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The Unifying Role of the Single Currency

Perhaps the single most tangible symbol of the European Union is its single currency, the euro. Within the European Economic and Monetary Union, it was seen as a tool to ensure that European integration would be truly irreversible. However, the euro has also contributed to cleavages and asymmetries. This article reviews whether the euro can fulfil the unifying role envisioned for it, examing the importance of the euro in four crucial European relationships.

The European Union was designed with the goal of overcoming the various forces of nationalism that had divided the continent for centuries. As a programme of peace, it includes certain economic tools, one of which over the last three decades has been the common currency. Launching an Economic and Monetary Union (EMU) in the early 1990s was explained by the need to fully exploit the potential of the Single Market, but it was also seen as a tool to ensure that European integration would be truly irreversible. It is, however, unclear to what extent the single currency can fulfil its unifying mission. Based upon the development of the recent financial crisis and reform period, it is important to examine this question at four levels: the German-French axis, the North-South polarisation, the divide between the UK and the Continent, and the East-West asymmetry.

German-French partnership

Monetary integration in Europe, like economic integration in general, has always relied primarily upon Franco-German cooperation. This cooperation has itself always relied upon a certain personal connection between the countries' leaders. This is why it was very important in the 1970s to initiate a meeting of minds between Valéry Giscard d'Estaing and Helmut Schmidt. These two leaders, first as finance ministers and then as President and Chancellor, worked together to develop the European Monetary System (EMS). Another outstanding couple: Francois Mitterrand and Helmut Kohl, who facilitated the 1992 Maastricht Treaty together.

When the euro was introduced, Gerhard Schröder and Jacques Chirac were Chancellor and President, respectively, and they enjoyed a honeymoon period without major challenges to the euro. However, under their successors Angela Merkel and Nicolas Sarkozy, the cohesion and sustainability of the currency union were called into question as fundamentally new challenges arose: the Great Recession of 2008-09 and the subsequent eurozone crisis.

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The Franco-German tandem did not collapse with either Merkel-Sarkozy or with Merkel-Hollande, yet the enduring crisis did manage to deepen the intellectual and political divide between the two countries, making it harder to design and implement the reforms needed for the long-term sustainability of the euro.

Brunnermeier, Landau and James explored this intellectual divide.[1] The trio of German, French and British economists explained that Germany regards the Economic and Monetary Union as primarily a rule-based stability union, while France on the other hand considers growth and stability to be of equal importance, allowing for the discretionary use of common policy instruments in the case of crisis.

While it can be said that the eurozone has recovered from its deep crisis, it is unclear whether it is prepared to handle another one. Emmanuel Macron knows this well, and it was no coincidence that his first foreign trip after assuming office was to Berlin. Macron is Merkel's fourth counterpart in Paris, and he launched his campaign knowing that he had only a brief window of opportunity to convince the German leadership of the importance of substantial eurozone reform.

Following the 2017 federal elections in Germany, in which both major parties lost portions of their support, the first attempt to form a coalition government occurred between the CDU-CSU, the FDP and the Greens. This attempt

1 M.K. Brunnermeier, J.-P. Landau, H. James: The Euro and the Battle of Ideas, Princeton 2016, Princeton University Press.

failed, and one of the primary reasons was disagreements regarding the need for and direction of eurozone reform. The renewed Grand Coalition between the CDU-CSU and the Social Democrats emphasised its openness to discussing eurozone reforms, though without committing to a specific package of measures.

The Franco-German understanding in the area of economic policy and more specifically eurozone reform has been cultivated by the cooperation between two groups of economists: the Eiffel Group and the Glienicker Group. An important outcome of this cooperation was the publication of a paper by 14 French and German economists in early 2018 which generated a wider debate on the immediate tasks of EMU reform.[2]

However, intellectual convergence between the two sides has been made harder to achieve due to mutual mistrust, including misconceptions about each other's objectives. Stereotypes about the weakness of the French economy are widespread in Germany. In reality, the performance of the French economy remains only moderately weaker than the German one, and French public debt is just moderately higher than it is in Germany. These gaps do exist, but they appear to be minor, especially if one takes into account better demographic trends on the French side and complex defence functions fulfilled by the French state.

France does not need a check from Germany. That is not the reason why it tends to challenge German ordoliberalism and its views on the monetary union. What France does need is a political victory for the euro, one based upon two policy shifts. First, Germany would need to boost investment and wages in order to reduce its huge current account surplus and consequently generate greater demand at home and inside the entire eurozone. Second, Germany and other surplus countries would have to approve some new fiscal tools which are needed not primarily by France but rather by countries in the eurozone periphery, i.e. Ireland, the Baltic States and Southern Europe.

