A political crisis in an economic tempest (January 2008 – December 2012)

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Abstract

The aim of this paper is to analyze the evolution of the European Union in the economic and financial field during the global crisis that stroke Europe, from January 2008 until December 2012. My argument is that the European Union has faced certain political and economical imbalances since its beginnings in 1992 which have worsen the European economic and financial scenario. These imbalances - rooted in the EU architecture – were the result of a primary political choice: building a European market based on neoliberal values and setting aside any political controversy that may have caused a slowdown in the economic and financial integration. Since 1992, the Maastricht Treaty has shown some incongruities which were not resolved in the following two decades. Moreover, the decision-making process became more intricate so that Europe faced the worst post-war financial crisis without the instruments to answer rapidly to the financial speculation. The ECB, following its price stability mandate, was not able to react with counter-cyclical measures, thus exacerbating the financial imbalances between Northern and Southern European States. After an economic "perfect storm", EU Member States need to have enough farsightedness to implement some fundamental reforms in order to give the necessary means to EU institutions to erect an efficient firewall against financial speculations.

Keywords: economic and financial crisis, European Union, sovereign debts, European Council, European Commission, European Central Bank

JEL Classification: G01, G20

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1. Introduction

It is widely accepted now that Europe is facing the worst crisis since the establishment of the European Community in 1957. This statement usually implies that this crisis is still primarily an economic issue; the political crisis come afterwards as "an unwanted consequence" that threats not only the Eurozone, but also, the European Union (EU) itself. David Cameron's recent speech (2013) on the future of the United Kingdom in Europe testifies for the enormous challenge EU has to cope with, particularly in those countries recognized as "euroskeptic."

In this paper I would like to emphasize that it would be more appropriate to reverse the cause-effect mechanism, i.e. the political crisis (that is the *political* decision to adapt the European Union architecture to the neoliberal principle of the self-regulated financial market) preceded the economic crisis. At the same time the aim of this paper is to trace a comprehensive description of the last four years events, trying to systemize the huge amount of information that deals with the EU crisis.

For that reason I start with a brief review of the last steps of the economic integration in Europe, that is the Maastricht Treaty and the Stability and Growth Pact. At a later stage, I will discuss the issue of who is in charge in European Union: the problem of a clear-cut distinction of functions between the European Commission, the European Parliament and the Council could account for the slowness in responding to the sovereign debt crisis that pounded Europe in the last years. Moreover, the role of the European Central Bank will be analyzed in order to assess its response to the multifaceted problem of the speculation on the European sovereign debt.

The description of the measures implemented by the so-called "troika" (European Union, European Central Bank and International Monetary Fund) is aimed to define how the institutional and political shortcomings that Europe has faced since the Maastricht Treaty approval may have influenced the economic situation in which the EU is stuck at the beginning of 2013. Finally, I draw a conclusion on the possible remedies, especially from the political and financial point of view.

2. Maastricht and the neoliberal triumph

"We believe that it is time 'to transform relations as a whole among the Member States into a European Union... and invest this union with the necessary means of action" (Bulletin of European Community, quoted in Blair 2005, p.122). With these words, in a letter dated 19 April 1990, the former French and German presidents, Francois Mitterand and Helmut Kohl, expressed their will for a more united Europe. The Berlin wall fell a year before and the relationship between sovereign States in the Old Continent were changing radically. The

result was the Maastricht Treaty, which built, for the first time, an economic union, throughout the cornerstones of the well-known convergence criteria and of the four freedoms (capitals, goods, services and people).

The year 1992 marked a political turning point for Europe, as it was 1951, with the European Coal and Steel Community (ECSC). Six countries, whose economic and political institutions were on the brink of a traumatic collapse after World War II, reached a historical agreement in order to sta bilize the Alsace-Lorrain situation between France and Germany. This diplomatic agreement was the first part of a more global project, i.e. to contribute to economic expansion and to raise the standard of living throughout the common market for coal and steel, capitalizing the economic support of the Marshall Plan. The first result for Western European Countries to reach the pre-War level of GDP at the beginning of 1950 (Carlucci and Cavone, 2004).

After forty one years, the path traced by Jean Monnet and Robert Schuman seemed lined with roses: the neofunctionalist perspective was near to win the bet of an economic and monetary integration bounded with the political union. However, some difficulties in the agreement[1] persisted, as testified by the financial attack on the most fragile countries in the international market. An attack that was a symptom of the difficulties of Member States (MSs) in acting together: this shyness, typified by the unnecessary (legally speaking) referendum held in France – after the Danish No in a recent referendum - cost very much to MSs in economic terms, due to the uncertainty in the European financial context. The same happened during the actual crisis with the Greek referendum on austerity measures: this time Papandreou was forced to cancel it due to international pressures and internal opposition.

