EDITORIAL
By Antonio Missiroli

Technocracy vs. legitimacy? An artificial debate

Every political system – national or other – is a balance of efficiency and legitimacy. Such balance may change over time (depending on political requirements) and space (depending on local traditions); but all systems include elements of both.

So it should come as no surprise that the euro zone debt crisis has had an impact on that balance too: of the five countries most severely hit to date – one is tempted to label them as the GIPSI, an acronym that also reflects better than any other one the sequencing of the crises – three have undergone political change through elections (Ireland, Portugal, Spain) and two have done so without (at least so far), giving way instead to “technocratic” administrations (Greece, Italy).

While the governments currently led, respectively, by Lucas Papademos and Mario Monti present some differences regarding to the ratio of “technocrats” in their ranks – and may also end up having different life spans – they certainly have in common the fact that they are led by former top EU officials at a time when the two countries need to (re) gain the full confidence of Brussels and other European capitals.

Actually, Mario Monti is not the first former European Commissioner to be appointed Prime Minister at home. Before him, and not long ago, the same happened to another Italian: Romano Prodi. Yet he had already been at the head of Italy’s government before coming to Brussels – and it is worth mentioning that, since then and especially over the past few years, a number of other former PMs have indeed joined the college.

In fact, the only relevant precedent for Monti is Raymond Barre, European Commissioner between 1967-73 and French PM between 1976-81, who was appointed by then President Valery Giscard d’Estaing as the country’s “best economist” – thus in a quintessential “technocratic” capacity.

In the past, however, a number of European governments have been led by unelected personalities with a marked technocratic profile without raising concerns about their
legitimacy: it happened, for instance, to Poland before and the Czech Republic after their respective EU accession. Italy itself, on its way to joining the euro in the 1990s, was led twice by former central bankers: one of them, Carlo Azeglio Ciampi, later became also President of the Republic – as did Horst Köhler, another central banker, in Germany.

Beyond (and behind) Plato and Machiavelli

From Plato’s philosopher-kings to Machiavelli’s ambition to teach his Prince the arts and crafts of ruling, from the Enlightenment to Oxbridge and the grandes écoles, the link between specialist knowledge and public policy has been a recurrent feature of European culture and politics. America, too, has had its own debates about the role of what David Halberstam famously called "the best and the brightest" – from the Founding Fathers themselves to Roosevelt’s “brain trust” and Kennedy’s “eggheads”.

This is to say that there is nothing extraordinary in the presence of “technocrats” in Western governments (which, incidentally, also highlights their sense of public service and readiness to take the heat at a critical time). Having personalities in charge who do understand market behaviour and can discuss yield curves and derivatives is definitely not a bad thing these days, and several European governments include former central bankers and financial experts anyway. The relationship between domestic policy, coordination and integration at EU level, and the globalisation of financial markets has become an increasingly intimate one. It is not by accident that analysts often resort to the term “intermestic” to define this domain – and handling it requires multiple skills, including reputational ones.

Moreover, the equation between different levels of governance and policy-making is now made all the more complex by the need to factor in both peer pressure and external conditionality. Although some West European countries had to resort to the IMF already in the 1970s to tackle specific debt crises, what is new and unique this time around is the level of interdependence between lenders and borrowers, which risks generating cascading effects well beyond national borders and governmental boundaries, thus making this crisis a systemic one.

The interconnectedness of financial markets, in turn, risks making it a global one, with worldwide repercussions of unprecedented magnitude. It was indeed quite striking – and telling – to hear US President Barack Obama talking about Greece and Italy at the final press conference of the Asia-Pacific Economic Cooperation (APEC) summit meeting in Hawaii in mid-November.

A challenging trilemma

The current and somewhat artificial controversy over unelected technocrats vs. elected politicians – that often involves also the role of EU institutions, especially the Commission – would strongly benefit from the analysis and the arguments put forward by the Harvard economist Dani Rodrik. In a recent book (*The Globalisation Paradox*), he illustrates what he calls the “fundamental political trilemma” of the current world economy: “we cannot simultaneously pursue democracy, national determination, and economic globalisation”. In other words, we can have any two of them, but not all three. His conclusion, however, is that acknowledging this reality should not necessarily lead to the end of any one of the three: “smart” (as opposed to “maximum”) globalisation is still conceivable and, above all, fully compatible with “re-empowering” national democracies.

