The Crisis and Its Potential Consequences on the Development of the European Union

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Introduction

The political agreement on a new intergovernmental treaty reached by 26 member states in December 2011 is at best a temporary solution to the problems of the eurozone and of the European Union. In truth, European integration seems to be moving towards a “three-speed” Europe.

The intent of 17 eurozone members and 9 other countries to come to an agreement is a timid step in the right direction, but it is only a half-measure, because a real fiscal union and enhanced European economic policy coordination are necessary if the euro is to survive. Moreover, as demonstrated on many occasions, intentions generally do not lead to concrete measures. In other words, even this timid plan may well sink into the political quagmire of the member states.

Why should this theoretical agreement be regarded as no more than a half-measure? The reasons are several: at the December summit, Germany was not prepared politically for the introduction of euro bonds; the French government was opposed to European control of economic policy; and the European Central Bank (ECB) was unwilling to buy (even temporarily) large amounts of government bonds. Yet a viable solution could have been based on these three pillars.

It should be noted that many elements of the current deal aimed at strengthening fiscal discipline are already present in EU law, but the rules in question were not adhered to by member states. It is unclear what could motivate them to comply with fiscal restraints in the coming years. The political history of the eurozone demonstrates that it is precisely at times of recession that member states tend to abandon the rules. The implementation of automatic sanctions is no guarantee of a recovery in Greece or that Italy’s public debt will decrease from the unsustainable level of 1900 billion euros to a more manageable level. The imposition of sanctions on member states that are struggling to cope would be counter-productive, because it would withdraw further resources from countries that are already cash-strapped.
If all goes according to plans, the new fiscal compact, which aims to deepen economic integration and resolve the debt crisis permanently, will be signed by member states in March – after the necessary parliamentary consultation in some countries (e.g. Hungary and Sweden). However, as already mentioned, there are many factors of uncertainty.

The two-speed Europe created by the decision of the UK to opt out will inevitably be followed, in my view, by a three-tier structure. The public in some member states – for instance, Ireland – will most likely reject the proposed changes in referendums, while other member states will try to force through concessions in the negotiations. Several eurozone members will opt to leave the eurozone or be forced to do so by the markets.

In order to restore the single currency zone, a high-level fiscal union must be created, which will require further measures of economic integration, such as the creation of a European finance minister, a far bigger EU budget, and an effective bank supervisory authority at eurozone level. Not all members will be able or willing to go that far in the medium term. Thus the core group will probably comprise the six member states with the best (AAA) credit rating – Germany, France, the Benelux countries and Finland. The next group would be made up of other members of the current pact (countries that currently use the single currency), while member states outside the eurozone would constitute the third group. While economic growth is the only means of overcoming the crisis, fiscal restraints will inevitably thwart growth in the initial phase. As a result, Europe faces some difficult years.

A two-speed Europe has already come into existence in practice with the UK’s decision to stand aside. Nevertheless, the dynamics of integration are extremely uncertain. This is partly because the alliance between the 17 current members of the eurozone and the voluntary participants is not a stable formation; for many of them, the bar will be set too high, and they will not be able to accept the degree of harmonisation needed to save the euro. An additional factor is that integration is to proceed on an intergovernmental – rather than supranational – basis, and there will be a need to clarify the roles of the EU bodies, in particular that of the European Commission. And, most importantly, the December agreement will not be effective at calming the financial markets, which have been watching anxiously as the EU searched for a way forward but saw itself divided in two with the UK’s departure. Clearly, the summit of December 2011 was not the last summit dedicated to saving the euro.

Leaving aside the abrupt changes in the markets and in politics and ignoring for a moment the shifting percentages and the hundreds of billions spent on crisis management, it is helpful to place the euro crisis in a historical and political context if we wish to have a better understanding of the situation and be able to predict precisely what lies ahead.
The Crisis and Its Potential Consequences

The Historical Context

The euro is one of the most sophisticated results of the process of modern European integration. It is also a symbol of peaceful collaboration between European countries, which has been accompanied by, or has resulted in, unprecedented levels of peace, stability and prosperity in Europe. The EU is not the first attempt to unify Europe, despite all claims to the contrary made in the last 50 years.

After the break-up of the first “European Union” – the Roman Empire – a shared Christian faith and a common enemy (the appearance of Islam in the 7th century) paved the way for a sense of European solidarity – a factor that should not be overestimated. “Who can understand all European languages, who knows all the traditions of the European peoples? Who could possibly conciliate the English and the French, unite the Genoans and the Aragonians or the Hungarians and the Czechs?” Such were the words of Pope Pius II, which he expressed after failing to unite Europeans against the Ottoman Empire.

Charlemagne, the father of Europe (pater Europae), was the first to attempt the integration of Christian Europe. His seal bore the words: Renovatio Imperii Romani. There is no better evidence for the fundamental symbolic significance of Charlemagne than the centuries-long dispute between two major European peoples – the Germans and the French – about whether this great ruler was “German” or “French”. In the age of Charlemagne, Europe was no more than a loosely defined geographical designation and an expression of nostalgia for the Roman Empire. It took almost a thousand years for this to change. Charlemagne’s rule and empire were short-lived, just like those of the “Europe-integrators” that appeared on different sides of the Rhine a thousand years later, Napoleon and – in his own terrible way – Hitler. The peoples of Europe fought many wars against each other during subsequent centuries.

