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Academic Foresights

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Euro

How do you analyze the present status and situation of the Euro?

Although it does not make it to the headlines anymore, the crisis of the Euro as a common currency of the Eurozone is still in full swing, some seven years after the crisis started in Greece in late 2009, as an extension of the global financial crisis (Ryner 2014). Several Southern European countries still have very high unemployment rates – up to 23.4% and 19.2.% in Greece and Spain, respectively. Youth employment is even higher, with 49% in Greece, 46.2% in Spain, 39.9% in Italy and 32.8% in Portugal (Eurostat 2016). Moreover, the Eurozone crisis is not only an economic and social crisis, but also a political one. Tensions between European countries have increased, populist anti-EU parties are on the rise, and trust in the European Union is at a historical low (Pew Research Center 2016).

Most academic observers agree that the Euro as a common currency and the policies devised to its rescue are at the core of the economic, social and political crisis that is affecting the Eurozone today (e.g. Stiglitz 2016). The common currency has been imposed on economies that are too heterogeneous in their institutional set-up (Nölke 2016a). More specifically, the Eurozone combines economies that are able – and willing – to use wage restraint based on a coordinated labor regime (Germany) to out-compete other economies in the Eurozone that lack this ability as they have uncoordinated labor regimes (e.g. Southern Europe). Moreover, the rise of China and other large emerging markets has affected Eurozone economies differently, with advantages for Germany and disadvantages for the Southern economies. For a number of years, the latter were able to maintain high growth rates in spite of increasing deindustrialization, based on increasing public debt and private sector financialization. The global financial crisis has brought this development path to an end.

The solution that has been developed to rescue the Euro as a common currency is basically a strategy of competitive internal devaluation which is socially very cruel and has not lead to substantial economic growth. The Eurozone has developed a series of technocratic mechanisms that are meant to limit public indebtedness and to decrease wages in the Southern economies, based on the Fiscal Compact, the Macroeconomic Imbalance Procedure and the European Semester. This increasingly authoritarian austerity strategy has not only put the main burden of crisis resolution on Southern labor and recipients of social transfers, but has also strongly decreased demand in the Eurozone. Correspondingly, it is not only deeply unpopular because of its unjust distributive effects and its huge constraints on national democracies, but also leads to economic stagnation and sluggish growth. In the end, the Euro as a common currency has probably only been saved – for the time being – by the extremely expansive monetary policy of the European Central Bank, which itself creates a plethora of new problems.

In your opinion, how will the situation likely evolve over the next five years?

After a series of elections in major EU member states, the issue of institutional reform of the Eurozone will return to the political agenda, most likely along the lines previewed in the Five Presidents' Report (Juncker et al. 2015). The Commission intends to publish a white book on the topic in March 2017. The core deal will probably be an exchange of additional European North-South fiscal transfers against an even more strict EU surveillance of the Southern Eurozone economies. At the moment, this deal is not feasible, since any accommodation of Southern Europe would negatively affect the election result of Chancellor Merkel's Christian Democratic Union during the September 2017 federal elections, particularly with regard to the challenge posed by the neo-populist AfD. At the same time, the threat of more intense EU economic supervision would strengthen the position of the Marine Le Pen during the 2017 presidential election campaign in France. However, given the strong economic advantages Germany derives from its Eurozone membership – it basically exports its unemployment to Southern Europe and France – it would be reasonable to expect a certain degree of accommodation, once the elections have passed.

The deal will probably somewhat pacify the situation for a couple of years. It will allow for additional public investment in the Southern Eurozone, partially financed by transfers via the European Union. However, the amount of transfers that will be politically feasible for the new German government will be insufficient for any major upturn of the Southern economies. At the same time, the conditions attached to these transfers will lead to renewed political tensions. Furthermore, major political steps towards a unified European State – with additional political and redistributive powers for Commission and Parliament – are neither likely, due to the enduring popular political opposition within the Union's member states, nor desirable at this point of time, given the current absence of major preconditions for majoritarian democracy on the EU level (Nölke 2016b).

What are the structural long-term perspectives?

The Southern Eurozone will not return to high growth rates, as long as the Euro remains the common currency. Political disaffection with the Euro will continue. Increasingly, neo-populist parties on the right will be joined by parties on the left in their opposition to the Euro as a common currency (Nölke 2015, 2016c). The societies of the affected countries will have to choose whether they will opt for the way of the Baltic countries – large-scale emigration, particularly of the young and well-educated – or turn against the Euro.

The main challenge to the Euro will probably come from Italy. Although the economic situation in Greece, Portugal and Spain is at least as grave as in Italy, the populations of these three countries share a deeply positive connotation of the EU, given the coincidence of their membership within the European Community with the end of dictatorship. Correspondingly, there is a low likelihood that they will be the first to turn against the Euro, even if their economic situation becomes more desperate. Italy, in contrast, has been a founding member of the Community and does not harbor this type of restraint. It also still has a fairly diversified industrial base that would be able to capitalize on the devaluation effect of any Euro exit. Moreover, a fairly high share of Italian public debt is held under domestic law, thus somewhat decreasing the legal challenge of denomination in contrast to Spain for instance (Nordvig 2014). Finally, Italy does not remotely share the huge redenomination risk of public sector debt that Greece and Portugal would be facing (Durand and Villemot 2016).

After one on the Southern economies – or Finland, where the issue is contemplated as well but has been shelved for the time being in order to wait for the consequences of Brexit – has left the Eurozone and has proven that an exit leads to positive economic effects, once the initial turbulences have been overcome, additional countries are likely to leave the Euro as well. Hopefully, the Union then is prepared for a constructive dissolution of the Eurozone, for example based on a reformed version of the European Monetary System (Höpner and Spielau 2015), together with a European Monetary Fund that combines the resources of the European Stability Mechanism and the expertise of the European Central Bank (Nölke 2016d).

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