The Euro Crisis as a Clash of Cultures or War of Ideas

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Europe is today facing multiple challenges. Although the financial crisis reached its dramatic peak in 2012, and Europe has been experiencing an increasingly robust economic recovery since 2014, the focus is shifting from economics to politics. The threats are increasing, and it appears that much of the progress towards integration made after the 1957 Treaty of Rome is nevertheless unraveling. The clashes are framed in terms of binaries: North versus South, East versus West. The poles are also about ideas, and currently the focus is about risk sharing versus risk reduction.

There is a problem of understanding and of communication: each new challenge produces sharply articulated but divergent analyses and policy responses (for a fuller version of this argument see Brunnermeier James and Landau 2016). The responses take up particular mental models, that almost always aim to be very comprehensive, and to explain how every problematic feature of modern European society can be resolved: but are in practice unworkable. There is an additional and even more serious drawback: the brilliant explanatory models, though they have a brilliant explanatory cogency, are incompatible with each other. That incompatibility is the theme of this presentation.

Recently, Dani Rodrik (2015) made a plea that economists should have a more modest view of the universalizability of their models, and instead should proceed rather pragmatically to "carry multiple models in their heads simultaneously" and "build maps between specific settings and applicable models." Europeans should listen to that advice, and build solutions and models that are more piecemeal and less comprehensive. If they don't, they will find the precarious European marriage disintegrates.

That fate, the European divorce, has often been foretold, and is almost always explained in terms of an incompatibility of cultures. It is fascinating that the debates of today have their exact counterparts over a century ago, when the nation-states of today's map were being formed. Already in the mid-nineteenth century, 150 years ago, in the aftermath of the German and Italian wars of unification, the distinguished British commentator Walter Bagehot thought about the possibility of a global money in the wake of the agreement on Latin Monetary Union. But he concluded: "In that case, there would be one Teutonic money and one Latin money; the latter mostly confined to the West of Europe, and the former circulating through the world. Such a monetary state would be an immense improvement on the present. Yearly one nation after another would drop into the union which best suited it; and looking to the commercial activity of the Teutonic races, and the comparative torpor of the Latin races, no doubt the Teutonic money would be most frequently preferred." (Bagehot 1869/1889, vi-vii)

Today's debates about the contrasting solutions occur in the context of multiple crises and challenges. Should the multiplicity lead us to throw up our hands in horror and say that the solutions are just too complicated? Or should we rather think that a difficult challenge needs a concerted solution, a grand compact of reform? The multiple crises are:

1. The Euro. Paul Krugman and Martin Wolf think the Euro is simply described by one word: "Disaster." Joseph Stiglitz similarly reflected on the "man-made calamity that could easily have been avoided." (Stiglitz 2014) Now perhaps the disaster view is fading, with a return to growth in most of the Eurozone since 2014. The IMF has been revising upwards its WEO expectations for 2018 growth (now 2.4 percent for the Eurozone). The most obvious reason lies in the exchange rate, as the rapid fall in the Euro gives a stimulus in particular for export-dependent areas of the currency bloc, but that makes Donald Trump think that Europe is unfairly manipulating its currency.

2. The Security Challenge. A strategic threat to Europe appeared in the aftermath of the collapse of the Yanukovych regime in Ukraine and the subsequent Russian annexation of the Crimea and destabilization of Eastern Ukraine. In 2014, tensions with Russia escalated to an extent reminiscent of Cold War conflicts, and made Europe's dependence on imported Russian gas seem like a security liability. The Cold War is back, but the uncertainties and instability are greater than in the predictable strategic doctrines of Mutually Assured Destruction in the Cold War: so the risk of tipping into a Hot War have indeed increased.

3. The Energy Crisis. European energy markets are segmented and liable to disruption – political as well as climatic and structural. There are different views of the choices between carbon and nuclear, or between wind and solar and carbon. But pooling energy would be desirable because it leads to gains from trade and the diversification of risks. This is not only because wind patterns and other renewable sources of energy are imperfectly correlated geographically, or because of different degrees of access to imported energy sources, but also because the risks of nuclear energy production are shared by all European countries and carbon emissions create a world-wide externality, regardless of where in Europe they occur. The failure to achieve greater coordination reveals how the greater part of policy formation and preference accumulation primarily occurs at the national level.

4. The Refugee Crisis. 2015 was a bizarre replay of 1989. 1989 was a spring time of the peoples, 2015 is the end – the grey autumn - of the illusions of spring. In August 1989, East German refugees streaming across the Hungarian-Austrian frontier set off an apparently unstoppable momentum that led to peaceful revolution in the German

Democratic Republic, the end of the Iron Curtain, the end of the GDR, and the end of the Soviet Union. In August and September 2015, the unstoppable momentum of Syrian – and other – refugees on Europe's borders, and especially on the Hungarian-Austrian frontier undermined the legitimacy of the EU.

5. Corporate Governance. The scandal about the manipulation of diesel emissions in Volkswagen engines broke at the same time as the refugee crisis was at its height, in September 2015, and further dented the image of Germany, especially as the scandal widened to include the automobile sector as a whole. The turmoil in Europe's large banks – including Germany's Deutsche Bank - should prompt a rethinking of the ways in which Europeans have set and policed the rules that are fundamental to the operation of a market economy.

6. Brexit and Trump. The British referendum and the US elections of 2016 both had a strong anti-EU component. Brexiteers and Trumpistas thought of the EU as a bureaucratic monster and a cover for a German plan for political hegemony. We also now know that a substantial part of the electoral mobilization for both results was the outcome of external interventions. The problem is connected to the general issue of security.

7. Democracy. All of the crises raise fundamental and constitutional issues. How may democracy be preserved when entities with different world views and different sensibilities need to be coordinated and harmonized? By 2018, a new situation arose in Italy, with an anti-European majority, but composed of mutually hostile and ideologically different parties, the Lega on the right and Cinque Stelle on the left. Increasingly fraught national debates intensify concern about the EU's democratic deficit, but amplify the culture clash between different European societies.

I shall examine the fundamental clash, and then ask whether and in what circumstances deeply entrenched ideas can change: how Europe can move away from playing a blame-game in which the other side is demonized to a union of ideas: if you like, to intellectual translation, or, perhaps too grandly, a Hegelian synthesis.

I. Culture Clash

The Euro crisis led both to the outbreak of a war of ideas in the European continent and to a seismic shift of power within Europe. Starting with fiscal problems in one of Europe's smallest economies, Greece, in late 2009, a long simmering battle over the appropriate economic philosophy and future design of the European Union broke into the open. It was a struggle between northern – above all German – and what are sometimes called southern – but above all French – theories. The debate is not limited to French and Germans. Italy is divided between a north that looks intellectually and economically more like Germany and a south with more sympathy for French style theories. Finns and Austrians and sometimes Slovaks and Poles behave as if they are more German than the Germans; and France is often seen as a champion of a Mediterranean Europe – especially in Greece. But in practice the clash is often treated as if it is a war of ideas fought out across the river Rhine. The French and German positions outlined in this lecture should be understood as "ideal types", a concept developed by the sociologist Max Weber to better understand problems, debates and institutions by thinking in terms of sharply differentiated features. Weber, and every good subsequent analyst, knew well that reality was messy, but thought that conceptual clarification could bring a greater realization of the roots of social peculiarities.