If the triumph of the neoliberal vision seemed to be clear for some analysts (Pollak, 2011) at the end of the millennium, two major issues were still unresolved: the sovereignty of MSs and the willingness to counterbalance this "victory" with another "ideology" of a regulated capitalism, which had a strong support among the Commissioners (Hoege, 1998). In the first case, not only the foreign policy remained in the sphere of intergovernmentalism with the CSFP, but the fiscal union was not in the European agenda either: obviously, the Union was rather economic than political. It was able to defend free movement of goods, capital, services and (lastly) people rather than stimulate a grand bargain on the institutional architecture of Europe. For many years, the precondition to reach a new agreement (the Lisbon Treaty) was to avoid any allusion to these issues. In the second case, few principles were marked, above all: the separation

[1] At first, Denmark voted against the ratification. In may 1993 it approved the Treaty. Moreover, a great problem arose with the role of the European Court of Justice, that initially should have decided on the respect of the principle of subsidiarity. A reform that was considered too much federalist.

between the European Central Bank (ECB) and the political power and the stability of prices, as asked by Germany. Given the issue of the Southern European competitiveness endangered by the unification of West and East Germany, the main task for the European Economic Community (which was abolished with the treaty of Lisbon) was to avoid competitive devaluations. The Stability Growth Pact (SGP) was created in 1997 to serve this purpose, hoping, at the same time, that the most financially permissive States would implement those structural reforms (notably labour market reform and retirement age reform) that could permit a better stability in the public finance.

The mechanism was all but automatic. The sanctions for an MS had to be decided in the Council of Ministers: rather than pure financial considerations, what prevailed in the Council were *political* and *national* calculations, such as those made by Italy when France and Germany faced an *infringement procedure*. This lack of automatism – that is, the predominance of *national* politics among *European* politics and economics – was criticized by some analysts (Heipretz and Verdun, 2003), while others stated that a focus on the growth rather than on strict boundaries would be more important (Quadro Curzio, 2004). The tension between politics and economics continued until the recent crisis.

3. The Stability and Growth Pact

After a few years of peaceful existence, the “P” of so called PIIGS, Portugal, opened a harsh debate about the usefulness of the Excessive Deficit Procedure (EDP), a measure contained in the SGP, that implied a sanction for those countries with more than 3% annual deficit of GDP. If only Portugal faced this sanction, probably the implementation would not be a serious problem; the fact that France and Germany soon after went under observation of the European Commission for their own deficit turned the situation into a *political* (and sovereignty) problem. These three countries together with Italy used their weight in the Council to block the sanctions. The European Court of Justice admitted that they had the right to do it with the judgment C-27-04 (Court of Justice of the European Communities, 2004), despite the willingness of the Commission to assert its commitment to the Treaty when inflicted the sanction.

Why did this clash between Commission and MSs happen? The answer lays in the political nature of the EDP. As Heipertz and Verdun (2003) and Leblond (2006) state, the SGP was created in order to ensure the participation of Germany in the European Monetary Union (EMU). However, if this was the goal of SGP, and in particular of the EDP's sanctioning mechanism, “then its political relevance would diminish after Germany had joined” (Leblond, 2006, p. 974): nonetheless, this “political relevance” was an *intergovernmental* relevance, rather than an European one. The discretion in the application of sanctions was a reflection of the latent France’s and Italy's fear of sovereignty loss. Interestingly

enough, Jabko (2010) claimed that even the EMU was, in a way, a tentative to reduce the assertiveness of Germany and the European leadership of Bundesbank. Once Germany was incorporated in the future Eurozone, the issue was just to bargain the power relationship between MSs; there were not *European* ideas about the future of the economic stability of Europe.

It was Germany that pushed to transform deficit reducing policies into real *European* policies; several years after its denial to a *European* infringement procedure, the German Finance Minister, Wolfgang Schaeuble (AFP, 2013), insisted with other MSs that there were not different paths from those traced by the European Union. However, in this case, the aim of the German government is not developing a *European* economic agenda; rather it seems that *European policies* are used for internal matters, especially on the eve of a legislative election.

In fact, Merkel's toughness on this side hides a more complicated problem, namely the necessity for Germany – the country that resisted better to the turmoil and which gained the greatest bargain power among MSs – to appear strong enough outside its borders in order to be not be perceived as weak internally.

However, as shown by Leblond (2006), on the one hand, investors do not consider an excessive non-structural deficit as a negative fact *per se*, so that even an automatic binding procedure will not have the effects supposed to create (a balance between revenues and cash outflow by increasing interest rates which should push any Government to carry out a restrictive policy). On the other hand, EDP is not unanimously considered the best way to force countries to be more respectful to their national budget. One can argue that the political nature of EDP itself transforms the way this process is seen on the exchange market: if states, especially the most powerful, such as France and Germany, have the right to refuse (or accept) the excessive deficit procedure for European Commission, then the credibility of this mechanism is inevitably weakened. Anyhow, it is also important to evaluate the effects of a sanction of 0,2 % of GDP on the national budget, in a context with no sustainable growth (as the case of some Member States): adding a fine to the deficit means exacerbating the state of finances deepening the deficit itself, instead of resolving the problem, even because a restrictive fiscal policy is costly, from an electoral and social point of view; for that reason, a strong MS prefers to "fight" in the European arena, as it was for Germany and France, rather than make their citizens pay a *European* fine. In this case, those States which had the means to stop an unfavorable decision, preferred to focus on their own economic sovereignty and on their self-interest. The Commission, the guardian of the treaties, remained a step under the Council, the political and intergovernmental organ of the European Union.

