Editorial

This issue of *Working Notes* focuses on the economic crisis in Europe, and in particular the deepening crisis in the euro zone countries. The Jesuit Centre for Faith and Justice is one of a number of Jesuit social centres in Europe featuring articles on these topics in Jesuit-published journals during spring/summer 2012.*

In the opening article of this issue, Kevin O'Rourke provides an historical perspective on the development of European Monetary Union (EMU) and the difficulties with which it is now faced. He suggests that the process of designing EMU in the 1980s reflected 'the intellectual fashions and policy preoccupations of that decade'. These fashions and preoccupations were 'at odds' with Europe's post-war tradition of social democracy (which had both shaped the economic and social policies of individual countries and influenced the movement towards European integration) and at odds too with the economic lessons of the 1930s. He argues: 'Europe needs to relearn those lessons, and re-engage with its social democratic past, if it is to survive this crisis unscathed'. He points to the dangers of the 'drive towards generalised austerity', and suggests that it is not just the economic harm of such an approach but the even higher political costs in the longer term that should be of concern.

In the second article, Tom McDonnell writes that the creation of a European single currency was 'arguably the most ambitious experiment in monetary union ever undertaken', with the euro instantly becoming the second most important currency on the planet. However, over the past four years the twin sovereign and banking crises have exposed the deficiencies and internal inconsistencies of the 'architecture' of EMU. Tom McDonnell suggests that many of these architectural flaws *can* be remedied, and that 'ultimately the success or failure of EMU will come down to political capacity and will'. He argues that changes to the system of economic governance of the EU need to include monitoring of social indicators such as poverty rates and income distribution, and concludes: 'The euro zone of 2020 should be a union that puts social justice centre-stage'.

The social impact of the euro crisis, and of the overall economic situation in the EU, is the theme of an article by Robin Hanan of the European Anti Poverty Network (EAPN) Ireland. Drawing on information and analyses assembled by EAPN members throughout Europe, he shows the multiple and in many cases devastating social effects of the crisis. Not only has unemployment risen significantly but in many countries there has been curtailment of employee rights, as well as an increasingly harsh application of work activation policies. Living standards have been squeezed from many directions, with reductions in incomes, increases in taxes and charges, and cuts in benefits and services. Robin Hanan argues that austerity policies risk undermining social rights and the European social model. He calls for social impact assessments of the causes and consequences of the crisis and a re-think of the development model that has predominated in recent decades.

In the final article of this issue, Ray Kinsella and Maurice Kinsella suggest that the post-2007 global financial crisis is above all an ethical crisis, which has seen a collapse of solidarity within the European Union. They argue that, in the aftermath of the Second World War, it was the principle of solidarity which generated the dynamic for a new beginning – one which opened the way for the nations of Europe to build economic and social relationships based on shared values such as freedom, justice, equality and mutual respect. That solidarity has, they suggest, been 'crowded out' in the EU's management of the euro crisis; there has been an absence of vision, a failure of leadership, a marginalisation of the people of Europe from the decision-making process and the imposition of heavy burdens on weaker Member States. In the authors' view: 'Unless and until the true meaning of solidarity is rediscovered and reanimated within the political leadership of the EU, there is unlikely to be economic stabilisation and recovery.'

** The other Jesuit centres involved in the initiative are: Ceras-Projet, Paris (http://www.ceras-projet.org); Centre Avec, Brussels (http://www.centreavec.be); Aggiornamenti Sociali, Milan (http://www.aggiornamentisociali.it); Jesuit European Social Centre, Brussels (http://www.jesc.net); Cristianisme i Justícia, Barcelona (http://www.cristianismeijusticia.net).*

European Monetary Union in Historical Perspective

Kevin H. O'Rourke

Introduction

Economic historians are well used to writing essays on historical parallels with current economic problems, and drawing lessons from the past. In the case of European Monetary Union (EMU), however, there are no historical precedents. To be sure, we have examples of currency unions that have broken up, but these unions typically existed in the context of multinational empires, such as the Soviet Union. When the empires collapsed, so did the currency unions, and it is not surprising that they did so in circumstances of conflict and economic chaos. To ascribe these conditions to the collapse of the currency unions involved, rather than to the breakup of the empires themselves, as some banking analysts have recently done, is clearly unconvincing.[1]

The nineteenth century Scandinavian Monetary Union, and Latin Monetary Union, were 'currency unions', or 'monetary unions' which, like EMU, involved independent countries. However, both were in reality little more than fixed exchange rate arrangements between countries, linking the value of their currencies to gold or silver. These arrangements did not involve a common, multinational central bank like the European Central Bank. And while the US Federal Reserve does operate in a union of states, that union also has a federal government with a federal tax policy.

European Monetary Union, then, was a completely unprecedented economic experiment.

Nonetheless, economic history has a lot to tell us about both the economics and the politics underlying this experiment. To anticipate the argument: the design of European Monetary Union very much reflects German concerns, as is well known, but EMU is also a creature of the 1980s, reflecting the intellectual fashions and policy preoccupations of that decade. Those fashions and preoccupations were at odds with the post-war political traditions of Western European democracies, which had informed the move towards European integration in the 1950s. They were also at odds with the economic lessons of the 1930s, which had been largely forgotten a half-century later, but which are frighteningly relevant today. Europe needs to relearn those lessons, and re-engage with its social democratic past, if it is to survive this crisis unscathed.

In the Beginning: The Origins of the European Union

On 9 August 1941, the *Prince of Wales* sailed into Placentia Bay on the coast of Newfoundland, after a risky journey from Scapa Flow. It was bringing Winston Churchill to a meeting with Franklin D. Roosevelt, a meeting which culminated in the agreement of the Atlantic Charter. This was an eight-point statement outlining the principles that the British, and later the Americans, were fighting for. Most of the points were a familiar restatement of Wilsonian internationalism – a rejection of military aggression, the principle of self-determination, a commitment to international trade. The fifth point, however, was different. It stated that the two leaders desired 'to bring about the fullest collaboration between all nations in the economic field with the object of securing, for all, improved labor standards, economic advancement, and social security'.

Whatever else may be said of Winston Churchill, he was not one of history's instinctive social democrats. What was he doing including a reference to improved labour standards and social security, in what amounted to a statement of British war aims?

To someone who had lived through the 1930s, this would not have seemed at all strange. The 1920s had seen a gradual reconstruction of the international economy and, with it, signs that Germany was being successfully reintegrated into the international community: the signing of the Locarno Treaties in 1925, Germany's admission to the League of Nations in 1926, the agreement of the Young Plan in August 1929. Moderates had reasons to be optimistic. The Nazis obtained just 2.6 per cent of the vote in 1928.

Then, in late 1929, the Great Depression hit and everything fell apart. Thanks to Brüning's deflationary economic policies, which emphasised austerity, Germany's national income fell by more than a quarter, and official unemployment rose to almost a third of the labour force. Optimism was replaced by a profound sense of insecurity. Inevitably, the extremist parties benefitted. In 1930, the Nazis increased their share of the vote to 18.3 per cent; in July 1932, they scored 37.8 per cent. By this stage, Brüning was gone, his successor had adopted some modestly stimulative policies, and there were signs of a partial recovery. Not coincidentally, in November 1932 the Nazi share dipped to 33.1 per cent; but by then it was too late, and the Weimar Republic was doomed.

The lesson was clear: states needed to provide their citizens with the security which the gold standard and the market system, left to their own devices, had so conspicuously failed to do. The alternative was nationalism in all its guises: economic nationalism at best, but potentially something much uglier and far more dangerous.

> *... the election of a Labour goverment [in 1945] symbolised the desire of ordinary Europeans, who had suffered so greatly during the war, to see their lives improve in its wake.*

And so the democracies of the post-war period became social democracies – although British voters in 1945 judged that Churchill was not the man best suited to bringing this about. His defeat, and the election of a Labour government, symbolised the desire of ordinary Europeans, who had suffered so greatly during the war, to see their lives improve in its wake. Given the experience of the Great Depression, they were hardly going to be willing to leave it to the market: 'embedded liberalism' in which the market was 'embedded' within a broader social and political context, and made to serve wider social aims, was a logical consequence.[2]

According to Alan Milward, the three crucial constituencies which post-war governments had to placate were: agricultural voters, whose disillusionment had led them to support extremist parties during the interwar period in many countries; workers; and those dependent on the welfare state.[3] The solution was to provide workers with rising wages and full employment, to ensure rising living standards for the agricultural sector, and to establish modern welfare states.

Accomplishing all three goals required an extension of government intervention in the economy. The welfare state reduced economic insecurity, while Keynesian macroeconomic policies helped stabilise economic fluctuations. As regards agriculture, after World War II all European countries experienced severe food shortages, at a time when governments wished to achieve food self-sufficiency for strategic reasons. The result was widespread agricultural intervention across Europe.

Another crucial component of post-war economic strategy in Europe was the dismantling of trade barriers between European countries, and between Europe and North America. This was essential to achieving the economic growth without which governments could not attain their other objectives. But how could this be reconciled with widespread government intervention as described above?

Governments of the time were deeply conscious of the need to reconcile domestic with international policy objectives, and of taking steps to ensure that the achievement of the latter did not undermine the former. For example, in the case of agriculture the answer was to replicate national agricultural policies at the European level, by setting up a Common Agricultural Policy.

Governments also feared that free trade would mean that their industries would be placed at a competitive disadvantage *vis-à-vis* industries in other countries whose social welfare systems were less well developed. It was politically essential that the domestic social welfare systems – which not only underpinned governments' political legitimacy, but their economic growth strategies as well[4]– not be undermined by the development of Europe-wide free trade. As Milward puts it:

The problem genuinely was how to construct a commercial framework which would not endanger the levels of social welfare which had been reached ... The Treaties of Rome had to be also an external buttress to the welfare state.[5]

The Treaty of Rome thus called for the (not yet realised) harmonisation of social policies. The EU has since developed a range of other policies designed to deepen economic integration between members, while allowing governments to collectively retain the regulatory control they deem necessary. European integration has therefore traditionally combined deeper economic ties among Member States with political structures allowing those Member States to retain the control over markets which their voters deem necessary. It has traditionally allowed governments to collectively achieve goals which would have been difficult for them to achieve on their own – in Millward's words, the post-war period saw the 'European rescue of the nation state'.

The Trilemma and EMU

In recent decades, however, Europe has been seen more and more as a constraint on national governments' ability to act, rather than as an enabler. The change came in the 1980s, with the Single European Act and the development of the Single Market. Logically, a single market required a single competition policy, while constraints on national procurement policies and other similar measures were also introduced. Increasingly, politicians were able to argue, or forced to explain to local populations, that particular policies were illegal under EU law, no matter how popular they might be domestically. And, of even greater relevance for today's economic problems, the abolition of capital controls between Member States placed great limitations on their ability to conduct independent monetary policies.

