Fondation
Jean Monnet
pour l'Europe

From Economic Crisis to Political Crisis in the European Union?

PAT COX

Debates and Documents Collection

Issue 3 – September 2015

From Economic Crisis to Political Crisis in the European Union?

PAT COX

Pat Cox has been the President of the Jean Monnet Foundation for Europe since January 1st, 2015. An Irish national, he is 62 years old. After teaching economics, he then became journalist and anchor-man of the news bulletin on the Irish national television. He was elected to the European Parliament in 1989, being re-elected for two terms until 2004. He was the President of the European Parliament from 2002 to 2004. He was the laureate of the International Charlemagne Price of Aix-la-Chapelle in 2004. He subsequently presided over the International European Movement from 2005 to 2011. He was a member of the special European Parliament mission to Ukraine in 2012-2013, jointly with the former Polish President Aleksander Kwaśniewski. He is currently the Coordinator of the European Union project for the transport corridor from Scandinavia to the Mediterranean.

Bibliographic Reference

Cox, Pat: *From Economic Crisis to Political Crisis in the European Union?,* Lausanne, Fondation Jean Monnet pour l'Europe, Debates and Documents Collection, issue 3, September 2015, 55 pages.

The author expresses himself in his personal capacity and his text does not commit the publisher of the collection.

Table contents

I. Introduction 7
II. A turning point? 9
III. An incomplete Union 11
IV. Context 13
V. Germany and the crisis 16
VI. German debt angst starts at home 19
VII. Life and debt 26
VIII. Surpluses and savings 34
IX. Reforms to date 36
X. Fiscal backstop – a missing link 40
XI. Future reform – timing and content? 42
XII. Conclusion 51
XIII. Bibliography 52

« *L'Europe se fera dans les crises. Elle sera la somme des solutions qu'on apportera à ces crises* ».[1]

I. Introduction

It has been my privilege to be elected to the presidency of the Fondation Jean Monnet pour l'Europe and to be invited to deliver an inaugural lecture on taking office in March 2015. Anticipating the prospect this paper began as a conversation in Zurich in January 2015 several weeks before the Greek elections that swept Syriza to power. It was several months after the European Parliament elections had witnessed a rise in support for populist parties, some of the extreme left and right. This prompted a reflection on whether the lingering economic crisis had spilled over into a political crisis for the European Union from which a tentative lecture title emerged. When it came to be written tension was rife between the new administration in Greece, the Eurogroup in general and Germany in particular. In the light of the prevailing circumstances in the early months of 2015 I decided to take a step back and to reflect in some more detail on this Greek-German dimension as it evolved over the period of the crisis and not just as it related to the moment in hand. The purpose was to explore and better understand some of the complexities and subtleties lost in the caricatures and clichés so prevalent in a good deal of popular media commentary.[2]

1 Monnet, Jean, Mémoires, Paris, Fayard, 1976, p. 488.
Translation : "Europe would be built through crises and that it would be the sum of their solutions."

2 The manuscrit of this article was completed in May 2015.

Recognising the lingering stagnation in the euro area compared to other advanced economies since the onset of the crisis in 2008, this paper focuses less on the well-established structural rigidities and economic imbalances and more on the lack of policy institutions, policy instruments and shared memory in confronting a crisis of this gravity. This has resulted in different understandings and responses to the crisis reflecting different histories and traditions. Every crisis has a narrative on its origins, its evolution and its conclusion. The terms of such narratives emerge over time. Typically they reflect the preferences and analysis of leading players. Germany, which is described as the euro area's indispensable nation and as a reluctant economic hegemon, is central to understanding the dominant crisis narrative that has framed the debate and the policy response. How the EU has dealt with the crisis, it is argued, cannot be understood without first seeking to understand German thinking and practice in terms of economic policy, especially so in the context of what has been an essentially intergovernmental model of crisis management.

There has been a series of reforms since the onset of the crisis. Taken together these should diminish the possibility of a similar crisis emerging in future but they have not yet struck the policy balance to lift the euro area from the lingering mediocrity of its current performance. The paper argues that the application of some of these policies is as asymmetric as the underlying crisis itself, that the injunction for member states to put one's house in order is not matched by a shared requirement to put the common European house in order. Among other things, the paper argues that the absence of a fiscal backstop is a key missing link in the architecture of economic and monetary union. Solutions are easier to identify than to deliver but it is claimed that resolving the crisis would be cheaper than the costs associated with deflation or disintegration, both of which are threatened by on-going stagnation and anaemic economic growth. Focusing on the development of appropriate policy instruments and tools with the minimum necessary institutional and treaty changes rather than endless institutional introspection is commended. It is suggested that to do whatever it takes should be the byword of the EU's political leaders and not just of the President of the ECB alone. What is needed is ambition with pragmatism. This does not always require large-scale constitutional and institutional change. What it does require is immediate action focused on the essentials capable of delivering real change and offering real hope. This approach together with a search for the common interest determined by and delivered through common institutions was and remains at the heart of the Monnet method. In this sense, in terms of inspiration, the paper concludes that Europe needs a new Monnet moment.

II. A turning point?

For a change, 2015 began with some good news for the euro area with the publication of the European Commission's forecast based on a better than expected fourth quarter outturn at the end of 2014. The euro area as a whole grew by an anaemic 0.3 % of GDP, but it grew. Its biggest economy, Germany, surpassed expectations registering a quarterly growth rate of 0.7 % of GDP. Conversely, the area's second – and third-largest economies, France and Italy, stagnated – in short, a better but still mixed picture. Why has this modest performance generally been reported as good news? Because in forecasting a euro area growth rate of 1.3 % for 2015, the European Commission is suggesting the area's best outcome since 2010 may be at hand. This is accompanied by the health warning that "*downside risks have intensified*".[3] After sweeping the last vestiges of Greece's old two party system from government in Athens with the election of Syriza, a formula has been found to buy some time for Greece but this still carries risks of unintended consequences. The ECB's quantitative easing programme and the depreciation in the value of the euro should add to GDP growth.

3 European Economy, 1|2015, ISSN 1725-3217 (online).

Potentially worrying price falls were observed in Germany, Italy and Spain. Whether these will endure and are they "*good deflation*", because of the fall in the price of oil, or "*bad deflation*", signalling the onset of a Japanese style secular stagnation is unclear. Whether the euro area stands at a turning point or is witnessing a false dawn remains to be seen. However, to try to evaluate the political dimension of the economic crisis requires a longer perspective than quarterly assessments.

From 2008 the global economy experienced its longest, deepest recession since the Great Depression of the 1930s and the euro area[4] has been at its epicentre. Several major economies such as the USA, the UK and Canada have reached and surpassed their pre-crisis output levels. In contrast the euro area's performance has been weak, characterised by a mix of anaemic growth and lingering stagnation. By way of comparison consider the recent remarks by the Governor of the Bank of England, Mark Carney, that "*on current projections it will take the euro area eight years to achieve the recovery that Canada secured in two*",[5] when he noted that "*Euro area nominal GDP has increased by a mere 5 % in almost seven years. Consumer price inflation is already below zero. Core inflation has been running at or below 1 % for over a year*". Contrasted with the UK, for whose monetary policy Carney is responsible, the euro area's fiscal deficit is half. According to the IMF its structural deficit is less than one third as large, yet the euro area's rate of unemployment is twice as high as the UK and the USA.

4 The euro is a currency shared today by 19 EU Member States and more than 330 million citizens. In spite of the crisis, it is the second most important currency in the world, with a 24.4 % (1999 : 18 %) share in global foreign exchange reserves, compared to the U.S. Dollar's 61.2 % share. Globally, 59 countries and territories have either directly or indirectly pegged their currency to the euro. Juncker Analytical note, informal European Council, 12 February 2015.

5 Carney, Mark, Governor of the Bank of England, *Lecture to honour the memory of The Honourable James Michael Flaherty*, P.C., Iveagh House, Dublin, 28 January 2015, www.bankofengland.co.uk/publications

The USA and Canada, as mature federations, and the UK, as a continuous global financial centre, retain some collective and institutional memory of the 1930s and the Great Depression. These insights were rediscovered and reanimated by their budgetary and monetary authorities. Analysts such as Larry Summers have revisited earlier theories of secular stagnation[6]. Applying this hypothesis to Europe he wrote : "*GDP is almost 15 % below its 2008 estimated potential and potential output has been written down by almost 10 %*".[7] He noted that Europe's output shortfall is almost identical to the one Japan experienced when the bursting of its "*bubble economy*" triggered a financial crisis.

III. An incomplete Union

Policy-wise the tone and content of the euro area debate has been very different to countries of the Anglo Saxon tradition. This is so for both historical and contemporary reasons. Historically, the community of states that constitutes today's European Union had no collective response to the Great Depression. They lived instead in the 1930s, state by state, with the mix of the deflationary trap at the end of the Gold Standard, beggar my neighbour protectionist policies, war reparation payments and associated debt restructurings. One of the most striking early adopters of Keynesian style stimulus policy was Nazi Germany whose subsequent political

6 The Harvard Economics Professor and former Secretary of the Treasury under Bill Clinton, revisited the works of a predecessor, Alvin Hansen, who, when he was Harvard's Chair of Political Economy, published his book *Full Recovery or Stagnation ?* in 1938. This advanced the thesis of secular stagnation, something the USA avoided with the onset of the Second World War. Summers, building on Hansen's logic, has argued that it has been close to 20 years since the American economy grew at a healthy pace supported by sustainable finance.

7 Summers, Lawrence H., *Reflections on the new* "*Secular Stagnation hypothesis*", 30 October 2014, VOX CEPRs Policy Portal.

toxicity spilled over to post was German attitudes to expansionary fiscal policy. European integration postdates the Great Depression and when compared with the USA or Canada can draw on no similar shared institutional memory. Faced with this complex crisis the EU has been obliged to build almost every collective policy response from the ground up. Moreover, this had to be done without the institutions; policy instruments and policy mix available to unitary or mature federal states.

