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Europe Entrapped

Does the EU have the political capacity to overcome its current crisis?

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for Adalbert Hepp, 10 April 2013

Abstract: *The EU in 2013 finds itself at the crossroads of either something considerably better or something much worse than the status quo; in other words, in a crisis. That much is nearly universally understood, both within Europe and widely beyond. So I am certainly not alone in believing that the current crisis, a crisis that is the cumulative outcome of a financial market, sovereign debt and EU integration/democratic deficit crises, is an extremely serious and unprecedented one, frightening due to its complexity and uncertainty. If it cannot soon be resolved (but nobody knows how soon is 'soon enough') through a major institutional overhaul of the EU, both the political project of European integration and the global economy will suffer badly—to say nothing about the massive social suffering it has caused already in the countries of the European periphery.*

I The Road Forward Blocked

The seriousness of the crisis is due to one core contradiction. In a nutshell: what is urgently *needed* to be done is also extremely unpopular and therefore democratically virtually *impossible* to do. What must be done, and everyone agrees on it 'in principle' (namely large-scale and long-term debt mutualisation resulting in massive redistributive measures both between member states and social classes), cannot be 'sold' to the voting public of the core member states which so far have been less affected by the crisis than those of the periphery. Analogously, a rapid and sustained boost of the competitiveness of the peripheral countries, an adjustment of *their unit cost of labour* (defined as the ratio of real wages and labour productivity) leading at some point to their approximation to a balanced trade and sustainable levels of budget deficits—all of this is deemed to be 'needed' yet is evidently impossible to implement without thoroughly wrecking their democratic political systems. Moreover, the incongruence between what is needed in economic terms and what is politically feasible, or the now symptomatically frequently invoked condition of 'ungovernability,' applies to both sides of the current and deepening European divide of core and periphery. Yet, if the Eurozone falls apart as a consequence of the failure to square this circle, the EU is very likely to follow suit. I believe that Chancellor Merkel is right in saying

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so—although she forgot to add what by now is also evident: It is the untamed and institutionally unembedded dynamics of the European Monetary Union and the Euro that threatens to disintegrate the EU.

The chasm between what is 'needed' as a set of promising policy responses to the crisis and what is 'feasible' in terms of Member State politics and available as political support applies to *both* sides of that new European divide. Northern 'populists' (as well as centrist political parties fearing the success of populist competitors) reject further tax-funded transfers and credit guarantees, while their Southern friends (or, rather, enemies) reject measures being imposed upon them that can be denounced as being part of a counter-productive austerity conditionality. Both profit from the crisis in widening their political support. The neo-Nazi party Golden Dawn in Greece has now grown to be the third largest party, as has the rejectionist and anti-political Grillo party in Italy. The moment such a party, together with other rejectionist forces, comes to be part of a governing coalition; the Euro would be a matter of the past due to immediate responses of the European Central Bank (ECB), International Monetary Fund (IMF) and the financial markets.

II No Return to Square One

On the other hand, if a cooperative way forward appears to be blocked, why not simply go back to pre-Euro conditions? I do not think that is an option, which it why I speak of a trap where one cannot move in either direction. Even if it were widely agreed by Member States that the introduction of the Euro into a fundamentally flawed currency zone was a huge mistake, the same applies by now to simply *undoing* that mistake. Legally, part of the commitments the new Member States made at the point of their accession was a promise to transform their economies in ways that made them viable, as prescribed by the Maastricht criteria, as members of the Euro zone. In return, they were endowed with the entitlement to financial aid from EU funds which supposedly (yet so far widely unrealistically) would help them to boost productivity and competitiveness of their national economies along a trajectory of 'cohesion' and 'convergence.' If these mutual commitments were to be suspended, an avalanche of adverse economic consequences would be triggered: the re-nationalisation of monetary policy would allow periphery countries to devalue their currency yet leave them all the more deeply in trouble with the challenge of servicing the Euro-denominated debt they have accumulated. Also, private sector financial lenders would immediately increase their pressure ('spreads') on Member States that have not yet left the Euro, thus causing the incalculable costs of a domino effect that eventually would also threaten the economy of the trade surplus countries because they would lose substantial parts of their export markets. Moreover, leaving the Euro would force leavers to also leave the regulatory regime of European law, as compliance with its rules would instantaneously become unaffordable to them. The dissolution of the Euro zone and, as an inescapable medium term consequence, the EU would be equivalent to a tsunami of economic as well as political regression.

The EU has served so far, apart from being a machinery of economic liberalisation, as a monitoring and regulatory device through which major deviations from standards of human rights and liberal democracy can be kept under control, and be it, in addition to judicial devices, by the 'soft' mechanisms of naming, blaming and shaming of violators (such as the Orban government in Hungary). The EU is also the only institutional location where binding rules governing the economic and fiscal interaction between Member States can be decided upon and implemented, if so far evidently to an insufficient extent. As a supranational authority, it is a common political resource that can be used, if properly designed and further developed, for bringing order and control to not just the political economy of Europe but also for defending peace and democratic civility on the continent. It could even be argued that the distinctiveness of cultural legacies and identities of European nations can be preserved and protected against homogenising market forces *only* through the help of supranational agency. In view of these precious capacities of the EU of being a catalyst of supervisory control and cooperation, it appears frivolous to even consider the dissolution of the EU through a dynamic of re-nationalisation as an acceptable way out of the crisis. Such re-nationalisation would neither benefit individual Member States nor the EU as a whole. Instead, it would cement European divisions.

III An Unsustainable Status Quo

At the same time, there is no denying that the Euro was a mistake from the beginning. If one puts Greece and Germany, just to mention the two extreme cases, into one and the same currency zone, one unleashes pressures and economic constraints on the poorer, less productive participant, the one with higher unit costs of labour and hence lesser competitiveness in international trade, and deprives them of the possibility of *external* adjustment of their national currencies. True, in that regard the Euro ties everybody's hands. Yet the inclusion of the less competitive periphery into the Euro zone was one of those vicious mistakes which, once having been made, preclude the option of undoing them by returning to the status quo ante.

