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The euro crisis: undetected by conventional economics, favoured by nationally focused polity

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This article interprets the initial success of the launch of the euro and its 'muddling through' since the outbreak of the Greek sovereign debt crisis. Two interrelated processes interacted to deliver a quite complex idiosyncratic systemic crisis. First, new classical macroeconomics had diffused the belief that market economies are structurally stable, money is neutral, financial markets are efficient and that the only culprit is public finance. The euro crisis was thus inaccurately diagnosed. Second, in the political arena, monetary integration has been used by many governments as a justification for liberalisation reforms opposed by various domestic social groups. At the European level, most governments have been defending national interests, whereas the European Commission and European Parliament had lost most of their expertise and legitimacy in defending a common community in line euro ambitions. Crisis resolution calls for leadership from a key collective actor, to return coherence to the eurozone's institutional setting.

Key words: European integration, Euro crisis 2010–12, Institutional economics, Political economy of the euro, New classical macroeconomics
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1. Introduction

The 10th anniversary of the euro was celebrated in January 2010: after an uncertain start, had the European Union (EU) not benefited from the shield of the euro, compared with the large amount of volatility that had come with intra-European exchange rates in the past, in spite of the severity of the worst world crisis since the 1930s? In the summer of 2012, European authorities and leaders of the eurozone stated that the euro was irreversible and the achievement of a half-century of European integration. On the other hand, in the USA and UK, many experts anticipated the collapse not only of Greece but of the entire eurozone. They had a strong argument: any monetary union calls for one form or another of fiscal and hence political federalism, and such a bold step in the pooling of national sovereignty would be problematic, since most Europeans are not ready to surrender that.

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The current study looks to overcome this rather simplistic dichotomy of 'full federalism versus the death of the euro'. It explains both the rise and fall of the hope associated with the common currency, via a brief retrospective and institutional analysis of the events that led to the current crisis. Mainstream economists do tend to like quite parsimonious, monocausal explanations, i.e. lax public spending and welfare in the context of global competition. In contrast, it is argued here that the current turmoil is so deep that outcomes are unpredictable, because they are at the junction of different processes that affect the evolution of macro-level theory, the nature of the political game at national and European levels and, finally, the inner forces that shape international finance following liberalisation and cross-border development.

Within the now-standard real business cycle (RBC) and dynamic stochastic general equilibrium (DSGE) macroeconomic models and mathematical financial theory, the present double-dip recession was thought to have a very small probability of occurring. This prognosis was inherent in the models used by central banks, various ministries of finance and financiers. This serves as an invitation to survey the debates that took place in the euro's preparatory phase in the 1990s (Section 2).

Dissenting analyses had been developed and were able to anticipate some, if not all, of the possible imbalances generated by a shift from the European monetary system to an irreversible system of fixed exchange rates and a common currency. Similarly, a survey of the Rome Treaty's origins and subsequent development hints that new European public goods—such as financial stability, or a modicum of solidarity—were essential to the long-term viability of the euro. In a sense, many of the flaws inherent in the euro that are now obvious to most observers had been highlighted by a minority of analysts very early in the process, in the late 1990s (Section 3).

Both the founding fathers of European integration and contemporary mainstream economists share a functionalist theory of economic institution building. Basically, politicians have only one specific role: to help implement the reforms needed to generate better, more Pareto-efficient economics. This restricted economist's vision of polity has hidden the complex web of social groups and national interests that may or may not sustain a transfer of sovereignty to supranational entities. A better understanding of the political logic at work helps in analysing the trajectory of the euro since 2000 (Section 4).

The interplay of these intellectual and political processes might explain why, in spite of there being many European Council meetings between March 2010 and June 2012, there has been no 'quick fix' to major imbalances generated by the euro. One of the key actors—finance, the European Central Bank (ECB), the European Commission (EC) or even the citizenry—needs to take the lead and impose coherence upon a complex, multilayered institutional reconfiguration of the relationships among member states, the EU and the world economy. There exists more than a high-road/low-road bifurcation, since many other reconfigurations can be imagined and this 'history in the making' will likely explore still-different paths. This is the central message at which this article arrives.

2. The neglected intellectual origins of the eurozone crisis

The first theoretical reference is of course the theory of optimal currency areas (OCA), derived long ago (Mundell, 1961) and revisited during the phase of discussions into the benefits and constraints associated with the creation of a common European currency.

Four features make the viability of a currency union more likely, thus creating the ability to enjoy economic policy that is efficient in terms of stabilising economic activity: labour and capital mobility across the region; price and wage flexibility; automatic fiscal transfer mechanisms to regions, nations or sectors that are adversely affected; and relatively well synchronised business cycles. Clearly, none of these requisites were fulfilled by the EU in the 1960s: there was very low cross-national mobility of labour, but an increase in geographical diversification in capital portfolios, significant nominal wage rigidity and very limited redistributive impact from European Structural Funds. Furthermore, the UK and continental Europe have not displayed synchronised timing *vis-à-vis* their business cycles.

Most experts involved in discussions on opportunities related to the euro recognised a basic fact: in its configuration, current at the time, the EU was not an OCA. Nevertheless, a majority of experts thought that the launch of the euro would trigger a wave of structural adjustments that would promote the fulfilment of most OCA conditions. The centre of the debate then moved from international monetary theory to the macroeconomics of activity stabilisation.

2.1 New classical macroeconomics at odds with major euro issues

The launch of the euro coincided with the loss of influence of the Keynesian paradigm and the rise of RBC models. Those models assume that business cycles can be explained by exogenous shocks hitting a pure Walrasian economy, where all markets adjust perfectly. This academic school has progressively gained influence in economic policy discussions, especially when many influential central banks have been using this approach in the evaluation of their monetary policy. The ECB has thus been developing second-generation models, under the rubric of 'DSGE models' (Smets and Wouters, 2002); this was presented as a definitive move towards a fully scientific approach, compared with previously highly ideological discussions about monetary and fiscal policy.

Without overestimating the influence of macroeconomists on the fate of the euro, this conversion to pre-Keynesian conceptions has contributed to a misunderstanding of many important issues (Table 1).

Clearly, the contrast between the key features of the eurozone and the core hypotheses of the DSGE models is striking.

First of all, the neutrality of money is central and it does not help explain recurring bubbles generated by the low interest rates set by the central bank. Furthermore, the central bank is the only financial entity to issue fiat money in the absence of any commercial bank or financial market. The control of money supply to maintain low inflation rates is meant to embody the essence of monetary stability; financial stability is implicitly and automatically fulfilled by monetary stability. One imagines the disarray of these experts facing the diffusion of the subprime crisis to Europe—not to mention the fall of state markets, which would reveal the financial fragility of many banks. In this context, monetary policy loses its efficiency, because the credit channel is broken (Draghi, 2012).

Since wages and prices are fully flexible, unemployment is voluntary in the sense that it is the outcome of a trade-off between work and leisure. Such a pattern is difficult to reconcile with the observation of millions of Europeans willing to work at the ongoing wage, but with no access to jobs, both pre-euro and after 2010, when the

Table 1. *The consequences of the new classical macroeconomics upon the assessment of euro viability*

Hypotheses	Mechanisms involved	Consequences for the euro	Degree of realism
1. Exogenous money created by central banks	• Typical monetarism • Neutrality of money in the long term	Price stability is the first objective of central banks	In modern financial systems, endogenous money creation via bank credit
2. Full employment equilibrium	• Perfect adjustment through price and wage flexibility • Unemployment is voluntary	Basically no inflation/ unemployment trade-off	Large and long-term involuntary unemployment in many EU economies
3. Symmetric shocks will prevail over asymmetric, country-specific shocks	A common monetary policy will fulfil the bulk of national macroeconomic adjustments in response to productivity shocks	Eurozone can be viable, even if it is not initially an optimal monetary zone	Significant endogeneity of productivity, heterogeneity of national macroeconomic trajectories
4. Rational expectations for all actors: - Firms, households - Governments	Economic policy rule associated with the euro will affect all private and public strategies	Principle of irreversibility of the euro is essential to its credibility and long-term viability	Adaptation of firms and banks … but governments play domestic political games in the absence of clear links, with the search for economic efficiency
5. 'One size fits all'	Existence of generic economic adjustments common to all member states	Euro will speed up a nominal and thus real convergence	The single market has generated a deeper division of labour; hence, heterogeneity and complementary specialisation

sovereign debt crisis erupted and 'infected' the banks. Clearly, the eurozone is facing a wave of involuntary employment, in line with a gap between production capacity and effective demand. If full employment was prevailing, austerity policies would boost private demand, but the opposite has been observed since 2010. Nevertheless, surprisingly, leading economists and politicians continue to trust and follow a failed eurozone representation; clearly, this does not help in overcoming the euro crisis (Artus, 2012A).

A third misrepresentation relates to the existence of generic mechanisms that are common to all eurozone members and a hypothesis that entitles them to successfully run common monetary policy. This postulate—i.e. the homogeneity of macroeconomic adjustments for each national economy—is crucial. On the contrary, since 2000, divergent evolutionary paths have been observed, enhancing the initial heterogeneity of national *régulation* modes. Therefore, the EU-level models lost their relevance, especially *vis-à-vis* the transmission of monetary policy: a very low interest rate does not translate into buoyant credit when the banks of some eurozone members are approaching bankruptcy. More precisely, the complementarity of innovation and export-led growth in northern Europe with a domestic demand-led configuration in southern Europe rendered false the hypothesis of a common European model. Alas, the diffusion of austerity policies (Boyer, 2012) prolongs the 'one size fits all' illusion that has been so detrimental to past International Monetary Fund (IMF) adjustment programmes in Asia and Latin America.

2.2 Polarisation on the relative frequency of symmetric and asymmetric shocks

In the late 1990s, debates among the leading experts focused on the fourth condition for an OCA, i.e. the even distribution of generic symmetric versus idiosyncratic asymmetric shocks. If perturbations originate in the world economy and coincide with technological advances, the centralisation of monetary policy is justified, whereas the irreversibility of an internal exchange rate precludes the repetition of previous European crises, such as the dramatic 1993 episode. If, on the other hand, perturbations are mainly idiosyncratic—e.g. national public finance crises, the adverse evolution of national competitiveness or major domestic social conflict—the centralisation of monetary policy will not make the European policy mix more efficient; on the contrary, it may even prevent the mobilisation of both national fiscal and monetary instruments.

