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THE CRISIS OF THE EUROZONE

Dorothee Bohle

EUROPEAN UNIVERSITY INSTITUTE, FLORENCE
ROBERT SCHUMAN CENTRE FOR ADVANCED STUDIES
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DOROTHEE BOHLE

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Robert Schuman Centre for Advanced Studies

European University Institute

Via delle Fontanelle 19

50014 San Domenico di Fiesole

Firenze, Italy

EUDO.secretariat@eui.eu

Abstract

An important tension had been underlying the first decade of the European Monetary Union. On the one hand, governments had embraced a revolutionary prospect when designing its institutions. They called on market forces and supranational institutions to limit popular democracy and scale back the interventionist state. On the other hand, they were unprepared to live up to this prospect. Hence the accumulation of large economic imbalances and their culmination in the Greek crisis and the instability of the Union's periphery. These developments have given governments pause. With breathtaking speed, elites have agreed on the need for austerity. But it is difficult to see how the current attempt to return to the spirit of Maastricht would fare any better than before. Permanent austerity is fraught with economic irresponsibility and political risks. Europe therefore needs a new political debate about how much it wants to allow markets to determine the fate of its citizens and countries.

Keywords

EMU, Greek crisis, austerity, popular democracy, legitimacy

“The two pillars of the national state are the sword and the currency and we changed that”

(Romano Prodi, FT April 9, 1999)

“Don’t treat it as a long term solution. It is a kind of morphine that stabilizes the patient. Real treatment has yet to come.” (Marek Belka, chief representative of Europe, IMF, FT May 11, 2010)

Introduction*

The crisis of Europe’s Monetary Union has demonstrated just how unprepared European leaders and societies are to live up to the consequences of their earlier choices. Ever since newly elected Greek Prime Minister George Papandreou announced in autumn 2009 that his predecessor had been borrowing far more than acknowledged, investors have started to be wary of the risk of lending to Greece. Noticing that Greece was not the only country where private borrowing of the previous years suddenly showed up in public debt and deficits, investors extended their distrust to other members of the European periphery as well. While the drama has been unfolding, European leaders have for the longest time been dragging their feet, hoping that the South would somehow miraculously be able to pull itself up by its own bootstraps, while the rest of the continent could look the other way. In Germany, the tabloid press incited public opinion against the lazy Greek, who after decades of indulging in a Mediterranean mix of indiscipline, extravagance and outright corruption now turned to hard working Germans to bail them out. If anything, this made German political leaders even more wary to make a step in Greece’s direction. In Greece, Spain and Portugal, governments trying desperately to regain the confidence of investors by imposing harsh austerity packages, are confronted with social anger spiralling occasionally out of control.

Caught in a drama of national politics and international distrust, European leaders have failed for a long time to understand that the crisis was much bigger than the question of how much the South needs to be punished for past sins before a rescue effort would be warranted – if at all. There is no doubt that this failure owes a lot to the fact that it was Greece which triggered the crisis. This country has indeed spectacularly messed up its public finances. What is more, its record in this respect is notorious. “From 1800 until well after World War II, Greece found itself virtually in continual default”.¹ European leaders however failed to recognize that once they agreed to enter the Monetary Union, they willy-nilly tied the fate of their own countries – at least in currency matters – to that of the weakest member of the club. While this is not a problem in good times, in hard times it means that members of the Union have to stand by each other, as the future of their common currency is at stake.

The Protracted Revolution

Currency matters, of course, are about more than money. In this respect, the designers of the European Monetary Union seem to have fallen into a similar trap as economic liberals in the 19th century who did not realize the deeply political nature of creating national currencies. They thought that the new token forms of money could be managed “in a fashion that closely resembled the automatic market principles by which commodity money had been regulated”. They could not have been more wrong. The introduction of national currencies and the institutionalization of central banks was closely linked to the enhancement of territoriality, that is the congruence between identity space and the space of

* I am very grateful to Colin Crouch, Bela Greskovits, Wade Jacoby, Peter Mair, Guglielmo Meardi, Graham Smith, Cornelius Torp and Alexander Trechsel for most stimulating discussions of the issues and comments on an earlier version of this essay.

