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Reawakening: From the Origins of Economic Ideas to the Challenges of Our Time

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# A Fiscal Union. Is it likely? Would it be enough?[1]

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## 1. Introduction

The current crisis is the culmination of a process of integration that has profoundly changed the structure of each member state, their inter-relations and their power relations. One of its side effects was the rediscovery of the terms 'centre' and 'periphery' to analyse the economic situations of the European countries[2]. In order to understand where we are heading it is important to understand how we got where we are now. In trying to provide an answer to the current crisis we must look beyond the short-run, analysing the different trajectories of the peripheral and core countries in terms of the *interdependence* between economies with different productive capabilities. The study of the evolution of the centre-periphery relations may help towards an understanding of the dynamics of the European integration processes of the second half of the 20th century, based on both their chronology and the processes of geographical redistribution of international production. As the Italian philosopher Giambattista Vico observed (Vico, 2011 [1725–28]: 61), chronology and geography are the 'two eyes of history'. As far as chronology is concerned, it should be recalled that all the countries of the Southern European periphery can be defined as latecomers, though Italy embarked on a path of industrialization and integration into European trade earlier than any of the other peripheral countries. As for geography, the changing geographies of production are contingent outcomes of the co-evolution of the asymmetric power relationships between individual and collective actors and institutions.

We need to bear in mind the background against which this co-evolution occurred, namely European integration of the peripheral countries (Europeanization) and globalization. As from the beginning of the 1970s, the countries of Europe were caught up between two different levels of deregulation, global and European. At the global level, the growing importance of the financial sector affected the rate and quality of growth of the capitalist economies, which moved from the two engines represented by investment and exports to the single engine of exports, occasionally complemented by consumption booms. Europeanization can be interpreted as EU-wide application of a policy of deregulation of goods and capital similar to the Anglo-Saxon model. Deregulation of labour markets and financialisation affected the timing, shape and direction of the European integration process. The interweaving between globalization and Europeanization represents the particular way the globalization process, which

[1] This paper draws from the book "Crisis in the European Monetary Union: A Core-Periphery Perspective" by Giuseppe Celi, Andrea Ginzburg, Dario Guarascio and Annamaria Simonazzi, Routledge, forthcoming January 2018.

[2] While the centre includes the countries of continental Europe, reference will be made mainly to Germany. The southern periphery includes Greece, Italy, Portugal and Spain.

originated in the US, was translated into Europe through the formation of the European Union and the Monetary Union. The US neo-liberal model, intermediated by European construction, institutions and norms designed in conformity with the German model, has modelled the structure and affected the functioning of the peripheral economies, substantially weakening their resilience.

An analysis of the main phases of the development of the European countries since the second post-war period provides evidence of considerable differences in the productive structures of the countries of the centre and the southern periphery of Europe at the start of the Europeanization process. These differences entailed the asymmetric capacity of countries at differing levels of development to adjust to external shocks. When joining the euro, the member states relinquished their national management tools. The single currency was formed without creating any supra-national governance to take their place. Moreover, the entire institutional architecture of the Monetary Union was based on the assumption that the countries that met the Maastricht criteria for accession were all on a level playing field. Convergence was interpreted with reference to financial rather than real indicators, and it was believed that any problem encountered could and would be addressed in time (neo-functionalism). Thus, the construction of the European institutions was disembedded from the specific social and political institutions that provide a solid and durable foundation for any monetary union, and with no consideration for the different levels of development of its members. Insufficient political cohesion and misguided economic theory played a role in shaping what was pre-eminently a political project. The crisis made it evident that this institutional structure was not sustainable.

The interaction between these various factors reshaped the economic and geopolitical relations between the European economies. German reunification and collapse of the Soviet Union opened the way to Eastern enlargement, and to a geographical reorganization of production at the European level. Germany's economic weight in Europe increased correspondingly. New peripheries came to the fore, while, with the weakening of the French economy, the core showed signs of internal fragmentation.

The outbreak of the crisis and its unequal consequences must be interpreted against this background. Mistakenly interpreted as a standard fiscal/balance of payments problem, the crisis was the final effect of a path of unequal development that the interaction between the international financial crisis and the incomplete nature of the European institutions has finally exposed. A longer-term perspective helps us better to assess the limitations of the solely macroeconomic alternatives that have been proposed to steer the EZ economy out of its present quagmire. While austerity and internal devaluation in the deficit (Southern European) countries has shown its destructive potential, expansion of internal demand in the 'core' countries (Germany) or unqualified Eurozone-wide reflationary measures, though indispensable, do not get to the root of the development and debt sustainability problems of Southern European countries, which continue to lack a sufficiently broad and differentiated productive structure. The problems associated with the structural rigidity of peripheral economies depend on their limited ability to operate in a regime where innovation and product-led innovation prevail, and not on scant labour flexibility.

