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Wolfgang Merkel
Democracy and European Integration: a »Trade-off«?

A conversation with Martin Schulz
»Europe has to defend its solidarity-based model of society, even in the age of globalization«

Günter Verheugen
What Kind of Europe Do We Want?

Peer Steinbrück
Banks Must be Allowed to Fail. A New Bid to Restore Confidence

INTERNATIONAL QUARTERLY EDITION

CONTENTS

Because its model of social organization is based on solidarity, the European Union views itself as a social democracy. As such it aspires to set an example for the rest of the world. Europe differs essentially from libertarian democracies such as the United States in recognizing the basic social and economic rights of all its citizens beyond the civic and political rights enjoyed by the inhabitants of any law-governed democracy. The expectation that the EU would treat those social and economic rights as obligatory norms for all the member nations – as well as the Union as a whole – finds expression in one of the Union's foundational agreements, the Lisbon Treaty of 2007. The EU has failed to move forward toward complete fulfillment of that promise in a way consistent with its own self-imposed obligations and the needs of European citizens. Indeed, the financial crisis that began in 2008 and continues essentially unresolved to this very day, has actually reduced the level of social democracy that had previously been attained. Social services and social insurance have been cut back in almost all the member countries. In the hardest-hit »crisis countries« in the Mediterranean basin, the cuts have been so drastic that they clearly weaken those nations' claim to be social democracies at all. The social dimension of the European Union has always played second fiddle to the power of its internal market, but now those social commitments seem headed for oblivion. What is more, the sovereign debt that governments have been forced to incur in the wake of the financial markets' dysfunctionality has left little money available for necessary investments in education and other fundamental social systems, both now and far into the future. The direct consequences of the crisis are clear enough: European citizens are now fed up with the lack of progress in resolving the crisis.

In this issue our authors address many of the topics connected to the crisis and the damage it has inflicted on social democracy in Europe. Some of the crucial issues discussed in these pages include: how the socially-minded, solidarity-based Europe can regain lost ground, and how democracy, certainly one of its prerequisites, can again be put on a solid footing. What sort of a Europe do we want, and what roles should be assigned to banks and to the democratically legitimated political sphere, respectively? And how can one impose durable, effective regulations on the financial markets when some of the political decision-making centers do not want to go along, at least for the time being. At first glance, this debate looks Eurocentric. But in truth its conceptual and practical outcomes will have broad implications for the way in which a crucial issue is handled: the intersection between the political sphere, which of course relies on democratic legitimacy, and the banking sector – indeed global financial markets as a whole.

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Democracy and European Integration: a »Trade-off«?

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The second rescue package for Greece turned into waste paper even more quickly than many feared. The requisite »modification« passed the Bundestag at the end of November, 2012 with unseemly haste and apparently irresistible necessity. All the talk was about solidarity with Greece ... with Greece? With citizens who stand to lose their jobs, their houses, and their incomes because of austerity policies forced on them by outsiders? Or was it supposed to be solidarity with the shipbuilders, entrepreneurs, lawyers, and investment advisors, who have long found ways to avoid paying their fair share of taxes in this »failing tax state?« Someone should also have mentioned that the lion's share of the credits »for Greece« would actually be flowing back into the big banks of France and Germany. This is not simply a matter of »solidarity« offered by rich countries to poor ones. It is also a kind of perpetual hostage-taking inflicted on democratic political institutions by speculators working in deregulated financial markets.

Crises call for specific political responses. They put pressure on government to take action. Decisions have to be made quickly. The elements of deliberation such as one finds, ideally at least, in political discourse and parliamentary negotiations, start to look like a democratic luxury. Crisis situations in politics demand rapid, simplified decision-making procedures. The dividing line between executive and legislative branches gets blurred. As the well-known Weimar-era expert on public law, Carl Schmitt, observed – evidently with some relief –, crises are the »hour of the executive.« That is not to imply that the present German government is following the script penned by this conservative theorist of sovereignty, or is even aware of it. Nevertheless, we can discern exactly that model of politics lurking behind the European policy currently being pursued by liberal-conservative coalitions in Europe, most certainly by the one in Germany. Political power is drifting toward the executive, even though the shift does nothing to resolve the crisis. Yet it is something that may cause long-term damage. The point is not to serve up yet another pointless lament about the democratic deficit in the European Union. There is more at stake here, specifically a shift of the axes of legitimacy between democracy and technocracy, legislative and executive, nation-state and EU.

We are currently witnessing a power surge in European institutions: the Council, the Commission, and the European Central Bank (ECB). Such a transfer of power away from institutions with democratic legitimacy such as parliaments and elected governments toward the poorly supervised ECB with its shaky claim to legitimacy is generally justified by appealing to economic imperatives. Attacks by oligopolistic hedge funds, insurance consortia, investment banks, and other speculators (misleadingly dubbed »the financial markets«) caused interest rates on the credits granted to vulnerable debtor nations to reach alarming levels. The German Chancellor's dithering gave the speculators a boost, driving interest rates as well as debt levels toward the stratosphere. Only wide-ranging guarantees issued by the ECB, or so it is claimed, were able to stop this ominous wave of speculation, thereby allowing the affected countries once again to get credit at interest rates they could afford to pay. Thus the ECB allegedly needs to retain its capacity for rapid and discrete – and therefore opaque – reaction. This line of reasoning looks convincing in an economic sense, but not in terms of the theory of democracy.

Trade-off I: Democracy vs. Technocracy

In keeping with democratic principles, every power surge in the ECB should be accompanied by a reinforcement of democratic control procedures over it and opportunities for public participation in its decisions. There is no interpretative wiggle room here. A »democracy problem« of this kind was already apparent in the case of the German Bundesbank, and is even more pronounced now with the ECB. The increasing power of the ECB during the euro-crisis has been accompanied by a decline in the power of national parliaments and even governments. This is true of both creditor and debtor nations. The ECB has used monetary policy, chiefly bond purchases, the European Stability Mechanism (ESM), and loans tied to austerity conditions, to intervene deeply in the budgetary policies of EU member states. It has extended its influence over member state policy-making not only through its own actions but also via the cooperation of the European Commission and the International Monetary Fund (IMF). None of these institutions is especially noteworthy for its democratic sensitivities, nor is any of them accountable to the people through democratic institutional channels. They owe their legitimacy instead to their expertise and their presumed problem-solving capabilities (which are at times frivolously attributed to them). Technocracy substitutes for the democratic mandate.

The right to craft a budget, the most cherished of all parliamentary prerogatives, is being hollowed out. This is true even of the »creditor nations« such as Germany, in which the Parliaments has ratified the crisis policies of Angela Merkel *ex post facto* (to which there are allegedly no alternatives) rather than discussing them *ex ante*. The debtor countries, with Greece as the prime example, have to accept the humiliation of being treated as immature wards, incapable of democratic self-determination. Since all of the guarantees and loans are doled out only if the PIGS countries, as they are sarcastically called (Portugal, Ireland, Greece, Spain), accept a »made in Germany« debt brake, they will be in thrall for many years to come to international financial institutions with no democratic legitimacy. It doesn't take much imagination to paint a picture of the restrictive impact that these conditions will have on departments that spend a lot of money, such as those in charge of social and educational policies. In all four countries the social dislocations arising from externally imposed deflation can already be identified. These measures thus violate not only the foundational principles of democracy; they also drain resources away from core areas of social justice policy. Post-democracy has arrived in Europe's South. Democratic institutions such as elections, parliaments, and governments are declining into mere facades, while the troika (see above) makes the real political decisions.

Of course it could be argued that the fading-away of democracy just has to be accepted on account of the economic »emergency,« although that emergency is really self-inflicted, since it has arisen primarily on account of the deregulatory policies pursued by leading Western countries. We are told that we must avoid at all costs making things any worse than they already are, say by allowing the collapse of the euro. This sounds plausible, but it does not relieve its advocates from the burden of proof. They have to show why the resulting economic dislocations would be worse for citizens than the loss of democracy that they, the advocates, are willing to put up with. It would certainly not be easy to calculate the final bill if one had to balance off the advantages in financial policy against the disadvantages to democracy. But it is not impossible. Still, up to this point no one on either side has actually figured out the bottom line. But even if this were actually done convincingly, one would have to admit that democracy had ended up the loser. This is being called a classic trade-off: less democracy in exchange for preserving the ability of decision-makers to act quickly in a crisis.

All this compels us to reflect on matters of principle. Is it even possible to move toward »communalization« of national laws and the policies of nation-states, i.e., toward the deepening of the EU, without undergoing a decline of democracy? Or is another trade-off looming on the horizon?

Trade-off II: Nation-state vs. Post-nationalism

Historically, democracy has undergone two great spatial transformations. The first one occurred when the direct democracies characteristic of ancient Greek city-states evolved into the indirect, representative democracies that began to emerge in European and North American territorial states beginning in the eighteenth century. The direct, but also exclusive, character of Attic democracy was transformed into a predominantly representative form of democracy that gradually lost its exclusive character due to the introduction of universal suffrage in the twentieth century. Democracy became indirect, yet at the same time more inclusive – a reasonable compensation for what was lost.

The second great territorial transformation of democracy, underway for quite a few years now, involves a transfer of functions from national representative institutions to supranational organizations and regimes. Unlike the first metamorphosis, this one threatens to leave us without any comparable democratic compensation. That observation appears to hold true for the global regime, which includes such bodies as the World Trade Organization (WTO) and the IMF, and still more for regional organizations such as the EU. But the institutional creativity and political will of the EU have so far not been sufficient to outflank the transfer of functions to the all-European level by enhancing the potential for democratic participation, representation, and supervision. It is possible to do all this, but so far it hasn't happened.

It is not good enough to meet this critique by offering its proponents the cheap advice that they should build support for their proposals and engage in the work of democratic persuasion. That sort of advice is as old as the European deficit in legitimation itself, but so far it hasn't changed anything.

It is not only the »subjective factor« – the democratic will to effect change – that is lacking here. It is objectively difficult to create a consensus among 17 of the 27 member states. They are much more heterogeneous, far more deeply riven by profound economic, social, and mental-cultural cleavages than is any individual European country within itself. To be sure, we should by all means protect and preserve differing historical traditions, languages, myths, and symbols. But when it comes to political decisions, the countries in question should be willing to acquiesce in common resolutions and in some cases just line up behind them. Despite the principle of subsidiarity, this is not an easy thing to do. It requires a willingness to compromise, mutual acceptance, and tolerance. These qualities are not to be had at bargain-basement prices even in federally organized nation-states, as Germany's perpetual quarrels over financial equalization among its states, and the nationality conflicts in Spain show. The EU can no longer allow the evolution of a common legal code and political decision-making to race so far ahead of democratic safeguards as has been the case in the past. In its previous decisions on European issues, Germany's Constitutional Court has consistently expressed its reservations about the eclipse of democracy at the EU level. If their reservations are not taken seriously, that will only stoke the national-chauvinist fires of right-wing populism.

