



# The Political Economy of the Crisis: The End of an Era?

*by Professor Loukas Tsoukalis*

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*The crisis we are going through will shape Europe and European integration for years to come; it also risks leading Europe down the road to disintegration. The crisis of the euro is part and parcel of a much broader crisis that has resulted from the bursting of the biggest bubble in the Western financial system for several decades. Greece served as a catalyst for the transformation of a financial crisis that had already hit the real economy into a sovereign debt crisis in Europe. No doubt, Greek politicians have much to blame. But there were also colossal failures in markets and institutions: prevailing orthodoxy has suffered a big blow.*

*There are several lessons to be drawn about the European dimension of the crisis so far. The euro area now occupies centre stage in the European political system. We need to find a new modus vivendi between democracies and financial markets. Banking and sovereign debt crises are closely intertwined and they both cross national borders. Yet, European solutions to a European problem have proved difficult to reach because of economic divergence and rising populism. Additional difficulties have been created because of understandable differences about the distribution of pain, and also because implementation is becoming even more difficult in an increasingly intergovernmental European system; is there a way back? There are deep underlying differences concerning the overall economic strategy to be adopted: they go a long way back. Yet, there is a silver lining on the horizon, namely the lively debate that is now taking place at both national and European levels about what needs to be done.*

*The stakes are high. Will the crisis act as a powerful catalyst for further integration in Europe? The alternative facing us today is disintegration at a very high cost. But what if the economic measures required to deal comprehensively with the crisis prove to be beyond the capacity of member states to deliver?*

*There is also the broader picture. The bursting of the bubble marks the end of an era. Crises provide opportunities to change the terms of the debate. We need to rethink our model of economic development, we need to renegotiate the social contract, and we also need to revise our ways of managing European (and global) interdependence. Europe seems better qualified than others to adopt new ways of thinking. The paper ends with a rallying cry for Europe the broad minded.*

## The Political Economy of the Crisis: The End of an Era?

Europe is in deep crisis: the statement now sounds like a commonplace observation. It is the worst economic crisis for decades, with no end in sight as yet. It will shape Europe and European integration for years to come, but it also risks leading Europe down the road to disintegration.

The contrast with the mood prevailing at the turn of the new century, just more than ten years ago, is stark. Back then, Europe was riding on a wave of euro-enthusiasm, and many people were convinced that further integration was an unstoppable process. Three big and highly ambitious projects were expected to transform radically the economic and political scene in Europe: economic and monetary union (EMU), the biggest ever enlargement of the EU following the disintegration of the Soviet empire, and the turning of the European founding treaties into a constitution. It was going to be yet another round of deepening and widening, as the European jargon goes, but on a much bigger scale than ever before.

A decade later, we are of course much wiser – lynched by reality, one might argue. European citizens and international markets have taught us lessons which proved to be rather expensive. We have learned, for example, that European citizens were no longer ready to give their leaders a *carte blanche* on the future of European integration. A yawning gap had opened between elected politicians and their electors on things European: parliamentary ratifications of the Lisbon Treaty (and its predecessor) were mostly comfortable, voted by large majorities, while referendum results revealed much unhappiness and also large amounts of ignorance on behalf of citizens. The elitist conspiracy of European integration, full of good intentions and with pretty remarkable results, probably reached its limits. The so-called permissive consensus was no longer.

We have also learned that although enlargement may be indeed the most successful foreign policy of the EU, it inevitably comes with a price in terms of internal cohesion. Numbers also make a big difference. With twenty-seven, European councils of different denominations are no longer a group. They have now come to resemble a mini-UN conference. And that

makes a big difference on the way those councils are treated, especially by representatives of the bigger countries. On the other hand, more people now realize that the EU is not a modern incarnation of Saint Panteleimon, the all-merciful healer of all kinds of disease. The miracle of Europeanization has been cut down to size through experience.<sup>1</sup>

The creation of the single currency has been undoubtedly the most important act of integration. We always knew that the construction conceived at Maastricht was unbalanced, but that was all that was politically feasible at the time. Before the crisis, I used to compare EMU to a postmodern construction (Tsoukalis, 2005 [2003]) that defied the laws of gravity. It did so successfully for more than ten years, and there were those who were lulled into believing that the good times would last forever. Alas, the laws of gravity (and the market) finally began to take their revenge – and they did so with great force. The year 2010 became the year of the crisis of the euro area. Was EMU a step too far in European integration? We are in the process of finding out the answer, and the stakes are very high indeed.

