Revisiting the Crisis of the EMU: Challenges and Options

by László Csaba

As the global economy has faltered in recovering from the debt and financial crises, the institutional efficacy (and sometimes even the overall viability) of one of its strongest constituent parts, the Eurozone, has been questioned by academia, the media and the political class alike. Observing the cat-and-mouse game between the all-powerful and swiftly reacting global capital markets on the one hand and the slow, hesitant, and always half-hearted reactions by EU governments on the other, the voices of scepticism gained in momentum. This contribution seeks to identify the object of the current crisis and to explain its underlying causes. Furthermore, emerging policy solutions are assessed with special emphasis on the economic theory of European integration.

Angesichts einer aufgrund der Wirtschafts-, Finanz- und Schuldenkrise weltweit schwachen konjunkturellen Entwicklung stellen Wissenschaft, Medien und Politik immer häufiger die institutionelle Leistungsfähigkeit (und gelegentlich sogar die allgemeine Tragfähigkeit) der Europäischen Währungsunion in Frage. Mit Blick auf das Katz-und-Maus-Spiel zwischen den scheinbar allmächtigen und schnell reagierenden globalen Kapitalmärkten und den langsamen, zögerlichen und häufig halbherzigen Reaktionen der EU-Mitgliedstaaten konnten skeptische Stimmen an Bedeutung gewinnen. Der vorliegende Beitrag beschreibt das Wesen der gegenwärtigen Krise und erklärt ihre Ursachen, um anschließend aus Sicht der ökonomischen Integrationstheorie erkennbare Handlungsoptionen vorzustellen.

I. The Puzzle of Bad "Governance"

The monetary model of European integration, based on a common monetary policy combined with separate, but voluntarily co-ordinated national fiscal policies, has been a subject to criticism ever since its inception. External observers, most prominently perhaps *Martin Feldstein*,[1] called it a victory of politics over economics and forecast its quick dissolution once economic rationale prevails.[2]

1 *Feldstein, M.*: The Political Economy of the European Economic and Monetary Union: Political Success of an Economic Liability, in: Journal of Economic Perspectives, 11/4 (1997), 23-42.

2 This idea was repeated by Czech President *Václáv Klaus* in his speech on the occasion of celebrating the 20th anniversary of the Visegrád Group at a public conference of Heads of States, held at Budapest Corvinus University, 19 November 2011.

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This argument rested on two pillars. First, monetary unions tended to be the last, rather than the first, step on the road towards political union. The latter – as in the case of the USA or the Austro-Hungarian dual monarchy – rests on a joint fiscal framework with enforceable common rules of the game. Enforcement, in a worst case scenario, may demand the use of force as an *ultima ratio*, i.e. through civil war, as was the case in America and in the Hungarian war of independence, leading to the *Ausgleich* seventeen years later, in 1867.

Second, if countries are at a different level of economic development, their social structures are rigid, and their administrative capacities limited, the weaker parts are likely to replicate the sad story of the Italian *Mezzogiorno* or simply exit the club. Should both conditions hold, the current crisis was inevitable, generic, and just a question of time.

Adherents to the existing EMU model offer the following counter-arguments:[3] First, the legal and political nature of the EU has always been unique, not comparable to a territorial state or even to any confederation of states, such as India, Germany or Switzerland. As long it does not acquire features of a federal state – or, in UK parlance, a "super state" – it cannot be empowered with supranational prerogatives and enforcement rights against sovereigns. As long as the principle of 'no taxation without representation' holds, expenditure patterns – similar to the structure of revenue raising –, which is at the heart of any political game in a democratic, pluralistic society, are not liable to large-scale centralisation and/or unification. This constitutes the material content of sovereignty and democracy – rule by representation – alike.

Second, EMU was not, in reality, launched on 1 January 1999. It had been around for almost two decades as a *de facto Deutsche-Mark*-zone, which emerged through largely spontaneous policy learning during the 1980s and 1990s. Following the collapse of old-fashioned Keynesian reflation attempts in Greece and France in the early 1980s, the conversion to monetary orthodoxy – meaning mostly the unilateral pegging of local currencies to the *Mark* – has been slow but steady, with Spain and later, in the mid-1990s, even Italy following suit.

Third, in the experience of the 1980s and 1990s, it is entirely possible that national fiscal policies follow the same philosophy and are thus able and willing to act in concert, rather than following *Sinatra's* Law, as they had in the 1970s.

3 *De Haan, J./Osterloo, S./Schoenmaker, D.*: European Financial Markets and Institutions, Cambridge, 2010, 33-130.

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Thus, budgetary policies are supportive of monetary stringency. Therefore, unification is neither necessary nor possible for reaching this outcome, a scope condition of monetary union.

Fourth, as has been shown, the nitty-gritty of the structure of expenditures and revenues as well as the momentous public choice over the size and functions of the state versus the markets, remain at the heart of politics in every democratic country. But neither of these really matters as long as price stability is not undermined by irresponsible fiscal laxity and conventional maxims of solid housekeeping – currently re-cast as 'sustainable public finance' – are not only preached but practised on the ground.

These counter-arguments appear to have enjoyed uncontested pre-eminence in the political realm. However, this comfortable position has been eroded ever since the spill-over of the global financial meltdown beginning in the autumn of 2008. The basic reasons for this are as follows. First, the Greek and Irish experiences have not just illustrated but proven the inefficacy of the joint fiscal surveillance mechanisms of the EMU. Second, the recurring massive cheating on official statistics, despite the strengthened involvement of Eurostat and the Commission, have shown the major asymmetry of information for which a joint framework is not a sufficient answer. Third, the issue of commitment and compliance, widely theorised in the literature but downplayed in policy-making, has proven decisive, as those unconvinced of the virtues of the joint fiscal framework and the entire logic behind the Stability and Growth Pact (SGP) felt that it was appropriate and useful to avoid the rules, in ways both open and covert. Fourth, sanctions against trespassers have proven to be inadequate, their deterrence minimal, so that implementation of fiscal rules remained lousy. Fifth, new facilities, such as EFSF and ESM, assisting adjustment in sufficient size and scope, have only been created with considerable delay. Even if the outcome, at the end of the day, may qualify as satisfactory, the belatedness left the markets with a bitter after-taste and fuelled their suspicion. The less governments were showing due diligence in elaborating the exit strategy from excessive spending, the deeper the crisis of confidence went. The debacle of 2011, when upswing was replaced by stagnation, was a clear sign of this state of affairs.

At the end of the day, we are back to one of the oldest trade-offs in the political economy of policy reform, namely the one between calibrating *ex ante* the appropriate size of funds to be mobilised versus the credibility and commitment of the Member State governments. Should the latter be reliable, even small amounts of buffers might suffice to overcome instability. And by contrast, if access to the

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private capital market financing is not restored, no amount of official funding will do the trick. This insight by *Dornbusch* was amply demonstrated by the various rounds of the Greek crisis, where ever bigger sums proved insufficient to revert the panic.[4] By contrast, in cases where government commitment was demonstrated – as more recently in Romania and Ireland, as well as in Latvia – relatively limited, one-shot intervention was sufficient to manage the crisis.

