Policy paper

RE/CON

The European crises in 10 points (and one mystical vision)

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It is wrong to talk of just one European crisis. There are at least five European crises (economic, financial, banking, sovereign debt and constitutional) which overlap and reinforce each other. The European Union and its Member States are condemned to fail in their efforts to deal with the crisis until they properly acknowledge its manifold character.

Measures which address one aspect of the crisis (for example, austerity in the form of internal deflation aimed at balancing budgets) only aggravate things on some or all the other four dimensions (undermining economic growth, questioning the Social and Democratic *Rechtsstaat*, deepening the banking crisis and devastating the solvency of the state). There is a need for specific measures that target each of the crises and are harmonious with each other; and so contribute to the mending of the overall crisis. Special attention has to be directed to the two lessons of the crises. Firstly, the untenable character of the combination of a self-governing European financial market, which controls the creation of money, coupled with individual Member States and the European Central Bank (ECB) as insurers and lenders of last resort. Secondly, the looming tension between the privatization of money creation and the production of social trust in money through redistributive taxation.

POINT ONE: Asymmetric Monetary Union (as defined in the Maastricht Treaty and the Stability and Growth Path)

Hybrid and unprecedented combination of (a) federal and depoliticized (*technocratic*) monetary policy, and (b) formally political and national fiscal and wage policies.

This combination creates several risks and hazards (including irresponsible fiscal behaviour by one state that unavoidably affects all the members of the currency union). This is why some form of *coupling* between national monetary policies, and of those with the federal monetary policy, could not be avoided. There is a need of

rendering the autonomous fiscal and wage policies coherent, that is, a *functional equivalent* of a single fiscal policy.

How? The classical answer is a political union and a federal state. However, the lack of political agreement on how to shape such a state, and when to create one, coupled with the political agreement to proceed with monetary union to anchor the reunited Germany to Europe, resulted in an experimental solution. This experiment was later relabelled as "governance" and has five main characteristics:

a) Full ownership of national fiscal policies, ruling out the acquisition of debt by the European Central Bank or national central banks, and discarding the collectivization or transfer of debt of any Member State.

b) "Rigorous" fiscal policy, as it has to be financed either through taxes or by means of issuing debt at market conditions (excluding privileged loans or forced loans and placing the creation of money in the hands of the ECB; and in constitutional practice, in the hands of private banks, as the ECB will abandon even the pretense of controlling the growth of money).

c) Free movement of capital not only *ad intra* but also *ad extra*, to ensure accountability of national fiscal policies *vis-à-vis* financial markets.

d) "Political" dialogue (meaning dialogue among governments in secret) as a means to coordinate national monetary policies and targets, and focusing heavily on annual deficits (maximum 3 per cent of GDP, with the objective being balanced or close to balance budgets). Debt criteria were simply left aside when entry conditions to monetary union were softened for Italy, Belgium and Greece, that all had levels of public debt well over the target of 60 per cent of GDP.

e) Excessive deficit mechanism which left room for collective discretionary decision-making. Sanctions had only a symbolic value, because in most cases applying them would harm the interests of all Member States (as the whole Euro area would be pushed into recession, especially if the sanctioned states were the large ones. This is why the Council of Ministers chose not to start the sanctioning procedure towards Germany and France in 2003.

POINT TWO: PIGS become a success story, but at what long-term price?

Ireland, Greece and Spain were widely regarded as *the* success stories of the European monetary union. From 1999 to 2008, statistics seemed to reveal a clear pattern of convergence with one Eurozone country at the "core", i.e., Germany. Even Portugal, which experienced a rather low and sporadic growth, improved its position vis-à-vis Germany in that period. Monetary Union seemed to be working and fostering actual convergence between its Member States.

