Journal of European Public Policy

ISSN: 1350-1763 (Print) 1466-4429 (Online) Journal homepage: http://www.tandfonline.com/loi/rjpp20

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To cite this article: Wolfgang Streeck & Lea Elsässer (2015): Monetary disunion: the domestic politics of euroland, Journal of European Public Policy, DOI: 10.1080/13501763.2015.1080287

To link to this article: http://dx.doi.org/10.1080/13501763.2015.1080287

Published online: 16 Sep 2015.

Journal of European Public Policy, 2015
http://dx.doi.org/10.1080/13501763.2015.1080287

Routledge
Taylor & Francis Group

Monetary disunion: the domestic politics of euroland

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ABSTRACT Regional disparities within the European Union have always been perceived as an impediment to monetary integration. Discussions on a joint currency were linked to compensatory payments in the form of regional policy. Structural assistance increased sharply at the end of the 1980s. Later, however, it had to be shared with the new member states in the East. Moreover, the low-interest credit that Southern European Monetary Union members enjoyed as a result of interest rate convergence is no longer available. We predict that considerable amounts of financial aid will have to be provided in the future by rich to poor member countries, if only to prevent a further increase in economic disparities. We also expect ongoing distributional conflict between payer and recipient countries far beyond current rescue packages. We illustrate the dimension of the conflict by comparing income gaps and relative population size between the centre and periphery in Europe and in two nation-states with high regional disparities, Germany and Italy.

KEY WORDS. European integration; European Monetary Union; Germany; Italy; regional disparities; regional policy.

1. INTRODUCTION

What will the internal politics of the European Monetary Union (EMU) – in short, of euroland – be like once post-2008 rescue operations have been declared successful (if they ever are)? Euroland is a unique construction: an association of sovereign states that have pooled their sovereignty on monetary and, increasingly, economic and fiscal policy in collective institutions such as an independent central bank, a supranational bureaucracy and a council of their heads of government. While euroland is not a state, and is not intended to become one, it may be described as an *international market regime*: a supranational governance arrangement – a polity – constituted by international treaties on a common 'internal market' with a common currency. This polity, like any other, has domestic politics, although these consist in large part of international relations and the foreign policies of constituent states. figuring prominently within them will be the economic disparities and the institutional heterogeneity between the latter, and the conflicts over economic sovereignty and economic distribution between euroland regions constituted as nation-states to which they give rise. This article will explore aspects of the interregional domestic conflicts as they are to be expected in a euroland polity of nation-states and international relations.

2. EMU, EU, EUROPE

We begin by taking exception with Angela Merkel's famous dictum: 'Scheitert der Euro, so scheitert Europa.'[1] Euroland is not Europe. Not even the European Union is Europe: after the experience of the crisis, Norway and Switzerland will be even less willing than before to join. Apart from the remaining Balkan countries, it is only Ukraine, Turkey, Armenia and Georgia that are hoping for admission. As far as the EMU is concerned, it is worth remembering that only 19 of the 28 European Union members belong to it in the first place. Denmark, Sweden and the United Kingdom (UK) – three European nations of considerable import – have reserved the right to remain outside,[2] and today it is less likely than ever that they will change their mind. Moreover, the crisis has caused the UK to demand a significant loosening of the European Union. Inside euroland, the division between the Western European centre and the Mediterranean periphery has deepened as a result of conflicts over austerity and has become *de facto* institutionalized in the Fiscal Pact and otherwise.[3] Whether the Eastern European countries that are already members of the European Union, like Hungary, and the Balkan countries waiting to be admitted will want to accede to the EMU as well – in other words, whether there will be an Eastern European EMU periphery in addition to the Southern one – will above all depend on the benefits they can expect. We will return to this.

Plans for European monetary union go back well into the 1960s (Issing 2010; James 2012). When the EMU was finally instituted in the 1990s, it was a project of European governments, in particular the government of France, who were tired of having to follow German monetary policy and hoped to achieve a more accommodating European monetary policy by Europeanizing the Bundesbank. Germany gave in – to relieve anxieties over unification in 1990 and after its government had convinced itself that with the right treaty language, its traditional hard currency policy could be made that of the European Union as a whole. In the South – not just in Italy but also in France – significant factions of the political establishment looked forward to using monetary union with Germany as a tool to discipline their national political economies, especially their trade unions. In the 1990s, nationalist modernizers became closely allied with neoliberal, globalization-oriented economists who in Italy were based in particular at the Banca d'Italia and at Bocconi University in Milan. At the same time, others hoped for cheap credit to allow for accelerated economic growth or politically profitable tax cuts, and some may have placed their hopes on increased financial support from the North. The divergent motives and expectations related to the EMU were never resolved and have continued to exist side by side up to the present day, where they underlie the often conflicting positions taken by different players on crisis management and institutional reform.

3. EMU, USA

Economically as well as institutionally, euroland is characterized by enormous internal heterogeneity. Regional disparities within euroland, in the form of national disparities between member states, far exceed regional disparities among the federal subunits of a country as diverse as the United States (US). The range of per capita income between the poorest and the richest states of the US has always been much smaller than the range between the poorest and the richest member states of the EMU.[4] Gross domestic product (GDP) per capita in Connecticut, the richest state, is roughly twice as high as in the poorest state, Mississippi – a pattern that has been fairly stable since the 1990s. In euroland, in contrast, Germany's GDP per capita in 1995 was eight times higher than Slovakia's, by far the poorest country at the time.[5] Excluding Slovakia, per capita income in Germany was three times that in the second-lowest country, Slovenia. In 2012, while Slovakia has almost caught up with the other poor countries, per capita income in the richest EMU country, Belgium at the time, was 2.8 times as high as in the poorest (2012).

The same picture results if we look at more comprehensive measures of income variation. Throughout the last two decades, the coefficient of variation in per capita income between euroland countries was consistently higher than between US federal states.[6] While the regional income spread in the US has been roughly constant since the early 1990s, with the coefficient of variation fluctuating between 0.156 and 0.160, national incomes in euroland began to converge in the mid-1990s. Still, even excluding Slovakia, variation has remained considerably above the United States, declining from 0.286 in 2000 to 0.252 in 2008, to rebound to 0.278 after the crisis (2012). Note that in the wake of the financial crisis, income inequality has risen between euroland countries[7] but not between US states. As there is no fiscal union under EMU, there are no automatic fiscal stabilizers in euroland, unlike within its member states. Automatic stabilizers, as built into taxation, pension and unemployment insurance systems, help countries equalize the regional effects of economic shocks by transferring resources to regions most hit by an economic downturn 'without the explicit intervention of a country's fiscal authority' (in 't Veld *et al.* 2012: 1).

The extent of regional disparities in the United States and euroland is perhaps best pictured by box plots representing the distribution of per capita incomes among territorial subunits (Figure 1). The boxes' lower boundaries mark the 25th, the upper boundaries the 75th percentile; the thin lines above and below the boxes indicate the range of the distribution. The smaller the box, the more compressed are the central 50 per cent of the cases around the median, which is represented by the line inside the box. We use standardized values to enable comparison between data in different currencies. The figure visualizes the true extent of the variation in regional per capita income as well as the dramatic difference in regional diversity between the US and euroland.