In the early nineteenth century, Madame de Staël, the daughter of the pre-revolutionary French finance minister Necker, and a leading intellectual who attempted to conduct a philosophical debate with Napoleon, wrote a tract *De l'Allemagne*, in which she tried to explain Germany to the French. She began with the observation that "French and Germans are at two extremities of the moral chain, because the former consider external facts as the motor of all ideas, while the latter think that ideas generate all impressions. The two countries nevertheless are in basic agreement on social relations, but there is nothing more opposed than their respective literary and philosophic systems." (de Stäel 1813, 4-5) After her, a varied range of distinguished literary and intellectual figures have undertaken the same task, of trying to explain the Germans and the French to each other: from Heinrich Heine through Heinrich Mann, Raymond Aron, Jean-Paul Sartre, and Joseph Rovan. All failed. On the political level, the great leaders of the mid-twentieth century who remade France and Germany after catastrophe, Charles de Gaulle and Konrad Adenauer, were both fascinated and attracted by the history of the other country. The incompatibility of thought is as striking in economics as it is in other intellectual domains, but no one has really tried to produce an intellectual reconciliation.

What are the roots of the long term historical, intellectual and cultural contrasts between German and French economic philosophies? One might think that each country exclusively fights for its own material interests. However, such a narrow perspective overlooks an even more important aspect: interests are interpreted through the lens of ideas, or visions. Some countries have developed their own economic traditions and schools. Given their historical paths, different countries in Europe follow different economic philosophies and derive different policy descriptions for how to respond to crises. Previously these differences were always taken for granted, but glossed over and never thoroughly discussed.

The process of European integration is full of the same kinds of misunderstandings and misinterpretations that often characterize relationships between men and women. According to an American popular psychologist who wanted to provide a “practical guide for improving communication and getting what you want in your relationships,” men and women are from different planets. The book was wildly successful, with seven million copies sold. His title was adapted to international politics by Robert Kagan, who argued that Americans were from Mars and Europeans from Venus. “It is time,” he said, “to stop pretending that Europeans and Americans share a common view of the world, or even that they occupy the same world.” (Kagan 2007, 3) Europe now has discovered that it has its own version of mutual incomprehension. It needs a psychologist, or a marriage counsellor.

The basic elements of the contrasting philosophies can be delineated quite simply. The northern vision is about rules, rigor, and consistency, while the southern emphasis is on the need for flexibility, adaptability, and innovation. It is Kant versus Machiavelli. Economists have long been familiar with this kind of debate, and refer to is as rules versus discretion.

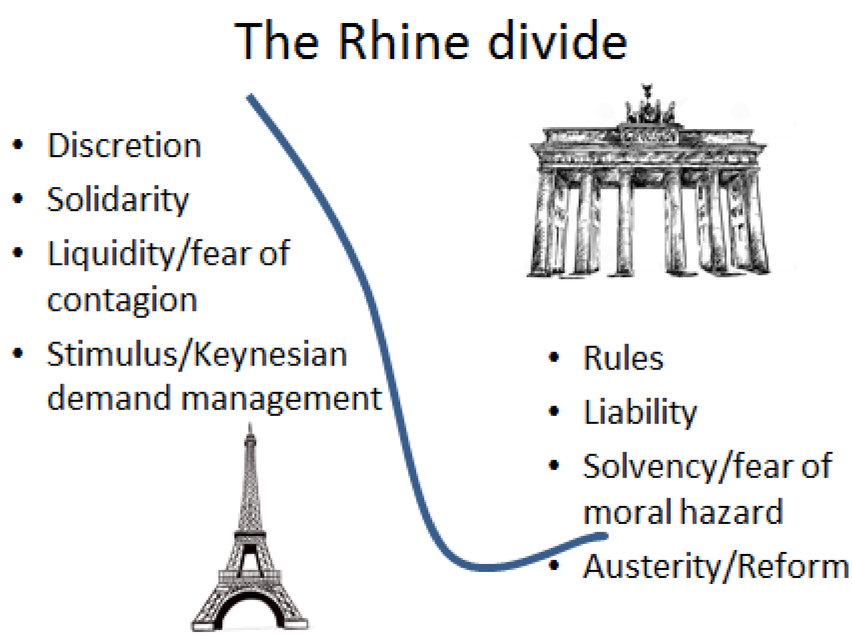
Some more specific policy preferences follow from the general orientation: the rule-based approach worries a great deal about the destruction of value and insolvency, and about avoiding bailouts that will set a bad example and encourage inadequate behavior among other actors (economists call this the moral hazard problem). In contrast, the discretionary approach sees many economic issues as temporary liquidity problems that can be solved easily with an injection of new lending, liquidity. From this point of view, the provision of liquidity is costless: there is no bailout, no incurred loss, and in fact the knock-on effects make everyone better off. There are, in this vision, multiple possible states of the world, multiple equilibria, and the benign action of government and monetary authorities can shift the whole polity and economy from a bad situation into a good one. The ECB should do more and more. To this, adherents of the moral hazard view point out the costs that will pile up in the future from the bad example that has just been set: the ECB’s activism is destroying Europe, generating an ephemeral and false prosperity while removing incentives to fix the underlying problems.

The different visions find their reflection in national literature. Goethe’s *Faust* presents a story of how money manipulation – inflation – follows from a diabolical agenda. Mephisto brings his proposal as a work creation measure, that will put the Emperor’s subject to productive employment; but it also represents a call on their imagination. The state has infinite power to create money: “But wise men will, when they have studied it, place infinite trust in what is infinite.” (Doch fassen Geister, würdig tief zu schauen, Zum Gränzenlosen gränzenlos Vertrauen. Ein solch Papier, an Gold und Perlen Statt, Ist so bequem, man weiß doch was man hat; Man braucht nicht erst zu markten noch zu tauschen, Kann sich nach Lust in Lieb und Wein berauschen.)

On the other side of the Rhine, at more of less the same time as Goethe was working on *Faust II*, Balzac saw debt as the center of political and human relations. The secret of the mysterious Vautrin's power over his fellow boarders in *Le père Goriot* is that he lends them money. As the over-indebted Delpine de Nucingen explains "Money counts for something only when feeling is dead."