Table 1. GDP growth*

Country	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Germany	23200	23800	24500	25100	25700	26000	26200	26800	27200	28200	29600	30200	29300	30600
	130.3	133.7	137.6	141	144.4	146.1	147.2	150.6	152.8	158.4	166.3	169.7	164.6	171.9
	100	100	100	100	100	100	100	100	100	100	100	100	100	100
Nether-lands	21900	22900	24400	26300	27900	28800	29400	30200	31500	33100	34900	36300	34600	35600
	123	128.6	137.1	147.7	156.7	161.8	165.2	169.7	177	185.9	196.1	203.9	194.3	200
	94.4	96.2	99.6	104.8	108.6	110.8	112.2	112.7	115.8	117.4	117.9	120.2	118.1	116.3
Finland	21100	22500	23700	25500	26800	27600	27900	29100	30000	31500	34000	34900	32500	33600
	118.5	126.4	133.5	143.3	150.5	155.1	156.7	163.5	168.5	177	191	196.1	182.6	188.8
	90.9	94.5	96.7	101.6	104.3	106.1	106.4	108.5	110.3	111.7	114.8	115.5	110.9	109.8
Austria	22900	23800	24800	25900	26400	27100	27500	28500	29600	31100	32800	34000	32800	33900
	128.6	133.7	139.3	145	148.3	152.2	154.4	160.1	166.2	174.7	184.2	191	184.2	190.4
	98.7	100	101.2	103.1	102.7	104.2	105	106.3	108.8	110.2	110.8	112.5	111.9	110.8
France	21000	21900	22700	23700	24500	25000	25600	26500	27300	28400	29600	30100	29300	29800
	117.8	123	127.5	133.1	137.6	140.4	143.8	148.8	153.3	159.5	166.2	169.1	164.6	167.4
	90.5	92	92.6	94.4	95.3	96.1	97.7	98.8	100.3	100.7	100	99.6	100	97.3
Italy	18500	19100	19800	20900	21900	22700	23200	23900	24400	25200	26000	26200	125200	25600
	103.9	107.3	111.2	117.4	123	125.8	130.3	134.2	137.1	141.5	146.1	147.2	141.8	143.8
	79.7	80.2	80.8	83.2	85.2	87.3	88.5	89.2	89.7	89.3	87.8	86.7	86	83.6
Spain	12800	13500	14500	15700	16700	17700	18600	19700	20900	22300	23500	23900	22900	23100
	71.9	75.8	81.5	88.2	93.8	99.4	104.4	110.6	117.4	125.3	132	134.3	128.6	129.8
	53.8	56.7	59.2	62.5	65	68.1	71	73.5	76.8	79.1	79.3	79.1	78.1	75.4
Portugal	10100	10800	11600	12400	13000	13500	13700	14200	14600	15100	16000	16200	15900	16200
	56.7	60.7	65.16	69.7	73	75.8	77	80	82	84.3	90	91	89.3	91
	43.5	45.4	47.3	49.4	50.6	51.9	52.2	53	53.6	53.5	54	53.6	54.2	52.9
Greece	11000	11300	12100	12600	13400	14300	15600	16700	17500	19000	20300	21100	20800	20400
	61.8	63.4	67.8	70.8	75.3	80.3	87.6	93.8	98.3	106.7	114.4	118.5	116.8	114.6
	47.4	47.8	49.4	50.2	52.1	55	59.5	62.3	62	67.4	68.5	69.9	70.1	66.6
Ireland	19600	21200	24100	27600	30300	33200	35000	36700	39000	41600	43400	40500	35700	34400
	110.1	119.1	135.4	155	170.2	186.5	196.6	206.17	219.1	233.7	243.8	227.5	200.5	193.2
	84.5	89.1	98.4	110	117.9	127.7	133.6	136.9	143.4	147.5	146.6	134.1	121.8	112.4
Euro-27	16200	17000	17800	19100	19800	20500	20700	21700	22500	23700	25000	25000	23500	24500
	91	95.5	100	107.3	111.2	115.1	116.3	121.9	126.4	133.1	140.4	140.4	132	137.6
	69.8	71.4	72.6	76.1	77	78.8	79	81	82.7	84	84.4	82.8	80	80

* *Evolution of GDP (nominal prices) (Base EU 27 1999=100) (Base Germany =100)*

How was that possible? It was primarily possible because PIGS [an acronym which, as is well-known, stands for Portugal, Ireland, Greece and Spain, but which generally also refers to Italy] chose (or exacerbated their previous choosing) a model of growth through debt, which created least political resistance on the path of (at least in short-term) successfully joining a currency union with Germany.

The model of growth was characterized by three main features which were common to all four PIGS, even if there were underlying differences among them: (1) Massive inflows of foreign capital reflected in extensive current account deficits; (2) Growth of private consumption (and reduction of savings, a characteristic of Greece and Portugal) and of unsustainable investment, such as in real estate (especially in Ireland and Spain); (3) Clearly above average inflation within Euroland, which made unit labour costs grew *without* an increase in the real purchasing power of wages (and consequently, of workers). In the case of Ireland, growth had been further sustained by its role as a tax haven for corporations within the Euro area.