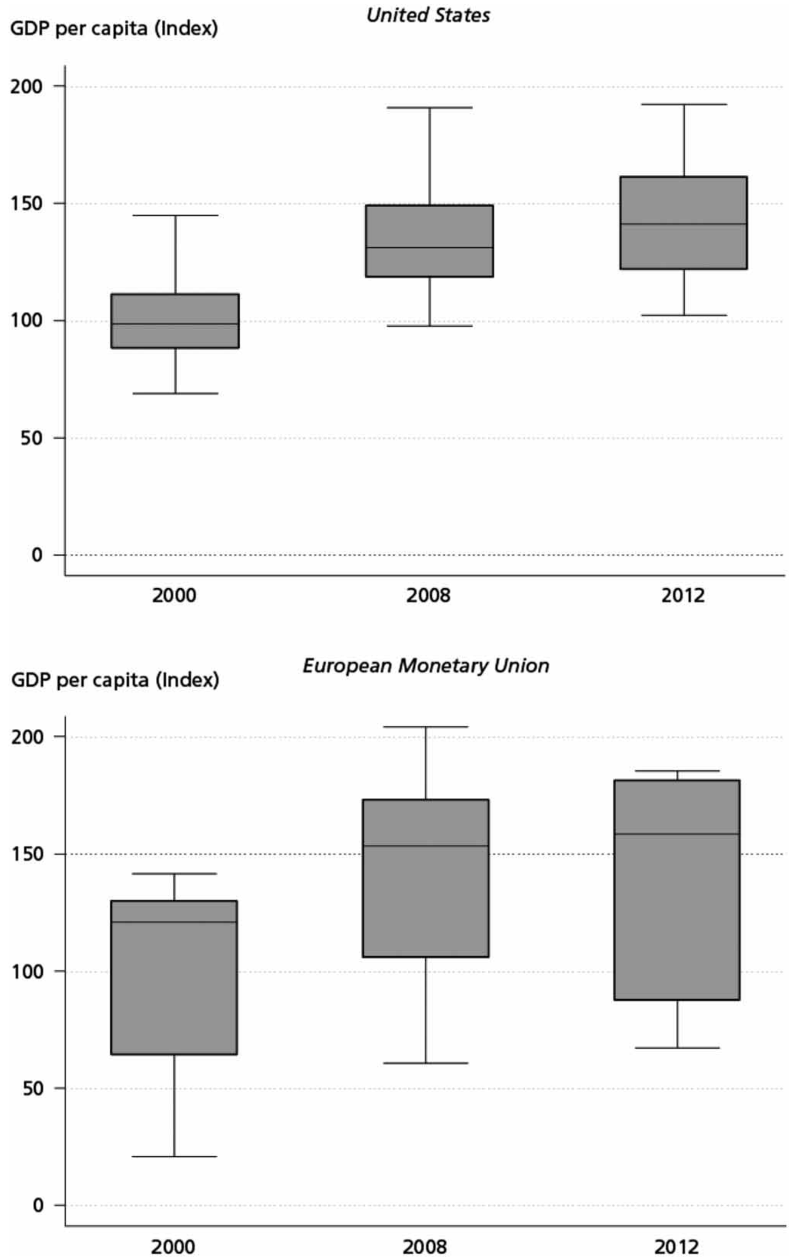

Figure 1 Variation in average per capita income, US federal states and EMU member states, 2000, 2008, 2012
Notes: Average per capita income in 2000 = 100.
Excluding states with less than one million inhabitants.
Sources: Eurostat; Bureau of Economic Analysis; United States Census Bureau.

It also shows the highly skewed nature of the euroland distribution – skewed toward the bottom – as compared to the relatively continuous distribution in the United States.

4. THE POLITICAL ECONOMY OF EUROLAND

Among the leaders of today's pro-euro coalition are the export industries of surplus countries, in particular Germany. Allied with them are the trade unions that organize their workers, who share the interest of their employers in assured access to a large 'internal market' where they can sell their products at prices undistorted by the politics of national exchange rates. Exporters in Northern surplus countries also appreciate that, because of the participation of the Mediterranean deficit countries, the external value of the common currency is lower than a Northern European or German currency would be. Furthermore, there is a long-standing alliance of liberal economists and European technocrats who, for partially different reasons, want to make money exogenous to national politics, so as to make national political interference with European 'market forces' impossible. In the Mediterranean countries, monetary union can also count on the support of large segments of a growing urban middle class to whom a devaluation of their national currency would mean higher prices for imported consumer goods, such as German luxury cars or kitchens. Moreover, high income earners obviously like the freedom of capital movement that comes with monetary union, as it allows them to take their money abroad whenever they want.

In an important sense, monetary union amounts to a return to an international gold standard. Conceived as the crowning completion of the internal market of 1992, the EMU eliminates national political discretion from the international political economy of the euroland part of Europe. While monetary union offers a robust solution to some of the co-ordination problems of an increasingly internationalizing capitalist economy, it eliminates devaluation as a last resort for member countries lagging in 'competitiveness' – i.e., producing at higher unit labour costs than other member countries. A common currency makes it impossible for countries with higher unit labour costs to mask their low competitiveness by cutting the value of the currency in which foreign customers pay for their products, thereby lowering their prices without having to lower the wages and entitlements of their citizens. Having lost the option of manipulating their unit of account, they have just two ways left out of low and potentially declining incomes and high and potentially growing unemployment: they may either lower the costs or upgrade the value of their products – bring down their prices in line with their international market value or raise their international market value in line with their national prices. The former replaces external devaluation with what has come to be called 'internal devaluation', raising productivity by cutting wages, pensions and public expenditure – euphemistically referred to as 'structural reforms' – in order to lower costs. The latter would raise productivity by upgrading production factors and products, relying on regional industrial policy paid for, ideally, by external financial aid and development assistance, to justify the high prices needed to pay for high costs. Both paths promise convergence in economic performance under the common currency and may, in principle, be combined.