The history of European integration exhibits a consistent pattern. Persuasive suggestions for offsetting the decline of democracy at the national level by expanding it at the European level have either not been put forward at all, or else they have not been effectively implemented. In particular, democratic values of transparency and oversight of decision-making have been more weakly developed at the European level than they have been in the democracies of individual countries. Moreover, civic participation leaves something to be desired. Let's take the case of the European Parliament (EP). In 1979 direct election of representatives to the EP was introduced in order to strengthen participation and representation at the European level. Since that time, the EP has been given additional functions. In spite of all that, average rates of voter participation have been declining, literally in every single election. In 1979 turnout rates stood at 65.7 % of eligible voters; by 2009 they had fallen to a mere 43 %. In six countries voter turnout in the last election was less than 30 %. Another awkward fact to consider is this: there is a »social selection« taking place in European elections, a creeping self-exclusion of the lower classes that is more pronounced in these elections than it is in their national counterparts.

The growth in the European Parliament's legislative reach has gone hand in hand with the aforementioned decline in citizens' interest. Given that trend, there is no way that democratic theory could countenance a further expansion in the functional scope of the EU Parliament at the expense of national parliaments. It has been proposed that the decline in voter turnout might be reversed by bestowing still more functions and visibility on the European Parliament, but empirical experience over the past three decades does not lend support to that claim. Why should it work any better in the coming decades? Even if matters take a turn for the better over the long run, voter turnout in EU elections will still not catch up to the national rates of voter participation anytime soon.

If one considers the problem solely from the perspective of democratic theory, a further drift of functions toward the European Parliament and the EU cannot be legitimized. This is an imperative that flows from democratic theory, not national political considerations. Each additional step in the direction of European integration has to be accompanied by a deepening of democracy. That is the only way that European integration will transcend its elitist character and become a democratic project of the peoples of Europe. Direct election of the Commission's President or Europe-wide referenda would be important steps in the right direction. But here again we must bear in mind that the self-exclusion of the lower classes is more severe in referenda than it is in national general elections.

Trade-off III: Output vs. Input

If the EU were thought of as a country seeking membership in the European Union, its petition would be rejected because it would not be able to meet the requisite standards of democracy. That witticism is well known. It is unrealistic to assume that anything essential in that state of affairs is going to change quickly. The EU will not attain the same quality of democracy as Sweden, the Netherlands, or Germany. Nevertheless, this certainly does not automatically rule out steps toward further integration.

That is the case because democracy has both an input and an output dimension. The input dimension includes the institutions and procedures of democratic participation, representation, and decision-making. The output side is embodied in the material results of the decisions that have been reached, i.e., such goods as peace, economic welfare, legal and social security, and generally the opportunities in life enjoyed by all citizens. The accomplishments of the European Union and its predecessors, the EEC (European Economic Community) and EC (European Community) are indeed impressive. The EU has spurred the exchange of goods and services, and enhanced the mobility of capital and labor. In this way it contributed in no small measure to Europe's prosperity, even though there have been losers as well as winners, and the social components of the EU have clearly lagged behind the neo-liberal legal framework for competition. Likewise the historically unprecedented reign of peace in Europe has come about thanks to its integrated community. Without the cohesion of European states and peoples, Europe could not maintain its affluence. It would become uncompetitive in a globalized world.

The EU's legitimacy has always owed more to the output side than to the input dimension. It can be legitimate to compensate for losses on one side of the ledger with gains on the other as long as these offsets are accepted by the citizens and the normative and procedural substance of democracy is not jeopardized. But at present neither of these conditions is automatically being met. In the midst of the euro-crisis the European Commission, the ECB and – last but not least – the present German government are exporting that German invention, the debt brake, and thus driving the entire Union into deep deflation. Greece's GDP, for example, has already fallen by one-fifth since the outbreak of the crisis, and every day 1,500 people lose their jobs there. In Spain and Greece one-quarter of the active work force is unemployed. No solution to the crisis is in sight. The crisis management of EU institutions and the leading member states has so far proven ineffective. Ordinary citizens understand that as well as the experts. Thus, the output legitimation of the EU is in trouble, since the troika has not been gentle in its handling of sovereignty rights and parliamentary oversight prerogatives. But if input legitimation is being narrowed in scope just at the same time that output legitimation is falling into crisis, then important sources of democratic legitimacy begin to crumble.

Cutting democratic losses

What is really at issue here is not whether we want »Europe,« but what sort of European Union we would like to have. Not every critique directed against Europe can be classified among the usual suspects: parochialism, nationalism, and clinging to the past. If we are going to describe European competition laws and the specific construction of the European internal market as aspects of a neoliberal project, then the critique of Europe cannot be countered by the argument that European integration has brought the Continent fifty years of peace. A person is not necessarily a nationalist just because s/he does not believe in the glossy fairy tale that Europe can simultaneously be enlarged, deepened, and democratized. If someone does not think a circle can be squared, that certainly does not count as heresy. It is high time that we put an end to the either/or debates, which are by now nearly as quaint as old wood-cuts, and started thinking about trade-offs. Problem-solving capabilities and efficiency can have costs, especially when trans-border issues are on the agenda. We have to reflect on the question of whether gains in efficiency will be achieved at the cost of less democracy. But the boundaries must be drawn more narrowly than is currently the case with the frenzied export of austerity. A democratic Europe deserves nothing less. European integration can no longer be run as an affair of the elites; otherwise, both Europe and democracy will be at risk. ■

A conversation with Martin Schulz

»Europe has to defend its solidarity-based model of society, even in the age of globalization«

How can the EU restore the appeal it once held for its citizens? What kind of Europe do we want? And how will Europe affect the German electoral campaign? The President of the European Parliament met with our interviewer, Thomas Meyer, to answer these and other questions.

NG/FH: We have reached a fork in the road where European policy is concerned. At this point we have to ask ourselves what direction we would like to take, what our alternatives are, and what is at stake for us, the citizens of Europe, and for the member nations. What possible alternatives do you see at this truly historic moment?

Martin Schulz: First of all I think it is necessary to reject the statement that, »there is no alternative to Europe.« There are alternatives to everything. That is what the European debate is all about right now. Considering the trends of recent years, do we have the courage to expand European collaboration and the cooperation of nations and states in joint organizations, or will we just throw in the towel? Are we going to regress back toward a »protected homeland?« That would be the surest way to make Europe insignificant in the international scheme of things.

NG/FH: But we are now in a situation in which citizens increasingly seem to be turning away from Europe, while many of the politicians in the EU member states have grown weary of European unification. And this is all happening just when more impetus is needed to make a new start. How is the Europe of the future ever going to come about against such heavy odds?

Schulz: We have to take the various concerns and needs of people in the member nations seriously and try to find solutions for them. Not everyone who criticizes the EU should be written off as an EU skeptic. I think of myself as a critic of the EU, but it is just this sort of criticism that makes it possible to identify and correct the Union's shortcomings. In order to do that we have to ask ourselves again and again what the idea is that underlies European unification.

In the 21st century European states and nations are facing a set of questions that none of them is able to answer by itself. No nation-state acting on its own could respond to the dilemmas of climate change, economic transformation, and the interdependence of international financial mar-

Mark Bollhorst, 2012

kets. Under those circumstances all of us would quickly run up against the limits of our own capabilities. To solve problems like these we need the energy of the 500 million people who still inhabit the wealthiest portion of the earth. Of course there are a number of politically formidable countries in the region, but none is strong enough anymore to go it alone in the global arena. That is the reason why we need the European framework which we call the Political Union. Yet unfortunately it is also quite true that just when we need more Europe, people have become more skeptical. But what is the target of all this skepticism? Is it directed at the idea of an integrative process designed to handle new challenges, or perhaps at the institutions as they are presently set up? I believe that people are turning away from the EU's formal structure, which is not legitimate or transparent enough as measured by the usual democratic standards and remains hamstrung by the principle of unanimity that prevails in the European Council, in which the heads of government meet. To enhance the EU's appeal for all its citizens, we have to tackle precisely those issues.

NG/FH: But in order to accomplish that, the EU needs new forms, new institutions, and new regulatory instruments. What position have the Social Democrats in the European Parliament taken on this, and what role are the German Social Democrats playing?

Schulz: To begin with, let's keep one thing in mind: in agricultural, economic, and monetary policy, in environmental policy, and in many other areas we have long since relinquished our sovereignty and transferred it to the European level. Accordingly, the EU has already become a quasi-state in certain areas, but we have not yet transferred to it the model of a division of powers which we know from the context of the nation-state. There is no European government that can be invested by a parliament or removed from office, no government that has to be accountable to the European public. But that is exactly what we need: a government responsible to parliament for the areas which the EU controls.

NG/FH: And yet what a great many people fear is that Europe will expand such a government into a transfer system, so that German tax revenues will flow unchecked into the coffers of foreign countries within Europe. Is our future wedded to a model such as this? And if that is indeed what the future holds, how do we communicate it to the citizens without frightening them?

Schulz: First of all, one has to be honest. In a certain sense we already have a transfer union, and one that entails joint liability. To be sure, euro-bonds, a common debt relief fund, and other such proposals were all rejected. In the meantime the crisis continued to get worse, because the financial markets of course noticed that no instruments of control had been put in place, so they could keep on speculating. It was not until the moment that the European Central Bank chief, Mario Draghi, announced that the ECB would purchase sovereign debt to prop up the euro, that we succeeded in reducing interest rates on loans taken out by the crisis countries. Sovereign debt held by the ECB is now guaranteed by the bondholders of the ECB: that is, the states of the European Union. *De facto* this means that there is joint liability. In case payment were to be suspended, the bondholders of the ECB would be liable for the unpaid amount in proportion to their investment. This fact has to be made clear to the citizens. Beyond this the Federal Republic of Germany has already guaranteed more than 400 billion euros due to commitments made in previous bailouts. Thus, anyone who claims that there is no liability union at present is pulling the wool over the eyes of German citizens.