In addition to revealing the negative spillover effects of significant structural rigidities and imbalances between euro area member states, the crisis also has exposed these institutional and policy shortcomings. Simultaneously these constraints both necessitated and limited the considerable reforms that have taken place in the management of the euro area. What is apparent is that critics, external and internal alike, consistently have underestimated the political capital and determination that EU and euro area leaders have invested in sustaining the single currency. Yet in spite of this political investment in recent years, Mario Draghi contends that "*for all its resilience, our union is still incomplete*".[8]

Completing that task will not be easy. The crisis is complex and multifaceted – a mix of financial, banking, economic, social, institutional and political crises. Its impact has been highly differentiated territorially, socially and economically. The gap between the best and worst rates of unemployment within the euro area today stands at more than 5:1 and for youth unemployment more than 7:1.[9] Consequently it cannot come as a surprise that public opinion is highly diverse in its assessment of and reaction to the crisis. EU citizens have become increasingly disaffected with politics and political institutions both national and European Union, especially so in the EU's periphery, as witnessed consistently by

8 Draghi, Mario, President of the European Central Bank, Speech, *Stability and Prosperity in Monetary Union*, the University of Helsinki, Helsinki, 27 November 2014.

9 Unemployment rates – Greece 25.8 % to Germany 4.8 %; youth unemployment rates – Spain 51.4 % and Germany 7.2 %. Source: Eurostat, 30 January 2015.

Eurobarometer polls since 2007.[10] This compounds the challenge in searching for solutions. Indeed, identifying what the problem is has become no less contested than the search for appropriate solutions. The prevailing official narrative has privileged fiscal profligacy and lack of competitiveness as the key explanations of the root cause of the crisis. In its turn this has framed policy responses and recommendations.

For some, the question is being posed as to whether the EU itself is part of the solution or part of the problem. It is possible to fix this. It is not advisable to ignore it.

IV. Context

The different understandings of the crisis and its origins are as deep as they are diverse and should be taken into account. In a speech towards the end of his mandate as European Council President, Herman Van Rompuy recalled: "*They often reflect different cultural, historical and intellectual traditions, including respective histories of economic facts and economic thought*".[11] One could add to these aspects comparative economic size, quality of economic performance and associated political weight and influence as other key elements that have shaped the policy response.

When the sovereign debt crisis emerged in Greece in 2009/10 the EU had a dilemma for which it was ill prepared. A long period of relative calm was about to be shattered as markets woke up to the

10 For a summary, see presentation by Jean Claude Juncker, Informal European Council, 12 February 2015, trust in Institutions, p. 11.

11 Van Rompuy, Herman, President of the European Council, Speech, Brussels Economic Forum 2014 – 4th Annual Tommaso Padoa-Schioppa Lecture Brussels, 10 June 2014, EUCO 127/14 p. 2.

issue of sovereign risk and began to look much more closely at macroeconomic and fiscal imbalances across the EU and the euro area in particular.

The Stability and Growth Pact originally was perceived as the decentralised budgetary counterpart of centralised monetary policy in the design of Economic and Monetary Union. It was honoured more in the breach than in the observance. The 3 % deficit rule was never respected by Greece. Among the largest member states Germany was first to break the rule and did so more than once. This was true also of France. The 60 % debt to GDP rule was broken constantly by Greece and Italy and regularly by Germany, though, in fairness to the latter, the extent of the breaches was very different in scale.

While the rules provided for peer-to-peer review at the level of the Council of Ministers and potentially for sanctions, a policy of lax mutual comprehension ensured that censure, if it happened at all, was minimal. Ministers avoided imposing penalties on each other lest or since they themselves feared to have to pay the price of their own actual or eventual policy laxity.

This laxity was paralleled by weak banking supervision at member state level accentuated by the total absence of an EU supervisory capacity. The US subprime crisis and its banking spillover into the euro area underlined how the EU banking system grew across borders but when banks failed they failed nationally. Bank loans were raised commercially but when property bubbles burst in Ireland and later in Spain this private debt was socialised and the sovereigns and their taxpayers paid the price. Mario Draghi accepts that "*Ireland and Spain, for instance, had low public debts and deficits on entering the crisis yet suffered serious contagion from Greece*".[12]

12 Draghi, Mario, op. cit 2012, p. 7.

If public authorities in retrospect were perceived to be asleep at the wheel, they were more than adequately matched by markets, which virtually ceased to factor in differentiated risk for loans to sovereigns in the euro area. This was irrespective of the underlying characteristics and sustainability of key macroeconomic variables. When awoken from their long slumber, ratings agencies and bond vigilantes more than compensated for their former lethargy.

In addition to the Stability and Growth Pact the EU Treaties had a "no bailout rule" and a prohibition on the European Central Bank providing monetary financing for states in trouble. This design feature prevented the EU institutions, as such, from assisting a state in trouble and initially complicated the policy response to the emerging sovereign debt crisis. It fell to the collective wisdom but divergent interests of the member states to propose a response with all the diversity between creditor and debtor states, richer and poorer states and northern and southern states that this implied. The system reeled from the crisis of banks "too big to fail" to existential fears about states, such as Italy and Spain in 2012, "too big to bail".

As a process involving 27 EU and 17 euro area states, at that time, it also exposed any eventual solutions to just as many public opinions, constitutional constraints and parliamentary majorities, in all their diversity, as the number of states themselves. Given its size in terms of share of EU GDP, the performance of its economy, its Triple A rating and its anchor role in the history of European integration, Germany always was going to be an indispensable player. This was especially so in these circumstances of heightened intergovernmental activity. Its national debate was and is far from unanimous and has led critics at different stages of the unfolding crisis to accuse it of everything from harshness to inactivity in its response. A deeper reflection on Germany is warranted.

V. Germany and the crisis

The weighty responsibility of that role was brilliantly captured and expressed by Radek Sikorski, then Foreign Minister of Poland, in a speech delivered in Berlin towards the end of Poland's first Presidency of the Council of the EU: "*And I demand of Germany that, for your own sake and for ours, you help it [the euro] survive and prosper. You know full well that nobody else can do it.*

I will probably be first Polish foreign minister in history to say so, but here it is: I fear German power less than I am beginning to fear German inactivity. You have become Europe's indispensable nation".[13]

This was at the height of the crisis when the precautionary principle saw euro area governments secretly make contingency plans for the reintroduction of national currencies. In the case of Ireland, the Minister for Public Expenditure confirmed this recently in public for the first time.[14] Sikorski's intervention also was before the European Council decided to establish a banking union and the subsequent decisive intervention of the ECB President eight months later, in July 2012, with its ringing phrase: "*Within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough*".[15] This steadied the markets and bought time. This bold declaration contained but did not resolve the crisis.

To return to President Van Rompuy's analysis: "*Germany, of course, has a different historical account and intellectual memory. It vividly remembers the hyperinflation of the 1920s – itself largely caused by the urgency to pay down the reparation debt. The fact that the Keynesian policies of the 1930s were undertaken by the Nazi regime also left traces. These memories have resulted in a strong scepticism towards economic policy discretion as well as towards policies susceptible to create inflation. These concerns, theorised by such thinkers as Ludwig Von Mises, are at the root of the German Ordoliberalism and the fear of "moral hazard". This "Angst" has of course underpinned quite naturally and I would say without effort the credibility of the Bundesbank; a credibility of course the ECB first had to earn*".[16]

Ordoliberalism was a major influence in the development of the post war West German economic model focused on the social market economy. It was adopted by Germany's first post war Chancellor, Konrad Adenauer, whose Minister of Economics, Ludwig Erhard, was an Ordoliberal adherent of the Freiburg School. It places a strong emphasis on the division of labour in economic management, assigning specific responsibilities to particular institutions. Monetary policy should be the responsibility of an independent central bank committed to monetary stability and low inflation, and insulated from political pressure through its statutory independence. Fiscal policy, the domain of government, should balance tax revenue and government expenditure; and social partnership between employers and trade unions should contribute to this stability. This model is deeply embedded culturally in Germany's economic policy institutions and in effect could be described as the default position through which any German analysis of the euro crisis should be viewed.

October 3 1990, Unification Day, marked the absorption into the Federal Republic of Germany of the former German Democratic Republic. Accompanied by a full economic and monetary union from the outset the reconstruction and restructuring costs of eastern Germany over a twenty year period cost an average €100 billion a year. This two trillion euro cost was borne by Germany's taxpayers alone. Once regarded as the miracle economy of

13 Sikorski, Radosław, Foreign Minister of Poland, *Poland and the future of the European Union*, Berlin, 28 November 2011, www.mfa.gov.pl.

14 Government planned to reinstate punt if euro collapsed Fri, 27 Februrary 2015 (www.irishtimes.com).

15 Draghi, Mario, President ECB, Speech, at the Global Investment Conference, London, 26 July 2012, http://www.ecb.europa.eu

16 Van Rompuy, Herman, op. cit. 2014, p. 3.

the continent, Germany struggled with the massive cost burden of unification and its search to balance the challenges of an ageing demography and the competitive requirements of global change. It faced up to these issues through the Hartz Plan[17] that unfolded in the early years of the new millennium reforming labour market institutions and the social welfare system, especially as it applied to the long-term unemployed. German economic vitality today owes part of its success to these politically sensitive but economically effective reforms. German insistence on structural reform is grounded in its own experience.

Viewed through this lens Germany avoided excess, so should others. The former ECB executive board member, Jürgen Stark, in a Financial Times article offered a classic Ordoliberal perspective: "*German economists oppose treating the symptoms. They warn against apparent solutions that act like political tranquillisers in the short term but only conceal the true economic challenges. Calls for additional macroeconomic stimulus ignore the causes of the European malaise. It is vital to remove structural barriers to growth*". Stark blamed the political elites of the periphery for having lost access to the financial markets, recalled that, not being a federation, the EU lacked a constitutional basis for a higher level of transfer payments; commented that much of the EU transfers to Greece seeped "*through the porous edifice of an often corrupt state*" and insisted that "*It is not because of Germany that France is experiencing economic stagnation and Italy has been in recession for three years. The problems are home-made*". He referred to historical experience and "*the lessons of the Great Depression, the failure of laissez-faire capitalism and the misuse of fiscal and monetary policy during the Nazi regime*". From this perspective "*the most important principles*", he argued, "*are the primacy of price stability; the promotion of competition in all markets; the protection of property rights; freedom of contract; and the idea that individuals should bear the risks of their own decisions and the losses of banks should not be borne by the whole of society*".[18]

This German political belief in stability, order and respect for rules is profound. It is an embedded reaction to the country's disastrous inter-war collapse and its consequences. The European Union is a normative rules-based polity. Respecting rules matters. Given its traditions, it should not be surprising that Germany is so insistent on playing by the rules.