Euroland, as we have pointed out, is highly heterogeneous economically, even in comparison with the United States. This fact was not unknown to the EMU's founders. They expected, however, that free access of weaker national economies to the European internal market and enhanced confidence of investors in monetary and political stability would result in these economies catching up through higher long-term growth, with time and, perhaps, a little help from their friends. Others recognized early on that there were also structural issues. For example, the Canadian economist Robert Mundell, the leading authority on the subject, was aware that euroland was far from an 'optimum' currency area, as lack of labour mobility across national borders and pronounced differences in the structural composition of national economies were likely to make the EMU highly vulnerable to 'asymmetric shocks.' In the end, however, he opted for monetary union as it would make it impossible for national governments to avoid liberal reforms by temporarily restoring competitiveness through devaluation (Mundell 1973). For those who followed in his footsteps, including the neoliberal hardliners at the Bundesbank who finally fell in line with the Kohl government, monetary union as instituted by the Treaty was justified insofar as it was a giant European convergence programme under which the Mediterranean countries would learn – and indeed would have to learn – to reform their institutions, in particular their labour markets, in line with the requirements of life under a hard currency regime like the German one.[8] Behind this was a general confidence in the salutary educational effects of unbridled competition, and in economic rationality of the German kind ultimately carrying the day even in countries like Italy or Greece.[9]

Less optimistic on convergence is a strand of literature more or less in the 'varieties of capitalism' tradition (Streeck 2011), which emphasizes the stickiness and inertia of existing national economic institutions, of established political power structures and conflict lines, and of habituated political–economic practices. The tenor here is that national economies that are as different from one another as in Europe, and are likely to remain so for a long time, cannot be equally viable under a common, one-size-fits-all monetary regime. Some – in particular countries of the German type, with the Netherlands, Austria and Finland mentioned most often in addition to Germany – will prosper while others, especially the Mediterranean countries, will suffer (Hall 2012). Different national economies need different national monetary regimes that fit their different institutional and economic endowments. Analytical concepts used to make the case vary: Baccaro and Benassi, for example, in an unpublished paper, speak of profit-led and demand-led economies; others distinguish export-led and domestic demand-led growth (Johnston and Regan 2014) or export-savings and consumption-credit regimes (Mertens 2013).[10] Related arguments have been made by economists for some time, among them

Martin Feldstein (2011) and Charles Blankart (2013).[11] While they all expect European Monetary Union either to break apart or cause highly divisive conflicts among member states, some see Germany rising to quasi-imperial dominance in Europe at the expense of the weaker economies of the South, while others expect Germany to be blackmailed by a majority of EMU members into subsidizing underperforming Mediterranean economies and ways of life.[12]

However that may be, hopes for convergence among EMU member countries have not materialized, and initial catch-up growth in the early 2000s is now seen as largely artificial, caused by speculative investment made possible by fundamentally unjustified access to cheap credit.[13] That growth ended in 2008 when what is now seen as irresponsible lending ended, laying bare deep-rooted differences in 'competitiveness'. To the extent that lagging competitiveness in peripheral countries is explained by their institutions, the common denominator of the literature is that EMU countries have different proclivities to inflation, some needing higher inflation than others to reach a socially acceptable level of employment and growth. Everything else being equal, being unable to adjust their exchange rates, lagging countries may have to live with a steady decline in competitiveness as their inflation rates continue to be above those of other countries under the same (hard) currency regime. How far apart EMU member countries are today with respect to their competitiveness is indicated by a calculation of what would be the 'fair value' exchange rate of their national currencies if they had one. While in 2013 the fair value of the euro compared to the dollar was, at 1.33, slightly lower than the actual exchange rate (1.36), for Germany the euro was undervalued by more than 13 per cent, whereas for Italy and Greece it was overvalued by 12 and 24 per cent respectively (Table 1).[14]

Differences in economic performance between the territorial subunits of a common polity, national or international, inevitably elicit a political response. While national governments may neglect the plight of poor regions at their political peril, such neglect is hardly possible in a union of sovereign states whose poorer members have, at least in principle, the option of secession.[15] Moreover,

Table 1 "Fair value" of the euro in US dollars for the eurozone and six national economies of EMU member states; actual exchange rate of euro for US dollar

	Fair value	Over-/under-valuation (percent)	Actual rate
Germany	1.53	−13.2	
Eurozone	1.33	−2.3	1.36
Spain	1.26	5.4	
Portugal	1.24	7.3	
France	1.23	7.8	
Italy	1.19	12.1	
Greece	1.07	24.4	

Source: Morgan Stanley (2013).

if economically weaker member countries are democracies, impoverishment resulting from low competitiveness may destabilize them politically. Just as regional disparities inside nation-states produce political pressures for some sort of inter-regional redistribution, national disparities in the polity of an international currency union will raise the issue of international redistribution. In both cases, there is likely to be resistance from those having to foot the bill, who will insist on transfers being kept as low as possible and conceived strictly as measures to enable recipients to become self-sufficient – with subsidies used for investment rather than consumption.[16] Transfers in favour of lagging territorial units, whether in a country or in an international monetary union, are therefore typically designated as aid for economic development supplied to enable recipients ultimately to stand on their own feet.

How economically effective such assistance can be – and how to prevent its diversion from investment to consumption – is a much debated question, especially at the international level, where donor countries may also want to keep co-operative governments in office and stabilize existing regimes and their state machineries. Mainstream economics tends to oppose any regional assistance that involves financial transfers, claiming that it is only through 'painful reforms' that low competitiveness can be cured. But while a position like this may perhaps be politically sustainable in a nation-state with a strong central government, such as Britain, it may break up an international currency union – not just because there are few if any examples of a neoliberal *Rosskur* working (Blyth 2013), but because imposing it from the outside on a national society would require a degree of international intervention in a country's internal affairs that its citizens may be unwilling to tolerate. This is why the prohibition on international compensation payments in the Maastricht Treaty is no more than *pro forma*: with significant performance differences between countries joined in a monetary union, there is no way around some sort of inter-country redistribution; the question is only in what form.

5. THE POLITICAL ECONOMY OF EUROPEAN REGIONAL POLICY

Financial assistance for Western Europe's Mediterranean fringe has a long history, documenting that European governments never had much confidence in spontaneous economic convergence. In the 1950s and 1960s, the six-country European Economic Community already provided regional assistance to Italy to help it manage the tensions between the rich North and the poor *mezzogiorno* (Ginsborg 1990: 160, *passim*; Irving 1976). Regional and social assistance programmes were greatly expanded after the transition to democracy of Portugal, Spain and Greece in the 1970s, and in particular upon the three countries' accession to what was to become the European Union. Designed to stabilize their Mediterranean *glacis* politically as well as economically, their objective was to prevent a return of fascism and military dictatorship and to avert the area turning Eurocommunist (Pons 2010; Webb 1979). In particular, membership of the European Union and the North Atlantic Treaty Organization (NATO) was to make it possible for the newly democratized Mediterranean countries to move onto a social-democratic development path and help them avoid the political risks associated with confronting semi-feudal local and regional power structures with their historical legacies of clientelism and corruption.

European regional policy was frequently reorganized, as were the institutions that govern it. Landmark reforms took place in 1988, leading to, among other things, a doubling of the so-called 'structural funds' by 1993 (George and Bache 2001). Today, structural funds amount to roughly one-third of the budget of the European Union, equivalent to 0.3 to 0.35 per cent of the combined GDP of European Union countries (2007–12). Whether this has contributed to economic growth in recipient countries andif so to what extent is examined by a vast body of literature ranging from case studies to econometric analyses and macroeconomic simulations (for two overviews, see Bachtler and Gorzelak [2007] and Ederveen *et al.* [2003]). The results are, unfortunately, inconclusive.[17] Arguably, however, this does not speak against the *political* effectiveness of regional policy, to the extent that one of its purposes was and is to keep democratic governments and the pro-European social coalitions supporting them happy and in power.