Currency exchange rate flexibility means that less productive national economies remain free (within limits) to devalue their currency in order to make their exports cheaper and imports more expensive, thus imposing an implicit extra tax on domestic consumers of, say, German luxury cars and Scottish whisky. Once one has adopted the euro, the devilish implication which people start now to feel is that you cannot devalue your currency any more. Instead, countries must now engage in some kind of *internal* adjustment in order to compensate for large trade deficits, with 'internal adjustment' being a euphemism for vast cuts applying to both the state sector and labour—unless, that is, they manage somehow to increase tax revenues from high incomes and wealth, which most political forces, including all social democrats, consider hardly feasible today. Why? Because, as borders are open, wealth can escape to national regimes with lower taxes and has done so since the financial market crisis began by the hundreds of billions (the 'Depardieu effect'), depriving countries from which they escape of much of available capital for investment. And why is that? Because an EU-wide tax harmonisation has not (yet) been accomplished.

So after the option of external monetary adjustment is taken out of the game for Euro members, the only remaining options for adjustment are labour and the public sector. The trade and budget deficits must be compensated for through pressures on wages, pensions, labour market regulations and public services such as health and education. In addition, deeply indebted states are mandated by supra-national authorities (the 'Troika' of ECB, the Commission and the IMF) to privatise state-owned assets, their political 'family silver,' in exchange for financial relief (that mostly serves to recapitalise troubled national as well as international banks anyway). Everything that is financed, provided and regulated by the state needs now to be 'liberalised.' Hence, the new and already ubiquitous semantics of 'reform.' It used to be the case that by the term 'reform,' we meant something proactive and 'progressive,' a step towards more distributional justice. Now, we see that the opposite is meant by reform: budgetary emergency measures with regressive distributional implications. Virtually the entire political elite of Europe and of Member States proclaims that reforms (in the new sense) are necessary, urgently called for and unavoidable as a *quid pro quo* for financial aid. Besides: Whatever the economic virtues of any reform proposal may be held to be, such proposals are most unlikely to be adopted if they are promoted not by a democratic political process of legislation but by foreign imposition and perceived blackmail. Little wonder that this causes a social uproar and huge protest movements. Unions fight with their back to the wall; at times, we saw explosions of these leftist populist mass movements almost every Sunday in the capitals and provincial towns of Greece, Portugal, Spain. Italy is a little better off (but perhaps not so anymore, after the outcome of the February 2013 elections), then comes France, where Hollande is trying to assume the position of a mediator. At the same time, the twin motivators of greed and fear lead financial wealth to flee to presumably safe and profitable places, be it within Europe or off its shores.

To provide some statistics, which I found quite telling concerning what measures of 'internal adjustment' are aiming at: For the Greek balance of external trade to become even, that country needs to become no less than 40 per cent less expensive in euro terms. On the other side, German exports would have to be 20 per cent more expensive in order to reduce that country's export surplus to zero.[1] (Incidentally, German export surplus for 2011 has been, relative to GDP, *twice* that of China.) Yet a balancing of international trade seems quite inconceivable to happen, as neither Greek workers, pensioners and political parties trying to defend their interests would allow this to happen nor German employers or any conceivable minister of finance. What makes things worse: Even *if* the Greek state budget were to be shrunk nearly as much in response to dictates of the EU, the ECB and the IMF by some authoritarian technocrat at the top of the country's government, the net effect on the debt-to-GDP ratio would not be favourable but strongly *negative*.[2] As the debt is made to shrink, the GDP would shrink even more rapidly, thus driving the ratio of the two *up* due to the negative multiplier effect of austerity measures. And as financial investors know that only positive growth prospects (a 'credible business plan' of a country, as in Japan) will generate the future tax base out of the taxation of which their claims can be serviced, they are likely to respond to the worsening debt/GDP situation by either punitively denying credit or increasing the spread to even less sustainable levels to the extent such growth prospects are quite plausibly deemed to be missing, an assessment which in turn triggers a self-fulfilling prophecy of economic decline.

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1 W. Schäfer, 'Die Eurozone leidet unter intern verzerrten Wechselkursen', *Frankfurter Allgemeine Zeitung*, 27 August 2013, available at http://www.faz.net/aktuell/wirtschaft/gastbeitrag-die-eurozone-leidet-unter-intern-verzerrten-wechselkursen-11868775.html.

2 O. Blanchard and D. Leigh, 'Growth Forecast Errors and Fiscal Multipliers', IMF Working Paper 2013/01, available at http://www.imf.org/external/pubs/ft/wp/2013/wp1301.pdf.

IV Solidarity?

So the overall question is: How might such huge and persistent trade imbalance be remedied *within* the framework of the euro? Or can it at all be remedied? Or should Europeans better give up trying? The main ideas are: a European clearing union, fiscal union or debt mutualisation, most practically in the form of Euro bonds, a mechanism that is currently disallowed by the Treaties and would amount to export surplus countries sharing with net importers the substantial (interest rate, tax revenues, as well as external exchange rate) benefits that they derive from their comparatively good standing with the financial and export markets. And something of the sort is being tried now, if with extreme suspicions on the part of public opinion, especially in the northern countries. The EU is, after all, not a federal state with the normal mechanisms of fiscal federalism and a central government which is constitutionally committed to take care of some permanent form of interstate redistribution. Publics in core countries such as Germany have so far failed to appreciate—and political parties have to a disastrous extent failed to enlighten the public about—the (uncontroversial, behind closed doors) fact that measures such as debt mutualisation are not a matter of 'transfers' or 'altruistic donations' but a matter of *solidarity* in the proper sense. That is to say: Solidarity means to do *not* what 'is good for you,' but what 'is good for *all of us*.' Instead, the ruling misunderstanding that mistakes acts of solidarity (in the sense just specified) for altruistic charitable donations invites the frame of asking: 'Why should "*we*" pay for "*them*"?'

