The Future of the Euro

Matthias Matthijs and Mark Blyth (eds.)

Oxford University Press
(2015)

Book Abstract

The Future of the Euro is an attempt by political economists to analyze the fundamental causes of the euro crisis, determine how it can be fixed, and consider what likely futures lie ahead for the currency. The book makes three interrelated arguments that emphasize the primacy of political over economic factors.

First, the “euro problem” is discussed as the result of the single currency’s fundamental lack of institutional embeddedness, insofar as its original design omitted three ‘forgotten unions’ alongside of monetary union: a financial and banking union, mutually supporting institutions of fiscal union and economic government, and a political union holding similar legitimacy to the nation-state.

Second, the “euro experience” shows how the euro’s unfinished design led to economic divergence – quietly altering the existing distribution of economic and political power within Europe prior to the crisis – which in turn determined the EU’s crisis response. The book highlights how the euro’s four most important members – Germany, France, Italy and Spain – each changed once they adopted the euro, why the crisis affected them so differently, and how each has since struggled to live with the commitments the euro necessitates.

Third, the book examines three possible “euro futures:” through the lens of the politics of its reluctant leader Germany; through the lens of the EU’s capacity to ‘move forward’ through crises; and through the geopolitical lens of the international monetary system. The book concludes that any successful long-term solution to the euro’s predicament needs to start with the political foundations of markets.

Chapter 1
Introduction: The Future of the Euro and the Politics of Embedded Currency Areas
Matthias Matthijs and Mark Blyth

This chapter lays out the overall framework of the book and sums up its main arguments. The chapter argues that while the Eurozone crisis was in many ways a direct consequence of the US 2007-08 financial crisis, what quickly became known as the European 'sovereign debt' crisis was nonetheless a long time in the making. The chapter critiques a purely economic understanding of the euro crisis, emphasizing instead the political foundations of markets. The chapter proposes that to achieve a better understanding of the euro one should begin by looking at the 'minimal' conditions required to make a multi-state currency union work. Only then should one ask whether Europe has those conditions in place or is likely to construct them anytime soon.

SECTION I: THE EURO PROBLEM

Chapter 2
Forgotten Embeddedness: History Lessons for the Euro
Kathleen R. McNamara

The fact that Europe is not an "Optimum Currency Area" is the wrong diagnosis for Europe's woes. Instead, McNamara argues that the Eurozone's biggest challenges lie not in its economic 'suboptimality' but in the fact that the euro is fundamentally 'disembedded' from the specific social and political institutions needed to provide a solid foundation for a monetary union. Markets need political authority to create stability, and a lack of governance will make the euro more vulnerable than its shortcomings as an optimum currency area. The history lessons of previous monetary unions – understood on a continuum of 'least embedded' to 'most embedded' – tell us that, if the euro is to succeed, the Eurozone should be transformed into an "Embedded Currency Area" (ECA) with a true lender of last resort, a fiscal and banking union, and an accountable and legitimate political union.

Chapter 3
The Forgotten Financial Union: How You Can Have a Euro Crisis without a Euro
Erik Jones

Two narratives typify the economic and financial crisis that befell Europe: one emphasizes the single currency's design flaws, the other focuses on the single market. While the two narratives are not mutually exclusive, the single currency narrative tends to garner more attention. To right this imbalance, Jones demonstrates that the failure to construct common institutions to safeguard Europe's financial markets was itself a critical mistake. When Europe's political leaders pushed for capital market integration and the liberalization of cross-border banking in the late 1980s and early 1990s, they failed to build common Europe-wide institutions to ensure financial stability. Instead, they held onto 'national' institutions for regulation, supervision, resolution and insurance.

Thus the absence of a financial union was sufficient to bring about some sort of crisis. If Europe's policymakers refuse to rectify the situation, the chapter concludes, they will have to relive the experience.

Chapter 4
An Elusive Economic Government and the Forgotten Fiscal Union
Nicolas Jabko

This chapter argues that another crucial aspect of the euro problem lies in having a common monetary policy without a common economic government. This conflict of 'divided sovereignty' became evident in the crisis, but it was not at all new. Under intense pressure, member states have de facto moved toward shifting more sovereign powers to the EU level, adopting treaty revisions that could reshape the landscape of economic governance such as the creation of the ESM, the Fiscal Pact, the Banking Union, and a "Pact for Growth and Jobs." Yet the crisis will not abate as long as the credibility of collective economic governance is in doubt. The main question that will determine the euro's future, according to Jabko, is whether the euro member states will continue to move toward stronger EU economic governance, or whether they will eventually reassert the national locus of sovereignty.

Chapter 5
Forgotten Democratic Legitimacy: "Governing by the Rules" and "Ruling by the Numbers"
Vivien A. Schmidt

Schmidt's chapter argues that the policies and processes adopted by the EU in the face of the euro crisis have in fact exacerbated long-standing problems of EU legitimacy and solidarity. Democratic legitimacy has suffered because Eurozone policies have failed to produce good outcomes and because EU citizens have even less say than ever over those policies. Indeed, the excessively intergovernmental processes of Eurozone crisis governance – the ECB acts, the member-state leaders in the European Council decide, the European Parliament is side-lined, and the European Commission serves as a secretariat – have unbalanced the EU's long-standing 'democratic' settlement in which all three latter institutions pulled their weight. By 'governing by the rules' and 'ruling by the numbers,' EU institutional actors seem to have forgotten that democratic legitimacy demands not just rules to follow but policies that both work and appeal to the citizens.

