Euro Crisis and the Future of the Euro: A Bump in the Road or Existential Failure?

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This thesis aims at developing plausible visions of future for the eurozone, based on a literature review and scenario methodology. The starting point of the analysis is the global financial crisis of 2008, which turned into a European balance-of-payment crisis in 2010. In the early 2020, COVID-19 pandemic ushered in a new crisis for the eurozone. The survival of the euro seems more uncertain than ever before. Thus, it is a timely effort to explore the various theories of the root causes for the troubles of the eurozone.

The research question of the thesis is the following. Utilizing scenario methodology, what kind of plausible futures can be envisioned for the eurozone? Is there a viable future for the EMU or is it doomed to fail due to its alleged flaws? What are the conditions in which the eurozone can prosper and the euro to become a well-functioning common currency? The hypothesis is that the future of the eurozone is extremely uncertain without significant social and fiscal reforms.

To tackle these questions, various theories and perspectives on the problems of the euro are reviewed. Despite the different views, there seems to be a consensus regarding the fact that the euro has failed in terms of the main objectives of the common currency, namely bringing prosperity and stability through economic integration and accelerating political integration. Quite the contrary, it has worsened the standards of living and created instability and deep political fragmentation across Europe.

The thesis utilizes scenario methodology as it is particularly suitable method for examining uncertain contexts. The scenarios are based on a literature review, which is further analysed from the author's perspective and developed into plausible scenarios for the future. It is argued that scenario methodology is a fruitful way to conceptualize uncertain future and potential shocks it may hold, while producing novel academic insights and interesting research.

The scenario-building exercise demonstrates how the different theories and views on how the EMU should be governed and reformed may play out in practice. Each scenario reflects certain school of thought that entails specific elements of reform and governing principles for the EMU. The paper demonstrates that there are conditions in which the euro can survive and even prosper. On the other hand, there are conditions in which the euro is doomed to fail due to its design flaws and lack of social integration within the eurozone. The scenarios in which the EMU prospers include aspects of social integration and banking integration. Vice versa, the scenarios in which the EMU cannot survive are characterized by lack of social and banking integration.

The key finding is that for the euro to survive, social integration in Europe must deepen. In other words, any meaningful reform in the eurozone structure requires increased solidarity within the union. There is a growing consensus between leading economists that the most important structural reform would be some level of debt mutualization and restructuring. The second conclusion is the importance of banking integration, which would enhance financial stability in the eurozone through common standards and harmonize the banking regulation between the member states. Banking integration also requires deepening solidarity in the EMU, so it cannot fully realize before social integration moves forward.

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Euro; Euro crisis; EMU; European integration; Scenario analysis

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Introduction

At the time of writing this thesis, it has been over a decade since the global financial crisis turned into a euro crisis. In the early 2020, a new crisis, caused by COVID-19 pandemic, is hitting the eurozone. The survival of the euro seems more uncertain than ever before. There are different explanations for the root causes of the eurozone problems: several academics view the euro as a gigantic historic mistake, whereas others argue that there is nothing crisis-prone in the nature of the euro. Despite the different views, there seems to be a consensus regarding the fact that the euro has failed in terms of the main objectives of the common currency, namely bringing prosperity and stability through economic integration and accelerating political integration. Quite the contrary, it has worsened the standards of living and created instability and deep political fragmentation across Europe.

This thesis aims at developing plausible visions of future for the eurozone, based on a literature review and scenario methodology. The research question of the thesis is the following. Utilizing scenario methodology, what kind of plausible futures can be envisioned for the eurozone? Is there a viable future for the EMU or is it doomed to fail due to its alleged flaws? What are the conditions in which the eurozone can prosper and the euro to become a well-functioning common currency? The hypothesis is that the future of the eurozone is extremely uncertain without significant social and fiscal reforms.

To tackle the research question, I will look at various theories of the problems of the euro and proposals for fixing the flaws. I will focus on three schools of thought within the field of macroeconomics: neoclassical, neo-Keynesian and ordoliberal theories. The scenario-building exercise aims at demonstrating how these different theories may play out in practice. Each scenario reflects certain school of thought that entails specific elements of reform and governing principles for the EMU.

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The thesis is structured as follows. Chapter 1 discusses the historical background of the EMU and the dynamics of the euro crisis of early 2010s. Chapter 2 develops theoretical framework of the study based on different theories of the EMU's problems and flaws. Chapter 3 explains the scenario method and key variables of the scenarios. In chapter 4, the scenarios for the future of the euro are presented. Chapter 5 concludes with remarks on how to move forward and which scenario is likely to prevail.

1 Historical background

This chapter discusses historical background of the European Economic and Monetary Union (EMU). First, the chapter looks at the founding process of the euro. The creation of the euro is of great importance, as many academics argue that the euro's inherent defects were coined as the euro itself was coined. On the other hand, several analysts disagree with the view that the problems of the euro are design flaws by nature. Either way, the historical background plays important role in understanding the future possibilities. Second, the chapter explores the dynamics of the European debt crisis that started in 2010, after which the new crisis, caused by COVID-19 pandemic, is discussed briefly.

1.1 Creation of the euro

Planning of the common European currency began in the late 1980s. The groundwork for the euro was laid out in the Werner Report (1970), which proposed a gradual plan for stabilizing the exchange rates in Europe with the goal of adopting a single currency. In 1989, the Delors Report set out concrete guidelines for the creation of the Economic and Monetary Union. The report emphasized the numerous advantages of a single currency: it would remove currency exchange costs and exchange risks while facilitating the movement of people and trade which would eventually boost investment and economic growth. (Gabel, 2019.)

In December 1991, European leaders gathered in Maastricht to create the rules for the European Economic and Monetary Union. The treaty introduced a concrete timeline to adopt the new currency. It also established *convergence criteria* for countries willing to apply the membership. Conditions included a requirement of annual budget deficits below 3 percent of gross domestic product (GDP), public debt ceiling of 60 percent of GDP, inflation rates not exceeding 1.5 percent of the 3 lowest inflation rates in the EU, and stable exchange rates. (Gabel, 2019.) It is worth noting that the convergence criteria is highly criticized by several academics, e.g.

Stiglitz argues that the fiscal conditions aiming at convergence became a major cause for the eurozone divergence. (Stiglitz, 2017: 15.)

Germany and France were the pivotal actors in the Maastricht process. The Germans and Dutch wanted to establish binding fiscal rules and sanctions for those who break the rules. According to several academics, the ceilings on debt and deficit were arbitrarily determined. Interestingly, the numbers reflected the level of deficits of France and Germany at the time. (Mitchell, 2015: 131-2.) These arguments will be reviewed more closely in the next chapter.

It is often argued that the euro was not designed by economists, but by politicians. In fact, there were plenty of economists involved in the creation process, but their theoretical perspective was quite biased. Stiglitz notes that "*a misguided economic ideology that was prevalent at the time*" led to creation of a structurally flawed monetary union. (2017: 10.) Mitchell argues along the same lines that the Maastricht process represents a neoliberal groupthink, which held that "*macroeconomic policy would concentrate largely on price stability with strict rules on deficits and that the changes to the Treaty would ensure Member states would accomplish a convergence in their economic policies* (Mitchell, 2015: 136)."

In addition, low inflation rate was set as a priority. Mitchell calls this *the inflation first* monetary policy obsession. The inflation first strategy, however, may have caused adverse outcomes by undermining economic growth, causing reduced output, and growing unemployment as central banks raise interest rates. These implications were largely ignored. Mitchell sees the neoliberal groupthink as the major failure when the union was created. (2015: 165-7.)

Nevertheless, the euro's founders did not ignore the risks involved in the monetary union altogether. The main concern was to leave fiscal policies to national governments. One of the greatest fears was that if a member state ran into difficulties with its debt, others may have to bail it out rather than let it default. Sandbu argues that the moral premise of the monetary union was "*that the prospect of a member state defaulting on its debt should be avoided as a matter of joint responsibility, in a way that a country's inflating away its debt had never been.* (Sandbu, 2017)."

1.2 The crisis begins: 2008 as a watershed

In 2008, housing bubble burst in the United States, which resulted in a global financial crisis. Soon after, recession hit Europe and turned into a balance-of-payment crisis in 2010. This can be seen as a watershed in the history of the euro, since the euro area never truly recovered from the crisis. In addition, the debt crisis revealed deep ideological frictions between the Southern and Northern members of the monetary union, as well as several structural shortcomings.

European debt crisis was not only an economic crisis, but also a political one. (Christopherson et al, 2015: 843–853) The economic problems have exacerbated the political fragmentation, and vice versa. Mainstream political parties keep losing popularity, while far-right and far-left euro skeptic parties gain support. At the national level, policymaking is becoming increasingly difficult as parties with divergent views, and with little history of co-operation, attempt to form governments. The fragmentation of the European political landscape causes uncertainty and unpredictability, which in turn weakens the economic prospects.

As Barry Eichengreen puts it: "*The acute phase of the crisis is over, but the chronic phase remains*". (2015: 415-422.) The economic problems of the eurozone have become chronic, and many economists have been for a while anticipating a new recession to hit Europe and the world economy. Europe is trapped in a vicious downward circle, which is increasingly seen as a consequence of misconceived crises management of the so-called Troika.

Troika, which refers to the International Monetary Fund (IMF), the European Central Bank (ECB) and the European Commission, chose to impose severe austerity programs on the crisis countries. The crisis countries received rescue loans with strong conditions attached. For instance, they were required to lower their deficits below the level of 3 percent. The Troika insisted that this objective could not be achieved without austerity policies and several structural reforms. These structural reforms included cutting the government expenditure and pursuing lower wages in the public and private sector. (Stiglitz: 17-19.)

However, these structural reforms and austerity policies have not helped the eurozone to recover. As Stiglitz notes, the crises policies have been nothing but counterproductive. The simple reason for this is that austerity leads to higher level of unemployment and weakens the demand, thus resulting in declining economic growth in the long run. The interesting question is, why did this come as a surprise to decision-makers, given that several economists have repeatedly warned about the counterproductive effects of austerity policies? (2017: 183.)

Stiglitz argues that certain ideas and beliefs of how economies function have misguided the whole euro project since the beginning. These ideas and beliefs played a key role in Troika's crises policies. This ideology, which Stiglitz calls market fundamentalism or neoliberalism, is based on the belief that markets are efficient and stable if only the level of inflation is controlled, even if it requires high level of unemployment to prevail. (2017: 15-16, 25.)

In 2019, the tone started to change among the leaders of IMF and ECB. Troika members seem to be acknowledging now that the austerity measures are not working. Mario Draghi and Christine Lagarde have been urging the eurozone countries to loosen their purse strings to stimulate the economy. These statements may indicate a paradigm shift in attitudes towards debt and in regards of economic policies more generally.

1.3 Outbreak of the COVID-19

The COVID-19 outbreak started in December 2019 in the city of Wuhan in China. In a matter of a couple of months, the virus spread across the planet, resulting in unprecedented lockdown measures all over the world. Businesses are fighting for their existence, unemployment rates are skyrocketing, and the capacity of healthcare systems is jeopardized.

The COVID-19 pandemic ushered in a new crisis for the eurozone. The extent of the economic crisis we are witnessing is unclear for the time being. Much depends on how long the pandemic will last, and whether the EU manages to respond to the crisis in a coordinated manner. In any case, it is starting to crystalize that there will be long-term damage for the global economy, and especially for the already fragile EMU. Since the ongoing crisis has just started, there is not much academic literature on the economic and political consequences to rely on. Nevertheless, many analysts and commentators, who did not previously believe in the doomsday predictions for the eurozone, are now questioning the future of the EMU.

The impact of the COVID-19 crisis in the future of the EMU is most likely twofold: it could serve as a driving force for deepening integration and solidarity, or it could intensify the frictions within the union. At the moment, it seems that the Northern EMU countries are not, once again, eager to rescue the suffering Southern counterparts. It seems that we are returning to the solidarity debates of the debt crisis of the early 2010s. There is a growing sentiment in Italy that the country is being abandoned by the EU. This sentiment is not restricted to anti-European thinkers, but thousands of pro-Europeans as well are changing their attitudes towards the union. Carlo Calenda, Italian permanent representative to the EU, argues that the EU is facing an existential threat, and he is not sure whether the EU will survive.

