The Euro Zone: No Turning Back

Uri Dadush
Senior Associate
Director of the International Economics Program

Bennett Stancil
Researcher
International Economics Program
Carnegie Endowment for International Peace (CEIP),
Washington DC

The core of the euro crisis is not fiscal, though fiscal issues did bring the crisis to a head. At its heart, today's problem stems from misalignments in Europe's economic structure. These are directly related to the adoption of the euro and the loss of competitiveness in Europe's periphery countries – Greece, Ireland, Italy, Portugal, and Spain – and can no longer be corrected through currency depreciation.

European leaders have come a long way in the last year toward recognising the need for rescuing the countries in trouble and the need to reform the monetary union to make it more resilient. Nevertheless, their response remains too timid and too complacent; they have yet to recognise the full extent of the inevitable losses and have not yet demonstrated the political willingness to share the burden of the greater adjustment to come. The survival of the currency and even of the European project in its current form now depends on policy makers correcting course and pushing for a tighter union.

More than a Fiscal Crisis

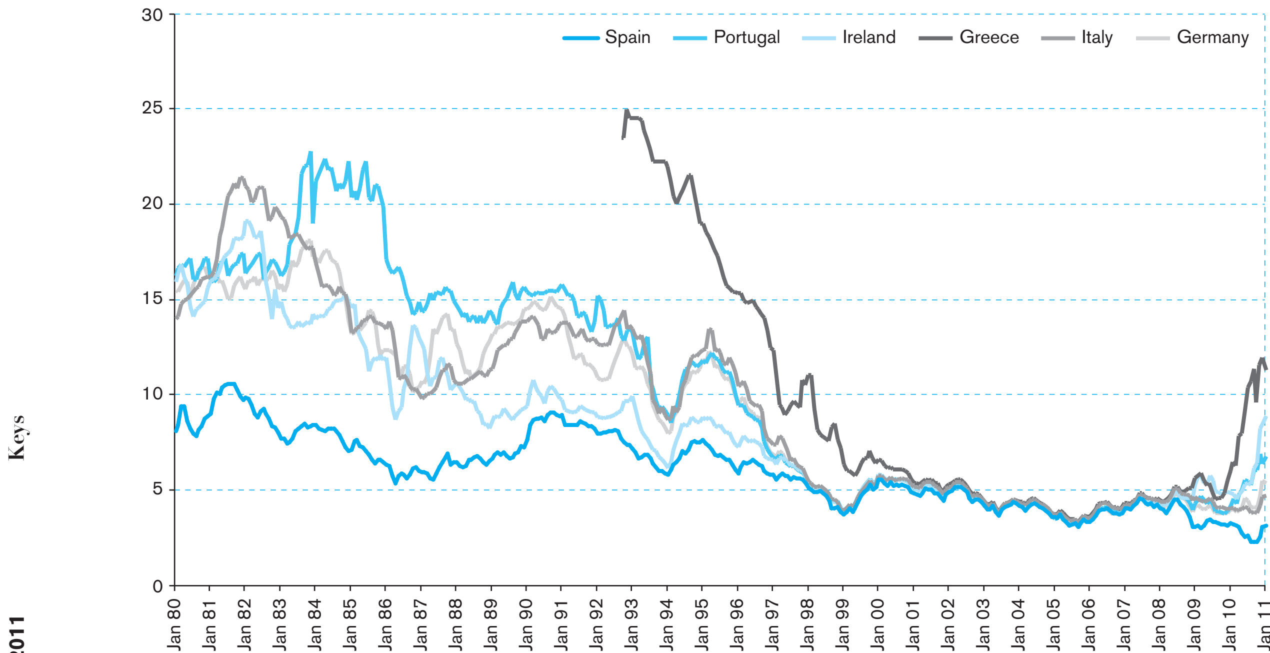
The euro crisis was created by a misallocation of resources among and within European countries, reflecting a loss of competitiveness in the periphery, which resulted from and was largely concealed by a demand boom associated with the adoption of the euro a decade ago. This process also led to a large rise in the foreign indebtedness of the private sector from the periphery. Today's fiscal problems are in large part the consequence of the breakdown of this unsustainable growth model, rather than its cause. A thumbnail sketch of the euro's formation illustrates these trends.

Nineteen years ago, European leaders signed the Maastricht Treaty, laying the foundation for monetary union and a single currency. The agreement eventually bound the currencies and monetary policy of the periphery to that of the core: Austria, Belgium, France, the Netherlands, and Germany, Europe's largest and most stable economy. Expecting the core's stability, wealth, and stronger institutional and economic frameworks to diffuse throughout the periphery, market confidence in Greece, Ireland, Italy, Portugal, and Spain (GIIPS) surged and a demand boom emerged.

