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Sovereign Debt Crisis in Euroland: Root Causes and Implications for European Integration

Henk Overbeek

This article considers the likely impact of the global crisis on the prospects for the European project. First, it considers the nature of the current crisis. It argues that it is comparable, in terms of its deep structural character, to the one in the 1930s. The crisis manifested itself first in the financial sector, but was caused by underlying problems of overaccumulation, which explains the succession of speculative booms and busts from the 1980s onward. The article then analyses how the financial crisis transmuted into the current sovereign debt crisis in Europe. It identifies a number of interdependent factors responsible for this: the bailouts of banks following the credit crisis; the stimulus programmes necessitated by the danger of a deep economic recession; the structural problems of the European Monetary Union leading to the accumulation of debt in the peripheral members; and finally the catalytic action of speculation in the financial markets. Finally, the article discusses responses to the debt crisis, outlining the contours of two alternatives (muddling through and Europeanisation), their implications, and some of the conditions for success. The conclusion is rather pessimistic: chances that an effective, timely and sustainable solution will be realised do not seem high.

Keywords: euro crisis, sovereign debt crisis, financialisation, overaccumulation, democratic deficit

Henk Overbeek is Professor of International Relations at the VU University Amsterdam. Email: h.w.overbeek@vu.nl. This article is an abbreviated and adapted version of a chapter ("Global Capitalist Crisis and the Future of the European Project") in *Globalisation and European Integration*, edited by Nousos, Overbeek and Tsolakis. The manuscript for the article was first submitted for review on 24 August 2011. The author is grateful to three anonymous reviewers as well as the editor of this special issue, Lorenzo Fioramonti, for very useful comments. The final version of the article was submitted on 6 December 2011. On the basis of the reviews, a number of changes were made to the original text. However, the author decided not to incorporate new events since August into the account. New developments were occurring almost on a daily basis and it would have been impossible to appreciate them correctly. Instead, a very brief Postscript has been added to reflect on the degree to which developments since August may or may not have made the analysis presented in the article redundant.

The euro is reeling, and with it the future of the European integration project. Governments in Europe seem unable to deal with the sovereign debt crisis, and as a result of this political paralysis matters are going from bad to worse, endangering the survival of the project that took off shortly after World War II with the plans to create a European Coal and Steel Community (ECSC). What has happened? In most accounts of the crisis, and in particular in the popular press, the *communis opinio* is that the crisis has its origins in the financial sector, and that it threatens to spill over into the 'real' economy. This view represents a profound misunderstanding of the nature of the current crisis. In the second section, this article will argue that it is a lingering problem of overaccumulation of capital in the developed capitalist economies that has produced the successive bursts of speculative, finance-based, growth that have all ended in busts. The relative absence of profitable investment outlets in the 'real' economy (i.e. in the production and distribution of goods and services that would satisfy the demands of human beings with sufficient income to afford these goods and services) explains the flight of capital into speculative enterprises (summarised with the term 'financialisation').

The article then turns to the question of how the global credit crisis of 2007–08 morphed into the European sovereign debt crisis of 2010–11. Here the argument is that the current situation was created by the interaction of three factors: the impact of the trend to financialisation in the European economies, the design defects of the European monetary union, and the neomercantilist accumulation strategy pursued by dominant economic interests in Northern Europe, Germany in particular. The increasingly parasitic behaviour of the European financial markets worked as a catalyst upon the contradictions inherent in this state of affairs. It is the relentless speculation by 'the markets' against what were perceived as the weakest links that transformed the issue of rising sovereign debt into an acute crisis early in 2010.

Subsequently, the analysis reviews the most likely 'solutions' to the crisis. Here, the argument is that the current scenario – muddling through – is likely to be continued for some time, with quite negative consequences for the European periphery as well as for the democratic legitimacy of the European project. Alternatively, we may see the gradual acceptance of the need for a truly European solution. However, public discussion of this scenario has so far conspicuously ignored the need for innovative European democratic accountability to restore some popular legitimacy to 'Europe'. Finally, the conclusion relates the European debate to the wider global context and concludes that there is little reason to be hopeful about the prospects of the European project.

The origins of the contemporary crisis in global capitalism

Capitalist crises can take various forms: underconsumption when there is insufficient demand, or overproduction when more commodities are produced than can

be sold on the market. In the longer run, all these cases amount to “a situation in which capital accumulates at a higher rate than what can prevent the average rate of profit across the capitalist system from falling”.¹ What matters is that the logic of the accumulation process itself produces a variety of crisis tendencies, together leading to (the anticipation of) a fall in the rate of profit that capital can realise: this is what is generally referred to in Marxist theory as overaccumulation.² In other words, we speak of overaccumulation when capitalist firms cannot invest their profits in the expansion of their primary activities in production and distribution at the prevailing rate of profit, and are forced to search for alternative outlets where profits are higher, such as in financial speculation. As a consequence, the accumulation of productive capital slows down.