## 2. Chronology: the long-term roots of the crisis

2.1 The three decades following WWII saw sustained growth in the industrial world, favoured by a stable international economic environment. The "Pax Americana" rested on two fundamental pillars:

the Bretton Woods agreement and US hegemony. Fixed (but adjustable) exchange rates and controls on capital movements provided a stable international monetary framework; the deficit of the US balance of payments guaranteed the necessary liquidity for international transactions. Two engines sustained the growth process, following the sequence investment-income-imports. High domestic demand in the US (and in the other industrialized countries) resulted in high world demand, stimulating world export growth that was transmitted to the capital goods sector. The high import content reinforced the expansion of the world market through the foreign trade multiplier. The two engines of investment and exports represented a powerful combination fuelling post-war growth. This mechanism broke down in the early 1970s, leaving only exports as the main driver of (a more modest) growth, occasionally supported by private consumption. Given the stagnation of wages since the 1980s, consumption sprees were financed by debt, therefore unsustainable in the long run.

The great inflation of the 1970s, associated with political and social tensions, opened the way to three fundamental, intertwined discontinuities in the modus operandi of western capitalist countries. The first discontinuity was associated with the transition from 'politicized' management of economic policy based on discretionality, to 'depoliticised' management based on the automatism of rules (Burnham, 2001; Krippner, 2011). Depoliticization should not be understood as the removal of politics, but rather as redefinition of the boundary between the political and the economic so as to allow policymakers to govern the economy 'at one remove' (Burnham, 2001). The second discontinuity was the transition from the inflation phase of the 1970s to the next phase, that of 'financialization', defined as a process in which financial activities play an increasingly leading role in the formation of the profits of the economy. The third discontinuity was the slow-down in capital accumulation and its delinking from exports, the latter remaining the main driving force of domestic growth.

The neo-liberal policy consensus, which replaced the Bretton Woods consensus, was transposed into the European context (*Europeanization*) through the adoption of two complementary role models: the German model and the US model. The former – whose influence was based on Germany's successful adjustment to the new inflationary environment following the collapse of Bretton Woods – advocated price stability as the only strategy for growth. The new theoretical paradigm, via a vertical Phillips curve, had it that disinflation could be obtained without costs in terms of unemployment. The latter role model – legitimized by the outstanding performance of the US economy in the first half of the 1980s – promoted the liberalization of labour, product and capital markets as the recipe for growth. The interaction of these two models paved the way to the European road to global finance and monetary integration. As a result, the institutions of the European Monetary Union left the currency disembedded from the fiscal, social, and political institutions required to make a currency union viable. It is this institutional incompleteness that lies behind the European leaders' (political) inability to prevent the international financial crisis from developing into full-blown sovereign and economic crisis. The political choices underlying the economic design are also at the heart of the growing divide between core and periphery countries in Europe.

2.2 Differences in the production structure between center and periphery were very large at the start of the Europeanization process, but decreased until the beginning of the seventies. All the countries in the periphery recorded high income growth, led first by investment and consumption, and then by exports. They all placed special emphasis on basic industry, deemed necessary for the creation of an industrial sector. The state supported accumulation either directly, through public owned companies, or indirectly, through subsidies and incentives to domestic and foreign capital.

The crisis of the 1970s, which was associated with the saturation of the principal mass consumer goods in advanced countries and the start of globalization, marked a profound break in the history of the relations between the centre and the periphery of Europe. It led to a profound transformation in demand, production, and competition. Demand for substitution and quality competition (vertical diversification) favoured the passage from price to product competition. Since the early 1970s, the international market regime has been increasingly dominated by the competition in differentiated products. This evolution has affected core and peripheral economies differently. The ‘centre’ succeeded in restructuring its industry, strengthening its ability to remain in the market thanks to processes of ‘creative destruction’ and reconstruction undertaken with the support of industrial policies[3].