In this light, the EU construction appears as a unique equation or, rather, as a peculiar interface between various spheres. Indeed, both top technocrats and political leaders are struggling with the “trilemma”, albeit to different degrees, and seem determined to test the validity of Rodrik’s “law” by de facto replacing “national” with “European”.

This issue of BEPA Monthly Brief comes out in the midst of the arguably most difficult moment of this long crisis. It does not pretend to offer final answers or workable solutions – just to ask the right questions and to put the problems in the right context, both politically and technically.
The worst arguments are those where both sides have a strong case – like the debate of the eurozone crisis. The creditor countries point to indicators for reckless fiscal spending in Greece, weak bank supervision in Ireland, and high levels of private indebtedness in Spain and Portugal. On top of these, they emphasize data for competitiveness: large current account deficits, high prices and wages, and declining market shares for exports. Their claim is that the debtor countries would not be in such a difficult situation if they had shown more self-control.

The debtor countries see something subtly different. They focus on the huge flow of capital that came into their economies during the early years of the euro. They ask whether it is realistic for all countries to aim for export led growth. And they argue that the sudden and continuing flight of capital to the safety of German bonds is what has triggered both the collapse in sovereign debt prices and banking funding problems.

These different perspectives suggest different solutions. The creditor countries want to see more adjustment at the national levels and call on the debtors to cut back on their borrowing and bring competitiveness into line. The debtor countries point to problems at the systemic level, and argue for a more aggressive response from the European Central Bank (ECB) in the short term to be paired with the more gradual development of euro-bonds.

These solutions are compatible but the order of operations is not. The creditors want the debtors to demonstrate their worthiness to participate in a strengthened euro zone. The debtors want the euro zone to be strengthened so that they have the time and resources to undertake necessary reforms.

Such subtleties are often lost on the public, which sees only one side or the other of the argument through the Manichean rhetoric of the tabloid press. In this extreme telling of the argument, the Greeks are deceitful and unworthy while the Germans are overbearing and ungenerous. Each side sees itself as being wronged so that the other side can benefit. Solidarity across Europe is weakened by such depictions. Trust in European institutions suffers collateral damage.

People(s) and populism

The Eurobarometer public opinion polling surveys show a clear trend in attitudes. From November 2009 to May 2011, the tendency to trust in the European Commission and the European Central Bank (ECB) has fallen while the opposite tendency has risen. Over the same period, the tendency not to trust in the EU as a whole has become larger than the tendency to trust in it. Similar trends can be seen in responses to questions about whether EU membership is a good or a bad thing, though positive perceptions clearly prevail.

The point here is not that national governments benefit from this loss of confidence in Europe. The Eurobarometer surveys show a clear predominance in the tendency not to trust national governments as well as parliaments. Even at their worst, the European institutions do much better. Yet it would be unrealistic to assume that the EU institutions can draw on the same wellspring for legitimacy. Identification with Europe is much weaker than identification with the member states; direct democratic participation at the national level is both stronger and more familiar; and, as research by Neil Fligstein has shown, most Europeans continue to live within the confines of their national cultures.

The significance of any damage to the reputation of the EU should not be underestimated – for both positive and negative reasons. On the positive side, compliance with European efforts at coordination is much stronger when the EU benefits from popular trust and support. As support declines, compliance weakens and so the process of coordination becomes less credible.

The more negative concern relates to political mobilization against “Europe”. Populist
politicians often seek to exploit any loss of confidence in EU institutions as part of a more general campaign against political “elites”. The Swedish Democrats and the True Finns are good examples. These movements are well aware of the broad support for European integration among the more well-established political parties. They are also aware of the discontent brewing within the populations of their countries. Their objective therefore is to combine attacks on traditional political parties with attacks on European policies: immigration in both countries; participation in the single currency in Sweden; support for sovereign debt bailouts in Finland.