This frame is something right-wing populist parties (as well as many forces in centrist parties) are taking advantage of and use for their campaign purposes, thus preventing national and European elites from pursuing a democratically broadly supported strategy mandated by 'self-interest, rightly understood' (as Tocqueville famously put it in a different context), ie solidarity. In the EU, the notion of a 'we' that defines the scope of solidarity is, however, poorly established as a reference of a shared identity. The contours of the entity called 'all of us' for whose benefit solidarity is to be practised are, only 'objectively' clear (namely 'all EU Member States,' the number of which is also involved in an ongoing process of expansion and thus remains a moving target) while they are blurred and contested in the subjective perceptions of Member State elites and masses alike. The horizon of the solidarity that is called for is not a state, least of all a 'family,' and not an association that members are aware of having voluntarily joined and therefore obliged to practise solidarity. It is rather an extensive community that is *still under construction* and hence weak (and getting weaker under the impact of the crisis with its winners and losers) as a source of solidarity obligations.

On the other hand: What a (currently shrinking) minority of EU enthusiasts among elites and non-elites would dream of for many years in terms of deepening the integration process, has suddenly, under the impact of the crisis, turned into the road map for an urgent rescue operation that makes the empowerment of fiscal and economic governing capacities at the EU level a plain imperative. Yet as this rescue operation lacks support of political parties (and hence voters) both in the still prosperous and the declining countries of the EU, the rescue operation is still unlikely to succeed, particularly as it is being conducted in an undemocratic, depoliticised and technocratic mode that violates standards of democratic accountability which publics in European Member States have (fortunately) learned to consider non-negotiable essentials of political life. Even in case the urgent fusion of supranational powers does succeed, it can thus easily be denounced by democrats as what it actually (and at best) is likely to be: A technocratically imposed, incompletely considered, judicially vulnerable, belated emergency operation with a dubious potential for putting the financial markets to rest and under control. To the contrary: As Member States undergo a metamorphosis from classical 'tax states' to debt states,[3] they become ever more vulnerable to the vagaries of the financial markets.

V The Financialisation of States and Their Inadequate Governing Capacity

Both proponents of the political left and the centre-right have recently called for referenda as an institutional device to bolster the democratic legitimacy of rescue operations initiated by 'Brussels,' with the left reluctantly betting on a 'pro' outcome and the right on the opposite due to the prevalence of notions of 'national' interests and growing mutual resentments between supposed winners and losers of the rescue operation. But, again: Before preferences of voters can be *counted*, they must first be *formed*, and formed in the light of consensual normative reasons and the 'enlightened understanding'[4] of the nature of the situation and the alternative escape routes and their consequences. In the absence of a Europe-wide party system with some hegemonic potential that could provide such enlightening orientation, and given the power of national blinders in the formation of voters' preferences, it is not easy to be confident about the 'emergency legitimation' referenda's capacity to provide support for strong interventions at the European level.

The supreme policy-making body of the EU is the non-partisan intergovernmental (as opposed to supranational) European Council (EC, not to be confused with the Council of the EU, a quasi-federal chamber that plays a major role in European lawmaking). It consists of the heads of state or heads of government of Member States. It meets four or more times per year and defines the directions and priorities of the EU and gives 'impulses' for EU policies; it is not involved in European lawmaking. (After its sessions, almost always in Brussels, a subtotal of the members, those belonging to the Euro zone, stay on for separate consultations.) The mode of decision making of this body (that meets behind closed doors) is peculiar: no votes are taken, but the president of the Council draws a 'conclusion' which is considered adopted as a consensual policy document once none of the members registers a formal disagreement. It also reflects power relations that serve to silence potential opponents to the (normally) prevailing French–German consensus. This unanimity rule represents the smallest common denominator that national top politicians of Member States are able to strike a compromise on. If it were otherwise and some kind of qualified majority rule were to apply, the national constituency of presidents or prime ministers who find themselves in the minority could (and certainly would) protest that they have been made subject to some kind of 'foreign rule,' the rule of the majority countries. This arrangement severely limits the potential *effectiveness* of (the non-legislative, but 'impulse giving') governance by the EC. Its democratic *legitimacy* is limited by the fact that members, while certainly being elected into their offices of prime minister etc, are thereby mandated to serve the good of the *country* in which they have been elected, not that of the *EU*; in contrast, members of the European Parliament are expressly elected to represent the European citizenry in EU legislation.

[3] W. Streeck, *Gekaufte Zeit: Die vertagte Krise des demokratischen Kapitalismus* (Berlin: Suhrkamp, 2013).
[4] See R. Dahl, *Democracy and its Critics* (New Haven: Yale University Press, 1989).

How did we get into this situation of urgently needed yet woefully deficient European and Euro zone governing capacity? What is the pre-history of the chain effects of financial market, debt and integration crisis? One element of the answer is the inexplicable (as it seems from today's perspective) failure of national and European authorities to regulate the financial industry in ways which might have prevented the chains of banks defaulting and governments stepping in to bail them out—a notable *attention deficit*[5] that has afflicted policy elites not just on Europe's side of the North Atlantic. Let me just allude to some of the deeper mechanisms that seem to have played a role in this extremely complex field. Part of the explanation of the story is that the states are so badly indebted and thus so vulnerable to the vagaries of financial markets because they had to bail out their banks, at least those which are proverbially 'too big to fail.' The public costs of saving private banks at the taxpayers' expense has added to the fiscal crisis which then in turn allows the banks to profit from crediting states—a manifestation of the banks' 'second strike capability' that is an obscenity in itself.