The restructuring of the core deeply affected the countries of the periphery which, in reorganizing their economies, struggled to adapt to the new environment, dominated by disinflation and quality competition. Restrictive monetary policies of the center country exert asymmetric effects on the periphery because of both its specialization in commoditized products and the hasty return of capital to the safe-haven center countries - a phenomenon observed time and again (Ginzburg and Simonazzi 2011), of last in the current sovereign crisis (the “sudden stop”). In the 1980s, the fall in the relative prices of 'flex price' items hit the countries in the periphery harder. Their basic industries and “mature” production faced the competition from developing countries, calling for drastic cuts in production. The new situation would have required innovation of the state’s capabilities in order to guide and facilitate the reorientation of investment to contrast a rapidly weakening economic structure. However, just when the state should have taken up new tasks to ease the process of restructuring, diversification and quality upgrading, these countries adopted across-the-board liberalization policies, implementing what might be called a ‘plain destruction’ of their capabilities to create new products, market niches, and markets.

Over the thirty years of European integration, the Southern peripheral countries were exposed to macroeconomic and industrial policy measures that, though apparently neutral, generated increasing regional disparities, both between center and periphery and within countries. Early liberalization policies in the periphery prevented public investment guidance: industrial policies were redefined as policies for the guarantee of competition. Thus, partly as a consequence of their policies, their growth fell behind in the 1980s, and the crisis associated with deregulation opened a gap in aggregate demand that was eventually filled by welfare and construction expenditure. This ‘premature deindustrialization’ — restructuring without industrialization — exposed the peripheral countries to stunted growth and persistent fragility with respect to external changes even before the formation of the Monetary Union (Ginzburg and Simonazzi 2017).

## 3. Geography: old and new peripheries

3.1 The German current account surplus has dominated the debate on the root causes of the crisis. Our analysis rejects the monothematic explanation of the German surplus in terms of wage moderation, in favour of a multidimensional approach that includes, besides cost competitiveness, other factors, such as the German linkages with the high-growth markets of the emerging countries and offshoring towards Central and Eastern European countries. The Hartz reforms mostly affected the “non-corporatist” part of the labour market, increasing the segmentation of the German labour market. The growing share of

[3] Although the exact extent and details of Germany industrial policy are difficult to ascertain, given the multiplicity of measures and actors (at the federal, Länder and municipality level), Chang et al. (2013) rate the German industrial policy as one of the most active in Europe.

low-paid workers and working poor in total German employment contributed to keeping the cost of services low, thus indirectly supporting the competitiveness of the export industry and, by reducing the purchasing power of a large part of the population, bringing about a reduction in the quality, as well as the quantity, of imported consumption goods (more on this below). Finally, the de-synchronization of the German real estate cycle from the global cycle of the period 1997-2012 resulted in falling house prices in Germany and waning residential investments, a decline in household consumption and a consequent improvement in the current account.

All these factors contributed to the re-organization of the German industrial fabric and to a reshuffle of German markets, which played a major role in the expansion of German surpluses and the emergence of two peripheries: a Southern and an Eastern periphery (SP and EP respectively)[4]. Indeed, the years following establishment of the EMU have seen Germany occupying the position of trade leader in Europe. The reorganization of its industrial platform, including its extensions abroad (mainly in the EP), is reflected in the evolution of its trade network: the changes in the geographical composition of trade flows signal modifications in the relative importance of the various areas and countries directly and indirectly linked to the German economy. We focus here on two distinct trade networks. The first network (N1) traces the bilateral trade relations between 6 EZ countries: the two main core countries - Germany and France -, and the countries of the southern periphery - Greece, Italy, Spain and Portugal. The second network (N2) extends the coverage to include, besides Germany and France, China and three clusters of countries belonging respectively to the SP, the EP and the Euro-9 (the remaining EZ countries). We observe how the structure of the two networks evolved before and after introduction of the euro, and before and after the crisis: that is, in the years 1999, 2008 and 2014. In 1999, Germany was running surpluses with all its partners (France and each SP country) in N1, and a deficit with the Euro-9 (N2). The SP had strong links with all the other EU countries and ran deficits with all of them, with the exception of the EP, which in turn had limited links with the whole network except Germany. China was still a minor player in terms of trade volumes.