To win people over once again in favor of the idea of European integration, I recommend a look at the elections in the Netherlands. During the electoral campaign Diederik Samsom, chairman of the *Partij van de Arbeid* (PvdA), said right from the start that there would be another bailout for Greece and that the Netherlands would have a stake in it. The outcome of the election was that he won 24 % of the vote in the end, even though he had begun with polls showing only 9 % support. Evidently, the voters respected his honesty. So when politicians honestly admit that they will have to run great risks to resolve the crisis, but that inaction is far riskier, their forthrightness will have a political payoff. And in the case of the EU it looks as though we will have to run those risks to save our currency from speculators, but that we will have to explain why we have gone down this road.

NG/FH: And why would Social Democracy want to take this road and not a different one?

Schulz: Just recently the Bertelsmann Foundation presented a study that investigated the follow-up costs in case of a collapse of the euro zone. One of the results was that the immediate follow-up costs for Germany alone would amount to about 4 trillion euros. In truth the euro is a real success story. It has been possible for us to keep interest rates and inflation low. Also, even though we have a weak political system in the currency bloc, we still have a strong currency. So why would we want to let the euro fall apart? The consequences for Germany would be enormous. A new D-Mark would have to be revalued upward, which would cause our entire export business to collapse, upon which thousands of jobs depend. So now we are facing a choice: are we going to take certain risks to avert a scenario that would impose a disproportionately heavy burden on all of us, or not?

NG/FH: So then which politicians in Germany would be able to present and then stick to such a risky line of reasoning?

Schulz: In Germany Peer Steinbrück has taken a clear position over the past few weeks and months. To be fair one must also say that Angela Merkel has not offered entirely different arguments, but only late in the game, and when she is compelled to take that road. Of course, that is partly because of the party she leads and the coalition partners she must please. But this sort of temporizing is costing the taxpayers of Europe a lot of money.

NG/FH: Is it even possible for Peer Steinbrück and the SPD to go on the offensive in the coming months by advocating – and sticking with – a pro-Europe course against the CDU and Mrs. Merkel? As everyone knows she has posed deceptively yet effectively as the guardian of German tax money.

Schulz: The publicly cultivated image of Mrs. Merkel is of course misleading. She does not refuse to spend the German taxpayers' money, but she creates the impression that such is the case. That is her strategy. Yet the reality is that Germany is already on the hook for 400 billion euros in case doubts arise. Frau Merkel took on those obligations. That is the reason why it would be much more important in an election campaign to unmask that false rhetoric and lay out the facts for people in an open, honest way. Another pan-European problem is the self-empowerment of the European council, to use the words of Jürgen Habermas. The heads of state and government have pulled all the decisions up to their level and have tried more and more to marginalize the Parliament and the Commission. As a result, the European Union is not making any more progress due to the rule that decisions of the Council have to be unanimous. That doesn't work, because there is always at least one head of government who is having problems in his own country and wants to gain a higher profile at Europe's expense. That is why the Lisbon Treaty intended to introduce the principle of majority rule in the European Council: to prevent vetoes by one or a few countries. But now this has been twisted so as to produce the opposite effect.

NG/FH: Supposing that we were to act on all of these arguments, especially the introduction of a system of economic governance, albeit placed under stronger parliamentary control at the European level. Are those the most important steps toward building a new Europe, or are there other things that need to be done?

Schulz: Of course we need far more stringent supervision and re-regulation of the financial markets. As long as those markets remain deregulated, there is always a danger that similar crises will come back to haunt us. If one considers the evolution of the crisis, it becomes obvious that regulation is necessary: in 2008 we had new indebtedness, on average, of less than 3 % of GDP in the EU. Then came the crisis and new indebtedness climbed to 6-7 %. Those debts were incurred in order to save banks that had gotten into trouble through speculation or by their negligence in making loans that could not be repaid. Now those same banks that were bailed out by the taxpayers are demanding higher interest rates from the very countries that saved them. We must put an end to this absurd system. And by the way, it an example that illustrates very well why we need a European ratings agency that would apply different standards in evaluating banks than the three American agencies use.

Another issue concerns the planned introduction of a financial transactions tax. Until now only eleven countries have expressed interest in participating in its implementation, but I am confident that quite a few more will eventually come on board. Another point that deserves emphasis is the waning solidarity of wealthy individuals via tax avoidance and outright tax evasion. Why is Germany seeking to conclude a bilateral agreement with Switzerland rather than doing it jointly with the entire EU? If the EU had a tax agreement with Switzerland, then we would have access to the billions of euros stashed away by tax refugees from Greece. Thus, the requisite financial regulation involves much more than the prohibition on short sales and other measures already decided upon. Now in this context one constantly hears the argument that many reforms will have to wait until a system of economic governance has been put in place. But that is not true in the sense intended. Many measures could be enacted even now. Yet of course there are always some EU member states that block agreement on such measures.

NG/FH: Would all of this lead to a Europe moving along at different speeds, with the euro zone as the core and the rest as periphery?

Schulz: No, the idea of »17 plus X« is false. European treaties clearly state that all the EU member countries are obliged to introduce the euro, not just the 17 that have already done so. The only exceptions are Great Britain and Denmark, since they have so-called »opt out« clauses as far as the euro is concerned. That is the reason that I advise everyone to think of ways to get the stronger European economies into the euro, rather than always speculating about who might abandon it. One such example would be Poland, which is right now the most dynamic economy in the European Union and has a pro-Europe government that has twice fended off the euro-skeptics. The point is that we have to take a different approach. To me that would entail a »27 minus X« strategy comprising all countries except those that do not want to participate, meaning Great Britain and perhaps Denmark. But even Denmark has already linked its krone to the euro and therefore has an interest in a stable euro.

NG/FH: Now of course many of the reforms you alluded to – and for that matter the very momentum of the process of integration – have become controversial in their own right. So where do the front lines between advocates and opponents of this project run inside the European Union?

Schulz: That is not an easy question to answer. The lines of conflict over the process of integration cut right across societies, parties, and institutions. On this issue there are hardly any homogeneous units. But there are ways in which one could break it down, for example over the question of how the crisis might be resolved. The conservative-liberal camp is banking entirely on budgetary discipline to regain investors' confidence and thereby to stimulate growth. But a policy of pure austerity does not work, as we see in southern Europe, where the debt crisis has worsened in spite of draconian austerity measures, because the economies there have collapsed. The more left-leaning camp, by contrast, favors the budgetary discipline approach coupled with investments designed to foster new growth. But in addition to this line of conflict there is another one over the most desirable degree of integration. Thus, for example, on one hand Great Britain is interested in a stable euro so that it can continue exporting to the European »near abroad«; but on the other hand that country rejects the regulation of financial markets in order to protect the City of London. Naturally, everyone else is against that, so a solution had to be chosen that leaves the British on the outside looking in.

A third line of conflict also touches on the future financing of the EU. In this matter, the countries can be divided into two camps: the »friends of better spending,« roughly the countries that are net payers, and the »friends of cohesion,« the countries that are net recipients of EU spending. The interesting thing here is that both social democratic and conservative governments are to be found in each of the camps.

NG/FH: In Germany elections are now scheduled for this year. During the French presidential election campaign, Merkel and Sarkozy closed ranks. Do you think we should expect the same thing to happen between Hollande and the German Social Democrats?

Schulz: It is quite clear that a socialist government in France would prefer to work with a social-democratic counterpart in Germany than with a conservative government there. By the same token, Angela Merkel naturally felt closer to Nicolas Sarkozy than to François Hollande. There is a positive side to this development, since we in Europe are all in the same boat and have to accept the fact that European interests now trump those of any one nation-state. Today we must take an interest in who is governing in other European countries and how elections there have turned out. The results of any given election will entail that one policy or another in Europe is going to acquire more advocates. For that reason I am assuming that European politics will also play a role in the outcome of the German electoral campaign.

NG/FH: Will the issue of Europe evoke a lot of controversy leading up to the German elections, or will parties be more inclined to sidestep it, because there is not that much difference between their respective positions?

Schulz: Both statements are correct. There is a great deal of common ground concerning the wish to stabilize and promote the euro and Europe. Yet at the same time there are certainly major differences in the ways such goals might be achieved, and those differences will become campaign issues. During the upcoming electoral campaign there will be a quite a bit of controversy over the question of who pays for crisis management. Will it be ordinary wage-earners and the more vulnerable members of society? Or will it be those who actually caused the crisis, the speculators and bankers. After that we will have to face the question of whether we are going to make our continent fit for the 21st century by investing in the technologies of the future and advancing needed structural reforms, or whether we will renationalize Europe and, by doing so, initiate its decline into international insignificance.

I am looking forward to this fight, because it will give us the opportunity to talk about what sort of Europe we want. I would prefer a Europe willing to defend its solidarity-based social model even in the age of globalization, one in which respect for human rights lies at the heart of our »brand,« and in which we remain leaders in developing high-quality, sustainable technolgies. ■

Almut Möller

The End of the EU as We Know It

The Greek crisis revealed weaknesses in the structure of the EU. Confined within the narrow boundaries of economic and monetary union, it has remained little more than a loose bundle of reforms and reactions. A new Europe, more socially oriented and committed to solidarity among its members, needs to be established.

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Quite a few governments in Europe believed that 2009 marked the end of the debate on the future of the EU – and presumably many more hoped that it did. First, the proposed European Constitution had gone down to defeat. Following its demise a substitute solution, the Treaty of Lisbon, had been painstakingly negotiated, then subjected to tough ratification fights. In December, 2009, the Treaty finally went into effect. That seemed to seal the deal and enable governments to get back to their day-to-day business after more than two decades of tinkering with the EU's constitutional foundation. Those negotiations had never been easy and, as the number of member nations increased and the number of sectors to be regulated grew apace, they became more and more difficult. The lesson seemed to be that the EU could not be reformed much more, so the best solution would be to close one's eyes to the problems and make do with whatever compromises had been embodied in the Treaty of Lisbon. In what was really a moment of great success, European governments grew faint-hearted, while doing everything they could to deflect criticism of the new Treaty.

