

CHAPTER 3: The Euro at 25: Looking back – Facing forward

The introduction of the single currency in the mid-1990s was one of the most important, if not the most important, events in the process of European integration. However, the political economy of the Euro, as the single currency became known, has been a stumbling block in the integrative process it is supposed to encourage. This is because primacy was given to fiscal austerity and supply-side economics. Given that monetary policy was assigned to the European Central Bank, i.e. fully centralised, the member states were deprived of an important policy tool, especially at a time of crisis.

The inadequacy of the institutional framework of the Euro, and of the Stability and Growth Pact, has indeed been revealed in every crisis during the past 25 years. The EU's response has been to make it even more complicated and detrimental to the needs of the European economy and society. The latest revision of the SGP, started in 2020 and concluded in 2024 - with a gap of three years (2020-2023) during which it was suspended - does not augur well. In spite of certain qualitative changes, the emphasis on fiscal austerity is ever present, while the urgent need for public investment to deal with the great challenges of the present time has not been accommodated.

In this chapter, we take a look back at the 25 years of existence of the Euro, the theoretical model on which it is based and its limits, its economic and social implications. We then extend our view over the next 25 years, discussing current issues and unfolding challenges and imagining the Euro in 2050. In doing so, we extend past experience into the future, assuming no major changes. The outcome is likely to accord with scenario 1 (S1) in the previous chapter, wherein disintegrative tendencies predominate. Not even when security and strategic challenges turn out as defined by EU establishment itself (requiring a response in accordance with S2 in the previous chapter), is the framework likely to prove adequate.

3.1. The Euro at 25 – Looking back

The policy model on which the European Union was built on represents the most faithful implementation of the theoretical conclusions reached by mainstream economics, according to which the free operation of market forces enables steady growth, internal convergence, and sound public accounts. There is a strong belief that the economic system has an auto-stabilizing nature, i.e. gross domestic product and unemployment fluctuate around their long-run value, which is assumed to be independent from active fiscal and monetary policies. The common institutions created to manage the monetary union reflect these beliefs: a central bank with the only explicit objective of price stability and a fiscal policy left to the management of individual states within a rigid budgetary discipline. In short, public action is downgraded to the role of

external shock¹, whose expansion is considered to be responsible of the reduction of private activity (crowding-out effects). In short, the basic idea is that - in accordance with the neoliberal paradigm - the construction of a common market, free from constraints with free capital mobility, labour market flexibility and government intervention reduced to a minimum, would have created a zone of shared prosperity and guaranteed growth for all the countries involved.

This model showed its limits in practice when faced with the multiple crises that occurred in the European Monetary Union. It highlighted the greater fragility of some countries in respect to others and made it clear that the economic policy structure was unbalanced in design and unable to cope with systemic shocks: unbalanced with respect to some countries and also with respect to the role of monetary policy to which inflation stabilization functions are assigned to the monetary union as a whole.²

In the 2008 financial crisis - as is well known and has been widely documented in previous Euromemo reports - this structure of economic policy brought to light what had remained below the surface, the division of the Eurozone into two major blocks. One, composed of the northern countries, with 'sound' public finances and very low or even negative debt refinancing rates - and another, with high levels of debt, which instead has difficulties in managing their public accounts.

These differences were partially narrowed in subsequent years by the European Central Bank which, starting with the Draghi mandate, launched a massive purchase of government bonds in the secondary market, reducing the difference in yields within the Eurozone. This change in strategy, despite being useful to save the single currency, was not enough to smooth out the differences in growth - as they were accompanied by restrictive fiscal policy measures for those countries with 'unsound' fiscal positions (the Fiscal Compact). Differences across the Eurozone countries did not disappear but rather evolved into a sort of balance of payment crisis, despite little increase in interest rates differentials. Therefore, asymmetries did not disappear, but rather fuelled capital flight toward 'more reliable' countries.

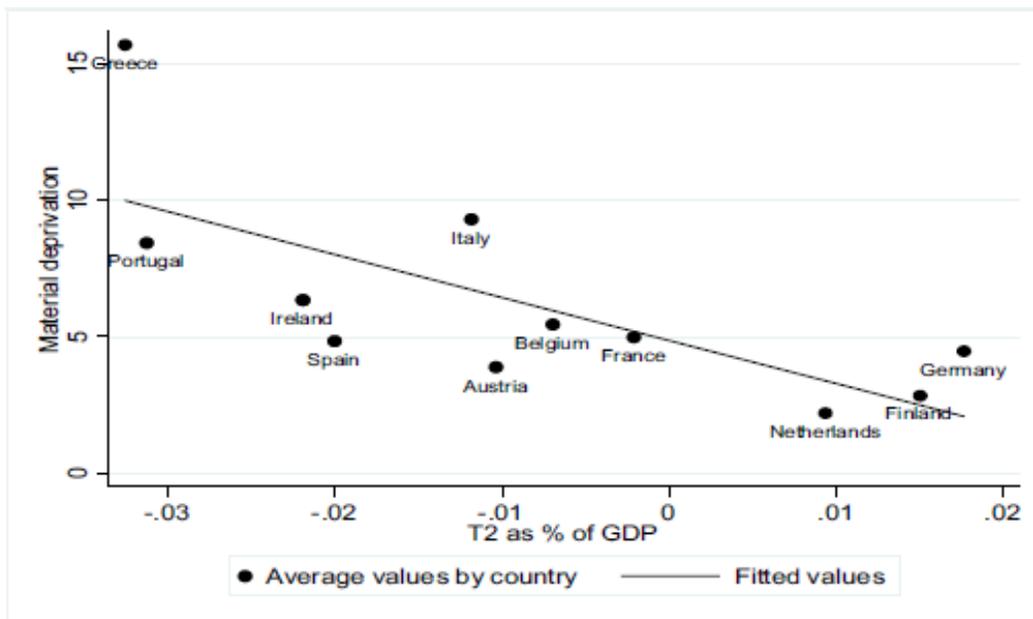
This is shown in the evolution of TARGET balances, the centralised payment system operated by Euro Area central banks to provide payment and settlement services for intra-Euro Area countries transactions. As the Eurozone is an irrevocable

¹ Bini Smaghi, L. (2011, September). *Regole e istituzioni di politica economica in tempi di crisi*. Rome: Forum for EU-US Legal-Economic Affairs.
<https://www.ecb.europa.eu/press/key/date/2011/html/sp110915.it.html>;
<http://www.ecb.int/press/key/date/2011/html/sp110915.it.htm>.