North-South polarisation

While intellectual convergence has to be fostered between France and Germany, real divergence has been the main problem between North and South – or more precisely, between the eurozone core and periphery – especially during the eurozone crisis (2011-13). The standard narrative of this crisis focuses on overspending by the Southern European governments. It is claimed that they violated the EMU rules, in particular the deficit threshold of three per cent of GDP. In reality, Spain and Ireland complied with all existing rules, and the violation of the Maastricht criteria was not a major problem in Italy or Portugal either. Certainly, all affected countries committed some mistakes, and the public budget of Greece violated all of the EMU's rules. However, the imbalances were caused primarily by capital flows from the eurozone centre towards the periphery, together with the fact that the EU was unprepared to handle the consequences of these flows.

The incomplete design of the EMU has been particularly disadvantageous for the eurozone periphery.[3] During the eurozone crisis period, major divergences developed between the North and the South. With or without assistance from the troika, countries in the periphery took a much bigger dive into the "double-dip recession" in 2010-11 than the countries in the eurozone core. Financial fragmentation and capital flight caused longer and deeper recessions in the periphery, which pushed unemployment to record high levels and increased poverty levels, too. Political structures were shaken. Legacy problems continue to linger well after the acute phase of the crisis, for example in the form of unsustainable public debt in Greece and banking sector uncertainty in Italy.

These developments can be explained by the fact that the designers of the Maastricht system (the members of the so-called Delors Committee) underestimated the importance of flexible and adjustable exchange rates, and overestimated the capacity of the EU's political mechanisms to introduce the missing elements of the EMU (common banking regulation, economic governance, fiscal risk-sharing, etc.) without a major crisis, i.e. in a preventive fashion.

Undoubtedly, the pre-crisis currency union was far more developed than its predecessor, the European Monetary System (EMS) that existed in the 1980s, since the national currencies had all been abolished and the European Central Bank had been established. This historic leap, however, has thus far not been followed by the necessary elevation of economic policymaking from the national level to the European level. The inherent logic of the system has hardly grown beyond that of a currency board, which is a remarkably stable but at the same time dangerously fragile currency regime.

Since 2011, many have proposed breaking up the eurozone, specifically through the departure of certain (typi-

2 See A. Bénassy-Quéré et al.: How to reconcile risk sharing and market discipline in the euro area, VoxEU, 17 January 2018, available at https://voxeu.org/article/how-reconcile-risk-sharing-and-market-discipline-euro-area. Further contributions to this debate, moderated by Jean Pisani-Ferry and Jeromin Zettelmeyer, are available at https://voxeu.org/debates/euro-area-reform.

3 See in particular J.E. Stiglitz: The Euro: How a Common Currency Threatens the Future of Europe, New York 2017, W.W. Norton & Company.

cally Southern) Member States, though most observers have not seen this as a desirable option. Various anti-EU forces (National Front in France, Northern League in Italy, etc.) have advocated an EMU break-up as a possible solution, but in 2015 it was the finance minister of Germany, Wolfgang Schäuble, who offered a "five-year holiday" from the euro to Greece (and it was clearly understood that the temporary nature of this exit was not to be taken seriously).

In order to avoid a break-up, convergence has to be restored, notably between the North and South. And in order to generate convergence again, in particular a lasting convergence, fundamental reform is needed. This explains the concentrated ongoing discussions on a deepening of the EMU and the high expectations in this regard. Facilitating the discussion and creating consensus is the task of the European Commission, which in May 2017 published a reflection paper on the future of the EMU.[4] If eurozone reform can be genuinely relaunched (contrary to the recent Meseberg summit of French and German leaders), the most urgent task will be the completion of the Banking Union through the addition of deposit insurance to the existing pillars, followed by the introduction of fiscal stabilisers to help foster risk-sharing and convergence.

Since 2012, a number of EU documents have confirmed the need for closer cooperation in the wake of the euro crisis. This means moving towards fiscal union, banking union and political union. However, full political consensus has not yet arisen around the reform process. The debate often appears to be polarised between those who would like to see faster progress towards fiscal union (i.e. including various transfers) and others insisting on further structural reforms (which often appears to be code for austerity). Opposition to fiscal risk-sharing and the completion of the banking union is mixed with openness to taking a few steps backward, meaning the withdrawal of tools established during the crisis (e.g. the abolition of the European Stability Mechanism).