As the end of 2009 neared, the Greek drama crashed down upon this fool's paradise. In the months to come it became obvious that European governments had certainly summoned up enough good will since the Maastricht Treaty to institute a series of institutional reforms. Yet in retrospect it became obvious that they had neglected one crucial »construction site« in their campaigns of reform. Even with the justified exuberance that accompanied the fall of the Berlin Wall, the governments of the (at that time) 12 members of the EU could not mobilize enough support during the Maastricht Treaty negotiations in the early 1990's to put their Economic and Monetary Union (EMU) on a solid footing. Of course, it would have required an enormous effort to persuade people in the EU to go along with serious reforms even then. But if that had been accomplished, Europe's nation-states would have entered the new century stripped of many of their previous powers and responsibilities. It is difficult to say where the EU, especially its euro zone, would be today if economic and monetary ties had been put on a solid foundation, but convincing arguments have been advanced that the euro would have strengthened the member-states economically and politically if it had been part and parcel of a »genuine« EMU.

All of a sudden the European question is on the table again, and this time in a much more radical way than in any of the previous rounds of reform. The latter were preoccupied with optimizing decision-making procedures and strengthening the EU's democratic legitimation. Those efforts succeeded only moderately well, but they still made possible a certain amount of progress. At bottom all of the rounds of reform that have been held since Maastricht – Amsterdam, Nice, the debates over the Draft Constitution, Lisbon – followed an institutional-bureaucratic logic.

Today much more is at stake: the future of the monetary union and, closely connected with it, the future of the EU as such. In the first place, then, the current situation evidently cries out for political responses. It now looks as though the Maastricht package will have to be opened up for the countries that belong to the euro-zone, and as yet we can only vaguely discern the contours of new agreements that might emerge on a banking, fiscal, economic, and political union. Surely there is always the option of withdrawing from the debate and pointing out that conclusions must be drawn from the fact that the idea of a united Europe, once so promising, has begun to lose its luster.

But there is a more worthwhile option than standing aloof from the debate. That is to seize the opportunity with both hands and come to grips with the misguided developments within the EU that none of the reform schemes of the 1990's – not even the Lisbon Treaty – were able to correct. There is now a chance to fight and advocate for a different kind of Europe, as a recent paper issued by the SPD's Commission on Fundamental Values has argued. The necessary leeway has opened up so that the course toward a more solidarity-based, democratic, and just European Union can now be set. If that were to be achieved, it would bolster Europe's internal cohesion so much that the EU would also be stronger vis-à-vis the outside world. In the last few months the German Chancellor, Angela Merkel, has been tirelessly repeating her mantra that there are »no alternatives« to her European policies, in order to mobilize support for them in the Parliament and among the voters. But in fact European policies, like all other policies, always have alternatives, especially in times of crisis. The chief agenda item now is thus to clarify and elaborate those alternatives. We need a public discourse that does not take refuge behind empty slogans such as »more Europe,« or a »genuine political union« or that assumes an unbroken line of development toward communalization and centralization. Still less do we need a discourse that tacitly threatens to use the »moral cudgel« against skeptics. Nor should a renewed discourse offhandedly brand critics of today's European Union as »hostile to Europe« just because they object to the way areas of responsibility are parceled out, or to a budget no longer suited to the times, or to the lack of democracy and transparency that has surfaced so dramatically in the current crisis.

No more patchwork repairs

So what should any such »new EU« look like, and how is it to be achieved? It really does look as though the reconstruction of the EU would have to be so radical that it would be equivalent to a founding moment. But the point here is not to tear down everything that has previously been accomplished, but to make it clear that another round of patchwork repairs, such as the EU has carried out in previous rounds of reform is simply unacceptable. Nor will the kind of horse-trading among governmental representatives behind closed doors, which has long been common practice, lead to a sustainable outcome. It has now become clear that only a more thoroughly integrated currency bloc will suffice to overcome the crisis. This will involve a long step toward a new federal balance between the EU and its members which will have to be cushioned by democratic measures at the national and European level. The new Union will also entail bold steps toward integration on the part of the 17 countries that belong to the euro zone, even at the risk – intentionally or unintentionally – of leaving the other ten EU nations behind. If the 17 and the 10 were indeed to get out of phase, that could undermine the EU's internal market and put the entire EU at risk. For that reason alone the euro zone countries will have to try to avert these risks as far as possible. If they don't succeed, there is a risk that one evil (the vulnerable currency bloc) will be replaced by another one (implosion of the Union as such).

Is it possible in these tempestuous times to win an election by campaigning on the euro? That is a question raised by this year's federal elections in Germany. It definitely will not be easy. There are growing numbers of people, including many in Germany too, who by now have become skeptical of or even hostile to the European Union, even though well-meaning contributors to debates on the EU are still trying to gloss over this unwelcome fact. European policy has finally arrived on the front pages, in parliamentary and electoral debates, and in public discussions. And those engaged in European politics often exhibit a certain fear of ordinary citizens, who are now, as never before, asking them tough questions about the costs and benefits of the European Union for Germany and for themselves. Skepticism and hostility complicate the task of devising policies that would enable governments to resolve the crisis. And those policies will have to be imaginative, since there is no blueprint to follow. We now need creative ideas about how to build the »new EU.« And we need answers that will convince Europe's citizens.

The fight for the new EU

Thinking about the future of the euro zone and the EU as a whole requires us to leave behind old stereotypes about the nature of the EU. The well-intentioned, consensus-oriented debate in Germany has been influenced for decades by a kind of thinking that has tended to limit rather than amplify debates on controversial issues. It also requires us to rethink central themes of the integration process in light of the crisis and reinterpret them with an eye to future challenges. What can solidarity mean in the aftermath of the crisis in Europe? How might a political understanding of the EU's final status emerge, as opposed to one based on geographical or functional criteria? The founding fathers and founding mothers of today have the opportunity to rethink the European Union of the 21st century. How might the EU look as a social democracy? And what narrative will sustain this new Europe? As we survey the global changes now taking place, there is much to be said for the idea that, in the end, our prosperity and social cohesion in Germany will hinge on whether we can lay the groundwork for a common future in the framework of the European Union. That would also reinforce cohesion within the EU, where more than three years of crisis have left their mark. But it would also presuppose a different EU than the one we have known up until now, one committed to the principles of subsidiarity, democracy, solidarity, and justice. It would be an EU which recognizes that citizens are at the center of whatever it does, and that the European level is not the most important reference point for most people in Europe. They will continue to be more strongly attached to their own countries, regions, and local communities. It would also acknowledge that language barriers will never simply vanish. Now the opportunity is there to reset our course toward this new kind of union.

Contrary to the dramatic statements one hears in current debates, the other EU countries do not expect Germany to finance the future EU. Rather, they expect compelling ideas that will guide our actions as we build the new Union. In Germany right now it is important to show that the EU debate does include alternative courses of action. That is especially vital where youth are concerned, since they are beginning to lose their faith in the promise of Europe.

In the past, everyone talked of »bringing along the citizen« and »connecting the citizen's life-worlds with those of Brussels« in much the same spirit that people rotate prayer wheels in Nepal – and all without much success. The past few months have shown that people in Europe will get involved in European affairs when they have the impression that really important decisions affecting their future are being made, and when they have the chance to make their voices heard in elections and plebiscites. In Germany they will have that opportunity in 2013, while the next direct elections to the European Parliament will be held in 2014.

If European social democrats seize the offensive and get involved in the impending elections while offering credible European programs, the goal of a new, socially-conscious, democratic Europe is within reach. The narrative for the 21st century would then be something like this: Europe is the place where we can be free in the future, because we have learned to assume responsibility for one another. That is so because we can only preserve freedom, justice, and peace on our continent by acting together. And only together can we create a union in which we and people from all over the world will want to live. ■

Günter Verheugen

What Kind of Europe Do We Want?

»More Europe!« That is the widely accepted platitude we hear in most of the ongoing discussions about ways to contain the crisis in the EU. It is easy to overlook the fact that the Continent's population is going to gain confidence in its institutions only when the individual citizen begins to equate progress in European integration with an improvement in his or her own personal prospects. In this article a former EU commissioner shows how that equation can be made to work.

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It may be that the worst is over. At least that is what the President of the European Council, Herman van Rompuy, said with some relief in the wake of the relatively uneventful meeting of heads of state and government held last December. By »the worst« he meant the breakup of the euro zone, perhaps even the collapse of the entire European Union. Even though most Europeans probably never seriously believed that such things might come to pass, it is nevertheless true that doubts are spreading about how or whether the process of European integration might go forward. The U.S. National Intelligence Center recently published a study on global trends up to the year 2030. Its forecasters believe that the most likely scenario for Europe is a further waning of the Continent's political significance coupled with its relative economic decline. The study identifies several reasons for its predictions, including demographic trends (which are stubbornly ignored, especially in German politics), deficiencies in technological development, and declining global competitiveness. But the most fundamental shortcoming, according to this report, is the political ineptitude of the European Union. Of course, things do not have to turn out the way the study forecasts, since our future still lies in our hands. But how long will that continue to be the case?

Yet van Rompuy's cautious optimism also has solid evidence to back it up. Monetary union is still a going concern. Greece continues to be part of the currency bloc and seems likely to remain so. The international exchange value of the euro has found a level that is appropriate and quite advantageous for us. The rate of inflation remains low. The debt burdens on Spain and Italy are decreasing. Europe's political slalom course is often referred to euphemistically as »line-of-sight« navigation, but it has nonetheless brought forth some results about which no one need be embarrassed. The Fiscal Pact may improve budgetary discipline in the EU; the European Stabilization Mechanism (ESM) is better designed to permit timely intervention than was its predecessor, the EFSF; consensus has been reached concerning banking oversight, although we still do not know how to wind up the affairs of large banks should that become necessary, nor do we know how to build a firewall between the banks' risky speculative business and their normal credit operations. Finally, the European Central Bank has now been authorized to fill the vacuum created by political inaction, having become, for all practical purposes, the lender of last resort. So far so good ... up to a point. It remains to be seen whether the instruments at our disposal will suffice to overcome the debt crisis once and for all. Besides that uncertainty there is another question that remains completely unresolved. The way in which the EU answers it will decide where we actually stand in the year 2030. This question may be posed as follows: How can we attain the level of political competence and economic strength necessary to remain – and be regarded as – an equal participant in the world of tomorrow. The classical response to that question is: more Europe. That is a respectable proposal, at least if one disregards its rather aggressive rhetorical tone, and the implicit denunciation of those who see things otherwise as bad Europeans who should be so kind as to get on their way. Such intolerance of dissent and doubt does the European cause no good. As a substantive policy matter, »more Europe« means the transfer by EU member states of further spheres of authority, ones belonging to core areas of national sovereignty, to the supra-national level. That is the way things have gone since 1957, and they would doubtless have continued on the same track if the crisis had only been a one-time slip, i.e., if there had not been some fundamental problems lurking behind the debt crisis.

