

James, Harold

Article

Growing Stronger: What Way Out for Europe?

CESifo Forum

Provided in Cooperation with:

Ifo Institute – Leibniz Institute for Economic Research at the University of Munich

Suggested Citation: James, Harold (2013) : Growing Stronger: What Way Out for Europe?, CESifo Forum, ISSN 2190-717X, ifo Institut - Leibniz-Institut für Wirtschaftsforschung an der Universität München, München, Vol. 14, Iss. 3, pp. 35-43

This Version is available at:

<https://hdl.handle.net/10419/166548>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.

Panel 3

GROWING STRONGER: WHAT WAY OUT FOR EUROPE?

HAROLD JAMES

Professor of History; Director, Program in Contemporary European Politics and Society and International Affairs, Princeton University

Introduction

I would like to offer two contrasting historical patterns or models, three lessons to be drawn from those very old experiences, and finally one principle – flexibility – on which a stronger Europe can and should be built. Maybe we should think of this exercise as carrying on the over-arching conference metaphor of slimming, getting fitter and building strength: what do we need to eat after the lettuce and carrots purgative regime? Should we get strong by eating Bavarian *Weißwürste*, Austrian *Knödel*, French *pâté de foie gras*, or English *roast beef*?

Some history and some models

We are today in Europe in the middle of a debt crisis and a political crisis. Debt can be a political poison, or it can become what Alexander Hamilton hopefully styled ‘the strong cement of our union’. Looking to history, we see two contrasting models of how apparently excessive debt can be handled, coming from two contrasting political traditions. They are associated with two revolutions, one peaceful and wealth-enhancing (1688 in England), the other violent and destructive (1789 in France).

Not reneging on public debts is a central principle of political life that is deeply intertwined with the development of legal security, of representative government, and of modern democracy. Both the movement to hold governments accountable and the move

to control budgets had their beginnings in England, before the successes of that largely peaceful ‘revolution’ inspired worldwide imitation. This is the roast beef solution.

In the late seventeenth century, in the wake of Britain’s Glorious Revolution in 1688, when Britain revolted against the spendthrift and autocratic Stuart dynasty, the British government adopted a new approach to debt. Voting budgets in parliament – a representative institution – ensured that the people as a whole were liable for the obligations incurred by their government. They would thus have a powerful incentive to impose controls. Fundamentally the people who voted the taxes in parliament were also the holders of government debt. A constitutional approach limited the scope for the wasteful spending on luxurious court life (as well as on military adventure) that had been the hallmark of early modern autocratic monarchy. The result was a dramatic reduction in the borrowing costs of the British state. Representative government, and its logical outgrowth, the democratic principle, became part of the classic model of good debt management.¹

It also reduced private borrowing costs, by promoting the operation of a well-functioning capital market. What distinguished the private borrowers from the state was the possibility of bankruptcy, which for the state had become an unthinkable event. A market, in which there are many separate interactions, and always a possibility of failure, thrived because of a state that was so managed that it could not go bankrupt.

At the beginning the achievement was precarious. Eighteenth century Britain seemed constantly in danger of ignoring the basis of the 1688 constitutional settlement, because of its costly addiction to Great Power politics. Particularly in the middle of the eighteenth century, British debt levels surged. At the end of the *Wealth of Nations*, Adam Smith commented on the legacy of the Seven Years War: “the progress of the enormous debts which at present oppress, and will in the long-run probably ruin, all the

¹ The classic exposition is North and Weingast (1989).



great nations of Europe, has been pretty uniform [...] When national debts have once been accumulated to a certain degree, there is scarce, I believe, a single instance of their having been fairly and completely paid. The liberation of the public revenue, if it has ever been brought about at all, has always been brought about by a bankruptcy; sometimes by an avowed one, but always be a real one, though frequently by a pretended payment” (Smith 1976, 466–467). So even the greatest economist was scared of debt and of the ruination it might cause.