Another interesting aspect is that the monetary union was not followed during the time by a coordinated fiscal policy. The redistributive policy, which

lays on the power to impose taxes by sovereign States, is still a divisive issue: each MS is jealous of its uniqueness in this field. Nevertheless, Uhlig (2003) demonstrates that in a context like that of the European Union where the monetary and fiscal authorities are unable to commit, the non-cooperation between them can lead to significantly inferior outcomes. The same worries were advanced by Tommaso Padoa Schioppa (2004, Pisani-Ferry, 2006).

The suspension of the EDP, and more generally of the SGP, did not turn into an economic crisis mostly because the excessive deficit was not considered an overwhelming problem by the global market (Leblond, 2006). As a consequence, why should MSs have deepened their integration? MSs national sovereignty and national bargaining power in the EU arena were saved, at least until a major crisis erupted in 2008: the necessity to respond quickly to the attack of the speculation in 2003 was just an unthinkable nightmare. The Lisbon Treaty confirmed the tendency to see in a long, exhausting, bargaining procedure the only way to achieve an agreement, based on the unanimously accepted lowest common denominator. While shifting part of the policy-making power in the European arena thanks to the co-decision procedure, Member States preferred to maintain fiscal policy in their own backyard. The European Union was not simply policy without politics: it was policy with national politics and without European politics; a lion without teeth; a Leviathan unable to scare anyone.

4. Who is in charge?

This chapter tries to describe briefly the decision-making procedure in the European Union, underlining the difficulties in reaching quick agreements at the European level. The issue of timing is not good *per se*, but for the item I am treating it is basic. As the description of the crisis from 2008 to 2012 would explain, the slow response to global market (and also to global speculation) creates a vicious circle, where the isolation suffered by MSs played an important role in worsening the sovereign debt crisis[2].

The complexity of the institutional architecture is due to the new concept of representation that emerged in Europe. On the one hand, the Council of the European Union, that is the Council of Ministers, is the expression of functional representation. In this case, with the Treaty of Nice and the Treaty of Lisbon, the initial pure intergovernmentalism was overcome by the system of qualified majority; until 2014 the approval of a decision requires: majority of countries (50%) if the proposal is made by the Commission, or else 67% if the proposal is not made by the Commission and 74% of voting weights, as provided by article

[2] All mentions to the international crisis are important to bind the slowness of the decision-making process to the worsening of the crisis, but they do not constitute a description of the crisis, which is treated in the next chapter.

205 of the Treaty establishing the European Community; every country is able to check if the majority include the 62% of the European population. We are facing a Machiavellian system which tries to balance the power of the most populated and richest countries (Germany, United Kingdom, France and Italy) with the need of representation of the smallest country; this is an overwhelming, if not contradictory, attempt to balance the efficiency in the outcomes and the democratic representativeness. On the other hand, the necessity to give voice to popular representation pushed European members to increase the legislative power of European Parliament (EP). This was made through the aforementioned co-decision procedure that became, with the Lisbon Treaty, ordinary legislative procedure, i.e. what used to be the exception in decision-making has become the norm for the majority of the policy areas. However, a major problem arises when we analyze what really happened at the European level during the last four years.

The 2008 mortgage crisis was transformed into a sovereign debt speculation, which hurt many European countries. In this context and despite the new assertiveness demonstrated during Eu balance debate, what EP was (un)able to do reflects its low capacity to influence the debate over the States' bailout. As an example, the austerity reforms proposed and implemented by the conservative government in Portugal[3] and the balanced budget inserted in the Spanish Constitution with an agreement of the Popular Party and the Socialists were "imposed" by EU and IMF, on the one hand, and the Central Bank on the other, with the implicit threat to exclude these countries from the European System of Financial Supervisor (ESFS) and without any kind of popular consultation (Tremlett, 2011). The same occurred, despite some differences, with Greece and Italy. Moreover, the approval of the ESFS was tied up with the decision of Bundestag, at first, and Slovakian Parliament in second instance (Merli, 2011). Although these events could not be pertinent to typify the decision-making process, it shows how, during a severe period of crisis (the first one, since the adoption of the Euro), the EP is overruled by national governments. Not by chance, if we transfer the national debate into the European arena, we will find that it is the European Council the place where all decisions are taken.