The demand boom in the periphery was in part the result of a large decline in real interest rates. After averaging over 550 basis points in 1980-1990, the average long-term government nominal yield spreads of the GIIPS vis-à-vis the core gradually declined to 22 in 2000 and 6 in 2003, while the difference in inflation between the periphery and the core fell by much less. Low interest rates and improved confidence fuelled a domestic demand surge, partly financed by foreign lending. As domestic spending increased in the GIIPS, current account balances deteriorated and private debt rose, especially in Greece, Ireland, and Spain.

As domestic demand accelerated in the GIIPS, the prices of domestic activities (i.e., those least exposed to international competition, such as housing) rose relative to the price of exportable products and attracted investment into the less productive non-

CHART 2 **Long-Term Government Bond Yields (%)**



Sources: IMF, Bloomberg. Note: Greek data unavailable for 1992.

tradable sectors. Consequently, the GIIPS' economies realigned away from manufacturing and industry toward services and construction: from 1997 to 2007, 4 percentage points of GIIPS' GDP shifted from industry to financial services, real estate, and business services – over twice the shift in the core.

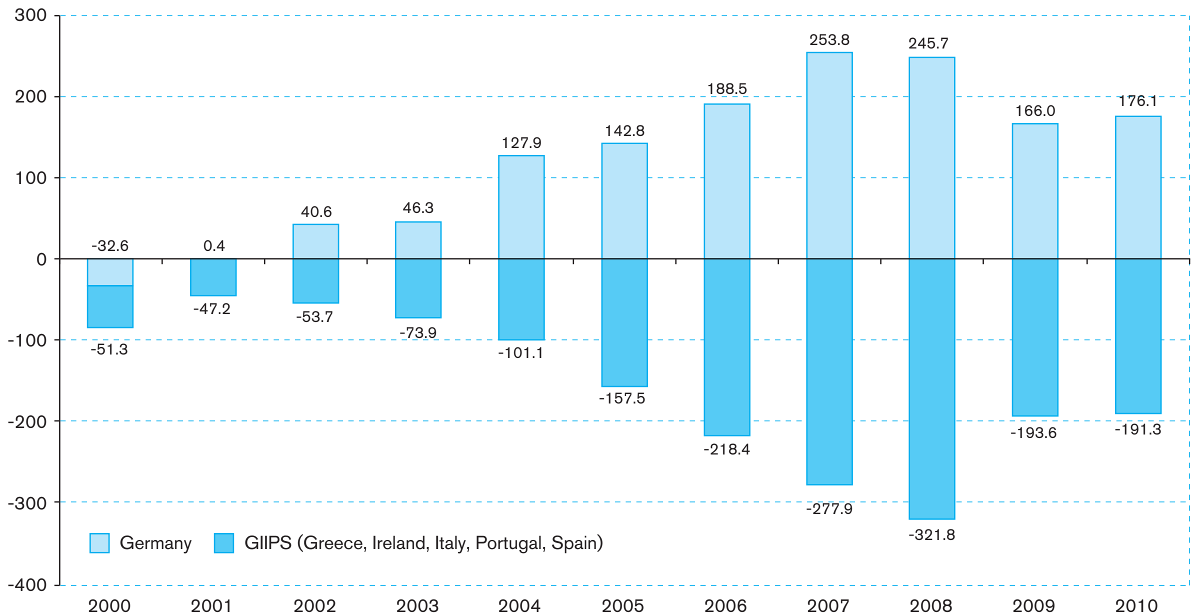
European Central Bank interest rates became too low for the periphery, fuelling construction bubbles in Greece, Spain and Ireland, as well as an unprecedented banking expansion in the latter

Over the same period, per capita employee compensation rose by an average annual rate of 5.9% in the GIIPS, despite annual rises in productivity of just 1.3%. The difference in the core was much smaller. As a result, unit labour costs rose by 32% in the GIIPS from 1997 to 2007, compared to 12% in the core. Reunified Germany's remarkable transformation into the world's largest exporter underpinned these developments. Defying the trend in nearly all other advanced countries, including the United States and Japan, German exports as a share of GDP rose by 19 percentage points from 1997 to 2007, compared to an average rise of just 2.6 points in the periphery. Consequently, current account balance diverged sharply, as shown in chart 3.

