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Heading South: Rethinking the Eurozone

The Ulysses Study

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Heading South: Rethinking the Eurozone

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1. Introduction

The (third phase of the) Economic and Monetary Union (EMU) faced an existential challenge in the crisis faced by Southern Europe economies (and some Eastern Europe economies), which had depression-like consequences in the affected countries and negatively impacted the entire European project.

The policy response to the crisis was essentially defined by the European Union (EU) governing institutions, in particular, by the European Council, the Governing Council of the ECB and the European Commission's DG-ECFIN, and by the IMF. The European Parliament and stakeholder-based *fora* (like the European Economic and Social Council) played a marginal or even neglected role in the design and the supervision of the policy response to the crisis.

The EU policy response to the events had two key characteristics in terms of process and substance: it was primarily based on an unprecedented transfer of sovereign powers from member states to the EU governing institutions and on what is generally known as the "austerity strategy". Despite large funding commitments from EU member countries and the ECB, this policy response had dismal results from the outset. It took Mario Draghi's July 2012 "whatever it takes" words to investment bankers in London to arrest the crisis. The ECB Governing Council followed up on that promise, and a large quantitative easing program ensued, which at the present aims to acquire, in cumulative terms, 2.3 trillion euro-denominated debt securities between March 2015 and December 2017, approximately 75% of which public debt of member countries.³

Economic growth finally ensued, with the first quarter of 2017 being the 16th consecutive quarter of economic growth for the euro area, and all euro-area and EU member countries finally registering, simultaneously, economic growth in that quarter.⁴

The ECB non-conventional monetary policy has saved the Eurozone, temporarily. It prevented the euro crisis from deteriorating even further. It provided the time and relative economic stability that was required to strengthen the euro area architecture and institutions.

With this background in mind, it is necessary to think about how the Eurozone could be redesigned to enhance its chances of survival. The aim of this study is to contribute to a change in the EU economic policy and, in addition, to appraise the instruments and of scope of the EU institutional responses to economic

³ For further details, see <https://www.ecb.europa.eu/mopo/implement/omt/html/index.en.html>.

⁴ See <http://ec.europa.eu/eurostat/documents/2995521/8057546/2-08062017-AP-EN.pdf/8321df8a-ba1b-433e-9cdc-bfd81e3f4a45>.

crises. This is accomplished not only by overviewing important EU governance and economic policy proposals by several authors and by the European Commission itself, but also advancing proposals of specific economic policy measures and also EU governance change recommendations. We thus show that EU policy makers have a wide range of policy options available to them, well beyond a strategy based solely on austerity. Thus, the EU is not a “*There-Is-No-Alternative*” economic and social space: there are many alternatives that can and should be considered.

Section 2 of this study outlines some of the problems affecting the existing EMU (Economic and Monetary Union), identifies four key ideas that should guide EU policy makers in their effort to reengineer the EMU architecture so as to make the euro sustainable in the future, proposes changes to the general governance scheme and how it should respond to economic or financial crises. Section 3 presents an overview of the rich set of specific policy proposals to respond to the crisis and to improve the EMU architecture, and identifies additional policy measures, available to decision makers. Section 4 refers to the need for new local- and regional- development policies. Section 5 focuses on the need for a new EU level focus on the real economy, through a new investment programme. Section 6 considers the environmental challenge caused by impacts of climate change and argues that the challenge of a low carbon economy has enough mobilizing power to drive European ingenuity, skills and industry in the pursuit of a more prosperous and fairer Union. The cooperative and strategic endeavor for sustainable development is also a key condition for the peaceful overcoming of the current dangerous stage of the European crisis. Section 7 concludes.

2. Is the EMU architecture viable?

In the years and decades prior to the launch of the third phase of the EMU, numerous academics and policy makers⁵ argued, in simplified terms, that the single currency faced enormous challenges since the Eurozone was not an optimum currency area (Jagner and Hafner, 2013). A few argued that with the single currency member countries might face a balance of payments crisis, correctly predicting the euro crisis (e.g. Pivetti, 1998).

⁵ For example, Karl Otto Pöhl, Bundesbank president between 1980 and 1991, warned German Chancellor Helmut Kohl that a single currency, without political union would be an “act of madness”. Karl Blessing, the second Bundesbank president between 1958 and 1969, argued that a monetary union required common trade, fiscal, budgetary, economic, wage and social policies. This meant that a monetary union would be a “dangerous fantasy without a political union” (Soromenho-Marques, 2014).

In this section, the authors first characterize what happened in the Southern Europe countries more directly affected by the euro crisis. The authors then argue that this experience is to a large extent a consequence of structural flaws in the EMU architecture.

2.1. The euro experience of Southern Europe countries

There is a striking linkage, which is hardly incidental, between the occurrence of sovereign debt crises in EU countries during 2010-2012 and the inherited specialization profile of those countries. With few exceptions, the countries most affected by the euro zone crisis are also the ones with the lowest weight of knowledge and technology intensive activities in the economy (Teixeira *et al.*, 2014).

In the two decades preceding the global crisis of 2008/9, EU economies have undergone significant transformations. EU member countries' economies experienced: the abolition of customs barriers within the EU, the creation of the internal capital market, the liberalization of financial flows and activities, the transfer of control over monetary and fiscal policies to the EU level, the unification of Germany and the massive enlargement eastwards that followed suit. Externally there were the trade agreements between the EU and China (and other emerging economies such as India and Turkey), the rapid development and diffusion of ICT (mostly pioneered and marketed by North-American and East Asian players), the sustained appreciation of the euro against the dollar (from 2003), the sharp increase in oil prices (between 2002 and 2008), and the growing instability of the southern Mediterranean belt (after 2010). These changes engulfed all EU Member States, but unevenly and the most vulnerable economies were not prepared to seize the opportunities and to face the pressures stemming from all those developments.

Most countries in the periphery of the Eurozone are historically specialized in the production of low value-added and low knowledge/technology products, which typically face high competitive pressures from emerging economies, have been experiencing low global demand growth, and are more sensitive to exchange rate developments. Plus, public-support for R&D had been on the retreat for years, especially among the countries behind the frontier which precisely most needed innovation and productive upgrades.

In sum, the tradable sector in these countries had been under strain for over a decade when the international crisis hit the European economy in 2008/2009. In contrast, the non-tradable sector had been developing fast, mainly as a result of

the substantial reduction in interest rates and the availability of credit, resulting from the deregulation of the financial sector, the liberalization of capital movements in the EU, and the participation in the euro. The combination of weak growth in the tradable sector and strong growth in non-tradable activities resulted in the accumulation of external debt in the periphery of the Eurozone. Eventually, the non-tradable sector exhausted its capacity to induce enough growth to sustain the past incurrence of debt. This, together with the weak growth prospects in those countries, were the main factors behind the increasing reluctance of international investors in lending money to the States and firms located at the periphery of the Eurozone.

The adjustment programs that were implemented in the crisis countries after 2010 attempted to improve the competitiveness of these economies through internal devaluation and 'structural reforms'. While this approach was expected to improve cost-competitiveness, it left largely unsolved a crucial weakness underlying the weak performance of those countries' tradable sector: the pattern of specialization and degree of sophistication of their productive profile. The absence of several policy instruments, which were historically used in order to promote structural change at the national level – such as monetary and exchange rate policy, or trade policy – leave the countries in the periphery of the Eurozone without much room of maneuver to promote a sustainable way out of the economic challenges it faced in the aftermath of the euro crisis.

The potential tensions deriving from the integration of national economies with significant differences in productive structures were recognized at an early stage of the institutional process leading to the EMU. In a famous report prepared in the context of the Single Market Program (Padoa-Schioppa et al., 1987, p.4), one could read:

“There are serious risks of aggravated regional imbalance in the course of market liberalisation. This is because different economic processes will be at work as markets integrate, some tending towards convergence, others towards divergence. Neither dogmatic optimism nor fatalistic pessimism is warranted in these respects. Opportunities for convergence will be increased, but adequate accompanying measures are required to speed adjustment in the structurally weak regions and countries, and counter tendencies towards divergence.”

In the context of the Single Market Program, the strategy to deal with risks of increasing economic divergence within the EU was based on the reinforcement of EU's Cohesion Policy. Structural funds were expected to promote the upgrading of infrastructures and skills in the less developed regions of the EU, in order to improve the capacity of their economies to compete in the European Single Market. Largely as a result of the EU's Cohesion Policy, the infrastructure in those regions improved significantly, helping to reduce the cost

and enhance the quality of transport, communications and energy services in the periphery of the EU. The impact of Cohesion Policy is also apparent in the indicators of educational attainment and scientific performance of the less developed regions. Convergence in GDP per capita among EU Member States during the 1990s and the early 2000s has been taken as a sign that the forces “tending towards divergence” had been successfully circumvented, to a large extent as a result of the structural funds.

However, later developments suggest that, instead of neutralized, the forces tending towards divergence have been temporarily obscured by the credit-led growth and asset-driven demand in the periphery of the euro zone. While the investments in infrastructures and skills have improved the competitive conditions in less developed regions, they could hardly have led to a significant reduction of the wide asymmetries in productive structures across the EU – which typically takes decades to unfold. The aforementioned developments in international trade and exchange rates have, in fact, reinforced the divergence tendencies, by putting in great strains the tradable sectors of those economies with less developed productive structures.

2.2. The main flaws of the EMU architecture

The recent experiences of Southern Europe countries illustrate some of the weaknesses of the EMU architecture. In the authors' view, it is necessary to make an exhaustive assessment of the EMU architectural flaws.

In this section, we focus on the more obvious – and important – EMU architectural flaws.

The first key flaw of the EMU is the appalling governance model of its “central government” – the EU governing institutions that define macroeconomic policies for the euro area –, i.e., the European Council, the executive committee and the governing council of the ECB, the European Commission's DG-ECFIN, the Economic and Financial Committee.

In comparison with member-state governments, the EU governing institutions were created recently, often from scratch. In several dimensions, these EU governing institutions are less robust and have fewer resources than their national counterparts.

Among other things, this governance model resulted in the development of weak, flawed macroeconomic policy strategies for the Eurozone, which remain largely in place to date. These strategies were based on a single monetary and exchange rate policy, firmly under the control of the most independent central

bank in the world, accompanied by the coordination of fiscal policies between member countries by means of the “Stability and Growth Pact” and the “Fiscal Compact” (Treaty on Stability, Coordination and Governance in the Economic and Monetary Union).

Following the euro crisis, EU governing institutions realized that weak (macroeconomic) governance was (and still is) one of the main deficiencies of the EMU architecture. But their diagnosis missed the mark. To EU governing institutions, the governance problem of the EMU was that the center did not have and did not exert sufficient “command and control” over the national governments’ macroeconomic and budgetary policies.

Thus, their policy response to the crisis was based on an unprecedented transfer of sovereign powers from the Eurozone member countries to the center (e.g., Fiscal Compact, Single Supervisory Mechanism, Single Resolution Mechanism).

Instead, in the opinion of the authors, the EU governance model flaw lies in the fact that EU governing institutions have always had excessive powers without corresponding democratic legitimacy, a weak and obscure decision-making process, and have not been sufficiently accountable.

The second key flaw of the EMU is that it is based on the idea that one can create an economic and monetary union without fiscal transfers between member countries and. Moreover, the European Union Treaty simply states that various forms of fiscal transfers were prohibited. Thus, the EMU architecture disregards economic theory and practice, on the basis of what can only be described as political “wishful thinking”. All existing economic and monetary unions (e.g., countries and federal unions) have very large fiscal transfers between regions. In the EMU, not only were meaningful fiscal transfers not allowed, but no measures were foreseen to make sure that such an unprecedented macroeconomic policy strategy could be sustainably maintained.

A related flaw is the effect of asymmetric shocks to euro area economies. If the asymmetries in productive structures are largely accountable for the diverging developments in the external balances of national economies within the EU prior to the international crisis, they are no less relevant for the future of an EMU under macroeconomic stress. Countries whose specialization profile is largely based on less sophisticated and internationally competitive goods and services will still be facing lower demand growth prospects and fiercer worldwide competition for years to come. As such, they will also be more vulnerable to negative exchange rate developments. Fostering structural change and dealing with asymmetric shocks will remain a major challenge

within the present EMU's institutional architecture, regardless of the solutions that may be found in order to deal with high levels of public debt in the 'crisis countries'. The attempt to deal with external imbalances through internal devaluation in the crisis countries not only is of questionable effectiveness in the short- to medium-term, but the permanent deflationary pressures are also a disincentive to structural change.

An additional limitation comes from a specific type of EU internal market regulation. In addition to the impossibility of using the exchange rate mechanism or trade policy in order to address the problem of external imbalances, Member States are also limited in their actions by the prevailing EU competition rules. Exemptions to the prohibition of state aid do exist, and have been used in order to reduce the costs of corporate investment in EU's less developed regions. However, state aid exemptions do not particularly target this type of regions and, in fact, have been common practice both in more and less advanced economies across the EU. Moreover, derogations to the non-state aid principle mainly apply to investment expenditures, reducing their potential impact on the external balance of each country. Furthermore, the use of state aid exemptions is dependent on the availability of public funds, which can be a severe constraint to their effectiveness in improving economic performance in times of crisis.

Finally, the EMU architecture is based on a flawed monetary policy strategy, instruments, and procedures. The euro area monetary policy strategy, instruments, and procedures represented a departure from orthodox monetary policy making, with the introduction of several radically novel elements. For example, the ECB accepted private debt as collateral for its main refinancing operations, treating it on an equal basis to sovereign debt. An unintended result of this policy is that the ECB monetary policy has very large fiscal effects (Cabral, 2012). ECB monetary policy also allowed the accumulation of current account imbalances between euro area member countries. Thus, monetary policy suppressed the market signals – for over a decade – that some euro area member countries were running unsustainable external current account deficits.⁶ As a result economic agents and governments continued with the practices and behavior that led to the accumulation of very large levels of external debt.

In summary, robust policy making requires an objective, unbiased evaluation of the EMU architectural shortcomings, so that EU policy makers are able to develop better policies for the EMU. In this section, the authors outline what

⁶ Only from 2011 onwards were balance of payments imbalances between member countries included in the macroeconomic surveillance criteria, that is, well after the onset of the euro crisis.

they consider to be some of the most relevant flaws, but a systematic analysis is required.

