Life and Death of the Euro

Killing the Single Currency May Be the Only Way to Save the European Union

By Jacques Sapir

The euro is destroying Europe. Ever since the Greek government debt crisis erupted in 2015 between the government of Prime Minister Alex Tsipras and European leaders, that is the inescapable conclusion. The destruction does not come, principally, from the sovereign debt crisis the eurozone has experienced since 2010. Even though that crisis continues, it is held in check—for the moment—by European Central Bank (ECB) policies. The monetary injections performed since fall 2012 have helped reduce interest rates substantially. Purchases of debt securities, and particularly sovereign debt, have helped reduce tensions that existed in the eurozone. Instead, the threat arises from the general economic and social frameworks that the euro favors or imposes in different member countries. It also comes from the implicit political framework that follows with the euro in eurozone countries. Clear examples of this corrosive political framework are the effective seizure of power in European decision-making by the eurozone finance ministers, known as the Eurogroup, an institution that exists de facto and not in any signed treaty, as well as by the ECB.

A poll by Gallup International covering fifteen countries in the European Union—14,500 individuals, carried out from November 30 to December 3, 2015—reveals significant changes in European attitudes toward Europe and the euro. The results show that we have entered a period of deep instability regarding European institutions. This became palpable with the prospect that, in the wake of the refugee crisis confronting the continent since 2015, Europe may suspend the 1985 Schengen Agreement eliminating border controls among the twenty-six signatory countries—indeed, France, Germany, Austria, Denmark, Sweden, Belgium, and Norway have already unilaterally re-imposed border controls.

▷ The European Central Bank, Frankfurt, Feb. 22, 2015. *Mikka Luster (mikka.is)*

One of the characteristics of the present situation is disenchantment with the "European Dream"—the belief

that policies promoting concepts like community relationships, sustainable development, and international cooperation would give Europeans an enviable lifestyle and an influential place in the world. Europe, especially in the form of the European Union, is no longer the stuff of dreams; rather, it is a source of worry and even fear. And the euro indisputably carries part of the blame for this change of attitude.

Ever since the common currency was put into place, starting in 2002, by nineteen of the twenty-eight EU member states, growth in eurozone countries has been significantly inferior compared with those European countries that did not join the monetary union (notably, the United Kingdom, Norway, and Sweden) as well as international economic powers like the United States and Canada. This phenomenon is important to understanding public disappointment with the EU. It seems like a negation of the promise of growth loudly proclaimed at the time of the euro's launch.

Pro-EU politicians like Jacques Delors of France and Romano Prodi of Italy lured Europeans with the glowing predictions of social and economic progress including full employment. Today, most Europeans are aware that the single currency has had negative effects on their economy for years: weak growth and rising unemployment. The eurozone crisis is obvious, even for the most narrow-minded ideologues. Not one of the basic problems first posed has been resolved. For example, the unitary currency system locks the relative exchange rates between countries. Yet it is necessary that countries have the ability to adjust their exchange rates, given the perfectly normal structural differences between states, and due to the absence of a true European budget, that is to say meaningful budget transfers, within the euro area. Without exchange rate adjustments or these budget transfers, it is left to the labor market and therefore wages and salaries to be negatively affected in the search for budget equilibrium.

Partial solutions have been offered, presented as historic steps towards a federal Europe. These solutions propose massive fiscal transfers between eurozone countries, from the richer to the poorer, to deal with the structural heterogeneity of these economies. But such transfers would create more problems than they would solve. For example, there exists a strong heterogeneity between regions within France, which is addressed through net annual internal transfers worth $300 billion. By contrast, such flows in all of Europe currently amount to about $40 billion. The implementation of such a federalization of economies in the eurozone would realistically require transfers of perhaps $300 billion per year. Moreover, these flows would have to be paid mainly by the countries benefiting from the euro. In the domestic French scenario, the burden of the flows is essentially shouldered by the Paris region and the Seine valley. This poses no problem in France, because redistribution between French regions populated by fellow citizens with a common history and identity seems normal. For the euro area, an increase in flows would entail at least 9 percent of Germany's gross domestic product (GDP), to the benefit of countries such as Greece, Spain, Portugal, Italy, and even France populating an area that is deeply heterogeneous. It is clear that Germany would be called on for the lion's share of the transfers, perhaps as much as 248 billion euros per year. We can't ask the Germans to do this. They don't want this burden, which would seriously undermine Germany's own economy.