One result was a dramatic decline in competitiveness in the GIIPS against other advanced countries. The loss was particularly severe relative to countries outside of the euro zone, which saw labour costs increase only moderately and whose labour costs in euros benefited from the euro's nearly 50% appreciation against the dollar from 2000 to 2007. This appreciation largely reflected the sharp increases in productivity in Germany and other parts of the core that the periphery was unable to match. The result was seen in the large rise in the real effective exchange rates of the periphery.

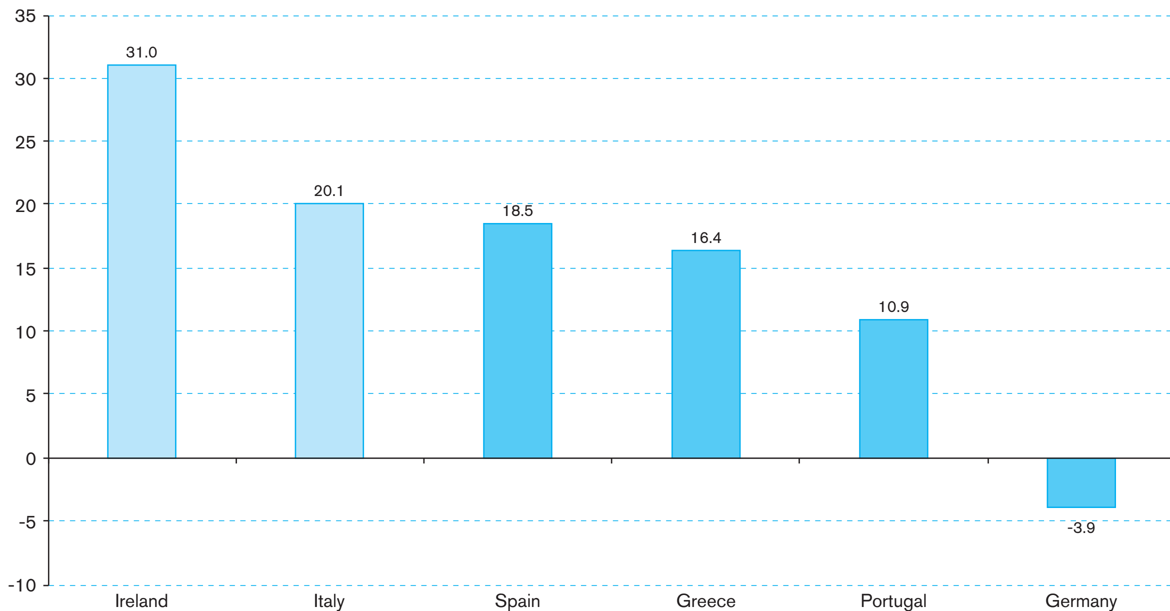
The euro zone's single monetary policy exacerbated these problems. During the boom, European Central Bank (ECB) interest rates became too low for the periphery, fuelling construction bubbles in Greece, Spain and Ireland, as well as an unprecedented banking expansion in the latter. An OECD study estimates, for example, that policy interest rates over 2001–2006 were approximately 50 basis points too high for Germany but 300 to 400

CHART 3 **Current Account Balance (US dollars, billions)**



Source: IMF.

CHART 4 **Change in Real Effective Exchange Rate from 2000 to 2007 (%, based on unit labour costs)**



Source: European Commission. Note: An increase represents a loss of competitiveness.

basis points too low for Spain, Greece and Ireland.[1]

Governments in the periphery failed to recognise that the revenue increases from the boom and the decline in public borrowing costs were windfall gains associated to adopting the euro. Consequently, government spending accelerated rapidly. From 1997 to 2007, public spending per person rose by an average of 76%, compared to a rise of 34% in the core.

[1] AHREND, Rudiger; COURNÈDE, Boris and PRICE, Robert, "Monetary Policy, Market Excesses and Financial Turmoil," *OECD Economics Department Working Papers*. March 10, 2008.

CHRONOLOGY OF EU DECISIONS IN RESPONSE TO THE CRISIS

2 May 2010: Joint Statement on Greece by EU Commissioner Rehn and the Managing Director of the International Monetary Fund (IMF)

The members of the Eurozone commit to a program of 80 billion euros while the IMF is to provide 30 billion dollars over three years through bilateral loans, following Greece's presentation of its corrective measures. The first disbursement will be effected as of 19 May, under the conditions set by the Eurogroup on 11 April, in order to effect repayment of a debt of 9 billion euros. The amount paid out in 2010 could reach 30 billion euros.