² De Grauwe, P. (2013). Design failures in the Eurozone: Can they be fixed? *LSE 'Europe in Question'*. Discussion Paper No. 57. London School of Economics, London.

fixed exchange rate regime, the presence of imbalances can be interpreted as deficit or surplus positions in the balance of payments, signalling the difference in investors' trust in each single country. However, TARGET positions affect financing conditions both for private and public bodies, therefore affecting growth and social conditions. TARGET balances are negatively correlated with absolute poverty (material deprivation) showing that the Eurozone has been experiencing, starting from 2008 a hidden balance of payment crisis affecting both growth and social conditions. This insight supports the interpretation that asymmetries were not solved by the ECB easy monetary policy, but instead were consolidated in the absence of other measures supporting growth, and calls into question therefore the role of competition and the common market in ensuring convergence (Figure 3.1).³

Figure 3.1.: Material deprivation and external imbalances in selected EZ countries (2008-2019)



Source: Canale, R. R. & Liotti, G. (2022). Target2 imbalances and poverty in the eurozone. *Journal of Evolutionary Economics*, 32(5), pp. 1395-1417. <https://doi.org/10.1007/s00191-022-00797-0>

³ Giordano, M. (2025) Monetary Subordination in the Eurozone: Fragmentation and Tiering of Markets and Institutions, Ph.D thesis, Department of Economics, School of African and Oriental Studies (SOAS), university of London.

The arrival of the pandemic in 2020 seemed to be an opportunity to change direction. The need to manage the health crisis and the systemic economic shock resulted in the State and fiscal policy once again being given a central role.

The SGP and the Fiscal Compact were suspended. The European Central Bank, under the new leadership of Christine Lagarde, extended, the government bond purchases with the PEPP (Pandemic Emergency Purchase Programme), without taking into account the rating and accepting a very wide range of collateral. But above all, the Next Generation EU was born, an important step towards a common economic policy strategy. This is financed through the issuance of bonds by the European Commission and was designed to finance public investments in individual countries aimed at reducing territorial gaps in infrastructure, promoting the digital transition and supporting the transformation of the production structure in the direction of environmental sustainability.

However, the end of the pandemic and especially the war in Ukraine changed the prospects once again. The rise in inflation (mainly due to shocks in the energy markets and production bottlenecks caused by the war) pushed the central bank to put price growth again at the centre of its strategy: interest rates increased (from levels close to zero in the first half of 2022 to 4.5percent in the first half of 2024) and the government bond purchase programme is not being renewed upon expiry (i.e. quantitative tightening). The deficit and debt of individual states are to be controlled once again with the putting back into force of the SGP, this time as a 'new' SGP. From the nature of the preliminary discussions, a new path seemed possible, but the result was again fiscal austerity. The new features are, firstly, that the focus is on the total deficit rather than on the concept of a structural deficit (not very transparent and referred to as a predefined potential output), and, secondly, that the lengthening of the debt adjustment path can reach up to seven years. In the face of these modest innovations, discretionary powers are granted to the European Commission, and there is no golden rule that excludes public investments from adjustment plans, nor are exceptions foreseen for expenses related to the green transition or especially to public healthcare, which had been so fragile during the pandemic period. In this context the Next Generation EU plan is just a drop in the ocean and will turn into new sovereign debt in the years to come. At the same time, as explained in chapter 1, the geopolitical situation makes it uncertain whether the reformed SGP will survive for much more than a year as 'Readiness 2030' is already invoking, once again, the General Escape Clause.

Austerity policies reveal a short-sighted vision regarding the strategic positioning of the Eurozone. The policies of price containment and fiscal austerity gave a huge competitive advantage to Germany in the past. Its current account surpluses,

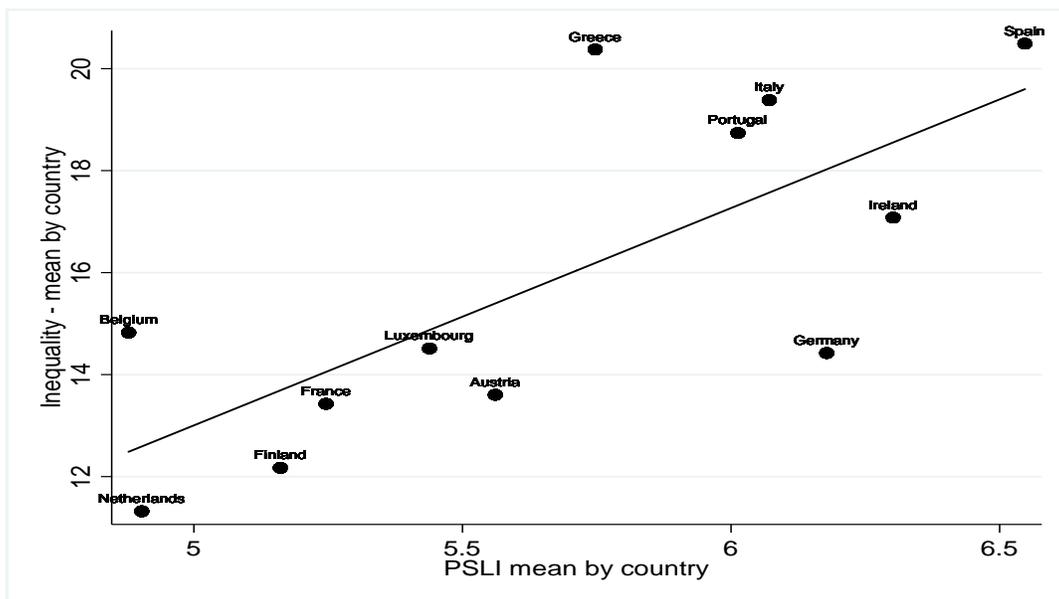
accompanied by capital inflows from the countries on the periphery of the Eurozone, gave Germany a competitive advantage in terms of the Euro exchange rate and represented a vehicle for economic connections with Asia (Russia, China, India) that in present times cannot be repeated. The war in Ukraine and the most recent conflict in the Middle East are facilitating the return to dollar-denominated investments. Large companies, rather than investing in Europe, where the war produces instability and increases in production costs, prefer to move towards 'safe havens'. In addition, not only the emerging tariff policy of Trump, but also measures taken by the previous US government to attract capital from abroad (in the form of the IRA, the Inflation Reduction Act) provides support to foreign companies that invest in the US (provided that they remain in the country for a long time) shifting the centre of gravity back towards the US. The effects of wars on the cost of energy have done the rest. In the context of these dynamics, Europe followed the usual policy strategy: persisting with austerity policies and the absence of a common industrial policy up to now. It has allowed the United States to reorganize itself, while renouncing the EU's potential role as mediator in global conflicts. Germany, which until a few years ago was the driving force, is now the sick man of Europe. Even Italy, a long-time US ally in the Mediterranean, has become an instrument of political and economic weakening of the Eurozone.

