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The Institutional and Political Crisis of the European Union and Some Ways for Overcoming it

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Loss of autonomy of governments, incoherent European governance

After the waves of the world crisis caused by the Lehman Brothers collapse hit the European Union, actions to preserve the Euro revealed a breach between national governments and a fuzzy supranational governance involving too many uncoordinated actors. Retrospectively, the weaknesses in the Eurozone decision process boil down to a common and deeper origin: instead of an explicit economic government (Boyer 2000), successive European treaties have resulted in a quite complex governance, implying a multiplicity of entities and actors with partial objectives, limited instruments, and contradicting interests. This configuration seemed roughly compatible during the credit and public deficit led-boom period, but became self-defeating once the realism of the Euro's architecture was challenged by international finance (Figure 1).

A constant feature emerges from the evolutions observed since March 2010, the date of the reversal of economic policies toward austerity: international finance is the Stackelberg leader in the European governance game, since its expectations set the amplitude of the spread to be paid for the refinanc-

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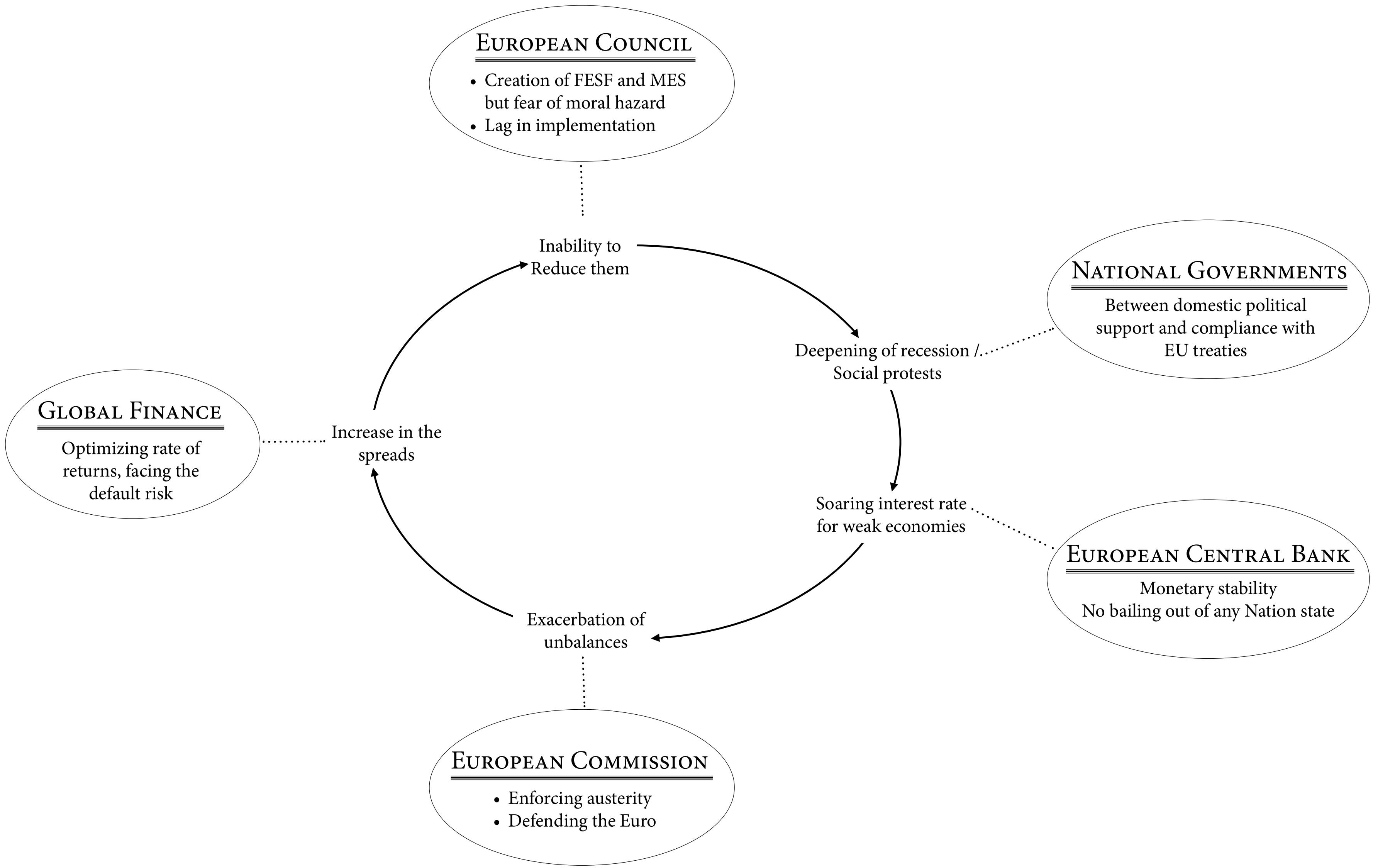
Figure 1. The Muddling through in the Eurozone: The Consequence of the Conflict between the Objectives and Interests of a Web of Actors