The EMU's future seems even more uncertain. We already knew that the EMU is incapable of responding to *asymmetric shocks*, but the economic crisis caused by

COVID-19 revealed that the EMU cannot even respond to *symmetric shocks*. (Financial Times, April 6 2020.) One must ask, is the COVID-19 pandemic the straw that broke the camel's back?

2 Theoretical framework

Theoretical framework of this study is a literature review on theories and perspectives regarding the problems of the euro. Theories discussed here serve as the backbone for the scenario analysis in chapter 4. The ideas by different authors presented here are quite divergent, even contradictory. The scenario methodology, which is discussed in the next chapter, allows us to combine and compare these theories and imagine how they may turn out in practice.

The first subsection discusses the three central schools of thought that form the theoretical framework of this study. The second subsection looks at the European integration process from political perspective, emphasizing the interconnection between political and economic realms. The third section discusses the aspect of solidarity in Europe, which is the key to well-functioning common currency according to neo-Keynesian theory. Subsection 2.4. focuses on the Neo-Keynesian view that the problems of the euro are essentially due to flawed design of the union. Subsection 2.5. explores the North-South divide within the eurozone and the controversial role of Germany. Subsection 2.6. discusses social and fiscal reforms that could save the eurozone, after which subsection 2.7. argues that the eurozone divorce is an option. The chapter concludes by discussing the view that there is nothing wrong with the euro itself, but the problems lay in bad policymaking, mostly at the national level.

2.1 Central schools of thought

There is a vast literature on the problems of the EMU and the reforms needed. Naturally, this thesis cannot cover all of it, so some level of categorization and generalization must be carried out. The views on the EMU's problems and potential solutions are quite divided, which also reflects prevailing disagreements within the field of macroeconomics in general. If we look at the big picture, we can distinguish between the main schools of thought that dominate macroeconomics and the EMU debate. School of thought refers here to a group of academics who share similar views regarding the EMU’s problems and desirable solutions.

An insightful distinction between dominant views on how the EMU should be governed and reformed is developed by De Ville and Berckvens. They propose a distinction between neoclassical and neo-Keynesian theories in terms of desired short-term reforms, and between ordoliberals and euro-federalists in regards of long-term reforms. (De Ville & Berckvens, 2015: 8.) The line between these theoretical orientations is not always crystal clear, yet the distinction allows us to understand better the disagreement between the different accounts of the causes of the eurozone problems and how to fix them.

According to De Ville and Berckvens, the distinction between neoclassical and neo-Keynesian theories is based on finding short-term solutions to the euro crisis. The standard neoclassical explanation of the eurozone problems holds that the balance-of-payment crisis, that followed the financial crisis of 2008, was mainly caused by unsustainable levels of public debt of certain member states, which in turn hinders economic growth. Fiscal consolidation is the key to restart economic growth, as it helps to restore the confidence of investors. Inflexible labor markets and excessive public expenditure are considered as main problems, which requires austerity measures and structural reforms aiming at cutting wages and public expenditure. Quite the contrary, neo-Keynesians argue that looser fiscal and monetary policies could help overcome the eurozone problems, as stimulating the economy paves the way to full employment, which is seen as the key to economic growth. Restructuring unsustainable levels of debt is also required. (De Ville & Berckvens, 2015: 8-9.)

The distinction between ordoliberals and euro-federalists is mainly focused on the long-term reform of the EMU. Ordoliberals believe that un-negotiable rigorous rules are needed for a stable and sustainable monetary union. Any arrangements aiming at a transfer union will potentially lead to moral hazard. Euro-federalists argue that the monetary union requires fiscal and political union in order to function. Thus, a common eurozone budget is necessary for counter-cyclical expenditure. (De Ville & Berckvens, 2015: 8-10.)

Ordoliberalism is often described as a German variant of neoclassical theory. According to Meiers (2015), "*Germany's post-war social market economy premises on the theory of ordoliberalism*". The key element that separates ordoliberal theory from neoclassical theory is the idea that a strong state is needed to surveille the free economy, guarantee its stability, and ensure free market competition among self-interested individuals. Freedom is seen from the perspective of rule-based freedom. In terms of expansionary fiscal and monetary policies, ordoliberals and neo-classicists share similar views. Ordoliberal theory highlights individual responsibility. Fiscal discipline is seen as a virtue and only remedy to current account imbalances. This is the reason behind ordoliberals' reluctance towards EMU reforms, especially the social and fiscal ones. (Meiers, 2015; De Ville & Berckvens, 2015: 9.)

As De Ville and Berckvens note, the line is not clear-cut between these schools of thought. Neoclassicists and ordoliberals tend to converge in many questions, while neo-Keynesians and euro-federalists are mostly in accord. One can disagree with De Ville and Berckvens regarding the categorization of these theoretical orientations in the long-term and short-term frameworks. Both neoclassical and neo-Keynesian theories do offer ideas related to the long-term governing principles of the EMU. Vice versa, both ordoliberals and euro-federalist have preferences regarding the necessary short-term policy responses. In addition, it should be noted that euro-federalism is not an economic school of thought *per se*, but rather a pro-European ideology that champions the benefits of accelerating European integration.

This thesis deploys De Ville's and Berckven's distinction, while acknowledging that neoclassical, neo-Keynesian, ordoliberal and euro-federalist accounts are not always mutually exclusive or tied to a certain time frame. Euro-federalism is not considered here as an economic theory, but rather a political orientation supporting European integration. Thus, the theories discussed in the next subsections represent mostly neoclassical, neo-Keynesian and ordoliberal schools of thought. It should also be noted that the scholars, to whom this thesis refers in connection to these theoretical orientations, do not necessarily consider themselves as representing the given orientation. The categorization is based on the extent to which their arguments reflect certain way of thinking.

2.2 Political aspect

There are two main starting points from political perspective in this thesis that constitute the narratives of the scenarios. The first is that any further European integration requires transfers of sovereignty at all levels (Castells, 2017). The second is that democracy, national determination, and hyper-globalization cannot co-exist (Rodrik, 2011). At first sight, these two arguments seem rather similar. However, the first argument categorically excludes a possibility of any further European integration unless power is transferred from the member states towards the European level, whereas the second argument allows us to differentiate between hyper-integration and better integration. A closer look at these theories below reveals the logic behind this reasoning.

Manuel Castells et al. discuss the multiple crises that Europe is facing, including economic, social, political, ideological, and migratory. The authors emphasize the interconnectedness of these crises, starting from the assumption that all these institutional crises arise from inherent flaws in the system. In the long run, the dysfunctional system may even break down altogether. (2017: 3-4.)

Oliver Bouin discusses the European integration process from the perspective of political economy. According to Bouin, the process of European integration has been dominated by private sector and market interests. The process is characterized by a democracy deficit and some degree of “forced integration”, as the integration process was not based on a social market economy model which is supported by most of the European citizens.

What about the euro? Firstly, Bouin points out the systemic flaws of the Euro that originate from political motives, aspiring deeper European integration, in the making of Maastricht Treaty. Bouin refers to Feldstein (1992, 1997) and Krugman (1993) who argue that the eurozone would be optimal currency area for some member countries, while producing turbulence and shocks within the area for the rest. Their prediction of looming problems was based on three key factors: the heterogeneity of countries, the inadequate mobility of labor between the countries and the lack of fiscal transfers.

Besides the inherent flaws in the euro, Bouin emphasizes several policy mistakes that have worsened the situation. A case deserving special attention is the response to the crisis of 2008 by European Central Bank (ECB). The drastic austerity programs implemented on the troubled countries of the eurozone resulted in a recession in 2012. However, 2012 can be seen as a turning point when the management of the crisis took a new direction: restructuring of Greece's debt was on the table, fiscal instruments, such as European Stability Mechanism (ESM), were created to serve as a lender of last resort for the eurozone. Also, ECB launched massive quantitative easing programs aiming at stimulating the economy. (Castells, 2017: 35-40.) It should be noted that both ESM and quantitative easing programs are highly criticized. ESM has strong conditions attached to receiving the loans. Furthermore, receiving more loan does little to help countries with already unsustainable levels of debt.

Boudin argues that European integration process cannot continue on the same grounds. Any further integration would require "*additional transfers of sovereignty on fiscal, social and political levels and has moved closer to the ultimate goal of political federalism that is definitely not an objective for many member states* (Castells, 2017: 35.)" Most importantly, deepening integration requires enhanced legitimacy in the eyes of the European citizens. (Castells, 2017: 40-45.) Boudin's argument leaves us with two options: deepening integration by shifting more power towards the center or disintegration through relocating the power to the national level. There is, however, a middle ground between these two extremes.

Dani Rodrik's globalization paradox provides a useful theoretical framework to highlight the idea that more national determination does not necessarily translate into less European integration. Globalization paradox reflects the fundamental political trilemma of the global economy: democracy, national determination and economic hyper-globalization cannot be pursued simultaneously. Given these options, Rodrik would sacrifice hyper-globalization. We must be realists regarding the reality of world politics. National governments will remain the key actors to the foreseeable future. Rodrik argues that we need better globalization, not maximum globalization. In fact, re-empowering national democracies might lead to better globalization. (Rodrik, 2011: 200-207.) Rodrik's political trilemma can be applied to European integration as well. Can democracy, national determination and European hyper-integration co-exist? From eurozone perspective, re-empowering national democracies might lead to better European integration. We need better European integration, not maximum integration.

2.3 Lack of solidarity

As the aspect of solidarity in the EMU is a major source of disagreement between the member states, it is worth elaborating how exactly the lack of solidarity appears in Europe. The solidarity debate also reflects the divide between the main schools of thought. Neo-Keynesians and euro-federalists consider solidarity as crucial, yet missing, factor for a well-functioning monetary union, while ordoliberals and several neoclassicists oppose any solidarity-based reforms.

Marcel Fratzcher's observations on solidarity in Europe during the euro crisis are quite intriguing. Fratzcher (2018) argues that there is a growing conflict about

Germany's role in Europe. In November 2016, Fratzcher attended a closed-door meeting of European policymakers and leading academics. The purpose of the meeting was to have an open discussion on Brexit, euro crisis and refugee crisis. The German participants expressed their disappointment about the lack of solidarity when Germany was dealing with the influx of refugees. The Germans argued that they helped other European countries with financial crisis, showing great solidarity and support, and after all this they received no help whit their refugee issues. Almost all other participants in the meeting argued exactly the opposite, as they felt that Germany had acted in a very selfish manner during the economic crisis, pursuing its own interest, while imposing questionable fiscal austerity measures on others. In addition, the German economic policy based on improving their cost competitiveness through "beggar-thy-neighbor" policy has caused economic disadvantage to other European countries. (2018: 5-6.)

"*Seldom have I ever seen a discussion with positions being farther apart and more irreconcilable than that of Germany's role in Europe. Yet the key for Europe's future today and in the coming decade will not be Britain's exit from the EU, Greece's fate, or the future of Europe's banking union, but rather whether this divide between Germany and Europe can be bridged and whether Germany can be prevented from disengaging with Europe and turning inwards* (Fratzcher, 2018: 7)."

Germany is often considered as egoistic and self-interested, pursuing its own national benefit at the expense of the other Europeans. Germany imposes austerity policies on other countries, while being the main cause of the EMU's economic and financial imbalances. In addition, Germany's actions in the refugee crisis were seen as controversial, since it paid little attention when Italy and Greece were the countries most affected, but when Germany itself started to be the country most affected, it started to complain. (2018: 132-3.)