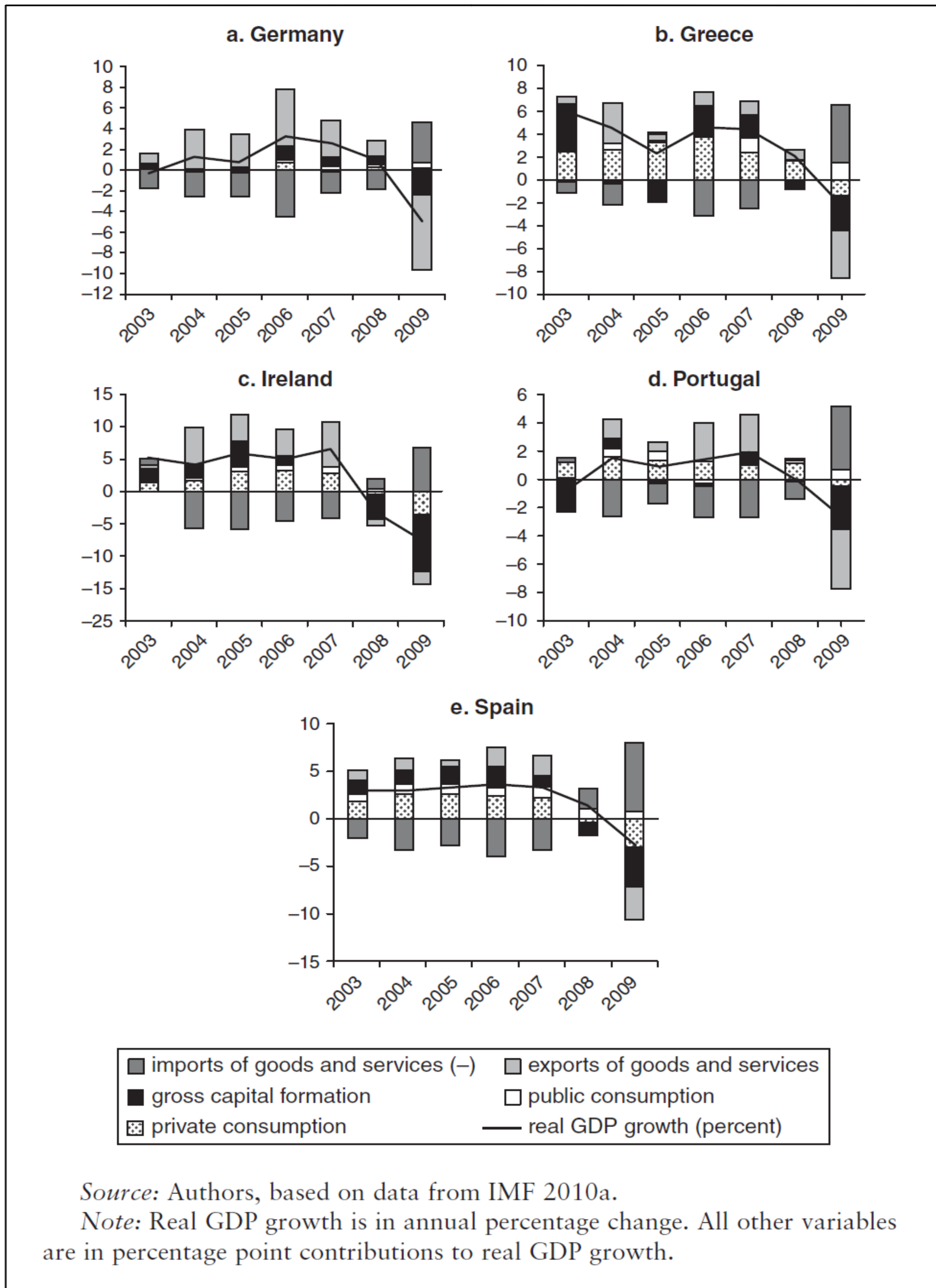

Figure 1. Disaggregation of growth drivers in PIGS
Source: Edgardo Favaro, Ying Li, Juan Pradelli and Ralph Van Doorn, Europe's Crisis: Origins and Policy Options, Sovereign Debt and the Financial Crisis, World Bank, p.237.

The speed at which private debt grew can (partially) be explained by the financial liberalization imposed by the European Union, especially under the "erga omnes"

conception of free movement of capital and the drive to create a "deep" and liquid single financial market.

Table 2. Current Account Deficits (millions of euro)

Country	1997	1998	1999	2000	2001	2002	2003	2004
Germany	-8880	-14539	-25176	-35235	425	42972	40918	102832
Holland	22172	11660	14664	7844	10911	11582	26153	36917
Finland	5610	6035	6534	10280	11636	12149	7027	9439
Austria	-4254	-3121	-3325	-1530	-1754	5871	3776	4842
France	34472	36295	35309	17702	25702	15353	7013	8940
Italy	29674	17724	7694	-6345	-713	-10041	-17337	-13036
Spain	-448	-6342	-16965	-24948	-26823	-23765	-27476	-44164
Portugal	-5876	-7590	-9665	-13167	-13879	-11574	-9230	-12432
Greece	-4231	-3294	-4801	-10624	-10580	-10201	-11266	-10718

Country	2005	2006	2007	2008	2009	2010	2011 (Q1)
Germany	112908	144999	181150	154833	133745	141442	35399
Holland	37275	50436	38427	26191	27803	42144	16639
Finland	5275	6998	7650	5271	4021	5575	357
Austria	4916	7105	9619	13757	8529	7758	3831
France	-8325	-10345	-18913	-33718	-28402	-33657	-10923
Italy	-23639	-38336	-37713	-46001	-31678	-50985	-22312
Spain	-66861	-88313	-105265	-104676	-54481	-48404	-17157
Portugal	-15924	-17186	-17075	-21669	-18362	-17061	-2939
Greece	-14744	-23748	-32577	-34798	-25814	-24057	-7400

The PIGS states endorsed this growth through debt model and maximized short-term political benefits, shifting taxes from sustainable flows of income and consumption to unsustainable flows of income and taxation. This was very attractive in the short-term, as it reduced the average tax burden of citizens (partially compensating for stagnating purchasing power).Nevertheless, it was highly problematic from the beginning because it reduced the states' capacity to brave the storm when a crisis eventually would hit (by compromising the states' ability to use of fiscal policy to alleviate the consequences of an economic downturn), and because it created a false impression that better public services could be provided with lower taxes (and so undermining the tax morale of the welfare state).

At the same time, unsustainable economic activities silently increased the liabilities to the exchequer to the extent that: (1) Each Member State continued to act as an ultimate guarantor of the "national" financial system, creation of money was privatized for all purposes, while each state remained the insurer of last resort (while the European Central Bank has become *the* inter-bank money market since 2007, through its fixed rate and unlimited lending to European financial institutions); (2) Each Member State continued to function as the insurer of last resort for those eventually losing their jobs. Since the size of the sustainable parts of the economy shrunk by non-sustainable activities, sustainable employment decreased (indeed, real estate speculation forced out business activities in both Ireland and Spain even in physical terms).