The current crisis, much like the Great Depression of the years 1929–45, marks the end of such a period of slow capital accumulation. Global capitalism experienced several decades of unprecedented growth during the postwar years, roughly from the late 1940s to the early 1970s. The nature of capitalism in this period, especially the predominance of Keynesian demand management, the relative closure of national economies and the ‘controlled’ restoration of international trade (cf. Ruggie’s concept of “embedded liberalism”³), was very much shaped by the experiences of the Great Depression. In a similar vein, the recession of the 1970s determined the character of the subsequent period of neoliberal globalisation. The main response of capital to the crisis of the seventies was a mix of temporal and spatial fixes, to use Harvey’s terminology.⁴

Spatial fixes involve the displacement of capital into foreign activities, whether through the relocation of production and the establishment of foreign subsidiaries, through cross-border mergers and acquisitions (M&As), or at a more general level through the incorporation of new zones into the capitalist world market (as emphasized in World Systems Theory⁵) in order to find new markets and raise profitability through cheaper inputs. This often involves what Harvey has called “accumulation by dispossession”, or the subordination to the pursuit of private profit of economic assets and activities previously not (fully) commodified.⁶ The key spatial fix of the past decades has been the incorporation of the People’s Republic of China into the capitalist world market after 1978, followed after 1989 by the incorporation of the former Soviet Union and Eastern Europe.

¹ Hung, “Rise of China and Global Overaccumulation Crisis”, 152.

² Cf. Harvey, *The New Imperialism*; Hung, *Ibid.*

³ In Ruggie, “International Regimes, Transactions, and Change”.

⁴ Harvey, *The Condition of Postmodernity*, and *The New Imperialism*; cf. also Duménil and Lévy, *The Crisis of Neoliberalism*, 19–22.

⁵ Wallerstein, *The Modern World System Vol. I.* and *The Politics of the World-Economy.*

⁶ Harvey, *The New Imperialism*, 145 ff.

The acquisition of local assets – often newly privatised – afforded international capital ample opportunity to realise profits very quickly. In a non-geographical way, the waves of denationalisation and privatisation in most European countries of the Organisation for Economic Cooperation and Development (OECD) during the 1980s and 1990s, and the subsequent creation of a market for corporate control in the European Union (EU), constituted other major forms of accumulation by dispossession.⁷

Temporal fixes for the problem of overaccumulation all function to maintain profitability in the present by impairing profitability and stability in the future through debt financing.⁸ Looking at how capital has responded to the problem of overaccumulation since the 1970s, we see that the temporal fix in this era has taken the form of an unprecedented financial expansion. As Robert Cox already commented in 1992, “finance has become decoupled from production to become an independent power, an autocrat over the real economy”.⁹ The financial sector has expanded far beyond any reasonable need to facilitate production, distribution and consumption, which are after all the basic functions that an economy needs to perform for society. These financial expansions (not new in the history of capitalism), called financialisations, are defined as patterns of accumulation in which profits accrue primarily through financial channels rather than through trade and commodity production.¹⁰ This trend is reflected, firstly, in differential profit rates between financial and non-financial companies, but can also be found within non-financial firms, expressed in the increasing proportion of total profits deriving from purely financial transactions as opposed to profits deriving from productive activities.¹¹

The global crisis first manifested itself in the collapse of the subprime mortgage market in the United States (US), then spread quickly through the Atlantic financial markets, and then transformed into a deep recession, thus underscoring that the real underlying problem was indeed a problem of overaccumulation: no matter how much liquidity central banks have pumped into the system since 2008, it has hardly resulted in a notable restoration of domestic investment in the ‘old’ OECD.

The genesis of the European sovereign debt crisis

In the recession of the late 1960s and early 1970s, overaccumulation of capital was as much a problem in Europe as it was in the US. European responses to the crisis

⁷ *Ibid.*, 145–82; also Van Apeldoorn and Horn, “The Marketisation of Corporate Control”.

⁸ Cf. Harvey, *The New Imperialism*.

⁹ Cox, “Global Perestroika”, 29.

¹⁰ Krippner, “Financialization of the American Economy”, 174; after Arrighi, *The Long Twentieth Century*.

¹¹ Ashman *et al.*, “The Crisis in South Africa”, 175.

varied widely. Both spatial and temporal fixes were actively pursued but the mix was different between countries as well as over time.

Overaccumulation and spatio-temporal fixes

The initial reaction on the part of productive capital in Europe was a combination of rationalisation and automation at home, and relocation especially of labour-intensive production processes to low wage countries: the ‘new international division of labour’ as it was dubbed in the classic study of the time.¹² The great German and French industrial conglomerates in particular have consistently advocated and pursued an accumulation strategy based on spatial fixes. In response to the crisis of the late 1970s and early 1980s, this first took the form of the integration of Southern Europe into the orbit of Northern European capital, and the relocation of a great part of the production of parts and assembly activity to Spain and Portugal.¹³ Subsequently, the transformation of the Deutsche Mark-zone into the Economic and Monetary Union (EMU) was the second cornerstone of this strategy: originally agreed for political reasons during the Maastricht Summit, the creation of EMU and the introduction of the euro rapidly became key ingredients of the accumulation strategy of Franco-German industrial capital, as they set a brake on the appreciation of the D-Mark and gave German (and French) industrial groups an important additional competitive edge, reinforced by a consistent policy of wage restraint and suppression of domestic consumption (actually pioneered by the Dutch in the early 1980s).

