VALDAI DISCUSSION CLUB REPORT

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THE EURO VS. EUROPE

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MOSCOW, MARCH 2017

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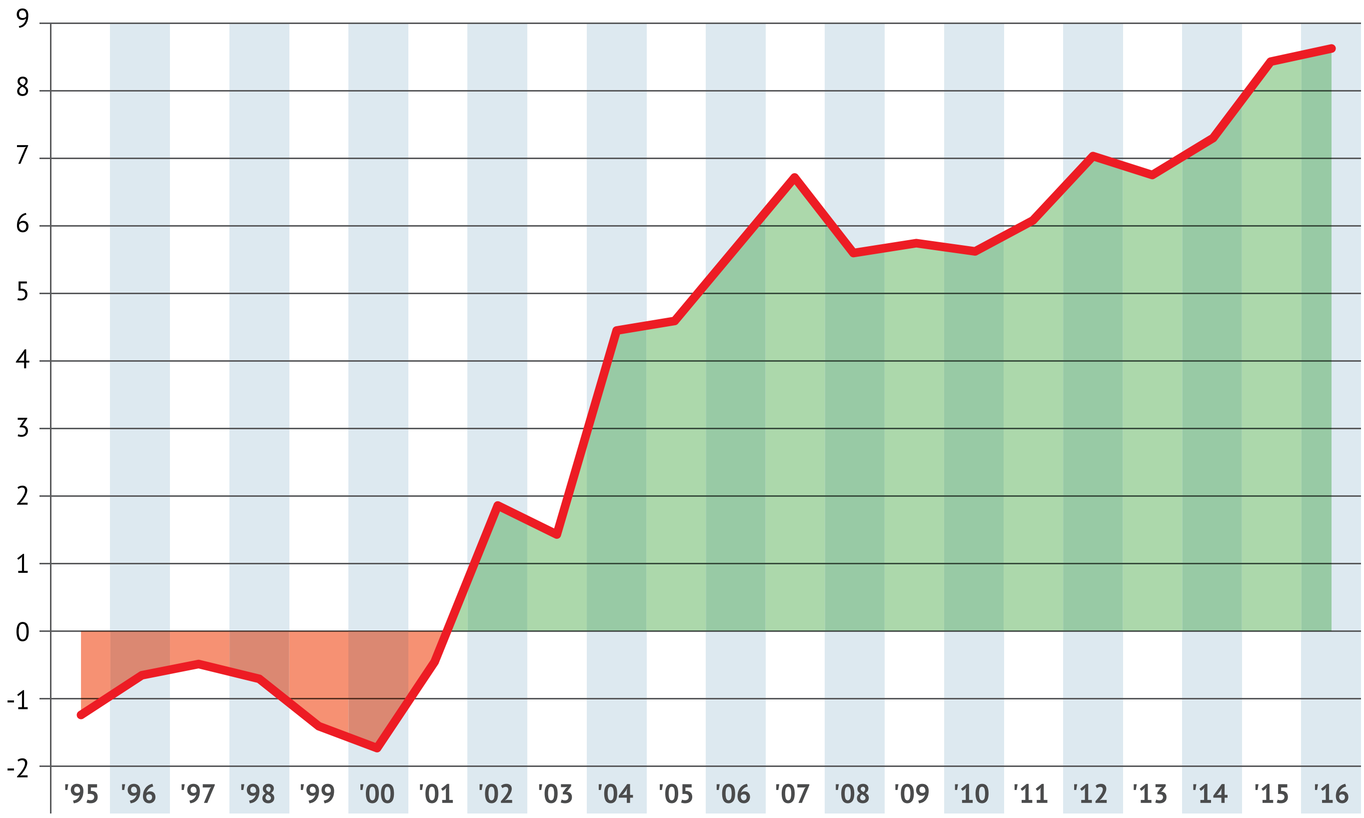
The European Union is currently experiencing a profound crisis that goes beyond the economy and touches on its very identity. And it was the euro that caused this crisis. Intended as the pinnacle of European integration, the single currency paved the way to the EU's decline. It is corroding the economic and social foundations of Eurozone countries, undermining democracy and gradually leading to tyrannical behavior, sparking an unprecedented populist backlash. The destructive impact of the single currency on the countries that adopted it is gaining momentum, with the sole exception of Germany, which is not a coincidence. In fact, the euro was created by Germany and for Germany. It created an environment in which the German currency was undervalued, while overvaluing the currencies of France, Italy [1] and Spain [2]. As a result, Germany benefits from a huge structural trade surplus to the detriment of its neighbors, and this surplus could spell the end of the European Union.