8 May 2010: Summit of Heads of State and Government of the Eurozone

This meeting is to finalize procedures for the implementation of support measures for Greece, which total 110 billion euros. In view of the crisis, the heads of government of Member States stress the need to accelerate the consolidation and reorganization of public finances, as well as the need for formally complying with the recommendations contained in the Stability and Growth Pact (SGP), creating a European Stabilization Mechanism (ESM), strengthening governance in the Eurozone and regulating the financial market. The European Council addresses these issues on 17 and 18 June 2010 and discusses the proposals put forth by the European Commission.

4 August 2010: European Financial Stability Facility (EFSF) Becomes Operational

As established in the agreement of 7 June, 2010 entered into between the Member States of the Eurozone, the securitization fund is henceforth authorized to issue bonds in order to preserve financial stability in Europe by providing financial assistance to states in the Eurozone experiencing economic difficulties.

28 November 2010: Agreement on a Future European Stabilization Mechanism (ESM) to Assist Member States Experiencing Financial Difficulties

Eurozone finance ministers agree to replace the current EFSF by an ESM in 2013. Council President Herman Van Rompuy submits this agreement to the European Council in December 2010 to discuss an amendment to the Treaty.
The ESM will be the guarantor of financial stability in the euro area and will be based on the current structure of EFSF while supplementing it in terms of economic surveillance.
Private sector participation will be decided on a case by case basis, as per current IMF practices.

7 December 2010: European Council Approves Aid Measures to Ireland

The European Council decides to grant EU financial assistance to Ireland on the basis of a programme negotiated with the Irish authorities, the European Commission and the IMF in collaboration with the European Central Bank (ECB). A loan of up to 22.5 billion euros will be made available, with a maximum average maturity of seven and a half years.

16-17 December 2010: Agreement of the European Council on a Future ESM, to Become Operational in 2013

Heads of State and Government agree on the general features of the ESM, as well as on a draft amendment to the Treaty necessary for its implementation. The latter must obtain the approval of all EU Member States, in accordance with their constitutional obligations, before it can enter into effect.
The ESM will be activated only by unanimous agreement of the countries and subject to strict conditionality in cases where the stability of the euro area would be jeopardized.

1 January 2011: Three New European Authorities: the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA)

Together with the European Systemic Risk Board, these three authorities, also known as the European Supervisory Authorities, have begun operating as part of the new European System of Financial Supervisors (ESFS), created in 2010 to address shortcomings in financial supervision.
The EBA is the successor to the Committee of European Banking Supervisors. Its mission is to contribute to the stability and efficiency of the financial system in the short, medium and long terms.
The EIOPA, in turn, ensures financial stability, transparency of financial markets and products, and the protection of insurance policyholders and members or beneficiaries of pensions.
The ESMA replaces the Committee of European Securities Regulators.

11 March 2011: Eurozone Summit and Agreement on the ESM

Country representatives endow the ESM with a response capacity of 500 billion euros. The ESM will be empowered to grant loans or purchase primary debt of Member States provided that the beneficiary states commit to take specific measures that will condition loan granting or intervention in the primary debt market (i.e. in recently issued debt securities).
ESM loans will enjoy "preferred creditor status, which will be lower only to that of the IMF."
Insolvent countries will have to negotiate a comprehensive restructuring plan with their private creditors in the context of collective action clauses (CAC) in order to return to debt sustainability.

17 March 2011: Aid to Romania and Ireland: The European Commission Issues a 4.6 Billion Euro Bond with a 7-Year Maturity

Ireland will receive 3.4 billion euros from the EFSF to finance its aid plan and Romania will receive 1.2 billion euros in loans through the Balance of Payments Facility.

(continue)

CHRONOLOGY OF EU DECISIONS IN RESPONSE TO THE CRISIS *(continuation)*

15 April 2011: Statement by the European Commission, the European Central Bank and the IMF on the Review Mission to Ireland

Teams of experts visited Dublin from 5 to 15 April for a quarterly review of the government's economic programme. The programme's objectives are "to address financial sector weaknesses and to put Ireland's economy on the path of sustainable growth, sound public finances, and job creation," according to the press release. The team believes that the programme is on track but that resolute implementation of the measures will be essential for overcoming the difficulties.

24 May 2011: The EU Issues a 4.75 Billion Euro Bond with a 10-Year Maturity to Assist Ireland and Portugal

Ireland will receive 3 billion euros and Portugal 1.75 billion euros as of 31 May 2011 via loans from the EFSF.