As far as monetary union is concerned, it was always clear, and in fact was already a subject in the earliest discussions on a joint currency, that the elimination of devaluation would have to be accompanied by substantial compensation payments in the form of regional and structural aid to less competitive participating states. During the negotiations on the Regional Development Fund in 1975, one main argument of the European Commission in favour of regional policies was that a future monetary union would not work without regional assistance programmes (Bache 2006). The problem, as seen at the time, is clearly exposed in the 'Report on the Regional Problems of the Enlarged Community' of 1973, better known as the 'Thomson Report,' which is worth quoting at some length:

> It is clear that rapid progress towards Economic and Monetary Union would be arrested if national economies had not undergone the transformations needed to avoid excessive divergences between the economies of Member States. The reduction, by appropriate means, of regional imbalances is therefore a factor for accelerating those economic changes upon which the strength of Economic and Monetary Union will depend when it comes to abandoning recourse to parity changes as a way of restoring a fundamental balance. No Member State can be expected to support the economic and monetary disciplines of Economic and Monetary Union without Community solidarity involved in the effective use of such instruments; equally Member States must be prepared to accept the disciplines of Economic and Monetary Union as a condition of this Community support. (Commission of the European Communities 1973: 6–7)

By the final decade of the twentieth century, however, European Union assistance to the future EMU member countries in the Mediterranean had to be shared with a set of newly democratized client states in the East, at a time when Western European countries were making first efforts to consolidate their public finances. Whereas at the beginning of the 2000s almost 60 per cent of the structural funds were devoted to the Southern European countries, today their share has shrunk to only 30 per cent while that of Eastern European countries grew bigger and bigger (Figure 2)[18] Since 2009, payments to the East of Europe have exceeded support for the South. Luckily, as mentioned above, accession to the EMU had the welcome side effect for Mediterranean countries of significantly easing their access to credit. For the European Union, this meant that it could freeze its assistance to the Mediterranean, and in fact slowly reduce it, at a time when it had to find ways to finance its transfers to the new democracies in the East.

The combined effect of EMU and the diversion of EU regional assistance to the Union's Eastern members is particularly visible in the Greek case (Figure 3). Even before EMU, the interest rate the Greek state had to pay on new long-term debt declined from 17 to 6 per cent within five years, to reach a low of 4 per cent in the mid-2000s. Simultaneously European Union structural assistance fell from 4 to 2 per cent of GDP. In compensation, the government deficit, brought down, in preparation of EMU accession, from 9 to 3 per cent in 1999, exploded to reach almost 16 per cent 10 years later. In spite of this, owing to the low interest rates made possible by EMU, the share of debt

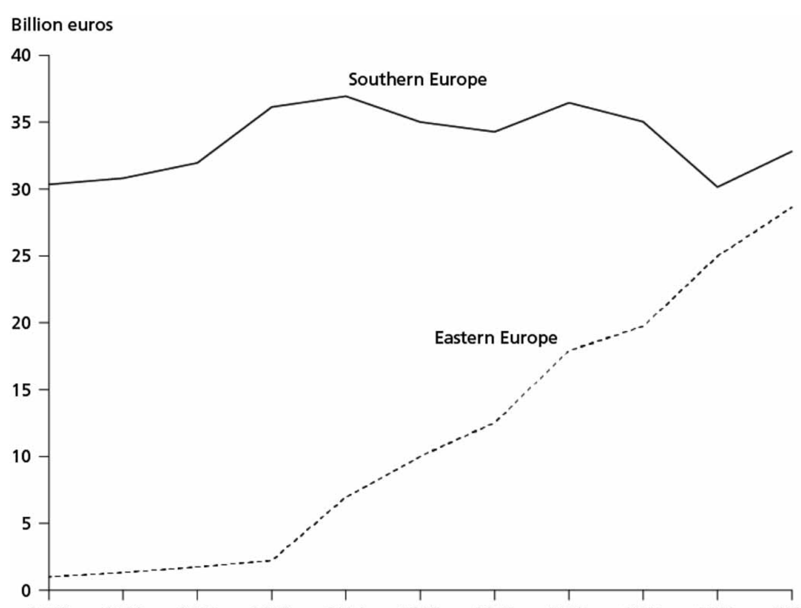

Figure 2 European Union gross transfers to Southern and Eastern Europe (2000–10)
Source: EU Budget 2010 Financial Report (European Commission 2011).

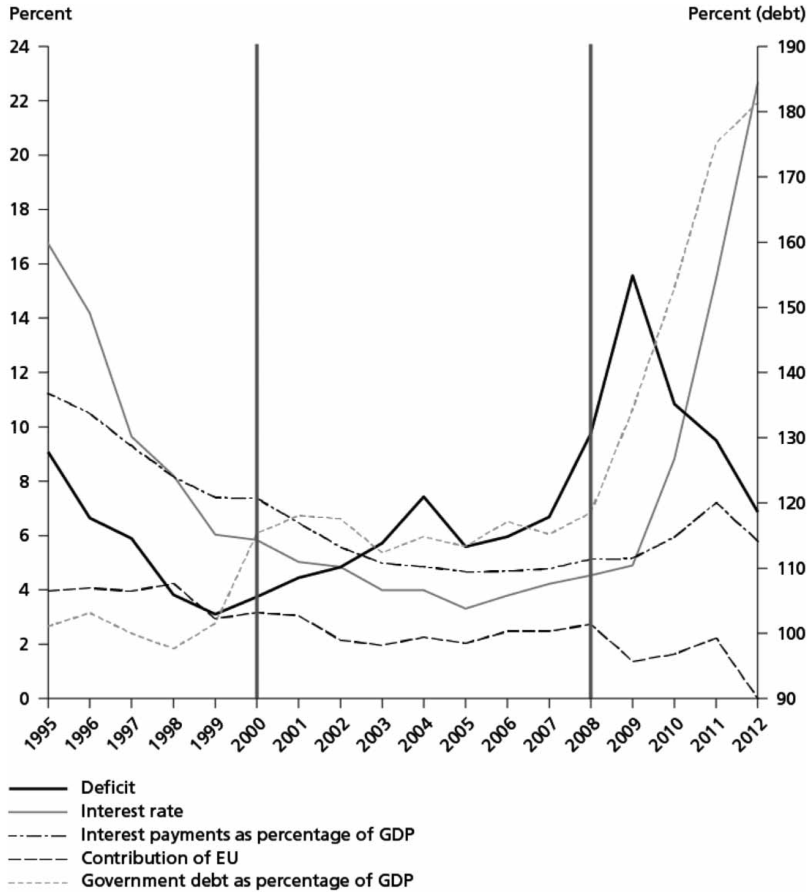

Figure 3 Greece: monetary union and public finance
Sources: European Commission: EU Budget Financial Reports (http://ec.europa.eu/budget/biblio/documents/2010/2010_en.cfm); Organization for Economic Co-operation and Development National Accounts Statistics (http://www.oecd-ilibrary.org/economics/data/oecd-national-accounts-statistics_na-data-en); Organization for Economic Co-operation and Development Economic Outlook Database (http://www.oecd-ilibrary.org/economics/data/oecd-economic-outlook-statistics-and-projections_eo-data-en).

service in public spending remained almost unchanged until after the crisis while total public debt rapidly accumulated.