Examples of this type of combined mobilization strategy can be found all across the EU. The most prominent include Heinz-Christian Strache’s Austrian Freedom Party, Geert Wilders’ Party of Freedom, and Marine Le Pen’s National Front. Not all of these parties are new, and neither are their political programs. The crisis did not create this mobilization possibility, but it has rendered the strategy of combining criticism of European integration with attacks on traditional political elites more effective – and it has brought that strategy more clearly into the mainstream of national campaigning.

Patterns at work?
The question is how long it will take before larger and more well-established political forces begin to adapt that strategy themselves as part of a process of “renewal” and in order to compete with the extremes. The rise of “euroscepticism” among Conservative Party backbenchers in the early 1990s illustrates how potent such a transformation can be. Then, as now, populist challengers used discontent with what they described as an ineffectual ruling class that had too closely aligned itself with the process of European integration. This argument was not new to the UK or to the Tories. In the aftermath of the 1992 exchange rate crisis, however, it soon became predominant – with lasting implications for popular attitudes toward the EU.

A similar dynamic may be about to play out within Silvio Berlusconi’s People of Liberty party in Italy. The motivation will be to hold onto the center-right electorate and keep the ambitions of Umberto Bossi’s Northern League in check. The first indications were given while Berlusconi was still Prime Minister. He had just returned from a difficult European Council summit meeting to face a weak bond auction on 28 October. His response was to shift the blame to the euro, “which never convinced anyone as a currency”.

This attack will fall on fertile ground. Many Italians distrust the euro and a plurality believes that they would have managed the crisis with the old Lira. If political competition is engaged on this theme, the end result will not be a groundswell of Italian voices calling for exit from the euro: it will be a more general and diffuse sense of disillusionment with the European project as a whole.

Collateral damage
This is where the collateral damage to Europe from the crisis will be felt. European integration has long benefited from a permissive consensus bolstered by what Fritz Scharpf described as “output” legitimacy. Europeans have tended to support integration as a broad set of objectives, and they have seen the economic advantages of the EU as validation for that support. Now that the economic advantages have been called into question, popular support for European integration has begun to wane.

It is not the first time this has happened. A similar process took place in the 1970s and 1990s as well. This time, however, it is exacerbated by a clear conflict in perspectives over the causes and consequences of the sovereign debt crisis. As long as that conflict continues, it will be difficult to reestablish a consensus on the benefits of Europe. And, given the strength of the arguments – and emotions – on both sides of the debate, there is little to indicate that the conflict will soon be resolved.
Lack of political agreement among European policy makers and stakeholders is often referred to for the ongoing and even worsening sovereign debt crisis in the euro zone. However, deeply rooted misunderstanding and disagreement of the true nature of the crisis is at least as much to blame.

In fact, an important element was misunderstood at the outset and is still not fully grasped, namely the difference between solvency and liquidity, including the fact that we are dealing with two sovereign debt crises at the same time: a solvency crisis for one or more countries, and a liquidity crisis for others (let alone the banking crisis, which is interwoven with both). The current crisis started out primarily as a solvency crisis, but then became increasingly a (market) liquidity crisis.

Solvency refers to one’s ability to pay back the totality of its debt over time. It measures whether future revenues (including the sale of assets) are enough to do that. Solvency can thus be improved by increasing future revenues and/or decreasing the amounts owed.

Liquidity refers to the immediate availability of cash to pay short-term obligations. Liquidity can be improved by borrowing money. This, of course, requires being solvent, i.e. able to pay back one’s debt in the future – or else no bank or investor would be willing to lend.

The EU has initially proposed liquidity solutions for countries with solvency problems (e.g. Greece), and is currently betting on solvency solutions for countries with liquidity problems (e.g., Spain, Italy).

This mismatch needs to be addressed. It is not only a question of delivering an effective and efficient response, but also one of avoiding counterproductive effects. Therefore, solutions need to be targeted, tailored, and differentiated in function of the specific challenges faces by countries.

Solvency & Greece
A government’s solvency is assessed primarily by looking at the evolution of its debt-to-GDP ratio. It is well accepted for governments to maintain certain levels of debt, rolling over previous obligations into newly issued debt. Investors and financial markets are typically willing to provide funding as they find in government securities an attractive, low-risk and highly liquid asset. It is equally acceptable that such debt grows in line with the country’s economic growth.