The adoption of the new classical macroeconomic paradigm has borne two consequences that have been detrimental to the realism of the ex ante assessment of euro viability. First, emphasis on the primacy of rational expectations leads to the anticipation that the irreversibility of the euro will create a European business cycle, which would be generated by the progressive synchronisation of national economic activities. This is a drastic simplification of the various and scattered mechanisms that shape firms' investment decisions, household consumption and banks' credit allocations, not to mention the political processes that can facilitate or impede structural reforms in public spending, taxation and welfare. To sustain long-term competitiveness in a regime that features fixed exchange rates, the primacy of symmetric shocks was not a credible estimate informed by past observation, but a risky bet about the unfolding of major transformations in response to the new epoch opened by the euro.

The second and major failing of this polarisation regarding the exogeneity of productivity shocks was precisely to neglect the endogeneity of the economic transformations generated by the euro: the eurozone member states were more heterogeneous than many thought, in terms of international specialisation, labour market institutions, welfare organisation and financing, priorities in public spending, financial markets, etc. Given the endogenous evolution of national *régulation* modes, the same monetary policy might well have had quite different impacts. For example, regarding national regimes that concern the financing of housing, the same low interest rate may generate a dangerous speculative bubble in Spain and Ireland but not in Germany. When these bubbles burst, the ECB faces an unexpected dilemma: continue to focus exclusively on a low inflation policy—as measured by the aggregate European consumer price index—or address more directly the issue of financial stability and adopt an 'unorthodox' monetary policy of 'quantitative easing'.

Intellectual frameworks based on the new macroeconomic orthodoxy appear today to be largely obsolete; however, they continue to inspire, by default, current austerity policies.

2.3 Governments as servants of economic rationality: compelled to comply with reforms demanded by the irreversibility of euro membership

There is another consequence of the rational expectations hypothesis (REH): all actors, private or public, had to develop strategies aligned with the commitments formalised in the Amsterdam Treaty. This was not overly problematic for large firms that deployed activities in response to the removal of exchange rate risk within the eurozone. Similarly, the banks extended their branches across the eurozone member states and diversified their portfolios by buying foreign public bonds and securities, none of which they would have acquired prior to the euro's launch. These two moves conformed to the REH-based prognosis.

It was not so easy for households living in economies with weak currencies: the brutal decline of nominal and ultimately real interest rates induced many of them to run larger and increasing debt amounts to buy houses and durable goods on an unprecedented scale. Soaring housing prices were fuelled by this easy access to credit; related speculative bubbles were welcome, since they fed bank profits, created jobs in the construction sector and even filled state funds, with some of them (e.g. Spain) experiencing a public finance surplus on the eve of the world crisis. Convinced that the financial markets were efficient and that no public authority was able to detect a speculative bubble in real time, leading analysts and economists praised these national experiences as promising evidence of the benefits of the euro and financial liberalisation. This hype was generalised, as evidenced by references to the 'Irish trigger' or Iceland's 'miracles' (Mishkin and Erbertsson, 2006; Portes and Baldursson, 2007)—both of which were considered promising models to be emulated.

A more severe flaw, however, was the rationality attributed to public authorities: having accepted the pooling of monetary sovereignty, they needed to undertake all the reforms needed to work out a viable policy mix and foster the building of a supranational growth regime compatible with their irrevocable adherence to the euro. This meant that politicians had to make necessary decisions while assuming pure economic rationality, with the hope that greater efficiency could generate the resources needed to satisfy all other citizen demands *vis-à-vis* taxation, public goods, welfare and job creation. In other words, the political domain needed to become mainly the locus where policies essential to the euro's success would be implemented.

This complete determination of polity by economy does not align with the observation that while the political arena deals with the accumulation of power over a given territory, economy is a matter of wealth accumulation and this latter process tends to cross national political borders (Théret, 1992). If this duality were taken into account, adherence to the euro would underscore major differences in national political alliances and economic policy styles. In societies where an industrial compromise prevails, the European treaties push forward existing public policies that focus on competitiveness. In other societies, European integration might well facilitate a 'clientelist' strategy of politicians—something quite alien to concerns for the long-term viability of the national mode of development. Had northern Europe explored the former path, and southern Europe the latter, the opposition and misunderstandings that permeated numerous European Council summits—and which have taken place since the Greek crisis—would have been obvious.

Rescuing the euro is not a pure technocratic game played in Brussels, but the outcome of specific political struggles in each eurozone member state.

2.4 Benign neglect of dissenting (but probably more relevant) theories and analyses

A rather wide consensus concerning the viability of the eurozone had been reached by excluding alternative approaches that, in retrospect, had quite rightly highlighted some, but of course not all, of the structural weaknesses of the Amsterdam Treaty and subsequent European treaties (Table 2).

Imagining that the eurozone would constitute a Walrasian economy—where adjustments are made possible through complete flexibility in prices and wages—ignores key facts: oligopolistic pricing is the rule in leading final goods production and nominal wage rigidity is a common feature. Similarly, households can optimise their consumption over time, but only if they have access to credit in perfect markets. Therefore, the Ricardian equivalence principle, which states that private agents will counterbalance any public finance decision, does not accurately describe the majority of European economies. This brings back the Keynesian argument: all European treaties have a structural bias towards growth that is smaller than that under the previous European monetary system regime. Somehow, the most recent DSGE models for the eurozone recognise that their simulations become more accurate if 'non-Ricardian households in the form of rule-of-thumb consumers' are introduced (Coenen *et al.*, 2012, p. 72). This is a hidden tribute to the Keynesian consumption function, where current income is the key factor in the formation of effective demand.

Nevertheless, the prognosis derived via the Keynesian textbook model concerning the negative impact of the euro and the Stability and Growth Pact (SGP) on economic activity was found to be erroneous for the 2000–08 period. This period is better captured by post-Keynesian analyses of the impact of financial liberalisation and innovation upon the recurrence of financial bubbles (Minsky, 1986). Clearly, the euro was a major financial innovation with few precedents. In any case, the typical pattern of liberalised markets is seen once again: after a wait-and-see period, the euro was perceived as successful, since the control of inflation to a low level had allowed a decline in interest rates. The dynamism of consumption and the housing market fuelled a wave of optimism and generated a bubble in a significant part of the eurozone. The 2008–12 period followed the pattern of previous bubbles: the loss of financier confidence and the poor reactivity of European authorities triggered a double-dip recession. Keynes and Minsky were right, after all: credit money is not neutral and by transforming domestic financial systems, the euro underscored the irrelevance of the Walrasian approach to macroeconomics.

The neo-Schumpeterian approach, too, has not been taken seriously in discussions regarding the consequences of the euro. First, that approach shows that productivity increases are not exogenous, but derive from the explicit strategy of firms to capture oligopolistic profits. Furthermore, product and organisational innovations are also key ingredients in the structural competitiveness of national economies. Second, neo-Schumpeterian economists have argued that Europe has been affected not only by exchange rate and financial volatility, but also suffers in lagging in the adoption of knowledge-based economy principles. This explains the slow growth of the old continent and why the sustainability of generous welfare systems was problematic (Rodrigues, 2002). The Lisbon Agenda intended to correct this weakness in European systems of research and innovation. In any case, Keynesian and neo-Schumpeterian diagnoses of the impact of the euro are more complementary than contradictory: their timings or horizons differ, but they agree that research and development (R&D)

Table 2. *Alternative approaches that deliver more accurate and fair assessments*

Approach	Core mechanisms	Consequences for the euro	Degree of realism
1. Keynesian theory	Effective demand is the key determinant of employment	Orthodox restrictive monetary policy and limits to public deficit will imply high unemployment	Realistic for the slow growth period (1993–99), but not for 2000–08, due to the rise of credit
2. Neo-Schumpeterian theory	• Innovation is the engine of growth • Knowledge-based economy is the new paradigm	• Speed up innovation via R&D and structural reforms • Growth is the condition for the success of the euro	• Germany and northern Europe are the ‘good pupils’ of the euro • Southern Europe is dramatically lagging
3. New economic geography	Increasing returns imply geographical polarisation	Euro triggers a deeper division of labour among regions and countries; hence, larger national heterogeneity	Productive imbalances put the euro at risk in the absence of fiscal federalism and large labour mobility
4. Post-Keynesian theories	Built-in instability of finance in the context of liberalisation, innovation and globalization	Need to build the credibility of the euro with respect to international finance, at the cost of lower growth	Typical sequence of optimism (2002–07) and pessimism (2008–12)

expenditures are procyclical and therefore reactive to the nature of macroeconomic stabilisation policy. Thus, long-lasting conservative monetary and fiscal policy reduces productive capacity formation and innovation in such a way that long-term growth is reduced (Dosi, 2008).

This synthesis becomes more and more pertinent as the eurozone's 'muddling through' persists. On one side, perseverance in maintaining austerity policies depresses demand, falsifying the crowding-out effect that is otherwise typical of public spending and is put forward by the new classical theory (Boyer, 2012). On the other side, depressed productive investment does reduce potential growth, but it makes the sustainability of public finance among the weakest economies more uncertain. This vicious circle cannot be easily and convincingly explained within the context of the ongoing macroeconomic paradigm.

Finally, the new economic geography (Krugman *et al.*, 1991) helps provide an interesting prognosis, against the convergence hypothesis implicit to most European strategies and the new classical macroeconomics. Given the importance of increasing returns to scale—which is typical in most contemporary sectors—and the agglomeration effects that foster innovation, the stabilisation of internal exchange rates had the likely consequences of polarising economic activity around already competitive regions; the more this was the case in a given economy, the more overvalued the domestic currency would be when converted to euros. This is precisely what changes between 2000 and 2012 have pointed out: northern Europe has maintained a strong manufacturing export basis, whereas the south has specialised in domestic services (Artus, 2011). The common currency has polarised the trade surplus to the north—versus a trade deficit in the south—and such imbalances cannot be corrected through a purely financial strategy.

