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Europe and the Eurozone: No Vision, No Strategy?

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The rise of populist parties across Europe is a severe threat to European integration. Irrespective of their underlying political ideologies, populist parties mainly benefit from widespread EU scepticism among their national constituencies. At the same time, criticising the EU is not about bashing Brussels anymore. It is about the South bashing the North, the North bashing the South, and some bashing Germany, quite often unfairly. It is high time for European leaders to recognise that the future of EU integration critically depends on a model of economic integration whose success is not measured by temporary success in plastering together a flailing Eurozone.

EU scepticism ranks at record high levels and anti-EU sentiment is gaining ever more momentum across Europe. While not new, a good part of the sentiment grew on the back of the Eurozone crisis and subsequent crisis-management policies. Europe's leaders made many promises, but were eventually caught up with political reality and failed to live up to the political expectations. Many Eurozone economies still suffer from economic stagnation and extreme unemployment. Public debt levels keep rising, accommodated by the ECB. The central bank continues to flood financial markets with money in a way that severely distorts asset prices, savings plans, and economic expectations. Most notably, the prosperity gap within the Eurozone keeps growing and many citizens consider themselves more looked down upon than ever before by the EU.

At the end of the day, support for any model of European integration will be won or lost on two central issues: the economic results it yields and if it can preserve a meaningful degree of political and economic sovereignty. On current trend, the Eurozone, currently at the heart of European economic integration, fails to meet both criteria. European leaders continue to follow trial-and-error policies to fight the economic forces that drive its members apart and threaten European unity. Yet these policies amount to only a weak defence. It is getting urgent to denounce the political illusions that are at the root of this trend.

Illusion 1: A single currency will finally facilitate deeper political integration of EU member states. The Eurozone was always a political rather than an economic project. Yet membership of the euro was previously associated with economic prosperity. Economies were fuelled by considerable capital imports. Public and private sector spending and income could rise. It is fundamentally different now. Many Eurozone countries are stuck in severe economic crises. For both insiders and outsiders, membership is now associated with EU-imposed austerity, lower standards of living, economic stagnation, decreasing incomes and painful cuts in retirement benefits. Eurozone membership is now the allegory of a gloomy future. This is the complete opposite of what the Eurozone's founders aspired to achieve: a solid fundament of lasting political unity. Yet the desired political integration is not on offer – far from it. No one should bet on the future of the Euro by assuming a 'fiscal union' or shared sovereignty over how governments tax and spend their resources.

Illusion 2: The Euro facilitates economic convergence between member states and yields rising standards of living. Today's crisis countries never had the productive structure to be as rich as they became after introducing the Euro. Their income was inflated by massive amounts of publicly or privately borrowed money that was consumed rather than invested and not used to upgrade their productive capacities. After a decade of artificial convergence, the welfare gap between the Eurozone's South and the Eurozone's economically better-off North is now rising. In 2007, Greece's per capita income constituted almost 70 per cent of the per capita income in Germany. It went down to less than 50 per cent when the credit boom ended. Portugal and Spain show similar patterns. Unemployment figures are alarming. While unemployment rates are lowest for Germany (4.8 per cent) and Austria (5.3 per cent), joblessness is record high and stagnating in

Greece (26 per cent), Spain (23 per cent) and Portugal (14 per cent). Notably, unemployment in the Eurozone's crisis-hit countries is far above that of non-Eurozone countries: Bulgaria, Romania and Hungary, for instance, show unemployment rates of 10.2, 6.4 and 7.5 per cent, respectively. The younger generations suffers the most in Greece and Spain, where youth unemployment exceeds 50 per cent. For many member states, the Euro only evoked the illusion of economic progress. Now the crisis countries struggle with the consequences of economic stagnation and poor economic expectations. Some call it a lost decade, but citizens may be deprived from a better economic future for a longer time.

Illusion 3: The survival of the Eurozone depends on fiscal discipline, structural reforms and the homogenisation of national legislations. What might look as a sine qua non in theory does not work out in practice. Intuition as well as empirics teaches that democratically elected governments are short-sighted. They tend to refuse structural reforms that are painful in the short-term and only pay off in the long-term. The old debate over which type of economic order produces better economic performance practically does not matter as long as governments do not run out of money or out of voters. In addition, structural reform programmes do not guarantee economic recovery. Germany's reunification offers a good example. Although productivity and income of the Eastern German economy has now reached 80 per cent of productivity and income in Western Germany, many regions in the East failed to attract investment despite extensive subsidy programs provided by the federal government and intra-German financial equalisation payments. It is one thing that Eurozone members consistently ignore appeals made by the European Commission for more stable fiscal policies. The transformation of an economic landscape is an entirely different matter. It cannot be delivered by the EU or imposed upon a country in a European semester procedure. It evolves over a long time.

The Eurozone has entered a crucial stage where future economic and monetary integration must genuinely be reconsidered. Despite the ECB's promise to stand by as the lender of last resort, the sword of exiting the Eurozone keeps hovering over every single crisis country. Although innumerable ad hoc policies aiming at the containment of the crisis have made the headlines and new institutions were set up for crisis resolution, the fundamental problems still prevail. Citizens and businesses in the crisis-hit countries live in fear of government default, the breakdown of national banking systems and capital controls. Therefore, European leaders face a crucial decision. It is the choice between *prolonged stagnation and growing EU scepticism* on the one hand and *long-term economic opportunities for crisis-hit countries and the renaissance of broader public support for the EU* on the other hand.

European governments' crisis resolution decisions have been made on the paradigm that the Euro is a sacred cow worth being protected from the abattoir. For some crisis-hit countries, however, exiting the Eurozone would improve economic expectations, business sentiment and investor confidence. Foreign investors hardly engage in countries that show some 50 per cent foreign exchange risk. The current economic and political environment do not allow for improvements in business confidence. Nor does it encourage reliable business planning. Amidst the financial market turmoil, many decisions were indeed needed to minimize the adverse effects of contagion and prolonged economic contraction. And the EU had to demonstrate that European integration is based on mutual solidarity. But after six years of economic stagnation, it is time to realise that solidarity became a rich source of political resistance rather than a source of economic strength.

The sharp rise of anti-EU populist parties in Europe is a direct consequence of European leaders failing to produce policies and institutions for lasting success. In a recent call for a new deal for Greece, Greek's finance minister Varoufakis once again badmouthed the Troika's strategic approach to focus on public finances, stating that it is 'no more than mere tactics'. Varoufakis argues that the new Greek government's 'undertakings are strategic, rather than tactical, and that [their] logic is sound'. The shame is that Varoufakis' call represents just another lip service of a government that is running out of other people's money. Previous Greek governments made similar promises. They did not work out. And many Europeans are just fed up by the fact that their governments invariably have to pick up the tab.

European leaders should acknowledge that monetary integration can produce unwelcomed economic and political outcomes. The larger the number of Eurozone member states, the less homogeneous the group; the more diverse formal and informal institutional landscapes, the less likely it is that commonly agreed rules will be respected. A new model for Europe would start with lasting policies and institutions for development, not the current design and structure of the Euro. In Europe's new development model, monetary integration would follow real economic and institutional convergence. Countries that fail to catch up would be free to leave. Monetary integration would remain the ultimate ambition for Europe. But a genuine single market, embodying the four freedoms, and greater real integration, should underpin it – and not, as today, hurried solutions for keeping the Euro together while core single market principles constantly get eroded.