### The outbreak of the crisis: who are culprits?

We live through a big crisis of the euro, which is part and parcel of a much broader crisis that has resulted from the bursting of the biggest bubble in the Western financial system for several decades.<sup>2</sup>

Greece served as the catalyst for the outbreak of the euro crisis, when markets began to realize that the financial crisis was rapidly transforming itself into one of sovereign debt. Greece had the worst combination of three different deficits: a large budget deficit, being added to an already big public debt; an equally large, indeed unsustainable, deficit in its current account – a deficit of competitiveness, in other words; and a serious credibility deficit as people realized that Greek politicians had been repeatedly economical with the truth and creative with the use of statistics. Greece was

not unique with respect to any of those three deficits among members of the euro area and the wider world. But it had, undoubtedly, the worst combination when markets began to panic again, while governments, and notably its own, took their time in trying to take a grip of an, admittedly, very difficult situation (Tsoukalis, forthcoming).

Much of the Greek political class (and those who elected them) had been adding for years to an already large public debt: clientelism was coupled with gross mismanagement, and the results were appalling. But the buck does not stop at the door of Greek politicians. Part of the responsibility surely lies with European institutions and Greece's EU partners. For several years, Greek governments pretended that public finances were in order and reforms were under way, while the rest pretended to believe them. On the other hand, the problem is not confined to Greece. There was systemic failure: the surveillance mechanism set up at Maastricht clearly did not work. The stability and growth pact was inadequate in its conception and poorly implemented. And when the crisis came, we all discovered (or were just reminded) that the EU had no mechanism to deal with it – some had apparently been afraid of moral hazard.

But were Irish politicians less to blame having allowed a small group of bankers to bankrupt the Irish economy? What about Anglo-American politicians, including those of New Labour, who had acted as missionaries for deregulated financial markets, allegedly the pioneers of modern capitalism? And were German politicians (and regulators), blameless and hence morally justified in chastising the others? They were apparently caught unaware that their own banks had been an integral part of the big bubble, feeding into it the savings of their customers while accumulating all kinds of toxic assets.

The crisis is the result of colossal failures in markets and institutions. It also marks a big failure for economic science and its prophets.<sup>3</sup> The efficient market

<sup>1</sup> The literature on Europeanization is rich and with a relatively long history. See, among others, Featherstone and Radaelli (2003).

<sup>2</sup> For a good analysis of the outbreak of the crisis and its broader economic, social and political effects from different perspectives, see Hemerijck et al. (2009).

<sup>3</sup> Padoa-Schioppa (2007) wrote that European financial supervision was neither super, nor did it have any vision. In *What Kind of Europe?* (Tsoukalis, 2005 [2003]). I wrote about the inherent instability of financial markets, the risk of systemic crisis in a deregulated environment, and raised the question about who will pay the costs, when the crisis does eventually break out: the finance industry, consumers, or taxpayers? Others, of course, expressed similar views, and more cogently: an old fashioned minority allegedly unable to understand,

hypothesis, resting on the behaviour of rational actors armed with perfect information, which had provided the intellectual basis for financial deregulation in the West, was shown to bear little resemblance to real life financial markets in which greed and moral hazard met in an explosive mix, with the old herd instinct being added for extra effect. One may indeed wonder what kind of world the authors of those theories inhabit, although some have been rewarded with Nobel prizes. Financial power often translates into political power: there were many instances of politicians being hijacked by financial lobbies. And the academic profession was shown to be particularly prone to mainstream thinking – attachment to mainstream thinking was sometimes apparently related to pecuniary interest.

### Lessons from the crisis

When the crisis acquired a strong European dimension, many people began to bet on the disintegration of the euro area on the belief that Europeans had neither the instruments nor the political will to deal with the problem. They were mostly, although not exclusively, to be found in Wall Street and the City of London. They have not won their bet as yet, but the game is far from over.

