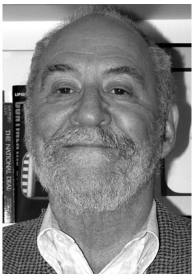
THE EUROPEAN DEBT CRISIS

INCREMENTAL REFORM, AUSTERITY, AND INSTITUTIONAL FAILURE[1]

Daniel Drache



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Abstract: This article focuses on the way a crisis needs an institutional actor and champion. Through painfully slow intervention and muddling through, the European Central Bank (ECB) created new policy space for a European financial and banking system that was on the point of collapse. However, the institutional commitment to austerity and deep cuts to state spending have pushed the goal of a stronger federal union farther away than ever. This article examines the strengths and limitations of institutional "ad hocery" of making policy on the go. It also has a comparative examination of the Canadian experience with policy ad hocery during Canada's long-running constitutional wars between 1960 and 2000. In the end, Ottawa's strategy left the Canadian federal union decentralized and much more fragile. It makes the case that despite the accomplishment of keeping European capitalism afloat with massive and repeated bailouts of public money, the worst-case scenario facing the Eurozone of some kind of collapse in the near future is still on the table.

Key words: EU integration; global financial crisis; institutional design flaws; comparative crisis management; governance; public policy; Europe's strategic options

The Story So Far

It is important to gain perspective on the European financial crisis that began in 2008 by asking the critical question of what we have learned so far about the European Union's (EU) institutional gaps, innovative processes, design flaws, and the pivotal role of the European Central Bank (ECB). The crucial fact is that the concerted interventions of central banks have kept global capitalism from collapse and on life support. The repeated interventions in the global financial markets by the ECB, the US Fed, the Bank of Japan, and the Bank of England, including quantitative easing, massive loans to rescue banks, and bailouts on sovereign debts, have topped an estimated US$8 trillion dollars of taxpayers' money so far and the bills keep mounting. It will take some time before a full cost accounting is available. The story is complicated, and there are still more questions than answers about the ECB's "muddling-through strategy." The article that follows examines the strengths and limitations of institutional "ad hocery." It argues that despite the achievement of keeping European capitalism afloat with massive and repeated bailouts, the worst-case scenario facing the Eurozone of some kind of collapse in the near future is still on the table. By contrast, the goal of a stronger federal union is farther away than ever.

Muddling Through: The Preferred but Costly Choice for States

Many years ago, the distinguished economist Charles Lindblom wrote an iconic article on "the science of muddling through," a defense of baby-steps instrumentalism and limited policy ambition adopted by policy elites when choosing among instruments for their goals. Certainly, better decisions result when the actions of individual administrators are coordinated with those of others but that process frequently breaks down. Administrators are not the rational actors of textbook lore because they do not look at real alternatives. Practitioners are drawn to short-termism because in a best-case scenario, "they expect to achieve their goals partially" (Lindblom 1959, 80). The policy trap is that policy elites become locked into this methodology repeating the familiar and tried sequences to preselect the policy instruments they know best. They build on the past step-by-step method avoiding a fundamental alternative to complex problem solving. The weakness is that a policy run by limited ambition tells little about the primary causes for the disaster and the structural reforms needed to exit the crisis.

Most experts are of the view that the EU had no preplanned strategy to address both the bank and sovereign debt emergency. There was no failsafe mechanism to manage a banking and sovereign debt crisis of such magnitude. It had no plan to deal with the growing number of bank failures and could not have anticipated the need for rolling sovereign debt bailouts in Spain, Ireland, Portugal, Greece, Cyprus, and Italy, with France possibly waiting its turn in the wings. This was simply not an integral part of its institutional design. Simon Johnson has shown the consequences of uncoupling the real and symbolic economies since the deregulation of financial markets became the high standard of public policy in the 1990s. In the EU, the distorting effect of the uncoupling of the real and symbolic economies has produced a disequilibrium of giant proportions. The banking sector is so concentrated that it has become "too big to regulate." Still, the EU has managed to overcome "the shock and awe" of the banking and sovereign debt crises through the ECB's creation of a new policy space, driven by necessity and backed by Germany.

The EU's Überbank and the Austerity Rescue Package

Historians will no doubt confirm that it is the ECB's concerted interventions as the EU's Überbank, more than the actions of any other actor, that have saved the EU from collapse. "They did what is absolutely necessary," said the head of the International Monetary Fund's (IMF) Financial Stability Department. Now they have to repair the financial systems and deal with the unintended consequences of cheap money (Giles 2013a). Europe's economic prospects have not been this dismal for two decades.

The stagnation of the European economy is the highly visible legacy of the austerity measures and deep cuts to state spending imposed on EU member economies. The lack of bank lending to small- and medium-sized enterprises in the south is particularly troubling. Unless refinancing rates fall further, the troubled economies will remain mired in recession, and new job creation will remain non-existent. The ECB has failed to fulfill its mandate to end fragmented lending rates as it announced it would when it justified the introduction of the Outright Monetary Transactions Program in autumn 2012. It saved the Euro but left the peripheral economies of the south deeply troubled.