POINT THREE: At "Core Europe" not all that glitters is gold

The growth through debt model of the PIGS was rendered possible by a "savings" glut in Germany, Netherlands, Finland, Austria and Luxembourg (although in the latter case, most of the money used the country merely as another tax haven in the European Union). See again Figure 1.

This pattern of capital flows from the core Euroland to PIGS was accelerated by the passing of German Agenda 2000 and Harz IV measures, which heightened the competitive position of German corporations by lowering wages and increasing the competitiveness of German goods (despite stagnating levels of investment); thus heightening the structural imbalances within the Euro area.

The flip side of the PIGS coin was the rapid growth of Germany's exposure to international trade. By 2010, 50 per cent of its GDP was exported. The rapid decrease in the wage share means that every year since 2000, Germany has become structurally more vulnerable to a downturn in international trade (as proven in 2008 and 2009, although it seems no lessons have been learnt).

As already indicated, "erga omnes" free movement of capital accelerated the underlying pattern of growth in the financial sector. It encouraged the particular path of adaptation of some countries of the core of the Eurozone to growth through debt; in their case, by means of becoming tax havens for all practical purposes. This is the case for the Netherlands, Austria and Luxembourg (and for the United Kingdom –although Britain is outside of the Euro area- and of the "PIG" country Ireland).

Consider that between 3500 and 5000 *billion* euro of corporate profit transits through the Netherlands every year to reduce or eliminate corporate tax liabilities (at an average 33% corporate tax rate, the EU could fund the European Financial Stability Facility *every year*, assuming –which may be problematic–that all these profits correspond to real capital and not to fictitious capital, and that they are not duplications and triplications of mad money flowing in a tax vacuum. Either way, the figures are staggering and reveal the deep contradictions at the basis of the socio-economic constitution of the Union).[1]

POINT FOUR: "Governance" arrangements *seem* to work fine, but they camouflage very real economic problems

The savings glut and extensive current account deficits were considered as evidence of the effective functioning of financial markets; evidence that there were better investment opportunities in the PIGS states. For example, Spain was generally praised in the famous "peer review" exercises which are part of the governance structure of the Euro area. And which have been revealed to be fully ineffective. Ireland was mildly (and ineffectively) reprimanded for pro-cyclical policies. Portugal and Greece were placed under the excessive deficit procedure while being praised for splendid structural changes that were said to have put the country back into a pattern of sustainable growth.

In brief, formal convergence was concealing the growing real divergence within the Eurozone.

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[1] See van Dijk, Miciel, Francis Weyzig and Richard Murphy(2006). 'The Netherlands: A Tax Haven?', Centre for Research on Multinational Corporations (SOMO) Report, Amsterdam: SOMO. Available at: http://somo.nl/html/paginas/pdf/netherlands_tax_haven_2006_NL.pdf

POINT FIVE: The crisis explodes

The long-term economic crisis, which started in the late 1960s, has pushed investment capital from non-financial activities into finance, and increasingly purely speculative finance. Several financial bubbles have succeeded one another. In the 1970s the banks captured the power to create money, which since then remains only nominally in the hands of the state through its central bank. In the late 1990s and 2000s, this power to create money shifted further to money markets and to the "shadow" banking sector, fuelled by the belief in the capacity of cybernetics (in the form of complex mathematical models) to ensure the stability of financial markets. A grotesque amount of accumulated fictitious capital was formed.

The bubbles were punctured by the unravelling of a major financial crisis between the fall of Northern Rock in August 2007 and the fall of Lehman Brothers in 2008. The interbank market came to a halt in September 2008. The crisis came in earnest.

Main implications of the crisis for the European Union:

a) In the PIGS, the structural tax deficit became visible, contingent liabilities resulting from the state as ultimate guarantor became real, and unemployment exploded. The economies of the PIGS became further dragged down by debt servicing to foreign creditors (which in 2007 represented 3.6 per cent of Greek GPD and 2.3 per cent of Portuguese GDP; the debt was also significant in Spain and Ireland).

b) In the "core" Euroland countries the crisis revealed that borrowing decisions taken by private financial institutions had created a *de facto* fiscal union by stealth. A short-lived panic followed in September 2008. A collection of national decisions, repackaged as European response to the crisis, underwrote the national banking systems and postponed the day of reckoning –i.e. the collapse of the economic and financial system- by means of shifting the fictitious capital from private to public hands. The national character of the decisions camouflage the power exerted by private banks when creating the debt that had created a "unity of financial destiny" within the Eurozone.

POINT SIX: Eurosclerosis redux

The economic constitutional framework of asymmetric monetary Union has been revealed to have played a *central* causal role in the development of the crisis.

Instead of convergence, it has fostered long-term economic divergence, as suddenly revealed in 2008 and amplified in 2009, 2010 and 2011.

Instead of good fiscal policy, it has driven fiscal policy to function pro-cyclically (turning good times exuberant and bad times miserable).

Instead of creating stability, it has rendered it incapable of absorbing any major economic shock. Therefore the Union was hindered from adopting measures when the debt spreads started to grow in early 2009, and also when spreads spiralled out of control in late 2009 after the new Greek government revealed the truth about the state of Hellenic public finances.

