<u>Saving the Euro Will Mean Worse Trouble for Europe</u>

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The EU has tried repeatedly, and failed repeatedly, to calm the markets. That is not for a lack of solutions at hand. Consider three: make the European Central Bank (ECB) a lender of last resort, spread exposure by pooling eurozone debt via eurobonds, or massively increase the European Financial Stability Facility (EFSF) and start bailing out weak economies in earnest.

Any of those solutions would reinstate confidence and lead to stability, but each is easier said than done. The first and arguably best solution -- in which the ECB simply buys debt without limits from Italy or any other member state in trouble -- is legally questionable under the EU treaty; what's more, Berlin rejects the idea, citing the bank's limited mandate, and says it could spark inflation. The creation of eurobonds is a political nonstarter for northern European states distrustful of their profligate, crisis-prone counterparts in the south. And eurozone leaders have already tried -- unsuccessfully -- to create a bigger EFSF on the cheap by asking the BRIC countries to buy in.

Simply put, markets are reeling because eurozone countries have failed to go beyond half-measures to resolve the crisis. The longer they delay taking any one of the three possible solutions, the closer the markets push them to the brink of disaster. But here's the rub: if the eurozone survives, the consequences may be just as ruinous. Austerity will be a drag on growth in the center and the north of Europe, and on competitiveness in the south. Add to this increasing unemployment, inequality, and poverty, and the continent has prepared a recipe for rising social unrest and polarization on the political extremes. Not until European leaders realize the fundamental flaw in their current approach -- a lack of real political and economic integration -- will there be an end to the crisis in sight.

First, consider the euro going bust. Europe would undergo a vast and painful transformation. How exactly it would happen remains uncertain, but there is little doubt that it would be ugly. Just think of spreads on Italian or Spanish debt zooming past ten percent; one would default, then possibly the other. France would surely follow, given the exposure of its banks to Italian debt, then, even, Germany. The EU as such would nonetheless survive, along with the single market. But that is where the certainty ends. One of two post-euro scenarios could emerge. In the first, a small group of northern European countries rally around Germany to create a new currency outside the eurozone and, arguably, the EU. The problem is that the new currency would skyrocket in value overnight because, without the dilution from the less competitive south, it would become much too strong to sustain powerful export-oriented economies.

In the second, the southern Europeans leave the eurozone in exchange for a modern-day Marshall Plan funded by, say, the richer eurozone members through the EFSF. The upside is that they would regain competitiveness through the depreciation of their currencies, rather than through the reduction of workers' wages and entitlements. The

downside is they would have to go back to national currencies, near-zero liquidity, inflation spurred by the higher price of imports, and, most likely, a ruined banking system.

Accordingly, no country is seriously contemplating an exit from the EU, however unpopular staying in has become. By the best estimate, at the very last minute and at great cost, the euro will most likely be saved. The ECB will finally decide that because the eurozone's financial stability and, indeed, the single currency's very existence is at risk, it can buy member-state debt without limit and still remain under the terms of the treaty. At the same time, the member-states will greatly increase the financial firepower of the EFSF, with further support from the IMF, reinforced by money from the BRIC countries.

But even if Europe saves its common currency, it will not solve the continent's biggest problems. Hiding behind Europe's debt crisis is both a growth crisis and a competitiveness crisis. The former is a result of the austerity policies that EU leaders signed onto last May in exchange for Germany's agreement to bail out Greece and establish the EFSF. Radical deficit reductions and fiscal consolidation was the answer. Rather than calming markets and restarting growth, however, it has produced an economic slowdown across Europe, which is now likely heading toward a double-dip recession, and less rather than more market confidence.

Austerity has already taken a toll. Across Europe, there has been a rapid increase of poverty, inequality, and unemployment. Very little has been done at the EU level to ease the pain. One has to wonder where Social Europe is. The structural funds designed to promote economic development in regions in need have gone mostly unused by the poorest of the southern European regions, largely because they lack the administrative capacity to jump through the bureaucratic hoops required to access the funds. Likewise, the European globalization adjustment fund (EGF), set up in 2007 with great fanfare to address unemployment problems resulting from globalization, turns out to have disbursed almost no money in 2010, even as unemployment continues to rise.