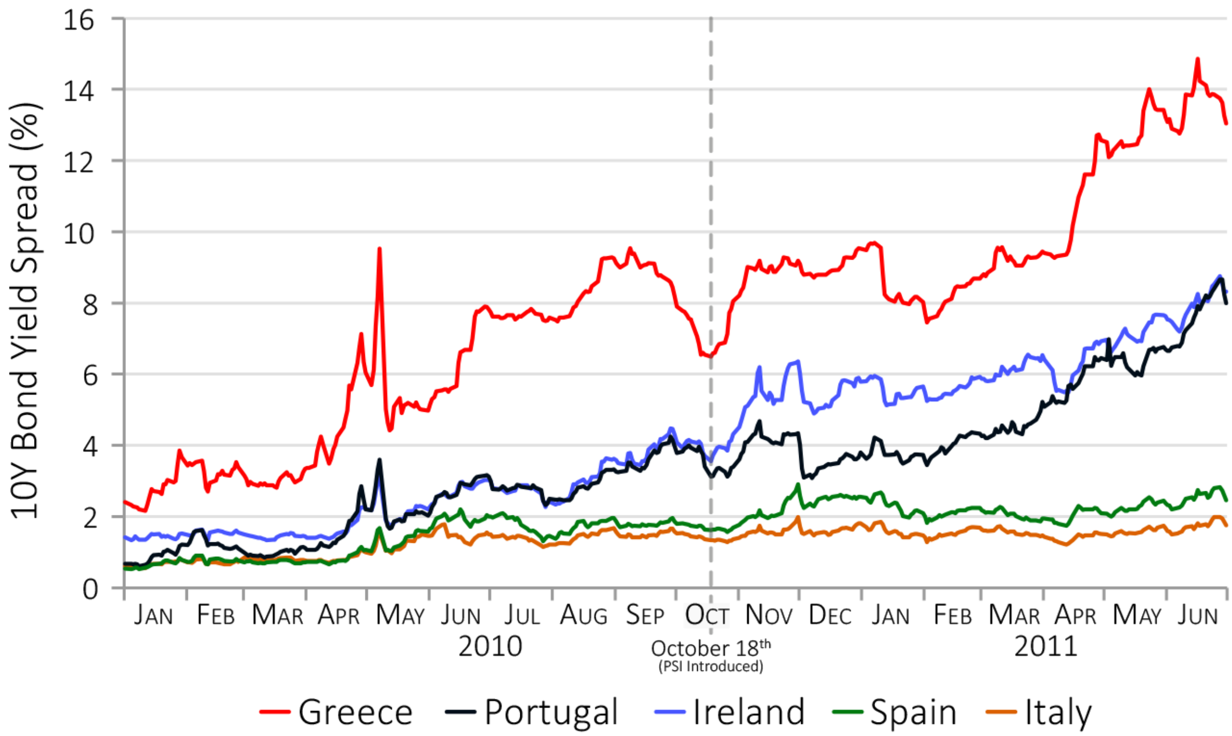
The national preoccupations meant that radical alternatives on how to solve the Euro crisis were ruled out. The French side did not want to see debt reduction, as that would cast in doubt the capacity and the credibility of the state. The German side did not want to see a mutualization of debt, as that would unleash the possibility for infinite obligation. It may well be true that either of these options would have greatly reduced the severity and impact of the financial crisis, but at the substantial cost of compromising the future.

Figure 1: Division along the River Rhine



The culture clash flared up at the turning points of the Euro crisis. First, in regard to the first Greek crisis in May 2010. Then the issue at stake was what sort of rules were needed to prevent the rescue operation constituting a moral hazard issue that would invite further countries to fiscal misbehavior? That debate led to the formulation of a strategy for private sector involvement in the bilateral Deauville meeting of Chancellor Merkel and President Sarkozy in October 2010, in which German preferences for fixed budgetary rules were watered down, and in return France accepted that the new crisis framework should provide "for an adequate participation of private creditors". German negotiators liked the result of the Deauville summit meeting – the spike in borrowing costs for crisis countries. They were frustrated that European institutions had proved powerless in disciplining fiscal policies. They feared that even the IMF and the Troika would not succeed in imposing sufficient conditionality and that moral hazard would be pervasive if financial support had to be granted to peripheral countries. Market punishment – which was brutal - was the substitute for the absence of a viable fiscal rule.

