Europe’s Perfect Storm
The Political and Economic Consequences of the Eurocrisis

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What exactly is the Eurocrisis a crisis of? Is it a currency crisis? A crisis of economic policymaking in Europe? Is it a crisis of a particular, expensive social model, as American conservatives like to claim? Or of the whole political project of European integration as it has been developing since the 1950s? The answer is, a bit of all of the above. In fact, it is a perfect political and economic storm, one that may still sweep away many accomplishments of the European Union—the greatest political innovation since the creation of the democratic welfare state. Even if the euro survives in its present form, the price millions of people will have paid for its preservation will be very high indeed. Quite apart from the economic disasters unfolding in Spain, Greece, and other countries, there have been less obvious but equally dangerous costs. The crisis has distracted elites from urgent political matters, above all, the rise of a new kind of illiberal politics in Eastern Europe. It has recreated political and cultural rifts between national elites long thought dead; it has also sown distrust and animosity between ordinary people. Not least, it leaves a deep sense of discontent and disillusionment with the European Union as such.

There is no consensus on either the economics or the politics of the crisis. Ask three economists and you will get four different answers as to what the underlying problems are and how to solve them. Ask historians why European elites created a common currency in the first place, and you’ll hear that it was the price Germany, with its strong Deutschmark, had to pay France for unification in 1990; but you might also hear that it was actually German business that wanted to eliminate exchange rate fluctuations. And if you ask political scientists, you’ll probably hear that Europeans will under no circumstances tolerate further integration to address the crisis—or an insistence on Europeans’ readiness to erect a full-fledged federal state, right here, right now. And, finally, if you ask the people themselves, you’ll get rants by Germans about lazy Greeks, and Greeks holding up posters of German chancellor Angela Merkel as a Nazi. Rarely, in recent memory, has there been so much confusion or outright disagreement both in elite circles and on the street.

This lack of consensus may seem obvious, but it is not trivial, as the European Union has always moved forward either by consensus or by compromise, a polite way of saying that reluctant populations were paid off to come along. Spain, for instance, was uneasy about fully joining the single economic market, fearing its industries might be uncompetitive; accordingly, Brussels invented “cohesion funds,” subsidies for infrastructure in the poorer regions of Europe, to create a package attractive for all. Today, there is no consensus—especially not between France and Germany, the traditional motors of European integration—and there is no money for what political scientists call “side payments.”

For all the conflicts and confusion, this was a crisis foretold. Already at the creation of the euro there was a clear sense that if European economies adopting the common currency did not converge, the eurozone would run into difficulties. The architects of European integration had long tried to reduce wild swings in exchange rates, because such fluctuations would distort what has been the core of the European project since the 1950s: the single,
tariff-free market. Yet all attempts had failed, until the early 1990s, when countries in Europe’s South urged a jump into full monetary union as soon as possible. Countries in the North, Germany above all, cautioned that European economies first had to come closer together; that is, Southern countries had to become more productive and squeeze out inflation.

In the end, a compromise prevailed: the euro became a reality in 1999, but in its run-up countries such as Italy did significantly reduce inflation. Yet the promise of the euro—that inflation rates of ever-more competitive economies would converge—has not been fulfilled. The average of European inflation has been on target, but individual countries have diverged significantly. Rates in the South have been too high; rates in the North have been too low; only France has been in the right zone (at around 2 percent).

Yet the Eurozone—created in the image of Germany’s central bank, but with even greater restrictions on following any kind of government line and without any mandate to promote economic growth—can set only one interest rate across the eurozone as a whole. The results have been unsustainably high levels of private debt and consumption in the South, where people were used to high inflation and currency devaluations, and welfare cuts, export booms and, ultimately, excess savings in the North. Again, no convergence of European economies.

Yet the North-South contrast—appealing as it is as a simplification that dovetails nicely with various more or less nasty national stereotypes—hides important fault lines. Of course “Northern” business did very nicely out of the Southern consumption boom, and “Northern” banks and private investors have continued to benefit from the various rescue packages, in particular for Athens. Within the South, there were crucial differences, too, as seen between Greece, which, everyone now agrees, should never have been admitted to the eurozone in the first place (Goldman Sachs famously helped to massage the figures) and which faced a real crisis of solvency in 2010, and countries such as Spain and Italy, where the crisis, at least initially, was about liquidity, not solvency, and which remain much stronger economies.