II. Learning By Doing?

While libraries have been produced to explain the emergence and functioning of the European Monetary Union, in times of crisis it is perhaps inevitable that fundamental issues are raised again and again. The first part of this section asks who benefits from the single currency, offering a brief survey of how the European Union arrived at its current state in the subsequent part.

If one asks about the benefits of the Euro, rather straightforward answers can be given, both at the macro and micro levels. A single currency saves considerably on transaction costs, especially in a continent known for high banking fees and margins. Furthermore, comparability of national prices allows for the evolution of what is known in economics as the 'law of one price', i.e. a tendency to equalise charges for the same output or service performed. In short, if the flow of commodities and services is free, competition and arbitrage creates a situation where prices no longer show the traditional wide dispersion across the EU countries and regions. The process is well demonstrable via the observation of wholesale and retail prices, basically across the board, including non-tradables. This has to do, first, with the opening of markets, after the Single European Act, to global competition, but also, second, with the direct comparability of prices charged by individual suppliers, from airfares to food. Third, stiffening competition itself is a source of consumer benefit. Fourth, by creating a zone of stability, the currency area institutionalises the gains of the period of 'Great Moderation'[5] in terms of price stability and – ideally – also financial policies, both in the fiscal and monetary legs. Finally, by creating a largely closed economy, comparable with that of the United States, the currency zone shelters its members from external shocks – so the conventional wisdom goes. This applies *a fortiori* for small open economies, where the efficiency of monetary and fiscal policies has

4 *Dornbusch, R.*: Stabilization, Debt and Reform, New York, 1993.

5 *Stock, A./Watson, M.*: Has the Business Cycle Changed and Why?, in: NBER Macroeconomics Annual, 17 (2003), 157-230.

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long been undermined by processes of globalisation and capital market liberalisation.

How far have those theories been born out by the facts? Historically speaking, the rather complex arrangements of the EMU have never followed from pure theoretical considerations[6] that were grounded either in economics or in political science, let alone integration theory. In reality, the EMU – conceived several times and by several 'founding fathers' – has by and large been the outcome of decades of 'learning by doing'. This took place in countries with very different histories and especially following the oil shocks of 1973 and 1979 when the efficiency of conventional Keynesian demand management was subjected to serious doubt. And while insights from monetarism were playing a role, insights from other schools were at least as important. For instance, fixing the exchange rate has always been an anathema to any serious monetarist, ever since the publication of the defining piece by *Milton Friedman*.[7]

It should be underscored that the practice of European monetary integration has therefore been, by and large, the opposite of what would have followed from monetarist teaching. Here, the red thread has been the gradual conversion to exchange rate stability, later price stability, and the discontinuation of the practice of fiscal profligacy.[8]

It should, furthermore, be noted that this 'conversion to orthodoxy' was an outcome of societal learning, not of academic consensus. In academia, voices hostile to the European monetary project have always been strongly represented. However, experiences with competitive and occasional devaluations, with instability and volatility of exchange rate arrangements across the 1970s and 1980s have lent support to those practitioners who advocated the artificial creation of a zone of stability, i.e. the currency union. Alas, this latter outcome is already in line with the then emerging wisdom of financial economics, the 'bipolar view', according to which only irrevocably fixed or freely floating exchange rates are sustainable.

Joining the currency union therefore has not required extra sacrifices in terms of 'giving up the exchange rate instrument'. Such an instrument is out of question among countries forming an economic union. Furthermore, it appeared as if the

6 *De Haan, J./Osterloo, S./Schoenmaker, D.*, op. cit., 2010.

7 *Friedman, M.*: The Case for Flexible Exchange Rates, in: Friedman, M.: Essays in Positive Economics, Chicago, 159-205, 1953.

8 *Marsh, D.*: The Euro: The Battle for the New Currency, London/New Haven, 2011.

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criteria of an optimal currency area could be considered to be largely endogenous, i.e. self-fulfilling. Indeed, business cycles tended to synchronise and intra-EU trade increased. Asymmetric shocks, an issue discussed widely in the academic literature, have not proven to be policy relevant, given the rather similar economic structures of the Member States, with intra-industry and intra-firm exchanges dominating.

Measured against the background of truly severe external shocks that characterised the two decades since the adoption of the Maastricht Treaty, it seems that the considerations and institutional arrangements of the EMU have proven viable and resistant to crisis. Neither inflation nor deflation emerged, not only because the ECB adopted a more rigorous – thus longer lasting – concept of recession than is customary in the United States. The harmonised index of consumer prices, i.e. the indicator elaborated and regularly controlled by the joint statistical agency Eurostat, has never been below 0.6 per cent per annum and never exceeded 3.3 per cent – in the troublesome year of 2008. As a rule, it fluctuated between 2.1 and 2.6 per cent per annum,[9] i.e. slightly above the numerical target of the ECB but ensuring price stability for any practical purpose. The single currency has remained strong, especially during times of the financial crisis of 2008-2009, against all competing currencies except the Swiss *Franc*. The EU has never experienced major current account deficits or surpluses. Current and capital account taken together fluctuated between a mere +0.2 per cent and –1.4 per cent of joint GDP even in the crisis period of 2007-2011. Thus, the level of the cross exchange rate must be considered to be an equilibrium level, despite regular complaints by some politicians and industrial interests.

If one disregards these criticisms in the literature as well as in public discourse, demanding the inclusion of objectives which are explicitly not assigned to the ECB, a clearer picture emerges. If one accepts that any joint agency must follow its mandate, set by its statutes, the EMU actually has delivered what it promised: price stability for a long period of time, i.e. over 13 years. Criticism blaming the single currency for what it was not designed to achieve or for factors that cannot be influenced by monetary policy is therefore mis-directed. Such criticism is rarely supported by statistics, including the Euro's alleged contractionary effects, unfavourable labour market impacts and the like.

9 Source, unless otherwise indicated: *European Central Bank*: Statistics Pocket Book, Frankfurt am Main, February 2012.

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It might be argued that zero or, at times, negative real rates of interest might well have contributed to the overheating of economies like that of Ireland, Estonia, and Spain. However, had fiscal policy followed the traditional maxims and had regulators exerted 'due diligence', they could easily have counteracted the mounting debt of the private sector, e.g. by tax increases or imposing harsh deposit requirements on loans financed by foreign currency borrowing. Low rates of interests on their own are no reason for expecting overheating, if one only considers the two decades of stagnation in Japan. Furthermore, public spending always follows political pressures, not interest rate signals, even in core economies like the US or France.