Monstrous Price

An alternative to fiscal transfers would be encouraging so-called competitive devaluations across the eurozone countries—reducing wages and inflation so as to make prices of goods and services more attractive. It would effectively mean applying the suicidal policy of Chancellor Brüning in Germany between 1930–32—a policy that became a breeding ground for Nazism, not hyperinflation. That devaluation was conducted in the name of rescuing the German banks. The banks were saved, but at a monstrous economic price. Yet, these internal devaluation policies are currently being implemented in Europe. It seems inevitable that the eurozone will move toward a deflationary policy, where real wages are pushed down by the combination of low prices, low nominal wages, and of course low employment. In such a situation eurozone countries are destined for a continuous contraction of economic production and high unemployment. This could lead to a rupture between the eurozone and its citizens, and ultimately cause the eurozone to collapse altogether.

The Gallup survey of changing public opinion was especially interesting when respondents were asked how close or how far removed they feel from the EU. There was a strong growth in the number of people feeling removed from Europe. This group is led by Greece, where 60 percent said they felt removed from the EU compared to only 12 percent who felt close to the EU. But this group also includes Britain (38 percent felt removed versus 13 percent who felt close); Netherlands (35-11); Belgium (38-9); and Italy (39-16). The inclusion of these latter countries in the group illustrates the strong rise in euroscepticism at the EU's very core.

A second group of respondents comprised countries where feelings of being removed from the EU have grown but nonetheless remain in relative balance with feelings of closeness—in Germany (25-19); Spain (25-21); Ireland (25-18); France (31-15). Lastly, a third group comprised countries where more respondents felt close than felt removed—yet even then the highest percentage of feeling close, seen in both Denmark and Romania, was only 26 percent.

The same survey revealed a big loss of appeal for the euro. Opinion against the euro is deeply entrenched in Britain, Sweden, Denmark, and Bulgaria. This shouldn't be surprising, because these countries are not part of the eurozone. Such is the rising anti-Europe sentiment in Britain that, in June 2016, nearly 52 percent of the British electorate voted in the Brexit referendum to withdraw from European Union membership.

What is unexpected in the Gallup survey is that, in two eurozone countries, Greece and Italy, preference for a national currency trumps the euro. In Greece's case, this is an important turning point, given that it was the threat of a Grexit—a Greek exit from the eurozone—and potential resulting collapse of the country's banking system that appeared to convince the government in 2015 to cave in to European institutions and agree to an austerity bailout package. Greeks, until recently, were in favor of the euro. Going forward, it seems that the possibility of a Grexit doesn't frighten the people anymore. The euro has become a tragedy for Greece, resulting in falling incomes, a sharp rise in unemployment, and a general fraying of the social fabric. The political crisis with the European institutions played a clear role in turning the Greek population against the euro. It is obvious that the bailout agreement has been unable to treat the underlying problem.

Italy's case also appears emblematic. Italy is a country at the historic core of the EU and the eurozone. A majority of Italians, however, prefer a return to the lira. There is a very deep polarization of the Italian population, manifested in the drastically downgraded social and economic situation in the country. Per capita GDP is stagnant, or dropping, since the early 2000s and investment is now well under its 1998 value. At present, at least two political parties, the Five Star Movement, or M5S, and the Northern League, have publicly and repeatedly expressed doubts about keeping Italy within the eurozone.

Other countries are also concerned. In the Netherlands, the euro wins by only a narrow majority; the country is witnessing a lively debate that partisans of the euro are barely winning over rivals advocating a return to a national currency. The survey suggests that whenever there is a real debate about the euro question, the public expresses declining support for the euro.

Even the attractiveness of the EU itself is waning. The cause comes back to the austerity politics put into place ostensibly to address the sovereign debt crisis and save the euro. The true cost of the crisis will not be only economic or even economic at all. It will spread into political reality. Europe's handling of the Greek debt crisis exposed as hollow the claim of the EU to be an area of cooperation and solidarity, devoid of conflicts. The eurozone proved to be an instrument of domination sought by Germany with the acquiescence of France. Germany quickly understood the political price for its apparent victory over Greece. In a few days it lost all the respectability, as a responsible country, aware of its past and firmly committed to European integration, it had taken decades to gain.

It is very likely that we will see a sharpening of conflicts within both the Eurogroup (eurozone) and the EU. German leaders are confronted with a choice. Either they accept the transformation of the eurozone into a transfer union, which they have refused since 1999. Or they organize the exit of Greece from the eurozone, under conditions that will quickly cause the implosion of the eurozone. Austerity policies have plunged the countries that apply them into deep recession. Leaders of those countries will have to come to terms with this, and either find ways to regain lost appeal or understand that they cannot keep institutions alive forever against the peoples' will.