In summary, eurozone turmoil also stems from inadequate economic theorising.

2.5 Early warnings regarding difficulties in implementing the excessive deficit procedure

Under pressure from Germany, negotiators for the Amsterdam Treaty (1997) were highly conscious that the shield provided by the euro could induce a free-rider strategy in terms of national public finance. Articles 99 and 104 institute a 3% limit for the public deficit–GDP ratio and a maximum total debt–GDP ratio of 60%. The related SGP was the basis of a multilateral surveillance mechanism; there was also an excessive deficit procedure to enforce it, wherein penalties should be levied to member states that did not comply.

Was SGP formulation more relevant? A lively debate took place and challenged it, but, finally, it did not change the articles of the Treaty. Opponents of SGP had many relevant arguments and most of them turned out to be correct: they justified reforms that brought about a softening of interpretations of the rules, in March 2005 (Boyer, 2006), and, on the other hand, a strengthening of interpretations, in October 2011. Finally, it was necessary to take into account other macroeconomic structural macroeconomic disequilibria, such as losses of competitiveness or excess credit (Table 3).

Public finance specialists and macroeconomists have pointed out the *ad hoc* selection of the 3% and 60% thresholds for public deficit and total public debt, respectively. This was built upon an *ad hoc* specification of the general formula while taking into account all the parameters that enter into an assessment of a public finance programme: the interest rate, the growth rate and the initial stock of the debt–GDP ratio. Clearly, the current deficit criteria are too generous in good times and too severe in times of severe recession. A better criterion would have been the structural deficit, corrected

Table 3. *The drift of public finance could be (and has been) anticipated*

Approach	Core mechanism	Consequence for euro	Degree of realism
Public finance	Theoretical conditions for public finance sustainability	Criteria selected by the SGP extrapolate past growth patterns and have no theoretical foundations	• Any growth slowdown implies a frequent violation caused by automatic stabilisers • Better rules are available (structural deficit, total public debt, etc.)
Econometric analyses	SGP rule has frequently been breached in the past	It will be difficult to enforce	Many countries have actually been unable to stick to the rule between 2003 and 2012, including 'virtuous' countries such as Germany
Political economy	Politicians respond to domestic social demands	Public deficits will expand in economies with major problems in adjusting to the euro	'Virtuous' competitive northern Europe may comply, but weaker southern economies may not

for cyclical fluctuations; this would imply clear countercyclical public finance management, at odds with the excessive permissive nature of SGP in boom periods. If the objective was to prevent defaults on public debt, then only the total debt criterion is relevant, whereupon a rise in interest on the refinancing of the state would serve as an early indicator of unsustainable public finance. Last, but not least, economic rationality would imply that finance current public expenditures could not be funded through the release of Treasury bonds, but could allow a deficit equivalent to public investment, if it contibutes to future growth.

On their side, statisticians have measured the frequency of breaches of the 3% and 60% thresholds in the euro's pre-launch period and they found it rather high. Therefore, compliance with SGP implied a significant change in the handling of public finance and such adaptations were left to the strategies of national governments in response to their acceptance of the European treaties.

Basically, political economy approaches stress that politicians respond to the demands of various social groups and that a confluence of such pressures, when brought to bear over the direction of public spending and the distribution of the tax burden, positions national public finance on the same level as economic activity. By nature, these expenditures exhibit considerable inertia, since they derive from past institutional compromises (Delorme and Andre, 1983); the activation of a series of perceived entitlements is the legacy of these past social and political compromises. Some societies have developed a political organisation that allows for the periodic renegotiation of these institutional compromises, especially when the economy is facing major imbalances—e.g. unemployment and external and/or public deficits. Nordic countries and Germany belong to this category and thus their adaptation to the euro has been a priori easier, since all private organisations and national institutions take into account the preservation and development of their respective economies' competitiveness. In contrast, other member states have been less involved in world trade and more conflict-prone; in such a configuration, public spending and tax concessions might become typical means of softening distributional struggles and postponing the resolution of macroeconomic imbalances to better times, via a permanent increase in public debt. Greece, Italy and France belong to this second category. The danger to European stability of large levels of heterogeneity in development and socioeconomic regimes was expressed quite early, in the late 1990s.

Nevertheless, geopolitical concerns regarding the need for an 'inclusive' Europe, paired with political hype, succeeded over the warnings of 'cold' analysts.

3. Institutional and historical analyses anticipating the eurozone crisis

It is time to propose an approach that embraces the mechanisms basically neglected by the conventional theorising within RBC and DSGE models, with respect to the euro. It is thus possible to correct two of its basic failings.

First, European integration is a programme of supranational institution building with the aims of monitoring competition, providing public goods and, since 2000, deciding monetary policy. However, this form of constructivism is a priori rejected by the general vision embedded in the new classical macroeconomics: only private actors are able to acquire information relevant to their respective strategies; moreover, efficient markets socialise this information and deliver a stable—and, under some condition, an efficient—equilibrium. Any active rule, either by a central bank or ministry of finance, is pernicious, since the private sector knows of the relationship between monetary supply and inflation and anticipates that any public deficit spending today will result in greater taxation tomorrow. This Ricardian equivalence implies the structural inability of public authorities to influence activity levels. The alternative, thus, is to consider that markets operate within a given set of institutional forms; their coherence and quality contribute to macroeconomic short-term adjustment—i.e. the *régulation* mode—but also to long-term trends, i.e. the growth regime.

Second, the European integration is a long-term historical process that aims to transform national economies by rearranging their relations. This is a permanently unbalanced process, since institutional advances in one area can reveal some emerging inconsistencies within the prevailing configuration. Such inconsistencies cannot be interpreted as a shift from a stable equilibrium to another—e.g. from a regime with an internal flexible exchange rate to the euro. This would mean that the historical process of European integration would cease and converge towards a stationary state: this idealisation is contradicted by the very chronology of the recurring crises and advances experienced by the EU (see Figure 1).

3.1 Back to the basic principles: the viability of any economic policy regime

How should a rational economic policy be decided? A school of macroeconomic modelling has proposed a useful framework (Tinbergen, 1952). Basically, macroeconomic activity is largely endogenous because consumption, investment, exports and imports relate to wages, profits, effective demand and relative prices, i.e. variables set by private agents. Generally, however, either involuntary unemployment is observed or an inflationary boom may imperil financial and even social stability. The policy makers

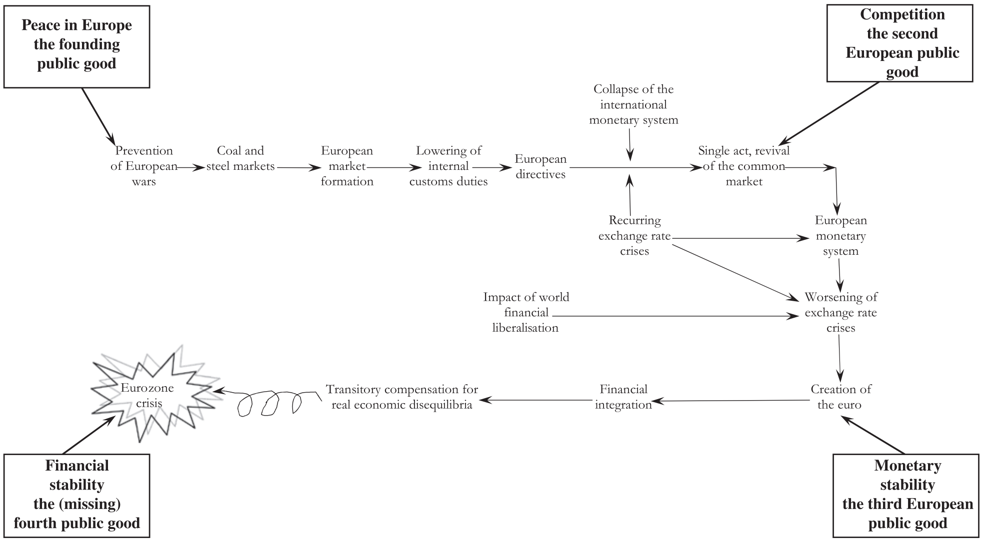

Fig. 1. *A half-century of European integration: building European public goods out of recurring crises.*

can correct for these evolutions since they control some instruments, such as taxation rates, public spending, wage norms for the public sector, interest rates and the exchange rate. By making an adequate move of these instruments, a better macroeconomic equilibrium can be reached. Policy makers may then try to decide their economic policy according to target variables concerning inflation, unemployment or external trade equilibrium and growth. Here is where 'Tinbergen's rule' comes into play: the number of instruments must be equal at least to the number of objectives held by policy makers.

In the Golden Age, the national state could use, rather freely, at least four instruments to fulfil these objectives: monetary policy, budgets and taxation, the exchange rate and industrial/innovation policy with the possible complement of income policy (Table 4). With the adoption of flexible exchange rates and the transnationalisation of finance, the autonomy of monetary policy has been limited by the will to limit the evolution and volatility of exchange rates and public deficits have been put under the scrutiny of financial markets. Frequently, the unemployment rate has been a variable of adjustment and, consequently, full employment has become more and more difficult to reach, particularly because public authorities have largely lost full control over exchange rates.