2.3. Required changes to the EMU architecture

If the current EMU architecture is not viable, then what changes are necessary? In this section, the authors suggest concrete policy measures. The aim should be not only to respond to the economic crisis in the Southern Europe countries but also to make the EMU a viable and thriving monetary and economic union in the future.

The first key idea is that the euro area does not face an impossible task in addressing its architectural shortcomings, though given the scale of the challenge, the most likely scenario still is disintegration. The euro area is an economic and monetary union power, with 341 million inhabitants, that is the World's second largest economy, with a GDP of 10.7 trillion euro, with a diverse and rich cultural heritage, and highly skilled and knowledgeable labor force.

The second key idea is that the euro area must make a much better use of its human and capital resources to improve its architecture and its decision-making processes. This means that it is incomprehensible that the EU governing institutions – and national member countries' governments – continue to restrict their decision-making abilities by framing their mindset too narrowly, by only considering the advice and ideas of (often the same) few, and by not adopting a systematic and exhaustive methodology to identify alternative policies with the aim of supporting the decision-making process.

The third key idea is that facts do matter. Past EU and euro area policies have too often been based on political wishful thinking. The EU Treaty, in some dimensions, aims to build utopia, since the aims are so different from the teachings of hundreds of years of civilization. One partial solution to this problem of lack of realism is to build new EU and euro area governing institutions that should become, by design and purpose, the EU governing institutions' harshest critics, i.e., new institutional checks and balances that force EU policy makers to face reality and to be accountable. Indeed, the EU must be compatible with the republican and democratic principles embodied in the Constitutions of all its member States. The EU institutions should reflect the principle of popular sovereignty, the separation of powers, and the rule of law in the different levels of governance, and particularly in the relationship between EU level and its Member-States.

Finally, the fourth key idea is that the euro crisis is a “crisis of the past” with consequences in the present, meaning that EU policy makers are dealing with the consequence of past policy mistakes made by the architects of the EMU, i.e., the EU policy makers that created the European Union Treaty: the euro crisis is the largest peacetime balance of payments and debt crisis. It is, foremost, the result of flaws in the architecture of the EMU that went unnoticed and were ignored beginning a few years before the launch of the euro and that continue, to some extent, to be ignored in the present.

Therefore, to assign blame and, more importantly, to put in place punitive policies like the “austerity strategy” that is still in place in the Fiscal Compact and European Commission rules are pointless policy exercises, as they bring the Eurozone no further in finding a solution to the crisis. In fact, such an approach is detrimental to the future of the Eurozone. This also means that current EU policy makers are wasting precious resources and time on trivia, rather than on substantive matters that contribute to making the EMU a sustainable architecture for the future.

In the opinion of the authors, what is required is that EU policy makers put the past behind and start anew. This means that they should change the key aspects of the EMU architecture that have brought this crisis about, and that they should think how they could redesign the architecture of the EMU to prevent the periodic reoccurrence of similar crises within the Eurozone. Thus, in the view of the authors, EU policy makers should, at the very least, and to start with:

- Promote a fresh start for the EMU by substantially restructuring the external debt of the most indebted Southern Europe and Eastern countries. Various proposals already exist on how to accomplish this objective (e.g., see section 3);
- Think anew about the feasibility of fiscal transfers between Eurozone member countries. If EU policy makers decide to maintain the EMU as a “no fiscal transfers” economic and monetary union, then they are required to think hard how can this policy strategy be monitored and sustained for the first time in World history, i.e., what policy instruments would be required to accomplish this feat;
- Although the positive role played by the ECB avoiding the worst in disruptive moments of the EU crisis, namely in end 2011 and in the summer of 2012, which gave birth to new non-conventional tools as are the LTROs and the quantitative easing programme (asset purchase programme and, within this, the public sector purchase programme), the fact is that a strong reform in the ECB functions and mission is deeply

needed. Article 123, 125 and 127 of the TFEU need to be adapted in order to allow the ECB to become a more conventional central bank, taking onto its tasks not only the control of price stability but the pursuit of full employment and systemic economic and financial stability of the Eurozone as well. The ECB presence in Eurozone financial markets is too overwhelming, and as a result it has suppressed market signals and allowed imbalances to accumulate for too long. EU policy makers should redesign the ECB and ESCB statutes to make the ECB a more accountable institution;

- Obtain independent analyses regarding the functioning and mandate of various EU governing institutions, including, the European Council, Ecofin/Eurogroup, the Economic and Financial Affairs Committee of the European Council, the ECB, the ESM, the European Parliament and the various European Commission's Directorate-Generals;
- Analyze macroeconomic policy making in the euro area (EU and euro-area wide monetary policy, fiscal policy, and exchange rate policy) and develop new tools to assess its effectiveness and impacts. Particularly, the analyses should:
 - identify the weaknesses and problems with the existing monetary policy and with existing euro-area fiscal policy coordination;
 - identify and outline alternative policy approaches, to the current monetary policy strategy and the to the stability and growth pact (and the fiscal compact), and to study how euro-area fiscal policy could be coordinated and implemented in those alternative scenarios. The aim would be identify possible and politically feasible improvements to the current Eurozone architecture;
 - analyze what procedures would be necessary to minimize fiscal transfers between member countries and how best to address balance of payments imbalances within the single currency.
- Change EU governance by making EU governing institutions more transparent (less secretive), more accountable, and less powerful.
- Study the issue of what institutional arrangements could be done to ensure more institutional checks-and-balances in EU policy making circles:
 - Particularly, the role of the European Parliament and its members should be carefully reevaluated, with the aim of ensuring that EU governing institutions could become truly accountable to individual members of the European Parliament;

- In addition, one should study whether it would make sense to reinforce existing institutions, or even create new institutions from scratch, such as new, more powerful, EU Inspectorate General, to monitor, follow up on member country complaints, scrutinize and appraise each of the remaining EU governing institutions.

The ideas outlined above suggest that there is much in the organization and functioning of the EU governing institutions – a (relatively) recent creation - that is taken for granted and that is assumed as the best possible institutional arrangement. However, the current euro crisis is a piece of anecdotal evidence that suggests that the current institutional arrangement might not be optimal. Thus, it is not only warranted but necessary, to study what, if anything, could be done to improve present day EU-level governing institutions and EU policies.

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3. Euro crisis response: Overview of policy proposals

It is well known that core Eurozone governments and key institutions of the European Union designed, together with the IMF, came up with an approach to the euro crisis in the peripheral countries that may be called an “austerity strategy”. This approach included the creation of an *ad-hoc* figure, the “Troika”. This set of actors (EC, ECB and IMF) was welded together in May 2010 to manage the “Economic Adjustment Programmes” and monitor the observance of the strict conditions that came with it. There was also the creation of new European institutions, in particular the European Stability Mechanism.

What is not so well known to the public is that the resources that were used to develop this austerity strategy were relatively small, relied heavily on political negotiations held in a state of disarray, and were underpinned by feeble and hardly evidence-based theoretical foundations. The new policy consensus was improvised around the stern positions of the German policy makers and the forged institutional solutions emerged outside the scope of the existing treaties. Moreover, core euro economies (such as Germany and France) had in the past violated the terms of the “Growth and Stability Pact” themselves whereas some periphery economies had sound public finances but very large private sector deficits (such as Spain or Ireland). In any case the wrath felled over periphery states’ borrowing, not on the eager-to-lend northern European financial institutions.

Another aspect of the process that slipped out of official discourse and public memory was the extent to which the initial response to the international financial crisis was shaped along counter-cyclical Keynesian lines – as should have been – and that such coordinated active governmental macroeconomic policy was not so much discredited on economic grounds as by political manoeuvring. In effect the mainstream representation of the crisis mutated from a US private sector “subprime crisis” to a euro public debt crisis in December 2009 after the newly-established Greek government announced that budget deficit had been grossly underreported in official statistics by the previous government.

From then onwards, the focus shifted from aggregate demand management to supply-side measures and “structural reforms”, such as labour market deregulation and social-spending cuts.

This chapter discusses alternative responses to the crisis. It reviews a number of schemes which have received much less media and expert attention than

their intrinsic merit would justify. When possible this review tries to distinguish between short-term and long-term remedies and solutions.

3.1. PADRE: Politically Acceptable Debt Restructuring in the Eurozone

PADRE is a holistic proposal by Pierre Pâris and Charles Wyplosz (2014) that advocates a reduction by half of sovereign debt. Pâris and Wyplosz start out by claiming that the European public debts are probably too big and unsustainable. This is, indeed, a position held by many specialists, scholar and public commentators. Data for 2013 indeed shows Euro area government deficit at 3.0% in 2013 and public debt at 92.6% of GDP (EU28 deficit at 3.0% and debt 87.1% of GDP) (Eurostat, 2014). Commentating on the doubts surrounding this sustainability of sovereign debt, Barry Eichengreen recently wondered whether the official European strategy for managing the rising and rigid debt was aimed at solving the situation or instead “at keeping the problem going for as long as possible.” For Eichengreen, at least, “Europe’s official strategy for resolving its debt crisis will not work”.⁷

The issue is quite controversial, since public debt was assumed at first to a no-risk asset in analytical (a positive statement backed by little evidence) and later argued in policy circles that it should not be defaulted (a normative statement put forward by EU authorities with little explanation). In any case, debt restructuring acquired egregious reputation, tantamount to “robbery” as the proponents of the PADRE plan note. At the same time, however, and resorting to the meanwhile somewhat discredited Reinhart and Rogoff (2010) research, the authors state that public debt is harmful to growth and to the stability of the Eurozone.

Interventions with conventional mechanisms are also unjust or politically unsustainable. Monetisation of bad public debt has political consequences:

“The case of the Eurozone is more complicated because many governments share a common central bank. If the ECB acquires bonds issued by, say, the Portuguese government, it takes the risk that the bonds could be defaulted upon in the future, which would impose losses to all the other countries since they are the shareholders of the ECB via their national central banks. On the other hand, the interest rate on Portuguese debt is likely to be higher than the borrowing costs of the ECB, which would imply a transfer from Portugal to the other member countries. These features violate a key condition of political acceptability: the absence of

⁷ “The bond market’s dance over European debt will not last forever”, *The Financial Times*, 18 November 2014, p. 9.

transfers, or risk of transfers, among countries.” (Pâris and Wyplosz 2014, p. 16)

In this context, what these authors attempt is a neat way to square the “political-economic” (“political economy” plus “economic analysis”) circle. They start out with four principles:

- That all countries should be treated equally and identically benefit from the scheme they propose (“principle of equality”);
- That there should be no unilateral fiscal transfers between countries in the Eurozone (“no redistributive effects”);
- That the independence of the ECB should continue to be safeguarded at all costs (safeguard against runaway inflation);
- That there should be no moral hazard: a new disciplinary and punitive instrument should be created that automatically penalizes countries that go back to registering large deficits and increasing government debt (“enhanced budgetary straitjacket”).

Through a swap mechanism the ECB would purchase half of the sovereign debt and transform it into zero-interest perpetuities. The ECB would finance this purchase of public debt by issuing a new debt instrument, which the authors call “ECB Notes”. This scheme would, in practice, wipe out half of the sovereign debt by transferring it to the ECB balance sheet. As a result, the ECB would face losses, since it would have to pay interest on the “ECB notes” and would receive no interest income on the perpetuities. These losses would be passed through slowly, over time, to the ECB shareholders – the member countries national banks –, in proportion to their adjusted capital key in the European System of Central Banks. The national central banks would have losses and, as a consequence, would reduce dividend payouts to national governments.

This mechanism would in effect recycle debt by spreading it away to all forthcoming generations including the present one, which would solely not have to pay for the commitments that past ones made in the name of the subsequent ones. Pâris and Wyplosz argue, not correctly in the authors’ view, that there would technically be no debt write-off and no cross-country debt-transfer, since the principal owed would be replaced by a perpetuity in the form of lower ECB profits, i.e., every country would pay back its debt in infinite time.

The roles of the actors would also change. The ECB would now become a loss-making institution with a status of “independent custodian”. Running on negative equity the central bank would need not to default or to call in taxpayers’ money, merely to be its own lender of last resort and recapitalize itself as needed so as to support the monetary system as a whole.

There are various problems with this proposal, among which: a) by not explaining how debt accumulated in recent times the plan does not understand the present crisis as a structural “balance of payments” crisis, and thus this could hardly be a “one-off” event; b) it assumes symmetry among countries while in fact different countries have different debt dynamics (and different external debt levels). Thus, a solution that treats all countries in a similar manner, while theoretically commendable, in practice would not address the problem of very dissimilar imbalances between Eurozone member countries. The most rigid feature of the current EMU architecture is precisely that excessive levels of (external) debt always end up in a number of the most fragile economies of the group under the same currency. The Pâris and Wyplosz proposal does not respond to this issue.

3.2. De Grauwe’s critique and contribution

Paul De Grauwe has been a critic of Eurozone economic policy, arguing that policy-makers decoupled their incentives from the political-economic cycles and entered the financial-economic cycle. For instance, the reaction to the Greek public finance problem was driven by fear; then subsequent austerity-oriented muddling through was guided by financial market sentiment (de Grauwe and Ji, 2013).

De Grauwe argues that financial markets command EU policy making. For De Grauwe, this is a broken governance structure leading to debt default spirals. This broken governance structure will ultimately culminate in the undoing of the social progress path that had defined the European model. The unsustainable dynamics of the EMU is explained by De Grauwe (2012, p. 255):

“When entering a monetary union, member countries change the nature of their sovereign debt in a fundamental way, i.e. they cease to have control over the currency in which their debt is issued. As a result, financial markets can force these countries’ sovereigns into default. In this sense, member countries of a monetary union are downgraded to the status of emerging economies. This makes the monetary union fragile and vulnerable to changing market sentiments. It also makes it possible that self-fulfilling multiple equilibria arise.”