There is, however, a limit. As debt levels grow, a “snow-ball” effect increasingly kicks in: interest rate charges on the debt become so large that government have to borrow ever more just to service them. Consequently, debt grows out of control, outpacing GDP growth. How early and strongly this snow-ball effect kicks in depends on the level of debt, the interest rates and the growth trajectory of each country. Ultimately, the snow-ball effect undermines a country’s ability to pay back its debt and remain solvent.

Greece has been facing such fundamental solvency issue. To restore its solvency, Greece needs “austerity”, i.e. to restore a positive primary surplus, and structural reform to support growth: this is a minimum but insufficient requirement.

Indeed, there is only so much austerity one can impose on a country without significantly damaging its economic growth. In addition, Greece needs to reduce the amount it owes, for instance via a “haircut” or bond buy-back/exchange plan; or to be financed for up to 20 years at a very low interest rate; or, of course, to do both.

Initial solutions were only providing liquidity solutions, i.e., short term lending at relatively high interest rates. This merely saved time and ’kicked the can down the road’. The combined decisions of the summits of July 21 and October 26, 2011 proposed for the first time a solvency solution through a lowering of the amount due via the “Private Sector Involvement”, a massive debt maturity extension, and a lowering of interest rates.

Liquidity & Spain, Italy
Moving beyond Greece and to some extent also Portugal and Ireland, which have similar “solvency” challenges, the nature of the crisis...
changed, as its key drivers were not the country fundamentals any more. For some countries – like Spain and, now, Italy – it is not any more about “markets fearing the fundamentals of a country”, but about “markets fearing markets”. The markets fear that the market “sentiment” – a highly subjective and prejudicial notion – may turn against a country.

Indeed, if and when that happens, a country that is fundamentally solvent will eventually become insolvent, the victim of a self-fulfilling prophecy. Once real interest rates shoot up to, say, 10 per cent (as investors sell the country’s government bonds), the gap between real interest and real GDP growth rates would simply become so wide that no realistic amount of austerity and growth would counter the snow-ball effect; and no country – not even Germany – would remain solvent.

It is a bit like a “bank run”: if all depositors pull off all their savings, even the best or biggest bank in the world will fail. This is why banks’ solvency is regulated, and why central banks were created as lenders of last resort.

The US and the UK have arguably worse fundamentals than for instance Spain, but somehow enjoy lower interest rates, despite the American near-default experience in August. In the final analysis, the US and the UK have central banks that have shown that they will stand by their governments’ debt if need be. The US has done that repeatedly in its history, including in this crisis, though “quantitative easing” (now equivalent to the entire US public deficit). So did the UK. And markets know that the two central banks can “outgun” them.

In the euro area, instead, the EFSF has limited scope and cannot be strong enough to finance Spain and/or Italy, while the ECB remains ambivalent about standing by even solvent countries. Investors are therefore concluding that nobody would act as a lender of last resort if markets go crazy against a country. So, when that starts happening, it becomes rational and prudent even for non-speculative investors to pull out.

A way forward

As a consequence, the solution to the crisis requires a lender of last resort for governments, just as for banks. That lender of last resort must be big enough and even have the ultimate weapon: “a printer in the basement”. Only the ECB has unlimited firepower and can play a role similar to the Federal Reserve in the US and the Bank of England in the UK. The “printer in the basement” is the equivalent of nuclear deterrence in the Cold War: it has to be a credible threat that one hopes never to use.

At the same time, no central bank should be in the business of absorbing “credit or solvency” loss, i.e. bailing out fundamentally insolvent countries. Instead, the EFSF/ESM or other (the “fund”) could absorb the credit risk, providing credit insurance for the extremely unlikely case of a solvent country’s default. This would allow the ECB to play only a liquidity provider’s role, without credit risk, if/when markets break down – a role that it is much more in line with its mandate and philosophy.

Moreover, such a solution would leverage much more effectively the fund’s core endowment, as the buffer required to absorb credit loss is a fraction of the money lent to governments. To avoid a transfer union (if this is the controversial point), the fund could charge an insurance premium to the covered countries and monitor conditionality.

This could be seen, of course, as undermining the principle of non-monetary financing. Yet safeguards can be put in place to avoid those risks (the US and the UK never led their countries to hyper-inflation).