Thus, the broad picture suggests that EMU has indeed worked on the ground. This stands out especially if one compares this venture to other major policies of the EU, such as the Lisbon Agenda, enlargement, reforming common agricultural policy, or improving the efficiency of cohesion fund, let alone the Doha Round of global trade talks. Against the limited success of those areas, the single currency is one of the success stories of European integration as a whole. While – as shall be shown below – it is questionable whether this outcome is attributable to the monetary and especially the fiscal framework safeguarding the common currency, the fact of the matter is that on the Community level it appears to have worked.

The *proviso* must be re-iterated that the European Union has remained intergovernmentalist in its basic features. Therefore, it does not and should not have any organ with supranational competences, able to enforce, in the worst case by military or other disciplinary measures, the decisions taken at Community level. Fiscal policy, unlike monetary policy, is not vested in a single supranational centre, because it would contradict the national foundation of democratic legitimation. Since those take place through elections to the legislatures of territorial states, the latter deciding over 98 per cent of expenditures in the EU, the common pool problem of who will foot the bill, in what proportions, and on what grounds, cannot be eschewed at the Community level. As these weighty issues are not clarified in sufficient detail in the fiscal compact,[10] to be discussed below, fiscal co-operation, a requirement for a successful monetary union, can only be based on voluntary compliance.

10 *European Council:* Treaty on Stability, Coordination and Governance in the EMU (TSCG), Brussels, 2 March 2012.

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The European Union, ever since its inception, has been a club of gentlemen. In other words, co-operation was based on commonality of values, objectives and revealed preferences of the participants to do things together, even to the point of attributing a value on its own to the factor of doing things together. This idea of the 'ever closer union' has been formative all across the history of the EU, acting as the driving force for various projects of deepening. In this context, sanctioning, let alone the exclusion of any of the participants would run against the spirit of the entire enterprise. Following the stipulations of the Lisbon Treaty of 2009, a Member State may voluntarily decide for an exit from the club. But other members, whatever their majority, cannot simply eject one of their peers[11] as demonstrated by the horse-trading on the sanctions regime against Austria in 2001.[12] Nor is the replication of the British-Danish opt-out from EMU an option, ever since the adoption of the Amsterdam Treaty of 1997. In rare cases, the European Court of Justice may superimpose Community legislation over national decisions. The attempts in 1997-2009 to politicise and federalise Europe have failed so that the current state of affairs must be taken as a given.

III. Was Convergence to Maastricht Endogenous?

Economic theory calls norms, rules, or criteria endogenous if successful compliances does not require activism on the side of an external actor. Thus, endogenous growth is generated by the interplay of agents within the system, not borrowed from the external world of technological change, as in neoclassical theory, nor imposed by governments, or imported from abroad, as in the trade theory models. Endogenous rules and criteria are basically self-fulfilling. In a *Coasian* world, for instance, original distribution of property titles does not matter, as arbitrage, competition, free pricing, and the capital market will jointly take care of liquidating inefficient owners and ensure the transfer of the title to actors able to make better use of it.

In the heydays of EMU, it was widely believed and also broadly discussed in the literature that the "optimal currency area" criteria for a successful currency un-

11 While Art. 7 TEU does allow for this, it is still difficult to conceive this to occur, just as no trespasser has ever had to pay the fines earmarked in the SGP.

12 For a good background, including political and legal aspects, cf. *Merlingen, M./Mudde, C./Sedelmeyer, U.*: The Right and the Righteous? European Norms, Domestic Politics and the Sanctions against Austria, in: Journal of Common Market Studies, 39/1 (2001), 59-77.

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ion, as elaborated by *Robert Mundell*,[13] are practically self-fulfilling, or in technical terms, endogenous. It was widely assumed that benefits from a single currency are so obvious and the theoretical consensus on the basics of solid finances so overwhelming, even trivial, that it did not require special institutional anchoring. Experience with the Benelux and later with the *Deutsche Mark* zones indicated that observing fiscal conservatism may indeed be taken for granted in mature economies. Under such assumptions, the deliberations enshrined in the Stability and Growth Pact are indeed endogenous, following from voluntary rule-abiding behaviour.

The economic consideration was complemented with a legal one, based on the peculiar political nature of the EU. The 'soft law' nature of European arrangements also implies that identification with Community ownership is even more important than any other factor. Law-abiding behaviour in general pre-supposes the agents' internal identification with values and objectives, formalised – always imperfectly – by the legislators. In cases of conflict, the spirit of the law and the intention of the legislator are matters for concern, up to the point of being decisive in settling court cases.

From this perspective, it should have been disturbing to see an ever growing number of states openly dodging the commonly elaborated fiscal arrangements. *Beetsma et al.* elaborate in great length that the stiffening of controls at times when players do not identify with the logic/value judgements behind the formal rules, has actually induced regular and large scale cheating across the board.[14] This was the case with fiscal policies, an issue that shall be elaborated in some detail.

It is certainly difficult to provide a lump sum assessment of complex developments of an entire decade, between 1999 and 2009. However, two or three general remarks may suffice for our purposes. First, as was shown above, in the first decade – until the eruption of the Greek crisis – the arrangements, however half-hearted, seem to have sufficed for sustaining price stability, and the exchange rate against the dollar even appreciated. Second, even if only in a very incre-

13 *Mundell, R.*: Capital Mobility and Stabilization Policy under Fixed and Flexible Exchange Rates, in: Canadian Journal of Economics and Political Science, 29/4 (1963), 475-485. Independently, a Scottish author published similar results, but was no longer alive by the time *Mundell* received the Nobel Prize in Economics for the insight cited, cf. *Fleming, M.*: Domestic Financial Policies under Fixed and Flexible Exchange Rates, IMF Staff Papers, 9/2 (1962), 369-379.

14 *Beetsma, R./Giuliodori, M./Wierts, P.*: Planning to Cheat: EU Fiscal Policy in Real Time, in: Economic Policy, 60 (2009), 753-804.

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mental manner, debt/GDP ratios in most Eurozone countries tended to decline, approaching the Maastricht limit (at 66.3 per cent in 2007), before exploding, as a sign of Keynesian crisis management, to 85.3 per cent by the end of 2010.[15] Third, in the years of the Great Moderation, there was a general tendency, both in academia and in politics, of believing that crises will never return.[16] What is seen from today's perspective as complacency was fairly widespread, both in the academic literature and in policy-making. Thus acting on the fiscal front, calling for more stringency or merely complaining about the lacklustre efforts at structural items of fiscal consolidation sounded like overzealous and pedantic textbook economics, especially to practitioners on the market and in public administration.