Paul De Grauwe also criticizes the amendments to the Eurozone governance apparatus in the follow up to the crisis. He argues that the new governance structure known as the “European Stability Mechanism” (ESM) - created by a new Intergovernmental Treaty in connection with the Fiscal Treaty -, is not well designed: The ESM was conceived essentially to support the austerity strategy (imposed by the troika on behalf of the European Council). It is to lend funds to

countries in trouble against strict conditionality conditions imposed by EU governing institutions. It is operational since 1 July 2013, having been constituted on 27 September 2012 as an international organisation located in Luxembourg.⁸ On its website its mandate can be read as aiming to “safeguard financial stability in Europe by providing financial assistance to euro area Member States.”

De Grauwe considers that this new institution is a European IMF, or an “European Monetary Fund”. Thus, this institution should be central to the EMU governance system. Given this structural remedy, what De Grauwe postulates are behavioural guidelines. Namely, De Grauwe asserts that the ESM has to complement negative incentives (staunch conditions upon the use of its financial facilities, i.e. “austerity”) with the provision of positive incentives (those that allow for the actual payment of the debt, i.e. “growth”). Otherwise, given the combination of feverish bond markets with a fragile Eurozone, the whole set-up will backfire and the scheme will be self-defeating: beginning in 2013 Eurozone members are obliged to include a “collective action clause”⁹ when issuing bonds. The intent is to signal that private bondholders may be asked to “step in” (i.e., suffer losses through debt restructuring) if a crisis occurs. However, de Grauwe argues that if a country would just simply contemplate such a scenario, this would lead to bondholders selling these bonds regardless of price, and this would force a crisis, *de facto*. Thus, a request for aid from the ESM, *per se*, may push countries into crisis. As a result, the ESM has to back up intervention with devices that make the sovereign debt of the rescued country a more desirable investment after it resorts to financial assistance from the ESM.

Furthermore, De Grauwe argues that another mechanism to internalise the externalities is important to strengthen the Eurozone: the joint issuance of Eurobonds. The two major objections that are often raised include moral hazard on the part of underperforming countries and the loss of Triple A ratings by the well-performing countries. In his paper De Grauwe says that it is possible to surpass these difficulties with a combination of two previously advanced proposals: Bruegel’s “blue bond” scheme (Delpla and von Weizsäcker, 2010) and his own “gains for all” scheme (De Grauwe and Moesen, 2009). In his words it would work as follows:

“Countries would be able to participate in the joint Eurobond issue up to 60% of their GDP, thus creating “blue bonds”. Anything above 60% would have to be issued in the national bond markets (“red bonds”). This would

⁸ See also <http://bit.ly/SgA3wN>.

⁹ A collective action clause, according to Wikipedia, “allows a supermajority of bondholders to agree to a debt restructuring that is legally binding on all holders of the bond, including those who vote against the restructuring”.

create a senior (blue) tranche that would enjoy the best possible rating. The junior (red) tranche would face a higher risk premium. This existence of this risk premium would create a powerful incentive for the governments to reduce their debt levels. In fact, it is likely that the interest rate that countries would have to pay on their red bonds would be higher than the interest rate they pay today on their total outstanding debt (see Gros, 2010 on this). The reason is that by creating a senior tranche, the probability of default on the junior tranche may actually increase. This should increase the incentive for countries to limit the red component of their bond issues.”

Finally, De Grauwe advocates a collective fiscal policy to deal with collective problems. De Grauwe argues that managing the Eurozone has to mean more than solely managing the Euro. He welcomes a stronger EU common government as a natural counterpart to an already common currency management.

His proposal is at once holistic and incrementalist but has a few limitations, among which: a) it is not explained how this new ESM mechanism could be implemented, especially because it is already in existence, b) the eurobond project is still suffering from great political opposition, namely from core countries, c) the hegemony of financial markets as source of volatility and disturbance amplification is left untouched, while De Grauwe himself believes markets misrepresent underlying economic fundamentals especially at critical junctures.

3.3. The Soros proposal

George Soros acknowledges that the EU is a very incomplete association of independent states. The management of the crisis has been tributary of German unwillingness to compromise on a number of concerns, including its fear of hyper-inflation. The euro has effectively contributed to a financial sector that has become a “parasite” as never before. If the EU escaped depression immediately after the acute phase of the crisis, it may not survive “long-lasting stagnation”.¹⁰

The 2012 Soros plan revolves around the need to establish a common European Treasury, with a fully-fledged capacity to tax and borrow. The way to do this is summarised in his own words:

“My proposal is to use the European Financial Stability Facility (EFSF), and its successor the European Stability Mechanism (ESM), to insure the European Central Bank (ECB) against the solvency risk on any newly issued Italian or Spanish treasury bills they may buy from commercial

¹⁰ See the 14 March 2014 Soros interview by the BBC, available at <http://bbc.in/PuSBbq>.

banks. Banks could then hold those bills as the equivalent of cash, enabling Italy and Spain to refinance their debt at close to 1 percent. Italy, for instance, would see its average cost of borrowing decline rather than increase from the current 4.3 percent. This would put their debt on a sustainable course and protect them against the threat of an impending Greek default.” (Soros, 2012)

The plan is an imaginative way to cut through the twin Gordian knots of the Lisbon Treaty and the ECB charter promising, simultaneously, swift impacts. The newly secured bonds from troubled countries can be treated as safe and liquid assets, which would drive their yields downwards and in convergence with the ECB's overnight rate for banks themselves. The ESM effectively would inject liquidity as if it was a budgetary agency and perform fiscal policy by proxy (the ECB) while not requiring any reform of the European Treaty or of the ECB mandate.

Soros' proposal is interesting since it shows that radical policy changes can happen while keeping the mainstay of the European institutional network. Perhaps the first problem with the proposal was its timing: it was made at a time where EU policy makers were not willing to consider alternatives. Soros' proposal might have made a difference. However, while it was designed to respond to the acute phase of the crisis (already in the past), it did not contain long-run measures to rein in the structural imbalances within the EU (some countries that accumulate positive current account surpluses while the public finances of others are in persistent deficit). It is also problematic how the ESM would be able to finance itself, given that its member countries would continue to be reluctant to coordinate policies among themselves.

3.4. EPPI's “progressive call”

The European Progressive Policy Initiative (EPPI) is an initiative from an international group of well-known economists (including Joseph Stiglitz and Jean-Paul Fitoussi) that has come up with a “progressive call for change” for a renewed European policy agenda before European elections in early May 2014. The EPPI report considers the outcomes of the prevailing economic consensus (“austerity strategy” and “structural reforms”) as being both ineffective as well as unfair, creating hurdles to growth and generating social disparities (generalised fiscal austerity slowed recovery and neo-liberal supply-side interventionism fostered inequality).

According to the authors the mutation of the EU into an “Austerity Union” is to be explained by five ingredients:

1. “Flaws in the design of the European Economic and Monetary Union, including the lack of a banking union with strong Eurozone institutions and a minimal fiscal backstop;
2. Poor policy advice given by the European Commission to national decision makers over the years;
3. Spill-over effects from the United States to Europe, and across European countries, notably due to simultaneous fiscal contraction in highly interdependent national economies, which European policymakers have consistently ignored;
4. A rules-based and largely undemocratic economic policy making process within the EU and the Euro area, with strongly pro-cyclical effects;
5. A failure to react, as the national social and political repercussions of austerity policies became even more severe.”

The change proposed by EPPI attempts to be comprehensive and also follows a five-bullet pattern:

- a) “growth-oriented public finances”;
- b) “a new strategy toward public debt”;
- c) “resolution of insolvent banks”;
- d) “a truly active and inclusive employment policy”;
- e) “a new European programme of social solidarity”.

Proposal (a) focuses on the need for a more positive policy context for public investment. It mentions a package of €200bn until 2020 directed to environmental goods, services and infrastructures; the instrument could project bonds leveraging on the EU budget. Another avenue is a €10bn investment in innovation, for instance to boost the Periphery’s SME competitiveness; the prime vehicle for which being the European Investment Bank’s (EIB). The ECB could support both schemes.

Proposal (b) is about new debt-management practice of immediate and effective consequences that keep within the bounds of current European law and treaties. In order to be economically desirable proposals should aim at reducing excessive debt burden in peripheral economies. In order to have a political viable outline proposals are supposed to avoid deploying national guarantees, inaugurating fiscal transfers, entrenching moral hazard perspective, debt monetisation. Two proposals are advanced to implement these goals:

- “A Modest Proposal for Resolving the Eurozone Crisis, Version 4.0” of Yanis Varoufakis, Stuart Holland and James K. Galbraith of July 2013. First, this proposal starts with a Case-by-Case Bank Programme (CCBP), which seeks to decouple sovereign debt from bank debt (and bank sector recapitalization needs) by allowing undercapitalized banks to borrow or to receive capital injections directly from the ESM. Second, the proposal advocates the conversion of the national Maastricht public level of 60% into ECB bonds. Third, a new investment program geared toward

specific areas (health, education, urban renewal, urban environment, green technology and green power generation) co-financed by an European Venture Capital Fund backed by the European Investment Fund (EIF) of the EIB. Finally, the launch of an Emergency Social Solidarity Programme that ensures minimal access to nutrition and basic energy to all EU citizen;

- A possible way out could be a synthetic Eurobond which is designed as a basket of national bonds where each country guarantees only its share in the basket. While such a common European government bond backed by joint guarantees would be issued and traded as a single debt instrument, each participant would be liable only for the interest payments and principal redemption corresponding to its share of the bond, and not for the debt of the other issuers (Favero and Missale 2010, p. 99). Proposals for such an instrument were made already by the Giovannini Group (2000), the European Primary Dealers Association, in 2008. In the reading of Favero and Missale, however, a common issuance implies “the creation of a new EMU issuing entity for centralized funding of euro-area Member States.”;
- A similar proposal is the “Basket-Eurobonds” (or BEBs) by Peter Bofinger (2014). The central characteristic of this scheme is to arrive at synthetic Eurobonds indexed to GDP or public debt weights of the individual European members. It could be either determined by the GDP weights of the member countries or by the share of their outstanding national government debt in the total government debt of the Euro area. A large issuance of BEBs would be issued by a Euro Debt Agency and contribute to more liquid markets. Given that a country like Germany would lose out since BEBs would have higher financing costs. However, a weight-inverted interest payment could compensate for this.

The other proposals can be summarised rather briefly. Proposal (c) is about case-by-case large bank resolution. Proposal (d) would capitalise the positive relation between good employment conditions and productivity, by promoting collective bargaining at all levels. Proposal (e) would create social solidarity fund to provide food assistance in the stress-stricken countries.

On the whole, the EPPI’s “Progressive Call”, by resorting to specific proposals put forward by other authors, is comprehensive and balanced.

However, the proposal does not explain how to kick-start the negotiation process leading to such a package and how to build a protection against predatory behaviour by financial market agents.

3.5. Expert Group on debt redemption fund and eurobills

Gertrude Tumpel-Gugerell, a former vice-governor of the Austrian central bank, was nominated by the European Commission on 2 July 2013 to chair an Expert Group to look into the “merits and risks, legal requirements and financial consequences of initiatives for the joint issuance of debt in the form of a redemption fund and eurobills”.¹¹ When the 86-strong report was published in 31 March 2014, it did not endorse any specific policy option on the mutualisation euro-area members’ financial obligations.

The group was meant to study the nature and contours of a “redemption fund and pact” (DRF/P) and that of “Eurobills” (the joint issuance of short-term government securities). The DRF/P is thought of as a way to deal with excess debt (above the Stability and Growth Pact level of 60% of GDP). The Eurobills are seen as way to integrate sovereign debt markets (which are presently fragmented and volatile):

- Redemption fund: euro countries could transfer debt above 60% of GDP with strict conditionality, i.e. “strings attached”. This would essentially mean that loans to countries in distress would be conditional on Troika type rules, financial penalties, the surveillance of monitoring body, etc.;
- Eurobills: these would allow for the quick exclusion of states that would be deemed not fiscally responsible. That is, “There would also be rules and mechanisms designed to contain moral hazard, going as far as a system for possible exclusion from the joint issuance scheme” (Tumpel-Gugerell *et al.*, 2014, p. 34).

Overall, the group concluded:

“Both a DRF/P and eurobills would have merits in stabilising government debt markets, supporting monetary policy transmission, promoting financial stability and integration, although in different ways and with different long term implications. These merits are coupled with economic, financial and moral hazard risks, and the trade-offs depend on various design options. Given the very limited experience with the EU’s reformed economic governance, it may be considered prudent to first collect evidence on the efficiency of that governance before any decisions on schemes of joint issuance are taken. Without EU Treaty amendments, joint issuance schemes could be established only in a pro rata form, and - at least for the DRF/P - only through a purely intergovernmental construction

¹¹ See http://ec.europa.eu/economy_finance/articles/governance/pdf/20140331_conclusion_en.pdf.

raising democratic accountability issues.” (Tumpel-Gugerell et al., 2014, pp. 6-7)

3.6. European Safe Bonds (ESBies)

Brunnermeier *et al* (2011) stress the need for safe assets in modern financial markets. They define a safe asset as one that has liquidity, minimal risk of default and works under a currency with stable exchange rate and inflation.

The authors propose the following new safe asset “ESBies”, which would be:

“securities issued by a European Debt Agency (EDA) composed of the senior tranche on a portfolio of sovereign bonds of the different European states held by that agency and potentially further guaranteed through a credit enhancement.”

Such new investment vehicle would be of international value and provide public good effects to the world financial markets as a whole since they would join their US counterpart and help the global market to be more liquid.

The problem is that the proposal does not seem politically feasible. This proposal aims at segregating financial stabilisation of the Eurozone through euro bonds from its political constraints through not requiring joint liability. This would be the scheme:

“A European debt agency would buy on the secondary market approximately 5.5 trillion euros of sovereign debt (60% of the Eurozone's GDP). The weight of each country's debt would be equal to its contribution to the Eurozone's GDP. Hence, each marginal euro of sovereign debt beyond 60% of GDP would have to be traded on a single bond market, where prices would reflect true sovereign risk, sending the right signal to the country's government. To finance its 5.5 trillion purchase, the debt agency would issue two securities. The first security, the ESBies, would be senior on interest and principal repayments of bonds held by the agency. The second security would receive the rest – it is therefore riskier and would take the hit if one or more sovereigns default. European banking regulation and ECB policy would be adjusted so that banks face incentives to invest in safe ESBies instead of risky sovereign debt.”

