EU leaders need to confront the political dilemmas of the Eurozone crisis

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Alongside economic issues, there is also a political dimension to the Eurozone crisis. **Renaud Thillaye** *emphasises the importance of this political debate and highlights the key questions which must be addressed by European policymakers as part of any solution. The potential for the crisis to deepen socio-economic divergences between member states, and the future relationship between Eurozone countries and the rest of the EU-27 must be addressed. The EU must also be reconciled with democratic politics and European citizens' often weak sense of identification, if it is to remain legitimate.*

Despite 20 summits, an impressive record of institutional reforms and countless reassuring declarations, the Eurozone finds itself in a situation every bit as precarious as two years ago, at the onset of the Greek debt crisis. Recent statements by EU Commission President José Manuel Barroso and European Council President, Herman Van Rompuy that the euro was an "irreversible" project sounded rather like autosuggestion. Angela Merkel warned again in June that there was no "magic formula with which the debt crisis [could] be overcome once for all".

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The story of the Eurozone's crisis management has been one of economics and politics pulling in different directions. This tension is at the core of a new Policy Network paper published for the FP7 research project "Welfare, Wealth and Work for Europe", which aims to identify the conditions for a successful socio-ecological transition of European economies. The publication shows that EU leaders not only lack a credible navigation map to tackle the debt and economic crises, but they fail to address the underlying political trade-offs which will heavily impact on the EU's destiny. Institutional innovations, such as the European Stability Mechanism (ESM), the Stability Treaty, the European Semester and the European System of Financial Supervision should not be underestimated. However, today's Eurozone governance does not deviate far from its original set-up under the Maastricht Treaty. In many aspects, the tightening of fiscal and macroeconomic surveillance hardly conceals the continuation of a flawed rule-based regime. Which country would dare bring a case against France and Germany in the Court of Justice for lack of obedience? How could debt-ridden member states comply with the Fiscal Compact's requirements, if not by repeatedly shifting their target to a better tomorrow? A poorly funded ESM would also be of little help in the event of a Spanish banking crisis or an Italian bond crisis.

Three broad strategies stand out for crisis resolution in the medium term. EU leaders could first decide to improve what they have implicitly been pursuing for two years, namely an "insurance-adjustment" strategy. This would require temporary but unequivocal action by the European Central Bank, a steady increase in the ESM's capacities, a more balanced approach to adjustment between debtor and creditor countries, and a substantial reorientation of the EU budget towards growth-enhancing measures. Albeit achievable, this strategy is rejected byBerlinfor fear of greater moral hazard and ongoing complacency.

A smaller Eurozone is a second but hardly attractive option. The euro's fathers expected the single currency to prompt structural reforms and bring the Euro Area closer to optimality. This proved a tall order for very diverse economies dealing with the same "one-size-fits-all" monetary policy. Some call logically to draw a line under this foolish experiment and keep the euro only in a homogeneous and well-integrated core. However, it may well be that the euro is "too big to fail". The exit of Greece or other countries from the Eurozone would be incredibly messy and costly. EU leaders seem to prefer doing what it takes to keep everybody afloat, rather than opening the Pandora's Box of unravelling the single currency.

This leaves us with the third and radical option of a fiscal federation, by far the most convincing one from an economic point of view. As counterpart to the partial or full mutualisation of sovereign debts, a European finance ministry would be enacted to veto member states' budgetary decisions. A banking union would be brought about through a common supervisor and a Europe-wide resolution fund. The EU budget would hand out automatic transfers to cushion cycle divergences.

Amid ongoing confusion and speculation, EU leaders would therefore be well-advised to announce which one of these three strategies they endorse for the next 10 to 20 years. Nevertheless, any of these choices implies a series of political trade-offs which leaders have so far failed to engage with. Policy Network identifies three of them.

The type of convergence currently being pursued in the Eurozone first raises the question of the socio-economic direction of the union. The ambition of levelling up living standards across the continent, which had long been the EU's trademark, is today under threat. Economic imbalances are being tackled through downward social pressures and cost-competitiveness. The reinforcement of fiscal surveillance casts a long shadow on the social investment logic of the Europe 2020 Strategy. The EU is no longer an anchor of hope for peripheral countries.

Second, there is no clear answer to what the relationship between the Eurozone and the rest of the EU should be. If the Eurozone is to integrate further, should its members set up their own institutions or continue to rely on the Community framework? The temptation to "go intergovernmental" has been obvious in the last two years, much to the apprehension of small and non-euro countries. Leaders should also beware of preserving the consistency of the union, both internally and externally, and avoiding a leadership competition between the European Council and the Commission.

Finally, EU policy-making needs to be reconciled with democratic politics. Although a majority of European citizens want to keep the euro, opinion surveys show that they are reluctant to pay the political and financial price for it. Debt mutualisation and the pooling of fiscal sovereignty are not seen as legitimate. Europeans should have a greater say, through both the traditional channels of national politics and more responsive EU institutions. Institutional creativity might not suffice: the weak sense of identification to the EU and the low appetite for solidarity need to be addressed head-on with a more positive narrative reconciling anxious European peoples. After the last June summit, Herman Van Rompuy declared: "Establishing a longer-term perspective for the euro area is a pressing priority". Defining a credible strategy out of the crisis remains an open challenge. Yet, national leaders also need to boldly engage their constituencies with a political vision of what the EU and the Eurozone should stand for in the future. Reluctance to act on both the economic and the political fronts will only widen the space for populist politics.

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