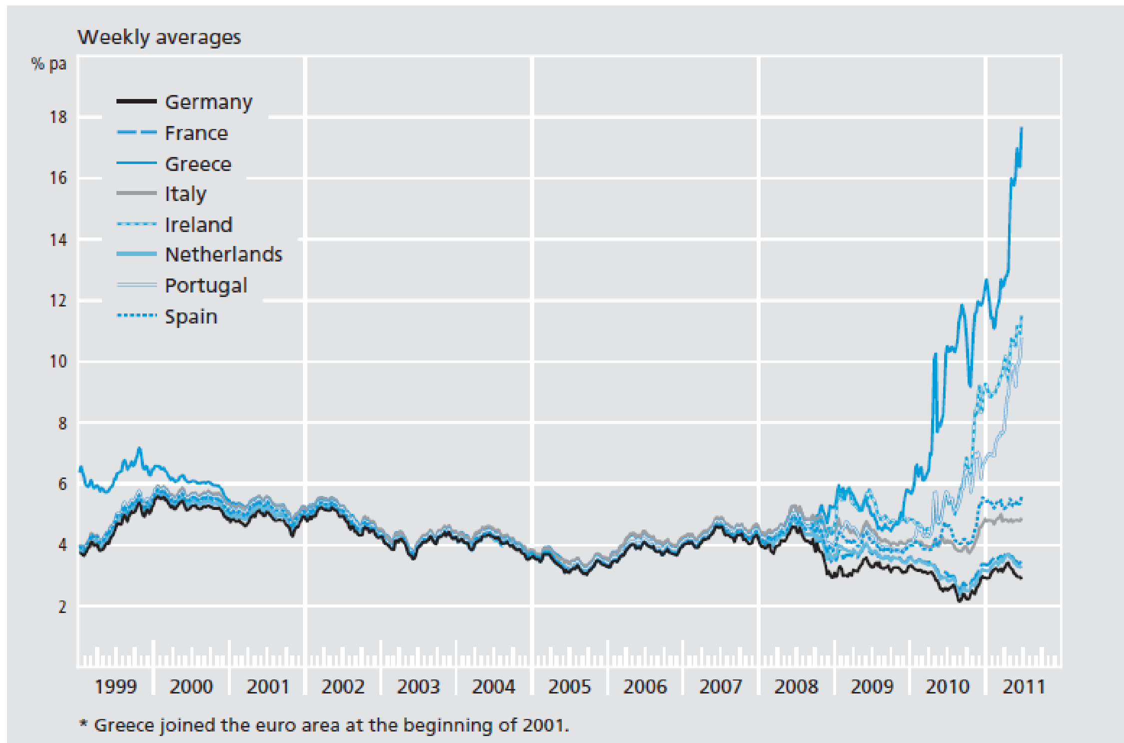

Figure 2. Ten-year government bond yields for selected euro-area countries
Source: Source: Deutsche Bundesbank, Monthly Bulletin, June 2011.

a) The Treaties seemed to preclude the ECB from acting as a creditor of last resort to Member States.

b) Other Member States could not do that either, since the intentional decision was taken to eliminate both the possibility of adopting unilateral safeguard measures and of creating an equivalent institutional structure to the balance of payments aid foreseen in the old Treaty of Rome (and which was activated in 2008 and 2009 for Hungary, Latvia and Romania).

c) The only small window left in the Treaties was article 122.2, which allowed the offering of assistance, provided that one Member State was hit by "exceptional occurrences" beyond its control (such as natural disasters).

However, such construction is problematic. If an economic disaster is to be regarded as akin to a natural disaster, other Member States should behave as they are expected to do when natural disasters hit, that is, in solidarity. That was hardly the way the Greek, Irish and Portuguese "bailouts" were designed. The German government insisted on a specific interpretation of its constitutional law which would prevent any action that could undermine the "stability" culture of Germany. Since collective assistance to Greece could be regarded as imperilling stability, and because a Greek default was equally regarded as endangering "sound money", these two options were off the agenda.

Media has referred to two sets of actors when reporting on the crisis –PIGS governments and core Euroland governments. That is deceiving. It fails to consider that financial markets (and more precisely, holders of both public and private debt) are not merely "markers" of financial health, but have become constitutional actors on their own right. This is especially the case of financial institutions which size exceeds the capacity of their "home" country to effectively wind it up in case it collapses. If a financial institution is too big to fail, it has such a degree of political

power that traditional legal and political analysis may have difficult time coping with its constitutional power, but the latter is however very real. Similarly, unregulated (until 2006 in the US and 2009 in the EU) credit rating agencies have played a key constitutional role by invitation. National and European norms have empowered rating agencies to be the ultimate judges on the financial soundness of investment, even of public investment.

THE MYSTICAL VISION: The Night of the Long Graphs of May 7th, 2010

And still, Member States were guarantors of last resort of their financial institutions, and moreover, such financial institutions had created a "common fiscal destiny" for Europe. It was indeed the "mystical vision" about the interconnection of the European financial system that prompted the U turn of the European Council on May 7th, 2011. Media reports have widely exposed that perhaps the key moment on that night was the slide in which President of the European Central Bank, Jean Claude Trichet, showed the members of the Council the data provided by the Bank of International Settlements on the extent of the involvement of European banks on Greek debt. That triggered the determination to act which had been lacking until then.