This plan would contribute to the further specialisation of international debt markets as well as to their liquidity. Some of the drawbacks: a) not a complete scheme, schemes would have to be established in law so as to create the incentive for financial players to purchase ESBies; b) it would require EU-wide coordination, and not just euro zone.

3.7. A sustainable programme for the restructuring of portuguese debt

A 2014 policy report authored by Cabral *et al.* (2014) argues that the euro crisis is the largest peacetime balance of payments and external debt crisis ever to occur, which resulted from a flawed euro area architecture.

It points out that the policy response adopted by euro area authorities – the austerity strategy – uses fiscal policy to achieve a very large improvement to the trade balance that would allow crisis countries to service their external debt and avoid default, if and only if the rest of the world accommodates this policy by increasing their net imports. Because essentially only one channel is used to achieve the external adjustment – the trade balance – the size of the adjustment and the contractionary effects of the austerity policy on the economy need to be very large.

Thus, it proposes an alternative policy response based on public debt restructuring and a new systemic resolution of the banking system with the aims of lowering affected country net external debt to sustainable levels and of lowering the impact of the external adjustment programme on domestic demand and the on the trade balance.

The report outlines how the methodology could be implemented in the case of Portugal and calculates the effect of a specific proposal on public and external deficits and debt.

Through the reduction of interest rates, the extension of the capital repayments of the General Government debt, and the restructuring of the liabilities of the banking sector, the report estimates an annual improvement of around €4.7 billion (2.9% of GDP) in the primary income balance deficit. This would be equivalent to a reduction of the present value of Portugal's external net debt from 103%, at the end of 2013, to about 24% of GDP. The restructuring of public and bank system liabilities would result in a overall reduction in the present value of debt estimated at approximately €249 billion (151% of GDP).

With the methodology proposed in this report the debtor country would not require foreign assistance in the form of multilateral or bilateral loans, in order to accomplish the debt restructuring.

3.8. The repair and growth after Brexit report

A recent report by Enderlein *et al.* (2016) also puts forward a set of policy measures and instruments – including changes to the mandate of existing institutions –, to reinforce the robustness of the euro architecture and to prepare

it for the next crisis, ensuring stability, but also with the aim of supporting more rapid economic growth in the Eurozone.

The report (hereafter, R&G report) is structured in three blocks of proposals (“building blocks”), organized around the perceived political difficulty in implementing them (Cabral *et al.*, 2017).

Essentially, the report argues for a stepwise construction of a Federal Union, based on the transfer, over time, of greater fiscal resources and policy powers (sovereignty) to new or adapted euro area institutional actors, such as a European Monetary Fund and a euro-area finance minister. This would avoid the need for intergovernmental negotiations (and zero-sum games) in addition to not requiring ratification by national parliaments.

The proposed building blocks do, in part, address current euro area architectural weaknesses, but are not sufficiently large nor robust to address inbuilt deficiencies in the euro-area architecture, particularly given the large legacy external debt that accumulated during the first 12 years of the euro.

Block 1 aims to strengthen the euro area response to future sovereign debt crises, by slowly transforming the European Stability Mechanism (ESM) into a European Monetary Fund (EMF), which would provide loans to member countries, on strict conditionality terms. The ESM would immediately be endowed with a €200bn war chest. The aim would be for the EMF (created as part of building block 3) to be able to draw on up to 10% of GDP (~€1100 bn) of funds, if needed, to respond to future crisis.

This element of the R&G report replicates, 70+ years later, the winning side of the Bretton Woods 1943 negotiations, where the US position – the major creditor nation at the time – prevailed that the IMF would lend countries facing balance of payments crisis limited amounts, based on strict conditionality loans. The approach that did not prevail at the time – defended by non-other than Keynes himself – was that the best response to balance of payments crisis was to provide deficit and debtor countries with unlimited automatic loans at 0% interest rates initially, with no strict conditionality attached. According to Keynes, the adjustment should be achieved by the country running trade (and current account) surplus, which should expand domestic demand.

But the aim of building block 1 also seems to find a permanent replacement to the quantitative easing ECB programme (Blyth and Lonergan, 2014), which is seen as particularly negative by Germany and other northern euro area countries with external surpluses.

Building Block 2 aims at creating a proto-euro area Treasury, with revenues derived from a euro area national budgets with the initial aim of funding

investment across the euro area. The most interesting and most relevant component of this block is the euro-area public investment programme. The funds allocated to the euro-area investment programme would benefit from an exclusion or exception clause from the fiscal rules of the Stability and Growth Pact and of the Fiscal Stability Treaty (European Fiscal Compact). The public investment component of this building block would be funded on a money-in-money-out principle. That is, member countries would receive investment equal to the funds transferred, so that in practice there would be no fiscal transfers between member countries arising from this new euro-area public investment programme.

Building Block 3 completes the creation of the proto-euro area Treasury, with: the establishment of European Monetary Fund, which replaces the ESM; the creation of euro-area or EU direct tax (or fiscal) capacity, namely through VAT, CO₂ taxes, or corporate taxes; the establishment of an euro Finance Minister; a solution to deal with the problem of legacy debt; a European deposit insurance scheme; and a tool for counter-cyclical stabilization, which could include an unemployment insurance fund complement.

Although the report is co-authored by several European center left individualities, it has apparently received at least partial informal support by Germany's finance ministry of Wolfgang Schäuble's era. Angela Merkel in fact, later, when talking about an alternative proposal by French President Macron, talked about the "important building blocks" of Macron's proposal¹², an expression that, perhaps by coincidence, almost seems taken out of the R&G report.

Thus, the perception of the authors is that the R&G report does seem to propose improvements to the euro area architecture that would be politically acceptable to pre-October 2017-election Germany. Thus, the R&G report does have the merit of seeming politically feasible in the short run, as Germany has been the country that has opposed changes to the euro area that would result in a higher degree of fiscal transfers between member countries and a change of the "austerity" strategy.

However, the main weakness of the report surely in the attempt to make the proposal politically acceptable to Germany and in that way, politically feasible, it does not identify nor satisfactorily address the fundamental weaknesses of the euro architecture.

These political impossibilities include the view that: the European Economic and Monetary Union should preclude meaningful fiscal transfers between member

¹² "Merkel signals readiness to engage with Macron on EU reform", Financial Times, 28 September 2017.

countries; the European Central Bank (ECB) should not be a lender-of-last resort to sovereigns nor should it guarantee an interest rate compatible with sovereign debt sustainability; fear of transfer of further sovereignty to a central euro-area government; changes to taxation – where each member country has veto right and loopholes in European legislation make it very difficult for member countries to tax certain types of economic activity and economic income –; and the ever present but never spoken role that the large countries, particularly, France and Germany, have in the design of the euro-area main economic policies.

Thus, the ESM or even the EMF “war chest” would be clearly insufficient to ensure interest rates compatible with sovereign debt sustainability and to prevent a speculative attack on the sovereign debt of a large euro area member country such as France or Italy simply because the ESM/EMF is a poor substitute for a central bank (Blyth and Lonergan, 2014) that can ultimately ensure that a sovereign is always able not to default on loans on its own sovereign currency, by printing new currency.

Thus, this EMF proposed in the R&G report, in substitution of the lender-of-last-resort role of a central bank, would be imperfect and a second best economic solution. Moreover, given its relatively small size, this “ivory tower” commitment of European authorities could be tested by the markets, as has occurred in various other instances in the past (e.g., the British pound peg to the ECU in the early 1990s, the CHF peg to the euro in 2015, etc).

Further, the strict conditionality as well as transfer of sovereign powers is at least in part based on the perception that the euro crisis is, to some extent, a consequence of Governance problems, notably in the southern European countries, and on the belief that central governance by a single European authority would result in better public administration and better economic results.

However, the euro crisis is a balance of payments and external debt crisis that results from a monetary union between vastly different economies with different degrees of international competitiveness. The architects of the euro ignored and neglected current account imbalances between member countries and forged ahead with a Monetary Union without meaningful fiscal transfers, despite economic advice to the contrary. Thus, “better governance” achieved by transferring policy powers from national to central decision makers is unlikely to be achieved nor to solve the underlying economic problems.

Finally, the size of R&G proposal seems too small given the significance of the euro area architectural weaknesses and the size of the legacy imbalances, namely large external debt by various euro area member countries.

Thus, the three building blocks are insufficient, likely too little too late. By accepting the above identified “political impossibilities” that define the Economic and Monetary Union as an unmovable constraint, the R&G report makes economic and monetary policy the art of the second best, an art of the possible, perverting or even inverting the role of economics and of politics.

3.9. The European Commission white paper: Different speeds ahead?

The European Commission published a white paper on the future of Europe on occasion of the 60th year anniversary on 25 March 2017 of the Treaty of Rome, which established the European Economic Community (EC, 2017).

The white paper identifies five main alternative strategies, outlining likely scenarios for the next 8 years: (i) more of the same, with new EU reforms and policies in response to crises or events; (ii) refocus the EU as an economic free trade area only; (iii) a multi-speed EU, with coalition of the willing countries advancing in the construction of a proto-Federal-Government; (iv) reduce the scope of the European Union, doing less, but more effectively and efficiently; and (v) deepen the European integration with the establishment of a proto-Federal-Government. The white paper argues that European Council must decide whether it wants to shape the future of Europe or whether it wants to let events determine its future evolution.

The white paper does not consider other possible scenarios (e.g., EU disintegration, a different role for the central bank, reversion to national currencies, etc.), some likely on political and financial market grounds, which is nonetheless disappointing. And the white paper seems to imply that the preferred outcome, or at least the most likely outcome (for the European Commission) is a multi-speed Europe, where a few member countries push the euro-area and the European Union towards more integration and towards a Federal government architecture.

The document is quite high level, and does not describe in sufficient detail the specific policy measures for each scenario, which would be challenging. But the white paper is even vague on the potential areas for further integration in the multi-speed Europe scenario, considering that it may include defense, internal security, taxation, or “social matters”, and describing briefly how cooperation in one of these fields might look like.

Thus, the white paper is a concept paper that does not really identify nor address euro area weaknesses. There seem to be no lessons learned from the past, and the strategy seems to be the same: when the European Union project faces difficulties the approach continues to be to move forward regardless.

The white paper does not explain how the issue of fiscal transfers is to be addressed, if at all, nor does it elaborate on changes to the current economic and monetary union architecture and monetary policy.

Thus, it seems an insufficient proposal on which to base changes to the Economic and Monetary Union and to the European Union architecture.

On December 6, 2017, the European Commission unveiled four very specific proposals or initiatives on how to move the European integration process forward.

First, a proposal to transform the European Stability Mechanism in a European Monetary Fund, which would provide strict conditionality loans to euro area member states “in financial distress” and to act as a lender of last resort to banks and to the Single Resolution Fund. The European Monetary Fund would no longer be controlled by the Eurogroup, instead being under the umbrella of the European Commission.

Second, a proposal to integrate the substance of the “Fiscal Compact” – a inter-governmental agreement known as the Treaty on Stability, Coordination and Governance – into the Union legal framework, i.e., into the European Union Treaties.

Third, a new set of relatively small policy instruments that provide for fiscal transfers between member countries conditional on certain conditions being met, namely reforms as envisaged by central authorities, specifically the European Commission, or exogenous shocks to a member state economy that result in a deficit-rules-mandated reduction in public investment.

Fourth, a proposal for a European Minister of Economy and Finance who could serve as Vice-President of the Commission and chair the Eurogroup.

While most of the proposals put forward by the Commission are being discussed in a form or another by other European decision makers, this variant seeks to put the European Commission in control of the new instruments, institutions, and governance process, so as to assure that the European Commission does not continue to lose influence and relevance in EU decision making.

However, it is already clear that the chances are small that the European Commission will be able to retain control of the instruments, institutions, roles,

and resources that will foreseeably be created in the near future. The inter-governmental nature of the Eurozone continues to dominate policy making and is likely to remain so in the future.

The European Commission proposals seem attuned to what the Eurozone powers, particularly Germany and France, see as reasonable policy initiatives. However, in doing so, the European Commission proposals: (i) continue restrict and to place unreasonable conditions on fiscal transfers between rich and poor member states; (ii) contribute to transform the Eurozone more and more into a “creditor’s club” where debtor member states have to comply with the rules and demands set out by institutions controlled by creditor member states, namely through the European Monetary Fund, through the new European Finance Minister role, and through the European Commission, itself.

3.10. The Macron vision of EU reform

Emmanuel Macron, freshly elected President of France, announced in late September 2017 a proposal for a reformed currency union.¹³ This initiative aimed at building a common platform with Angela Merkel, which following September elections, is likely to remain Germany’s Chancellor, beginning a new term. Trying to cease the policy momentum in the prospect of a post-Brexit context, it also waives at “avant-garde” member states to “move forward” without the burden of others “who wish, that’s their right, to move more slowly or less far”.¹⁴

Macron calls for a stronger and deeper EMU. This is, in effect, an overhaul of the Eurozone governance contract it postulates a substantial common budget (“several percentage points” of GDP), a Brussels-based finance minister, a European Monetary Fund and a Eurozone parliament with pan-European lists running for seats.

But ideas also point to a “sovereign, united and democratic Europe.”¹⁵ These were uttered in his *Sorbonne Speech*¹⁶ of September 26th, 2017, also cover a variety of other topics (see Box 1). On the international front, with a call for a more muscular commercial policy and a more explicit economic diplomacy. There is a call for as tighter cooperation on defense, including, setting-up a “military intervention force”, a common military budget by 2020, a European

¹³ <https://www.ft.com/content/d2af3178-3ed9-11e7-82b6-896b95f30f58>

¹⁴ <https://www.ft.com/content/97916d18-8ca9-11e7-9084-d0c17942ba93>

¹⁵ <https://www.ft.com/content/37c54ebc-a2ad-11e7-9e4f-7f5e6a7c98a2>

¹⁶ <http://international.blogs.ouest-france.fr/archive/2017/09/29/macron-sorbonne-verbatim-europe-18583.html>

agency to deal with counter-terrorism intelligence, and, presumably, support for military and security-oriented industries.