If one were to put oneself in the shoes of a financial investor, he wants one of two things (and there is a trade-off between these two things): *security* for the financial investment (a positive assessment of the probability that the loan will be serviced and paid off) and a high *yield* in terms of interest (as a partial compensation for the remaining risk that the debtor defaults). *States* used to be preferred debtors because they have two advantages, as seen by lenders, compared to private debtors. First, they have the political authority to *impose* taxes on citizens to service their debt. Second, they can *print* money and thus devalue their debt in real terms through inflation. The latter attraction is no longer valid if the debtor state is a Euro state, thereby being prohibited from printing its own money. The former attraction has also been rendered questionable, from the point of view of financial investors, as states are rightly perceived by them to relate to each other, as EU Member States with open borders, as rivals in a game of *tax competition*. Raising taxes in order to provide assurance to creditors is not an option either if that came to be seen by investors to undercut the state's international economic competitiveness, hence its future tax base, hence the ability to service its debt. In an open economy, states must be cautious with imposing taxes on corporations and the earners of high income; if they cannot rely, instead, on imposing them upon ordinary workers and consumers, and to the extent they cannot cut their expenditures, there remains no alternative other than relying on loans from private creditors—loans which become less readily available (or more expensive) due to the two points just made.

Throughout the period of global liberalisation, ie since the early 1980s of the 20th century, the total debt of OECD states has thus been continuously growing. (Incidentally, the gradual transition from the taxing state to the borrowing state has some interesting distributional implications: The *taxing* state *diminishes* the disposable income of the well-to-do through (progressive) taxation, while the *borrowing* state *increases* that income by paying interest on what the well-to-do can well afford to lend the state.) Throughout the same period, the volume of the financial sector as a whole and the portion of the revenues it derives from the financing of public debt has been growing, while the portion of income that financial investors derive from borrowers in the 'real' economy has been shrinking.

5 R. Posner, *The Crisis of Capitalist Democracy* (Cambridge: Harvard University Press, 2010).

It has been argued by the German sociologist Christoph Deutschmann[6] (2011) that the shift of the financial industry from financing investments in the 'real' economy to financing sovereign debt and speculative trading in debt is due to a relative shortage of 'classical' debtors—debtors who take out loans in order to finance investment in productive activities, the returns from which allow them to service their debt. This shortage of demand for credit in the 'real' economy can arguably be attributed to the combined effect of the demographic change of aging societies (wealthy pensioners acting as *rentiers* rather than entrepreneurs) plus a secular decline of economic growth rates throughout the OECD world (as Robert J. Gordon has argued in an influential paper on US long-term growth prospects).[7] To the extent it does take place, *growth depends on credit* that is granted to states, firms and households. (As Streeck has shown in his recent book,[8] the total indebtedness (or degree of 'financialisation' of the economy and polity) has increased to a factor of *eight* times the annual GDP in Germany and of *nine* times that of the United States, roughly doubling since the 1970s in the United States and since the early 1990s in Germany, in the latter country mostly due to debt-financed unification.)

Yet, it is also true that *credit depends on growth* for its sustainability. Moreover, the stability of a capitalist society critically depends upon growth. The one thing that capitalist societies, even the most prosperous of them, cannot afford is to *stagnate* (contrary to the hopes and predictions of J.S. Mill who foresaw a liberal steady state economy).[9] For if growth were not anticipated for at least the medium term future, investors would have no reason to invest and workers no opportunity to work and earn an income from being employed. To deepen the dilemma even further, let me just point to the currently widely shared doubts whether we in the advanced societies can at all *afford* growth ('as we know it') for environmental and, in particular, climate change considerations. Taking these considerations together, we get three propositions, each of which is as plausible as they are mutually incompatible: (1) growth is indispensible, (2) growth rates are approximating zero in advanced economies, (3) growth becomes unaffordable in view of its negative externalities.

I lack both the space and the competence to do more here than just raise these questions rather than outlining answers concerning what happens in a zero growth condition. Instead, let me return to the configuration of forces and strategies in the current debt and Euro crisis. Bailing out Greece (and now Cyprus), to say nothing about Spain and Portugal and Italy, through debt mutualisation, Eurobonds, and other mechanisms of burden sharing among Member States is likely to turn out to be an extremely expensive transfer that would have to be paid through inflation or/and increased budget deficits in the North. That is to say, it is extremely unpopular in countries which would be seen and see themselves as net contributors to the rescue operation. The only argument to possibly convince 'northern' voting publics that burden sharing (of course, with harsh conditionalist strings attached) is still an acceptable idea is the argument that *failing* to do so might be even *more* expensive.

6 C. Deutschmann, 'Limits to Financialization. Sociological Analyses of the Financial Crisis', (2011) 52 *Archives Européennes de Sociologie* 347–389.

7 R.J. Gordon, 'Is US economic growth over? Faltering innovation confronts the six headwinds', Centre for Economic Policy Research, Policy Insight, No. 63/2012, available at http://www.cepr.org/pubs/PolicyInsights/PolicyInsight63.pdf.