The EU is experiencing an unprecedented tidal wave of job loss, anemic growth, and soaring unemployment particularly for those under 30. It is estimated that almost 50 percent of people under 30 years in Spain, Portugal, Cyprus, Ireland, France, and the UK are without work. In Spain, 1.9 million households are without a breadwinner. The number of unemployed in Spain broke the 6 million mark, setting a new high, and France's jobless numbers broke the 3.2 million barrier (Buck 2012). In 2012, German Chancellor Angela Merkel again recommitted Germany to higher borrowing rates; regarding the Eurozone's peripheral economies, she said that the ECB has to do more to make liquidity available to small and medium-sized firms. She made these remarks within the context of deteriorating economic conditions and the economic suffering of millions of EU citizens. However, it is not possible to bring down the unemployment numbers before the economy recovers. At this time, the governance crisis is creating a two-speed or multi-speed Europe, evidence that this policy failure will be responsible for even greater hardship.

Since 2008, the EU has come through a baptism of austerity fire; however, the union is more divided than ever, and the deep structural crisis between southern and northern Europe is highly visible. Debt levels for the four most distressed Eurozone members continue to soar hitting all times high. Portugal is close to surpassing Italy as the second highest indebted nation. Ireland, Spain, and Portugal saw their debt levels increase since enshrining austerity in the "fiscal compact" by legally restricting the size of budget deficits.

Arthur Donner warns that fiscal austerity is worsening the debt picture in most of Europe, and IMF projections point toward the conclusion that government debt will continue to grow more rapidly than the economies this year and next (Donner 2013). José Manuel Barroso, the European Commission President, admits now that Europe is near its austerity limit (Spiegel and Ehrlich 2013a). France's debt is more than 80 percent of gross domestic product (GDP) and Italy's more than 125 percent. An immediate effect of the ECB's austerity policy combined with record low interest rates is that even though France is able to borrow at rock-bottom interest rates and Spain's borrowing costs have fallen, both countries are suffering a surge of unemployment as the austerity policies have pushed them deeper into recession (see Figure 1).

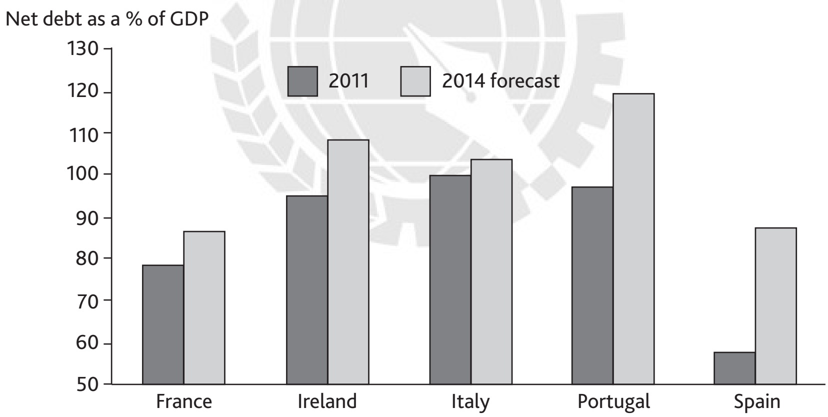

Figure 1 The Nasty Debt Trap of Austerity

Source: Quoted in Donner (2013).

The Functionality and Limits of Small Policy Steps

With Europe deeply troubled, an increasingly skeptical European public is footing the bill for the twin crises of sovereign debt and insolvent banks, and as this is written, more drama is on the way. In their seminal work, *This Time Is Different: Eight Centuries of Financial Folly*, Carmen Reinhardt and Kenneth Rogoff make the case that Europe, like the rest of the globe, is in the middle of a 10- to 15-year cycle of weak, slow, stop-and-go recovery during which more turbulence can be expected. The policy lesson for the EU is that further austerity will push the Eurozone farther from growth maximizing levels (Hallett 2013). Second, although inflation is very low, consumer confidence has been badly shaken by the severity of the spending cuts. ECB policy is inflexible on the fundamentals, and given the amount of slack in the EU economies, the austerity measures and unrealistic inflation targets prevent the Bank from responding to the deepening recession effectively. So far, there is no evidence of any green shoots of recovery in consumer confidence.

The IMF warns that improvement in financial conditions has to be sustained through policy actions that address "the underlying instability and promote an economic recovery" (Giles 2013d). The Bank's job, according to Martin Wolf, "is to aim for the highest level of economic activity consistent with stable inflation" particularly in worsening situations (Wolf 2013). It is going to take a lot more to clean up this financial mess, than low inflation targeting and a steady diet of austerity. If unemployment remains at near record levels, temporary joblessness is likely to become permanent. France may require a sovereign debt bailout if it fails to reduce its debt levels. New constitutional court challenges from angry citizens may derail the austerity packages negotiated by the so-called Troika comprising the IMF, the ECB, and the Commission. This happened in Portugal in April 2013 when the proposed austerity package was derailed and had to be renegotiated to comply with the constitutional court's decision that the government had failed to protect the pension rights of its public sector employees. Europe's troika of elite managers still has lot on its plate. Even the "best regulated" German banks need to be reorganized, rescued, and merged, and the reforms have not really begun in earnest. Monetary policies are not effective on their own; they have to be complemented with measures designed to build a more resilient financial system with higher capital standards and effective macroeconomic policies that support demand and job creation.