¹ Carmen M. Reinhart and Kenneth S. Rogoff, *This time is different. Eight Centuries of Financial Folly*, Princeton and Oxford 2009, p. xxx.

political decision making. National currencies were part and parcel of a “a political project, which called for inhabitants of a territory in the new role as ‘national citizens’ to make direct claims on the state to provide certain political rights and economic benefits”, and central banks were the institutions that tied money to this project.² They were inextricably linked with the two elements that formed the backbone of territoriality – mass democracy, in many cases backed by a strong labor movement, and an interventionist state which protects its citizens against the dislocation caused by market forces. During its most successful period, this institutional formula brought about what John Ruggie famously called the compromise of embedded liberalism. That is, while market forces were not abolished, they were tamed so as to provide citizens with a fair amount of stability and security in their lives.³

Until the mid 1980s, European integration itself stabilized the compromise of embedded liberalism. It exerted only limited pressure on member states to open their economies, and market liberalization was only gradually lowering the high and diverse levels of national protection. It also impacted very little on the democratic form of government. Although driven by elites who carefully avoided engaging with citizens in the process, European integration left the national channels of democratic representation and accountability largely intact. In addition, in several enlargement rounds the EU also contributed to extending the very compromise of embedded liberalism from the European core to its periphery in the north and the south. Enlargement also led to the emergence of a fragile architecture of cross-European solidarity. Social, regional development and cohesion funds bear witness of that.

Since then, however, European integration has taken a quite different character. Disenchanted with embedded markets degenerating in economic stagnation, and intergovernmentalism preventing further integration, European leaders, in a decisive act of liberation, called upon the market to discipline societies and states. Underlying this was a growing conviction that something had gone fundamentally wrong with popular democracy and the interventionist state. In the eyes of political and economic elites alike, Western democracies had become ungovernable because citizens overindulged themselves. Their demands on government were too high, forcing a substantial increase in state activities and thus “the fiscal crisis of the state”.⁴ But citizens also trusted governments less. They challenged authority that was based on hierarchy, expertise, seniority or wealth and not on democratic sources. There was a need, therefore, to limit popular democracy, restore authority, and scale back the interventionist state.⁵

This exactly is at the core of the European Monetary Union, and it is for this reason that Perry Anderson once called it a revolutionary prospect.⁶ It is revolutionary in its form: by elevating the central institution of monetary governance high above the national electorates, the new currency is entirely separated from broad political accountability and popular-democratic processes. To be sure, national central banks had already taken a turn towards independence from these processes before. But the supranational centralization of monetary policy goes a significant step further. In the terms used above, it constitutes a major shift towards a deterritorialized polity, that is a major shift in the

² Emily Gilbert and Eric Helleiner, ‘Introduction - Nation-States and Money: Historical Contexts, Interdisciplinary Perspectives’, in Emily Gilbert and Eric Helleiner, (eds.), *Nation-States and Money: the Past, Present and Future of National Currencies*, London 1999, p. 7; see for the more general argument on territoriality Charles S. Maier, ‘Consigning the 20th Century to History: Alternative Narratives for the Modern Era’, *American Historical Review* 105/3 2000, pp 807-31; Stefano Bartolini, *Restructuring Europe. Centre formation, System Building, and Political Structuring between the Nation State and the European Union*, Oxford 2005.

³ John Gerald Ruggie, ‘International Regimes, Transactions, and Change: Embedded Liberalism in the Postwar Economic Order’, *International Organization* 36/2 1982, pp. 379-415.

⁴ James O’Connor, *The Fiscal Crisis of the State*, New York 1973.

⁵ The best statement of this is Samuel P. Huntington’s contribution to *The Crisis of Democracy : Report on the Governability of Democracies to the Trilateral Commission*, edited by Michel Crozier, Samuel P. Huntington and Joji Watanuki, New York 1975.

⁶ Perry Anderson, ‘The Europe to Come’, in Peter Gowan and Perry Anderson, eds., *The Question of Europe*. London 1997, pp. 129-133.

separation of identity and decision making space. It is probably not by chance that Friedrich von Hayek was an early proponent of such a solution to protect the economy from democratic politics. In his 1939 essay on “The Economic Conditions of Interstate Federalism”, he set out the political logic underlying today’s Monetary Union. An economic union would not only do away with independent monetary policy on the national level, but also put a break on most of the economic interference states have become accustomed to. While the room for manoeuvre for interventionist policies on the national level is limited, it is even more difficult to reinstate it on a supranational level. Intervention requires agreements over values and objectives. Such an agreement is easier achieved in homogenous societies glued together by national solidarity than in an international federal setting. “Although, in the national state, the submission to the will of a majority will be facilitated by the myth of nationality, it must be clear that people will be reluctant to submit to any interference in their daily affairs when the majority which directs the government is composed of people of different nationalities and traditions.” Government in such a federation will therefore necessarily be restricted.⁷ This is the second aspect of the revolution Anderson was writing about: The core socio-economic content of the system envisaged by Maastricht was to unmake the compromise of embedded liberalism. Commitment to full employment, a fair share of the working population in societies’ wealth and social services which protect against the dislocations of the markets were to be a thing of the past.