The picture changed dramatically in 2008. Germany's surplus towards the whole network (N2) skyrocketed (113.5 billion dollars), driven by a huge surplus with the SP and France. The sharp increase in trade volumes with the EP evidences the creation of production connections with the Eastern European countries. The value of the EP's exports to Germany exceeded the value of the SP's exports, indicating the gradual displacement of SP producers within the German manufacturing platform. Finally, the spectacular growth of Chinese exports (ten times higher than in 1999) reminds us that the processes of productive reorganization occurring in Europe are interwoven with global trends.

Finally, the trade network in 2014 reveals how deeply the 2008 crisis has reshaped the structure of trade, which is now dominated by the German-EP-China triangle: Germany runs a surplus with China and a deficit with the EP, which in turn runs a deficit with China. Underlying the formation of this triangle is: i) the need for Germany to compensate for the sharp fall in the SP's imports, and its success in reorienting its exports to China (and the US, not included in N2); ii) the increased economic importance of the EP, which is reflected in its capacity to run a surplus with Germany.

We can conclude that, as from the introduction of the euro, the SP experienced a weakening of its industrial base and an increasing dependence on foreign financial flows. The integration of these economies into the EU, and the process of Europeanisation meant opting for (premature) liberalization. In the absence of guidance, the forces protecting and freezing the status quo of institutions and

[4] The EP includes the Czech Republic, Hungary, Poland and the Slovak Republic.

productive specialization thus prevailed, opening the way for a kind of bank-led ‘privatised Keynesianism’ that concealed — until the outbreak of the global crisis — the existence of a demand-and-supply constraint on development in the European peripheral countries.

In contrast, the EP became part of a “Central European Manufacturing Core” (Stehrer and Stöllinger (2015) headquartered in Germany. Their increasing integration into the supply chain of the German industry speeded up their diversification and specialization processes and sustained their growth by reactivating the two engines - investment and exports – that had supported the capitalist countries’ growth in the “trente glorieuses”. However, unlike that scenario, their growth was now combined with persistent containment of internal demand in the major economies of the euro area. Hence, it did not spread its effects across the region, but went hand-in-hand with an impoverishment of the productive matrix of the southern regions less connected with Germany and, more generally, with a broad rerouting of trade flows.

The reorganization of the division of labour within the enlarged Europe has reinforced the dependency of the two peripheries, albeit in different ways: while it partly crowded out the Southern periphery (as producer of inputs for the German network and as exporter of consumption goods), the hierarchical organisation of the value chains within the central manufacturing core contributed to contain the cost of intermediate goods for the German manufacturing industry. The different experiences of the two peripheries highlight the importance of understanding the divergent trajectories of the core and peripheral countries in terms of *interdependent* economies with different productive capabilities. The story of the southern periphery cannot be told “in isolation” – without, that is, taking into account the repercussions of the choices of the core, which does not imply exonerating national actors from their responsibilities (Simonazzi and Ginzburg 2015).

3.2 Just as not all the peripheries are alike, nor do the core countries share the same destiny: Germany’s successful economic performance in the last decade contrasts with France’s economic and political decline. A great country that aimed to provide guidance in the process of European integration, France ended up sharing many traits in common with the countries of the Southern periphery: declining rate of accumulation and high unemployment, public deficits coupled with increasing current account imbalances, internal inequalities. After Mitterrand’s failure to embark on an isolated expansionary policy in 1983, France discarded its dirigist post-war economic strategy to adopt a vast programme of liberalization. To “anaesthetize” (Levy, 2013) the social and economic effects of these measures, and particularly the flexibilization of the labour market, social spending was substantially increased. With the fiscal constraints imposed by entry into the Monetary Union, the increase in social spending contributed to crowding out resources from public investments and industrial policy. Attempts to rehabilitate the instruments of public intervention came up against the problem that the dismantlement of most of the tools of statist industrial policy in the 1980s and 1990s had stripped the state of critical institutional and fiscal capacities (a development common to all the countries in the SP). According to Levy, after decades of neo-liberism, the French authorities lacked the vision, policy instruments and financial means to forge an effective, statist response to the 2008 crisis.