The debate, however, is not only about speed, and has more than two sides. Given the stalemate between fiscal federalists and ordoliberals, some have supported a third position which rejects both fiscal union and excessive austerity.[5] It advocates a kind of "renationalisation" of fiscal rules and the restoration of the "no-bailout principle" (perhaps with the establishment of a sovereign default mechanism).

The majority of economists seem to agree – and perhaps even the majority of German economists – that in its current composition, various elements of solidarity are needed in order to create cohesion in the eurozone and to generate more prosperity and better balance. Some, however, and especially those in the North, believe that if the current model (i.e. without fiscal transfers) does not suit everybody, the weak members should simply quit. This is applied not only to Greece but also to larger countries. However, if Greece or larger countries (such as Italy) were to quit the EMU, the European character of the single currency would be diminished, and the idea that the euro fosters the economic and political unity of Europe would have to be abandoned.

Brexit and the question of currency

The United Kingdom never joined the single currency and will be leaving the EU altogether next year. Although slogans like "taking back control" and issues like immigration were more prominent in the pre-Brexit discussions, it is important to see what role the monetary union played in the rise of anti-EU tendencies in the UK and specifically in the Brexit referendum result.

In the second half of the 1980s, the UK was still very supportive of the effort to create a Single Market. However, the Conservative government of the time did not agree with the additional reforms that the European Commission considered organically linked to the Single Market. Margaret Thatcher did not welcome the idea of the single currency and also opposed Jacques Delors's effort to build a social dimension within the Single Market.

Having restructured the British economy and the welfare system, Thatcher was keen to weaken trade union power at home and did not like the idea of social dialogue at the EU level. A currency union was also seen as a threat to the economic autonomy of the UK. In July 1990, Nicholas Ridley, Secretary of State for Trade and Industry, gave an interview in which he described the proposed Economic and Monetary Union as "a German racket designed to take over the whole of Europe" and said that giving up sovereignty to the European Union was as bad as giving it up to Adolf Hitler.[6] Ridley was forced to resign, although it was obvious that he was not alone with his opinion.

4 See European Commission: Reflection paper on the deepening of the economic and monetary union, 31 May 2017, available at https://ec.europa.eu/commission/publications/reflection-paper-deepening-economic-and-monetary-union_en.

5 See in particular M. Sandbu: Europe's Orphan: The Future of the Euro and the Politics of Debt, Princeton 2015, Princeton University Press.

6 D. Lawson: Saying the Unsayable About the Germans, The Spectator, 14 July 1990, p. 8.

Nevertheless, many in the Conservative Party believed that joining the Exchange Rate Mechanism (ERM) would help to bring down inflation. The UK joined the ERM under Thatcher, with John Major as chancellor.[7] However, the recession of the early 1990s put pressure on the peg, forcing the UK to eventually leave the ERM. The turbulent experience of departure ("Black Wednesday") essentially closed off any possibility of future UK membership in the proposed EMU. After becoming prime minister, Major negotiated an opt-out; Denmark later did the same.

Together with the EU's social agenda, the monetary union played a significant role in alienating large parts of the British establishment from the European project. Many in Britain never fully signed up to the continental concept of the social market economy, which is also enshrined in EU treaties. However, British Euroscepticism was particularly energised by the creation of the euro in the 1990s.

At the time of the Maastricht process, two small political parties, the UK Independence Party (UKIP) and the Referendum Party, were launched in order to prevent deeper UK engagement in the European Union – and the abolition of the pound sterling. Even though the UK eventually received an opt-out from joining the EMU, UKIP kept its campaign going and maintained the sterling sign in its emblem until 2017.

Despite the opt-out, the gulf between the UK and the continent was widened by the launch of the monetary union. The Labour Party, which took over from the Conservatives in 1997, was more pro-EU and wanted to pursue various integration policies. However, while they dropped British opposition to EU social policy, they could not make a breakthrough on currency. Chancellor Gordon Brown introduced "five tests" in order to assess the potential impact of eurozone accession and concluded that the reform should not take place.

Later, the eurozone crisis provided ammunition to UK Eurosceptics who asserted that "the EU is not working". This card was played out in domestic politics, even though macroeconomic austerity was not forced upon the UK by Brussels but was entirely self-inflicted by the Conservative-Liberal coalition government, orchestrated by Chancellor George Osborne. In the run-up to the referendum on EU membership, it was not so much the existence of the euro that fuelled UK Euroscepticism but its functioning and performance. As pro-Brexit campaigners often claimed, Britain was chained to a corpse.