"*The common narrative is that the German government was too passive and complacent in fighting the European crisis, agreeing highly reluctantly, too late, and* *with too little support in various crisis situations. Germany agreed to the creation of a banking union, the common rescue mechanism, the European Stability Mechanism (ESM), and various rescue programs too late or endowed or designed them not sufficiently well—so goes the accusation of some (Fratzcher, 2018: 132).”*

Germany’s view, however, differs radically from the common European narrative. Quite the contrary, Fratzcher argues that a majority of the Germans consider themselves as victims of the European crisis. Troika imposed structural reforms and fiscal discipline on the crisis countries, and Germany has been the main contributor to the rescue programs. Germans also disagree with the view that Germany’s economic policies have been harmful for other Europeans. It is the unsustainable fiscal and social policies of others that have caused the instability, and Germany has managed to provide some degree of stability during the crisis. Germany has implemented hard reforms in order to restore its global competitiveness, and the other countries should follow their example. (2018: 133-4.)

There is a crystal-clear contradiction between the view that Germany has been the main influencer behind the misconceived crisis policies, and the perception that Germany was forced to rescue the crisis countries at the expense of its own. (2018: 136-8.) This perception has been exacerbated by provocative media stories on how the taxpayers will have to pay for the mistakes of lazy Greeks laying under the olive trees.

The diverging views and mutual scapegoating that dominate European politics have deepened political divisions between the member states, and European cooperation is increasingly displaced by nationalist interests. Populism, protectionism, and paralysis are the future concerns, according to Fratzcher. The expansion of populism has been further enhanced by politicians themselves, as they have blamed the EU for failures, while taking the credit when succeeding. (2018: 167.)

In the midst of the corona crisis of 2020, the solidarity debates are surfacing again. Italy has replaced Greece as the pariah of the union, and anti-European sentiment is rapidly rising in Italy. In the heart of the dispute is, once again, whether to rescue the Southern EMU members through fiscal aid. The debate is, however, much deeper than just a matter of financial instruments required to tackle the crisis. The German daily Frankfurter Allgemeine Zeitung published recently an advert written by Carlo Calenda, Italian permanent representative to the EU, in which he accuses the Netherlands and Germany of lack of ethics and solidarity. Moreover, Financial Times published a letter signed by leading economists, who call for debt mutualization and solidarity to survive from the COVID-19 crisis. "*We need a common debt instrument in order to mutualise the fiscal costs of fighting this crisis. Now is time for action. Now is the time for solidarity. It is time for eurobonds.* (Financial Times, 23 March 2020, 6 April 2020.)"

Nevertheless, the response from Germany, according to Financial Times, is that emotional arguments should be left out from the debate, and Italy should not blame its problems on Europe and Germany. (Financial Times, April 6 2020.) This illustrates the fundamental antagonisms in Europe, that quite frankly seem unresolvable. The Northern countries refuse to see the economic problems in connection to solidarity and ethics, while the Southern countries insist that it is fundamentally a matter of solidarity and ethics.

What are the implications of the solidarity debate to the EMU? It can be argued that the aspect of solidarity is indeed crucial for the functioning of the EMU. Theory of *embedded currency areas* supports this argument. The key objective of the euro was to reduce transaction costs and reduce interest rate and exchange rate volatility between the countries. The theory of optimum currency areas (OCA), pioneered by Robert Mundell, states that there are certain geographical areas, not bounded by national borders, that could benefit from a common currency. In times of economic disturbances, an OCA takes advantage from fixed prices, if full employment can be achieved without exchange rate adjustments, for instance through free movement of labor and capital, wage and price flexibility, or private or government transfers between countries. (Sandbu, 2017.)

When founding the euro, there was a widespread belief that the eurozone would be an optimum currency area that would benefit from a common currency. However, not everyone agreed that the eurozone would be an optimum currency area. Economists such as Krugman (1993) and Fieldstein (1992, 1997) predicted quite the opposite. They argued that the eurozone would be an optimum currency area for some member countries, while producing turbulence and shocks within the area for the rest of the countries. This argument is by no means novel today, but rather a standard explanation for root causes of the euro crisis. Eurozone did not constitute optimum currency area with free mobility of capital, labor, and goods, which resulted in asymmetric shocks.

More importantly, the eurozone did not constitute *an embedded currency area* (ECA). This concept is developed by Matthijs and Blyth (2015), who argue that OCA must be embedded in shared political and social frameworks that enable it to respond in asymmetric shocks. In other words, when a country is facing a shock, it cannot be bailed out because there is a lack of transnational solidarity that would legitimize a bailout policy. (Schwartz, Acta Polit (2016) 51: 403.)

If we look at the solidarity debate from the ECA perspective, there is no way forward until the EMU is embedded in shared political and social frameworks, that build the foundation for social integration within the EMU. For eurozone to become an OCA, it must first become an ECA. As illustrated in this subsection, transnational solidarity in Europe is a complex question and a major source of divergence between the member states.

2.4 Design flaws

Many neo-Keynesian academics argue that the defects of the euro were coined already in the creation process. As discussed in chapter 1, dynamics behind the Maastricht process may reveal a great deal of root causes for the eurozone's problems. According to neo-Keynesian theories, driving forces behind the creation of the EMU were ideological biases and promotion of the interests of the key players, namely France and Germany, which led to establishing counterproductive convergence criteria (see chapter 1). This subsection takes a closer look at the "design flaws" view, which is mostly supported by neo-Keynesian academics. Different economic structures and diversity in Europe, lack of social cohesion, inadequate mandate of the ECB, and lack of monetary sovereignty are of great importance here.

Joseph Stiglitz's argues that the problems of the euro are direct consequences of its flawed birth. Stiglitz emphasizes that the euro was above all a political project, aiming at a united and stronger Europe. However, there was not enough political cohesion to create economic institutions needed to make it work. It is often argued that the eurozone countries did not have enough economic similarity. However, even similar economic structures do not guarantee that the countries share similar "belief systems". Stiglitz notes that economists have systematically neglected the political and social conditions needed for a well-functioning monetary union. Economists do acknowledge that there should have been necessary institutions to support the monetary union, but the reason why such institutions were not established is related to lack of political unity and solidarity. For Stiglitz, solidarity precedes political integration, as high level of solidarity builds confidence in collective decision-making and increases willingness to give up national sovereignty. (Stiglitz, 2017: 52-53.)

It is safe to say that economic integration has outpaced political integration in Europe. When creating the euro, it was assumed that economic integration would automatically result in political integration. This aspiration did not realize. (2017: 35.) Stiglitz argues that eurozone's failures stem largely from "*combination of a misguided economic ideology and a lack of deep political solidarity*". (2017: 4-11.)

In addition to good institutions, a common currency needs solidarity or social cohesion, which is straightforwardly missing in the EMU. (2017: 22.) This leads us to one of Stiglitz's main arguments: certain ideas and beliefs of how economies function misguided the whole euro process from the beginning. In other words, the problems lie in the ideology behind the euro, which led both to flawed structure of the euro and to flawed policies. This ideology, which Stiglitz calls market fundamentalism or neoliberalism, is based on the belief that markets are efficient and stable, if the level of inflation is controlled, even if it requires high level of unemployment to prevail. (2017: 15-16, 25.)

According to Stiglitz, the main structural flaws of the euro are design flaws by nature. Due to diversity in Europe, one of the main flaws is that the member states have transferred their control over exchange and interest rates to European Central Bank (ECB). Common interest rate for such a diverse set of countries is problematic since the economic cycles are different in each country. One country might be facing inflation which would require raising the interest rate, whereas another country may be in a recession and in need of lowering the interest rate. Naturally, a single interest rate cannot serve the needs of the both countries simultaneously so someone must take the bullet. (2017: 87-8)

Convergence criteria was intended to overcome the problem of diversity. In retrospect, the presumption that these differences would not matter, if only the member states kept their deficits and debts under control, was misguided. The diversity in Europe is related to different economic structures, so the differences will remain even if the level of deficits and debt is controlled. In fact, convergence criteria resulted in growing divergence in the eurozone through eliminating the use of fiscal policy as a tool when facing economic downturn. Convergence criteria required countries to cut expenditure and raise taxes, which effectively weakened total demand when the exact opposite would have been needed. (2017: 93-4.)

Another evidence of flawed structure of the eurozone for Stiglitz is its poor economic performance. Comparison between the eurozone and other similar countries reveals striking differences in real GDP per capita growth after the 2008 financial crisis. E.g. the United States per capita GDP has increased 3 percent between 2007 and 2015, whereas the eurozone has declined 1.8 percent. Moreover, even before the crisis, there was no overall growth spike in the eurozone after adopting the common currency. (2017: 68-70.) Besides the euro, also the ECB was flawed at birth. ECB's mandate is limited to controlling inflation, which in fact is the least of the problems the eurozone is facing today. Stiglitz compares this with the US Federal Reserve, which is mandated to maintain growth and full employment, besides controlling inflation. Again, ideology explains a great deal of the ECB's flaws. Stiglitz argues that the belief in market fundamentalism, which played key role when creating the euro, translated into ECB's narrow focus on inflation. What Stiglitz calls *fixation on inflation* led to ignoring financial stability. In addition, the ECB contributed to Europe's growing inequality. (2017: 146-50.)

Another related problem in the EMU is that the ECB is not allowed to finance the general governments. There is a supranational organization in charge of monetary policy, without any supranational authorities to ensure its accountability. Holappa argues from Neo-Chartalist perspective that the EMU reduced the debt resilience of its member countries as they lost their monetary policy sovereignty. Holappa emphasizes the problems of economic policy based on improving cost competitiveness, because in practice, this translates into low domestic demand and stagnant wages. Germany has created its current account surplus utilizing this strategy, which is not sustainable from the perspective of other EMU countries. (Holappa, 2016: 10-12.)

According to Patomäki, the main problem of the EMU is that there is a monetary union without a political union. It has no federal budget or other mechanisms for balancing surpluses and deficits within the union, and central bank funding is prohibited. This allows the private debt markets to dominate the member countries who have lost their tools to exercise monetary policy. This in turn has led to escalating political crisis and lack of legitimacy. (Patomäki: 2013: 128-9.)

Stiglitz argues that the hegemonic political discourse in the eurozone, *there is no alternative* (TINA), is problematic. There are indeed alternatives and reforms that would make the euro work. TINA discourse is based on the belief that the crisis is due to individual countries' reckless finances and fiscal failures. Stiglitz argues that the crisis was caused collectively through flawed structures and policies. Thus, social and fiscal reforms are needed in terms of the eurozone structure, not in individual member states. (Stiglitz, 2017: 11, 28.)

2.5 North-South divide

As noted in the subsection 2.3., Germany's role in the EMU is highly controversial. Several economists argue that Germany enjoys disproportionate economic advantage in the EMU at the expense of other member states, especially the Southern ones (often referred to as periphery). There is a tremendous imbalance between the trade surpluses of Germany and other eurozone member states. The German economic strategy is based on internal devaluations, which means restricting growth of wages. This *"low-demand, low-import"* strategy undermines the balance of budgets within the EMU (Krahé & Adler, The Guardian).

The imbalances stemming from Germany's excessive surpluses are related to a more fundamental problem, which is a growing North-South divide within the EMU. The North-South divide reflects divergent political and economic visions within the EU and after the euro crisis, the division has extended to economic performance and wealth. Even more importantly, the euro crisis changed the balance of power within the EU as the poorer members became debtors and wealthier became creditors. The wealthier members dominate the economic policymaking and dictate the structural reform conditions attached to financial aid programs. (Jokela, 2013.)

Regan analyzes the North-South divide within the EMU in the framework of varieties of Capitalism (VoC) theory. Regan sees the North-South divide as the main reason behind the problems of the EMU, and the real source of the euro crisis. His main argument is that merging two different macroeconomic regimes resulted in growing imbalances. According to Regan, there are two variants of Capitalism in the eurozone. The Northern European countries can be labelled as coordinated market economies, whereas the Southern European countries represent Mediterranean VoC. These variants of Capitalism form two distinct "*macroeconomic growth regimes"* within the eurozone*:* the growth of the Southern economies is based on *"domestic demand-led models"*, while the Northern economies represent *"export-led models"* (Regan, 2015).

There are competing views on what kind of reforms are needed to resolve the eurozone problems. Interestingly, the desirability of social and fiscal reforms seems to correlate with the North-South divide, also reflecting the controversial position of Germany. De Ville and Berckvens (2015) conducted a survey among eurozone academics to find out their preferences on how the EMU should be reformed. Their most important finding is that German academics (and Finnish, but only with 5 respondents) are strikingly more reluctant than their counterparts from other member states towards reforms related to social and fiscal union.