Another graphical representation presented here reveals the extent to which tax havens are indeed key turning planks of European finance, as a significant portion of Greek liabilities passes through these. Nevertheless, that role was not part of the official mystical vision, in the same way that the establishment of the special vehicle which sunk Northern Rock in Jersey has been sidestepped in the British political debate.

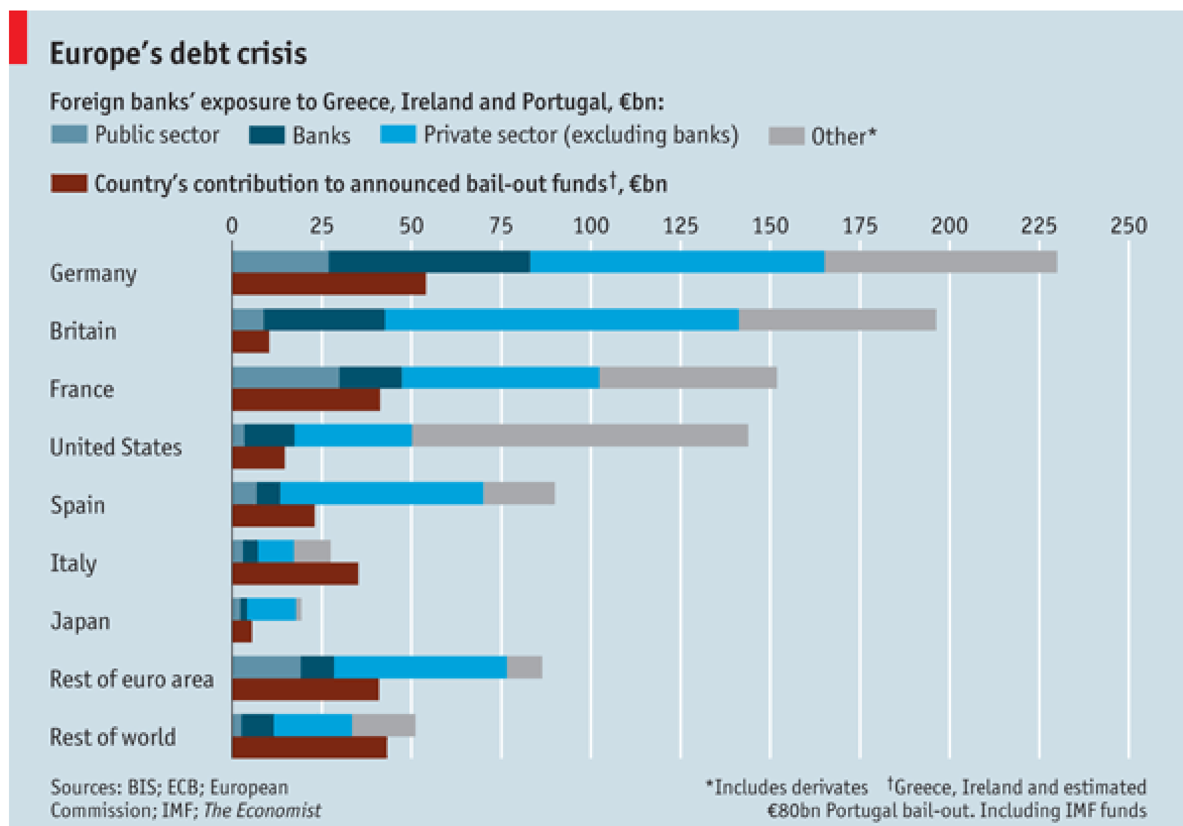

Figure 3. Core Euroland exposure

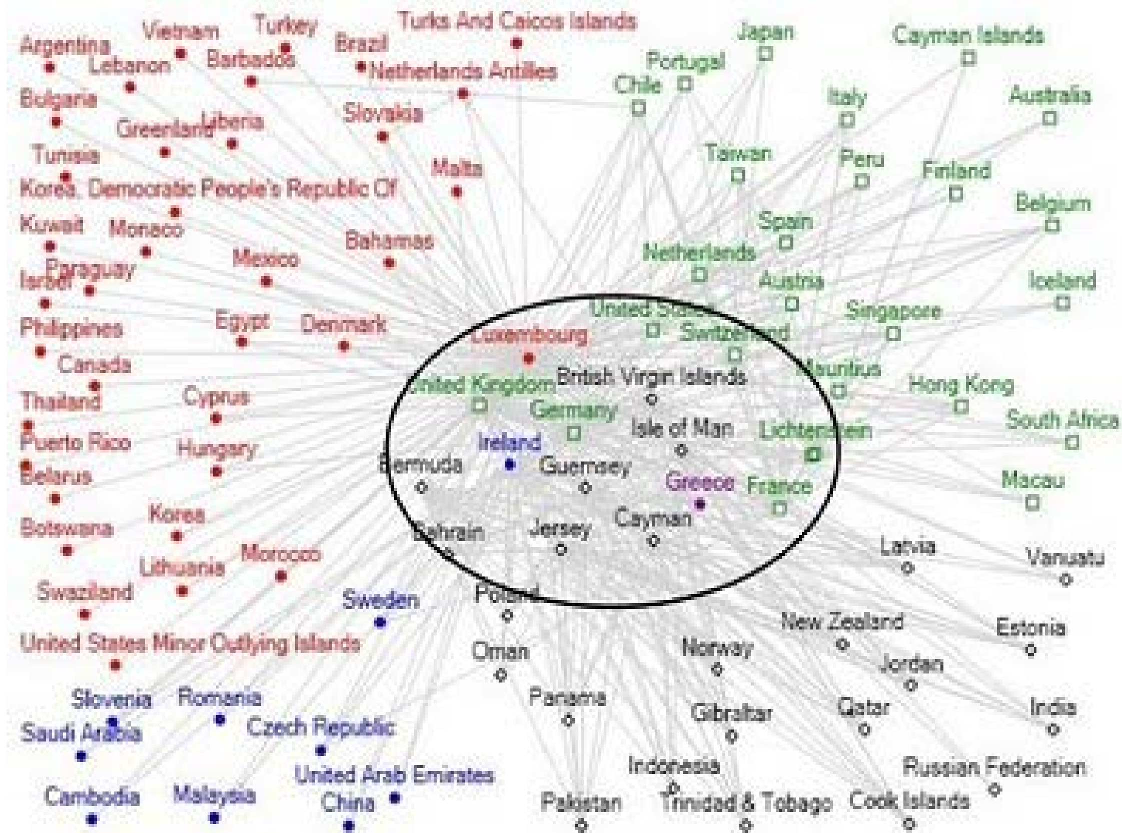

Figure 4. The mystical vision through the Cayman eye
Sources: Lipper (Thomson Reuters); and Fund staff calculations

POINT SEVEN: A constitutional mutation in vain

European leaders pretended that the Greek problem was one of liquidity, not of solvency (and they have continued with this line of thought with Ireland and Portugal).

Greece was provided with bilateral loans (obviously, outside the Treaty framework) at non-concessionary rates on May 2nd. The package was conditioned to a drastic set of austerity measures, at the cost of taxpayers and public employees. Following the precedents in 2008 when aid was provided to Hungary, Latvia and Romania; Europe renounced the idea of being self-supportive and involved the International Monetary Fund financially and operationally.

By May 7th, the constitutional fiction of bilateral loans had to be set aside. Fully fledged albeit formally temporal institutional mechanisms had to be created, using the template of the "bilateral" loans to Greece. Article 122.2(concerning mutual assistance in case of disasters) was invoked to create a European Financial Stability Mechanism reintroducing the old "balance of payments" facility within the Euro area.

At the same time, a "private" intergovernmental agreement created a special purpose vehicle (the European Financial Stability Facility), domiciled in Luxembourg. This hybrid made in the semblance of a hedge fund was to issue debt according to English law for up to 440 billion euro to create the financial basis that could be used for extending further loans to Member States. Collective support was thus interpreted as consisting on loans at punitive rates under strict conditionality.

At the same time, the ECB started to de facto set aside the prohibition of buying national debt by acquiring on secondary markets Greek debt. The securities markets programme was created and activated in the name of ensuring the proper transmission of monetary policy. The same rationale was offered in August 2011 when it was radically expanded to include the acquisition of Italian and Spanish debt (so now extending to almost half of the Euroland public debt market). Though formally speaking this measure has contributed to this objective, it has also resulted in the overlapping of monetary and fiscal policy.

Clear evidence that the Greek and Irish bailouts were being rather counterproductive led to the abandoning of punitive rates in July 2011, but not to a thorough reconsideration of the main features of the strategy followed since May 2010.