The alternative model to that of British constitutionalism was that of *ancien régime* France: there regular state bankruptcies involved a reduction of interest payments and a stretching of maturities on state debt. France’s debts too built up in the eighteenth century as a consequence of great power politics, the search for empires, and costly wars. After the conclusion of the American war of independence, instead of going back to the old French model – default – which had been put into effect as recently as 1770, the French elite did everything they could to avoid a default. They were afraid that their system was fragile, and so, in 1787, the government offered *foie gras*. It bailed out the private investors who had lost in an immense speculative scheme to corner shares in a reorganized East India Company (see Velde and Weir 1992). But there was a problem: the existing tax system had reached the limits of its capacity, and no more revenue could be raised without ending time-honored privileges and immunities. In the end, the only viable course was massive confiscation – the creation of *bien nationaux* as the basis for the issue of state debt. But that measure, instead of calming the financial situation, led to an escalation of expectations of what the state could and should do, and exacerbated social tensions. In short, adherence to the principle of non-default produced the French Revolution. The lesson of the French experience is that political systems will collapse if they take on too much debt and then try to pay at any cost. The situation was the reverse of Britain: there was no adequately functioning market that discriminated between risks, and as the counterpart a state whose commitments became incredible as it absorbed losses produced in the non-functioning market. The experience involved a long term cost. It made French society poorer relative to Britain in the century after the Revolution, as well as habitually inclined to look for *étatist* solutions.

A European problem

Contemporary Europe faces a new version of these eighteenth century historical dilemmas in an acute form. Do we or do we not have a debt level that is unsustainable? And if it is sustainable, how does Europe need to be organized so as to let the confidence in the secure asset of state debt translate into a more general capacity to finance private initiative, based on a secure belief that private claims are safe from unpredictable acts of state seizure?

In theory, Europe shouldn’t be in a bad shape. The fiscal picture is not hopeless, even in the aftermath of the acute financial crisis of 2008–2009. For 2012, the government deficit for the eurozone was 3.6 percent, and the net government debt level (swollen in some countries such as Spain and Ireland by the cost of bank bailouts) was 71.9 percent of GDP. The debt figure is lower than that of the United States (87.9 percent), whose deficit is also much worse (8.5 percent) and Japan’s statistics are much worse (134.3 percent and 10.2 percent).²

There are reasons to be confident, and even proud: the history of the major successes of post-1945 Europe, of restoring democracy and peace to a war-ravaged continent. But currently Europe is in an existential crisis, more profound than any challenge of the postwar order. The problem is primarily political. Muddling through is a characteristic response of complex intertwined and interlocked political systems, but it is deeply destructive of confidence and capacity, and ultimately of legitimacy. In fact, maybe we should think of a third historical model, alongside that of Britain and France: that of the multinational Habsburg Empire. While France had increased its power by military conquest, the Austrian Habsburgs depended on the chance accumulation of territories with mutually incompatible political and legal orders through dynastic marriage (*tu felix Austria nubes*). There is more than a little of the old Austrian principle of *Fortwursteln*, muddling through, in contemporary Europe’s approach to crisis.

There are two related problems: the political/institutional disfunctionality that turns the overall debt and deficit figures into existential issues; and a long term doubt about the effectiveness and capacity of Europe to produce innovation, entrepreneurship,

² See IMF World Economic Outlook, April 2013.

dynamism, and growth. Even before the financial crisis, long term growth assessments were generally gloomy; they have become worse since then.

What can governments do to improve longer term capacity? It is hard to see isolated big infrastructure projects – more Stuttgart stations or Berlin-Brandenburg International Airports – as the answer, though such spending is vigorously championed by newly invigorated Keynesian enthusiasts for stimulus. Later, I shall return to the theme of measures that might make the labor market operate more efficiently, on a European rather than a national level. At the moment, fixing the institutional flaws looks like the most urgent task.

Problems and lessons

The first lesson from the historical models is that indecision, trying to take ideas and policies eclectically as a result of a bargaining process leads to poorer choices and indeed paralysis. That was the French problem on the eve of the French Revolution: denying that debts should be written off, but at the same time accepting a large expansion of potential claims.

