

The Euro-Mediterranean Area and the Global Economic Crisis

Josep Piqué

President

Pangea XXI Consultora Internacional, Barcelona

Today, it can no longer be denied that we are in the midst of a global economic crisis, one that affects the entire planet and is of a scope unseen since the crash of 1929 shook the very foundations of the capitalist world. Eighty long years have passed since then! Yet even today people debate the causes of that crisis. There are two main schools of thought, which, though divergent, are not necessarily incompatible. For some (Milton Friedman and his acolytes), its origin can be traced to an unconventional and unpredictable monetary policy that was unable to ensure a constant flow of liquidity. For others, the cause lay in a fiscal policy too insufficiently proactive to provide what Keynes called 'effective demand' in a context where monetary policy had been rendered inefficient as a result of what Keynes termed the 'liquidity trap'.

The standard conclusion (which is most likely also the correct one) is that, faced with such deep crises, the best solution is a sound combination of monetary policy (stable and predictable) and fiscal policy (expansive, when necessary, but stable in the medium term and generally aimed at ensuring a balanced budget).

However, irrespective of conventional macro-economic policy (which would also include exchange rate policy in those countries where that is still possible, given the current circumstances), other policies are strictly required.

Specifically, policies geared toward carrying out structural reforms in our economic systems are needed, including:

- Reforms in strategic sectors, such as telecommunications, transport and energy.

- Reforms in the markets for productive factors, such as the capital market, where the reform and strengthening of the mechanisms for central bank oversight of financial institutions appears critical, or labour market, where the optimum blend of flexibility and security and the appropriate allocation of financial and human resources must be sought.
- Reforms in highly sensitive spheres that are essential to achieving and maintaining the competitiveness required in an increasingly open and competitive global world, such as the sphere of education and professional training or the operation of government and the public sector.
- Reforms in tax systems and the role of different taxes in the breakdown of public spending, or reforms in legislation, to provide legal security and stability, as well as incentives for private initiative.
- Reforms that leave sufficient margin for well-regulated and supervised market freedom and that privatise anything that can be done in the private sector without allowing political considerations to distort the decision-taking process.
- And many, many more...

In a word, there is much to be done.

And the first step is to diagnose the situation properly. To this end, a closer look is in order.

The first observation is that we are clearly dealing with the convergence of multiple crises. There is a glaring real estate crisis in western countries; there is a crisis caused by supply shocks, due to the enormous volatility in the prices of basic raw materials; and there is a financial crisis, which can only be described as unprecedented.

And let us not forget, those of us beyond a certain age have witnessed many crises. We have certainly experienced real estate crises, although none as deep as

the current one or with such a distant horizon in terms of absorbing the huge stock of finished and unsold homes. The dust will take time to settle, several years even, and in some countries, such as Spain, more.

We have also experienced supply-side crises: in 1973 and again in 1979... We know what must be done to move on: restructure the current breakdown of productive factors to adapt it to the new relative prices thereof. It is hard, complicated and costly, but we know how to do it and how long the adjustment will take.

We have also lived through financial crises, both local and global.

We have seen local crises such as those undergone in my country, Spain, which was racked by a severe banking crisis in the early eighties, when half the existing banks quite literally disappeared (approximately 50 out of 100). We watched as an entire sector teetered on the brink (the so-called industrial banking sector, which had earlier played a crucial role in safeguarding Spanish industry) and then, seemingly overnight, simply ceased to exist (as has occurred, in a certain sense and on a much larger scale, with investment banks).

One good lesson to be drawn from everything happening now is that no one and nothing is safe from the storm, including institutions that once seemed indestructible but have since shown themselves to be fragile.

Regardless of the western world's capacity to absorb the real estate crisis and of the crises caused by the prices of strategic raw materials, what makes this crisis new is the nature and scope of its financial facet

One need only look at the last ten years, over which the world has experienced financial crises such as the 'tequila effect', Russia's default, Argentina's 'corralito', the financial crisis in southeast Asia, the Turkish banking crisis of 2000 or the virtual (and real) collapse of the Japanese banking system.

In short, we have multiple examples of multiple crises. *Res novum sub sole*. Nothing new under the sun.

So then? Whence the worry and gloom? The politically correct conclusion is that, as in the past, noth-

ing is preventing anyone from assuming that, despite the current context, we will once again overcome. This is the argument espoused by the 'anthropological optimists': there is no sense in worrying too much, since, sooner or later, everything will go back to normal.

The problem arises when one believes that this is not just another crisis. Which, of course, it is not.

For regardless of the western world's capacity to absorb the real estate crisis (which is not due to a demand shock sprung from real need, but rather to excess supply, brought about in response to speculation, whose flames were fanned by the massive liquidity on the markets, which, in many cases, were offering negative real interest rates, thereby making it 'rational' to take on debt, as a result of monetary policies that remained expansive over a long period of time), and regardless of the crises caused by the highly volatile prices of strategic raw materials, what makes this crisis new – what makes it unprecedented and unique – is the nature and scope of its financial facet.

Let us now take a closer look.