VI. German debt angst starts at home

From the outset Germany under the federal constitution[19] limited debt both at federal and Land level. However, there was one exception. Borrowing was permitted for public investment under the so-called "*golden rule*". The logic was that investment, by adding to the future productive capacity of the economy, was in the common good. The passage of time and what the Bundesbank criticised as investment expenditure that was "*too loosely*" defined by rules that were "*overly vague*", when combined with "*inadequate monitoring of compliance*",[20] led to a comprehensive debate on reform of the constitutional rules at federal and state government level.

17 The "Hartz Committee" was founded on 22 February 2002, by the federal government of Germany led then by Gerhard Schröder. *Kommission für moderne Dienstleistungen am Arbeitsmarkt* (Committee for Modern Services in the Labour Market). Peter Hartz, then Volkswagen's personnel director, chaired the15-member committee.

18 Stark, Jürgen, The historical and cultural differences that divide the Europe's Union, Financial Times, 11 February 2015, www.ft.com.
One notes that many in Ireland wish this latter proposition actually had been true when their banks collapsed and their taxpayers picked up the banking bills owed to German banks, among others.

19 Grundgesetz für die Bundesrepublik Deutschland.

20 Deutsche Bundesbank, *The debt brake in Germany – key aspects and implementation*, Monthly Report October 2011.

Flexible interpretation of the rules contributed to the quadrupling of the state's Debt to GDP ratio from a figure of 20 % in the 1950s to 80 % in 2010. In their turn, the Länder were not immune to this phenomenon. Anxious about the consequences of the US subprime crisis and after the collapse of Lehman Brothers and its associated financial and banking turmoil, the German constitution was amended in the summer of 2009 after achieving a broad consensus in both houses of parliament, the Bundestag and the Bundesrat.

A new debt brake rule, the Schuldenbremse, was incorporated into the basic law, to be implemented by 2016 at the federal level and 2020 at the Land level. By fixing a debt threshold, both discretion and ambiguity were lessened and infringements were rendered open to intervention and interpretation by the Constitutional Court. Germany borrowed from the Swiss debt brake model, which was supported by 85 % of that country's voters in a 2001 referendum. This new rule was first applied in Switzerland in 2003. For Germany, the policy change also was introduced to ensure that in future it would practice what it had preached as regards the need to respect the EU's Stability and Growth Pact. Its introduction was several months before George Papandreou was elected to govern Greece in October 2009 and before the incremental exposure to the consecutive and destabilising upward revisions of Greek budget deficits and national debt. The die was cast.

A variant of the same logic, the Fiscal Compact[21], was adopted through an intergovernmental treaty in 2012 by all EU member states with the exception of the United Kingdom and the Czech Republic. This contained no interpretive role for the European Court of Justice. The Treaty entered into force in 2013.

Significantly, Germany's debt angst appears to extend to a more general aversion to public investment. The German approach is not just tough on others but also on itself. According to

21 Treaty on Stability, *Coordination and Governance in the Economic and Monetary Union* also referred to as TSCG.

calculations by the Berlin based institute, DIW,[22] the investment shortfall [public and private] between 1999 and 2012 amounted to about 3 % of gross domestic product, the largest "investment gap" of any European country. Looking only at the years 2010 to 2012, the most vulnerable phase of the euro crisis, the gap, at 3.7 % was even bigger. While the government and the economy were investing 25 % of total economic output in new roads, telephone lines, university buildings and other public projects in the early 1990s, this proportion declined to only 19.7 % by 2013, according to figures from the Federal Statistical Office. Some slowdown in public investment could have been expected after the drive to modernise eastern Germany. Corporate sector hoarding also was evident with companies having almost €500 billion stashed in savings, according to Marcel Fratzscher, then the DIW President.[23]

Spiegel[24] reports that Germany's transportation budget is chronically underfinanced. "*DIW experts have meticulously calculated that between 2006 and 2011 alone, the federal government, states and municipalities annually invested nearly €4 billion too little in maintaining Germany's over 650,000 kilometres of highways and its railway network encompassing some 40,000 kilometres of tracks. Dilapidated bridges are just one example*". According to a report… "*looking at road bridges in towns alone, over 10,000 of them will have to be replaced by the year 2030. The capital investment required amounts to €16 billion by 2030. In addition, more than a third of Germany's nearly 25,000 railway bridges are over one hundred years old and maintenance can only be carried out to a limited extent*".

22 Deutsches Institut für Wirtschaftsforschung, Berlin.

23 Fratzscher, Marcel, the former head of the German Institute for Economic Research, DIW and author of Die Deutschland-Illusion, Hanser 2014.

24 Spiegel Online International, Germany's Ailing Infrastructure: A Nation Slowly Crumbles, 18 September 2014; Germany plans €10bn extra public spending, 6 November 2014.

BDI[25], the voice of German Industry, insists that "*Germany needs investment funding to match this need. For years the Federal Government has been investing less than 11 billion euros annually in national transport routes. For highways, railways and waterways the sum required is at least €14 billion a year. The Daehre Commission on the future of transport infrastructure financing highlighted a funding shortfall for existing networks of €7.2 billion each year. That must be the yardstick*".

Plans have been announced to spend an additional €10 billion on infrastructure over a three-year period, most likely on a toll related self-financing basis, positive but a gesture in terms of the needs identified.

What Germany decides to invest publically is a matter of national sovereignty but given its size within the euro area and the wider EU economy it also is a matter of common European interest. Regular suggestions by commentators, and in particular the IMF suggesting that Germany had some room to stimulate domestic demand have irritated authorities in Berlin but these proposals still remain on the table. Unlike public consumption, genuinely productive investment would durably raise German output and would induce measurable, if limited, growth spillovers for the rest of the euro area.

For example the IMF argued in May 2014 that: "*stronger public investment, particularly in transport infrastructure, is needed and feasible. The government's decision to boost spending in this area is welcome, but the amount is small relative to estimated needs. Additional investment up to 0.5 % of GDP per year over four years could be financed without violating fiscal rules and would have only a minor impact on the debt-to-GDP ratio given the growth offset. Such a program would yield a persistent increase in GDP by crowding in private investment and would also stimulate growth in the rest of the euro area*".[26]

The European Commission's 2015 draft economic report on Germany concurs, observing that: "*higher public investment would strengthen growth in Germany and provide a considerable positive spillover on the euro area. Public sector investment can play an important role in addressing Germany's overarching challenge of strengthening domestic demand and the economy's growth potential. It is a tool available to policy makers, which has the potential to impact productivity growth in the economy directly but also indirectly by improving conditions for private investment*".

According to the Commission: "*Germany's currently favourable fiscal position provides scope for additional public sector investment in full respect of European and national budget rules. Current projections indicate scope annually of up to 1 % of GDP under Germany's medium-term budgetary objective and of up to 1/2 % of GDP under its national "debt brake". Therefore, even under the more constraining national "debt brake", fiscal space exists for a time bound boost of public investment*".[27]

A sturdy defender of German policy orthodoxy but not uncritical of German policy, Otmar Issing, former Chief Economist of the ECB, accepts that: "*public investment is seen as too low. Infrastructure shows signs of decay. Streets and bridges need repair. No doubt, these and other deficiencies are strong arguments for increasing public investment*".[28]

25 Bundesverband der Deutschen Industrie, the voice of German Industry, www.bdi.eu.

26 IMF, Germany – 2014 *Article IV Consultation Preliminary Conclusions*, Berlin, 19 May 2014, www.imf.org.

27 European Commission Staff Working Document, Country Report Germany 2015 (including an In-Depth Review on the prevention and correction of macroeconomic imbalances), p. 53.

28 Issing, Otmar, *Blame Germany for bad policies, not its reluctance to spend more*, Financial Times, 23 October 2014, www.ft.com.

These calls for more investment are happening at a time of historically low real interest rates. This is true for long-term government bonds whose costs are lower for Germany than any other government in the EU. Not to take advantage of these circumstances suggests a debt aversion on the part of policy makers. This runs so deep, that even when productive investment is needed, identified and justified in terms of genuinely adding to future growth and productivity it still struggles to secure public financial backing.

It must be acknowledged that increased German public investment by itself and on the scale described would not lift the euro area economy out of stagnation, nor given their size and challenges would it significantly influence the state of the French or Italian economies. What it would do, however, is establish that the concept of the common European interest is a two way street where each player should do all within its means to minimise negative and maximise positive systemic spillovers in the interests of the system as a whole. Germany's margin for manoeuvre is limited by the fact that it is close to full employment and has a modest potential output gap. But while fully respecting both its own and the EU's budgetary rules, it still has an unused capacity to act in public investment terms. Politically this sharpens the contrast between euro area states deemed to have excessive deficits and those who are in better economic shape. For the former there is a mandatory requirement to adjust their policies in the common interest. For the latter, states not in excessive deficit, there is a discretionary policy choice to opt out from choices that would contribute to the common good.

The recently published Juncker initiative states that: "*Europe urgently needs an investment plan*". It recalls that: "*as a consequence of the economic and financial crisis, the level of investment in the EU has dropped significantly since its peak in 2007 by about 15 %. This level is also well below the historical trend. Only a partial rebound is projected over the coming years. Economic recovery, job creation, long-term growth and competitiveness are being hampered as a result*".

The document clarifies that "*in some Member States, that dip is even more dramatic. This is notably the case for Italy (-25 %), Portugal (-36 %), Spain (-38 %), Ireland (-39 %), and Greece (-64 %)*".[29]

The Juncker plan is welcome, so far as it goes, as an indication of positive intent and as a willingness to place the need for a collective investment strategy on the EU's agenda. The readiness to explore some margin of manoeuvre to encourage investment by indebted member states also is a fresh, if modest, start.

Mario Monti and Sylvie Goulard explore this topic in greater depth in a recent paper. It makes a case for a new balance between fiscal discipline and public investment in Europe. They argue for what one describes as a conditional golden rule where the Stability and Growth Pact "*should drive reflection about the exclusion of part of public investment from the 3 % threshold*". Theirs is a plea for a sustainable policy orientation that is at once both stability and growth-friendly. They argue that such a policy reflection "*should include both the national and the European level*".[30] Today's policy menu falls well short on this count.

Striking a new deal at European level between reform with growth rather than the reform with stagnation that has characterised the past several years has become an urgent political no less than economic imperative. Failure to address this issue risks further alienating public opinion from the integration process and placing traditional parties of the centre, left and right, under increasing electoral pressure in a significant number of member states. Reform with stagnation risks becoming the political gift that never ceases to give to Europe's populists and political extremes. This is precisely why, to quote one of Barack Obama's campaign messages in 2008, those in power today need to recognise "*the fierce urgency of now*". The EU and in particular euro area member states are

29 *An Investment Plan for Europe*, European Commission Brussels, COM (2014) 903 final.