The development of the French trade balance is one significant indicator of the increasing difficulties of the French economy. The reversal in the French trade balance was essentially imputable to the automotive sector, whose progressive deterioration since 2004 went hand-in-hand with the international relocation of production undertaken by the French companies (Renault, PSA). The French firms’ internationalization strategies differed greatly from those pursued by the German companies. While the latter outsourced parts and components, maintaining final assembly at home (especially in the medium-high quality segments), the French automotive industry relocated the entire process (with the bulk of the medium-high quality segments produced abroad). These different approaches to internationalization produced a positive impact on the trade balance in Germany, but had a negative impact in France. We conclude that the interpretation of trade deficits as purely macroeconomic phenomena, disregarding their microeconomic origin, is at the root of misguided therapies that risk exacerbating the problem. The initial cost in terms of loss of industrial jobs and erosion of the domestic productive structure, due for instance, to the strategies of international delocalisation of national firms, is aggravated by further decline in employment and productive capacity as a result of deflationary macroeconomic policies.

3.3 Polarization and divergence also occurred within the core, as indeed within the countries of the periphery, characterized by historical regional divides. The increasing segmentation of the German labour market is the other side of the coin of Germany's economic success: on the one hand, high-skilled manufacturing workers employed in the export sector benefiting from protection and high wages; on the other, low-paid workers, working poor and precarious labourers, employed prevalently in the services sector. Labour market segmentation and increasing income inequality in Germany shed new light on the origins of the German trade surplus. The increase in the share of low-wage employment in Germany coincides with a marked rise in the incidence of low-quality consumption goods in German imports (Celi et al. 2018). This evidence holds two important implications. First, it highlights the relevance of "income effects", besides internal devaluation, in generating the German trade surplus. Second, it underlies the transformation underway in Germany's trade network, i.e. the diversion of German imports from the "luxury" goods of the SP to the low-quality, cheaper consumption goods of China, the growing interconnections with China and the EP, and the declining linkages with the SP.

A core-periphery pattern is also to be seen within the peripheral countries. Focussing on the North-South divide in Italy, the asymmetric involvement of Italian regions in the internationalization processes (further intensified over the last two decades), abandonment of the industrial policy in favour of a market-oriented agenda, and the differential impact of the 2008 crisis contributed to widening the distance between the Italian Mezzogiorno and the rest of the country. Since 2008, the fall in southern GDP has been twice that of the Centre-North, with more marked decline in investment, employment and productive capacity in the South. The structural polarization between the southern regions and the rest of Italy has been exacerbated by a significant revival in internal migration from the South to the Centre-North. Unlike in the past, recent migration flows from the Mezzogiorno are made up of highly educated young people, a circumstance that penalizes even further the future development of the Mezzogiorno.

## 4. Short and long-term policies for EMU sustainability

4.1 A longer-term perspective helps us better to assess the possibilities and the limits of the solutions proposed to steer the EZ economy out of its present quagmire and to put it on a sustainable path. Austerity policies, structural reforms and internal devaluations in the debtor countries have proved counterproductive. Not only have they entailed a destruction of productive capacity, but also, combined with more 'flexible' labour markets, they have provided a perverse incentives to firms in their pursuance of quality innovation (Guarascio and Simonazzi 2016). Moreover, labour market reforms and cuts in social investment have resulted in higher income inequality and families' impoverishment in core and periphery countries alike, reducing consumption and investment, undermining long-term growth.

Underlying this approach is the idea that low growth is a problem of misallocation of resources. Firms are seen as fundamentally homogeneous, except for “distortions in the factors and/or product markets” that can explain why “marginal value products might not be equalised across them” (Calligaris et al., 2016). Well-designed structural reforms of product and labour markets may entail costly adjustments in the short run, but in the long-run the greater productivity of a more efficient allocation of labour will prevail again. This view contrasts with the competence perspective (or ‘dynamic capabilities’ view), where the firm is seen as a knowledge-accumulating entity in which knowledge grows through cumulative processes and firms’ competitive advantages are deeply rooted in their ability to build endogenous capabilities (Penrose 1959; Traù 2017). Firms’ performance crucially depends on both the structured interrelationships (the linkages) that they can establish upstream and downstream, and the support received from the material and immaterial infrastructures, development agencies and financial institutions that sustain the process of innovation in the long term (Ginzburg 2012). Innovative countries rely on the presence of innovative businesses that compete on the basis of new products or processes and/or more effective use of new technologies. However, firms far from the efficiency frontier perform important functions, from providing training to workers entering the labour market, to participating in the value chains, to providing a richer and thicker productive structure that supports the region’s complexity and employment. Reporting the experience of the Nordic countries, Ornston (2013) demonstrates that social supports to cushion adaptation and restructuring helped firms to adjust the quality of their products and processes to the emerging requirements of competition. It is not obvious, then, that an increase in a country’s productivity obtained by forcing low productivity firms to exit leaves the country better off.