While designing the architecture which breaks with major principles of the political project of the past, European elites also had a promise for the future in store. The de-politicized nature of monetary and economic governance would greatly enhance the capacity for effective government and problem solving. Citizens might well lose out when it comes to political participation and the representation of their social and economic preferences. But they do get something in return, and that is an overall greater efficiency of the system. As economic governance has become more complex in an interdependent world, and unpopular reforms have to be taken in order to assure the adjustment of existing institutions, the promise was that the new system which relies on specialized agencies and independent experts rather than politicians and demanding electorates can carry out policies effectively and efficiently. And, as all good things go together, effective government was also being seen as strengthening democracy, as it provides a much needed common good for the people. To put it differently – in a context in which government *of* the people, and *by* the people, that is political participation and citizen representation is seen to be at loggerheads with government *for* the people, democracy is being redefined with a stress of the beneficial effects of the latter. In Fritz Scharpf’s famous distinction, it is not the citizens’ input, but the EU’s policy output that is to provide legitimacy.⁸

How far have the members of the eurozone embraced the revolutionary prospect they signed up to? In retrospect it is obvious that during the first decade of the Union’s existence, Europe has not really been in a revolutionary mood. It is true that the Monetary Union has gone some way in unmaking the social compact of the past. In the run up to the Union entry, many states engaged in welfare state reforms, and made significant headway in controlling their public debt and deficits. Trade unions got engaged in competitive rather than social corporatism, trading competitiveness oriented wage restraint and labor market flexibility for an at best uncertain prospect of job creation and political participation. While retrenchment has taken place, the welfare state has however not been sacrificed on the altar of monetary stability. In a similar vein, although the Maastricht criteria concerning public deficits, debt and inflation, reinforced by the Stability and Growth Pact, are not conducive to fostering catching up

⁷ Friedrich August von Hayek, ‘The Economic Conditions of Interstate Federalism’, reprinted in Friedrich August von Hayek, ed., *Individualism and Economic Order*, Chicago 1948, pp. 264-5; see also Anderson op.cit.

⁸ Fritz Scharpf, *Governing in Europe: Effective and Democratic?*, Oxford 1999. On the process of redefinition of democracy, see Peter Mair, ‘Ruling the Void: The Hollowing of Western Democracy’, *New Left Review* 42, November-December 2006, pp. 25-51; Richard S. Katz ‘Models of Democracy: Elite Attitudes and the Democratic Deficit in the European Union’, *European Union Politics* 2/1 2001, pp. 53-80.

development in the periphery, European elites could not really bring themselves to leaving the periphery behind.

All in all, when push came to shove, European elites were therefore always ready to bend the rules. This is how the Stability and Growth Pact was quickly amended when Germany and France failed to meet its requirements. This is also how Greece could enter the Monetary Union in the first place, although it was an open secret that Greek politicians cooked the books, and the state simply lacked the capacity to collect taxes and keep finances in order. Not leaving Greece behind was a political decision, which took its cue from the European identity of the project rather than crude macroeconomic indicators. As in the 19th century no country introducing its national currency represented an “optimum currency area”, so the eurozone is less than optimal in economic terms. Instead, it draws on economics and some vague idea of a European project alike, this way assuring that the unification of the continent is not only for the richest and the most powerful.

It also turned out that markets, far from being the disciplinary force that the signers of the Maastricht treaty had hoped for, rewarded rather than punished Mediterranean extravagance. With the blessing of markets, the divide between what Martin Wolf has recently called ants and grasshoppers has deepened.⁹ While some countries continued to produce stuff at competitive prices and sell it to the rest of the eurozone, others lived on credits significantly cheapened by the common currency and a uniform interest rate, producing housing bubbles rather than real things, and losing their competitiveness in the process. Neither markets nor European authorities seemed to be much concerned about the growing imbalances, unsustainable level of debts, and major asset bubbles, the former because handsome profits could be made, and the latter because they put their trust in markets.