Today, the replacement of international fiscal transfers by international private credit – much in parallel by the way to the 'privatization of Keynesianism' in the domestic political economies of the 1990s (Crouch 2009, 2011) – has collapsed, and with it the deceptive economic progress in Mediterranean countries. One way of reinstating credit would be mutualization of the accumulated public debt of deficit countries, together with a guarantee by the rich countries of the North of repayment in the case of default. Even though Northern governments have effective means to hide commitments of this sort from their voters, however, it is far from certain that they would in the end succeed. A return to direct fiscal assistance, as before 1999, is not unproblematic either, given that the number of countries that will be claiming support is now much higher as it includes the Balkan states still waiting for admission to both the EU and the EMU. Moreover, member states at the centre of EMU have, more than ever, come under fiscal pressure themselves – by the global financial industry demanding consolidation of their public finances, as well as by the very tax competition they have in the past considered a central pillar of the European 'internal market'.[19]

Still, assessing the likely lines of conflict and issues of contention within EMU as a multi-state polity, it seems reasonable to assume that the current rescue operations in response to the debt crisis will not be the end of international financial assistance. Ongoing debates on a 'European Marshall Plan' or a 'European growth package' make a continuation of financial support into the foreseeable future seem likely, in whatever form and under whatever name. This holds true even if it was in fact possible to improve the competitiveness of peripheral countries in the neoliberal way: by cutting them off from financial assistance and leaving them with harsh structural reforms as their only remaining option. The risk of governments being voted out of office and EMU, or even EU, breaking apart as a result of popular discontent in its periphery would probably seem politically unacceptable. As long as member state governments in the South, and later in the East as well, need to be democratically elected, they will therefore be in a position to extract some sort of financial aid, to enable them to build up a competitive infrastructure; prolong and thereby ease the internal devaluation process; buy political support to prevent the rise to power of an 'anti-European' opposition party; or all of the above.

In the following section, we will explore the international configuration and the political–economic requirements, possibilities and limits of regional assistance policy inside the EMU, whether to improve the indigenous potential for growth, support structural reform by buffering its economic and social costs, or stabilize pro-European national politics. To do this, we will look first at the structure of distributional conflict in EMU as a whole and then compare it with two member countries with high regional disparities, Italy and Germany, where in the latter country regional inequality is associated with another monetary union, that with the former German Democratic Republic (GDR) in the course of German unification in 1990.

6. GIVERS AND TAKERS: DISTRIBUTIONAL CONFLICT IN EUROLAND

Of the 18 states that are now in the EMU, five are economically weak and will remain so for the foreseeable future, while six others are mini-states with populations of less than two million. *Only five countries have relatively strong economies and more than five million citizens,* with three of them – Germany, France and the Netherlands – accounting for a population of 162 million out of a total of 175 in this group. In other words, the EMU's economically and politically relevant centre consists of only three countries, while its Southern periphery consists of six[20] and its potential South-eastern periphery of no less than 10: Bulgaria; Croatia; Hungary; Rumania; and later, after their accession to the European Union, Albania; Bosnia and Herzegovina; Kosovo; Macedonia; Montenegro; and Serbia.

Treating euroland as an integrated international polity, a central issue of its domestic politics will be the nature and extent of the regional policies to be put in place in order to promote cohesion and convergence in economic competitiveness. In a stylized account, two goods will be traded between the centre and the periphery of the Union: *financial support* given by the former to the latter; and *political control* conceded in return by the latter to the former. This is because financial support will not be given unconditionally, not even if it is sold as an expression of 'European solidarity'. Typically, giver countries will conceive transfers as assistance to becoming self-sufficient, at least for public presentation. While they will be keen on not paying more than necessary, whatever that may be, they will also insist that the money is used for investment rather than consumption, to the greatest possible extent, with the declared purpose of receiving countries becoming self-sufficient. These, for their part, will want to maximize what they receive and use part or all of it for consumption, if only to keep political discontent manageable. At the same time, they will strive to minimize the extent to which they have to concede control over domestic policies to giver countries, while these will demand that control over the use of transferred funds be international rather than domestic (Table 2).

How the EMU member states will divide into a ruling centre and a ruled periphery, and at what economic cost for the former and political price for the latter, will have important consequences for democracy on both sides. External political control will constrain national democracy in receiving countries, while the need to hide the true amount of transfers from an electorate that is itself facing fiscal austerity may do the same in giving countries. The terms of the exchange will also affect the attractiveness of the EMU to potential members.

Table 2 Centre vs periphery: preferences on financial support and political control

	Financial support	Political control
Centre	Minimize amount Maximize investment	Maximize international control
Periphery	Maximize amount Allow for consumption	Defend national control

If transfers are extensive and international control over their use limited, rich countries like Denmark or Sweden may continue to remain outside while the poor countries of the European Southeast may have a strong incentive to join. *Vice versa*, if financial benefits are low owing to fiscal constraints or political discontent in the centre, and international political interference is strong, rich countries may be prepared to join while poor countries may prefer to stay out and become ‘anti-European’, or join only in order to change the terms of the settlement in alliance with the other poor countries. In the latter case, conflict inside the EMU would further intensify.

To get a sense of the problem load for a future EMU regional policy, we can compare income gaps and relative population sizes for different divisions between the European centre and its Mediterranean periphery (Table 3). Taking Germany, France, and the Netherlands to be the centre, different peripheries would be associated with different degrees of regional disparity. For example, Italy had a population in 2012 that amounted to 37 per cent of the population of the three centre countries, while its per capita income was 21 per cent below the weighted per capita income of the latter. All four Mediterranean countries taken together were more than twice as big as Italy in relation to the centre, while their income gap amounted to 29 per cent.

What does this imply for the regional policy effort required to alleviate EMU regional disparities or at least contain political discontent in poor countries? Note that neither the financial transfers of the 1990s nor the ample infusions of cheap credit after 2000 were sufficient in 2008 to prevent the collapse of regional competitiveness under the impact of fixed exchange rates. If this means that financial assistance would have to be significantly stocked up to effectively promote convergence – also in view of the current credit crunch – prospects must appear bleak. Not only will countries at the centre be unable or unwilling to pay for more than a symbolic increase in European Union regional funds for the Mediterranean, but an ever larger share of the available financial resources for regional policy will have to be devoted to Eastern

Table 3 EMU: Population size and income gap (2012)

	Population	Percentage D, F, NL	Income	Income gap
Italy	60.8	37.1	25,700	20.5
Spain	46.8	28.6	22,300	31.0
Greece	11.1	6.8	17,200	46.8
Portugal	10.5	6.4	15,600	51.7
I, ESP, GR, P	129.2	78.9	22,917	29.1
ESP, GR, P	68.4	41.8	20,444	36.8
D, F, NL	163.8	100.0	32,328	

Notes: I = Italy; ESP = Spain; GR = Greece; P = Portugal; D = Germany; F = France; NL = Netherlands.