The second lesson is that the difficulty of reaching a clear and consistent answer is heightened when class or distributional conflict becomes the major focus of concern. The Cyprus crisis has exposed a new dimension to the clashes over Europe's debt and bank crisis. The discussion of a levy on bank deposits, and whether small customers should be exempted, puts class conflict at center stage. At one of the tensest moments, as Cyprus was looking for an alternative rescue package from Russia, the German Bundesbank announced the results of a new ECB study on comparative wealth distribution in Europe. According to this study, German average wealth was below that of the southern European states, largely because fewer Germans own their own houses. The message must have been intended to influence the international discussions: why should poorer Germans make sacrifices to support Mediterranean millionaires? Or Russian oligarchs?

On the other hand, southern Europe saw itself as a victim of a mercantilist export promotion strategy of the north – especially Germany – to obtain competitive advantages through a fixed currency re-

gime. That was a case that was already sometimes made in respect to the European Monetary System established by Helmut Schmidt and Valéry Giscard d'Estaing in 1978, but more potently in respect to the currency union. North and South see the effects of the monetary union in class terms.

In the aftermath of the financial crisis, income and wealth distribution has moved to the center of political discussion. Even the cardinals of the Catholic Church seem to have caught the new mood quite precisely, when they elected Archbishop Bergoglio as Pope Francis. The clear reference to St. Francis of Assisi recalls the Church's mission to stand up for the poor.

The third historical lesson is that solutions become even harder – and distributional conflicts more common – when there is an obsessive focus on economics and economic growth alone. There is a well-known paradox of freedom, that free institutions promote economic growth, but that if you desire freedom primarily and instrumentally because it is likely to bring growth, you are unlikely to get the good result. The story of state- and nation-building is similar: good rules make for prosperity and happiness, but explicitly looking for growth backfires.

Europeans find it hard to find a positive way of describing the exercise in which they have been engaged for the past half century. One common interpretation is that integration is simply the best or most convenient way of making people better off. Togetherness is supposed to be a foundation of prosperity. The Common Market was presented at the beginning in terms of an argument about the gains that would follow from increased trade. There then followed a debate about the benefits of capital market integration, and then of a single currency.

This case was a repetition of some powerful arguments that were made in the nineteenth century about national integration and unification. In particular the two countries whose problems drove much of the need for twentieth century European integration – Germany and Italy – were culturally and politically highly diverse. In the early nineteenth century, both countries had had a romantic and idealistic nationalism – but that gave way after the failures of the revolutions of 1848 to a new hard-headed sobriety and an obsession with economic forces.

The influential German journalist August Ludwig Rochau, the inventor of the term *Realpolitik*, gave a very nice definition of the new German mood on the eve of Bismarck's last war of unification. German unity was not a question of a desire of the heart, he said. Rather it was 'a mundane business transaction, in which no one should lose, but everyone should grab as much as they could for themselves'.

This sort of economic nationalism briefly produced in Germany and Italy coalitions of interests that supported the drive to national unification under Bismarck and Cavour. The problem arose that when growth faltered, the credibility of the national project seemed to crumble. Instead, movements emerged that championed a much more aggressive and confrontational nationalism that was based on the principle of a violent assertion of principles of cultural identity. That is the risk that we are currently facing.

Constitutionalization

Europe has not gone about constitutionalization in the way traditionally associated with state formation, and with the British example of 1688. In the often-cited case of the United States, the monetary framework, with the 1790 Coinage Act, and the fiscal framework provided by Alexander Hamilton's controversial debt mutualization, took place in 1790. That was only possible because the Congress had agreed in 1787 on a constitution: it was deeply influenced by the lesson of 1688.

Nineteenth century Germany also has the same very clear pattern. Constitutional rules first, a monetary framework later. The German Empire was created on 18 January 1871. In 1873 the coinage systems of the German states, the Thaler of the north and the Gulden of the south, were superseded by the establishment of the Mark. Only two years later was a central bank, the Reichsbank, created: not to handle fiscal issues so much as to deal with the financial instability that followed in the aftermath of the *Krach* of 1873.

The Europeans seemed to turn this on its head in the 1990s. They developed a mechanism that provided a mechanism for debt claims to expand, without a secure and precise set of rules limiting the exposure of the public sector to private obligations. In choos-

ing a 'pure' money in the 1990s, free of any possibility of political interference and simply designed to meet the objective of price stability, Europeans were taking an obvious risk. They were obviously and deliberately flying in the face of the dominant modern tradition of thinking about money. The creation of money is usually thought to be the domain of the state: this was the widely prevalent doctrine of the nineteenth century.