There is more to the protracted revolution than hesitant elites and credit boom economics. What the first decade of the Monetary Union’s existence suggests is that a system of partially depoliticized economic governance is not conducive to problem solving and output legitimacy. To the contrary, it seems that the eurozone has entered a slippery slope where problems are not solved, while politicians are even more than before expected to act on the population’s behalf and are being held accountable. While the Monetary Union effectively has coped with one problem – that of monetary stability - it has simultaneously pushed other problems into the open – those of fiscal discipline, welfare state retrenchment and wage restraint. These issues have kept a high political salience on the national level, and the fate of governments is closely tied to their stance on these matters. Governments therefore manoeuvre uneasily between their international responsibilities and responsiveness to their electorates.¹⁰ It is in this context that watering down the most revolutionary provisions of Maastricht has allowed governments to survive, and the euro to succeed, that is to be accepted with surprisingly little contention. Lenience, looking the other way, and allowing for major imbalances have been the ways how the revolutionary prospect of the Union could be reconciled with the legacies of popular democracy, embedded liberalism and cross-European solidarity. But this could of course only go on for so long. As the credit boom turned bust, European governments found that they had not only accumulated a vast amount of problems but also lost some of the trust of their populations in the process.

The return of the spirit of Maastricht

The Greek crisis has given European governments pause. The unprecedented attack of the markets which almost led to the euro’s collapse finally drove home the message that this crisis is bigger than

⁹ Martin Wolf, ‘The grasshoppers and the ants – a contemporary fable’, *Financial Times*, 26 May 2010.

¹⁰ See on the growing gap between responsible and responsive government Peter Mair, ‘Representative versus Responsible Government’, Köln 2009, MPIfG Working Paper 09/8 2009; and on the growing problem solving gap in the European multi-level governance system Fritz Scharpf, ‘Problem Solving Effectiveness and Democratic Accountability in the EU’, Köln 2003, MPIfG Working Paper 03/1.

that tiny country.¹¹ Consequently, European leaders agreed on two issues. First, in a heroic act, they set up a stabilization fund worth its name. 750 billion euro, more than half of which is to be raised by a special purpose vehicle, can be provided to cover the debt servicing need of highly indebted eurozone countries. This was a bold step. The sheer magnitude came as a surprise. It also effectively overrode the no-bailout clause Germany had insisted to be put in the Lisbon treaty, thus acknowledging that members of the eurozone are not left on their own when in trouble. But perhaps most importantly, and much to its own surprise, the European Central Bank got deeply drawn into the politics of European solidarity, something everybody always thought it stood well above. In the weeks following the set-up of the rescue plan, the Bank agreed to purchase eurozone government bonds on a large scale. In sum, the rescue effort confronted the markets with a political declaration of solidarity.

As European authorities were however finding out fast, markets were demanding more. They were still to be convinced that the rescue plan addresses the issue of sovereign default. Therefore, they wanted to know what states were ready to do to clear up their public finances. They also found that the Central Bank's new role has set the stage for yet another danger, that of inflation. Faced with this disconcerting declaration of distrust, European governments and institutions have started backpedalling from solidarity in a big way, and promised to finally live up to the spirit of Maastricht. With breathtaking speed, an elite consensus is being formed according to which eurozone members need to trim their public sectors and retrench welfare programs.

European credits come with heavy strings attached. Importing a crisis management that has worked in East-Central Europe before, the European Union has called on the IMF to design the Greek austerity package. The package is tough even by this institution's standards. As member of the eurozone, Greece has to adjust by "internal devaluation", that is by deep cuts in wages and public spending rather than currency depreciation. Consequently, at the core of Greece's crisis management is a hefty fiscal adjustment of 11 percent of GDP in cumulative terms through 2013, amounting to €30bn. Retrenchment is to focus on public sector wages, expenditures, and social security funds, particularly the pension funds. Simultaneously, tax increases and an overall strengthened effort to collect taxes are supposed to boost state revenues by 4 percent of GDP through 2013.¹² Feeling the pressure, other peripheral states have been forced into harsh austerity packages as well. The Irish, Spanish and Portuguese parliaments have all adopted drastic measures, invariably involving public sector pay cuts and tax hikes. Shortly after, the austerity wave has also swept into the European core, and beyond the eurozone. Germany took the lead, unveiling plans for the biggest cuts in the country's history, to be surpassed only few weeks later by the newly elected conservative-liberal British government.