It should be noted that a number of countries were performing well, or even extremely well, such as Ireland (until 2008), Estonia, Luxemburg, Finland, Spain, Slovenia, and Slovakia. The performance of the Netherlands, Austria, and Cyprus also looked acceptable. Some countries outside the Eurozone, such as Bulgaria, Latvia, Denmark, Lithuania, the Czech Republic, Romania, Sweden, and even Poland were, even in 2010, well within the Maastricht limits of debt ratios. In other words, there appears to be no evidence, theoretical or empirical, that would warrant the usual litany of some economists about the irrationality, unfeasibility, and non-practicality of meeting the Maastricht criteria at a generalised level. The more we note that the still extensive Scandinavian welfare states all fared very well also under this criterion, doubt seems increasingly justified.

From this angle, one may advance several hypotheses. Countries which were severely derailed in the 2008-2011 period were fraught with some fundamental failures of economic policy – prior to the crisis, for a longer period of time. For if public debt explodes without any preliminaries, it must be a reflection of some previously covert structural imbalances. And it is hard not to observe that the asset bubble in both Ireland and Spain, the mismanagement of banks in Greece and Ireland, the dodging of structural reforms in Portugal and not least Italy, all

15 *European Central Bank,* op. cit., 2012, 56; the estimate for 2011 is 87.9 per cent. While this is a rough and early number, it indicates continuation of the drift all across 2011, despite statements to the contrary by public officials.

16 The term originates in *Stock, A./Watson, M.*, op. cit., 2003, and implies the regular and lasting diminishing of imbalances as well of business cycles in advanced economies. As the paper shows, there was also a certain *chicken and egg problem* in explaining whether this is an outcome of policy choices or whether policies eventually free-rode on the smoothing of activity indicators, the latter resulting from financial globalisation and the ensuing massive arbitrage across markets and countries.

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constitute platitudes within the literature by now. The hopeless state of Italian public finances counts among the evergreens of the public finance literature.

One may indeed wonder, especially against the background of the wide acceptance of the theorem of efficient markets in the pre-crisis decade, how the allegedly super-rational, fully informed, and ruthless capital markets allowed Italy, Greece, or Belgium to get away with their lousy and never-improving public finances, chronic deficits and 100+ per cent debt rates, without even attempting to deliver the punishment which, according to finance textbooks preaching the efficient markets hypothesis, should have been 'instantaneous' and devastating.

In short, it seems rather straightforward that various problems emerging in the countries listed above are particular to the individual economy and have fairly little, if anything, to do with the common framework of fiscal co-ordination, let alone with EU spending (at a mere one per cent of the combined GNI of the Member States). By contrast, the trespassing, with or without EMU, has been flagrant and extreme, recurring, and structural in nature in each of the aforementioned cases.

By the same token, it is important to underscore that the nature of each of the respective crises has been different, not least because these were not attributable primarily to EMU and SGP arrangements. True, ECB practices of accepting debt obligations of heavily indebted countries without a discount, in the name of mutuality, solidarity and a non-differentiated currency zone, or engagement in liquidity injections to commercial banks, contributed to the ills. But it would be hard to ascribe the ill to an arrangement which has by no means caused similar outcomes in countries with different policy options. The number of the latter, as listed above, is considerable. Furthermore, as could be documented prior to the crisis, regular trespassing, primarily by big players, has gone notoriously unpunished.[17] This has surely contributed to undermining the credibility of the joint fiscal framework and surveillance mechanisms, for reasons quite unrelated to the spill-over of global financial instability.

It should merely be noted how different the respective crises have been. In the case of Ireland, the overheating of the economy, an asset bubble and lack of regulation, as well as lasting inaction by the governmental agencies at times of overt crisis joined to create major trouble.[18] In short, it was trouble with over-

17 *Csaba, L.*: The New Political Economy of Emerging Europe, Budapest, 2007, 215-235.

18 *Honohan, P.*: Euro Membership and Bank Stability – Friends or Foes? Lessons from Ireland, in: Comparative Economic Studies, 52/2 (2010), 133-157.

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heating, with non-interventionism, and with an overdose of laissez-faire that created parallel bubbles in the construction and banking sectors. By contrast, Portugal, according to all accounts, has been a country with miniscule if any productivity growth, with little if any economic dynamism, minimalist policies across the board and the ensuing lag in terms of competitiveness, highlighted already years ago.[19] Finally, Greece is an entirely separate case, where analysts stress the *de facto* failure of the Greek state as well as the political instrumentalisation of various adjustment packages for domestic policy, irrespective of longer term ramifications.[20] This experience, elaborated in detail by *Visvizi*, is largely a reflection of a popular attitude just opposite to what proponents of fiscal federalism consider to be a necessary pre-condition for their suggestion to work in practice,[21] namely: a popular opinion holding policy-makers responsible for fiscal irresponsibility and a lack of reform.

What the three cases have in common is a fundamental incongruence of domestic policies and institutions with the underlying logic of the monetary model of European integration. Once a member no longer identifies itself – at the level of decision-makers and elites (broadly understood) – with the original project of the political union, or *finalité politique*, the concrete arrangements that emerge as an outcome of intergovernmental bargains may appear absurd, irrational, and of limited use (to attain the pedestrian, immediate targets of the policy-makers). Once this assessment prevails, a minimalist approach replaces the traditional commitment to European goals.

While intergovernmentalism has long helped to overcome crises, lack of commitment, foot dragging over macroeconomically insignificant issues and financial flows, and generally, playing a theatre scene for domestic audiences instead of focusing on the solution of Community goals, both in the technical and political fields, translated into inaction and drifting. The defining feature of the 2008-2011 period has been the collapse of Great Moderation at the global scale, and the peaceful waters that used to characterise that period. By contrast, ever since the eruption of the financial crisis and the domino effect on a number of EU countries, fire fighting has replaced strategic thinking. Managing the task of the

19 *Blanchard, O.*: Adjustment Within the Euro: the Difficult Case of Portugal, in: Portuguese Economic Review, 6/1 (2006), 1-21.

20 *Visvizi, A.*: The Crisis in Greece and the IMF Rescue Package: Determinants and Pitfalls, in: Acta Oeconomica, 62/1 (2012), 15-39.

21 *Hallerberg, M.*: Fiscal Federalism Reforms in the European Union and the Greek Crisis, in: European Union Politics, 12/ 1(2011), 127-142.

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day clearly prevails over any broader consideration, including the economic strategy of the EU, the Europe 2020 project.

