No end in sight

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The euro is doomed. That claim was first made as soon as a European single currency was officially suggested in 1970. Predictions of disaster have come steadily ever since. The actual appearance of the currency in virtual form in 1999, the euro zone banking crisis that started in 2010, and now a new eurosceptic Italian government have all spurred warnings of inevitable woe.

A new book by Ashoka Mody, “EuroTragedy: A Drama in Nine Acts”, presents the gloomy case particularly well. The Princeton professor marshals history, politics and economics to justify his title. (Full disclosure: The author asked for my comments on a draft of the book.)

As befits a tragedy, the hero of Mody’s drama has a fatal flaw. The euro was created before its proper time in history. The nation-states of Europe were not unified enough to take on the responsibilities of a shared currency. Electoral loyalties were too national for a central fiscal authority, and there was no democratically elected body to supervise the central monetary authority.

The historical inadequacy led to messy political compromises. The mandate for the European Central Bank was vague, controls on the fiscal deficits of member states were ineffective, and the risks of national banking in a multinational currency zone were studiously disregarded.

The messy politics led to bad economics. Mody argues that the rigid exchange rate amplified the differences between stronger and weaker economies. That case is controversial, but excessive foreign lending to the banks and governments of weaker euro zone members definitely led to an existential crisis. It only ended when one of the initial political uncertainties, the power of the European Central Bank, was resolved in 2012.

That step forward was possible because the ECB had the political support needed “to do whatever it takes to preserve the euro”, in the words of Mario Draghi, its president. The politics have become more doubtful since then. Italy’s Deputy Prime Minister Matteo Salvini, the most powerful politician in the country’s new coalition government, is the greatest current nemesis. But he is only slightly more hostile to the single currency than many of his peers.

Mody sees little alternative to a painful unravelling of this doomed experiment – the inevitability of classic tragedy. Having run the International Monetary Fund’s operations in Ireland during that country’s 2010 banking crisis, he is certainly well informed. However, his historical perspective is too short. There are old and strong historic forces pushing towards monetary unity.

Draghi’s step forward may have looked like an act of near desperation, but it fits into a pattern that has endured for almost three-quarters of a century. Since the end of the Second World War, there has been uneven but steady progress towards a more unified European economy and shared political responsibility.

The recent drive to unity was a response to chaos, but it has many strong foundations. For two millennia there has been a European history of ideas, art, science and religion. This common culture gave the world imperialism and industrialisation, among many other things.

A full European banking union and some risk-sharing on sovereign debt would take history further along this already long journey. These changes, along with more flexibility on fiscal deficit limits in bad times, would probably be enough to keep the next euro crisis from being existential.

The post-crisis baby steps taken so far, most recently the anointing of the communally funded European Stability Mechanism as a backstop to eliminate depositors’ losses at distressed banks, are not enough to ensure the euro’s survival. If a crisis comes soon, the politicians and the ECB will once again have to cobble together a solution.

Fortunately for them, the euro is more of a historical fact now than in 2012. Memories of national currencies are fainter, and the losses from splitting up the single currency are greater. Nationalist parties in both France and Italy have discovered that campaigning against the euro costs them votes.

Unfortunately for advocates of greater integration, history seems to be changing directions. Militant nationalism is rising around the world. The European Union was originally constructed to tame this historically destructive force, and until recently managed the tension between national and regional goals very well. European institutions have become stronger and the economy increasingly borderless, with only modest losses in national political sovereignty.

Now, though, Europe has fallen prey to global decline in confidence in the sort of multilateral cooperation needed for a multinational currency. That change is not the euro’s fault: it afflicts the United States, Russia and Turkey as well. Nor can the single currency explain the United Kingdom’s decision to leave the EU or the rise of illiberal democracy in non-euro members Hungary and Poland. The euro remains popular in Greece and Italy, although resentment about its effects may have contributed to the rise of nationalist politicians in those two countries.

Still, while the euro did not spark the rise of nationalism, that rise could certainly doom it. The future of the single currency depends on which historical force proves stronger – the drive for nationalist independence or the momentum towards European unity. The latter, which brings peace and prosperity, is down but far from out. This drama could still have a happy ending.

Context News

"EuroTragedy: A Drama in Nine Acts" by Ashoka Mody was published June 1 in the United States by Oxford University Press. The UK edition will be published July 26.