In order to understand the latter point, it is helpful to turn to the famous economic trilemma which generations of economists have taught their students, and which, as Obstfeld and Taylor have shown, is essential in understanding the broad contours of international monetary history over the past century and a half. In their words:

> *... the chosen macroeconomic policy regime can include at most two elements of the 'inconsistent trinity' of three policy goals:*
>
> - *full freedom of cross-border capital movements;*
> - *a fixed exchange rate; and*
> - *an independent monetary policy oriented towards domestic objectives.*[6]

The proof of this proposition is fairly straightforward. If capital is free to flow internationally, then it will search out the highest available returns, which will as a consequence be forced into equality internationally. To investors contemplating investing in different currencies, the returns they can expect will depend not only on interest rates, but on anticipated exchange rate movements. However, if exchange rates are credibly fixed against each other, returns will depend on interest rates alone. In this case, capital mobility will, by equalising the returns on investing in different countries, lead to interest rates being equalised as well. If a smaller country adopts a fixed exchange rate *vis-à-vis* a larger economy, and allows capital to flow freely between them, it will as a consequence be forced to accept whatever interest rates are decided in its partner country. In other words, it will lose the ability to choose interest rates appropriate to its own economic circumstances: if it sets them lower than abroad, capital will flee the country, the central bank's reserves will be depleted, and the country will as a result be forced to exit the fixed exchange rate arrangement.[7]

Confronted with this economic trilemma, governments have made very different choices at different moments in history. Under the classical (pre-1914) gold standard, open capital markets and fixed exchange rates meant that central banks subordinated interest rate policy to the goal of maintaining gold reserves and staying on gold. Faced with a drain, a country would in principle raise interest rates, thus inducing capital to stay, while the resulting deflation (an internal devaluation, we would say today) would restore its competitiveness in the longer run.

This approach to economic policy sat well with the liberal philosophy of the time, but was gradually undermined by the growing rigidity of product and labour markets. Internal devaluations became more difficult to achieve, and since wages were now less easy to cut than before, deflationary policies increasingly led to unemployment (by lowering the price of economic output, relative to the cost of the labour required to produce it).

Not only did the unemployment costs of such policies rise, but the political costs rose as well, since the extension of the franchise means that those most affected by unemployment were now in a position to express their objections at the ballot box. Democracy and the gold standard were, in the end, mutually incompatible.[8] Since markets could observe all this, governments' protestations that they would stick with gold, no matter what the economic and political consequences, gradually came to seem less and less credible.

Matters came to a head after 1928, when the gold standard transmitted higher US interest rates worldwide, turning a national contraction into a global one. Worse, gold standard membership made it impossible for national governments to fight the recession once it had begun. As long as countries stayed on gold, they could not, by definition, engage in expansionary monetary policy, and indeed they were also reluctant to engage in expansionary fiscal policy, since they feared that it would lead to a drain in reserves, by sucking in imports. Worse, governments very often adopted pro-cyclical, 'austerian' fiscal policies – notably in Germany, as we have seen – and in some cases perversely raised interest rates rather than lowering them.[9] The net result was that a severe recession became a depression, with the social and political consequences that we know.

In the long run, these attempts to save the gold standard by destroying the economy came to naught, and countries were forced to abandon gold anyway as the economic situation spiralled out of control. And as they did so, one after the other, their economies started to recover. Those that left gold earliest, like the United Kingdom, recovered earlier than those, such as the French, who stuck to gold right to the bitter end, which came in 1936.

After the interwar disaster, a new regime was instituted at Bretton Woods, which prioritised domestic monetary policy autonomy and fixed exchange rates. The result, in accordance with the logic of the trilemma, was capital controls, which persisted for many years, but were eventually undermined by the markets. In 1973, fixed exchange rates were thus abandoned, and the world entered the era of capital mobility and floating rates which persists to this day.

While capital mobility has proved troublesome on many occasions – especially when market participants have persuaded themselves that they did not need to concern themselves with exchange rate risk – there is no doubt that the floating rate environment was one reason that the policy response to the crisis of 2008–9 was so much more successful than the policy response of 1929–32.[10] Nor is it a coincidence that the current global economic black spot is the euro zone, which of course embodies the polar opposite of floating exchange rates.

Within Europe, the move to floating in the 1970s was seen as a serious challenge because of the threat it was feared sharp exchange rate movements might pose to the Common (and later Single) Market, and for technical reasons having to do, for example, with green exchange rates. Attempts to limit exchange rate fluctuations soon got underway, culminating in the creation of the European Monetary System in 1979. Initially, the system functioned fairly well, due to residual capital controls, and frequent exchange rate realignments. However, after 1987 the system became far more rigid, while capital controls were abolished as a result of the Single Market programme. Countries were thus, in accordance with the trilemma, increasingly obliged to follow German interest policy, which became more restrictive in the wake of unification.

In retrospect, the collapse of 1992–93 can be seen as inevitable, since (as George Soros correctly foresaw) there was a limit to the extent to which national governments were prepared to subordinate national monetary policy to the requirements of a fixed exchange rate regime, or tolerate higher interest rates and growing unemployment in order to stay pegged to the Deutsche mark.

The Single Market, and capital mobility, thus posed a problem for European governments: it made it much more difficult for them to credibly adopt a fixed exchange rate system. A radical solution to this problem was to abolish national exchange rates altogether: EMU can thus be seen as a logical technical response to free capital mobility. Unfortunately, the institutional design of EMU left a lot to be desired. The European Central Bank – uniquely among the major central banks of the world – is supposed to focus on limiting inflation, to the exclusion of all other goals, such as limiting unemployment. This in part reflects the German preoccupation with inflation, which is odd, since as we have seen Hitler came to power as a result of austerity, deflation and depression, not as a result of the much earlier hyperinflation.

It also reflects the policy preoccupations of the 1980s, a decade when governments and central banks were largely concerned with squeezing the last remnants of the 1970s inflation out of the system. Intellectually, the decade saw the widespread acceptance of the principle that rigid rules were to be preferred to macroeconomic policy-making discretion, since in the long run, it was claimed, activist policy did nothing to lower unemployment, and only served to make inflation worse. And politically, of course, this was the decade that saw the post-war social democratic consensus shatter under the onslaught of the radical pro-market views of Ronald Reagan and Margaret Thatcher, who sought to 'disembed' liberalism, and the market, from the social and political constraints of earlier decades. The result was that the most conservative major central bank in the world was grafted on to the old social democracies of Western Europe. The political consequences of that decision are there for all to see today.

Saltwater economists never abandoned the view that in certain circumstances – not always! – labour markets could fail to clear as a result of a lack of aggregate demand, and that as a consequence Keynesian countercyclical policies might be needed from time to time. Furthermore, since the business cycle might vary across European countries, some countries might need monetary policies which dampened demand at the same time as others needed expansionary policies. One monetary policy, therefore, might not suit all countries simultaneously. This was one reason for Keynesians to oppose EMU, on purely technical grounds, while the hard-line monetarist design of the ECB was another. Such a stance did not, however, come easily to many, since on political grounds they were anything but Eurosceptic.

The Current Crisis

I have argued that on balance floating exchange rates have been good for the world since the breakdown of the Bretton Woods regime in the 1970s. The other component of today's global financial system, international capital mobility, has been far more problematic, however. Of particular concern has been the way in which there have been periodic bouts of excessive lending to rapidly growing economies, fuelled largely by the assumption that the lending was riskless, and channelled through the books of banks and other financial intermediaries. The result has been property bubbles, wage and cost inflation, the loss of competitiveness, and eventual crises associated with the rediscovery of risk, the reversal of capital flows, the pricking of bubbles, and the insolvency of the banks through which these capital flows had been channelled.

Such was the story of Thailand during the Asian financial crisis of 1997, for example, and the symptoms I have described will be familiar to an Irish audience as well. It is Ireland's great misfortune, however, that unlike Thailand it does not have its own currency to devalue in order to regain competitiveness. By a process of elimination, the only available policy to restore competitiveness – as long as EMU membership is unquestioned, and no matter how objectively lousy the policy may be – is the 'internal devaluation' strategy that successive Irish governments have been pursuing since 2008, after a fashion.[11] But for such a strategy to have any chance of working, everything else has to go right. In particular, foreign economies have to remain buoyant, since export markets become vital when domestic ones are being squeezed. The generalised rush towards European austerity in 2010, egged on by conservatives who saw this as the great opportunity to shrink the state, and by Irish politicians who liked to be seen as poster boys for the new orthodoxy, was therefore an unmitigated disaster for Ireland. And in order for such a strategy to work, debt burdens also need to be reduced, which is one reason among many why saddling Irish taxpayers with the debts of defunct banks was so unconscionable.[12]

The drive towards generalised austerity is bad not only for Ireland, but for the entire euro zone economy.

The drive towards generalised austerity is bad not only for Ireland, but for the entire euro zone economy. That it is economically harmful is obvious, but the political costs could be even higher in the long run. If this drive were to become constitutionalised, via the proposed fiscal austerity pact, it would do untold damage to the European project. As French voters pointed out in 2005, when they rejected the European constitutional treaty, it is inappropriate for constitutions or treaties to rule out policies which are properly the subject of normal domestic political debate in modern democracies. Doing so will in the long run only serve to heighten disaffection with the European project, which for all its many flaws has been the great political success story of post-1945 Europe.

We are slowly and painfully relearning the economic lessons of the 1930s: it is difficult to lower nominal wages across the board in a modern economy, and being able to devalue your currency is thus an economic policy tool whose loss is extremely costly. Contractionary fiscal policy is indeed contractionary, especially when exchange rates are fixed, and even more so when everyone is doing the same thing simultaneously. Central banks have to care about much more than inflation. And so on.

But we also need to remember the political lessons of the 1930s. A colleague of mine recently opined that only an economist would be stupid enough to think that having foreigners impose austerity and 'internal devaluations' on the euro zone's southern periphery would work. I know what he meant but, in fairness, saltwater economists, like Keynes himself, have always had an instinctive understanding that you need to take the predictable political consequences of your actions into account when designing economic policies. This is why, aside altogether from any moral considerations, fairness and democratic legitimacy are so important. It is why the social democrats of the post-war period advocated not only regulation (in particular of the financial sector), and reflation (when necessary), but redistribution as well. These 3 Rs are as relevant today as they were in the 1950s, and if Europe is to survive and prosper politically it has to rediscover them.

Are there any signs of hope on the horizon? Paradoxically, the fact that current economic policies are so clearly failing may be Europe's best hope of salvaging something from this mess. The French Socialists have said that they will renegotiate the fiscal austerity pact, should they be elected to the Presidency in 2012. Mario Monti, appointed Italian Prime Minister in November 2011, may become the spokesman that the periphery needs: Italy is a large country which will probably not accept the 1930s-style contractions in income which have been experienced in smaller countries such as Ireland or Latvia.

