Is the Euro a failure?

Antony Peter Mueller

**Introduction**

Many political analysts and even some prominent economists put the blame for the current economic crisis in Europe on the euro. In their view, the crisis showed that the European Monetary Union has no future. Right from the beginning of the current crisis, these pundits proclaimed that the demise of the euro was imminent. As if hit by a kind of amnesia, these authors seem to forget that it was the American real estate market from where the crisis spread and that not only members of the European Monetary Union suffer from economic malaise but also many other countries, which do not belong to the euro. Those who proclaim a euro crisis seem to ignore that there are countries in the euro zone that are doing relatively well and that the severe crisis is limited to some countries in the Southern periphery of the euro area, most prominently to Greece. Other than by proclaiming massive contagion, there has never been a solid reason how an economy the size of Greece, which represents a small part of the total gross domestic product of the Eurozone, could bring down the European Monetary Union.

The very same authors who announced the imminent demise of the euro do not propose that highly diverse countries such as the United States itself should get rid of their common currency despite the fact that the current crisis has had quite different economic impacts on the various regions of the United States. According to the thesis that a common currency would require
homogenous conditions, Brazil, for example, would have to install at least five or seven different currencies in its territory.

The use of a common currency is surely not without negative consequences, yet these costs of a single currency stand against the costs that have to be borne when within a highly integrated region every country, even the smallest, should have its own currency. Theoretically, there is no point in claiming homogeneity as a precondition for a single currency. By this standard, any large city should have a multitude of currencies. In fact, the difference that we find in most cities in terms of income *per capita* in its various districts are often larger than those that exist among countries. Likewise, the old-fashioned thesis that a common currency would require a homogeneous exposure to external shocks would prohibit a common currency for most large cities and for most countries of the world with exception of those countries whose economy is concentrated only in one sector, such as oil, for example.

Taking the focus on cities it also becomes clear that one more popular argument against common currencies does not hold. Most large cities are not only economically highly heterogeneous; they also do not possess full sovereignty, as they are subject in various areas to the authority of the whole country, to the central government and the government of their individual State. As it is the case with countries, it also applies to cities that not only a few of them will do better when monetary sovereignty is beyond their control. There is no need to have political sovereignty in order to have a common currency.

The decision to take part in monetary union is the result of the evaluation of a trade-off between the pros and cons of being in or out of the monetary union. We have to investigate whether this evaluation was not careful enough and whether it followed or not from an erroneous analysis. Along with that, we also have to
ask whether the project of a common European currency should be abandoned or whether serious efforts should be made to consolidate the common currency.

**Origins of the Current Crisis**

The euro crisis has an American origin and it has a monetary origin. Monetary policy had entered center stage of economic policy making in the late 1970s. Since then financial markets have emerged as sectors of high economic growth fed by a rising stream of new money (see figure 1).

**Figure 1: United States Adjusted Monetary Base**

![Figure 1: United States Adjusted Monetary Base](image)

This trend of monetary expansion has continued over the time of the change of the millennium. After the outbreak of the current financial crisis there was a veritable explosion of the monetary base (see figure 1). With the internet boom over, the US Federal Reserve System embarked upon a policy of extremely low interest
rate in order to stimulate the American economy and to prevent the recession from deepening. While the central bank succeeded in preventing a prolonged slump of the American economy, it created a new bubble in the form of the American real estate boom.

In 2008, the American real estate bubble burst and the consequences spread across the globe. Since then not only the US economy is in a prolonged stagnation, but also large parts of Europe. The global financial crisis brought about a reassessment of creditworthiness when lenders began to differentiate more carefully among the borrowers as to their payment capacity. As to the countries that form the euro area, this reassessment of the creditworthiness led to rising interest rate in several countries exactly at a point in time when these countries needed to increase their borrowing in the face of the recession. The main victims of this change were the countries for which the new acronym “PIIGS” was invented: Portugal, Ireland, Italy, Greece and Spain.