Ad Hocery and Policy Innovation: EU's Successful Crisis Management Strategy in the Past, but This Time It Is Different

Theoretically, the ECB's response has to be understood as a non-linear intervention for non-normal times. Supra-national bodies like the EU have survived on a crisis management diet of ad hocery and policy innovation "on the go." The current financial crisis is the biggest challenge to its existence in a half century touching the lives of more than 600 million of its citizens. Innovations on the go saved it in the past, but today, it could be a kind of "dark hole," the wrong process-driven management strategy. Since its earliest days as the Coal and Steel Community, the EC has muddled through each crisis in its history to arrive at a new stage in its development. It lurches into institution-building and innovates at 2 minutes to midnight. The Stability and Growth Pact of 1997 was another example of policy-making on the fly. Its immediate goal was to impose fiscal discipline on structural deficits by taking tough measures to correct these imbalances. That pact fell into disarray, however, when France, Germany, and Italy among others repeatedly missed their mandated deficit target of less than 3 percent. In response, however, the ECB waived the rules in a stunning example of the failure of collective responsibility. Even in 2013, France, Holland, and Italy are going to miss the 3-percent barrier.

Europe's intergovernmental treaty binds peripheral economies, such as Italy, to payback debt worth more than 2 percent each year. This would require them to run surpluses for at least a generation. Yet, to a degree, some would find surprising, the rules of the "fiscal compact" to restrict budget deficits can be altered in exceptional circumstances. Germany's 2013 extension to France of a 1-year grace period before getting debt levels down was politically motivated. German officials do not want to provoke a Franco-Germany quarrel just months away from the German national election (Münchau 2013). Such ad hoc policy decisions reinforce the governance divide between the north and the south and are part of the latest crisis of integration moving the Eurozone toward a multi-speed Europe. Members such as France, Italy, Ireland, and Portugal negotiate deals with vastly different terms and debt payback schedules. Why should this be?

ECB's Stepping Up to the Plate and Fudging the EU's Constitutional Restrictions

As the most important player managing the crisis, the ECB did not come to its leadership role precipitously. The ECB was prohibited from being a lender of last resort by s. 125 and s. 123 of the Functioning of the EU Treaty (Braun 2013). Finding a creative way around these restrictions following the 2008 Lehman Brothers meltdown is what Paul Krugman calls "rule-bending" in extraordinary times. The ECB's sustained intervention in the rolling sovereign debt crises that engulfed Ireland, Portugal, Spain, Greece, Cyprus, and Italy is a tipping point of sorts. In 2011, the ECB offered banks unlimited 3-year loans and then created a bond-buying program. The ECB's successive interventions allowed the EU to survive but at a cost as a much-weakened political entity (see Figure 2). Without growth, any chance of building a strong federal Europe is impossible. For the third year, the IMF has revised downward its projection for a gradual EU recovery. Christine Lagarde, IMF Managing Director, warned of a three-speed recovery in which some nations do well and some slowly mend while others remain in deep trouble. By 2012, Lagarde publicly "distanced" the IMF from the Bank, the

Commission, and Germany. It is not clear whether or how a banking union could come into being that would mutualize risk and transform the EU into a much stronger federal union in the face of Merkel's opposition. If a renewed and much stronger EU is the end goal, many Europeans are bleak in their assessment of an imminent recovery along with institutional reform.

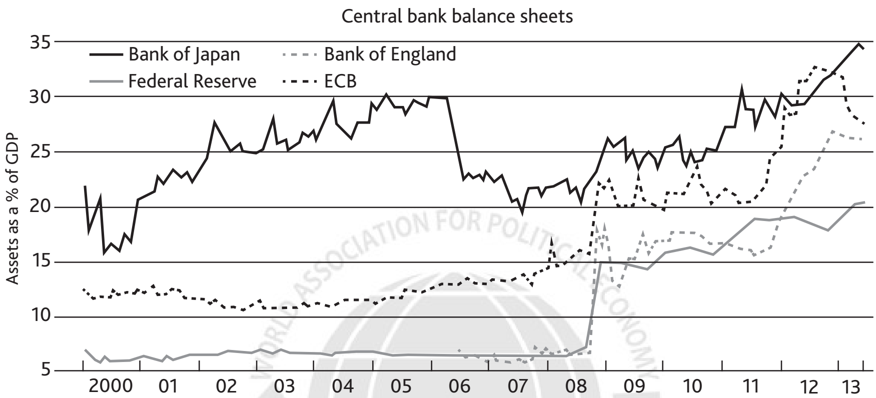

Figure 2 A Massive Keynesian-Style Rescue Effort by Central Banks

Source: Giles (2013b).

Can the EU Survive without a Viable Political Project? Who Has the Real Power?

Much of the gloom is due to the deep cleavages within the EU and the unwieldiness of its governance structures. National governments want more decision-making power. The membership does not want another Blair-like figure or a powerful bureaucrat such as Jacques Delors, former President of the European Commission, to run the show. Where the Commission was once the epicenter of the EU under Delors, power has shifted to the Council of Ministers where member states expect to and do have much greater influence in setting the agenda on major issues. Institutionally, power is now parceled out and distributed between its competing decision-making centers—Barroso, the President of the Commission; Herman Van Rompuy, the first full-time president of the Council of Ministers; Martin Schulz, President of the European Parliament; and the European Court of Justice (ECJ). At one time, the economic aims of the EU served a very explicit political project as European integration was intended to build, extend, and fashion "a genuine political community." The political project was sold to the founding member states, in Henri-Paul Spaak's aspirational words, as "the first stage of a yet greater political revolution" (Maas 2008, 584). At present, the EU has 27 members, and Baltic countries are lining up to join, but there is no longer a clear and compelling political project. Europe needs to go well beyond the tunnel-like focus on Merkel's ortholiberalism to build popular loyalty and commitment among its citizens (Ryner 2012). The first priority for Europeans is stable employment and a secure future. Austerity has crippled the Eurozone social market as the real economy has steadily worsened; as Jacques Delors has pointedly noted, "it is difficult to fall in love with a common market" (Maas 2008, 584). Add to the messy governance mix, the gaping socioeconomic divides between the north, south, and many of the former members of the Soviet Bloc in the Eurozone. It surprises no one that the community is in a state of permanent crisis and unable to make difficult decisions about its future.