With the adoption of the euro, however, national authorities lost access to a second tool: monetary policy adequate to national needs. Indeed, the situation created by the euro is *radically new*: it embodies neither the full autonomy of independent national states nor a typically federalist configuration (Dehove, 1997). The responsibility of economic policy is now shared at two levels and *nested*, in the sense that neither the *supranational rules* nor the *subsidiarity principle* exert a dominant role. Clearly, *monetary policy* is now the full responsibility of the ECB, in charge as it is of maintaining price stability in Europe as a whole. However, the credibility of the euro—and especially its exchange rate with respect to the US dollar—is significantly affected by the conduct of

Table 4. *Tinbergen's analysis of economic policy: the euro means the loss of two key instruments and the ability of the central bank to refinance public debt*

Instruments Objectives	Golden Age	Route towards the euro	Euro
1. Inflation	Autonomous *monetary policy*; eventually income policy	Restrictions on monetary policy (i.e. defence of exchange rate)	• Mainly the objective of the ECB • Interdiction of the refinancing of national public debts
2. Full employment	Mainly *budgetary policy*; sometimes social pacts	Restrictions on budgetary policy (i.e. reduction of public deficit in order to comply with convergence criteria)	• Budgetary policy autonomy limited by the SGP • Structural reforms (competition, labour market) that promote job creation
3. External equilibrium	Adjustment, via political decisions, of the *exchange rate*	Exchange rates become financial market variables, tentatively controlled by central banks	• No more formal external constraint for member states • The euro exchange rate is a pure market variable and no longer the outcome of governments' decision making
4. Growth	Innovation and industrial policy	Primacy of the macroeconomic approach of the business cycle	• Enforcement of competition as an alternative to industrial policy • Lisbon Agenda and open method of coordination

national budgetary policies. Given the fixed exchange rate system irrevocably installed with the euro among its 11 first members, the Mundell–Fleming model implies that *budgetary policy* becomes the only efficient instrument by which national governments can control domestic levels of activity (Wyplosz, 1997). Therefore, each national state may have an incentive to 'free ride' on the collective good produced by the wise budgetary policy followed by other member states. This is the SGP's *raison d'être*. However, this introduces yet another limit to the use of traditional tools in stabilising national economies.

Last, but not least, there is a third loss concerning the autonomy of national policy: besides monetary policy and the exchange rate, the European Treaty forbids the monetisation of national public debts, which was an essential device during the Golden Age. Consequently, only the private credit channel is open at the ECB, unlike the case with other central banks, such as the US Federal Reserve, the Bank of England or the Bank of Japan. In a sense, eurozone member states emit debts in a currency that can no longer be created at the national level. As such, eurozone member states have something in common with emerging countries that must float their public debt in US dollars or some other international currency; consequently, some Latin American economists compare the Argentina crisis of 1997–2001 to the evolution of the Greek economy since 2009. However, there are significant differences in the two crises; among them, European authorities have perceived the danger of contagion to larger economies: in violation of the letter of treaties, the ECB has in the short term decided to buy directly Italian and Spanish Treasury bonds.

3.2 European integration as a process of progressive institution building around basic public goods: financial stability should have followed monetary stability

There is no better example of the underestimation of the consequences of institutional failure as generated by the euro: policy makers have worked to eliminate previous sources of crisis, i.e. internal exchange rate volatility; they even have tried to anticipate and overcome some of the most likely fragilities inherent in the new institutional design—e.g. forbidding 'free rider' national fiscal policies. Nevertheless, policy makers seemed to ignore the fact that public mismanagement is not the only factor of financial fragility within the eurozone: the private sector, and especially the banks, might adopt quite risky strategies—e.g. fuelling a real-estate boom, pushing securitisation or using huge leverage effects—thus provoking a typical Minskian financial crisis. This is precisely what happened in Spain and Ireland. Back in 1997, the Asian crisis showed that very sound public finances could not protect against the effects of massive entries of capital, followed by their brutal stop. Paradoxically, the cognitive reference of the builders of the euro was more the German hyperinflation of 1923, or the 1980s' and 1990s' Latin American sovereign debt crises, than the new risks associated with financial globalisation or its supposed effects on the 'animal spirits' of the private sector. Again, the basic postulate of a 'naturally' stable market economy—a convenient hypothesis for model builders—has hidden the perception of the dangerous path followed by the eurozone after 2003. Finally, in October 2011, the European Council recognised the need for a set of macroeconomic indicators that capture the imbalances generated within the private sector—e.g. trade balance, real-estate prices, deterioration of competitiveness and excess credit—but it was already too late.

In retrospect, in the mid-2000s, European policy makers had convinced themselves that the EU has finally reached its purpose and that no new initiative was necessary (Figure 1).

The founding fathers of the euro were tasked with preventing an economic downslide comparable to those stemming from the two World Wars, both of which generated self-destruction and afterwards the decline of the old continent. Peace was the primary and most sought-after public good: if it was impossible to derive it through a Europe of the Defence, the other road was through the organisation of orderly economic relations among Germany, France and all other nations involved in recurring conflicts. However, a common market is supposed to have game rules that maintain fair competition—something that had been elevated to the level of a basic European public good, whose achievement seemed to justify a progressive and patient extension of European-level competencies (Boyer and Dehove, 2001A, 2001B).

The process had to be relaunched with an increase in exchange rate volatility and its impact *vis-à-vis* fairness of competition on the single market. After a long period of experimentation, a growing number of European elites became convinced that a common currency was needed to foster the benefits stemming from the deepening of inter-European trade. Quite anybody was conscious that this could have been a jump into a radically new configuration. The merits and strengths of German representatives in proposing to extend the approach of ordoliberalism to relations between Brussels and national entities made the difference: the viability of monetary integration, even in the absence of fiscal solidarity or political union, could be warranted by virtue of a set of common rules that would preclude any opportunistic national behaviour that could bankrupt the eurozone. This was the victory of German conceptions with regard to organising the EU, but it does not at all represent a transposition of German federalism, since an institutionalised redistributive system equivalent to the one created among Länder had not been proposed at the European level.

This genuine ‘prudential federalism’ was supposed to render unnecessary fiscal, financial and political federalism. When unanticipated sources of fragility appeared, however, what was to be done? What if the rules were not followed by all? Should policy makers accept a financial meltdown just to better enforce the rules that have been violated and thus prevent a moral hazard that could generate another crisis? Would the EU continue to exist? Europeans came to the painful recognition that had already been clear among North American analysts: it is difficult to defend the euro in the absence of a ‘lender of last resort’, with there being a tiny and balanced European budget and no clear political leadership.

The dangerous path followed between March 2010 and July 2012 showed that financial stability was the next public good needed to preserve EU cohesion. It was already too late, however—so late that the next step was a form of fiscal federalism, however limited, just to guarantee the European Stability Mechanism and the European Financial Stability Facility, both of which were in charge of managing the direct bailout of some ailing European banks.

3.3 Significant transformations in régulation modes, especially difficult for some poorly internationalised economies

These last remarks point to an underestimated consequence of the euro: it not only implied a change in the economic policy mix among monetary and fiscal tools, but also drastic changes in the institutional architecture of most national member-state economies.

If one adopts the conceptual framework of *régulation* theory, the viability of any socioeconomic regime relates to the short- and long-term compatibility—or, even better, *complementarity*—of five institutional forms: the monetary regime, the wage–labour nexus, the nature of competition, integration into the world economy and, finally, the links between the state and the economy (Boyer and Saillard, 2001). *De facto*, the process of European integration has progressively altered all these institutional forms (Table 5).

The monetary regime has shifted from having large national autonomy in the Golden Age to policies largely constrained by international financial movements. When the members of the eurozone decided to pool their monetary sovereignty and create a supranational and independent ECB, their national monetary regimes vanished; this was the case even for Germany. In theoretical terms, the monetary regime becomes hierarchically superior and definitely exterior to national specific arrangements; this configuration is at odds with the past Keynesian configuration, where the monetary regime was subordinated to support the basic capital–labour institutionalised national compromise. This inversion of the institutional hierarchy implies that this past compromise was no longer viable; the wage nexus has actually experienced many transformations: a deindexing of nominal wage with respect to inflation and productivity, the decentralisation and individualisation of labour contracts, and recurring reforms in the organisation and financing of welfare. These pressures on the redesign of post-World War II domestic order were especially strong, in response also to the fact that previous oligopolistic competition at the domestic level had been challenged by the globalisation of production, the emergence of quickly industrialising economies and the loss of control by public authorities over industrial dynamics. Overcapacity in the production of manufactured goods at the worldwide level destabilises most European economies, either because domestic capital delocalises employment in search of long-term competitiveness or because massive imports trigger a massive deindustrialisation in the weakest market economies.

In the past, periodic devaluations of a domestic currency could stop these adverse changes, but this degree of freedom progressively vanished with financial liberalisation: basically, the exchange rate tended to equalise the rate of return of financial capital across nations, thus generating cumulative imbalances in external trade balances. The situation becomes still more difficult with the euro: the European currency may appreciate with respect to the US dollar, even if exporting sectors and nations were to become uncompetitive. The only solution left is what conventional theory refers to as 'internal devaluation', i.e. reductions in indirect taxes, social contributions and, finally, wages. Nonetheless, the macroeconomic impact is quite different from typical devaluations.

The post-World War II socioeconomic order is thus over, but the new institutional architecture—where both monetary stability and competition lead macroeconomic adjustments—is far from self-regulating: unemployment becomes an adjustment variable that hinders domestic demand and stirs up social conflict and, potentially, political turmoil—especially when years of austerity policies succeed only in converting a recession into a depression and in exacerbating feelings of unfairness among a large portion of the citizenry, as was observed in Greece from 2008 to 2012.

Table 5. *The euro: epochal change for national modes of régulation*

Level of institutional forms	'Golden Age' 1945–71	'Painful decades' 1972–99	Happy days of the euro 2000–09	Decade of reckoning 2010–
1. Monetary regime	National	More and more constraints upon national monetary autonomy	*Same European monetary policy for all members*	• Loss of efficiency of conventional ECB tools in facing national banking and sovereign debts crises • Major concerns for financial stability
2. Wage–labour nexus	National	National, but transformations in reaction to fiercer competition	Still *national* but *benchmarking* at European level	Labour market and welfare reforms, to restore national competitiveness
3. Nature of competition	Mainly national	Growing impact of European competition policy	Stricter enforcement of competition at European level	Overcapacity at world level triggers fiercer competition in EU
4. Insertion into world economy, exchange rate regime	Exchange rate is the outcome of political decisions	Financial markets tend more and more to set spot and future exchange rates	Single common exchange rate set by financial markets	Promotion of 'internal devaluations' via wage austerity and welfare cuts
5. Link state/economy	Large welfare state	Recurring public and welfare deficits	Diverging evolution of public deficits	Sovereign debt crisis, diverging trends across eurozone
	Large and redistributive tax system	Less progressive income tax	Erosion of tax base by capital mobility	Self-defeating austerity policies spill over across Europe

Finally, the second adjustment variable comprises the public deficit and debt, which remain moderate in economies that are structurally competitive, but are stubbornly large for those unable to cope with the standards of the world economy. The issue at stake here is not simply the restoration of a 'correct' policy mix, but the reconstruction of a socio-political order that is compatible with both the requirements of the eurozone and the pressing social demands of its citizens. Does a viable compromise exist and can it be negotiated while facing the impatience of international finance and the reluctant solidarity of the healthier members of the euro?