30 Goulard, Sylvie and Monti, Mario, *Fiscal Discipline and Public Investment in Europe, Council on the future of Europe*, Berggruen Institute, Brussels, 10 December 2014.

learning the lesson that to be sustainable economic policy requires rigour but also for the political centre to hold that this should not fossilise into rigidity.

VII. Life and debt

No two states better exemplify the contested nature of euro area policy for the past several years than Germany and Greece. To simplify, but hopefully not at the risk of excessive simplification, they mirror their respective public opinions. Germans perceive themselves as victims of the rule-breaking, high spending profligacy of others and worse, although thrifty themselves, they are obliged to pay the bill. They did not sign up for this. On the other hand, Greeks perceive themselves as exhausted by endless and uncaring austerity, stuck with a mountain of debt and worse, though needy themselves, were obliged to pay for foreign bankers who got it wrong. They did not sign up for this.

This kind of popular lose-lose discourse of victimhood is no basis on which to develop and sustain the currency union. As Mario Draghi has remarked: "*Members have to be better off inside than they would be outside. The reason for this is as follows: if there are parts of the euro area that are worse off inside the Union, doubts may grow about whether they might ultimately have to leave. And if one country can potentially leave the monetary union, then this creates a replicable precedent for all countries*".[31]

Given the no bailout and no monetary financing rules of EMU, when Greece's revised deficit statistics settled at 15% of GDP a crisis was at hand. Something had to give. Either Greece would get assistance or it would be forced to leave the euro. Germany weighed the options and in the end agreed to a bailout. This came with explicit conditions for Greece and implicit conditions for the euro area. Germany, though a reluctant hegemon, exercised its institutional power. The design of and terms for accessing the rescue funds and the new budgetary and fiscal rules that followed were, not surprisingly, strong on conditionality. Creditor states defined the rules of engagement. This was the wider price for saving the euro. The emerging new fiscal rules progressively mirrored German practice. Germany's institutional weight also was entrenched through the role played by its Federal Constitutional Court. This has been a vigilant and active guardian of the limits democratically and financially of Germany's exposure to crisis resolution, a role reinforced by the absence of an EU Treaty legal base for bailouts. It is a constraint and a card for the German government to play in its dealings at the EU level.

In September 2011 the Court decided that, subject to the legislature being responsible for assessing the economic situation in the euro area and making decisions about the resources that should be used to solve the problems, the German government was authorised to act in matters concerning European integration and to safeguard the European currency.

One year later, in September 2012, the Court again intervened in the establishment of the ESM rescue fund. The ESM Treaty was declared constitutional subject to a clear role for the Bundestag as regards budgetary implications and placing an upper limit of €190 billion on Germany's exposure.

In February 2014 the Court questioned whether the decision of the ECB, to do whatever it takes, through Outright Monetary Transactions, had transgressed its Treaty mandate. The matter was referred to the European Court of Justice for interpretation. The ECJ's interim ruling cleared the way for the ECB. Mario Draghi, within days of the ruling in January 2015, announced quantitative easing. There also have been tensions between German Board members and the current and past Presidents of the

31 Draghi, Mario, *Speech at the Global Investment Conference*, London, 26 July 2012, p. 2.

ECB.[32] German political, economic and institutional power and influence now permeates the euro area's creditor-debtor contested politics.

While Germany is the EU's largest and best performing economy it was not immune to the banking crisis. A Financial Market Stabilization Act was passed in October 2008 to help recapitalise, guarantee or acquire banking assets. This had a funding package of €480 billion, of which €400 billion was by way of guarantees in return for a fee. It was scheduled to run until 31 December 2009. By this time the Greek crisis was looming into view and alarm bells started to ring. According to Bank of International Settlements data, just under half of foreign claims on Portugal, Ireland, Italy, Greece and Spain related to French and German bank loans to those countries.[33]These dwarfed the banking exposures that France and Germany had dealt with domestically up to that point.

"*In the banking sector, integration of interbank markets proceeded much faster than integration of retail markets. Thus, most banks'assets remained concentrated in their local markets, while their liabilities were mainly comprised of short-term debt. This meant that when a large local shock hit, they were exposed to heavy and concentrated losses. And rather than sharing those losses, their creditors were able to "cut and run". The resulting financial fragmentation also meant that cross-border credit markets could not do their job*".[34]

The political debate on Greece quickly focused on the risk of contagion to other peripheral euro area states. The hundreds of billions of euros of bank assets that would be exposed to heightened

32 German tensions on the limits of ECB monetary policy spilled over when Alex Weber who was openly critical resigned from his post as Bundesbank President in February 2011. This frustrated Chancellor Angela Merkel's plan to have him succeed Jean Claude Trichet as President of the ECB. Jürgen Stark who resigned from his role as ECB Executive Board member followed Weber later the same year in September. Those tensions reportedly continue between Mario Draghi and Jens Weidmann, President of the Bundesbank.

33 Thompson, Helen, *The Crisis of the Euro: The Problem of German Power Revisited*. SPERI Paper No.8 ISSN 2052- 000X, Table 1, December 2013.

34 Draghi, Mario, Helsinki speech, 27 November 2014, op. cit., p. 5.

or even ruinous risk focused minds. The Greek bailout, followed months later by Ireland and Portugal, assisted the sovereign to cope with adjustment at a time when access to bond markets at affordable rates was excluded. It also shifted the liability for bad bank loans in the periphery to the taxpayers of the sovereigns in question and more widely to the IMF, EU, ECB and the EFSF.[35] The default risk of French and German banks was shifted from their sovereigns to the wider rescue community of which they were part but not the whole in terms of liabilities. Judged on the basis of the comparative and systemic costs to domestic French and German taxpayers of a euro style Lehman Brothers, the bailout strategy might look less onerous than at first view.

The established narrative, described by some as a morality tale, casts the protagonists on one side as thrifty, on the other side as spendthrift, with echoes of good and evil vying for the attention of the audience from centre stage. This account serves to obscure as much as it reveals. Spiegel International reported the views on the Greek bailout of the former Bundesbank President, Karl Otto Pöhl, in March 2010. Asked if he accepted the domino theory [first Greece, then others] as an explanation for the Greek bailout, he answered: "*I do not believe that. I think it was about something altogether different*". "*Such as?*" Pöhl replied: "*it was about protecting German banks, but especially the French banks, from debt write offs. On the day that the rescue package was agreed, shares of French banks rose by up to 24%. Looking at that, you can see what this was really about -- namely, rescuing the banks and the rich Greeks*".[36]

Since the IMF's loan to Greece was the largest in its history, the first to a euro area state and novel in working through a Troika, it published an ex post evaluation of the 2010 agreement with Greece in June 2013.

35 European Financial Stability Facility (EFSF) was created as a temporary crisis resolution mechanism by the euro area Member States in June 2010.

36 Pöhl, Karl Otto, Former President Bundesbank, *Bailout Plan Is All About "Rescuing Banks and Rich Greeks"*, Spiegel Online International, 18 May 2010.

It too recalls, less bluntly than Pöhl, that: "*private creditors were able to significantly reduce their exposure… there was a large-scale substitution from privately held to publicly held debt. Part of this was by design; program financing was to be used to repay maturing bonds in 2010 and 2011…*».[37]

The issue of private sector creditors taking a hit for their own commercial risks became more prominent in the German national debate. Responding at a Franco German Summit in Deauville in October 2010 Chancellor Merkel and President Sarkozy agreed that there should be private sector involvement (PSI) in debt management, but not until 2013. This offered additional exit time to banks exposed to Italy and Spain, whose liabilities dwarfed those of Greece. Between Q3 2009 and Q4 2012 French bank exposure to the euro area's periphery had reduced by 39 % and that of Germany by 51 %.[38]

Meanwhile, back in Greece, public debt exploded during the crisis from around 100 % of GDP to more than 170 % in 2011. This prompted the second bailout that included some private sector debt write off, maturity date adjustments and interest rate cuts. The result in 2012 was a temporary fall in the debt to GDP ratio but it rose again in 2013 and 2014 to a level of 175 % of GDP. Superficially, this begs the question did the Greek government simply lose the plot?

Since the debt to GDP concept is a ratio, change depends on how the numerator, and the denominator evolve. In the case of Greece according to the IMF "*a large reduction in the fiscal deficit was achieved. The change in the primary deficit during 2010-11 was 8 percentage points of GDP slightly above target, despite the deep recession. The authorities introduced additional measures in 201139 once it became clear that the initial set of fiscal measures was insufficient to deliver the consolidation target*".[40] The outcome was a primary surplus of 2.7 % of GDP. All other things being equal this should have seen a downward trend in the debt to GDP ratio. This did not happen because the economic downturn proved considerably more severe than projected. "*The unemployment rate in 2012 was 25 % compared to the original program projection of 15*"[41] admitted the IMF. The troika got its sums wrong. The pick-up hoped for in the private sector never occurred.

Nominal output contracted in the currency union as a whole in 2009 but in Greece it has been negative for six consecutive years, falling by a total of 25 %. This explains the explosive growth in the debt to GDP ratio. The denominator fell by one quarter. The rest is arithmetic. Any given ratio rises if the denominator it is divided by falls. For Greece because of its pace and depth the cure has proven to be as severe as the disease, certainly more severe than for any other state in the euro area. Greece's debt management problem was compounded by the drift towards deflation, with ultra-low rates of inflation robbing it of the possibility even to mildly erode debt through nominal rises in price.

The extent of unemployment, the scale of poverty and the growth in inequality in Greece are extreme and pose a serious question about the pace of adjustment sought and the policy mix chosen. The question of debt sustainability is a separate one since it depends not just on the size of the debt but also on its associated conditions. Somewhat counter intuitively, in spite of the high level of debt, Greece pays less interest payments in relative terms than many other EU states, inside and outside rescue programmes, in spite of having what is relatively speaking the biggest debt burden. A 10-year moratorium on interest payments, together with ultra-low interest rates, just above 1.5 % on ESM loans, and a stretch in loan maturities to 30 years, has resulted in Greece's debt overhang being less urgent for at least a decade.

37 IMF, Greece: Ex Post Evaluation of Exceptional Access under the 2010 Stand-By Arrangement, http://www.imf.org, June 2013 IMF Country Report No. 13/156, p. 17-18.