In the medieval period, Europe did not exist at all in a “political” sense. Nevertheless, a shared religion and common traditions, to an extent, marked the cultural borders of the continent. The idea of “unifying the civilised lands under one ruler” was never lost, and Latin as a language remained a cohesive force for a long time.

Modern Europe was born after the first real “world war”, the Thirty Years War, in the 17th century. Relations between the political states and between the centre and periphery (which was a defining feature for a long time) became ossified between east and west. By the beginning of the 19th century – roughly at the time when nation states evolved – it became natural to refer to Europe and to a special European civilisation. But even before this, in the age of the Enlightenment, European civilisation was increasingly defined – in isolation from religion – as a continent that had the most developed culture and economy, and where – uniquely in the world – there was an opportunity for freedom. France established the prototype of modern constitutions,
which many European nations would use as a model in subsequent decades. Liberalism and a constitutional system of government evolved in parallel in Europe. But once again – and more bloodily than ever before – a war was needed for the ideal of European integration to germinate. Unlike earlier attempts at integration – which were based on conquest or on imperial prestige – modern European integration has been a voluntary alliance of member states committed to a common set of laws. It is however important to remember that European history has been characterised primarily by war, conquest and conflict rather than by peace and co-existence.

**The Relationship between the Euro and Integration**

Despite its undoubted successes, modern European integration is – in historical terms – an extremely unstable and fragile phenomenon. The main reason for this is the absence of a precise self-definition. Europe is still a nascent formation, consisting of political compromises, a common system of law, and political and institutional responses to crises. Although the peoples of Europe have lived side by side for thousands of years, they do not share traditions, living myths, a common identity or language; nor do they project a single image towards the outside world. The political class and the intellectual elite are just as divided: some want more Europe, while others think that even the present level [of cooperation] is far greater than desirable. The underlying reason is that no one has a clear picture of the function, goal and future development of the EU; there is no agreed vision.

One of the two conflicting schools, federalism sets out the ultimate (political) goal and it plans the necessary constitutional steps towards this goal. In contrast, functionalism proceeds step by step in the form of concrete – mostly economic – measures. Federalism would like to concentrate the power of the nation-state in the hands of integration, while functionalism seeks to combine the activities of states at a higher international level. Federalism would like to curtail state sovereignty and it condemns nationalism. The aim of federalism in its pure form is to unify states by constitutional means, whereas functionalism seeks to develop a framework for economic and social welfare through the cooperation of participating member states and shared organisations. In federalist ideology, governments and states are considered the central actors of integration, whereas for functionalists this role is fulfilled by organisations at the “sub-governmental” level, i.e. economic actors and interest groups. Legal regulation has a central role for the federalist school (which has a more uniform doctrine than functionalism with its numerous branches). In contrast, functionalism considers legislation to be simply one means of integration.
Federalists believe that the time has come to establish a United States of Europe, or more accurately, that now is the last opportunity: the alternative is a collapse of the integration project. Many people believe, however, that political union is not only unnecessary but also impossible in Europe. Many member states, much of public opinion and of the European cultural elite reject the idea of a political union. In addition, Europe is not yet prepared mentally for such a union. In my view, there are three reasons for this. First, the lack of common European traditions, identity and language. Second, the member states having extremely divergent visions for the European Union and holding a variety of opinions on what is the ideal economic and social model. Third, it is a physical impossibility to create a unified political union out of a Europe that has 27 members and is expected to expand continuously. Consequently, the result will inevitably be a multi-speed Europe. In late 2011, the United Kingdom (the most striking advocate of functionalism and, of course, the most determined opponent of a single currency) in a rather odd manner – and contrary to the appraisal of the British government – did great service to the EU while causing great damage to itself: it did not oppose (because it is not strong enough to do so and it is not in its interest to do so since a collapse of the euro would push its own economy deeper into crisis) the formation of a multi-speed Europe. John Major himself is encouraging continental countries to form a closer economic and political alliance – naturally, without the UK. Thus the British have stood aside, thereby creating a good pretext for the German–French duo to press on with establishing Core Europe while avoiding the EU-27. Why do they feel this is necessary? Why are they setting off in the direction of closer economic policy cooperation and political integration, even though this will be accompanied by a further reduction in their sovereignty? The reason is that surrendering more of their sovereignty will be far less painful than a euro meltdown. Moreover, Chancellor Merkel seriously believes that the demise of the euro would be the downfall of the EU (never mind that the Czech foreign minister has stated otherwise). The French–German tandem will go out of their way to save the single currency.