Overall, the purported objectives of such a bundle of economic commitments and institutional reengineering are stability, solidarity and stimulus. The proposals from Paris are short on details, namely as the formula and level of effort of the national budgets contribution to a common tax pot. It is also unclear how fiscal centralization would necessarily bring about social convergence. However, possibilities for development abound. The Eurozone parliament could, for instance, pass not only a euro-budget but also cushion euro-investments with fresh debt. It also flags the opening of discrete decision-making mechanisms without compromising the existing framework that would increase the ability to “react to to unexpected situations”.

These ideas represent a bolder and more far-reaching plan than any that coming from Berlin, where fiscal transfers from core/disciplined economies to weaker/peripheral ones have been fiercely resisted.¹⁷ Merkel/Schäuble-type reforms have mostly referred to incentives in a form of a (small) fund that would reward well-behaved economies who nonetheless could not find enough room for expansionary policy within the Stability and Growth Pact. Berlin’s establishment nonetheless uttered support in favor of more effective fiscal coordination providing enhanced coherence in terms of economic policy across the euro area to ensure that “competitive factors are harmonised”.

¹⁷ <https://www.ft.com/content/82263fc6-ad97-11e7-aab9-abaa44b1e130>

Box 1. Macron's wishlist, by the *Financial Times*

- EU military intervention force and budget in place by 2020
- A European intelligence academy to train officials
- A European civil protection force for responding to disasters
- A European public prosecutor for terrorism and organised crime
- A European asylum office for joint processing of claims, common procedures
- A European frontier police
- A carbon frontier tax levied on imports into EU
- A European innovation agency, for research into artificial intelligence
- EU subsidies to support development of electric vehicles
- Targeting of US tech companies with a tax on value created, rather than profits
- A bigger EU budget to fund investment and cushion economic shocks
- Overhaul of farms policy and new EU food inspection force
- Accelerated harmonisation of corporate tax bases
- Gradual harmonisation of corporate tax rates and social security contributions
- A guaranteed minimum wage adapted to each country
- All young Europeans enabled to spend six months as student or apprentice in another EU country
- Creation of European universities based on networks of institutions
- Six-month series of national and local conventions to discuss the future of Europe
- Half of MEPs to be from EU-wide lists by 2024
- A much smaller European Commission, of only 15 commissioners
- A multispeed Europe with Britain possibly rejoining simplified version
- A new European trade prosecutor ensure competitors stick to EU rules
- A Franco-German co-operation treaty, with focus on harmonising corporate regulation

Source: <https://www.ft.com/content/37c54ebc-a2ad-11e7-9e4f-7f5e6a7c98a2>

3.11. Summary

In conclusion, despite variants of the argument, by some EU policy makers, that there are no alternatives to the current economic policy – the “austerity strategy” –, the fact of the matter is that the growing number of alternative proposals by influential thinkers, European Commission, and the EU Government Heads of State, is a sign that a growing consensus exists that the current EU policy strategy is unsustainable and that there is the need for an alternative policy response to the euro crisis. It may take time, but these alternative proposals are the seeds to a new policy response to the euro crisis.

One common element to the alternative policy proposals analysed in this section is that their economic value is very large. Despite this, the proposals are of varying sizes and, in the opinion of the authors, most are not sufficiently large to address the crisis – a proper EU policy response has to be of a dimension comparable to the crisis, lest it be ineffective. Moreover, most proposals do not sufficiently address the accumulated external imbalances between member countries, the resolution of which require implicit or explicit fiscal transfers between member countries, a taboo subject.

Another common element of several of the proposals is the role of the European Central Bank directly, or indirectly via European Stability Mechanism or, alternatively, some form of debt mutualisation guaranteed by all member countries. This is no accident. It is based on the recognition that the ECB is one of the few institutions that can, by issuing new fiat money, develop a sufficiently large policy response to the euro crisis.

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4. Place-based development policies: investing on sustainable, inclusive and catalytic habitats

The objective of this section is to provide main elements to achieve a virtuous relationship between necessary new models of socioeconomic development and the rich European human and natural territorial landscapes. It is highlighted how this relationship can and should be made clear, and a politico-cultural key-driver for the restructuring of European political and public strategies and policies.

This will be made with a particular focus on Southern Europe; and through two specific but very much interdependent areas: urban regeneration, and transport and mobility. The aim is to frame a wider debate on the necessary structural changes and political support to tackle the present European uncertainties and complexities. This will mean the assumption of global principles, and correspondent policy materialization and action, in necessarily different scales and dimensions.

4.1. The value on the territory: Socio-economic and environmental place-based principles

4.1.1. The perfect storm: Causes and consequences

Southern Europe is just now slowly recovering from very painful times. The 2008 financial crisis was, after an initially counter-cyclical policy response, quickly followed by the predictable knee-jerk European policy response, based on ruthless austerity measures. These austerity measures disrupted the established social, economic and territorial existing equilibria. The policy measures were not consistent with the concept of an inclusive and sustainable society. But the crisis we are in has multidimensional reasons: above all, it must be perceived as a crude evidence of a failure of the old economic order, namely its support on large amounts of non-secured credit – financial, but also social, territorial and environmental over-credit. As expressed by the Green New Deal group (2011, p. 2):

“the global economy is facing a ‘triple crunch’. It is a combination of a credit-fuelled financial crisis, accelerating climate change and soaring

energy prices underpinned by an encroaching peak in oil production. These three overlapping events threaten to develop into a perfect storm.”

In fact, the crisis we are facing is not just a financial crisis. It is deeply connected with the supply-type urbanisation economic models that prevailed for at least the last five decades, based on sub-prime credit, but also with severe environmental and socioeconomic consequences due to a continuous sub-spatial and political dispersion (EEA, 2006). The financial crisis exposed deep flaws in the approach to economics that has dominated policy-making for several decades. Since the mid-1950s, European cities have expanded on average by 78 %, whereas the population has grown by only 33 % (id.). A major consequence of this trend is that European cities and its urban life have become much less compact. The trend towards new low-density environments is also evident in the space consumed per person in the cities of Europe - during the past 50 years, this space has more than doubled. In the last three decades (1978-2008), more than thirty new houses per hour were built alone on the main eight southern European metropolitan urban regions,¹⁸ whereas the demographic expansion was five times inferior.¹⁹ This is a dramatic result of the combination of human needs with the explosion of credit; and most enduringly the vast economical shift towards an urbanisation or urban production economic model, mostly input-based and with little correspondence with socio-environmental and productive investments.

A paradigmatic example of the environmental costs of the urbanisation-driven economies can be seen today in the major changes affecting the coastal zones. These areas, where the Mediterranean countries are particularly sensible, are the home to one of the world's 34 biodiversity hotspots. The increased demand for land and water for urban use competes with natural landscapes and the agricultural activities. These problems have been exacerbated by collateral investments such as on tourism, where the over-extraction of groundwater has led to salt-water intrusion into the groundwater.

Clearly, all these issues suggest that the current economic development model based on tourism, which largely fuels this urban sprawl, may not be sustainable. Interestingly, this phenomenon is particularly evident in countries or regions that have benefited from EU regional development policies. Where Mediterranean countries invested in new road corridors, new development patterns can also be observed. Although the population decreased in the last 15 years in many regions of Southern Europe, urban areas were still growing in those areas until the 2008 crisis, notably Spain, Portugal and some parts of Italy.

¹⁸ Lisbon, Madrid, Barcelona, Marseille, Milan, Rome, Athens, Istanbul.

¹⁹ Calculations of the authors, from National Statistics data and Urban Audit.

In the most recent decades, Portugal has experienced some of the most rapid increases in urban development in the EU. The main pressure occurred on its coastal areas – in 2000, 50 % of continental Portugal's urban areas were located within 13 km of the coastline, an area which accounts for only 13 % of the total land area.

In countries like Spain, economic growth supported by credit and a continuing tourism boom has resulted in a vast increase in the number of households and second homes, particularly along the Mediterranean coast. This led to the development of vast areas of combined built accommodation, infrastructures and specialized leisure facilities. These were decisive factors that conducted to a massive growth of real estate prices that eventually crashed in the late 2000s crisis. In 2013 Raj Badiani, an economist at IHS Global Insight in London, estimated that the value of residential real estate in Spain had dropped more than 30 percent since 2007 (Smyth, 2013). This leading to wider implications, as more families slipping into negative equity and poverty, dragging consumption further down.

Throughout the 2010 decade, the combination of the severe impacts of the financial crisis on the peripheral countries of the Eurozone, the following austerity politics, and the aggressive fiscal policies directed to attract foreign investment; accelerated the global commodification of the real estate markets on the southern European countries. The housing sector, most particularly in the most attractive southern inner cities, is becoming extremely overheated, fuelled by relevant amounts of foreign real estate investment as well as by a remarkable tourism boom.

Another consequence of urban sprawling inequalities is the increase of energy consumption. Even if here is an intricate relationship between urban density and energy efficiency it is generally accepted that lower densities encourage the usage of less energy transportation modes and therefore more fuel consumption (trains are twice more energy efficient than private cars). This in turn does have a detrimental impact on families' disposable income and on countries' dependence on foreign import of petrol - taking the example of Portugal: 35.7% of the total energy spent was consumed by the transport sector, most of it fossil fuels. These externalities of everyday consumption (like housing and mobility) are having negative and in many cases irreversible consequences for the future generations that will have little financial resources to face the challenges that will wait for them in the near and medium future. Southern Europe in particular is creating a demographic time bomb with nearly 50% of young people under 25 unemployed in countries like Spain and Greece.

It is also vital to understand that most of these youngsters live in suburban or less-dense urban areas (EC, 2011).

The analysis on the most recent impacts of the European crisis in southern European urban areas shows that there seems to be three considerably different crisis-impact phases. The first phase had impacted strongly on the urbanisation-driven economies and its most dependent sectors and territories; the second phase affect most of the urban territories of southern Europe – namely the ‘social transfers’ poorer classes but as well as on middle-classes and public employment; the third phase is approaching now is a result of the skills and demographic depression. There is the urgent need to reverse these structural trends and find a balance between the market and the non-market; the private and the public; the individual and the community. The way to overcome these systemic problem is through a set of solutions which must address the whole; creating conditions for a new sort of development, both inclusive and safeguarding the natural environment. And southern Europe has structural conditions to put forward this new type of progress.

4.1.2. Towards sustainable, inclusive and catalytic goods

The *genius loci* of the Mediterranean urban habitat, for centuries one of the main homes to human development and cultural enhancement, is not only still possible today, but, in our view, should continue to play a central role in the future. A significant part of the explanation for the historical dynamism of the Mediterranean cities lies in their density and compactness. The five urban areas of the Eurozone with residential densities of more than 10 000 inhabitants/km² are all located in southern Europe. These human environments are complex ecological systems that produce extraordinarily active cultural and social landscapes that make a strong case for the capacities of the south to be part of a European wider pathway on new directions.

We should understand this moment as an opportunity to re-think and to embrace new paradigms. Considering the enormous environmental challenges ahead, it is time to fundamentally redesign the economic and ecological systems. Combining socioeconomic and environmental values should be at the central goals of policy-making. Market prices should reflect more realistic social and environmental costs and benefits. Building such values at the core of public and private decision-making is a vital first step, upon which much else depends. Based on new principles and correspondent political visions and goals, the financial and taxation systems will have to be much more based on such values – charging more for what we consider as bad value and charging less for what

we consider most valuable. In this sense, traditional indicators like the GDP (and its correspondent measurements, like public debt) should not be the obsessive measures for what the governments of Southern Europe have pursued at all costs.

As written in the Stiglitz Report, “there appears to be an increasing gap between the information contained in aggregate GDP data and what counts for common people’s well-being (...) It has long been clear that GDP is an inadequate metric to gauge well-being over time particularly in its economic, environmental, and social dimensions, some aspects of which are often referred to as sustainability” (2009, p. 8-9). This report proposes different (and still realistically achievable) elements to measure value, such as well-being: a multi-dimensional element implying simultaneously material living standards (income, consumption and wealth); health; education; personal activities including work; political voice and governance; social connections and relationships; environment (present and future conditions); insecurity (economic as well as a physical nature).

For public finance, it will be highly relevant for a shift from taxing ‘goods’ such as work to taxing environmental and social ‘bads’ such as pollution, consumption and short-term speculation. For private finance, it is suggested to link the ability of banks to create credit with the ability of borrowers to build social and environmental value.

These proposals require a strong place-based approach: the territory and its bio- and human-diversity being a mainframe for sound equitable development and for active governance subsidiarity.

Territory is clearly a transversal dimension, combining different political arenas in areas such as environment protection, spatial planning, regional and urban development, spatial cohesion, biodiversity and nature conservation, transport and mobility, water, waste, energy. This characteristic cuts across the classical borders of technical domains and political arenas. It also leads to relevant political misconception and mostly to a fringed-type management with impact measurement or at the most some cohesion policies based on the effects caused by main sectoral policies with strong territorial and environmental impacts.

These are dimensions where the EU has been developing a relevant approach. It is already considerably visible in the main frameworks for the Europe 2020 Strategy; and will tend to be deepened in the following strategic frameworks. At the same time, territorial and environmental dimensions are areas that are particularly sensitive to the quality of governance - where public, private and civic actors interact and influence within its varied scales of intervention from local to global.

Specifically, the remainder of this section focuses on three specific policy measures for what are transversal areas: urban regeneration, transports and mobility, and better local governance. These can be thought as useful pilot projects of what might be wrong and what kind of integrated solutions might be needed to re-think these dimensions in Europe (and Southern Europe in particular) for the next decades.

4.2. Urban Regeneration: Urban life as a strong economic and environmental asset

Europe is inconceivable without its cities. Around 80% of the Europeans live today in urban areas; in southern Europe, this amounts to 75%. Cities and urban life have played and will continue to play a prominent developmental as well as problematic role, both when focusing at local as well as at more systemic and global levels. Cities are remarkable human energy accumulators; expressing high externalities, whether positive or negative. Concentrating and replicating global issues such as climate change, spatial inequalities, youth unemployment, poverty; but also dynamic local economies, creativity and innovation, knowledge and education, energetic externalities. All these are strong factors demanding the capacity to foster alternative and more integrated principles and different developmental models.