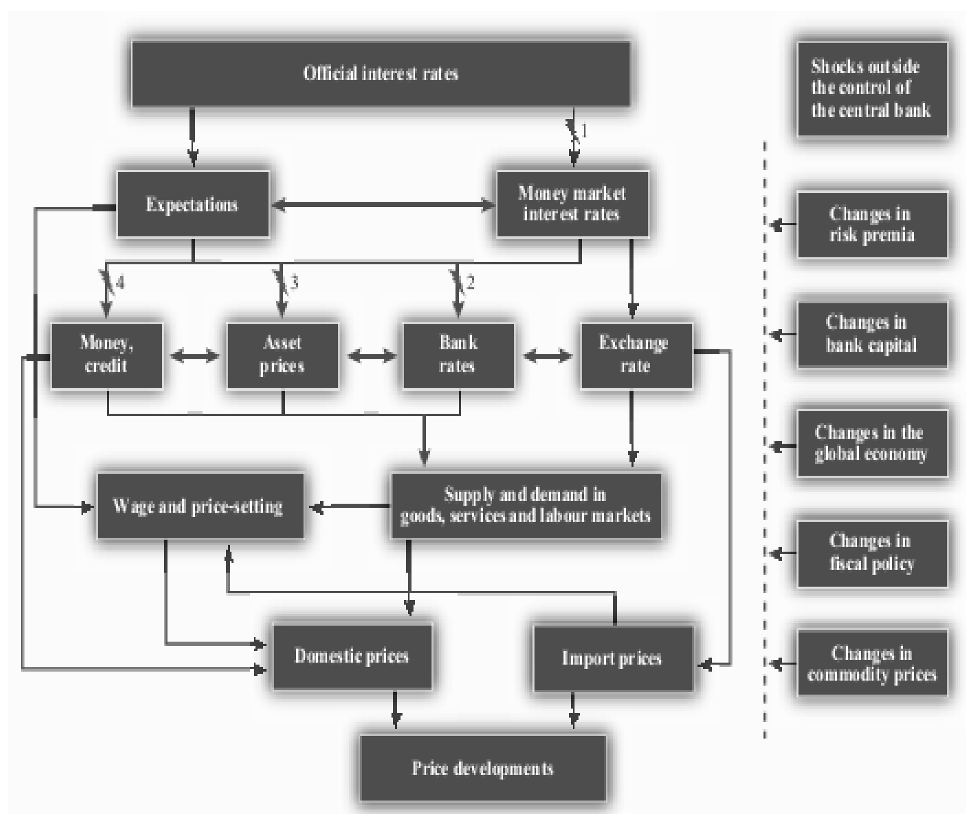
Despite the co-decision process that gives the Commission and the Parliament substantial weight, the "Council-centric view" is today the most obvious option in the decision-making process. How can this fact be demonstrated? The answer lays on the EP election. The EP members are elected in a national party and to a national party and they have to justify every choice to national electors. Would a member of the Popolo della Libertà- PDL (Italian conservative party) distinguish from the decision taken by his leader in the

[3] Part of these new austerity measures were recently blocked by the Portuguese Constitutional Court.

European Council? Would an Italian member vote against an EPP national leader (i.e. Berlusconi), even if other national leaders (i.e. Angela Merkel) which belong to the same European family, ask to vote in a way that would contradict national interest? These are all rhetoric questions that do not need an answer.

But, despite the fact that "legislative behavior in the EP is structured more by party affiliation than national affiliation" (Hix, 2001, p. 684), it is also true that EP legislators must devote much more attention to their home party and its leadership if candidates are chosen by a small inner circle of the party leadership rather than a ballot of all members or by regional party organizations (Faas, 2003, p. 844). Moreover, it was also noted (*ibidem*) that the national government pushes very hard to have its members in the EP vote the compromise reached in the Council.

Figure 1. Stylised illustration of the transmission mechanism from official interest rates



Source: ECB Monthly Bulletin, October 2010

Until now, no mention has been made about the role of the Commission, the guardian of the Treaties, which also has no negligible functions in the European context such as proposing new laws to Parliament and the Council, managing the EU's budget and allocating funding, enforcing EU law (together with the Court of Justice), representing the EU internationally by negotiating agreements between the EU and other countries. During the crisis, the Commission has come under stronger challenge in this crisis than ever before (Huges, 2012).

Finally, the European Central Bank (ECB) had a prominent position among other institutions. As mentioned above, its recognized role is linked to the monetarist theory, that is the strict control of consumer price inflation. An example of this willingness to maintain price stability can be found in
2008 during the US subprime crisis, when the ECB decided to reach an interest rate of 4,25% (see Figure 1).

Its particularity in the European institutional architecture is, on the one hand, its independence from the political power and, on the other hand, the lack of accountability. The latter feature is strictly connected to the former (Sibert, 2009). Accountability is often seen by ECB as a way to explain and justify its actions, but, at the same time, it is not possible to know the report of the ECB meeting as well as the votes in the ECB (if a real voting procedure exists) (*ibidem*). The only accountability mechanism is the annual report submitted to the EP; moreover, ECB representatives participate in the EP's committees at the request of its members or on its own initiative (Article 284.3 of the Treaty and Article 15.3 of the Statute). Nonetheless, neither the EP nor the Council of Ministers have the political power to influence in any way the ECB mandate. De Hann (2000, p. 405) analyzed the problem at the beginning of the ECB activities, reaching the conclusion that ECB was "more reluctant to be accountable and transparent with the danger of hiding some of their strategies", with respect to Anglo-Saxon central banks.

Following the Bundesbank model, the strict independence from political power is guaranteed by the article 127 of TFEU that imposes the price stability as "the primary objective" of the ECB and European System of Central Banks (ESCB)[4]. In order to ensure that the political influence does not overcome the decision-making of ECB, any kind of loans to national or local institution is prohibited. However, how did the ECB react when the financial crisis reached its peak in 2009 and 2010? Did it coordinate its decisions with other political institutions? Did it follow its monetarist philosophy? The answers to these questions will be given in the following sections.