GERMANY: BALANCE OF FOREIGN TRADE, % OF GDP



Source: IMF database (October 2016).

Had it not been for the euro, Germany's trade balance would have led to a revaluation of the German currency, while making other currencies cheaper. But the very existence of the euro makes all this impossible. For instance, in 1999 Germany reported a trade deficit of -1.4 percent of GDP, but by 2015 its trade surplus had reached 8 percent. What matters most here is that the surplus has been steadily rising ever since the introduction of the euro.

Since 2010 we have witnessed a series of crises with serious social implications both direct (growing unemployment, especially youth unemployment in southern Europe) and indirect, such as the adoption of the foolish restrictive budget policy to “save the euro,” bringing investment down to historic lows and dealing a blow not only to economic growth, but also social wellbeing. At the same time, the successive crises in relations *within* the EU have pit its countries against one another, threatening European cooperation. The euro challenges and threatens the European spirit, as many economists now agree, including former Governor of the Bank of England Mervyn King, who recently published a book criticizing the euro, [3] Nobel prize winners like Joseph Stiglitz [4], and the economists who published a collection of essays on this subject [5]. They all share the same view and are supported by prominent politicians like Oskar Lafontaine, the former head of the Social Democratic Party and founder of The Left party [6], or Stefano Fassina, former member of a center-left government in Italy [7]. This critique represents the articulated and substantiated side of the same movement that put wind in the sails of populist movements across Europe, from the Five Star Movement in Italy and PODEMOS in Spain to the French National Front and similar organizations in the Netherlands and even Germany (AfD). All this naturally raises the question of why the euro was created in the first place.

1. HISTORY OF THE EURO

The euro project was a long time in the making. The idea of a single European currency can be traced back to the late 1960s when the Werner Report was published [8].[1] The obstacles such a project would face were already clear back then. In 1977, then-President of the European Commission Roy Jenkins proposed creating a single currency for countries in the European Economic Community. However, his proposal involved the creation of a common budget equal to 10 percent of the member states’ combined GDP. Although the idea was consistent from a technical perspective, it was dismissed by all the countries for political reasons. It would be a viable concept even now, given that the EU budget does not exceed 1.25 percent of combined GDP. In fact, the euro can’t work without a federal budget. Nevertheless, these countries introduced the euro, even though they understood that the budget that was supposed to make it work was insufficient. This can be explained by a number of reasons.

The political project to build federal and supranational institutions was in the making since the late 1980s and took shape with the entry into force in 1993 of the Treaty of Maastricht that effectively created the European Union. The only problem is that the people of Europe have disavowed the project every time their opinion has been asked. Suffice it to recall the draft European constitution rejected by voters in referendums in France and the Netherlands in 2005. This forced European leaders to come up with skillful maneuvers and *knowingly* create faulty institutions (of which the euro is the most spectacular example) in the hope that the ensuing crises would force people to hastily accept what they refused to approve after careful consideration. The trick did not work, however. One crisis followed another, but this did nothing to promote the federalism that the euro’s founding fathers sought. Only the French government is now pushing for a federalist project. Even the German government, which used to be France’s main ally in this endeavor, are now backing away from the political logic

[1] *In 1970, Pierre Werner, Luxembourg Prime Minister, was given the mandate to draft, with a group of experts, a blueprint for an economic and monetary union within the EEC. – Ed. note.*

that would have put the entire burden of building this federal structure on their shoulders. For this reason, they are content with the current status quo that clearly works to their benefit.

We have reached an impasse, no longer able to move forward and not daring to take a step back. This is why we are doomed to live in perpetual crisis. The euro is slowly destroying the old nations that built and consolidated democracy. The Treaty on Stability, Coordination and Governance, ratified only because of Francois Hollande's insistent efforts in September 2012, deprives national elected officials of any budget controls, which is an essential element of sovereignty. What this means is that politicians wanted to pass the buck and are to blame for their own impotence. Everyone keeps saying that the euro provides protection. From what? How? These questions remain unanswered, and there is a good reason why. "The euro facilitates growth" is another slogan belied by the plain facts. The euro is not and can not be an economic agent. Moreover, the euro is not even a political agent. It has become a figment of the imagination that obfuscates the fact that what political leaders actually want is to disappear into an anonymous mass so as not to shoulder the burden of responsibility alone.

The 'Good News' Told By Economists and Other Lies

With this in mind, let us go back to where it all started. The euro was initially described as a promised land, but it turned out to be one big lie. Just like the biblical Magi, the economists Robert Mundell, Ronald Ian McKinnon and Peter Kenen were supposed to have delivered good news, but the latest research suggests otherwise.