Why, then, is the euro so important to European integration? By creating the euro (which was in many respects an irresponsible enterprise or a visionary act, depending on one’s perspective), Europe crossed the Rubicon: it pushed integration to a point of no return where it either presses on with a fiscal and political union or must bear the catastrophic economic and social consequences of a break up of the common currency.
Monetary Union as Such

More than 120 years ago, the editor-in-chief of *The Economist* wrote that “one day Europe – excluding Great Britain – would have a common currency”. But what is monetary union? Contrary to popular belief, monetary union does not necessarily mean a common currency – albeit the eurozone is such a system. The minimum precondition for a monetary union is to have fixed exchange rates of participating currencies and full convertibility. At the other extreme, monetary union means the complete abolition of the participating currencies, their replacement with a single currency and the establishment of a common central bank – this is what happened in Europe in recent years as part of monetary union. A major advantage of monetary unions is that they reduce currency volatility and eliminate the costs of currency exchange. The main disadvantage is that member countries lose an important instrument of economic policy, which can be used to regulate their economies: they entrust monetary policy, including the setting of interest rates, to a central body – in our case to the European Central Bank (ECB) in Frankfurt am Main. Member countries with weaker economies thus fall into a trap, unable to artificially devalue their currency. Nevertheless, the surrender of sovereignty in favour of a monetary union is no new phenomenon. Indeed, in 1867, three great powers of the era – Great Britain, France, and the United States – seriously contemplated the idea of a global currency. True, before long, they realised that the idea was unrealistic. Still, monetary unions have been formed in almost all parts of the world – only to be abolished usually after a few decades. In what is now the United States of America, was by four New England colonies a monetary union in 1750, the essence of which was their recognition of each other’s currencies. Of far greater significance was the Latin Monetary Union, established on a French initiative in the second half of the 19th century (the members were France, Belgium, Italy, Switzerland, Greece and Bulgaria). The Franc Zone was formed, which was similar to the post-WWII D-Mark area in Germany; insofar as, it operated under the influence of a dominant strong currency. The Latin Monetary Union had a common currency, but there was no common or coordinated monetary policy. It was officially disbanded in 1926, but it had lost most of its significance some time before that date as the Anglo-Saxon world began to peg their currencies to the so-called gold standard. The Scandinavian Monetary Union, established in 1873 with the involvement of Sweden, Denmark and later Norway, was also short-lived. There have been monetary unions closely linked to nation-states, such as the monetary union of the Austro-Hungarian Empire, or the Prussian-dominated monetary union established by Bismarck after German unification and the formation of the German Customs Union (*Zollverein*). Bismarck forced Germans, who were using more than a dozen different currencies, to accept the Reichsmark as an exclusive means of exchange, which only the Reichsbank was entitled to print. The Bismarckian
monetary union was extremely stable; it survived an economic depression and two world wars. How? The reason is simple: the currency was backed by an increasingly unified state. Less well known is the fact that Belgium and Luxembourg also formed a monetary union from 1921 – which was only superseded by the introduction of the euro.

The greatest and most ambitious monetary union of all time, the Economic and Monetary Union, or eurozone, is a pre-eminent symbol not only of Europe, but also of an extremely ambitious political project, which – as many people thought at the time of its inception – not only put the finishing touch on the single market (far from complete), but also revived the idea of a political union and a United States of Europe.

The European Monetary System (EMS) was established in March 1979. The aim of the Exchange Rate Mechanism (ERM), part of the EMS, was to minimise exchange rate variability. Under the system, members had to follow the monetary steps of the country with the strongest currency – Germany – if they wanted to keep their exchange rates within the margins. The system was, in effect, an exchange rate system fixed to the policy of the German central bank, the Bundesbank. In other words, it was a quasi-fixed exchange rate system. Owing to the success of the system, the idea of monetary union surfaced once again. This required the full convertibility of participating currencies, the complete elimination of capital restrictions, and the irreversible fixing of cross rates of exchange. As already noted, a single currency is not necessarily needed in order to establish a monetary union, but it is, to a certain degree, the culmination of the process and will accompany the introduction of a common, supranational monetary policy.

The founding fathers perceived – correctly – that the mere coordination of national monetary policies would not be sufficient, due problems of credibility. Yet, they could not foresee that Greece would cook the books and report false economic figures when applying for eurozone membership. Nor could they predict that five years after the introduction of the euro, one in two member states would exceed the prescribed budget deficit ceilings. Moreover, a common monetary policy required a proper institutional setting: a central bank for Europe had to be established to take over and expand the role of the Bundesbank and guarantee the value of the common currency. And, of course, there was a need for standards, which, if met, would guarantee that acceding countries were worthy of the euro and would not jeopardise its stability. Such standards were expressed in the form of the famous Maastricht convergence criteria, which governments throughout Europe are finding difficult to meet even today. More than once, European capitals have blamed election defeats or the need for austerity measures on the Maastricht criteria. But it is not the criteria that are misguided; in fact, as we have seen, they are actually rather insufficient. The fault lies with overspending governments, which undermine the future of their rapidly ageing societies. This is one of the most critical issues facing the European economy. The stability and credibility
of the euro are no minor matter, but disciplinary measures imposed by Brussels have sparked great passions and have stirred considerable controversy. As has Frankfurt’s intransigence, whereby the ECB sought to isolate itself – until now and the accentuation of the crisis – from the influence of member states.