In this puzzling context, the economic crisis highlighted the political incapacity of European institutions to react with coordinated measures to save

[4] ESBC is the institutional framework of all central banks within the Euro-zone.

the monetary union. The self-assertion of the Council of Ministers in the last months of 2011 showed that three years of motionlessness fostered the rise of national-based interests, especially of those countries which were traditionally not involved in the European project and that now preferred to look at the national arena rather than deepen the integration process, i.e. Great Britain (Hutton, 2011).

5. The crisis and the response to it

When the housing bubble burst at the beginning of 2008 in the US, the crisis went global immediately. In Europe, the response to this unexpected crash was different from nation to nation, without a common plan: different were the problems, different were the solutions adopted. The government of UK, after the bailout of Northern Rock in 2007, injected £37bn in Royal Bank of Scotland (RBS), Lloyds TSB and HBOS just before the opening of the G-20 summit in November 2008, where the policy agenda did not in fact go much beyond the pre-existing international initiatives that had already been developed in more technocratic international bodies. In this way, the analysis [of the summit's official communiqué] highlights how far short the summit fell from expectations that it might set a new agenda for ambitious and innovative international financial reform (Helleiner and Pagliari, 2009, p. 276).

After UK, other national plans were predisposed by Sweden, Denmark, Portugal, Greece, Holland, without the intervention of ECB (Russo, 2011).

Meanwhile, after the collapse of Lehman Brothers in September 2008, the European Central Bank, faithful to its monetarist mandate, decided an increase of the interest rate to the historic high of 4,25%. During what was perceived in 2009 as the worst financial crisis since the Great Depression (IHS, 2009), the ECB was not eager to adapt its strategy to a mutating financial context.

In the US, after the controversial approval of the Troubled Assets Relief Program (TARP), $7.700 millions were pumped into the bank market with an interest rate near to 0% (Da Rold, 2011); the decision-making problem, especially at the end of the Bush presidency and after the mid-term election in 2010, when Obama lost the majority in Congress, were patent and similar to the European institutions indecision, but "the strength of American political system allows a safety navigation, while the European path is proceeding throughout the tempest"(Prodi, 2011). The difference between the US and the European Union is in the fragmentation of the interventions: with a stable political context, although divided between Republicans and Democrats and despite the recent shocking downgrading of the rating, the speculation on the US stopped within two years. At the beginning of December 2011 the attention is in the downgrade of the Eurozone (Euronews, 2011b). So, why is Europe still in danger?

In October 2009, the former prime minister of Greece, George Papandreou, announced that the annual deficit of the State would be 12,7%. The

conservative party altered the financial indicators of Greece to enter in the Eurozone and the socialist Prime Minister needed, at the time, 400 $ billion to cover the Greek debt. Within two months, Greek bonds became "junk", but the first intervention of Ecofin and International Monetary Fund (IMF) arrived only at the beginning of May and it was too shy to convince the global markets. Within a week (from 1st of May to 8th), IMF and EU agreed on a €110 billion loan with an interest rate of 5.5%: the main condition was the implementation of austerity measures. On the 9th of May 2010, a new European fund, called European Financial Stability Facility (EFSF), was created in order to erect a firewall against financial speculation on Greek debt. In November 2011, the EFSF guaranteed up to 30% of new issues from the troubled Eurozone Government in order to raise the funds needed to provide loans to countries in financial difficulties, to intervene in the debt primary market and in the debt secondary markets, to act on the basis of a precautionary program, to support recapitalisations of financial institutions through loans to governments including those in non-programmed countries (European Council, 2011a). The second emergency fund, approved by all Member States, was the European Financial Stabilisation Mechanism (EFSM). It was created on the 10th of May 2010 "with a view to preserving the financial stability of the European Union" (article 1) (Official Journal of the European Union, 2010).

The panic generated by the black Friday of the 8th of May 2010 was a reaction to the slowness of the EU and mostly of the Chancellor Angela Merkel, who apparently waited for the North Westphalia election before the bailout of Greece (Hall and Waterfield, 2011).

One year after, the Greek Prime Minister Papandreou, seeing no clear evidence of recovery, announced a referendum on austerity measures that were imposed in the country. Criticism raised throughout the European Union, due to the possible destabilization of financial panorama in the short-term: the referendum was blocked few days later, but it cost his resignation.

Looking back to the short history of the European Union, it is possible to find one precedent; in effect, the situation was similar to the referendum held by France in 1992 on the Maastricht Treaty. In that case, some national currencies were attacked because of the delay in the signing of the agreement; however, in 2011, financial and international pressures prevailed on national sovereignty.
The same delay shown with Greece occurred with Portugal. The loan was given only when the situation arrived to the edge of the precipice, i.e. the impossibility to pay public wages (Wise, 2011 and Traynor, 2011). The financial crisis of 2010 reached Ireland, Belgium, France, Spain, but mostly Italy. Italy, with its enormous public debt, was the perfect candidate to be attacked. Even if the bank system was almost stable and the public deficit was put under a strict control by the former minister, Giulio Tremonti, under the supervision of Mario Draghi and

Jean-Claude Trichet[5], structural problems of growth and endemic tax evasion transformed Italy into a perfect victim. Europe looked at Italy as the "worst-case scenario" said a manager of Artio Global Equity Fund (BJGQX) in July (Baden, 2011). The international press was aware of the danger (Pisa, 2011 and Aldeman and Donadio, 2011) but the Italian economic sovereignty seemed to be untouchable, despite the ECB letter that tacitly imposed some reforms: Italy could do on its own because its banking system was stable, according to Silvio Berlusconi (Rush, 2011); the rating agency and, in particular, Moody's did not have the same opinion and, a month before Berlusconi's declaration, downgraded the outlook on the Italian banking system (Global Credit Research, 2012). In the given situation, another plan for the bailout of the third economy in the EU was considered politically unsustainable, because it meant a consistent increase of the EU budget, stuck at the 1% of the GDP of all MS. Only when Berlusconi left, the spread between the Italian *Buono del Tesoro* and the German *Bund* decreased, after peaking 533 points on the 9th of November.