It is crucial that the centre and centre-left seize the initiative now, and show voters that their opinions matter, that their votes can fundamentally change the direction of policy, and that we are not going to ditch the European social model in the name of European Monetary Union. Otherwise Europe's many extremist political parties will make hay. As Tony Judt put it: 'Why have we been in such a hurry to tear down the dikes laboriously set in place by our predecessors? Are we so sure that there are no floods to come?'.[13]

Notes

1. '… almost no modern fiat currency unions have broken up without some form of authoritarian or military government, or civil war'. UBS Investment Research, 'Euro break-up: the consequences', *Global Economic Perspectives*, 6 September 2011.
2. John G. Ruggie, 'International Regimes, Transactions, and Change: Embedded Liberalism in the Postwar Economic Order', *International Organization*, Vol. 36, Issue 2, March 1982, pp. 379–415.
3. Alan S. Milward, *The European Rescue of the Nation-State* (second edition), London: Routledge, 2000.
4. Barry Eichengreen, *The European Economy since 1945: Coordinated Capitalism and Beyond*, Princeton NJ: Princeton University Press, 2007.
5. Alan S. Milward, *op. cit*., p. 216.
6. Maurice Obstfeld and Alan M. Taylor, *Global Capital Markets: Integration, Crisis, and Growth*, Cambridge: Cambridge University Press, 2004, p. 30.
7. A fixed exchange rate implies a commitment by the central bank to buy and sell foreign currencies at a fixed price, which in turn implies that it needs adequate reserves of foreign exchange so that it can sell these if the demand arises.
8. Barry Eichengreen, *Golden Fetters: The Gold Standard and the Great Depression 1919–1939*, Oxford: Oxford University Press,1992.
9. The phrase 'austerian' has come into vogue since 2010. It is a play on words, since economists who self-identify as 'Austrian' tend to support the pro-austerity policies which swept across Europe in that year. See http://www.ritholtz.com/blog/2010/06/word-origins-austerians/
10. Barry Eichengreen and Kevin H. O'Rourke, *A Tale of Two Depressions*, 2009 (http://www.voxeu.org/index.php?q=node/3421); Miguel Almunia, Agustín S. Bénétrix, Barry Eichengreen, Kevin H. O'Rourke and Gisela Rua, 'From Great Depression to Great Credit Crisis: Similarities, Differences, and Lessons', *Economic Policy*, Vol. 25, Issue 62, April 2010, pp. 219–65.
11. In principle, Ireland's social partnership institutions might have been deployed in 2009 to ensure that wages and costs were reduced across the board in as fair and comprehensive a manner as possible. Instead, that year saw the emergence of a divisive and distracting split between the public and private sectors, fuelled by the right-wing media. Ireland thus offers the latest proof of Milton Friedman's skepticism regarding the ability of modern societies to successfully 'internally devalue' to the extent that would be required to maintain full employment. It is important to note that Friedman, just like mainstream Keynesians, felt that being able to really devalue was important at times for an economy's health. Ireland's unemployment rate suggests that he was right.
12. http://www.irisheconomy.ie/index.php/2010/12/01/barry-eichengreen-on-the-irish-bailout/
13. Tony Judt, *Ill Fares the Land*, London: Penguin, 2010, p. 224.

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Where Do We Want the Euro to be in 2020 and How Do We Get There?

Tom McDonnell

Great Expectations

European Monetary Union (EMU) was supposed to be a harbinger of growth and stability for its member states, yet the euro zone debt crisis is now in its fourth year and continues to rumble on, in a seemingly endless cycle of crises, summits and false dawns. The currency union creaks under the deficiencies of the euro zone's fundamentally flawed design, while its survival and capacity to prosper depend on its ability to fix these design flaws. The stakes are high.

The new single currency was introduced with great pomp in electronic form in 1999, and then in physical form in 2002. This project is arguably the most ambitious experiment in monetary union ever undertaken, and was the latest step in the post-war process of European integration. A group of sovereign European states chose to combine their national currencies and transfer control over monetary policy to an independent institution, the European Central Bank (ECB). The group included some of the largest and most powerful economies in the world. The euro instantly became the second most important currency on the planet, and the euro zone expanded from its original eleven countries to its current membership of seventeen.

According to its proponents, EMU is an indispensable step in the long, slow journey towards integrating the European Union economies. The euro was expected to become a global reserve currency which would rival the US dollar and deliver all the privileges that result from that status. The single currency was also expected to become a stabilising anchor for its member economies, providing a degree of protection against the instability of large exchange rate fluctuations, and embedding lower inflation and interest rates.

However, the sheer persistence, severity and systemic nature of the twin sovereign and banking debt crises have cast grave doubt on the inherent stability and coherence of EMU. Although a misguided and incompetent political response has certainly not helped, it is nevertheless clear that the architecture of EMU, as currently constructed, and its internal inconsistencies have gravely exacerbated the crisis. Many of these architectural flaws can be remedied, and ultimately the success or failure of EMU will come down to political capacity and will. The euro entered its teens on 1 January 2012 and now is the time for reflection. Where do we want the euro to be in 2020 and how can we get it there?

This Time is Different

While there have been a number of successful monetary unions, the history books are full of examples of failed experiments. Experience suggests that having some pre-existing form of centralised political union greatly improves the chances of a monetary union succeeding. Classic examples of resilient monetary unions include the USA, the UK and even the former USSR. Yet the normal fate for currency unions is eventual failure and dissolution. Most such unions around the world are now just historical footnotes.

In Europe, there was a Latin Monetary Union (LMU) based on the French franc, and centred on France, Belgium, Switzerland and Italy, which lasted for most of the late nineteenth century. While the LMU had no single currency, the four main countries all minted their own gold and silver coins that were then considered legal tender in all of the other countries. The union was officially dissolved in 1926, but in practice had failed long before then. The Scandinavian Monetary Union (SMU) between Sweden, Denmark and Norway was a similar venture set up in the 1870s.

Both the LMU and the SMU broke apart because there was no central institution to enforce a common monetary policy and because of divergent fiscal policies. France also attempted to set up a 'universal currency' in 1867. The universal currency was intended to be centred on the minting of universal gold crowns of equivalent value. However, France was unable to convince the UK or the USA to take part in the scheme.

The Gold Standard

Perhaps the most famous example of a *de facto* currency union was the gold standard. The gold standard developed internationally from 1870 onwards and was a system of fixed exchange rates based on convertibility to gold at set prices. The system temporarily broke apart under the pressures of World War I, and then came under severe pressure again following the stock market crash in 1929. The gold standard finally unravelled in the early 1930s, as virtually all countries abandoned gold convertibility. The turbulent 1930s were characterised by floating currencies and by a long sequence of competitive beggar-thy-neighbour devaluations. These race-to-the-bottom policies were blamed for disrupting trade, increasing instability and prolonging the Great Depression.

In a bid to prevent this happening again, there was a movement by the victorious powers of World War II to establish an international monetary system based on the convertibility of certain national currencies into United States dollars. The outlines of this system were agreed in July 1944 at Bretton Woods. The US dollar was itself backed by convertibility into gold, and this effectively meant all participating currencies were indirectly pegged to gold and therefore to each other. A key purpose of the system was to provide the stability needed for post-war economic recovery, although countries could still devalue their currencies under certain conditions.

The Bretton Woods system began to fray in the late 1960s, as the United States became increasingly unable and unwilling to sustain the dollar exchange rate with gold. Dollar convertibility into gold was eventually terminated by the United States in 1971, and the major European economies broke their links with the US dollar over the course of the following two years. The Bretton Woods era was characterised by sustained economic recovery, low unemployment and strong growth in real economic output. As a result, the Bretton Woods system of pegged currencies became associated with macroeconomic strength in the minds of European policymakers.

Stabilising Exchange Rates in the EEC
The years that followed the collapse of the Bretton Woods system were characterised by the shock of the oil crises and by prolonged stagflation.[1] The currency instability of the 1970s prompted a series of attempts to stabilise exchange rates in the European Economic Community (EEC).

The first such attempt was the 'Snake in the Tunnel' system which aimed to peg all of the EEC currencies to one another within narrow bands. By the mid 1970s, the Snake had been reduced to a rump zone based around the Deutsche Mark. A renewed attempt at monetary coordination was made in 1979 with the launch of the European Monetary System (EMS). The EMS was based on a system of narrowly fluctuating exchange rates known as the Exchange Rate Mechanism (ERM), which in turn was centred on an artificial currency called the European Currency Unit (ECU).[2] The Deutsche Mark quickly became the anchor currency of the EMS.

European Central Bank, Frankfurt *© Istock Photo*

The system was characterised by devaluations by many of its member states in its first decade and it began to buckle following the shock of German reunification in the early 1990s. Germany's post-reunification expansionary fiscal policy to support the rebuilding of the former East Germany, combined with ultra-tight monetary policy, forced other countries to keep interest rates at extremely high levels to support their currencies and prevent capital outflow to Germany. A number of European currencies increasingly came under speculative attack, and sterling's membership of the ERM was spectacularly suspended on 'Black Wednesday', 16 September 1992. Italy then withdrew on the following day.

As with previous failed attempts to fix exchange rates, the system had been undermined by conflicting policy goals in the different countries and by the inability of member countries to harmonise their monetary and fiscal policies with each other. The ERM was effectively dismantled in 1993 when the fluctuation band for national currencies was extended to 15 per cent. The major European currencies subsequently floated against each other within these bands between 1993 and 1998.[3]

Towards EMU
Despite these setbacks, the process of integration continued apace in the 1990s under a group of

policies aimed at a European Monetary Union (EMU).[4] These policies were designed to establish convergence between the various European Union economies in areas such as rates of inflation and control of the public finances so as to create the conditions for a viable currency union. The push for currency union was motivated by the belief that unpredictable exchange rate fluctuations were incompatible with a fully open and competitive internal market. Yet one of the main lessons from the experience with ERM was that systems of fixed exchange rates tend to buckle under the strain of divergences in domestic policies and objectives. A single currency and single monetary policy under the control of an independent central institution was therefore pursued in preference to yet another system of fixed exchange rates.

Eleven European Union Member States were deemed eligible to join the single currency in 1998 when their national currencies were made convertible to the euro at established rates. The euro was officially launched the next year, with monetary policy and enforcement falling under the authority of the independent European Central Bank (ECB). The desirability of the euro was hotly contested in academic and policy circles. In particular, there was considerable debate about whether the euro zone economy was an 'Optimum Currency Area'. Robert Mundell defines an Optimal Currency Area as a region for which the benefits of adopting a single currency or a fixed exchange rate system outweigh the costs of relinquishing the exchange rate as an instrument of internal adjustment within the region itself.[5] It is still unclear whether the euro zone will prove durable in its current form or is destined to go the way of earlier failed attempts at monetary union.[6]

An Asymmetric Union

The current crisis has exposed existing limitations and design flaws in the euro zone. Of particular importance is the absence of a central institution or mechanism capable of softening what are known as 'asymmetric shocks'. Asymmetric shocks occur when one or more economies within a currency union are disproportionately impacted by an economic shock.

Consider an asymmetric shock for Ireland. A sharp appreciation of the euro against sterling will reduce Ireland's exports disproportionately more than it will reduce the exports of other euro zone economies. This is because the United Kingdom is a proportionately more important trading partner for Ireland than it is for the euro zone as a whole. A country or region-specific banking crisis is perhaps the classic example of an adverse asymmetric shock.[7] Members of a monetary union afflicted by adverse asymmetric shocks can become plagued by destabilising and prolonged collapses in demand and persistently high unemployment.