The double (political and economic) transformation in Central and Eastern Europe after 1989 provided this strategy with new momentum:¹⁴ the low-paid, highly skilled, labour forces in Central Europe provided Western European business with the ideal platform from which to deepen its internal division of labour and open a new offensive on the global markets.¹⁵ In the wake of the great industrial conglomerates, German and French banks also expanded their activities in Eastern Europe, followed by Austrian and Italian banks in what could be considered a subordinate role.¹⁶

Politically, this ‘Euro-liberal’ orientation aims to create a prominent role for the European political level (though not necessarily institutionalised in the EU) in establishing and guaranteeing a ‘level playing field’ through market-based convergence within the EU.¹⁷ It is politically spearheaded by the German and French governments and the European Commission. In the early days, traditionally

¹² Fröbel *et al.*, *The New International Division of Labour*.

¹³ Cf. Holman, *Integrating Southern Europe*.

¹⁴ Holman, “Integrating Eastern Europe”.

¹⁵ See Bohle, “Race to the Bottom?”.

¹⁶ Vliegenthart and Overbeek, “Corporate Governance Regulation in East Central Europe”.

¹⁷ See Vliegenthart and Overbeek, “Corporate Tax Reform in Neoliberal Europe”, for the original characterisation of this orientation.

protectionist European firms were influential in setting the tone of the debate e.g in the Delors Commission, emphasising the unique character of the European social model and the ambition to reproduce something like a Rhenish capitalist model on the EU level.¹⁸ However, the advocates of such a strategy suffered defeat when its main protagonist in the erstwhile German government, Oskar Lafontaine, was forced to resign his influential cabinet post in 1999. His departure from the political stage marked the end of protectionist forces in Europe and their succession by the much more neoliberally oriented 'Euro-mercantilist' camp.¹⁹

The ambition of this orientation is to utilise the enlarged European economic space to develop an integrated European technological-industrial complex ultimately able to compete with the US and the great industrial powers of Asia. The social basis of this camp is made up of a range of internationally competitive, Europe-based, manufacturing conglomerates (many of the members of the European Roundtable of Industrialists) dubbed 'Euro-contender capital' by Van der Pijl (e.g. Daimler-Benz, Fiat, Volkswagen, Unilever, and Deutsche Bank²⁰), as well as of parts of the established trade union movement. A recent study has shown that the rise to centrality of especially German capital in the networks of corporate interlocks actually predates the crisis and can be seen as a continuous process since the end of the Cold War and the creation of the Single Market and EMU, and has intensified in the new millennium.²¹

Nevertheless, although spatial fixes have been central to the strategies of the big European industrial conglomerates in the past decades, these have at the same time engaged heavily in pursuing other shortcuts to increased profitability, such as hoarding cash, currency and real estate speculation, and consumer credit financing. In the United Kingdom (UK), the Thatcher revolution with its liberalisation, privatisation and deregulation offensives unleashed an internal, unmediated and forceful wave of accumulation by dispossession.²² Financialisation developed quite unevenly in different European countries: of the major countries, it developed latest and slowest in Germany (see Table 1 for some indicative data²³). By the end of the 20th century, finance-led accumulation had become the predominant growth model, not only in the traditional centre of financial globalism, the UK, but also in most of continental Europe.

¹⁸ Holman, "Transnational Class Strategy and the New Europe".

¹⁹ Van Apeldoorn, *Transnational Capitalism and European Integration*.

²⁰ Van der Pijl, *Global Rivalries from Cold War to Iraq*, 264.

²¹ See Van der Pijl *et al.*, "The Resurgence of German Capital", for data.

²² Cf. Overbeek, *Global Capitalism and National Decline*.

²³ Also see Konings, "European Finance in the American Mirror"; Dünhaupt, *Financialization and the Rentier Income Share*.

Table 1. Gross Value Added in Financial Intermediation, Real Estate, Renting, Business Activities & Construction, as % of Total Gross Value Added, 1995–2008

	France	Germany	Italy	Netherlands	Spain
1995	34.6*	33.2	27.7	29.6	25.4
2000	35.9	32.7	29.7	32.9	27.8
2005	37.9	30.5	32.9	33.0	32.6
2008	40.1	33.7	34.1	34.1	34.4

* = 1999

Source: Calculated from OECD National Account Statistics, <http://www.oecd.org>.

The rise to supremacy of finance-led accumulation even in Germany, compounded by such global transformations as the disintegration of the Soviet Union and the Asian financial crisis which represent a watershed in the deepening of global neoliberalism, has strengthened the hand of the neoliberal globalist camp. This neoliberal globalist orientation refuses any attempt to ‘regulate’ European capital and advocates the freedom of capital to move and to accumulate. This orientation expresses the specific interests of mobile European capital competing directly on the global markets (primarily financial and commercial interests plus the international oil and gas sector): such corporate interests as Royal Dutch Shell, BP, British Gas, British Telecom, Glaxo and Nestlé, as well as global finance and services capital (the City of London, but also Allianz) come to mind.²⁴ Politically, the British government traditionally represents this orientation, often supported by organisations of highly skilled labour.