The real dealmaker, Germany is not prepared to entertain the fundamental changes to Europe's financial system that would allow the ECB to lend directly to governments. Germany's finance minister warns that the current proposal for a rescue fund and a single EU über-bailout agency requires change to the Lisbon Treaty before either fundamental initiative could become law. This two-step process will take many months if not years to effect. The German public and its political class appear to be of one mind in opposing bailouts for troubled Eurozone economies because such measures would breach existing treaty restrictions. So for the moment, there is new uncertainty regarding whether the Bank will have the legal authority to become the common, powerful centralizing regulatory authority. Germany has put its foot on the brakes of a bailout plan for far-reaching regulation reform. Effective co-operation requires a lot more inter-European co-ordination than has existed up until now if the ECB intends to centralize the supervision of Europe's largest banks.

For instance, the ECB needs protection from any losses incurred by members who receive reduced lending rates under the Funding for Lending Scheme; however, there is no agreement on how this should be done. A number of technical and political issues remain in limbo given the glacier-like pace of reform. Once the 2013 election is behind Merkel, Germany may soften its position on rigid austerity targeting and support less orthodox policies for the ECB. She has been the "iron lady" since the 2008 financial crisis jolted the EU into reverse gear. Experts make the case that her deep-rooted opposition to expanding the powers of the ECB has softened for pragmatic reasons since the financial crisis took down banks and pushed member's economies to the edge of insolvency. Still, for the 30 million unemployed throughout Europe, the German election is unlikely to change anything. Public spending curbs and slowdown in growth and more austerity measures will see further economic contraction in 2014.

EU's Multiple Regulatory Failures

The sovereign debt crisis exploded many myths about the superiority of the European regulatory regime and the structural importance and positive externalities associated with the EU's social market. Compared to the Obama Administration's rapid intervention and massive bailout of banks and near banks, the EU's response merits barely a passing grade. Although in the end, Mario Draghi, President of the ECB, committed the unlimited resources of the EU to stem the contagion. Europeans have not fully absorbed the fact that German, Swiss, Dutch, and British "A"-level banks invested billions of Euros in sub-prime mortgages and other sketchy investment assets that have compromised their balance sheets. The regulatory safety nets that Europeans believed made their financial institutions crisis proof have turned out to be more fiction than fact. The number of distressed banks that failed the Brussels-demanded "stress tests" for solvency and stability shocked European public and drove a wedge between Europe's political class and the ordinary citizen. The imposed rigid austerity measures have pushed temporary and long-term jobless numbers to record levels. Growth has been stunted.[2] Much of the Eurozone remains handicapped by elevated borrowing costs, deteriorating asset quality, low profits, and a torn social net. Without more progress, the IMF warns that the Eurozone will be marked by worsening financial conditions and "by recurring bouts of financial instability" (Giles 2013c). Surely, these destabilizing effects are the poisoned chalice of austerity and regulatory failure.

The second myth that was shattered, though far from vanquished, is that neoliberalism fundamentals do not require a failsafe mechanism to address the possibility of a sovereign debt crisis and system-wide bank failures. There was no provision for adequate safeguards in the event of a financial meltdown. The hubris of the Maastricht Treaty has led to questioning about the fundamental viability of the European polity. Member states want to retain local norms and practices even while supporting, in theory, genuine transformative financial regulation beyond the nation state (Maas 2009). With the anti-austerity camp on the rise in crisis-stricken Europe, the leadership of disciplinarian Germany is itself an obstacle to winning back the public's support for democratic reform and reform of the financial system (Spiegel and Ehrlich 2013b). The question of whether the Bundesbank is accountable to the European polity or only to the German voter arises. Power sharing at the European level is not part of German constitutional culture nor is it ever likely to be. The real power behind the throne is the Bundesbank and German domestic politics. With the global economy stuck in a rut, there are few grounds upon which to believe that Europe can achieve a sustained lift-off by piece-meal reform. Not surprisingly with so much ambiguity between the ECB and the "real seat of power," any lessons learned from post-crisis planning by different banking authorities are not well integrated across the Eurozone.

In the absence of a coordinated institutional response to develop one-stop regulatory financial authority, the prospect of a single resolution regime for banks along with a single supervisor remains a distant hope. The Cyprus intervention confirms the skeptic's view of the weakness in the EU governance model. A regulatory learning curve was not visible in the least, and afterward, Draghi did not mince words in calling the ECB's Cyprus bank and sovereign debt rescue a "botched" initiative (Steen, Wilson, and Ehrlich 2013). The confiscation of individual bank deposits in Cyprian banks, a response that Draghi signaled would not be the future template for other crisis interventions, opened a new and controversial chapter in the Eurozone's long-running sovereign debt crisis.