»More Europe«: what does it mean?

The question has to be asked: under the conditions that now prevail is it even realistic to advocate a policy of »doing what we have always done?« Indeed, would such a policy even be desirable? In any case it would not be realistic. In practice a transfer of spheres of authority entails a change in treaties. A new EU treaty would require ratification by 27 – soon to be 28 – member states. A considerable number of them would have to submit the decision about a new treaty to a referendum. It is quite unlikely that the member states would be able to agree on a new treaty in the foreseeable future. And it is even less likely that any such new treaty would be able to surmount the hurdles standing in the way of ratification. The dim prospects of ratification are intimately connected to another fact: »more Europe« seems to a growing number of Europeans more like a menace than a worthwhile goal. The word has gotten around that the advantages of European integration are very unevenly distributed. That is the case for social groups and regions as well. The word has also gotten around that European politics-as-usual is the domain of the executive, where highly placed officials – and always the same ones – make decisions in back-room deals. It is no exaggeration to speak of a crisis of integration here, in the sense that the legitimacy of European politics is more and more being questioned, while confidence in Europe's political leadership has been shaken.

This crisis of legitimation and confidence is not the result of the Lehman Brothers collapse and its repercussions. Poor crisis management by national governments and Brussels institutions certainly intensified feelings of deep insecurity, but did not create them. Let us recall the years after 1989. European integration had been until then a project carried out in and by the West; and then, all of a sudden, its pan-European dimensions became visible. Yes, eastward expansion was a strategically courageous response, but have the »newcomers« really arrived in the EU? Are they really welcome and accepted as full-fledged partners? They themselves do not see it that way. The Maastricht Treaty, which was supposed to usher in a true political union, did not achieve that goal. Instead, it created a monetary union with severe construction flaws. Each additional European treaty has just barely squeaked through. The project of an EU Constitution has failed utterly. We are witnessing strong tendencies toward re-nationalization. To be sure, there are no true anti-integration movements out there. However, populist and nationalist forces in many places use Euro-skepticism and European uncertainty among their own electorates as a transmission belt for their own highly dangerous schemes. And then we have the Federal Constitutional Court in Germany. Although it is surely not hostile to integration, its jurisprudence concerning European issues admits of only one interpretation: steps toward integration following the usual pattern push the limits of what Germany's Basic Law allows. The judges in Karlsruhe have indeed raised their index fingers in a gesture of warning, but quite apart from their concerns, we can no longer postpone confronting the problem of how European decisions are going to be given democratic legitimation. What is commonly called European progress regularly runs afoul of the persistent will to defend the traditional nation-state. Only a fully developed system of parliamentary democracy at the European level will change that.

Coherent policy making

We will not reach that point unless the people who live in the European Union are willing to go along. It will not be possible to carry out the required rebuilding of Europe as a *tour de force* of the elite, even if they were prepared to undertake it. And there are at least two areas in which reconstruction is needed: foreign and security policy as well as the economic and monetary union. The first step is to lay the foundations for confidence: the individual person has to see advances in European integration as bringing improvement in his/her own life prospects. For that reason I think we should worry about »more Europe« only as a second step. The first step should be about creating a better Europe, a European Union that acts in accord with its own values by strictly limiting itself to regulating only those things that the nation-state is no longer able to handle. In other words the EU would stop regarding homogeneity as European progress; instead, diversity would be celebrated as a good integral to national identity, i.e., something worth protecting.

Let's begin with the issue of money, something which – as has been so strikingly confirmed in recent years – puts an end to friendships. The European Commission showed itself to be tone-deaf when if proposed a multi-year financial framework that implied that there would be a considerable increase in the EU budget. It made this suggestion just at a time when it was calling upon the member states to exercise greater fiscal discipline, and even asking for the right to force national parliaments to accept such discipline. Although the whole European world painted the British as the villains of the piece, they overlooked the fact that other important countries, including Germany, likewise saw no reason why the EU needed more money. In that situation the right thing to do would have been to think more seriously about how to use European resources in a more efficient, carefully targeted manner. The largest sources of spending – the agricultural fund, the structural fund, and research expenditures – should not automatically be regarded as sacrosanct. There are far too many projects that got approved only because there were European funds available for them, not because they were really necessary. For example, can a regional policy really be correct if it results in widening the disparities in the living conditions of people in different regions rather than narrowing them? Or again let us look at the regulatory framework for the European economy.

Today, the EU not only bears responsibility for the single market in order to determine that framework. In addition it has meanwhile gained new, treaty-based legislative powers, with which it can regulate economic processes and operations. What is lacking here is coherent policymaking, even though the Commission, a collegial body, would be well suited to coordinate policy. But in fact policymaking is fragmented and contradictory. The goals of industrial policy collide with those of climate protection; the objectives of energy policy run counter to the factual circumstances in the economies of individual countries, etc. What is worse, during the crisis little attention has been paid to real-world economic factors. And such neglect has admittedly been due to German influence. In fact regulatory requirements imposed on specific countries have created and deepened the recessions there. There is no European treaty that would have required any such thing.

The unrestrained juggernaut of Europe's regulation mania offers another example of EU overreach. In this respect our previous positions were actually more advanced. At one time the maxim, »think small first« was a fundamental rule of action that was borne out by political experience. It means that it is unnecessary to impose European rules on business corporations and institutions when their activities do not cross national borders. The project of abolishing superfluous regulations or optimizing regulations to avoid placing needless administrative burdens on business enterprises has unfortunately ground to a halt, despite the professed commitment of the European Commission to »smart regulation.« More and more rules, spheres of responsibility, budget posts, and of course new positions are constantly being created. To stem the tide one would have to intervene deeply in the mind-set and deeply ingrained habits of European and national bureaucracies. That is difficult and controversial, but no treaty prevents us from doing it. It is a matter of political will and leadership.

Having said this much, we now come to decision-making procedures. It does not appear as though the Treaty of Lisbon has brought about a change for the better. What one does see in it is the establishment of the European Council as a sort of European super-government, except that the Council is more oriented to intergovernmental consensus. The heads of state and government sit around there micromanaging everything according to the principle of homogeneity. The functional significance of the General Council, which is supposed to worry about the coherence of EU policy, has been vitiated. Other councils, notably the Competitiveness Council, on which the economics ministers serve, are caught up in minutiae. No one has noticed them making any truly substantial contributions, for example explaining how the real economy can once again create robust, sustained growth. It goes without saying that the capital cities of the EU have to take an interest in making the councils work better if they are ever going to improve, and that cannot be taken for granted. This observation seems especially applicable to Germany, where European policy is crafted by a handful of high-ranking officials in the Chancellor's office (and sometimes still by a stray finance minister), but there is no true coordination and priority-setting that transcends the purview of specific agencies and bureaus.

This list could be lengthened, for example by adding the pseudo-common foreign and security policies. What emerges from all this, however, seems to me pretty clear. We do have a need for reform in the EU where our methodology and setting of priorities are concerned. I repeat: no new treaties or institutions are needed to accomplish those reforms. What is necessary, however, is that the responsible parties should comprehend and take seriously both the national dimensions of European decisions and the European dimensions of national decisions. It is also necessary for those in positions of responsibility to summon up the courage to talk honestly with people about our strengths and weaknesses. Above all they have to understand that, given our present situation, we can no longer gain national advantages to the detriment of others in Europe or of the entire European project.

Once all this has been accomplished, we will have to carry on some intensive discussions about how to make democracy work on the European level. But if we fail to make the best out of the circumstances in which we presently find ourselves, we will eventually reach the point where we fall into the worst case scenario that the American analysts predicted. Then no one will have to take us Europeans seriously any more. ■

Hanjo Kesting

The Life of the Mind in Europe

Art and Literature as the Foundations of a Shared Tradition

Hanjo Kesting

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When we talk about Europe, we almost always end up discussing sovereign loans, indebtedness, austerity programs, bailouts, protection of creditors – in short, the administration of programs designed to deal with the multiple causes of the »crisis.« And no word is used more frequently nowadays than »crisis.« Yet it is rare for the conversation to turn toward the real Europe: a continent with great political and geographic diversity as well as a rich history and culture. This landmass got its name from a Phoenician princess who is supposed to have set foot on its soil – allegedly in Crete – several thousand years before the Common Era. There are quite a few famous figures in European literature: Don Quixote, the knight who cut such a sad figure; Hamlet, the perpetual doubter; Oblomov, the superfluous man; and Faust, known for his relentless, troubled striving. We all know them and other such figures as well: Don Juan, Till Eulenspiegel, Tartuffe, Robinson Crusoe, even Sherlock Holmes. Although they come from different national literatures, they have entered Europe's common cultural memory. There they have long since taken on lives of their own, quite separate from that of their creators.

Other authors have used and reinterpreted these figures, bestowing on them a continuing existence in the universe of imaginative literature. There are German Hamlets, English Don Quixotes, Russian Don Juans, and French Robinsons. These figures have long since become sources of inspiration for other art forms too, including painting, music, and cinema. This list alone suffices to show that there is indeed something resembling a shared European culture. But it is an altogether different question how important this culture is to us, and what it might still mean to us today, in the midst of Europe's grave crisis.

What sort of Europe did we have in mind 65 years ago, after the Second World War, when we set about turning the idea

– or, if you prefer, the vision – of a united Europe into a reality? That idea did not come out of the clear blue sky; it arose from another, far more negative experience on this continent: its self-destruction and self-mutilation in endless wars. As Thomas Mann put it, »European wars will always be fraternal wars as well, as long as they are fought out on the terrain of the intellect. And that must always be the case.« To grasp the meaning of his remark, one need only consider the first half of the twentieth century or, for that matter, just the thirty years from 1914 to 1945, the age of world wars and totalitarian regimes.

These experiences were the seedbed of the European unification process, which found its first formal expression in the Treaties of Rome. Nationalism was to be laid to rest, hunger and mass poverty were to be eliminated, and untrammeled capitalism, which had led to the catastrophe of 1929, was to be domesticated. These three goals, political, social, and economic, were regarded as aspects of a unified whole, as an inseparable triad.