Financialisation and crisis

In the run-up to the global financial crisis in 2008, the grip of finance on the European political economy strengthened enormously, most spectacularly in those European economies where financialisation constituted the core of the response to the lingering problem of overaccumulation. Spurred by the concentration of the global financial sector in the City of London, financial expansion was most pronounced in the UK, Ireland and Iceland (which according to a senior official of the International Monetary Fund could no longer be considered a country but instead had to be understood as a hedge fund²⁵). The ratio of financial assets to GDP increased sharply, reaching nearly 600 percent in the EU, nearly 700 percent in France and the UK, and 900 percent in Ireland (see Table 2).

²⁴ See Van der Pijl, *Global Rivalries from Cold War to Iraq*, 264.

²⁵ Quoted in Palma, “The Revenge of the Market”, 834.

Table 2. Bonds, Equities and Bank Assets as % of GDP, 2007

Euro Area	557.6
<i>of which:</i>	
Austria	406.2
Belgium	824.1
Finland	371.3
France	668.5
Germany	430.8
Greece	436.7
Ireland	900.4
Italy	453.9
Luxembourg	3,234.4
Netherlands	830.8
Portugal	389.5
Spain	550.2
<i>compare to:</i>	
World	439.6
UK	690.2
US	445.0
Japan	546.6

Source: IMF, *Global Financial Stability Report*, 177.

In Iceland, not an EU member state but deeply integrated with the EU economy, the assets of the three biggest banks alone surpassed 800 percent of GDP by 2007.²⁶ The integration of financial markets in the EU, and the creation of a European market for corporate control,²⁷ facilitated and indeed stimulated the penetration of the practices of financialisation in those continental European economies that had been relatively insulated from this development before (Germany in particular).

Another temporal fix pursued by money capital in a number of European countries was overinvestment in real estate, especially in Ireland, the UK and Spain, where house prices increased about threefold in the period 1997–2007.²⁸

Finally, European banks were differentially affected by the spread of securitised subprime mortgages from the US. Most Spanish banks, and some of the more ‘conservative’ European banks like the Dutch *Rabobank*, were hardly affected.²⁹

²⁶ Wade and Sigurgeirsdottir, “Lessons from Iceland”, 14.

²⁷ Van Apeldoorn and Horn, “The Marketisation of Corporate Control”; see also Horn, *Transformation of EU Corporate Governance Regulation*.

²⁸ “Houses Built on Sand”, *The Economist*, 13 September 2007, <http://www.economist.com/node/9804125>.

²⁹ See Nesvetailova and Palan, “A Very North Atlantic Credit Crunch”, 166–7.

UK banks initially accounted for the bulk of securitisation, but after 2007 continental banks (France, Netherlands, Germany) overtook the UK on this score.³⁰

From banking crisis to sovereign debt crisis

As of early 2010, the crisis in Europe mutated from a banking crisis into a sovereign debt crisis threatening the credibility of the world's second most important reserve currency, the euro. A key nexus here is the structure and functioning of the EMU. The introduction of the single currency on 1 January 1999 stabilised the credit ratings of the eurozone member states:³¹ Ireland received triple-A status in 2001 and Spain in 2004 (while Italy, Portugal and Greece had lower ratings).³² However, the exchange rate at which the currencies of Portugal, Spain and Italy were locked in was unsustainably high, presaging trouble for the future.³³ Furthermore, the institutional and technical design of EMU eliminated the traditional instrument that allowed these countries to maintain their competitiveness, currency devaluation. The only road left was wage suppression, also known as 'internal devaluation'³⁴ or, alternatively, compensation by increased budget deficits, which for a time seemed a viable strategy as Southern EMU governments could borrow money on the European capital markets at very low rates.³⁵ The creation of EMU and the introduction of the euro thus led not to convergence but to divergence in the eurozone.

The mercantilism of the Northern EMU members – essentially the members of the former informal DM-zone (Germany, Netherlands, Austria, Scandinavia, Belgium) – continued to be based on the relative suppression of domestic demand through wage restraint and balanced budgets in order to maximise surpluses on the external account. This policy aggravated the position of the Southern EMU members as it structurally limited access to their most important export markets. In the years 1996–2008, Germany's export volume grew twice as fast as that of the rest of the eurozone; domestic demand in Germany by contrast declined by 1.5 percent per year against the rest of the eurozone.³⁶ Its trade surplus fed capital exports from Germany, both reinforcing the transnationalisation of German industrial capital as well as injecting

³⁰ *Ibid.*, 175.