The survey concludes that no consensus on EMU reforms has been achieved among eurozone academics after the euro crisis. Quite the contrary, the findings indicate growing dissensus, that also reflects North-South divide (core-periphery divide). The respondents from Southern member states generally support reforms aiming at social and fiscal union, while the support from Northern member states is clearly lower. Opposition from German respondents, however, is striking. The opinions of the academics correspond with the outspoken preferences of their national governments. (De Ville & Berckvens, 2015.)

Based on the findings of De Ville and Berckvens, it can be assumed that clear national differences persist regarding the preferable future direction of the EMU, and Germany stands out as particularly reluctant towards social and fiscal reforms. In terms of the four main schools of thought, neo-Keynesians and euro-federalists tend to be more supportive towards social and fiscal reforms, whereas neoclassicists and ordoliberals are inclined to oppose the reforms. In the next subsection, these reforms are discussed in more detail.

2.6 Social and fiscal reforms

From neo-Keynesian and euro-federalist perspective, certain social and fiscal reforms could make a single currency work for an area as diverse as the eurozone. Stiglitz lays out a comprehensive proposal on how to fix the design flaws of the euro. First of all, Stiglitz argues that the key objective should be full employment, which would require major reforms to the structure of the eurozone. In other words, the institutions, rules, and regulations that govern the eurozone must be redesigned to maintain full employment. The reforms Stiglitz suggests would require an ideological shift from the prevailing neoliberal agenda. (2017: 240.)

The number one reform would be creation of a banking union. According to Barry Eichengreen and Stiglitz, the major shortcoming of the monetary union is the absence of a banking union. Banking union could help overcome the problem of financial instability and the lack of governance and supervision by providing a common deposit insurance and common regulations for all banks in the EMU. Banking integration would enhance financial stability through common standards and harmonize the banking regulation between the countries. It would also provide a resolution mechanism for banking failures with a mandate to intervene in situations that threaten stability of the financial system, while increasing the coherence of the whole eurozone. Stiglitz argues that the banking union must entail a common deposit mechanism, which ensures that money will not flow from weak to strong countries. Common regulation system prevents potential abuses of a common deposit insurance. Creation of a banking union was agreed in 2012 as it was deemed to be a crucial step to solve the euro crisis. (Christopherson et al, 2015: 415-422; Stiglitz, 2017: 241.)

Even though the banking union is considered as vital in order to prevent the increasing divergence within the eurozone, it has never truly realized. Northern member states, Germany being the most vocal of them, are worried that the banking union would result in a transfer union, in which money is transferred from the strong countries to the weak. (Stiglitz, 2017: 129-130.)

Secondly, Stiglitz argues that some level of mutualization of debt is needed to prevent divergence in the eurozone. Interestingly, several neoclassicist-oriented economists agree that debt restructurings for heavily indebted countries are needed. Martin Wolf proposes establishing debt relief programs for countries that meet specific criteria under the initiative of IMF and World bank that started in 1996. (Martin Wolf, Irish Times, January 27 2015.) Moreover, Financial Times published in March 2020 a letter signed by several leading economists, who call for eurobonds and debt mutualization for eurozone to survive from the COVID-19 crisis. (Financial Times, March 23 2020.) It seems that there is a growing consensus between economists from different theoretical and ideological backgrounds regarding importance of debt mutualization within the eurozone.

Thirdly, the eurozone must create a common framework for stability. This requires reform of the Maastricht convergence criteria, creation of a solidarity fund for economically troubled countries, introducing automatic stabilizers for countries facing an economic downturn, creating credit flexibility, stronger regulation for the markets that create instability, and finally, redesigning fiscal policies in an active counter-cyclical way. (Stiglitz, 2017: 243-44.)

Fourthly, Stiglitz suggests reforms aiming at a true convergence policy. The excessive surpluses of certain eurozone countries drive divergence. Thus, a policy that discourages accumulating surpluses is necessary in order to balance the surpluses and deficits within the eurozone. This could be achieved through Keynes's proposition of a tax on surpluses. The revenues would then be used to fund a solidarity fund for economically weaker countries. In addition, the surplus countries should abandon the strategy of internal devaluation through raising their minimum wages and engaging in expansionary fiscal policies. In addition, the eurozone should support the poorer countries to enhance the quality of their infrastructure. Finally, the eurozone needs a structure that promotes full employment and growth. For this end, Stiglitz proposes reforming the mandate of the ECB, which means broadening the scope beyond controlling the inflation towards promoting full employment, growth, and stability. (Stiglitz, 2017: 252-57.)

2.7 Eurozone divorce

There are numerous theories how a single member state could unilaterally exit the EMU. Any viable exit model must address a multitude of technical issues, such as handling euro denominated public and private debt, euro denominated bank deposits, ensuring economic stability, managing inflation etc. A controlled and coordinated break up process of the entire monetary union seems an unlikely scenario. (Mitchell, 2015: 394.)

Determining the best exit strategy is not the purpose here, but rather to demonstrate that exiting the eurozone is an actual option and does not necessarily translate into an apocalypse, as the mainstream economic models predict. This apocalypse reasoning is vividly illustrated in the next quote by Martin Wolf. "*Breaking up would be hugely traumatic, financially and economically. It would also threaten the survival of the EU itself, which has always been built on a foundation of economic integration. The single market would quite possibly collapse. So, then, might the possibility of co-operative relations.* (Martin Wolf, Financial Times, January 15 2019.)"

Moreover, there is a widespread belief that the EMU divorce would automatically translate into the divorce of the EU as well. This is a crucial aspect of TINA discourse that prevents European decision-makers from even thinking about future without the euro. As de Weck and Valatsas put it: "*European leaders need to find the courage to tell their populations the truth: There will be more Europe, or no Europe.* (Foreign Policy Research Institute, 2020)."

According to Mitchell, eurozone exit must be accompanied with abandoning the neo-liberal austerity ideology and restoring nation's currency sovereignty. (2015: 395.) This ideological shift is the first step towards dissolution of the eurozone. If the hegemonic TINA discourse dominates decision-making, there is no room for alternative economic policies. After the first leap of faith, there are several ways to tackle the transaction costs and fiscal issues related to the process.

Mitchell's argument above is related to Modern Monetary Theory (MMT), according to which the states that enjoy currency sovereignty, cannot go bankrupt. At the heart of MMT lies the endogenous money theory, which rejects the textbook theory of how money is created. MMT is based on the idea that money is created when banks issue loans. If a government issues and controls the currency it taxes and spends, it cannot default. (Matthews, 2019.) From MMT perspective, the main problem for the eurozone is the lack of monetary sovereignty. This leaves the eurozone with two options. The first is to transform into a federal union, and the second is to return to national currencies.

Stiglitz argues that a eurozone divorce can be carried out in an amicable manner, without excessive costs. Obviously, there will be some costs in case of a country leaving the eurozone. However, the costs of preserving the status quo will be tremendously higher. (Stiglitz, 2017: 272-73.) In practice, how could a country leave the euro? Stiglitz uses Greece leaving the bloc as an example. First of all, the country needs a new financial system. Stiglitz argues this does not necessarily mean returning to the drachma. An entirely new financial system can be created, which

Stiglitz refers to as a "*21st century financial transactions system*". The system is based on electronic money. Greece would create "the Greek-euro", which would serve as the money inside the Greek banking system. The Greek-euro would have "*a well-defined value relative to the ordinary euro*". (2017: 274-76.)

After leaving the euro, Greece will have monetary sovereignty again, and thus ability to create credit. Moreover, the new financial system would be accompanied with *21st-century banking system*, allowing to overcome problems caused by private banks' power to create credit. The key problem is increasing inequality that stems from tremendous rents and exploitation by the current banking system. In the framework of 21st-century banking system, governments could start regulating heavily the credit creation process and direct the credit towards productive investments, rather than accumulating private profits. However, the point of this reform is not only normative aspiration to interfere with bankers' exploitation, but it is aimed at restoring macroeconomic stability. (2017: 279-84.)

Finally, the exit by one of the crisis countries described above is not the only option. As a matter of fact, the easiest option in Stiglitz opinion would be that some of the more stable countries leaves the block (e.g. Germany, Netherlands or Finland). This would enable the eurozone to adjust the exchange rate to match the northern countries, which in turn would help balancing current accounts and stimulate growth through increased exports. (2017: 292-3.)

Another solution to the eurozone problems according to Stiglitz is *flexible euro*. The flexible euro would mean that each country or a group of countries has its own euro, with a fluctuating value. Eventually, the national and regional euros could potentially achieve the goal of a single European currency. The flexible euro system would utilize the 21st century financial system that Stiglitz proposed related to the amicable divorce option. The value of each euro would vary relative to others. The current rigid exchange rates cause trade imbalances, so the flexible euro would provide stability in exchange rates. This would also allow the eurozone to abandon structural reform programs that aim at internal devaluation to fix the problem of rigid exchange rates. (2017: 296-300.)

2.8 Bad policy making

This subsection explores reforming the EMU mostly from neoclassical perspective. According to neoclassical theory, the problems of the eurozone stem from the national level, not so much from the eurozone structure. As discussed earlier, the standard neoclassical cure for eurozone problems relies on austerity-based structural reforms. This subsection broadens the perspective from austerity to other potential remedies, emphasizing the responsibility of the member states.

Sandbu (2017) argues that visions of a political and fiscal union are based on a paradox: more powers must be unified to fix the damage caused by unification. Moreover, the demands for greater integration are based on "*politics of blackmail*", which refers to the discourse of "*no alternatives*". Europe is trapped in a failed monetary union, and there is no alternative other than almost an apocalypse. According to Sandbu, this is a misperception – other options do exist. (Sandbu, 2017.)

Sandbu's key argument is that the euro crisis was not a result of euro's inherent birth flaws. The crisis escalated because of cardinal policy mistakes, mostly because the leaders wanted to avoid debt restructurings at any cost. Sandbu disagrees with the view that the euro prevented the decision-makers from managing the financial crisis. In addition, Sandbu disagrees with the idea of a crisis-prone nature of the euro. He opposes the view that the structure of the monetary union made the crisis more likely, since the crisis would have occurred with or without the monetary union. The global credit bubble in 2008 was not restricted to eurozone countries. The phenomenon of "compression of the borrowing costs" was not a euro-specific problem; it occurred at the global level and would have happened without the euro as well. (Sandbu, 2017.) This argument reflects the fundamental divide between neoclassical and neo-Keynesian theories in terms of the EMU's problems. Neoclassical theory assumes that the structure of the EMU is not flawed, whereas neo-Keynesian perspective emphasizes the union's structural shortcomings.

The euro is blamed for not allowing countries in trouble to devaluate their currency as they did before the euro, but this argument downplays the creditors' responsibility. If financial markets allowed Greece to borrow from the same grounds as Germany, even though Greece is not capable of devaluating its currency, creditors should have noted the related risks. Moreover, effectiveness of monetary independence is widely exaggerated. The national governments did have tools to control the credit bubble and overborrowing. (Sandbu, 2017.)

The argument that the euro did not in fact restrict the policy tools of national governments to control the bubble that lead to the crisis reflects the idea that the member states tend to blame the euro for their own failures, which fuels anti-euro sentiment. According to Sandbu, it was not the design flaws of the euro, but policy mistakes at the national level that caused the crisis. Sandbu also addresses arguments regarding export competitiveness. It is true that prices and wages developed differently in the eurozone core and periphery, yet this did not happen in the traded sector, which is why Sandbu argues the euro cannot be blamed for export competitiveness problems.

Main cause of the euro crisis, according to Sandbu, was "*huge flows of capital, which came to a sudden stop in 2009-10 and knocked the receiving economies to a ground."* In addition, the euro is not to be blamed for the debt accumulation that led to the balance-of-payments crisis. The first reason for this is that the member states were not without tools to address the excessive debt accumulation. The second is that debt accumulation occurred simultaneously outside the eurozone as well. Sandbu suggests that the eurozone countries that borrowed recklessly would have done it irrespective of the currency they used.