Despite the intervention in the Italian domestic debate with a (not-so) secret letter, the ECB was stuck in its mandate: the price stability. Nevertheless, when the crisis became *European*, the ECB was forced to act in order to avoid a financial disequilibrium: the Securities Markets Programme (SMP) was launched in May 2010 to ensure depth and liquidity in those market segments that are dysfunctional. It was not properly a quantitative easing measure, but it was quite similar. The impact of SMP was less effective than it was expected. In fact, the worsening of the debt crisis in the European periphery led Mario Draghi (Bloomberg, 2012) to state that ECB would do "whatever it takes to save the euro". Officially, the intervention in the secondary market planned in July 2012 was realized to preserve price stability. In Mario Draghi's words (2012): the outlook for the euro area economy as a whole was increasingly fragile. There were potentially negative consequences for Europe's single market, as access to finance was increasingly influenced by location rather than creditworthiness and the quality of the project. The disruption of the monetary policy transmission [see Figure 1] is something deeply profound. It threatens the single monetary policy and the ECB's ability to ensure price stability. This was why the ECB decided that action was essential.

Factually, the goal was to act within the mandate (without intervention in the primary market), but using non-conventional measures to avoid Italian and Spanish failure (Greece technically failed with a debt restructuring on March 2012). The ambiguities of this tactics were necessary to overcome the criticism

[5] In a letter dated 5 August 2011, Draghi and Trichet call Berlusconi government to implement a comprehensive reform strategy to liberalise professions and privatise local public services, to reform the collective wage bargaining system and to review the rules regulating hiring and dismissal of employees.

of a reluctant German government that wanted to avoid the internal pressure with a view to the next legislative election; nonetheless, they also showed the lack of cohesion in the Eurosystem and, mostly, the historical low predictability of ECB behavior, as was already pointed out by the Ross IMF report ten years ago (2002).

After three years, none of these measures were able to prevent the worsening of the economic crisis: the General government gross debt (% of GDP) grew in Greece, Ireland, Italy, Portugal and Spain; the prospect of the IMF (2012) on the variation of the GDP at a constant price was, and still is, negative for all these countries.

What comes after is a recent story of a political failure. Whilst the issue of sovereignty and accountability of the European Union emerged strongly (Bassetts, 2011, Babilar, 2011 and Beck, 2011), a solution for a deeper integration, that is the transformation of the ECB in the lender of last resort, was blocked by Germany, scared by the dangers of excessive inflation. According to Paul Krugman (2011) and Jean-Paul Fitoussi (in Franchon, 2011) this measure would have dissuaded the global market to speculate on Eurozone debts. In the extraordinary Council of the 9thof December an agreement was reached with the opt-out of the British Prime Minister Cameron and of the Czech Prime Minister, on the austerity measures to be implemented at the European level. The Council decided that the European Stability Mechanism (ESM) would come into force in July 2012. The Treaty Establishing the European Stability Mechanism is not a completely new found: its predecessors were the EFSF and ESFM. Nonetheless, due to the opposition of Great Britain and the Czech Republic, it was transformed into an international organization located in Luxembourg, outside the institutional architecture of the European Union. After the approval of the German Constitutional Court on the 12th of September 2012, it came into force at the end of the same month. The European Commission and the European Parliament, in this context, disappeared from the debate. The former, as a guardian of the four freedoms, should have played a more significant role; this role, however, was not recognized as valid in a financial turmoil, as it was in 1997 with the EDP procedure.