Figure 2: Post-Deauville bond spreads

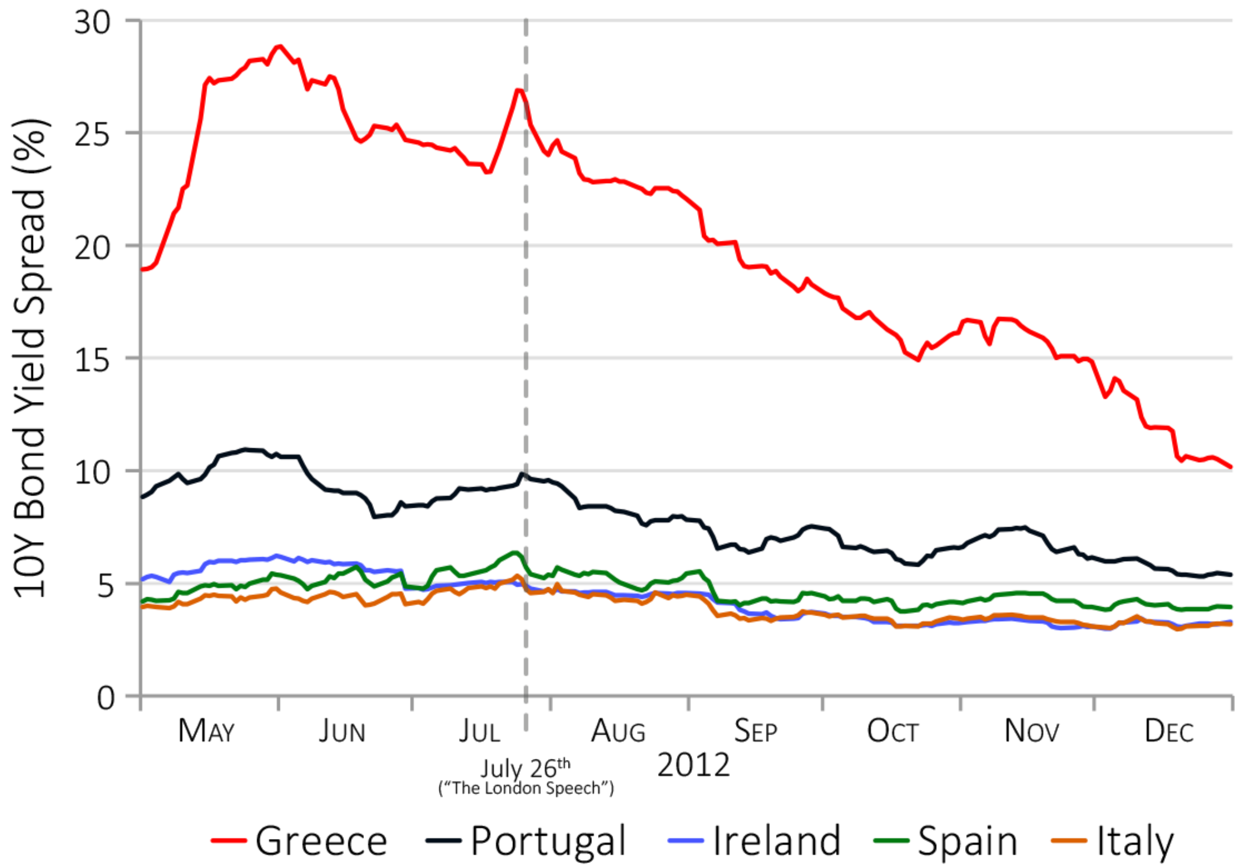


Second, the divisions between France and Germany resurfaced again in thinking about the appropriate central bank (ECB) response to the threat of Eurozone disintegration in the summer of 2012. Then it looked as if Europe was tipping into something worse than a regular "bad equilibrium" but had embarked on a spiral of collapse. Germany yielded, the Chancellor abandoned her moral hazard concern, and encouraged the ECB to break the spiral. But many Germans continued to worry about the long term moral hazard implications of the action. A further revival of the clash of ideas occurred in 2015, in respect to a renewed uncertainty about the Greek program and the threat of a Grexit, when the Greek negotiators tried, unsuccessfully, to present their case as a generalized act of resistance to the German vision.

The ECB proved to be the most effective forum in which genuine and effective policy initiatives emerged – above all in July 2012, with Mario Draghi's dramatic intervention and then the formulation of the OMT (Outright Monetary Transactions) program, and again in 2015 with the move to a QE program (for which the ground was prepared intellectually in Draghi's Jackson Hole speech of 2014: Draghi 2014). The OMT provided for the purchase of country debt in the secondary market if country is in a program with "strict and effective conditionality"; and in practice the rescue organizations involved a partial mutualization of Europe's debt obligations. In that sense, the ECB was engaged in an intellectual endeavor to make sense of Europe's crisis.

But there are obviously limits to which policy initiatives – especially with large potential fiscal implications - can be delegated to a central bank whose mandate is primarily concerned with monetary stability. The reconciliation business is fundamentally about politics, and not about following a precise mandate. A central bank should not be a school for political reeducation. North Europeans started to complain that the ECB looked more and more like a club of southern finance ministers. The terms for the new debate about an appropriate policy response were in consequence necessarily limited.

Figure 3: Post-London bond spreads



II. Changing Ideas

Cultural attitudes can combine extraordinary durability and extreme changeability. Alexis de Tocqueville in *The Ancien Regime and the French Revolution* referred to the French as "a people so unchangeable in its leading features that it may be recognized by portraits drawn two or three thousand years ago, and yet so fickle in its daily opinions and tastes that it becomes at last a mystery to itself." (de Tocqueville 1856, 253) France was "endowed with more heroism than virtue, more genius than common sense; better adapted for the conception of grand designs than the accomplishment of great enterprises; the most brilliant and the most dangerous nation of Europe, and the one that is surest to inspire admiration, hatred, terror, or pity, but never indifference?" (de Tocqueville 1856, 254) By the twentieth century, a similar paradox existed in Germany: a country of intense intellectuality but also of tremendous brutality and destructive power, where foreign observers felt tempted to trace the origins of twentieth century disorders back hundreds of years, to Martin Luther, or even thousands of years, to the tribes of the ancient Teutonic forests. A powerful account of the Reformation sees it as the outcome of a cultural misunderstanding, between the plainspoken Martin Luther, who attacked fancy theological thinking as a mask for southern (papal) interests, while the papacy saw Luther's revolt as a product of populist anti-intellectualism.

Some modern economists try to operationalize their perception of long-enduring national character traits into an economic model. Thus a recent attempt by Guiso Morelli and Herrera (2013) to understand the euro crisis tells of the incompatibility of national cultures, and in particular the incompatibilities of a culture obsessed with "cheating" (Greece) and a contrary culture obsessed with "punishment" (Germany). The authors then develop a model of the interactions of choices between these two cultures, and show that "interactions between Greeks and Germans result into excessive 'cheating' (by the Greeks) and excessive 'punishment' (by the Germans), with a generalized loss of welfare, which is increasing in the degree of cultural heterogeneity, and which cannot vanish rapidly given the inertia of cultural norms. In such circumstances countries may reconsider participation in the union facing either the choice of breaking up and reverting to a national currency equilibrium or otherwise considering the creation of a fiscal authority that can be endowed with any punish-forgive strategy the players agree to, hence giving a better chance of converging to a superior steady state and with lower transition costs."

The intellectual exercise raises the question of how and in what circumstances a revolutionary improvement in the institutional framework can change behavior and thus also apparently deeply entrenched cultural norms. To take a famous case from another European country, Poles were held to have a lazy and cheating culture – which the Germans dismissed as *polnische Wirtschaft* – and then Poland ended communism, introduced democracy and a market economy, and within a few years Poles occupied another stereotype, as the hardest-working Europeans. There is a powerful case that simply identifying the particularities of supposed cultural divergences allows a design of institutional mechanisms that can actually change them.

The easiest explanation of the thought divergence of France and Germany follows simply from political structure. Cameralism, the early modern model of the bureaucratic guidance of an economy- might be an appealing philosophy for one state, but it clearly requires some sort of central direction. France, of all modern European countries, most closely resembles the ideal-type of a centralized unitary state. Indeed, historians have seen the centralizing urges of the French state as a long-term feature of continuity that spans deep divides between dynasties and even ideologies, from the *missi dominici* of the Charlemagne and the Merovingians to the *intendants* of the Bourbon Louis XIV, and then to the structure of departments with centrally appointed prefects after the Revolution and Napoleon. According to the historian Albert Sorel, the function of the French Revolution was simply to finish or accomplish the task set by the *ancien régime*. So centralization has a history in France which goes back a thousand years or so.

By contrast, modern Germany has always been a federal system, with the catastrophic exception of the twelve years of the Nazi dictatorship which implemented a policy of unification and centralization or *Gleichschaltung*. Before 1806, the German speaking territories were organized in a loose association of the "Holy Roman Empire," with some 350 territorial units directly subject only to a loose and cumbersome imperial judicial system and some notional limits on their foreign policy. Some of these units were quite large states – Brandenburg-Prussia, Bavaria, Saxony and Württemberg – while the smallest were little towns or even just parts of villages. After the 1815 Vienna Settlement, some vestiges of the old order were kept with a German Confederation, composed of 38 states (again, some of them were still quite small). The German Empire of 1871 was created as a result of the initiatives of Bismarck's Prussia, but it remained a league of princes, and the three large south German states, Baden, Bavaria, and Württemberg, even kept their own armies. The state structure of 1871 was retained in 1919 in the Weimar Republic, even though many critics argued that it was politically and economically dysfunctional. After 1945, the Allies – in particular the United States – rightly insisted on a revival of Germany's federal tradition. Madame de Staël had made this tradition the center of her analysis, when she wrote that Germans provided a contrast to Latin countries in which there was "skill in escaping from duties." By contrast, Germany lacked this "souplesse hardie" (bold suppleness) and instead was obsessed with the "honorable necessity of rules and justice."