Sources

http://ec.europa.eu/economy_finance/focuson/crisis/index_en.htm
http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/11/248

In Ireland and Spain, surging revenue more than compensated for spending increases – they were two of only four euro zone countries to average a government surplus from 2000 to 2007. Other GIIPS, however, showed clearer evidence of fiscal deterioration. In Greece, blatant mismanagement added to the troubles – despite strong growth, Greek deficits averaged 5% of GDP from 2000 to 2007.
The financial crisis in 2008 brought an abrupt end to this post-euro growth model. As the periphery countries plunged into recession, tax revenues from overinflated housing sectors and other domestic activities collapsed, huge bank losses materialised in Ireland and governments discovered that their spending was unsustainable. At the same time, their loss of competitiveness and inability to resort to currency devaluation dimmed hopes of turning to foreign demand for recovery.

Three Scenarios

At the outbreak of the Great Recession in the second half of 2008, the fiscal situation of the periphery looked solid, with debt levels in Ireland, Portugal, and Spain lower than in Germany. Even in profligate Greece, the true state of the fiscal situation would not be exposed until late 2009. Italy had the highest debt/GDP ratio in Europe, but had seen it decline post-euro. Since that time, European leaders have been scrambling to address the fiscal hole in Greece, as well as those that appeared in the other GIIPS as their economies deteriorated.
Confronted with political opposition – to bailouts in the core and austerity in the periphery – policy makers have nevertheless taken unprecedented steps on both fronts to hold the euro together. Although bailouts were previously assumed to run directly counter to provisions of the Maastricht Treaty, euro zone members agreed to provide direct rescue funds for Greece, Ireland and (soon) Portugal, drawing on a newly-created rescue mechanism, the European Financial Stability Facility (EFSF), established jointly with the IMF. Meanwhile, after much debate, the ECB voted to directly purchase government bonds in addition to injecting very large amounts of liquidity into the banking systems of the worst-affected periphery countries.
Spreads on the government bonds of the periphery have remained high, however, signalling that markets remain unconvinced and – despite large guarantees by the core – are focused on solvency rather than liquidity. As stated, embattled countries need to repair public finances and fix banks (especially in Ireland and Spain), while simultaneously restoring competitiveness so they can grow again – a catch-22, as the latter requires wage and price deflation that makes debt burdens harder to bear.
Going forward, one of three outcomes is foreseeable: a long slog in troubled countries created by austerity and deflation; debt restructuring, with the euro remaining intact; or fragmentation of the euro zone. Each scenario is bad, but the last one could spell catastrophe. Though the probability of a break-up of the euro is small, it can no longer be dismissed as fanciful. Moreover, examining it helps clarify other options.

Scenario 1: Muddle through

If sovereign defaults or a break-up of the euro zone are to be prevented, the crisis cannot spread to Spain – the Spanish economy is nearly twice as large as those of Greece, Ireland, and Portugal com-

bined. For this to be achieved, Spain and the rest of the periphery must convince markets that they are containing deficits and re-establishing the conditions for growth. As part of these changes, these countries must find ways to achieve a competitive realignment (or internal devaluation) vis-à-vis the rest of the world. By definition, this will require prices to moderate or fall and wages to fall relative to productivity. To the extent that structural reforms increase productivity, demand and employment will have to suffer less to achieve the same devaluation.
In addition, the ECB and the European core must commit to more expansionary policy over a long period, contrary to the ECB's recent decision to raise interest rates. Euro zone countries (and the rest of the EU) will also need to commit to further augmenting the EFSF if needed. We will return in more detail to what is needed for 'muddling through' to work below.