ing of each national sovereign debt. The various European Councils discuss the creation of successive public funds to provide a transitory relief by refinancing at lower interest rates, because they understand that the excessive pessimism of private finance would mean the march to default for many economies: Greece, Portugal, Ireland, and potentially Spain and Italy. But the German and Nordic governments want to block any moral hazard-prone configuration and request control of the effectiveness of these economies' adjustment programs. This means new austerity measures, on top of the ones already decided upon.

Even after the announcement of a decision, the process of implementation remains uncertain: on the one hand, the national Parliaments have to approve participation in the Financial European Stability Fund followed by the European Stability Mechanism, but on the other hand, the governments that benefit prospectively from these funds face increasing difficulties when their austerity policy does not reverse the downward macroeconomic evolutions: many social groups (civil servants, the unemployed, beneficiaries of welfare transfers…) vocally oppose the policy's unfairness and ineffectiveness. In Southern member states, governments suffer from a form of schizophrenia: they need Europe's help, but are unable to convince the public that the conditions imposed are useful and legitimate.

International finance does not like such ambiguity, and therefore castigates these governments; this leads to a new wave of pessimism. A fourth actor potentially – if not legally – has the ability to counteract, at least transitorily, the explosion of the spreads for state and bank refinancing: the Central Bank. The United States, United Kingdom, and Japan have massively used this instrument and succeeded in lowering the interest rate, thus easing the stress on banks and public finance. Unfortunately, the letter of the Lisbon Treaty forbids this traditional role of the European Central Bank (ECB) as an open lender of last resort. Therefore each government realizes that the Euro has become the equivalent of a foreign currency. Consequently, the unique objective attributed to the ECB – to conduct a monetary policy maintaining a low aggregate inflation rate – is blocking one of the easiest solutions for monitoring the interest rate paid on sovereign debt. Finally here comes the less influential actor: the European Commission, allied with the ECB and the International Monetary Fund, has the rather limited task of monitoring the national programs of adjustments for the governments that have benefited from European funds. This conjunction of actors' strategies triggers a new sequence in the vicious macroeconomic circle that started in March 2010, under international finance pressure.

This process was partially stopped when the ECB stated that the threat of banks declaring bankruptcy (and of governments defaulting) was blocking the credit channel in the transmission of monetary policy to economic activity. Therefore, the ECB was able to buy Treasury bonds from Greece, Portugal, Spain, and Italy. This creative interpretation of the Lisbon Treaty was threatened by *Bundesbank* protests and the inability to get unanimous support within the ECB Monetary Council. Immediately the adverse macroeconomic evolutions manifested themselves so powerfully that Mario Draghi had to announce in July 2012 that the Euro would be defended by any means available (Draghi 2012). The calm then prevailed in financial markets at least until spring 2013. Nevertheless credit might buy time, but it is not an alternative to difficult institutional reforms of European governance, the more so the more adverse the impact of the diffusion of austerity policies. Consequently if all the entities involved in the governance of the Euro stick to their traditional objectives, past strategies, and instruments, a way out of the Euro crisis will not emerge. But fortunately this is not the only scenario.

