

Live and Let Die

June 9, 2020

Memorandum for the Chancellor

Subject: Your Attendance at the Euromark Council

It is somewhat ironic that your meeting with the Euromark Council falls almost exactly 10 years after the European Union first agreed to a bailout package in an effort to stabilize Greece's then-massive debt. At that time, European leaders asserted that Europe has always moved forward through crisis—and this would be true again for the eurozone.

Instead, that decision—or rather, the weakness of it—appears to have been the catalyst which, given underlying trends, set in motion the chain of events that has brought us to the decision before the Euromark Council this weekend: whether to put the Reinfeldt Commission's recommendations for a new European Confederation up to individual member states for ratification. If approved, those states invited to ratify will remain part of a single market and currency zone; the rest will remain outside with loose political coordination among all. The practical effect will simply be to recognize the reality that has set in over the past several years: that the dream of a unified Europe that motivated an earlier generation will never be realized, and instead that the “euromark zone” will be recognized as the new core Europe. And within the euromark zone, Germany will continue to be an even more dominant player than it had been in the old eurozone.

It is worth retracing the steps that brought us to this point. When the eurozone crisis first hit ten years ago, the Lisbon Treaty had just been put into effect. Yet the centrifugal forces pulling Europe apart were already well at work.

Underlying Economic Factors

On the economic side, the most important of these was the interplay between globalization and demographics. In the preceding 50 years, Europe had built a social welfare model based on a large working population, with a globally competitive economic output, support-

ing a modest elderly population. Each of these foundations, however, had changed by the time of the eurozone crisis.

When women joined the workforce, Europe's working population continued to grow, even as total population growth stabilized and began to reverse. Once women were "in," however, the overall size of the working population itself began to decline, while improvements in health care meant that the size of the retired population continued to grow. This alone would have been enough to put pressure on state budgets as the costs of pensions and health care for the non-working population could not be borne by the size of the residual workforce.

But the rise of lower-cost, less regulated economies around the world meant that while the population was changing, jobs and productivity gradually migrated away from Europe as well, leaving this smaller European workforce without the income-generating possibilities needed to sustain this old economic model.

Immigration has done little to change this dynamic—and indeed Europe's failure to manage its immigration issues has been one of the key components of EU decline. As we have failed to create mechanisms to attract and retain high-skilled labor, Europe has become a magnet for the unskilled, which has only fueled political conflict and given rise to the populist movements that have entered parliaments all across the continent. And even though Europe feared that the revolutions sweeping the Arab world in 2011 and 2012 would generate a massive immigration from North Africa that would bring low-wage workers into a weak economy where there were already not enough jobs for the existing European workforce, in fact the opposite happened. As the "Arab Lion" economies took off, immigration dwindled and even some long-resident populations returned home, further depriving Europe of the influx of human talent it has needed. Although the United States, in its own chaotic way, managed to adapt through population growth, deregulation, and drastic reform of social programs, Europe was literally shrinking.

A further factor was the self-imposed cost of Europe's regulatory choices, most importantly in the energy sector. The year 2010—or perhaps a few years before—marked the beginning of the transformation of global energy markets. Prices of traditional fuels began to rise dramatically as newly developing economies used them to power eco-

conomic growth. Because they endured almost no costs on the back end by burning them “cleanly,” they were able to bid up prices on the front end, raising costs to all consumers.

Those developed nations that invested in market-competitive alternatives—nuclear power in China, Russia, India Brazil and (belatedly) the United States, shale gas in North America, etc.—were able to absorb the impact of the rising cost of traditional fuels. Much of Europe, unfortunately, was not.

The nuclear standards imposed by Europe—as the German price for continued French and central European development—meant that nuclear power was never the cheap alternative it could have been. The European ban on shale gas production after the 2014 Krakow disaster meant that Europe’s only access to natural gas was from Russia’s monopolistic and diminishing supply, or from LNG—in either case pushing the price of gas in Europe today to nearly 4 times global market levels. And finally, the European mandate on renewables has added as much as a further 35 percent to the cost of electricity production in Europe as compared with global markets.

The high costs of energy have had a significant effect on prices throughout the European economy, and in turn have led to a modest reversal of low external tariffs, as well as diminished European role as an innovation economy. It is simply faster, cheaper, and easier to develop new technologies and processes on the spot in places like India—where they can be brought from drawing board to mass-market in nearly a single and constant motion. European-owned capital, while still significant, invests, profits, and re-invests largely outside of European territory.

