Prologue: Other People's Eyes

In a matter of just a few years the euro area has been close to sinking at least three times: in September 2008, in May 2010, and in November 2011. Each time the existential reasons for the euro area have proven stronger than the weaknesses of the ship and the clumsiness of its command.

For a long time the timid solutions to the crisis were dictated mainly by national fears and reciprocal mistrust. Then, by the end of 2011 national politics had reached its limits. European priorities dictated even the change of governments and new common policies prevailed. However, until Europeans emerge with a common—non-national—narrative of the crisis, they will not be able to use the only possible means needed to end it: deeper political integration.

Until then, the crisis may be tamed and even settled temporarily, but it will keep corroding the foundations of the European Union, the world's most advanced attempt to form a human community among different peoples through supranational cooperation and acknowledgment of a common destiny. If the European experiment fails, the world will see national interests resurge in a time when global issues have become vital and cannot be solved by any single nation: social justice as well as freedom, economic cooperation and financial stability, the free circulation of people and of the fruit of their work, the protection of the environment, and peaceful developments in large parts of the emerging world. If there is any hope of a global democratic governance of those issues, it rests on the experience of pooled sovereignty.

The euro is the fragile crown of the European project of shared sovereignty. That is why its survival is so important. The fragility of the monetary union, institutionally and politically, has loomed larger against the backdrop of the

power of financial markets whose size and feverish hypochondria are becoming both a guaranty and a pathology for democratic decisions. Under that pressure, European politics have often let mistrust prevail over inspiration. The repatriation of politics and the resurgence of national interests have already infiltrated the European economy. At the end of 2011, the European banking system—the fundamental infrastructure of economic integration—was completely segmented along national borders. The same was true of the financial system. National debts were largely repatriated. Gradually, the national economies were turning back into closed systems. At some point, if this process continues, it might not make much sense to share a common currency, strict fiscal rules, and an onerous system of laws. Since we know that Europe's breakup would hurl it back into obscurity, the search for solutions that do not go in the direction of repatriation must go further.

The reason why this is so difficult is that most of us are still following the wrong explanations of the causes behind the euro crisis. There is no European-wide public discourse, and the narratives are left in the hands of national politicians relating to national public opinions. Inevitably, the story of the euro crisis has become a story of national recriminations prevailing over facts.

I will give one example. On May 6, 2010, the Governing Council of the European Central Bank held an emergency meeting in the restaurant of a fifteenth-century palace in Lisbon. In a dramatic night when the whole world economy seemed to be collapsing, council members made the most unexpected decision in the history of the crisis of the euro area. One of the governors decided to speak the unspeakable and proposed that the ECB buy government bonds of the countries under attack from the markets. His proposal breached a taboo on which the euro had been built. It was a step that would cause the political contamination of the central bank's sacred independence, but it also was the first step into a shared fiscal responsibility among the different countries of the euro area. The shock of all the other bankers around the table could not have been greater because the man who had violated the dogma was Axel Weber, the head of the ultra-orthodox German Bundesbank.

That decision saved the euro, at least temporarily. But the central bankers had just landed back home in Frankfurt the following day when they received an e-mail from Weber saying that he had changed his mind. After a few days, he went public, attacking frontally the very decision he himself had proposed. By hiding the fact that he had been the inspiration for this momentous step, he inadvertently gave reasons for the false myth that Germany had been betrayed by her euro partners. This myth provided an unfounded but powerful narrative that changed Europe, inspiring a sense of mistrust and divisions that hampers the solution and may need decades to be mended.

When three of the participants told me this story—of maybe the single most significant event in the development of the crisis of the euro zone—and when I heard about many other episodes and saw how little-known or even secret they were, I had to accept that economics was not the only tool I could use to understand the amazing sequence of events known as the euro crisis. No matter how much deeper one could go into the study of the databases, that kind of analysis was insufficient and sometimes outright misleading. Unfortunately, the story of the crisis in the euro area had much more to do with politics and human behavior than with predictable statistical models. There was not an invisible hand behind the spiraling events, but rather governments, and private interests, and, above all, people who lost their jobs and safety nets. Finally, I thought that they, too, had remained invisible far too long.