8 Streeck, *supra*, note 3, p. 233.

9 J.S. Mill, *Principles of Political Economy* (Oxford: Oxford University Press, 2008) [first edition: 1848].

This is an entirely prudential argument, not one from solidarity obligations. Nobody can know for sure what is going to happen if *nothing* happens, ie if some form of debt mutualisation does *not* materialise. The most recent prognostics from a Bertelsmann study[10] suggest a disaster: a domino effect throughout the northern Mediterranean, including France and perhaps Belgium would be hugely destructive for the global economy, and in particular the entire European economy. Germany, as well as Finland and the Netherlands, would be very badly affected, too. So, as a matter of prudence rather than solidarity, it is better to bail out Greece (if need be, through another 'hair cut' at tax-payers' expense) in order to stop the predators of the financial industry from imposing ever higher 'spreads' on one after the other of the countries in question. To be sure, the financial institutions will warmly welcome such acts of anxiety-driven supra-national 'solidarity,' as these acts assure them that their risk will eventually be covered, at least to an extent that allows them to stay in business. Yet more than temporary transfers is needed in order to restore the trust in the debtor countries' ability to pay and to service their debt: In order to fully assure long-term investors, what Greece would need is not just the (at any rate limited, in both time and financial volume) willingness of vicarious debtors to step in by paying for Greek debt but a recovery of the tax base of the Greek economy so that, at some point in the fairly distant future, Greece can cover its financial obligations from its own production (plus from permanent transfers from EU funds, such as an economically backward province would be entitled to receive from the central government of an ordinary federal state). That is to say, in order to prevent the banks from anticipating (and thereby causing in a self-fulfilling loop) the risk of default of Greek and other Mediterranean states, the EU, instead of urging counter-productive austerity and 'reforms,' thereby further undercutting growth prospects and stirring up disruptive social conflict, would have to become instrumental in rebuilding the ailing and largely uncompetitive economies of the Southern Euro zone. But no one, argues Streeck,[11] pointing to the (presumably 'easier') intra-state examples of the post-German Democratic Republic (GDR) *Länder* and the Italian *Mezzogiorno*, knows how to accomplish that in an effective and robust manner. Besides, the sobering fact is that the EU in its present shape (lacking its own taxing power and with its medium-term budget just having been significantly decimated, in early 2013, by Member States' governments) is neither institutionally nor economically nor politically willing and able to take the initiative towards any of those things. A minimally promising 'Marshall Plan for Greece' is not forthcoming from 'Brussels.' Besides, if it were, it would not fall on the fertile ground of a post-war reconstruction boom, as did its predecessor. As long as nothing of the kind is likely to happen, the banks are bound to have the final say on what happens to the populations and economies of the South.

In an economic space where national borders are perforated so that people, investments, goods and services can freely move from member state to member state, a web of causalities and interdependencies emerges the scope of which vastly exceeds the scope of control, or governing capacity. What 'all of us' are passively affected by cannot be actively shaped and managed by any agency that is endowed with legitimate power by 'all of us'. This gap between the horizon of causation and the horizon

[10] Bertelsmann-Stiftung, 'Wirtschaftliche Folgen eines Euro-Austritts der südeuropäischen Mitgliedsstaate', *Policy Brief 2012/06*, available at http://www.bertelsmann-stiftung.de/cps/rde/xbcr/SID-267920F9-4673CEFF/bst/xcms_bst_dms_36638_36639_2.pdf.

[11] Streeck, *supra*, fn 3.

of control applies with particular force to members of the Euro zone: they are disempowered to manage their national currencies (as there is none anymore) yet unable to collectively establish the governing capacity that would allow them to manage their interdependency in ways that are tolerable for all and capable to curb the power of the financial sector. The ECB, being the supreme fiduciary institution of the Euro zone and remote from any political accountability has neither the mandate nor nearly the capacity to fill this control gap.

Sociologically speaking: The scope of functional integration is much wider than the scope of social integration, or what we are passively *affected by* is beyond our collective capacity to *act upon*. The European political economy is (at best) experienced by its citizens as a community of *fate* but not as one of fate *control*. Markets and the currency are international, while democratic politics remains essentially national and framed in the code of what has been called 'methodological nationalism.' The twist, however is that some participants of this game, such as Germany, have no urgent reason nor incentive to remedy this imbalance because they can live with it or are even favoured by its outcomes, while others are on the receiving side of massive and uncontrolled negative externalities, ie the beggar-my-neighbour effects originating from Member States which have managed to combine high productivity with wage restraint, together yielding low unit costs of labour and high export surpluses. Yet with the EU having no taxing authority of its own, any permanent and appropriately large-scale international redistribution initiated by the Commission would meet with the complaint of 'taxation without representation.' But this imbalance can be taken care of in either of two ways: Either by further cutting the budget of the EU or by endowing the EU with a democratically accountable taxing and spending authority of its own (which, to be sure, would require not only amending the Treaties, but also national constitutions, such as the German *Grundgesetz*).

It used to be the case that, in order for one country or a group of countries to take full control of the economy and polity of another country, the former must *occupy* the latter by military means. This is no longer needed. Today one can have perfectly peaceful relations with a particular country and still literally own it—simply by appropriating its economy through a permanent trade surplus and by destroying its sovereignty by depriving the country (in an *ad hoc* fashion of rescue conditionality, if not through European law) of its budgetary and other legislative autonomy. Just an example: 40 per cent of the manufacturing sector of Hungary is estimated to be owned or jointly owned by German companies. And these are only German (co-)owners—if you add France, Austria, Great Britain, this must amount to the majority of all assets of that country. Given this constellation of economic and political power, it does not come as a surprise that within those countries the situation is perceived as a new version of imperialism and dependency—a view the anti-European mobilisational potential of which yields very gloomy prospects for the future of European integration.

VI Whose Responsibility?

Coming back to the question of who can or must be 'blamed' for such international power imbalances deepening within the European political economy and the Euro zone, the only 'agent' we can point at is the institutional setup of the EU and the 'attention deficit' of its designers. Their design of the Euro zone was a giant mistake from the beginning because of the (further deepening) heterogeneity of the economies it comprises, as was the failure of the Maastricht treaty to provide effective sanctioning mechanisms for the violation of its criteria as well as the failure of the Lisbon treaty to establish an adequately capable regime at the European level for the implementation of supra-national economic, fiscal and social policies. Nor can any 'automatic' adjustment of socio-economic imbalances be expected to take place, be it through the lowering of wages and prices in the less prosperous parts of the system or through outward migration of labour to the more prosperous ones; the latter adjustment through labour mobility is largely hindered, within the EU, by the multilingual nature of the EU with its no less than 23 official languages. On top of all, there was the mistaken political decision to engage in the competitive liberalisation of the financial industry, in Germany (under the Red-Green Schröder administration) and elsewhere. So it seems that 'all of us' have made great, serious and highly consequential mistakes.