Scenario 2: Debts Rescheduled, Euro Zone Remains

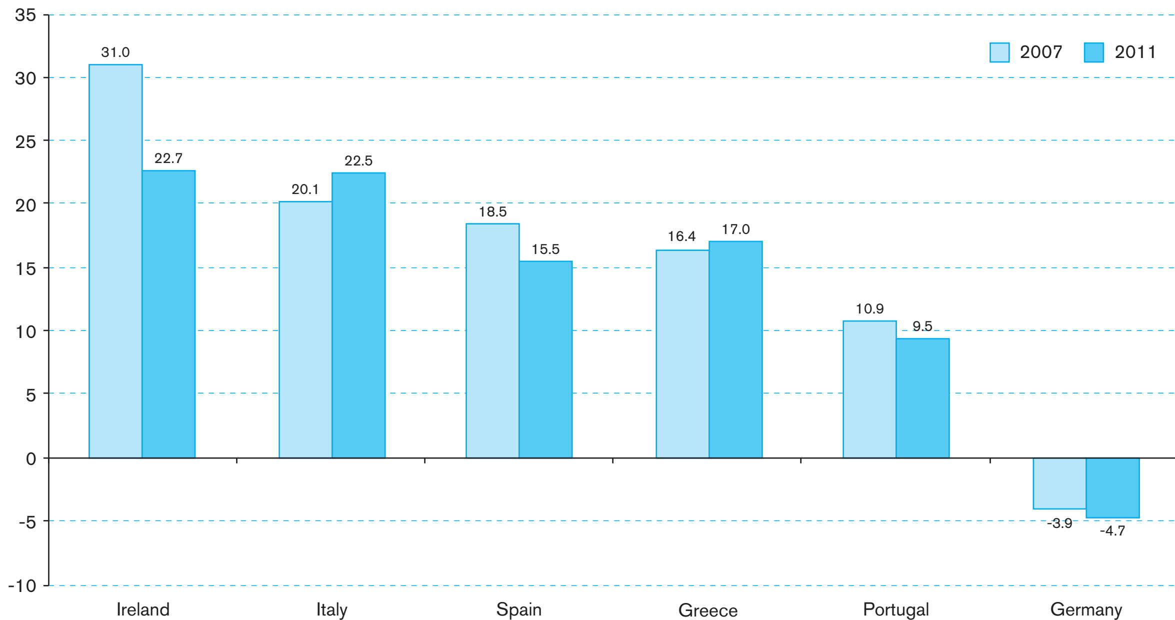
Greece, where debt has already reached 142% of GDP and is rising rapidly, will almost inevitably have to restructure its debt at some point. The cases of Ireland and Portugal are less clear cut, though they too are projected to have debts in excess of 100% of GDP by 2014. If the crisis reaches Spain and the EFSF and ECB facilities are not greatly expanded, Spain's ability to pay down its debts could also be called into question. Should the crisis spread to Italy, rescue would be close to impossible and debt restructuring would become inevitable, implying another global financial event of 'black swan' proportions.
The sovereign debt restructuring could take a soft or hard form. The soft form could include an agreement to reschedule debt at much longer maturities, a lower interest rate, and even a lower principal. The EU no longer explicitly excludes such an approach, as European leaders agreed at their latest summit to incorporate collective action clauses for all euro zone government debt issued after 2013. (Collective action clauses allow a super-majority of bond holders to agree to a restructuring that applies to all creditors, even those who oppose it.) In principle at least, this could be done without major disruption: for example, private creditors could accept the change in terms in return for a full or partial guarantee from an expanded EFSF.

Under a hard restructuring, effectively an imposed default, creditors would take a large hit on principal, which could be in the range of 30-50% (following its default in 2001, Argentina imposed a 70% hit on its creditors). A hard restructuring would have far-reaching implications for banks and private sector entities in the defaulting country, as well as broad effects throughout the EU and beyond. Contrary to the impression sometimes created by politicians, the cost of the default would not be small. For example, were Greece to default on half of the public and private debt it owes abroad, its creditors would lose about €200 billion, a multiple of the direct cost imposed on creditors during Argentina's default. If several periphery countries defaulted, a banking crisis would almost certainly erupt – France and Germany hold over €700 billion in debt from Ireland, Spain, Portugal, and Greece. Resolving such a crisis would require another large dose of government support for banks throughout Europe. The defaulting countries would fall back into very deep recession amid a collapse in confidence and capital flight.

Scenario 3: The Euro Zone Breaks Up

No country would willingly choose to exit the euro zone. Any exiting periphery country would face capital flight, catastrophic recession, and widespread household, corporate, and banking defaults. Though not impossible, the legal, logistical and political challenges of introducing a new currency in these circumstances would be daunting – for example, how would one convince a creditor or pensioner that is owed euros to take devalued drachmas? The new currency would need to be devalued greatly vis-à-vis the euro, driving up import prices and possibly leading to higher inflation; the country's borrowing costs would also remain elevated well into the future.
Nevertheless, judging by numerous precedents (consider Argentina again, and more recently, Iceland) an immediate devaluation would help restore competitiveness, boost exports, and probably reignite growth within one to three years – an outcome debt restructuring alone cannot achieve. (Indeed, debt restructuring could erode competitiveness further by encouraging the private and public sector to resume spending, allow wages to rise again and so on.) Thus, if after prolonged austerity a country concluded that debt restructuring was its only viable option and deemed a large banking crisis probable anyway, it could come to see exiting

CHART 5 **Change in Real Effective Exchange Rate since 2000 (%, based on unit labour costs)**



Source: European Commission. Note: An increase represents a loss of competitiveness.

the euro zone as its least bad option for recovering lost competitiveness and returning to growth.

