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Policymakers on Parade

"By definition a country has no conscience. Sometimes it has a policy, but nothing more." – Albert Camus

The world is awash in politicians who believe that they have the solution to what ails their respective dominions. This certainly has always been the case, and the current display of desperation and frustration would be comical if it weren't so maddening. The same administrations that are now scrambling to fix the current mess are of course largely responsible for it.

The Euro mess provides an opportunity to see in real time the result of policymakers folly. When the Euro was introduced in 1999, the intent was to create an economic union and a currency that would allow for free exchange of goods and services throughout Western Europe. Great Britain elected to retain its own currency, but most western European countries adopted the Euro over subsequent years. The agreement called for, among other commitments, countries to maintain annual deficits below 3% of their Gross Domestic Product (GDP), and total debt below 60% of GDP. These rules were flouted almost immediately and were met with hand wringing, furrowed brows, and stern words, but no real consequences (as a point of comparison, California's current budget deficit is 1% of GDP and its total debt is 4% of GDP).

Investors noticed. Two new acronyms emerged to describe groups of countries with very different economic realities. Portugal, Ireland, Greece and Spain became known as "PIGS" and Brazil, Russia, India and China as the "BRIC" countries. PIGS was coined all the way back in the mid 90's to describe a group of countries clearly lagging behind the rest of Europe and the world. BRIC came into being in a paper by Jim O'Neil, then chairman of Goldman Sachs Asset Management (irony alert) in 2001.

Of course, back in the good old days of falling interest rates and escalating asset prices, no one cared. These laggards were able paper over their problems with cheap money (read: debt). But, as Warren Buffet has been oft quoted, "when the tide goes out you learn who's been swimming naked". Obviously the time to have fixed these problems was when times were good. Incremental improvements would undoubtedly have lessened the need for the current proposed draconian austerity measures. But, as usual, politicians didn't disappoint the skeptics. Why talk about the fiscal realities when there is an election to be won. Promises of reform and restraint don't win elections, "free stuff" does.

Our founding fathers were pretty clever guys. When they created our "union" they established some important and lasting differences from our European heritage. First, our states are required to have annually balanced budgets. No state can print money (issue debt) to mask problems (are you listening Washington?). Second, we have a unified fiscal system. We have one currency that is used across all state lines. Third, we have a single labor market not hindered by borders, culture or language. These are significant differences that have helped make this country into what it is today, and if preserved, will help us be competitive in the future.

Europe is a disaster. Labor costs have skyrocketed with the introduction of the Euro. Since there is no longer a currency exchange rate, unproductive labor markets are paid the same as those that are extremely efficient. A worker in Greece (if you can find one) is paid roughly the same as one in Germany. Government finances are alarming. Deficits and debt levels in Europe make California look like Xanadu. Money is quietly flowing out of Europe into perceived safe havens like Switzerland.

All of this has got the attention of the pols. Inevitably Europe will pull out of this morass, but not because of their efforts. It will be a long painful slog. In the meantime, we will look to the US and the BRIC's to build a stronger foundation.