SECTION II: THE EURO EXPERIENCE

Chapter 6
Germany's Euro Experience and the Long Shadow of Reunification
Abraham Newman

Newman's chapter examines Germany's critical role in Europe's regional architecture. The German government has pushed a euro crisis response motivated by a concern for the moral hazard generated by other member states. As such, Germany has played the role of reluctant leader – cautious and circumscribed – a strategy that was not without risk. While a number of academic and policy analyses have suggested that this halting response inflated the cost of the crisis by sowing the seeds of market doubt and contagion, it is important to understand why policy frames stressing either German exports or the risk of contagion were rejected in Berlin. This chapter stresses how the costs and timing of German reunification combined with the post-2005 economic recovery, relative to the timing of the euro crisis, set in motion a series of political economy dynamics that favored the use of the 'moral hazard' frame over other possible crisis alternatives.

Chapter 7
Europe's Middle Child: France's Statist Liberalism and the Conflicted Politics of the Euro
Mark I. Vail

Vail's chapter concerns the contradictions and inconsistencies that affect France's position as Europe's 'middle child.' Three factors have generated a particular set of trajectories in France's financial and economic policy: the competing allures of statism and liberalism; France's vacillating commitments to Keynesianism and austerity in policy; and the decline of its core partnership with Germany. The chapter's central claim is supported by an empirical study of the political debates surrounding the incipient Economic and Monetary Union in the late 1990s and the European financial and ensuing Eurozone sovereign debt crisis after 2007. In both of these instances, but most obviously in the latter, French policy was guided by these contradictory imperatives. As a result, its position and ability to shape policy in Europe is much diminished.

Chapter 8
The Troubled South: The Euro Experience in Italy and Spain
Jonathan Hopkin

Hopkin's chapter argues that the fate of the euro hangs on the outcome of the crisis in the Southern European democracies. Moving beyond the standard narrative of debtor and creditor nations, it examines the political and distributional consequences of EMU within the 'big two' Southern member states, Italy and Spain. The chapter demonstrates how the euro brought big gains to the sheltered, non-tradable sectors of the economy, whilst manufacturing workers saw wages stagnate. The policies imposed on the South in response to the crisis, however, have come down hard on unionized workers and other lower income groups, whilst protecting the politically powerful lobbies that gained during the boom. Southern Europeans have shown remarkable resilience during the crisis, but the imposition of austerity and reform constitutes a major natural experiment with high stakes: it counts on Southern European citizens maintaining their unwavering commitment to the euro to justify years of sacrifice.

SECTION III: THE EURO FUTURE

Chapter 9
Europe’s New German Problem: The Timing of Politics and the Politics of Timing
Wade Jacoby

Jacoby’s chapter adds an electoral and federal dimension to Germany’s euro crisis response that allows us to project future German policy by considering two distinct worlds. In the first world where the ‘timing of politics’ matters, German policymakers accept the need to act, but they want to pick the optimal time of intervention to maximize the efforts of private actors to deter moral hazard. In the second world where ‘politics of timing’ matters, German elites feel they cannot intervene until they have properly prepared their voters. These two worlds operate simultaneously, with the result that if one lives in the first world, patience is a virtue: elites should wait and minimize moral hazard. If one lives in the second world, patience is a vice: windows of opportunity for stemming the crisis slam shut. Living in both worlds at the same time leads to weak and inconsistent policy.

Chapter 10
European Integration Past, Present, and Future: Moving Forward through Crisis?
Craig Parsons and Matthias Matthijs

Parsons and Matthijs’ chapter tests the claim that “European integration always moves forward through crisis.” After reviewing the historical record, the authors conclude that no major step in the EU’s institutional development responded in any clear way to a crisis. Rather, the major steps that led to today’s EU followed from a positive organizational project and a meeting of minds. The chapter further argues that while the EU suffered its first “real” crisis in 2010-12, its response has been reactive, slow, ad hoc and minimalist. And while the EU has made itself somewhat better able to respond to similar crises in the future, it has not actually addressed the euro’s underlying vulnerabilities. Successful projects of reform in huge political organizations rarely arise as technically necessary responses to crisis. The authors posit that only a positive vision of new goals will allow the EU to recapture a sense of forward movement.

Chapter 11
The Future of the Euro in a Global Monetary Context
Eric Helleiner

Helleiner’s chapter places the future of the euro in geopolitical context, viewing it through the lens of the international monetary system. The global financial crisis (and the euro crisis that followed) revealed quite starkly both the hidden sources of the dollar’s dominance, as well as the weaknesses of the euro’s international standing. These events also drew attention to a new rising international monetary power, China, whose influence on the euro’s prospects were felt by Europeans for the first time in a significant way. These two factors humbled those Europeans who harbored aspirations for the euro’s global role. Yet over the longer term they may serve to boost political prospects for the euro as the desire to challenge US monetary power may bolster European backing for reforms that take regional monetary cooperation to the next level.

Chapter 12
Conclusion: The Future of the Euro – Possible Futures, Risks, and Uncertainties
Matthias Matthijs and Mark Blyth

The book's conclusion is unusual for an edited volume. Rather than simply rehearse all the arguments in short form as conclusions normally do, this chapter teases out the observable implications of each of the arguments for the future of the euro going forward, and tries to make predictions on that basis. This chapter first compares the sequencing of political institution building between the European Union and the United States, and then moves on to note the significant developments in the EU since the euro crisis, including the changing Franco-German alliance, the return of the North-South gap, the new dynamics in EU decision making, and the legal implications of the euro going forward. It then applies a typology of 'white, grey, and black swan' events that correspond to the observable implications and presents the possibility of each 'swan' for charting the likely future of the euro over the next several years.

****