Yet this insight, though widely and occasionally even ruefully shared by today's political elites in Europe, does not really help to redesign policy. What would help, in my view, is not to allocate *blame* retrospectively but what I would call forward-looking *remedial responsibility*. The moral principle underlying this move is simple. It postulates that the *less* an agent (member state and its economy) has suffered as a consequence of the mistakes collectively made or the *more* it even has benefitted from them having been made (through interest rates which are lower than they otherwise would be, and external exchange rates of the Euro more favourable), the *greater* the share of the burdens the agent must shoulder in compensating others for adverse consequences resulting from the original mistake. This moral calculus can even be read in a deontic and a consequentialist perspective—the latter because the beneficiary will have a long-term interest in preserving an arrangement that has yielded it so many benefits at comparatively low costs and sacrifices. Yet, however one is to read it, the answer to the question who that agent might be bearing the greatest remedial responsibility in today's Europe is compelling: Germany. Yet, German political elites and publics are far from *appreciating* this answer as compelling and from acting accordingly—quite the contrary and certainly not at a time when incumbent parties and governments are facing national elections.

What we have here is one of the rare cases where the demands of moral duty *coincide* with those of well-considered long-term interest. Yet still its practical implications are virtually universally being rejected. Needless to say, a proposition to

- partially sacrifice national sovereignty and substantial economic resources, for the sake of
- creating an enhanced European-level governing capacity, for the sake of
- bailing out Member States and subsidising their economic recovery as well as alleviating the misery of their social conditions, for the sake of
- appeasing the financial industry and restraining its charges of interest, in order to
- consolidate the Euro zone and eventually the EU

—such a complex chain of strategic moves is a non-starter in terms of national politics, and not just due to its complexity and the uncertainties involved. Whoever were to advocate this line of action has to face fears, resentments and nationalistic backlash on a massive scale coming from all over the spectrum of political forces.

VII The Poverty of Party Politics

To repeat, we face the abysmal gap between policy and politics. Political parties—preferably supra-national political parties addressing a Europe-wide constituency—would have to be able to bridge this gap by shaping and educating public opinion. Instead, we see parties desperately clinging to national frames and short-term cost calculations as they are afraid to provoke the worst resentments of the voters and of losing votes to populist competitors as a consequence. What their leaders say and decide behind closed doors in Brussels is often risky to state openly and defend at home in the national media because of the omnipresent suspicion of betrayal of 'national' interests. Political parties as power-seeking organisations are corrupted by the positivistic opportunism of responding to voters' '*given*' preferences, while shying away from the challenge of *shaping* these preferences in the first place—which is arguably the supreme mission of democratic political parties.

If that mission were to be fulfilled, parties would have to accomplish a switch from the dominant code of 'nation versus nation' to an at least supplementary code of 'social class versus social class.' That is to say: Two Germans, one of whom is threatened by long-term unemployment, have probably *less* in common, as far as their socio-economic interests are concerned, than two Europeans being threatened by unemployment (or, for that matter, deriving income from financial investments), one of whom happens to be a German.

As a rule of thumb, politicians can afford the more consistency the further they are remote from a direct involvement in national policy making. Populist leaders, both on the left and the right, are often quite consistent exactly as they cannot hope for government office anyway. As long as governing responsibilities are out of reach, they can be denounced as 'sour grapes,' and office holders denounced as self-serving, incompetent and corrupt. Populists are obsessed with what Max Weber called 'negative politics': politics of obstruction and anti-politics. Populists such as the Italian *Cinque Stelle* movement float mobilising demands for the benefit of their campaign that they rightly do not expect to have to implement as the makers of public policy. Another current example is Horst Seehofer, the Bavarian prime minister. As his role in EU crisis policy is at best a very limited one, he can well afford to 'be tough on the Greeks'—a position on which he has to retract though when it comes to demonstrating support for Merkel's coalition government of which his party is a junior partner. On the other hand, I am less optimistic than, for instance, Habermas[12] regarding the question whether political parties *are* in fact able and willing to shape public opinion through argument and persuasion in order to generate support for far-sighted and inclusive policies. What would be needed for political parties to shape preferences through persuasion and argument is the capacity to overcome widespread fears, sentiments of distrust, short-sightedness and suspicion.

One of those popular attitudes that parties are typically not capable of coming to terms with is the suspicion that if 'we' make sacrifices in favour of 'them,' 'they' will use 'our' generosity as an opportunity to take unfair advantage of 'us.' In short, 'they' are portrayed as engaging in the frivolously self-serving behaviour that economists call 'moral hazard.' The cognitive bias of mass constituencies that parties fail to

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12 See P. Bofinger, J. Habermas and J. Nida-Rümelin, 'Einspruch gegen die Fassadendemokratie', *Frankfurter Allgemeine Zeitung*, 03 August 2012, available at http://www.faz.net/aktuell/feuilleton/debatten/europas-zukunft/kurswechsel-fuer-europa-einspruch-gegen-die-fassadendemokratie-11842820.html.

overcome is the understanding that a problem is 'their' problem, not a problem of 'all of us.' This weakness could perhaps be remedied if parties were able to switch from their dominant 'nation versus nation' code to the 'class versus class' code.

Yet the primary problem is the widely shared *perception* of such threat of moral hazard and its anticipated turn into a negative-sum game. If 'we' are generous to 'them,' 'they' will respond by exploiting the situation by stopping to perform 'their' obligations, thus spiralling 'all of us' into a bottomless pit. If that were so, 'we' would do better to stop making mindless sacrifices on our part, which is a politically popular conclusion which drives the whole scenario. It stands in the way of the acceptance of socially inclusive and far-sighted policies. Yet the negative-sum scenario is not just driven by the interest of potential donors in finding an excuse for not donating, but it is often also provided plausibility by observations on how recipients actually *do* behave and are induced by their institutions and traditions to behave. In several of the Mediterranean Euro countries, there is in fact credible evidence of tax authorities and entire political elites being corrupt, tax evasion being considered a mark of cleverness, special interest being institutionally privileged and tax-exempt, organised crime playing a big role in the making (or at least sabotaging) of public policy and agents in public administration and the judiciary deviating far from what in other parts of Europe is considered an appropriate ethos of public service. It is the evidence of these deficiencies (which are hardly to be overcome by foreign pressures, threats and moralising accusations) that nourishes negative perceptions and resentments on the part of those in the north of Europe who have an interest in excusing themselves from duties of solidarity, if not even a plain propensity to victim blaming. If neither the Greek state nor European legislation finds means to prevent rich citizens of Greece to reportedly transfer every year an estimated 40 billion euros out of the country into their Swiss bank accounts or elsewhere, this fact, as processed by media reporting, is quite unlikely to stimulate other Europeans' sense of obligation and responsibility. While Greece is probably the most ethno-nationalistic country in the EU, its economic culture is arguably also the least patriotic.