At the same time, a framework of multilateral surveillance is being set up, which will monitor member states' fiscal and macroeconomic policies. To this end, the European Commission advocates tougher rules to enforce budgetary disciplines, a tightening of the Stability and Growth Pact, and a multilateral assessment of national budgets early in the process, before these are endorsed by national parliaments. Countries that fail to meet the Maastricht Criteria are to be sanctioned. The Commission also advocates the monitoring of unit labor costs, so as to ensure overall competitiveness. Other actors decided that a stronger medicine is needed to keep the European house in order. Not putting too much trust in the eurozone's finance ministers' peer pressure, the European Central Banks advocates an independent agency to police governments' tax and spending decisions. It also developed a lively imagination when it comes to possible sanctions for fiscal sinners – their EU aid could be cut, voting

¹¹ In the case of Chancellor Merkel, sheer market forces were not enough. In addition, it took a forceful intervention of IMF director Strauss Kahn, US American President Obama, Commission's President Barroso and allegedly the threat by French President Sarkozy to pull out of the eurozone altogether to convince her that the times when she could bury her head in the sand were finally over.

¹² International Monetary Fund, Greece: Request for Standby Agreement. Washington 2010, IMF Country Report 10/111. It is of course ironic that nobody ever ventured the idea that Greece's huge military budget should simply be cut.

rights suspended, and outside experts be dispatched to police the country in question. Not surprisingly, German Chancellor Angela Merkel and Finance Minister Wolfgang Schäuble have added a distinct Teutonic flavor to the debate. Not only is fiscal austerity the order of the day, but in addition it is the strong states that must teach the weaker ones how to restore balanced budgets and increase competitiveness. As a first step, Germany has advised all governments to take its own constitutionally enshrined limit on budget deficits as a model to follow. Moreover, in German eyes there is little reason to be patient with countries that violate the zone's fiscal rules. If they cannot or do not want to adhere to the rules, why not expel them? Most recently, the German Finance Minister has aired yet another idea bound to scare policy makers in Brussels and other European capitals. Advocating the creation of an authority which would manage an orderly debt restructuring, Schäuble also suggests that this authority be endowed with far reaching rights. According to a draft of the plan, the process of debt restructuring "will require restrictions on sovereign discretionary powers." Budgetary policies would be controlled by "an individual or group of individuals familiar with the regional characteristics of the debtor nation," to be appointed by a team of experts called the "Berlin Club". In the eyes of a *Financial Times* editorial, such a plan "would place the debtor nation in a position of colonial submission. If ever agreed to, this would be politically explosive.... When sovereigns default, what is needed is a conference table not a torture chamber."¹³

Can it work?

At this point it is too early to tell whether austerity packages will be delivered, monetization of public debt can be avoided, and supranational centralization of fiscal and macroeconomic policies topped by Teutonic thoroughness will be institutionalized. If this happens, the revolutionary prospect Anderson was talking about will finally come true. But it is difficult to see how the revolution would work any better than when it was planned originally. The sheer magnitude of fiscal retrenchment will effectively put an end to many entitlements of the past. It is hard to see how this can happen under a popular democratic setting – or what is left from it. Any government that feels the need to keep some responsiveness towards its electorate is bound to fail on the task of internal devaluation. Consequently, therefore, in addition to the monetary authority, now also the fiscal authority is to be elevated above national electorates. Paradoxically, however, this move is only to increase the stress national democracies are being exposed to. This is because, in the words of Peter Mair, the gap between responsive government which is concerned with voters and public opinion, and responsible government which stands by its international obligations, a gap which has already been torn wide open in the past, is becoming unbridgeable.¹⁴ As a consequence, governments that abide by their European obligations have to be ready to vacate the sphere of popular politics altogether. But even if they are ready to do so, they inevitably will be challenged by opposition parties claiming to be more responsive to citizens' needs. Voters, in turn, are likely to get increasingly irritated with governments that don't represent and opposition parties which cannot deliver. It is not difficult to see how this constellation sounds the death knell for a political system which has served Europe well in the past.