The Unraveling of EU's Social Market

One lesson learned from the financial crisis is that there is a high degree of ambiguity in the material world that statistical models fail to capture. Uncertainty and fluidity are critical factors in the way conventional ideas are discursively delegitimized by events. Since 2008, the dynamics between elites and non-elites have deteriorated. The political class no longer gets to decide who speaks on the financial crisis and defines the public agenda (Birchfield and Hayes 2013). In an age of mass texting and social media, publics are no longer phantoms easily led by their national elites. Social media and networked activism have become mega variables that complicate the understandings between Brussels' powerful bureaucrats, finance ministers, presidents, and prime ministers. In his latest book, Jürgen Habermas argues that the Eurozone is in crisis and that capitalism cannot sustain itself as it is presently organized. The public has grasped this essential truth but so far has been able to intervene strategically only in Spain, Italy, and France with limited effect (Habermas 2012). It has proved incapable of resetting the Eurozone's priorities toward building a stronger federal union.

Disenchantment with European politics and its leaders has led to the surprising win of anti-establishment political parties in Italy and Greece but not surprisingly in Spain or Ireland, both of which are fertile grounds for grassroots electoral organizing against the political class. The public's disaffection with EU austerity policies has registered finally with Europe's political elites in early 2013. Barroso was forced to admit that "Europe is near [the] austerity limit," and that the policy is a failure if it does not "have the minimum political and social support" (Spiegel and Ehrlich 2013a).

Shoring up domestic growth requires improving the health of banks, and particularly in the south, additional loans to small and medium enterprises in the troubled economies. The lending operations of the ECB have not passed on the low interest rates offered to European banks to companies and households. While banks have had a backstop, there is no recovery in the distressed Eurozone labor markets. The nasty side effects of austerity have left the labor market very much a junior partner compared to the efforts put forward to encourage private sector spending. New public investment is not part of the game plan up until now nor has expansion of demand been a priority so far, when faced with the determined opposition from the Bundesbank. Countries have not been given the breathing room in which to repair their gridlocked economies by backstopping a massive lending program (Münchau 2013).

EU's Four-Option Future

The picture of the future is quite confusing because four contradictory economic scenarios are currently jockeying for the inside position:

(1) Continued muddling through the Eurozone crisis as piloted by the ECB with limited steps to reform the financial system, through higher capital standards and some aggressive regulatory oversight. Some structural reforms are on the distant horizon only.
(2) A multi-speed Eurozone in which core economies doing well with low-risk sovereign debt levels, medium-risk budget deficits, low inflation, and banks with strong balance sheets. Real measures are needed to improve the conditions for growth momentum and to halt the slide toward stagnation and shrinking levels of national income. For Europe's peripheral economies stuck in the austerity rut, a policy space is required in which national governments have the freedom and capacity to design and implement public policies of their own choosing.
(3) The most dire option is the possible collapse of the euro and the implosion of the EU from a banking crisis, a member exiting the Eurozone or a failed recovery. With the UK threatening secession, the third option has gained significant traction.
(4) The most optimistic goal is for a renewed federal union as a result of the dramatic changes introduced to solve the interrelated problems of deficient demand, anemic growth, an unreconstructed financial system, and high public debt. This "distant shore" seems an exercise in utopian thought. It has no roadmap to transform the community into something much more than it is by transferring decision-making power to a supranational body. Without political power concentrated as envisioned by the Lisbon Treaty in the Council and other bodies, decision-making will continue to be trapped by political–cultural conditions that cannot spur innovation at the institutional level.

All of these options are on the table; however, with the Eurozone fighting for its life, last-minute ad hocery is the default choice for the Commission and the Bank. With the EU in the third year of a recession, weighed down by a financial system with bad assets and a largely unreformed banking system, it could continue to lurch from one bailout to the next with only Brussels' elites committed to the idea of a stronger federal Europe. Domestic politics remains the number-one obstacle to structural reforms. Germany rejects out of hand any idea of a banking union with supervision and deposit insurance. So, without the means for effective collective action, narrow self-interest will "fail to defend the common good."

Many, like Wolfgang Münchau, believe that a Eurozone breakup is nearby. The biggest risk, he stresses, "stems from repeated policy errors, slow and cumulative" and not a big calamity (Münchau 2013). In terms of non-standard crisis management, his analysis should surprise no one. As the designated first responders, institutions and political elites react to immediate need. Their policy reflex is to eschew a big idea approach; however, eventually stopgap measures will prove inadequate to the structural stagnation. New institutional practices are required to address a rapidly escalating systemic financial crisis. Anti-austerity movements are on the rise in the Eurozone periphery as the weakening economic picture wreaks havoc on their economies and population. Certainly, the EU has committed many damaging blunders; by far, the worst is that the austerity framework now in place has heaped fresh pressure on governments to back away from rigid austerity-driven policies. So far, the breathing space provided by the easy money injected into troubled economies has not led to measures which will repair the financial systems. If long-term interest rates close to zero cannot turn the Eurozone ship of state around, what's next?

Canada's 40 Years of Constitutional Wars Triggered by the Quebec Independence Movement: Some Striking Parallels with the Eurozone's Crisis Management

For a comparative perspective, Canada's constitutional wars, 1970–2000, are a relevant example of asymmetric crisis management in a highly diverse federal country comprising 10 provinces' powerful actors in their own right, highly articulate First Nations, and a federal government in Ottawa responsible for macro rowing and steering. Canada had a variety of competing scenarios facing it, much like those facing contemporary Europe: a multi-speed Canada with different deals for major provinces, some kind of special status for Quebec, outright independence for Quebec, or a stronger federal union.