It is not easy to recall the enthusiasm and euphoria that accompanied the idea of a unified or unifying Europe in those days, not as we pass through the vale of laments and worries about Europe as it is today. The Europe of the postwar era was supposed to be a project of peace, democracy, liberty, and shared cultural traditions. And these cultural traditions, spanning more than 3000 years, really did exist. The idea of Europe had long since become a reality in them. Those traditions are what constitute the substantive core of Europe – the »old Europe,« as Donald Rumsfeld contemptuously called it at the outset of the Iraq War. If this old Europe did not exist, then Europe would be nothing more than a community held together by economic interests. But we must not inflict that fate on our continent.

Above all else, Europe is an intellectual/spiritual space. There is no other way to put it. This space was already in existence when Rousseau traveled to England to meet David Hume or when Baron Grimm sent off his secret correspondence from Paris to Enlightenment insiders all over Europe, or when Queen Christine of Sweden invited René Descartes to her court. It existed even earlier (perhaps more fully than it does today) when the Scottish philosopher Duns Scotus went to Toledo in Spain to translate the works of Aristotle from Greek and occasionally even Arabic into Latin. These translations count among the foundational acts that gave rise to a great intellectual movement that spread from Italy and became known by its French name: the Renaissance. That word means rebirth, and was supposed to connote the resurgence of classical antiquity. The ancient world provided the most powerful intellectual stimulus for it: patterns, models, criteria, mythological materials and historical subjects. All of this persisted far into the 18th century, to a degree that it is nearly impossible to imagine today.

French classicism in its entirety developed under the aegis of antiquity, especially its Roman phase. And one can say without any qualification that classical German literature, which arose with such amazing vigor and richness in the last third of the 18th century, derived its models from antiquity as well, but this time from the Greek rather than Roman phase. It may be a truism of cultural history, but we have to say it again anyway: without Socrates and Plato there would have been no Kant and Hegel. Without Aeschylus and Sophocles, there would have been no modern theater – no Schiller, Kleist, or Brecht. Without Solon and Pericles, there would have been no modern democracy. The Greeks founded today's system of law, they investigated nature systematically; they found out – as Heraclitus put it – that »all is in flux,« that matter consists of atoms, and that the earth is a sphere.

Europe without Greece?

It is worth mentioning these cultural ties, because our politicians have not been shy about taking modern Greeks to task. One Bavarian minister had the nerve to say that we ought to make an example of the Greeks, *pour encourager les autres,* so to speak. He seems to have forgotten that during the Greek liberation struggle at the beginning of the 19th century, a member of the Bavarian Wittelsbach dynasty was the first to assume the Greek throne. At that time Hölderlin wrote: »O Greece, where have you gone with your genius and piety?« Today people declare unapologetically that the prospect of Greece's exit from the European monetary union no longer frightens anyone. That may be true if one thinks only of the fear that once gripped the financial system at the prospect of Greece's departure. But isn't it far more frightening to imagine Europe without Greece, and Greece left to grapple with its own misery all alone? Such comments reveal a deplorable loss of consciousness, an atrophy of any broader historical sense of what European identity and European values are all about. They represent a triumph of egoism and narrow-mindedness that evokes the bitter lament of Hyperion in Hölderlin's novel of the same name. In that work Hölderlin transforms himself into a Greek in order to tell the Germans, now dressed in Greek garb, their own history of suffering: »and so I came among the Germans,« writes Hyperion, »barbarians from ancient times, who have only become more barbaric through industry, science, and even religion, profoundly incapable of any divine sentiment …«

A network of infinite relationships

Our classical age was preceded by what is now called the *Sturm und Drang,* a brief but boisterous epoch of new departures in literature. Classicism had not come on the scene ex nihilo, and neither did the *Sturm und Drang* movement. Shakespeare was its direct inspiration, and Goethe's speech, »On Shakespeare's Day,« gave the signal to begin: »The first page that I read in [Shakespeare] put me under his spell for the rest of my life, and when I finished reading the first play by him, I felt like someone who had been born blind, but whose sight was restored in an instant by a miraculous hand.« Ever since then, Shakespeare has been the regent of the German theater. His influence on German culture has been so powerful and profound, that people at times have wanted to turn him into an honorary German. Although Shakespeare was the archetypical genius, he showed little originality in his choice of material. About a third of his plays draw on English historical chronicles; another third trace back to ancient sources; and the last third are rooted in Italian novellas from the Renaissance. The material for such famous plays as *The Merchant of Venice, Romeo and Juliet, As You Like It,* and *Much Ado about Nothing* was not invented by Shakespeare. Their models were Italian novellas that were making the rounds everywhere in Europe at the time, most of them composed after the manner of Boccaccio. His Decameron was the prototype for many of them, yet they also drew on a great variety of narratives, including sources from the ancient, Arabic, and medieval worlds such as the story of the Jew Melchizedek and the three rings, which Lessing borrowed for his *Nathan the Wise.*

So, when one zigzags his way through European cultural history, one is drawn into a network of infinite relationships, the structure of which can never be made fully transparent. If you leaf through the volume entitled *Stoffe der Weltliteratur (Materials of World Literature)* by Elizabeth Frenzel, you get the impression that almost all of European literature consists of variations on a few basic patterns drawn mainly from classical antiquity. In a similar vein, the English philosopher Alfred North Whitehead coined the witticism about the history of European philosophy: »The safest general characterization of the European philosophical tradition is that it consists of a series of footnotes to Plato.«

Europe and America

Of course a glance at the ominous fiscal and economic problems that threaten our present-day existence should induce us to ask a question similar to the one Hamlet asks in Shakespeare's play, when an actor presents the great scene of Priam's death: »What is Hecuba to me?« Today, the question would have to be revised so that it asks: what are Shakespeare and Dante, Homer and Virgil to us? How can they help us solve the problems we have now? One could also cite Mark Twain's *The Adventures of Huckleberry Finn.* The hero is a lovable vagabond who prefers to dress in rags and live in a big barrel and refuses to be »civilized.«

It is no accident that Huckleberry Finn is an American, just like his creator, the writer Mark Twain. Of the latter Hemingway once remarked that, »all modern American literature comes from one book by Mark Twain called *Huckleberry Finn.*« It is certainly true that American culture emerged from European, and that they jointly form what is known as »Western culture.« But we should not overlook the differences either.

When the American writer Susan Sontag received the German Book Trade's Peace Prize in 2003, she explored the reasons for the alienation between America and Europe in her acceptance speech, a tension that had become palpable on account of the Iraq War. She warned against the assumption that the divergences reflected merely evanescent differences of opinion. Rather, she argued, there is a latent antagonism in their differences that is deeply rooted in history and was at work long before the current alienation. Sontag explained that, from a psychological perspective, this antagonism was »at least as complex and ambivalent as that between parents and children.« She described the gap between the two continents on several different levels: »American innocence and European sophistication; American pragmatism and European intellectualizing; American energy and European world-weariness; American naivety and European cynicism; American goodheartedness and European malice; American moralism and European arts of compromise.« Behind all of these antitheses one could allegedly detect the Americans' wish to free themselves from Europe and become independent, but at the same time the urge to undermine and demolish the whole system of European values. The logical conclusion, as it were, would be that America was founded upon the idea of breaking with the European past. Europe's past, she argued, was thus not just an annoying burden to Americans, but also – in its emphasison cultural traditions – »thoroughly undemocratic.«

Europe-a cultural graveyard

There is no doubt that American attitudes manifest a deep questioning of Europe, its culture, and its intellectual/spiritual identity. One can observe something quite similar in Russia, which undoubtedly belongs to Europe in a geographical sense, at least as far as the Urals, but which has no role to play in the dream of a »United States of Europe.« In Dostoyevsky's *Brothers Karamazov,* Ivan says to the younger Alyosha: »I want to travel in Europe, Alyosha. And yet I know that I am only going to a graveyard, but it's a most precious graveyard, that's what it is! Precious are the dead that lie there … I know I shall fall on the ground and kiss those stones and weep over them even though I'm convinced in my heart that it's long been nothing but a graveyard.«

The image of Europe as a graveyard suggests that Dostoyevsky is deadly serious about turning his back on the old continent, because, as he sees it, Europe has only a past, not a future. Dostoyevsky thought that European life lacked the most important element of all: a religious essence. One can observe something very similar in America. The United States is the only Western nation in which religion still plays a decisive role. On religious questions Europe pretty much abstains or remains indifferent.

There is no reason to suppress these »outsider« views of Europe: Dostoyevsky's take on Europe as a graveyard and – assuming he is representative of America – Donald Rumsfeld's sarcastic evaluation of war-weary »old Europe.« Yet the very deficiencies of Europe that these outsiders identify also embody the strength and energy of our continent. To repeat, it is more than anything else an intellectual/spiritual space, and that is the underlying reason for its unique attractiveness. If you travel to California, the locals point out their oldest historical monuments: the Spanish missions along the Camino Real that date back to the late 18th and early 19th century. The only things in the state older than those missions are the rocks and the giant sequoias.

Europe, by contrast, has an ancient culture: the Parthenon and the Colosseum; Florence, Venice, and the Sistine Chapel; the Prado and the Louvre; the tiny, ancient Greek Orthodox churches and the Gothic Cathedrals of France; the Charles Bridge of Prague and Warsaw's Wawel Castle. Europe boasts Claudio Monteverdi, Johann Sebastian Bach, Wolfgang Amadeus Mozart and its inexhaustible musical tradition, which must be defended today against Anglo-Saxon pop music. Finally, it has a great literature, the richness of which continues to infuse other literatures, especially those of North and South America.

Southern Europe as the Continent's Seedbed and Heartland

We miss what is most important about Europe if we reduce it to its fiscal and economic dilemmas. To think about Europe in new and more substantive ways, we need to bear in mind the truths of its past: the ancient world, classical humanism, and the European Enlightenment. We may even need the religious traditions of the Continent to imbue the notion of solidarity – what the French Revolution called »fraternity« – with new meaning. Catholic social teachings emphasize this principle of solidarity, as do Lutheran doctrines with their expectation that the state will provide care and support. Rigorous finance capitalism, by contrast, follows quite different laws, ones rooted in greed, selfishness, and egoism. Yet the doctrine of predestination does give that sort of egoism a divine sanction. That doctrinal heritage also plays some role in the trans-Atlantic antagonism adumbrated above.

