

## Outside views on EMU reform

---

*Ambassador Wolfgang Petritsch<sup>1</sup>*

Europe is full of breakaway sentiment and we see a surge of right-wing populism. There's been a return of borders in Schengen; Italian and – next year – German, Dutch and French voters are threatening a reckoning for their countries' elites.

EU members in Central and Eastern Europe - the Visegrád Four in particular - are calling for a strengthening of their own national sovereignty and are espousing authoritarian tendencies.

What a misunderstanding, considering the Rome Treaty's core idea of an ever closer Union. For many member countries, the EU is either part of the problem, or at least it is unable to provide solutions.

The BREXIT vote and the election of Ronald Trump as the 45th President of the United States were only the latest iteration of an angry backlash against globalization that has been long in the making.

Analyses and speculations about the underlying reasons of this backlash currently fill the op-eds of international and domestic media. But if there's one thing that every observer can seem to agree upon, then it's that the anger we're seeing would be less intense if the economy were in better shape. But the crisis of the Eurozone has been drawn out and far away from a comprehensive solution. Growth is anaemic and unemployment – particularly among the young – remains high, while investment is low, in spite of the ECB's QE-policy. What we're experiencing now is the effect of the crisis-responses of 2010-2012; austerity and lopsided structural adjustment policies. Now, four years on, we know that austerity doesn't work – even the IMF has come around to back this claim, and they are no radicals.

The structural adjustment programmes implemented in the wake of the crisis – liberalizing labour markets, cutting back collective bargaining and regulations, etc. – have humiliated European crisis countries. It might make sense from an economist's point of view to say these countries need to suffer in the short term, undergo 'internal devaluation – as it is dubbed – in order to become more competitive.

But from a political point of view it's a disaster! Imagine the position of a party voted into power by the population that is forced by the EU institutions to enact policies half of which damage the economy – austerity – while the other portion directly harms the population. They have to bargain with the Eurozone leaders – and nowadays this more or less means Germany – and can't change things. It's humiliating for governments, and it might explain why parties who promise to get back sovereignty and take power away from the EU experience such a surge.

Of course, the problems of the Eurozone CAN be overcome, and the Five Presidents' Report outlines a potential path towards a solution. But there's a major issue with the whole plan: For it to work, it presupposes further integration of the Eurozone, further surrender of sovereignty, and new centralized institutions. While it might very well be true that this is the only way to save the Euro as a single currency, such ideas seem to fail to recognize the signs of the times:

We're at a point where the European Project seems as precarious as it's ever been. The Commission, without good cause, abandoned one of the few true shared competencies of the EU in the CEFTA negotiations. A referendum in the Netherlands brought to fall a vital plan for closer association with Ukraine, a central tenet of the Union's common foreign policy plan to manage the on-going conflict. All around the Union, and in all policy fields, the trend seems to point towards disintegration,

Yet the plans to save the EMU all presuppose steps for further integration, and quite radical ones at that. Many economists believe that if the Eurozone is going to survive its next crisis, it will need some

---

<sup>1</sup>President, Austrian Marshall Plan Foundation

sort of joint fiscal capacity: Eurobonds, a common budget, a ministry of finance for the currency area with appropriate democratic oversight. Whether this has chances of happening is hard to predict.

But two major issues to consider are that the two most powerful Eurozone countries – Germany and France – would have to relinquish some of their most dearly held political convictions in the process: Germany would need to come around to accepting what would effectively be a transfer union and France would have to give up fiscal sovereignty. Alas, considering the current state of affairs, this is difficult to imagine.

The Five Presidents' Report is certainly reflective of the power of Germany and other rich northern Eurozone countries in that it doesn't foresee common lending (euro bonds) and only alludes to a "euro area-wide fiscal stabilisation function" in case national budgets are "overwhelmed." The "Five Presidents" call their plan "ambitious yet pragmatic," and it certainly won't be a break with the fundamental orientation of the EMU – whether this is a good thing is up for discussion.