It is on the European urban fabric that we can most crudely see what is changing – and it is on the same urban fabric that we will be able to materialize new and alternative models for progress. And if this is particularly true in wider Europe, the history and position of its Mediterranean urban territories makes their role highly important. After a time of crisis and austerity, cities will reinforce their crucial role as engines for transition. Their very nature makes them inevitable places for connectivity, citizenship, creativity and innovation - all fundamental characteristics to provide us with the necessary tools to face the times ahead. At the same time, they are centres of consumption and services for the rest of the territory. Due to their density cities will also have a crucial role to help us move towards a more carbon-neutral economy.

However, and as the European Commission itself recognized, “the European model of sustainable urban development is under threat” (2011, p. 14). A threat that was developing not only from the crisis upheaval and the crash of urbanisation models based on several types of credit; but also with mainstream political and financial responses to the crisis itself. This brought new pressures on urban socioeconomic and environmental ecosystems; particularly on the

growing spatial polarisation and disparities both on income as well as on universal access to urban rights, such as housing; and to higher difficulties to effectively develop new models of social and economic progress in parallel with a fundamental ecological regeneration.

In short, the challenges for more sustainable, inclusive and catalytic urban life, can be systematized through four main vectors: *a)* the shape of urban fabric, and the dilemmas between compactness and dispersion throughout the territories where urbanisation has long developed; *b)* the functionalities and opportunities of urban life, and the dilemmas between complexity and specialization; *c)* the social inclusion and cohesion in the city, and the pressures between a deeper social integration or a continuous socio-spatial segregation; *d)* the recognition and identity of the city, and the choices between the deepening of our complicity with it, or the moving towards a fearful cognitive fragmentation.

There is clear evidence today that cities that are: more compact and less sprawled; widely multifunctional at its smallest scales in its different neighbourhoods; politically and geographically more just and inclusive; and culturally as well as civically actively perceived by its inhabitants – are cities where economic and labour dynamism is higher and stronger and also where more equitable and sustainable lifestyles are pursued.

As the European Commission (2011) proposed, concerning aims, objectives and values, there must be developed a clear shared vision of the *European city of tomorrow* as a place of advanced progress with high degrees of socially and economically cohesive and healthy habitats, enduring an 'education for all' service provision; as a place of green, ecological or environmental regeneration; as a place of intelligence attraction and enhancement, and an engine of economic growth; as a hub for democracy, cultural dialogue and human diversity.

Among other political vectors, the materialization of these visions would imply: for every urban project, assuming the basic principles above proposed on the main four vectors of urban life; approaching the political administration boundaries and strategies much more towards the scales of contemporary urban problems (namely, the metropolises/urban systems and the neighbourhoods); bringing more onto each cost-benefit analysis, balance sheet, and political decision, the building of social and environmental value; expanding small-scale sources of finance as well as more secure and accessible local banking systems, including the enhancement of local bonds; developing a tax/fiscal system more connected with the social, energetic and environmental impacts on the urban fabric, on urban (re)production and on urban

consumptions; creating time banking systems²⁰ in the territorial communities; developing a large-span housing policy protecting families from financial speculation and crash-related evictions.

These vectors demand the development of a comprehensive urban regeneration European investment programme. It also implies a unique opportunity to build progress based on new socioeconomic and green approaches to value, and the correspondent political, fiscal and financial restructuring. Urban regeneration should be seen as a complex, integrated and centrifugal socioeconomic and political process that deals with pre-existing urban fabrics, human settlements and politico-administrative boundaries; but by adopting strengthened political principles both in administration, finance/credit, governance and civic/community participation, it goes much beyond old (and crashed) expansionist urbanisation models.

Nonetheless the large reform challenges and inner complexities driven from these proposed approaches, we believe that there is today in the European knowledge and institutional arenas – including in the EU own institutional and administrative realms – a sufficient recognition and know-how for a qualified structuring of a vast urban regeneration driven programme.

4.3. Transport and Mobility: The need for a new paradigm

The movement of people and goods in a territory has enormous social implications. It tells us how a society is organised but more importantly, it creates patterns of behaviour that has profound impacts on how we organize ourselves as individuals, families or even as a political system. Transport and mobility can increase or reduce economic performances and social inequalities, depending on what kind of investments the political system is ready to make. Mobility is a form of consumption with visible and invisible economic consequences. Negative externalities (the cost that affects a party that did not choose to incur that cost) are key elements that explain social exclusion, deficient taxation causing unfair allocation of public goods and massive economic losses in Europe. At the same time, the rising cost of energy from fossil fuels (more than a tenfold increase in the first years of the 21th century) can partly explain the 2008 crisis and indirectly present European troubles. Although the current trend to price decline of the oil barrel in the world market, after June 2014, shows how complex and non-linear the understanding of fossil fuel price formation is.

²⁰ Time banking is a pattern of reciprocal service exchange that uses units of time as currency.

After pursuing more and more mobility (quantity of movement) in the last decades of the Twentieth Century, the cities of Southern Europe need to embrace a new paradigm. In this model, people have been travelling longer every day, spending more energy and money. Mobility is how far people can go. Accessibility is how many useful or valuable things people can do. To value what is really valuable it is time to make accessibility (quality and possibility of access) as the main policy and planning objective for the transport sector in the Mediterranean space. Mobility (quantity of movement), being easier to measure, like other classic economic indicators, used to be taken as a sign of vitality and economic prosperity. However, the same way the Stiglitz Report (2009) points out that the GDP is an inadequate metric to gauge quality of life, mobility should also be abandoned as the indicator to pursue and maximize in a society.

In fact, it is the quality and ease of access between people, between people and goods and between goods that has to become the key indicator of the quality of life of cities that in the last decades changed their approach. Considering the real need of people to participate in activities, the indicators of accessibility should include all age groups, gender and social classes and thus measure the level of accessibility by different kinds of modes of transport. However, what we have seen during the last few years of austerity in the southern European countries are cuts on the accessibility indicators, which are the results of cuts in the public investment in Public Transport services.

Human mobility patterns follow a triangular shape (Sauter, 2010): more short-distance trips and progressively less often for longer trips. Most kilometres are done around our neighbourhoods and cities, less within the region where we live, and even less European trips. However, most resources for transportation of people and goods in the last decades were directed towards helping to build long distance infrastructure - providing easier ways to cover long journeys. At the same time, short trips have become less and less convenient. In fact, it is all too common to find examples of public space in various levels of degradation and decay in southern cities. Narrow and damaged pavements, excessive motorized vehicle speeds, obstacles, and badly kept pedestrian crossings are sometimes the rule and not the exception. While millions of Euros were spent on long distance infrastructures like airports, motorways, and high-speed trains, public space as the primary infrastructure where most human mobility takes place was not seen as a transport infrastructure nor as the stage for the essential sociability that keeps communities together. Likewise, short-distance Public Transport – commuter trains, local neighbourhood buses, tramways - did not received as much investment in the last few decades.

Despite the price of petrol reaching record values in 2008, the economic crisis that succeeded (if the origins of the crisis are related indirectly to the surge in the prices of petrol is uncertain but plausible) made its price plunge to lower values. The uncertainties related to peak-oil are still considerable but will have a dramatic effect in the countries of southern Europe that import all of their petrol. Nobody knows exactly when the global oil supplies will start to decline (Monbiot, 2009). One thing is certain, global discoveries of oil fields peaked in the 1960s. The International Energy Agency's report claims that oil production will hold steady when the global resource has fallen "to around one half by 2030" (IEA, 2009, p. 80). The UK Energy Research Centre's review confirms "a significant risk of a peak in conventional oil production before 2020" (Steve Sorrell et al, 2009, p. 164). This means that in this decade, there will be gradual but sure temptations to speculate with oil prices, making it probable the oil price will rise significantly. The gradual increase of the price of mobility will have profound impact on the daily lives of people living the urban areas of the Mediterranean space especially those residents in the urban sprawl far from public transport.

Therefore, a major overhauling of taxation in the transport sector will be necessary to sustain the existing public transport and to start to re-invest in more transport infrastructure and technology again. This can be achieved applying the already mentioned Green New Deal based on a new set of values: to make expensive what we don't want (unsustainable forms of mobility) and making cheaper what we want (some cities are even testing free public transportation).

There are already some experiments on how to finance "good" mobility by taxing unsustainable modes. Cordon based charging systems like London congestion charge, the Stockholm congestion tax, the Milan Area C are all examples that Mediterranean cities will have to consider to raise revenue to increase the offer of public transport or at least to the same level in bankrupted cities. In Milan during 2012, the Area C program had total revenues of about €20.3 million and net earnings after expenses of over €13 million. These resources were used to increase service on the Milan Metro, on surface public transportation network and to finance the extension of the BikeMi bike sharing scheme (Comune di Milano, 2013).

Value capture is also a type of public financing that needs to be considered. It is a system that attempts to recover some or all of the value that public infrastructure generates for private landowners. Public investments, such as building transportation, increase adjacent land values, generating an unearned profit for private landowners. The unearned value (increases in land value which

otherwise profit private landowners cost-free) may be "captured" directly by converting them into public revenue.

In France, the "*versement de transport*" is a hypothecated local tax levied on the total gross salaries of all employees of companies. Set up in 1971, this transport tax is paid by all companies with more than 9 employees, private and public, in cities with at least 10 000 inhabitants. Depending on the financing needs and ranges between 0.5% and 2% of the payroll of the companies. Originally intended to raise capital for investment in local public transport infrastructure, but more and more used to cover its operating expenses. The tax is levied on the employer, not the employee directly. In 2010, for example, this tax financed nearly 40% of the operational cost for the public transport network in Ile-de-France.

Whatever tools to be used change based on a totally different transport policy paradigm can only be achieved by constructing powerful policy visions. From policy based on predict-and-provide, we need to be able to share, ponder and discuss the consequences of our daily acts. Instead of modelling-and-decide, we need more of a political process of debating-and-decide (Alves, 2010).

4.4. Improved (local) governance for a better transition

The challenges ahead are enormous and to face them new forms of territorial governance and political decision-making processes are essential. Political and administrative models need to be more multi-governance but also more integrated, more flexible but also more participative; with much more holistic perspectives on how to interpret, comprehend and mitigate problems, and move ahead. Governance will need to be more political with stronger levels of federalised participation at very early stages of the processes. Policies will need to be much more based in shared visions and strategies accepting and embracing conflicts and not avoiding them. Institutional and territorial subsidiarity should be the basis to deal with different time and space frames. This will mean more local power with more resources and reducing sectoral powers of central administrations, as well as developing long-views especially for systemic regional and metropolitan strategies. Only with these coherent long-term strategic policies based in shared visions of the future it will be possible to keep flexible to manage transition and still move forward onto new forms of human and ecological progress.

However, political spaces cannot be understood – as well as rearranged – as simple containers. Much time and effort is required to change and evolve socio-

political systems; particularly when moving towards more transversal, multilevel and subsidiarity approaches. The institutional and political territorial and environmental stances, even in Europe, have structural or even secular insufficiencies, particularly in most of the southern Europe regions and its more organic-driven governance dynamics (Seixas and Albet, 2012). However, and alongside with the pressures for new and more active public policies in Western Europe, including some comprehensive European-wide proposals driven towards new type of developmental policies (see for instance the Barca report, 2009), there is also a clear recognition of a parallel growingly active attitude from several local and regional governments, as well as from the citizenship itself; this also being true throughout several territories of Southern Europe. Interesting new proposals of integrated green as well as socioeconomic approaches with sound strategic and administrative capacitation are developing in cities from Lyon to Bari and to Lisbon, from Barcelona to Naples and to Thessaloniki.

Alongside with the defence of main global principles, it must be recognized that decision-making needs to be made more genuinely participatory and meaningful. The principle of subsidiarity should also apply to the private sector: it is important to determine which goods and services are best produced locally, regionally, nationally and/or internationally. Greater local production will require us to relearn many skills that have been forgotten. From agriculture to manufacturing to the provision of local finance, returning to appropriate scale means equipping ourselves with the means to do so.

As above expressed, new forms of multi-governance processes are essential to tackle these vast and new challenges. Implying more integrated, holistic and evolving governance models; with the construction of shared and compromised strategies; combining multisectoral visions with a politically variable geography; with permanent structures for citizens empowerment, thus permitting also here social and informal innovation; with good foresight and monitoring capacity (namely considering the 'managing transition'). In a certain sense the territorial and community strategic articulation, understood in the operational frameworks for Europe 2020 materialization, shows to go on these directions. The charter for multilevel governance in Europe approved by the Committee of the Regions also follows these perspectives. They are good instruments that point towards good directions. But considering the huge paradigm shifts necessary, much more will be needed for a necessary endurance, with sound global as well as local capacitation.

In a context of improved governance, in the ways suggested above, we will need to be able to make more informed and debated choices, to take risks and

to experience the consequences of each decision. In our view, one comprehensive way to ensure that kind of political integration – in the name of more equitable and sustainable development principles – can happen at the local level and will need a threefold dimensional European-wide public policy. First, to have a clearly written development programme in the name of accorded developmental principles. Second, by lowering the scale of power structures and letting communities – through reframed political spaces towards pertinent scales and paralleled by European-wide learning networks – to have access to more resources and information to solve everyday problems. And third, to allocate resources for this programme. Resources that in previous decades have been wasted in urban sprawl and long-distance traveling should now be redirected to more local and sustainable based decision making. Top quality public/political spaces in compact and dense areas with good public transportation will help communities to gain more control of their future and will ensure more transparency and proximity governance. This massive transfer of human, learning and monetary resources to the local level, in the name of very clear principles, can be helped by territorial based taxation where the money collected will be closer to the communities where is spent. This will also increase political accountability.

For this to take place it will be necessary a sound development programme for the regions in most need – this could be called the "*Ulysses Programme*". A programme supported by a massive restructuring of the taxation systems; and a better income redistribution to low- and middle-income households. To ensure striving communities living in compact cities with affordable housing and quality of life we need to spend better in what really matters according to long-term sound and ethical values. We can spend 'better' by reforming taxes, making them more territorial-based and to reflect political values so that we tax more what we want less of (like pollution and urban speculation) and less what we want more of (like public transport and urban regeneration).

