

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

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Abstract

The article constitutes a political economy exercise in trying to understand the crisis of the euro area and draw lessons from it. The bursting of the biggest bubble in the Western financial system for decades has led to a big crisis in a currency union without a state, which is the euro area now occupying centre stage in the European political system. The culprits are many, but there have also been colossal failures in markets and institutions. A new *modus vivendi* between democracies and financial markets needs to be found. Banking and sovereign debt crises are closely intertwined and they both cross national borders. Yet European solutions have proved difficult to reach because of economic divergence and rising populism. The distribution of pain is hardly an easy task, while implementation has been rendered more difficult in an increasingly intergovernmental EU system. There are deep underlying differences over the overall economic strategy. Yet a lively debate has developed as manifestation of an emerging European public forum. The stakes are high. Will the crisis act as a powerful catalyst for further integration in Europe? The alternative would be disintegration at a high cost. Crises provide opportunities for change. This is arguably the end of an era. The article ends with a rallying cry for Europe the broad minded.

Policy Implications

- European integration needs to turn again into a positive sum game for creditors and debtors, surplus and deficit countries by looking for new ways of distributing the burden of adjustment, recognizing the political boundaries of solidarity with conditionality, and strengthening common institutions.
- Europeans need to rethink their model of economic development, redefining the relationship between democracies and financial markets, adopting more environmentally friendly policies and more socially inclusive, while placing more emphasis on qualitative growth.
- We need to revise our ways of managing European (and global) interdependence, while deciding how far we want to go in trying to defend common interests and values in a world where size still matters a great deal.

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 is stark. 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.

Now, we are much wiser – lynched by reality, one might argue. European citizens and international markets have taught us lessons that have proved to be rather expensive. We have learned, for example, that European citizens are no longer ready to give their leaders a *carte blanche* on the future of European integration. A yawning gap has opened between elected politicians and their electors on things European: parliamentary

ratifications of the Lisbon Treaty (and its predecessor) were mostly comfortable, and with large majority votes, while referendum results revealed much unhappiness and also large amounts of ignorance among the citizens. The elitist conspiracy of European integration, full of good intentions and with remarkable results, had 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 27 (soon to be 28), 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 Pantaleon, the all-merciful healer of all kinds of disease. The miracle of Europeanization has been cut down to size through experience (Featherstone and Radaelli, 2003).

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 the EMU to a postmodern construction (Tsoukalis, 2005 [2003]) that defied the laws of gravity. It did so successfully for more than 10 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. Was the 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 area, 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 (Hemerijck et al., 2009; Roubini and Mihm, 2010).

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, added to an already sizeable 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, 2012).

Much of the Greek political class (and those who elected them) had been adding for years to the 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? More recently we began to learn more about the Spanish version of the bubble – and there are surely other national lessons to learn given the chance. 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.¹ The efficient market 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 having been 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 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: fiscal consolidation measures and structural reforms have been applied in the most vulnerable countries, together with big bail-outs that dare not speak their name; binding coordination procedures of national policies are now enshrined in a new treaty; large refinancing of private banks has been made through the European Central Bank (ECB) and direct purchases of sovereign bonds in secondary markets; and the setting up of a big crisis mechanism that was not supposed to be there because of the fear of moral hazard. 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 flawed.

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 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 subsystem 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 further step in the direction of an institutionalized two-tier Europe was taken with the signing of the treaty on stability, coordination and governance in March 2012, from which the UK and the Czech Republic have chosen to abstain.

Democracies and financial markets do not operate on the same clock. This 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. A distinction needs to be drawn between democratically regulated markets and market-driven democracies. Many

years ago, Susan Strange coined the term 'casino capitalism' and warned us of the likely consequences (Susan Strange, 1986). Critics of a system that clearly grew out of control follow up the analysis with recommendations for stricter regulation and supervision of financial markets. We surely have not seen the end of this story. To be fair, Western governments have themselves to blame not only for the excessive deregulation of financial markets but also for their increased vulnerability to the vicissitudes of those markets through their growing dependence on borrowing. There are two sides to the story. The second and more controversial lesson is about the tense relationship between democracies and financial markets in today's world, which needs to be recast in a more solid mould.

The crisis began a few years ago with runs on banks, followed by runs on states and 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.² 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 in Europe 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 the collateral damage of the crisis. If it were to continue, it would risk having broader consequences for the European project.

Political leaders need to cope with growing dissatisfaction in their societies – in some of them it 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 (Auer, 2010; Kaldor and Selchow, 2012; Della Porta and Caiani, 2011; Mény and Surel, 2002). 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.

