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Saving the euro is the wrong goal

By Gideon Rachman

As the European ship heads for the rocks, so the officers in charge are being thrown overboard. This week could see the departure of the prime ministers of both Greece and Italy. But while politicians may come and go, European leaders insist that one thing will remain eternal – the euro. No summit is complete without the ritualistic declaration that Europe will do "whatever it takes" to preserve the single currency. But the repeated vows to save the euro betray a dangerous confusion.

The euro is not an end in itself. The single currency is just an instrument, aimed at promoting economic prosperity and political harmony across Europe. As the evidence mounts that it is doing the precise opposite, it is time to think not about how to save the euro – but about how to scrap it, or at least allow the weakest members to leave.

For reasons of pride, fear, ideology and personal survival, it is extremely hard for European leaders to accept that the euro is a large part of the problem. Instead they search for other explanations for the economic crisis. Countries have failed to stick to the rules. They have lied. Europe needs new political structures. The bazooka is not big enough. The markets are irrational. The people are revolting.

There are elements of truth in all these explanations. But they fail to get to the root of the problem. After roughly a decade we are discovering that a single currency area, uniting different countries with different levels of economic development – and very different political cultures – is inherently flawed.

The euro has helped both to create and sustain the crisis in Europe. First, it caused interest rates to plunge in southern Europe, encouraging countries such as Italy and Greece to go on a borrowing binge. Now the single currency rules out the options that postwar Italy and others traditionally used to cope with high levels of debt: inflation and devaluation of the currency. Neither policy was cost free, but they provided an alternative to the "internal devaluation" (otherwise known as wage cuts and mass unemployment) that is currently being urged on Italy, Greece and much of southern Europe.

The global financial crisis exposed the euro's weaknesses. When it first became apparent that Greece was in serious trouble, in 2009, the EU set itself two tasks. The first was to resolve the Greek crisis. The second was to convince the markets that Greece is an isolated case that bears no resemblance to the rest of the eurozone. They have failed comprehensively in both tasks.

Economic chaos in Greece is now being supplemented by political chaos. In Italy, meanwhile, borrowing costs go up and up – in a way that will soon make the country's finances unsustainable. If Italy, the world's seventh largest economy, applies to the EU bail-out fund – or even to the IMF – there simply may not be enough money to meet its needs. It would be like an elephant getting into a life raft.

The markets have spotted that, while Greece is an extreme case, it is not unique – whatever EU leaders say. Italy has many of the characteristics that make Greece dysfunctional: widespread tax evasion, huge government debt, a political system based around patronage and an unhealthily dependent relationship with the EU. It is true that Italian industry has a strength that Greece cannot remotely replicate. But Italy's wobbling prime minister, Silvio Berlusconi, makes the departing Greek leader, George Papandreou, look like Lincoln.

Greece and Italy are not the only problems. Ireland and Portugal have already had to accept bail-outs – and may be destabilised anew by the latest crisis. Spain's vulnerability is clear. France has not balanced its budget since the 1970s and is fretting about its triple A rating.

Faced with these mounting problems, the "whatever it takes to save the euro" crowd are left advocating solutions that are less and less credible. If all goes to plan – after debt relief and further austerity – Greece will have reduced its debt to a mere 120 per cent of gross domestic product by the end of the decade. And that is the optimistic scenario. Meanwhile, despite the clear evidence that sovereign debt in Europe is risky, Italy will somehow persuade the markets to go back to lending to it at 2 per cent, rather than 6 per cent or more. In the meantime the European Central Bank will buy junk bonds from Italy without limit, for as long as it takes. None of this sounds credible.

On the political side, the long-term fix to the euro's malaise is said to be a fiscal union, a true political federation. But this is a solution that will take decades to implement, for a crisis that is escalating by the week. The final destination is, in any case, inherently implausible, given the lack of pan-European solidarity revealed by the current mess.

It is true that breaking up the euro would be fiendishly difficult and dangerous. Capital flight and debt default in countries quitting the euro could cause banks to collapse. Economic and political chaos might follow – at least for a time.

A new Italian government with a credible economic programme might just buy Europe some time. But given the euro's design flaws, the respite is likely to be brief.

Some argue the destruction of the single currency will destroy the EU itself. But such alarmism risks becoming a self-fulfilling prophecy. Key European achievements such as the single market, border-free travel and co-operation on foreign policy preceded the single currency and they can survive its demise. Rather than insisting that the break-up of the euro is unthinkable, Europe's leaders need to start planning for it.

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