Germany flipped from a state-centered view of the economy to one in which rules were crucial to limiting inappropriate state behavior and bad incentives. Known as *Ordo-Liberalismus* (or sometimes as the Freiburg School), and chiefly expounded by Wilhelm Röpke, by Walter Eucken and Alfred Müller-Armack, a new school of thinking argued that rules needed to be formulated in general terms, and that the state's actions should be confined to the enforcement of such general laws: for instance, laws on competition and against cartels, which had been an important part of the older German tradition of business management. Unlike Friedrich Hayek, who insisted on the spontaneous creation of order and rules, the Ordo Liberals emphasized the need for an initial elaboration of an appropriate framework.

Their vision of order included both a system of general rules and a mechanism by which those rules define the liability (or responsibility) of individuals, and of economic agents. The system depended fundamentally on the accountability of market participants. Any measure limiting accountability or responsibility and promising some sort of contingent rescue would create destructive incentives producing an accumulation of unfulfillable expectations on behalf of the economic actors, and unfulfillable liabilities on the part of the government as the ultimate insurer. As a consequence, Ordo Liberal worried greatly about moral hazard, a term taken from insurance (a well-insured person may not take sufficient care that his house does not burn down). On these grounds, the Freiburg school and its modern successors (such as the prominent German economist Hans Werner Sinn) even worry about the limited liability principle for corporations. "Unlimited liability is part of a competitive system," Walter Eucken wrote (Eucken 1992, 316). In his eyes, the problem was that the development of the legal system and the increased complexity of laws tend to subvert the liability principle: "its destruction by legal policy endangers the functioning of this system." So too many, and too complicated, laws would breed moral hazard and give the economic agents incentives to game the system.

France before 1945 had been the bastion of classic economic liberalism, the land of Bastiat and Jean-Baptiste Say, the inventor of the concept of laissez-faire. Like Germany, it began the postwar era by rejecting the economic orthodoxies of its past, and also by seeking to Europeanize its new priorities. The economist and economic historian Alfred Sauvy characterized the old economics, which emphasized the limitations on government action, as contributing to "Malthusianism," low-growth and stagnation. Low growth and stagnation had weakened France politically and socially, and also militarily. The obsession with balanced budgets had led to a cutting of defense expenditure that made France more vulnerable. The architect of the "super-deflation" of the 1930s, Pierre Laval, was also the man who after 1940 went furthest in the political compromise with Hitler. "Malthusianism" thus was held to bear the ultimate responsibility for the military collapse of 1940 and the end of the French Republic. Part of the "Malthusian" picture had been French unwillingness to take John Maynard Keynes seriously. Originally, Keynes was not a popular figure in France, doubtless because of his well-known criticism of the 1919 Versailles Treaty. The role of the state was in pre-1940 French debates not seen primarily in terms of macro-economic stimulus. The new postwar French alternative to Malthusianism emphasized in particular rather the need for the state to coordinate and plan investment. An unplanned or spontaneous market order was likely to lead to under-investment and low growth. There was thus a need for *planisme*.

Out of this experience, France drew a view in which economics were subordinated to grand strategic considerations. In the Sorbonne speech, President Macron presented the need for a "common culture," a European strategic culture; while Germany seemed to many observers to be in the grasp of a *Strategievermeidungskultur*. For Macron, "what we need is a long-term economic and political strategy, and our challenge within the eurozone is to work out how to make it an economic power which can compete with China and the United States." (Macron 2017) Security was the foundation of Macron's vision; for a long time, Germany wanted to abdicate its security to others (in particular the United States).

Macron as a young man had worked as a research assistant for the great French personalist philosopher Paul Ricoeur, who had worked for a pragmatic republicanism, based on a cult of practical wisdom, *la sagesse pratique*, that ultimately drew on Aristotelian thought, in particular the concept of *phronesis* developed in the Nicomachean ethic. In particular, Ricoeur wanted to overcome the dichotomy between communitarianism and liberalism: avoiding the constraints that may come with communitarianism as well as the destructive assertion of individuality that may subvert true freedom. Most interestingly, he saw political work as a continual exercise in translation.

III. The German Issue

How much, and in what circumstances, and why will the German position change? In her initial meeting with Macron, Chancellor Merkel spoke about the "magic of a new beginning" (Und jedem Anfang wohnt ein Zauber inne, Der uns beschützt und der uns hilft, zu leben, Herman Hesse). Germany has constantly, for the last two centuries, been wrestling with the relationship of German and European thought. In the critical moments of 1989-90, German political leaders tried to tie their country's developments into a broader European framework. In phrase of Thomas Mann's that they endlessly repeated, Hans Dietrich Genscher and others argued for a European Germany, not a German Europe. But they rarely articulated precisely how they thought that Germany needed to Europeanize itself, and in practice they gave very German recommendations. The priority that was given to European monetary union is probably the most telling example of this insistence on European Union as a necessary accompaniment of German unification. What is Europe? Are politicians capable of really articulating a vision that goes beyond the nation state?

For some, in the past, Europe was a metaphysical concept, that dissolves and resolves the problems of the past: a dispenser of forgiveness and redemption. Charles de Gaulle saw Europe as focused on a French-German psychodrama. He depicted the relations of the two countries in a narrative of betrayal and decadence. He thought that in the path of constructing Europe, France needed to make the first step because "in western Europe, France suffered most. […] France suffered most because France was more betrayed than the others. That is why it is she who must make the gesture of pardon. Germany is a great people that triumphed, and then was crushed. France is a great people that was crushed and then associated itself [in Vichy] with the triumph of another. It is only I can reconcile France and Germany, because only I can raise Germany from her decadence." (Peyrefitte 2002, 77) De Gaulle's concept seems completely remote from the interactions of Angela Merkel and François Hollande, yet the story of 1940 that de Gaulle told, of German triumph and French self-defeat is being reenacted in contemporary Europe. What is the connection between the vision and the economic drama, in which betrayal of elites and incapacity to reform are bringing Europe back to a bitter past?