The post-crisis search for fiscal rules and for a banking union, with not only a system of regulation and supervision, but also a resolution mechanism, is part of a drive to make the eurozone more like a conventional state. But both of these exercises raise profound problems.

How can Europeans be created?

What is the alternative tradition to thinking about Europe as a way of generating wealth and prosperity? A few years ago, the European Union was extolled as a postmodern creation, not like a traditional state with a firmly defined sovereignty (and a dramatic contrast with the United States) – see Cooper (2004). Sometimes analysts looked at the old, but very long-enduring, Holy Roman Empire, famously analyzed by the jurist Samuel Pufendorf as 'like a monster' because it had no clear head or sovereign. In fact, I believe, something of this flexibility needs to be revived.

What is needed is a new flexibility: not a replication of any sort of existing state. That flexibility is the core principle needed for realizing a secure and robust system of rules. The primary goal of such flexibility should be to avoid the build-up of expectations about support – or bailout – from common political institutions; and at the same time build an awareness of Europe's unique interconnectedness.

More flexibility in monetary policy

A common criticism of monetary union is that it requires a single monetary policy, that thus becomes 'one size fits all' and deprives policy-makers of a policy tool in responding to particular national or regional circumstances. This old critique was recently taken by Chancellor Merkel.³ It reflects a genu-

³ Financial Times, 26 April 2013, Merkel austerity comments highlight eurozone division on interest rates.

ine problem in the original conception of monetary union. When the EC Committee of Central Bank Governors began to draft the ECB statute, it took two principles as given: price stability as the primary objective of the central bank; and the indivisibility and centralization of monetary policy. This would not be ‘in contradiction with the principles of federalism and subsidiarity’ (James 2012). But in fact the second assumption was not really justified either historically or in terms of economic fundamentals.

Think first of the gold standard. A critical part of the gold standard was that individual national central banks set their own interest rates, with the aim of influencing the direction of capital movements. Incidentally the same differentiation of interest rates also occurred in the early history of the Federal Reserve System, with individual Reserve Banks setting their own discount rates. The eurozone is now moving to a modern equivalent, driven by a new concern with macro-prudential regulation. Bank collateral requirements are being differentiated in different areas; and the logic should be carried further in order to forestall future regional bubbles (Brunnermeier 2012). This represents a remarkable incipient innovation. In the aftermath of the crisis, some policymakers are beginning to see that a monetary union is not necessarily identical with unfettered capital mobility. Recognition of diverse credit quality is a step back into the nineteenth-century world, and at the same time forward to a more market-oriented and less distorting currency policy.

More political flexibility

In the aftermath of a big financial crisis, banking regulation is inevitably linked to implicit or explicit lender-of-last-resort functions and to resolution for failed banks. So there is also a significant fiscal cost, and that raises the same thorny political questions. In particular, what is the optimal unit for handling the resolution issue? The logic of possible bank workouts points to a desirability of larger banks and more cross-national banks as a risk-sharing mechanism. But the fiscal cost and the fact that only states can bear that cost push in the opposite direction, and have led in the past three years to a dangerous disintegration or renationalization of finance in Europe.

What is now termed a banking union – that is common European regulation with some fiscal capacity for resolution in the case of failed banks – is a very

belated but necessary completion of the monetary union. Even this step is still uncertain, and excites a great deal of opposition from Germans who do not want to bailout south European banks. The critics have correctly identified the problem that some sort of permanent fiscal mechanism is required in order to pay for the bailouts and thus in fact implies a move to a real political union which regularly redistributes resources.

Problems of transfers in a large unit are at the heart of the political process of building federations or federalism. Integration had its own historical momentum, and if and when it goes into reverse, that process will also have a counter-momentum. The argument against the creation of new European structures rests on hostility to a transfer union that might lead to some redistribution of resources. Why should our money be taken away and given out to people in a very different area? What sort of claim do those very different peoples have?

The better way of discussing transfers within a large and diverse political order is to think of them as individualized or personalized. In particular, a European-wide social security system would not only offer the advantage of completing the labor mobility requirements of the single European market. It would also provide an important buffer in that booming areas would pay in more, and shrinking areas would draw out more – without these payments going through government bodies and appearing as transfers from North to South – whether in a country such as Italy or in the whole of the European area. Defusing the political problem requires less stateness and statehood, and not the erection of a European super-state.