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5. Putting the euro back in the real economy: Towards and European Investment Programme

The European integration process dates back to the founding of European Coal and Steel Community (ECSC) in 1952. This simple fact is often forgotten. And the early story behind European integration in the mid-20th century is usually told without significant reference to it.

In the push and pull of accusations and explanations concerning the current euro crisis a connection is missing. Along the way European construction became more about money and exchange than wealth and production, more about currency than value and more about speculation than investment.

The lack of reference to industry and the real economy is awkward. It denotes how the European project drifted away from its industrial policy origins and its attention to the regulation of critical resources.

This section argues that it is time to go back to the real-economy nature of the European integration project, by coming up with an investment programme focused on industrial and economic development.

5.1. The (industrial) origins of the European project

5.1.1. The European Coal and Steel Community

An emphasis on the real economy is at the genesis of the European project. The European Coal and Steel Community (ECSC) was established in 1952 as part of an architecture designed to coordinate the investment in resources and regulate their collective administration. Supported by Schuman and Monnet, and shielded by Adenauer and de Gasperi, the idea was about stability through coordination. The ECSC was founded on the assumption that progressive inter-country co-existence was dependent on assuring fair access to core inputs that are used to benefit a large range of critical sectors in a variety of regions.

Box 2 shows how the language of the Treaty of Paris was indeed about production and modernisation of conditions, work and employment-based welfare, etc. That is, it was an experiment based on economic engineering; it was a new institution based on industrialisation. The rhetoric was much more

about regulation and plans, rather than the talk about the markets and efficiency of the present.

Box 2 Quotes from the Treaty of Paris (April 18, 1951) on the mission of the European Coal and Steel Community (ECSC):

Preamble

- "...to substitute for historic rivalries a fusion of their essential interests..."

Article 2

- "...contribute to economic expansion, the development of employment and the improvement of the standard of living in the participating countries ..."
- "The Community must progressively establish conditions which will in themselves assure the most rational distribution of production at the highest possible level of productivity, while safeguarding the continuity of employment and avoiding the creation of fundamental and persistent disturbances in the economies of the member States."

Article 3

- (e) "promote the improvement of the living and working conditions of the labor force in each of the industries under its jurisdiction so as to make possible the equalization of such conditions in an upward direction;
- (g) "promote the regular expansion and the modernization of production as well as the improvement of its quality, under conditions which preclude any protection against competing industries except where justified by illegitimate action on the part of such industries or in their favor."

5.1.2. Sufficiency, not efficiency

The sectorial justification for coordination combined intra-ECSC trade in coal and steel with significant actual and potential interventions. The realm of economic integration was a mixed regime, and accepted the need for technical knowledge redistribution. So, competition (that would lead to efficiency) was tempered by an orientation toward reinforced cooperation (that would lead to collective self-sufficiency).

In 1958 this focus on coordinated technological diffusion and quality assurance was extended to the European Atomic Energy Community (Euratom). Its objectives singled out a particular science-based field and channelled international interaction for the interest of up-to-date research. This was open to all the member-countries, not necessarily those enjoying comparative advantages in capital-intensive areas.

5.1.3. A mix-mode of consultation

The process of coal-and-steel policy deliberation is one to be highlighted since it was not a linear one and not a top-down one. The governance structure of the ECSC had a so-called “High Authority”, which stands as the early the predecessor of the European Commission. This executive unit was assisted by a “Consultative Committee” that included representative organizations of productive capital, labourers and consumers.

Hence, a strategy for stable growth was underpinned by an effort to give expression to a European-wide civil society organised around professional and factor of productive groups. There was a social and political model of mediation that replicated at the European central the practices and institutions that existed in some post-war countries. This consisted in a flexible mechanism to connect industrial and social goals and accommodate the impact of economic forces while maintaining political order (Ruggie, 1982) and align the domestic and international agendas (Schäfer, 2003).

5.1.4. Dismantling the real economy bias

By 1957, when the Treaty of Rome was signed creating the European Economic Community (EEC), “economic considerations had gained the ascendancy over politico-military matters.” (Hu 1981, p. 23) The focus had changed to the “common market” and, with the exception of the agricultural and transport sectors, there was not an agenda toward specific sectors or mention to a common industrial policy (Hitiris 2003, p. 294; Pelkmans 2006, p. 50). The emphasis from now on would be economic liberalism.

The 1970s was a decade of Europessimism and, in the 1980s, this background combined with the Thatcher-Reagan momentum would lead to a movement toward deepening and widening markets. European economic policy would turn inward and loose its connection to concrete economic activities. The preferences for low inflation would solidify at the expense of fiscal policy (McNamara 1998, p. 3). Soon enough monetary policy would come to be considered the queen of all public policies.

5.2. The emergence of the monetary-finance policy monoculture

5.2.1. Disentangling the monetary-finance complex

The conventional rationale behind independent central regulators, namely central banks, is technocratic and detached from the political struggles. This set-up has lost credibility after three decades of being in vogue and in the wake of the global financial crisis. Joseph Stiglitz (“Stiglitz against central bank independence”, *The Times of India*, 4 January 2013, <http://bit.ly/QRFS2x>), delivering a speech at the Central bank of India has, for instance, attacked the very principles of independent central banking from a distributional perspective:

“There is no such thing as truly independent institutions. All public institutions are accountable, and the only question is to whom,”

(...)

“It is unconscionable that such power over the purse be given to a non-elected body.”

The delegation of monetary policy and financial markets regulation to unelected bodies creates, indeed, an ensemble of structures pregnant with conflict of interest. As a consequence, only the views of one single industry are represented in the dominant policy arena: the financial sector.

5.2.2. Emergency aid to financial actors in the context of the crisis

According to official data on public aid to the economy just in the first two years of onset of the current crisis in Europe (September 2008 to late 2010) EU states disbursed about 10% of GDP in aid to the banking system (European Commission 2011, p. 6). Banks benefited from measures described as: “State guarantees for bank liabilities, recapitalisations, impaired asset relief and restructuring aid” which were defined in July 2009 (European Commission 2011, p. 10). This orchestrated but discretionary intervention consisted of an unprecedented amount of State aid (see Box 3). The total amount of support did not stop there.

What is more, the supervision deficit of the financial sector should be probably considered as a form of invisible subsidy. According to research conducted by the *Financial Times* (13 November, 2014, p.1) 2014 was the most expensive year ever for banks in terms of fines for allegations of misconduct, collusion, insider trading, customer defrauding, market manipulation and other fraudulent activity prompting “questions over how comprehensively banks have reformed in the wake of the financial crises.”

Box 3. Assistance to banks in the critical phase days of the financial crisis

The largest 15 beneficiaries State aid during 2008 and 2010:

- UK (RBS, Lloyds Banking Group),
- IE (Anglo Irish Bank, Allied Irish Bank),
- BE (Fortis, jointly supported by the NL and LU, and Dexia was jointly supported by FR, LU and BE),
- DE (Bayern LB, Commerzbank, HSH Nordbank, IKB, LBBW, West LB) and NL (ING, ABN Amro).

The collapse of Lehman Brothers takes place in September 2008. In an unprecedented way, the measures put in place in the EU were set in motion rather quickly:

- The ECB also cut the interest rate by 50 basis points to 8 October 2008; then more cuts on the ECB favouring the main refinancing lines to the banking sector brought interest rates from 3.25% to 1.00 % in May 2009, that is, in just seven months (European Commission 2011, p. 20).
- Between 2009 and 2010, the stimulus package, or expansionary fiscal policy, on the part of member states amounted to € 170bn, a budgetary expansion equivalent to about 1.2 % of EU GDP (European Commission 2011, p. 21).

5.2.3. Finance as the target of selected industrial policy in Europe

Emergency aid coordinated at the European Commission (EC) level between 1 October 2008 and 1 October 2012 was massive (European Commission, 2012). During these first four years it is estimated that the size of public support made available (*approved*) for the financial sector amounted to €5058.9bn (that is, 40.3% of EU GDP). The entire amount was not supposed to be used, it mostly figured as a signal for reassure markets. But between October 2008 and December 31, 2011 the support actually obtained (*actually used*) by banks amounted to €1615.9bn (i.e. 12.8% of GDP).

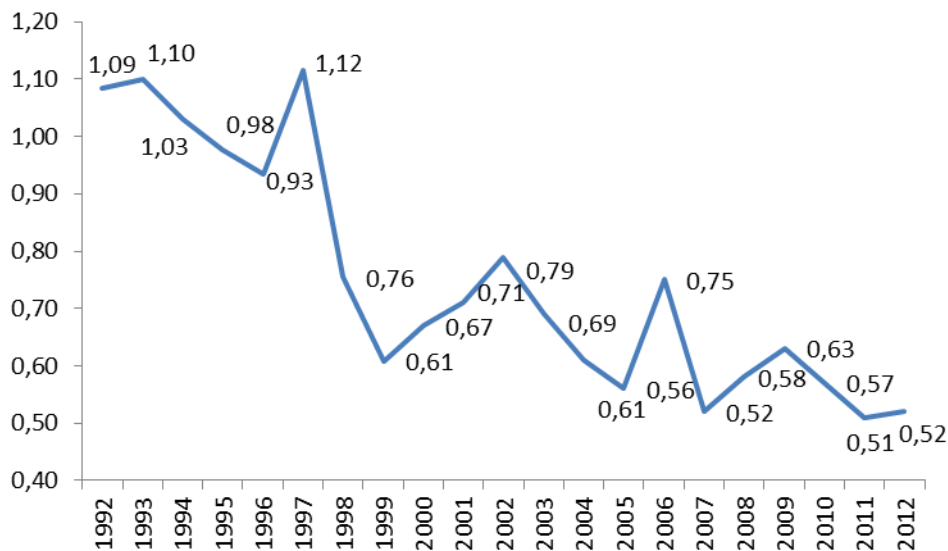
Support of the real economy paled in contrast. The new Horizon 2020 framework approved for the entire period 2014-2020 was considerably less (€960bn, in 2011 prices). The assistance allocated to productive enterprises for reasons related to the crisis amounted to merely 1.6% of all crisis-related aid put to the service of banking and other financial operators: between December 2008 and October 2011, member states made available the € 82.9bn under the temporary anti-crisis program (lines of credit). Moreover, the actual use of funds

to support decreased over time: € 21bn in 2009, €11.7bn in 2010, and 4.8bn in 2011(or 0.037 % of EU GDP for this year) (see European Commission, 2012).

5.2.4. The long-term decline of non-emergency support to the productive side of the economy

Not only emergency aid to the real economy has been small it is also significant that non-emergency State aid has been on a secular decline. According to the European Commission (2013) data state aid in terms of subsidies to manufacturing and services (excluding railways) amounted to an average of 1% of value added in the Community in the early 1990s; by the early 2010s it was half as much (see Figure 1).

Figure 1 Total non-crisis State aid % of GDP, EU-27



Source: European Commission (2013)

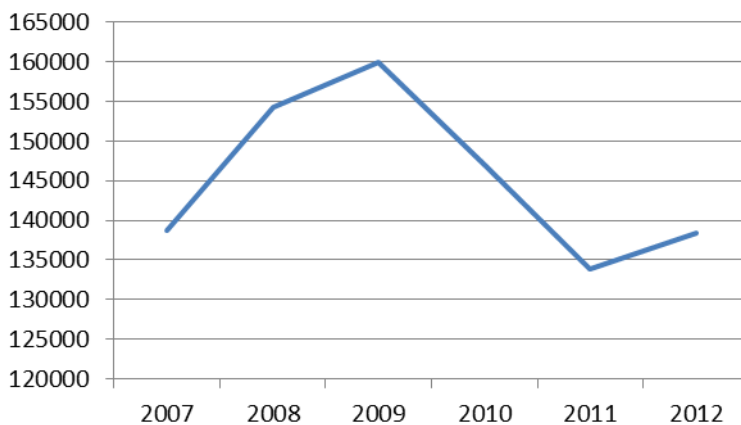
It should be noted that, as member states were deleveraging their subsidies to productive activities, a succession of asymmetric shock hindering the tradable sectors were occurring: 1970s great increases in oil prices leading to inflation, 1980s loss of favour of public intervention in the economy, 1990s the increasing competition of the newly industrialising countries pulling up the value chain under a new wave of globalisation, 2000s the rising rivalry of the BRICs in an increasing array of goods and services in times of state-led capitalism, and finally the financial crisis in the turn to the 2010s.

5.3. Conclusion: Promoting (real economy) growth

5.3.1. Abandoning the “non-intervention policy” in the real sectors

In the European Union, between 2001-06 (pre-crisis) and 2007-12 (crisis) non-crisis-related state aid to industry and services decreased by about 0.13 percentage points of GDP. Figure 2.2 shows total non-crisis-related state aid amounts. As can be seen, in 2012 aid levels were €21.2bn below its peak (reached in 2009).

Figure 2 Total non-crisis State aid, EU-27 (2012 € millions)



Source: European Commission (2003)

Note: € millions in 2012 constant prices

5.3.2. Policy measure: Re-structuring the “real economy” economic policy

It was argued above that State aid to the real economy in Europe has been on a declining long-run trend. The euro crisis aggravated this trend, resulting in a substantial reduction in state aid levels. It should be possible to at least recover the loss of 0.13% of the EU GDP in public-driven productive investment: that is, the EU should “invest” at least an additional €17bn yearly until 2020 in further state aid to industry and services. This amount, which would be raised from European tax revenues, would simply allow state aid levels to return approximately to the levels in place just before the start of the euro crisis.

The process of deployment of these resources through a common European investment programme should not be made in the way that has become the European “business as usual”. The actual targets should be selected in a way that restores representation of real economy stakeholders. That is, it should

remove the undue influence of financial pressure groups and give new ground to real economy actors, through a distributed social dialogue mechanism.

Thus, the key is that the new funds should be obtained primarily from budgetary sources and that they should not be captured by a single sector, namely the financial sector: they should be exclusively earmarked for state aid to industry and services.

This manoeuvre would require getting three hard and complex measures at the European level:

1. remove the ECB from the centre of the European project and reform its role and functions;
2. tax heavily short-term capital flows;
3. prohibit tax havens in the EU and discontinue tolerance for the organizations that employ outside ones.