For those reasons, this book is more about politics than about money. Some of the most relevant stories are only apparently financial. In April 2009, for instance, a portfolio constraint was informally imposed on the banks of the euro area that were instructed to channel massive liquidity they had received from the ECB to the states. This mandate to the banks was the first substantial violation of the EU treaty, but it took place in silence because it favored in particular those countries that were considered the bastions of the economic orthodoxy and could, in a system deprived of transparent democratic procedures, exploit their soft power in a hard way. Again, in late May 2010 European banks were told to avoid selling Greek, Irish, or Portuguese bonds because those countries had just been aided by the ECB. In just a few hours, French and Dutch banks started unloading the bonds to the ECB, leaving the burden to the rest of the euro area. The resentment for that imbroglio exploded months later, after German chancellor Angela Merkel and French president Nicolas Sarkozy agreed to impose losses on future investors of euro area bonds. Immediately Germany's banks triggered a sell-off of bonds of the debt-ridden countries, leading to the fateful crisis of 2011.

The story of the euro crisis is a story of developments in politics that raise questions about the pillars of democracy as we know it. Between 2009 and 2011, the crisis was influenced by an irresponsible tug-of-war between the ECB and the national governments. The consequences of the conflict between an unelected body entrusted with the general welfare and the democratically elected governments representing national interests were so grave that they represent a first disquieting test of the contradiction between jealous national powers and a weakly legitimated supranational governance.

Economists do not like to meddle in political analysis for fear of confusing the causes or, as they say, facing problems of reverse causations and of multicollinearity. I thought it was useful to proceed more descriptively, following the

chronology and using heterogeneous facts without fear of compromising the analysis. The outcome of this long and tortuous journey is a diagnosis of the European malaise that differs from current public debates that lay the blame on two specific causes. The crisis was neither the fault of a bunch of profligate countries, nor was it caused solely by a group of reckless banks investing the net savings surpluses of their home markets in the bubbles of the European periphery. Those activities contributed, for sure, but the catalyst for the crisis was mainly political: Each country's national political leaders had been unable, since the outset of the euro, to respond to the social costs of globalization once they could no longer resort to the instruments, often delusive and deceitful, of national monetary policy. National politics shoved under the rug the structural changes connected to the new open economic environment, and in order to do that, each country would resort to different tricky stratagems that proved unsustainable once the crisis started. The rest of this prologue explains this interpretation more thoroughly. It concludes that fiscal coordination will not be enough to keep the euro area together and sees a compelling reason for more political integration. My take on events is that once the monopoly of national interpretations is removed, the crisis of the euro may bring a new direction to the history of Europe and beyond, to the role of the state, and to the relationship between public powers and the citizen.

The book is divided by years. It begins arbitrarily with September 2008, at the height of the global financial crisis, when Europe was less than one step away from bringing the world economy to its knees. I am still amazed to see how little understood was the devastating extent of the European banking crisis at that time. In chapter 2, I try to explain the powerful national political interests behind the decision of Chancellor Merkel and many other leaders not to tackle the banking crisis jointly. From that decision, in October 2008, originated the first signs of a sovereign debt problem in Europe, one year before the crisis became public. Political divisions also prevented Europe from taking the lead in shaping a new and fairer world economic and financial system. But the divergent interests among the EU countries were not only due to the inabilities of some leaders and to the pressure of the crisis. The euro countries are still different because of longstanding structural divergences, as explained in chapters 3 and 4, and it was naive to think that national leaders were capable of forgetting their interests by adopting artificially the same policy preferences.

It is surprising how rare the knowledge is that the sovereign debt crisis was evident at the very beginning of 2009 and that very advanced political countermeasures had already been studied (chapter 5). Eurobonds, fiscal union, and other remedies were already on the table. National interests behind the banks, again, were the reason why politics could not agree on actions other than involving the ECB in financing the banks and through the banks finance the governments'

public debt (chapters 6 and 7). All this—the first substantial violation of the prohibition of ECB monetary financing of the states—was done in favor of German, Dutch, and French banks, and again it happened by keeping the public unaware. More important, the subterfuge of having the ECB silently finance the purchase of government debt produced the segmentation of sovereign markets, and was a major element of the fight between the ECB and governments in the design of the solution.