What is completely missing within the Eurozone is a mechanism for correcting asymmetries that in the end dragged the whole Europe into decline. Now differences in long-term interest rates are negligible and TARGET imbalances are also reducing. But it is a signal of convergence toward a downward path. The absence of shared fiscal policy choices, capable of giving a boost to the common growth project realized in a sustainable manner through innovation and capital accumulation, threatens the existence of the Eurozone and prefigures the end of the European political project. European institutions sense the danger of decline. The programmatic declarations of the president of the incoming Commission, Ursula von der Leyen, identify the objectives – environmental sustainability, digital transformation, innovation, etc. – but continue to insist on the same instrument: more competitiveness for the European single market, occasionally assisted by a European budget designed to be always balanced.⁴

⁴ European Commission (EU). (2024, July). *Political Guidelines 2024-2029*. https://commission.europa.eu/document/e6cd4328-673c-4e7a-8683-f63ffb2cf648_en

Enlightening in this sense is the Letta report⁵ whose title is ‘Much more than a market’ in which a ‘fifth freedom’ based on access and sharing is evoked to enhance research, innovation and education by neoliberal means. More competitiveness and less bureaucracy in these fields are supposed to generate a reduction of poverty and inequality. However, from studying the effects of the liberalizations in the public sector in the years preceding the pandemic (derived from the dimension of public expenditure and inequality measured as the percentage of people living with an income below the threshold of 60 percent equivalized disposable income) results seem to indicate a different outcome in practice.

Figure 3.2: Public Sector Liberalization Index (PSLI) and inequality in the Eurozone (2000-2019)



Source: Own elaboration on Eurostat and Fraser Institute data

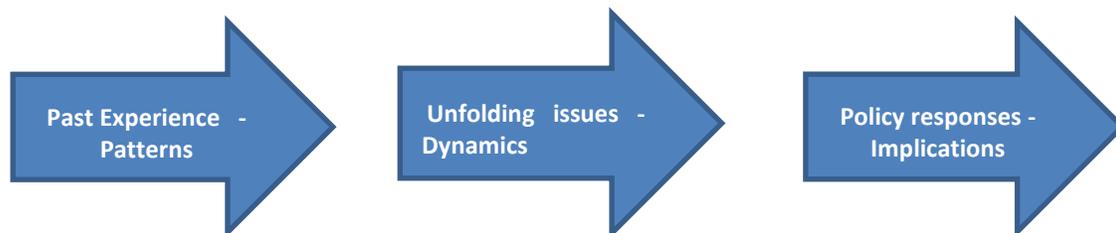
The Draghi Report would seem to be a small step forward in this context. It calls for a European investment programme, financed by common debt, for a coordinated industrial policy supported at the European level. However, it still relies on financialisation, deregulation and competition and on international capital markets to

⁵ European Commission (EU). (2024, April). *Enrico Letta's Report on the Future of the Single Market*. https://single-market-economy.ec.europa.eu/news/enrico-lettas-report-future-single-market-2024-04-10_en

finance the expenditure, creating a source of potential instability. It identifies strategic investments in armaments (despite its limited potential -see chapter 1-) as the way to support the process of technological innovation (dual use of technology) and reindustrialization of the European continent, too long devoted to low value-added manufacturing production. 'What remains is a supply-side agenda based on financialisation, deregulation and liberalisation, coupled with a more aggressive (though illusory) approach to international economic relations' that fails to respond to the challenges posed by the changing international equilibria.⁶

3.2. The Euro at 25 – Facing forward

Constructing scenarios of possible futures is partly an extrapolation of the present and partly a detection of unfolding issues and trends to come. Our imagining of the Euro in the middle of the 21st century, that is twenty-five years from now, follows such a methodological approach. More specifically, we draw on past experience of macroeconomic policy patterns, focus on the most salient issues and unfolding trends of the present time and discuss possible future policy responses. This is about the current and long-term challenges the EU is facing and the way it deals with them. In such an approach, the single currency acts as an enabler while it is also subject to the implications of such policy choices.



Past experience – Policy patterns - As shown in the previous section, the Euro has had a chequered history in its first twenty-five years of existence. Following the inception of its fiscal framework, the SGP, in the mid-1990s, this was revised twice (2005 and 2011-2013), suspended for three years (2020 to 2023) and revised for the third time at its reactivation (2024).

The economic basis of the SGP was rightfully critiqued as arbitrary and unsound both theoretically and empirically from the start. Luigi Pasinetti, one of its strongest

⁶ Raza, W., Ertl, M. & Soder, M. (2024, September). *Draghi on 'competitiveness': new wine in an old bottle*. Social Europe. <https://www.socialeurope.eu/draghi-on-competitiveness-new-wine-in-an-old-bottle>

critics, considered the fiscal benchmarks of the SGP, and especially the 3 percent limit on the public deficit, as either a 'myth' or a 'folly'.⁷

The 2005 revision introduced cyclical elements into the SGP, which had already been violated by Germany and France, amongst others, following the dot.com bubble of the late 1990s. The 2011-2013 revision tightened the fiscal rules, purportedly to deal with the 'moral hazard' risk of the sovereign debt crisis and the fiscally 'lax' EU Southern periphery. The Covid-19 pandemic, which hit the EU symmetrically and severely, led to the suspension of the SGP in 2020. The fiscal rules were revised and reactivated in 2024. The revised SGP has drawn on some of the lessons of the pandemic, although it has not diverged from the main policy elements of the past, nor the political economy on which these are based.