Many things have happened since the outbreak of the crisis. The unthinkable has indeed happened in many ways, including fiscal consolidation measures and structural reforms in the most vulnerable countries together with big bail-outs that dare not speak their name, new coordination procedures and the setting up of a new crisis mechanism at the European level. The unthinkable has therefore happened, but at every stage markets reached the conclusion that it was not enough. Political responses to the crisis have generally been slow, inadequate and poorly handled. Some critics go further: they argue that the overall strategy is deeply flawed.

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among other things, what a huge difference sophisticated computer models made in the functioning of financial markets. Now, we all do, although having drawn very different conclusions from the ones propagated by the economic orthodoxy at the time. In a remarkable piece of self-criticism, the independent evaluation office of the IMF (IEO, 2011) wrote about groupthink, intellectual capture and incomplete analytical approaches behind policies that had led to the crisis.

I shall attempt to draw below some general, albeit preliminary, lessons from the crisis. Seven is a number with allegedly mystic or sacred powers, and this is the one I shall use here. Who knows, we may in the end have to resort to those powers in order to save the euro!

The crisis in Europe manifests itself mainly as a crisis of the euro area. Thus, strictly speaking, it concerns only 17 out of the 27 members of the EU. But of course we all know that the rest, in the non-euro area of the EU and much beyond, are indirectly affected in many different ways. The crisis of the euro has tended to monopolize interest and attention, thus turning the sub-system of the euro into the core of EU activity. This is unlikely to change any time soon, and it is bound to have broader implications for the European political system. This is the first and rather straightforward lesson. A very important step in the direction of an institutionalized two-tier Europe was taken at the European Council of 8-9 December 2011. Interestingly enough, when it came to the crunch it was only the UK that chose to occupy the second tier, later followed by the Czech Republic.

Democracies and financial markets do not operate on the same clock. The lack of synchronization becomes highly destabilizing in a world where markets set the pace. This has become glaringly obvious during the crisis, especially in its European manifestation where the political clock usually operates at the speed of the slowest of democratic polities in a multinational system. One may draw the distinction between democratically regulated markets and market driven democracies. Many years back, Susan Strange had coined the term casino capitalism, and warned us of the likely consequences<sup>4</sup>. Critics of a system that clearly grew out of control follow up the analysis with recommendations for stricter regulation and supervision of financial markets. To be fair, Western governments have only themselves to blame for their increased vulnerability to the vicissitudes of financial markets through excessive borrowing. There are two sides to the story. The second and more controversial lesson is about the tense relationship between democracies and financial

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<sup>4</sup> Back in 1986, Susan Strange began her last book with the sentence '[T]he Western financial system is rapidly coming to resemble nothing as much as a vast casino' (1986: 1), and she then proceeded to explain that the new system was both unstable and uncontrolled. It took most people many years to realize this fundamental truth about the new financial system.

markets.

The crisis began a few years ago with runs on banks, followed by runs on states, and now we are back again. Large bank exposure and rising sovereign debt have been operating like communicating vessels across national borders. In other words, there is a close interdependence between the banking and the sovereign debt crises in Europe<sup>5</sup>. They therefore need to be tackled jointly in the transition to the post-crisis world. And since this is a European problem that clearly goes beyond national borders, it also requires a European solution. This is, however, easier said than done.

One reason for the difficulties encountered has been growing economic divergence inside the EU as a result of the crisis. Different countries have been affected in different ways and in different times. Most of the countries in the core and the eastern periphery were hit first. They were followed by countries of the southern periphery, plus Ireland. Economic reality and policy perceptions in Greece, Portugal or Spain continue today to be very different from those prevailing in Germany, Austria or Finland. Regional integration as a big convergence machine between the core and the periphery of Europe has now gone into reverse gear. This is a kind of collateral damage of the financial and economic crisis. If it were to continue, it would risk having broader consequences for the European project. On the other hand, there is also serious economic divergence between Germany and France, the two leading economies (and creditors) of the euro area, although the gap may narrow, if and when recession spreads across Europe.