This “negative” cluster of measures is necessary to clear the way. Then, another, more “progressive” set of measures, should be implemented. A mix of under-utilised practices and institutions as well as new actors and innovative processes should be combined, in particular:

- 1) monetize the supply of capital directed to large European projects and SMEs via existing structures such as the European Investment Bank and European Investment Fund;
- 2) create a new European Agency for Industrial Development and Fair Competitiveness and give new impetus to the European Institute of Innovation and Technology for these new institutions to promote a process of growth into the real economy, managed in a sustainable and environmentally friendly manner;
- 3) put the European Economic and Social Committee as the coordinating body of this new wave of policies and strengthen the oversight role of the European Ombudsman Citizen economy.

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6. How to turn the environmental and climate change crisis into an opportunity?

In May 2013 the concentration of carbon dioxide reached the astonishing level of 400 ppmv (parts per million by volume). This is a striking increase on the 275 ppmv CO₂ in the pre-industrial period, but also a sharp increase regarding the 387 ppmv attained in May 2008. If we include the combined impact of the other greenhouse gases covered by the Kyoto Protocol, then we are nearing dangerously towards the tipping point of 450 ppmv CO₂, which the majority of the scientific community -- namely the thousands of participants in the recent Fifth Report of the Intergovernmental Panel on Climate Change (IPCC) - considers as the threshold beyond which climate change over the course of the present century could lead to serious and uncontrollable consequences. That eventuality could lead to an average global temperature increase in excess of 2 °C compared with the pre-industrial period, triggering a series of positive feedback phenomena which could lead to the disappearance of the Arctic sea-ice, the transformation of the Amazon forest into a vast savannah, the erosion of the Himalayan glaciers, the destabilization of the permafrost (permanently frozen soil) with the release of huge amounts of methane and other greenhouse gases (GHG) to the atmosphere, the growing acidification of ocean water, the rapid shift in biodiversity equilibrium, among other phenomena known as “tipping points”.

Climate Change is today the main (but not the sole) feature of the global environment crisis. It is a kind of synthesis of the tasks humankind has to face together, if we are to overcome the various and herculean tasks of our common survival well into the 21st century and beyond. These tasks should become the true metrics that can help us in evaluating the positive or negative nature of both European and national public policies.

Among these tasks, the following are particularly relevant:

- Finding new, lasting and non-polluting energy sources that can be the basis of new forms of environmentally friendly production and transport.
- Successful completion of the transition towards a new paradigm of science and technology capable of establishing a symbiotic relationship, rather than a collision course, with natural systems.
- Gradual but determined progress towards a planetary response to the major global challenges of the environment: the depletion of the ozone layer, consolidating the victories already won; climate change, securing a new and more ambitious climate protection regime, delayed since the

expiry of the Kyoto Protocol in December 2012; the loss of biological diversity; the degradation of the atmosphere; the critical decline in vital water resources; and the degradation of arable soils.

- Achieving a joint world campaign against the millions of 'black spots' of various types of pollution accumulated over the last two centuries, together with all traces of chemical contamination, including in the most intimate codes of the human body. Special attention needs to be paid to nuclear dumps and nuclear power stations. The end of the dangerous illusion of 'peaceful nuclear power' should also take place in the coming decades.
- Fulfilling the hope contained in the United Nations Convention on the Law of the Sea, to turn the oceans into a common good for humanity, to be managed and protected jointly.
- Avoiding the realisation of the pessimistic prophecy of some 'environmental security' analysts who foresee the scarcity of natural resources as the cause of the wars of the future.
- Constructing a system of world environmental governance based on a reinforcement of the successes of environmental diplomacy over the last four decades, and the restructuring of the United Nations in terms of environmental targets. A positive step in this direction could be the creation of a World Environmental Organisation and a close understanding between the United States and the European Union on major global environmental issues, reversing the trend towards mutual confrontation, which has been the keynote of the years under the Presidency of G.W. Bush.

The Paris Agreement, achieved at the United Nations Conference on Climate Change in 2015, sets carbon emission targets for each of the countries with varying degrees of demand and has allowed an understanding among all nations of the world about the progressive higher temperature rise. After years of negotiations, following a limited commitment to developed countries established by the Kyoto Protocol in 1997, following the collapse of an agreement in Copenhagen in 2009. After years of conflicts, advances and setbacks in the United States and of China, President Obama and President Xi Jinping overcame their differences in September 2014 and managed to reach an understanding in this matter made in December 2016 in Paris. Unfortunately, President Trump in June 2017, announced that the United States would formally leave the Agreement. This departure is based on reasons of internal policy and President Trump's assertion, with doubtful justifications, since the costs of inaction will always be higher than the emission mitigation measures and jobs are increasingly green. However, the US exit does not jeopardize the enormous

effort to reduce emissions and transition to renewable energy since it is occurring in the world but also by many American states, municipalities and, mainly, companies. Investments in renewable energy and energy efficiency will continue to happen in America and the world, and we are moving towards a planet and economy that is increasingly free of fossil fuels. This alienation from the US weakens multilateralism and concerted action on a global scale, but will not lead other countries back. The Agreement will surely provide new leaders such as China, also allowing it to raise the morale of the European Union that must be more united and ambitious. Fortunately, the Paris Accord is greater than any nation or any government.

6.1. How to make energy policy the fundamental lever for change?

Between 2001 and 2030 the European countries of the OECD will probably invest two trillion dollars in new electricity generating stations (equivalent to nine times Portugal's GDP in 2007).

If we consider the world as a whole for the same period, the investment rises to the astronomical figure of 16 trillion dollars (equivalent to 72 times Portugal's GDP in 2007). This is due to the increasing obsolescence of the world's generating capacity. In the European Union alone in 2005, more than 50% of coal and oil-fired electricity generating stations were over 25 years old. The same is true of the nuclear sector, particularly after the 2011 Fukushima tragedy and the following political blow of the German decision to phase out all nuclear power plants in a short time period. This therefore represents a major opportunity to make huge public investments that will affect the entire 21st century, with irreversible environmental and economic consequences.

The priority is political in nature. We need new public energy policies at all levels (regional, national, European and global). We need policies that offer a stable regulatory horizon for public and private investment, and which at the same time help to step up the pace of technological innovation in the energy sector. The technological situation in the energy sector corresponds well to what Thomas Homer-Dixon calls, as the syndrome of our times, the "ingenuity gap". Successive decades of cheap fossil fuels have blunted the appetite for a major innovation drive based on an ambitious research and development strategy. This trend of cheap oil, extremely hostile to technological innovation and investment, returned by mid-2014, with complex effects that we are still unable to fully evaluate. In spite of our technological prowess, the truth is that there is a huge gap between the vast size of the problems and the scarcity of existing technological solutions which needs to be filled with the maximum

urgency. It is absurd that our civilization is so fundamentally dependent on energy sources, and the technologies associated with them, that date back to the 18th century (for coal) and the mid-19th century (for oil).

Until the “eruption” of the “sovereign debt crisis” in 2009-2010, the EU was proud to appear as the world regional power with the most ambitious vision, pointing by practical example into the right direction and setting the urgent priorities, like the following:

- It is essential to link the issue of energy with climate change. Only the latter can confer on the former the strategic direction and sense of urgency that are needed to mobilise the international community to tackle the biggest challenge of our times, which is the lack of viability of our civilisation model in the longer term.
- The diplomacy of the European Union and its Member States should always take account of the need to overcome the void created by the closure without alternative of the Kyoto Protocol to the UNCCC. This means that the economic and technological aspects of diplomacy should always include the reduction in emissions of greenhouse gases and alliances and synergies to that end.
- In relation to energy policy, in terms of choosing the energy mix, it is important to keep three objectives in mind which should also be the three criteria for the selection of good policies and the investments associated with them: a) the environmental suitability of the options; b) security of energy supplies (the current crisis with Russia is a critical example of this feature); c) contributing to enhancing the overall competitiveness of the economy.
- In the area of research and development, it is important that words are turned into action. Both the European Union and the International Energy Agency have emphasised, in various reports, that despite the growing articulation of concerns about the critical dual situation of energy and climate change, the fact is that investment in R&D for the promotion of alternative energy sources and for increasing the conservation and efficiency of conventional energy sources is far below not just what is needed, but also below investment levels of relatively recent history such as the beginning of the 1980s, in response to the oil crises of the 1970s.
- Scientific and technological cooperation in the field of energy and climate change should rapidly become a synergetic factor in the mobilisation of global intellectual capabilities, involving the European Union and the USA, but also China, India, Brazil and other emerging countries.

All this calls for a change in people's ethical values both in their dual role as citizens and consumers. Without a change in attitudes and behaviour reflected in lifestyles and consumption patterns, it will be difficult to achieve the social and political groundswell of support for the major changes needed. In spite of the overwhelming burdens of a flawed austerity that was imposed upon it, Portugal is a leading country in the linkage between energy policy and the fight against climate change. In 2016, the production of electricity from renewable sources in mainland Portugal accounted for 64% of electricity consumption. In May 2016, Portugal had the electricity consumption guaranteed only by renewable sources for 107 consecutive hours. A set of 1130 hours, corresponding to more than a month and a half, was the period in which the renewable production was sufficient to supply the national electricity consumption. Electricity production from renewable sources in mainland Portugal contributed heavily to a record export balance between Portugal and Spain, ie a balance between exports and imports of more than 5 TWh *, 10% of national consumption, at an average price of exports of € 37.2 / MWh.

There is a strong identity of goals in the Portuguese and German energy policies. That coincidence is reflected in the fact that both the principles and methods pursued in the German "Energiewende" (Energy Transition) are also replicated in the Portuguese Energy Strategy, which aims to reduce drastically the emissions of GHG and to increase rapidly both the level of energy efficiency as the share of renewables in the final energy use. The Ulysses project could easily pick the climate/energy issue as a core milestone for pan-European cooperation. The huge investment needed to renew power infrastructures, namely to build a European-wide smart-grid will represent a strong impetus for the economy as a whole. From job creation to industry, from capital investment to the creation of new opportunities to SME. Last but not least, this strategic goal will allow the EU to become self-sufficient in energy, therefore avoiding the hazardous dependence on Russian gas or on Arab oil.

The clean energy transition is changing the global energy markets and the European Commission wants the EU to lead the clean energy transition, not merely to adapt to it. In November 2016, it presented a package of measures to keep the European Union competitive in this sector. For this reason, the EU has committed to cut CO2 emissions by at least 40% by 2030 while modernizing the EU's economy and delivering on jobs and growth for all European citizens. The proposals have three main goals: putting energy efficiency first, achieving global leadership in renewable energies and providing a fair deal for consumers. However, this large package of negotiations lack ambition in many goals and, in conjunction with the European climate policies, will need further strengthening if Europe wants to truly fulfil the Paris commitments.

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7. Concluding remarks

This report is, in essence, a call to action that seeks to contribute to a change in the EU policy response to the euro crisis. It argues that:

- There is a growing number of alternative proposals by influential thinkers, which is a sign that there exists a growing consensus that the current EU policy strategy is unsustainable and that there is the need for an alternative policy response to the euro crisis. It may take time, but these alternative proposals are the seeds to a new policy response to the euro crisis;
- The euro crisis is a strong example of the unsustainability of monetary policy to work as the single cohesion force to form a compound polity involving directly 19 nations, and a wider circle of the 28 Members States of the EU. The euro crisis is the consequence of EMU architectural flaws, which need to be corrected if both the euro and the EU are to survive;
- The euro crisis is, therefore, a crisis of the “past”, i.e., with origins in the past and consequences in the present, meaning that EU policy makers are presently dealing with the consequence of past policy failures made by the architects of the EMU, which became worst given the wrong diagnosis and mistaken policy measures that were undertaken thereafter;
- EU policy makers have to, at some point, desirably in the near future, come to terms with the fact that the past cannot be changed. Past policy errors cannot be made disappear, *ex-post*. EU policy makers need to recognize that their role in History is to assume the costs – and clean up the consequences – of those past policy mistakes by earlier EU and euro area policy makers, namely by directly responding to the challenge of excessive external (and public) debt of several euro-area member countries to allow these countries to adopt growth supportive budget policies;
- EU policy makers challenge is thus to be forward looking:
 - To focus on the changes to the EMU architecture that are required to make the euro a viable project for the future;
 - To focus not on trivia but on the big challenges facing Europe today and in the near future;
 - To focus on a broad strategy able to rescue and strengthen the EU project, based on a comprehensive set of policies (monetary, economic, political, social and environmental), establishing a bridge between the new challenges that demand European

common action to be tackled with success, and the core values that pervade our constitutional culture, namely, a strong commitment towards democracy, humans rights and sustainable development;

- To focus on the need to avoid the lethal danger of political fragmentation and economic and financial disarray. This danger grew particularly visible and strong after the May 2014 elections for the European Parliament and the 2016 Brexit referendum. The price of political and economic reform will be mild in comparison with the overwhelming cost of collapse.
- There is a plethora of policy options available to EU policy makers to build a better future for the Eurozone and for the European Union.

The report proposes specific alternative policy measures to respond to the crisis:

- It points out that the euro crisis that manifests itself in large external imbalances between member countries can only be solved through explicit or implicit fiscal transfers, a *taboo* subject in European policy making circles. The longer these policy circles refuse to face facts the longer it will take to design an effective response to the euro crisis;
- The EU should reengineer the architecture of its governing institutions so that it becomes far more democratic, transparent and accountable. The governing institutions of the European Union have driven it to a costly and socially disastrous dead-end. It is high time that they reflect on what went wrong and that they own up to their own mistakes;
- It argues that European cities should be the key drivers of the development of the European Union and of Southern European Union, suggesting three areas of intervention: urban regeneration; better transportation/mobility; and improved city/local governance.
- It argues that the European Union should focus economic policy around the “real economy”, and design an investment programme to promote industry and services investment; and
- It points out that the environmental and climate change crisis is both a challenge and an opportunity. EU policy should use the environmental and the climate change crisis as an opportunity to reinvent its energy policy at a true pan-European cooperative scale, and as by/product, promote economic growth, within green and sustainable criteria.