Restraint in the creation of new state structures is required for another reason. We know that a commitment to monetary stability is only possible in the context of governments that can credibly commit to a fiscal regime in which there is no long term build-up of claims that cannot be funded through taxation – or in modern parlance, avoid fiscal dominance. That was a problem to which federal systems of the past were especially vulnerable (Sargent and Wallace 1981). Hyperinflation almost tore apart early 1920s Germany, with separatism in Bavaria, the Rhineland and Saxony. In late 1980s Yugoslavia, as the socialist regime disintegrated, the monetary authorities in Belgrade were closest to Serbian poli-

ticians such as Slobodan Milosevic and to Serbian business interests. The Croats and Slovenes wanted to get away. In the Soviet Union, inflation appeared as an instrument of the central Moscow bureaucrats, and more remote areas wanted to break away. A coherent and stable framework is needed to stop the proliferation of fiscal actions that destroy monetary stability.

Concluding remarks

The euro story is about the breakdown of governance mechanisms in the face of enormous financial claims, for which there is no obviously just mechanism of working out a burden-sharing arrangement. It echoes some of the problems of ill-defined or poorly constitutionalized federalisms of the past: the Austro-Hungarian Empire or Argentina. The European experience holds broader lessons, for other countries as well. Risk can be better managed if it is broken down into smaller packets, and not consumed as an indigestible whole.

(1) Mega-finance is a danger to fiscal stability, because first it permits the easy financing of deficits, but also the development of large disparities of wealth and income. Its breakdown then requires large government funded rescues and raises the problem of fiscal sustainability.

(2) Fiscal sustainability in the long run requires some sort of politically negotiated agreement. That needs to be rule-based, but also to permit flexibility as part of a strategy of immediate crisis response. Rules do not often constrain governments, so it is better to run stabilizers through non-government institutions such as insurance systems.

(3) Without such flexibility sovereign bankruptcy becomes a disastrous and destructive event that uncontrollably generates contagion.

Though all the underlying problems have been around for a long time, there is always a temptation to do what Europeans did until the financial crisis that is merely hope that with time the problems would vanish.

Preserving democracy in the face of antagonistic competing claims on the state involves the elaboration of mechanisms for giving citizens a share in a

joint project – both materially and imaginatively. That was essentially the lessons of 1688: payments can become an act of solidarity when people believe they may benefit, and know that they won't be expropriated, because overall liabilities are legally and politically fixed. The alternative lesson is that of 1789: when claims become too complex as well as too large they trigger a distributional free for all in which solutions can no longer be negotiated, and need to be violently imposed. Europe today should be looking for its 1688, and not for a reenactment of 1789. Roast beef, not *foie gras*.

References

- Brunnermeier, M. (2012), "Macroprudential Regulation: Optimizing the Currency Area", in: European Central Bank (ed.), *The Great Financial Crisis: Lessons for Financial Stability and Monetary Policy*, Frankfurt, 29–35.
- Cooper, R. (2004), *The Breaking of Nations: Order and Chaos in the Twenty-First Century*, London: Atlantic Monthly Press.
- James, H. (2012), *Making the European Monetary Union*, Cambridge Mass.: Harvard University Press.
- North, D. and B. Weingast (1989), "Constitutions and Commitment: The Evolution of Institutions Governing Public Choice in Seventeenth-Century England", *Journal of Economic History* 49, 803–832.
- Sargent, T.D. and N. Wallace (1981), "Some Unpleasant Monetarist Arithmetic", *Federal Reserve Bank of Minneapolis Quarterly Review* 531, Fall, 1–17.
- Smith, A. (1976), *The Wealth of Nations*, Chicago: University of Chicago Press.
- Velde, F. and D. Weir (1992), "The Financial Market and Government Debt Policy in France, 1746–93", *Journal of Economic History* 52, 1–39.