The introduction of the euro was basically a politically motivated decision; its message was the continued evolution of the spirit of European unity. There were, of course, more subtle considerations in the background: by placing monetary policy in the hands of a common central bank, France and the Netherlands increased their independence from Germany and the German Bundesbank, which had dictated European monetary policy not by force, but due to market realities. Meanwhile, Germany, by renouncing its monetary policy hegemony, was able to make a gesture to countries anxious about the increased strength of a newly unified Germany. It proved its “Europeanness” by giving up the Bundesbank’s hegemonic role and the Deutschmark – one of the most successful currencies of all time.

“The euro is no more than a fixed exchange rate system sealed in a glaze of political glory, in which otherwise economically incompatible countries are linked together by poorly functioning rules, and which a few global hedge funds (here they are again, our friends the hedge funds) could, if they wanted to, destroy in a single day. The euro is lucky that – so far – it has not been in their interest to do so.” Such opinions were commonplace in the press – above all in the British press. “The euro will be abolished in 20 years time,” American financial investors said following the introduction of the currency. In 2012, we are more inclined than ever to take these predictions seriously.

Clearly, the eurozone is not an optimal currency area (OCA) – based on the criteria of the theoretical model. History has shown that a monetary union can be successful if there is at least one economic powerhouse acting as the driving force of the alliance. Historically, monetary unions have established central bodies to oversee and enforce the rules. The more successful ones were those that were preceded by political unions (US, UK, Germany). The flexibility of wages and prices within the currency area is a basic requirement. For instance, wage restraint should be a possibility in regions with weaker economic performances. And inter-regional transfers may also help. Another necessity has been the setting of criteria for economic convergence and their implementation. In the eurozone one can hardly speak of true labour market flexibility or, indeed, of a political union. Moreover, the EU budget is not capable of making significant income transfers, for it amounts to a mere one percent of European GDP. The other “conditions” are met. In contrast to a US federal budget of EUR 3.3 trillion, the EU has a “federal” budget of only EUR 120 billion – much of which goes to non-eurozone member states. The difference between the two monetary unions in terms of income-transfer capacity is quite evident. Furthermore, in the absence of a European identity, it is far more difficult – and this is a proven fact – to persuade a German of the use of spending even more of

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his money to rescue the Greeks than it is to convince a Californian of the importance of providing financial support to the good people of Utah.

The European monetary union appears to have serious operational deficiencies, which are rooted in burgeoning differences within the zone (e.g. in terms of inflation, productivity and growth rates, or related to the current account deficits of individual countries vis-à-vis Germany), as well as in the problems of the institutional framework itself. And on top of it all, gaps are growing rather than narrowing. The most important deficiency is the lack of real economic policy coordination. The euro is a political creation – and it is politics that must now save it.

As noted in the introduction, currency unions not based on a single country have been – historically speaking – remarkably short-lived. It was also noted that the euro was a political project without a true political union backing it. Even so, this half-baked project has functioned surprisingly well for a decade. Indeed, the euro climbed to above parity with the dollar, inflation was kept low by the ECB and the euro increasingly became a reserve currency of choice. At the same time, however, some serious underlying problems and imbalances accumulated, and the outbreak of the global crisis clearly revealed the weaknesses of the common currency’s institutional framework.

**The Crisis as Such**

The world has already experienced a period of global capitalism – from the end of the 19th century to the outbreak of World War I. During these years the movement of capital, goods, persons and information was completely free in the capitalist world. Moreover, a global gold standard was operative, in which, at the turn of the 20th century, each country participated – with the exception of China and Persia. Growth rates were very high, living standards improved steadily, poorer countries were catching up with richer ones rapidly, and modern businesses were formed (among them the predecessors of today’s multinationals). Everyone thought the miracle was unstoppable, but something was not right. The world was beset by political tensions. The Balkan peninsula was a “powder keg”, French–German antagonism was becoming more acute, and unified Germany, increasingly self-confident and powerful, was demanding its place at the table of the world’s great powers and colonial masters. Still, there were also less spectacular reasons for the collapse, which hold relevant lessons for us today. At the time of the first liberal world order, globalisation spread across the world at an extremely rapid pace. In other words, economic links became completely free from one moment to the next: there was nothing to hamper the free movement of goods. This was equally true for agricultural produce, which flooded into Europe from the New World, causing serious
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livelihood problems for the farmers of Europe, whose production methods were more costly. During the same period, there was increasing hostility to globalisation, but governments could easily keep things under control, with workers’ movements only beginning to emerge, democratic rights limited, and multinational corporations with strong lobbying power nonexistent. In the wake of a war fuelled by political and social tensions, representative democracy and European social democracy grew in strength, and the first steps were taken towards a welfare state as a means of reducing such tensions. Global capitalism was not the cause of the problems (the increasing poverty, dictatorship and war), but it did stir up the world economy, forming links between economies on various continents at breakneck speed and eliciting rapid social change. The root of the problem – aside from the geopolitics of the era – was the failure of governments to recognise the need to deal with social issues.