The euro zone does not have mechanisms in place to soften asymmetric shocks. On the other hand, consider what happens when an asymmetric shock such as a hurricane or a region-specific recession hits a monetary union such as the United States or the United Kingdom. The effects of these localised shocks are automatically softened by transfer payments from the central government because a monetary union such as the United States is constructed on a federal political system with federal taxes. In the aftermath of the asymmetric shock, the depressed economy pays less in taxes and receives more in transfer payments from the central government. These 'automatic stabilisers' help the affected economies to recover.

The current crisis has exposed existing limitations and design flaws in the euro zone.

Unfortunately, this is not how it works in the euro zone because there are no euro zone taxes and therefore no reserve fund to access if a member state is hit by an adverse shock. Rather, the reduced levels of tax receipts and increased levels of spending on social protection put pressure on the member state's public finances. Unless they have built up large reserve funds, euro zone members can only adjust to these shocks through painful and prolonged austerity and through internal devaluations with all the brutal social consequences that these entail.

Multiple Equilibria and Negative Feedback Loops

When the euro zone countries gave control over their currencies to the ECB Governing Council, they unwittingly exposed themselves to the risk of a negative feedback loop of spiralling interest rates and eventual insolvency. As the crisis erupted, the weaker member states found the risk status of their government bonds reduced to that of emerging economies.[8] Paul De Grauwe and Yuemei Ji show that markets systematically misprice sovereign risk in a herd-like fashion that produces what are known as 'multiple equilibria'.[9] In another study, De Grauwe argues: '... in a monetary union, countries become vulnerable to self-fulfilling movements of distrust that set in motion a devilish interaction between liquidity and solvency crises'.[10]

The multiple equilibria problem arises because individual euro zone member states lack the ability to finance their debts by issuing currency, and lack control over a central bank they can lean on to flush the domestic banking sector with liquidity and thus ease pressure on sovereign bond prices.

Crucially, the member states do not have a lender of last resort for their sovereign borrowings. Unlike countries in control of their own currency, it is possible for euro zone member states to run out of money and become unable to pay their creditors. Following an adverse economic shock the weaker countries can come under recurrent speculative pressures from the markets. Such speculative pressure becomes self-fulfilling as the member state's debt servicing obligations become increasingly unmanageable. Once the negative feedback loop is seen to have taken hold, the markets become even less willing to lend and the sovereign debt dynamics become increasingly untenable. The country is now trapped in a bad equilibrium.

At some point, the country's cost of borrowing may become so unmanageable that it finds itself unable to access the international markets at a sustainable price. At this stage, the country becomes dependent on international bailout mechanisms. Greece, Ireland and Portugal have already succumbed while Spain and Italy have come under pressure.

The vulnerability of the European banking system interacts toxically with the multiple equilibria phenomenon because the banking system's ability to lend to sovereigns is impaired and this reduces the demand for sovereign bonds. Spain and Italy are currently being supported indirectly by the ECB's desperate injection of €1 trillion in cheap money to the financial sector.[11]

The most straightforward solution to the multiple equilibria problem is to mandate the ECB to operate as a lender of last resort to sovereign borrowers at a sustainable interest rate. However, the ECB is expressly forbidden under European Union law to perform this function for sovereign borrowers. Changing the mandate of the ECB requires treaty change.

Writers coming from a range of viewpoints have proposed eurobonds of one form or another as a solution to the multiple equilibria problem.[12] Eurobonds are similar to sovereign bonds but are issued jointly by the seventeen euro zone countries. The money would be lent to the euro zone countries as a whole through a central intermediary, and then forwarded on to the member governments. Treaty change may be required before eurobonds can be introduced, as Article 125 of the Lisbon Treaty states that EU Member States are not liable for the obligations of other members.

Daniel Gros and Thomas Mayer have pointed out that although the ECB is barred from lending directly to euro zone member states it is already acting as lender of last resort to private credit institutions.[13] They suggest that a viable solution to the sovereign debt crisis would be to award the euro zone's permanent bailout fund, the European Stability Mechanism (ESM), a banking licence. Once registered as a private credit institution, the fund would be able to engage in large-scale purchases of government bonds, using its substantial existing resources, and then could use these bonds as collateral to secure its own funding from the ECB.

This credit institution would effectively function as the lender of last resort for sovereign borrowers. Moral hazard concerns could be accommodated by offering different interest rates to different countries, depending on the member state's own actions and its particular context. The credit institution would announce the interest rate it is demanding in advance of the bond auctions, and this would create a ceiling on sovereign bond prices. This solution would not diminish the reality that Greece and perhaps other member states require substantial debt write-downs. However, it would at least prevent countries falling into bad equilibriums in the future, thereby enhancing euro zone stability.

Optimal Currency Areas and Central Regulation

To qualify as an Optimum Currency Area (OCA), a currency union should ideally have labour and capital mobility across the region as well as a risk-sharing system involving automatic fiscal transfers. It is also important that member states have similar business cycles.

The ECB Governing Council sets the interest rate to suit the euro zone as a whole. However, the overall needs of the euro zone as a whole are not necessarily consistent with the needs of individual members, as the different economies are likely to be experiencing very different inflation and growth rates. Unfortunately, the current euro zone architecture lacks the policy instruments to accommodate its seventeen member states' divergent places in the economic cycle.

The single interest rate actually spawns asymmetric shocks by overheating economies in the good times and exacerbating recessions in the bad times. The property booms in Spain and Ireland were straightforward asset price bubbles, caused in part by an interest rate set by the ECB to suit the needs of the euro area as a whole – but a rate that was far too low for the needs of already booming economies. The result was a negative real interest rate which spurred excessive levels of private lending and private borrowing and triggered debt-fuelled booms.

This boom inflated housing prices far beyond their underlying values. In the Irish case, poor regulation, pro-cyclical fiscal policies and a range of property-related tax breaks also contributed to the boom and bust. When these prices collapsed in the wake of the 2008 financial crisis, the real economy and banking sector in both Spain and Ireland were saddled with massive levels of debt which will drag on those economies for years to come.

The one-size-fits-all interest rate generated a misallocation of resources that amplified the boom and bust cycle within individual economies. There was also a big build-up of debt in Greece, France, Italy and other countries prior to 2008. It is important to stress that the build-up of debts prior to 2008 in most euro zone countries – Greece being a spectacular exception – was primarily a private sector phenomenon. Government borrowing only ballooned after 2008 and that was in response to the recession. It was the financial sector and private borrowing which got out of control.

Despite the drawbacks of the single interest rate, it simply is not feasible to have separate interest rates for each economy in the euro zone. So what can be done? There is a clear need to monitor a wider set of indicators than just the inflation rate. The so-called 'six-pack' rules for economic governance are intended to fulfil this role for governments.[14] However, it is also crucial for the success of a monetary union that supervision and regulation of the banking sector be conducted at the central level, including an early warning system to identify developing imbalances and advise individual member states well before things get out of hand. Centralised banking regulation and centralised bank resolution mechanisms are essential prerequisites for the long-term success of the currency union.

... the build-up of debts prior to 2008 in most euro zone countries ... was primarily a private sector phenomenon.

Crisis Response

The official response has been to treat the euro zone debt crisis as a problem of fiscal discipline in member states. New fiscal oversight and supervisory mechanisms have been put in place and bailout mechanisms created to fund loan facilities for the countries shut out of the international markets. Access to these loan facilities has been made conditional on austerity policies being adopted by the affected member states. The result is internal devaluation and austerity in the periphery without countervailing fiscal expansion in the core countries. These policies naturally deepen the recession in the weaker countries.

The euro zone is also likely to continue to suffer from major and chronic imbalances in external payments due to the competitive weakness of some countries particularly those in the periphery. These imbalances are a continuing threat to the political stability of the monetary union. Countries can no longer resort to exchange rate devaluation to restore competitiveness and if surplus countries do not increase their own domestic demand, those with large current account deficits, such as Portugal, face a long and difficult process involving fiscal consolidation, reduced domestic demand and falling wages.[15]

The Euro Zone in 2020

It is clear there are immense political and socio-economic difficulties involved in maintaining stable exchange rates even among countries that are close trading partners and have well-developed financial markets. Changes in competitiveness are reflected in current account imbalances over time that would ordinarily be punctured through currency devaluation under a floating currency regime. In a currency union without fiscal union, the less competitive economies must instead suffer higher unemployment and lower growth as the economy rebalances. This can be a prolonged and painful process.

The weight of history and the experience of the crisis suggest that some degree of fiscal federalism is probably a necessary component of an effective and sustainable monetary union. This does not mean the euro zone has to become a full fiscal union, nor does it mean that each member state must have identical tax systems or levels of public spending. Full fiscal union is undesirable given the substantial democratic deficit that exists at the euro zone level.

Nevertheless, an intra-regional insurance system involving counter-cyclical transfers is crucial to the smoothing out of asymmetric shocks and also to ensuring the political sustainability of the euro zone in the long-run. This insurance system should be run by a dedicated institution and could be funded directly from a hypothecated tax such as a portion of member states' VAT receipts. The insurance system could be required to run a small surplus over the medium-term with its resources drawn down by regional economies based upon strict protocols, and ring-fenced for competitiveness-enhancing projects. It would effectively function as an automatic stabiliser and would ameliorate the severity of recessions.

The euro zone's lack of a lender of last resort is another missing piece of critical institutional architecture, and this design flaw downgrades weaker member states to the status of emerging economies. Giving the ESM a banking licence and a mandate to purchase sovereign bonds is a viable solution to this problem. The moral hazard issue can be managed by automatically differentiating the interest rates that the ESM offers to sovereigns – for example, by offering better rates to a member state that adheres to the six-pack rules.

If a European institution with sizable fiscal resources is created, then the quid pro quo must be better oversight and enforcement of budgetary discipline at the euro zone level. The 2008 financial crisis illustrated the vulnerabilities caused by decentralised financial regulation and oversight. The ECB's mandate should be expanded to target more than just inflation, and the ECB should be given responsibility for regulation of all euro zone credit institutions. It is clear that a common framework for regulating the financial system is required, including a common bank resolution framework.

Europe now has a choice. The euro zone can be made to work if it is properly designed. However, we must be conscious always of issues regarding democracy and social justice. The currency union has taken a disturbing turn since the crisis began, with more powerful member states appearing to run roughshod over the concerns of smaller members. Private debt has been socialised, entailing a massive transfer of wealth from ordinary people to the financial sector, while most of the democratically elected governments have been revealed to hold less power than the ECB Governing Council.

While the new six-pack rules monitor a wide range of economic indicators, it is notable that this list of indicators does not include poverty rates or income distribution or indeed any other social indicators except unemployment. This needs to change. The euro zone of 2020 should be a union that puts social justice centre-stage. While we can solve the design flaws, we also need to make sure that the European machine serves society and not the other way around.