IV. The Mirage of a Fiscal Union

Crisis management in the EU has, by the time of writing, reached a new dimension. First and foremost, the global economy has not returned to the normality of the pre-2008 period, not least because of the crisis of confidence dominating the financial markets. Most players remain unconvinced of both the ability and willingness of major governments to manage their public debt solidly. This is only exacerbated by these governments' – implicitly and explicitly – assuming responsibility for a large part of private debts in their countries.[22]

Indeed, for market players the insight that there is no longer a Chinese Wall between public and private debts accumulated in the same country, implies a *Copernican* turn in the way market participants evaluate macroeconomic fundamentals. This is not least due to the additive nature of the two mountains of debt that undermined the faith of markets in governmental policies, which in 2009-2011 showed little if any commitment to revert the tendency – an obvious warning sign according to the historic evidence marshalled by *Reinhart* and *Rogoff*.[23] By the same token, combined fiscal and monetary easing, as practised in the USA, can do precious little to alleviate the problem, which is not rooted in effective demand, but in actors' anticipating further worsening, quite in line with the classical *Lucas* Critique of the inefficiency of such policies.[24]

The period 2009-2011 has seen an unprecedented degree of attempts to create new mechanisms for fire-fighting, crisis management, and also to bring about a sustainable and lasting, permanent mechanism of pre-emption and cure, the European Stability Mechanism, effective from 2013. This contribution does not provide a detailed summary of this issue, which is extremely complex both in

22 Iceland is perhaps an extreme case where the government guaranteed the repayment of all deposits, way above the 20,000 Euro limit stipulated by EU banking regulations. But bailing out big firms, like GM and Chrysler, or big banks, like Fortys or Hypo Vereinsbank, implied by and large the same for the fiscal position of the respective countries.

23 *Reinhart, C./Rogoff, K.*: The Forgotten History of Domestic Debt, in: Economic Journal, 121/552 (2011), 319-350.

24 *Lucas, R.*: Econometric Policy Evaluation: a Critique, in: *Brunner, K./Melzer, A.* (eds.): The Phillips Curve and Labor Markets, Carnegie-Rochester Series on Public Policy, New York, 1976, 19-46. A rather obvious indication of this is the fact that commercial banks deposit most of the money pumped in the process of liquidity easing in the system on accounts of the central banks in fear of future uncertainties should any crediting occur, cf. *Wall Street Journal,* 21 February 2012.

https://doi.org/10.5771/1610-7780-2012-1-53 - Generiert durch IP 216.73.216.63, am 25.06.2026, 09:25:33. © Urheberrechtlich geschützter Inhalt. Ohne gesonderte Erlaubnis ist jede urheberrechtliche Nutzung untersagt, insbesondere die Nutzung des Inhalts im Zusammenhang mit, für oder in KI-Systemen, KI-Modellen oder Generativen Sprachmodellen.

terms of management techniques and in terms of institutional arrangements. Analysing these questions, a leading British authority calls for the severing of the SGP with incremental quantitative targets for national fiscal policies so that these could mitigate the lack of competitive position of the South while addressing the excessive competitiveness of the North, all in a symmetric and synchronized manner.[25] Still others recall earlier attempts to impose national fiscal straightjackets that ensure compliance with SGP and these would already enjoy legitimacy and enforceability.[26] The European Semester and the Fiscal Compact of March 2012 move in this direction.

Others, coming from the Austrian School (or pure monetarism) may object by raising the classical doubts against fiscal policy being even a half-way efficient tool of tackling structural problems, let alone bringing about lasting competitiveness at the national level, except for the very short run (months rather than years). Yet another author may formulate an agnostic stance on any formal rules that are not internalised by one or several players.[27] In this view, recent experience has fundamentally shaken the credibility and thus the efficacy of any formalized arrangements, especially of institutional straightjackets, for the aforementioned lack of external enforcement mechanisms against non-compliance.

First and foremost, the three current crises, exacerbated by the eruption of previously covert, but lasting instability in Italy[28] and, to a lesser extent, in Spain, have made the underlying contradiction between sustaining intergovernmentalism in decision-making and supranationalism in terms of substance. The latter is particularly clear when national debts are ‘mutualized’, to use the euphemism coined by former Commission President *Jacques Delors*,[29] when the idea of

25 *Vines, D.*: Recasting the Macroeconomic Policy-Making Systems in Europe, in: ZSE 9/3 (2011), 310-323, 322f.

26 *Benczes, I.*: Rules-based Economic Governance in the European Union: A Re-appraisal of National Fiscal Rules, in: Global Business and Economics Anthology, II/2 (2011), 598-608.

27 *Győrffy, D.*: Institutional Trust and Economic Policy in the European Union: Intrinsic Challenges to the Euro, Budapest, forthcoming.

28 According to the *Wall Street Journal* of 10 September 2011, over 70 per cent of the bond purchases by the ECB, reaching close to 80 bn. euros, was directed to the troubled southern members, leading to the ECB owing the larger part of external government debt of these nations, which is bizarre, given the statutory prohibition protecting the ECB from financing any government debt.

29 *Delors, J.*: Euro Doomed from Start, in: *The Telegraph*, 2 December 2011. He was not yet specific in the interview, but implied enforced surveillance of fiscal accounts for all those exceeding the Maastricht limit of 60 per cent debt/GDP ratio. He also advocated the mutual adjustment by surplus and deficit countries. Many of these ideas re-emerged in the Draft on the fiscal compact (*European Council*, op. cit., 2012), though the latter was watered down by the Council.

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issuing common European debt obligations has been gaining acceptance and when the *de facto* co-funding of individually issued debt, explicitly forbidden by the Stability and Growth Pact and the ECB statutes, is becoming an on-going practice.

Against this background, it is perhaps unsurprising to see attempts at creating more bureaucratic/obligatory co-ordination of fiscal policies, monitored and censored by the Commission. Trespassers, according to the original version of the proposed Fiscal Compact, would even be fined in an automatic procedure.[30] The harsh reaction by the UK – total rejection – and the Czech Republic – Premier *Necas* calling for a referendum on the compact – do not bode well for the idea of pushing through a fiscal union without closer political integration. The compromise of 30 January 2012, expressed in a Council resolution,[31] reflect a balance between insiders and outsiders, rights and obligations – basically refraining from automatism of sanctions, and applied only to Eurozone members. This clearly reflects our concern about the fundamental nature of sustaining intergovernmentalism as a defining feature of the EU, to be reflected in the fiscal side.

The final outcome is even more nuanced.[32] It contains the disciplinary elements, including reliance on structural deficits and automatic triggers.[33] It also calls for constitutional anchoring of debt ceilings. However, it is not the Commission, but the European Court of Justice which is the final arbiter over sanctions. The Fiscal Compact applies to Eurozone members only and is scheduled to become part of the TEU five years later. It comes to effect when twelve national legislatures have ratified it. Furthermore, non-Eurozone members will also be present at meetings of the Euro group when decisions on trespassers take place.

Even this balanced arrangement has triggered harsh and immediate reactions.[34] Ireland joined the two rebels, the UK and the Czech Republic, in calling for a referendum on the compact. French presidential hopeful *Hollande* promised an immediate re-negotiation of the compact. Judging by their comments, Spanish,

30 *European Commission:* Draft Treaty on Stability, Coordination and Governance in the EMU, Brussels, 19 January 2012.

31 *European Council:* For Growth-oriented Consolidation and Job-creating Growth, Brussels, 30 January 2012.