We know from surveys that in none of the countries that suffer from great trade and budget deficits majorities favour the idea of leaving the euro—quite to the contrary. The economic and political reasons are obvious. First, by exiting from the euro they would lose their 'nuisance value'—the capacity to pressure the EU to rescue their banks, budgets and economies. Second, they still would have to service their Euro-denominated debt on the basis of a heavily devalued new national currency. Also, no reasonably responsible politician in the rest of Europe would urge them to leave, as chain reactions affecting other countries would be likely (and at least highly incalculable as to their costs) as a consequence.

The EU and its Member States suffer from three deficits that are by now almost proverbial: The deepening *trade* deficits of the poorer economies, the ubiquitous (except for Sweden) *budget* deficits and the glaring *democratic* deficit at the level of EU governance. To briefly illustrate: GDP per capita relates from the (admittedly: outlier of) Luxemburg at the peak to Bulgaria at the bottom as 17 relates to 1, with 10 of the 12 new Member States together making up the lower end of the distribution. There is not a single euro country where public debt levels comply with the Maastricht limit of 60 per cent of GDP. And the European institutions, in spite of the direct and deep impact they have upon the life of citizens, operate in stratospheric distance from democratic mechanisms of accountability and representation. The most supranational and most democratic of the EU institutions, the European Parliament, suffers from the anomaly that it does not meet (and will hardly ever obtain) the standard of a 'peoples chamber,' or a normal legislature; for that, it would have to comply with the 'one man one vote' rule and the principle of *equal weight* of each vote. As, for instance, the populations of Germany and Luxemburg relate to each other in quantitative terms as 204:1, the constituency of Luxemburg (or Malta or one day Iceland) would hardly ever agree to be massively downgraded in its representational weight in the EP through an abolition of the rule of 'degressive proportionality' currently in force; yet that rule has already been declared 'undemocratic' for lower houses by the German Constitutional Court.[13]

These three deficits are tightly interrelated, with the last one, the democratic deficit, being the strategic leverage point for any promising attempt to deal with the other two. In order to have a steep increase in terms of integration, fiscal pact, permanent oversight of the Commission, in order to make a regime controlling banks and budgets a stable regime (rather than an ad hoc emergency measure adopted behind closed doors), most of all: in order to implement the large-scale redistribution (both interstate and inter-class) that such a regime would entail, one certainly cannot do without the political support of the European citizenry that expresses its will, as shaped and guided by political parties, in general elections and referenda. And, as democratic procedures go, the outcome can be yes, or it can be no; democratic processes are open-ended choices. Their outcomes depend upon the capacity of political parties to persuade and enlighten citizens. If we were to leave choices concerning policy, but also those concerning institutions, to the technocrats to decide upon, then chances are that everything they decide will be worthless the day after tomorrow, ie after the day national constitutional courts or the ECJ have passed their judgments. In order to create solidity, permanence, calculability and continuity of the terms of integration, we need democratic legitimation. This is a functional argument: If we want to be effective, we cannot do without democratic legitimacy in the first place in order to endow policies and institutions with the authority and validity that the (alleged) expertise of technocrats cannot possibly substitute for through 'output legitimacy.'

At any rate, the way forward cannot be charted by Thatcher's (and Merkel's) TINA maxim that 'there is no alternative' to what incumbent elites declare the only way out. Invoking TINA is just tantamount to admitting that previous policies have failed their mandate to *keep* choices open, thereby trapping all of us in an allegedly alternative-less situation.

No doubt, there is a problem here. Liberal democracy has been suspected to be both procedurally slow in recognising and addressing societal problems and myopic (inadequately 'future-regarding') in setting agendas as elites are fixated on what can be achieved by the date of the next election. (Either of these defects can be easily illustrated using current climate change politics and policies as an example.) On the one hand, it is in the very nature of democratic processes, including appropriate information gathering, will formation through public debate and deliberation, coalition building, campaigning etc, that it is highly time consuming, compared to decision making in de-politicised technocratic committees. This applies *a fortiori* to democratic institution building: The time needed to accomplish a major overhaul of the Treaties governing the EU can safely be estimated as ranging between five and 10 years. Yet

[13] Judgment of the German Federal Constitutional Court on the Treaty of Lisbon, of 30 June 2009, available at http://www.bverfg.de/entscheidungen/es20090630_2bve000208.html, especially par. 274–295.

in order to produce a viable response to emergency situations in financial markets, one often has a day or two. Sometimes it is a matter of hours to: Brussels' decisions on how to appease financial markets must be out at 2 am Sunday night, ie before the Tokyo stock exchange opens. Yet still: Those making such decisions must be capable of being held democratically accountable or at least be able to claim legitimacy on the basis of a fiduciary mission democratically granted to them. The solution of this problem might be that policies become more proactive, anticipating and paying attention to seemingly remote possibilities (remote both in time and in probability) in order to be prepared—the opposite of what was the case in the financial market crisis of September 2008.

Besides, the absence of choice is often a false claim of politicians and their ideological preoccupations and ways of framing political and economic realities. Take the familiar case of a gaping budget deficit. The technocratic answer is the call for austerity. Yet instead of cutting expenditures, the gap can also be closed by raising taxes. Yet that would antagonise investors, whose resistance would have to be neutralised by, among other things, harmonising the system of direct taxes throughout the EU. But trying to do so would provoke objections in the new Member States which feel compelled to compete for investment through low (and often flat rate) corporate income tax rates; and so on. Claiming 'no alternatives' is often just a cover for surrendering to perceived (and no doubt: accurately perceived) power relations, the powers that defend the status quo of the free movement of financial capital.