The so-called “euro crisis” began in earnest in 2010 when it became apparent that Greece would not be able to meet its public debt obligations (ECB 2013). The adoption of the euro by Greece had brought immense advantages for this country in terms of interest payments. Yet when the financial crisis came, the euro has functioned as a constraint. Even as the euro is not a foreign currency for Greece, because this country is part of the system of European central banks, the fact that the country’s central bank cannot autonomously decide on the money supply, makes Greek debt in euros *de facto* a foreign currency debt. The membership to a common currency blocks the usual escape that is in place for a country whose debt is in its own national currency. When debt is denominated in national currency, the national central bank can devalue the national debt by inflating its currency. Yet when a country that forms part of currency union is threatened by default, government and cannot inflate its currency at will. Greece cannot devalue its debt through inflation and currency depreciation.
because it has a money, which is managed by a supranational body in the form of the European Central Bank (ECB). In this case the country must apply so-called “austerity measures”, which involves cuts of public spending. It is easy to see that a financial crisis tends to become an economic crisis and finally turn into a social and political crisis. This happened most severely in Greece while Portugal and Spain are still under the threat of a similar fate.

**National versus international currency systems**

In the face of the current “euro crisis”, the question arises why a group of European countries decided to launch a common currency and why up to now the group of the countries that form the euro zone has grown to 17 members (see table 1). Additionally, one must ask whether the promoters of the currency union were fully aware of its consequences for the conduct of domestic economic policy. The answer to these questions is quite clear: The promoters of the euro knew from the start what a common currency would imply for the conduct of domestic policies. It was also obvious that there is a trade-off involved when a country opts for a membership. The decision to join the euro area has been a voluntary decision. The decision to say yes to a monetary union requires a careful evaluation and it is without doubt that the decision to join has been based on such evaluations. The decision to opt for membership in the Eurozone reflects the experience of monetary chaos. The disastrous consequences of the breakdown of the Bretton Woods System for European economic integration were a dark reminder of the interwar period when Europe suffered from the absence of a common monetary arrangement. In this respect, the euro is not a recent project. The aim to establish a common currency has been on the agenda since the start of the European economic integration process and definite plans were already launched in the late 1960s (see table 1).
### Table 1: Timeline of European Monetary Union 1970-2009

<table>
<thead>
<tr>
<th>Year</th>
<th>Steps taken</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>The Werner Report, named after Luxembourg’s then Prime Minister and Finance Minister, sets out a three-stage approach to EMU – which is shelved because of difficult economic conditions in the early 1970s.</td>
</tr>
<tr>
<td>1978</td>
<td>The European Monetary System is launched, consisting of an Exchange Rate Mechanism (ERM) and the European currency unit (ECU)</td>
</tr>
<tr>
<td>1989</td>
<td>The Delors Report (named after the then Commission President Jacques Delors) maps out the road to EMU in three stages</td>
</tr>
<tr>
<td>1990</td>
<td>Launch of the first stage of EMU: closer economic policy coordination and the liberalization of capital movements</td>
</tr>
<tr>
<td>1992</td>
<td>Signature of the Maastricht Treaty setting out the timetable for Economic and Monetary Union and the convergence criteria that Member States will be required to meet to participate in EMU</td>
</tr>
<tr>
<td>1994</td>
<td>Start of the second stage of EMU: creation of the European Monetary Institute (EMI). Member States are required to work to fulfill the five convergence criteria on inflation, interest rates, government deficit and debt, and exchange rate stability</td>
</tr>
<tr>
<td>1995</td>
<td>Madrid EU summit: The single currency is named ‘the euro’, and the scenario for the third stage of EMU – the introduction of the euro – is set out, with a three year transition period between the introduction of the new currency and the launch of euro cash</td>
</tr>
<tr>
<td>1997</td>
<td>The Stability and Growth Pact is agreed at the Amsterdam EU summit, to ensure that Member States maintain budgetary discipline in EMU. The European Council also agrees on the revised exchange rate mechanism (ERM II) which links the euro and currencies of non-participating Member States</td>
</tr>
<tr>
<td>1998 May 1-3</td>
<td>The European Council agrees to launch the third stage of EMU on 1 January 1999 and that 11 of the 15 Member States meet the criteria to adopt the single currency. These are: Belgium, Germany, Spain, France, Ireland, Italy, Luxembourg, the Netherlands, Austria, Portugal and Finland. It establishes the European Central Bank, which replaces the EMI as of 1 June 1998</td>
</tr>
<tr>
<td>1998 June 1st</td>
<td>The European Central Bank starts operating with a mandate to decide and conduct monetary policy for the euro area. The primary objective of the ECB is to maintain price stability</td>
</tr>
<tr>
<td>1998 Dec 31</td>
<td>The exchange rates between the euro and the currencies of the Member States that will adopt the euro are irrevocably fixed as from 1 January 1999</td>
</tr>
<tr>
<td>1999 Jan 1st</td>
<td>Following compliance with the Maastricht criteria, Greece becomes the 12th country to join the euro area</td>
</tr>
<tr>
<td>2001 Jan 1st</td>
<td>Following compliance with the Maastricht criteria, Greece becomes the 12th country to join the euro area</td>
</tr>
<tr>
<td>2002 Jan 1st</td>
<td>Euro banknotes and coins are introduced in the 12 euro-area Member States</td>
</tr>
<tr>
<td>2007 Jan 1st</td>
<td>Slovenia becomes the 13th member of the euro area in 2007</td>
</tr>
<tr>
<td>2008 Jan 1st</td>
<td>Cyprus and Malta bring the number of euro-area members to 15</td>
</tr>
<tr>
<td>2009 Jan 1st</td>
<td>Slovakia joins EMU</td>
</tr>
<tr>
<td>2011 Jan 1st</td>
<td>Estonia becomes 17th member of the Eurozone</td>
</tr>
</tbody>
</table>