Given the experience of the past 25 years and assuming that the currently predominant economic paradigm and balance of socio-political forces continue to prevail, a full EU fiscal union looks unlikely, while the pattern of ad hoc policy measures at times of crisis will repeat itself. This reveals a certain flexibility on the part of policy makers, on the one hand, as well as the persistence of the main elements of an inadequate, indeed irrelevant model, on the other. Such a model has served the interests of the dominant EU financial elites and political class until now. Going forward, its sustainability will come under strain, given the multiple challenges the EU is faced with.

A similar dominance of constraining concepts and policies can be seen in the setting up of the monetary policy framework of the Euro. The European Central Bank was set up along the lines of the Bundesbank. Indeed, its mandate is even narrower than that of its prototype, focusing on price stability almost to the exclusion of other policy goals.

According to its 2021 Strategy Statement, 'The Governing Council considers that price stability is best maintained by aiming for 2 percent inflation over the medium term'⁸. However, as Pollin and Bouazza have argued, 'no serious body of research has been produced that provides a clear justification for a 2-3 percent inflation target as the central goal of macroeconomic policy. Further, if the objective is to facilitate economic growth, there is no body of evidence showing that economies at any level of

⁷ For a discussion of the Pasinetti critique, see Marica Frangakis (2024). Pasinetti and the EU Fiscal Governance Framework: A Debate That Will Not Go Away. *International Journal of Political Economy*, 53 (3), pp. 235-251.

⁸European Central Bank (2021). *The ECB's monetary policy strategy statement*. https://www.ecb.europa.eu/home/search/review/html/ecb.strategyreview_monpol_strategy_statement_en.html

development consistently experience stronger economic growth outcomes when inflation is maintained at less than 3 percent as opposed to higher inflation rates, certainly within a 4-5 percent range⁹.

In the course of the various crises in its twenty-five years of existence, the ECB has occasionally adapted to the needs of the hour. However, its basic construction remains unchanged.

Overall, confidence is a requirement of any currency, much more so of one that is used by 20 of the 27 EU member states and by about 350 million people. It is confidence against the risk of depreciation and inconvertibility that makes a currency a 'safe' asset, one that can serve as a unit of account, a means of exchange and a store of wealth. The euro has shown resilience so far, one that has come at a high social and environmental cost.

For example, at the height of the Euro crisis, the path that was chosen for Greece, in the epicentre of the crisis, was one of internal devaluation, the imprint of which is still evident in the Greek economy and society. In view of the mounting challenges ahead, continuing along the same path does not guarantee the euro's future, nor does it support the urgently needed socio-ecological transformation of the EU.

Unfolding challenges - Policy responses. The European economy is at a critical juncture. Issues such as climate change, shifts in geopolitics and advances in technology give rise to wide-ranging economic, social and political dynamics. Although the future appears uncertain and volatile, certain trends may be discerned. We shall look into the current state of affairs, the EU policy response, the role of the Euro and the policy implications for its future in each of the above areas. It should be stressed that this list of unfolding issues is in no way exhaustive. However, it includes areas of critical importance. The way macro policy is going to respond to the emerging challenges is going to be crucial for the future of the Euro and, even more broadly, of European integration.

Climate change. According to the European Environment Agency, 'Global mean temperature between 2013 and 2023 was 1.19° to 1.22°C warmer than the pre-industrial level (1850-1900), which makes it the warmest decade on record. European land temperatures have increased even faster over the same period by 2.12 to 2.19°C, depending on the dataset used. The UN Framework Convention on Climate Change (UNFCCC) member countries have committed to limiting global temperature increase to well below 2°C above the pre-industrial level and aim to limit the increase to 1.5°C

⁹ Pollin R. & H. Bouazza (2024). Considerations on inflation, economic growth and the 2 per cent inflation target. *Review of Keynesian Economics*, Vol. 12 (4), pp. 453-474

under the Paris Agreement. Without drastic cuts in global greenhouse gas emissions, the 2°C limit will already be exceeded before 2050.¹⁰ The election of Donald Trump to the Presidency of the USA strongly supports the view that there will be a regression in the area of climate change. This will impact Europe and indeed the world as a whole most negatively.

The 1.5°C threshold has become a rallying point. At just 1.2°C of warming, millions of people have experienced devastating extreme weather. With every fraction of a degree of warming from the burning of fossil fuels, heatwaves, fires, heavy rainfall and drought will become more intense and more likely.

Under the 2021 European Climate Law¹¹, the EU is going to establish a binding climate target of a 90 percent emissions reduction (compared to 1990 levels) for 2040, as an intermediate goal between the 2030 target of a 55 percent emissions reduction (over 1990) and the goal of net-zero emissions by 2050.

In contrast to the EU's climate ambitions, the latest Climate Action Progress Report notes that 'Overall, progress towards the EU climate targets appears insufficient. Action is most needed in areas where significant emission reductions are still required and where progress has been lacking'.¹² Furthermore, the 2040 target has met with resistance from the business world. For example, the German Chamber of Commerce and Industry (DIHK) and Association of Municipal Companies (VKU) strongly oppose the 2040 climate target.

Failing to attain the climate policy goals carries social and economic repercussions. These are primarily related to health risks. According to the International Disaster Database, heat-related mortality has increased by around 30 percent in the past 20 years and heat-related deaths are estimated to have increased in 94 percent of the European regions monitored¹³. In 2023 alone, 63 lives were lost due to storms, 44 to floods and 44 to wildfires in Europe. Further, weather- and climate-related extremes

¹⁰ European Environment Agency (2024, June). *Global and European temperatures*. <https://www.eea.europa.eu/en/analysis/indicators/global-and-european-temperatures?activeAccordion=ecdb3bcf-bbe9-4978-b5cf-0b136399d9f8>