The Euro Collapse

It was these underlying factors, setting the conditions for fundamental financial unsustainability, that lay behind the eurozone collapse in 2013, and the continued weakness of the euromark and wider European economy today. Bailouts and austerity measures might have worked, had the underlying factors been favorable. But it became clear to markets, and eventually to European leaders, that no amount of bailout money or painful austerity measures could compensate for these underlying fundamentals.

The European social model had to be reworked—and it had to be applied differently across different member states based on their underlying economic fundamentals. While some could sustain a more generous system, most could not. Once the first debt restructuring was announced in Greece, the floodgates were open. The run on Greece led to the runs on Portugal and Spain. The other eurozone members saw the price of their debt skyrocket to unsustainable levels. What had previously been unthinkable—the dissolution of the eurozone—instead became the only means of self-preservation for the healthy and stressed economies alike. The new “euromark” in the north was all that could be salvaged—and that in turn became the foundation of the two-speed Europe that has since emerged.

As you know more than perhaps any other leader, even this euro-mark zone remains under long-term economic pressure. The competition from Asia, South Asia, the Middle East, and the Americas remains exceptionally tough, and structural realities within the euro-mark zone mean that fiscal and monetary policy options remain extremely limited. But at least the well-being of the population in this zone has remained somewhat stable, whereas much of the rest Europe has suffered steep declines in per capita income.

This new, northern Europe also rests more squarely on the shoulders of Germany than the EU as a whole ever did. Indeed, the EU at its origins was created as a way to constrain Germany. Today, German militarism is barely a historical memory, while Germany’s fiscal discipline, strong industries, and global trading relationships are more important than ever in sustaining the vitality of the euromark area. And while the euromark zone cannot financially prop up the governments of southern Europe, the underlying strength of the euromark economy has spillover effects that benefit the entire continent.

The southern European states have managed to stabilize currencies and government finances at lower levels of real wages and GDP per capita than had been the case in the old eurozone. While this is a decrease in prosperity on paper, and indeed in reality, it is less significant in practice than expected. The persistence of gray economies, seasonal tourist economies, small-scale agriculture, together with cultural and lifestyle differences with northern Europe have meant that

the “decline” in the south has been relatively modest, and the region’s economics are now more stable than before.

The euromark zone has also helped stabilize a more constructive relationship with Russia. Russia continues to suffer from its own problems—worse than the rest of Europe, with declining population, a long-term public health crisis, lack of robust economic diversification, internal ethnic and religious strife, and decaying infrastructure. Russia continues to be a major source of energy for the euromark zone, but the euromark zone itself now enjoys a diversity of supplies and a healthy balance sheet, meaning Russia is an economic partner, but has no capacity for mischief affecting Europe.

A Less Perfect Union

It is important to review these economic fundamentals from several years ago, because they led to the political changes that define the Europe we face today.

First among these was the rise of nationalist movements on the right in virtually every EU member state. Initially dismissed as fringe elements, these movements have now become the dominant political forces shaping every European state—much as the Social Democratic movements had done during the period of European construction starting in the 1960s. The difference, however, is that today’s movements mark a clear departure from the concept of European “solidarity” that had been championed for so many years. The dream of Europe was seen as an alternative to the dream of strength and prosperity, and publics opted for strength and prosperity at a national level instead.

The politics in each member state is now principally driven by the health of the nation: national well-being, national finances, religious and ethnic affirmation. Whereas the Lisbon Treaty has aimed to build a more integrated Europe through more empowered institutions, the unanticipated effect was that nationalist movements were able to use the new structures to tie central European institutions into knots while they advanced national agendas at home.

This is not to say that the concept of “Europe” has been fully removed from the vocabulary. Rather, it is the meaning of this concept to average Europeans that has changed fundamentally. Instead of a

concept that defines oneself, it is instead a concept that defines one's neighborhood. Whereas publics in an earlier era, thinking of themselves as "European," accepted costs, direction, identity, sacrifice—and expected benefits as well—from European Union institutions, publics today accept neither the costs nor the benefits beyond the national level. Europe is back to being a geographic concept, not a political one.

With such changed expectations, the de facto development of a two-speed Europe—the ten euromark countries in the north, and the remainder in the periphery—was only a natural extension. And indeed, seven years on, this loser Europe appears to be stable and even hopeful.

Cheap Security

Perhaps the one bit of good news is that no serious security threats appear to affect Europe. Violence and instability in the Middle East has been replaced with booming economies. Radical Islam has marginalized itself as a political force as Muslim reformers have shown publics a better life on this earth. The terrorism that hit its peak in the 2000's has retreated as a threat to Europe. Though nuclear weapons have spread to 17 nations, the likelihood of their use—and particularly use against any part of Europe—remains extremely low. Russia remains consumed by its internal disintegration. And the regional conflicts in which Europe was engaged a decade ago—Afghanistan, Libya, Syria—have long since ended.

