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‘Crash of the Bumblebee’: on the Euro

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Last week Mario Draghi, the president of the European Central Bank, declared that his institution “is ready to do whatever it takes to preserve the euro” — and markets celebrated. In particular, interest rates on Spanish bonds fell sharply, and stock markets soared everywhere.

But will the euro really be saved? That remains very much in doubt.

First of all, Europe’s single currency is a deeply flawed construction. And Mr. Draghi, to his credit, actually acknowledged that. “The euro is like a bumblebee,” he declared. “This is a mystery of nature because it shouldn’t fly but instead it does. So the euro was a bumblebee that flew very well for several years.” But now it has stopped flying. What can be done? The answer, he suggested, is “to graduate to a real bee.”

Never mind the dubious biology, we get the point. In the long run, the euro will be workable only if the European Union becomes much more like a unified country.

Consider, for example, the comparison between Spain and Florida. Both had huge housing bubbles followed by dramatic crashes. But Spain is in crisis in a way Florida isn’t. Why? Because when the slump hit, Florida could count on Washington to keep paying for Social Security and Medicare, to guarantee the solvency of its banks, to provide emergency aid to its unemployed, and more. Spain had no such safety net, and in the long run, that has to be fixed.

But the creation of a United States of Europe won’t happen soon, if ever, while the crisis of the euro is now. So what can be done to save the currency?

Well, why was the bumblebee able to fly for a while? Why did the euro seem to work for its first eight or so years? Because the structure’s flaws were papered over by a boom in southern Europe. The creation of the euro convinced investors that it was safe to lend to countries like Greece and Spain that had previously been considered risky, so money poured into these countries — mainly, by the way, to finance private rather than public borrowing, with Greece the exception.

And for a while everyone was happy. In southern Europe, huge housing bubbles led to a surge in construction employment, even as manufacturing became increasingly uncompetitive. Meanwhile, the German economy, which had been languishing, perked up thanks to rapidly rising exports to those bubble economies in the south. The euro, it seemed, was working.

Then the bubbles burst. The construction jobs vanished, and unemployment in the south soared; it’s now well above 20 percent in both Spain and Greece. At the same time, revenues plunged; for the most part, big budget deficits are a result, not a cause, of the crisis. Nonetheless, investors took flight, driving up borrowing costs. In an attempt to soothe the financial markets, the afflicted countries imposed harsh austerity measures that deepened their slumps. And the euro as a whole is looking dangerously shaky.

What could turn this dangerous situation around? The answer is fairly clear: policy makers would have to (a) do something to bring southern Europe’s borrowing costs down and (b) give Europe’s debtors the same kind of opportunity to export their way out of trouble that Germany received during the good years — that is, create a boom in Germany that mirrors the boom in southern Europe between 1999 and 2007. (And yes, that would mean a temporary rise in German inflation.) The trouble is that Europe’s policy makers seem reluctant to do (a) and completely unwilling to do (b).

In his remarks, Mr. Draghi — who I suspect understands all of this — basically floated the idea of having the central bank buy lots of southern European bonds to bring those borrowing costs down. But over the next two days German officials appeared to throw cold water on that idea. In principle, Mr. Draghi could just overrule German objections, but would he really be willing to do that?

And bond purchases are the easy part. The euro can't be saved unless Germany is also willing to accept substantially higher inflation over the next few years — and so far I have seen no sign that German officials are even willing to discuss this issue, let alone accept what's necessary. Instead, they're still insisting, despite failure after failure — remember when Ireland was supposedly on the road to rapid recovery? — that everything will be fine if debtors just stick to their austerity programs.

So could the euro be saved? Yes, probably. Should it be saved? Yes, even though its creation now looks like a huge mistake. For failure of the euro wouldn't just cause economic disruption; it would be a giant blow to the wider European project, which has brought peace and democracy to a continent with a tragic history.

But will it actually be saved? Despite Mr. Draghi's show of determination, that is, as I said, very much in doubt.