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Post-Greek Crisis Reform of the Eurozone: Competitiveness on the Sidelines

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The difficult situation in Greece has accelerated reform of the eurozone towards an austerity profile of coordinated fiscal policy and the strengthening of the Stability and Growth Pact. So far, however, the changes are weak on measures to promote structural reforms. Poland, as a candidate for member of the common currency area, should support solutions that build lasting competitiveness in the Economic and Monetary Union.

Five years on from the beginning of the rescue plan for Greece, the architecture of the euro area has changed with the creation of financial assistance funds, tightening of economic governance, strengthening of the Stability and Growth Pact (SGP) and the institutionalisation of crisis management actions in the banking sector. The crisis in the southern European countries caused by excessive debt and lack of structural reforms has highlighted the existence of similar (though smaller) problems in the eurozone. It also pointed to the low stability of the eurozone caused by the unsustainable macroeconomic policies of its members, to its vulnerability to external shocks and to the high economic interdependence of countries. The crisis in Greece and the rest of the south accelerated the implementation of the austerity measures promoted by Germany's vision of economic governance. Successive reforms have not been enough, however, to enable the proper functioning of the economy and it is necessary to strengthen the powers of the zone in terms of competitiveness.

The Direction of Reforms. In response to the crisis, the most important change in the functioning of the euro area has been the institutional strengthening of the SGP and, connected with it, the emphasis on austerity policies. At the same time, EU institutions have much more closely coordinated macroeconomic policies through the community's Macroeconomic Imbalance Procedure (part of the so-called six-pack), which is synchronised with the annual cycle of coordinating national economic policies (i.e., the European Semester). Simply institutionalizing the coordination of macroeconomic policies of the eurozone countries is not sufficient, however, to maintain the stability of the common currency area, because of the growing risk of insolvency of some of the countries. Therefore, to guarantee the solvency of eurozone countries most at risk of bankruptcy it was necessary to establish a funding vehicle, which is the European Stability Mechanism.

However, even the current austerity reforms, along with institutional reconstruction of the banking system, have not helped the area recover from the crisis. The eurozone's public debt (over 90% of GDP in 2016) and unemployment (over 11%) remain high, and those factors indicate that the current direction of institutional change is not working. These modest results are partly the effect of inadequate emphasis on competitiveness in the reform process.

The Course of Structural Reforms. Currently, there are two proposals for changes in the Economic and Monetary Union to promote improvement in the eurozone countries' capacity to compete. The first is the existing intergovernmental agreement Euro Plus Pact. Although it is ambitious in its content, its real impact is negligible. This is mainly due to the lack of ownership of the project. Under the agreement, a state pledges to reform its national economic policies using the open method of coordination involving peer pressure for reforms.

In reality, however, few countries carry out difficult structural reforms and the impact of the pact on the reforms undertaken is small (for example, structural changes in Portugal are mainly a consequence of the receipt of the aid package, not the pact). Low interest in difficult structural reforms encouraged by the pact is primarily due to the local publics' disinterest in enacting such reform, as well as the lack of incentives for countries undertaking the effort. Another weakness is the overlap of the solutions for economic policy coordination with the solutions in other Community mechanisms, for example, in the Excessive Imbalance Procedure, and this further reduces the interest of states in reforming through the pact. Another major deficiency is the lack of an institution that would oversee a country's adaptation to the provisions of this agreement.

The second proposal was expressed in the so-called five presidents' report. It also puts an emphasis on competitiveness, but the changes it proposes—which to a large extent are similar to the provisions of the pact—will be possible only with a treaty change (and therefore the pact has remained an intergovernmental agreement and is not EU law). Without these changes, an extension of the competences of the EU institutions regarding economic policy coordination in the eurozone countries will not take place.

Both solutions include the creation of a system of independent national competitiveness authorities based on the example of existing institutions in Ireland, Belgium and the Netherlands, which exert influence on regulations to improve the productivity of the economy. This proposal is most likely a favour to the UK, which sees issues related to reform of the eurozone as vital if it is to continue to be an important economic partner. The thing that differs in these two proposals is how to include these authorities in the existing framework with the recent changes in economic governance (the European Semester and the Macroeconomic Imbalance Procedure). The five presidents' report assumes a significant role for the EC in surveillance of the competitiveness authorities and the incorporation of their work into the framework of existing mechanisms for coordination of national economic policies, while the Euro Plus Pact, because of its early "birth date" (March 2011), was not seen as part of the broader framework of economic governance in the euro area. Mechanisms such as the European Semester or the legislative package strengthening financial discipline—the six-pack—were created later.

Although the introduction of these authorities, which are supposed to be independent from national governments, can be a step in the right direction, they will not solve the problem of low competitiveness in the southern euro area. The reason for this is that the authorities overseeing competitiveness focus on surveillance of wage adjustments to changes in productivity in the economy. As a result, their efforts are mainly limited to cost controls (wages) at the expense of other elements of the competitiveness equation, for instance, innovation. In addition, the authorities are likely to suggest the need to raise wages rather than reduce them, which can negatively reflect on their competitiveness compared to the rest of the world. Additionally, it is not clear how the eurozone states relying on these authorities' suggestions can raise or lower wages, since enterprises set them individually or on the basis of negotiations between employers and trade unions.

Yet another problem associated with these authorities is their unknown influence on national economic policies. Furthermore, the introduction of these authorities at the national level but coordinated at the euro area level is extremely difficult to comprehend, because the states are not interested in keeping a body that is both independent of them and interferes in the conduct of their economic policy. For the same reason, this solution may eventually be diluted, resulting in these new institutions not having any impact on the economy.

Missing Links. The proposed reforms to improve competitiveness basically ignore one of its key areas, which is redefining the role of the ECB to become similar to the role of the Federal Reserve in the U.S. This would be a move away from controlling inflation to promoting growth. Although the role of the ECB has been gradually evolving towards more active support of the economy since the announcement of "quantitative easing," officially the objective of the institution remains the same: to maintain the euro's value. However, the changes that have already occurred in the ECB's policies enable a start of the discussion on the evolution of the bank's role in stimulating economic growth.

One should note the untapped potential of existing solutions. For example, the Euro Plus Pact could be better integrated into the existing mechanisms of economic coordination, made treaty proper and supported by the EU institutions. This could ensure adequate discipline of economic policy coordination among the eurozone countries to improve their competitiveness. In conjunction with the European Semester, the pact would allow for the creation of a stable framework for enhancing the ability of eurozone countries to compete with the rest of the world. Thus, instead of adopting the new solutions outlined in the five presidents' report, the eurozone would successfully conduct pro-growth policies with the current (but more effective) mechanisms to boost competitiveness.

At this stage of the euro area's institutionalisation of budgetary discipline, Poland should promote competitiveness and distance itself from a further strengthening of austerity policy coordination. In this sense, it should promote such measures as more flexible labour markets (through deregulation of professions or by reducing the tax wedge) or a change in monetary policy to support economic growth more forcefully. A good idea also might be to present a proposal to gather best practices on the flexibility of labour markets in the EU and to compare them with parallel solutions used outside the EU, with an attached feasibility study on the eurozone countries. Then, this collection of best practices could be used within the European Semester to enhance overall competitiveness.