Robert Mundell devised the theory of optimum currency areas back in 1961 [9]. It was intended as the theoretical underpinning for the existence of areas that could benefit from a single currency. Ronald Ian McKinnon made his contribution to this theory two years later [10] by arguing that an economy that is more open to the world will have a lower currency exchange rate. However, the interest in correction using the exchange rate is declining. As for Peter Kenen [11], he claimed that in a diversified national economy, what the economist calls an exogenous shock is limited, enabling a country to establish ties with other countries with a fixed exchange rate. All this leads to the conclusion that a country may be *interested* in sharing a single currency with other countries if there is flexibility in terms of capital and workforce, if the country remains open to international trade and its economy is diversified. Some economists have argued, based on an analysis of large-scale shifts on the currency markets in 1975–1990, that in today's economy there is little interdependence between export (import) volumes and the cost of goods. There was this idea that international trade was all about the *quality* of the product. An attempt was made to prove that a single currency provides *substantial economic advantages*. A single currency was expected to substantially increase trade flows within the currency area, as Andrew Rose tried to show [12]. A body of literature favoring currency unions was born that depicted national currencies as a barrier to international trade [13], higher productivity and trade opportunities [14]. A monetary union in Europe was expected to create conditions for the "optimum currency area" to succeed [15] in what seemed to be an endogenous process [16].

Some politicians even recklessly claimed that the mere existence of the euro could bring about economic growth. Jacques Delors and Romano Prodi claimed that with the euro the European economy would expand by 1–1.5 percent within several years. They could not have been more wrong.

The Awful Truth

Research based on fuller and more accurate data tempered, if not canceled out, the assumed positive effects of a currency union [18]. The econometric method turned out to be erroneous [19]: the models created using it failed to account for the existence of international trade [20]. As a result, the conclusions were invalidated. Harry Kelejian studied the impact of the monetary union on international trade of its member states [21], concluding that the benefits had been exaggerated. In fact, the results turned out to be devastating. The existence of an economic and monetary union accounted for a 4.7–6.3 percent increase in trade, far below the most pessimistic of the previous forecasts of 20 percent, and nowhere close to the 200–300 percent figures suggested in earlier works by Rose. Consequently, within just ten years, the forecasted positive impact dropped ten-fold from 200 to 20 percent [22], and after that another four-fold down to 5 percent [23]. This means that the benefits were exaggerated, which can of course be explained by political considerations.

There was also this idea that a monetary and financial union could mitigate risks related to sudden changes in the economy [24]. Euro proponents started to use risk sharing as an argument [25] to prove the protective nature of the single currency [25]. In any case, a closer look at these risk sharing practices shows that it results not so much from the existence of a single monetary and financial market, as it does from the use of various budgeting mechanisms [26]. The Eurozone has not yielded any discernable evidence that it has actually had an impact of this kind [27]. The only thing that is clear is that the euro proponents lied. If the currency area does not affect international trade in any meaningful way, this may mean that the price (the so-called competitive pricing) had a much bigger effect than the dominant school of thought suggests [28]. This underscores the importance of currency devaluation as a tool for restoring competitiveness in certain countries.

Reassessing the Positive Effect of Currency Devaluation

The interplay between the exchange rate and the trade balance is well understood, and the rapid recovery of the Russian economy in 1999 and 2000 [29] is usually put forward as one of the key examples confirming this assertion. IMF economists conducted a systematic review of about fifty countries [30] without finding a single piece of evidence to support the widespread notion of a gap between foreign trade and the exchange rate. The IMF showed that a 10 percent decline in the exchange rate adds about 1.5 percent to GDP. In other words, the euro was imposed on the people and voters using lies and quasi-academic rhetoric. This was outright manipulation by economists and politicians who relied on their research, and can only be described as deception, which means that the euro lacks a democratic foundation.

2. THE EURO AND EUROPE

The European Union is adversely affected by the euro. However, not all EU countries adopted the single currency. A number of countries, including important players like Great Britain, Hungary, Poland and Sweden refused to join the Eurozone and remain outside the single currency area, and they are doing fairly well now. The euro undermines the union. It is the euro crisis that has been having a paralyzing effect on the EU since 2010, dragging it down the dubious path of austerity, which in turn sparked protests among voters. The electoral success of Eurosceptic parties, also called populists, is a case in point.

The Euro and Weak Economic Growth in Europe

Let's compare annual growth rates reported by the nine key Eurozone countries with other developed economies. The average gap between Eurozone countries and other economies is about 1 percent, despite the fact that countries like the US or Great Britain have also faced a number of challenges.

