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WHAT HAS HAPPENED TO EUROPE?

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About fifty years ago, in 1961, Jean-Paul Sartre complained about the state of Europe then. "Europe is springing leaks everywhere," Sartre said, in the Preface to his book The Wretched of the Earth. He went on to remark: "It simply is that in the past we made history and now history is being made of us." Sartre was undoubtedly too pessimistic. Many major achievements of great significance have occurred in the last half a century in Europe, since Sartre's lament, including the emergence of the European Union, the reunification of Germany, the extension of democracy to Eastern Europe, the consolidation and improvement of national health services and of the welfare state, and legalization and enforcement of some human rights. All this went with a rapidly expanding European economy, which comprehensively rebuilt and massively expanded its industrial base and infrastructure - devastated during the Second World War.

There is indeed a long-run historical contrast to which Sartre could have been referring. For centuries preceding the Second World War, a lot of world history was actually made in Europe. If that generated, around the world, much admiration mixed with some fear, the situation changed rapidly in the second half of the twentieth century. When I first arrived in Cambridge as a student from India in the early 1950s, I remember asking whether there are any lectures given at Cambridge University on the economic history of Asia, Africa and Latin America. I was told that there were indeed such lectures, and they are given for a paper called "Expansion of Europe." That view of the non-European world would seem a little archaic now, not merely because the grand European empires have ended, but also because the balance of political prominence and economic strength has radically changed in the world. Europe is no longer larger than life.

There is, of course, nothing particularly remarkable - or lamentable - in the changing role of the different regions of the world with the progress of history. This has happened again and again in the annals of the world. What is really striking is not the historical rebalancing of the different parts of the world, but the mess that Europe has managed to get into in the last decade or so, particularly over the last couple of years. There is a lot of discussion right now - appropriately enough - on how Europe is going to liberate itself from its financial disarray, economic misery and political chaos. "What to do now" is certainly an important issue today (not least in this symposium), but "what not to do" is also an important question in looking at Europe's immediate past. This is important not just because past mistakes are relevant in deciding on what to do here and now in Europe (even though what has been done cannot be readily "undone" - there is never any automatic translation from past follies into present rectifications), but also because the negative lessons are important to avoid similar adversities in the rest of the world.

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So what has gone wrong in Europe in the recent years? I shall divide my analysis into three broad subjects: (1) the challenge of European unity, (2) the requirements of democracy, and (3) the demands of sound economic policy. They interrelate.

The unification of Europe is an old dream. It is not quite as old as it is sometimes suggested - the dream is not of classical antiquity. Alexander and other ancient Greeks were less interested in chatting with Goths, Vikings, Angels and Saxons, than they were in conversing with ancient Iranians, Bactrians and Indians, and Julius Caesar and Mark Anthony identified more readily with ancient Egyptians than with other Europeans, located to the north of Rome and or to its west. But Europe went through successive waves of cultural and political integration - greatly helped by the powerful spread of Christianity - and by 1464 King George of Podebrady in Bohemia was talking about pan-European unity.

This was followed by many others in the centuries to follow, and by the eighteenth century, even George Washington wrote to the Marquis de La Fayette, "One day, on the model of the United States of America, a United States of Europe will come into being."

However, it was the sequence of the two World Wars in the twentieth century, with a flood of European blood that firmly established the urgent need for political unity of Europe. As W.H. Auden wrote in early 1939, on the eve of the Second World War:

> In the nightmare of the dark
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> All the dogs of Europe bark,
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> And the living nations wait,
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> Each sequestered in its hate.

And the events to follow only confirmed Auden's worst expectations. The terrible fear of a repeat of what European countries had seen in these World Wars continued to haunt a great many thoughtful Europeans. It is important in this context to appreciate that the movement for European unification began as a crusade for political unity, rather than for a financial unification or a common currency.

The birth of the European Federalist movement was motivated strongly by wanting a political unity - free from self-destructive wars - as the content both of the Ventotene declaration of 1941 and of the Milan declaration of 1943 bring out very clearly. There was no hostility to economic integration and not even to a financial union; however, the priority was not banking and currency, but peace and goodwill and a gradually evolving political integration. The fact that the political unification has fallen way behind financial incorporation is a later development, and the problems generated by that chosen sequencing is not, I will argue, irrelevant to understanding the complex nature and extensive reach of the present economic crisis in Europe.

One point is particularly important to note in this historical context, especially since it is often missed. The problems created in the Euro zone by going first for the integration of currency and having a monetary union without the supportive presence of a closer political union and a fiscal union extend well beyond economic mishaps into social adversities in the relation between people in different European countries. Anger and frustration, in many different forms, have generated tension between the countries with differential fortunes within the Euro zone, and have also empowered extremist politics of a kind that Europe would have expected to have left behind.

There is nothing particularly surprising about the problems of balance of payments and other economic adversities that many of the European countries - Greece, Spain, Portugal - have faced with the inflexibility of the Euro zone restrictions on exchange rate adjustment and monetary policies. The consequent scenario of crises and rescues involving demands for draconian cuts in public services have also frayed people's tempers on both sides of the divide. It has strongly exacerbated international disaffections within Europe, as is clear from the political rhetoric coming in recent days, in very different forms. from the north as well as the south of Europe – with pejorative anger targeted at objects of contempt that vary from “lazy Greeks” to “imperial Germans.”

An often-invoked "analogy” with German sacrifices to achieve the unification of East and West Germany, which clouds at least some European thinking, is thoroughly misleading here. This is partly because the sense of national unity that prompted the German sacrifice does not exist, at this time, between the different European nations, but also because the sacrifice in that remarkable exercise of national unity fell mostly on the richer part of Germany on the west, not on the poorer components as is being demanded right now from many of the afflicted European countries, from Greece to Spain.