Neo-Chartalists argue that a country with currency sovereignty cannot run into a default because it has the authority to create money. The argument goes that the eurozone countries lost their monetary sovereignty when joining the union, and thus cannot balance their economies (and debt) by printing money. Sandbu argues that the peripheral eurozone countries would have done the same without the euro by pegging their currencies to euro. Printing money would not have helped if the country had borrowed in foreign currency, as many of the eurozone countries did. In addition, "giving up the printing press" was a major motivation for many high-interest and high-inflation countries to join the euro in the first place. Sandbu suggests that many of these countries would have tried to achieve monetary stability and quit printing money in any case.

To sum up, Sandbu's argument is based on the idea that the peripheral countries would have ended up in trouble whether they belonged to the euro or not. The evidence behind this argument is the similar situation of other European non-eurozone countries during the crisis. The main problems lie in bad policy choices at the national level. The euro has become a scapegoat for the economic problems that are by no means unique to the eurozone, but rather originate from wider economic problems of Europe and the member states. Wider economic problems refer mostly to inadequate economic growth. Indeed, several analysts suggest that perhaps the most important fix to eurozone problems would be accelerating economic growth. (Eichengreen, 2015: 415-422.) This is, however, something Europe has been pursuing since the outburst of the crisis, with a relatively little success.

Sandbu suggests there are three economic problems the eurozone member countries need to tackle. From his perspective, the problems are not euro's problems, but problems of the member states. The first is to learn to deal with balance-of-payment crises, which is a matter of financial and monetary policy. The second is related to economy's resources, namely level of employment and aggregate demand. The real economy must function properly. The last problem is to sustain economic growth and productivity. Solving these problems is not hindered by the euro. (Sandbu, 2017.)

Sandbu agrees with neo-Keynesians regarding the tools for national governments to prevent crises and manage declining capital flows. Sandbu argues that debt restructuring would be the most effective tool for this. Unwillingness to carry out public and private debt restructurings was the major policy mistake when handling the eurozone debt crisis. The crisis could have been ended right in the beginning without the ideological resistance to restructure unsustainable levels of debt. The following mistake was to implement damaging fiscal and monetary policies as a condition for rescue loans.

Sandbu disagrees with the conventional view of the euro critics that a monetary union requires a fiscal union to balance asymmetric shocks. The aggregate demand problem is often seen as Germany's fault, as it is the most vocal proponent of austerity policies and runs excessive current account surplus. Germany opposes stimulus policies and is reluctant to loosen its own purse strings, urging other eurozone countries to handle better their finances. Germany believes firmly in *black zero* policies, which means having no fiscal deficit. Sandbu points out that the debt countries shared Germany's view on austerity and tightened their budgets more than was even demanded. In addition, monetary policy mistakes were not solely Germany's fault. The inadequate aggregate demand is largely related to waste of resources, as millions of unemployed people and unproductive investments do not enable economic growth.

What constitutes better economic policies? Sandbu's answer is twofold: the power must be sifted back from the regional level towards the national level, and the remaining power in the center must become more fit for purpose. At the European level, new direction in policy making means abandoning "no alternatives" discourse. For this to realize, Germany and France should play a decisive role, France being the first to start. While not being mandatory, a fiscal union would certainly bring benefits. There is no reason why countries considering a fiscal union as desirable could not create one. There is nothing in the structure of the euro that would prevent these countries. Renationalizing policy making, above all fiscal policy, would transfer not only the power but also the responsibility back towards the national level. Sandbu suggests that "*Paradoxically, greater national autonomy may encourage more integration*".

According to Sandbu, the prospects for the eurozone are not at all that bleak as generally is assumed. Corrective measures are already taking place. Sandbu reminds us of the euro's advantages. A single currency increases predictability for businesses, facilitates trade and investments within the monetary union, and removes the devaluation tool, which incentivizes governments and companies to fix problems related to low productivity. "*To heal the politics of the euro, it must be admitted that it is compatible with more national self-determination than conventional wisdom has it."* (Sandbu, 2017.)

3 Methodology

This chapter begins with an assessment on the advantages of scenario analysis in general and proposes that scenario methodology can serve as innovative, yet scholarly and rigorous, way of producing “interesting research”. (Ramirez et al., 2015.) The second subsection explains the scenario-building process and defines key concepts of scenario methodology. Finally, the chapter introduces the scenario matrix and key variables of the thesis.

3.1 Scenario methodology

Scenario analysis is increasingly common tool to prepare for the future in business strategies. Perhaps the greatest example is the one of Royal Dutch Shell in the oil crisis in 1973. While almost all other Western institutions were unprepared for the crisis, Royal Dutch Shell was prepared. It had developed future scenarios, and in one scenario the oil prices spiked substantially. (Nordic West Office, Global Scenarios, 2017.) This illustrates vividly how scenarios thinking can help institutions to prepare for the future shocks and surprises.

As stated in the introduction, no one could have anticipated the crisis caused by COVID-19. Indeed, the magnitude of the havoc caused by a pandemic could not have been predicted. However, the possibility of a large-scale global downshift was predicted in Global Scenarios report by global affairs think tank Nordic West Office (see figure 1). In the process of developing the scenarios, the downshift option seemed the most unlikely one. It was even considered to drop out the fourth scenario altogether. How could we possibly end up in a world where everything is local, trade declines and globalization backlash occurs? The answer was that “*an unpredictable global crisis results in zero growth* (Nordic West Office, Global Scenarios, 2017.)”.

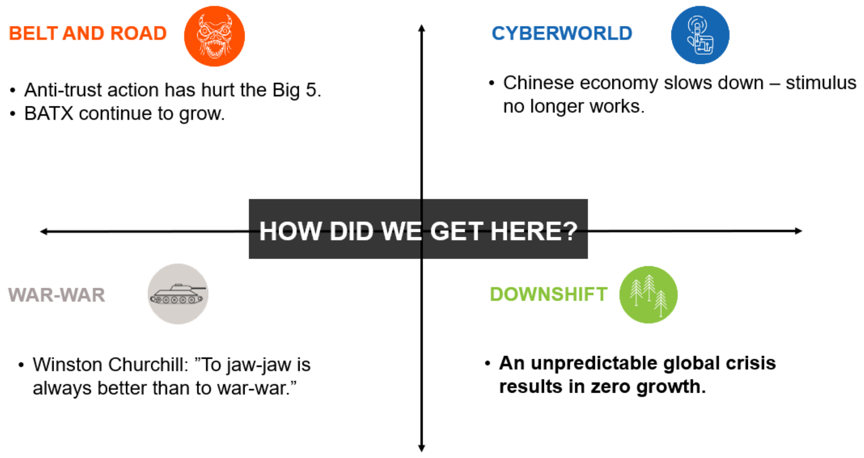


Figure 1 (Source: Nordic West Office, 2017)

Besides business strategies, can scenario analysis be utilized in academic research? This thesis suggests that scenario methodology can be an extremely useful tool to provide novel academic insights and a way to connect theory and practice. As a matter of fact, the scenarios are all we have during uncertain times, such as a global pandemic. It seems that scenario-based analysis has surged in economics and media in the early 2020.

The paper *Scenarios as a scholarly methodology to produce "interesting research"* examines three research studies that utilized scenarios as scholarly research methodology. (Ramirez et al., 2015.) The authors propose that scenario methodology can serve as innovative, yet scholarly and rigorous, way of producing "interesting research". Their key finding is that scenario methodology enables us to question prevalent assumptions while developing new ways of inquiry. The method is particularly useful when dealing with multifaceted issues and uncertainty. Ramirez et al. argue that scenario research can co-exist, complement, and challenge the conventional qualitative and quantitative research methods.

Dong-ho Han discusses using scenarios in the field of international relations and suggests that scenario thinking is a tool for producing new ideas, widening the scope of causal relationships subject to our inquiry, helping us to grasp the evolution of global politics and the related elements of change. Han highlights how the scenario methodology is one of the most effective methods to connect theory and practice, as it helps us to understand the possible future paths and serves as an actual tool in policy making. (Han, 2011.)

Han argues that there is a growing need in the field of IR for scenario analysis. First of all, the scenario method allows to combine diverse theoretical insights. This point is one of the main reasons for this thesis to utilize scenario method, as it facilitates and legitimizes the simultaneous use of contradictory theories. As we cannot neatly determine which theory of the euro's problems is the great truth, it makes sense to compare these ideas in a coherent manner.

While predicting the future is impossible, we can nevertheless anticipate the trajectories and trends leading to certain outcomes. Han suggests that scenario method could help overcome the problem of difficulty of prediction in social sciences. However, it is not asserted here that social sciences should aim at predicting the future or adopt positivist approach and methods of natural sciences. Quite the contrary, predicting in social sciences is essentially based on historical precedents and imagination, which is often downplayed in research. Because of the uncertain and unpredictable nature of the world politics, innovative way of thinking of plausible future outcomes is a powerful tool for exploring the future.

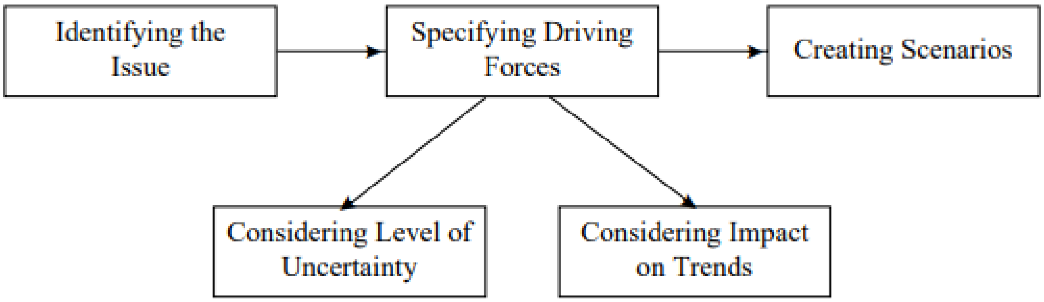
Han refers to Janis Gross Stein and her colleagues' input in understanding the future of Israeli-Palestinian conflict as a practical example of applying scenario methodology in IR. Gross Stein et al. construct five scenarios for the Israeli-Palestinian conflict, including status-quo, negotiated agreement and Palestinian autonomy. The key variables in their analysis were domestic political sentiments and actions in Israel and Palestine, which they further analyzed in different scenario frameworks. (Janis Gross Stein, et al., 1998.)

3.2 The process and key concepts

Ramirez et al. define scenarios as “*small bespoke set of structured conceptual systems of equally plausible future contexts, often presented as narrative descriptions, manufactured for someone and for a purpose, typically to provide inputs for further work* (Ramirez et al., 2015).” Han defines scenario method as “*a means by which people can articulate different futures with trends, uncertainties, and rules over a certain amount of time. Showing all plausible and possible stories and clarifying important trends, scenario thinking enables decision makers to make an important decision at the present time* (Han, 2011).” For Han, an important aspect of scenario-building exercise in IR is the value it can produce for policy making purposes.

Han identifies five key concepts related to scenario methodology: driving forces, predetermined elements, critical uncertainties, wild cards and scenario plot lines (Han, 2011). This thesis utilizes Han’s definitions of these concepts. *Driving forces* are different combinations of causal factors that constitute the overarching narrative of each scenario. *Predetermined elements* are occasions that have already taken place or are almost certainly about to take place. In other words, these can be assumed as the certain elements that may cause other outcomes. *Critical uncertainties* are the critical elements of the scenario-building process, as identifying the unknown factors is the most important contribution of the scenario analysis. *Wild cards* are defined as extremely unlikely, yet possible, events that could radically alter the entire scenario plot line. *Scenario plot lines* refer directly to the overarching narratives of the scenarios, encompassing all the previously presented concepts and collecting them into comprehensive stories of the possible future eventualities, explaining how the events proceed from the current situation towards the assumed future. (Han, 2011.)

According to Han, the process starts with identifying the problem, after which the driving forces are examined. This also includes separating “knowns” and “unknowns” and conceptualizing the critical uncertainties and wild cards (see figure 2).