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Notes

1. Stagflation refers to a period of stagnant economic growth coupled with high inflation.
2. The ECU was calculated based on a basket of European currencies and each national currency had a central rate against the ECU around which the national currency could narrowly fluctuate.
3. The Irish punt was devalued by 10 per cent in 1993 which greatly improved Ireland's competitiveness. The following half decade – between 1993 and 1998 – was the first time the Irish currency had ever floated. This period coincided with the fastest rates of economic growth in Ireland's history and with the emergence of the 'Celtic Tiger'.
4. The Treaty of Maastricht entered into force on 1 November 1993. Maastricht established the completion of the EMU as a formal objective for the European Union.
5. Robert A. Mundell, 'A Theory of Optimum Currency Area', *The American Economic Review*, Vol. 51, No. 4, September 1961, pp. 657–65. For a review of the relevant literature, see Luca Antonio Ricci, 'A Model of an Optimum Currency Area', *Economics: The Open-Access, Open-Assessment E-Journal*, Vol. 2, 2008-8, 14 March 2008.
6. Two of the most enduring international currency unions are the West African and Central African CFA franc unions. These currency unions have existed since 1945 and were

pegged to the French franc until 1999 and thereafter to the euro. The West African CFA has eight member states while the Central African CFA has six member states.

7. The Irish banking crisis is estimated to have cost the Irish State over 40 per cent of its annual GDP. This was far in excess of the scale of the banking crisis in any of the other euro zone countries and is a good example of an asymmetric shock.
8. Reinhart and Rogoff argue that an 80 to 90 per cent debt to GDP ratio is the danger zone for emerging economies (see Carmen M. Reinhart and Kenneth S. Rogoff, *This Time is Different: Eight Centuries of Financial Folly*, Princton NJ: Princeton University Press, 2009).
9. Paul De Grauwe and Yuemei Ji, *Mispricing of Sovereign Risk and Multiple Equilibria in the Eurozone*, Brussels: Centre for European Policy Studies, January 2012 (CEPS Working Document, No. 361).
10. Paul De Grauwe, *The Governance of a Fragile Eurozone*, Brussels: Centre for European Policy Studies, May 2011 (CEPS Working Document, No. 346).
11. The ECB provided banks across Europe access to €1 trillion in three-year loans at low rates through its Longer-Term Refinancing Operations.
12. Although the catch-all term 'eurobonds' is often suggested as a solution to the crisis there are, in fact, a wide variety of ways in which eurobonds could be implemented. See, for example, the blue bond proposal of Delpla and Weizäcker (Jacques Delpla and Jakob von Weizäcker, 'The Blue Bond Proposal', *Breugel Policy Brief*, Issue 2010/03, May 2010); the E-bond proposal of Juncker and Tremonti (Jean-Claude Juncker and Giulio Tremonti, 'E-Bonds Would End the Crisis', *Financial Times*, 5 December 2010) and the ECB bond proposal by Varoufakis and Holland (Yanis Varoufakis and Stuart Holland, *A Modest Proposal for Overcoming the Euro Crisis*, Levy Economics Institute of Bard College, Policy Note, 2011/3, 2011).
13. Daniel Gros and Thomas Mayer, *Refinancing the EFSF via the ECB*, Brussels: Centre for European Policy Studies, 18 August 2011 (CEPS Commentaries).
14. The 'six pack' refers to a set of five new Regulations and one new Directive which came into force in December 2011. These new measures aim to strengthen economic governance within the EU by increasing not only fiscal surveillance (aimed at preventing and responding to excessive debts and deficits) but macroeconomic surveillance of Member States.
15. There has been a tendency since the crisis began to conflate fiscal consolidation with economic recovery. For a wider discussion on the need for a Marshall Plan for Europe, see Tom McDonnell, *The Debt and Banking Crisis: Progressive Approaches for Europe and Ireland*, Dublin: TASC, 2011 (TASC Discussion Paper).

The Social Impact of the Economic Crisis in Europe

Robin Hanan

Introduction

What is happening in Greece is dramatic; the IMF/EU plan for saving the country is destroying the country; the Greek people are more aware than a year ago that the remedy is killing the patient. It is destroying any kind of solidarity at European level. It can happen to Portugal, Spain, France, Italy and Belgium. The question is not about our public sector or our corrupt government or about the Greeks that are lazy … The question [is] is the IMF changing the actual character of our European social model [?] ... there is impoverishment of our middle class, a return to the countryside, and emigration of our youth. There is a support network at neighbourhood and village level, because public sector formal social support networks have collapsed … People day by day are not any more fighting poverty; they are fighting for survival.[1]

EAPN Greece

The European Anti Poverty Network (EAPN) is made up of hundreds of organisations working with or representing people experiencing poverty across Europe, grouped in EAPN national networks, and Europe-wide organisations which share its aims. In working to put the fight against poverty at the top of the EU agenda, EAPN is concerned both to mitigate the effects of the current crisis on people experiencing poverty and to promote longer-term solutions which create a more equal and inclusive Europe.

Governments and EU institutions talk about the importance of protecting the most vulnerable from the impact of the current recession, but there is little sign of this being translated into policy or budgetary measures. On the contrary, the experience of EAPN members is that the worst impacts of the crisis are falling on people who were already experiencing or were at risk of poverty and on the many now falling into poverty through unemployment and cuts in incomes and services.

Tracking Social Impacts

In June 2011, the European Commission stated:
In 2008 the EU was hit by the worst global recession for decades. The impact of this major crisis on economic growth and unemployment was felt almost immediately. But the social impact of the crisis, feeding through more indirect channels, is only beginning to appear.[2]

The experience of EAPN members, however, was that the social consequences of the recession for the most vulnerable were, in fact, evident from an early stage. EAPN members were frustrated by the lack of official systematic monitoring of these social impacts. To fill this gap, and to give a perspective from the ground up, EAPN produced two reports, the first in 2009 and the second in 2011, on the effects of the crisis as seen by our members;[3] it has incorporated this material into a broader analysis, published in March 2012.[4]

In more recent times, official monitoring of the social impact of the crisis has been increasing and the European Commission and the Social Protection Committee, which links social affairs ministries across Europe, now report regularly on this. However, the Commission and the Social Protection Committee have noted that most EU Member States 'are not in a position to give an overall assessment of the impact of the crisis' and noted also that statistics often lag well behind rapidly shifting realities.[5]

Inequality – The Gap Widens …

It might have been expected that the gap in income between richest and poorest would narrow during a recession, as the very wealthy lost out. It might also have been expected that 'relative poverty' might fall because of the lowering of overall income. In fact, however, there is increasing evidence of a widening gap between rich and poor, as the top 10 per cent emerge as clear winners.

Meanwhile, austerity measures and regressive taxation choices can only serve to widen this poverty and inequality gap. EAPN national networks, quoted in the EAPN 2011 report, pointed to the negative impact of regressive flat income taxes (for example, in Bulgaria and Hungary) and to widespread increases in VAT which hit poor people hardest. The German network noted that tax breaks for the middle class have reduced resources for social services and social inclusion. On the positive side, there is some discussion in a few countries on introducing or increasing wealth or property taxes. However, these are seen as interim measures; by contrast, there has been very little indication that public service and social protection cuts are being considered as only interim measures.[6]

Inequality has been acknowledged as one of the main causes of the crisis, as well as a major determinant of increased health and social costs. Can the EU afford the devastating long-term social and economic costs of austerity and fiscal consolidation measures that can only generate an increasing income and inequality gap?

Vulnerable Groups Hardest Hit

Much of the media focus in recent years has been on 'the new poor'. While it is undoubtedly true that many people who previously believed themselves to be secure are now falling into poverty, many of those who have been worst hit come from distinct vulnerable groups – in particular, people already experiencing poverty before the crisis, young people, people who are educationally disadvantaged, migrants and ethnic minorities, older people, children and lone parents.

Incomes of poor people have been squeezed from many directions, including reductions in employment incomes and income maintenance payments, tax increases, and retirement pension changes. Furthermore, the erosion of purchasing power as a result of increases in the price of basic commodities is increasingly seen as a major threat. In many countries, gas, electricity and water charges, as well as bank charges and the cost of food and rents, are rising. In Hungary, as in other Central and Eastern European countries, the impact is particularly devastating: 'most people experiencing poverty cannot afford to use gas for heating. They take wood from the forests'.

The upward trend in the price of essential items seems to have begun before the crisis in many countries – and may have contributed to consumer over-indebtedness and the crisis itself. In most countries, social assistance payments are not index-linked to cover these increases in the cost of essentials.

The European network, Eurochild, warns of a potential 'lost generation', with families disproportionately affected by the crisis. They see the effects on children's physical and emotional well-being and the impact of economic strain, with cuts in education and care services and in subsidies to NGOs.[7] Youth unemployment rates are above 20 per cent in most countries, reaching crisis proportions of 37.2 per cent in Estonia and 42.5 per cent in Spain. Migrant workers in many countries are particularly at risk, since they may be in danger of losing their residence permits if they become unemployed. Meanwhile, vulnerable ethnic groups, particularly Roma, are increasingly treated as scapegoats in countries such as Slovakia, the Czech Republic and France.

Many of the worst social impacts of the crisis are not readily apparent but are likely to have serious long-term implications. Such impacts include hidden unemployment and erosion of working conditions; family tensions; stress and risks of chronic ill-health and violence; a loss of confidence and aspiration among children, as well as the impact on housing insecurity and homelessness, indebtedness and declining living standards. Many EAPN networks refer to severe deprivation, pauperisation, out-migration and increased domestic and urban violence. There is noticeably increased competition for scarcer resources amongst poorer people, sometimes leading to rising intolerance, racism and xenophobia.[8]

Many of the worst social impacts of the crisis are not readily apparent but are likely to have serious long-term implications.

The scale and impact of social problems such as these are much harder to document than, say, increases in unemployment, but they represent a real threat to social cohesion and social inclusion.[9]

In the early stages of the crisis, severe poverty and exclusion were most obviously increasing in Eastern Europe, particularly in countries already in receipt of IMF/EU loans, such as Romania, Bulgaria, Hungary and Latvia, which experienced sharp cuts in public services as part of the loan terms. By 2009, however, the EAPN social impact report was showing that Denmark, Spain and Ireland were already recording significant increases in demand for services addressing basic needs, such as food, clothing and temporary housing.[10]

Unemployment

The growth in unemployment, especially youth unemployment, is of course one of the most visible signs of the economic crisis. Even in 2010, there was a wide variation in unemployment levels, from 5 per cent in Austria and the Netherlands to 19 to 20 per cent in Latvia and Spain.

Men's unemployment rose first,[11] but women are more affected by cuts to social sector jobs and by the slowing of the services sector of most European economies. Services account for as much as 70 to 80 per cent of employment, and lower-wage service jobs are dominated by women. Two-thirds of public sector job cuts in the UK, for example, have fallen on women.

In its 2009 social impact report, EAPN noted that alongside the increase in unemployment, there had been a significant decline in working hours due to short-time working.[12] Among measures to save jobs noted in the 2011 report were reducing employers' social costs and supporting enterprises through subsidies.[13] While initially welcome, these risk exacerbating 'jobless recovery' and as the Belgian EAPN network said: 'who's out – stays out' of the labour market.[14]

A stark indicator of the economic crisis © *Istock Photo*

Some national networks have highlighted the priority being given to reducing employment protection by increased flexibility of working time, lowering standards in working conditions, making hiring and firing easier and limiting workers' rights. This adds up to a clear strategy to reduce wages and employment costs generally, in order to encourage export-led growth, but at the risk of increasing poverty among marginal workers. In some cases, this is a direct result of IMF/ECB pressure, as in the case of Bulgaria, Romania, Hungary and Latvia at first, and Ireland, Greece and Italy more recently. Other countries, such as the UK and France, have taken this on as a domestic policy choice.