Between Euro collapse and federalism: So many contrasted futures

There is implicit teaching from this analytical framework: no durable way out of the Euro crisis can emerge from the present status quo, and de facto almost all of the actors involved in European governance have put forward various reform proposals. This uncertain juncture brings to mind a set of scenarios built on the rise of a key collective actor who tries to rebalance and resynchronize the scattered components of European governance: the ECB, the German government, Southern European public opinion, the British authorities, a transnational federalist movement, and, finally, international finance are possible drivers toward contrasted reconfigurations in relationships among the EU, member states, and global finance (Table 1).

1. ***Federalism by technocratic rationality*** is the first path to be explored in light of the key role of the ECB in calming the anxiety of financiers about the irrevocable collapse of the Euro since the summer 2012 (Draghi 2012). This sets into motion the adoption of the principle of a genuine banking union by the European Council (2012) on top of the Fiscal Compact aiming at disciplining national public finance, which was previously adopted. The impulse comes from the unique fully federal institution, the ECB, which would be the big loser if the Euro were to disappear. Clearly it calls for a coordination of European monetary policy with national budgetary and tax policies consolidated at the EU level, and these knock-down effects should progressively re-design the whole architecture of European governance. Nevertheless, this scenario faces severe obstacles. First, an easier refinancing of public debts does not overcome the poor competitiveness of most Southern economies and may even postpone the required structural reforms. Second, this rather technocratic approach disregards the sinking legitimacy of European institutions in most national public opinions and its quasi-complete neglect for democratic principles. Last but not least, the very founding principle of modern societies is not to be forgotten: 'No taxation without representation', which is an absolute barrier to the launching of a genuine federal budget with redistributive and stabilizing objectives.

2. ***A German Europe built upon ordoliberalism*** delineates a second and quite different scenario, as evidenced by the recurring frictions between Mario Draghi and the German authorities regarding the inflationary perils associated with the unorthodox ECB monetary policy and the moral hazard induced by the bailing out of imprudent governments. Basically, the way out of the present mess is up to the full reassertion of the rules of good governance: compliance with limited public deficit, strict independence of a Central Bank exclusively in charge of monetary stability, wage negotiations preserving competitiveness, and efficient tax and welfare systems. This federalism by rule compliance makes unnecessary any step toward more solidarity. These features mean both the attractiveness of such a future for German citizens and its dubious or quasi-impossible implementation in other Southern societies. On one the hand, German authorities argue that this conception has been quite helpful for the recovery of their own economy after the reunification, that it was the core of the Maastricht and Lisbon treaties – agreed upon by all member states – and that it allows them to help ailing economies. On the other side of the coin, is it realistic to strengthen rules that weaker societies have been unable to comply with? Haven't German firms benefited from the economic policy mistakes of Southern Europe? Hasn't the Euro organized and deepened a de facto complementarity between competitive manufacturing in the North and sheltered services in the South? Therefore, aren't significant transfers from the North to the South necessary to prevent the complete collapse of 60 years of European integration?

3. A North/South grand divide might be the unintended final outcome of the previous scenario: the persisting asymmetric power of Germany, converted from economy to polity, could well make the split of the old continent according to a North/South or center/periphery dividing line increasingly likely. At least three brands of capitalism used to coexist