³¹ In 1999, the eurozone was established by Austria, Belgium, Luxemburg, Germany, Spain, Finland, France, Ireland, Italy, the Netherlands and Portugal. Greece joined in 2001, Slovenia in 2007, Cyprus and Malta in 2008, Slovakia in 2009 and Estonia in 2011. Plans by other Central and East European member states to join the single currency have been postponed in response to the current crisis. "East European States Push Back Entry Dates", *Financial Times*, 13 June 2011, 5.

³² De Haan *et al.*, *European Financial Markets and Institutions*, 84.

³³ Bellofiore *et al.*, "The Global Crisis", 130.

³⁴ Cafruny and Talani, *Economic and Geopolitical Dimensions*, 13.

³⁵ *Ibid.*, 16.

³⁶ Young and Semmler, "The European Sovereign Debt Crisis", 10.

speculative capital into the Southern periphery, especially in the construction sector.³⁷ In Southern Europe, membership of the eurozone provided insulation from currency crises and kept interest rates low, thus leading to rising current account deficits and rising household debt.³⁸ Local banks, but also international private banks, built up very high exposure to government debt: by 2010, eurozone banks were exposed to the tune of USD1.4 trillion (German and French banks each for roughly USD500 billion), with US and UK banks each exposed for about USD400 billion.³⁹

In Ireland, but to a less dramatic extent also in countries such as the Netherlands, Belgium and the UK, governments rapidly built up huge debts by stepping in to bail out (or nationalise) their banks when the credit crisis started to hit them late in 2008, after the collapse of Lehman Brothers in the US. In addition, nearly all European governments introduced sizeable stimulus programmes in 2009–10 to counteract the effects of a lack of credit on the international capital markets.

Thus, a combination of factors contributed to the rise of European sovereign debt. Poor competitiveness, stagnating export markets, low interest rates, domestic political pressures, and the cost of bank bailouts and stimulus programmes, interacted to cause the rise of sovereign debt all over Europe. By 2010, general government gross debt stood at 85 percent of GDP for the eurozone as a whole. This is high compared to the years just before the global credit crisis erupted in 2008. Nevertheless, it is not unprecedentedly high, and for several member states debt is even (considerably) lower than during the second half of the 1990s (Belgium, Finland, Italy, Netherlands, Spain). This suggests that, especially given the prevailing low interest rates, overall eurozone debt could, in principle, be comfortably financed.

The conclusion at this point can only be that European sovereign debt has not become an acute problem because its level has passed some absolute and objective point of no return, but rather because the markets are demanding an exorbitant premium when lending to peripheral eurozone governments. The governments of Greece, Ireland and Portugal were being charged 4–8 percent higher interest rates than the governments of Germany or the Netherlands (which borrowed at 2–2.5 percent), while the Spanish and Italian governments were being charged 3–4 percent higher. The markets do not trust the longer-term capability of these governments to service their debts and therefore insulate themselves against possible future default by realising a superprofit in the present, thus making it nearly impossible for the governments in question to honour their commitments.

³⁷ *Ibid.*, 13.

³⁸ Cafruny and Talani, *Economic and Geopolitical Dimensions*, 16.

³⁹ EuroMemoGroup, "Confronting the Crisis", 8.

As Europe is learning the hard way, market expectations have a habit of becoming self-fulfilling prophecies. However, the concept of ‘the markets’ needs to be unpacked. The market is not an actor, but an arena in which actors play out their individual strategies and in which they respond to each other. Therefore a look has to be taken at the agency of the financial institutions active on these financial markets, and first of all at the most active ones, that is the leading global banks and the major hedge funds.

Financial institutions have played a key role in the European sovereign debt crisis, not just in the past two years driving up the interest premium that targeted governments are made to pay, but all along. Take the role that the world’s most powerful bank, Goldman Sachs, has played in the Greek crisis. It helped the Greek government hide part of its debt in order to qualify for EMU membership in 2001–02.⁴⁰ Subsequently, it advised the Greek government on how to comply with the conditions of the European Central Bank–International Monetary Fund (ECB-IMF) rescue plan in 2010, as joint lead manager on the issue of €8 bn worth of government bonds as well as on the Greek privatisation plans.⁴¹ All the big international banks have been involved in the trade in credit-default swaps (CDS): “These contracts . . . effectively let banks and hedge funds wager on the financial equivalent of a four-alarm fire: a default by a company or, in the case of Greece, an entire country. If Greece reneges on its debts, traders who own these swaps stand to profit.”⁴²

What is to be done?

Roughly speaking, there are three possible ways of dealing with the euro crisis. The first option would be to accept the inability of the eurozone to deal with the debt crisis now facing its peripheral members and to arrange for a managed exit of Greece,⁴³ maybe also of Ireland and Portugal, and possibly even of Spain and Italy, leaving a core eurozone that would look suspiciously like the informal D-Mark zone that preceded it. In a more radical departure, the complete dissolution of the eurozone could come about if Germany were to decide to leave the euro.

⁴⁰ “How Goldman Sachs Helped Greece Mask its True Debt”, *Der Spiegel*, 8 February 2010, <http://www.spiegel.de/international/europe/0,1518,676634,00.html>.