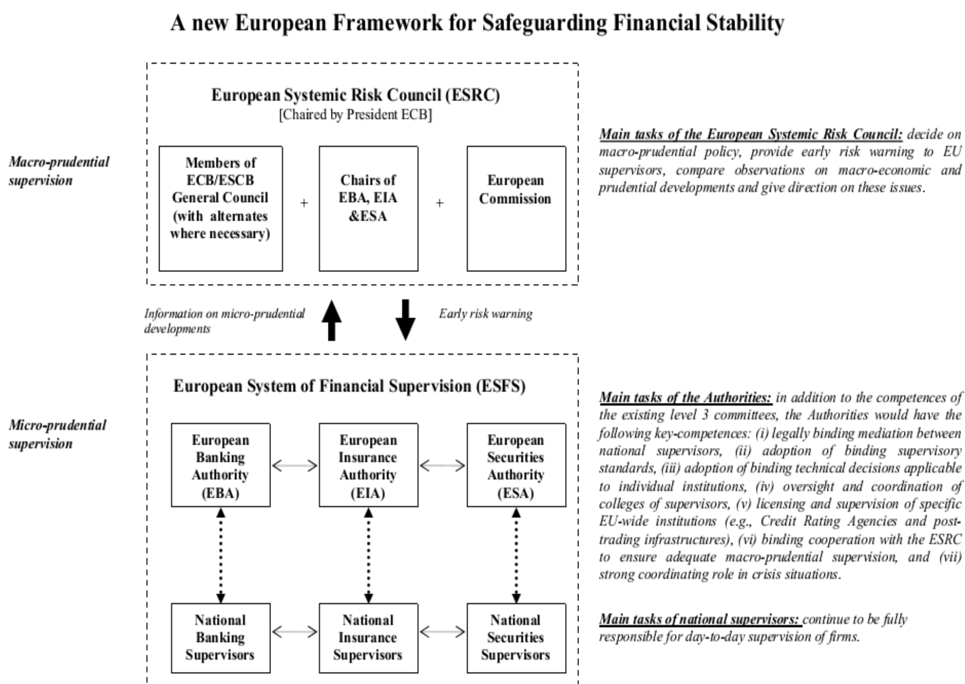
Instead, within the European Union, the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG) was signed in February 2012 (European Council 2012a): neither a proper fiscal union nor the Eurobonds were created. The new Treaty requires national budgets to be in balance or in surplus: this goal will be achieved only if the annual structural government deficit does not exceed 0.5% of nominal GDP.

Member States are asked to incorporate this "balanced budget rule" into their national legal systems, preferably at the constitutional level. The deadline for doing so is one year at the latest after the entry into force of the treaty. After the Council of Minister in December, Italy, following the example of Poland

(1997), Germany (2009) and Spain (August 2011), was one of the first Member State to modify its Constitution with a balanced budget amendment in April 2012 (articles 81, 97, 117, 119)[6].

The excessive deficit procedure will also be more automatic. The Euro area member states commit to support the Commission's proposals except when a qualified majority of them would be against the decision. The recent elections in Greece, France and Germany showed that this slow-ripening decision was not appreciated by the electorate.

Figure 2. A new European Framework for Safeguarding Financial Stability



Source: de Larosière, 2009, p. 57

TSGC and ESM are considered "complementary in fostering fiscal responsibility and solidarity within the economic and monetary union"

[6] The main parties (Partito Democratico, Popolo delle Libertà, Unione dei Democratici di Centro) voted those modifications, adding some exceptions for "harsh economic recession", "financial crisis", "natural disasters". The actual economic and financial crisis is considered as part of those exceptions: in fact, Italy's public debt hit an all-time high in June 2012 Gazzetta Ufficiale, 2012.

(European Council, 2012c, p. 4); both require Member States to implement austerity measures in return for loans. In particular, the ESM established five supporting programs - Sovereign Bailout Loan, Bank recapitalization, Precautionary financial assistance, Primary Market Support Facility and Secondary Market Support Facility - "on the basis of a strict conditionality, appropriate to the financial assistance instrument chosen if indispensable to safeguard the financial stability of the euro area as a whole and of its Member States" (European Council, 2012c, p. 5). How this strict conditionality can propel "sustainable growth, employment, competitiveness and social cohesion" remains to be seen. What is clear, until now, is that the determination to take "the measures required to ensure a financially stable, competitive and prosperous Europe" expressed during the European Council of June 2012 (European Council, 2012b) was not followed by an equal desire to maintain social and political stability in those countries crossed by popular upheaval against their Governments and the "troika". Mostly, these measures came four years after the eruption of the US mortgages crisis. Considering the financial perception of Time, four years can be considered an enormity. These time laps should have been used to implement some *European* reforms, but it served to rekindle soothed nationalism.

6. Which remedies?

As Reiner Lenz (2011) shows in an interesting article, there are multiple explanations for the crisis, not only that of indecision of the European institutions; probably one of the most important is the unequal distribution of debts in the Eurozone due to the imbalance in trade flows, but what lacks is, above all, a "European economic policy or economic government whose task would be to take preventive countermeasures with regard to differences in real wages".

Nonetheless, other suggestions were made in 2009 by Jacques de Larosière. In his report several recommendations, among others, were proposed in order to stabilize the Bank system and to supervise the Credit Rating Agency (whose role in the economic crisis cannot be analyzed here). Firstly, the overreliance on micro-prudential regulation neglected the issue of the macroeconomic stability: therefore, monetary authorities "can and should implement a monetary policy that looks not only at the consumer prices, but also at overall monetary and credit developments, and they should be ready to gradually tighten monetary policy when money or credit grow in an excessive and unsustainable manner" (de Larosière, 2009. p. 14). Secondly, he proposed a substantial reform of the regulatory framework; it should be based on the assumption that even if pro-cyclical measures have to be carefully evaluated in this recessive context (Slovik and Cournède, 2011), some aspects of new bank

regulations have to be implemented (particularly, the minimum capital requirements and promoting countercyclical buffers). The establishment of the European Banking Authority (EBA) in 2011, as proposed in the de Larosière Report, and the implementation of a so called "European Banking Union" seem a step forward in this regard. The latter will be operative in July 2013; for that reason an overall assessment on both reforms cannot be made.