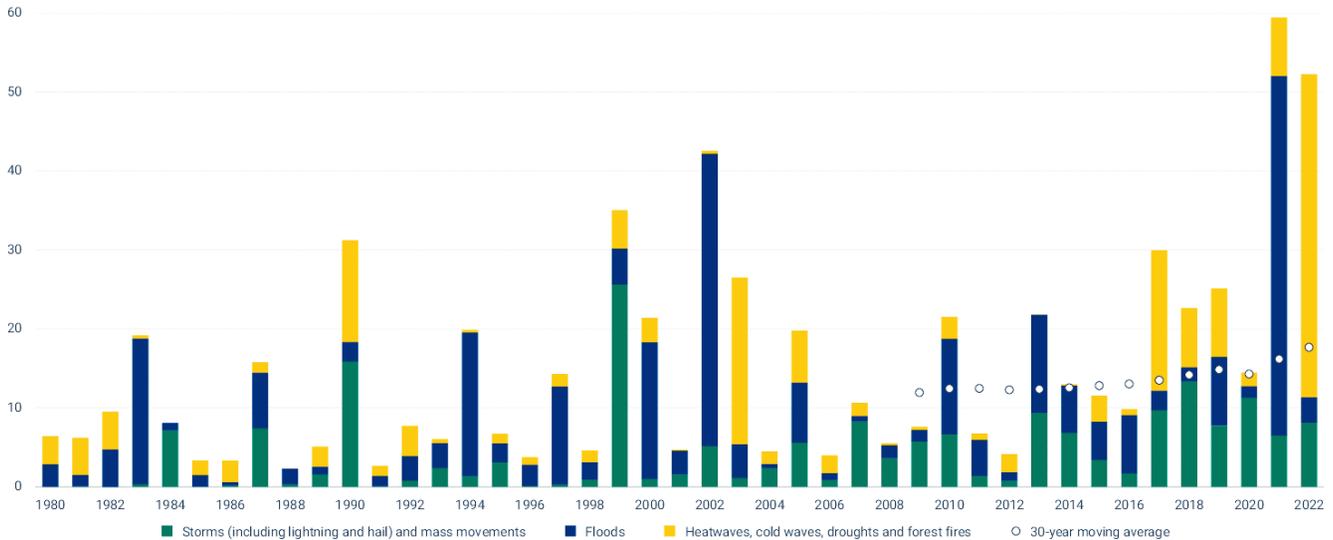
¹¹ Regulation (EU) 2021/1119 on establishing the framework for achieving climate neutrality and amending Regulations (EC) No 401/2009 and (EU) 2018/1999 ('European Climate Law')

¹² European Commission (2023). *Climate Action Progress Report*. https://climate.ec.europa.eu/news-your-voice/news/climate-action-progress-report-2023-2023-10-24_en

¹³ Copernicus Climate Change Service (2024, April). *European State of the Climate Report 2023*. <https://climate.copernicus.eu/widespread-floods-severe-heatwaves-esotc-2023-puts-europes-climate-focus>

caused economic losses of assets estimated at EUR 738 billion during 1980 - 2023 in the European Union, with over EUR 162 billion (22 percent) between 2021 and 2023.

Figure 3.3: Annual economic losses caused by weather and climate-related extreme events in EU Member States (EUR billion in 2022 prices)



Source: European Environment Agency. (2024, November). *Annual economic losses caused by weather- and climate-related extreme events in the EU Member States.* <https://www.eea.europa.eu/en/analysis/indicators/economic-losses-from-climate-related/annual-economic-losses-caused?activeTab=265e2bee-7de3-46e8-b6ee-76005f3f434f>

Those who suffer most from extreme weather conditions are those who are least able to protect themselves from the impact. These people are mostly the poorest and most marginalised in societies, the homeless or living in informal housing, people with disabilities or underlying health issues and outdoor workers. Climate change is thus deepening inequality.

Heussaff et al. delineate four risks that threaten the EU’s climate policies. These include (i) geopolitical instability, endangering the massive capital investment needed for the transition; (ii) technological progress, a primary determinant of the economic viability of decarbonisation; (iii) exacerbated inequality, which must be guarded against;

and (iv) policy credibility, signified by a concrete commitment to the established climate policy pillars.¹⁴

Climate change is the most important unfolding trend. The EU macro-economic governance framework is out of sync with the needs of climate change policy. The fiscal restraints imposed by the new version of the SGP and the ECB's limited micro approach to climate-related financial risks do not provide the necessary tools to deal with the climate transition.

In the long run, this will weaken the Euro internationally, while it also undermines trust in the integration process by the European citizens. According to the Eurobarometer, 42 percent of the respondents to its July 2024 survey consider 'climate change and environmental issues' as the second most important global challenge for the future of the EU, the first being 'conflicts in the world' selected by 44 percent of the respondents.¹⁵

Overall, to the extent that no major transformation of the EU macro policy takes place, hence impeding the climate change policy from taking full effect, the long-term implications for the Euro are negative.

Geopolitical tensions. These have been building up over time, picking up after the end of the Cold War in the late 1980s and the emergence of a unipolar world based on USA dominance. The key driver challenging the US-led international order is the growing power of China and the emergence of a US-China hegemonic rivalry, giving rise to tensions of economic nationalism. Further, the emerging multipolar world includes the EU, regional powers, such as Russia and India, and niche powers, such as Saudi Arabia. Such a complex multipolarity bears an increasing potential for conflict. For example, Russia's invasion in Ukraine and Israel's war of aggression in the Middle East are connected and adding to geopolitical tensions. Against such multipolarity, the 'Make America Great Again' dogma of the new US President, Donald Trump, introduces further complications and heightened antagonism, as well as a marked shift to populist, ultra right-wing politics. As the Euro is subordinated to the Dollar hegemony, the capacity of the EU to develop any meaningful strategic autonomy to deal with these tensions, is severely limited.

¹⁴ Heussaff, C., Emmerling, J., Luderer, G., Pietzcker, R., Reissl, S., Rodrigues, R. & Way, R. (2024, October). *Europe's 2040 climate target: four critical risks and how to manage them*. BRUGEL. Policy Brief 23/2024. <https://www.bruegel.org/policy-brief/europes-2040-climate-target-four-critical-risks-and-how-manage-them>

¹⁵ European Commission (2024, June-July). *Flash Eurobarometer 550 2024, EU challenges and priorities*. chrome-extension://efaidnbmnnnibpcajpcglclefindmkaj/https://www.ipsos.com/sites/default/files/2024-09/EU%20challenges%20and%20priorities%20FL550_summary_en.pdf

Overall, globalization is in transition. Competition for resources, technology and influence will intensify geopolitical tensions. The relationship between old and new powers will determine future global governance. As Qureshi and Jeong point out, ‘Future patterns of globalization will depend crucially on how countries manage the changing international power dynamics’¹⁶. What is the position of the EU in the new dynamics and how will this shape the future of its economy and society? What are the implications for the Euro itself? In probing the above questions, it is worth noting the position of the EU compared to the USA, the present superpower, and China, the ascending one.