Over time, even more debt has been transferred from private (but still very "national") financial institutions to common European institutional structures. It is surprising that the media has not noticed that this shift works to the net advantage of the core Euroland countries, which see their contingent liabilities as insurers of last resort of their financial institutions diminish.

Table 3. Reduction of core Euroland exposure

Sep/Jun 2010	France	Germany	Italy	Netherlands	Portugal	Spain	UK
Portugal	-4.9	-4.5	-1.9	-4.6	0.0	1.4	1.7
Ireland	-5.6	-19.9	-2.4	-5.5	3.0	0.2	-4.5
Greece	-8.0	-3.9	-2.0	-6.4	-1.0	-0.1	1.0
Spain	-19.7	-12.2	-0.9	-20.7	-0.9	0.0	9.8
PIGS	-38.2	-40.5	-7.2	-37.2	1.1	1.5	8.0
Italy	-27.3	1.0		-10.5	3.7	33.0	13.6
Belgium	22.4	3.3	-0.5	-2.9	0.7	4.9	4.5
France		20.5	-0.4	-16.2	8.5	30.0	-8.0
Source: Bank for International Settlements, Markets & Beyond							

POINT EIGHT: The contradictory reform of the economic governance of the European Union

Simultaneous attempts to amend the key features of the governance arrangements of the Union have revealed the impractical character of the multi-headed efforts to reform European economic governance (with clear contradictions between the approach proposed by the Commission, Van Rompuy's Task Force, and Juncker as Mister Euro). Too many heads make the Union headless. Several simultaneous reform processes were launched and these were expected to culminate in October 2011 with the approval of the economic governance package:

a) Fiscal policies are to be coordinated by a shift from a political discretion that is governed by legal principles to a rule-based fiscal policy, which is supposed to ensure *automaticity*.

b) A new set of macroeconomic indicators will allow for a modicum of macroeconomic coordination, backed up and supported by sanctions (and expected to ensure, together with macroprudential supervision of the financial system through the Systemic Risk Board, that no more Lehman Brothers affect Europe).

c) Sanctions to countries in breach of the Stability and Growth Pact are supposed to be "easier" to implement thanks to the introduction of the rule of "reversed

qualified majority"; meaning that if the proposal of the Commission is not blocked by a qualified majority of Member States, it will be applied. The democratic legitimacy of this reversed qualified majority decisions seems to be exceedingly thin. Expect constitutional challenges before national constitutional courts (albeit perhaps not before the German Constitutional Court).

d) Fiscal and wage policies are expected to be discarded as means of achieving autonomous socio-economic principles, unless such objectives can be accomplished in rigorous observance of "sound" fiscal policy.

e) But while sanctions are beefed up, the same "sanctioned" states will be offered bailout funds. At a heavy price, however.