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The fact that nowadays many countries have their own national currency does not make national currencies the natural way of things. In fact, during most of history, the dominant monetary regime was the existence of an international system. Money in circulation existed mainly in gold coins or in silver coins. Irrespective of their local origins, precious metal coins moved freely across borders. Coins served as a means of payment according to the value of their content of precious metals. The introduction of national paper monies did not do away with the internationality of the monetary system. As long as the countries defined the exchange rate of the paper note in terms of physical gold at which national central bank would exchange at wish, they automatically became members of the international gold standard - as it was the case for large parts of the 19th century. This monetary system of the international gold standard was international in its functioning and it was the intention when joining to take away from governments the control of money.

This system broke down with the onset of World War I when the belligerent countries abandoned the gold standard in order to gain full sovereignty over their money supply to finance the war efforts. It would not take long and the consequences of the nationalization of money would show up in the form of hyperinflation, currency wars and the Great Depression as forerunners to the follow-up of World War I in the form of World War II.

For the founders of the international post World War II monetary order the perils of national monies and nationalistic economic policy were still vivid and it was the common aim to establish a system that would prevent the return of monetary nationalism. The most comprehensive plan of global monetary order came from the British delegation led by the economist John Maynard Keynes. He wanted to install a kind of global central bank that would emit its own global currency, which he baptized
as “Bancor” – signaling that it would be a “bank” money, which would issue a money as good as gold: “or” – the French name for gold. Keynes did not succeed to have his plan realized. Instead, the American delegation won out (BOUGHTON 2002). The new system received the name Bretton Woods according to the place of the conference. The Bretton Woods international monetary system, although not international in its design, was international in its consequence as it became the dominant monetary system in that part of the world where the United States dominated as the new hegemon.

The Bretton Woods System provided a huge benefit for European integration. European integration in the 1950s and 1960s could not have advanced without a kind of common currency. At this time, the US dollar played this role as it served as an international money for trade and currency reserves.

As is quite clear that that deeper economic integration cannot take place without stable currency arrangements, the demise of the Bretton Woods System in the early 1970s became a major challenge for the Europeans. As soon as it became clear that the dollar standard would fall apart, the Europeans launched the project of a common currency. The first plans go back to 1970 with the so-called Werner Plan. Various steps were taken on the way to a common currency such as “the snake” along with several other currency arrangements. Along the way, it became obvious that deeper economic integration requires a reliable common currency system. With the dollar out of question and the anchoring of the system to the German mark problematic for various reasons (politically, economically, and as to the relative size of the then West German economy to the rest of the European bloc), a proper European currency of its own emerged as the most preferable solution.
Performance of the Euro

In order to understand what is going on with the so-called “euro-crisis”, it is helpful to put the current crisis in terms of at least the time span since the inception of the euro.

We begin this part of the analysis with a look at the Eurozone as a whole and then highlight some of the problems of individual countries such as Greece and Spain that suffer currently from a severe economic crisis.

The euro was launched as a single currency at first for banking transactions in 1999 and two years later on January 2002 also as a physical currency (see table 1).

The initial exchange rate of the euro was 1.16 to the US dollar and due to the re-shifting of portfolios of international financial investors, the euro declined in the first couple of month to hit a low of 0.87 in February 2002 (Figure 2).