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<sup>5</sup> See also Buiter et al. (2011); Darvas et al. (2011); and Kopf (2011). For an extremely lucid and readable story of the development of the crisis of the euro, see Pisani-Ferry (2011). Several people, including prominent politicians and analysts, have put forward proposals for the issuing of Eurobonds, partially replacing national sovereign bonds, as a way of restoring stability and confidence in financial markets (Juncker and Tremonti 2010; Steinmeier and Steinbrück 2010; Gros and Mayer 2010). Such a move would constitute a first, big step towards fiscal union, considered by a good number of economists as an essential component of EMU. However, some of the key political players are not ready for it, at least not as yet. Short of this more radical move, the euro area is forced to rely heavily on the European Central Bank (ECB) and the European Financial Stability Facility (EFSF) in order to contain the problem.

Political leaders need to cope with growing dissatisfaction in their societies, which in places goes one step further and turns into anger and social unrest. Populism is on the rise and so are anti-establishment parties. They offer simple solutions for complex, yet real, problems, they love scapegoats, and they carry a strong nationalist message with often anti-European and generally xenophobic undertones<sup>6</sup>. They have a strong presence in several countries in Europe, even in what used to be social democratic Scandinavia long perceived as being immune to that kind of problem. And some are pretty ugly.

There is a host of factors behind the populist phenomenon, of different scale and combinations across European countries: large immigration, widening income disparities, growing uncertainty in times of rapid change, and dissatisfaction with the 'Golden Straitjacket'<sup>7</sup> imposed on societies when Left and Right converged. It is now getting worse as the feeling of unfairness spreads in our societies, especially among the young, while the old economic orthodoxy is shaking. Unhappiness turns into social unrest in those countries where the problems are more acute, the culture of social protest is stronger and the institutions weaker. Financial markets remain as imperfect as they have always been, while national governments are increasingly constrained by their public opinion in seeking solutions which require a strong European (and global) component for problems that have long ceased to be confined within national boundaries. It is like trying to navigate between Scylla and Charybdis. We know from Greek mythology that this required enormous skill and courage, qualities that are apparently in short supply among political leaders in today's Europe. The combination of economic divergence and populism makes Europe-wide responses to the crisis very difficult indeed. This is the third lesson.

Distributional issues add a great deal to the difficulties: the fourth lesson relates to distribution. There is a big problem of distribution regarding the cost of adjustment to a world after the crisis. We are talking here about distribution of pain, not gain; and it is pain that is not confined to national borders. The latter is the

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<sup>6</sup> For an interesting article on populism and different conceptions of nationalism in Europe, see Auer (2010).

<sup>7</sup> A term introduced by Thomas Friedman (1999).

most difficult problem of all. Many observers agree that a comprehensive solution to the crisis of the euro has to include the recapitalization of European banks, rescue operations and/or orderly defaults of countries, as well as large interventions in financial markets coupled with more effective rules for fiscal coordination and discipline. What will be the sequence and timing of those measures? What is the appropriate mix between budgetary consolidation and monetary easing? By forcibly putting the issue of a 'haircut' of Greek sovereign debt on the negotiating table, the German Chancellor has tried to rally taxpayers against private creditors and banks across borders: it may have backfired in the end. Distributional issues are difficult to handle, and this is particularly true of the EU despite many years of integration. Differences of interest and perception, and the cacophony created when they are aired in public, have further destabilized markets.

With respect to the overall macroeconomic stance of the EU as a whole, seen as a sum of national macroeconomic policies, another problem of distribution arises, namely between surplus and deficit countries. It has proved an impossible problem to solve on the basis of generally agreed principles and rules, despite repeated efforts, mainly by the French, to ensure some symmetry between the two sides (Tsoukalis, 1997). This is an old problem acknowledged by Keynes during the Bretton Woods negotiations. At the time, the Americans represented the surplus countries, although not for very long. We have learned from experience that when the rules are not there, the will of the strongest usually prevails.

And then, there is the old problem of implementation. We all know about the gap between decision and delivery in the EU, which is in turn closely related to subsidiarity and the highly decentralized structure of the European political system. Having reached the edge of the precipice, European leaders have taken decisions that would have been completely unthinkable only a short time ago. We will end up with stronger and more effective governance structures, including new rules and institutions for the regulation of financial markets, closer and more binding coordination of national economic policies with a much broader agenda, backed up with the threat of (more or less) automatic sanctions and more effective surveillance procedures, greater

emphasis on structural reform aiming at restoring the competitiveness of national economies that have been lagging behind, as well as a mechanism for crisis management on a permanent basis with (more or less) large sums of money. There will be strong conditionality and close IMF involvement for those countries that have to resort to European programmes of financial assistance<sup>8</sup>.

