



## Steering the Eurozone Through Critical Passages

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## 1 INTRODUCTION

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Bond markets and other Eurozone stakeholders are rightly concerned about illiquidity and possible insolvency in Greece, with Portugal and Spain potentially close behind. Clearly the Eurozone faces a systemic crisis of economic connectivity.

European monetary union was designed to enhance the connectivity of the economic system. For six years this brought increased efficiency, trade, and GDP growth, along with low interest rates, across the Eurozone.

Then the global financial crisis taught us that such connectivity is dynamic and cuts both ways; that we have created a level of financial and economic interdependency considerably exceeding our ability to understand and manage it. Two years later that gap has not narrowed.

## 2 SYSTEMIC AND ECONOMIC CONNECTIVITY IN THE EUROZONE

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Today systemic connectivity is amplifying hard times in the Eurozone house, bringing the viability of individual nations into potential conflict with that of the Eurozone itself. Greece cannot regain national solvency without major fiscal adjustments and structural reforms for which there is not success-precedent during a prolonged downturn and without currency devaluation. Wolfgang Münchau observed: "...this will invariably produce a debt-deflation dynamic in the Greek private sector [driven by systemic connectivity] of the kind described by the economist Irving Fisher during the 1930s." Spain and Portugal are

just as vulnerable to the debt-deflation spiral.

Questions about the crisis illustrate the power of economic connectivity. Will Greeks go quietly into deep private-sector deflation (the national equivalent of debtor's prison) while large repayment outflows continue to banks in other Eurozone nations? How long can the Eurozone continue the emergency funding needed to prevent Greece from defaulting?

Connectivity has spread the virus beyond Greece, raising larger and more existential questions. Will ongoing aid weaken cost-cutting and reform initiatives in at-risk nations? How can ECB bond purchases best support those nations' access to credit markets- by holding down interest rates to support fiscal retrenchment, or by allowing higher rates that will attract lenders? Could aid aimed at staving off default perversely make default more likely- only later and in larger national economies? Might the consequences of Eurozone connectivity force the economically weakest (or strongest) nations out of the Eurozone? How should leaders weigh the risk of national default and its effect against the underlying threat that ongoing aid poses to Eurozone sustainability?

Today there are no clear answers to these systemic questions. Mainstream forecasting and analysis have not adequately reflected the rich interdependencies that link Eurozone nations and drive their economic performance. Even the most detailed econometric models have largely ignored the tipping-point connectivity that drives

bond markets under pressure and the self-reinforcing linkages that propel the debt-deflation spiral. In Einstein's words: "We can't solve problems by using the same kind of thinking we used when we created them."

The old non-systemic thinking and actions weren't good enough even in good times—they created the conditions underlying the Eurozone crisis. That crisis will remain unresolved in the absence of systemic solutions, and those solutions will not be found in the non-systemic logic on which we relied in the past.

### **3 A SYSTEMIC EUROZONE SOLUTION**

A Eurozone example shows the power of systemic versus non-systemic logic and solutions. A leading European manufacturer of capital equipment employed a system-simulation platform to understand connectivity-driven cyclicalities in their global market. The platform supported an exploration process that gave warning of an impending, systemically-driven "black swan" change in the market cycle and collapse of demand. That process also revealed the depth and duration of the collapse along with solutions that would sustain the firm through the downturn. Without the process and its supporting platform, the warning and solutions would not have emerged in time for effective action. This firm's main competitor lacked such a process and platform and had a much more difficult time of it.

As in this example, systemic Eurozone solutions exist and their synergistic power will limit damage and enhance sustainability. Much is known about what works and what does not in searching for such solutions. Three things are needed for Eurozone solutions; systemic principles; a solution-revealing process; and a platform on which the process can take place.

The principles are both simple and profound: systemic Eurozone problems require truly systemic solutions; such solutions will synergistically balance the Eurozone whole and its constituent parts and their near- and longer-run futures; solutions must emerge from a community process because the Eurozone is too large, diverse, and connected for any one mind or group to reliably grasp.

On one level these principles are inarguable, yet they can also seem idealistic and impractical. That stems not from the principles themselves but from an unavoidable conflict between mainstream decision-making and systemic reality. We have a compulsive desire to determine the end from the beginning, to establish static points of fixity before we start the process. Mainstream decision-making then chooses between contending opinions based on non-systemic logic. Such fission will never resolve the dynamic Eurozone crisis.

Systemically effective solutions emerge from a fusion process, one that is iterative and organic in nature, mirroring the action of the Eurozone system itself. Such solutions reveal themselves in the course of open-minded, reflective inquiry by community stakeholders. Those solutions are not ends but ever-evolving means to greater realization of Eurozone objectives, and this solution-revealing process reflects in a practical way the principles outlined above.

This fusion process requires a facilitating platform to sustain it, one which allows systemic solutions to emerge. Such a platform produces time-compressed systemic experience, enabling participants to engage with the future performance of the Eurozone system under a wide range of options and candidate solutions. It must transparently include the elements and connectivity that drive the Eurozone economic system, especially those forms of connectivity that most threaten

sustainability. Such platforms are a test-bed for ideas on which hybrid solutions can evolve, and the right hybrids turn out to be systemically more robust than their components. There is a great deal of experience with such platforms, based on proven dynamic simulation technology, and with their ability to support the process from which systemically effective Eurozone solutions can emerge.

The integrity of this Eurozone fusion process will derive from participating stakeholders- politicians, civil servants, business and union leaders, workers, consumers, and economic experts from countries across the monetary union. Engaging in the solution-revealing process, they will help move the Eurozone from fission to fusion, from fragmented perceptions and actions to integrated and systemically effective solutions. This is the opposite of utopianism- only through hard, pragmatic, systemic work can the crisis be resolved and Eurozone sustainability assured.