The eurozone crisis also boosted unwelcome intra-EU migrant flows from the South to the UK and made it harder to reduce the level of immigration. Furthermore, many Britons became disaffected when they saw how the European community – or more precisely, the eurozone finance ministers – treated its most vulnerable member, Greece, in the summer of 2015. People asked if this really was the community Britain should belong to.

There were various other reasons why the Leave campaign was more successful in 2016 than the Remainers. However, in a three-decade-long debate, the currency question repeatedly played a role in putting a wedge between the United Kingdom and the continent, and eventually contributed to the UK's departure from the EU.

East-West cleavages

When the currency union was designed, the Eastern member states were not yet part of the European Union. When Delors established his committee of European Community central bankers, the Council for Mutual Economic Assistance (COMECON) and the Warsaw Pact still existed. When the countries between the Baltic, Adriatic and Black Seas got a chance to join the EU, it was made clear to them that the single currency was not optional, but rather an obligatory part of the EU accession package.

The current Eastern member states of the EU can be distributed into three categories based on how they relate to the single currency.[8] The first group includes those already inside the eurozone: Slovenia, Slovakia, Estonia, Latvia and Lithuania. They were wholeheartedly determined to quickly join the eurozone. The second group is the South-East: Romania, Bulgaria and Croatia. The governments of these countries compensate for the weaknesses of their economies with their strong commitment to stability. More than likely, the next country to join the euro will emerge from this group.[9]

7 The ERM was established in 1979, with the goal of creating exchange rate stability among member states by maintaining a narrow fluctuation band (+/- 2.25%) around bilateral exchange rates between participating currencies.

8 Central European divisions regarding the euro are well explained in K. Than: EU reform effort reopens eurozone divide in Central Europe, The Christian Science Monitor, 22 January 2018, available at https://www.csmonitor.com/World/Europe/2018/0122/EU-reform-effort-reopens-eurozone-divide-in-Central-Europe.

9 Prime Minister Boyko Borisov used the Bulgarian Presidency of the Council in Spring 2018 to voice his country's strong interest in joining the euro; see Sofia News Agency: PM Borisov: We have in Fact Fulfilled the Numerical Criteria for Entering the Currency II Mechanism, novinite.com, 26 April 2018, available at https://www.novinite.com/articles/189739/PM+Borisov%3A+We+have+in+Fact+Fulfilled+the+Numerical+Criteria+for+Entering+the+Currency+II+Mechanism.

The third group is the so-called Visegrad group, minus Slovakia. Poland, the Czech Republic and Hungary are all mid-sized EU countries, and as such, monetary policy autonomy is meaningful in their case. The Czechs have always been rather reserved with regard to their interest in eurozone accession, while Poland's initial political commitment was derailed first by the global financial crisis and more recently by the rise of PiS, the Kaczynsky brothers' Eurosceptic conservative party. Hungary had two target dates for accession when the government was held by Socialist-Liberal coalitions (first 2008, then 2010), but the endeavour to join the euro was washed away by the global economic crisis and the general political instability of the EU, despite the relative popularity of the euro in Hungary.

In September 2017, European Commission President Jean-Claude Juncker outlined his vision to reunite the eurozone and the EU.[10] In order to ease the further eastward enlargement of the eurozone, he proposed a budget line to smooth the accession of those who want to join in the coming period. This proposal is linked to reflections on the post-Brexit situation in Europe, and it revives the original idea that there should be no separation between the currency union and the Single Market.

At the time of writing, the form of such a budgetary instrument is still rather abstract. However, it is important to note that there are simultaneous discussions about reducing the scope for Cohesion Policy within the Multiannual Financial Framework (MFF), the seven-year EU budget. This creates the risk that the overall support for EU countries on the periphery would not increase at all. The package as a whole seems inadequate for creating the appetite in the East to join the eurozone.

It would also be necessary to clarify how the Maastricht rules of accession would be interpreted in the case of the Visegrad and South-East groups of countries. For example, in order to allow high-debt member states (e.g. Belgium, Italy, Greece) to join the euro, the rules had to be interpreted accordingly. Similarly, suitable interpretation was necessary for the Baltic States, using currency board arrangements to skip the ERM-II exchange rate mechanism. The question of interpretation is particularly important for the South-East.

