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The beginning of the end

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GLOBAL ECONOMY

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The eurozone crisis has entered a new phase, which will hopefully be the beginning of the end in the long saga of policy interventions to shore up the common currency. A new scenario has been created by the European Central Bank's decision to intervene in the secondary sovereign debt markets and by the German Constitutional Court's verdict validating Germany's contribution to the European Stability Mechanism.

These decisions come in the wake of enormous political pressure from both within and outside the eurozone, and of continuing market woes. The uncertainty surrounding the future of the euro has been substantially reduced, at least for now. Italy and Spain now have breathing room to implement reforms, and the specter of a breakup of the monetary union has receded.

The European Central Bank (ECB) has committed to buying unlimited amounts of its sovereign debt of up to three years' maturity to stabilize the markets and keep risk premiums at manageable levels. This is a bold decision, especially taking into account the adamant opposition of the German Bundesbank. This is the first time that the ECB has made a momentous decision against the will of the very institution that served as its template when it was founded in the late 1990s.

It is a mystery to us why the ECB has waited so long to make a decision that could have avoided the turmoil in the markets over the last year. In delaying decisive action, the ECB has put the monetary union, and perhaps the entire European Union, at risk. Moreover, the recession has been prolonged, perhaps unnecessarily. Unemployment has soared across the eurozone, with the notable exception of Germany.

The creation of a second bailout fund, the European Stability Mechanism (ESM), represents a big achievement for German Chancellor Angela Merkel. This fund will have 500 billion euros ready to be used in case of emergency. The first beneficiary will be Spain, which before the summer negotiated a line of credit of up to 100 billion euros for several of its banks. In the absence of the ESM, this money would have computed toward Spain's sovereign debt burden. Now the banks can borrow directly from the fund.

Another welcome development is the creation of a single banking supervision authority for the 17 banking systems in the eurozone. This is an important move because banks have a high degree of exposure to sovereign debt. It is important to break the vicious cycle damaging banks' balance sheets as the sovereign spreads rise. The ECB will assume eurozone-wide supervisory powers within months as national authorities give up their powers.

Each of these developments improves upon the rather precarious situation in two key ways. First, they show that European leaders are at along last taking steps toward the creation of a credible financial and banking architecture that can withstand the ups and downs of the economy and the markets. And second, they signal that no member state of the eurozone is seriously thinking about a dismantlement or fragmentation of the monetary union.

The latest news from Europe about the real economy, however, clearly indicates that the ECB's more forceful approach and the creation of the bailout fund are actions directed at averting disaster. They do not address by themselves the lingering problems with economic growth and unemployment. Europe is almost 20 percent of the global consumer market.

Thus, its anemic economic performance represents a major drag on global growth. The crisis that started in 2008 is the first since World War II in which all members of the OECD, the club of the most developed countries, were mired in a recession for two consecutive quarters, as we point out in our new book, Global Turning Points.

We need Europe to overcome its growth problem, especially now that Brazil, China, India and other emerging economies are also seeing their economies slow down. European leaders must not be complacent. Now that they have created a sounder financial architecture for the eurozone, they must address the problem of growth.

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