⁴¹ “Goldman Sachs plays Key Role in Rescue”, *Financial Times*, 29 January 2010, <http://www.ft.com/intl/cms/s/0/fb84df2e-0c75-11df-a941-00144feabdc0.html#axzz1V6OWWN73>.

⁴² N. Schwartz and E. Dash, “Banks bet Greece Defaults on Debt they Helped Hide”, *New York Times*, 25 February 2010.

⁴³ The details of this possible scenario will not be examined here. Suffice it to say that a breakup of the euro area, although undoubtedly extremely costly, is not impossible. This was the conclusion of Barry Eichengreen, who added that because of the political obstacles it is most unlikely to happen “except under the most extreme circumstances” (Eichengreen, *The Breakup of the Euro Area*, 36).

The second option would be to seize the opportunity that the crisis presents and complete the design of the monetary union by creating a minimal joint fiscal and economic policy, some mechanism for the correction of unequal development within the monetary union and the creation of a eurobond market (partly) replacing the existing 17 national bond markets of the eurozone.

The third option is the one that seems to be the natural first choice of the EU whenever confronted with a problem: that is, muddling through. It consists of avoiding any radical choices in the hope that the problem will go away. This option usually works for a while in the sense that the symptoms of the problem are temporarily weakened, but it never succeeds in resolving the underlying problem.

In the nearly permanent discussions on the right way to handle the crisis, the dominant voice so far has been that of the German government, usually cheered on by the Dutch and – sometimes reluctantly – supported by the French. On the one hand, the position taken has been that the euro will be defended at any cost, but on the other hand, the German government has vetoed any move towards further Europeanisation of sovereign debt in whatever form:⁴⁴

- it opposes the buying up of bonds by the European Central Bank (ECB) – even though the ECB has so far intervened massively twice, by buying Greek and Portuguese (2010) and Spanish and Italian debt (2011) to the total tune of nearly €100 bn – both because of the inflationary pressures that may result, and because it exposes the surplus EMU members directly to the risk of default by the deficit members;
- it has so far also blocked the creation of eurobonds, again mostly on the grounds that this would expose Germany to the risk of default by the peripheral countries.

The German line has in effect been to muddle through. It has pushed through the European Financial Stability Facility (summit December 2010) and agreed with France on creating ‘true European economic governance’ (in July 2011). In reality, these are essentially intergovernmental constructions sidelining the European institutions. This has led, and will no doubt continue to lead to frictions between the German government and the ECB. It will not bring structural reforms to EMU, it does not entail stricter regulation of the financial markets, and as a consequence it seems a recipe for recurring crises because the markets will keep smelling blood. The only ‘critical’ component of Germany’s preferred package, a contribution by the financial sector itself – the famous ‘haircut’ – was watered down to a very vaguely formulated voluntary contribution during the July 2011 negotiations over the second Greek bailout package.

⁴⁴ Young and Semmler, “The European Sovereign Debt Crisis”, 14–15.

The implications of this line of action, for as long as it may last, would be the further deepening of the European neoliberal project, prioritising the interests of financial capital over those of production and the working population, and continued austerity in Northern Europe aimed at strengthening the German-led mercantilist strategy. This global competitiveness project is pursued at the expense of the European periphery (inside and outside the EU). It will impose continued internal deflation in Southern Europe, with rapidly rising social inequality, political risks, rising authoritarianism. In spite of the lengths to which the Greek and Portuguese governments have already gone to placate their Northern creditors, there are limits to the burdens they can impose on their populations. The external pressure exerted on these governments is enormous, and is reflected in the language used in the editorial comments in one of the leading international financial papers: “Athens must be put under the gun”, and “Spain occupies the Eurozone front line”.⁴⁵ In fact, the so-called rescue packages for Greece, Ireland and Portugal have already brought “disciplinary neoliberalism”⁴⁶ into the European Union, and are exposing them to accumulation by dispossession: as the *Wall Street Journal* noted, “Greece is for sale – cheap – and Germany is buying”.⁴⁷ Pursuit of this line can in the longer run only result in the demise of the EMU. But the demise of the euro will also spell the end of German mercantilism: it will imply the resurrection of a DM-zone, and the DM will soar on the international currency markets (like the Dutch guilder and the Austrian schilling), and Germany’s surpluses will quickly shrink.

There are alternatives to this scenario. The most likely alternative would be a gradual acceptance, *contre cœur*, of the Europeanisation of the sovereign debt markets and some form of European economic governance. The modalities are unclear at present. In the short run, there will inevitably need to be a restructuring of Greek (and possibly Portuguese and Italian) debt; banks hit disproportionately by such write-downs will have to be recapitalised. In the somewhat longer run, eurobonds may be promoted as (part of) the solution,⁴⁸ while others prefer the ECB to continue and to expand the buying up of national debt.⁴⁹ These short-term measures will enable peripheral governments to refinance their remaining sovereign

⁴⁵ “Athens Must be Put Under the Gun”, Editorial Comment, *Financial Times*, 10 May 2011, 8; and “Spain Occupies the Eurozone Frontline”, Editorial Comment, *Financial Times*, 1 August 2011, 6, respectively.