Naturally, the position of Europe in the world has changed. One can discern innovative movements of all kinds taking shape around the shores of the Mediteranean, the full meaning of which is not always easy to ascertain. And we must not forget the ceaseless flow of immigrants from Asia and Africa. Both phenomena primarily affect Europe's southern periphery, around the Mediterranean. Probably this part of Europe will become even more important in the future. A previous French President even imagined a »Mediterranean Union« of the former provinces of the Roman Empire, which once ringed that sea. It was not intended to be a rival of the European Union, but its completion. In any case, however one modifies the idea of Europe for the present age, the Continent can only rediscover and assert itself by reflecting on its cultural tradition and the richness of its culture. ■

Peer Steinbrück

Banks Must be Allowed to Fail

A New Bid to Restore Confidence

In September of 2012 Peer Steinbrück introduced a plan that would strengthen the oversight and regulation of financial markets. At bottom, what is at stake here is the future role of banks in the economy and society. Readers will note that the core ideas in his plan represent a significant departure from current government policies and thus afford a preview of one of the key alternative policy proposals to be offered to voters in the 2013 elections.

Ever since the international financial crisis erupted in 2007 one crucial unresolved issue has hovered in the background: who will determine the course that the economy and society take? Will it be untrammeled financial markets, driven by anonymous managers responsible to no one and operating with unimaginable sums of money, trolling for maximum yields? Or will it be institutions endowed with democratic legitimacy? One of the decisive political challenges of our time is to provide an answer to that question and thus to put some political restraints on the brand of capitalism that is driven by financial markets.

The crisis costs more than money. In the eyes of many citizens it violates the imperative of justice and any sense of moderation and fairness. They see themselves as the underwriters of last resort who must stand surety for bank managers' poor decisions. It is vital that we regain the power to shape and direct events on financial markets in order to fulfill one of the most important conditions for political efficacy: confidence. This confidence has been lost in the aftermath of the financial crisis, because citizens no longer believe that political actors wield the conductor's baton to direct events. Yet confidence in the ability of politics to shape and direct events is one prerequisite for the stability and efficacy of our social and economic order. Even firms in the financial and real economies ulti-

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mately depend on that stability as well. That is why it is essential that we must take some bold steps toward the regulation and oversight of financial markets and try to encourage a new banking culture.

Between 2008 and 2010 European governments had to come up with 1.6 trillion euros to bail out the banking sector. That sum is equivalent to 13 % of their entire economic output. Three quarters of that amount was devoted to guarantees, while 400 billion euros were set aside for direct recapitalization measures to be undertaken by the state itself. Therefore, we have long demanded that financial markets should be required to share in the costs of the previous bailouts through a financial transactions tax. The groundwork for such a tax has already been laid.

Every transaction would be taxed in which either the buyer or the seller is located in a territory where applicable EU guidelines are in effect. The only way for banks to evade the tax would be to shift their registered places of business out of Europe, which is not likely to happen. Only trades on the financial markets would be taxed. No taxes would be levied on shares of stock or loans issued by corporations.

The EU Commission generally rates the impact of a financial transactions tax on economic growth as »negligible.« Moreover, small savers would be exempt. 85 % of the business volume subject to the tax would be generated exclusively by transactions between financial institutions. Banking commissions such as those provided for in Riester contracts would be many times more costly than the amount that might have to be paid in transaction taxes. Even if banks shift the costs entirely to savers, the latter's burden would stay within reasonable limits.

Banks should be allowed to fail! We are asking for a European body to handle liquidations; this new institution would have a restructuring fund available, financed by the banks. Furthermore, we want to establish a uniform European liquidation procedure for so-called »system-relevant« banks and those whose operations transcend national boundaries. When a bank needs to be bailed out, liability for the bailout should first be assigned to the bank's owners. Next in line would be the bank's creditors who should also be required to ante up for some of the losses.

When it comes to financing the liquidation fund, at the very least we ought to skim off the interest-rate advantage that the big, system-relevant banks enjoy due to the fact that – as markets are well aware – no country could afford to let such institutions fail. This interest-rate advantage is implicitly a government subsidy that banks now cash in as profit. For Deutsche Bank a banking levy at the level of the interest-rate advantage, around one to two billion euros, would far exceed the current banking levy of roughly 100 million.

In other words, the banking levy the Federal Republic of Germany has imposed is really just a placebo. With the connivance of the German government, banks are allowed to buy their way out of their responsibility for a pittance and can continue to pocket the profits they reap from their interest-rate advantage. In 2011, for example, only 600 million euros were collected from the levy. At that rate there is no hope of accumulating enough resources over the long haul to liquidate a struggling bank without risk to the financial system. The banking fund would be restricted to banks that operate across national boundaries. In effect, the banking fund would exempt all other banks (savings-and-loans, cooperative banks, and all small and medium-sized banks) in Germany from the risks that larger banks assume. By contrast, the plans offered by the European Commission are focused on the national level, which means that the risks assumed by Deutsche Bank, for example, also become the risks borne by small banks.

The time-tested German system of institutional guarantees and deposit insurance would be retained for small and medium-sized banks. For that reason we also oppose any European-level deposit insurance system.

Reducing the risks of extortion

In the case of banks involved in complex deal-making, a way must be found to protect the deposit-taking and commercial operations of these institutions from the riskier trading activities characteristic of investment banking. Big banks are crucial to Germany's export-oriented economy in their capacity as providers of financial services; hence, they should continue offering all of those services under the aegis of a holding company.

Under the auspices of such a holding company, lending and deposit-related (commercial) businesses, investment banking and other operations would continue to exist, but now as legally and economically distinct subsidiary enterprises with their own financial statements and boards of directors. By separating these different business divisions, risk and liability would be linked. Liability for risks would be assigned to the unit that had collected the profits generated by those risks. But if a high-risk division incurred heavy losses, the damages would likewise remain confined to that division. All large banks with complex trading activities in investment banking would be required to separate their business divisions.

We demand an end to speculative proprietary trading by banks. Proprietary trading includes all trading book business carried out with the objective of earning short-term profits on the bank's own accounts. Any institution that does proprietary trading should not be permitted to accept deposits or have access to central bank funds. By the same token, banks that do accept deposits or have access to central bank funds should not be allowed to have holdings in other financial institutions, hedge funds, or other shadow banks that engage in proprietary trading, nor should they be permitted to refinance the latter.

Such regulations would exempt over 90 % of banks, including almost all savings-and-loan institutions and cooperative banks, because their activities are below the *de minimus* limit. In the few other cases where the regulations might apply, institutions could demonstrate that they should be exempt because they do not engage in proprietary trading. Separating different kinds of banking operations is no panacea, but it would insure that customers' deposits would not be used for speculation. That one measure alone would not suffice to prevent every financial crisis, but it would rein in the ability of big banks to engage in extortion.

Large commercial and investment banks are not immune to crises just because they can spread risks across their various internal operations. This sort of hedging against risk always runs in one direction only: low-risk business arrangements, e.g., those with corporations or private clients, serve to hedge against the higher risks inherent in the (proprietary) trading business. But when speculative deals go seriously awry, that kind of risk-spreading is never enough, and the deposits of ordinary citizens are put in jeopardy, which means that the government again has to come to the rescue.

Between 1932 and 1999 the United States maintained a strict separation between commercial and investment banking. Learning its lesson from the financial crisis, the U.S. also introduced the so-called Volcker Rule in 2010 which prohibits proprietary trading. In September of 2011 Great Britain committed itself to a strict separation of banking business operations.

On October 2, 2012 a group of experts convened by the EU Commission presented its suggestions for structural reform of the banking sector. In large measure the experts' ideas dovetail with the proposals adumbrated above for regulation of the financial markets. In particular, the group of experts likewise proposed a separation between commercial and investment banking.

Shining a light into dark places

Shadow banks such as hedge funds, private equity funds, and special purpose entities make up an ever greater share of the financial markets, even though they have not been thoroughly regulated. In the future one principle should apply to the shadow banking system: those in the same business should be subject to the same set of regulations!

Many shadow banks have their headquarters in tax havens outside the EU. How should they be regulated? Shadow banks rely on financing from the banking sector; in fact, they are often nothing but extensions of banks already located in Germany or elsewhere in Europe. If one could supervise banks located in and capital flows out of Germany, one would thereby indirectly oversee the shadow banks as well.

In many instances financial transactions have lost any connection to the real economy. Derivatives, for example, do not embody trades in real products; instead, they anticipate future price movements or special risks. The bulk of these transactions are carried out as so-called over-the-counter (OTC) trades beyond the reach of regulated markets. We demand greater transparency, oversight, and standardization of derivatives trading.

The involvement of banks and other financial market actors in raw materials markets has finally gotten out of hand. Banks buy and sell whole oil tankers and use commodity futures trading to drive prices for food into the stratosphere. We are therefore asking that banks be prohibited from using investment and index funds to trade in foodstuffs, agricultural products and energy unless there is some reason related to the real economy for them to do so.

We demand an across-the-board prohibition on unsecured »short« purchases of credit derivatives on governments, banks, business enterprises, etc. The unsecured shorting of credit insurance is a bet that only pans out if the other party goes bankrupt.

A large proportion of the trading done on stock markets is no longer between human beings, but rather between machines. Algorithms buy securities in large volumes, only to sell them again a very short time later, resulting in rapid price fluctuations that endanger the stability of financial markets. The crucial point in any effective regulation of so-called high frequency trading is to set up an approval procedure for the algorithms themselves.

The German Federal Government insists upon an approval procedure for trading houses and leaves oversight of the algorithms up to them. We are asking for direct control and the approval of each algorithm on its own merits. And any changes to an existing algorithm would have to be reapproved. We also demand a minimum holding period for stock exchange orders generated by the algorithms.

The appraisal of financial products, risk management, and especially the securitization of shareholders' equity capital depend mainly on the ratings issued by specialized agencies. The market for these services is dominated by three American firms. If they turn thumbs down on a given company or institution, that can send the whole economy into a tailspin. We demand independent oversight of ratings issued for governments by the OECD or the IMF, a reform of the business model used by ratings agencies, the establishment of a European ratings agency in the form of a not-for-profit foundation, and the development of ratings procedures especially tailored to banks. It makes sense that European influence should not extend to the internal legal structure of the three U.S. ratings agencies, but that does not alter the conclusion that they should carry less weight in the European economy. Therefore, the proposed regulatory scheme features three alternatives that could be implemented in Germany or Europe.

Living up to our responsibilities

The financial crisis made it apparent that many banks had not reserved enough of their own capital to cover their losses, nor did they have enough liquid funds to maintain their liquidity throughout the crisis. Basel III calls upon banks worldwide to meet higher reserve and liquidity requirements (Basel III was the final package of reforms approved by the Basel Committee of the Bank for International Settlements in response to the weaknesses of banking regulation revealed by the global financial and economic crisis beginning in 2007: editor's note). It would be a good idea to implement those reforms expeditiously, but without jeopardizing the supply of credit to local governments and the middle class. Moreover, the new regulations will need to be adapted to the three pillars of Germany's banking system and its high proportion of credit-granting institutions that operate regionally.