Source: Robert Lempert, "Can Scenarios Help Policymakers Be Both Bold and Careful?" in Francis Fukuyama (eds.), *Blindside: How to Anticipate Forcing Events and Wild Cards in Global Politics* (Washington, D.C.: Brookings Institution Press, 2007), p. 112.

Figure 2

This study uses scenario methodology because it is particularly suitable for examining uncertain contexts, which is exactly what the future of the euro is. Scenarios are not predictions, but plausible futures, that allow us to prepare for the potential risks and opportunities of the future. The scenario plotlines are built on existing research and analysis, that is further analyzed from the author's perspective and developed into plausible scenarios for the future. Han's concepts are utilized in the scenario-building process.

3.3 Key axes: Economic and political integration

Scenarios for the euro are built on two key variables. The first is economic integration versus economic disintegration, which forms the y-axis. The x-axis is based on juxtaposition of political integration and political disintegration (see figure 3). Naturally, there is a variety of eventualities in between the extremes. The concepts of economic and political integration are not easily defined or reduced into two simple variables. It should be noted that the variables here are simplified versions of their complex empirical counterparts for analytical purposes.

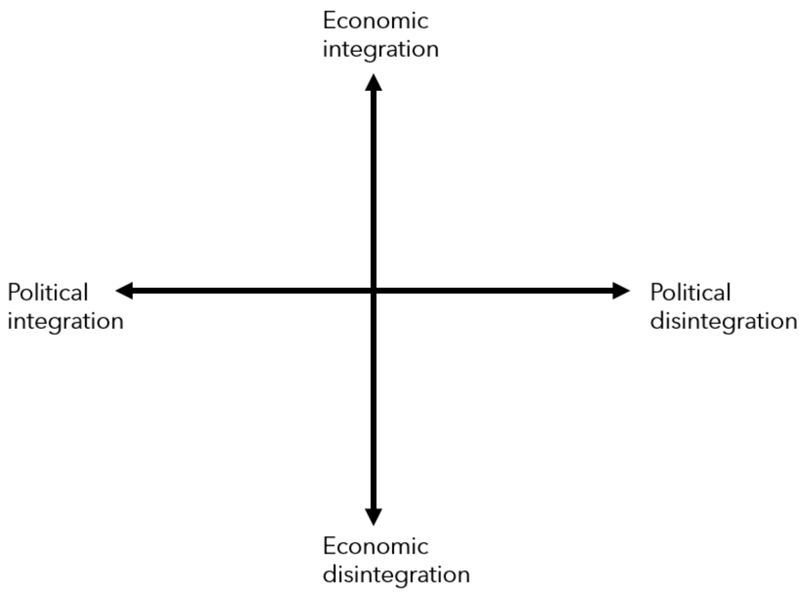


Figure 3

Political integration refers to continuing centralization of the political decision-making power from national level towards the regional level. *Political disintegration* refers to relocating the political decision-making power and sovereignty to national governments. *Economic integration* entails deepening the economic co-operation and the power of related EMU institutions, whereas *economic disintegration* refers to declining economic co-operation and re-empowering the national governments, particularly in terms of monetary and fiscal policies.

There is one important variable missing from the matrix: *social integration* (see figure 4). In fact, it is the pivotal factor in this analysis based on the literature review. Social integration variable is seen here as encompassing the issues of solidarity, legitimacy, and social cohesion. Low level of social integration is connected to anti-EU sentiment, lack of solidarity and distrust towards the EU institutions from the citizens. High level of social integration means validation for the integration process from the citizens, enhanced transnational solidarity, and increasing trust towards the EU institutions. Social integration turns the eurozone into *embedded currency area* (see chapter 2).

It is suggested here that the political and economic integration variables are independent from social integration variable. The political process can indeed continue without support from the citizens, but the consequences depend on the the direction of social integration variable. Paradoxically, political disintegration and economic integration, accompanied with deepening social integration, may lead to better functioning common currency. Vice versa, deepening political integration and economic disintegration in connection to social disintegration may result in the opposite outcome. Thus, the social integration spectrum determines how the different combinations of economic and political integration turn out.

There is one crucial point we must bear in mind when utilizing this axis. Economic and political integration do not automatically translate into economic growth and well-being. Vice versa, economic and political disintegration do not equal economic problems. As a matter of fact, disintegration may lead into better economic performance. This is an important note since disintegration is often associated with negative outcomes and considered as an undesirable development. However, the history of European integration shows that this is not necessarily true.

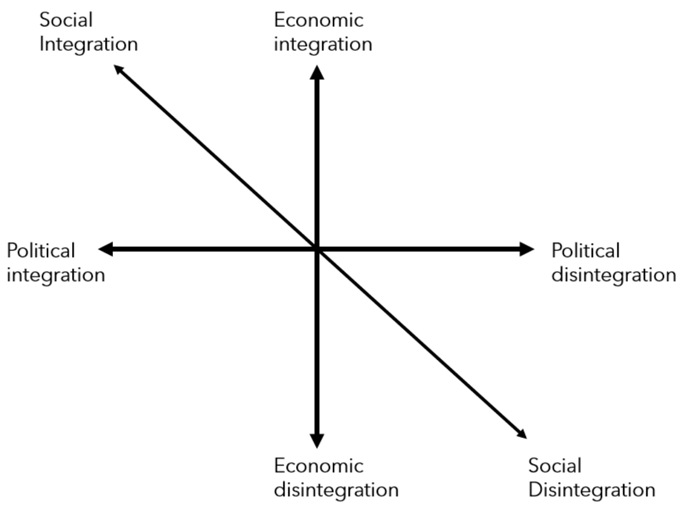


Figure 4

4 Scenarios for the euro

Based on the theoretical framework, this chapter aims at developing alternative future scenarios for the euro. For analytical purposes, the scope of the scenarios is restricted rather narrowly to the political economy of the EMU member states. It must be noted that there are countless variables beyond the political economy of the EMU that affect the future of the euro. For instance, both global financial crisis of 2008 and corona crisis of 2020 originated from factors outside the EMU. For this reason, the scope of this scenario analysis is by no means all-encompassing or exhaustive.

There are four extremes in the scenario matrix (see figure 5). The first scenario is based on the idea that the euro becomes a well-functioning common currency through European federalization. The second scenario is based on the idea that the euro crisis was just a bump in the road and increased national determination helps overcoming key problems. The third scenario envisions a continuation of ordoliberal and neoclassical resistance towards EMU reforms. The fourth scenario portrays the euro as an existential failure as the euro is dissolved into national and regional currencies.

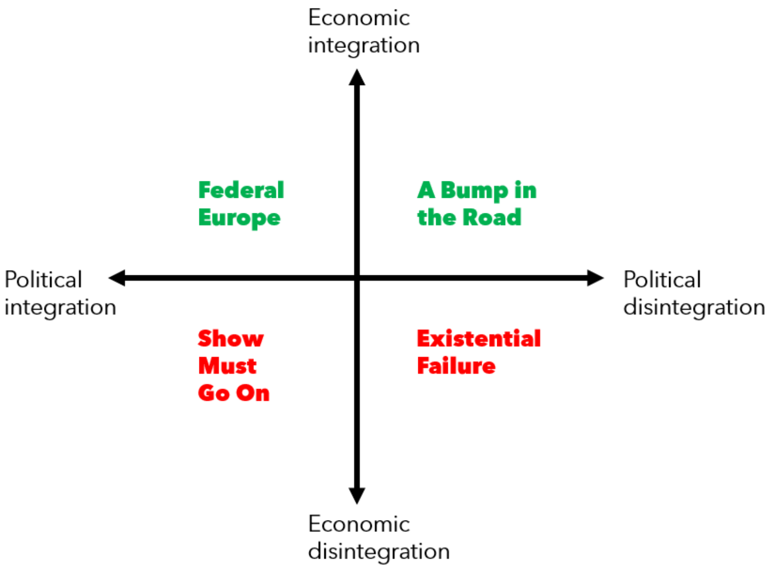


Figure 5

Each scenario combines different varieties of political, economic, and social integration. In the first scenario, the EMU integrates economically, politically, and socially. Economic and political integration continue due to deepening social integration. In the second scenario, the EMU continues functioning without further political integration. The economic integration deepens as the political disintegration re-empowers the member states. The logic here is that the problems the EMU is facing can be resolved, and the problems are mainly seen deriving from the actors at the national level, not originating from the euro itself. This view emphasizes the importance of continuing economic integration, which does not necessarily require deeper political integration. The third scenario envisions artificially continuing European political integration, not supported by social integration, which escalates economic disintegration. The fourth scenario is the most dramatic vision for the future. Political and economic disintegration lead to EMU divorce. The narrative highlights systemic failures and design flaws of the EMU. It is not, however, a doomsday prediction. Europe can prosper without a common currency.

How far in the future are the scenarios located? Structural changes do not occur over night – and yet we might wake up one day noticing we are in a crisis that no one saw coming. This scenario-building exercise is based on understanding long-term trends and changes, however, not excluding possibilities of perfect storms or black swans. Thus, the timeframe here is from five to ten years, which is not unthinkable future far away, but still serves as a realistic timeframe for long-term changes to occur.

The chapter is structured as follows. First, the plot line of each scenario is presented. Then we move on to analyze key driving forces of the scenarios. Finally, critical uncertainties and potential wild cards that could reverse the logic of the scenarios are discussed.

4.1 Scenario 1: Federal Europe

"…An ever-closer union among the peoples of Europe…" -The Treaty of Rome

Scenario plot line

This scenario is mainly built on neo-Keynesian literature and euro-federalist ideology. The starting point is that any further integration requires transfers of sovereignty on fiscal, social, and political levels, and that the monetary union must be accompanied with a political union. (Castells, 2017; Patomäki, 2013.) This scenario is characterized by unprecedented level of regional regulation in the EU and EMU. Economic integration and political integration continue due to deepening social integration, which further enhances the legitimacy of the union. The EMU is an embedded currency area (ECA) (Matthijs and Blyth, 2015). In other words, the EMU is an optimal currency area, embedded in shared political and social frameworks, that enable it to respond in asymmetric shocks.

The key defining features of this scenario are high levels of political, economic and social integration. This means that the whole eurozone structure has been reformed. The EU resembles a federal state, led by Germany and France. The monetary union, which previously did not work properly without a political union, is now a well-functioning federal authority. The EMU has a federal budget for balancing surpluses and deficits within the union, and central bank funding is allowed. (Patomäki, 2013: 128-9.) The EU adopts Modern Monetary Theory as a guiding principle. The nation states have transferred their sovereignty to the regional level to a great extent. The EMU members do enjoy currency sovereignty at the regional level.

The ECB's mandate is now extended to maintaining full employment, instead of solely controlling inflation. (Stiglitz, 2017: 240, 256.) The EMU has a strong banking union for common regulation, common deposit insurance and common resolution mechanisms. The eurozone has a common framework for stability. The EMU has established a solidarity fund for economically troubled countries, automatic stabilizers for countries facing an economic downturn, credit flexibility, stronger regulation for the markets that create instability, and redesigned fiscal policies in an active counter-cyclical way. (Stiglitz, 2017: 243-44.)

The Maastricht convergence criteria is reformed to be more fit for purpose. Instead of arbitrary ceilings for debt and deficits, a true convergence policy is promoted. Surpluses and deficits are balanced within the eurozone and excessive surpluses are discouraged and taxed if exceeding a certain limit. The revenues from the surplus tax are used to finance the solidarity fund for economically weaker countries. In addition, internal devaluation policies are discouraged. Germany and other surplus countries have shifted towards more expansionary fiscal policies and raised minimum wages. The weakest EMU member countries receive support to build high quality infrastructure. (Stiglitz, 2017: 252-56.)

How did we end up here? As mentioned earlier, this scenario was achieved through deepening political and social integration. The COVID-19 crisis started a shift towards solidarity-based European social integration. The humanitarian catastrophe, caused by the pandemic, strengthened the solidarity within the EU. The EMU adopted MMT principles in order to rescue the damaged European economies. Ideological change started in Germany and France. A messy Brexit process helped to curb the anti-EU sentiment and strengthened the citizens' support for the EU. Sustainability and climate change combating became real priorities, as worsening climate conditions forced the EU countries to deepen their co-operation.