Today we are experiencing the second wave – and great crisis – of modern globalisation. Many factors are radically different, but there is one historical lesson: at a time of rapid change, it is very important that the body politic should react quickly and with appropriate measures. This is true today too. To be successful, we need more than just the ability to deal with everyday threats. A long-term strategy manifesting the interests of Europe as a whole is required. When British-led capitalism failed and was followed by the era of global wars, the world got another chance with the rise of America. The question is, will US-led global capitalism suffer the same fate in the 21st century as UK-led capitalism did in the 20th century? The second – American – age of global capitalism differs from the first in many respects: it has been constructed more slowly and with far stronger “social brakes”. Western societies today are advanced self-organising democracies; modern welfare services (even in the USA) amount to a true social democratic paradise – compared with the European social system of a century ago. The problem is that the entry into the global marketplace of China, India and several other major countries has brought with it 2.5 billion new people to the global labour market. This is unprecedented in history. Decision-makers find themselves in a sticky wicket on both sides of the Atlantic, but the task of the political elite is particularly challenging in Europe, for they have to rescue the process of European integration at a time of sensitive geopolitical transition and amid a gloomy economic outlook.

It is important to note that Europe at the beginning of the 21st century is facing not only an economic or financial crisis but also a political crisis (caused in part by the economic crisis). It is a political crisis in the sense that the political institutions established after World War II, including those of the EU, have lost the confidence of the electorate. Society and the economy are undergoing rapid change. For many, such change is an opportunity, but for even more people it is a threat. This undermines society’s confidence and leads to the chronic rejection of political institutions and a widening of the chasm between the elite and the man in the street. The welfare model
that was designed to prevent a repetition of the disastrous social problems of the
interwar period is now in a crisis, thereby jeopardising the social peace that was based
on keeping the middle-classes satisfied. This in turn has added to economic and social
tensions caused by immigration and to a hysterical fear of globalisation. In the view
of many, globalisation – or as the anti-globalists call it: the unbridled competition of
dog-eat-dog capitalism – finds embodiment in the European Union. It is therefore not
accidental that there is a growing rejection of European integration, accompanied by a
general rejection of the political mainstream.

Responsible Social Democratic, Christian Democratic and liberal parties in Europe
watch passively as voters rush towards the extremes or become completely apathetic.
The political pendulum swings to the left and to the right – evoking an enthusiastic
response from whichever party happens to be on the winning side – business as usual.
However, the emptying of the political centre is not business as usual. If the centre
loses is the trust and support of those who care about the future, we will be witness
to a political climate change in Europe. Worrying signs are already apparent in most
Western European countries: society has rebelled against the political elite, and the
situation will not change until the centre is able to offer a credible and persuasive vision
for society in the 21st century.

According to Voltaire, “Decadence was brought about by doing work too easily
and being too lazy to do it well, by a surfeit of fine art and a love of the bizarre.”
Taking the easy route is no longer an option for Europe’s politicians – especially not for
the German chancellor and the French president. The era of announcing half-measures
with accompanying political eulogies is all but over. The first step is to avert the eco-
nomic crisis – financial fire-fighting. At the same time, however, the European Union
needs to be reformed, in order to prevent another collapse when the next financial crisis
hits.

Crisis Management

To date, crisis management measures have basically addressed the economic crisis (first
and foremost, the liquidity problems of banks and the solvency problems of certain
member states). The economic side of the current crisis takes several forms: in Greece, a
profligate state is bankrupt; in Ireland, an overstretched banking sector is bankrupt; in
Italy, the high level of public debt poses first and foremost a psychological threat.

Crises are inherent to capitalism, but the crisis that began in 2008 has several unique
features. The first is its rapid spread in the financial sectors of the developed world,
which was due to the unprecedented interconnectedness of the world’s financial
markets. Many have drawn comparisons between the current crisis and that of 1929.
True, at that time too, an irresponsible deluge of credit had caused economic bubbles, but the crisis was one of over-production. In other words, the problems of the 1930s originated in production, i.e. the real economy. In contrast, the crisis of 2008 originated in the financial sector. There were no problems with the foundations of the real economy until they were rocked by the financial meltdown. But the most important feature of this crisis is that – contrary to previous ones in the second half of the 20th century – it is a crisis of the West. The scenario is not that of a collapsing emerging economy (Argentina, Mexico, Russia, East Asia) that has proved itself incapable of implementing the operating principles of Western liberal capital. On the contrary, the rest of the world remains relatively stable while the economy of the West (USA and EU) seems to be cracking. Ground zero of the financial crisis was in the United States, the key archetypal capitalist actor. However, by 2011, the eurozone had become the real focus of the crisis. China, Japan, and the United States are keeping a watchful eye on the success (or failure) of Europe’s crisis management, while drawing up various strategic scenarios. Thus the crisis has crossed the Atlantic, and made the leap from the financial sector to the real economy, affecting in particular national budgets. Act Two of the current crisis centres on unsustainable national budgets. This explains why, in Europe, a rescue is needed not only for the banks but also for the member states.