The table below presents some pertinent data in this respect. In particular, in 2024 the population of the EU was larger than that of the US by 33 percent, although it amounted to only 32 percent of that of China. By contrast, its share of world GDP was smaller than that of both the US and of China, while its rate of growth was also significantly lower and unemployment higher. The EU’s current account balance was, like China’s, positive, although relatively greater in relation to GDP, while the US is running a current account deficit. Last but not least, the EU appears to be pursuing a tighter fiscal policy than the US or China.

Table 3.1: Basic indicators USA, China and EU, 2024

	Real GDP growth (percent)	Share of world GDP (percent)	Population (millions)	Unemployment rate (Percent labour force)	Current Account (Percent GDP)	Public Deficit (Percent GDP)	Public Debt (Percent GDP)
USA	2.8	14.99	336.81	4.1	-3.3	7.6	121
China	4.8	19.05	1,410.80	5.1	+1.4	7.4	90.1
EU	1.1	14.41	447.57	6.4	+3.3	3.1	82.7

Source: IMF, 2024¹⁷

¹⁶ Qureshi, Z., & Jeong, D. (Eds.). (2024). *New global dynamics: Managing economic change in a transforming world*. [Brookings Institution Press](#).

¹⁷ IMF. (2024). United States. [Data Set]. <https://www.imf.org/external/datamapper/profile/USA>

Thus, the EU appears to be a middling power, its economy tied to the fate of the rest of the world buying its goods and services, intent on fiscal austerity, even at the cost of its potential place in the international order.

Every five years, EU leaders agree on the EU's political priorities for the future in the context of the European Parliament elections. The Strategic Agenda 2024-2029 of the European Council was adopted on 27 June 2024.¹⁸ It sets forth three priorities as follows: (i) a 'free and democratic' Europe; (ii) a 'strong and secure' Europe and (iii) a 'prosperous and competitive' Europe.

A spate of EU officially commissioned reports have appeared, dealing with aspects of the EU's place in the world:

- As discussed in detail in chapter 2, the Draghi report: 'The Future of European Competitiveness: A Competitiveness Strategy for Europe', published in September 2024
- The Letta report: 'Much more than a (single) market', published in April 2024
- The Niinistö report: 'Strengthening Europe's civilian and military preparedness and readiness', published in October 2024

Certain common themes run through the three reports, echoing the priorities set by the Strategic Agenda. Namely, reducing 'regulatory burden' for businesses in the name of 'better regulation', enhancing competitiveness without considering its broader distributional aspects, focusing on security and the single market as drivers of integration, relaxing the state aid rules so as to support the creation of industrial 'champions', proposing large sums of public investment in support of industry, including the military industry, promoting financial integration via the creation of a Capital Markets Union.

What is missing from these reports is the inherent policy incoherence of the EU, i.e., the fact that the recently revised EU fiscal governance framework sets strict limits to public spending. Although the possibility of increased military spending is taken into account in relation to the Excessive Deficit Procedure, there is no 'golden rule' in

IMF. (2024). China, People's Republic of [Data Set]. <https://www.imf.org/external/datamapper/profile/CHN>

IMF. (2024). European Union. [Data Set]. <https://www.imf.org/external/datamapper/profile/EU>

¹⁸ European Council (2024, June). *Strategic agenda 2024-2029*. <https://www.consilium.europa.eu/en/european-council/strategic-agenda-2024-2029/>

relation to the public investment needed in other areas, such as climate change, health, research and development, digital transition, etc.

Furthermore, the EU budget has remained at 1 percent of EU GDP since the end of the 1980s (about €160 billion to €180 billion annually). Hence, the Capital Markets Union (CMU) is presented as the solution to the problem. However, a high level of financial integration has already been achieved in the EU since the late 1990s. Also, the creation of a CMU presents regulatory problems as pointed out by the chiefs of ESMA and of EIOPA.¹⁹

Awarding the EU a Central Fiscal Capacity to be financed by Common Borrowing would provide both a means of financing the ambitious investment plans set out by the three above reports and create a safe asset supporting the EU's financial resilience and stability. Indeed, the EU investment needs stressed by the Draghi report and the fact that part of these will have to be publicly financed point in this direction.

In a global framework of mounting tensions, including conflicts of a rising intensity, the EU chooses to look at the symptoms rather than the roots of the problems. It seeks to move forward while preserving the deregulatory drive of the neoliberal policy framework. What are the implications for the international role of the Euro?

The euro is the world's second preferred currency for borrowing, lending and central bank reserves, as shown in the table below. This gives it leverage over global exchange rates and monetary policies. For example, around the world, 60 countries and territories, accounting for some 175 million people, have directly or indirectly pegged their currency to the euro.²⁰ On the other hand, in its 25 years of existence the euro has not challenged the dominant role of the US dollar in the international monetary system. Neither is it likely to do so in the future, given that by its very design and the export-oriented growth models it facilitates, the EU accepts the subordination of the Euro to the Dollar and thus to US hegemony. As Germain and Schwarz have pointed out 'The EU's current institutional arrangements and its economic geography create macro-economic consequences that diminish the euro's capacity to operate as a top currency'²¹.

¹⁹ Brunetti, A. (2024, October) EU markets and insurance watchdogs' bosses warn CMU won't happen without some centralised supervision. Euractiv. <https://www.euractiv.com/section/economy-jobs/news/eu-markets-and-insurance-watchdogs-bosses-warn-cmu-wont-happen-without-some-centralised-supervision/>

²⁰ European Commission (2021, January). *The international role of the euro*. https://finance.ec.europa.eu/eu-and-world/open-strategic-autonomy/international-role-euro_en

²¹ Germain, R., & Schwartz, H. (2014). The political economy of failure: The euro as an international currency. *Review of International Political Economy*, 21(5), pp. 1095-1122.

Table 3.2: Share of main currencies in the international monetary system (indicators of international currency use in percent)

	US Dollar	Euro	Japanese yen	Chinese remninbi	Total share of the four currencies
Foreign Exchange Reserves	58.41	19.98	5.70	2.29	86,38
International debt	64.06	23.19	1.65	0.90	88,15
International deposits	51.87	14.75	4.72	Na	71,34
International loans	50.68	18.36	3.79	Na	72,83
Foreign Exchange turnover * (2022)	88.45	30.54	16.70	7.01	135,69

Source: European Cuncil (EU). (2024, August). *International role of the euro*. <https://www.consilium.europa.eu/en/policies/international-role-euro/>

* Since transactions in foreign exchange markets always involve two currencies, foreign exchange turnover shares add up to 200 percent.