But will it work? The optimists point to the high stakes and remind us that when it comes to the crunch European leaders finally take the necessary decisions in order to save the integration project – the euro being undoubtedly a key part of it. The new governance structures will have to work, they add, and remaining gaps will be filled as we go along. The pessimists, however, point to the enormity of the challenge ahead and the big questions that still remain unanswered.

Coordination of policies is much easier said than implemented, and the political basis on which it rests remains shaky. How will national parliaments react, especially those of the bigger countries (we are surely all equal, but some are still more equal than others!), when they begin to receive more or less binding instructions from Brussels and/or their partners? Even more so, what will Heads of State or Government of the euro area make of the collective ownership they have taken of the new Euro plus Pact, which is meant to extend coordination to policy areas beyond those coming under the more constraining rules of the Treaty? The experience with the old Lisbon Agenda is hardly promising. Is it again the triumph of hope over experience?

Implementation of decisions in response to the crisis has been even more difficult than usual because the leading creditor countries, Germany and France in particular, opted for intergovernmental procedures as a way of ensuring a better and more direct control of common European actions. Bail-outs, as well as the setting up, funding and operation of the EFSF, have been decided and implemented on an intergovernmental basis. This turned decisions and their implementation hostage to national politics in each one of the countries concerned,

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<sup>8</sup> There is a rapidly growing literature on the new European economic governance. For a good summary description, albeit unavoidably rather sterilized in political terms, see European Central Bank (2011). For a cogently argued and critical paper on the subject, see also De Grauwe (2011).

and hence subject to the speed and the whims of the slowest. This is the fifth lesson. While waiting for intergovernmental mechanisms to deliver the goods, the ECB as the European federal institution par excellence has been forced to assume ever growing responsibilities, thus stretching the limits of its own terms of reference and political legitimacy as well.

With the agreement reached at the European Council on 8-9 December 2011, the countries of the EU, minus the UK and the Czech Republic, have taken a big step further in terms of fiscal coordination and discipline, including an agreement on constitutional breaks at the national level and biting sanctions enshrined in an intergovernmental agreement, which will rely on EU institutions for its enforcement. It will be a delicate political and legal exercise.

There are also deep seated differences regarding the appropriate economic strategy to be adopted. One side argues that the bursting of the bubble follows many years of high indebtedness, both private and public, with the mix varying from country to country. There is now need for deleveraging and fiscal consolidation accompanied by structural reforms, which should help to bring countries back to economic health and sustainability<sup>9</sup>. This sounds like a plausible argument, with the qualification that what is good for one country may not necessarily be good for all countries at the same time. This is a familiar distinction that Keynes highlighted many years back. The counterargument therefore runs as follows: at a time when the private sector is trying to reduce its debt, any attempt by governments in most countries to do the same through budgetary contraction risks sending the European (and/or the global) economy down a deflationary spiral. The policy conclusion that follows from this argument is that countries with a margin of manoeuvre should boost domestic demand, while for those less fortunate or careless fiscal consolidation should not be excessively frontloaded. A growing number of analysts see the ECB as the crucial lender of last resort as market confidence sinks. But all this is still anathema to many Germans. Until the time of writing, it was the latter imposing their

version of economic truth, although with growing concessions to sinners.

Provisions for closer coordination of national economic policies do not automatically resolve the problem of who actually sets the priorities for the euro area (and the EU as a whole). At the present juncture, as has already happened in the past, the will of the strongest has prevailed. Beyond any doubt, the strongest country (and economy) is Germany. The government there strongly believes that other countries have no better alternative than simply follow the German example of sound public finances, wage moderation and structural reform. This is indeed what they have been trying to do with varying degrees of consistency since the financial crisis turned into a crisis of the euro. However, what may be good medicine in the long term and under normal economic conditions, now risks killing the patient by throwing the economy into a deep recession. When all economies in Europe do the same, the effect will be cumulative. And there is another flaw with the argument that everybody should do like the Germans: if we all strive for current account surpluses, countries outside Europe will have to provide the corresponding deficits. The United States are unlikely to accommodate. Do we have a better chance with China?