Recall that the *Parti Québécois* (PQ) burst onto Canada's political landscape in the early 1970s committed to separation and an independent Quebec (see Table 1). It formed the provincial government in 1976 with the iconic Rene Levesque becoming premier. Two referenda were held—1980 and 1995—in the second, the PQ fell short of a majority by a mere 70,000 votes. The political wars eventually engaged the rest of Canada, which was the missing actor. Pierre Trudeau broke the deadlock and repatriated Canada's constitution in 1982 without Quebec's signature. His strategy was to split the sovereignist support by offering Quebec minority rights language protection and making French, Canada's second official language. But his betrayal of Levesque and Quebec's constitutional ambitions during the repatriation of the constitution sowed the seeds that led to the second referendum in 1995, which Ottawa came within a hair of losing (Russell 2012).

Table 1 Timeline of Constitutional Crises in Canada

1968—Formation of *Parti Québécois* (PQ).
1969—Official Languages Act promoting equality between English and French communities.
1970—October Crisis: Canadian government proclaimed the War Measures Act to suppress a feared violent revolt after the *Front de Libération du Québec* (FLQ) abducted British trade commissioner James Cross and murdered Quebec Labour Minister Pierre Laporte.
1976—PQ wins Quebec provincial election under René Lévesque whose government introduced Bill 101 (Charter of French Language) in 1977 leading to a flight of businesses from Montreal to Toronto.
1980—Quebec referendum on "sovereignty association" defeated (59.6% to 40.4%).
1982—Prime Minister Pierre Trudeau (Liberal) repatriates Canadian Constitution from Westminster but Quebec refuses to ratify the Constitution Act.
1987—Meech Lake Accord negotiated between Prime Minister Brian Mulroney (Conservative) and 10 provincial premiers recognizing Quebec as "distinct society."
1990—Meech Lake Accord defeated by Manitoba and Newfoundland.
1992—Charlottetown Accord rejected in national referendum.
Resurgence of Quebec sovereignty movement after the 1993 earthquake election wiped out the Progressive Conservatives and gave the Bloc Québécois 54 of Quebec's 75 seats in the federal parliament making it the official opposition despite its lack of a national mandate.
1995—Second Quebec referendum defeated by a margin of 1%.
2000—The Clarity Act becomes law.
2011—Electoral defeat of the Bloc *Québécois* federally winning only 4 seats down from 74 seats in 2008.

Source: Francoise Boucek (2012).

Quebec's Focused Strategy vs. Ottawa's Reliance on Intensive Innovation

Quebec had a plan, a purpose, a strategy, and the single goal of independence. By contrast, the Canadian government had many improvised plans to blunt the separatist appeal in Quebec. Ottawa muddled through each crisis responding in ad hoc manner to every step taken by the PQ, first trying to crush the *independentiste* movement and then accommodating it. Trudeau fought the PQ tooth and nail though ultimately failed to defeat the separatists in Quebec. His constitutional wars against the desire of Quebecer's to be recognized as a separate society cost the Liberal party its federal seats in Quebec. These constituted the base of its political power and allowed the Liberals to rule Canada for 60 years almost without interruption.

With Trudeau's retirement from public life, the Conservatives followed his game book with a policy mix of carrots and sticks. When the political clout of the PQ threatened to break up Canada, Brian Mulroney offered Quebec special status—creating a two-speed Canada with constitutional reform. The final act occurred in the late 1980s, but it also failed to deliver Canada with a new constitution when in a referendum, Canada's First Nations rejected the Charlottetown Accord, Mulroney's initiative to offer Quebecers, and First Nations constitutional reform. This was to be the consensus reached by Canada's elites after a lengthy consultation process and much fanfare and high expectations to settle once and for all Canada's constitutional wars over the division of powers between Ottawa and the provinces.

The transformative part of the story was the policy dynamic that emerged following the adoption of Canada's Charter of Rights and Freedoms in 1982. For many experts, in the slipstream of searching for a new entente between Canadians, the most important development was the broadening and deepening of Canada's social market with its rights and freedoms that characterizes all modern identities (Maas 2008).

From the vantage point of today, we can see that Canada's political culture was transformed in ways few anticipated. The popular appeal of the promise of equal inclusion into the Canadian polity cannot be underestimated. The Charter also recognized the asymmetrical needs of language protection for Canada's two official languages, gender rights, and First Nations collective rights. It was the great equalizer in theory, but its concrete effects for individuals in dismantling mobility and affirmative action barriers was mixed.

The point worth stressing is that the lack of legitimacy in Canada's institutional structures did not prevent Ottawa from introducing measures to reform social welfare programs like pensions, collective bargaining, and employment insurance that transcended the narrow legalism of Canadian federalism. Canadian governance had been largely silent on the conception of modern citizenship and community. A strengthened membership in a community that is both provincial and national is one of the tools for individual and collective empowerment. The expansion of rights from the 1980s onward has given meaning and content to Canadian citizenship even if the importance of multiculturalism—interculturalism in Quebec—remains far from clear (Gagnon and Tully 2001).

Some Opportune Lessons for Europe: The Key Role of Popular Movements for Political Change

One of the lessons that Canada's constitutional wars explains is that a public policy of incrementalism in the end left Canada's federal union weaker, more fragmented, and decentralized. It opened the door for decentralization of the federal union. In the absence of strong federal leadership in the areas of health, education, and labor market job training, these critical powers were parceled out to local and regional authority. These policy areas had always been shared jurisdictions constitutionally and the federal government when the Liberals were in office had taken a leadership role in setting national standards because Ottawa controlled the purse-strings. The current Harper government has instituted a policy revolution wanting to shrink the role of the federal government, reduce the federal transfer of payments to the provinces, and get out of the business of standards setting.