The basis for departure was the perception of Germany as a political dwarf but an economic giant. The threat of German economic power loomed over every discussion – long long before 1989. Germany also presented itself as a model for Europe. Back in the first major postwar economic crisis, in the aftermath of the first oil shock, in the election campaign of 1976 Chancellor Helmut Schmidt spoke of a "Modell Deutschland." That exemplary character is more in evidence now: its labor relations, its labor market reforms, its apprenticeship scheme, its approach to monetary stability and budgetary orthodoxy (so that Schuldenbremse is one of those words like Angst and Kindergarten and Schadenfreude that exist outside the German language). The (sub)conscious message is that other Europeans need to be more German – but the Germans will still define what is right. And they will benefit from it.

Was the monetary union really a realization of German – not European - interests? It certainly ignored some prevailing economic ideas about how monetary integration should proceed, notably the Optimal Currency Area theory developed by Robert Mundell (1961), Ronald McKinnon (1963), and Peter Kenen (1969). An OCA was viewed as a geographic area in which the benefits of a single currency in terms of reduced transaction costs outweighed the costs of giving up the use of domestic monetary policy to offset the effects of asymmetric shocks. Mundell contemplated labor mobility and wage flexibility as possible solutions, before rejecting them on empirical grounds. The early approaches to OCA in consequence assumed a Keynesian world with nominal wage rigidity and labor immobility. In addition to the degree of labor mobility, the theory stressed openness: the more open an economy as measured by the share of traded goods, the greater the benefits of a reduction in transaction costs. In the wage rigidity and labor immobility environment, a monetary union between disparate regions would only work to the extent that it was complemented by a fiscal union (fiscal federalism), which would compensate those areas already affected by the shocks which an independent monetary policy could have offset. Such a fiscal arrangement generally depends on a high degree of political integration.

The mundane truth about the evolution of Europe's monetary order is that it was in fact the outcome of global debates about currency disorder in the mid-1980s. In practice, nothing came of a global plan for nearly fixed exchange rates proposed by Edouard Balladur, the French finance minister, but then he formulated a much tighter European scheme. When German foreign minister Hans Dietrich Genscher appeared sympathetic, Europe's central bankers were asked by the president of the European Commission, Jacques Delors, to prepare a timetable and a plan for currency union. The result was a report, presented in April 1989, when no one in Bonn or Paris was thinking about any possibility of a profound geopolitical transformation of Europe, that laid the basis of the Maastricht Treaty negotiated in 1991 (for more detail, see James 2012). France liked it for the reasons clearly expounded by Michel Sapin, Finance Minister during the exchange rate crisis of 1993: it stopped the currency runs that looked like national humiliations for France.

Because the Treaty was negotiated in the aftermath of a seismic geopolitical shift, the result gave rise to highly influential - but completely wrong - theories that currently circulate about how and why the Euro was created. They both inflame political passions and at the same time give absolutely no guidance at all on how to find solutions. Both focus obsessively on the politics of the German role in driving monetary union, so that it again appears that solving the German question is central to the future of Europe. Both are mirror images of each other: in one Germany appears as uniquely virtuous, in the other as terribly vicious. Looking at the real history of the Euro can clear up misconceptions, but also highlight the real problems that remain to be tackled.

In the first view – the virtuous German story - the currency union was a high-minded European political project that ignored economic realities. It was needed to stop the recurrence of war between France and Germany. Both proponents of the Euro project such as the veteran German Foreign Minister Hans-Dietrich Genscher, but also by opponents such as the economist Martin Feldstein, have touted this theory. But it is implausible. Americans are perfectly aware that they haven't had a war with Canada or Mexico recently (although in the long past there were indeed such conflicts), and that they don't need a currency union to improve relations with neighbors.

Then there is the vicious view, a conspiracy theory about a deep-seated German masterplan. Some of its earliest proponents were British (like the former U.K. Chancellor of the Exchequer Denis Healey: see Healey 1990), but now it is circulating widely in southern Europe. Since Germany had lower rates of wage inflation than France and much lower rates than the Mediterranean countries, a locked currency would guarantee increased export surpluses, at the price of misery elsewhere. A German grasp for European economic primacy would succeed at the end of the twentieth century and in the new millennium where a similar German military plan had failed one century earlier.

This view seems as absurd as the first myth about peace and money. If this is what the Germans were aiming at, wouldn't other countries be able to get some whiff of the nefarious plot? And more importantly, if this were really a strategy it is a pretty short-sighted one (not really that much better than the disastrous Schlieffen Plan of 1914 to defeat both France and Russia at the same time). Plunging one's neighbors into national bankruptcy is not a good way of building any kind of stable prosperity.

For the critics, Germany's currency manipulation was a mercantilist strategy of securing permanent trade and current account surpluses, that would give Germany a commanding control of resources. In each phase of the negotiation about European monetary integration, Germany's partners in consequence tried to devise an institutional mechanism to control German surpluses, and believed that an institutional move to Europeanization would admirably do that job. Until 2009-10, when the global financial crisis reached Europe, the strategy seemed to be working, even though overall

Europe was struggling to compete in a global economy. In the past, small crises seemed to push Europe towards greater integration. Today, big crises are pulling it apart.

The management by crisis approach adopted by the European elite leads to a perception that the broader rationale is being hidden; and that in turn produces suspicions that the crisis, when it arises, is being used instrumentally. The more the crisis management is combined with a mantra like repetition of a general message of the "Europe brings peace" variety, the more skepticism swells up. The linkage between the assertion of the interests of the particular and the ritual invocation of the very general sometimes takes extreme forms. A fine instance was the insistence of Finance Minister Giulio Tremonti in the dying days of the Berlusconi government in 2011 that "If I fall, then Italy falls. If Italy falls, then so falls the euro. It is a chain." Angela Merkel had offered another version of the same logic, to which Tremonti was clearly alluding, with her famous and often repeated claim that "If the Euro fails, Europe fails." These statements inevitably invite the question: really? In the aftermath of the financial crisis, many national politicians began to see themselves as Samsons: chained, eyeless in Gaza at the mill with slaves, but capable of exerting a heroic push that would bring down the European structure in an orgy of chaos and violence.

IV *The Blame Game*

The sentiments and the passions that built up in the course of the long drawn out European debt crisis spill over into other discussions. Germany's response to the refugee crisis has been polarizing, in exactly the same way that the monetary debate was polarizing. For the critics, including Hungary's Viktor Orban, Germany produced the crisis: the strength of its economy, combined with the generosity of its welfare system, set off a giant sucking effect. Modern Germany is eulogized – and demonized – as much as the old Germany. Since 1989, Germany thinks of itself as more open, more global, more ecological, more peaceful, more flexible- but also more moral. But that morality, that German *Überheblichkeit*, does not make finding answers to global questions easier.