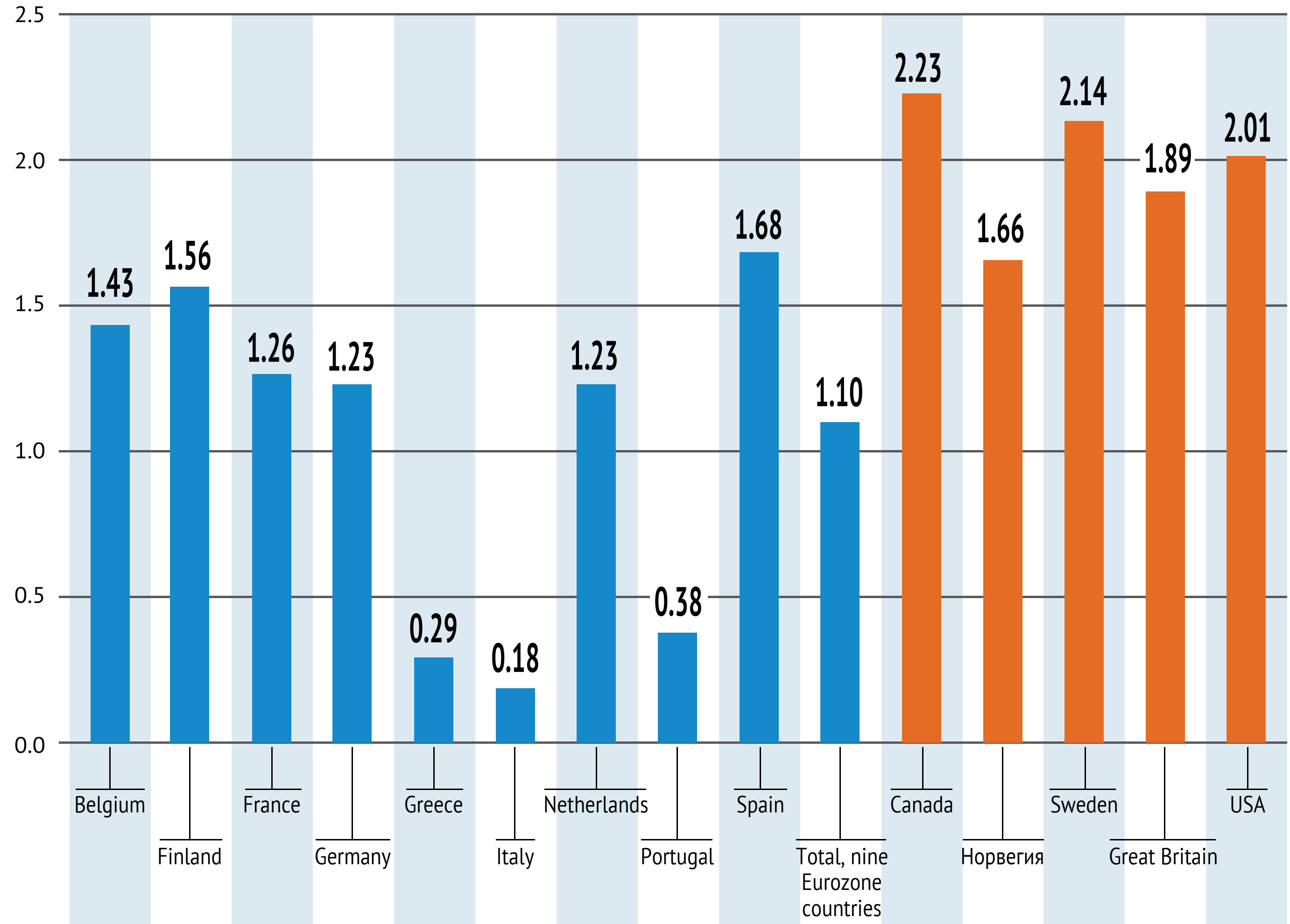
The gap becomes even more spectacular when comparing the Eurozone with Sweden, a European country that did not adopt the euro, or Canada. This shows the extent to which the euro undermines economic growth. The Eurozone crisis widened this gap even more. It was the euro that made the recovery slower and even made the situation worse in many countries. Countries outside the Eurozone found it easier to overcome the 2007–2010 crisis. This