Then there is the competitiveness crisis. As the across-the-board cuts mandated by EU authorities for southern Europe spare nothing -- including investment in areas required for future growth, like training and education, support for job and business creation, and economic modernization -- these countries will not be able to get out from under their debts, let alone prosper. Austerity measures designed on the so-called German model may work for Germany's export-fueled economy. But it spells nothing short of decline for Europeans on the Mediterranean.

The EU's crises are not just economic and social. They are also political. Politics in Europe are already becoming more national. Euroskepticism is on the rise both in southern Europe, where citizens see the EU as imposing unnecessarily harsh austerity to placate northern Europe, and in the north, where citizens see the EU as imposing unnecessarily high costs in bailing out the south. European leaders have done little to counter these perceptions.

In Germany, for example, Chancellor Angela Merkel's discourse in the months before agreeing to the first Greek bailout and creation of the EFSF did nothing to prepare the public for it, and instead seemed to agree with the tabloid press bent on castigating the lazy Greeks. As such, "saving" the euro proved a much harder sell. The same problem holds for today. Although she now proclaims the need for deeper political and economic integration, Merkel remains the primary holdout to the ECB's becoming a lender of last resort.

Accordingly, political extremes are surging in capitals across Europe. Populist parties have become increasingly vocal in opposition to bailouts, from France's extreme right National Front to Germany's extreme left Die Linke (the Left Party). In the Netherlands, Gert Wilders has succeeded in making his Freedom Party the second most popular in the Netherlands by shifting his emphasis from anti-Muslim to anti-European politics, while the far-left Socialists, equally opposed to the eurozone rescue packages, have also moved up in the polls. Anti-European sentiment has even increased outside the eurozone, most noticeable recently in Britain, with the backbenchers' revolt in the Conservative party.

Those really pulling the political levers now are the so-called technocrats. For national democracies, the resignations of elected prime ministers, whether Silvio Berlusconi in Italy or George Papandreou in Greece, and their replacement by presidentially appointed economists, have raised direct questions about the democratic legitimacy of unelected officials taking the place of elected governments.

But whereas Italy's shift to a technocratic government could very well be a chance to make democracy work anew -- with a replay of the country's mid-1990s success in reforming to join the euro, now to stay in -- this is much less clear in the case of Greece, which, under the harsh orders of the troika technocrats (IMF, ECB, and European Commission), imposed increasing pain on a disenfranchised public. In this light, Papandreou's call for a referendum could be seen as a genuine desire to bring participatory democracy back in, by allowing the electorate to vote on whether to accept the bailout package and, by extension, to stay in or to leave the eurozone.

The catch, however, is that in re-enfranchising the Greek public Papandreou was single-handedly disenfranchising the greater public of eurozone countries, who all knew that the fate of the euro suddenly hinged on the referendum vote.

Given the delays and hesitant solutions that have repeatedly failed to calm the markets, the real European power centers -- and Germany in particular -- have not, to put it bluntly, led. The European Parliament, the only directly elected body in the EU, has barely been involved, so there has been no political debate to change the conversation over the efficacy of austerity. EU leaders do not seem to see a problem with the rise of technocracy, or the recourse to automatic rules, agreed without parliamentary debate, whether in the EU or national government. But they are likely to be in for a rude awakening, in particular if markets decide that Italian, Spanish, or French debt is too much to handle.

The EU needs more than deeper economic integration. It also needs deeper political integration. Talk has surfaced about a new fiscal pact that would impose restrictions on national budgets. Although this is the right move to convince the ECB that becoming lender of last resort will not open the door to moral hazard, since the pact is to bind all countries to fiscal probity, the austerity policies embedded in it are likely only to reinforce the growth crisis. Moreover, by undermining one of the main tenets of parliamentary democracy -- budgetary responsibility -- it will only increase the Eurozone's democratic deficit.

Blinkered by their increasingly euro-critical electorates and, dare it be said, by their neoliberal and ordoliberal (read: German) economic ideas, EU leaders have so far ruled out the appropriate economic initiatives that could solve the debt crisis. Equally problematic, they have cut off the political debates that might provide better policies with greater public legitimacy. As a result, EU leaders, rather than saving the euro and, with it, Europe, may kill off both.