4.2 Scenario 2: A Bump in the Road

"Paradoxically, greater national autonomy may encourage more integration." - Martin E. Sandbu

Scenario plot line

This scenario combines neoclassical and neo-Keynesian ideas. The starting point is Rodrik's political trilemma of democracy, national determination, and globalization. In the eurozone context, the trilemma is about the co-existence of democracy, national determination, and European integration. In this scenario, re-empowering national democracies leads to better European integration. The focus is shifted from maximum integration to pursuing better integration.

The key driving force of this scenario is Sandbu's argument that eurozone problems do not originate from the euro itself. The narrative here emphasizes the importance of the monetary union and how it should not be doomed as a gigantic historic mistake. Continuing economic integration does not necessarily require deepening political integration. Quite the opposite, rolling back the political integration enhances social integration, as the political power is relocated to the member states and the legitimacy of the union is improved. However, it is not continuation of the same with increased national self-determination. Structural reforms have been carried out both in the member states and in the EMU.

In this scenario, economic integration continues, mostly in the form of gradual banking integration. Renationalizing policy making and re-empowering national governments has led to enhanced co-operation between the nation states. The EMU pursues smarter economic integration, not maximum economic integration. Legitimacy of the union is improved due to enhanced democracy in the member states. To state the obvious, there are numerous wild cards and critical uncertainties in this scenario plot line. Re-empowering national governments may backfire and lead to entirely opposite direction. These wild cards and critical uncertainties will be discussed in more detail later.

In the big picture, a paradigm shift has occurred in terms of ideology and economic policy. Most importantly, the attitudes towards debt have changed, which paves the way to introducing debt restructuring programmes for heavily indebted countries.

Economic policymaking has been relocated to the national level, and the remaining regional economic policy is no longer based on TINA discourse. The responsibility of fixing the problems of the eurozone is transferred to the member states. These problems include balance-of-payment problems, controlling real economy problems, such as supporting employment and demand, and maintaining economic growth and productivity. National governments are prepared to prevent crises: e.g. unsustainable public and private debts are restructured when needed. The monetary union continues to function without a fiscal union. The aggregate demand is supported through efficient allocation of resources at the national level, which includes promoting full employment and investments. (Sandbu, 2017.)

In this scenario, it is recognized that "one size fits for all" approach does not suit the eurozone. National varieties of fiscal policy are supported, and likeminded countries establish fiscal unions within the EMU. A single currency continues to increase predictability for businesses, facilitates trade and investments within the monetary union, and removes the devaluation tool, which incentivizes governments and companies to fix problems related to low productivity. (Sandbu, 2017.)

How did we end up here? For this scenario to realize, abandoning the TINA discourse is the key. Germany and France should play a decisive role, while France being the most likely to start. The COVID-19 crisis of 2020 nearly devastated European economies, leaving no choice but to intervene in unsustainable public debt accumulation. The crisis also made visible how incapable the EU is to respond to a crisis such as this, and how the real power remains in the hands of national governments.

4.3 Scenario 3: Show Must Go On

"Creating the euro is the second-worst monetary idea its members are ever likely to have. Breaking it up is the worst." -Martin Wolf

Scenario plot line

In this scenario, the driving forces are neoclassical and ordoliberal theories. The starting point, again, is the notion that any further integration requires transfers of sovereignty on fiscal, social, and political levels. However, the result is the opposite of Federal Europe. European political project continues, accompanied with social disintegration, leading chaotically to economic disintegration. This scenario is characterized by continuing “forced integration”, which means that the integration process is not based on a social market economy model which is supported by most of the European citizens. (Castells, 2017: 35-40.) In the literature and media this scenario is often referred as *muddling through*. It means continuation of the *status quo*: no significant changes or reforms take place. Due to forced political integration, in the absence of social integration, the result is growing fragmentation and polarization between the Northern and Southern member states.

The demands for greater political integration continue to be based on TINA discourse. Europe is trapped in a failing monetary union, and there is no alternative other than almost an apocalypse. (Sandbu, 2017.) TINA discourse is based on the belief that the problems of the EMU are consequences of individual countries' reckless finances and fiscal failures. (Stiglitz, 2017.) There is a widespread belief that the destiny of the monetary union and the European Union are tied together, and one cannot exist without another.

In fact, TINA discourse is the driving ideological force of this scenario, causing a political gridlock that paralyzes the decision-makers and prevents them of doing any decisive moves towards meaningful reforms. This gridlock is further exacerbated by mutual scapegoating that dominates the ever more fragmented European political landscape. Political divisions have deepened, and European cooperation has been displaced by nationalist interests. Populism, protectionism, and paralysis are the driving forces here. The expansion of populism has been further enhanced by politicians themselves, as they keep blaming the EU for failures, while taking the credit when succeeding. (Fratzher, 2018: 167.)

The divisions between the Northern and Southern members of the EMU escalate. Southern member states accuse Northern member states of lack of solidarity. Northern members, especially Germany, are considered as being egoistic and self-interested, pursuing their own national benefit at the expense of the other Europeans. Germany continues to be the most vocal proponent of austerity policies, while being held responsible of the EMU's economic and financial imbalances. Germany and other Northern EMU countries insist that it is the unsustainable fiscal and social policies of others that have caused the instability. Northern countries implemented hard reforms in order to restore their global competitiveness, and the other countries should follow their example. It is unjust that German taxpayers will have to pay for the mistakes of lazy Greeks laying under the olive trees. (Fratzcher, 2018: 133-4.)

The main practical reason why the EMU is still up and running in this scenario is due to the fact that the doomsday predictions by several commentators since the financial crisis of 2008 have still not realized. Against all odds, the eurozone has continued muddling through for almost ten years. At one point, it seemed extremely likely that Greece would have to leave the monetary union. Nevertheless, no country has left the union, and the political will to preserve the EMU has remained strong, even if it means poor economic performance and social predicament in the member states.

How did we end up here? The combination of neo-classical and ordoliberal economic doctrine continue to dominate the EMU decision-making. No significant reforms to the eurozone structure take place. This scenario is continuation of status quo, which exacerbates the prevailing disputes and frictions within the EMU. The whole EU failed in terms of responding to the corona crisis of 2020. The member states did not manage to deliver a coordinated approach to the crisis, and the economic downturn was severe.

4.4 Scenario 4: Existential Failure

"*The euro can and should be saved – but not at any cost.*" -Joseph E. Stiglitz

Scenario plot line

This scenario is mostly based on neo-Keynesian arguments. In this scenario, it turns out that the euro was indeed a gigantic historic mistake and a growing political fragmentation results in a dissolution of the monetary union. This scenario is the ultimate existential failure, as the eurozone is dissolved into new national and regional currency areas. However, it is not necessarily an existential failure in terms of economic and political success of the countries. Acknowledging that the euro was not a good idea after all does not necessarily translate into an apocalypse. Existential Failure scenario combines both political and economic disintegration variables. The starting point is Rodrik's political trilemma of incompatible democracy, national determination, and globalization, applied to the European context. European hyper-integration had to be sacrificed for democracy and national determination.

The eurozone divorce is carried out in an amicable manner, without excessive costs. A set of institutional reforms smoothened the transition. In this scenario, Italy is the first one leaving the bloc. The new financial system is created, along with the lines of Stiglitz's proposal of *21st century financial transactions system*. The system is based on electronic money. Italy creates Italian euro, which serves as the currency within the Italian banking system.

After leaving the euro, Italy has monetary policy sovereignty again, and thus ability to create credit without a fear of a default. Moreover, the new financial system is accompanied with *21st-century banking system*, allowing the states to overcome problems caused by private banks' power to create credit. In the framework of 21st-century banking system, governments can start heavily regulating the credit creation process and direct the credit towards productive investments, rather than accumulating private profits. (Stiglitz, 2017: 279-84.)

Furthermore, the more stable countries in the euro area create regional currencies. Countries such as Germany, Netherlands and Finland create *Northern Euro (neuro)*. The countries joining the neuro are similar enough in terms of their economies, which decreases the likelihood of asymmetric shocks. This time, the mistakes of the previous common currency experiment can be avoided. The Northern European Central Bank (NECB) is allowed to fund its member states and there are no arbitrarily determined debt and deficit ceilings. The NECB mandate is primarily focused on maintaining full employment.

The Europe continues to be divided both politically and economically. A critical uncertainty here is the future of the European Union. We must keep in mind that the dissolution of the EMU does not inevitably correlate with the dissolution of the EU. The EU can continue to exist and facilitate the co-operation between the nation states. It is difficult to imagine a future where the EU was dismissed altogether. However, it is a crucial aspect of the scenario-building exercise to take into account those extremely unlikely, yet possible, developments. If the EMU divorce becomes ugly, EU break-up might be an option. Thus, the dissolution of the EU is considered as a wild card of this scenario, while amicable or chaotic divorce of the EMU being the critical uncertainty. These variables are clarified in the following subsections.

How did we end up here? The COVID-19 pandemic was the straw that broke the camel's back, escalating tensions between the Northern and Southern member states. Nationalist forces downplayed the demands for European integration driven by political elite. The Southern member states were forced to search for alternatives as the damage for their economies became to heavy to handle. Brexit was a success, which also encouraged them to search for alternatives.

4.5 Driving forces

Driving forces are different combinations of causal factors that constitute the overarching narrative of each scenario. The key driving forces of each scenario are presented in figure 6. Driving forces of economic ideologies are presented in figure 7.

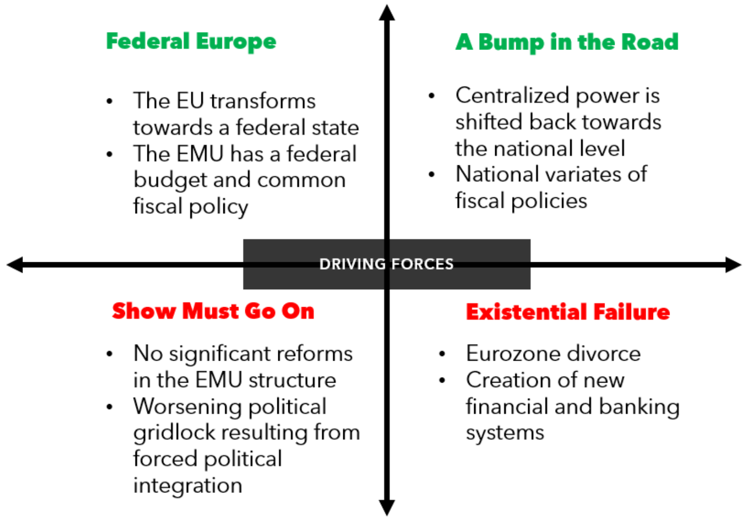


Figure 6

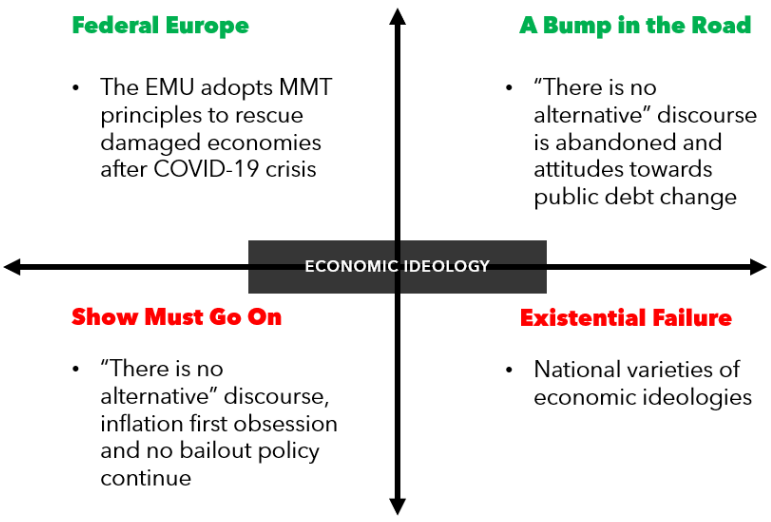


Figure 7

4.6 Predetermined elements

Predetermined elements are occasions that have already taken place or are almost certainly about to take place. In this analysis, the predetermined elements are portrayed as megatrends that are likely to prevail in each scenario. However, these known elements may cause quite different outcomes in different frameworks.