32 *European Council,* TSCG, op. cit., March 2012.

33 Unlike headline numbers, this indicator does not contain one-shot measures, like temporary levies, revenues from selling property and the like, which have traditionally played a role in meeting the headline target in many countries in many years.

34 "25 EU Leaders Sign Fiscal Compact Treaty", in: Euractiv, 2 March 2012.

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Greek, and Polish reactions are unlikely to be positive. Non-Eurozone members as well as countries with opt-outs (such as Denmark) are also about to abstain. In sum, the Fiscal Compact is more likely to remain a patchwork rather than a straightjacket, mirroring the political realities in the Community of 27, nowhere close to a confederation, and the priority of national responsibility for sound public finance is hardly weakened.[35]

Second, one may describe the problem as follows: if the SGP contains an explicit 'no bail-out' clause, the idea of political community and European solidarity also contains an implicit 'no bankruptcy' clause. As was argued above, for at least a decade, the two contradictory considerations seem to have been co-existing pretty well. But once the fundamental assumptions over gentlemanly behaviour are violated, when the Irish, Greek, and the former socialist Portuguese governments run openly counter to their own obligations to revert the financial catastrophe, a system based on understanding and the spirit of co-operation was clearly and openly challenged. This is why many observers by now talk about the crisis of the periphery being gradually but irrevocably transformed into the crisis of the Eurosystem. For if there exists a recurring practice of not abiding by the rules followed by a lack of sanctions, it is clearly a sign of erosion of the arrangement as a whole.

Third, it is hard to overlook that policy improvisation without a map inevitably leads into a dead end. For even if one were sympathetic to the policy-makers acting under informational constraints and bounded rationality, that would not help us over the unresolved fundamentals, which are like devil – coming back through the window once thrown out of the door.

To cut a long story short, the twelve years leading up to the adoption of the Lisbon Treaty were an attempt to politicise and deepen the European Union. Whatever the reasons, the outcome has clearly been an outright rejection of anything, even symbolically, supranational and avowedly federalist. *Claudia Reh* rightly talks about the de-constitutionalising of the Union in and by the Lisbon Treaty, implying the watering down of the top-down, federalist, and structurally binding components of previous drafts.[36]

By the same token, it is ironic to see propositions, as tabled by the Dutch, Finnish, German, and Slovak governments, where fiscal trespassing by another

35 Cf. also: *Di Fabio, U.*: Europa in der Krise, in: ZSE, 9/4 (2011), 459-464.

36 *Reh, C.*: The Lisbon Treaty: De-Constitutionalizing the EU?, in: Journal of Common Market Studies, 47/3 (2009), 625-650.

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member state could be actually punished, to the point of ejecting the sinner from the Eurozone. It should be recalled that the point is not the compelling nature or the economic rationality of this argument, which is also questionable, since the need to overcome the obvious moral hazard implicit in the ways the 2009-2011 crises were managed are clear. It is rather that the constitutional, legal, political, and thus technical pre-conditions have not been created and even consciously weakened. "European governance" may, on the surface, appear like the gateway to a planned economy with its excessive formalism and bureaucracy. In reality, it is perhaps the opposite problem that prevails: the complete lack of enforcement mechanisms. True, the European Semester practised since 2011 has created the rituals for some *ex ante* co-ordination and also much tighter monitoring of details on the spot. Still, it remains to be seen whether the Commission, being a servicing unit rather than a central government of supranational prerogatives, can indeed ensure implementation by non-abiding members.[37]

There has been a long lasting row between the European Parliament, employing its enhanced powers of co-decision, anchored in the Lisbon Treaty, and the traditionally all-powerful Council. The latter was particularly worried over the quasi-automatic nature of sanctions to be imposed on trespassers. This controversy is just another sign of the deeper problem: issuing Eurobonds or accepting government bonds of highly indebted countries as a collateral, without a discount, constitutes two major infringements of the original EMU model. First, it equals to quasi-fiscal activity and, second, to a re-tailoring of the burden of debt at the Community level, without however enjoying the legitimation of the citizens, who will, at the end of the day, have to foot the bill, now or in later generations.

Support for issuing Eurobonds is particularly strong in the financial community, as readers of the Financial Times would be quick to appreciate. In a way, this option – as well as the monetary easing, introduced by President *Draghi* in his first days, approaching 500 bn. euros – would help bridge the liquidity problems of the banking sector, as well as of fiscal authorities, without having to resort to measures with an unfavourable impact on their respective balance sheets. Thus, technically speaking, it could alleviate the problem of heavily indebted countries.

37 This is clearly spelled out in the detailed first assessment of the DG EcFin of the Commission, elucidating the details in terms of procedures and competences, cf. *Flores, E.*: The 2012 European Semester: Policy Priorities for Times of Crisis and Lessons from 2011, Paper presented by the Director of Policy Strategy to the High-level Conference on Economic Governance, Budapest, 24 November 2011. One may not agree with the supranationalist propositions of the aforementioned contribution but can nevertheless appreciate its analytical substance.

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However, as long as the TEU is the Lisbon Treaty of 2009, which may well be criticised on a number of grounds, but has been ratified by all 27 Member States, its rules remain the singular point of reference. As long as it cements the traditional model of the EMU, the aforementioned initiatives at monetary easing and fiscal activism, in political and legal terms, remain non-starters. As shall be shown below, their economic rationale is equally doubtful – especially as little transparency and accountability are provided for on who will foot which part of the bill and at what time – as required in usual banking and business practices.

Therefore, one could join the alarmist voices which regret the gradual, but unmistakable, distancing of the ECB from its model, the *Bundesbank*.[38] Owing to a series of eclectic compromises struck at the highest political level, without due consideration of the fundamental principles of economics and public administration, the ECB has clearly entered a slippery slope. Contrary to the basic requirement of assigning tasks, to be found in any serious handbook on management, the multiplication of its responsibilities is observable. While the *Bundesbank* had been a guardian of price stability, the ECB has become, by 2012, a bailout agency, a tap for fiscal activism, a money machine, and also a bad bank, or cemetery of foul assets, based on the US/Irish examples.

This is unlikely to work even within a single country, where the above listed activities are entrusted to different agencies. In the case of a commonwealth of nations, without its own fiscal base, and lacking the powers to tax and directly punish disobedience (such as sacking a CEO responsible for the chaos), the chances are even slimmer. The confusion is likely to multiply by the number of actors and conflict-of-interest situations. Buying government bonds of heavily indebted countries, which is clearly a fiscal function, or pumping money to commercial banks, which later deposit these assets at the central banks, are just the more obvious examples of slippage.