Table 1. Economic Growth in Eurozone Countries and Five OECD Countries

COUNTRY	GDP IN 2015 100=1999, %	AVERAGE GROWTH IN 1999–2015, %	AVERAGE GROWTH IN 1999–2007, %	AVERAGE GROWTH IN 2008–2015, %
BELGIUM	125.6	1.43	2.23	0.6
FINLAND	128.2	1.56	3.73	-0.6
FRANCE	122.2	1.26	2.11	0.4
GERMANY	121.5	1.23	1.64	0.8
GREECE	104.7	0.29	4.07	-3.4
ITALY	102.9	0.18	1.48	-1.1
NETHERLANDS	121.6	1.23	2.28	0.2
PORTUGAL	106.2	0.38	1.52	-0.8
SPAIN	130.6	1.68	3.74	-0.3
TOTAL, NINE EUROZONE COUNTRIES	119.1	1.10	2.18	0.0
CANADA	142.3	2.23	2.80	1.7
SWEDEN	140.2	2.14	3.24	1.0
GREAT BRITAIN	134.9	1.89	3.00	0.8
USA	137.5	2.01	2.65	1.4

Source: IMF database.

AVERAGE GDP GROWTH IN 1999–2015, %



Source: IMF database.

means that the single currency did nothing to protect the countries using it. Only one country in the Eurozone, Germany, has seen an increase in per capita GDP since 1999. It is also the only country where this indicator grew in 2008–2015. All in all, Germany is the only country in the Eurozone with growth figures comparable to *outside* countries such as Canada, Great Britain, Sweden and the US.

What we see is a substantial decline in Greece (down 3.2 percent per year since 2008) with Finland, Spain, Italy and Portugal also facing hardship. Leaving Germany outside the equation makes the situation in the Eurozone look even worse.

Fixed capital investment also fell sharply, undermining economic growth for years to come and creating the prospect of a lost decade for the Eurozone. Most of the countries included in the review saw a decline in fixed capital investment. Although moderate in absolute terms, as a per capita figure the decline becomes much more pronounced. As a result, per capita fixed capital investment never recovered. The contrast with countries outside the Eurozone is striking.

Table 2. Decline in Fixed Capital Investment

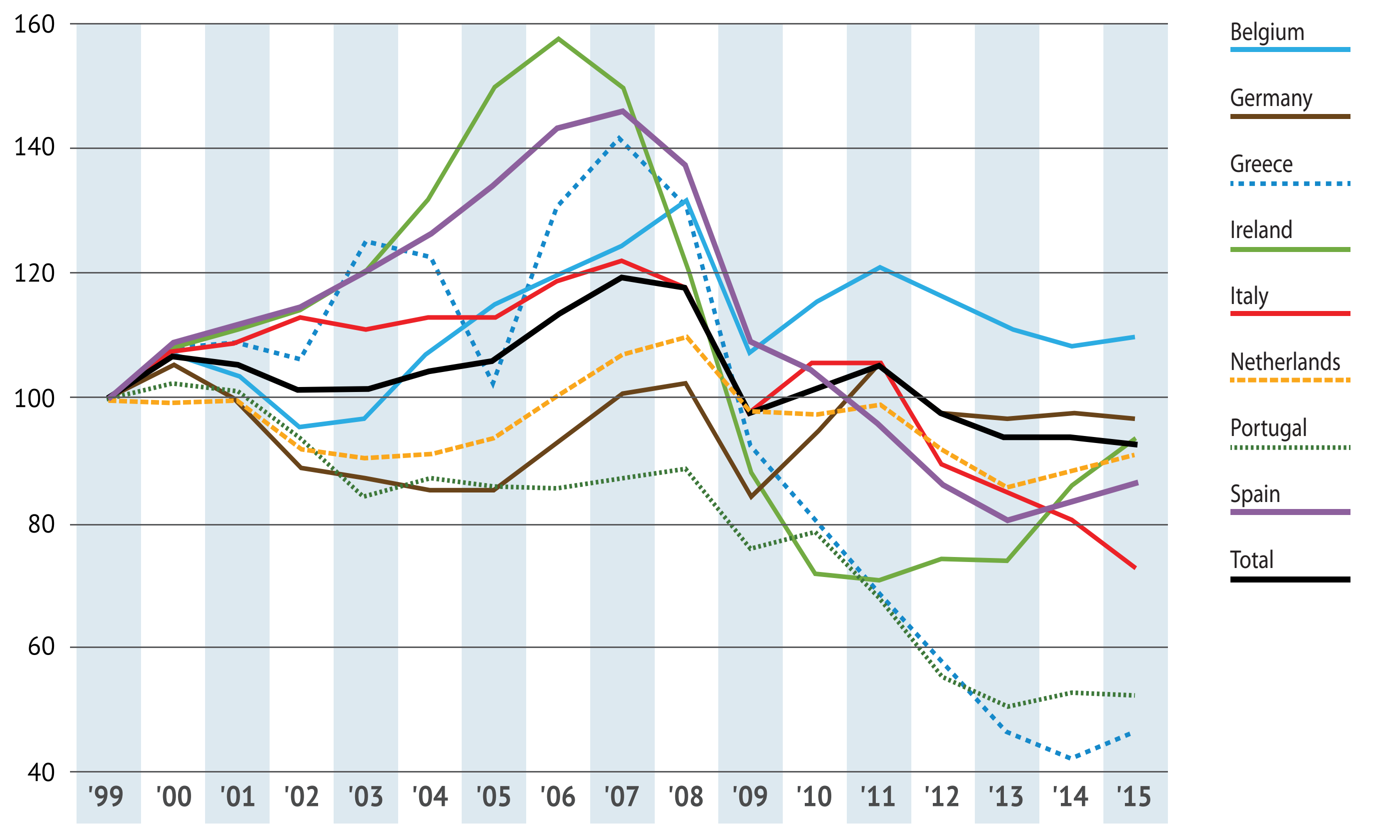
СТРАНА	TOTAL INVESTMENT, %		PER CAPITA INVESTMENT, %	
	2015 COMPARED TO 1999	AVERAGE ANNUAL GROWTH	2015 COMPARED TO 1999	AVERAGE ANNUAL GROWTH
BELGIUM	120.8	1.2	109.8	0.6
FINLAND	114.9	0.9	107.9	0.5
FRANCE	122.9	1.3	111.9	0.7
GERMANY	96.2	-0.2	97.1	-0.2
GREECE	47.2	-4.6	46.7	-4.7
ITALY	77.2	-1.6	73.0	-2.0
NETHERLANDS	97.0	-0.2	90.6	-0.6
PORTUGAL	53.6	-3.8	52.6	-3.9
SPAIN	100.5	0.0	86.5	-0.9
TOTAL, NINE EUROZONE COUNTRIES	98.3	-0.1	92.5	-0.5
CANADA	163.2	3.1	138.2	2.0
SWEDEN	157.8	2.9	142.2	2.2
GREAT BRITAIN	123.8	1.3	111.9	0.7
USA	120.2	1.2	104.4	0.3