Federal Solution?

Erecting a federal form of the eurozone is sometimes brought up as "the" solution to the euro crisis. Some see it as the only solution, with the alternative being austerity policies that could lead to the impoverishment of the eurozone's southern countries. One can understand why German Chancellor Angela Merkel seeks a right to control the budgets of other countries and refuses to consider a transfer union that would however be the logical form a federal structure for the eurozone would take. It is therefore necessary to grasp the consequence: federalism may be desirable, but it is not possible and so it is pointless to debate whether it is a good or a bad solution.

In August 2015, Emmanuel Macron, the French economy minister, shared important comments on the euro in the German paper *Süddeutsche Zeitung*, in which he detailed his policy proposals for a "eurozone government" that had been drawn up in collaboration with his German counterpart, Sigmar Gabriel. Macron's suggestion that national leaders transfer "more sovereignty" to a "commissioner with a broad mandate" has been widely discussed. Federalism is indeed often presented as the only possible survival option for the euro. In fact, the question of budgetary transfers has already been widely discussed over the viability of the eurozone and is central to the issue of the single currency. If federalism naturally involves political institutions, it also involves fiscal transfers between the federation of member countries, as these transfers in fact exist between regions within the same country. Macron's comments were nothing new, but following the crisis with Greece they take on particular significance in admitting the political nature of the euro and how this reality must be the framework for economic governance.

The idea of a federal structure matching the eurozone has been around for a while. In an analysis of the matter published in *Social Europe* last year, economist Michel Aglietta and political scientist Nicolas Leron spoke of the "incompleteness" of the eurozone, which they emphasized had been highlighted by the Greek crisis. Recalling that a currency can also be analyzed as a common good, they added, "A public good par excellence, a currency cannot function without an organic link to political power: it requires a sovereign." They insisted on going further, explaining that the euro is incomplete (and cannot, therefore, function properly, which allows for crises to be repeated) because it does not have behind it a common social debt. All of this is exactly true.

Yet promoters of a federal Europe do not seem to comprehend the implications of its creation, especially in what concerns the flow of transfers. Transfers already exist between the countries of the European Union. We can note that these transfers are relatively low. It is the net transfer that really matters, the difference between the contributions and EU subsidies. Contribution to the budget is limited to 1.23 percent of GDP, so the EU budget is capped. The annual net transfer to the recipient countries is 43 billion euros. This represents about 0.5 percent of the GDP of EU members collectively, yet a transfer flow of 5 to 7 percent is the absolute minimum for a recipient country to function as an economic entity and single currency.

We must therefore calculate the size of transfers that would entail real federalism across the eurozone. The actual total transfers from four leading eurozone countries—Germany, Finland, Austria, and the Netherlands—would likely be in the range of 280 to 300 billion euros. This suggests that Germany would bear 80 to 90 percent of the cost, or at least 248 billion euros per year—9 percent of GDP in the most modest assumption, and as much as 12.7 percent in more extreme estimates. Germany is not politically capable of financing such a level of transfers. Hence we see the political limits of budget transfers and the problems arising from the abandonment of sovereignty over national budgets.

All of this adds up to one conclusion: federalism is not a real option. That leaves two possibilities. The first is the rapid impoverishment of the southern countries of the eurozone. This could have extremely unpleasant political consequences, especially in the context of the ongoing refugee crisis, and could well lead a challenge to the European Union itself. The second possibility is the dissolution of the eurozone to allow the necessary adjustments without resorting to massive budget transfers. This may be the only way to salvage what is left of the European Union.

Brexit Lessons

The British vote of June 23 to exit the European Union did not occur by chance. It is clear that the euro currency had created strong concern about federalist developments in the EU. Those concerns encouraged even moderate pro-European voters to go along with Brexit.

That European elites were so surprised by the British vote is a tribute to the magnitude of their denial of reality. The habit of denial being what it is, one should not expect a serious questioning of European policy by the very European policymakers who implemented it. But facts are stubborn things: any commitment toward more federalism, toward more supranational governance, will only produce more resistance from the people.

This British vote conveys disapproval for a form of the European project. Logic and common sense would suggest that we take note and act accordingly: that is, return to forms that are more respectful of the sovereignty, and therefore democracy, within the framework of nations that make up Europe.

The pro-Brexit victory was made possible because part of the Labour Party electorate defied the instructions of the party leadership and voted to leave the EU. The Labour Leave movement was critical to the ultimate success of the "Leave" vote. This is a lesson for the forces of the left throughout Europe.

Translated from the French by Amir-Hussein Radjy.

.