The shifting geopolitical and international power structures are reflected the case of the BRICS alliance, which currently includes 10 member states, accounting for 37 percent of global GDP in 2023, compared with 29 percent of the G7 countries, while more countries have applied to become members.²² Already, members of the alliance are using their own currency in the trade exchanges between them, while their goal is to introduce a common currency system. Such a prospect appears distant, especially given the extensive exposure of the Chinese financial system to dollar assets. However, it is a political goal that needs to be considered.

²² The BRICS countries are Brazil, China, Egypt, Ethiopia, India, Iran, Russia, S. Africa, United Arab Emirates and Saudi Arabia as of 2024. Myanmar, Pakistan, Senegal and Sri Lanka have applied for membership.

Box 3.1: Tariffs and Currencies

On February 1, 2025, the newly elected US President D.J. Trump imposed a 25 percent additional tariff on imports from Mexico and Canada and a 10 percent additional tariff on imports from China. As a result, the dollar soared against the main currencies, approaching parity with the Euro.²³ These events point to the complex economic reactions that tariffs set off and which extend beyond the targeted goods. Such a train of events has been put in motion by the new US president, the full effect of which remains to be seen. The underlying logic is the huge trade deficit of the USA, reaching \$918.4 billion in 2024, up by 17 percent from 2023.

One of the most significant consequences of tariffs is their effect on exchange rates. More specifically, tariffs influence the flow of trade between countries. When tariffs reduce imports from a particular country, they also reduce the demand for its currency both directly and indirectly through the expected decline in its economic activity. Such a devaluation of its currency may help it weather the storm, depending on the importance of the targeted goods in its trade with the USA and the world at large.

On the other hand, tariffs can have an inflationary impact on the importing country, in this case, the USA. This is likely to delay the reduction in interest rates by the Federal Reserve, which in turn will make investments in dollars relatively more attractive, further reinforcing the rise of the dollar. The long-run implications of the tariffs for the USA itself may well turn out to be less than beneficial, as the appreciation of the dollar may hurt its exports. The EU is also targeted as Donald Trump has threatened, but not yet announced, tariffs on imports from it. The impact will be strongest on the large exporter countries to the USA; namely, Germany, followed by Ireland and Italy. The European Commission has responded by making a statement, whereby, 'the EU will react firmly and immediately against unjustified barriers to free and fair trade, including when tariffs are used to challenge legal and non-discriminatory policies. The EU will always protect European businesses, workers, and consumers from unjustified tariff measures'.²⁴ To the extent that the targeted countries retaliate in kind, a trade war may well be started, concurrent with a currency war. The resilience of the Euro, amongst other currencies, will be severely tested.

Advancements in technology. This is an area where major changes are taking place, with both geopolitical and climate-related implications. The digital revolution of the late 1990s and 2000s was followed by the Artificial Intelligence (AI) revolution of the 2020s, transforming business models, work, financial systems, trade and international

²³ Ganguly, S. (2025, February). *More crowded US dollar trade ramps up expectations for euro parity: Reuters poll.* <https://www.reuters.com/markets/currencies/more-crowded-us-dollar-trade-ramps-up-expectations-euro-parity-2025-02-05/>

²⁴ European Commission (EU). (2025, February). *Statement on the US reciprocal tariff policy.* https://ec.europa.eu/commission/presscorner/detail/sl/statement_25_515

comparative advantage. New opportunities emerge, as well as risks including economic and social disruptions, widening disparities and inequality. The social, economic and political dynamics of the latest technologies are still evolving.

The USA and China are at the forefront of developments, competing for resources, know-how, trade and influence. The EU, on the other hand, is falling behind, as shown by both its 2024 European Innovation Scoreboard (EIS) and its Second Report on the State of the Digital Decade.²⁵

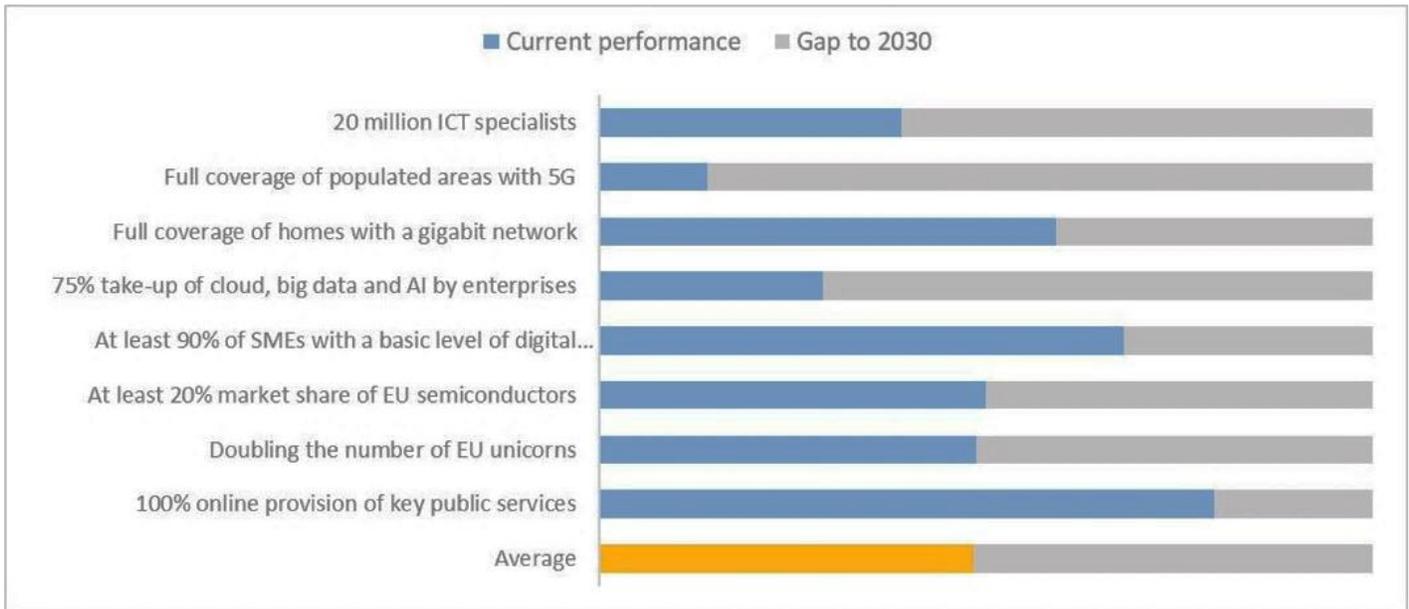
In particular, according to the EIS, while the EU performs strongly in certain areas, such as new doctorate graduates, international scientific co-publications and share of SMEs introducing product innovations, it is middling in others, including private sector R&D expenditure, public-private co-publications, collaboration between innovative SMEs and trademark applications.