In sum, the EU needs to provide appropriate answers to both solvency issues and liquidity/market risks – which may imply differentiated treatment from country to country:

Fundamental solvency risks/issues need to be addressed by a combination of debt consolidation with low interest rate (where still possible) and debt reduction (where ultimately unavoidable);

Liquidity/market risks can only be addressed by the right institutional set-up, thus giving the euro zone the same warranty of unwavering support of the central bank as other developed sovereign countries.

Credit insurance provided by a European fund for the solvent countries would thus neatly separate solvency and liquidity issues, allowing the ECB to use its instruments to ensure government bond market liquidity.
A Three-pillar Firepower to Solve the European Sovereign Crisis: A last chance!

This paper proposes tackling the sovereign debt and banking crises with a comprehensive multi-pillar mechanism that involves cash and synthetic solutions aimed at enhancing the European Financial Stability Facility (EFSF), but without necessitating any structural transformation. Accordingly, the public and private sectors would collaborate to design the necessary tools – a blend of cash and guarantees – capable of convincing the market. Central to this framework are the credibility of the public-private guarantee of potential future losses and the effectiveness of the instruments that the mechanism would design. This mechanism must be agreed at the highest political levels and implemented promptly to halt the downward spiral that could lead to a protracted recession in the EU – a scenario considered as highly plausible today, if no credible political action is taken.


The International Monetary System is Changing: What opportunities and risks for the euro?

The authors foresee that the International Monetary System (IMS) will undergo major changes in the next two decades. The role of the dollar as the main reserve currency will gradually erode due to the relative decline of the US economic weight and growing concerns of countries (such as China) that are exposed to US external imbalances. In the next 10-15 years, a more multipolar IMS is likely to take shape. The Chinese renminbi will probably become a leading and reserve currency. Regarding the euro, although the outcome of the ongoing debt crisis is far from predictable, the institutional reforms undertaken could both strengthen internal stability and external attractiveness. Such action would ensure a prominent role for the euro in the IMS.


The EU as Global Robin Hood: Proposal for a multilateral convention on a global financial transaction tax

The paper examines the institutional and legal challenges that the creation of an international Financial Transaction Tax (FTT) raise. It underlines the immense barriers to be overcome should the EU continue to pursue this objective. An international convention on FTT would require defining the tax’s scope and rate; distributing revenues; and establishing a conflict-settlement regime. Its monitoring should be assigned either to a reformed IMF or to a new international organisation. However, the prospect of a new hard law regime seems implausible today given US and BRIC opposition. Only a united and resolute front of EU member states, and a European discourse articulated around goals of funding global public goods and correcting the financial market, could make a difference in the long term.


The 2011 Euro Plus Monitor: Progress and the turmoil

The publication proposes to rank euro zone countries according to their overall economic health and to their speed of adjustment to the challenges raised by the sovereign debt crisis. While acknowledging the political difficulty of the task, the survey finds that long-awaited structural reforms are effectively being implemented in most countries. Greece, Portugal, Spain and Ireland rank among the top-adjusting countries. As hinted by the Estonian recovery, the resolute addressing of fiscal imbalances and competitiveness gaps leaves reasonable hope of long-term resilience and convergence with top performers (unsurprisingly, Germany, the Netherlands, Finland and Austria). France should be the primary matter of concern since it combines mediocre fundamental health with poor adjusting performance. Thus, a reduction of labour costs and an easing of employment regulation are urgently required.

The Open Method of Coordination: A governance mechanism for the G20?