Macroeconomic policies capable to sustain aggregate economic activity and ease the sovereign-bank loop – which cannot be deferred – should not disregard their possibly asymmetric repercussions on the real economy. With quantitative easing having reached its limits as an instrument to create demand, attention has shifted to fiscal policy: given the extremely expansionary monetary policy, public investment would be carried out at almost zero cost to the public budget. It is argued that countries with fiscal space should expand public investment; this would benefit also deficit countries through the operation of the foreign trade multiplier. Expansion of internal demand in the ‘core’ countries (Germany), though necessary and helpful, does not respond to the problem of closing the gap in productive capabilities between deficit and surplus countries. The composition of demand that will “trickle down” to the periphery will reflect the priorities of the expanding countries, which do not necessarily respond to the competitiveness and growth problems of the periphery. Moreover, it may not match their productive capabilities, which had been estimated to be small for some countries (Bundesbank 2011), and were further reduced by the destruction of capacity caused by the crisis.

What is needed is a coordinated policy sustained for a period long enough to produce its effects on investment and productive capacity. However, reliance on unqualified macroeconomic (expansionary) policies risks repeating past mistakes. The expansion of demand should be targeted to the specific developmental needs of each country. The EZ’s long-term sustainability entails a new strategy geared to diversifying, innovating and strengthening the economic structures of the peripheral countries. A change of strategy is even more important today, since the crisis marks another major structural break in world trade. With the fast path of technical change and globalization, and the increasing commodification and private appropriation of knowledge, the EU latecomers can be caught in the “middle-income trap”, no longer (price) competitive because of developing countries’ catching up, and not yet capable of entering world-wide (quality) competition.

4.2 The severity of the crisis has led to the return of the concept of “industrial policy” in the economic strategies of the EU. Though welcome, the first examples of this reorientation of strategy - the Investment Plan for Europe (Junker plan) and Industry 4.0 – have so far failed to show the capacity to support a process of structural convergence and, in the case of Industry 4.0, given the structural heterogeneity existing in Europe and the unequal capacity to support national systems of innovation, the new technologies risk remaining concentrated in the more advanced area.

The “new” European industrial strategy must implement a multilevel policy targeted at rebalancing the core-periphery divide in Europe. In turn, the periphery needs to implement a policy that responds to its problems of re-industrialisation. This implies assigning the state a key role of investment guidance. State intervention is needed not because “the government officials [are] omniscient or cleverer than businessmen but because they [can] look at things from a national and long-term point of view, rather than sectional, short-term point of view” (Chang 2011). For latecomer countries, the focus on potential markets can reveal opportunities also in less obvious venues than exports or manufacturing. Imports, for instance, can signal the existence of unexploited opportunities - final demand for products or bottlenecks to development - that a well-integrated policy action can help to seize. The transfer and adaptation of technologies, organizations, business strategies, products originally designed in other socio-economic systems may pose difficult, specific problems in both the supply and demand domains that public policy can help solving. The provision of public goods for the productive sector can offer new opportunities for innovative firms, while exerting a strong activating capacity. Public services exhibit a rapid growth in demand in cities and metropolitan areas: the focus on welfare as an engine for growth calls for a systemic action at different levels of governance (national, regional, municipal) and institutions, to coordinate the supply and demand of innovative services. The public action can support firms in their process of innovation and provide guidance to development strategies that promote products (and capabilities) as a way to create incentives to accumulate capabilities (and develop new products) in a cumulative, virtuous circle (Mazzucato 2013).

4.3 Is it feasible? The difficulties in implementing such a policy cannot be underestimated. Firstly, a strategic policy of industrial development calls into question the institutional construction of the Eurozone. The required degree of political consensus and fiscal solidarity is non-existent in Europe today[5]. Yet, if permanent transfers must be ruled out, weaker countries must be put in the position to stand up for themselves. Reliance on the market mechanism for convergence has proved deceptive and its probability of success is even less likely in the present context. This means that the periphery must try new strategies. Ensure that, in devising the macroeconomic and institutional reforms targeted at finding solutions to the financial disequilibria that threaten the very survival of the EZ, equal attention be paid to their effects on the productive structures of weaker members. Although the Juncker Plan is inadequate both in terms of financing (most of it actually comes from national development banks, such as the Italian Cassa Depositi e Prestiti) and in terms of focus (Celi et al. 2018), find ways for a coordination with the structural funds to implement truly development policies.