The main problem lies in the lack of confidence in our financial systems, that is, in the widespread distrust in the real quality and, thus, assigned value of the assets held on financial institutions' balance sheets. Moreover, whilst we know what the banks owe, and know that it is a lot and quite important, we do not know what they own. Consequently, we have no way of knowing whether they are solvent. We do not know if, under current circumstances, they will be able to pay off their debts.

Because we are dealing with the financial system, this situation is especially dramatic, for we are not talking about specific economic sectors, no matter how large or strategic, but something even bigger, namely, our circulatory system. When the lifeblood ceases to flow, an organism will die, no matter how healthy its vital organs, muscles and tissues may be. That is what is happening today.

It is also the main challenge: how to restore confidence in the international financial system, first and foremost, the financial system's confidence in itself. For that is, most likely, the first step: for financial institutions to regain their faith in themselves and each other. This can only be achieved via a twofold process. First, it requires bank recapitalisation, which, as we are seeing, calls for major commitments from the public authorities. In other words, governments (and, to the extent possible, markets) must recapitalise their

banks. This gives rise to another debate: to what extent should banks be recapitalised? To the point of outright nationalisation?

Second, banks clearly need to 'clean up' their balance sheets, re-assessing (according to current market criteria) and re-allocating the value of their assets, so that everyone knows what to believe and can gauge the true 'health' of our financial institutions.

Until this occurs – and surely both steps go hand in hand –, we will not meet the necessary, let alone sufficient, conditions to emerge from the crisis.

Hence, the current climate of pervasive uncertainty. For it cannot be stressed enough that we are talking about the necessary, rather than sufficient, conditions to overcome the crisis: if financial institutions do not clear up their balance sheets, any other measures taken will be insufficient and, thus, counterproductive, even if only as a result of their futility.

However, let us go one step further, refusing to allow ourselves to be 'paralysed by fear'.

Obviously, nothing is possible if we do not settle the financial issue. It is a *sine qua non* condition.

Therefore, for the time being, we must concentrate our efforts on solving it. Irrespective of ideological determinants and political prejudices, either we save our 'circulatory system' or we will not survive. Once we have done that, we can begin to determine how to strengthen our muscles and improve our overall health. Without blood, however, nothing else matters.

Fortunately, governments at last seem to have understood this. They may be improvising measures, designing methods by 'trial and error', etc., but it seems to have dawned on them all that they must save our financial systems or nothing else will matter. Proof of this can be found in the so-called 'stress tests' set up for financial institutions in the United States or, also in the US, the implementation, following a series of failed attempts by the previous administration (the so-called Paulson Plans), of the so-called Geithner Plan, named after the new treasury secretary, which seeks an attractive combination of (or 'complicity' between) the public and private sectors to recapitalise the banks and 'set' realistic market prices for their assets.

There will be time to assess and judge what has happened later and, of course, to determine how much of the responsibility lies with the managers of our financial institutions. Some will need to 'purge' themselves of their excesses, errors and, in some cases, fraudulent decisions.

However, right now the safeguarding of the international financial system must take priority over all other considerations.

In any case, regardless of the dramatic consequences of the current global crisis, we must not forget that the world continues to evolve in accordance with the underlying trends.

I am referring to the major geostrategic trends that will shape the course of the coming decades and, no doubt, the first half of this tumultuous and uncertain 21st century.

To this end, it is worth looking to history.

Ever since the industrial revolution, the world has been 'Euro-centric'. The major European powers believed they had a 'natural' right – wholly unacceptable from an ethical standpoint today – to 'split' the world between them. And so it went: so began the era that came to be known as 'colonialism'. However, things have changed dramatically since then.

From a geostrategic perspective, Euro-centricity peaked during World War I and then entered into decline. This decline was paralleled by the global rise of what would eventually become the two main 'super-powers' of the last century: the United States and the Soviet Union. However, Europe continued to serve as the 'theatre' for the world's great strategic struggle. The rise of fascism and Nazism in Europe inexorably led to an unprecedented armed conflict with the continent's democracies and, as a result of 'unholy' alliances, with a Soviet Union ruled by a totalitarian communist regime.

These strange alliances later evolved into deep-seated confrontations, which set the basic geostrategic stage for the second half of the 21st century. With the defeat of the Nazis and fascism, the world saw the dawn of a vast new conflict, affecting all levels of life, between two main blocks: on the one hand, the West, led by the United States; on the other, the Soviet Union and its so-called 'satellite states'.

This situation lasted until 1989. It was the so-called 'balance of terror', also known as the doctrine of 'mutually assured destruction'. True, we had reached the edge of the abyss, especially during the Cuban Missile Crisis in the early sixties. However, for the first time in centuries, the major powers did not dare to fight each other directly, but rather fought through proxies in Central and South America, Africa and Southeast Asia. They were engaged in a vast strategic struggle that spanned the globe, from Vietnam to Indonesia, as well as, of course, the Middle East. All conflicts were related to this giant struggle between the two

powers, which was at once political, economic, social, ideological and cultural, in short, global.