Devolution in a multi-speed Europe presents new challenges as a way of doing politics in which the system largely leaves political elites in charge of its primary institutional processes and decision-making. The lesson learned is that with the modern European public largely excluded from the policy table, Europe faces more turmoil on the streets and at the ballot box. Habermas (2012, 126) acerbically notes that popular opinion—the creature of opinion polls—"is not the same thing as the outcome of a public deliberative process leading to the formation of the democratic will."

A shared European destiny will not evolve somehow on its own. It needs an army of public activists with a vision and an end to the austerity measures which are choking opportunities for stronger growth. Habermas does not believe that political support for a strong federal union will come from the transfer of the sovereignty rights of member states to the core domains of the EU (Habermas 2012). Most importantly, the EU's project has stalled because the popular support for the political project of the EU has decreased sharply. For Habermas, this elite project will only go forward if it switches from operating as an administrative project to one driven by the enfranchisement of European citizens. How this is going to happen remains uncertain for the foreseeable future. Social media is engaging people against austerity and the EU project; however, the anti-austerity movement has failed to shift the weight of debate in its favor up until now.

In contrast, Germany has rediscovered itself. Its role as disciplinarian has made it the game changer able to impose its policy model on Greece, Portugal, Cyprus, and Spain. It is nakedly apparent though that Germany is the unelected power broker of the federal union, but its position in a democratic polity is unsustainable in the medium-term and problematic for building a transnational democracy. Given the opportunity, will neighboring countries eventually push back against German dominance? Unlike North American Free Trade Agreement (NAFTA), where the USA is the kingpin and its policies are not subject to legal review by a peak constitutional authority, Germany is accountable constitutionally to Europe's supranational authority. It walks a narrow line between German domestic politics and its pan-European austerity policies. It is the G-1 of Europe with full imperial regalia and power and is the lightning rod for Euro-anger and alienation.

Bringing the Public to the Table: Will European Citizen Rights Protect Europeans at a Time of Austerity?

Bringing the public to the table is the fundamental challenge, which has not been met in the Eurozone, the political heartland of voter outrage. The success of Italy's anti-establishment's Five Star Party in capturing 25 percent of the Italian vote has badly shaken the EU's political class. The policy elites are now worried that they have to do something to placate voter resentment before they completely lose control of the policy agenda. The question is will the Eurozone continue to "fly by the seat of its pants" as the way forward or does it have the firepower and will to exit the crisis?

It is accurate to stress that for the EU with a policy knife at its throat alternative scenarios may evolve very quickly. Achieving a stronger federal union requires a strategy, roadmap and the capacity to move the Eurozone in this direction. Ryner's much cited analysis of the production of expert knowledge underlines just how constrained the EU was from a policy viewpoint once neoliberalism captured the inner circles of the Bank, the Commission, and the Council. Any policy that departed from the Washington consensus priorities and German monetary discipline was rejected (Ryner 2012). Certainly, little thought was given to an exit option. According to Ryner, the single market dramatically reduced national prerogatives "without giving rise to [the] pan-democratic polity" that would be needed to alter the goals of neoliberal integration with its very weak forms of political and social solidarity (Ryner 2012).

Advocates of European citizenship as a fundamental pillar of integration will be cruelly disappointed (Maas 2013). Multilevel citizenship rights offer no policy relief from the austerity policies of the Commission and Council. Ironically, workers have turned to the Courts for relief and in a recent decision the European Court of Justice (ECJ) ruled against Dublin's decision not to pay pension claims to workers at Waterford Crystal because of the economic crisis. The Court dismissed Dublin's rationale "that it did not constitute an exceptional circumstance" and would have to pay the workers "a higher level of protection." This is a tactical defeat for the EU's neoliberal policy. The Court has not ruled on the precise level of entitlements, but it is likely to run into millions of pounds based on earlier precedents (Smyth 2013). Small victories like this are important because there are so few.

A Stronger Federal Union: A Distant Option

Europe today is a long way from being a strong federal union. It is more decentralized and governments are more jealous of their national authority. Europe's citizenry is also disaffected and alienated from the idea that European citizenship has produced a fundamental change in their lives. Growing skepticism about the future of Europe is back in the headlines not only because David Cameron had committed to holding a referendum on Britain's membership. The Eurozone is in danger of losing the social market, one of its fundamental pillars of the modern European project. The social market, covering social rights and entitlements for 600 million people, was designed as a counterweight to the powerful dynamic of market-led integration. The deep cuts to social entitlements, cuts in state spending, and higher taxes have promoted widespread anger and deepened the divide between elites and the common citizen without providing any immediate economic relief.

Europe remains trapped with few prospects for addressing the long-term problems of government finance, regional underdevelopment, and persistent structural unemployment. On the political side, Europe's prospects remain unclear. The fact that the EU has not found the political will to push through financial reforms with the Bundesbank and the ECB working from the same songbook to create a single European regulator after 4 years of discussion is troubling. Equally unsettling is the fact that the harshness of the austerity regime has pushed Europe farther away from "growth friendly policies" in the words of the managing director of the IMF.

Brittle Governance Practices and the UK's Exit Strategy

Europe's governance structures are creaky with much fragmentation and sharp internal divisions between the Commission, the Bank, the Council, IMF, the Bundesbank, the unelected power broker and disciplinarian, and increasingly the Parliament, the people's tribune. Process dominates decision-making to an unhealthy degree in the councils of governance at the expense of meaningful policy debate. From afar, it looks like a continuous pushing match between jostling centers of power. The unelected power broker and major domino is the Bundesbank that has a commanding position at the center of decision-making with a strategy and fixed goals. It does not make policy on the go.