Figure 2: Euro/US-dollar exchange rate 1999 -2013

![Euro/US-dollar exchange rate 1999 -2013](image-url)
Thereafter, the euro began a steady rise until early 2008. A reversal set in for the euro dollar exchange rate with the beginning of the international financial crisis. For some time international investor sought refuge in the dollar as a safe haven but the downward trend stopped in 2010 and the exchange rate between the euro and US dollar has experienced little volatility as the rate stabilizes of around 1.3 dollars to the euro. Despite the warnings of doom and gloom for the euro zone with the call for the imminent break-up of the Eurozone at the beginning of the crisis and thereafter, not only the euro exchange rate has stabilized since then, but the euro area has also held together. While since the beginning of the crisis, no member country has left the zone, the euro area could actually welcome new members after the outbreak of the crises with Slovakia, which joined in 2009 and Estonia, which became a member in 2011 (see table 1).

Looking at the overall performance of the Eurozone, its attraction for many countries to join, particularly for East European Countries, is obvious. The gross domestic product per capita in terms of purchasing power parity has seen a steady and impressive rise since the launch of the euro up to the mid of 2008, when, at a level of 35 000 dollars (in terms of purchasing power), gross domestic product (gdp) per capita has moved sideways. One can see in the chart below (figure 3), that the latest data for per capita show that the low point has been left behind and that currently gdp per capita has already surpassed the pre-crisis level.
In order to put the overall euro gdp performance in perspective, it should be noted that a major difference between the pre-crisis period and the current situation is still in place. While before the crisis all member countries of the euro zone moved largely along the same trend, there has been a sharp division among the countries since the outbreak of the crisis. While countries such as Germany, Austria the Netherlands have already fully recovered from the crisis and are experiencing economic expansion, some other countries, particularly those at the Southern periphery of the euro zone, such as Greece, Spain, and Portugal are still mired in the depth of the economic crisis.

While in Germany the unemployment rate has drastically fallen since the outbreak of the crisis (see figure 4), it has exploded in Greece, Spain and Portugal to extreme levels.
Figure 4: Unemployment rates for Germany, Greece, Portugal, and Spain since 2000

Source: National Data, Trading economics
Different from Germany, Greece experienced a decline of its unemployment rate in the years preceding the crisis (see figure 3). Yet when the crisis came, it experienced an extreme rise that lifted the unemployment rate over 25 per cent. A similar fate had Spain, which saw its unemployment rate decline since the mid-90s but then experienced a rise of its unemployment rate to the same exorbitantly high levels of over 25 per cent as has happened in Greece.

Differences in the performance of the labor market among the countries that form the European currency union is also clearly reflected in the interest rate that the various government as borrowers have to pay. While before the crisis, there has been a common trend, and countries like Greece and could profit substantially by lower interest payments on its public debt, this common trend has given way a much more differentiated picture.

Similar to Greece, there has been a strong convergence of interest rates for the rest of the PIIGS up to the beginning of the current crisis when a strong divergence set in. Although the extreme degrees of divergence have gone by, significant deviations still exist (table 2).
### Table 2: Interest rates for selected member countries of the Eurozone 2012/13

<table>
<thead>
<tr>
<th>Country</th>
<th>2012 June</th>
<th>2012 December</th>
<th>2013 May</th>
</tr>
</thead>
<tbody>
<tr>
<td>Germany</td>
<td>1.30</td>
<td>1.30</td>
<td>1.29</td>
</tr>
<tr>
<td>France</td>
<td>2.57</td>
<td>2.01</td>
<td>1.87</td>
</tr>
<tr>
<td>Italy</td>
<td>5.90</td>
<td>4.54</td>
<td>3.96</td>
</tr>
<tr>
<td>Ireland</td>
<td>7.09</td>
<td>4.67</td>
<td>3.48</td>
</tr>
<tr>
<td>Spain</td>
<td>6.59</td>
<td>5.34</td>
<td>4.25</td>
</tr>
<tr>
<td>Portugal</td>
<td>10.56</td>
<td>7.25</td>
<td>5.46</td>
</tr>
<tr>
<td>Greece</td>
<td>27.82</td>
<td>13.33</td>
<td>9.07</td>
</tr>
</tbody>
</table>