⁴⁶ Gill, “Globalization, Market Civilization”.

⁴⁷ Quoted by M. Hudson, “The Financial Road to Serfdom. How Bankers Use the Debt Crisis to Roll Back the Progressive Era”, *Global Research.ca*, 13 June 2011, 2, <http://www.globalresearch.ca/index.php?context=va&aid=25250>.

⁴⁸ As advocated, for instance, by G. Amato and G. Verhofstadt, “A Plan to Save the Euro, and Curb the Speculators”, *Financial Times*, 4 July 2011, 7; by M. Monti and S. Goulard, “Eurobonds are the Only Answer”, *Financial Times*, 21 July 2011, 11; and by J. Stiglitz, “Now the Central Bank Must Act”, *Financial Times*, 21 July 2011, 11.

⁴⁹ P. De Grauwe, “Only the ECB can Halt Eurozone Contagion”, *Financial Times*, 4 August 2011, 9.

debt at low (close to German) interest rates, thus making their debt service financially sustainable in the long run.⁵⁰

In most cases it is agreed that such a solution requires some form of European fiscal governance: strong and automatic sanctions need to deter governments from spending and borrowing beyond their means. For such a solution to be credible, it would require that the oversight task be entrusted to some independent authority that is not subject to direct political control by the member state governments. Looking at the discussions generated by the need for a second Greek ‘rescue package’, this alternative is not completely unthinkable. If the acute situation on the financial markets deteriorates further, such an alternative may become a realistic option, for instance involving the expansion of the ECB mandate or the creation of an independent European ‘budget authority’ (as proposed by the Dutch government). There are however at least three (partly inter-related) problems that would also need to be resolved for these short- and medium-term measures to become effective, but which are currently not recognised as real problems.

For one, as this analysis has shown, the high deficits in the Southern peripheral countries (Greece, Portugal, Italy) have much to do with the suffocating effects of EMU on Southern exports to the North. Any strategy to restore the health and stability of the euro will therefore need to include a strategy for restoring real economic growth (as opposed to speculative bubbles). In effect, the monetary union will have to be complemented by some form of a transfer union as well. The one percent of European GDP now going to the total EU budget is grossly inadequate to perform this role. In this context, there will also have to be a European public investment programme for which the European Investment Bank, once created for precisely such purposes, might be revitalised and capitalised on an adequate scale, as Joseph Stiglitz has recently suggested.⁵¹ Some key ingredients of such a programme may be the integration and large-scale expansion of Europe’s high-speed railway network; large-scale investment in the development of sustainable energy; and on that basis the massive and accelerated introduction of a new generation of automobiles propelled by sustainable fuel.

Secondly, eurozone policies have so far concentrated on insulating the banks from losses: they are allowed to make extraordinary (private) profits while their losses are ‘socialized’ and paid for by the European populations.⁵² In July 2011, in

⁵⁰ J. Sachs, “Greece can be Saved – Here is How to do it”, *Financial Times*, 1 July 2011, 9.

⁵¹ J. Stiglitz, “Now the Central Bank Must Act”, *Financial Times*, 21 July 2011, 11.

⁵² M. Hudson, “Drop Dead Economics: The Financial Crisis in Greece and the European Union. The Wealthy won’t Pay their Taxes, so Labor Must do so”, *Global Research.ca*, 11 May 2010, and “The Financial Road to Serfdom. How Bankers use the Debt Crisis to Roll Back the Progressive Era”, *Global Research.ca*, 13 June 2011; M. Hudson and J. Sommers, “The Spectre Haunting Europe: Debt Defaults, Austerity, and Death of the ‘Social Europe’ Model”, *Global Research.ca*, 18 January 2011, <http://www.globalresearch.ca/PrintArticle.php?articleId=22846>.

an obvious attempt to disarm the German government's call for private sector 'participation' in the second rescue package for Greece, the Institute of International Finance (representing the majority of financial institutions in Europe) in a six-page report (some might be tempted to call it a ransom note) rejected this idea and demanded "that the European Union commit itself to a buy-back of the debt, possibly with billions in government money".⁵³ In fact, the banks want to have their cake and eat it too. They charge very high-risk premiums when lending money to peripheral governments based on the logic that they must protect themselves against the risk of default, and that they must use the extra interest in order to make proper risk provisions in their balance sheets. Then they turn around and demand that the German, French, and other Northern governments guarantee to take Southern bonds off their hands without any loss. If Northern governments do that (as they have done so far), then where is the risk, and therefore the legitimation for the risk premium? With respect to Greece, this line will safeguard the banks from paying the price for their gamble. "In 2015 Greece will be bankrupt but its debt will be held overwhelmingly by public lenders: the EU, the ECB and IMF. When default comes, the banks will be out of it and Europe's taxpayers will bear the burden."⁵⁴

Stricter regulation of the financial markets, however, or a ban on the most risky forms of derivatives trading, is kept off the agenda in a remarkable demonstration of the structural power of finance. Yet, there is nothing inherently inevitable about the demands of the markets. In March 2011, speculators turned against the Japanese yen in the aftermath of the tsunami plus nuclear reactor meltdown, "betting that Japanese insurers and other big companies would have to repatriate funds to meet claims and pay for reconstruction"⁵⁵ and thus push up the exchange rate of the yen. The four leading central banks in the world (the Federal Reserve Board, the ECB, the Bank of Japan and the Bank of England) undertook concerted action to repel the attack and were successful in driving down the yen.⁵⁶ Even without formal regulation, when acting decisively, the proper authorities are apparently perfectly able to restrain the markets.