The Bundesbank is pushing for constitutionalizing in EU treaty law rules that require members to surrender more power to Brussels over fiscal and economic policy. This will be a tense and conflict-riven debate. The proposed treaty changes would mean deepening economic integration and giving more power to Brussels to police national budgets. It would make possible a banking union with a single European supervisor, and it would create a second institution with Europe wide power and authority to rescue and restructure failing European banks. There would also be an EU deposit insurance plan that would give Brussels the power to recapitalize a bank or close it down. All of this could provide the exit moment for Cameron, UK's Prime Minister who wants the very opposite approach. The so-named austerists have amassed new powers despite the fact that conveying the spirit of muddling through to broad publics is not the right strategy for southern Europe (Spiegel 2013). Europe's peripheral members have paid a very high price for austerity policies, and they face a very stormy passage back to health. The raison d'etre of the European grand project is to create a sense of "Europeanness" and a European ensemble of institutions and networks. The building of trans-European markets is inseparable from the building of social institutions. The wish list behind Cameron's proposed referendum is to reverse the course of European integration. His design of decentralization and less regulation is un-European at the core and a serious misreading of European economic culture. Rules, regulation, budgetary contribution, and cash transfers are the positive externality of belonging to this sprawling community.

The British public never developed a liking for Brussels and the European transnational state.[3] It is a festering discontent that grips a significant section of the British public, fed by an anti-immigrant often racist and nationalistic partipris. So, the exit option that 6 months ago would have been dismissed as crank politics now has significant momentum in the Conservative Party and is entrenched in British public opinion.

Neoliberalism's Tenacious Grip on Power and the Triple-Dip Recession: Is There an Alternative Strategy?

Incremental reformism in its excessively cautious view of Europe's financial crisis has led to a weakening of common European social values and shared institutions. The 2012 *Augur Report Europe 2030* prepared for the Commission warns that the instability of prolonged stagnation will lead to a fall in expenditure in all major fields of activity. "Internal competition will increasingly be based on social costs," and the race to the bottom will make new demands on the role of government (European Commission 2012, 34). It is difficult to see how member states will be able to protect the universality of social programs with such a drastic change of welfare regimes after all the budgetary cuts and spending retrenchment of the last 5 years (Petit 2012). A triple-dip recession with a severe credit crunch and household consumption contracting is choking growth and has made business and consumers pessimistic about the "elusive" recovery. It stands to reason that family benefits will be fewer and less generous and wages will continue to flat line, and in many industries be cut. In this environment, the Eurozone will rely less on international institutions to gain access to markets and more on regional trade deals and a transatlantic free trade pact for export-led solutions to European macroeconomic difficulties.

For the majority of Europe's vulnerable members, the rigid austerity agenda is not sustainable. On the other hand, the logical alternative policy option to boost growth and target unemployment levels is severely constrained by its institutional structures (Boyer 2012). The alternative scenario is to adopt clear goals to put

Europe back to work and grow the economy back to health. While there are signs that the Commission will eventually have to abandon austerity as its framework, the "flying by the seat of their pants" approach screens out alternative options for the time being. This was one of Lindblom's (1979) basic insights.The strategy-dependent incremental reform postpones structural change and new growth-based macro-initiatives. The goal of a stronger federal union has lost much ground in the fiscal crisis.

The Eurozone will face more testing as the federal union has to grapple with structural adjustments that cannot be resolved by another bailout or an extra round of quantitative easing. Barossa has signaled an easing of austerity in early 2013. European publics have an increasingly tense history with the Bundesbank and will eventually be drawn into a clash with Germany. Can this be interpreted as a welcome sign that the anti-austerity camp is the game changer, ascendant in the power circles of Brussels and beyond?

Notes

1. This article was originally given as comments at the International Studies Association (ISA) annual convention for a panel organized by Magnus Ryner, Kings College London, entitled "The IPE of the Euro Crisis—Managing the Crisis?," San Francisco, USA, April 3–6, 2013. Presenters included Benjamin Braun (2013), Vicki Birchfield and Jarrod Hayes (2013), Joachim Becker, Johannes Jager, and Rudy Weissenbacher (2013), Daniela Gabor (2013), and Henk Overbeek (2013). Special thanks to Magnus Ryner, Terry Sullivan, Enrico Wolleb, Arthur Donner, and Pascal Petit for their different kinds of support, feedback, and suggestions.
2. The downgrade of 2013 growth projections by the International Monetary Fund (IMF)—the fourth downward revision in so many years—again highlights the depth of the feeble recovery and the dangers of fiscal tightening (Giles 2013c). It is not clear that the EU can claw its way out of this crisis with the Eurozone contracting 0.3 percent in 2013 and projected to grow only 1.4 percent in 2014.
3. The UK Independence Party success in local elections has given a renewed sense of purpose to the conservative back bench. Cameron's Anglo-American variety of capitalism with its attack on the welfare state, the public sector, and unregulated labor markets looks to the unjaundiced eye as a continuation of Thatcherism's principal idea, in her words that "there is no such thing as society" (Brittan 2013). More than 100 backbenchers are demanding Cameron accelerate his referendum plans. Even Obama has intervened and warned Cameron that exiting the EU would lead to a loss of British influence on the world stage. None of these warnings are likely to matter since the choice of staying or leaving is, in the final analysis, a domestic matter for the British public.

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