Source: IMF database.

The only countries spared by this trend were Belgium, Finland and France. Italy and Spain saw a substantial decline, which took on catastrophic proportions in Portugal and Greece, where investment shrank to levels last seen in the 1980s. In the Eurozone, per capita fixed capital investment has been stagnant since 1999, although this indicator covers specific elements such as housing, infrastructure, roads, bridges, railways, airports, water channels, communication networks, as well as productive capital, including machinery, their installation sites, etc.

This explains why declining or even stagnant fixed capital investment is such a major threat for the future of the European population.

PER CAPITA INVESTMENT, %



Source: IMF database.

At the same time, non-Eurozone EU countries (Sweden, Great Britain) and North American countries (USA, Canada) have been reporting increases in fixed capital investment.

The Euro Discredits Europe

It was impossible to introduce a single currency without causing havoc in Europe and the global economy as a whole. The aftershocks of the austerity policies enacted for the sole purpose of saving the euro can be felt far beyond Europe [31]. The job market is a real disaster, especially youth unemployment in southern Europe. In countries like Greece, Spain and Italy the young generation has become demotivated and even desperate. In this case, the damage caused by the euro cannot be measured in financial terms. Millions of young people no longer believe in themselves, which could have dramatic social ramifications.

With this in mind, it is understandable why Europeans are reluctant to welcome refugees fleeing from the Middle East. One has to be blind not to see that the opposition to refugees is underpinned by anxiety about the future and loss of confidence among millions and millions of people. In 1945–1950, European countries faced a migration crisis much larger in scale and more dramatic. However, back then people believed in the future, despite the hardship of the post-war recovery. People still believed that things were improving by the month, which explains why refugees found a place in Europe. All this shows the price Europeans are paying for the euro. It is directly affecting Eurozone countries and indirectly harming other countries. And because the euro was born in Europe's historical center, it was inevitable that the euro crisis would reverberate across the continent.

Forget Federalism

The crisis in Greece, a country which accounts for less than 3 percent of the Eurozone's GDP, has given rise to some very serious consequences. It shattered and discredited the very foundations of the EU. The Italian banking crisis (following the Spanish crisis and preceding one in Germany) became a new source of anxiety for financial markets. In this case, the institutions created in 2012 to deal with the crises (the so-called banking union) turned out to be ineffective once again. Crises will have to be dealt with at the national level. Of course, the necessary resources are there, but the cracks in the Eurozone are becoming bigger with every crisis.