However, after the specter of Greek default and exit from the eurozone was created by Northern elites, the financial markets started playing the game of “who’s next?” In other words, bad policy-making had a significant role in spreading the crisis. This in turn exposed yet another underlying structural problem: once investors started differentiating between individual Eurozone members in terms of risk assessment, the peculiar nature of the European Central Bank as a federal bank that is not guaranteed by a sovereign state—and is prohibited from acting as a lender of last resort—meant that the crisis could not be addressed in the way that a “normal” federal nation-state would have done: by printing more money. Instead, the ECB has stretched its mandate here and there, seemingly favoring some countries over others and creating discontent all around.

There has been a standoff between two approaches to solving the crisis, each correct in certain economic respects and politically unfeasible in others. The German government has conceded on one point after another, but at this writing still insists that there cannot be any mutualization of debt—such as common Eurobonds that do not differentiate between individual countries, but which effectively would be backed by German strength—without supranational control of individual economies. Otherwise, the argument goes, the creation of a so-called “transfer union” would mean that some countries will simply keep spending the money of others. This could lead to a permanently deindustrialized South
essentially dependent on subsidies from the North. Germans are sensitive to this point not least because they have had a not-so-good experience with their internal “transfer union” between West and East Germany for the last twenty years: staggering sums of money have been spent in the name of “national solidarity” since unification, and still, the East remains largely an economic wasteland.

What is flawed in this vision is not the demand for structural reforms in the South: Greece really ought to shrink its bloated and in many ways dysfunctional state sector, clamp down on tax evasion, and make individual professions more open to competition—measures that, in knee-jerk reaction, have been derided by the Left as neoliberalism, even if the current Greek social contract is hardly a fair one, benefiting an oligarchy and the clientele of a corrupt political class only. Rather, the flaw is with the German insistence that structural change and fiscal austerity must be linked. As many economists have pointed out, cuts in the middle of a recession will not solve a debt problem; they will only deepen it. And no matter how competitive Southern countries might become, if there is no demand, there won’t be growth, a logic that is also beginning to affect Germany.

What is more, state debt was not really the problem of countries like Spain, which, under a socialist government over much of the last decade, proved exceptionally thrifty. The country was pushed into its current debt crisis only by irresponsible banks, giving rise to a vicious circle of private debt, public debt, and an ever more severe recession. Social over-spending was not the problem; the problem was created by the socialization of private losses (and, conversely, the privatization of gains), the very pattern that has characterized much of the aftermath of the meltdown of Lehman Brothers in September 2008.

In addition, there is no objectively right level of debt for any given country, and inflicting severe cuts on entire populations in the vague hope that this will restore market “confidence” has already provoked serious social unrest in Spain. As the Harvard historian Charles S. Maier has pointed out, in the past, deleveraging of the magnitude we now see in Europe happened through disposing savers or by increasing unemployment (youth unemployment in particular). Think of the first half of the 1920s in much of Europe, when Germany chose inflation (but also to keep up employment), whereas Britain protected savers by sticking to the gold standard. In each case, someone has to bear losses that have already happened (as has happened with Spanish real estate).

What can be done, then, or rather, what could be done differently? It is important to recognize that for all the contingent factors at work here—a badly designed currency union, admitting the wrong members to the club, mistakes in response to the initial Greek crisis—the problems of the eurozone ultimately touch on the very nature of the political project that is the European Union. So far, to pick up a celebrated formula by the lawyer Joseph Weiler, the Union has pulled off something that can be characterized as “federalism without a federal state.” The EU has created laws and rules obeyed by nominally sovereign European nation-states, even though in case of a failure to obey, Brussels cannot send in the troops or, in fact, do anything more than impose fines that would do little harm to the budgets of the bigger countries.

Why nation-states have obeyed is a question scholars of the EU have debated for decades: some hold that the European order has become like a supranational constitution that has gained its own freestanding legitimacy; others insist that European rules are legitimate because they have all been freely endorsed by national legislatures—sometimes with the implicit goal of disempowering those very same legislatures, making them immune to national interest groups pressing for advantages in the single market. “Brussels made us do it” has become an excuse much welcomed by many national governments, even if, at the same time, they complain about the supposedly undemocratic nature of the European Union.

Still, whatever one thinks about how the European Union came to be accepted by national governments (and electorates), the essence of its working was one of commonly agreed, in a sense depoliticized,
rules, voluntary rule-following, and sanctions in case of rule-breakings. For the single market this logic largely worked. But it has not worked for the currency union. Markets do not believe in voluntary rule-following

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and they do not believe in sanctions as they currently exist. The Eurocrisis has exposed a stark choice: dismantle or at least shrink the eurozone to such an extent that voluntary rule-following becomes credible (even though advocates of a “Neuro,” a Northern Eurozone, tend to forget that “Northern” chancellor Gerhard Schröder, in alliance with France and Italy, was instrumental in first weakening the rules in 2005). Or, alternatively, centralize supervision. Instead of relying on self-monitoring (as has famously failed with the Greek state), toughen sanctions and take decisions on whether to apply sanctions out of the hands of nation-states.