"Rescued" countries and countries under the shadow of needing rescuing will have for all purposes their democratic sovereignty suspended for a long period. The "carrot" of bailout funds will be harsh conditionality hidden under the neospeak jargon of "national ownership" of austerity measures. The underlying premise is internal deflation would allow them to re-stabilise their economies. Which given the circumstances in which they find themselves (with a clear incapacity of public authorities to foster investment), means a brutally lower wages and, consequently, an increase of the capital share in the economic pie.

The new governance arrangement will be further amended according to Van Rompuy's statements on the matter (new proposals have also been announced by the Commission). For once, that seems proper. The new scheme is permeated by a major paradox: countries in difficulties will be sanctioned, only to be offered at the same time bailout funds. What is the rationale of this?

POINT NINE: Some troubling questions

What is the chance of a brutal internal deflation delivering economic recovery without currency depreciation? As a recent study by the International Monetary Fund has reminded us, there are few instances of long deflation processes, and none of these resulted in the "restarting" of the economy. On the contrary: most of them ended in default. Invoking the Latvian program of internal deflation as a success story, as Van Rompuy has become keen on, is a trifle too cheeky. The jury on Latvia is definitely still out. The temporary "success" in increasing exports results from the peculiar pattern of Latvian trade, in particular, from Sweden and Russia being its two major trade partners (two partners that have experienced a temporary higher growth rate than the Euro area in the last couple of years). Whether this will allow a permanent mending of the Latvian economy is still to be seen (and for sure the Latvian in the Clapham omnibus seems very-very sceptical on this one).

What is left of democracy if during one wild night a Prime Minister (the Irish one) can decide with six bankers to spend between 100% and 200% of the national GDP?

What is left of the Social and Democratic Rechtsstaat when for reducing one form of debt (financial debt), the state repudiates another form of debt (social debt)?[2]It must be taken into account that this surrender of the state, this repudiation of obligations assumed by the state is characteristic of all austerity programs? What is left of the idea of democratic constitutional law when constitutional reforms are introduced without any significant political mandate and through procedures of

[2] Social debt is what all citizens owe to each other in the form of socio-economic rights.

"urgency" which are alien to the "pace" of *both* representative and participative democracy? Or when the national constitution is simply set aside? A clear instance of a European fostered breach of the national constitution is the recent troika-imposed firing of tenured civil servants in Greece. This is a plain breach of Article 103 of the Greek Constitution, which guarantees a post for life to tenured civil servants.

POINT TEN: A self-destroying European Union?

Fiscal Union must be, will be, but can't be.

Any attempt at achieving fiscal union through a brutal process of internal deflation and adherence to a draconian subordination of fiscal and wage policies to monetary policies is a recipe for disaster. Following that path, European collapse is just one political accident away. That political accident could be a parliamentary rejection of one bailout or social protest pushing one rescued state to go against the austerity measures. It must be kept in mind that there is no precedent whatsoever of internal deflation being effective in reviving an economy. That being so, following this strategy in five Member States is a very risky experiment. If PIGS are pushed to the wall, and forced to impose measures which require the State abandoning overnight commitments at the core of the constitutional foundational pact of each society, when the societal tissue will break up is uncertain, but that it will break up is close to unavoidable. What seems suicidal from the standpoint of core Euroland (exiting the Euro and the Union) would sooner or later become a respectable alternative to thirty years of austerity.

Bringing in common debt through Eurobonds could only work if it implies assuming the need of redistributing the costs of the debt across borders, and if it results in combining common tax revenues to back the issued debt. European debt requires European taxes which presuppose a genuinely representative European Parliament. There is no money without taxes. It is taxes that create the trust in the money, and actually constitute it while constituting society. While much emphasis has been placed on the limits of the Treaty, and German constitutional limits on the move to fiscal union, the real obstacle is political. The recent judgment of the German Constitutional Court proves again the extent to which it is more the politicians than the judges who are the prey of constitutional fetishism.

The recently proposed Financial Transactions Tax is very commendable in abstract, but given that the Commission has not advanced any explanation of how it could muster a unanimous approval among Member States, it seems a nice piece of rhetoric. Consider again the case of the Netherlands. Having developed a tax evasion industry which controls flows of a size several times the national GDP, could the Commission expect a positive vote of the Dutch government? Only when the Commission would take seriously Article as a means of avoiding unanimity in tax matters, the European Tobin tax would stand a chance of being written in the books of European law.

Conclusion

After the Single European Act Altiero Spinelli claimed that the mountain had given birth to a dead mouse. We know now that the asymmetric monetary union was a very dead mouse indeed. Furthermore, we know by now that internal deflation was never anything else but a dead mouse. How many more dead mice can the European political project afford?