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Gummed up

Europe's leaders need to rediscover the resolve they showed during the euro crisis

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IT WAS just like old times. On October 16th, almost five years to the day after Greece's government triggered the euro crisis by confessing that its budget deficit was twice as big as had previously been reported, yields on Greek ten-year debt rose to 9%, and share prices tumbled. Long-suppressed memories of bail-outs, late-night summits and market meltdowns briefly resurfaced. Perhaps the crisis wasn't over after all?

The panic soon subsided. Investors' concerns were limited to political uncertainty in Greece, and a plan by the country's embattled prime minister, Antonis Samaras, to exit its IMF bail-out programme early. Greece remains the runt of the euro-zone litter, labouring under a debt pile equivalent to 175% of GDP and a sky-high unemployment rate. But there are slivers of light: after six grinding years of recession, it may grow modestly this year. Elsewhere, too, the champions of austerity have found cause for cheer: unemployment is down and output up (a bit) in Spain and Portugal; Ireland, which had to be bailed out in 2010, seems to be experiencing a mini-boom. Even France and Italy appear finally to have accepted the need to reform.

The overall picture, though, remains bleak: growth prospects are dismal and unemployment within the euro area stands at 11.5%. What to do? Rather like the quest for peace in the Middle East, everyone knows what to aim for but no one knows how to get there. France and Italy need to cut red tape and ease their labour laws, in exchange for more time to get their budgets in shape. The Germans need to invest at home, and not to stand in the way of the European Central Bank moving towards quantitative easing (printing money to buy sovereign debt).

But such moves need political and economic co-ordination, and trust is in short supply. The Germans have lost patience with the French, who are wary of being lumped in with the Italians, who think the German obsession with fiscal rigour in a time of recession absurd. Small countries resent big-country stitch-ups (another, on the French budget, looks imminent). Mario Draghi's accommodating stance at the ECB is testing the patience of German politicians and constitutional judges, and inaction at national level will anyway dull the effects of monetary activism.

The machine is not entirely gummed up. The international chorus urging Germany to loosen up a bit may be getting through; this week the German and French finance ministers said they would present a growth and investment plan by December, though they gave no details. The Poles think they are making headway with a proposed €700 billion ($894 billion) pan-European investment fund, and Jean-Claude Juncker, the incoming president of the European Commission, will soon present his own ideas. But Europe has never lacked for grand investment plans; it is the will to execute them that has been in short supply.

The smack of firm bond yields

One way to understand the impasse is to look at the lessons that governments drew from the wrenching years of the euro crisis. Rather than rely on flaky politicians and spendthrift central bankers, Germans and others found the iron rod of the market the most effective means to bring discipline to the wayward. It was spiralling bond yields, not bunga-bunga scandals or legal troubles, that rid them of the troublesome Silvio Berlusconi in 2011. Greece, Ireland and Portugal reformed their economies, and trimmed their budgets, only under the whip of international supervision after being forced into bail-outs. Even in these "programme" countries some officials acknowledge, *sotto voce*, that they would have struggled to make such changes in calmer times.

For a supposedly slow-moving place, the European Union has shown that in the teeth of crisis it can transform its machinery at great haste. Vast bail-out funds have been engineered, rule books torn up and rewritten, sovereign debt restructured. Many predicted the euro could not survive. In 2012 Angela Merkel, Germany's chancellor, and her advisers indeed considered cutting Greece loose, but ultimately determined that the currency must remain intact. Here there has been no lack of political will, of a sort.

Yet it has evaporated as the crisis has subsided and economies have stagnated. Europe today lacks leadership. Mrs Merkel holds power but does not wield it. Her fellow heads of government are diminished figures, struggling to navigate their own fractured domestic political terrain. The heyday of the installed functionaries in Brussels appears to have been about 20 years ago. Mr Draghi has shown courage but represents no one. And populists are rising to plug the political vacuum, in both creditor and debtor countries. Syriza, a hard-left party that wishes to stiff creditors, may win power in Greece next year. If that happens, the market will probably panic again.

As with everything in Europe these days, change must come first from Germany. Its (slight) softening on investment is welcome. But more is needed. Officials are wary of an Italian proposal to exclude investment spending from the figures used to calculate budget deficits. But such a change would allow governments to exploit low borrowing costs to earn later returns without falling foul of Brussels's rules. **Another idea, proposed by the Lisbon Council, a think-tank, is for the new European Commission to identify reforms needed across euro-zone members, rather than pick on the usual suspects. As a start, it proposes that 11 countries jointly tackle their job-killing labour taxes.**

Europe did well to hold together through the crisis years, but its failures are apparent: a jobless army 25m strong; millions more underemployed. Such numbers do not seem to galvanise politicians the same way bond yields at 7% do. "We are last-chance Europe," Mr Juncker told MEPs this week before they approved his new commission. But not everyone sees it that way.

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