3.4 The long legacy of a north–south divide in productive capacity and competitiveness

Clearly, different societies have reacted quite differently to pressures associated with their 'Europeanisation' and this might be a source of a future 'grand divide' within the EU.

On the one hand, small open economies, such as those of Finland or the Netherlands, have long experience in designing and managing domestic institutions that foster their competitiveness and successful integration into the world economy. An open social dialogue, dynamism among entrepreneurs and political stability are key ingredients of such 'negotiated capitalism' and these economies' export- and innovation-led growth (Pedersen, 2008; Fellman *et al.*, 2008). For them, joining the euro was not a priori difficult, since large continuities prevailed with their post-World War II trajectories, even as Denmark and Sweden decided not to join the euro. In these economies, collective bargaining takes into account the objective of competitiveness; governments place emphasis on education, training and innovation; and social partners have agreed to turn welfare into an asset in world competition, by virtue of well-designed and patient reforms. In some cases, the reforms are anticipatory; they are not triggered solely on the basis of a dramatic and unexpected crisis. Germany, a medium-sized economy, has developed its own configuration to cope with the requirements and evolution of the international economy. The complementarity between the high-level skills of the workers and the quality of exported goods is the outcome of genuine efforts to organise the country's education and innovation systems (Streeck, 1991, 1997). Besides this long-term institutional competitive advantage, wage moderation—associated with the higher levels of unemployment triggered by German reunification—has been completed through the implementation of significant welfare reforms. These two features and the leading role of German conceptions in the design of the European treaties significantly explain, in part, divergence with respect to France, Italy or Spain. What is more, German actors do not believe deficit spending can solve major macroeconomic imbalances, since they believe the role of public policy is to shape stable expectations within the private sector and foster entrepreneurship.

On the other hand, most medium-sized or less-industrialised economies used to rely more on monitoring of the domestic market. It should also be considered that industrial relations are more wrought with conflict than they are prone to durable compromises; Schumpeterian entrepreneurs are more the exception than the rule and recurring political instability has made the coherence and continuity of economic policy quite difficult. In the past, southern European countries recurrently solved their macroeconomic imbalances through inflation and currency devaluations. When they joined the euro, this degree of freedom vanished. Consequently, all unsolved macroeconomic disequilibria—e.g. high youth unemployment, excessive specialisation in services, obsolescence of past industrial specialisations, lagging innovation, tax evasion and inadequate welfare systems—translated into large and permanent public deficits. For these configurations, joining the euro implied a complete redesign of most domestic institutions. The impossibility of devaluation meant either the implementation of a permanent income policy or the use of unemployment as either a painful disciplinary device or a means of promoting prompt upgrades in industrial specialisation; however, these are long-term strategies that deliver benefits only after one or two decades of effort. Furthermore, the small tax base and limited size of the export sector make a strategy of investment in R&D and infrastructure quite difficult, given that they are not financed by European Structural Funds. The impossibility of monetising domestic public deficit implies that governments must convince international finance that they can reimburse by generating both trade and public surpluses. In some cases—such as Greece—this is an impossible task, given their pre-euro configuration legacy.

The present analysis concludes that the north–south divide might be one of the major threats to the current eurozone configuration. Whereas interest rates have converged (Figure 2), the trade balance diverged after the launch of the euro (Figure 3) and some southern European economies have experienced permanent and large deficits (Figure 4).

Three main characteristics explain why the crisis can take different profiles and bear different degrees of severity among different areas within the same eurozone: the quality of state organisation and government handling of the crisis, the degree of structural competitiveness and the ability to control and monitor finance.

Northern economies (e.g. the Netherlands, Finland and Germany) enjoy a good fit with the evolution of the world economy, with an effective and reactive state and relative (if even imperfect) control over finance. They thrive relatively well in terms of external surplus (Figure 3) and ability to reduce the public deficit (Figure 4); thus, they can comply quite readily with EU and eurozone rules. They ask that their partners do the same and they represent the benchmark of most European policies.

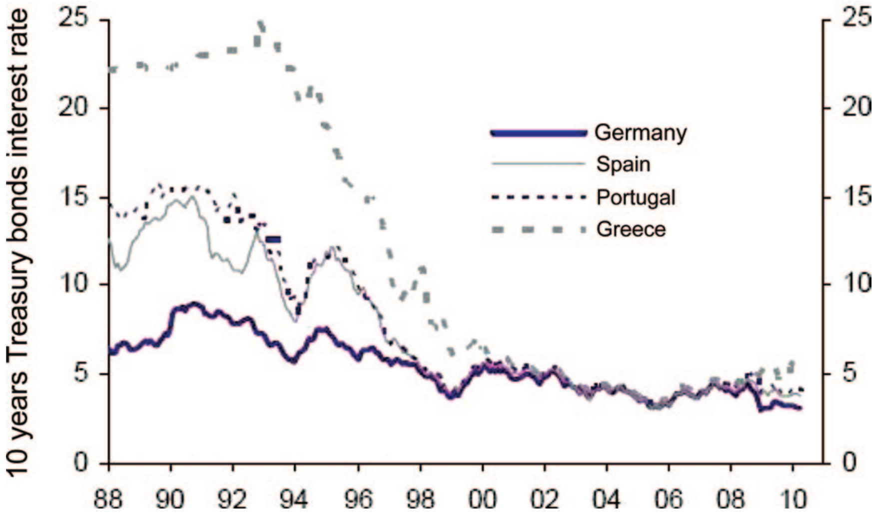

Fig. 2. *Convergence of 10 years of Treasury bond interest rates.*
Source: Artus (2010).

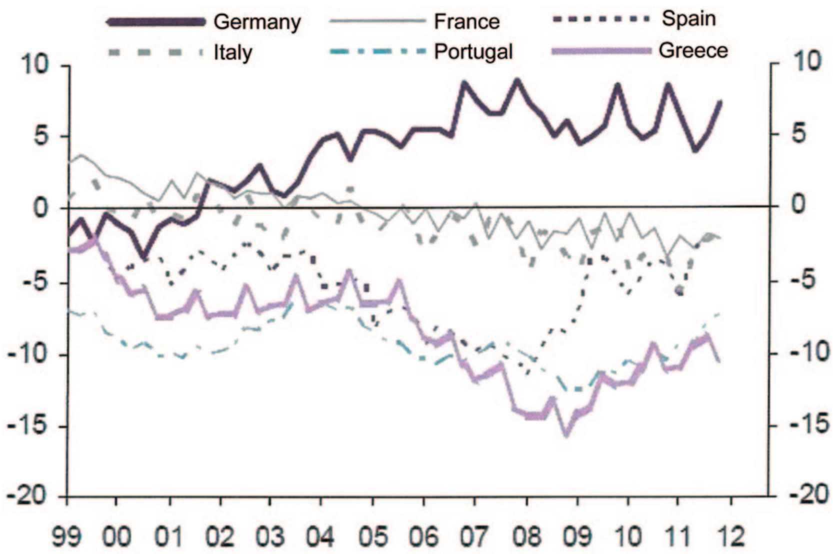

Fig. 3. *Trade surplus in the north, growing trade deficit in the south: current balance/GDP (%).*
Source: Artus (2012A).

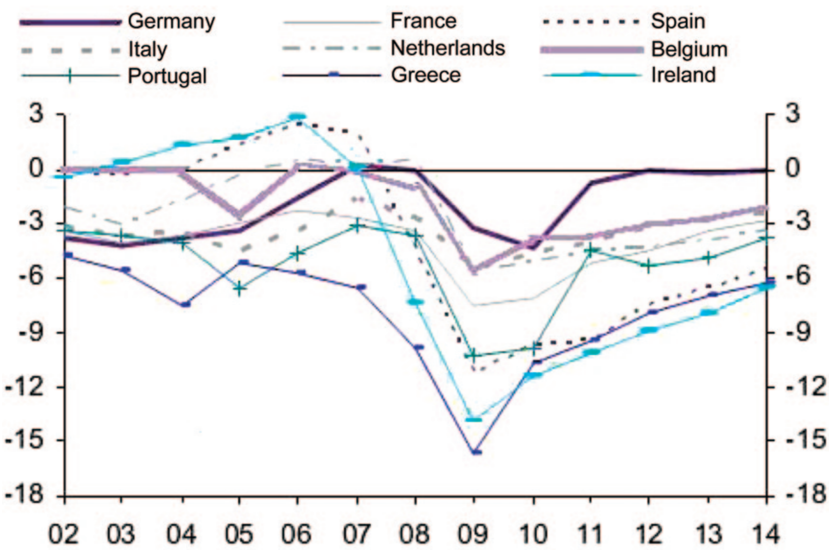

Fig. 4. *Structural public deficit/GDP (%) of Greece, Portugal and Ireland.*
Source: Artus (2013).

Unfortunately, southern economies do not bear the same configuration, since they tend to suffer from a structural lack of competitiveness (Figure 3) and the state tends to have limited ability to intervene efficiently in order to curb public deficits (Figure 4). Some of them have suffered from speculative real-estate bubbles generated by financial liberalisation. Given the persistence of public deficits and the deterioration of trade balances, it is very difficult for these southern economies to adhere to the adjustment programmes negotiated with the EU and IMF.

The heterogeneity of the eurozone is found to be still larger when one takes into account three hybrid configurations: France is the intermediate case between north and south; Greece is an exceptional case of clear and largely irreversible insolvency; and Ireland is a failed individual 'tiger' perverted by careless financial liberalisation, but with a large capacity to rebound to a viable export-led regime.

In summary, a historical and institutional approach makes intelligible the present euro crisis, far removed from monocausal, simplistic and normative interpretations.