PANEL

Taking up Mr James' idea that prosperity alone is not sufficient to cement a union, the second speaker, **Wolf Klinz**, Member of the Committee on Economic and Monetary Affairs (ECON), European Parliament, Brussels, insisted that Europe is more than the euro and the eurozone, it is a vision of basic shared values. Yet a clear vision of Europe twenty years from now and the consensus to implement such a vision are both currently lacking, noted Mr Klinz. Instead there is a widespread crisis of confidence in Europe among its citizens.

Against this background, Klinz believes that this visionary element urgently needs to be added to the bail-out packages for crisis-afflicted countries as re-

cent euro rescues have violated many of the shared values expressed in the European treaties. Europe, in Klinz's opinion, needs to be relaunched with a focus not on ceding sovereignty, but on pooling it. In the relaunch of Europe the question of subsidiarity is very important in the sense that decisions should be taken at the right level. The principle of democratic accountability needs to be applied much more strictly in the future, he added. Due to time pressures and the need to react to the markets, the member states have opted for an inter-governmental approach over the last 2–5 years, rather than implying a community method; leaving the European parliament out of decisions on important projects like the ESM and the fiscal compact. Mr Klinz also highlighted flaws in the European Parliament itself, which is not based on proportional representation and needs to become more transparent. Open communication policies are required to manage the expectations of Europe's citizens more effectively, argued Mr Klinz.

Looking ahead, Mr Klinz expressed the hope that tomorrow's Europe will be attractive to investors and innovation leaders, it should ensure that non-eurozone members like Britain are happy within Europe, that the competences between member states and regions are readjusted by pooling sovereignty and implementing a European approach to issues like energy policy, transport etc.

Mr Klinz ended his speech by raising two questions: whether the powers of the European parliament should be beefed up in the future to give it more clout, and whether a second, Senate-like chamber should be introduced, so that we can say that these representatives have been directly elected. In Mr Klinz's view the European Commission should be reduced to the status of a governing body with a president elected by the European Parliament.

Despite the progress that has been made in Europe, Mr Klinz acknowledged that it is not an optimal currency area. In his view, this is all the more reason to try to make improvements in areas where they are possible like the labour market by facilitating more migration within Europe. Welfare standards should be at least partially harmonised, he concluded, and elementary school education must be improved if Europe's re-launch is to be successful.

The next speaker, **Jay Ralph**, Member of the Board of Management of Allianz SE and Chairman

of Allianz Asset Management, Munich, began by pointing out that both the United States and Switzerland didn't have federal currencies initially, and that their currencies were only introduced at a later date. Citing the Latin Monetary Union (LMU), which was founded in 1785 and disintegrated in the late nineteenth century, Mr Ralph highlighted three lessons to be learned from it. Firstly, cheating destroys unions, so you need a means of enforcement if you have a union; secondly, fixed exchange rates can attract speculation, so systems with flexible mechanisms are needed to deal with change; and thirdly, any monetary union will fail without a political and a fiscal union.

Will the crisis push the EU towards a stronger fiscal, banking and political union? In Mr Ralph's opinion, this is inevitable as the alternative is chaos. He outlined the following seven pillars for the future of Europe: tougher EU governance *via* EU institutions with greater democratic legitimacy, explicit exit rules, a fiscal rule book, the provision of economic guidance to correct imbalances, institutions with enhanced competencies, common policies to foster competitiveness and growth, and a sovereign debt mechanism. In his opinion, less banking intervention is needed and more political leadership. He wound up his speech by saying: "*We need a destination that is clear and a roadmap on how to get there*".

Werner Hoyer, President, European Investment Bank, Luxembourg, picked up on the historical perspective of the euro crisis presented by Mr James and Mr Ralph. Mr Hoyer began by recalling that the link between political and economic union was clear to everybody when the euro was designed. There was a very controversial debate between Hans-Dietrich Genscher and Otto Graf Lambsdorff at that time. Lambsdorff supported the optimal currency area, but thought that events were happening in the wrong order, i.e. that political union should have preceded financial union. Yet Genscher sensed that there was no political will amongst Germany's neighbours (shortly after German unification) to make the *quantum* leap towards political union at that time, so he reasoned that monetary union would bring about the necessary pressure to proceed with political integration.