Chapter 8 sets the stage for the forthcoming and amazing role of the German Constitutional Court. The crisis cannot be understood without knowing the constraints that the court, at several stages, imposed on Chancellor Merkel. Chapter 9 deals with the discovery of a hidden accumulated deficit on the Greek account books, probably one of the best-known "secrets" of European history. The fact that European institutions had not been able to react earlier to the growing imbalances hidden in Greece led to a breakdown in trust in a common currency.

Dealing with the first half of 2010, chapters 10 to 14 are a central part of the book. They are primarily a chronological tale of the most acute phase of the euro crisis, when a mistaken strategy was adopted, and ending with the first bailout of Greece in May 2010.

Not well known at the time, nor since, the logic behind Merkel's reluctance to intervene was not only electoral, but legal, and she needed to bring the crisis to the point where it affected the whole euro area before she could legitimately intervene in the Greek bailout. Unfortunately, the interaction between politics and finance reached deep into the sentiments of the European peoples, often marring them. The attempts to build a new governance for the euro area were again a test of the conflict between national governments and the ECB (chapter 15). The rest of the story for 2010 is dominated by the shocking decision in Deauville by Merkel and Sarkozy to impose the so-called private sector involvement (that is, losses) in case of future defaults. Market fears took the lead in the crisis. Banks broke the hidden agreement with their governments not to sell the public debt of Greece, Ireland, and Portugal (chapter 16). The landslide began to accelerate.

In 2011 the crisis was marked by a dramatic intensification of the arm twisting between EU governments and the ECB. The acme came in March 2011 when the central bankers voted secretly to suspend the purchase of government securities (chapter 17) of Greece, Ireland, and Portugal. Soon, those countries' bonds became unsellable. Banks trying to deleverage began to sell bonds of the closest proxies: Italy and Spain. In the following months, during the summer, the landslide became unstoppable and extended to the whole euro area while national governments were still trying to buy time before tackling the crisis. In July 2011 (chapter 18), after the contagion went even beyond Italy and Spain, politics became the center of the problem (chapter 19). The insufficient response at national levels—the lack of credibility of the Italian government

and the philosophy of "punishment" prevailing in Germany because of mistrust and pigheaded brinksmanship, transformed the crisis from something that directly affected just some countries into one that threatened the entire euro area. Finally, at the end of 2011, the crisis seemed to head toward the break-up of the euro area (chapter 20). This was a dramatic moment that forced national governments, EU institutions, and the ECB to get their act together and design a partial solution: massive liquidity provided by the ECB would facilitate the financing of state debts, but without preventing the markets from continuing to pile pressure on the ailing countries. The goal was to reach 2013 with a euro area turned into a fiscally sterilized zone; in other words, the fiscal problems of any one country could not infect the others. Once public debts were harmless, it would be possible to rearrange some form of economic solidarity and some new kind of economic government. At least, that is the hope.

The lessons of this crisis depend on what we know surrounding the events that led up to and during the crisis, and they will determine the political future of Europe. For this reason I thought it was important to offer a description of the events now, at the beginning of 2012, before the crisis is over, for better or for worse. It will take decades to unravel all the details of the current events, and I am perfectly aware that this book cannot be other than a first contribution. It highlights the mistakes but also the objective difficulties of policymakers in tackling a crisis that could, if handled properly, mark the end of national divisions in a united Europe. In this sense, the euro crisis, after coming close to disrupting the global economy, could still change the world for the better by showing a new sense for human interdependency that speaks the language of solidarity.

In order to overcome the crisis, understanding its causes is indispensable. Two distinct interpretations have dominated discussions of how the crisis matured, and they both begin with the observation that after 1999 there was a significant decline in real interest rates in the so-called peripheral countries within the European Monetary Union: Greece, Ireland, Portugal, Spain, and Italy. According to the first analysis, financial investors from countries that had accumulated excess savings reacted to the absence of devaluation risks in the euro area by moving capital rapidly from the core countries to the periphery, where interest rates were still relatively higher. German and French banks, among others, invested many hundreds of billions of euros in the peripheral countries in a short period of time. The massive inflow of capital led to a sudden and indiscriminate increase in domestic demand, both private and public consumption or investments, in countries like Greece, Ireland, and Spain. The stimulus pushed up the price levels and reduced the competitiveness in those countries, making them even more dependent on foreign capital inflows. That

money suddenly disappeared with the financial disruptions of 2008 and the heightened risk aversion caused by the global crisis, and external deficit in the periphery became unsustainable.