38 Thompson, Helen, Table 2, op. cit, 2013.

39 Medium-Term Fiscal Strategy, amounting to 10.5 % of GDP during 2011-14.

40 IMF op. cit., 13/156, 2013.

41 *Ibid.*

Many have argued that debt restructuring could have been a better option. In the March 2010 Spiegel interview already cited, Karl Otto Pöhl remarked that: "*the European Union should have declared half a year ago or even earlier that Greek debt needed restructuring*". The IMF evaluation report reveals that this option "*had been considered by the parties to the negotiations but had been ruled out by the euro area*".

It is instructive to consider the reasons.

"*Some Eurozone partners emphasized moral hazard arguments against restructuring. A rescue package for Greece that incorporated debt restructuring would likely have difficulty being approved, as would be necessary, by all the euro area parliaments.*

Debt restructuring risked contagion to other members of the Eurozone and potentially another Lehman-type event, yet the EFSF was not yet in place. European banks had large holdings of Greek bonds – but also, and of more concern given the scale of their exposure, had large holdings of the bonds of other European sovereigns that would drop in value were Greek creditors to be bailed in".[42]

The question of standards in banking and their absence continues to fill our headlines. Offering his insights on this theme, the Governor of the Bank of England remarked that: "*with a growing conviction that financial innovation had transformed risk into certainty, underwriting standards slipped from responsible to reckless and bank funding strategies from conservative to cavalier. Financial innovation made it easier to borrow. Bonus schemes valued the present and discounted the future*".[43] In economics, moral hazard occurs when one person takes more risks because someone else bears the burden of those risks. Policy makers set aside the moral hazard of the banks and bankers who loaned money to banks and sovereigns in peripheral states, but to quote the IMF report, "*emphasized moral hazard arguments against restructuring*" for indebted states.

42 IMF op. cit., 13/156, 2013, p. 27.

43 Carney, Mark, op. cit., 28 January 2015, p. 3.

Since debt write down clearly was ruled out, to ask what would have happened if there was early debt restructuring is speculative, but this question has grown as a field of research in recent years. One of the leaders in this field is the economics department of the University of Munich. Restructuring usually occurs: "*during hard times when other policies and measures have been tried and proved inadequate, insufficient, unsustainable, or a combination of these*". As to the aftermath, having examined forty five debt episodes, their study concludes that: "*the general picture that emerges is that, once the restructuring is completed decisively, the economic panorama tends to improve in terms of growth, debt servicing burdens, debt sustainability (higher growth lower debt), and international capital market access*".[44]

What this short review suggests is that the debt question is more subtle and complex than the simple morality tale of good versus bad. Without bailouts the dramatic and unavoidable retrenchment of states denied access to debt markets at affordable prices would have been socially and economically devastating. The immediate austerity effect would have been more severe than the calibrated and conditional alternative afforded by a bailout. This would have led to a disintegration of the euro area with serious implications for the internal market and wider European integration. This has been avoided. Equally, without the bailout strategy several member states would have been faced with the prospect of domestic banking meltdowns, Lehman Brothers – style, with deep and serious costs and consequences for their taxpayers and national finances. This has been avoided. Research suggests that decisive debt restructuring can be and has been a successful means to re-set the economic prospects of heavily indebted states but for reasons of moral hazard and anxieties about securing necessary parliamentary support, as reported by the IMF, this option has been ruled out. It is the decisive and

44 Reinhart, Carmen and Trebesch, Christoph, *A Distant Mirror of Debt, Default, and Relief*, Munich Discussion Paper No. 2014 - 49 Department of Economics University of Munich, Volkswirtschaftliche Fakultät Ludwig-Maximilians-Universität München, http://epub.ub.uni-muenchen.de/21832, p. 4 and p. 43.

definitive nature of the restructuring that is the key to success; ending not extending the drama is the striking research message. That this drama lingers on reflects politically on both sides of the argument and on the policy choices both that have been made and have been excluded.

VIII. Surpluses and savings

The burden of adjustment in the current crisis has focused on fiscal consolidation and improving competitiveness. Its results have been uneven and its effects highly differentiated geographically, socially and economically. Boosting productivity takes time during which debt dynamics, as seen in the case of Greece, can become oppressive. Improved competitiveness should lead to more exports. Higher exports, however, are harder to achieve when EU and global economic growth have been so sluggish. Internal devaluations have imposed demanding political choices on how risk is shared between capital, labour, the private sector and the state. When effective, such devaluations should reallocate demand within the currency union, but they do not increase overall euro area aggregate demand. "*Put another way, since competitiveness is relative, a solution for some cannot be a solution for all*".[45]

In the euro area the distribution of debt and assets is spread unequally. Moving surplus savings from where they are accumulated most to where they are needed most has proved elusive. This mismatch is captured by Lorenzo Bini Smaghi, former member of the executive board of the ECB: "*Europe is thus in a Catch-22. On one hand, Germany and a few other countries want to continue to save a high portion of their income and accumulate assets through record current account surpluses. On the other hand, peripheral countries cannot, and do not want to, borrow more from abroad because they have to deleverage in order to put their own houses in order and reduce their excessive debt. This ends up in an overall excess of savings in Europe which … produces deflationary effects*".[46]

In the case of Germany national savings exceed national investment by more than 6 % of GDP. Germany depends for nearly 50 per cent of its GDP on exports. When there is a global slowdown, without a compensating rise in domestic demand, "*the huge excess of German savings over investment will drag the European economy into a deflationary spiral*".[47] This balance of payments dimension has been widely disputed but the debate has not prompted policy change. Arguing that the economy is near full employment, close to its potential output and is performing well, many German economists contest this view. In plain terms they ask if it is not broken [viewed from Germany] why fix it?

A glimpse of official views on this argument can be found in IMF documents that argue: "*with negative output gaps, no fiscal space, and liquidity traps in many of its main trading partners, as the largest European economy, Germany could play a stronger role to help regional rebalancing. This can be achieved through policies that durably increase Germany's output while also generating positive outward demand spillovers to the region and reducing the current account surplus*".

The IMF urges stronger public investment and insists that: "*Germany has the fiscal space to finance an increase in public investment of some 0.5 % of GDP per year over four years, which would be associated with appreciable positive regional spillovers*".

45 Carney, Mark, op. cit., 28 January 2015, p. 3.

46 Bini Smaghi, Lorenzo, Here's why Germany needs to start spending, 28 October 2014, www.ft.com, archive.

47 *Ibid.*

For their part the German authorities expressed: "*some scepticism over the need for demand stimulus in the rest of the euro area, and saw structural reforms as the main priority. They also emphasized that any additional public investment should not lead to a higher public deficit, as buffers are needed to be preserved under the fiscal rule*".[48]

Ruling out the need for demand stimulus in the rest of the euro area is in effect also the prevailing EU policy mirroring creditor state preferences in general and Germany's analysis in particular. What is not contestable is that the euro area has remained stagnant for much longer than other advanced economies, except Japan, a repeat of whose deflationary trap the ECB through QE is now striving to avoid.

IX. Reforms to date

Hit by an economic crisis that was historically deep and politically and institutionally complicated, the EU and its member states had no collective template to refer to. There was no script. So one had to be written. What priorities should be set, by whom, how and when had to be worked out. European Council summits multiplied with regular, extraordinary and informal summits and a new Euro summit format convened with increasing intensity from mid-2008, reaching a peak in 2011. Eleven summits were held in 2011 alone, four of which were Euro summits. What vision, which values, what interests, what capacity, which institutions, what policy instruments? – All had to be negotiated and decided. In short, defining and interpreting the crisis was not a given, not just

48 IMF 2014 Article IV Consultation – Staff Report; Press Release and Statement by the Executive Director for Germany, July 2014, http://www.imf.org/external/pubs/ft/scr/2014/cr14216.pdf.

"facts", but rather the product of a highly complex political process. For Monnet the test of European success was clear: "*ce qu'il faut chercher, c'est une fusion des intérêts des peuples européens, et non pas simplement le maintien de l'équilibre de ces intérêts*".[49] It is worth recalling what has been done.

Significant reforms have been adopted since 2010. There was no fund and no firewall available in the EU to assist member states in financial difficulty. Indeed the Treaties expressly contained a no bailout clause. A permanent crisis mechanism, the European Stability Mechanism, the ESM, with a maximum lending capacity of €500 billion, was established by an intergovernmental treaty in 2012. It replaced two earlier temporary EU funding programmes – the European Financial Stability Facility (EFSF) and the European Financial Stabilisation Mechanism (EFSM).

In parallel the Stability and Growth Pact (SGP) was reformed in 2011/2013, reinforced by the Fiscal Compact[50], an intergovernmental treaty that introduced stricter rules. Its key element is a numerical debt benchmark aiming to ensure convergence towards debt ratios, below the Maastricht reference value of 60 % of GDP. The introduction of reverse qualified majority voting in the Council for decisions under the excessive deficit procedure is intended to increase the automaticity of the procedures. In force since the beginning of 2014, the treaty states that the signatories shall attempt to incorporate the Fiscal Compact into the EU's legal framework, on the basis of an assessment of the experience with its implementation, by 1 January 2018.

The six-pack, the two-pack and the European Semester developed a new Macroeconomic Imbalance Procedure (MIP) to detect the development of macroeconomic vulnerabilities earlier on and to provide instruments to correct them. The European Semester is

49 Monnet, Jean, *Mémoires*, Paris, Fayard, 1976, op. cit. p 371.

50 The full title of the treaty is *Treaty on Stability, Coordination and Governance in the Economic and Monetary Union* also referred to as TSCG. It is an intergovernmental and not an EU Treaty. The UK and Czech Republic did not sign the Treaty.

the first phase of the EU's annual cycle of economic policy guidance and surveillance. This is when the Commission analyses the fiscal and structural reform policies of every Member State, provides recommendations, and monitors their implementation. The second phase of the annual cycle, the National Semester, is when Member States should implement the policies they have agreed.

Banking Union has been established since 1 November 2014, with the ECB undertaking the role of the Single Supervisory Mechanism (SSM), directly supervising all significant banks in the euro area. The Single Resolution Mechanism (SRM) and the Bank Recovery and Resolution Directive provide a framework for a more orderly resolution of banks in difficulty. For the first time EU law incorporates a burden-sharing mechanism between shareholders and creditors, a bail-in clause. Together with the Single Resolution Fund (SRF), which will grow over time, the intention is to seek to break the toxic link between distressed banks and sovereigns. Harmonised national deposit-guarantee schemes, but not equivalent to the US Federal Deposit Insurance Corporation, are in place with the aim of better protecting depositors in future.