All this means that Europe's maintenance of minimal national defense establishments—no more than a quarter percent of GDP—still carries little risk. While Europe is not able to mount substantial military operations, even for UN peacekeeping missions, the need to do so is also practically non-existent. The United States and South Asia continue to lead on global security matters. Europe is able to contribute to international "policing" operations where appropriate, and usually along its own periphery, but has long since given up the unnecessary ambition to lead truly international operations, or take part in more aggressive interventionist operations. Meetings at NATO's cavernous headquarters in Brussels, though embarrassing and anachronistic, are also largely irrelevant, especially since the United States has stopped attending at ministerial level. The United States

looks outside of Europe for dealing with hard security issues, and security issues internal to Europe are outside of NATO's purview.

As with much else, the real issues on security are dealt with at a national level—intelligence, police, cyber, borders. The widespread use of biometric scanners linked to detailed personal data profiles has allowed the euromark zone to maintain a single external border for its core continental members, while their use throughout the rest of Europe states adds to the security of Europe as a whole. All of this has come at far lower cost than the prior investment in high-end conventional military equipment, which was unaffordable in difficult economic times and went largely unused.

A Distant United States

The lack of any real security threats is also important because it means the growing U.S. distance from Europe is of little relevance. While Europe lurched from internal crisis to internal crisis, the United States grappled with its own internal crises. The United States, however, has re-emerged as a strong global political, economic and military player.

After coming to the brink of financial ruin in 2013—when in parallel with the euro's collapse, markets began dumping U.S. Treasury bonds—President Obama and the Republican-controlled Senate and House hammered out a massive restructuring of public finances that slashed social and defense spending and raised revenue through tax reform. At the same time, substantial industry de-regulation was introduced (especially in the energy sector, and at the expense of environmental and labor concerns) in an effort to lure economic activity back to the United States from outsourcing abroad.

Though extraordinarily painful for the first few years—resulting in the weakest showing of the Democratic Party since the Civil War in the 2016 elections—the U.S. economy began rebounding in 2017 and is now experiencing strong growth. The effect of a rebounding U.S. economy has tied it even more tightly to Asia, South Asia and Latin America, which are enjoying strong growth of their own.

In short, the Bush Administration's unilateralism and the Obama Administration's cool *insouciance* toward Europe were not aberrations,

but in fact harbingers of what is now a deeply embedded reorientation of the United States to the newly developed world. While the combined US-NATO-EU Summits were relegated to “one-per-Administration” events, APEC, U.S.-ASEAN, OAS, and bilateral U.S.-India, U.S.-China and U.S.-Brazil summits are now all at the top of the U.S. priority list. And as these relationships have matured, the contributions of newly developed countries to global peace and security have largely replaced those made by Europe in the last century.

The New Core Europe

All this brings us back to the subject of this weekend’s Euromark Council meeting. The 2015 Luxembourg summit took the first steps in cleaning up the debris of the eurozone collapse: amending the Lisbon Treaty, eliminating layers of accumulated Brussels bureaucracy, establishing coordination mechanisms between euromark and non-euromark European economies, and restoring national sovereignty over nearly all but pure Single-Market issues.

This weekend’s gathering will complete that task. It will seek to codify what has stabilized as a less ambitious but more sustainable European order. Gone are the dreams of Europe being a major global actor, of a single Union, an economic powerhouse able to use its strength to leverage soft power in the world. In its place is a diverse Europe with a Single Market, but with significant variance in economic performance, living standards, and external relations.

For the periphery, this has been a mixed bag. Ironically, in Greece, which was the catalyst of the eurozone collapse, day-to-day life has been only marginally affected. While there is little economic growth and wealth creation, and social spending has been slashed since its heyday in the 2000’s, the people remain close to agriculture, fishing, and family—and tourism has continued to bring cash into the economy. For Ireland, however, times have been exceptionally hard. In either case, however, it is clear that euromark citizens do not have the capacity to sustain the economies of the periphery.

And yet amid all this, the euromark zone, with its emphasis on economic centralism but political pluralism, has proven itself an effective model for a more modest core Europe. Stripping away the residual baggage of past structures will allow the euromark zone to reform—

tackling more deeply some of the economic fundamentals that caused the collapse of the old eurozone in the first place. If leaders seize this opportunity, it can give an outlook to more robust economic growth in the euromark zone in the future, which can become a driver of growth in the neighboring non-euromark areas.

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