Clearly, the present crisis is one of the most serious ones in the history of European integration. It is fundamentally a political crisis rather than a purely economic one. It is the consequence of a downward spiral of political and economic problems that mutually reinforce each other. At its centre lies a weakness of political vision in the EU and in the eurozone. (In economic terms, Europe is better placed than the USA; yet it is the eurozone that has become the epicentre of the crisis.) History teaches us that monetary unions are unsustainable without political coordination and a fiscal union: a major economic crisis has now made this painfully clear to the eurozone too, and the eurozone crisis has knock-on effects across the globe.

Alongside the European Commission’s own proposals, in recent months market analysts, economists, member state politicians, the Council, the ECB president, and even politicians from outside Europe have come forward with their own action plans aimed at resolving the euro crisis. The key to any solution, however, will be Germany’s political position and the final agreement between Germany and France.

The most pressing tasks include saving Greece (temporarily), enhancing the EU’s crisis management tools (an increase in the financial fire-fighting potential), stopping the spread of financial contagion, undertaking a coordinated and targeted recapitalisation of the European banking system and imposing higher capital requirements on a temporary basis. Here one might also mention the implementation of rules adopted in the field of economic governance (the so-called Six Pack, the Euro Plus Pact, and the European Semester) designed to keep a lid on overspending by member states.
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Greece’s planned default has already occurred in practice with the significant write-down of its debt. However, the price of this was the removal of the government and its replacement by a government of technocrats. Italy has suffered the same fate. Evidently, we can speak here of a complete failure of the pro forma democratic system: appointed caretakers instead of elected representatives, are put in charge of saving the national economy.

By mid-December 2011, the draft of a new fiscal compact (already mentioned in the introduction) was completed. Eurozone countries agreed to sign up to this agreement, with nine other member states pledging to do the same. Signatories of the compact undertake to ensure that their structural budget deficit – deficit without debt repayments and cyclical effects – does not exceed 0.5 percent of GDP and to keep public debt below 60 percent of GDP. Signatories must incorporate this pledge into their constitutions or an appropriate piece of legislation. The compact also allows the EU to take member states to the European Court of Justice if rules are repeatedly violated, to. It is hoped that the text of the compact will be finalised in early February 2012. All EU member states will take part in the negotiations, but the United Kingdom, which has refused to sign up, will only be able to do so as an observer. The new fiscal compact will enter into force as soon as more than half of the eurozone countries (i.e. at least nine countries) have ratified it, but problems have already arisen because Ireland has linked its ratification to a rescheduling of its debt, while Finland stated earlier that it would insist on unanimous decision-making rather than the proposed majority voting.

Under the new system of economic governance (Six Pact) that entered into force on 13 December 2011, eurozone members failing to comply with Commission recommendations will be subject to a penalty. For countries outside the eurozone, failure to comply will lead to further recommendations without sanctions, but repeated failure to comply may result in the suspension of the payment of cohesion funds. In fact, this was already the case. The Six Pact of legislative measures – consisting of five regulations and one directive – enhances the economic and budgetary supervision of the EU-27 member states in several ways, but its implementation is still in its infancy. In January 2012, the Commission will kick things off by publishing its first Six Pact report. At the December EU summit, member states agreed in principle to stricter rules on budgetary discipline, but owing to the UK’s opposition, such rules will be adopted by means of an intergovernmental agreement rather than through a treaty amendment. Nonetheless, in view of the decision to make the rules governing the excessive deficit procedure apply almost automatically, amending the Treaties will also be necessary – because a change in the voting rules requires a revision of the Treaty. The fiscal compact will comprise three parts – unless the plans are swept aside by events. The compact will be founded on the Six Pact with an enhancement of the Stability and Growth Pact, and it will be complemented by a dual package of measures introducing
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stricter rules on budgetary supervision, concerning which the Commission made a proposal on 23 November and which should be debated by the early spring. A final element is the inclusion in national constitutions of a clause on balanced budgets, capping structural deficit at 0.5 percent. By the end of 2011, this much had been agreed to – in principle – by the leaders of the member states. Thus the eurozone and the European Union face long months of political horse-trading and technical negotiations with the promise of inherently unsatisfactory results.

Fortunately, in the meantime, the ECB has begun deploying significant resources to preserve liquidity in the European financial markets: in late December, it injected half a trillion euros at the first tender of a new three-year bank liquidity facility, which, in practice, is very similar to the FED’s quantitative easing – money-printing – policy. Admittedly, all this is happening in a covert rather than overt manner. These measures will, at most, buy some time – until real political reforms are passed or, in their absence, until the final crisis of the eurozone.

As noted in the introduction, the deal of December 2011 will not resolve the economic crisis or the institutional crisis. It will rapidly be swept away by history.