However, a more significant problem is that of the political division among Member States. This division has left some fundamental issues for the European Union architecture unanswered, and they cannot be resolved only by technicians. After all, "the Greek crisis should have been resolved quite easily: after all, it's the 3% of European GDP. It turned out in a titanic duty not for economic, but for political reasons" (Dassù, 2001). The possible solutions for the European political uncertainty may lay in a motto "more Europe, not less". This is not the equivalent of a Federal State similar to the United States of America. Pragmatically, several measures should be discussed and implemented in order to avoid an inconsistent transportation from the EU level to the MS level, in order to reach a real harmonization set of rules in the EU. The final stage, which implies a significant sovereignty transfer of MS, would be a European System of Financial Supervision (see Figure 2).

Moreover, a reform in the mandate of ECB/ESBC has to be put in the EU agenda; if it is not conceivable in the short term to modify radically the role of the ECB, it would be recommended to give to ECB "an explicit formal mandate to assess high level macro-financial risks" throughout the creation of a "European Systemic Risk Council (ESCR)" whose task would be "to form judgments and make recommendations on macro-prudential policy, issue risk warning, compare observation on macro-economic and prudential developments and give direction on these issues" (de Larosière, 2009: 44). This does not mean that a political agreement, even if it had been reached in the first years of the crisis, would have solved the structural economic problems of the European Union. Nor a mere economic coordination will transform the European Union in a political and democratic space. The dilemma about how an elected Government can balance its executive power with the conditionality posed by international institutions is still unresolved; the problem of the EU Council's accountability, an unelected institution that, quoting Habermas "engages in politics without being authorized to do so" (Diez, 2011); the issue of the transparency of the ECB; the substantial distance - at least, perceived, as the recent Eurobarometer report shows (2013) - between "eurocrats" and citizens, with the raising of the anti-system movement throughout Europe[7]: all these

[7] Despite their substantial differences, from the Euro-skeptics and xenophobic movements of Front National and Golden Dawn in France and Greece to the communist party, EKK, in Greece, crossing the Pirate's Party in Germany and the 5 Stars Movement

disputes pose enormous challenges to the future of the Old Continent. The more political are the answers to these challenges, the more likely is the EU to survive. As De Grauwe (2010) suggested, there can be little doubt that the survival of the Eurozone depends on its capacity to embed itself into a political union. The latter must imply some transfer of sovereignty in the conduct of macroeconomic policies other than monetary policies and the organization of minimal forms of automatic solidarity between member states even when some of these have misbehaved. The lack of a “real” accountability of some supranational institutions, such as the ECB or the IMF - or even the European Commission - hides a deeper problem, i.e. the withdrawal of politics in the European arena. In that sense, austerity measures are not only an economic issue, which can be discussed by specialists, but mostly a political affair that needs a public discussion among citizens. In this perspective, reducing the “democratic deficit” (Follesdal and Hix, 2006) of the European Union, by politicizing the economic, financial and fiscal issues rather than imagine them as an objective matter of fact, would be a good starting point.

7. Conclusion

Social sciences – and economics among them - are not hard sciences; for that reason, it is impossible to demonstrate that a political union would have certainly prevented the shift from the mortgages crisis to the sovereign debt crisis in Europe. In my paper, I underline the role that a more coordinated political action would probably have eased the fury of the speculation among the Eurozone, as the Greek bailout and the cases of Italy, Spain and Portugal demonstrated. The EU architecture was not ready to face the challenges that the financial turmoil caused: the first symptoms of this unsuitableness can be found in the problems faced in applying the Stability and Growth Pact; however, the interest rates bonanza in the last ten years delayed any pressure to reform the financial and political systems. It is not surprising, therefore, that since 2008, the electoral calculus had the preeminence in the MSs agendas with respect to comprehensive *European* political and economic reforms and that ECB, faithful to its mandate, preferred a tough monetarist policy rather than implementing counter-cyclical measures. Economic national sovereignty, after the loss of monetary policy, was a primary concern for all MSs even before the eruption of the sovereign debt crisis. With the financial turmoil, this tendency was strengthen: the recent European Councils demonstrated that watered-down compromise with very limited objectives was the only point which MSs were to able agree on.

in Italy, there is a growing consensus among members of these parties on the inability of traditional parties to answer to the financial and economic crisis.

Even the ESM and TSGC seem an arrangement between the necessity to safeguard financial stability in the EU, especially in its southern periphery, and the austerity (and pro-cyclical) measures required by the so-called troika, as well as by Germany and other northern neighbors: no evidence of actual willingness to implement a binding mechanism of political coordination among European institutions can be found. The recent Cyprus bailout seems to confirm this tendency: in this case, the European Parliament was able to react only with ex-post statement to a decision taken elsewhere. Nevertheless, the scenario may be less dark than it is frequently depicted if only a whole reform of the political architecture of the EU would be implemented in the next years. The starting point of this reform should be a more coherent regulatory financial framework and a new conception of the ECB mandate that allow ECB itself to act by pursuing macro-prudential stability. Finally, a slow path toward a more balanced fiscal policy should be undertaken, despite the fact that the current financial and economic crisis does not allow a grand bargain among MSs. The priority is for the short-term, but, without imagining a long-term transformation of the EU policy-making, none of these short-term reforms will succeed.

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