The differentiation among the interest rates that for the various countries that form the euro area points to the main difference between the period before and after the outbreak of the current international financial crisis. The outbreak of the crisis came not only as a shock to the policymakers, most of all it was also a major shock for the operators on the financial markets themselves. For decades, these financial players had become accustomed to a monetary policy, which would bail them out if things should go wrong. That was the lesson learnt in 1987 when the stock market crash induced the American central bank to provide ample liquidity to the market and this way prepared the exuberant 1990s (LvMI 2008). A similar successful injection of liquidity occurred when the Internet bubble burst in early 2000 when the American central bank successfully injected liquidity into the market making way for a period of extremely low interest rates. Over the past decades, there has been a highly expansionary monetary policy in place, which drove down interest rates in a cascade-like manner towards zero (Figure 5).
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Figure 5: United States policy rate of interest (Federal funds rate) 1979-2013

The period of extremely low interest together with the conviction that central banks would bailout the system in case of a derailment launched the search for higher yields at the expense of the awareness of risk. Domestically, US money swamped into real estate, while internationally the global liquidity avalanche swamped into emerging markets. For the euro currency, the targets for the inflow of money were those that should become the center of the crisis: Ireland, Greece, Spain, Portugal and Italy. The early attraction of these countries was that they still offered relatively high interest rates and in the search of higher yields seemed just as attractive as the US real estate market (MUELLER, 2011). Just as much as the American real estate market seemed safe, as much the countries at the Southern periphery of the euro area seemed a safe bet because of their membership in the euro area.

As money from abroad flowed into countries such as Greece and Spain, interest rates for governments bonds would fall and
give rise to increase public borrowing. Apparently justified by lower interest rates and ample liquidity along with a domestic boom that in Spain centered on private consumption for real estate and in Greece on public consumption in form of the expansion of public sector employment, government deficits expanded. Yet both, lenders and borrowers, misinterpreted what was happening as a confirmation of their preconceptions as to the assessment of the creditworthiness of the countries involved. Not only banks as lenders overestimated the safety and credit capacity of the borrowers. The borrowers themselves also overestimated the safety of their borrowing and their capacity to service their debt.

When the crisis hit, the usual injection of liquidity did not work as before. The American central bank did not hesitate to slash interest rates. After the outbreak of the current financial crisis, the American central bank rapidly lowered its policy rate (figure 5) in tandem with the European Central Bank to a level called “zero bound” when the reduction of rates has hit its limit (figure 6).

**Figure 6: European Central Bank policy rate of interest since 2007**

The collapse of the American real estate market came as a shock to the financial market. After this shock followed the apparent inability of the central banks to revive the markets and likewise the failure of fiscal policy to stimulate the economy with tax credits and extra spending. In Europe, the fear of an imminent break-up of the euro area sent shock waves through the financial system and the specter of a global financial meltdown appeared, in which the demise of the euro would take down the dollar with it.

Crisis Management

As of now, the acute financial crisis has been limited to the smaller partner countries of the Eurozone. In terms of their gross domestic product, countries like Portugal and Greece represent only a small part. Things would turn serious, however, when the crisis should become acute in Spain or even Italy (see table 3).

Table 3: Gross domestic product of selected Eurozone countries 2009 in US dollars
Share in percent of total

<table>
<thead>
<tr>
<th></th>
<th>Eurozone</th>
<th>Germany</th>
<th>France</th>
<th>Italy</th>
<th>Spain</th>
<th>Greece</th>
<th>Portugal</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
<td>12,460,362</td>
<td>3,330,032</td>
<td>2,649,390</td>
<td>2,112,780</td>
<td>1,460,250</td>
<td>329,924</td>
<td>227,676</td>
</tr>
<tr>
<td>Share</td>
<td>100.00</td>
<td>26.73</td>
<td>21.26</td>
<td>16.95</td>
<td>11.72</td>
<td>2.65</td>
<td>1.83</td>
</tr>
</tbody>
</table>


The main object of the European crisis management was to contain default to Greece and contain the crisis of not spreading to more seriously to Spain and Portugal. This way, the European debt crisis has led to a series of initiatives under the so-called “troika” (triumvirate) composed of the European Commission, the European Central Bank and the International Monetary Fund.
Greece represents the country with the largest emergency aid. After a first bailout package of 73 billion euros, Greece received 163.7 billion from the newly instituted European Stability Fund in cooperation with the International Monetary Fund. As of December 2012, the European Central Bank jumped in and bought sovereign bonds amounting to 30.8 billion dollars. Along with Greece, Spain Portugal and Italy also received emergency aid (see table 4).