Europe consists of nation states, citizens and social classes; there are plenty of alternatives concerning how we want to engage all these various forces and actors into the democratic process. Generally speaking: *input* legitimation is indispensable, particularly at present when *output* legitimacy—the legitimacy claimed for the making of effective decisions—is in such a miserable state. If one thinks of the so-called 'permissive consensus' in favour of Europe that prevailed until a decade ago, virtually nothing is left of it. Mass constituencies are up in arms against 'Brussels,' 'Berlin,' 'Europe'—thus we need to rebuild Europe on the basis of democratic mechanisms of representation and accountability.

There is no shortage of policy proposals which serve as proof that there *are* 'alternatives.' An EU-wide tax harmonisation applying to direct taxes would help to disincentivise 'regime shopping' practices and transnational capital mobility—a mobility with which labour cannot cope, partly because labour speaks in 23 languages, while capital is 'speechless.' Budget deficits can be addresses not just by austerity measures and 'internal' devaluation; they can also be solved by increasing taxes on high income and wealth, and be it by forcing the wealthy to buy government bonds. Indirect taxes have the great advantage that their tax base cannot flee the country and the well-known downside that their incidence is regressive: the relatively poor spend greater parts of their income and thus shoulder a greater proportion of the burden of indirect taxes. Why not applying a progressive schedule on Y-S = C per tax year, ie annual income per person minus documented savings/investment, as the basis of progressive taxation instead of a flat sales tax, thus combining the advantages, in terms of distributional fairness, of direct and indirect taxation? Furthermore, proposals have been made to Europeanise the systems of unemployment insurance[14]

[14] S. Dullien, 'Eine Arbeitslosenversicherung für die Euro-Zone', SWP-Studie, 1/2008, available at http://mercury.ethz.ch/serviceengine/Files/ISN/117151/ipublicationdocument_singledocument/5c00a007-19ac-494c-aa45-2b53189f701a/de/2008_Unemployment_Insurance_D.pdf.

and social assistance/poverty relief,[15] the realisation of which may well boost, as a side effect, the mass identification with Europe as a political entity. Moreover, without violating the 'subsidiarity' principle enshrined in the Treaties, a European legislation could be launched that specifies maximum permissible Gini-coefficients for member state societies, with the level inversely tied to their current GDP per capita values. Also, commercial banks can be prohibited to accept deposits from financial investors who can be identified as fleeing from debt-troubled countries. All of this *can* be done, but it hasn't been done. These and other policy proposals can largely be implemented through European legislation. The problem is that before that can happen, a basic 'mental reframing' of the situation is called for in that the prevailing 'methodological nationalism' code of 'nation versus nation' must be partly substituted and supplemented by a code of 'losers versus winners' of the crisis, if not socio-economic 'class versus class.'

Institutionally, and in order for any of those proposals to win favourable prospects, the European Parliament needs to be strengthened and the Commission needs to be transformed into something like a parliamentary government. It is precisely those EU institutions which have the *greatest* impact on daily life of people which are so far the *farthest remote* from democratic accountability: the European Central Bank, the ECJ and the European Commission. They are completely depoliticised and thus can act in majestic independence of whatever citizens, parties and parliaments prefer or reject. Again: We face a deep divorce between politics and policy: On the one hand, there is often populist mass politics (including identity-related 'culture wars') that has no perceptible implication for policy making on citizens' core interests and bread-and-butter issues. On the other, there is elitist policy making that has no roots in, no links to, nor legitimation through politics. This is the deepening bifurcation of those two spheres within the European polity. Political elites are increasingly unable to achieve outcomes that voters desire and to convince voters that their interests are in their, the elites', trustworthy and competent hands. What voters need and want is beyond the capacity of the political system to deliver, without the latter being able to explain the former what the hindrances are, and how they might be removed. It is as if one has mail ordered a shirt and is supplied a pair of socks. The promises and appeals by which political power is *acquired* (ie *politics*) are disjointed, under the dictate of financial markets, from the purposes to the achievement of which power resources mandated to governments are *effectively employed* and used for the making of *policies*.

To this situation, elites (as well as commentators and academic observers) respond by diagnosing and complaining about an emerging condition of 'ungovernability.' Non-elites feel cheated and follow the appeals of ever shriller and ever more anti-political forms of fundamental opposition campaigns, such as that of Grillo in Italy who, right after winning a spectacular quarter of the popular vote in the February 2013 national elections, gleefully predicted that the Italian Republic's disintegration and exit from the Euro zone within a matter of six months due to its manifest fiscal starvation.

What if the Euro fails and the losers of the Euro game are forced to leave the common currency area? I suppose there are lots of drawers in lots of government offices that are filled with emergency plans for the hour when all the rescue plans have turned out futile. I have not seen these plans, nor has anyone I know. If the EU

[15] See P. Van Parijs, 'No Eurozone without Euro-dividend', Unpublished manuscript, 2012, on file with the author.

disintegrates, in 'controlled' ways or otherwise, we'll stand at the beginning of a giant negative-sum game in which everyone is going to lose. That much is well understood, and widely. As I have pointed out, one core problem for the saving of the euro is that the banking crisis has spilled over into a debt crisis, and the debt crisis in an EU integration crisis. The latter crisis consists in the re-nationalisation of horizons of solidarity and rich countries of Europe dictating the poorer ones the austerity cure in order for them to regain the trust of the financial industry. They do so in spite of all the evidence that austerity is a highly poisonous medicine, an overdose of which will kill the patient (rather than stimulate growth and expand the tax base), in which case the weakest Euro zone members (and eventually all of them) become ever more dependent on lenders and allow them to charge ever higher and ever more unsustainable rates. It is becoming ever more difficult to envisage the bootstrapping act by which European political elites might escape from this vicious circle. I think it will eventually need the protest and resistance of those suffering most from the crisis to push those elites on a more promising path. But nobody, as of today, can claim the possession of valid knowledge on what that path may be, nor who may assume a leadership role in guiding us there.

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