In the light of the false deficit reporting in Greece prior to 2009, Eurostat powers were strengthened in 2011. Under the amended regulation Eurostat is entitled to examine member states'public accounts and to make on-the-spot investigations in the member state concerned.

The spillover effects into the banking system of diverging economic fundamentals between different euro area economies and the extent of financial fragmentation that followed had not been anticipated. Its consequences for economic activity were and remain significant. Before the crisis, the European financial system appeared to be highly integrated. Cross-border bank loans accounted for more than a third of total bank lending.

To quote Mario Draghi: "*a banking union is even more important than in the US because over two- thirds of firms'external financing takes place in the form of bank loans. For small and medium-sized enterprises this share is even higher. In the US, by contrast, the role of banks in firms'external finance is only about one-third or even less. Hence, a Banking Union is crucial also for the euro area real economy*".[51] Over time, but it will take time; the Banking Union should improve both access to credit and also spread the risks of any future crisis more fairly. "*But limited risk-sharing within the euro area is not just about banks; it also reflects our relatively incomplete capital markets, and in particular equity markets*".[52]

The European Commission recently launched a Green Paper on creating a Capital Markets Union, one of the "*flagship projects*" proposed by the Juncker Commission. The Commissioner responsible for this initiative, Jonathan Hill, told the European Parliament: "*a single market for capital will benefit the whole European economy, helping to unlock the capital that is currently frozen and putting it to work to support Europe's businesses, particularly SMEs and start-ups*", adding that, "*reliance on banks also makes the European economy more vulnerable when bank lending tightens. We saw this happen during the financial crisis, and we saw banks and investors retreat to their home markets. So, there is a financial stability angle to this, as well*". The new Banking and Capital Markets Unions are designed to improve financial integration and increase the level of private risk sharing in future crises.

In March 2015 the ECB launched a Quantitative Easing (QE) programme that is set to continue until at least September 2016. It is a €1.1 trillion stimulus package of asset purchases at the rate of about €60 billion a month. The ECB's goal is to achieve about 2 percent consumer price inflation, which currently it stands at a negative 0.1 percent. The aim of QE is to combat the threat of deflation and to boost economic growth. The immediate impact of the QE initiative has been a sharp decline in the euro's exchange rate, lifting the euro area's export potential and a drop in the borrowing costs for euro area governments. The evidence suggests

51 Draghi, Mario, lecture, Europe's pursuit of "a more perfect Union", Harvard Kennedy School, Cambridge (USA), 9 October 2013.

52 Draghi, Mario, Helsinki speech, op. cit, 27 November 2014.

that the asset-purchasing programme of the ECB, at least at this early stage, is a success. Critics of QE fear the emergence of asset price bubbles or express the fear of possible complacency among governments regarding the need for further reform to underpin the sustainability of the euro.

Taken together these reforms are substantial steps. Had they been in place from the outset the emergence and evolution of the crisis could have been tempered, though not eliminated. Having and developing new rules is a start. Successfully implementing them will be a challenge.

X. *Fiscal backstop – a missing link*

Even with the Banking Union and the anticipated but potentially complex Capital Markets Union fully implemented "*we could still not call EMU complete. We also have to acknowledge the crucial role that accrues to fiscal policies in a monetary union*", according to Mario Draghi. There are he says: "*in principle two ways to protect the safe haven status of sovereign debt: the first is a strong fiscal governance framework that is implemented in a credible manner. This means having sufficient buffers over the cycle to absorb exceptional shocks, and having public debt levels that are sufficiently low in good times that they can rise in bad times without disrupting market confidence. The second way is some form of backstop for sovereign debt. In the euro area, due to various aspects of our institutional framework, we have very much pursued the first approach, strong fiscal rules*".[53]

53 Draghi, Mario, Helsinki speech, op. cit, 27 November 2014.

Sticking to commitments under the Stability and Growth Pact should be beyond dispute in Draghi's opinion but: "*whether it is sufficient to safeguard fiscal policy as a stabilisation tool, however, has been challenged by our experience during the crisis*".*54*

A fully respected and functioning Stability and Growth Pact operating over the course of an economic cycle as described above could indeed be an effective shock absorber. Additionally, if one considers the plan for a Capital Markets Union, if and when realised, this too, as in the USA, could absorb shocks independently of the sovereign. In terms of the architecture of EMU, over time and taken together, these policy elements could be the key first responders in absorbing asymmetric shocks to the system. Today's problem is that neither of these conditions prevails and so the challenge of how to unlock the euro area from its current stasis remains.

In summary, strong fiscal rules matter but experience also has taught that in the euro area these are a necessary but not a sufficient condition to ensure stability with growth. Draghi is correct in implicitly proposing that a fiscal policy stabilisation tool should be an essential component of a sustainable monetary union. Fiscal policy in the euro area remains underdeveloped. A macroeconomic stabilisation instrument still is a missing link and potentially a decisive flaw. The adoption of the many reforms noted above confirms that the original design and architecture of Economic and Monetary Union proved insufficiently robust when stress tested by crisis. The lesson to be drawn is to complete the job, not to stop half way. The crisis has been contained not resolved. The EU's demographic challenge already will limit its potential output growth in future. In this context the EU can ill afford what currently is the lingering mediocrity of the euro area's collective growth and its inability to date to shake off the consequences of the asymmetric shock at the heart of the euro area crisis.

54 *Ibid.*

XI. *Future reform – timing and content?*

For so long as the Economic and Monetary Union lacks such a stabilisation policy tool it is likely ultimately to lack credibility. This conclusion is suggested by the analytical note submitted recently to the European Council by the European Commission President, Jean-Claude Juncker: "*the euro area has not recovered from the crisis in the same way as the U.S., which might point to the fact that an incomplete monetary union adjusts much slower than one with a more complete institutional setup in place*".[55] The note is intended "*to start a discussion process that will feed into a forward-looking report by the Four Presidents*".[56]

The four Presidents report on Genuine Economic and Monetary Union was published in June 2012.[57] This was at the height of the crisis. However, when the immediate existential threat to the euro eased the urgency to reflect and act on its longer-term dimensions, the capacity to act appeared to do likewise. With the new institutional office holders now in place the discussion is starting again. What political prospect awaits it?

55 Juncker Analytical note, Informal European Council, 12 February 2015, www.http://ec.europa.eu/priorities/docs/economic-governance-note_en.pdf.

56 The note ends with a footnote promising to "*draw on input*" from the President of the European Parliament, who remarked to the summit that the *"European Parliament must be fully involved on an equal footing with the other institutions in the on-going analysis and development of a roadmap. All other institutions are participating and it is a question of respect for the only directly elected European institution to be fully involved in the discussion about the future of the EMU*".

57 Van Rompuy, Herman, President of the European Council, Report, *Towards a Genuine Economic and Monetary Union*, 26 June 2012, (the four Presidents Report-Presidents of the European Council, the European Commission, the European Central Bank and the Eurogroup).

There is no specific timetable in the Juncker paper and it contains no specific proposals, apart from eleven questions.[58] It "*is intended to start a discussion process*" to prepare a report by the four presidents in which "*all member states will be closely involved*". Institutionally, the rhythm of EU policy making is constrained not just by national political preferences but also by national political cycles, especially in large member states. The British general election which has returned a Conservative government with a slim majority will result in an in/out EU referendum in 2017, if not sooner. The negotiation terms and conditions sought by Prime Minister Cameron as yet are unspecified. The outcome for the moment therefore is both unknown and unknowable. It is to be doubted that any available outcome short of quitting the EU, Brexit, would satisfy the most ardent Euro sceptics in British politics. The question is whether enough can be agreed to permit the Prime Minister to argue that Britain's net interest is best served by remaining inside the EU, his own instinctive preference. What the recent election confirms is the electorate's instinct for stability over change. This is something that may encourage a less

58
- How can we ensure sound fiscal and economic positions in all euro area Member States?
- How could a better implementation and enforcement of the economic and fiscal governance framework be ensured?
- Is the current governance framework – if fully implemented – sufficient to make the euro area shock-resilient and prosperous in the long run?
- To what extent can the framework of EMU mainly rely on strong rules and to what extent are strong common institutions also required?
- What instruments are needed in situations in which national policies continue – despite surveillance under the governance framework – to go harmfully astray?
- Has the fiscal-financial nexus been sufficiently dealt with in order to prevent the repetition of negative feedback loops between banks and sovereign debt?
- How could private risk sharing through financial markets in the euro area be enhanced to ensure a better absorption of asymmetric shocks?
- To what extent is the present sharing of sovereignty adequate to meet the economic, financial and fiscal framework requirements of the common currency?
- Is a further risk sharing in the fiscal realm desirable? What would be the preconditions?
- Under which conditions and in which form could stronger common governance over structural reforms be envisaged? How could it foster real convergence?
- How can accountability and legitimacy be best achieved in a multilevel setup such as EMU? Juncker Analytical Note, op. cit, p. 8.

pessimistic forecast than some of Britain's most Euro sceptical media and opinion polls might suggest. Moreover, the anxiety to preserve the unity of the United Kingdom may add weight to a campaign that would seek to avoid converting a potential English opt out from the EU into a Scottish opt out of the UK. That said, in the meanwhile, it is not possible at this remove to predict what the outcome will be, nor what state the EU will find itself in as regards its economy, geopolitics or political cohesion on the British question. The only certainty will be continued uncertainty.

The two rounds of the next French Presidential elections are scheduled for April and May 2017. An underperforming economy, the need for further budget adjustments and the necessity to improve the underlying competitiveness of the French economy have resulted in a French Republic uneasy about and unhappy with itself. To this can be added the societal and security tensions associated with growing Islamic radicalisation and the marginalisation of a significant share of suburban youth. The rise of the Front National, as witnessed by the European elections of 2014, confirms a drift towards anti-establishment and anti EU political tendencies. How these will impact French preferences and timing as regards EU reform remains to be seen. A United States of Europe or a Europe of United States marked a key difference of emphasis over several decades between the visions of Jean Monnet and Charles de Gaulle. This tension has not gone away but rather has been accentuated by recent economic and political developments.

The next Bundestag elections in Germany are scheduled for sometime between August and October 2017. Germany has become by circumstance, whatever about choice, the EU's indispensible player. The Chancellor, Angela Merkel, commands a standing and respect unparalleled by any other EU leader. How she chooses to accommodate David Cameron, what, if anything, she chooses to do on Euro area and wider EU reform and whether she supports change within the existing treaties, or pushes for limited or significant Treaty modification will be decisive in framing the coming debate. Chancellor Merkel has a reputation for cautious decision-making. This has led one unnamed senior advisor of hers to be quoted recently as remarking "*the danger is that we are now buying time but not using it*".[59] Reconciling the EU's needs and Germany's preferences, as illustrated by this paper, are not straightforward or simple. However, Germany has never been found wanting when the time to advance the common European cause has presented itself.

