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If anyone ever writes Ten Commandments for building an economic union, one should probably start with 'Know Thy Partners Well', followed by 'Now Double-check'. Over the past two years, the eurozone has been faced with a massive fiscal crisis, originating in Greece and spreading to other countries collectively termed PIGS, to be revised later to PIIGS, and recently to the more politically correct GIIPS: Greece, Italy, Ireland, Portugal, Spain. Much of the reluctance of the core to take timely and drastic support measures emanates from perceptions regarding the ability of people in the periphery to reform and escape the crisis.

At the center of the debate in Germany lies a deep dilemma. On the one hand, support of debt refinancing prevents unilateral default and departure from the eurozone, signaling to markets that euro membership is a one-way street; on the other, it creates moral hazard by removing market pressure to run primary surpluses, and undertake painful wage cuts and productivity-enhancing reforms. Both concerns are legitimate.

Letting a country fall out of the euro sends a powerful signal to markets that exit is possible under easily verifiable conditions: high debt- and deficit-to-GDP ratios invite higher spreads, themselves contributing to default. It is not an accident that the euro area did not build emergency exits. Forty years ago, the Bretton Woods system collapsed mainly because it gave a similar one-way bet: to currency speculators monitoring external imbalances and contributing to devaluations. Bretton Woods was a system of 'fixed but adjustable' exchange rates, while the euro was designed to be one of fixed and immutable rates.

On the other hand, it seems unwise to keep lending to countries that not only proved incapable of balancing budgets in the past but also appear unwilling to save, work hard, reform, and ultimately get on a growth path. The difficult balancing act involves support to prevent exits, and monitoring of debt accumulation. Recent moves towards a 'stability union' can be viewed in this context.

Strict rules for fiscal monitoring are not sufficient: people of troubled countries must be willing to work hard to boost productivity, and to be prudent so as to avoid over-borrowing. Those in strong countries need to perceive the efforts of their ailing partners and potential for improvement. The image of laid-back Zorbas dancing the night away can be excellent for tourism but detrimental for the cohesion of an economic union. Interestingly, this applies not only to Germans looking at PIGS, but also to PIGS looking in the mirror. Citizens of troubled countries need to realize that their compatriots are hard workers, albeit inefficient; and that they should apply to their State the same prudent principles they apply to their own private wealth management.

Contrary to perceptions, workers in PIGS work hard. Data from the UK Office of National Statistics and Eurostat, quoted in Guardian on December 8, show that Greeks, together with Austrians, are EU champions in average hours worked per week among full-time employees, at 43.7 hours. The Portuguese lag only a bit behind at 42.3. Germany takes

8th place with 42. However, Greeks and Portuguese rank 20th and 22nd, respectively, in productivity, which stands at 76 and 65 percent of the EU average, with Germany at 124 percent. While productivity differences are difficult to decompose, their size indicates room for substantial transfer of organizational capital and international best practices to troubled partners, so that they spend less time dealing with inadequate management practices or inefficient bureaucracies and more time producing goods and services.

At the time their countries were accumulating excessive debt, private households in PIGS were maintaining a substantial wealth buffer, consistent with increased uncertainties they face. Internationally comparable data on net household wealth of households aged 50 or more are now available for the first time.[1] Using the Survey on Health, Ageing, and Retirement, The Table shows that, adjusting for purchasing power, median net household wealth in 2006-7 was comparable in Greece and Germany and substantially larger in Spain and Italy. Net wealth among poorer households, at the 25th percentile of the distribution, was triple in Greece and Italy to that of Germany, and six times as large in Spain. Among richer households (75th percentile), Greece was only slightly below Germany, while Spain and Italy were substantially above.

As shown in the Table, the main driver of these differences is widespread ownership of real estate and limited mortgage indebtedness of older households in troubled countries. This has two implications. First, taxing real estate to meet fiscal targets affects a much wider part of the wealth distribution in troubled countries. Second, the liquid 'buffer' in net wealth positions was much more limited in those countries than in Germany prior to the crisis. Given that it is neither feasible nor advisable (in view of the subprime crisis) to provide vehicles – such as reverse mortgages – for turning houses into ATMs under present conditions, the ability of these countries to withstand lower incomes and repeated tax collections is likely to be severely limited.

Might it be, then, that PIGS are hard-working rather than lazy, prudent rather than prodigal, inefficient and disillusioned rather than hopeless, illiquid rather than insolvent, and in need of reforms rather than of sanctions? As I watch people in the European core become increasingly frustrated about supporting lazy, irresponsible partners, and people in the periphery protest against repeated tax assaults and pressure for hasty reforms, I wonder whether this threatened divorce may be based on rumors rather than fact, stereotypes rather than reality, and bad judgment rather than immutable characteristics. Is it worth breaking up the euro family for this?

[1] For an extensive study of international differences in household portfolios see Christelis, Georgarakos, Haliassos, "Differences in Portfolios Across Countries: Economic Environment versus Household Characteristics", forthcoming in Review of Economics and Statistics.

Data Source: S.H.A.R.E. 2006-7	Net Wealth Percentiles			Home Equity At Net Wealth Percentiles			Real Estate Equity At Net Wealth Percentiles		
000s 2005 Euro, PPP	25	50	75	25	50	75	25	50	75
Austria	30.5	130.5	252.2	2.0	79.2	205.6	2.0	79.2	205.6
Germany	21.0	136.2	287.5	0.0	95.3	219.3	0.0	95.3	219.3
Sweden	39.6	135.3	292.0	0.0	76.0	213.7	0.0	87.0	213.7
Netherlands	14.0	170.5	335.2	0.0	125.6	261.6	0.0	125.6	274.4
Spain	124.4	228.6	419.8	114.2	207.3	286.6	114.2	207.3	305.6
Italy	69.8	190.3	347.8	57.7	157.6	295.2	57.7	171.1	295.2
France	91.0	234.3	433.4	32.7	200.3	310.7	32.7	211.8	357.5
Denmark	41.5	157.8	337.9	22.0	92.3	151.2	22.0	108.1	206.4
Greece	65.3	132.0	245.3	53.5	114.0	189.5	59.4	124.6	209.7
Switzerland	53.4	206.9	454.4	10.1	117.4	208.3	19.1	117.4	296.2
Belgium	122.6	244.5	413.4	83.2	229.8	304.6	83.2	229.8	304.6