Table 4: European emergency funding (in billions of euros, book values as of December 31, 2012)

<table>
<thead>
<tr>
<th>Euro zone and IMF</th>
<th>EFSF and IMF</th>
<th>ECB</th>
<th>ESM</th>
<th>EFSF, EFSM and IMF</th>
</tr>
</thead>
<tbody>
<tr>
<td>Greece</td>
<td>73</td>
<td>163.7</td>
<td>30.8</td>
<td>--</td>
</tr>
<tr>
<td>Spain</td>
<td>--</td>
<td>--</td>
<td>43.7</td>
<td>100</td>
</tr>
<tr>
<td>Portugal</td>
<td>--</td>
<td>--</td>
<td>21.6</td>
<td>78</td>
</tr>
<tr>
<td>Italy</td>
<td>--</td>
<td>--</td>
<td>99</td>
<td>--</td>
</tr>
</tbody>
</table>


The European Financial Stability Facility (EFSF) came into existence on May 9, 2010 by all 27 member-states of the European Union (EU). The EFSF has the objective to provide financial assistance to Eurozone member-states whose financial situation has become precarious and therefore need temporary financial assistance. The EFSF has the right to raise funds in order to recapitalize member states banks and buy sovereign debt from the member states. In order to raise funds, the Facility will issue bonds, which are backed by guarantees of the Eurozone member states. The EFSF has lending capacity of 440 euros, which may increase
by 60 billion euro through the European Financial Stabilization Mechanism (EFSM). Together with funds from the credit line of the International Monetary Fund (IMF) of 250 billion euros, the financial safety net amounts to 750 billion euros.

On November 20, 2011, finance ministers of the Eurozone agreed to expand the financial power of the EFSF by creating certificates that proved a Eurozone guarantee for up to 30 percent of new sovereign bonds issues by Eurozone member states.

These institutions and instruments are to be fully replaced by the European Stability Mechanism (ESM), which already put up 100 billion euros in emergency aid to Spain (see table 3 above). The European Stability Mechanism was established on September 27, 2012 and began its operation on October 8, 2012. Its object is to provide a permanent financial security mechanism for the member states by providing instant access to its financial assistance programs. The ESM has a lending capacity of 500 billion euros. The ESM will replace earlier programs such as the EFSM and the EFSF. Different from the earlier mechanisms such as the European Financial Security Mechanism (EFSM) and the European EFSF, the European Stability Mechanism (ESM) is based on a formal treaty (ESM 2013). In order to obtain funds, the member state is obliged to be a member of the European Fiscal Compact.

In order to obtain ESM aid, the country in need must accept the evaluation of its finances by the so-called Troika, which is composed of the European Commission, the European Central Bank and the International Monetary Fund. The first Financial Assistance Facility Agreement of the EMS was made in April 2013 at the amount of 100 billion euros for the Spanish banking sector along with 9 billion euros for a sovereign bailout in combination with a financial sector recapitalization program for Cyprus.
The fiscal compact is one more tentative to bring the fiscal policies of the euro member states in line with the requirements of financial stability. The Maastricht Treaty, which established the rules of convergence for the countries that were to join the common currency, postulated the rule for fiscal stability by the criteria of a deficit of no more than three per cent and a ratio of public debt to gross domestic product of no more than 60 per cent. Yet already during the convergence process, the rules got watered down and ironically enough it was first Germany and France that violated the criteria after the launch of the euro.

Another attempt to prevent extreme divergence of fiscal policies among member countries came with the so-called Stability and Growth Pact (SPG), which set up rules for fiscal policy for all members of the European Union along the lines that the Maastricht Treaty had already established.

Now, so it seems, some of the basic errors of the earlier attempts will be repeated with the Fiscal Compact. While the Fiscal Compact is more detailed than the previous rules, the problem remains that legally and in practice, it is very difficult to put controls on the national budgets when there is domestic resistance. Full compliance to conditions imposed from international or European bodies usually only occur in the form of “conditionality” under financial assistance programs the way by which the International Monetary Fund administers its programs. Besides these problems, the fiscal pact also suffers from the same inflexibility that characterized the Stability and Growth Pact and consequently led to its non-compliance when financial difficulties began to emerge.