**Possible Directions**

In the history of European integration, crises have acted as the triggers of major political and institutional changes. Europe and the EU face many external and internal challenges, the scale of which has grown in recent decades (greater international competition, a whole series of demographic, social and budgetary problems). Member states have often made feeble and belated responses to such challenges (with delayed reforms and poor management of immigration and demographic trends), and the responses of the European Union have not been more robust either (impossible and formal visions and plans such as the Lisbon Programme, diplomatic weakness due to the lack of a common EU position, years of impasse in the institutional system before and after the adoption of the Constitution, etc.).

The question is whether the present crisis, which threatens the existence of the most important achievement of European integration – the common currency – will lead to a “quantum leap” towards closer political integration or perhaps towards a multi-speed Europe. In my view, it may indeed have such an effect.

In the mid-term, the whole of Europe must prepare itself for a decade of sluggish economic growth. The gap in economic, social and political development within the eurozone will only widen unless there is a major change of direction in the integration process. In the long term, the European welfare state is unsustainable in its present form (cf. ageing and shrinking populations, budgetary over-extension, an increasing
competitive disadvantage vis-à-vis Asia). For this reason alone, it would seem sensible to pool European resources and to aim for a common European political and geopolitical agenda. But that will be the result of economic necessity rather than rationality.

A potential European political union will not mean the formation of a regional world government or the elimination of Europe’s nation states. The nation state is a European invention, and Europe’s nations will never be dissolved into an all-embracing pan-European political unity – if for no other reason than because for Europeans there barely exists a sense of European identity, and Europe does not have a common language like the United States does. Political union could mean closer political integration, a real common foreign policy, a real European president, real European parliamentary elections, a real budget, and a truly common economic policy. It could also mean unified European representation (a single seat and a single voice) in international organisations as well as stronger pan-European symbolism in daily life. The euro would still not be backed by a real country, but there would be regional integration with a far stronger political profile.

Currently, the key question concerning the future of European integration is whether or not a currency without a country is viable. The European Union has tried to establish a monetary union without a political union, but it has become increasingly clear that both are needed – or neither. Some thought that this ambiguous situation would lead to a great crisis, forcing the EU to establish closer political integration. That is to say, what cannot be achieved through nice words, will happen under pressure – as has been the case so many times before. Angela Merkel is right saying that if the present euro crisis leads to the end of the euro, this would result in the collapse of European integration as a whole, at least in its present form.

Not only is the common currency without a country; it also has no backing in the form of political institutions or even the basic foundations of economic integration. The EU barely has a budget: in a modern market economy, the budget amounts to a measly 40 percent of GDP, while the EU budget amounts to just one percent of European GDP. Moreover, money is not spent on things that a “normal” budget would target, but for very different purposes, such as farm subsidies – which still account for almost every second euro spent. These factors add up to a budget ill equipped to make significant transfers between eurozone members at different levels of development and in different stages of the economic cycle. An even more important deficiency of the eurozone is its lack of a common economic policy and cumbersome decision-making with unanimity required, for instance, to adopt common fiscal rules.

A closer union in fiscal and economic policy terms (a European finance minister, eurobonds, common financial supervision, a closely coordinated economic policy) seems inevitable, as does, in certain respects, a political union. All this will require a new treaty, an amended ECB statute, and above all political will. Closer integration
may certainly be envisaged in the form of a multi-speed union. A radically different European space is appearing before our very eyes. And in this new space the role of Europe’s major powers will change, and there will also be a shift in the relative clout of countries. Germany will be the greatest beneficiary of the reshuffle with its newfound regional primacy. Almost right across the spectrum, the German political elite supports closer integration, which will help mitigate fears of German hegemony, but the German–French tandem will no longer be regarded as a partnership of equals. History (and necessity) has made the economy – and the common currency – the driving force of federalism, rather than political institutional development or the construction of a European cultural identity, which would have favoured the French.

The French wanted the euro – and the whole process of integration – as a means of keeping the Germans in check, but in reality the opposite happened. The principles of France’s European policy – the multiplication of French power and capacities at the European and global level coupled with categorical intergovernmentalism – have been sorely wounded. France’s elite must now decide what to do with an EU in which Germany is once again powerful and where the supranational principle is coming more and more into view. Without the French, there is no core Europe, but they too are aware that it will be called “Kerneuropa”.

In the new European space, the United Kingdom will be the biggest loser. In late 2011, British politicians accepted the multi-speed model, having excluded themselves from the first round. True, the British immediately began organising a bloc of non-eurozone members around themselves, but this will have no real significance in the future. It suffices to mention the failure of EFTA or to consider Poland’s ambition to join the eurozone. The UK’s loss of clout in Europe will not be counterbalanced by their “special relationship” with the United States – a relationship that has become rather hollow, particularly under the Obama administration. Indeed, by turning their backs on Europe, Brits may even be risking an acceleration of Scotland’s journey to independence.