'Activation' Policies and Welfare Cuts

EU Member States remain nominally committed to the idea of 'active inclusion' – an integrated strategy to tackle social exclusion by guaranteeing adequate income support, access to decent jobs and quality services.

In practice, however, increased conditions attached to receiving benefits have generally not been accompanied by the services which would make it possible for people on welfare to take up work – or by the jobs to be taken up. The net effect, therefore, is not to help people move from welfare to employment but to increase poverty. Many EAPN national networks, in fact, consider that the priority for their governments in the face of the employment crisis is one of 'hardening activation policies' and 'increasing work conditionality upon benefits claimants through cuts and sanctions regarding unemployment benefits and minimum income'.[15]

The assessment of the social impact of the crisis by the European Commission and the Social Protection Committee showed that measures to reduce public expenditure have hit social protection and social inclusion systems first.[16] The measures adopted include: restrictions on eligibility; shortening of benefit payment periods; reduced benefits; narrower family benefits; reduction of benefits for adults and children with disabilities; abolition of maternity and school grants; changes in cost-of-living indexation rules for benefits; cuts in sickness benefits and in social care services; increased targeting of housing and child benefits; staff cuts in social services. While individual countries may not implement all of these measures, the reality is that each one is likely to impact most severely on those who are most vulnerable.

The exclusion from social insurance of long-term unemployed people and others without suitable work histories is a long-standing problem. However, in the early years of the crisis, few countries resorted to further cuts in benefits, understanding their counter-cyclical importance in supporting spending in recession as an 'automatic stabiliser'. But now, under the name on 'modernisation of social protection', EU institutions are encouraging the tightening of eligibility for benefits even in wealthy countries – such as Sweden, Denmark and the Netherlands – with relatively generous systems.

There are exceptions to this. Estonia, for example, has increased benefits from January 2011 and the government has a strategy to invest in employment. There are some positive movements in education and training for the unemployed in the Czech Republic, Sweden and Finland.[17] However, only a very few countries are spending enough on training to make a real difference.

As EAPN pointed out, without social impact assessments at national level, nobody knows what will be the effect of these measures, in terms of poverty and social exclusion.[18] What is clear is that keeping many people on the margins of coping puts them at risk of poverty from small changes in many directions. It is also evident that stable and sustainable growth requires a focus on fair distribution of income and an effective strategy to prevent as well as alleviate poverty.

Cuts in Services

By 2010, there was a clear trend of governments choosing 'austerity' programmes centered on cuts in benefits and services. Only a few countries also adopted tax increase measures. Public sector pay has been cut in many countries, including Romania, Latvia, Bulgaria, Ireland, the UK and Spain.

Waiting lists in the health services for treatments and operations have increased, for example in Ireland and the UK. In Central and Eastern European countries, health care co-payments are becoming more widespread – accelerating a process which had begun following the 'transition' of these countries to a market economy. In some Western European countries also, users are now expected to pay a bigger proportion of the cost of treatment. These types of cost containment measures inevitably hit hardest those on low or modest incomes.

In some countries subsidised access to services is being reviewed or has already been reduced or removed – for example, the abolition of transport subsidies for students and the elderly and the removal of energy subsidies in Romania.

The UK has voiced its specific intention to move to a new model of welfare: the 'commissioning and contracting state' with services provided by 'any willing provider' from any sector.[19] The focus is on competition and cost efficiency, with universality and equity downgraded as goals.
In reality, across Europe the rolling back of 'the welfare state' was already taking place before 2008; it may well be that the crisis has provided cover for the acceleration of a politically unpopular strategy that was being pursued anyway.

Interestingly, a few countries have applied a less stringent austerity policy. However, the lack of assessment of social impacts means that it is difficult to really understand the consequences of different policy approaches.

Accommodation and Homelessness

The downward pressures on rents in the recession should have provided some relief to people on low incomes. In fact, evidence from EAPN members suggests that any rent decreases have been more than offset by higher utility and food bills, and so housing may be still unaffordable for many on low incomes.[20] In many countries, people's ability to access decent, affordable housing has lessened as statutory authorities have withdrawn from housing provision – a process which started long before the recession, but whose impact is made worse in the context of increased long-term unemployment.[21] By 2010, Spain, Denmark and Hungary were reporting significant increases in the number of evictions. Rough sleeping increased everywhere, especially in Germany, France, Netherlands and the UK, with young people most affected.

FEANTSA, the European Federation of National Organisations Working with the Homeless, argues that services for homeless people have been seen as an easy target for cuts by municipalities trying to reduce expenditure. Such cuts mean in effect moving from long-term housing solutions to policies centered on emergency accommodation – but in the medium to longer term this approach is very costly not just in personal but in social and economic terms.[22]

Squeeze on NGOs

NGOs play a vital role in providing frontline social services. Most NGOs report an increase in demand, at the same time as funding and income have been reduced. Requests for food bank services, homeless supports, budgeting advice and daycare, in particular, have risen significantly. In most cases, however, the increase in demand for services is coinciding with shrinking resources, cuts in public funding, difficulties in applying for new funding and reductions in donations. The only exceptions appear to be in Nordic countries, with an increase in private donations. Meanwhile, European funds, particularly Structural Funds, are not compensating for the shortfalls in other funding. An overall trend towards re-orientating the ESF (European Social Fund) away from supports for vulnerable groups is apparent. Funding shortfalls are also hitting innovative projects, and undermining support for the role of NGOs in advocacy, empowerment and participation.

Reduced Dialogue with Civil Society

In the face of the crisis, governments appear to have become less willing to discuss solutions with civil society. Since 2009, few governments have engaged effectively with NGOs on the causes and social impacts of the crisis, and the solutions to it.

A survey in early 2011 by Eurodiaconia, a Europe-wide federation of Christian based organisations, showed that just over a quarter of the sixteen member organisations which replied to the survey had been directly involved in consultation on policies in response to the crisis.[23] EAPN networks, especially in countries most affected by the crisis, have been frustrated by governments' refusal to pay attention to their concerns. As the Portuguese network said: 'Not only are we not being listened to, we are not being respected'.

An EAPN study in 2011 revealed that national networks which had participated in consultative processes in the context of National Reform Programmes had experienced inadequate and very unsatisfactory processes, with limited opportunities for input or serious engagement and a sense that their efforts had minimal impact. This occurred despite an official commitment that the Europe 2020 Strategy should be implemented and monitored in partnership with a range of stakeholders, including representatives of civil society.[24]

Conclusion

In the early days of the crisis, there was a willingness in some EU Member States to boost social protection systems to prevent hardship, but this weakened as the priority shifted to reducing public deficits. This process was mirrored in the approach of the EU which has, since the beginning of the crisis, taken a key role in attempting to co-ordinate responses. Initially, in 2008, the EU's response included a commitment to an anti-cyclical approach,[25] 'alleviating human costs' by maintaining jobs, and supporting the most vulnerable through strengthened social protection and services. But as financial instability grew, alongside increased public debt and deficits, priority shifted to salvaging the euro and enforcing a neo-liberal recovery plan focused on a narrow interpretation of competitiveness and fiscal consolidation.

This has involved strictly enforcing the Stability and Growth Pact requiring euro zone member states to quickly reduce deficits below 3 per cent – primarily through cuts in public expenditure rather than raising taxes. Europe's competitiveness is to be kickstarted by driving down wages, increasing flexibility and raising the age of retirement.[26] For the countries within and outside the euro needing financial bailouts from the EU, this pattern of measures – which is devastating to social rights – has set the template for the rest. This is occurring, despite the launch in 2010 of a new overall policy, the Europe 2020 Strategy, which aims to promote 'smart, sustainable and inclusive growth', and which established for the first time a target to reduce poverty and social exclusion by at least 20 million by 2020.[27]

There is little evidence of an integrated approach to the EU's declared policy of 'active inclusion' of people excluded from employment;[28] in practice, this is being interpreted as hardening conditionality in granting benefits, while the support services and the jobs necessary to make activation a reality remain absent. Across Europe, cuts in income maintenance, health, housing and support services signify a harsher attitude to poor and vulnerable people.

This raises a question over the implicit social contract and the European social model which have provided stability and a level of protection for the poorest since the early stages of the movement towards European integration. It also undermines the faith of people across Europe in the EU as a social and democratic project rather than an economic union for its own sake.

The austerity that has come to be the dominant policy response to the crisis is an unlikely path to achieving the goal of increased quality, sustainable jobs in Europe, and a certain road to increasing the risk of poverty and material deprivation.

The failure to debate the causes of the crisis and to reconsider another model of development is the major complaint of most EAPN networks. They highlight key hidden causes: the decline over several decades in the share of GDP going to wages and salaries; financial and economic deregulation; deconstruction of the welfare state; the constant rise in inequalities, and fiscal and social dumping.

Alternatives to the present approach *are* possible, but need to built and fought for through new alliances. The immediate demands of EAPN include:

- A pro-active social impact assessment on the causes and consequences of the crisis;
- Alternative exit strategies, which reduce deficits more slowly and invest in recovery, boost demand and include a commitment to a social model which offers adequate protection and equality of opportunity;
- A comprehensive rethink of the development model which has predominated in recent decades, with a view to devising an alternative that will allow for the hope of building a better life for all.

Notes

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The Implosion of Solidarity: A Critique of the Euro Zone Crisis

Ray Kinsella and Maurice Kinsella

Introduction

The post-2007 global financial crisis was, fundamentally, an ethical crisis.[1] This crisis and its aftermath presented in a distinctive way within the euro zone. What distinguishes the euro zone crisis has been the collapse of 'solidarity', considered both as a social virtue and as an integral part of the Schumann–Monnet model of a new European order, a renewal of Europe from the ashes of World War II. Unless and until the true meaning of solidarity is rediscovered and reanimated within the political leadership of the EU, there is unlikely to be economic stabilisation and recovery. In other words, a failure to move the Franco–German dominant consensus away from the hegemony established in the wake of the euro zone crisis, and towards a rediscovery of solidarity, will result in the serious risk of the 'Balkanisation' of Europe within a generation.

In Ireland, the disastrous policies adopted in the years leading up to December 2010 were compounded by the acquiescence of the Irish authorities in 'Troikanomics', the price of assistance from the 'Troika' (i.e., the European Commission, the European Central Bank and the International Monetary Fund). These policies, fixated on austerity, have impelled Ireland down an economic *cul de sac*. In effect, the terms of the 'bailout' were directed towards protecting the balance sheets of continental countries from their own failure in risk management and its consequences. The price has been the emaciation of Ireland's economic capability, with all of the human as well as economic costs this has entailed and, also, the emasculation of Ireland's constitutional integrity. Great damage has been done to solidarity within Ireland and across the euro zone, as well as in the wider EU.