There is no realistic alternative to the G20 for the management of global economics. Yet, the forum’s limited impact – as the recent Cannes summit confirmed – creates growing concern. The report argues that the G20 must not only become more legitimate by further enlarging its base, but above all more efficient. Today, ‘prisoner’s dilemma’ best characterises the follow-up of summits, whereby member countries implement recommendations incoherently. The transformation of the G20 into a permanent structure and the use of the EU’s “open method of coordination” are well designed to address this structural weakness. Final communiqués should include precise, context specific and timely goals. A permanent secretariat should deliver evaluation and boost peer review and mutual learning. Several G20 members have oriented themselves towards this Europe-inspired type of soft law governance.

http://www.bertelsmann-stiftung.de/cps/rde/xcbg/SID-89E82D61-D14472D2/bst/bz.xsl/nachrichten_110230.htm

Die Weltraumpolitik der EU. (The space policy of the EU)

This paper focuses on the development of the European Space Policy (ESP), concentrating on its implications on EU policy fields of its Member States. These implications result not least from the April 2007 Commission communication on the ESP. Besides analysing this communication, the paper assesses the two flagship projects the EU conducts with the European Space Agency (ESA): the Galileo satellite programme and Global Monitoring for Environment and Security (GMES). While Galileo can be used for both civil and military purposes, the civilian direction of the ESP is more dominant. The report calls for: (1) Germany to build a strategic partnership with France; (2) Germany to actively engage in ESP in the EU and ESA; and (3) Germany to contribute to the development of a genuine European space strategy.


Les citoyens européens et l’Union européenne dans le contexte actuel de crise

This paper analyses current populist trends in European public opinion. Having first emerged in 19th century USA as a backlash against the widening gap between representatives and the people, ‘populism’ is a necessary element of democracy. It is a recurring ideology and a highly workable rhetorical resource, especially for small political parties. Today’s anti-EU discourse points to three aspects: the weak democratic legitimacy of Community institutions; alleged consequences of policies of free movement on immigration; and the supposed neoliberal bias of the Commission’s economic approach. EU responses are uneasy because they cannot turn against universal suffrage and have limited resources. Nonetheless, alarming stances should be avoided: practice shows that the participation of populist parties in government coalitions has a ‘normalising’ effect on their attitude.


Europe and the Arab revolutions: A new vision for democracy and human rights

Although southern Mediterranean protesters share some of the EU’s values, transitions in the region are likely to produce results with which Europeans are uneasy. This brief argues that, in response, the EU should focus on the development of legitimate and accountable governments in the Arab world aiming to create the background conditions for fair and inclusive politics, rather than back specific political groups. The EU should also support human rights and civil society development. Adopting such an approach in Libya, Tunisia and Egypt and embedding it in its instruments – conditionality and a new European Endowment for Democracy – could ensure EU effectiveness. The use of violence against civilians in countries like Syria should be a red line for limiting cooperation, drawing condemnation and sanctions in severe cases.

http://www.ecfr.eu/page/-/ECFR41_HUMAN_RIGHTS_BRIEF_AW.pdf
Départs
Maria Alberta Ribeiro du secrétariat de l’équipe EGE a pris sa retraite le 1er novembre dernier.

Événements
Le 8 novembre, le Président Barroso a rencontré, en présence de la Commissaire Vassiliou, une quarantaine d’acteurs du monde culturel venus de différents Etats-membres. Dans une atmosphère très positive, les échanges ont porté sur les politiques de l’Union en direction des arts et des industries culturelles, et plus largement sur la façon dont le secteur culturel peut contribuer au renforcement de l’esprit européen.


Le 15 novembre, le Groupe européen d’éthique (EGE) s’est réuni en présence d’experts extérieurs de haut niveau pour une discussion ouverte sur son projet d’Aris sur les implications éthiques des technologies de l’information et de la communication. Des représentants des organisations internationales (Nations-Unies, Conseil de l’Europe), du secteur privé (Google, ETNO), ainsi que du monde universitaire, étaient présents. Ces échanges très constructifs ont permis de mieux intégrer les différentes sensibilités dans l’Avis, qui sera soumis au Collège des commissaires en décembre et proposera plusieurs options politiques.


Enfin, le 30 novembre, les organisations philosophiques et non-confessionnelles ont rencontré les Président Barroso, Buzek et Van Rompuy à l’occasion d’une réunion de travail et d’un déjeuner. Conformément à l’article 17 du Traité sur l’Union européenne, cette rencontre annuelle adopte le même format que le dialogue entre les institutions et les organisations confessionnelles. Une trentaine de représentants des associations humanistes européennes étaient présents et ont eu l’occasion de s’exprimer sur la protection et la promotion des libertés et des droits fondamentaux au sein de l’Union et dans le cadre de la politique de voisinage.