Furthermore, there is a persistent innovation divide across its members. Based on their performance relative to the EU average in 2024, member states fall into four different performance groups: Innovation Leaders (Denmark, Sweden, Finland and the Netherlands), Strong Innovators (Belgium, Austria, Ireland, Luxembourg, Germany, Cyprus, Estonia and France), Moderate Innovators (Slovenia, Spain, Czechia, Italy, Malta, Lithuania, Portugal, Greece and Hungary) and Emerging Innovators (Croatia, Poland, Slovakia, Latvia, Bulgaria and Romania). The performance of both Moderate and Emerging Innovators (15 countries in total) is at or below the EU average.

In 2021, the European Commission set its Digital Decade Policy Programme (DDPP). The digital objectives for 2030 are shown in the Figure below, compared to the starting point of the Programme in 2021.

²⁵ European Commission (EU). (2024). *European innovation scoreboard*. https://research-and-innovation.ec.europa.eu/statistics/performance-indicators/european-innovation-scoreboard_en and European Commission (EU). (2024). *Second report on the State of the Digital Decade calls for strengthened collective action to propel the EU's digital transformation*. <https://digital-strategy.ec.europa.eu/en/news/second-report-state-digital-decade-calls-strengthened-collective-action-propel-eus-digital> respectively

Table 3: EU 2021 levels vs. digital compass targets for 2030



Source: European Commission Communication (2021). *2030 Digital Compass: the European way for the Digital Decade*. <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52021DC0118>

The Second Report on the State of the DDPP was published in July 2024. It states that: ‘The Commission’s analysis shows that, in the current scenario, the collective efforts of Member States will fall short of the EU’s level of ambition. The identified gaps include the need for additional investments, both at EU and national levels, in particular in the areas of digital skills, high-quality connectivity, uptake of Artificial Intelligence (AI) and data analytics by enterprises, semiconductor production and start-up ecosystems²⁶ (*emphasis in the original text*).

As in the case of innovation, there is a digital divide, between urban – mainly large cities - and rural areas, as the latter do not have the same infrastructure deployments and expected returns on investment as the former. Given that only 55.6 percent of the EU population have at least basic digital skills, such a divide has significant social implications.

Technological advancements are transforming the way people work and live. The EU Platform Work Directive, adopted by the European Parliament in April 2024, aims at ensuring that platform workers have their employment status properly specified and

²⁶ European Commission (2024b). *The Second Report on the State of the Digital Decade calls for strengthened collective action to propel the EU’s digital transformation*. https://ec.europa.eu/commission/presscorner/detail/en/ip_24_3602

regulating the use of algorithms in the workplace. However, important gaps remain, especially as platform work has come to workplaces across the socio-economic spectrum, while automated decision-making in the workplace poses significant risks to decent working conditions and fundamental rights²⁷.

Structural transformations are economically and socially disruptive, deepening existing divergences and creating societal discontent, which may give rise to populist and divisive politics, as already witnessed in the EU and elsewhere. The overriding concern of the EU leaders (echoed in the recent reports by Draghi, Letta and Niinistö) is about competitiveness. Valid as this concern may be in a geopolitical context, it is narrow insofar as it overlooks the social, economic and political dynamics of the EU.

Box 3.2: Global contest and the Chinese disruptor

Open-source AI models, launched by Chinese startup DeepSeek, have disrupted the global AI landscape, challenging US supremacy and posing important policy questions for Europe. The AI models released by DeepSeek rival the latest systems from OpenAI and Meta, while being significantly cheaper to develop and operate. By contrast, the US Stargate Project, announced by newly elected US President Donald Trump, is estimated at US\$ 500 billion, while it assumes away so-called 'regulatory burdens'. Will the new global landscape lead the EU to dilute its governance framework and digital regulations that prioritise AI safety? As Aida Ponce Del Castillo argues, 'technological capability alone is not the defining issue. Instead, the focus must be on AI's societal impact – on democracy, the rule of law, employment and fundamental European values'²⁸.

3.3. Conclusion

Overall, the future of the 'Euro at 50' appears uncertain and volatile. The implications of the EU response to climate change, to the geopolitical challenges of the present time and to the great technological shifts taking place lead to the conclusion that safeguarding the Euro in the long run requires a radical change of policy direction, not only in terms of macroeconomics, but also in the other vital areas where tectonic shifts

²⁷ Open Letter (2024, November). *Algorithmic Management and the Future of Work in Europe*. Social Europe. <https://www.socialeurope.eu/open-letter-algorithmic-management-and-the-future-of-work-in-europe>

²⁸ Ponce Del Castillo, A. (2025, February). *China's DeepSeek is changing the AI race – What is Europe's edge?* Social Europe. <https://www.socialeurope.eu/chinas-deepseek-is-changing-the-ai-race-what-is-europes-edge>

are taking place. Three such areas were discussed above, climate change, geopolitical challenges and technological advancements. The list is not exhaustive. However, these are critical areas of concern as the second quarter of the 21st century is about to start. The response of the EU to these challenges will be crucial for the future of its economy and society and by extension of the single currency.

European leaders have been known to take a realistic turn and rise up to the occasion at a time of crisis. However, they are also known to go back to their previous practices, once the crisis is over. Such a policy vacillation is damaging and a source of disappointment for large sections of the population, which bear the brunt of their leaders' lack of vision and foresight. A change in policy paradigm, as argued in Chapter 1 above, is urgently needed. The alternative proposals made throughout this report point to the direction that the EU needs to go; nothing less than a socioeconomic and ecological transformation will safeguard the future of the EU and of its currency. Business as usual is no longer an option.