And here a true borderline has been reached. European financial solidarity without political foundations, without checks and balances, without remedying mechanism and enforcing accountability of those responsible for the dismal outcomes, is questionable. All the more so since comparable cases in the corporate world trigger regular and harsh punishments. This applies even in the much sheltered medical profession. Thus, granting competences to anybody and for

38 *Haering, N./Hellmann, D./Münchart, J./Vits, C.*: Die verlorene Unschuld der EZB, in: Handelsblatt, 21 January 2012.

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whatever reason, without checks and balances is a contradiction in terms anyway, especially in a community committed to democratic values.

Therefore, far-reaching suggestions to strengthen actual fiscal federalism along the lines of the Brazilian example are missing the point.[39] At the end of the day, Brazil is a federal state, with centralized conduct of fiscal policy, whereas the European Union has never reached this stage. Moreover, the formative features of the most recent editions of the TEU, even though they accommodate measures already taken in setting up the European Financial Stabilization Facility and the European Stability Mechanism, still clearly fall short of delegating, even in part, responsibility for the conduct of fiscal policy to anybody 'in Brussels'. True, size matters. Thus, calls for doubling the EFSF to 1 bn. euros even prior to its formal approval rightly stirred up resistance of the creditors[40] since this would indeed mark a giant step toward setting up a fully-fledged common monetary authority, with quasi-fiscal functions, but without detailed legislative control over those activities.

V. Who Is to Foot the Bill?

It goes without saying that any forecast is a speculative exercise. The experience of the 2007-2011 period in the EU has cast doubt over the majority approach in the literature which took for granted a continuation of 'muddling through' as the baseline scenario for any policy-relevant analysis. With time passing, new options become politically feasible every day, even ones that used to belong to the realm of phantasy only a few months earlier.

The first option, which is being pushed by the creditor countries, such as Finland, the Netherlands, and Slovakia, would openly move toward a degree of formal fiscal federalism. This has long been a proposal in the EU literature, still was constantly rejected on political grounds. One would need to see how fiscal rationality would be able to dominate the underlying political, legal, historical, and emotional considerations. Asking for collateral *per se* is anything but appalling. However, when the Finnish Minister of Finance suggested something similar, it triggered Greek outrage, understandably so. But in a Community, where the Competitiveness Pact with its much softer arrangements was adopted by less than unanimity, generalising stricter solutions was bound to be derailed, as shown above.

39 *Hallerberg, M.*, op. cit., 2011.

40 As reported in the *Wall Street Journal,* 23 January 2012.

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The second option is a return to the old ways, including reliance on understandings and compliance basically through voluntary action, gradual adjustment and co-ordinated external finance. This would pre-suppose a co-operative and even ambitious approach from the debtor side, a case which one can observe in the case of Portugal and Spain, not, however, in Greece and Ireland, the major culprits. Here, the basic insight is that of *Reinhart* and *Rogoff* citing two centuries of evidence on the formative role of domestic debt and of the subordinate role of external exposure in case of each sovereign default in modern times.[41]

Finally, a third possibility is one of disintegration, where some member states either leave the Eurozone or are expelled by the others. This option, long forecast by American and academic critics of the EMU, would solve one problem by creating two new ones. First, the exiting country, adopting its old currency, is likely to fall even deeper in inflation and recession, owing to the foreseeable devaluation of the national currency. Second, this would be a heavy blow to the entire European project, whose significance is perhaps beyond our ability to understand. But not even under this scenario should one consider the un-learning of the lessons of past four decades. One way or another, with a dozen countries having benefitted from the currency union, Member States are likely to go on with the exercise, with those leaving – or ejected – paying a truly heavy price and those remaining enjoying the advantages of a single currency and a single market.

Irrespective of which of the options will materialise, current magnitudes of external debts in Ireland and Greece have reached 96.8 per cent and 142.8 per cent GDP by the end of 2010.[42] While the Irish case seems to have been largely resolved, with the nationalisation of banks and the IMF assistance programme, the Greek drama goes on. The latter is to be managed by a parallel restructuring of official as well as private debt. The Euro group agreement of 20 February 2012 on the exchange of Greek sovereign bonds at a discount of 53.5 per cent is a step in this direction. The agreement also stipulates a series of structural reform measures and fiscal adjustment for a period as far ahead as 2020. It remains to be seen – as the immediately leaked analysis of the troika overseeing the Greek drama has indicated – if there is willingness and ability in the Greek polity to

41 *Reinhart, C./Rogoff, K*, op. cit., 2011.

42 These are the last numbers officially certified by Eurostat and ECB in *European Central Bank,* op. cit., 2012, 46; more recent data are pure estimates. Preliminary figures for 2011 are 172 per cent for Greece and 91 per cent for Ireland, indicating the different structure and thus the different trend in the two cases.

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manage along those lines, or further similar measures are yet to be taken, as most observers would have it.[43] But this step is a proof beyond any doubt that our claim about the relevance of a *de facto* no-bankruptcy clause/understanding is indeed a very real one.

Application of the no-bankruptcy clause started with the agreement with private creditors to Greece in November 2011. This step was unusual in preceding agreements over public debt. The discount of 50 per cent followed the precedent of *Brady* bonds of the mid-1980s applied to solve the Mexican debt crisis. According to the two deals – with private and public lenders – the debt/GDP ratio of Greece should come down to 120 per cent by 2020, which is about the current Italian level. In short, the measure addresses the core of the problem, but its size seems insufficient to appease the markets, which are forward looking. If a country is contracting by 7.5 per cent and external debt service is over 8 per cent, as in the case of Greece in 2011, this situation remains unsustainable, even after the formal and organized debt restructuring – an issue that was out of question as late as in September 2011. All the less so since Greek savings are nowhere near as high as Italian savings and the value of Greek assets is nowhere close to Italian levels. While Italy can, by and large, self-finance is mountain of debt, Greece is dependent on external credit. Thus, regaining credibility and access to external money markets remains pivotal for the viability of the rescue operation.

Likewise, the tripling of Irish debt in 2007-2010, as well as the open unwillingness of the new government to go along with the Fiscal Compact, created a situation where return to the pre-crisis normalcy is likely to be slow and incremental, despite the considerable progress made by the workout process in 2011. While the situation of the two nations is dissimilar, as is the case for Portugal and Spain, arithmetic remains arithmetic. Thus, sustainability conditions are yet to be worked out by those involved. It is perhaps unfortunate that orderly debt restructuring has only very incrementally and unwillingly become official policy, at times when markets tended to react in seconds and governments in quarters rather than months.

VI. Some Conclusions for the Economic Theory of Integration

This contribution argued in favour of preserving the original economics behind the EMU framework rather than replacing it with something untested or incongruous to the peculiar legal and political architecture of the EU. In the original

43 For both documents (21 February 2012), cf. the excellent web site *Euractiv*.

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political economy approach, EMU has never been presented merely as a matter of financing techniques. Rather it was seen, and also meant to be, a prelude to broad de-regulatory and marketising reforms and structural adjustments on the large scale. Those who warned countries with rigid social structures and fatigue, even hostility to economic flexibility, from joining in,[44] were proven to be right. This is no more and no less than a re-hash of the previously cited original *Mundell-Fleming* argument, implying that the EMU, seen as an outcome of political compromise, does not meet the criteria of an optimal currency area.

