The euro has become a zombie currency

Oliver Hartwich | The New Zealand Initiative | 21 January 2016

As we begin year seven of the euro crisis, observers may ask what all the fuss was about. Wasn't the euro supposed to collapse? Didn't many experts and commentators predict the demise of the common currency? And didn't the euro survive despite all such doomsaying?

Well, with apologies to Mark Twain, news of the euro's survival are greatly exaggerated.

Yes, there is still a currency circulating in Europe that calls itself the euro. In fact, its notes and coins look exactly as they did before the crisis. There is also the European Central Bank that issues euros, and all the treaties regarding the setup and operations of monetary union are also still in place.

And yet, today's euro is a fundamentally different currency from the one that entered the euro crisis in 2009. It is no longer the euro that promised to be a hard currency like the deutschmark, on which it was modeled. It is increasingly resembling much softer, southern European currencies. If you like, the "euro mark" has morphed into a "euro lira".

If you prefer fictional parallels, the euro has degenerated into a zombie currency. Its dead body is animated by political and monetary magic. But one thing is clear - what still looks like the euro has little to do with the currency as it was once designed.

To see the difference, you only need to go back to the debates of the 1990s, when Europe's political leaders negotiated the institutional framework of the monetary union. Back then, Germany had been blackmailed into giving up its deutschmark in favour of the euro. Otherwise, Germany would have never been allowed to reunify.

In the same way that Germany was forced into a monetary union its people did not really want, it tried to at least ensure that its own monetary culture would prevail. Thus the euro was designed as an almost exact replica of the deutschmark system.

There was supposed to be a central bank with the sole task of ensuring price stability. The independence of that central bank was meant to be sacrosanct. It was forbidden from repeating mistakes that Germany itself had made in the past, not least to become involved in financing government expenditure. Such policies had created two episodes of hyperinflation in Germany within half a century. Finally, within the system of the euro, no country would be liable for the debts of any other country.

All of these goals were not only solemnly proclaimed but enshrined in treaties. The Germans, old-fashioned as they were, put a lot of faith in such laws. Except, as they were to find out, not everybody else is as rule-obsessed as the Germans.

What we have all learned over the past six years is this - none of the rules, laws and provisions that were meant to govern the eurozone are worth the paper they are printed on. When push came to shove, every single rule could be bent, amended, ignored or broken.

The violations of the letter and the spirit of the laws governing the eurozone are manifold. Ironically, they started with Germany's own transgressions. When Germany ran a budget deficit exceeding the allowed limits in the early 2000s, they should have been fined. Instead, they got away with it. Ever since, the stability criteria prescribing debt and deficit rules have been missed over a hundred times by various European countries and not a single fine has been issued to date.

We have now become so used to the ways in which the euro's original rules have become obsolete, we hardly even think about them anymore. Individual governments have been bailed out on many occasions, starting with Greece. In fact, the original no-bailout clause has been turned on its head by the establishment of the European Stability Mechanism whose very purpose is to facilitate bail outs which were never meant to happen.

We have also witnessed how the European Central Bank has turned into a political actor. It no longer conducts itself as a central bank concerned with price stability. Instead, it has made the guarantee of the euro's very survival, the liquidity of eurozone governments and the stability of Europe's banking system its goals. Through its TARGET mechanism, the European Central Bank has also stepped in to allow persistent balance of payments imbalances. Where private capital is no longer willing to fund individual eurozone economies, this task has effectively been taken over by the central bank.

As we now know, not even that was enough to prop up these ailing economies. Over the past weeks, the European Central Bank was forced to admit it allowed national central banks to purchase bonds in order to support their own national governments. It still tries to downplay the significance of this so-called Agreement on Net Financial Assets (ANFA), officially maintaining that it happened fully within the ECB's mandate and under its control. Yet for something supposedly so straightforward, it is surprising how much effort the ECB undertook to keep it from the public's eye.

Bailing out governments, setting up rescue funds, directly financing balance of payment deficits, purchasing government debt, the pursuit of unconventional monetary policy such as quantitative easing, and injecting vast amounts of money into the banking system through long-term refinancing operations - none of these measures were envisaged when the euro project started. They would have been considered incompatible with the kind of currency the euro was meant to be.

After so many years of the euro crisis, we have witnessed all of the above. And yet, we still have a currency that is called the euro. But the name is about the only thing that is left of the currency as it was initially conceived.

To everyone who asks why the euro has not collapsed yet, the answer must be - But it has!

All that is left of it is a currency that bears the same name but that has none of its original features. It is a zombie currency, an undead monetary system pretending to survive, a true European horror story.

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