4. Benign neglect of the political legitimacy of the euro within democratic societies

It is time to address the political perceptions of the euro, as seen in various national public opinions and social groups, and to question the political status of the euro: is it a simple technical device or a definite step towards a federalist Europe? The problem, precisely, is that no consensus was built before the launch of the euro and that then the sovereign debt crisis put at the forefront of the issue the relationship between economic rationality and polity, giving rise to a dilemma between a technocratic supranationality as a way out of the present uncertainty and the assertion of democratic rights. Again, a brief retrospective might help clarify analysis of the issues at stake.

4.1 From the start, a polarisation of perceptions of the euro among various social groups

By reducing transaction costs, removing uncertainty inherent in exchange rate volatility and preventing inflation that otherwise erodes competitiveness, it was thought that the euro would bring general improvements to the welfare of eurozone citizens. The existence of powerful mechanisms of redistribution among possible losers and a majority of winners—via taxation and welfare transfers—was thought to suffice in alleviating opposition as voiced by a portion of the population that could be negatively affected by fiercer competition and the restructuring of firms and jobs.

Public opinion surveys executed while preparing the euro actually showed generally positive appraisals of the common currency. For example, in France in April 1997, 70% of the population had a positive evaluation of its likely consequences and, with the exception of the UK, a majority of Europe expressed positive expectations (Sondoscope, 1997; see also Table 8). Nonetheless, the distribution of opinions was not at all uniform across socioeconomic groups, even within a single nation (see Table 6).

Large firms anticipated a few and only transitory difficulties; in reality, their transnational operations were largely facilitated by the launch of the euro, which allowed them to redeploy their production sites in line with their performance and, for some products, to be closer to areas of greater demand.

This feeling was not shared by small and medium-sized enterprises (SME) and retailers, who are generally less export led and are more likely to be linked to domestic and local markets. Unlike their German counterparts, French SME and, especially, subcontractors suffered from pressures applied to their costs, as exerted by large internationalised firms. This difference in perception is reflected in statements of various business organisations among these two business categories, *vis-à-vis* the euro.

Table 6. *France: the likely consequences of the euro for various social groups—the differing perceptions of the groups (in %)*

	Not too many problems	Transitory difficulties only	Long-lasting problems	Without any opinion
Large firms	**62**	32	4	2
Younger people	**60**	31	7	2
Small and medium-sized enterprises	37	**53**	6	4
Retailers	22	**65**	11	2
Savers	20	**51**	21	8
Low-income individuals	7	49	41	3
Elderly	1	8	**90**	1

Note: Figures in bold mean the highest proportion for each social group.
Source: SFRES (1997, p. 110).

Young people did not expect many problems as a result of the euro; they were also right to imagine that the euro could facilitate their mobility, since most but not all of them had acquired the education and competence needed to succeed in an arena that featured more open competition. On the other hand, low-skilled, low-income groups expected long-lasting problems to arise from their adaptation—or lack thereof—to the epochal change of the euro. They were largely right to expect such things, since internationalisation and 'Europeanisation' forced them to compete with workers who were earning lower wages and were devoid of any extensive welfare. Finally, the most pessimistic tended to be the elderly citizens, since they feared a negative impact on the generosity of their pensions, their deindexing from current wages and, ultimately, higher consumer prices.

The potential sources of destabilisation of both past social compromises and equilibria were thus clearly diagnosed by all the actors; this was a source of early political opposition, under the banner of 'national sovereignty defence', with which governments were forced to cope.

4.2 Enter (or not) the euro: the nature of political process matters

A favourite method of economists is to undertake an overall analysis within their favourite (and highly synthetic) model. Thus, the proponents of the euro concluded that its launch would enhance national welfare; they then lobbied civil servants and policy makers, to convince them to adopt their vision and finally decide to join the euro. If they perceived opposition from a portion of society, they proposed that pedagogical efforts be undertaken to disseminate their solution and they could say that their viewpoint had been informed by rigorous and scientific analysis far removed from ideologies and politically oriented passionate debates. From the start, in many countries, the euro suffered from a democratic gap in terms of legitimacy, but this was not inevitable: some societies are more democratic than others, and this feature has had definite consequences. For example, after intensive, pluralist and decentralised debates, the Swedish government decided not to join the euro, since some gains were

Table 7. *Polity matters: why France joined the euro and Sweden did not*

Institutional features	France	Sweden
1. Social inequalities and stratification	Significant	Moderate
2. Degree of political conflicts	High	Moderate
3. Nature of the political system	Presidential	Parliamentary
4. Style of economic policy debates	Technocratic/elitist	Involvement of most social sectors
Consequences upon the decision to join the euro		
5. Access of various opinions to the debate	Existing but not very wide	Quite exhaustive
6. Extent of the criteria taken into account	Narrow, only macroeconomic management	Wide spectrum of criteria
7. Involvement of citizens	High at grassroots level, but not formally	Direct and indirect, via deliberation
8. Political procedure	1. Referendum gives a majority to 'NO' 2. Parliament votes 'YES': France joins the euro	Government decides not to join, given the mixed and uncertain economic and social consequences
Medium- to long-term outcomes	• Progressive erosion of competitiveness and economic performance • Rise of opposition to euro	• Steady economic performance • No major opposition in favour of joining euro

certain but minor, whereas some adverse and highly uncertain consequences might have been quite detrimental to Swedish social cohesion and its ability to decide its economic fate autonomously.

In an expert report released prior to the Swedish government's decision (Calmfors, 1997), at least 14 different criteria were analysed; for each of them the assessment was quite balanced and contained no aggregate monetary evaluations, because they could not capture the complexity of the changes to be expected in Swedish society. A reduced democratic sphere of deliberation was found to be a cost that might be incommensurate with the larger influence of Sweden within the EU. Finally, the report focused on the large amount of uncertainty surrounding the consequences of the euro, with acute problems in the case of failure (see Table 7). The UK government, too, decided that it was not in the interest of the country to join the euro. Nonetheless, 11 other governments made the opposite choice.

From where does this opposition come? Basically, the intricacies of each national political system have played a role, because it is the sphere where various interests, visions and strategies struggle to set a final decision. Political scientists have the task of disentangling the contribution of a complex web comprising those economic, social and political processes, but they are far from agreeing upon common conclusions. Nevertheless, the average voter hypothesis here appears to resemble a drastic and probably misleading fiction (Figure 5).

Europe exhibits a large variety of electoral and political systems and this characteristic has had a specific role, besides those related to the aforementioned purely economic and institutional differences: parliamentarian versus more presidential regimes, proportional or majority-based electoral systems, possible or compulsory appeals to referendum, the frequency of elections and the average terms of governments are all factors to be taken into account. The French case is a good illustration of this complexity: in 2005, a referendum on its adherence to the euro was called and the answer was a clear majority: 'NO'. Nevertheless, the government decided to present a slightly amended treaty to its parliament and the treaty instituting the euro was approved.

All these differences in the political systems (Table 7) continued to play a significant role in 2012, in the midst of a major systemic eurozone crisis. In Germany, every agreement made in Brussels with regard to financial funds for bailing out other governments or banks has had to pass through the domestic political and legal system (i.e. Federal Constitutional Court of Germany); in France, however, these agreements were automatically translated into the French system, without parliamentary control. In this long and chaotic process—just look at the succession of governments in Greece—international finance takes the lead by imposing huge spreads for the public debts of governments that are unable to work out credible strategies. Clearly, polity matters, especially in response to the same challenges addressed by the leading role of finance in the unfolding of the euro crisis.

4.3 Resilience of the euro versus a renationalisation of economic policies? A permanent threat

If one accepts the core argument presented to date, the euro is *not* failing, because any constructivism is bound to fail; however, because the crisis is a consequence of various flaws in the design of its governance—many of which could have been prevented and probably can still be corrected—relief provided by the unambiguous and full support

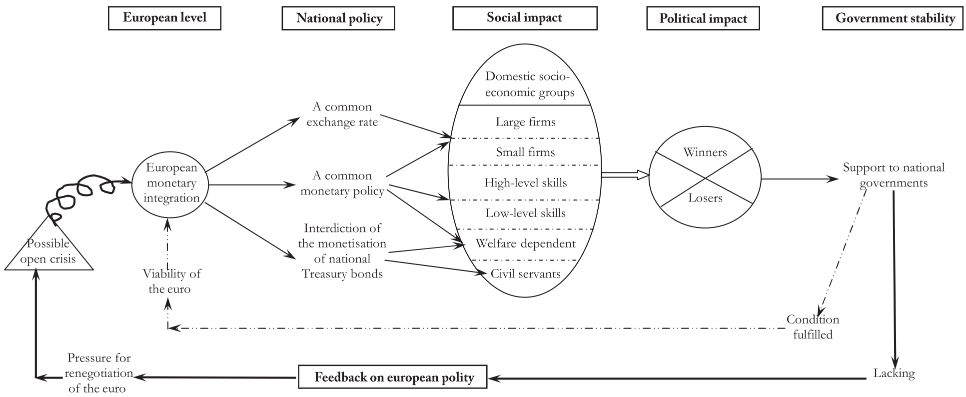

Fig. 5. *Social and political viability of member-state adherence to the euro.*

of the ECB to the euro, announced by Mario Draghi on 26 July 2012, can be used to build the required European procedures and institutions (e.g. in the direction of a common financial supervision and responsibility). The jury is still out, so to speak: will private actors and, especially, financiers be convinced that a genuine European federalism is in the process of being made or will any bad news trigger a 'domino effect' towards a more or less complete renationalisation of economic policies (Figure 6)?