Meanwhile, the brinkmanship that has followed the Greek elections has strained relations in the Eurogroup with the new Syriza – led government. Matters are unsettled and therefore unsettling. Rights and responsibilities have to be balanced and must be assumed by all for the euro area to work. The sooner these matters are resolved the better. The longer they last the more they feed national stereotyping and nationalistic chauvinism and anger and so the risk of unintended consequences grows. Rising distrust corrodes the kind of mutual confidence necessary to succeed. Raking over the ashes of history, blame games and resentment are not a way forward, nor is procrastination. The exit of Greece from the Euro area, Grexit, would damage the fabric of the single currency, converting it de facto to a fixed currency regime and exposing its current or future weak links to relentless pressure at times of crisis to exit the system. Moreover, wider systemic effects of a collapsing Greek financial, banking and economic system could be more difficult to contain than some of the more benign commentaries suggest. Pending a settlement on the terms and conditions attaching to future financing of Greece by its external partners, the risk of an exit, whether preferred or not, remains high.

In taking these elements into account, the time to choose may narrow down to what is left of 2015 and 2016. Alternatively EU reform ambitions risk sliding, at best, to the latter half of the Juncker Commission mandate. This begs the question, if not soon and with a sense of purpose and urgency, at what point would the time for reform be ripe?

59 Duff, Andrew, *How to Change The European Union*, John Harper Publishing, UK, 2015.

Politics abhors a vacuum. There is no shortage of polemics and politicians willing to fill such a void. It is time for those privileged to lead to do so sooner and not later. If not, the euro area's policy stasis risks to become a gift that keeps giving to the growing number of increasingly prominent sceptics, populists, anti EU and even anti politics political forces of the left and the right gathering momentum in the EU today. Better that these should be confronted with a coherent vision for the future of the euro area and the wider EU than to have them feed off lingering stagnation, indecision and timidity.

Jean Monnet, was not beyond criticising the institutions when he became impatient with delay: "*La forme administrative des résolutions, les lenteurs et les complexités techniques lassent le public. Les institutions ont été indispensables et le sont encore, mais elles ne correspondent pas aujourd'hui* à la nécessité *d'aller vite et de décider*".[60] This could have been written for today.

The euro has created a "*community of destiny*" in the words of President Juncker.[61] This community is the most obvious place to start and drive reform but it is has been severely tested by the complex crisis of interdependence of the past six years. The economic shock and its effects have been deeply asymmetric. The severity of that crisis and its duration has strained the euro area's periphery. It has led to sharp falls in the trust both in domestic and European political institutions. It has been accompanied by increasing political volatility. It has placed traditional centre parties, both of the left and the right, under great strain. The crisis has seen fragmentation within this "*community of destiny*" between the north and the south, between creditor states and debtor states, and social cleavages witnessed by mass unemployment and rising poverty and social inequality. Like excessive deficits a line needs to be drawn under these excesses also. For the "community of destiny" to work it must respond to the needs of all, must be able to deliver solidarity as well as to demand discipline and above all it manifestly must be able to determine and act in the common interest. Every member state must benefit if the system is to sustain itself. Reasserting positive sum logic is essential. As is evident from the earlier analysis in this paper, however certain it may appear to be to different actors, "*the truth*", to quote Oscar Wilde, "*is rarely pure and never simple*". The common interest requires searching for common truths and common solutions. A new balance needs to be struck.

60 Monnet, Jean, *Mémoires*, p 594. This was written to encourage the establishment of what eventually became the European Council.

61 Juncker, Jean Claude, President European Commission, Analytical Note, op. cit, p. 1.

The economic crisis itself evolved. Unsustainable public deficits, financial imbalances and wage and price differentials within the euro area were hidden, in full public view, until these weaknesses were cruelly exposed post Lehman Brothers and the onset of the Greek debt crisis. Putting one's house in order with an emphasis on supply side adjustments and internal devaluation was the primary policy response. In the middle phase, bank resolution was slow to emerge and meanwhile broken banks began to break sovereigns. Collectively the euro area's fiscal stance at the peak of the crisis was pro cyclical, aggravating the depth and duration of the downturn from 2011 through 2013. The depth of the austerity and its by-product of popular political push back impeded necessary reform. Putting the common European house in order, particularly as regards the overall fiscal stance remains elusive. The potential compensatory weight of increased domestic demand in surplus states, whatever the limits of its effects, never materialised.

The Macroeconomic Imbalance Procedure (MIP) has greatly enhanced the surveillance capacity of the EU. It places a strong focus on key economic indicators at member state level but lacks an equivalent perspective for the euro area as a whole. Consequently, the feedback loops between the collective common interest and separate national performance is underspecified and therefore inadequately addressed. The policy prescriptions under the MIP and Economic Semester process should be applied symmetrically with equal emphasis for both positive and negative imbalances, for the deficits and surpluses that count. In the euro area the

asymmetric shocks that marked the crisis have been compounded by the asymmetric response to dealing with imbalances. In effect there is no institution specifically charged with responsibility for the overall euro area fiscal stance and no officeholder designated as the responsible authority to do so. The concept of the common interest is a two-way and not a one-way street. This is an issue that the European Commission should take in hand as an urgent matter of common concern.

The tentative moves to enhance investment, public and private, should be deepened and reinforced by facilitating robust but realistic budgetary accounting rules. Margins for flexibility within the rules should not be dismissed automatically or in knee jerk terms as amounting to laxity. Rigour should not be allowed to mutate into rigidity when striking a new balance between putting each member state's house in order and putting the common European house in order. The European Fund for Strategic Investment (EFSI), the Juncker Plan, shows leadership in recognising the importance of investment in kick-starting the European economy. Its financial base is narrow. Its funds are drawn from existing EU budgetary allocations, lessening commitments in some areas to replace them with new projects in others. Consequently, it will cause some displacement effect, making its net contribution less than the gross figures may suggest. Its leveraging is ambitious but potentially achievable. However, its scale, spread over three years, even if it succeeds on its own terms, is not sufficient to shift the euro area economy from the lingering mediocrity that has seen it hover between deflation and anaemic growth.

If member states contribute to the Juncker Plan funding this will not count against their budget deficit calculations. As "*golden rules*" for investment go this is a very modest beginning that should be recognised and welcomed but deepened. The EU budget was worth approximately €144 billion in 2013, very small compared to the sum of the 28 EU member state national budgets of over €6,400 billion. Total government expenditure by the 28 member states is almost fifty times the size of the EU budget.

Most of this government spending at national level is spent on consumption expenditure. More of it needs to be shifted to investment expenditure, which can add to future productive capacity and, if judiciously chosen, can add more to GDP that it adds to debt. In October 2013, the European Parliament by 433 votes to 131, recommended an economic policy trade-off between consolidation and reform, a flexibility clause, suggesting that member state co-funding of EU approved investment programmes should be set aside when estimating the state's compliance with Eurostat's budget deficit rules. This has gone unheeded. Between its almost total absence today and one hundred per cent implementation there is a wide margin of manoeuvre worthy of open political exploration and decision.

Almost everything remarked on above could be achieved without any recourse to Treaty change. Even if there is reticence by some, or many, in this regard much more could be done to stimulate the euro area macro economy beyond the obvious and positive stimulus it has received from the ECB's monetary policy and the consequential fall the Euro's exchange rate.

Beyond the question of better coordination of the euro area's fiscal stance and introducing some margin of flexibility in investment policy is the question of whether the EU itself needs to develop a fiscal capacity. The Medium Term Financial Framework of the EU 2014-2020 reduced the EU's budgetary capacity as a proportion of collective GDP and was adopted at a time of a threatened existential crisis for the euro area. "*Cuts at home, therefore cuts in Europe also*" appeared to be the Council's mantra. The absence of a common fiscal tool was not even an issue. In the prevailing circumstances at that time, this always struck this author as an act of strategic economic illiteracy. The relatively new European Stability Mechanism has a maximum lending capacity of €500 billion. It was designed to issue debt instruments to euro area member states. It is independently managed, is entirely separate from the European Commission and it is not a stabilisation tool. Developing such an instrument would require budgetary, institutional and governance choices to be specified and decided.

There is no shortage of suggestions on what to do.[62] What is missing is a political project specifying policy choices, sequences and timetables. The acute phase of the crisis has passed but this should not be a cause for complacency. The Euro area economy is still profoundly marked by the effects of the crisis and has a very weak immune system to cope with any future crises. There has been tremendous pressure on policy making, delivered under the most stressful circumstances, but the task remains incomplete. All the reforms agreed to date and those contemplated, such as a Capital Markets Union, hopefully, can help to avoid a repeat of the current crisis but lack the capacity to lift the euro area to its post crisis new normal. The euro area today needs more growth and more inflation. It needs growth with reform. It needs demand and supply side policies to be complementary and not substitutes. It needs to assess evidence from past experience and from present circumstances without taboos. The competitive gaps, especially between its three largest member states, Germany, France and Italy, are not consistent with a sustainable monetary union and must be addressed.

Arguably, it is time to press the reset button the better to sustain the euro area in order for the single currency and the Euro area economy not just to survive but also to thrive. Subject to agreed parameters and democratic accountability the time is at hand to consider shifting the euro area system from rules to common institutions and from policy coordination to decision making in the common interest. The Community Method, even if allied with the Council's preference for intergovernmentalism, should not be marginalised in seeking a common, durable and democratic response to the crisis. Public opinion needs to be reassured that the euro area's necessary commitment to discipline can distinguish between rigour and rigidity and that the system can manifestly exhibit the possibility to put the common European house in order no less than putting one's own house in order. The key policy institutions have to be and to be seen to be part of the solution, if not, they risk to be dismissed as being part of the problem. This is not a plea for a long round of endless introspection. What the EU needs now is to put the right tools in place to finally and decisively end the crisis.

62 For example see Trichet, Jean Claude, *Governance of the Eurozone, Past, Present and Future*, IIEA, Dublin, 30 April 2015 on an embryonic federal budget, a Minister and Ministry for Finance for the euro area, and democratic accountability, governance and legitimacy.
Euro area Governance – what to reform and how to do it – Brugel Policy Brief, Issue 2015/01, February 2015.
Mody, Ashoka, Brugel Working Paper, 2015/03.
Enderlin, Henrik and Fritz-Vannahme, Joachim, Repair and Prepare, Bertelsman Stiftung, 2014.