In the face of all the difficulties, the most simple course is to blame someone else. And the response is at least partly right. In obvious ways, all of the multiple crises originated outside the EU. So sometimes Europeans like to reassure themselves by saying that after all it's not their fault. The debt crisis that started with Greece in 2009-2010 and then threatened a Europe-wide contagion was a secondary consequence of the global financial crisis of 2008 that unambiguously started in the US and reached its highpoint with the Lehman collapse. The security threat that followed from Russia's annexation of Crimea and the launching of a de facto invasion of eastern Ukraine in 2014 had its origins in Kremlin policy and in a turn to a confrontational posture with "the West" that started with the Georgian war – also (perhaps not just coincidentally) in 2008. There is an environmental crisis – seen most obviously in CO_2 emissions – that follows from the rapid industrialization of so-called emerging markets. A debate about nuclear energy followed from the Japanese nuclear catastrophe in Fukushima. And there is a refugee crisis that is the aftermath of civil war and state failure in Somalia, Eritrea, Libya, Iraq and Syria. The repercussions – or political fallout – produced a divided European response, and policy was formulated along quite divergent national lines. So after blaming outsiders, Europeans began to finger other Europeans.

However easy it is for Europeans to blame someone else for their problems, one of the main claims – boasts - of Europe at the height of the continent's self-confidence was that it would offer a framework of stability for the rest of the world. At the moment, the European model is looking sadly frayed, and that has bad implications for regional stability in other critical areas, including East Asia but also the Middle East.

It is clear that there are many divisive issues that are clearly home-made: the design flaws or structural defects of the monetary union, the ageing demographic profile of many parts of Europe, the weakness of growth. The general problem is how to coordinate responses to these diverse challenges, and to build an effective community in which the substantial uncertainties and risks – economic, environmental, social, political – can be mutualized. At the same time, the mutualization of risk cannot succeed if the benefits and burdens are distributed so as to create permanent gains or losses for parts of the Union.

V *Mutualizing Ideas*

The economist and political scientist Mancur Olson identified what he termed a logic of collective action, in which powerful sectoral groups frustrate attempts to find an overall collective solution that corresponds to a general or over-arching interest (Olson 1971). His analysis offers a helpful way to understand Europe's contemporary stasis. Obviously the complex political construction of a mechanism for integrating and coordinating the positions of 28 national governments lends itself to blockage by particular interests. In modern Europe, there is really no clear way of articulating and politically representing the general interest of Europeans.

There are more immediate financial reasons why a crisis makes people look more at the national political framework. Managing the aftermath of major financial crises, as opposed to trying to prevent them developing, always involves the mobilization of substantial fiscal resources. That task inevitably remains in the hands of national governments, since the EU has only a very small fiscal capacity of its own. So inevitably, when it comes to demands for state action, people focus on the national states, and these are the wrong framework for dealing with many of today's problems.

There is in other words a need for a mechanism for seeing the big picture: for zooming out from the obsession with the national and onto the aggregate, to Europe considered as a whole. But how can Europeans get this larger picture, and how can they stop seeing the world primarily in terms of national interest, national advantage and national egotism? It may be that aggregating problems, rather than making them more intricate and less easy to solve, allows the negotiation of a grand bargain. Big crises – and even more the concatenation of big crises – prompt a rethinking, that may give birth to big solutions.

Is the German constitution (the Basic Law) a guide? After the 1990 unification, Article 23, which had allowed the accession of the East German *Länder*, was modified so as to state (paragraph 1): "With a view to establishing a united Europe, the Federal Republic of Germany shall participate in the development of the European Union that is committed to democratic, social and federal principles, to the rule of law, and to the principle of subsidiarity, and that guarantees a level of protection of basic rights essentially comparable to that afforded by this Basic Law." The powerful and highly respected German institutions, the Constitutional Court and the Bundesbank, acknowledge this as a limitation on their interpretative action: they are not willing to risk a European crisis for the sake of a highly problematic German tradition.

The Ukraine-Russia coheightened nflict, and the humanitarian catastrophe, Brexit and Trump, have all the European stakes. 1989 was an unanticipated shock that could not have been prepared for; in 2015 we know that there will be plenty more shocks. 1989 delivered the lesson that the nation-state was a sort of psychic insurance mechanism in an era of turbulence; 2015 indicates the need for a much larger sort of insurance system. Like any insurance, it requires careful designing, and a system of rules to guard against abuse. Without such a mechanism, however, even the psychic assurance of the nation-state will be impossibly strained.

Can there be a way of reconciling the perspectives or rules versus discretion, of introducing some flexibility to the principle of rules? In practice, the rules are already over-complex. The fiscal stability provisions notoriously involve 224 pages of precise guidelines. In the *Nicomachean Ethics* (5x), Aristotle set out the logic of looking for a malleable rule: he thought as an analogy of the lead (rather than iron) rule that sculptors on the island of Lesbos used to cut curved lines: "When the law speaks universally, and a case arises on it which is not covered by the universal statement, then it is right, where the legislator fails us and has erred by oversimplicity, to correct the omission-to say what the legislator himself would have said had he been present, and would have put into his law if he had known." In this spirit, here are some proposals for greater flexibility: for the mood that Angela Merkel reflected in the summer of 2015 when she responded boldly to the refugee crisis with "wir schaffen es": "We can do it.".

We should take another great European thinker as our guide. The most notorious chapter of his most infamous book, "The Prince," Chapter XVIII, appears to be an argument that the most successful rulers are those who "think little about keeping faith and who know how cunningly to manipulate men's minds." It sets out to explain the circumstances in which it is permissible and even desirable for rulers to break promises. In consequence, everyone thinks Machiavelli is telling his political advisees that they should lie as often and as much as they can. But in fact, Machiavelli explicitly and expertly analyzes the wider implications of deception and spin-doctoring. In order to pursue the strategy effectively, the real Machiavellian also needs to be a pretender and a dissembler about manipulation itself. With that step, we enter the world of logic games. If someone is always known to be a liar, he will never be effective. So it is essential to cultivate a good reputation.

Every part of democratic politics and of modern policy-making is about promises. Parties set out manifestoes with lists of promises to woo potential voters. People have to respond to plausible promises: when they are implausible, no one responds any more.

Monetary policy offers a variety of this conundrum. In the jargon of modern monetary technocrats, it is a question of anchoring expectations. Forward guidance, the promise to keep interest rates for a long time, cannot make any sense when policy makers have to admit there are circumstances in which they would have to change their minds and their policies very rapidly. Today's central bankers increasingly are moving away from ideas of long-term pre-commitments, and emphasizing instead policy flexibility and nimbleness.

Machiavelli saw a need for the appearance of consistency, and of virtues that would give a solid foundation to the principle of consistency. Those virtues, he thought, are in fact the basis for proper politics. "Deve adunque avere un Principe gran cura, che non gli esca mai di bocca una cosa che non sia piena delle soprascritte cinque qualità, e paia, a vederlo e udirlo, tutto pietà, tutto integrità, tutto umanità, tutto religione. E non è cosa più necessaria a parere d'avere, che quest'ultima qualità." Yet the default mode of modern politics is to think of pragmatism, and to follow up with broken promises. Europe styles itself as being a postmodern construct, but one of the features of postmodernism is the reduction of political life to the playing out of cosmetically charged narratives, or to listening to constantly changing focus groups.