Finally, and directly following from this, all proposals for some form of European fiscal and economic governance have ignored the question of democratic accountability. There are strong tendencies towards technocracy (strengthening the role of the ECB), and towards intergovernmentalism (especially French-German bilateralism), while parliamentary oversight is extremely weak at the national level

⁵³ "Markets Rocked as Debt Crisis Deepens", *Financial Times*, 12 July 2011, 1.

⁵⁴ C. Lapavistas, "Euro Exit Strategy Crucial for Greeks", *The Guardian*, 21 June 2011.

⁵⁵ "G7 Nations in \$25 bn yen Sell-off", *Financial Times*, 19–20 March 2011, 1.

⁵⁶ *Ibid.*

and non-existent at the European level. For any 'European' solution to the debt crisis to work, it will need to be legitimate as well as technically feasible. Most European politicians, especially those in government, have not even begun to publicly address these issues, preferring as they do to concern themselves primarily with the short term, and especially with their chances to survive in the next elections (coming up in 2012–13 in several of the leading eurozone member states). They shy away from thinking creatively about how to strengthen the democratic credentials of European institutions and of Euro-level decision-making, and revert (at least rhetorically) to an unholy mixture of intergovernmental deals and renationalisation.

Conclusion

There is every reason to be pessimistic about the prospects of the European polity. The dynamics of the sovereign debt crisis have so far strengthened the relative position of German-led neomercantilist forces, which are guided less by considerations of strengthening European integration *per se* than by the imperative of strengthening the competitive position of transnational European capital *vis-à-vis* its American and Asian rivals. This suggests that the debate on the European sovereign debt crisis is inward looking, largely ignoring the global context in which the future of the European project will be decided. In fact, the euro crisis ties in with the debt crisis in the US, and with the pressure this puts on the role of the US dollar as the prime international reserve currency. Even if the Europeans themselves may not realise this, many emerging economies look to the euro as a valuable alternative to the dollar. The Chinese government, which is sitting on a record USD3.2 trillion mountain of currency reserves, is looking for ways to reduce its dependence on the dollar and on US government securities, which explains its interest in buying troubled eurozone government bonds. Other new economic powers from the global South such as Brazil likewise look to Europe. Strengthening relations with these new economic powers might provide the eurozone with additional tools with which to deal with the internal problems of the European economies. However, here too a credible solution to the political and institutional shortcomings of the eurozone is a precondition for this to actually materialise.

There is one final issue to be addressed. Even if all the conditions mentioned so far were met, and a credible, strong and democratically legitimated new style EMU with strictly regulated financial markets were to emerge, it is very unlikely that this would mean the end of the economic and financial problems. As argued at the beginning of this article, the financial crisis is not the ultimate cause of the problems that have brought the European project to the brink. The financial crisis is itself a symptom and product of the underlying structural crisis of overaccumulation that has plagued developed capitalism since the 1970s. This is a problem of the

‘real’ economy and cannot be resolved by whatever ‘money artistry’ the Europeans (or the Americans for that matter) come up with.⁵⁷ Only once the underlying crisis of overaccumulation is overcome can better prospects for the European economies emerge. But, perhaps unfortunately, chances are that these conditions will not all be met in sufficient measure. Europe may then well go globally the way that Tuscany has gone within Europe: it would become a magnet for wealthy rentiers and rich tourists from Asia and the Americas, rather than one of the leading powers in the post-crisis world order.

Postscript, 6 December 2011

As these lines are added, the Euro Summit of 9 December is fast approaching, and the situation of the moment has made it abundantly clear that the days of muddling through have passed. Europe is facing a historic choice: either the European leaders succeed in charting a way forward for the euro, or they fail and thus set in motion a dramatic return to national solutions to the crisis. There are some signs that the first outcome is still possible: differences between Sarkozy and Merkel seem smaller than before; there seems to be better coordination between the German government and the ECB than before; political developments in Greece, Italy and Belgium seem to hold some promise; and there seems to be a growing awareness of the dangers that a failure would entail. But on three key issues little or no progress has been made: there is a very one-sided obsession with balanced budgets without any recognition of the need for pro-growth policies; there is very little talk of regulation of the financial markets; and there are no provisions for increased democratic legitimacy for the European project. Failure to include these elements in the package, it has to be feared, can ultimately only strengthen the hands of the populist extreme right throughout Europe. The responsibility resting on the shoulders of the European leaders could hardly be greater.

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⁵⁷ Ivanova, “Can ‘It’ Happen Again”.

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