Essentially, the combination of the ascendency of a culture which had economic power and political hegemony at its 'centre', alongside bad economics, has resulted in a haemorrhage of trust in the European ideal, and in the erosion of the euro zone's credibility in financial markets. Inevitably, it has generated political instability, particularly in the peripheral countries impacted by the imposition of 'Troikanomics'. The rejection by the French and Greek voters, in 2012 elections, of a nihilistic economic and political orthodoxy may provide a catalyst for change and a new economics based on solidarity. To date, the response by those in power – in Germany and in the economies it effectively controls – has been a refusal to understand, much less respond to criticisms.

We believe that 'There *is* an alternative', contrary to the assertions of those whose policies have compounded the problems confronting the euro zone.

The argument we make in this paper regarding the 'crowding out' of solidarity within the euro zone, and the effects of this, is not predicated on what is euphemistically dismissed as 'bleeding heart liberalism'. The systematic deconstruction of the Greek economy – consequent on the 'bailout' terms imposed on that country – shows clearly just why hearts *should* bleed. The analysis by international economists of the impact of the policies insisted upon,[2] and the data on the effects of the bailout programme on the health status of the Greek population[3] – to cite but two examples – highlight the seriousness of the consequences of the measures which have been imposed.

Nor is our critique based on a wistful rejection of a need for adjustment in deficit countries, with all of the political challenges and social costs that such adjustment requires. It is clear from the data on, for example, Ireland and Spain that economies had been over-leveraged because of household and also corporate and sovereign indebtedness levels. This has made them vulnerable to the 'perfect storm' unleashed in the global financial crisis of 2007 and to its 'after-shocks' as this collapse progressively impacts on the real economy. The need for reform and change is evident. What is really at issue is the timescale for adjustment and questions as to whose fundamental interests are being served in the reforms being carried out.

The crucial question is whether, or not, there is place for a form of solidarity that allows policies be adopted that go beyond the destructive paradigms, and beyond the self-interest of those who stand to gain from the suffering imposed on populations other than their own.

Two Pillars of Solidarity

At the core of solidarity are two pillars. The first is rooted in the unique dignity of the individual.[4] This innate dignity arises directly from the individual being made in the image of God. From this flow rights and responsibilities on the part of those charged with maintaining the welfare of peoples. There is, in the great theistic faith traditions, a common understanding of the individual's relationship with God, mediated through mutual respect between individuals. In community, this finds expression in laws, institutions and governance in which the dignity of the individual is held as the locus upon which these are pivoted.

The second pillar can be approximated by 'universals' – that is, fundamental values acknowledged across all cultures and which find their social and political expression in the common good. These values embody justice, equality, and love – which is charity, and is the epicentre of fraternity. 'Solidarity' strives to give expression to these truths which are held in common, and which embody the aspirations that have guided the community in its growth. These values extend into the future as the essential guarantor of the inalienable rights of the individual and of the best interests of a free people.

There is a continuum between the two pillars of solidarity, noted above, which may be expressed in different institutional forms across cultures. But the fundamental integrity of the two pillars is recognised for what they are: foundational values from which the internal governance *of*, and relationship *between*, countries flow.

A measure of the true extent of radical solidarity is therefore that it embraces the totality of all individuals. Within the context of Christianity, its first expression was solidarity of *service to the person* and an equality of all individuals before God. The solidarity was therefore rooted in 'the brethren'; 'the disciples'; 'the community' – whichever of these, not identical but over-lapping, terms one chooses. That is, the individual never loses his or her individuality, and all that it implies, in terms of innate rights and dignity. But this individuality is expressed within community and the rights and responsibilities which this entails.

A Long Lineage

In Europe, the lineage of these ideas can, in their different dimensions, be traced back to Greece. Justice is an important example. It provides a benchmark against which to assess the nature of the Greek 'bailout' – and the dynamic of the underlying *relationships* – as to whether, or not, it can be validly seen as a practical exercise in solidarity.

Appropriately perhaps the concept of justice was critiqued by both Plato and Aristotle. Very broadly, Plato emphasised the eternal and unchanging dimension of justice *within* the individual. Aristotle shed new light on the extent to which justice was shared *amongst* individuals – and without doing violence to his analysis, across countries. The Christian anthropology which was developed against this background, and which absorbed these traditions, emphasised the over-riding importance of love, being '... the only basis for human relationships that respect in one another the dignity of the children of God created in his image ...'.[5] This is a dynamic of western, and in particular European, civilisation writ large.

The French Revolution represented a major historical catharsis. The nature of this revolution forged a solidarity encompassed within the principles of equality, fraternity and liberty. But it 'crowded-out' charity and was driven by a reactionary intolerance.

More generally, the post-revolution history of Europe can be seen as a progressive process of *political* liberation, developed around essential political freedoms but without encompassing the whole of the human person. It failed to give full expression not alone to the twin pillars of solidarity but, more importantly, to link these ideals to 'universal values' and to animate this whole construct by drawing on its Christian heritage.

The single most radical expression of authentic solidarity is to be found in the Gospels. This takes the whole Judaic tradition of political liberation and imbues it with the new dignity to which we are called and the solidarity that this creates. The Kingdom of God is not *of* this world, but it begins to take root and grow within this world and within the everyday experiences of individuals. This is the context within which the Greek and Irish 'bailouts', and their effects on the community and the self-esteem of the countries, must be assessed. There is little evidence in the policies adopted of the political principles of equality, liberty and fraternity. Still less is there evidence of Christian solidarity, as mediated through the Schumann–Monnet 'new' Europe.

The Schumann–Monnet Plan

The Schumann–Monnet plan for a new beginning, built from the wasteland of World War II, was crafted around a wholly new approach to achieving solidarity across nations. In terms of all that had gone before it, this plan, which was endorsed by German Chancellor Adenaeur, expressed in a transformational way shared fundamental truths.

At the heart of these truths was a rejection of a culture of *power and domination*, of which World War II was a most malign expression. The shared values embraced freedom and justice, equality and mutual respect among members, and governance that extended so far beyond pure self-interest as to constitute something completely new in modern European history.

All of this can be best understood in the light of the deep Christian principles of its primary architects. In the absence of these principles, a very different template for Europe's post-war future might well have emerged. The whole precept of, for example, fraternity – distinct from, but overlapping with, solidarity – can only be properly understood where it has, at its epicentre, charity as well as justice.

Of course, such solidarity was already embedded within Europe. It was a necessary expression of Judeo–Christian values. The descent into conflict that became World War II reflected the negation of solidarity and the assertion of a culture based on power rather than on service and mutual respect.

Consider that the initiative towards European integration should have been undertaken a mere five years after the ending of the war. This is something so remarkable that it can best be understood in the context of a Christian anthropology of redemption. This was, without doubt, embedded within the mindset and thinking of the foundational fathers of Europe. It is extraordinary that Europe committed itself to a future that rejected utterly a culture of any form of domination – that is, a Europe which was imbued with the twin pillars: respect for the individual, and institutions founded on fundamental rights and on an equality of nations.

It is also extraordinary that this voyage should have been embarked on side by side with the imposition of communism – an ideology predicated on the subjugation of the individual and a deterministic perspective on history – on the countries of Eastern Europe. The true extent of this historical dichotomy played out in a divided Europe is aptly reflected in the purported justification on the part of a centralised Soviet State for the invasion of Hungary in 1956, and of Czechoslovakia in 1968, in order to enforce 'fraternal solidarity' between a hegenomistic centralised authority and its vassal states.

(Even more remarkable – and it is hardly a coincidence – is the fact that the catalyst for the collapse of the Soviet empire was the assertion of those fundamental truths and shared principles which were at the heart of the Polish freedom movement, 'Solidarity'. This movement encompassed all that Poland was and aspired to be again. It was reinforced by the momentum imparted by the return to his native Poland of the newly-elected Pope John Paul II, whose early life was marked by the nihilistic philosophies of Nazism and communism – the very antithesis of solidarity, justice and charity. What 'Solidarity' aspired to were the very truths and principles on which the European Community – and, in passing, the Irish nation – was founded.)

It was, then, the principle of solidarity which provided the dynamic for the emergence of something wholly new in European history ...

It was, then, the principle of solidarity which provided the dynamic for the emergence of something wholly new in European history: a solidarity which stretched across the foundation states – former adversaries – and progressively opened out to other European countries and to the wider international community. This process in turn provided the impetus for reconstruction, growth and acknowledgement of mutual interdependence in achieving higher living standards for the peoples of Europe. Internationally, it became a witness to the innate 'good' of solidarity. *That is what has been 'crowded-out' in the management of the euro zone crisis. That is why we argue that only in rediscovering this solidarity can the crisis be resolved, allowing Europe, true to its roots and mission, to move on.*

An Absence of Vision

There are, we suggest, three fundamental forces which have in recent times impelled Europe down a *cul de sac*. The first of these was the rise of corporate capitalism, particularly in the wake of the fall of communism in Eastern Europe. The second was the progressive emergence of a 'hegemonistic' centralisation of economic power, in place of the ideal of equality across member nations which was an essential characteristic of the European initiative and embedded in the term 'community'.

The third factor was the emerging tensions of a Europe that was progressively expanding, but without due regard for structural differences and without adequate institutions, such as fiscal federalism. Most importantly, the expansion was occurring without the legitimacy of popular support across Europe. Politicians are apt to be a little wary of trusting 'the people' – except when they are seeking election. In these terms, 'enlargement', and 'deepening' of the European Union were embarked upon without any fully articulated expression of what such a Europe stood for and, equally, without regard to the architecture which would be required to give expression to such a process – one characterised, above all, by the centrifugal force of solidarity, and with the whole process grounded in the spiritual and cultural heritage of Europe. It was a strategy and an opaque one at that – but it was not a vision.

What had defined the foundations of the European Community was 'the vision': institutions followed and acquired their legitimacy from this same vision. In the euro zone crisis, Europe and its institutions have allowed themselves to become semi-detached from the peoples of Europe. There has also been the rise of a Franco–German political economic dominance.

This has occurred against the backdrop of a transfer of progressively greater powers to European institutions – notably, the EU Commission and the European Central Bank (ECB). Indeed, the context of the frenetic and unavailing political 'summitry' of the crisis years has been the assertion of power by the ECB, which has taken the lead in pushing 'economic governance' – effectively political union, under conditions that the founding fathers would not have countenanced and with neither preparation nor legitimacy. (This is apparent in the rejection of such policies in the 2012 elections in France and Greece.)

It is one of the ironies of the present crisis that it is precisely the ECB, whose principles and mandate were essentially transposed from those of the Bundesbank, which has allowed its balance sheet (a mirror image of its policies) to become subverted in the defence of an ideology which is at variance with its foundational mandate.

In important respects, the over-leveraging and the indebtedness, measured against conventional ratios such as household and/or national income, and the resultant structural weaknesses in western economies, were a manifestation of a deeper ethical malaise.[6] Significantly, this malaise was anticipated by Galbraith as far back as the late 1950s.[7] It reflects the subversion of solidarity through the inculcation of a culture of consumerist 'wants', funded by banks driven by the primacy of short-term profits, and impelled forward by advertising fixated on the siren call of private affluence.

It gained traction in the ideologically-driven financial 'reforms', notably in the US and the UK, in the 1980s, and became progressively more pronounced in the emergence of an 'idolatry of the markets' – to use the evocative phrase of the *Compendium of the Social Doctrine of the Catholic Church*.[8] All of the clichés retrospectively fitted to the post-2008 crisis are evident in this lineage. They highlight the progressive erosion of solidarity.