As the Germans were keen to see some protection against the potential risks of a monetary union, the idea of the stability and growth pact was born. As

an instrument this pact may have had too few teeth from the outset, conceded Mr Hoyer, but the principle of minimising risk was clear. Nobody would ever have imagined that the strongest partners in the EMU, France and Germany, would later be the first to break pact, he continued. They exerted their influence to escape the few teeth of the pact, but have suffered the consequences. According to Hoyer, these developments highlight the urgent need to re-establish the link between political and economic union. This process should involve rebalancing the equality of peoples within Europe to give a small country a say, but to grant citizens equality. Like Mr Klinz, Mr Hoyer emphasized the need to reweight votes into the European Parliament in order to give it greater legitimacy.

Moving on to the topic of reform, Mr Hoyer cited perseverance as a major problem in Europe and stressed the need to invest more heavily in sustainable structures. He noted that the ECB has taken courageous steps towards restoring confidence in the EU, but these measures have only bought time for politicians to sort things out and this time is running out. One of the lessons to be learnt from the crisis, he added, is that people should concentrate on their own remit and not mix functions. He expressed concern that expectations regarding the possibilities open to banks like the EIB and ECB are too high and need to be managed. Mr Hoyer ended by warning that we should not rely exclusively on banking finance, which is Europe's major weakness, but should ease access to long-term financing and credit for SMEs.

The first question from the floor was raised by **John B. Richardson**, Special Adviser on Maritime Affairs, FIPRA International, Brussels, who pointed out that there had been a great deal of talk about austerity, but little of solidarity. In his view the use of these terms is often confusing. According to Mr Richardson, Europeans want greater fiscal responsibility and discipline, not austerity, from their governments. He floated the idea that the richer citizens of Europe may prove more willing to express solidarity with their fellow European citizens suffering from austerity if they could bypass government. Mr Klinz responded that austerity often leads to misery and can produce empathy among others, but likened it to chemotherapy treatment for cancer, which may cause pain, but subsequently leads to a

return to solidity. Solidarity and solidity need to go hand in hand, emphasised Mr Klinz.

The next question came from Clare Pearson, Corporate Social Responsibility Manager Asia, DLA Piper UK Ltd, Beijing, who asked what Europe is doing to integrate immigrants, to engage China and to flatten its borders in order to sell projects. How is Europe going to compete as a continent in the future? Mr Klinz did not think that Europe should try to imitate China's behaviour in conquering new global markets. It is true that China is successful, conceded Mr Klinz, but he was sceptical about China's value as a role model.

Guy de Jonquières, Senior Fellow, European Centre for International Political Economy, London, shifted the discussion towards a common social security system by asking how it would be financed and whether this would revive quarrels about a transfer union. Mr James answered that it would be very problematic to set up a common social security system and such a system would have to depend on payments into it, which would mean moving towards a US-style system as a model.

Mr Ralph noted that workers in Switzerland pay into a corporate system, but if they switch jobs, their pension moves with them. Any fiscal union involves some redistribution of wealth, noted Mr Ralph, who suggested taking VAT revenues, pooling them and redistributing term per capita and issuing Eurobonds against those funds backed by stream of revenue, with conditionality. Mr Ralph believed that these bonds would only be used to finance debt and speculated that immediate liquidity would be seen in the markets. Such VAT backed bonds would only serve to eliminate debt, he argued. However, Mr Sinn questioned the viability of financing European bonds *via* VAT, or introducing any form of redistributive mechanism, without a European state.

Andy Goldstein, Executive Director, LMU Entrepreneurship Center, Munich, raised the serious issue of high youth unemployment and asked how this could be reduced and how young business could be more effectively supported. While Mr Hoyer described youth unemployment as a ticking bomb, he admitted that there was no quick-fix solution to the problem and highlighted the need for a hugely differentiated toolbox to tackle the issue. To boost start-up businesses and venture capital projects, Mr Hoyer ad-

vocated a focus on innovation and stressed the need for Europe to be less inward-looking and to adopt a more global outlook by analysing major worldwide trends and their implications more closely. Mr Klinz suggested that start-ups should enjoy a grace period of exemption from strict labour market laws, which would enable them to hire and fire on a totally flexible basis. Mr Klinz concluded by remarking that the successful dual education system of Germany and Austria should also be applied more widely.