If this were to occur, defaults in troubled countries would be more widespread than in scenario 2, triggering a deeper banking crisis in the remaining core countries that would require even greater government support. Simultaneously, the smaller remaining euro zone would see appreciation and competitiveness loss. Together, these forces would likely push the core back into recession, which would in turn limit the export performance of the periphery.

Given the disruption it implies, and the lengths euro zone partners would surely go to resist it, this scenario is unlikely.

A less painful but still traumatic version of the break-up would begin with a German exit. This scenario is even more unlikely, but again worth examining. If further bailouts required Germany to bankroll its larger neighbours as well and ECB liquidity injections were seen to threaten a sharp rise in inflation, German public opinion could force such an outcome. A return to the stronger deutschmark would reduce German competitiveness and hurt export performance. Banks could also suffer as the value of euro-denominated assets fell.

Euro depreciation and looser monetary policy would likely follow in the periphery, making the competitiveness adjustment easier and enhancing growth there. Sharp fiscal adjustments would still be needed, however, and debt rescheduling could still be necessary, especially since depreciation would make foreign-currency loans more expensive to repay. Without its German anchor, and the prospect of its financial support, the truncated euro zone would potentially experience an even greater loss of confidence. It is difficult to see how the European project could survive a voluntary German exit.

Is the ‘Muddling through’ Scenario Working?

As the three scenarios illustrate, Europe has no good option. To muddle through and avoid even worse outcomes, policy makers need to stop the fiscal bleeding and to address the root causes of the disease – diverging competitiveness and structural misalignments. In principle, an extended period of austerity (in the form of fiscal consolidation, increased household savings and corporate and bank deleveraging) could lower prices and wages in the periphery, thereby re-establishing competitiveness – but is this occurring?

Certainly, there is no shortage of austerity. Since 2007, when economic activity in Europe peaked, domestic demand has fallen by an eye-popping 23% in Ireland, 11% in Greece and 8% in Spain. It has also declined modestly in Italy (4%) and Portugal (2%), while growing by 2% in Germany.

However, despite announced wage cuts across the periphery and the euro’s decline (down about 3% in

effective terms since two years ago), Ireland is the only periphery country to see its competitiveness improve significantly. As shown chart 5, Spain and Portugal have regained competitiveness modestly, but only at about the same pace as Germany; Greece and Italy have continued to lose ground. Moreover, while world trade is booming again, consensus forecasts for 2011 expect the periphery countries' economies to be stagnant or shrink.

Thus, austerity alone appears able to redress the competitive and structural divergences at only a snail's pace. With the possible exception of Ireland, the periphery countries have no choice but to enact structural reforms to stimulate innovation and increase competition in product and labour markets. Without these changes, the divergences between the periphery and the core may persist, or even widen.[2]

So far, each country has taken modest steps toward such structural reforms, but they have been insufficient. Though not yet reflected in competitiveness indicators, Greece alone appears to be embarking on far-reaching structural reforms as part of its EU-IMF programme. This should not be too surprising: reforms such as liberalising the markets for professional services attack powerful interest groups directly and nearly always require the application of an external force. (It remains to be seen how financial rescues will affect the will to act in Ireland and Portugal, as the governments that requested support were or are soon likely to be voted out of power.)

Rather than push more forcefully for structural reforms, however, policy makers in Brussels and in the capitals remain overly focused on austerity measures, fiscal consolidation and how to finance the adjustment. In fact, the array of proposals brought forward to ease the financial burden on the periphery is truly impressive; they range from debt restructuring, to allowing the EFSF to buy government bonds directly, reducing IMF-EU loan interest rates and extending their maturity, and issuing euro-bonds to fund much of the euro zone countries' financing requirements.

While each of these proposals has merit, each could also ease the pressure on politicians to act. More crucially, they fail to address the root causes of the crisis.

What Should Be Done Differently?

First, leaders in the euro zone must recognise that they are dealing with at least a five-year problem, and plan their response accordingly. Improving competitiveness, export performance, and the composition of growth will prove to be more important than meeting short-term fiscal targets. Efforts to strengthen economic governance and macroeconomic cooperation have yielded only modest progress so far. The 'Euro Plus Pact' – a series of rules designed to improve competitiveness and policy coordination among euro zone members that emerged from the March 2011 EU summit – reinforced the principle of peer review of fiscal and structural reforms established in previous agreements, but offered no new enforcement mechanisms.