A host of factors lies 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' (Friedman, 1999) 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 public opinion in seeking solutions that 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 not always in ample supply in today's Europe although perhaps this has more to do with structural factors than personalities. The combination of economic divergence and populism makes Europe-wide responses to the crisis very difficult indeed. This is the third lesson.

As might have been expected, it has been extremely difficult to agree about the distribution of the burden of adjustment to a world after the crisis, especially because much of it crosses national borders. This is the fourth lesson and perhaps the most difficult problem of all. Many observers agree that a comprehensive solution to the crisis of the euro has to include a European guarantee for bank deposits, recapitalization and restructuring of European banks coupled with joint supervision, rescue operations and/or the orderly restructuring of debt, large interventions in financial markets, as well as continued fiscal consolidation and structural reforms in individual countries together with more effective common rules. This is a very long and difficult list indeed, involving large sums of money.

Another manifestation of the distributional problem relates to surplus versus deficit countries, which is in turn connected to the overall macroeconomic stance of the EU as a sum of national macroeconomic policies. 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). It was recognized as such in the early stages of the long journey leading to monetary union: an old problem first 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. Moreover, there will be greater emphasis on structural reform aimed 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 large sums of money. The European edifice will surely look very different as a result of the crisis, assuming it does not fall apart in the meantime.³

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 binding instructions from Brussels and/or their partners? Even more so, what will national political leaders of the euro area make of the collective ownership they have taken of new and much more demanding forms of European economic governance? The experience with the old Lisbon Agenda is hardly promising. Admittedly, it was the open method of coordination then and hence not binding. Will it be very different from now on, with provisions and constraints legally enshrined? Or, is it again the triumph of hope over experience?

The EU system of governance has become more inter-governmental in many ways. Germany and France have led the way opting for intergovernmental procedures as a way of ensuring a better and more direct control of common European actions during the crisis. Bail-outs, as well as the setting up, funding and operation of the EFSF, have been decided and implemented on an inter-governmental basis. This turned decisions and their implementation hostage to national politics in each one of the countries concerned and hence subject to the speed and the whims of the slowest. This is the fifth les-

son. While waiting for more permanent structures to be set up in the context of a closer political union, 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. When some national politicians call for political union in Europe, the seasoned observer may be forgiven for thinking of the famous phrase 'God give me virtue, but not yet'.

There are deep-seated differences regarding the appropriate economic strategy to be adopted (Wren-Lewis, 2012). 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. 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 (and accept a higher rate of inflation?) 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.

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). Germany has emerged, beyond any doubt, as the indispensable country inside the euro area, the lender of last resort in many ways. Thus, much of the politics of choosing the way to go about dealing with the crisis has been played out in Berlin, not Brussels. German political leaders have struggled to keep their French counterparts along with them, usually on their own terms. The Franco-German leadership (or hegemony) will be tested as economic differences between the two countries grow and so do their respective perceptions and policy preferences, especially after the election of President Hollande in France. Finding a working compromise between the two countries will be absolutely crucial for the survival of the euro.

The German example of sound public finances, wage moderation and structural reform should be imitated by other countries but up to a point. What may be good

medicine in the long term and under normal economic conditions now risks killing the patient by throwing the economy into 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 as the Germans do: if we all strive for current account surpluses, countries outside the euro area will have to provide the corresponding deficits. The USA is 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, especially since the benefits accruing to them through participation in the euro have rarely been explained properly by national politicians. 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 increasingly perceive the EU as the policeman of austerity or simply a convenient scapegoat. 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-sum or even negative sum game. This is the sixth lesson.

Luckily, the seventh lesson is more encouraging. The crisis has generated a lively European debate about what needs to be done, which is much more than the usual mere juxtaposition of national debates. A good part of the European policy debate has been conducted in the pages of the Financial Times and other leading European and international newspapers. There has also been intense debate in 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. A large number of economists argue against current policies and bail-outs and some think the euro is not worth saving, while others believe that more decisive action is needed. The German Social Democrats

have taken a big risk by adopting a strong stance in favour of deeper European integration as a way out of the crisis. We will know the verdict of German citizens at the next election scheduled to take place in autumn 2013.⁴

What is the price that Germany and others are prepared to pay for saving the euro? How much adjustment is the European South willing or able to make? What is the appropriate mix for European macroeconomic policy? Should the ECB behave like a normal central bank, and should private banks be rescued or some of them at least be allowed to go under? And who stands to lose the most from an eventual disintegration? These are hot political issues that are now being aired in public.