Europe. This goes a long way towards explaining why Western European countries and the European Union place their hope for economic growth and EMU cohesion so desperately on neoliberal reform, even in the absence of any positive example.[21]

7. FOR COMPARISON: GERMANY AND ITALY

To learn more about the prospects of an EMU regional policy, we may look at the experiences of two member countries with high regional disparities, Italy and Germany. Both regard regional policy as essential for national cohesion. In 1990, West Germany entered into a much debated monetary union with an entirely uncompetitive East Germany, while Italy tried hard throughout the twentieth century to close the economic gap between its rich north and poor south. Although in both countries, considerable resources were transferred in a long-drawn effort to equalize living standards, regional inequalities are far from resolved. As a crude indicator of the two countries' current regional problems one may take the sum of the relative size of the population in peripheral areas and the difference in per capita income (Table 4). It turns out that Italy, with a figure of 94 (53 plus 41), is far worse off than Germany, where the sum of the two percentages is 52 (25 plus 27). We have applied the same measure to different centre–periphery constellations inside the EMU, finding the German problem load to be comparable to a situation where the periphery in relation to the three countries of the centre is constituted by either Spain or Greece. A problem load similar to the Italian one is reached when the periphery consists of Spain, Greece and Portugal, or of all four Mediterranean countries including Italy.

Going back to Germany and Italy, we can now tentatively explore the relationship between problem loads, fiscal transfers, and the success of regional policy over time. In Italy, transfers were as high as 5 per cent of GDP in a period when, after the end of post-war growth, the national income gap began to increase for more than two decades. Recently the North–South income gap

Table 4 Centre–periphery problem load: Germany, Italy and EMU

Centre	Periphery	Problem load
Northern Italy	Southern Italy	94
West Germany	East Germany	52
D, F, NL	Greece	54
D, F, NL	Spain	60
D, F, NL	ESP, GR, P	79
D, F, NL	I, ESP, GR, P	108

Notes: I = Italy; ESP = Spain; GR = Greece; P = Portugal; D = Germany; F = France; NL = Netherlands.

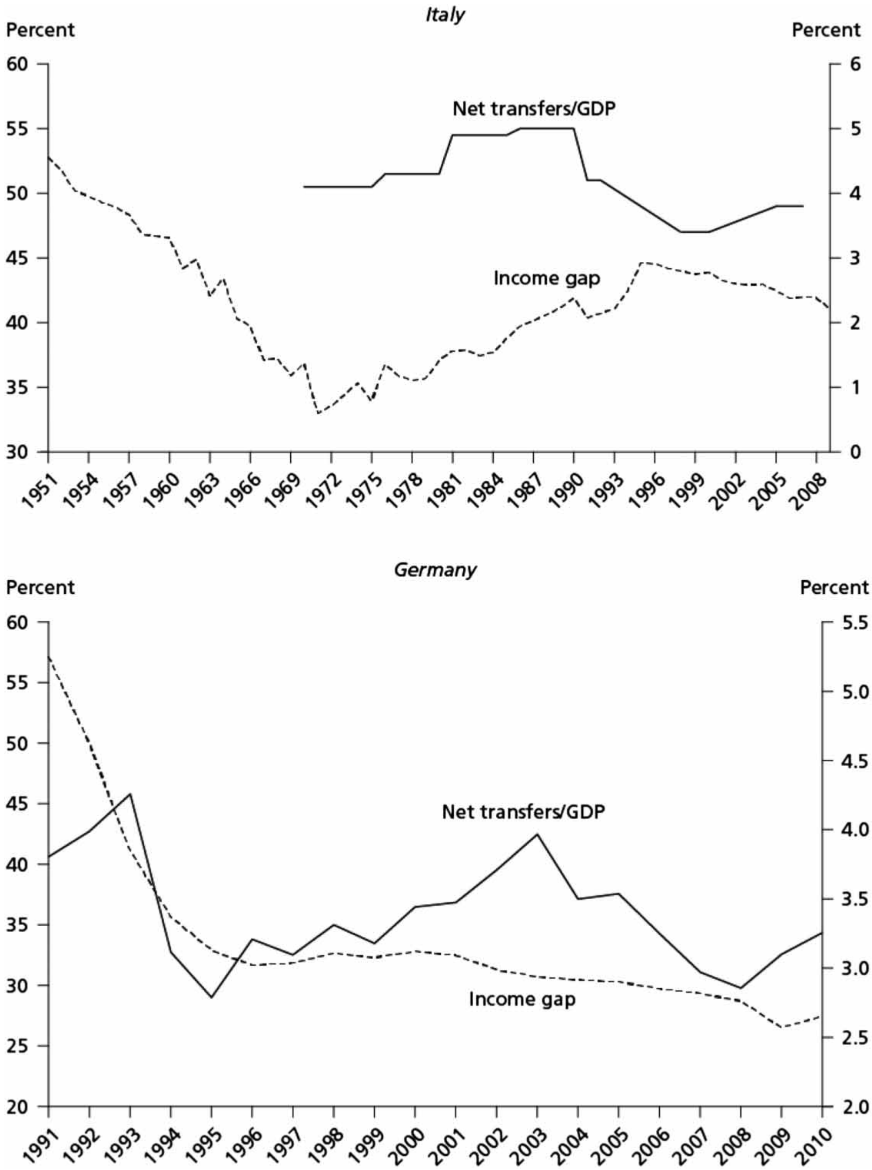

Figure 4 Regional policy in Italy and Germany: income gaps and fiscal transfers
Notes: Net transfers to Mezzogiorno as percentage of gross domestic product and per capita income gap (1951–2009).
Net transfers to East Germany as percentage of gross domestic product and per capita income gap (1991–2010).
Sources: Italy: Daniele and Malanima (2007); Instituto nazionale di statistica (Istat), www.istat.it/en.
Germany: Arbeitskreis VGR der Länder: Bruttowertschöpfung in den Ländern und Ost-West-Grossraumregionen Deutschlands 1991 bis 2010, Reihe 1, Band 1 (http://www.vgrdl.de, accessed 18 June 2012); Kloß *et al*. 2012.

seems to have declined and is now probably where it was in the early 1960s (Figure 4).[22] In Germany, where the peripheral population is proportionally far smaller than in Italy (25 per cent as compared to 53 per cent), transfers amounted to between 3 and 4 per cent of GDP since the mid-1990s, which in effect was almost one-and-a-half times as much as in Italy.[23] *Still, the income gap has declined only very gradually since the mid-1990s.*

Why has regional policy in the two countries affected so little? Clearly, Italy suffers from a demography that is more unfavourable than Germany's, making transfers of a given percentage of GDP both more expensive for the paying regions and less substantial for the receiving regions. Another explanation points to the social structure of the *mezzogiorno* and the politics of the Italian south, causing economic aid to be appropriated by corrupt local power élites and criminal enterprises, or converted into an instrument of vote-buying by governing parties in the region or nationally. This has contributed to making help for the *mezzogiorno* highly unpopular with voters in the North, and every new example of bribery and corruption reinforces resistance to further transfers. In fact, for almost two decades now, a separatist political party, the Lega Nord, has commanded a majority in several northern Italian regions.

