



Europe after the Greek Election, Part II

Jacob Funk Kirkegaard says that while the bond markets remain dubious about Europe, there are signs of progress as Europe stumbles toward fiscal and political union and banking reforms.

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Steve Weisman: Jacob Kirkegaard, research fellow at the Peterson Institute is here with me, Steve Weisman, talking about the latest developments in Europe. We just had a conversation about the prospects of the new Greek government achieving the reforms that the whole world is demanding. Meanwhile, Europe faces problems of the Greek contagion spreading to other parts of the periphery. There has just been a G-20 summit in Mexico, where this was discussed. Has any progress been achieved at that meeting?

Jacob Kirkegaard: I think we should be very realistic about the relatively small amount of leverage that the rest of the G-20, including of course the United States, actually has over European leaders in this issue of creating new euro area institutions. That is essentially a domestic policy issue in Europe. Quite frankly, I don't think they're going to listen to a lot of what other people tell them about that issue.

But I was actually quite positively surprised by the degree of detail on this issue put into the G-20 communiqué. It said very specifically, for instance, that the euro area will—that was the verb used—act to stabilize the European banking system and break the feedback loop between banks and sovereigns. That's the kind of language that certainly, in my opinion, is going to make it a lot more difficult for the euro area to not take more decisive actions on both issues -- the banking sector integration, as well as the longer term fiscal union at the upcoming EU Council meeting on June 28-29. I'm quite optimistic, especially on the banking integration part, that quite substantial progress is going to be announced at that meeting.

Steve Weisman: What's the situation in terms of interest rates reflecting market skepticism about all this?

Jacob Kirkegaard: I think that there is a general degree of market skepticism here, if you look at the bond markets. But on the other hand, you could look at Italian and Spanish yields right now. Italy is just below 6 percent and Spain is just below 7 percent, although they have come down in the last couple of days. But if you look at other markets -- the equity markets, for instance, or the foreign exchange market -- that seems to not necessarily reflect the same level of stress that these do.

Steve Weisman: These markets in Europe?

Jacob Kirkegaard: In Europe, yes. But also in the United States. If you look at the dollar-euro exchange rate, it's been relatively stable. It's down 3 or 4 percent over the year. But it's basically flat, considering the headlines -- the euro is about to collapse in a few months. That has been the case for many months now.

Steve Weisman: A couple of years.

Jacob Kirkegaard: Yes. In my opinion, there are several reasons for why the financial markets, in general, exaggerate the risks associated with the current situation in Europe. First, I think that the

political situation in Europe is a lot more stable than most headlines suggest. We almost daily hear about the threat of populism in Europe. This was definitely a genuine risk in Greece. But in political terms, Greece is outlier in Europe. Greece suffers uniquely from the dual collapse, both of the economy, but also of the established political system, where both traditional ruling parties are discredited as a result of their own corruption and the economic collapse since 2009. But that's not true in other countries in Europe.

If you look at every other election in the periphery, every single time you've actually forcefully rejected available populist alternatives. Instead what electorates in Ireland, Portugal and Spain and arguably even in France have done is, yes, kicked out the incumbent government or President. But then they have put in place a government or a President that is going to follow policies that are very similar. You could say that the European electorate tends to get rid of the person, but they keep the policies in the place. Again, this is very contrary to the situation that we have in the United States, where there is divergence between the Democrats and the Republicans.

The situation in Europe is very, very different. In fact, the political megatrend in Europe is the increasing convergence between the main stream center right and center left parties in almost every European country. Which means that it actually doesn't matter very much. In the case of France, whether [Nicolas] Sarkozy or [Francois] Hollande is President, or whether the UMP [Union for a Popular Movement] or the Socialist Party has a majority in Parliament, on the broader fiscal and social policy issue their programs are very similar. This wasn't true [in the past]. You go back to the last time a Socialist President was elected in France, *François* Mitterrand in 1981. The first thing he did was nationalize all the French banks and a whole lot of other very radical things.

When you have this convergence at the center, it's not surprising that there is more room at both the political extremes, both on the right and on the left. This is important. If you look at the elements that constitute the platforms of every single populist party in Europe, whether it is the National Front in France or the True Friends Party or the Freedom Party in the Netherlands or Austria, they basically have this combination of right wing nationalists and anti-immigration rhetoric, the traditional left wing pro welfare anti-austerity social policies. There's plenty of space for this in the current political environment.

But the reality is that this is not a populist platform that really has much chance, in my opinion, of ever reaching a governing majority. In fact the European political systems are historically very adept at dealing with sizable populist representation in parliaments or at least among the electorates. Remember that the popular vote in the first round of the French parliamentary election for the National Front was bigger in 1997 than it was this year.

Steve Weisman: Yes.

Jacob Kirkegaard: The bottom line is that, considering the economic crisis, and the very significant structural reforms implemented in Europe, in particular the southern periphery, the degree of domestic political stability is actually remarkable. There's no reason to believe that that's going to change fundamentally. European voters are getting old, but they're still rich. They have a lot to lose if they adopt populist policies, like getting out the euro or something like that. I don't think they'll do it.

Steve Weisman: Thanks.

Jacob Kirkegaard: All right, thank you.