The most critical predetermined element in each scenario is prolonged economic downturn caused by COVID-19 crisis. As noted earlier, this element is likely to play out differently, depending on the given driving forces. In fact, the response to the COVID-19 crisis is key determinant on where we are heading in terms of the scenario matrix. The crisis can turn out to become a trigger for a large-scale paradigm shift in terms of economic policies or it can become a source of growing fragmentation and disintegration. Figure 8 illustrates how the COVID-19 crisis as a predetermined element potentially causes different outcomes.

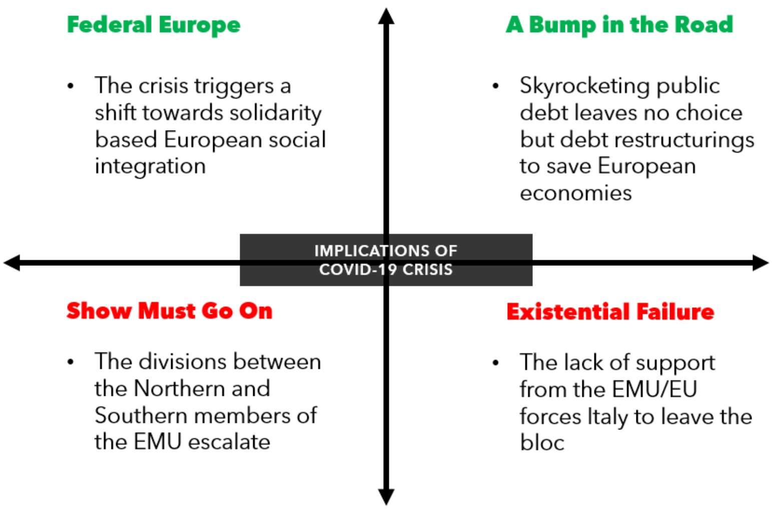


Figure 8

4.7 Critical uncertainties

Critical uncertainties are the critical elements of the scenario-building process, since identifying the unknown factors is one of the most important contributions of scenario analysis. Figure 9 presents the critical uncertainties of the four scenarios. In this analysis, these uncertainties are above all criticism of the logic of the scenarios.

First of all, it is rather uncertain how genuine social integration can be achieved in Federal Europe, given the fragmented political reality in Europe. Meanwhile, A Bump in the Road scenario assumes that re-empowering national governments would lead to better economic policies, but this could backfire in countless ways. For instance, it is uncertain whether the national governments will choose to pursue economic integration or even democracy. Show Must Go On scenario is based on continuing uncertainty, but for how long can the status quo be preserved? Finally, in Existential Failure scenario the EMU divorce is assumed to be amicable. However, divorces are seldom amicable, but rather ugly. If the divorce is chaotic, the logic of the scenario might be completely reversed, resulting in severe economic downturn.

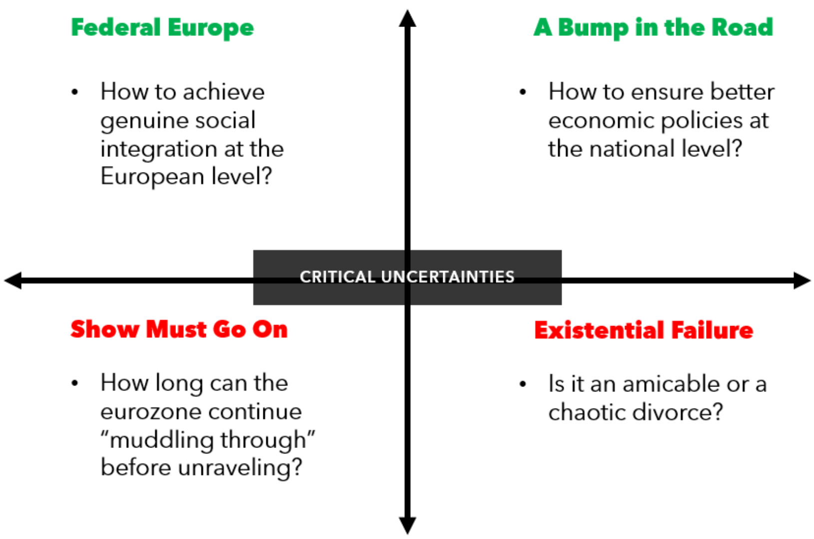


Figure 9

4.8 Wild cards

Wild cards are defined as extremely unlikely, yet possible, events that could radically alter the entire scenario plot line. These events are exactly the kind of black swans that can throw us from one scenario into another. Figure 10 presents the wild cards of each scenario.

Regarding Federal Europe, if an unpredictable event causes tremendous decline in the level of output and production capacity in Europe, the MMT conditions do not apply anymore. This could throw us in Show Must Go On or Existential Failure world. Same applies to A Bump in the Road scenario: ever growing political disintegration and rising nationalism might lead to Show Must Go On or Existential Failure. In regards of Show Must Go On, the real wild card would be a gradual emergence of social integration in Europe, which could lead us Federal Europe. Vice versa, if social integration continues declining, we might be headed to Existential Failure. This is not, however, considered as a wild card as declining social integration does not seem extremely unlikely. Finally, the logic of Existential Failure could be reversed if the political integration in Europe truly escalates to the point in which the whole EU is dissolved. It would not necessarily throw us in any other scenario, but it would certainly alter the logic of Existential Failure.

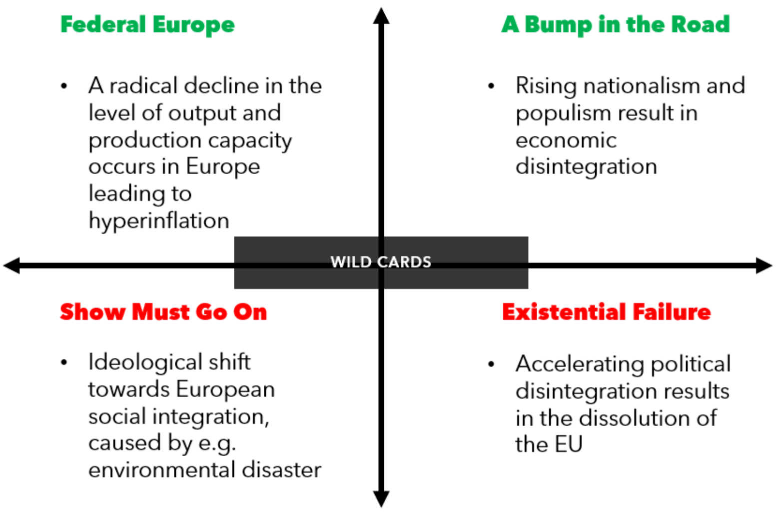


Figure 10

5 Conclusions

This thesis argues that scenario analysis is a fruitful method to conceptualize uncertain future and potential shocks and turbulences it may hold. The paper demonstrated that there are conditions in which the euro can survive and even prosper. On the other hand, there are conditions in which the euro may be doomed to fail due to its design flaws and lack of social integration within the eurozone. Utilizing scenario method, chapter 4 presented four plausible futures for the euro.

The scenario-building exercise demonstrates how the different theories and views on how the EMU should be governed and reformed may play out in practice. Each scenario reflects certain school of thought that entails specific elements of reform and governing principles. Scenario Federal Europe is based on neo-Keynesian and euro-federalists accounts, whereas A Bump in the Road scenario combines neoclassical and neo-Keynesian theories. Scenario Show Must Go On is based on neoclassical and ordoliberal theories, while Existential Failure scenario builds on neo-Keynesian arguments.

The hypothesis of the thesis was that the future of the euro is extremely uncertain without significant social and fiscal reforms. The hypothesis is not supported by ordoliberal theory, which insist that the eurozone problems can be fixed through fiscal discipline. From neo-Keynesian and euro-federalist perspective, this premise seems to be correct. Interestingly, neoclassical economists seem to be divided regarding this question and it seems that a paradigm shift may be occurring among several mainstream economists in terms of certain social and fiscal reforms. The hypothesis is also supported by the evidence of growing North-South divide within the EMU, as the question of solidarity has become a central element of this debate.

Thus, the key conclusion is that for the euro to survive, social integration must deepen. In other words, any meaningful social or fiscal reform in the eurozone structure requires increased solidarity within the union. It cannot be concluded that there would be a consensus among different schools of thought regarding social integration. However, this thesis argues that the future of the euro is extremely uncertain without increased social integration and solidarity within the eurozone.

Regarding the reforms, there is a growing consensus between different schools of thought (except ordoliberal) that the most important structural reform would be some level of debt mutualization and restructuring. Another important reform would be increased banking integration, which would enhance financial stability in the eurozone through common standards and harmonize the banking regulation between the member states. Debt restructurings and banking union would require deepening solidarity in the EMU, so they cannot be expected to fully realize before social integration moves forward.

The scenarios in which the EMU prospers (Federal Europe and A Bump in the Road) include aspects of social integration and banking integration. Vice versa, the scenarios in which the EMU cannot survive (Show Must Go On and Existential Failure) include lack of social integration and banking integration. There are, however, divided views on the interplay between political and economic integration. Federal Europe scenario combines ideas based on the argument that any further integration requires additional transfers of sovereignty at social, political, and fiscal levels. Quite the contrary, A Bump in the Road scenario assumes that re-empowering the nation states might in fact lead to better economic integration. Meanwhile, Show Must Go On scenario starts from the same assumption as Federal Europe regarding any further integration requiring additional transfers of sovereignty from nation states to European level. In the absence of social integration, artificially continuing political integration results in economic disintegration. Existential Failure scenario sacrifices both economic and political integration, as it turns out that achieving social integration is a mission impossible in the EMU.

Federal Europe. In this scenario, the EMU integrates economically, politically, and socially. The main driver is deepening social integration, which allows social and fiscal reforms in the EU and EMU to emerge.

A Bump in the Road. In the second scenario, the EMU continues functioning without further political integration. The economic integration deepens as the political disintegration re-empowers the member states. The logic here is that the problems the EMU is facing can be resolved, and the problems are mainly seen deriving from the actors at the national level, not originating from the euro itself. This view emphasizes the importance of continuing economic integration, which does not necessarily require deeper political integration.

Show Must Go On. The third scenario envisions artificially continuing European political integration, not supported by social integration, which results in economic disintegration. The main driver here is “there is no alternative” discourse, which entails neo-classical and ordoliberal approach to economic policies. No significant reforms to the EMU structure take place and thus the eurozone continues muddling through.

Existential Failure. The fourth scenario is the most dramatic vision for the future of the euro. So dramatic that many commentators do not want to see it as an option. In this scenario, political and economic disintegration lead to EMU divorce. This narrative highlights the systemic failures and design flaws that turn out to be unresolvable. It is not, however, a doomsday prediction. In this scenario, Europe can prosper without a common currency.

At this point, a relevant question arises: which scenario is likely to prevail? An objective likelihood assessment is naturally beyond the scope of this thesis, and quite frankly beyond the scope of any research. Again, it is not the purpose of scenario analysis. However, we can always propose subjective assessments on where are we heading. Here is my educated guess, based on the above-mentioned main drivers for a prospering EMU and for a disintegrating EMU.

The likelihood of social integration to accelerate in Europe seems low in the current atmosphere. Unfortunately, it is something we cannot force. Social integration in Europe would require genuine sense of a common European identity, quite similarly as the nation states and national identities emerged. Much depends on the most powerful actors, such as Germany and France, who do not show any intention to take steps towards socially integrated Europe. Thus, it seems that Show Must Go On is the most likely scenario we are facing in the immediate future. The EMU continues to muddle through until it faces the wall. After hitting the wall, an ugly divorce might not be avoided. The second likely scenarios for the EMU would be A Bump in the Road or Existential Failure. These both would require tremendous structural reforms and ideological reorientations. The most unlikely scenario is Federal Europe. It is simply something no one in Europe desires, even if it would probably be the best alternative. Thus, the show must go on.

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