It might be argued that the death of mass democracy is in the end not such a big loss. After all, is it not that a too strong sense of entitlement, voiced by most privileged social groups such as public

¹³ 'Germany plans for what comes next', *Financial Times* editorial, 14 July 14 2010. The German plan for the debt resolution authority is quoted after <http://theglobalrealm.com/2010/07/17/the-%E2%80%9Cberlin-club%E2%80%9D-germany-plans-to-put-europe-on-rations/>. For the Commission's plan see 'EU nimmt Schuldenstaaten an die Kandare', *Spiegel online*, 12. Mai 2010, at: <http://www.spiegel.de/wirtschaft/soziales/0,1518,694419,00.html>. Much of it has been adopted by the European Council in June 2010, see European Council, 'Conclusions', Brussels 2010, EUCO 13/10; for the ECB's plan 'ECB's stance on the question of governance', *Financial Times*, 21 June 2010, and for the German position 'Berlin impose sa vision de l'Europe economique', *Le Monde*, 16 June 2010; Tony Barber, 'A tent to attend to', *Financial Times*, 17 June, 2010.

¹⁴ Mair, op.cit., fn 12.

sector workers, is what brought countries like Greece into trouble in the first place? So is there anything wrong in finally driving home the lesson to the most intransigent parts of society that the party cannot go on forever? Some things can indeed be said about how privileged social groups could advance their gains at the expense of the common good, or, to put it differently, how the insiders to embedded liberalism failed to engage in forward oriented strategies which include outsiders, once the system started to fall apart. However, this is only part of the story, and not the most troublesome. Arguably more important is that the term responsible government is somewhat misleading, as it refers to governments which administer very irresponsible economics. A continent which, in order to satisfy markets, is engaged in simultaneous budget cuts of the dimensions currently envisaged is likely to enter a downward cycle of slow growth, reduced revenues and new budget cuts. While so-called responsible governments pretend that they are still living in a “slow sort of country”, where “you’d generally get to somewhere else – if you ran very fast for a long time”, what governments really are suggesting is to move on to a place where “it takes all the running you can to, to keep in the same place.”¹⁵

Even if fiscal restraint turned out not to be that suicidal, it is simply the wrong battle to fight. Lax fiscal discipline is not the root cause of the crisis of the eurozone. If that were the case, Germany and France would be among the bigger sinners, along with Portugal and Italy, although admittedly Greece still played in a league apart. Ireland and Spain on the other hand would belong to those countries entitled to teach Europe fiscal discipline. In 2007 Spain had a budget *surplus* of 2 percent and a government debt of 36 percent of its GDP. For Ireland, the respective numbers are 3 and 25 percent. These countries did more than requested. They built up surpluses in good times, to be prepared for bad times. In contrast, Germany had a budget *deficit* of 1.6 percent, and breached the Stability and Growth pact with a government debt of 65 percent. Between 1999 and 2007, Ireland and Spain never breached the 3 percent deficit rule, while Germany did so 4 times. The real shock is how budget surpluses in Ireland and Spain could turn within the time span of only two years into two-digit budget deficits. Clearly, something else is going on here, which is not captured by Maastricht criteria and cannot be cured by fiscal restraint. This is the burst of the bubble economy, or the division of the continent in ants and grasshoppers. Grasshoppers like Ireland and Spain were much better at keeping fiscal discipline than ants. Once the summer was over, however, their governments were forced to step in to take over private debt and bail out their banks, and this is what derailed their public finances. One debate that has yet to make its way into Europe is how to prevent asset bubbles in the future, and how to restore growth and competitiveness in countries that have lived on housing bubbles for so long.

This points to yet another aspect of irresponsible economics. Even if bubble economies found their way back to producing useful stuff, a task made so much harder when exchange rates cannot be tampered with, who would be there to buy it if the whole continent is engaged in a simultaneous pro-cyclical debt strategy? And vice versa, if bubble economies stop consuming, where exactly will Germany turn to sell all its goods? In the past, it could always rely on the United States to engage in deficit spending and absorb an important share of its huge export surplus. There is some irony here that Germany banked on bubble economies big and small in order to pursue its virtuous path of wage restraint, domestic saving and export growth. It would be even more ironic if now again it would preach restraint at home, and in order to achieve this, rely on economic irresponsibility abroad. Germany’s chancellor Merkel has understood as much, and has now also rushed to convince the US that fiscal order must be restored. This time around, the US is also less likely to be able and willing to play the role of the neighbor-to-be-beggared. But the point is that Germany cannot have it both ways. Its virtue has rested on American, Spanish, Irish, Greek and Portuguese vice, and if these countries are to turn more like Germany, then Germany must change.

¹⁵ Lewis Carroll, *Through the Looking Glass*, London 1899, p. 46; quoted after the electronic version prepared by Electronic Text Center, University of Virginia Library.