The second analysis explains that after the onset of the euro, on the back of lower interest rates, the pressure on government debt service declined in the peripheral countries. Governments abused the fiscal leeway by increasing primary spending. Between 2000 and 2008, Portugal and Ireland both saw annual increases in public expenditure levels of around 6 percent at constant prices, while Greece and Spain averaged around 3.5 percent. Those countries mismanaged the "euro-dividend," that is, the benefit of joining a strong currency with lower interest rates, or they did not take advantage of the new scenario to decisively tackle their public debts. Until 2007 the large increases in public spending were broadly offset by revenue generated from real estate bubbles in Spain and Ireland, also a consequence of low real interest rates. But when financial conditions worsened, the precariousness of fiscal positions in the periphery emerged dramatically.

The first explanation blames the German or French banks for reckless investments, while the second blames the stubborn fiscal profligacy, private indebtedness, low efficiency, and political backwardness of peripheral countries.

Neither of the two explanations cited above is self-sufficient in explaining the crisis without highlighting a significant factor backing both, an understanding of which is required to design a stable solution. And this factor is that the crisis actually was produced by a vast array of short-sighted national policy choices enacted intentionally by all countries for many years since the beginning of the euro in substantial disregard of the consequences for Europe as a whole.

In the 1990s the political meaning of the forthcoming euro was not entirely understood. The common currency was often characterized as an instance of foreign exchange rate integration, one that would reduce exchange rate uncertainties and cut costs for trade. The effect of the monetary union on trade growth within the euro area was overestimated. The overarching effect of globalization changed the expected scenario for European integration, because trade developed more intensely toward other areas (notably Eastern Europe and the new emerging economies), creating more competition than integration among states sharing the same currency. Germany, in particular between the conception of the euro and 2008, became the most trade-oriented country of the G-7 group, almost doubled export and import relative to its GDP, and moved its supply chain for intermediate goods from the south of Europe to the non-euro Visegrad countries (Czech Republic, Hungary, and Poland) and its imports toward products produced most cost effectively by China rather than in Europe. Thus, while German exports (capital goods, intermediate goods, or pharmaceuticals)

remained largely insulated from the new global competition, Europe's periphery faced the new reality of global low-wage competition and growing trade imbalances within the euro area.

Also because of the delays in the full implementation of the EU single market, the expected homogeneity induced by internal trade remained only a muted driver of reforms in the euro area. Benign increases in global trade and the toxic stimulus of monetary policy made it easy for governments to hide the need for political action at both the domestic and the European level.

The challenge for politics—in shifting from national frameworks, protected by national monetary policies, to a global open economy—was unprecedented. In the monetary union, governments had to give up a large part of their past policy instruments. While competition increased both within and outside Europe, the countries of the euro area had relinquished the tool of domestic currency devaluation necessary to correct a deficit of competitiveness or an external imbalance. Nor could changes in the money supply and in price levels be used anymore to rebalance the relationship between labor and capital or among sectors of activity. The maneuvering room for fiscal policy also was limited by the strictures of the common fiscal rules. Finally, the old industrial policies, favoring certain sectors of the economy or even specific companies, were limited by the rules of the EU internal market.

In one sense, this was exactly how things were meant to be. European countries needed to embrace stable economic policies and to concentrate on restructuring their economies in an open global market. To do that they committed to apply structural reforms that let capital flow toward the most productive activities and to improve the quality of the labor force. Some countries indeed did this, notably Germany and northern European countries, which started growing at the fastest rates in the western world. Some other countries thought mainly of buying themselves some more time. But all of the euro countries, even the most virtuous, resorted to policies leveraging some form of national opportunism and self-protection that finally produced the crisis.

There is one common rationale in all political systems, however different they may be. Whether in Greece or in Germany or anyplace else, governments prefer policies that allow them to minimize the political cost relative to the result. They do not want to lose the consensus of their voters when they must implement unpopular policies. Hence, they look for "under-the-carpet" strategies. If they have to cut public expenditures, some will opt for shifting the effects onto future generations. If they have to make work more flexible, some prefer to apply it first to migrant workers, who often do not have the right to vote. If national industry has to undergo a painful restructuring, governments will find some kind of financial buffer that will transfer the cost to the future or abroad, in either case again to nonvoters. Each of these is a perfectly rational

choice if measured against the political time-horizon of a legislature: the time scale of political costs and elections, four or five years in general. But the kind of economic processes that this behavior helps produce can slip out of control in a matter of a few years and then reveal its real face: political opportunism based on subconscious nationalism and hidden imbalances. In Europe it has been the dark side of the coin, literally, an inglorious national reaction to the visionary choice of creating the euro.