XII. Conclusion

The next act in this drama should be undertaken in a spirit of confidence and hope. As Monnet always argued, crisis was necessary to provoke change and as such should not be a counsel of despair or discouragement. Resolving this crisis is affordable economically and would be much less costly than the alternatives of secular stagnation or disintegration. Sorting things out is unavoidable if politically the Union is to regain the confidence of its citizens. To do whatever it takes should be the byword of the EU's and, in particular, the euro area's political leaders and not just of the President of the ECB alone. Decisiveness is required. Procrastination and timidity risk failure. If in the end Europe's rising generation loses hope, because so many of them are experiencing long term mass unemployment, then Europe will lose.

As Monnet wrote to Schuman on the eve of the famous declaration: "*Il faut changer le cours des évènements, pour cela il faut changer l'esprit des hommes. Des paroles n'y suffisent pas. Seule une action immédiate portant sur un point essentiel peut changer*

l'état statique actuel. Il faut une vision profonde, réelle, immédiate et dramatique qui change les choses et fasse entrer dans la réalité les espoirs auxquels les peuples sont sur le point de ne plus croire".[63]

What is needed is ambition with pragmatism. Words are not enough. This does not always require large-scale constitutional and institutional change. What it does require is immediate action focused on the essentials capable of delivering real change and offering real hope. This was and remains at the heart of the Monnet method. In this sense, in terms of inspiration, what the EU needs is a new Monnet moment.

XIII. Bibliography

Bini Smaghi, Lorenzo, *Here's why Germany needs to start spending*, Financial Times, 28 October 2014

Brugel Policy Brief, *Euro area Governance – what to reform and how to do it*, Issue 2015/01, February 2015

Carney, Mark, Governor of the Bank of England, *Lecture to honour the memory of The Honourable James Michael Flaherty*, P.C., Iveagh House, Dublin, 28 January 2015

Deutsche Bundesbank, *The debt brake in Germany – key aspects and implementation*, Monthly Report, October 2011

Draghi, Mario, President ECB, *Speech at the Global Investment Conference*, London, 26 July 2012

63 Fontaine, Pascal, *Jean Monnet – Actualité d'un bâtisseur de l'Europe unie,* Lausanne, Fondation Jean Monnet pour l'Europe, Paris, Economica, 2013.
Monnet, Jean, note to Schuman, *Un changement d'espérance,* 3 May 1950.

Draghi, Mario, President ECB, lecture, *Europe's pursuit of 'a more perfect Union'*, Harvard Kennedy School, Cambridge (USA), 9 October 2013

Draghi, Mario, President ECB, Speech, *Stability and Prosperity in Monetary Union*, the University of Helsinki, Helsinki, 27 November 2014

Duff, Andrew, *How to Change the European Union,* John Harper Publishing, UK, 2015

Enderlin, Henrik, and Fritz-Vannahme, Joachim, *Repair and Prepare*, Bertelsman Stiftung, 2014

European Commission, *An Investment Plan for Europe*, Brussels, COM (2014) 903 final

European Commission Staff Working Document, Country Report Germany 2015 (including an In-Depth Review on the prevention and correction of macroeconomic imbalances)

European Economy, 1|2015, ISSN 1725-3217 (online)

Fontaine, Pascal, *Jean Monnet – Actualité d'un bâtisseur de l'Europe unie,* Lausanne, Fondation Jean Monnet pour l'Europe, Paris, Economica, 2013

Goulard, Sylvie and Monti, Mario, *Fiscal Discipline and Public Investment in Europe, Council on the future of Europe*, Berggruen Institute, Brussels, 10 December 2014

Hill, Jonathan, *Speech at European Parliament Economic & Monetary Affairs Committee*, Brussels, 24 February 2015

IMF, Greece, *Ex Post Evaluation of Exceptional Access under the 2010 Stand-By Arrangement*, IMF Country Report No. 13 / 156, June 2013

IMF, Germany – 2014, *Article IV Consultation Preliminary Conclusions*, Berlin, 19 May 2014

IMF, 2014, *Article IV Consultation,* Staff report, *Press Release and statement by the Executive Director for Germany*, July 2014

Issing, Otmar, *Blame Germany for bad policies, not its reluctance to spend more*, Financial Times, 23 October 2014

Juncker, Jean Claude, President European Commission, Analytical note, Informal European Council, 12 February 2015

Mody, Ashoka, *Living (Dangerously) Without a Fiscal Union*, Bruegel Working Paper, 2015/03

Monnet, Jean, note to Schuman, *Un changement d'espérance*, Archives, Fondation Jean Monnet, Lausanne, 3 May 1950

Monnet, Jean, *Mémoires*, Paris, Fayard, 1976

Pöhl, Karl Otto, Former President Bundesbank, *Bailout Plan Is All About 'Rescuing Banks and Rich Greeks'*, Spiegel Online International, 18 May 2010

Reinhart, Carmen M. and Trebesch, Christoph, *A Distant Mirror of Debt, Default, and Relief*, Munich Discussion Paper No. 2014-49, Department of Economics University of Munich, Volkswirtschaftliche Fakultät Ludwig-Maximilians-Universität München

Sikorski, Radosław, Foreign Minister of Poland, *Poland and the future of the European Union* Berlin, 28 November 2011

Spiegel Online International, *Germany's Ailing Infrastructure: A Nation Slowly Crumbles,* 18 September 2014

Spiegel Online International, Germany plans €10bn extra public spending, 6 November 2014

Stark, Jürgen, *The historical and cultural differences that divide Europe's union*, Financial Times, 11 February 2015

Summers, Lawrence H, *Reflections on the new "Secular Stagnation hypothesis"*, VOX CEPRs Policy Portal, 30 October 2014

Thompson, Helen, *The Crisis of the Euro: The Problem of German Power Revisited*, SPERI Paper No.8, December 2013

Trichet, Jean Claude, *Governance of the Eurozone, Past, Present and Future*, IIEA, Dublin, 30 April 2015

Van Rompuy, Herman, *Towards a Genuine Economic and Monetary Union*, Report by President of the European Council (the four Presidents Report), 26 June 2012

Van Rompuy, Herman, President European Council, Speech Brussels Economic Forum 2014 - 4th Annual Tommaso Padoa-Schioppa Lecture Brussels, 10 June 2014

The Foundation was created in 1978 by Jean Monnet himself, one of the founding fathers of the European Communities, who donated to it the entirety of his archives. As an independent institution serving the general public interest, a non-partisan and non-militant structure, it enjoys the support of the State of Vaud, the Swiss Confederation and the City of Lausanne. It operates out of the Dorigny Farm, at the heart of the campus of the University of Lausanne, which is its main partner.

Many additional archive collections are preserved here and put to good use, in particular those of Robert Marjolin and the European papers of Robert Schuman, as well as iconographic and audio-visual documents. It accommodates a specialized library and a European Documentation Centre. In-depth accounts from active participants and witnesses constitute an ever-growing compilation of filmed interviews. In all, this comprises an impressive body of resource material, on the origins and development of European construction and on Swiss-European relations, which is made available to the public and is especially fruitful for researchers. Each year, the Foundation awards the Henri Rieben scholarship to several advanced doctoral candidates.

Benefiting from the prestige of this heritage and of the collaboration between Jean Monnet and Professor Henri Rieben, Foundation President until 2005, the Foundation has become an indispensable venue for meetings, debates and reflection on the major issues confronting Europe today. Regular conferences, European Dialogues and international symposia are organized, building partnerships with renowned institutions. The Foundation bestows its Gold Medal on leading political figures for their work on behalf of the common interest of Europeans. The Foundation also welcomes numerous visitors and scholars, assisting in their research, and contributes to the training and education of students.

An editorial mission completes the scope of the Foundation's activities, in the form of the "Cahiers rouges", created by Henri Rieben in 1957 and co-edited with Economica since 2007, which has published 215 issues to date. In 2014 a new series called the Collection débats et documents was launched. These publications serve to highlight the documentary heritage of the Foundation, its public events and the expertise of its members and partners.

The Foundation Council, comprising some 500 members from all domains, meets once a year, as does the Scientific Committee. Pat Cox, former President of the European Parliament and of the European Movement International, has presided over the Foundation and its Executive Council since January 1, 2015. His predecessors are José Maria Gil-Robles (2009-2014), former President of the European Parliament and of the European Movement International, Bronislaw Geremek (2006-2008), Member of the European Parliament and former Polish Foreign Affairs Minister ; and Henri Rieben (1978-2005), Professor at the University of Lausanne. As of 2012, the institution has been under the direction of Gilles Grin, Doctor in International Relations and lecturer at the University of Lausanne. Hervé Bribosia, PhD in European Constitutional Law, is the Deputy Director and the historian Régis Clavé is Head of the Archives.

Publications already published

Ferry, Jean-Marc : *Les voies de la relance européenne*, numéro 1, avril 2014, 51 pp.

Grin, Gilles : *Méthode communautaire et fédéralisme : le legs de Jean Monnet à travers ses archives,* numéro 2, septembre 2014, 27 pp.

Fondation Jean Monnet pour l'Europe

www.jean-monnet.ch

The public debt crisis struck Greece with particular severity, resulting in deep social unrest. The rescue packages cooked by the Troika proved to be too optimistic. Following Syriza's access to power and the emergence of the populist parties at the last European elections, has the economic crisis of the Euro zone transformed itself to a political crisis for the European Union? The adopted reforms are not enough. The author also underlines the pivotal role played by Germany so as to understand the answers to the crisis and regrets the latter's reluctance to take a bigger part in public investments. Europe needs a new "Monnet moment": when ambition meets pragmatism.

Pat Cox is the President of the Jean Monnet Foundation for Europe and former President of the European Parliament. The analysis he puts forward was highlighted in his opening conference of March 12th, 2015 as new President of the Foundation. The text was completed in May 2015.

Le présent numéro est également disponible en langue française dans cette collection.

ISSN 2296-7710
9 772296 771001

Fondation Jean Monnet pour l'Europe
Ferme de Dorigny – CH-1015 Lausanne
secr@fjme.unil.ch – Tél. +41 21 692 20 90 – Fax +41 21 692 20 95

Réalisation et impression : atelier Kinkin – www.kinkin.ch