The financial crisis originated in real estate bubbles in various countries (the United States, Great Britain, Spain, Ireland), where mortgage loans covering up to 100 % of the total cost of the property were approved; indeed, some loans for up to 120 % were made in anticipation of rising real estate prices. We favor the traditional rule that mortgage loans should not cover any more than 80 % of a property's appraised value, and we think that this rule should be legally enacted throughout Europe. We want to protect citizens against the risk of excessive indebtedness. The proposed upper limit of 80 % is already being observed by reputable banks in Germany; besides, it is consistent with the consumer-friendly Warentest Foundation's recommendation concerning proper levels of home mortgage debt.

We are asking for a more appropriate remuneration system in the financial industry. Among other things a better system would entail that: bonus payments not exceed an employee's fixed salary; all top earners and not just the board of directors should have to reveal how much they earn; bonus payments would have to vary inversely with the level of risk incurred to earn them; and some limits would be placed on the tax-deductibility of executives' salaries. At this time it is still legally possible to impose limits on the amount of the deductions that highly paid executives can claim. For example, the corporate income tax has long limited the deductibility of directors' remuneration, such that only ½ is deductible from taxable revenues.

Up until now when banks evaluated risks, they all too frequently closed their eyes to what was really going on so as not to jeopardize the profits of trading operations. We insist that the risk models used by banks be more carefully scrutinized and subjected to more stringent limits. The currently existing loopholes used to evade equity requirements have to be eliminated.

Oversight requires a level playing field

The European Central Bank should initially be given the task of acting as a regulatory board, although we should bear in mind that its functions could later be spun off. It would be responsible for heading off systemic risks at an early stage and overseeing big, trans-border banking operations. Admittedly, the ECB is already deeply involved in the financial markets. But in the short run there is no other body besides the ECB able to take on the functions of European oversight. In order to prevent any conflicts of interest, we therefore ask that the regulatory function be kept strictly separate from monetary policymaking and assigned to a legally independent oversight entity. But as noted, eventually we would like to spin off the ECB's regulatory responsibilities to some other body.

Democratic control of European banking oversight must be lodged in the European Parliament. Oversight of small and medium-sized banks (especially savings-and-loans and cooperative banks) in Germany should stay where it is: in the hands of the Federal Institute for Oversight of Financial Services and the German Central Bank. National oversight should be strengthened by improving cooperation among all the parties, accelerating the regulatory processes, expanding regulatory authority, and improving the training and remuneration of regulators. ■

Gustav A. Horn

How to Achieve Effective Oversight of the Financial Markets

By now there is a broad consensus on the need for better oversight of financial markets, but not on how to accomplish it. Does there have to be an international agreement on every measure to be taken, or could Germany act on its own?

Gustav A. Horn

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The economic system of Western industrial nations has undergone fundamental changes since the end of the seventies. As new government policies increasingly deregulated markets, control over the means of production, and thus over returns on capital, shifted noticeably. The deregulation of financial markets led to a situation in which more and more financial resources were being invested in securities markets. The new owners increasingly tended to be institutional investors acting in behalf of capital accumulated from a wide variety of sources. In contrast to individual stockholders, who were usually not very aware of what was being done with their money, the new breed of institutional investors actively exercised their rights as the true owners of the securities purchased in their name.

The term »financial market capitalism« has been coined to describe a state of affairs in which firms are run in accordance with criteria set by the financial markets. This trend has given firms in the financial sector extraordinary powers via their function as nodal points for the accumulation and distribution of capital. They have gained a degree of control over the means of production. As a rule, the losers amid all these changes have been dependent employees, who now have to assert their interests against a coalition of investors from the financial markets and management. However, the full force of these power shifts has been moderated in Germany, because co-determination requirements have survived unchanged.

The most fundamental change in the structure of the economy involves the increased mobility of finance capital. That mobility enhances the economic power of and insures comparatively higher rates of return for finance capital vis-à-vis real capital and employees, who inherently react more slowly. In turn, that advantage strengthens the incentive to invest in finance rather than real capital, which only serves to enlarge the financial sector still more. Another trend has reinforced the first: on a global level the traditional pay-as-you-go system for old age provision is being replaced by investment in the financial markets. That too quickens the influx of new money into financial markets and explains the rise of pension funds, which now exert disproportionate influence due to their enormous capital stocks which are always on the lookout for investment opportunities.

This shifting balance of power in the structure of the economy is leading to a redistribution of returns; those from investments or employment in the real economy fall as compared to those in the financial sector. But that is not a sustainable situation in perpetuity, because the expectations of high returns in the financial sector cannot be met over the long run. Returns to the financial sector ultimately depend on those achieved in the real economy. For that reason finance capital is confronting the danger of structural depreciation.

These trends also provide the most compelling reasons for strengthening regulation. The only way to correct the imbalance between the real economy and financial markets – which tends over time to reduce returns – is to impose limits on the activities of financial markets. That is also the only means of overcoming the danger of structural depreciation already alluded to. Regulation makes investment in securities less risky, and thereby renders old-age pension plans backed by capital a surer bet, just to cite one example. Uncertainty is the raw material that financial markets deal in. Financial investors enable other financial investors and business corporations to buy their way out of uncertainty. In return they demand interest and profits. Whenever the limits imposed on these transactions are too weak, trade in this commodity can be expanded almost at will, since the uncertainty being marketed becomes ever greater and more intensely felt. The results were evident in the form of the financial crisis of 2007 and its aftershocks.

All of these observations have universal validity. Because markets for goods and capital in today's economies are so closely integrated, the tendencies identified above ultimately affect every national economy. But they are especially applicable to those, like Great Britain's, in which the financial sector contributes a relatively high proportion of the value created across the entire economy. In that respect countries such as these should be especially interested in stricter regulation.

After all, the macroeconomic dangers posed by financial crises are especially acute there. On the other hand regulation also hampers financial transactions, thereby slowing down the expansion of this sector, which is so crucial to the entire economy. Moreover, there is also a considerable incentive to free-riding behavior here. If regulation is relatively weak in a given economy, financial enterprises will want to move operations there, which means that the financial sector will expand more vigorously. On the whole a country such as Great Britain is torn between two imperatives: imposing strict regulation to meet its heightened need for security versus creating sufficient leeway for the expansion of the financial sector.

Analysis thus shows that there is an underlying, objective need for stricter regulation across the board. For that reason even countries like Britain and the United States have long since enacted tougher restrictions. Despite their flaws, some parts of their regulatory schemes, such as the Dodd-Frank Act in the United States, go farther than any measures yet adopted in Germany or the EU. Nevertheless, they are mostly designed to limit banks, leaving a great deal of leeway for private equity investors. That is, the banking sector includes only a part of the entire financial sector, albeit a highly important one. It certainly makes sense to impose limits on banking activities, not least to reduce the risk that the government will one day have to assume the banks' debts in order to stabilize monetary transactions. But the private equity sector poses dangers of its own when high-risk financial instruments are traded there that eventually lead to defaults. Hence, a rational scheme of regulation would have to address this sector as well.

It is just at this point that the battle lines are drawn between the Anglo-Saxon countries and the rest, since the former wish to restrict tougher regulation to the banking sector alone, leaving other financial sector actors with enough elbow room for innovations that will continually enhance the efficiency of the financial sector. At the same time, there is no obligation on the part of government to assume any liability here. The actors have to assume that they will go bankrupt if they run excessive risks. The idea is that, once they realize how vulnerable they are, that recognition alone will put a sufficient damper on their willingness to take risks.

The problem lies in the integration of the banking sector with the rest of the financial sector. As the financial crisis revealed, this interdependence can allow risks to arc over from one part of the financial system to another. Countries such as the United States try to meet that challenge by setting up a separate banking system, such that regulatory limits on integration prevent weaknesses in one bank from spilling over into the remainder of the financial system. But the problems with that sort of arrangement lie in the details. It turns out to be extremely difficult and complicated to completely understand, supervise, or in some cases even prohibit such interdependence.

Given this complex background, a gradual approach to re-regulation would seem to be the most appropriate one. To create the greatest possible commonality, all steps for which a broad consensus exists should be enacted as quickly as possible. That would help prevent what might be dubbed »regulation evasion,« whereby financial institutions shift operations to more lax regulatory environments. In other words, the strict models prevalent in the United States and Britain should be adopted in all points concerning banking regulation. Among other things, that would mean setting up a separate banking system. Such a step would limit the banking sector's radius of action, forcing it to concentrate on less risky forms of investment.

The arguments presented so far have shown that even this level of regulation is not sufficient to avert the risks to macroeconomic stability. Consequently, a further step is necessary: regulations must be enacted that create a framework to limit the risks posed by other actors in the financial markets. This second stage will work best if a uniform system of regulation is created all across the euro area, especially if a transaction tax is to be levied on all forms of investment. The most sensible approach would be to impose the tax on all transactions that involve institutions in the euro area, since that would rule out regulation evasion. Furthermore, there is complete agreement about the need to register all financial transactions, for otherwise it would not be possible to tax them at all.

Likewise negotiations should sound out the prospects for enacting further joint measures. It would be desirable if broad agreement could be reached on a rule that financial instruments should be allowed on the market only with prior approval, or that derivatives not backed by goods in the real economy should be banned in principle. Additionally, structured investments should be marketed only in a standardized form, so that every investor knows what he or she is being offered. It would also be desirable if unanimity could be achieved on all these measures and others to follow. But if that is not the case for all or some of those steps, then the remaining measures should be enacted in Germany alone in a third phase.

If that were to happen, Germany would have an economy that handles financial transactions in an especially restrictive way. That would have two advantages. First, it would generally limit the negative effects that an orientation toward financial markets entails. Second, it would make financial transactions carried out with institutions in Germany appear especially safe. That could have particular appeal to investors who are interested in security and therefore could attract capital flows. It has been argued that relatively stringent regulatory measures would limit the influx of capital.

However, that has been proven false in the past, as the examples of Canada and Spain show, where relatively tough restrictions were in place. The only drawback to tougher regulation would be diminished opportunities for employment in the financial sector. But considering the risks posed by that sector, this should be an easy pill to swallow. ■

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