In a European context the gap between international obligations a government has to abide to – no matter how irresponsible they are - and responsive government is also becoming unbridgeable because, as argued above, there is no common identity and no sense of solidarity to draw upon. As decisions are taken on a transnational level, but democracy plays out on a national level, nations are, especially in hard times, inevitably pitted against each other. German citizens feel they have to bleed for Greek sins and ask why this should be the case. Greek citizens think that they are, once again, submitted to German imperial rule, and why should they accept this. Some European leaders have started thinking out loud that there might be a way out of this dilemma: the euro, and its newly reinforced federal design, could be limited only to those countries that share a common identity, namely what Kenneth Dyson calls “stability culture”. While stability culture is certainly not as elevated a suggestion for a common identity as the “constitutional patriotism” which Jürgen Habermas suggested should replace nationalism in a post-national era, a eurozone limited to countries whose societies do not look upon debt in terms of its economic meaning, but rather as a moral issue, would put an end to the conflict between the thrifty north and the lazy south.¹⁶ This was the eurozone Germany was anyway always dreaming about. Interestingly, this idea is not only popular among the usual suspects, but also gained support in the East. Eurozone member Slovenia’s Prime Minister Borut Pahor made clear that he wants to see institutional reforms of the single currency area “including mechanisms for the exclusion from the euro zone in case rules are seriously breached”. And Czech’s President Vaclav Klaus, an ardent opponent of the euro, surprised many with the following statement: “... I can say that the Czech Republic is part of something I would call German economic space. It breathes in a similar way as the other countries in this German economic space. And I believe it could be good for the Czech Republic to create a common currency with this space. Whether or not, say, Portugal belongs into the space, is another topic”.¹⁷

It is probably not by chance that this idea is popular among east European policy makers, who, in contrast to their southern counterparts, have never experienced any EU lenience on their currency matters in the first place. These countries were put under much stricter supervision, and those few select who made it to the club are now also called upon to bail out Greece and possibly other Club Med members, in all of which salaries and pensions still far exceed anything the east can afford. However, kicking the unreliable members out, while plausible in principle, is likely to lead to insurmountable conflicts in practice. How are European authorities going to decide who will be a member of the club and who not? Can France really be trusted to share Germanic debt aversion? This is highly doubtful, but can France be kicked out? Most certainly not. And how about Italy, a founding member of the EU and the Club Med at the same time? And then, how much is really known about our neighbors further east – might it not be better to kick them out as well and have them reapply, just to make sure that stability is a culture rather than a lack of choice. On the other hand, what are we to make out of the fact that most of the few countries that really can be trusted on the issue of stability culture have actually decided to stay out of the eurozone altogether? At the end, a smaller eurozone would still have to be built on political compromise rather than imagined cultural affinities. With this, the problems of solidarity wearing thin will prevail.

While an orderly re-tailoring of the boundaries of the Monetary Union is difficult to achieve, it might still come about in a very disorderly fashion. This is if the Greek, fed up with austerity which cannot work anyway, start taking to the idea of default, an idea which has some additional attraction because it would return some of the pain to their creditors which happen to be mostly German (and French) banks. Should the Greek decide so, other countries might consider following. Markets in turn will do theirs to impose this choice on whomever they find a plausible exit candidate. A thus reduced eurozone, borne amidst a crisis and as a result of major policy failures would however not inspire

¹⁶ Kenneth Dyson, ed., *European States and the Euro: Europeanization, Variation and Convergence*, Oxford 2002; Jürgen Habermas, 'Staatsbürgerschaft und nationale Identität', in *Faktizität und Geltung*, Frankfurt a.M. 1992, pp. 631-60.

¹⁷ <http://www.eubusiness.com/news-eu/greece-finance.4i3>; <http://www.praguepost.com/business/4348-greek-woes-strike-bond-market.html>.

much confidence and identity among the survivors. Moreover, as a German economic space, tied together by a common currency, does not have much appeal beyond the Czech President, states might simply decide to go it alone again.

Can anything be done?

If permanent austerity is not a solution, and the eurozone cannot be easily designed so as to only embrace debt-averse societies, can anything be done to set the Monetary Union on a less revolutionary path while coping with the fallout of the financial and Greek crises? There is no doubt that a sustainable Union will require a more coordinated approach to fiscal and macroeconomic policies. It also needs to address the imbalances between creditor and debtor countries, and will have to find a way back to sound public finances and growth. To make the economic prospect of such a Union more viable economically, it takes a different distribution of the burdens of adjustment than currently envisaged.