Likewise, as in the original theorem, and contrary to later theorizing, these criteria have not proven to be endogenous, but would have required actual restructuring and de-regulation. However, this had been widely proposed at the time of launching the EMU, but largely dodged by those who were mostly in need of change in the decade to follow. Unsurprisingly, crisis management in 2008-09 has only made the drift between normative and descriptive aspects of EMU even bigger, with the Eurozone closing with a debt/GDP ratio of 87.9 per cent by the end of 2011.

But short of a shallow *post hoc ergo propter hoc* argument, the outcome should not be presented as something pre-ordained or inevitable. Whatever happened in the past two years, history remains as it was. As a matter of fact, unified monetary policy, complemented with synchronized, but separate national fiscal policies, has been reality in a dozen of EU countries, ever since the emergence of the *de facto Deutsche Mark* zone in the 1980s. The puzzle is thus no longer open: dodging the rules – in economics and politics – tends to be myopic. Voluntary co-ordination could work, but under myopic policies, has not.

While formulating the broader contours of the landscape one is confronted with the following puzzle. Feasibility of the EMU has always tended to be subject to doubt in the more abstract lines of reasoning, along the conventional *Mundell-Fleming-Feldstein* lines cited above. This conventional wisdom, voiced long before the launch of the project, warned of two major risks: first, external shocks that induce divergent adjustments across the various regions of EMU, leading to its eventual disintegration, once rigidities, taken as given by these approaches, indeed prevail in reality and, second, an inability of poor countries to adjust. The latter might be explained by historical legacies, institutional rigidities, and their roots in local culture, or taken as given in the *Keynesian*-structuralist-*Marxist*

44 *Feldstein, M.,* op. cit., 1997.

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worldview (as opposed to the unconditional convergence hypothesis of the neo-classicals). As long as analysts sustain the validity of classical *Keynesian* reasoning, the crisis of 2008-9 is not a derailment, but an inevitable outcome, which just reinforces long-known calls for a paradigmatic re-assessment of the entire logic behind EMU.[45]

A first counter-argument is as follows: it was shown by invoking empirical and theoretical studies that EMU has not, in reality, been suffering from either of these ills. External shocks, from the burst of the IT bubble to oil price hikes and the recent financial meltdown have not really shaken its foundations. The balance of payments of the Eurozone has always been within plus/minus 1 per cent of joint GDP. This is roughly the equilibrium level, for all practical purposes, but especially against the background of such major tremors of the global economy. The real challenge came from within, from a small but notoriously non-complying nation. Second, countries significantly poorer than Greece, such as Estonia, Slovenia and Slovakia, could actually cope with the entry criteria and eventually did qualify for EMU. Furthermore, other EU states, as Latvia, Denmark, or Sweden, could also join in, should they opt for it. In those not meeting the criteria, it is bad governance, rather than the level of per capita GDP which has proven decisive.

Second, it might be a subject of a separate inquiry if, and to what degree, the very divergent evolution of real exchange rates, as well as of national balance of payments positions are to be seen at the root of the current crisis. With the benefit of hindsight, this is one possible line of reasoning. However, if one were to follow this line, the disintegration of the Eurozone, and indeed, of any currency union, would be the necessary result. In reality, as is known from the experience of federal states, such as the USA to Germany, Brazil, and even Italy, structural imbalances may, and indeed do, survive for decades, even centuries, even within a territorial state. This remains true irrespective of the presence of lavish transfer or compensation systems.

While such developments do stir concerns and, on occasion, political debates, they have yet to produce a case – short of civil war or a global cataclysm, like a world war – that translates into a concrete secession. What has been observed in the past decade in Belgium, in the UK, and to a lesser extent in Spain, are internal re-arrangements of the earlier struck give-and-take deals, rather than actual

45 Most recently in: *Laski, K./Podkaminer, L.*: The Basic Paradigms of EU Policy-making Need to Be Changed, in: Cambridge Journal of Economics, 36/1, 253-270 (2012).

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secessions in the full sense of the word, as in 1918 from the Ottoman Empire, Austria-Hungary, or Russia.

Therefore, the aforementioned conventional economic argument seems circular and remains non-compelling concerning the pre-eminence of real factors over policy blunders. As has been argued, the currency union is not just viable, but even irreversible owing to the prevalence of interests in sustaining it. Thus, it seems that peripheral countries will have to bear most of the burden of adjustment, in the hope of future gains derived from remaining part of a large market. This allows them to Fiscal Compactenjoy the benefit of enhanced competition, and not least the fundamental advantages of being in a stability club during global financial imbalances and uncertainties.

Third, when asking for the way ahead, the idea of an eventual ‘transfer union’ cannot be avoided. Our line of reasoning lends support to the views of those who are sceptical about the emerging solution via an open fiscal union, or its covert-packaged version, as reflected in the Draft of the EU Commission.[46] Lack of transparency and limited (if any) political accountability – let alone public support – do not bode well for such technocratic solutions, as the eventual fragmentation of the Fiscal Compact indicates.

Fourth, this case study leads back to the broader new political economy initiatives, which aim at re-incorporating institutional as well as psychological factors in standard economic analysis to make it more meaningful. It has been attempted to document that an internalisation of the logic behind SGP is vital. Otherwise, sanctions – also earmarked by the European Semester and the Fiscal Compact of 2012 – inevitably trigger more cheating rather than more compliance. Thereby, it was attempted to show that convergence to the Maastricht criteria in 1999-2008 was indeed largely endogenous. This was induced by the indirect impacts of the Great Moderation, rather than the outcome of specific legal measures and sanctions embedded in the EU joint fiscal surveillance framework.

Fifth, such broad internalisation may emerge as an outcome of professional consensus-building and societal learning, evolving in parallel in an ideal case scenario. Lacking those conditions equals to giving in to populism – this was the practice of much of Europe in the post-1999 decade. If people in Greece vote against austerity measures and the demos of Germany similarly opts against

46 *Hesse, J.J.*: Die europäische Verschuldungskrise: eine dreifach unerledigte Agenda, in: ZSE 9/3, 338-351 (2011), 347 and 350f.

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diminishing the size of the structural current account surpluses, no institutional straightjacket elaborated on the EU level will be of much avail.

Therefore, highlighting the need for an open and firm commitment to the European project and to the spirit of mutual adjustment, *Jacques Delors* might have a point whose validity reaches beyond the immediate problems. Interestingly, in order to be able to overcome a crisis on the systemic level, actions in Community fora should better be downscaled and activity on the structural adjustment of public finances on the national level intensified at the same time.

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