POLITICS IN ACTION . . .

THE EUROZONE CRISIS: REGIONALISM BEYOND ITS LIMITS?

Events: The euro officially came into existence on 1 January 1999. Of the European Union's then-15 members, only the UK, Sweden and Denmark chose not to join the currency. As membership of the EU widened, the eurozone subsequently expanded to 19 members. The new currency achieved parity with the US dollar by November 2002 and increased steadily thereafter, peaking at a value of $1.59 in July 2008. However, the onset of the 2007–09 global financial crisis and a global recession created deepening problems. As growth slowed and tax revenues contracted, concern grew over the heavily-indebted countries in the eurozone; notably, Portugal, Ireland, Greece, Spain and, to some extent, Italy. The crisis in Greece was so severe that, in May 2010, it led to a massive German-led eurozone bailout, backed by the International Monetary Fund (IMF), with a further bailout being agreed in July 2011. Similar bailouts were agreed for Ireland in November 2010 and Portugal in May 2011, amid fears that 'contagion' might spread to Spain, Italy and beyond. In each of these countries severe austerity measures were introduced in the hope that spending cuts and increased taxation would reduce budget deficits and so restore the confidence of financial markets.

Significance: A single European currency had been seen as an important way of bolstering growth and prosperity within the EU. The key attraction of the euro was that its introduction promised to boost trade by reducing the costs and risks involved in transactions. Cross-currency transactions incur costs because of the need to buy or sell foreign currency. Such transactions involve risk and uncertainty because unanticipated exchange rate movements may make trade either more expensive or less expensive than expected. A single currency would therefore complete the single market, and help to ensure unrestricted labour and capital mobility. What is more, much had been done already to ensure the success of the euro, as many barriers to the free movement of goods and peoples within the EU had been removed by the Single European Act (1986) and the Treaty of European Union (1993). This encouraged the view that the EU constituted an optimal currency area, with confidence that, over time, the workings of the single currency would foster greater economic harmonization. An additional advantage was that a single currency would bring with it

helpful economic disciplines; notably, limits on the size of budget deficits and national debts, as laid out in the 1997 Stability and Growth Pact.

The eurozone crisis, nevertheless, highlights the limitations and flaws in the single currency project. Some even argue that monetary union was, in principle, economically unfeasible and stretched European regionalism beyond its proper limits. Any transnational currency area is likely to contain such disparate economies, operating according to different business cycles, that it may be doomed to fail. A particular concern is that monetary union prevents an underperforming eurozone member from using one of the three traditional strategies for boosting growth: devaluation, reducing interest rates, and Keynesian-style deficit budgeting. For some, the chief problem with the eurozone is that monetary union was established in the absence of fiscal union, or 'fiscal federalism'. A major step to rectifying this, acknowledging that the Stability and Growth Pact has simply proved to be unenforceable, was the Fiscal Stability Treaty, or 'fiscal pact', signed by 25 EU states in March 2012. However, the fiscal pact has at least two key drawbacks. First, in substantially strengthening political union it risks precipitating a backlash as populations recognize that losing 'fiscal sovereignty' is more significant than losing 'monetary sovereignty'. Crucial decisions about government spending and taxation will therefore be transferred from eurozone member states to EU bodies. Second, the terms of the fiscal pact are designed to restore the confidence of financial markets, but critics have alleged that their net effect has been to generate EU-wide austerity and make economic growth impossible to achieve.