A fundamental condition for restoring growth is to disarm the ticking debt bomb underlying Europe's economies. But it is not clear why the burden should be shouldered entirely by European societies. Orderly debt restructuring, which puts a fair share of the costs on creditors and gives debtors some breathing space is an alternative. While this option is currently being discussed for the overindebted periphery, there is also a case to be made for extending the scheme beyond these countries. Greece's debt mountain should not blind us to the fact that almost all eurozone members are undergoing, as Wolfgang Streeck has argued a "historical exhaustion of the financial resources of the democratic interventionist state of the postwar period".¹⁸ In order to avoid that financial actors entirely dictate the conditions under which European societies reinvent themselves, some burden sharing between debtors and creditors is warranted.

A fairer distribution of the cost of adjustment can also be extended to the relations between states. This is not even a very original idea. Already at the Bretton Woods Conference in 1945, John Maynard Keynes advocated a global monetary system that encouraged economic growth rather than price stability, the major tenet of the competing White plan. A central idea of Keynes' plan was to bring pressure on both creditor and debtor countries. In Keynes' design of an International Clearing Bank, "creditor countries would be allowed or required to revalue their currencies, unblock any foreign owned investments, and be charged rising rates of interest ... on credits running above a quarter of their quota. Any credit balances exceeding quotas at the end of a year would be confiscated and transferred to a Reserve Fund."¹⁹ The eurozone would have to find functional equivalents to currency revaluation, currency quota, and excess reserves, but the basic ideas are there.

The same spirit could be invoked for wage formation. Overall, rather than focusing uniquely on restoring national competitiveness, wage formation would need to include productivity gains and inflation. Moreover, countries that have been engaged in excessive wage moderation in the past might commit to a period of faster-than-productivity-growth wage increases to provide for much needed markets.

If enforceable criteria of macroeconomic and fiscal prudence there shall be, then these criteria could be revised so as to target the problems the crisis has unveiled. Anti-inflationary policies are helpful to keep prices of goods down, but they do nothing to control asset bubbles. Debt and deficit criteria are targeting the state, but they do not help to rein in the private sector responsible for the huge imbalances that turned out to be so destabilizing. Wage restraint might be good for competitiveness,

¹⁸ Wolfgang Streeck, 'Endgame: The Fiscal Crisis of the German State', Köln 2007, Max Planck Institut für Gesellschaftsforschung, MPIfG Discussion Paper 07/7

¹⁹ Robert Skidelsky, 'Keynes, Globalisation and the Bretton Woods Institutions in the Light of Changing Ideas about Markets' *World Economics* 6/1 2007, pp. 5-30.

but if this is not accompanied by asset-earning restraint, the major outcome is growing inequality. Hence there is a need to adjust the criteria that guide economic behavior in the eurozone.

While all of this can be elements responsible governance could draw on, it is more difficult to see how any of this can undo the decline of popular democracy or generate greater legitimacy for the European project. While European institutions would have greater problem solving capacities because their competences increase, this does not mean that they will finally gain output legitimacy. As long as some channels of input legitimacy remain, output legitimacy requires a shared understanding of problems and how they are to be solved. Currently there is no such understanding, and no channel that can generate it. Citizens of the core countries are not going to like the call for greater European solidarity as many of them fared well with the old model. They will think they are being dragged into other people's problems. Citizens in the periphery will still be scared by the shadow of imperial ideas that threatens their sovereignty. As the crisis has reinforced national over European identities, it is also hard to conceive that popular sovereignty is getting reinstated in a genuine supranational democracy to catch up with economic governance. It seems the best the eurozone can therefore hope for is to get out of the economic crisis. The political discomfort is here to stay.

But if this is what depoliticization has gotten European societies into, there may be a case for bringing politics back in. After all, there is currently frightening little debate about the fact that the European rescue architecture is designed to keep the confidence of the very market actors that have caused so many of the troubles in the first place, and that to this end, basic norms of social justice are being violated. The austerity packages put an overly large burden on poorer strata of society, while those groups who already profited most from the past boom years are being largely spared. In light of this, Europe does need a new debate about how much it wants to allow markets to determine the fate of its citizens and countries. The outcome of such a debate is uncertain. But can it be much worse than what is in store for Europe anyway?

Author contacts:

Dorothee Bohle

Central European University

Political Science Department

Nador u. 9

1051 Budapest

Hungary

Email: bohled@ceu.hu