In this debate, Germans are not just pitted against Greeks or Italians, 'hard working Northerners' against 'lazy Southerners'. Alliances are also being formed across national borders. There are trade-offs between taxpayers and bank stakeholders, between those with safe and well paid jobs and others joining the ever longer queues of unemployed in Europe. Not surprisingly, this increasingly European debate has been all-inclusive, from the populist variety often degenerating into nasty exchanges of national stereotypes to well-informed exchanges among economists and practitioners, and the more or less visionary speeches of a few 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.

With the crisis, the 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. 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 very big and so will be the ensuing risks for creditors, while national adjustment programmes will be stress-testing political stability in the debtor countries, the flexibility of their economy as well as their social endurance. A new balance will need to be found between stabilization and growth. The survival of EMU requires a new political bargain among member countries, as well as more effective common institutions and rules to back it up.

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; it is already gradually happening in the market. But what if there are real misfits in the euro area? Some people point to Greece, having in

mind its admittedly slow progress of structural reform, although they usually underestimate the huge and painful effort already made in that country in terms of fiscal consolidation and lower wages and salaries. The fear of a domino effect is also present in most people's mind. 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?

End of an era?

While trying to manage the crisis we should not lose sight of the broader picture. The crisis that began in 2008, 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 in 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 USA 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 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 neoliberal 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 doing so, 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 eco-

conomic 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 and more socially inclusive, and with more emphasis on qualitative growth.⁵ We need to renegotiate the social contract by catering more for the interests of the economically weak, as well as the interests of the younger generations who are the main victims of the crisis – analysts already refer to the lost generation in some countries. 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 in trying to defend jointly common interests and values in a world where size still matters a great deal (see, among others, Tsoukalis et al., 2009). Many of the old style sovereigntists 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 to provide 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, until recently at least) 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 has looked like a car without a driver, in which the map was replaced by a global positioning system (GPS) going on and off, where the Poles insisted on taking out an insurance policy with God, and nobody wanted to pay for the petrol (some clearly cheated), while those inside had an argument about how many more could fit into the car.

In order to avoid a crash we desperately need a capable driver – and some people believe she will have to be German, at least for the next part of the journey. 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 begun to raise their pretty or ugly heads. There is no single European narrative (see Pélabay et al., 2010), 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.⁶ 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. The crisis may help to bring them forward. 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.

More integration is not good for its own sake. And if it were so in the past, it is no longer: there are not enough buyers now. In some policy areas, however, Europe will require more 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 governance of the euro and also parts of the internal market. Can we seriously argue, for example, that in a single market with the 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. 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.⁷

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.⁸ 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.⁹

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 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.

Notes

1. Before the crisis, 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 have expressed similar views, and more cogently: an old-fashioned minority allegedly unable to understand, 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 International Monetary Fund (Independent Evaluation Office of the International Monetary Fund, 2011) wrote about the group think, intellectual capture and incomplete analytical approaches behind policies that had led to the crisis.
2. 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 also Pisani-Ferry (2011).
3. There is a rapidly growing literature on the new European economic governance. For a short and critical article on the subject, see De Grauwe (2011).
4. See the letter signed by 172 economists and published in *Frankfurter Allgemeine Zeitung* (2012), as well as Sarrazin (2012) and Habermas et al. (2012) as representative examples of very different views. They often go beyond narrow economic arguments, presenting alternative visions of Europe. See also Guérot and Leonard (2011); Paterson (2011); and Schwarzer (2012).
5. 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 an emphasis on inequality, and Kaletsky (2010), who criticizes excessive faith in the efficiency of markets. On qualitative growth, see the report submitted to former President Sarkozy by a group of eminent, yet unorthodox, economists, including Stiglitz et al. (2009).
6. Habermas (2011) has written a plea for a European constitution as a democratic response to the crisis. For a more historical approach, see Luuk Van Middelaar (2012). Politicization in the EU remains a controversial subject: Hix (2008) has strongly argued in favour, and I have also done so (Tsoukalis, 2005, 2007), while Moravcsik (2006) thinks otherwise.
7. 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 relaunching of the internal market programme.
8. Jacques Delors has repeatedly and convincingly argued the case for solidarity as a key part of the European bargain and so has Helmut Schmidt.
9. In Margaret Thatcher's words: 'there is no such thing as society, there are only individual men and women, and there are families' (Thatcher, 1987).

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