The malleable and changeable sense of reality of modern politics is a stark contrast with the Europe of Winston Churchill, Konrad Adenauer, Charles de Gaulle, Alcide de Gasperi or even Jacques Delors: they all believed something. They were also full of all kinds of political trickery: but it was the bedrock of an overall conviction that allowed the trickery to be effective. Machiavelli should be correctly interpreted as calling for a politics of deep conviction: the opposite of postmodern political style. That approach means action as well as words. The only way of being consistently and deeply rather than sporadically and shallowly Machiavellian is to really do something that will make a new reputation.

VI. Concrete Recommendations

There are indeed a number of institutional reforms that might build Europeanness. I suggest five main categories in which Europe can bridge its cultural divide.

1. Currency Innovation

The Euro has become too much of a straitjacket. Here we might draw a lesson from the past. In 1992-3, the EMS crises almost destroyed the path to the Euro, but the crisis was resolved by instituting greater flexibility: through wider (15 percent) margins in the exchange rate bands. The modern equivalent to the band widening of 1993 would be keeping the Euro for all members of the Eurozone but also allowing some of them (in principle all of them) to issue – if they needed or wished it – national currencies, as a supplement rather than a replacement of the common currency. The aim would be to remove the sharp either-or character of the existing debate on "exit" from the Eurozone: Grexit and analogous threats.

The countries that took this step that would find their new currencies immediately trading at what would probably be a heavy discount. California adopted a similar approach at the height of the recent financial crisis, issuing IOUs when faced by the impossibility of access to funding. The success of stabilization efforts could then be read off from the price of the new currency. If the objectives were met, and fiscal stabilization occurred and growth resumed, the discount would disappear. In the same way, after 1993, in a good policy setting, the French franc initially diverged from its old level the band but then converged back within the band. Such a course would not require the redenomination of bank assets or liabilities, and hence would not be subject to the multiple legal challenges that a more radical alternative would encounter. There would also be the possibility that the convergence does not occur. The two parallel currencies could then coexist for a very much longer time period. This is not a novel thought. It was one of the possibilities that was raised in the discussions on monetary union in the early 1990s, that there might be a common currency but not necessarily a single currency.

Such a possibility also helps to overcome the uneasy coexistence of the EU and the Eurozone. All EU members, with the exception of the opt out countries Denmark and UK, are committed to Euro membership once the convergence criteria are met: a mechanism allowing temporary exits would ensure that the EU, and not the Eurozone, continues to be the political arena in which European policy is built.

2. Minimizing Financial Vulnerability

What is now termed a banking union – that is common European regulation with some fiscal capacity for resolution in the case of failed banks – is a very belated but necessary completion of the monetary union. Even this step is only partial, and has excited a great deal of opposition from Germans who do not want to bailout south European banks. Thus while there is European supervision, the resolution process is predominantly national. Critics have correctly identified the problem, that some sort of permanent fiscal mechanism is required in order to pay for the bailouts and thus in fact implies a move to a real political union which regularly redistributes resources.

Financial vulnerability has provided the key linkage by which instability is transferred from the primarily technical domain of currency arrangements to the large fundamentally political problems of democracy and the international order. Taking the fangs out of a dangerous financial system – for instance moving along the path from a bank-based system to a greater orientation toward capital markets – is thus an important element in rectifying flaws.

3. Transfers without Politics

Problems of transfers in a large unit are at the heart of the political process of building federations or federalism. Fiscal federalism is not the automatic answer that it is sometimes – especially in the United States – taken to be. The availability of central transfers over long periods of time undermined rather than fostered the catch up of regions such as the eastern parts of Germany, or the Mezzogiorno. The better way of discussing transfers within a large and diverse political order is to think of them as individualized or personalized, and not organized through states. In particular, a European-wide social security system would not only be a logical completion of the labor mobility requirements of the single European market. It would indicate that the insurance principle is not just one which it is appropriate to apply to financial institutions. It would provide an important buffer in that booming areas would pay in more, and shrinking areas would draw out more – without these payments going through government bodies and appearing as transfers from North to South – whether in a country such as Italy or in the whole of the European area. Defusing the political problem requires less statehood, rather than necessarily requiring the erection of a European super-state. But like the problem of designing better bank insurance, it also depends on making more adaptable labor markets so that the threat of large-scale unemployment swamping and destroying the insurance system is minimized.

4. Other "Unions"

A great deal of political capital is currently being devoted to "completing the Union." (Five Presidents' Report, 2015) . That should involve extending the areas of common policy to encompass a union to deal with the refugee issue, an Energy Union, and also military integration.

5. Thinking Globally

The management of cross-national problems and the containment of nationalistic quarrels certainly require technical fixes. But it also needs more. Disaster: there is plenty of potential for it! At the core of the argument presented this evening lie the linkages between currency and monetary and large political issues. The fatal loops that tie badly managed currencies to the destruction of the international economic and political order inevitably conjure up memories of the disasters of the 1930s, the Great Depression and the drive to war. Trade wars look as if they are coming back. Today, in large part as a result of the long-term aftermath of the Global Financial Crisis in both the US and Russia, global conflict seems nearer than at any other moment since 1945.

Conclusion

All these proposed measures represent some variant of a common insurance. Taken individually, however, they insure only particular sectors. That is why they are more likely to be realized as a grand compact rather than as a series of incremental measures, each produced in response to a particular crisis (an approach that has been characteristic of the European process so far, and was identified by Jean Monnet as working to integration through crises). They also require for their realization a negotiation method that identifies overarching or general interests rather than sectional preferences.

Insurance – the pooling of risk - helps to establish predictability. That is an essential element in allowing the establishment of ever more complex social interactions, involving more people, across longer distances, and with new and innovative and inherently unforeseeable technologies. It is in fact on this basis that the modern world, and the modern view of the world, has been built. But it is only when the overall level of risk is reduced that risk-sharing mechanisms can kick in. One of the reasons that pre-modern farmers and artisans – and those living today in poor countries – are vulnerable is that they cannot insure themselves against disasters such as harvest failures which posed and continue to pose a threat to their means of existence. Experimental psychology has produced an increasing amount of evidence that shows that very poor people under tight resource constraints make poorer quality decisions, and that momentary poverty depresses measured intelligence levels (Mullainathan and Shafir 2011). Well-being and an increased ability to make rational choices are closely connected with each other, and with a sense of preparedness and of certainty about the future. The instinct to insure is linked to and derived from the instinct to organize, and to evolve more and more complex and interlinked structures of mutual support. That support – which is central to the French tradition - can only work if it is credible – a point firmly made by the German tradition. In short, what we have characterized as the German and the French view actually need each other in order to be sustainable.

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