Bogged down by foreign competition, southern European countries have developed a dual market economy where the less vocal or less official part of society—the young, the migrants, the poor—absorbed all the flexibility that was needed to protect the others. The part of the economy that was submerged or even undeclared was also obscured by the political debate. Italy is a good example: it is thought to have lost 30 percent of its competitiveness against Germany in the decade after the onset of the euro, and that is surely so if calculated on the basis of official labor costs. But if one takes the consumer price level as way to compare competitiveness, Italy's competitive loss relative to Germany was almost irrelevant (2–3 percent over ten years). What Italy had done was to compensate for the competitive loss in the regular market by taking advantage of its lowest paid workers, often immigrants, the young, and women, or by abusing tax loopholes through extreme outsourcing, and by sinking part of the country's activity into the black economy. All this allowed Italy to maintain high official wages and at the same time relatively low prices to compete with the other economies. Paradoxically, it also was a politically efficient way to adapt to the monetary union because it ensured to the Italian government the support of a majority of voters. When the crisis broke, however, the underlying fragility of this economy, previously shoved under the carpet, became evident, and Italy had between 2008 and 2011 the worst loss of GDP in the euro area.

Every country reacted with its own tricks. France allowed for higher-than-average public deficits and defended national agricultural and industrial champions by any means. In the ten years after the onset of the euro, France six times violated the deficit limits of the Stability and Growth Pact with no economic justification and kept its public debt at a round total of 15–20 percent of GDP above what was justified and had been agreed with its partners. Ireland tapped European savings through a combination of free riding on the European tax regime and of real estate inflation without any sense of the damage it was causing, first, to the other countries and, second, to its own economy. Political opportunism had also a more conventional face. Luxembourg, for example, had exploited its less-than-accessible tax regime to grant its citizens the highest level of income in the EU. But most of the under-the-carpet opportunism had not been consciously conceived before the euro; it was only the fruit of short-sighted political navigation. Spain's system stands out because of the structure of its

collective bargaining, which greatly constrains wage flexibility, and the privileges of permanent workers. Flexibility is provided entirely by a minority: 30 percent of the labor force is mostly deprived of the guarantees given to others. Madrid entered the European monetary system with the highest unemployment rate at 24 percent. In the strong growth period that followed, the unemployment fell to 8 percent in 2007. As the global financial crisis struck, unemployment soared back to 20 percent and swathes of the economy bogged down, proving the precariousness of previous reforms. Between 2000 and 2008, Portugal increased its public-sector wage bill to 13 percent of GDP, while Greece, Ireland, and Spain increased public-sector pay to around 11 percent of GDP. Those salary policies provided political consensus, but they also required external indebtedness that at the time seemed cheap. Greece's hidden buffer for absorbing the competitive pressures was more extreme and pervasive; as noted, the financial reality was hidden and statistics obfuscated.

Even Germany had a secret that allowed it to accommodate the challenge of globalization under monetary union, and actually became a primary cause of the crisis. German banks could get money at the lowest rates in the euro zone and invest it for a decade in higher yielding assets: for much of the 2000s, those were not only American toxic assets but the sovereign bonds of Greece, Ireland, Portugal, Spain, and Italy. For ten years this German version of the carry trade brought substantial profits to the German banks—on the order of hundreds of billions of euros—that did not show up on their balance sheets because the money was transferred to German firms as low-cost loans or to the German political system in the form of abundant financing for regional projects such as infrastructure development. Those profits, paid by other countries' taxpayers, enabled Germany to master, like no other, its restructuring for the global challenge. The relevance of this source of profit is amazingly neglected, although between 1997 and 2008 Germany exported two-thirds of its substantial domestic savings. The total amount of German capital exported between 2002 and 2010 was above €1 trillion, which, thanks to the euro, could be rewarded at rates far higher than the cost of provision and without currency risk. The German advantage, relative to all other countries in terms of cost of funding, has developed into an exorbitant privilege. French banks exploited a similar advantage, given their major role as financial intermediaries between AAA-rated countries and higher yielding debtors in the euro area. The substantial resulting profits often were transferred into assistance for French national firms.