As a matter of fact, these crises were caused not by the debt piled up by Greece or Italian banks or questionable financial transactions by German banks, but the way the Eurozone operates. It pits nations against each other, which is reminiscent of the worst moments in European history. Even though the EU and Europe are not one and the same, what is now at stake in Brussels is not just the future of Greece or the euro but the very existence of the European Union and the future of Europe.

A single currency works for federal states like India, Germany and the US, despite the differences (sometimes major) that exist between their regions. This is primarily attributable to the fact that these countries have large-scale distributive streams. There is no such thing in the Eurozone due to the objection of many countries, and primarily Germany's categorical refusal. Many of those who support the euro lament supposed "German egoism" [32], without even bothering to calculate what it would cost Germany to finance these streams. But such calculations are available from other sources [33]. In fact, helping out just four countries of the European south – Spain, Italy, Portugal and Greece – would cost some EUR 260 billion per year over a ten-year period. It is fair to assume that 90 percent of this amount would have to come from Germany, which amounts to taking away 8–9 percent of its GDP. In another paper, the author suggests that the bill for Germany could be as high as 12 percent of its GDP [34]. These contributions would have destroyed the German economy. It is not that Germany *doesn't want* to do it. It simply *can't* afford it.

Towards Tyranny

As reaching agreement on redistribution was impossible, the Eurozone governments believed they found salvation in blending austerity (whose recessionary consequences weakened their economies) with the ECB's expansionary monetary policy. Nevertheless, this monetary policy did not solve the problems, and has reached it limits. It's like treating pneumonia with aspirin, a drug that lowers temperature but does nothing to deal with the underlying cause of the illness.

Today Germany is more opposed than ever to redistributing funds within the EU, and it succeeded in imposing its logic by implementing the solidarity pacts signed since 2011 [35]. These are six documents stipulated in the Treaty on Stability, Coordination and Governance that was signed in 2012 [36] and came into force on January 1, 2013. These agreements only reinforce austerity mechanisms, holding European economies in their clutches. More importantly, the discipline they impose is *above* national sovereignty. This attitude is indicative of the European Union's gradual shift towards tyranny [37]. The euro has only deepened discord in Europe, resulting in even more aggressive economic policies, which have left people feeling exasperated. They pit the countries that have been spared against those that suffer the most. Consequently, far from becoming a factor of unity and solidarity, the euro has brought about rampant egoism and escalating political tension.

3. GIVING UP ON THE EURO

A growing number of politicians and many French and foreign economists – currently more than 175 [38] – recognize the dangers and risks associated with the euro. If we want to save the European Union, we have to give up on the single currency either by agreeing to dissolve the Eurozone or through unilateral withdrawal. Just as the way out of the 1929–1932 crisis was to abandon the gold standard, the euro has to go for Europe to overcome the crisis that has been going on for the last decade. A number of recurrent questions are raised when talking about leaving the Eurozone or dissolving it.

The Imperative of Liquidating the Single Currency

Could devaluing the euro be an alternative to dissolving the Eurozone? This was a hotly debated issue from 2010 until 2014 when the euro exchange rate was very high. However, proponents of this approach tend to forget that

- *(A) Devaluing the euro will not affect in any way the current balance between member states, since the main issue is the differences that exist within the Eurozone [39]. Germany stands to gain much more from a cheaper currency than other countries, if the exchange rate within the Eurozone remains as it was in 1999. The only way to deal with increasing productivity gains and inflation in every country is to change the exchange rates within the Eurozone, which can only be done by liquidating the euro.*

- *(B) Countries in the Eurozone have varying levels of integration. For instance, France is far behind Spain and Italy in terms of integration. If the euro were to be devalued, France would stand to gain much more than its two southern allies. Consequently, devaluing the euro against the dollar could have destructive consequences for southern member states.*

The Eurozone is akin to the gold standard of the early 1930s in that it imposes inflexible parity on its members, making devaluation impossible. Economists know all too well the shortcomings of a system of this kind. It hinders the capacity for much needed self-correction, since productivity gains and inflation rates vary from one country to another. It was the lack of flexibility in the system that was one of the causes of the Great Depression that followed the 1929 crisis. In fact, the depression started even before countries started to devalue their currencies and abandon the gold standard. At the outset, Germany and Great Britain tried internal devaluation in order to keep the gold standard alive. However, internal devaluation is nothing more than what was called deflationary policy in the 1930s [40]. It was carried out, with tragic results, by Ramsay MacDonald in Great Britain, Pierre Laval in France and Heinrich Bruning in Germany [41]. Given the persisting price rigidity [42] and unvaried nominal financial costs, *all* these policies brought about social and economic turmoil. Today, similar policies are to a large extent accountable for the growing unemployment in the south of the Eurozone. In any case, the fact is that there is no getting away from austerity *as long as we remain in the Eurozone.*

Will Leaving the Eurozone Be a Catastrophe?