When European elites—German politicians in particular—talk about “political union,” this is what they mean: weaken legislatures, the ones in the South in particular; establish close supervision of national budgets by supranational, unelected institutions such as the European Commission in Brussels; and put the power to sanction in the hands of institutions removed from popular will formation, such as European courts. In other words, the European Union would take on at least some characteristics of a state.

The political logic of this proposal is plain. Merkel has gone on record as saying that if the euro fails, Europe—that is, the project of European integration—fails. German politicians have insisted that Germany’s national interest is inextricably tied to this project, hence, Europe cannot fail. Yet it is politically unacceptable for a German government to keep paying for Europe as a whole; that is, to sign on to a “transfer union” without thorough checks on the nation-states receiving money.

Hence “political union” is something like a desperate *fuite en avant*, as the EU, unable to undo the currency union, urges deeper European integration as the only choice. It is not the stuff of conspiracy theories to assume that some avid supporters of a European federal state wished for this very scenario all along: they knew the euro would not work and would thus necessarily lead to “more Europe.”

Yet one problem that has plagued the eurozone will probably haunt it even with some sort of political union: rules based on numbers such as a 60 percent public debt-to-GDP ratio seem essentially arbitrary and are legally hard to enforce. Fiscal coordination is a realistic hope; optimal fiscal consolidation cannot be determined by either Eurocrats or markets, no matter what the economics textbooks say.

In any case, one must ask, are German politicians serious about political union? Some observers think they are not: according to them, demanding a further transfer of traditional nation-state powers to Brussels will be unacceptable to France, and the Germans know this. But this way they can blame the failure of the eurozone on Paris. Still, there are signs that Germans do mean what they say—and hope it will happen. Finance Minister Wolfgang Schäuble has claimed that within five years the Germans might have to vote in a referendum on a new constitution which allows for more power in Brussels. The president of the German Constitutional Court, the most powerful and respected in Europe, has voiced similar expectations. This is in itself extraordinary: the constitution, together with the Deutschmark, was the great symbol of postwar German success. First, the Germans were asked to surrender the Mark for what is effectively a softer currency, the euro; now they might be asked to bid farewell to what has been the longest-lasting constitution in German history. But they might do so—if asked nicely and provided with good arguments.

*Yet good arguments* cannot simply come down to “the markets made us do it.” Nor will it be plausible for European elites to claim
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that they initially wanted the euro in order to create a federation, but that they now have to create a federation in order to save the euro, when many European peoples might not want such a thing. In other words, how could “political union” be democratically legitimate? Its advocates agree that deeper integration cannot happen without more supranational democracy, because national parliaments will necessarily be weakened. Without a sense of democratic ownership of political union, however, populists—who have been thriving across the continent—will gain even more support. They will charge that yet again distant supranational elites are imposing schemes that benefit only banks. Yet no real decision-maker has put forward any blueprint for European democracy. It is a bad omen that the core group of politicians working on such proposals does not even include the president of the European Parliament—the only European institution that is elected directly by citizens.

Finally, step away for a moment from the immediate day-to-day crisis and assess what the euro’s troubles have meant for politics in Europe as a whole. As I have argued in these pages (Spring 2011, “The Hungarian Tragedy”), an illiberal politics has been on the rise in Central and Eastern Europe. First Hungary, then Romania witnessed what can only be described as an attempt to dismantle checks and balances and establish a Putin-style “guided democracy.” Such backsliding toward illiberalism was never supposed to have happened in the Union at all: once inside the club, countries were to count their liberal-democratic blessings and be immune to authoritarian siren songs. The EU is not just a single market, but a community of non-negotiable political values. In the case of Romania, Brussels did react swiftly and force the government to take back some of its self-serving emergency decrees; on Hungary, the record has been more mixed. The crucial point is this: European elites have had to spend so much attention (and political capital) on the Eurocrisis that other threats to Europe’s political order have been neglected. They have also effectively abandoned any promise that Europe could serve as a model for other world regions. It is almost forgotten that only a few years ago leading intellectuals such as Jürgen Habermas would advocate for the EU as an agent to “tame” globalization and counter neoliberal ideology. Meanwhile, Russia and China have probably lost whatever respect they might have had for the European Union; and in the United States, where, the financial crisis originated, Europeans are now routinely scolded for not getting their act together. Europe has already paid a high price for its financial experiment in federalism without a federal state.