Second, the core countries must recognise that allowing or promoting domestic demand to grow faster and wages to rise will both help them and also facilitate the adjustment in the periphery. Surplus countries as well as deficit countries have to contribute to the adjustment. If, through market processes or policy choices, demand growth accelerates in the core – which accounts for a large share of periphery exports – the likelihood that the crisis will be contained increases. Though the objective of the periphery must be to improve competitiveness vis-à-vis all its trading partners, the speed at which wages and demand rise in the core is important since they set the benchmark for price rises throughout the euro zone, and also determine the value of the euro. The recent ECB interest rate hike, though perhaps appropriate for Germany in isolation, will slow the recovery in the periphery and make the competitiveness adjustment more challenging. Rescuing the euro while keeping European inflation slightly below 2% would be just perfect, but the former, not the latter is the main objective.

Third, policy makers must resolve several issues surrounding existing financing mechanisms. At the March summit, leaders were unable to finalise an agreement to enlarge the EFSF; while the lending capacity of its replacement, the European Stability Mechanism, will be expanded to €500 billion, it will not reach its full capacity until 2018. Clarity on the financing mechanisms will help calm bond markets and reduce the chance of Spain coming under

[2] "The impact of the global crisis on competitiveness and current account divergences in the euro area," *Quarterly Report on the Euro Area, European Commission Directorate-General for Economic and Financial Affairs*. Vol 9, No 10, 2010.

attack. But, critically, the precise shape of these mechanisms is less important than the inclusion of conditions that maximise incentives for politicians to act – including measures that discourage drawing on financing in the first place.

Fourth, clarity is needed on whether and how an eventual debt restructuring will be effected. Sovereign debt restructuring should be seen only as a last resort. However, markets are convinced (correctly, we believe) that Greece will very likely require such restructuring eventually. Both Ireland and Portugal could follow, although that is less certain. Since the three countries are effectively shut out of private markets, the most likely scenario is that the EFSF and ESM will progressively become the owner of a very large part of the debt of these three countries, which the IMF projects will reach 800 billion euro by 2015. Even with eventual rescheduling and reduction in interest rates, some part of this debt will probably have to be forgiven. Under what conditions will that be allowed to happen? How will debt forgiveness be linked to progress on fiscal and structural reforms? Assuming that current private bondholders will be completely sheltered as promised, will new bondholders after 2013 have to take the brunt of private sector haircuts? Answering these questions today presents formidable political challenges in the core countries, but will surely be a prerequisite to ultimate resolution of the crisis and to Greece and others eventually regaining market access.

No Turning Back

Ultimately, the choice facing the euro zone is a more fundamental one than deciding how to capitalise the EFSF, what fiscal goals to target or even what debts to forgive. Though some of the euro's problems today reflect countries adjusting to the adolescent regime, unpredictable asymmetric shocks and divergent development paths among members will inevitably confront the monetary union again in coming decades. To insulate itself against a repeat of the current tensions, the monetary union must be greatly strengthened. Difficult as it is to envisage this politically today, this will inevitably include a tighter fiscal and transfer union (of which structural funds and the EFSF, for example, are harbingers); tighter coordination of fiscal policies, including tax policies; and increased flexibility of product and labour markets, including facilitation of movement of people across national boundaries.

To be sure, a more fiscally centralised euro zone would mean spreading countries' debts and risks among its members: helping hard-hit countries return to fiscal health would come partly at the expense of those that are better off. But the risk that asymmetric shocks destabilise the whole euro zone would be reduced.

The political integration that is implied by these changes would also have wider benefits, helping Europe retain its influence on world affairs as several developing countries rise to become the world's largest economies in years ahead

If such transfers were activated automatically and supported shared European objectives – such as an expanded EU programme to help provide basic unemployment insurance – they may be more politically acceptable. The political integration that is implied by these changes would also have wider benefits, helping Europe retain its influence on world affairs as several developing countries rise to become the world's largest economies in years ahead.[3]

A key objective of the euro's architects was to draw Europe ever-closer together – to ensure 'there is no going back.' The crisis has already shown that in this, they may have succeeded beyond their expectations. The euro zone today has no realistic alternative but to press forward with even greater integration – fiscal, structural, and ultimately political. Other courses lead to renewed financial crisis and, as one former euro zone head of state suggested, the potential end to 60 years of European peace. The choice is clear – now politicians have to find a way to bring their people behind them.

[3] Dadush, Uri and Stancil, Bennett. "The World Order in 2050," *Policy Outlook*, Carnegie Endowment for International Peace. April 2010.