problem is that we have a highly centralized currency policy on the one hand, and we have a very low degree of integration when it comes to economic policy. There is a currency union but not an economic union. The gap in the EU is between economic and currency policies. That's not a conflict. It is more a question of where the power resides to take decisions.

One is for the EU and one is for the member states. The member states need to strengthen their cooperation at the European level, in order to avoid the problems we have in the past.
Begg: It's true that there have been quite profound changes in governance agreed. The trouble is that they will take a year or two to become fully adopted, and in that period there will still be vulnerabilities, especially Portugal. But I think if Portugal does require a bailout, that will be the last one.

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GT: Investor George Soros has warned that the collapse of the euro cannot be ruled out. Do you agree?
Börzel: The collapse of the euro is nonsense. When you look at it internally, the euro is doing OK. Externally, the euro is a stable currency regarding the currency rate with the dollar. There is no euro crisis, but instead a crisis in several euro countries. Exiting the eurozone is not a solution either economically nor politically.

What we have to do is to first make countries reform their economy. In the case of Ireland, it is about the banking sector and banking regulation. Second, find mechanisms to prevent individual countries from going into crisis, and spreading to the rest of Europe.
Bishop: Collapse cannot be ruled out entirely and the EU may have to get perilously close to it to realize just what that would do to its economies and decide that it is better to stick together and resolve the problems.

Once that is accepted, there is no provision in the existing treaties that enable a state to leave the euro. However, it can leave the EU and achieve the goal of leaving the eurozone indirectly. But the consequences of leaving the EU would be dramatic, especially for the poorer, peripheral states that receive large transfers from the EU.

GT: China is buying more European sovereign debts. Will this affect the relationship between China and the EU?
Börzel: Some people argue that by buying European sovereign debts, China is building up its political influence in a way that will put the country in a position to make order. But I think the relationship between China and the EU is mostly based on economic cooperation.

China is a huge future market. There are strong economic interests on both sides to engage in closer cooperation. I don't see any major change in the relationship between China and EU, because China has always been a very important trading partner of the EU.
Bishop: At the end of the crisis, the eurozone will have emerged as a political federation, loose in some respects, but with tightly centralized economic governance at its heart. The proven commitment to fiscal probity may even make it attractive relative to alternative investments around the world.

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In three years or so the eurozone current account surplus and aggregate budget deficit will be below 3 percent of GDP, along with falling public debt ratio and with significantly rising competitiveness. There is another currency area with a budget deficit twice that of the EU, rising debt ratios and over $1 trillion deficit. Which currency would China prefer to hold?

GT: Some other regions are also considering regional integration. For example, the former Japanese prime minister Yukio Hatoyama has proposed East Asia Community. what lessons can they learn from the current challenges faced by European integration?
Börzel: Interesting enough, if you look at the trade flows in East Asia, particularly in Northeast Asia, it is one of the most integrated regions in the world. At the same time it has very few and weak institutions compared to the EU.

Asian countries are always reluctant to yield significant powers to reach institutions.

However, after the financial crisis, Japan and South Korea, historically reluctant to engage in regional cooperation, have called for more regional cooperation, because they realized that institutions like APEC don't really help in addressing the crisis.

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Begg: It is important to recognize that the many levels of European integration and the construction of the EU took decades, proceeding by increments.

One lesson may be that if East Asia aspires to a currency union, it will be important to identify and create the complementary political institutions needed to make such a currency work. Europe is now creating a "model 2" form of economic governance to overcome some of the shortcomings exposed by the crisis of the last year. Asia should study these.
Bishop: The key driver of European economic integration is the need for a political imperative that transcends feelings about national sovereignty.

For Europe that imperative was supplied by World War I and World War II which now feel more like a civil war in two parts that lasted for half a century. The feeling among all those who experienced such events was that there must be a better way of organizing relations with the neighbors.

GT: What do you think are the major challenges and obstacles for European policymakers?
Bishop: A critical flaw in the current discipline process is the market's recognition that the EU's political class has failed to impose, let alone enforce, any sanctions during the first decade of the monetary union.

The crisis has now delivered a powerful stick and carrot that, if properly applied, could provide that certainty of genuine sanctions that will restore confidence. The eurozone will emerge from the financial crisis as a political federation.