Interestingly, though not surprisingly, the Central Bank of Hungary (CBH) came out with a new set of criteria in 2017 which would be monitored before the country decided whether to join the euro. This set of criteria raised the bar very high regarding "the maturity of the EMU" for welcoming Hungary.[11] The CBH criteria, from a distance, resemble the criteria designed by Gordon Brown for the UK when the government under Tony Blair was contemplating eurozone accession (and eventually concluded that the UK should not join).

A key factor in the new set of criteria by the CBH is the real economic convergence as measured in GDP per capita. This creates a false appearance that eurozone membership would be an obstacle to higher growth rates. It also suggests that if your per capita GDP is near the EU average, you will have fewer problems inside the eurozone. This latter implicit assumption is confuted by the examples of Italy and Ireland.

If the question is whether eurozone membership would constrain real economic convergence in the Eastern ("new") member states, the answer is likely no. If we look at the last five years, the Baltic States and Slovakia grew much faster than Hungary did. In other words, it is by no means assured that countries can take advantage of the freedom provided by having a national currency.

When we look for the reasons why the Visegrad group (besides Slovakia) wants to keep its distance from the single currency, it is mainly due to their insistence on holding on to the possibility of making autonomous decisions. The dilemma of joining the eurozone is thus essentially the choice between more or less autonomy in their decision-making processes. In the current political framework, marked by strong Polish, Czech and Hungarian nationalism, the ruling powers clearly favour more national discretion and autonomy. By this, they also assume the risk of becoming part of a political periphery in a supposedly inevitable two-tier EU.

Current debates revolve around the need for the EMU to be reinforced by a variety of new instruments (European Monetary Fund, eurozone finance minister, MFF budget line, etc.). If the EU becomes a two-tier system as a result of a reinforced EMU, all countries could decide autonomously which tier they would belong to. However, if a country were to choose the outer tier of the EU, it could not obstruct the further deepening of the EMU if that were desired by the inner tier of eurozone members.

Non-eurozone countries may also have less influence than eurozone members. To see this in an Eastern context, we should note that the finance minister of Slovakia recently

10 J.-C. Juncker: State of the Union Address, speech, 13 September 2017, available at https://ec.europa.eu/commission/priorities/state-union-speeches/state-union-2017_en.

11 A summary of the Hungarian euro debate is provided by V. Jóźwiak: Prospects of Euro Adoption in Hungary, PISM Bulletin No. 97, 2017, available at https://www.pism.pl/publications/bulletin/no-97-1037.

appeared among the candidates for the Eurogroup presidency. Furthermore, though it is not explicitly forbidden, it is quite unlikely that a politician from a non-eurozone country would be considered a strong candidate for Commission president.[12] Slovakia should be seen as an encouraging example of the possible benefits of EMU membership, since the country managed to successfully exploit eurozone accession as part of a broader confidence-building strategy shortly after joining the EU.

An acceleration of EMU reform that led to better functioning could increase the appetite of the larger Visegrad countries to join. If reform occurs fast enough, it may bring currency reform to the centre of economic policy debates in the East, and it might also diminish the power of nationalism. This aspect is all the more important because, notwithstanding the speed and direction of EMU reform, many Eastern advocates of eurozone accession put an emphasis on the political arguments in favour of joining, i.e. that EMU membership would cement these countries inside the EU and eliminate the risk of them drifting to the periphery or entirely out of the union.

12 Irrespective of his chances, it is an important development that Vice President Maros Sefcovic of Slovakia declared his candidacy for European Commission President in June 2018.

Conclusions

Establishing a currency union and belonging to it has been a symbol and a driver of an ever closer union in Europe over the past three decades. However, with its imperfect initial design, the single currency has also contributed to existing cleavages and asymmetries. North-South divergence was particularly severe and consequential during the 2011-13 eurozone crisis, which also helped drive the UK out of the EU and caused some non-eurozone countries to be more cautious about pursuing accession. Nevertheless, the EU has recently grown more concerned with ensuring that eurozone membership is seen as an essential component of EU membership. But without substantial eurozone reform, it is hard to see how the unifying role of the single currency could be strengthened. Despite meaningful post-2010 reform measures, it is still doubtful whether they would be sufficient for surviving the next crisis. The design and resilience of the euro should be a top issue under discussion during the 2019 European Parliament elections. Whether preceding or following elections, a Bretton Woods-style conference among representatives of all EU member states would allow for comprehensive talks about the financial, economic and social models of the EU and the necessary steps for a prosperous and sustainable EMU.