There may be many reasons for this polarisation of a wide variety of interests across only two options. First, nostalgia for the Golden Age persists: many actors dream of returning to a period when wage increases had the wonderful consequence of higher employment and a lower public deficit while preserving the dynamism of investment. If austerity measures fail, then the opposite should succeed, correct? Let us return to the past socioeconomic regime. Clearly, this assumes a complete reversibility of two

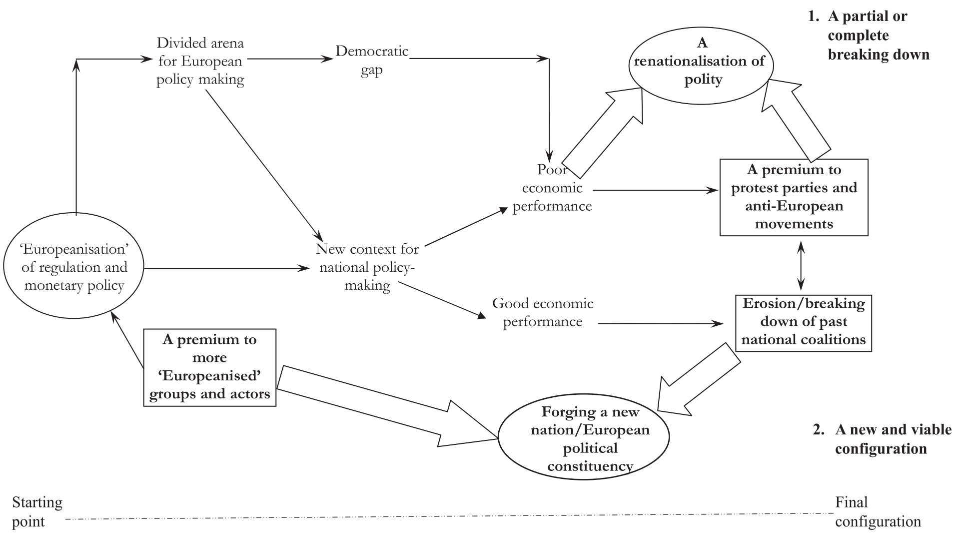

Fig. 6. *Success of the euro … or a renationalisation of national policies?*

decades of internationalisation, the rise of finance, a productive paradigm shift and the transformation of European societies. Second, if the EU has not been able to implement democratic principles in Brussels and Frankfurt, public opinion is entitled to ask for a return to control by citizens of the government; until now, the nation state has been the only territory whose polity is organised and where democracy can be exerted, however imperfectly. The enforcement of drastic adjustment programmes, run jointly by the EC, the ECB and IMF, feeds the feeling that a form of technocratic logic has replaced democratic principles.

Third, the fact than the EU was and is based on the cornerstone of unfettered competition and its relentless extension from manufacturing to services, labour and finance, calls for a return to more cooperative strategies: if they are blocked at the European level, a nation, region or local community can favour them. Fourth, facing the limits of the generalisation of export-led growth and financialisation, antiglobalisation movements may convince a growing proportion of the public opinion to abandon unfettered free trade. Given the deadlocks that have occurred in the course of negotiating a more regulated and fairer international system, the renationalisation of European economies is a tempting option, presented by both extreme rightist and leftist political parties. The impressive recovery of Argentina after its default and complete U-turn of its economic policy (Boyer and Neffa, 2007) is thus more and more frequently cited as an example of how to emerge from the current 'Greek tragedy'. Nevertheless, the size and competitiveness of Greece's exporting sector is far inferior to those of its other European counterparts, and immediate contagion effects constitute a considerable difference between Argentina in 2001 and Greece in 2013.

In contrast, the appeal of European institutions is quite low and this plays a role in the nature of the likely bifurcation of European integration. Will it serve as a 'high road' out of the crisis or signal the collapse of the very ideal of Europe?

4.4 Europeanisation as a modernisation process and a burgeoning of European procedures, to legitimise possibly unpopular domestic reforms

Joining the European Community and then the EU has been a powerful instrument for organising the transition to democracy in many southern European nation states and speeding up the modernisation of public infrastructure, domestic regulations and, more generally, the productive organisation of firms and improving the living standards of a majority of the population. This was the Golden Age of Europe, but this period seems to have ended; the relationship between the member states and European entities is no more than a positive sum game. With long-term slow growth, past social rights are becoming more and more difficult to finance and sustain, even as welfare systems as such enjoy strong support from the population.

Within such a context, in the domestic arena, politicians may argue that drastic reforms are imposed by EU directives and that they are not responsible for them. In reality, they both indirectly and directly gave approbation to these decisions, which are generally unanimous. This ambiguous argument might help once or twice, but it cannot become a general means of legitimising reforms of which a majority of the population disapprove.

The invention of the open method of coordination (OMC) (Rodrigues, 2002) has introduced a new tool, built as it is upon the pooling of national reforms in light of common objectives in terms of welfare, labour institution reforms, innovation policy and, finally, gender and fairness issues. By its voluntary nature, this benchmarking exercise is far from having succeeded in reconciling productive modernisation and remodelling welfare systems; nonetheless, it has the merit of respecting the subsidiarity principle: frequently, bargaining at the domestic level has blocked unpopular (and probably inefficient) reforms.

In any case, the efficacy of traditional instruments (i.e. directives) has been eroded and the new ones (i.e. OMC) have not overcome the distance between the framing of issues in Brussels and the realities of economic and social processes at the grassroots level. This is a major cause of concern for the whole of the EU and, of course, for the euro.

4.5 From an EC-led community approach to intergovernmental bargaining within the European Council

Within the entities that form the European governance—and for the sake of simplicity, the European Court of Justice, however important, is not taken up here—the euro has been associated with a shift in their respective powers.

First, the creation of the ECB has weakened the power of the EC with reference to the conduct of economic policy: money is a federal responsibility and the ECB exerts it quite singularly, given its formal and complete independence from any other administrative or political entity. In contrast, fiscal policy remains a national attribute, and so the EC is only an enforcer of competition, a guardian of the SGP and a coordinator of medium-term national programmes.

Second, in spite of a reform that has extended the power of the European Parliament, its role remains quite limited indeed. Its interventions in the euro crisis are nearly invisible. Therefore, leadership in response to the Greek crisis and its progressive diffusion to Portugal, Ireland, Spain and Italy has been taken up by the European Council, which has had to meet more and more frequently in order to try to stop the downward spiral, in response to each speculative attack on national sovereign debts.

This move was an improvement over the long silence of the EC and the inability on the part of the European Parliament to take the initiative, but it also implies the absence of a central actor that will defend a community-based approach. Clear leadership was replaced by a laborious bargaining series at the intergovernmental level, which led to quite shaky and unconvincing compromises, late decisions and a permanent underestimation of the severity of the problems ahead. Still, the national public debt and banking crises are dealt with as liquidity crises—hence the call for an ECB intervention—but there is a risk of diffusion of the solvency issues that started with the Greek government and Spanish banks.

The inability to reform the SGP so as to make it an effective control over lax public finances is a good example of the pernicious impact of intergovernmentalism: the governments were exempting each other from complying with the enforcement of sanctions and the EC was unable to prevent this dangerous shift from occurring (Boyer, 2006). The euro crisis originated in large part from this specific distribution of power within the (complex) European governance. Conversely, however, the June 2012 and February 2013 European Councils exacerbated previous imbalances in the bargaining power of various EU members. The fiscal compact, i.e. the 'golden rule' for public finance management, was largely imposed by Germany, while the reduction of the European budget for 2014–20 was largely the outcome of an alliance between Germany and the UK, against the interest and will of southern Europe. The spirit of community put forward by the founding fathers seems to have disappeared with the emergence of the euro crisis.

4.6 The same European treaties, but different national interpretations: why rescue plans recurrently fail

The Germans have had intellectual and political primacy in the drafting of successive European treaties ever since they decided to abandon the Deutsche mark—but only if the new currency was run according to German principles: prevent, at any cost, open inflation and forbid the monetisation of any public deficit, making the bailing out of one state by another impossible. Since fully fledged federalism was out of reach, Germany nevertheless imagined transposing a part of its ordoliberalism: the euro would fulfil its role only if *everyone* complied with *all* the rules, as *agreed upon* in the treaties. Here originates a dramatic misunderstanding: for many other eurozone members, the treaty clauses are to be interpreted in each new context; they do not at all embody a categorical imperative. For the German government, compliance with agreed-upon clauses is a moral issue that cannot be discussed or freely amended. Such a vision has largely proliferated among northern European societies, but this is far less the case in the south; this cultural/legal divide continues to make euro rescue plans quite difficult. Among German public opinion, a government that

Table 8. *The same European treaties … but conflicting visions of the dynamics they imply*

1. Conception of the ECB	Normative Absolute autonomy, to preserve price and therefore monetary stability	Instrumental Dependence with respect to political power; search for a trade-off between inflation and unemployment
	Germany	France
2. Leading principles for economic governance	Pure markets EU should be a free-trade zone	Public monitoring European-level institution building on top of markets
	UK	France, Germany
3. Conceptions of welfare and labour institutions	Market enhancing	Protection from market insecurity
	Workfare; privatisation of most components of welfare	Extended welfare, the ideal of a social Europe, and the role of collective negotiations
	UK	Denmark, France, Germany
4. Roles of public spending and taxation	Minimalist Ideal of a balanced budget	Key political tools Active stabilisation policy
	Germany	France
	Ideal of a flat tax	Progressive personal taxation
	UK	Denmark, Sweden

has been cheating has no legitimacy in begging for help from 'virtuous' ones. The subsequent collapse generated by the absence of bailouts may inflict various and sometimes important losses in the other so-called virtuous economies, but this is the cost to be paid in enforcing respect of the rules of the game in the future—at least, if the EU still exists.

These misunderstandings are multifaceted. For the French elite, the ECB should be the instrument by which to achieve a better policy mix, whereas for German experts and politicians, its normative role is exclusively the defence of monetary stability. In the 1990s, the UK and French governments agreed upon the same treaty, but their intentions were quite different: on one side, the single market was an opportunity to destroy the legacy of domestic state interventionism, in order to prepare Europe for world competition; on the other, this was the starting point of constructing, at the European level, the institutions that had become inefficient at the domestic level. Similarly, successive UK governments have implemented workfare and largely privatised social security; in contrast, most continental Europe societies continue to define themselves as welfare capitalisms, even if slow growth puts at risk previously generous entitlements. Last but not least, the various tax systems of the member states quite contrast with the trade-off between economic efficiency and social solidarity (Table 8).