There is a political counterpart to the economic risks associated with the prevalent strategy. In the years before the crisis, the EU had become increasingly identified with economic liberalization, hence running the risk of being delegitimized in the eyes of those who found themselves on the losing side of economic change. Parties of the centre-left in particular had become very much aware of this problem. Now, the perception is changing. In the North, the spectre of a European 'transfer union' is haunting people: the bail-out of the bankrupt economies of some of their partners requires ever increasing amounts of financial assistance and guarantees provided by Germany, Austria, the Netherlands and Finland among others; and their citizens (and taxpayers) are manifestly unhappy. They may, however, underestimate the benefits accruing to them through participation in the euro. On the receiving end of guarantees and transfers, which are in effect interest bearing loans as long as they are being serviced, there are people who go through a long and painful process of budgetary consolidation and who

<sup>9</sup> The best proponent of this kind of argument is Mr Wolfgang Schäuble, the German Minister of Finance. See, for example, Schäuble (2011). For the counterargument, see for example numerous articles by Wolfgang Münchau and Martin Wolf in the *Financial Times*.

increasingly perceive the EU as the policeman of austerity. The combination of the spectre of transfer union for some and the policeman of austerity for others could be political suicide for Europe. The crisis is turning European integration into a zero- or even negative-sum game. This is the sixth lesson.

Luckily, the seventh lesson is more encouraging. The crisis has generated a lively debate about what should be done at both national and European levels. And this is not a debate that simply pits Germans against French or Greeks, 'hard working Northerners' against 'lazy Southerners'. There is a lively debate inside countries (witness, for example, the intra-German debate)<sup>10</sup>, while alliances are being formed across national borders. This is precisely what has been lacking in Europe, namely a proper debate on things European. Not surprisingly, this debate is all-inclusive, from the populist variety to well informed exchanges among economists and practitioners, and the more or less visionary speeches of some political leaders who dare cross the threshold of the pedantic. There have been many more manifestations of a European public forum as a result of the crisis.

### End of an era?

With the crisis, EMU has become a make or break issue for Europe. We have clearly reached a new integration frontier, and we are not at all sure what lies ahead. The measures required to deal comprehensively with the crisis form a tall order, arguably one that may be well beyond the capacity of member states and EU institutions to deliver. The banking and sovereign debt problems need to be dealt with jointly, and half measures are unlikely to stabilize markets that exhibit simultaneously signs of panic and the behaviour of

carnivores that smell blood. The financial firepower required will be huge, while national adjustment programmes will be stress testing political stability at home, the flexibility of the economy as well as social endurance. A new balance will need to be found between stabilization and growth. And we have now decided to go for yet another revision of the treaty (an intergovernmental agreement plus to be precise in order to bypass the UK veto). If and when this is set into force, it will take Europe into another stage of integration.

The stakes are very high indeed. The crisis is acting as a powerful catalyst for further integration in Europe. Admittedly, the appetite is not there. But necessity has often been a more powerful driver than good intentions or even desire. The alternative facing us today is disintegration at a very high cost. But what if there are real misfits in the euro area? And what if the economic measures required to deal comprehensively with the crisis prove to be beyond the political capacity of member states to deliver? The agreement reached in December 2011, important though it surely is, is not likely to be the end of the story.

While trying to manage the crisis, we should not, however, lose sight of the broader picture. The crisis that began in 2007, and has already gone through different phases, arguably marks the end of an era. It was an era of globalization that created many new opportunities for growth, while permitting a shift of production and economic power of an unprecedented scale from the West to the East, together with the integration of hundreds of millions of people into the world capitalist system, people who had been living until recently in subsistence conditions. It was an era of major innovations and rapid change. But it was also one characterized by growing inequalities and the squeeze of the middle class in the West, especially in the US and the UK where the finance dominated model of capitalism was the most developed. And last but not least, it was an era marked by two very big market failures which led to the bursting of the financial bubble and to global warming. Growing consumption had been largely paid through rising debt and with deleterious effects on the global environment.