Comparing this to Germany, one may note that in Eastern Germany after unification, the entire ruling class of the former German Democratic Republic was replaced with political leaders, civil servants and businesspeople imported from the West, together with the full package of West German institutions. Corruption and vote-buying were almost non-existent, certainly in comparison with the *mezzogiorno*, and issues of governance were resolved by putting in place an entirely new political establishment and fundamentally reconstructed administrative machinery. Still, differences in living standards between East and West Germany diminished only slowly if at all, *even though transfers were effectively higher than in Italy*. In fact, it is widely understood that present levels of regional support will have to be maintained when the current regional policy program for Eastern Germany runs out (Kloß *et al.* 2012).[24] If transfers were significantly curtailed, regional disparities can be expected to increase again – implying that most of what financial aid has achieved up to now, after a quarter of a century of *Aufbau Ost,* was to prevent the income gap from widening further.

8. REGIONAL REDISTRIBUTION IN AN INTERNATIONAL POLITY

For the EMU this does not bode well. Even if some of the Mediterranean countries were soon able to stand on their own feet, the minimum effort required from the three countries forming the centre of the EMU to avoid a further increase in international disparities is likely to be equivalent to the German effort for East Germany. Roughly speaking, this would require increasing the budget of the European Union at the minimum by 300 per cent, from about 1 to 4 per cent of European Union GDP, at a time when member states are facing strong pressures for fiscal austerity.[25] This does not take into account problems of governance, which will be considerable between sovereign countries. Unlike East Germany, but very much like Southern Italy, it will be out of the question to replace the old local élites with representatives of the centre.[26] Political deals will be inevitable and they will resemble Italian more than German politics. Perhaps most importantly, while in Germany and Italy there is still a (sometimes surprisingly strong) sense of national identity and obligation, this is clearly missing, or in any case is much weaker, between, say, the Netherlands and Portugal. It seems unlikely that such a sense can be developed on short notice for the purposes of stabilizing the EMU.

Would a supranational European federal state, governed by a democratically elected parliament, be better able than the European Union in its present shape to mobilize financial solidarity between the rich and poor regions of euroland? Would political union on top of monetary union be the solution to the problem of regional disparities, as suggested among others by Jürgen Habermas (2013)? The experience of regionally diverse European nation-states speaks against this. Italy, with its strong opposition in the North to further transfers to the *mezzogiorno* and the difficulties faced by the German federal government as it gets ready to prolong the *Aufbau Ost*, are not the only examples – see Scottish, Catalan and Flemish 'nationalist' separatism. Indeed, everywhere in Europe, under the impact of slow economic growth, richer regions increasingly resist subsidizing poorer regions as public opinion grows ever more sceptical about the capacity of regional policy to make itself expendable. Even in a culturally and institutionally comparatively homogeneous country like Germany, the long-standing institution of *Länderfinanzausgleich* – the constitutional obligation of richer *Länder* to share some of their tax revenue with the poorer ones, to provide for *Einheitlichkeit der Lebensbedingungen* in all parts of the Federal Republic[27] – is currently being challenged in the Constitutional Court by the richest Land, Bavaria. Can one expect transfers instituted by a European parliament between nation-states to be more popular with voters than transfers between regions instituted by national parliaments inside nation-states?

What exacerbates the problem in the European case is that, as we have seen, it is only three countries – Germany, France and the Netherlands – that are both rich and big enough to matter as providers of regional assistance to the Mediterranean and, later, Eastern peripheries. In a European parliament, they would have to face the possibility of the other countries using their numerical majority to raise the fiscal contributions they have to make to the union. This applies in particular to Germany – which will for an indefinite future have to attend to its own regional disparities – as France is not just economically weaker but has always reserved the choice of defining itself as a Mediterranean country if this fits its interests. This will make it impossible for Germany to agree to political union without extensive constitutional safeguards against being made the only major payer for the cohesion of the EMU and of Europe as a whole.

Can distributional conflict inside euroland be mitigated in the way of the past, by high economic growth allowing for redistribution without detracting from the prosperity of the rich? While it is true that a rising tide lifts all boats, it seems improbable that such a tide will arrive in any foreseeable future. For two decades, growth rates in the centre of the European state system have fallen. Restoring them to the level of the late 1980s – not to mention the 1960s – would require a secular turnaround that and can say how it could come about. If there is to be growth in the periphery, it will clearly not come from a 'Marshall Plan' paid for by a prosperous hegemonic centre.[28] The main support for the periphery that the centre will be able to afford will consist of recipes for neoliberal reform that cost nothing to those providing them. However, whether the bitter medicine of neoliberalism will work is uncertain, not to mention whether the patients will be ready to take it.

9. THE EMERGING DOMESTIC POLITICS OF EUROLAND

What are the prospects for the European state system if, as is likely, its élites insist on defending the euro? Everything points to a long-drawn crisis, lasting for many years after the crisis-related emergencies will have been declared to be over. Political life in integrated Europe will be highly uncomfortable, both within and between member countries. International distributional conflict will be rampant, between a periphery of countries deprived of the capacity to devalue their currencies to improve their 'competitiveness,' and a centre suffering from over-extension, especially once the Balkan states will have been admitted to the European Union and the EMU. Financial support as can be made available to the periphery will not be nearly enough to help them keep up with the centre, to say nothing of equalizing living conditions across Europe. In the most likely case, it will serve to keep in power 'pro-European' coalitions that may, however, need to secure electoral support by means of anti-Northern rhetoric, making them seem, in Northern eyes, to be biting the hands that feed them.

The domestic politics of euroland will likely be dominated by an ongoing and potentially ugly tug-of-war over entitlements and obligations to international financial solidarity. While the centre will urge the periphery to implement 'structural reforms', so as to become self-sufficient, it will still have to provide financial subsidies of various kinds in order to insure against political instability. Discontent with the European construction, unless calmed by renewed economic growth, will require effective suspension of democracy in both the centre and the periphery – in the latter by institutionalized curtailment of national sovereignty, like under the Fiscal Compact, combined with political and economic intimidation of electorates; and in the former by a cartel of silence organized by the political class to hide the true costs of keeping euroland together (costs which in effect amount to subsidies for national export industries). Government, renamed 'governance', will migrate to institutions insulated from political and electoral accountability, like the European Commission and, in particular, the European Central Bank (Mair 2013). Their advantage is that they are better placed than national governments to *rule by stealth* – for example, by surreptitiously extending credit to states that have lost access to capital markets, keeping the economy going by injecting into it potentially unlimited amounts of synthetic money, underwriting or mutualizing the bad debt of under-regulated national banking systems, and insuring financial investors against governments defaulting on their loans. One may doubt whether this will make for economic stability or, for that matter, for the 'ever closer union among the peoples of Europe' proclaimed by the Treaties.[29]