Listening to those who condemn any attempt to move away from the euro, you would think it will lead to a horrible economic catastrophe. However, all this rhetoric does is provoke fear instead of facilitating reasoned and rational reflection. The very fact that the debate boils down to such arguments shows the extent to which any discussion of leaving the Eurozone has gone beyond reason and rationality. According to one argument, with the disappearance of the single currency France's debt would snowball, with catastrophic consequences. Former President Nicolas Sarkozy was one of the fiercest proponents of this concept, which is actually a spectacular lie.

It is important to remember in this respect is that in international law what matters is not *the lender's nationality,* but the *law of the contract*. If the debt, whether public or private, incurred under French law, the currency to repay the debt will be the national currency of France no matter what you call it (euro, frank, lira, peseta, etc.). This is what the *Lex Monetae* principle is all about [43]. In France, as of 2013 French law contracts accounted for 97 percent of the debt, while for households this figure reached 98.5 percent. This means that private debt would remain unaffected. For companies operating outside the financial sector, contract law becomes an issue only for those big corporations that contracted loans in dollars, pounds, yen and yuan. However, these companies mostly do business outside France using the abovementioned currencies. An increase in their debt burden would thus be offset by higher foreign currency turnover. As for financial companies (banks and insurance companies), a study by the Bank of International Settlements (BIS) showed that the cost for the French banking system would not exceed $5 billion, a manageable amount for the industry. Even if the government has to step in to help the sector out, the intervention would be insignificant in size.

Withdrawing from the Eurozone would radically change the monetary and fiscal policy of *all* its member states. The key feature of this trend would be the return to so-called monetary repression. The same policy was used after the Second World War and was exceptionally beneficial in terms of productivity gains and investment [44].

Advantages of Dissolving the Eurozone

France, as well as Italy, Spain, Greece and Portugal would all greatly benefit from the dissolution of the Eurozone. Dissolution or unilateral withdrawal would spell the definitive collapse of the currency area, enabling countries to adjust the value of their currencies through appreciation or depreciation. A cheaper currency can positively affect the economy, as confirmed by a number of recent studies including one by the IMF. Offering competitive prices is what matters the most for France, which means that the country could recover the competitive advantages it had lost since the 1990s when it started moving towards the euro.

The devaluation of currencies in countries facing financial turmoil and the change in the Deutsche Mark's value would provide for three to five years of solid growth accompanied by the creation of a large number of jobs. This growth would free up budget and tax resources that are needed to carrying out structural reforms. Lower unemployment would rebalance the social security system and could even make it operate at a surplus. In fact, the rapid return to steady economic growth and higher employment is the best way to reform the social safety net or the pension system. Devaluation is the most effective means of facilitating structural reforms. If several countries devalue their currencies all at once, they will not cancel each other out. There is no doubt that the Deutsche Mark would gain in value against the Italian lira, the Spanish peseta and the French frank, which would be good news for France and a number of countries in the south of the Eurozone. Germany's 'monstrous' trade surplus would disappear due to the difference in the value of the mark against the frank, the lira and the peseta instead of destroying the European economy. In addition, it could create a surplus for France, Italy, Spain, Greece and Portugal. This hypothesis has already been tried and tested [45] confirming that devaluation can boost economic growth not only in France, but across southern Europe.

Would the End of the Euro Spell the End of the EU?

There are some people who, while acknowledging the harm done by the euro to France and the EU in general, argue that giving up on the euro would *automatically* spell the end of the European Union. However, there are countries in the EU, and not the least developed ones, that are not part of the Eurozone: Great Britain (despite its upcoming withdrawal), Poland and Sweden. In addition, it should be noted that the EU existed long before the euro was introduced. For this reason it would be wrong to say that the EU will inevitably fall apart after the dissolution of the currency area. It is the euro that now compromises the EU, undermining its image and reputation across its member states. It is in the name of the euro that the austerity policies were introduced with destructive consequences for the economies of the European south (not least judging by the number of suicides and health issues). It is the euro and its adverse effects that are turning Europe into a stagnating continent compared to North America (the US and Canada) and the Asia-Pacific. It is the euro and the crises it caused in a number of countries that threatens their political stability and integrity. For this reason, economists have come up with the European Solidarity Manifesto [46], calling for an end to the euro before it destroys Europe.

We should not bury our heads in the sand. The euro has poisoned the European Union, though the dissolution of the Eurozone would definitely raise a number of serious issues. That said, Europe is more than just the EU. Even if the EU ceases to exist, European countries would still have to work with one another.

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