The current 17-member eurozone is far from being a certainty in the long term, as economic weakness in Greece and a referendum in Ireland will probably lead to the exit of those countries from the zone. For the latter, this will also amount to a failure of its efforts to secure independence from the UK. Other eurozone members (in the south and the east) may well find themselves in a similar situation if they are unable or unwilling to keep pace with what is required of them.

Of course, my predictions will only turn into reality if the eurozone does not fall apart, creating a tide of anarchy. In theory, there is even a possibility that the EU – having admitted its inability to operate the monetary union properly and acknowledged the market and political risks – will withdraw the euro from the market intentionally, doing so with a professionalism to match that displayed at the time of the euro’s
introduction ten years ago. But this is only a theoretical possibility; in practice, it is almost unthinkable. Thus, there remains the other route, which the political generation that unified Europe may yet choose. That generation, which appears to have lost the globalisation contest, will have no choice but to act and press on towards a (multi-speed) political union. Of course, it is an extremely dubious project plagued by many uncertainties. Having said that, if it were to come into existence, it would even solve issues such as Turkish accession, which is of vital geo-strategic significance.

It is extremely difficult to foresee future developments, especially the specific positions of the various member states if, or when, the quantum leap occurs. It is undeniable, however, that barely a year ago no one could have imagined member states taking action so soon to amend the Lisbon Treaty, the adoption of which caused so much grief and pain. Yet this is what has happened. In the long term, however, small steps will not be enough to deal adequately with the challenges of an increasingly heterogeneous union operating in an environment of growing uncertainty.

Summary

1. Historically speaking, hostility, rivalries and war are the norm on the European continent; periods of peaceful co-existence are the exception
2. Also, in historical terms, modern European integration (voluntary cooperation between sovereign states, the only guarantee of which is respect for common laws, and which was launched after World War II with a strengthening of economic and commercial relations but for the primary purpose of pacifying Germany) is a highly unstable formation.
3. As a consequence of the two above points, peace and solidarity on the European continent may soon be replaced by growing hostility – if the economic situation deteriorates and becomes crisis-ridden in a geopolitical milieu that is increasingly unstable.
4. The fate of the boldest achievement and symbol of EU integration – the common currency – is intertwined with the fate of integration as a whole: an anarchic collapse of the euro would be accompanied by the break-up of the EU and political paralysis in Europe.
5. History has proved several times that a currency without a country is not viable: without a political union (or at least a substantial economic policy union) the euro will eventually cease to exist. The euro is fundamentally a political and symbolic creation; in its present form, it does not have firm economic foundations.
6. In light of points 4 and 5, it is in the interest of the EU to save the euro by establishing a strong economic policy union.
7. The situation in Europe is so serious because the crisis is a financial and political one, which also affects the operation of the EU. The most important experience of the past two to three years is the inability of the EU to take appropriate measures to deal with the crisis. In a reactive and defensive manner, it follows market impulses, which are pushing the system towards a break up of the eurozone. Meanwhile, the response of politicians – by way of defence – is to steer integration towards fiscal and political union. However, experience shows that their efforts are neither quick enough nor sufficiently persuasive.

8. With its present architecture, rules and stakeholders (whether they are the EU-27, the EU-26 or the EU-17), the European Union is incapable of moving forward at the right speed and depth. The momentum is lost in the political morass of 27 member states. In addition, European public opinion gives a cool or hostile reception to any initiative coming from above, from Brussels.

9. The European Union thus faces two possible scenarios. Under the first scenario, it passively allows the centrifugal forces (markets, member-state sabotage, public disinterest) to break it up or it ceases to exist in its present form, with the unplanned termination of the euro. All of this would be temporarily accompanied by an extremely grave crisis, a new medieval era. Under the second scenario, in the lands of Charlemagne (basically Germany, France, the Benelux countries, Austria, and perhaps some Nordic countries), a new intergovernmental treaty will be signed, resulting in strong economic policy integration and preserving the euro. The second and third groups of countries could join later based on new conditions (which would be far stricter than they are today).

10. The historical (and European) lesson is that regional integration projects are far from everlasting, and often the temporary break-up of a poorly designed form of integration is the key to a restructured formation that guarantees long-term survival. The United Kingdom’s split from the group of pioneer countries was an important prerequisite for this necessary transformation. Nor can the eurozone (with its current 17 members) be the foundation for stable European integration in the long term. The break-up of the EU – in its present form – will doubtless happen in our lifetime, but the important question is whether or not this process can be managed in a planned and controlled manner. For years, people have been calling for a closer union in Europe, the creation of a United States of Europe. But the basic motive has been to prevent Europe from losing its international economic and geopolitical significance in the world. In 2012, the situation is different: a united states of Europe in a certain form is needed purely for survival, but clearly only some, and not all of the member states will be able to take part in this endeavour.
Europe – it seems – is always a journey, but never a destination. Decades ago, Robert Schuman wrote the following in his memoirs: “Europe is searching for itself. It knows that its future lies in its own hands... May it not miss the hour of its destiny, its only chance for deliverance.”

Bibliography