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NOTES

1 'If the euro fails, Europe fails.' Angela Merkel in the Bundestag, 19 May 2010.
2 The UK and Denmark are formally exempted from having to join, while Sweden is informally allowed to keep its own currency owing to expected popular opposition.
3 Under the various agreements on debt reduction negotiated during the crisis, debtor countries will for decades have to have their budgets approved by the European Commission, which will in effect be acting on behalf of the rich center states in the North. See, for example, Scharpf (2013) on the so-called 'Excessive Imbalances Procedure' and similar control instruments.
4 Federal states and member states respectively with less than or around one million inhabitants are excluded. Among them are outliers such as Luxemburg, the District of Columbia and Alaska, which have an extremely high per capita income owing to unusual economic conditions.
5 Slovakia had a GDP per capita of only 2,800 euros in 1995. In comparison, per capita income in other relatively poor countries like Greece and Slovenia was 8,500 and 8,100 euro, respectively.
6 Again, countries and states with a population of around one million or less are excluded.
7 See also Bönke and Schröder (2015), who measure between-countries disparities in terms of purchasing power parity (PPP)-adjusted disposable income.
8 As noted, there were influential sympathizers with this view in the respective countries themselves, for example at Bocconi and the Banca d'Italia.
9 Those who did not share that confidence, like the President of the Bundesbank from 1993 to 1999, Hans Tietmeyer, remained skeptical on EMU, although they only rarely spoke up in public.
10 See also, in a similar vein, Armingeon and Baccaro (2012), Collignon (2013), Hancké (2013), Höpner and Lutter (2014), Höpner and Schäfer (2012), Iversen and Soskice (2013), Ramskogler (2013), Scharpf (2013), and others.

11 Blankart (2013) gives a detailed historical and institutional account of the different functions especially of money as an institution and public spending as a tool of policy and politics in Germany and France.

12 The reason why German liberal economists have come to oppose an institution like the EMU that had originally been designed to their taste is their lack of confidence in Mediterranean governments carrying out the 'economic reforms' supposedly necessary for economic convergence, as well as suspicion about Kohl-style international opportunism of German governments caving in to combined pressures from France and the Mediterranean periphery for financial redistribution from Germany.

13 Credit was cheap because of a rapid decline of long-term interest rates during the run-up to EMU, from 17 per cent (Greece) and 12 per cent (Portugal, Italy, Spain) in 1995 to only 5 per cent in 2000. Between 2000 and 2008, net external debt increased from 20 per cent of GDP to 80 per cent in Greece, Spain and Portugal, and 40 per cent in Italy.

14 Following the European Central Bank's turn in early 2015 to 'quantitative easing', the euro fell against the dollar by about 20 per cent. While this did improve the external terms of trade for all EMU countries, relative competitiveness inside EMU, for example between Germany and Italy, remained unchanged. Moreover, the country that benefitted most from the euro's devaluation was Germany, with an export share of 46 per cent of GDP (2013) – as compared to Italy with only 29 per cent (2003: 23 per cent). Since both Italy and Germany send roughly two-thirds of their exports to countries outside the EMU, the country with the far larger export share was and is favoured most by the low euro.

15 The Maastricht Treaty on European Monetary Union does not provide for member country exit or exclusion. But what this means in effect has never been tested, and in a state of emergency there is no limit to institutional creativity.

16 The equivalent in social policy is the replacement of 'passive', 'decommodifying' benefits with 'active' or 'activating' ones.

17 For recent negative assessments, see Becker *et al.* (2012), Hesse *et al.* (2012), Zentrum für Europäische Wirtschaftsforschung (2012).

18 In the 1990s, structural aid from the European Union amounted to between 2.5 and 3.5 per cent of GDP in Portugal and between 2.0 and 3.2 per cent in Greece. In Spain, transfers from the structural funds ranged from 0.7 to 1.4 per cent of the country's GDP, whereas in Italy financial assistance was always below 0.5 per cent (EU Budget Financial Reports, http://ec.europa.eu/budget/biblio/documents/2010/2010_en.cfm; own calculation). Today, receipts from European Union structural funds range between 1.5 and 2.0 per cent in Portugal and Greece, and contribute only 0.5 per cent to GDP in Spain. Numbers do not include payments under the Common Agricultural Policy (CAP), as only regional and structural policy is explicitly targeted at poor regions, the objective being regional and national convergence. Support from the structural funds (the two most important ones being the Regional Development Fund and the European Social Fund) is provided mainly for investment in infrastructure, human resources, and the 'productive environment', meaning small and medium-sized enterprises.

19 It remains to be seen which methods will be devised to keep deficit countries financially afloat in order to keep their political élites and, through them, their populations sufficiently 'pro-European.' In this respect, an important role will be, and indeed is, played by the European Central Bank.

20 Portugal, Spain, Italy, Malta, Greece, Cyprus.

21 The latter may, in turn, explain the current recourse to a policy of cheap money, as pursued by the European Central Bank.

22 Data on Italy are from Daniele and Malanima (2007).

23 By far the biggest share of fiscal transfers in Germany is social security payments to East German citizens. Relative to the East German GDP, net social security payments amount to around 20 per cent. Moreover, through the fiscal equalization system among the Länder, tax revenue is horizontally transferred from West to East. Furthermore, the federal government funds regional policy programmes to combat the structural weakness of the East German economy (Kloß *et al.* 2012). The latter transfers come closest to those in the context of EU structural policy; they amount to 5 per cent of the East German GDP. We have found no reliable information on the structure of fiscal transfers in Italy.

24 The so-called *Solidarpakt II*, which regulates part of the transfers to East Germany, will run out in 2019. Tense negotiations are already under way between the federal government and the *Länder*, as well as between 'old' and 'new' *Länder*.

25 Increasing a country's contribution to the European Union by 3 per cent of its GDP would mean diverting roughly 7.5 per cent of its public expenditure to the Brussels regional assistance programmes (assuming a government share in the national economy of around 40 per cent).

26 Remember the Papademos and Monti experiments, which failed dismally.

27 In English: uniformity of living conditions. The wording is from Article 106 (3) 2 of the German constitution.

28 Under the Marshall Plan, formally European Recovery Programme (ERP), the US transferred around 13 billion US dollars' worth of economic aid to Western and Southern European countries in the four years between 1948 and 1951. This amounted to an average of roughly 1 per cent of the yearly GDP of the United States during the period. As to control, receiving countries under the Marshall plan were, by and large, free to decide how to use the aid provided to them, even though American authorities played a major role in its administration (Judt 2005).

29 The present article was completed well before the election of the Syriza government in Greece in early 2015. Subsequent events, including the temporary settlement of the Greek membership crisis in July, 2015, do not require a revision of the basic analysis presented here. They may be drawn upon in future work to elaborate on and illustrate the fundamental dynamics of the domestic politics of EMU, as analysed in the present article.

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