Table 1. A tentative Assessment of the Seven Scenarios

Scenario	Strengths	Weaknesses	Political viability/ legitimacy
“Federalism by technocratic rationality”	Search for coherence and resynchronization of EU institutions	New reduction in national sovereignty	Weak unless strong political impulse by a charismatic leader
“Ordoliberalismus für Alle”: A German Europe	Integration without fiscal federalism	Does not overcome North/South structural unbalances	Deepening of the Maastricht Treaty principles that failed
“A North/South divide”: A flexible exchange rate between two Euros	Overcomes the basic present unbalances by a return to growth in Southern Europe	A de facto breaking down of the Economic and Monetary Union	A partial recovery of national autonomy, but large political costs for federalists
“Chacun pour soi”: A wave of nationalism and protectionism	Recovery of national sovereignty	Possible high economic costs	A response to both left and ultra right demands
“A British apolitical Europe”: Free trade zone + ad hoc partnership	A reconciliation of the diversity of national interests	The end of political federalism in Europe	A third way between complete collapse and a federalist Europe
“More democracy”: A condition for a path toward a federal Europe	A response to the erosion of EU legitimacy	Assumes that an European citizenship can be the cornerstone of a new EU	Dubious in the midst of economic depression
“International finance strikes back”: The storm after the calm	Puts pressure upon an unsustainable European configuration	Puts at risk the very basic European project	The real economic global power: complete mobility of huge amounts of capital

in Europe and their differences have been exacerbated by the Euro (Boyer 2013). This scenario assumes furthermore that it is better to collectively organize the demise of the Euro than to let it happen via a succession of costly crises. Silently the fast internal and external financial liberalization process has allowed an easy financing of trade and public deficits, thus hiding the cumulative loss of competitiveness of the weakest European economies. Given the irreversible loss of national exchange rate policy formalized by the European treaties, public and welfare cuts and severe wage concessions seem to be the only tools available to restore the lost structural competitiveness. Unfortunately, consumption and investment are plummeting faster than trade deficit reduction, hence a rise in unemployment and an open rebellion of wage earners, unemployed youth, and citizens facing cuts in education and health care (Boyer 2012). In this configuration, austerity is self-defeating (Krugman 2012) and threatens the very foundations of European societies. Political instability is the logical outcome of this dramatic rupture in the past, rather smooth process of European integration and the objectives of Europe's founding fathers. Symmetrically, the public opinion in healthier and more dynamic economies is not ready for the finance of long transfers in order, for instance, to reindustrialize ailing economies. A strategy could be for governments to agree to keep a common currency for the EU's external relations but to create two Euros, one for the South and another for the North, with a floating but managed exchange rate between them in order to limit a dangerous overshooting in the transition period. The less competitive economies could thus benefit from the devaluation of the Southern Euro, return to growth, and extend their production capacity. Their external debt should be rescheduled and renegotiated, a quite perilous task indeed. One or two decades ahead, when structural competitiveness is well established in each country, one could contemplate a new tentative in monetary integration. But this assumes a lot of pragmatism and flexibility from European authorities in order to prevent the unfolding of a still more dramatic scenario.

4. A contagious wave of nationalism and protectionism is precisely the permanent threat to a mishandling of such an organized monetary – but not economic – divorce within a reformed EU. Actually, most Southern economies have a common political interest in negotiating a more balanced treaty, but their economic health, political tradition, and public administration capacities are quite different indeed. If they fail to speak with a single voice, the weakest member states might face a speculative attack on their public debt and be pushed into default. But the crisis might also mature at home with the rise of new political movements or parties advocating an exit from the Euro: too many sacrifices and no reward (Greece, Portugal, Spain, or even Italy), and excessive intra-European transfers, but no recognition by other member states (Germany, Finland). The successful handling of default by the government of Argentina is frequently mentioned as a possible reference. Nevertheless this could be the starting point for a stampede out of the Euro, fed by a vocal nationalism gathering both left- and ultra-right-wing parties. Would pride about the recovering of national sovereignty be sufficient to compensate for the large economic costs of a protectionist move? What about the political governability of societies where European integration has long been the alpha and omega of the elite? Could the single European market survive the uncertainty of exchange rates and a creeping or open protectionism, decided to tentatively sustain domestic employment? This should be the nightmare for Europeans and federalists: the beautiful motto 'Unity in Diversity' should then be changed to 'Diversity in Disunity'.