If this is indeed the end of an era, we are not sure as yet what will succeed it. We find ourselves in an intermediate stage when the old is dying and the new

<sup>10</sup> There has been intense debate inside Germany about ways of dealing with the crisis, as well as about the pros and cons of bail-outs (a dirty word in German). As would have been expected in any country, the arguments ranged all the way from the sophisticated to the vulgar, from the European to the narrow nationalist. Many spoke of punishment, fewer of forgiveness. See, for example, Guérot and Leonard (2011); Paterson (2011); and Schwarzer (forthcoming). For representative, yet different, views on ways to handle the sovereign debt crisis, see Belke (2010); and Bofinger (2010). See also the position paper signed by over 180 German economists against further rescue packages (Lucke 2011).



has not yet been born. According to Gramsci (2010), this is precisely the time of monsters. In today's world, the monsters are taking the form of populism. Populism is trying to fill the vacuum created by the collapse of neo-liberal ideology. And this has major implications for national as well as European politics and policy-making. It would be dangerously naive to think that the European dimension of the crisis can be dealt with independently from the rest.

Many people pretend, and have good reasons for it, that the crisis was an unfortunate accident of the kind that can happen all the time ('stuff happens', as Donald Rumsfeld would have said). We should therefore deal with the damage as well as we can and go back to life as usual, they say. After all, there are vested interests to defend, as well as intellectual idleness and well-worn habits to contend with.

Crises provide opportunities, including opportunities to change the terms of the debate. Surely, our European economies need to become more dynamic – the economic prospects are not good and the demographic trends are even worse. Yet while doing so, we need to rethink our model of economic development: redefining the boundaries of financial markets, proposing policies that are more environmentally friendly, more socially inclusive, and with more emphasis on qualitative growth<sup>11</sup>. We need to renegotiate the social contract catering more for the interests of the economically weak, as well as the interests of the younger generations who are now expected to foot a large part of the bill. European welfare systems surely need to be reformed, but in order to better preserve their essential features in changing conditions. After all, it is not the European social model in its different national incarnations that has brought Europe close to bankruptcy, but rather a particular variety of capitalism that had been advertised for years as the only way forward. And we need to revise our ways of managing European (and global) interdependence, while deciding how far we want to go

<sup>11</sup> Today, critiques of the old order do not always stem from the same analytical or ideological basis, nor do they end up with the same, or even similar, policy conclusions. See, for example, two excellent works by Hutton (2010), with the emphasis on inequality, and Kaletsky (2010), who criticizes excessive faith in the efficiency of markets. On qualitative growth, see the report submitted to the President of the French Republic by a group of eminent, yet unorthodox, economists, including Joseph Stiglitz, Amartya Sen, and Jean-Paul Fitoussi (Stiglitz et al. 2009).

in trying to defend jointly common interests and values in a world where size still matters a great deal<sup>12</sup>. Many of the old style 'sovereignists', apparently gathering strength as a result of the crisis, seem to inhabit a world of their own. It would be a dangerous world to go back to, and this needs to be clearly explained.

Europe is better qualified than other parts of the world to adopt such new ways of thinking and eventually even providing a model for others to follow. It has democratic traditions with strong roots, deeply ingrained notions of social justice and environmental concern, a long history of a mixed economy, and a healthy scepticism (of the large majority so far) of so many '-isms', including crude forms of nationalism, a scepticism earned through bitter experience. Elsewhere, I have tried to translate the more widely accepted etymological explanation of the word Europe, meaning broad eyes in Greek, into a rallying cry for Europe the broad minded (Tsoukalis 2011).

For a long time, European integration had been like a car moving uphill: the French usually provided the driver, the Commission the map, the Germans paid for the petrol, and the British oiled the brakes. In more recent years, it looked like a car without a driver, the map was replaced by a GPS, going on and off, the Poles insisted on taking an insurance policy with God, nobody wanted to pay for the petrol (and some clearly cheated), while those inside had an argument about how many more could fit into the car.

We have been for some time moving downhill at an accelerating speed. In order to avoid a crash, we desperately need a driver – and the signs are that she will be German. We also need a GPS that functions, a sense of direction, a minimum of order inside the car and an agreement about how to share the bill. It is crucial that European integration turns once again into a positive sum game, which has not been for some time.