All those policy choices were abused as substitutes for structural reforms and for the elimination of remaining barriers within the EU single market. These choices contributed in different and substantial ways to the building up of divergences and imbalances that came close to destroying the euro area. When the

crisis broke, the euro area economy was strained exactly in those points: German banks, Italy's growth, France's public finance, and so on.

The crisis in the euro zone is not a story, certainly not only a story, of delinquency in Greek government statistics. Neither is it a story of irreducible differences in national cultures that will forever separate a selfish but reliable North and an irresponsible and easygoing South. These are catchy suggestions ingrained in a corner of our experience, in our need for categories and clichés, and also in our complacency with prejudices.

It would be unjust to put all countries on the same level, but the crisis was caused by a collective exercise of political illusionism, based on a deliberate choice not to see the euro as a common responsibility and the euro area as a new political dimension. Our political traditions based on partisanship in closed economies provided a justification not to adopt structural economic policymaking consistent with an open political and economic space.

Governments defend their "absurd monopoly," as German finance minister Wolfgang Schäuble called it. But the worst monopoly is the one that concerns the misleading communication by national governments to their electorates. Contrary to the simplistic and self-serving explanations offered in the various capitals, the euro crisis is a multifaceted problem of fiscal crisis in Greece; competitiveness deficits in the southern periphery; a banking crisis in Germany, France, Benelux, Ireland, Spain, and elsewhere; a flawed initial design of the institution presiding over the euro area; and most of all a failure in national politics. If these problems are not tackled together, the crisis will resurface regularly. The lack of a common "European narrative" makes it easier for the national political monopolies to deny the need for further transfers of sovereignty and ultimately solve the crisis.

I do not underestimate the difficulties faced by policymakers during the crisis. The events show that the pressure of financial markets, particularly when they are led by their most speculative avant garde, can be an enormous ballast for policymakers who need to design a long-term strategy allowing savings to flow again from one country to another of the euro area as requested by the inevitable current account imbalances. The euro market for interest rates swap, for instance, is twenty-five times larger than the total amount of government debt in the euro area. A shiver on its spine can break a country in a matter of hours.

Governments are accountable foremost to their national democratic systems. Merkel and the leaders of the German opposition, for instance, have carried the public opinion a very long way beyond where it started. At moments, the nationalistic resurgence in the German public state of mind has been strong and disturbing. More radical feelings surfaced uncontrolled in many other countries, and it was crucial that the German Parliament kept them at bay by consistently

repulsing populist temptations. Merkel has left her fingerprints on some fundamental mistakes—hiding the vices of German banks, dragging the Greek crisis on far too long, and imposing losses for private investors—but she found little cooperation from the other heads of governments of the euro area when she sought for a strategy beyond the short term. Merkel is actually unique in building an ambitious strategy that leads Europe to the Political Union. Sarkozy had the right intuitions at the beginning but then retreated into national thinking. New actors like Mario Monti can be the harbingers of a new generation of European-national policymakers. Others were pathetic and dangerous. Nevertheless, it must be acknowledged that even during the deepest recession in the history of the EU, the leaders did not unwind the rules and the laws presiding over the Union.

Unfortunately, Greece's discovery of a shocking fiscal deficit in 2009 was seen as the "proton pseudos," the original lie, that eroded trust and solidarity. Most countries resorted to minor accounting tricks—as shown by the discrepancies between the levels of public debt and the sums of the yearly deficits—but discovering that the Greek deficit was reported at 3 percent of GDP when it actually was 15 percent appeared such a blatant fraud that the smaller fudges across the euro area disappeared and moral judgment adhered to national characterizations edging on racism. It was not important that Germany and France, with the active support of Italy, had violated and changed the rules of the Stability and Growth Pact and that they had prevented the European Commission from gaining the powers to control national accounts. It came all too naturally that, at a moment when national governments had to counter the effects of the crisis on their electorates, the political rhetoric allowed national identity to prevail over integration. It was a major political mistake. So we are now inclined to think that we have to disentangle the virtuous and the vicious along national borders.