At the same time, no country is likely going to leave the Eurozone on its own accord. The countries of the European south have fought hard to get into and stay inside the Eurozone and won't easily abandon it. The idea of two Euros – a northern and a southern one – as suggested by the winners of the Lord Wolfson Prize – seems unworkable. And Germany, which many economists, including Josef Stiglitz, see as the main culprit for many of the current woes, is not going to pull out of the currency either, as Stiglitz somehow disingenuously suggested. As German Chancellor Merkel said: If the Euro fails, Europe fails!

It seems like an intractable problem where economic and political trends are mutually reinforcing: The Euro – a fundamentally political project – was established with built-in economic deficiencies. These deficiencies exacerbated the impact of the crisis, which was countered with faulty policies. The crisis-policies deepened the human impact of the crisis, fostering anti-EU sentiments. Anti-EU sentiments hinder further integration steps, necessary to overcome the crisis and the deficiencies of the Euro.

What can we do to counter this? In my opinion, what is needed to regain passion for the European project and enable the necessary integration is a new content for European politics! By this I mean a reorientation towards making the Union work for its citizens. It has become obvious now that even policies that contribute to overall economic growth fail to augment the lives of most people. Real wages for the lower middle and working classes have been stagnant for too long. In order to make European integration work, we need to make Europe work for the people – in terms of equality, job prospects and social security – the whole gamut.

By way of concluding, here are six – admittedly complex and interrelated - issues that will determine the future of the EMU:

## 1. The euro's design flaws

- Divergence between Eurozone economies is too deep and persistent
- The common currency takes adjustment mechanisms of exchange rates and interest rates away from states – adjustment must happen mostly through fiscal policy.
- at the same time, deficits were capped at maximum 3% by the Stability and Growth Pact (which Romano Prodi in his time as President of the Commission has called "stupid" with regards to its rigidity). This makes countercyclical policies impossible.
- The ECB's sole focus is on inflation – unlike the FED, which has the mandate for inflation, but also unemployment growth and financial stability.
- The EMU creates pressures on national labour markets and welfare states; it incentivizes deregulation and the dismantlement of welfare.
- This discredits progressive parties.
- No means of ensuring countries adopt structural reforms.

## 2. German policies

Germany could contribute massively to the quicker regeneration of the Eurozone if it allowed wages and domestic demand to rise, thus lowering its massive current account surplus (currently around 278bn €, or almost 9% of its GDP). Brussels, Washington, the IMF, and the US Treasury have called upon Berlin to lower its current account surplus. Lowering the German surplus would have similar effects for the competitiveness of the crisis countries in the Eurozone as the current “internal devaluation” these are going through right now – without the massive social and political costs of lowering wages and prices in these countries (and thereby increasing leverage).

## 3. Upcoming elections

Marine le Pen has promised to push for a concerted dismantling of the euro should she be elected. Elections elsewhere in Europe threaten to bring to prominence similarly euro-sceptic politicians. The EU and the euro are widely identified with neo-liberal and free-trade economic policies, both of which are seemingly past their political use-by date now.

## 4. Democratic deficit

The EU institutions have a long history of low democratic accountability, which has been partially reined in through the expansion of competencies of the EP. The informal institutions established in the crisis response to save the Euro – namely the Troika – are even less accountable. The outsourcing of vital policy areas to unelected technocrats and experts is a trend in western democracies that has started in the 20th century already. Now our societies seem to have arrived at a point where this is no longer sustainable and a massive backlash against ‘experts’ and ‘elites’ is visible. (Think BREXIT: Michael Gove – the people have had enough of experts)

## 5. Drivers and inhibitors of integration

It used to be that crises have been drivers of European integration. It seems true that the only way to overcome the current crisis of the EMU is further integration as well. However, the crisis has also empowered forces inhibiting further integration – calls for a return to stronger sovereignty or outright exit from the EMU or the EU. The incomplete integration that is the current EMU has created the condition for these inhibiting forces to thrive.

## 6. Trust in integration

A series of crises — starting with the financial crisis and followed by the Eurozone debt crisis, the war in Syria, the Russian-Ukrainian conflict, as well as terrorist threats, and above all the migration and refugee crises — have weakened the essential principle of every democratic political project: the trust of its citizens in its capacity to solve the fundamental problems they are facing. The crucial task for the political representation of the EU 27 is precisely that — to strengthen Europeans’ trust in integration itself.