The European political scene has become more pluralistic, with a wide range of opinions and interests. The interplay of national interests has always determined the course of European integration, the famous Community method notwithstanding. But as integration deepened and widened, national interest became more relative as a concept, and more directly shaped by partisan preferences. Other interests have

<sup>12</sup> See, among others, Tsoukalis et al. (2009).

begun to raise their pretty or ugly heads. There is no single European narrative<sup>13</sup>, as constructivists would have said. If it ever existed, it has surely suffered several deaths as a result of successive rounds of widening and deepening. And that is not necessarily a bad thing, just another sign of the European political system becoming more pluralistic and hence more mature.

Europe needs political oxygen to breathe. Otherwise, it may suffocate, or die from boredom<sup>14</sup>. True, interminable council meetings conducted through interpreters in search of the long-winded compromise is not the stuff that is likely to attract the old-style politician full of adrenalin. The nature of European politics is indeed different, but no less real. It often looks dull and introverted. There is something stale in the European world of Brussels. But we also know from experience that a few personalities can make a big difference, and we desperately need them today. Politics is about choices, and choices need to be clearly articulated and explained to citizens. In our European countries today, political choices must have a strong European component. Our security and prosperity depend on it.

There is a role for individual countries and for European institutions to play in giving concrete form and shape to the new era. The division of labour between the nation state and the EU needs to be protected both from the missionary zeal of bureaucrats and judges keen on bulldozing all kinds of national particularities and idiosyncrasies in the name of the four fundamental freedoms of the treaties, but also from the illusions propagated by 'sovereignists' in a highly interdependent, congested and pretty small, yet highly diverse, continent. There should be enough room for differentiation in order to cater for internal divergence, as well as flexibility for those who may want to stay (temporarily?) out of common policies. And more emphasis should be placed on policy innovation and measures that work in a complementary fashion with those at national and local level.

In some policy areas, however, Europe will require more

<sup>13</sup> On Europe's narrative diversity, see Pélabay et al. (2010).

<sup>14</sup> Politicization in the EU remains, of course, a controversial subject. Hix (2008) has strongly argued in favour, and I have also done so (Tsoukalis 2005 and 2007). Moravcsik (2006) thinks otherwise.

not less coordination and integration. Financial markets are a prominent example, because interdependence in the market place has already gone very far.

Interdependence needs joint management, and this has to be explained to people: there is an educational role for politicians as well. The same applies to the environment, the governance of the euro and also parts of the internal market. Can we seriously argue, for example, that in a single market with free movement of goods and capital, there is no need for coordination in the area of taxation, including corporate taxes? Unless we imply that taxes do not matter, or that free riding should be elevated into a high principle of the integration project. Of course, nobody is seriously talking about harmonized taxes, only for minimum rates that would put a floor underneath what now looks like a race to the bottom<sup>15</sup>.

Solidarity should remain an integral part of the overall European bargain. But it needs to be explained and defended against all kinds of populists and narrow nationalists. It also needs to be connected to common projects and common goods, in which most if not all see tangible benefits for themselves; and it has to be subject to conditions and rules<sup>16</sup>. No free lunch, in other words. This surely applies to the governance of the euro, and it should increasingly apply to immigration and free internal borders. Solidarity does not enjoy ample space in our increasingly atomized societies – and this is more true across borders. We shall need to rediscover the meaning of society and the value of public goods in the years to come, thus partly reversing a trend that has lasted for long and has gone too far.<sup>17</sup>

Of course, none of the above is value free. But political economy in its classical form was not value free either. We have been invited to present and debate future options for Europe that go beyond conventional wisdoms, thus following the example that Ralf Dahrendorf had himself set as an author and political animal. This is my own modest contribution to the

<sup>15</sup> This is an argument put forward by Mario Monti, now Prime Minister of Italy, in his report to the President of the European Commission (Monti 2010), as part of a new European bargain for the re-launching of the internal market programme.

<sup>16</sup> Jacques Delors has repeatedly and convincingly argued the case for solidarity as a key part of the European bargain.

<sup>17</sup> In Margaret Thatcher's famous words: 'there is no such thing as society, there are only individual men and women, and there are families' (*Women's Own Magazine*, 31 October 1987).

debate. With reference to *What Kind of Europe?*, Ralf paid me a huge compliment when he wrote: 'it restored my belief that it is possible to be pro-European and analytical, indeed critical'. I have tried to remain loyal to that objective.

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