5. A British, apolitical Europe could define another trajectory, which would not be so glorious but would be less gloomy than the race to the bottom – typical of the fourth scenario. It would explore a third trajectory between a march to federalism and the complete demise of the whole European project, between the search for a problematic political Union and the chaos provoked by the long-lasting denegation of heterogeneous if not totally conflicting national interests and conceptions concerning the relations between markets and states, and between economic performance and social justice. In this fifth scenario, Europe should be restricted to a free trade zone, with minimalist administrative enforcement, i.e., a training ground to cope with the globalization of competition – the real challenge of this century – acknowledging the shift in the center of gravity of the world economy toward Asia. In this respect, German and British governments seem to share the same conception: Europeanization should now become a means for achieving world competitiveness, and no longer a political goal. The February 2013 European Council decision to reduce the share of the common budget in relation to the EU's gross domestic product is quite emblematic of a new alliance, at the detriment of the demands of Southern European governments and the traditional Franco-German leadership in the promotion of a deeper and deeper integration. The trajectory could display many variants: a two- or multiple-tier Europe, or a flexible configuration, tailored according each national interest – an idea that is quite old and has been promoted for several decades by British think tanks. In a sense this would be the post-mortem victory of Margaret Thatcher's strategy against Jacques Delors' grand vision. It was far easier to erase economic frontiers than to build new supranational political institutions.

6. A democratic federal Europe is frequently presented as the counterpart and only alternative to the demise of the Euro. Many experts and some policy makers stress that economic and financial interdependency and externalities have reached such an intensity that the only reasonable strategy is to build at the supranational level the political institutions to govern them (Cohn-Bendit and Verhofstadt 2012). Others emphasize that federalism is both an opportunity but also a risk (Artus 2011). In any case, it requires overcoming the democratic deficit in the present distribution of power and competences in the EU (Goulard and Monti 2012), which is not an easy task at all: an integration among unequal partners puts the democratic ideal at risk (Hopner and Schafer 2012). No doubt, legitimacy is required to build new and heavy institutions, but it is quite a challenge to pretend to restore the credibility of the EU and the Euro in the midst of as systemic crisis by correcting a long-lasting democratic deficit of European integration. Most of the citizens have been hurt by unemployment, welfare, and public service cuts that were imposed by outside factors. Furthermore, the time of the economy is not synchronized with the time of polity, and the reforms of today will bring their fruits a decade ahead: in between, how would it be possible to overcome the perils of a systemic collapse of the EU? Last but not least, the German political elite that used to propose a federal Europe two decades ago is now much more skeptical (Issing 2012); the more so, the clearer the political divide from both sides of the Rhine (Sinn 2012).

7. International finance strikes back and ultimately decides about the EU's future. Innovative decisions have been taken by policymakers about the future sound management of public finance and principles for a banking union. Nevertheless, a fiscal union, that would make credible the future bailing out by the EU of an ailing bank, is missing, and there are disagreements in the precise implementation of the banking union. Consequently, any bad news- inability to comply with public deficit reduction target, social unrest, political deadlock..- may trigger a renewed distrust in the viability of the Euro and the ability of political systems to deliver quick and relevant responses. Until the spring of 2013, a strange calm prevails among international financiers: the banking crisis in Cyprus has not set into motion a negative contagion across Europe. Remember that markets shift brutally from naïve optimism to black pessimism, and, frequently, a surprising calm precedes the storm. The world will experience new financial crises and Europe is the weakest pole of the triad that structures the world economy (Boyer 2011). This will once again put into motion the search for alternative reconfigurations for the EU.

Prospective studies are at best cognitive maps to tentatively shape today's decisions, knowing that history is full of surprises and innovations. Thus all previous scenarios and many others could be explored successively and generate a largely unpredictable trajectory. We should abandon the current black-and-white vision: either federal Europe or the end of the Euro. History is a long time in the making.

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