But this does not go far enough. The greatest single cause of the implosion of solidarity was the systematic exclusion of God from Western Culture – which is precisely why we define the crisis as ethical. This process is evident right across the spectrum, from public discourse to the manner in which the centre of gravity of private morality has shifted decisively towards the exclusion of social virtues. If one were to look for a 'sign' for all of this, it was the exclusion of God and of Europe's spiritual heritage from a proposed European Constitution.

The overall effects – and it is a telescopic view that we offer – were three-fold. Firstly, there was the progressive growth of a 'culture of control'. The true extent of this should not be underestimated and has been forcefully argued by, for example, Noam Chomsky. Secondly, there was an associated shift in the moral mindset *away* from the concept of solidarity. Solidarity without charity conflates to ideology. Thirdly, and related to this, history teaches that when a society ceases to believe in objective fundamental values which constrain us from going beyond the siren calls of our own egos, we end up, either as individuals or as countries, being held hostage.

A Failure of Leadership

The consequence of these processes was a lack of legitimacy – a marginalisation of the people of Europe from the decision-making process, a process that came to be opaque, jaded and centralised. This was political cowardice. The combination of institutional weaknesses and political cowardice came back to haunt Europe. This is reflected in the nature of the policy response to the euro zone crisis that threatens all that had been achieved by European cooperation.

Mitigating seismic 'shocks' is a defining challenge of leadership. The reference point is always the dignity of the individual, the integrity of the family and the overriding societal importance of universal values. In the post-2008 economic crisis, leadership within the EU and, more specifically within the euro zone, has failed this test.

The euro zone system has been taken to the very brink of collapse because of its fixation on protecting the balance sheets of the banks of the core European countries and of the US, rather than on recovery based on sustainable growth.

Troikanomics – or *the politics of austerity* – has been imposed on a structurally imbalanced set of countries, at different points in their macro-economic cycle, which have been impacted by the greatest shock since World War II. This austerity has, predictably, failed to restore stability. Instead, a financial contagion has metastasised into a still-spreading fiscal crisis.

The necessary condition for stabilisation is a rebalancing of the debt–GDP ratio so that, pursuing necessary reforms and generating sustainable economic growth within an appropriate time frame, countries and their systems may extricate themselves from the fiscal trap in which they are now mired. In other words, 'a focus on GDP growth is the key to national solvency'.[9]

The markets are betting on a fragmentation of the euro. Yet, the prevailing orthodoxy has fixated on reducing the debt burden. This has proved to be an illusion – an economic fallacy that has imposed extraordinary suffering, particularly on the peripheral nations.

The reference point for both the dominant euro zone countries and for the euro zone institutions is currently far removed from any concept of the common good. In the foundational Schumann Monnet Plan, 'equality' was seen as having a pivotal role to play in guiding relationships across the countries that were to constitute a whole new European order based on solidarity and subsidiary. *In the post-2010 period, the European Union has fragmented and the concept of solidarity has been all but excised from governance.* This has been subversive not alone of Europe, but also of the global economic order.

The price of the futile and doomed defence of the paradigm has been the collapse of solidarity, played out in slow motion in the financial markets and in the wasteland of the economies of the peripheral countries within the euro zone.

Defending a Failed Paradigm

It is characteristic of failing paradigms that they will be defended to the death. The strongest evidence of this in the current crisis is that the euro zone orthodoxy not alone suffocated solidarity in the policies imposed on the weaker countries, but subverted those institutions – notably the ECB – actually charged with the *preservation* of stability.

> *It is characteristic of failing paradigms that they will be defended to the death.*

The sense of 'denial' is palpable. It is this denial that has undone the whole fabric of solidarity embedded within the Schumann–Monnet Model. Specifically, it is the denial that, in the face of the greatest shock to the whole western economic system, the preservation of solidarity is more important than the nihilism of 'austerity'. It is the denial of a need for transformational *political* change, beyond any 'reform'.[10] It is the denial that it was absurd to reconstruct a financial system that had failed *for reasons integral to the system itself.* It is the denial that other systems, including Islamic finance and models crafted around the Judeo–Christian social ethic, might offer a superior template to the reconstruction of a system that had imploded. Finally, it is the denial of the human costs of these same denials.

So, our analysis of solidarity is not predicated on 'liberalism', or indeed on a rejection of the need for a major structural adjustment in western economies. What we assert is that solidarity was the casualty of a primarily ethical crisis which, in turn, was a manifestation of a move away from the foundational principles of the EU itself.

It was also the consequence of seriously bad economics. This is no coincidence, since one of the reasons for the expansion of the post-war international economy was precisely the respect for markets and, in Europe, the commitment by European countries to the fundamental values which had taken Europe away from a culture of power to one based – in effect – on Catholic social teaching.

The credibility of euro zone policies is so badly impacted and the ability to back-track so compromised that any kind of economic recovery will be a lengthy and difficult process. The markets were never convinced by 'summitry'. When markets made the right call by downgrading the credit status of a widening group of core European economies, they were castigated by the euro zone leadership. The euro zone 'authorities', in defence of a failed orthodoxy, threw an unprecedented array of monetary interventions at the financial system in an attempt to shore it up.

It hasn't worked. In reality, the priorities adopted were the wrong ones. It was always the case that the emphasis should have been on adjustment and reform through growth.

The final line of defence began in 2011 with the insistence on a move to full political union by way of 'economic governance'. The process was premature, lacked legitimacy and, at least in economic terms, was as close to a cry of despair as can be imagined. In effect, the euro zone 'leadership' was bartering the Schumann–Monnet legacy of which it was the trustee and, in the process, eviscerating the spirit of solidarity which was at its heart.

The euro zone economy is in a worse state today than it was at the outset of the crisis, not least because so many of the options have been used up and because, instead of a vision that engages the people in the process of transformation, there is nothing left to fall back on except the mantra: 'There is no alternative'. There is, of course, an alternative, but the rediscovery of trust and solidarity and the rebuilding of dialogue with the peoples of Europe and the markets will take a lot longer and take a lot more.

Conclusion

In summary, the current situation within the euro zone represents the culmination of a reversal in the foundational philosophy of Europe, combined with short-term, counter-productive and destructive economic policies in defence of national self-interest and embedded within what we have termed 'Troikanomics'. What has happened, and been acquiesced in, strikes at the heart of solidarity at a number of levels.

- It offends against justice. That is, the policies pursued have created a generation of unemployed, encompassing millions mired in long-term unemployment, many of whom will not work again and so be left dependent on the state. The policies offend against justice in that in Spain, to take one example, almost 50 per cent of those under twenty-five are now unemployed. No amount of economic sophistry based on 'flexible labour markets' can detract from the reality that this generation has been cut off from the right to work, and to give expression to their talents and their capacity to support a family. Whole new segments of society have been cast into poverty and this offends against justice and the shared values which once animated the European ideal.

- It deconstructs the ideal of equality among the members of what was once conceived of as a genuine community. A young worker or householder in Greece or Ireland cannot be said, without doing violence to language, to be equal to his or her peers in Germany. Again, this is not to argue in defence of economic policies which were profligate (albeit incentivised by a financial system which has wholly detached from its constitutive purpose).

- At an institutional level, equality has been crowded-out. One notable example makes the point. In late 2011, at a time of protracted debate on the Greek bailout, Germany moved to impose a 'Budget Commissioner' on what remained on Greek democracy, in order to do the will of the economically and politically strong.

- Subsidiary, a central characteristic of the Schuman–Monnet initiative, has also been

> casualty. Where once the European Community reached out to embrace regional development, the new orthodoxy led to moves to impose, by *fiat*, control over weaker countries, whose vulnerability was exacerbated by the very policies imposed upon them.

The corollary of our analysis is evident to any serious student of European history. There is a growing disenchantment with the very idea of Europe. If this were to continue, it would be a tragedy. There is a real prospect of the euro zone conflating to a 'Deutche euro', or to a cluster of countries prepared to accommodate their political and social systems to German monetary and fiscal policy.

In any case, the current situation reflects a fragmentation of what began as a set of treaties and developed as a community driven by the principles of solidarity and subsidiary. This failure of the euro zone political leadership and the terrible costs that it has imposed on countries has led to growing opposition across Europe. There is little evidence that this same leadership is either willing or capable of listening (although the results of the 2012 elections in France and Greece should, as noted above, give pause for thought). The response by those who acquiesced in this failure is the all too familiar response of repression – both political and economic – backed, as a telling metaphor, by the training of riot police for dealing with 'extremists'.

There has been in the last three years a haemorrhage of trust in Europe – in the ideal and in the institutions. This has succeeded in reversing the enormous achievements of the last half century and more.

The failure of the euro zone leadership to nurture solidarity as a platform for learning from, and mitigating, the damage of the 2008 collapse casts a shadow into the future – the shadow of a Europe upon which an inflexible economic template has been imposed, generating secessionist tensions and with the real possibility of a Balkanisation of the European heartland within a generation. Schumann and Monnet, and those in whose memories they launched their 'new' Europe, deserve better. The people of Europe, inheriting the vision of these men, and the burden of the destruction of these ideals, deserve better.

Notes

1. See Ray Kinsella and Maurice Kinsella, 'Ethical Causes and Implications of the Global Financial Crisis in Ireland: Political Contagion and Political Transformation', *Studies*, Vol. 98, No. 391, Autumn 2009, pp. 285–308.
2. For an insightful analysis, see James K. Galbraith's talk on 'The Global Financial Crisis', given at the Institute of International and European Affairs, Dublin, 9 June 2009.
3. See Alexander Kentikelenis *et al*, 'Health Effects of Financial Crisis: Omens of a Greek Tragedy', *The Lancet*, Volume 378, Issue 9801, 22 October 2011, pp. 1457–58 *(http://www.thelancet.com/journals/lancet/article/PIIS0140-6736(11)61556-0/fulltext).*
4. Teresa Iglesias gives an insightful critique in her book, *The Dignity of the Individual: Issues of Bioethics and Law*, Dublin: Pleroma Press, 2001.
5. Pope John Paul II, Homily, Grant Park, Chicago, 5 October 1979.
6. See Ray Kinsella, *Rebuilding Trust in Banking: Regulation, Corporate Governance and Ethics in Banking*, Dublin: Vonier Press, 2009.
7. John Kenneth Galbraith, *The Affluent Society*, Boston MA: Houghton Mifflin Harcourt, 1998. (First published 1958.)
8. Pontifical Council for Justice and Peace, *Compendium of the Social Doctrine of the Catholic Church*, Libreria Editrice Vaticana, 2004.
9. Ray Kinsella 'Why Ireland should Undertake a Managed Exit from the Euro Zone', Presentation to FESTA (The Foundation for the Economics of Sustainability) international conference, 'National Strategies for Dealing with Ireland's Debt Crisis', Dublin, 22–23 September 2011.
10. Ray Kinsella, Presentation to OSCE Parliamentary Assembly Economic Conference, 'The World Financial Crisis', Dublin, 27–29 May 2009.

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