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[5] Drawing a list of the policy measures required to strengthen the monetary union, Klaus Regling (Managing Director of the ESM) makes clear what we don’t need: “Full Fiscal Union, Full Political Union, More permanent transfers, Special facility for symmetric shocks”. He however acknowledges the need for a complete banking union, inclusive of a European deposit insurance, and a European Safe Asset in the long run (Regling 2017). The Bundesbank (2017), on its part, has reiterated its views on a stricter compliance with the “Design and implementation of the European fiscal rules”.

Secondly, faith in the market and mistrust in the government meant that the infrastructure of knowledge, experience, ideas and culture required to implement a “new” industrial policy has been neglected in the universities, ministries, think-tanks or society at large and needs rebuilding almost from scratch. As Levy (2016) argues in the case of France, the dismantling of most of the tools of statist industrial policy in the 1980s and 1990s stripped the state of critical institutional and fiscal capacities. Thus, “breaking with the neo-liberal paradigm requires more than political will; it also requires state capacity, and such capacity cannot be presumed, even in a country like France with a long tradition of state intervention in the economy and a relatively positive view of the state” (Levy 2016: 20).

Last, but not least, there is the problem of the credibility of southern European governments in carrying out effective development policies. Although concern about government’s inefficiencies should be taken seriously, it should not justify inaction.

## 5. Concluding remarks

As Kevin O’Rourke has rightly remarked, ‘Europe is now defined by the constraints it imposes on governments, not by the possibilities it affords them to improve the lives of their people. This is politically unsustainable.’ The southern countries’ elites were not blameless for this turn of economic theory and policy. What prompted them to accept convergence on what has been defined a 'neoliberal consensus' - which served as a basis for the creation of the Monetary Union, placing it before political and fiscal union - was a mix of pragmatism and myopia. German economic policy provided a model to follow in order to emerge from the quagmires of the oil crises, stagflation and the first great industrial restructuring. Viewed through monetarist glasses, the ‘facts’ appeared to agree with the framework offered by academic monetarism. Once in the EMU, acceptance and implementation of austerity became difficult to resist for economically enfeebled countries and politically weak coalitions. The Southern European leaders have proved incapable of joining forces to counter Germany’s dogmatism by offering an alternative, viable program. In many cases, centre-left politicians have eagerly embraced austerity to prove their bona fide to the markets (and to the creditor countries). In the process of building a European 'neoliberal consensus', the shift towards austerity in France was decisive (Matthijs and Blyth 2015). With the new presidency of Emmanuel Macron, an enfeebled France is trying to relaunch “la ligne droite” of its special relations with Germany, once again embracing the German model as a way to solve its problem, though possibly with a twist towards a more *dirigist* policy[6].

The perspective on changing the EZ rules are scant. There is no real will to move in the direction of budgetary and political union in Europe today, nor consensus on how to deal with excessive debts. As in the neo-functionalist approach, the expectation is that muddling through along a (possibly milder) austerity route would eventually get the southern periphery out of its crisis and return to growth. The costs have been high not only for the debtor countries of the periphery, but also for the core: the waste represented by the German external surplus is appalling when considered in the light of its population’s increased inequality and poverty. European leaders will have to acknowledge that technocratic fixes

[6] According to Cohen (2017), “Emmanuel Macron considère que la France depuis 1983 est orpheline d’un grand discours industriel national. Il considère que la gauche a rendu les armes face à l’idéologie du tout-marché. Il comprend certes que la gauche, expérience faite de 1981 à 1983, ait fait son aggiornamento et ait commencé à ouvrir les marchés et laisser circuler les capitaux. Mais il dit ne pas comprendre pourquoi cela s’est accompagné de la renonciation à toute ambition industrielle et à tout discours en direction du monde ouvrier”.

cannot paper over the failures of “functionalism” indefinitely. Ironically, both in the US and in Europe the attempt to replace explicitly political decisions with technocracy and automatism have led to the reappearance of politics in the guise of demagogy (‘populism’). Europe is at a crossroads. On one way, there is the stiffening of core-periphery hierarchical relationships and a further narrowing of democratic space, with its worrisome populist corollary. On the other, the attempt to unify progressive forces across debtor and creditor countries to redirect voters’ protest away from populism to the solution lying in the political identity of Europe.

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