Identity means also that the euro area has now adopted one single reading of the crisis, according to which its sole cause was the fiscal profligacy in the periphery. It is a simple, single, and wrong explanation. Once this "linear" interpretation prevails, we give up the task of understanding that all the mechanisms of the crisis are actually "nonlinear": contagion, multiple equilibria, sudden stops, changes of regime, risk correlation, self-fulfilling expectations, and so on. All of these financial phenomena would require a "nonlinear" political response or, more simply, an assumption of common political responsibility for the euro area as a whole.

Moreover, identity is simply the wrong approach for an economic integrated area. Although Germany is showing the most encouraging model for single economies in a global context, all countries cannot be equal. On the contrary, an integrated area thrives from the various specialties of its regions or states. Inevitably each region will have different productivity levels, and each state's

balance of payments does not have to be on par with the rest to coexist. But if integration must prevail on identity, there is no alternative: some form of solidarity is intrinsic to integration. Eventually, since different economic structures create different political preferences in each country, a democratic system of decisionmaking must emerge and political union must follow.

Political responsibility is needed to develop the strategy of fiscal consolidation into a real fiscal union. The process is already pointing in this direction. National budgetary rules are being strengthened all across the euro area, in part through the adoption of constitutional obligations to keep budgets balanced. Reciprocal control will be enhanced and centralized surveillance will be strengthened. The new legal procedure to prevent excessive imbalances and the European Systemic Risk Board should prevent the buildup of excessive private indebtedness, and further improvements are in the pipeline. The ECB surveillance of countries that receive aid proves that all major domains in economic policy will be kept under scrutiny, including productivity developments and wage-setting agreements. Mutual assistance will be accompanied by comprehensive macroeconomic adjustment programs, which will be discussed and voted on together. National policies will be confronted and discussed in Brussels before even being presented to the national parliaments.

Even if the root causes of the crisis were not fiscal in nature, all its remedies have a fiscal character, representing a transfer of aid from one country to another. So it is important to proceed with fiscal stabilization that can offer guarantees on the future to the creditor countries. From this perspective, 2013 should be the turning point of the crisis. In order to get there, the euro area must undergo a number of severe tests, whose outcomes are far from certain; first of all, it will have to avoid a debt-deflation spiral. Two years later, in 2015, all countries will have a balanced budget, and political cooperation will be possible. The crisis itself has produced the pillars of fiscal federalism and of political cooperation, as explained in the last pages of this book. On its face, this framework promises to make the euro area a more "optimal" currency area. But is democracy so easy to put aside? Or shall we not discover one day that European rules will be circumvented again if they are not discussed and voted on by the citizens? The new institutional framework creates a problem of political legitimacy. As Kant said, the citizen's juridical liberty is the faculty not to obey external laws but rather those to which he has been able to give his consent. A political dimension at the euro level seems inescapable.

The amazing structural changes happening in all euro area countries as a consequence of the crisis, although obscured by the drama of the daily emergency, show that if it manages to endure its painful transition, the euro area soon could

be quite a different place, more homogeneous than ever, both in economic and in sociopolitical terms. As in all homogeneous societies, solidarity will find an easier terrain. Guaranteed by reciprocal fiscal control, common initiatives to promote growth on the continent might find solid ground. Pooling resources to build up European research, infrastructures, and welfare will be a rational development. Eventually a common public discourse might see citizens of different countries discuss and decide together their common future in a real federal union and maybe even discover a new non-national meaning for the old aspiration of brotherhood, equality, and liberty.

The aim of this book is not to find solutions, but to offer a mirror to European citizens, so that they could see themselves through the eyes of others. And to show to the American observer how critical interdependency will be in the future. In this sense, the European crisis provides for a formidable challenge for the rethinking of national democracy, also from the American side.

The European crisis had the potential to be the "worst" economic crisis in the history of Europe. It has also the potential to be the "best" political crisis. But to finally approach Ithaca, Ulysses had to cross Scylla and Charybdis. It was never meant to be easy. It may even be a sign of destiny. In ancient times, the Italian strait between Scylla and Charybdis was especially dangerous because of its troubled waters. And because of the harsh mythological wind blowing from Greece. Whose name was Euro.