Another misunderstanding has made political bargaining in Europe still more difficult. In the late 1990s, public opinion surveys showed a contrasted configuration: southern European and French opinion were quite enthusiastic about the euro, but in northern Europe, and especially in Germany, the people feared the euro (Table 9). The former group is now experiencing major difficulties in belonging to the euro,

Table 9. *The paradox of the launch of the euro: European Survey, early 1997*

A rather enthusiastic southern Europe		A skeptical northern Europe	
France	70% have a positive appraisal of the euro 58% believe that the benefits outweigh the required sacrifices	Germany	60% fear the consequences of the euro
Spain	70% have a positive appraisal of the euro	UK	58% fear joining the euro, but 56% of business people wish the UK to join
Portugal	53% are ready to make financial sacrifices in order to have their country in the first wave of the euro	Netherlands	A drastic breaking down of acceptance of the euro 1995: 73% 1996: 46.3% 1997: 34%
Italy	70% have a positive appraisal of the euro		

Source: Sondoscope (1997, pp. 70, 71, 73).

whereas the latter has been quite successful in using the European single market to boost its growth by exporting to southern Europe, thus compensating the lack of dynamism in domestic demand in response to a long period of wage austerity in Germany.

There is one final paradox: while a majority of public opinion in the south suggests that they want to continue to belong to the euro, their productive structures and specialisations make the fulfilment of the euro rules very difficult, if not impossible. In the north (e.g. Germany and Finland), politicians actually need to fight against the feelings inherent in their public opinion, strongly opposed as it is to any European solidarity with the south, in spite of the fact that Germany has finally benefited economically from the rest of Europe, in both the boom and crisis periods. Would the German working poor—who have emerged from successive cuts to welfare benefits—understand massive support of the unemployed in southern Europe? This is another neglected dilemma: some want to belong to the euro but are unable to cope with its economic consequences, whereas others can thrive economically but are not so eager to be part of the eurozone.

Of course, an accurate diagnosis of the weaknesses of the current state of European integration is required, but with regard to the future of the euro, polity still matters more.

5. Conclusion

The current article introduced some factors that have been conspicuously absent from analyses of the eurozone crisis. Erroneous economic theorising, the domestic bias of political intermediation and the power of financial globalisation interact within quite complex processes. They have led to the current turmoil and make impossible any firm prognosis *vis-à-vis* the way out of the present 'muddling through'. More precisely, seven conclusions are put forward.

Conventional wisdom offers a dual interpretation. At the economic level, it states that the euro crisis is no more than a typical first-generation crisis, i.e. the consequence of incompatibilities among a fixed exchange rate, full international capital mobility and an excessive public deficit. This is only partially true. At the political level, the second-most frequently made assessment is that no money can be viable without the backing of a fully sovereign state and that this truism also applies to the eurozone crisis; however, the crisis has still other and deeper origins that relate to the explosive synergy among three interdependent processes.

First, the new classical macroeconomics has convinced a majority of economists and politicians that a market economy is structurally stable, while taking into account neither the role of credit nor the impact of financial markets on expectations. Thus, the related economic models used to assess the impact of the euro are built upon hypotheses that make any crisis virtually impossible: a structurally stable macroeconomic equilibrium is moved only by the recurrence of exogenous real shocks, high-powered money is neutral, the expectations of all private and public agents are fully rational, unemployment is basically voluntary and the bankruptcy of firms and banks is impossible. Actually, these hypotheses were a rather poor starting point for analysing a complete change in the economic policy mix and the degree of autonomy inherent in national *régulation* modes. For any given

Table 10. *Solving the incompatibility of objectives and interests by the leadership of a key actor: some tentative scenarios*

Key actor	Strategic asset	Impact on euro	Final configuration	Permissive factors	Obstacles
Breaking of the euro					
1. International finance sets the destiny of the euro	Mobility and volume of assets controlled by finance	Speculation reveals the institutional mismatch of the EU and inability to reform the euro	• Exclusion of insolvent states • A two-speed/tier euro with flexible exchange rate • End of idea of a common currency; return to complete national sovereignty	• Impotence of European authorities • Conflicting national interests	• Loss of legitimacy of high finance, following recurring scandals • Coordination of major central banks to restore financial stability
Pragmatism but coherence					
2. ECB fights back	Monetisation of national public debts; 'lender of last resort' for banks	• Mitigates speculation • Gives time to national economies, to adjust structural unbalances	• Debt forgiveness for insolvent states • Rescheduling of illiquid public debts • Fiscal federalism, to rebuild competitiveness of weak economies	• Compromise between German and Keynesian conceptions of central banking • Knockdown impact on EC and European Council	• Opportunistic behaviour of national governments • Irreconcilable national conceptions of central banking • Impotence of weak states
European Community					
3. Renewed community approach	Defence of European public goods, including the euro, by a strong EC	Complete refoundation of EU makes the euro viable	• Euro as a common (but not single) currency • Taxation of capital at EU level • European financial regulatory and federal deposit insurance • Large structural fund that reindustrialises the weakest economies	• Recognition of large, productive heterogeneity • Devaluation far better than inefficient austerity policies • The principle of solidarity better fulfilled by growing economies	• Obstacles to admitting flaws in the euro's design • Loss of EC expertise and leadership • Legacy of intergovernmental negotiations at European Council level

Table 10. *Continued*

Key actor	Strategic asset	Impact on euro	Final configuration	Permissive factors	Obstacles
Opposed outcomes					
4. European citizenship	Democratic principle: control by the people of the political and economic institutions they live with	Uncertain, according to the level of action: either typically national or European	**Economic nationalism** • Democracy can be expressed only at the nation-state level • Reconquest of full sovereignty, including the monetary one	• Failure of austerity policies, both inefficient and unfair • Diffusion of grass-roots movements against inefficient and undemocratic reforms	• Some nostalgia for 'Golden Age' • Democracy or typical nationalism? • Danger and limits of protectionism
			Democratically negotiated Europe • Radical political innovations allow for the emergence of a democratic EU	• Recovery of euro's credibility • Emergence of transnational parties	• Europe is not yet constituted as a democratic arena • Opposed conceptions within the same parties (left or right) • Domination of powerful lobbies defending status quo • Reluctance of new social movements to organise themselves as national/European political parties

member state, joining the euro implies the loss of two instruments: monetary and exchange rate policies. These instruments should have been replaced by others, such as innovation and industrial policy, social pacts and income policy; some countries were able to do so, while others could not (and did not) and are now in severe crisis.

Second, politicians and macroeconomics have downplayed the heterogeneity of eurozone members in terms of productive specialisation, economic policy styles and political and legal conceptions. What is more, the deepening of the social divide—between groups that gain from the euro and those that are fearful of losing from it—imperils the governability of domestic democratic systems, chiefly by referencing rules negotiated at the European level that are to be implemented regardless of domestic public opinion. For example, a referendum on the European treaties delivered a 'NO' in each of Ireland and France, but those treaties were nonetheless ratified. In contrast to this technocratic approach, some social democratic societies have decided not to join the euro, precisely because the uncertain balance between gains and losses made the choice of an irreversible monetary union quite risky.

The complexity of the decision-making process in the EU has been used by governments to follow a modernisation/internationalisation agenda; in the past, when decision making was blocked by domestic political processes, the governments used public spending and tax reductions, which were rare and easy instruments to use within the restricted scope of economic and social policy. Hence, there have been recurring violations of the SGP and a permanent increase in the public debt–GDP ratio in the weakest economies that have been unable to reduce structural imbalances suffered since the 1970s. Following adherence to the euro, public spending and welfare transfers have been used as safety valves to sustain growth and job creation; then, following the subprime crisis, automatic stabilisers hollowed public deficits and, finally, unconditional support to ailing financial systems exacerbated public deficits to the extreme in, for example, Ireland. It is thus wishful thinking to imagine that a drastic and temporary austerity policy could rapidly overcome imbalances that have been piling up over the last one or two decades.

A third process relates to the genesis and unfolding of the euro crisis: financial deregulation and globalisation have created major disequilibria. Most governments have happily removed from the political arena unpopular decisions involving capital allocation and economic restructuring. Initially, they feared that product and labour market liberalisation would imply slower growth by strengthening economic constraints; however, the innovativeness and internationalisation of finance have removed the intertemporal income constraints of households, firms and states. Furthermore, finance has entitled poorly competitive economies to enter the euro, thus providing them with instruments by which to hide and/or transfer related risk. Given a lack of political authority and the will to enforce the excessive deficit procedure, European entities (e.g. the European Council and the EC) have been happy to delegate this task to international finance. Hence, there is a certain irony concerning the sequence of, first, extremely permissive finance and, then, a highly and overly pessimistic appraisal of the viability of the euro. This pathological pattern, typical of liberalised finance, has turned the local and limited crisis of Greece into global distrust with regard to the future of the euro and even the EU itself.

The recurring inability to find adequate responses to the euro's creeping and eventually open crisis does not derive from any irrationality or lack of political will, but rather from conflict arising from the incompatible objectives and interests of a complex web of key collective actors. The ECB, for example, is compelled by past treaties to deliver price stability; within the European Council, intergovernmental negotiations are quite messy and slow, due to conflicting visions of the future of Europe; international finance has been given the power to work towards high and stable returns and it now dominates most other actors, by virtue of its massive web of global networks and the complexity of its products and organisations; the EC lacks the legitimacy and instruments needed to rejuvenate a European Community-based approach that hinges on the defence of core European public goods and the creation of new ones; and the citizens of Europe complain about risks to democratic principles and the poor performance of European institutions in coping with a crisis for which they do not feel responsible.

The future of the euro is open. There may exist as many possible futures as collective actors able to shape the strategies of other entities towards a more coherent configuration with respect to the repartition of competences between the European and national arenas (Table 10): the collapse of the euro under the relentless pressures of an impatient finance is a possible and still likely scenario. A complete renationalisation of economic policy and control of finance is not excluded; a north–south divide within the euro is looming; the power and centrality of the ECB could entitle a progressive reconfiguration of the web of national and European institutions; and the EC could oppose the value of cooperation with the competition principle, which is deeply embedded in the present European treaties and would serve as an alternative to intergovernmentalism. Last, but not least, Europe's citizens may call for a revival of democracy with ambiguous consequences, but at what level? Is the nation state the only available and adequate arena for democracy or will a democratically negotiated and constructed Europe finally prevail?

Hence, we derive a prognosis: the euro crisis is here to stay and it will likely bring many surprises.

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