Beyond these governmental facilities, the European Central Bank began to become active as a bailout facility.
When coping with the crisis, the major change in the European financial landscape did not occur by way of new institutions and new pacts, but by the European Central Bank’s program of “Outright Monetary Transactions” (OMT). With this instrument, the ECB proclaimed its readiness to purchase government bonds on the secondary market. As the market turmoil approached its peak in the summer of 2012 and panic sales of sovereign bonds of the countries of the Southern periphery set in, the European Central Bank announced to act as a “lender of the last resort” (ECB 2012). Through this maneuver, the ECB managed to convince the financial market operators that it would stabilize the market. Consequently, the sell-off stopped and the yields of the bonds began to fall (table 2). It is not without irony that the major contribution in ending the acute phase of the euro crisis was a legally highly problematic measure by the central institution of the euro, the European Central Bank itself. With the “Outright Monetary Transactions”, the ECB deliberately exceeded its statutes, which explicitly forbid the ECB to act as a source of funding of sovereign debt. The ECB succeeded to escape outright legal sanctions by linking its OMT program to the conditionality attached to Financial Stability Facility and the European Stability Mechanism (EFSF/ESM).

Financial matters can only partially come under full legal control because – as the old saying goes – without money the king loses his rights. Therefore, member counties must direct much more efforts towards good governance. The treaties, protocols and amendments serve only as guidelines. In the end, it is up to the individual nation state to conduct sound economic policies. On the way to accomplish this task, a common currency works as a disciplinary mechanism.
ABANDON OR CONSOLIDATE THE EURO?

In order to make an evaluation whether to abandon the euro or not, the overall performance must be taken into account and not merely a transient crisis event. As to the basic macroeconomic indicators such as economic growth, inflation and the current account, the European system has shown a good performance in which all but one indicator – employment – has performed badly. Over the more than ten years of its existence the euro positioned itself as a strong currency backed by a high degree of price level stability. The average inflation rate has remained close to the aim of two percent per year and the current account has been largely in balance with only marginal deviations. It is mainly the unemployment rate, which gives reason for concern. As the comparison of the data of the individual countries shows, the unemployment rate reflects much more structural factors than cyclical impacts. It is not the euro, which produces unemployment in certain countries, but the structure of the national labor market. In this respect, too, the next major challenge is for many member countries to come up with reforms in a move to establish good governance.

Institution building has been the trademark of the European economic and monetary integration process. Before the launch of the euro, there had been predecessors such as “the snake” and the European exchange rate mechanism. Under the name “ECU”, there was also an artificial European currency already in place long before the euro came into existence. The current crisis makes no exception as to how the authorities have reacted to the challenge.

Historically, the process of European integration has made its major advances in periods of crises. This was the case at the time of the breakdown of the Bretton Woods System when global monetary instability disrupted the integration of the common
market. Further major steps occurred in the face of the breakdown of the Soviet Union and with German unification. As it happened with the fragile new democracies in Southern Europe when these came “on board” to the European Union in the 1980s, political stabilization took place also with respect to the Eastern European country. In this view, the European Union is not only an economic success story for the original six members that founded the European Common Market in 1957, but over the course of time European integration has also become a major factor in making large parts of Europe more prosperous and democratic.

CONCLUSION

As many times before, in the euro crisis as well, the real course of events proved the doomsayers wrong. Of course, creating and maintaining a common currency, which binds together a large group of highly diverse countries, has been no and never will be a cakewalk. For the future, many more challenges lie ahead. What matters in the end is the trade-off, the size of the margin by which the benefits of the euro outweigh its costs. In this respect, the calculus leaves little room for doubt. In terms of peace and prosperity, European integration has brought immense benefits for the continent.

As it became apparent at the time of the breakdown of the Bretton Woods System, common currency arrangements and finally a common money are necessary to keep the integration process going. In this respect, the euro is not an aim but a means. The logic runs from the euro as a means of deepening economic integration to economic integration as a means of maintaining peace and prosperity.

The so-called “euro crisis” represents one more of the series of challenges that Europe has to cope with. The response so far
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has been to set up new institutions such as the European Stability Mechanism (ESM) and the Fiscal Compact. The implementation of its “Outright Monetary Transactions” program by the European Central Bank opened up the way for the ECB to act as a “lender-of-the-last-resort. With the expansion of the European Union going on and more countries joining the euro, the acceptance of a common ideal of governance represents the next major task.

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