Then, the conflict ended, graphically, with the tearing down of the Berlin Wall in November 1989. This was followed by the collapse of the Soviet Union and its partition into no fewer than 15 countries, as a result of the failed coup d'état of August 1991. A world disappeared, and one side surrendered unconditionally. The 'Cold War' ended with a clear victor: the West, led by the United States, and, apparently, its values.

Certain eminent political scientists were explicit, claiming we had reached 'the end of history'. The triumph of western values was clear: the market economy, representative democracy and social tolerance had clearly won the round, and the whole world would continue down that path. We had seemingly entered a sort of 'happy Arcadia', where 'western' values were spreading around the globe.

Nothing could be further from the harsh truth.

The illusion was shattered, in brutal fashion, on 11 September 2001. On that day, the Western World discovered, through the collapse of the Twin Towers in New York (and of the Pentagon in Washington), that the threats to our collective security had not disappeared with the Soviet Union, but rather, for the first time, were able to launch their attacks on American soil. They did so using 'asymmetric' techniques. They were not armies, and they did not launch a conventional attack; rather, they aimed straight for the 'heart', at our societies' morale and capacity for democratic resistance.

Hence, the transformation in the focus of US foreign policy and, by extension, that of the policies of other western countries, with varying degrees of nuance. The 'war on terror' soon became the face of western and, above all, American foreign policy. Everything was subordinate to this goal. Let there be no doubts: we are dealing with something extremely important, something that remains important years later. However, in interim, several major events have unfolded.

First, now that relative stability has been brought to Iraq (although it remains to be seen for how long), the war on terror continues in Afghanistan. It is being waged on the blurred and porous border with Pakistan. The new president, Obama, knows that much of his country's international credit is riding on this effort, but he seems wholly willing to take the gamble.

Consequently, no one should underestimate what is at stake or the strategic importance of winning the fight against international terrorism.

At the same time, however, irrespective of the new scenario, we are also facing new panoramas, which oblige us to delve deeper into history and geography. For, ultimately, history always repeats itself and geography is always a factor.

It is worth remembering that, aside from the joint fight against international terrorism, the world is changing. The new geostrategic balances give rise to an initial, obvious conclusion: the planet's centre of gravity is shifting quite clearly and, moreover, quite quickly, and it is increasingly far removed from Europe. This notwithstanding, it is not clearly situated in the Pacific, as some would have it.

The future global role of southern Mediterranean countries inevitably depends on looking not only 'horizontally', but also 'vertically', that is, along the North-South axis

It would be better defined as lying at some unknown point between the Pacific and Indian Oceans, sufficiently sensitive to 'the Americas', but also suitably aware that Europe (the European Union) continues to play a crucial role, due to its economic and commercial, as well as political and cultural, weight. Not to mention, of course, its strategic weight. Should we dare to specify even further, we might situate it at a point near the Strait of Malacca, a natural passage-way between the Indian Ocean and the waters of China, equidistant from Europe and America.

All of this, of course, has yet to be defined; however, precisely for that reason, we can all play our cards. For Europe, the Euro-Mediterranean area card is vital.

For I am convinced that the future global role of southern Mediterranean countries, as well as their status as Arab states (with the exception of Israel, which is a separate issue) and their geographical inclusion in Africa, the Middle East and Asia Minor, inevitably depends on looking not only 'horizontally', but also and quite clearly, 'vertically', that is, along the North-South axis.

This confluence of vital and strategic interests between North (the European Union) and South (the Mediterranean coastal countries that do not belong to the European Union and, thus, include non-member 'north-

ern' countries, primarily the Balkans) will be critical in the new global geostrategic situation.

The deepening, above all in the current global and unusually deep economic crisis, of the shared Euro-Mediterranean space is more urgent than ever

For all of these reasons, the deepening, above all in the current global and unusually deep economic crisis, of the shared Euro-Mediterranean space is more urgent than ever.

First, because this gradual integration may help us tackle the challenges posed by the crisis, allowing us to enlarge markets and increase trade flows, investments and joint projects.

Second, because the progressive creation of a common space will further allow us to play a likewise common role and will strengthen the capacity of all countries from the space for dialogue within the new balance and scheme of global powers.

Third, because all of the foregoing will contribute to a regional scenario of peace and stability, which is especially important for the world at large, not to mention its specific impact on the secular conflict in the Middle East.

In short, the Euro-Mediterranean space can and must be vital to the South. However, Europeans must understand that it is likewise vital for them. Moreover, we must act in keeping with that understanding.

The commitment to strengthening the Barcelona Process, through the Union for the Mediterranean, must be more than an essentially voluntary political statement. For the evolution of the southern Mediterranean – whether economic, social, political, cultural or in terms of energy – is inextricably linked to the evolution of the countries in the North.

The commitment to strengthening the Barcelona Process, through the Union for the Mediterranean, must be more than an essentially voluntary political statement

The European Union must accept this responsibility unwaveringly, not for reasons of timely political opportunism, but rather as a strategic and, therefore, medium- and long-term commitment. A commitment unmarred by short-sightedness. We will all be more important in the world if we move together. And together we can.