

## Hamlet without the Prince: Politics and the Eurozone

*An economic solution to the eurozone's ills cannot be found without political legitimacy.*

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The current European crisis has most often been viewed as the combined consequence of misguided technical arrangements and unanticipated economic shocks. In contrast, little attention has been paid to the political requirements of a successful fiscal and economic system. Where these have been considered at all, they have been usually viewed in terms of a need for greater European unification: for example, the vesting of new and greater powers (such as for the supervision of banks) in pan-European institutions. However, a deeper question – that of the “democratic deficit” in the relation between the eurozone economic institutions and European society – has been largely neglected.

One way to understand the euro project is that it involved an effort at “institutional substitution”, seeking to embed the anti-inflationary policy of the Bundesbank in place of that of national central banks which possessed less inflation-fighting credibility. The logic was that the euro project could not succeed without the consent of the German people, which, in turn, required sufficient guarantees that the European Central Bank (ECB) would respect their particular historically derived aversion to inflation. The stability pact for fiscal convergence sought to secure this project of institutional substitution by limiting deficits and thereby also the political temptations to monetise them. For some time, both borrowers and lenders in Europe appeared to reap the benefits of this replacement. The anti-inflationary regime created the conditions for a strong euro, which for a time even helped to underpin a growing role for the euro as a global reserve currency. The foundation of the euro was the effort to take key economic decisions (in particular concerning the growth of money supply) out of the realm of politics.

This was achieved for a time, before the inevitable return of the repressed: As Europe has found, such institutional substitution has its limits. The ECB has hewed to its appointed role longer than governments have stayed within their borrowing limits. However, the ECB too is under severe pressure as it becomes increasingly clear that only a change in its functions (e.g., to allow it to lend to governments as do normal central banks elsewhere) can provide a lasting solution to the eurozone crisis. At the broadest level, the lesson is that institutional substitution cannot by itself

provide a long-term solution to problems which are manifested in weak pre-existing institutions. Only a political and social project aiming to change the conditions which made those institutions weak in the first place can ultimately succeed at creating institutions which do not suffer their deficiencies. This principle was until recently obscured by the cheap money made available in the eurozone but its significance has even now not been absorbed.

One illustration of this point is offered by the approach pursued recently in Italy, and before that in Greece, of forming technocratic governments with which to attack the underlying sources of fiscal deficits. Such efforts can in the short run provide a palliative, but must ultimately come to terms with the fact that a fiscal deficit is not merely a phenomenon of accounting but rather reflects the weakness of state in relation to society. All wish to take but none wish to pay and the State is unable to bridge this gap by asserting either moral or political authority. The resulting fiscal weakness of a state represents not only the balance of social forces but also more intangible factors. The obstacles to closing fiscal deficits are thus unlikely to be addressed by a set of technocratic manoeuvres alone. No project of raising taxes or reducing expenditures can adequately succeed in any democratic country without the active consent of its people, which in turn requires that the project be viewed to a sufficient degree as necessary and legitimate. Here we see in stark relief the difficulties of the eurozone project as a whole. Austerity is counterproductive in Europe for two reasons. The first is that its contractionary effects are leading to a downward spiral. The second is that austerity runs the risk of being viewed as a punitive and illegitimate alternative to burden sharing, as a result of which it will fail to garner the social consent needed for its economic success. A lasting solution to the eurozone's ills must be politically legitimate in order to be economically adequate. Attempting to address the economic problems of the eurozone without recognising the political requirements of a successful solution is like trying to stage a performance of Hamlet without the Prince. The euro was born from the ambition to free the economy from politics. Rising from the ruins of that shattered illusion is a different vista: politics and democracy as salvation, not threat.