The costs of failed economic policies extend well beyond the statistics of unemployment, real income and poverty (important as they are). The grand vision of a union with a cementing sense of European unity is itself threatened by what is going on in the economic arena. Those who advocated a "unity of an European currency" as a "first step" towards a united Europe have, in fact, pushed much of Europe into an entirely counterproductive direction for achieving European unity. There is, of course, no danger of a return to 1939, but, to use the analogy of Auden, "dogs of Europe" barking from sequestered regional bases of resentment and contempt - if not hate – does immense harm to the cause of cultivating European amity and unity.

I turn now to democracy. The founders of European unity whose ideas moved the European Movement wanted a "united democratic Europe." The Europe that emerged from the Second World War had learned certain things from bitter experience that it was not going to forget. Perhaps the foremost idea was the importance of democracy, giving each person not only a vote but also a voice. If democracy in the form of periodical elections is firmly instituted in the constitutions of most European countries, the commitment to have preparatory public discussion before taking large policy decisions is no less ingrained in contemporary European values. Walter Bagehot defined democracy as "government by discussion" - following a line of political analysis that John Stuart Mill had done much to clarify and champion - and the visionary leaders initiating the quest for European unity never wavered on this dedication.

I shall presently argue that some of the policies that were chosen by the financial leaders and economic powers of Europe were certainly mistimed, if not downright mistaken. But even if the policy decisions taken by the financial experts were exactly correct and rightly timed, an important question of democratic process would remain. For example, the decimation of something as fundamental as the public services that are essential pillars of the European welfare state could not be appropriately left to the unilateral judgments of financial experts (not to mention the error-prone rating agencies), without public reasoning and informed consent of the people of the countries involved. It is, of course, true that financial institutions are extremely important for the success and failure of economies, but if their views were to have democratic legitimacy, that must be through a process of public discussion and persuasion, involving arguments, counterarguments, and counter-counterarguments.

If democracy has been one of the strong commitments with which Europe emerged in the 1940s, an understanding of the necessity of social security and avoidance of intense social deprivation has surely been another. Even if savage cuts in the foundations of the European systems of social justice had been financially inescapable (I don't believe they were, but even if they had been), there is a need to persuade people that this is indeed the case, rather than trying to carry out such cuts by fiat.

The disdain for the public could hardly have been more transparent in many of the chosen ways of European policy making.

Quite aside from that question of democratic legitimacy, there is also an important issue here of political practicality - the practice of the "art of the possible" (as politics is meant to be). People could be denied their voice, but given the democratic institutions, they could not be denied their votes in periodic elections. Not surprisingly the people excluded from taking part in the process policy making could not be politically silenced, and in election after election, the incumbent governments carrying out the dictates of financial superpowers have been deeply threatened and sometimes summarily removed. And voting rights without effective policy voice have also made it very difficult for practical solutions to emerge, with appropriate attention to well-reflected priorities and to acceptable give and take. Public reasoning is not only crucial for democratic legitimacy, but also for better epistemology on the basis of considering divergent perspectives. It is also essential for more effective practical reasoning, which can bring out which particular demands and protests can be restrained in interactive public reasoning, in line with scrutinized priorities between a cluster of quite distinct demands (a process of "give and take" that many political analysts from Adam Smith and the Marquis de Condorcet in the eighteenth century to Frank Knight and James Buchanan in our time have made us appreciate better).

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I move now to the soundness of economic policy making. There are two issues that arise immediately: (1) the viability of the common European currency, the Euro, and (2) the policy of austerity - chosen by or imposed on - European countries in financial difficulty. On the first question, most of the attention has tended to be concentrated on the short-run survival of the Euro, through providing liquidity to the troubled countries, by one means or another. Many alternative rescue efforts are being considered right now, such as new bail-out packages helped by the financially stronger countries, or the floating of guarantee Euro bonds, or the purchase of Greek, Spanish other high-interest bonds from troubled countries by Germany (thereby earning high interest, without much risk, so long as the Euro survives in its present form). Many of these "rescue" proposals are worth considering and may prove useful, but none of these rescue proposals address – or are meant to address - the long-run viability problem arising from the inflexibility of the exchange rate through the shared Euro, even as countries with relatively lower productivity growth (such as Greece or Spain or Italy) fall behind other countries in the Euro zone in terms of competiveness in trade. A country, such as Greece, may find that it has increasingly less to offer for sale at the fixed exchange rate of the Euro, unless what is not done by exchange rate adjustment is brought about by the brutal process of cutting wage rates – even in terms of the national currency – to an extent that would not be otherwise necessary.

In the absence of exchange rate adjustments, competitiveness for the countries falling behind can be recovered through sharp wage cuts and other such ways of cutting earnings, thereby further reducing living standards. This would yield much suffering and an understandable resistance. There would also be resistance to the other "solution" through increased migration of the population (for example from Greece to Germany). A unified currency in a politically united federal country (such as in the United States of America) survives through means (such as substantial population movements and significant transfers) that are not available to a politically disunited Europe. Sooner or later the difficult question of the long-run viability of the Euro would have to be addressed, even if the rescue plans are completely successful in preventing a break down of the Euro in the short run.

I turn now to the second issue, concerning the effectiveness of austerity in cutting public expenditures in steering the countries in difficulty out of their immediate problem of excessive deficits and huge debts. It is difficult to see austerity as a soundly reasoned economic solution to the European malaise today. And it may not even be a good way of reducing public deficits.

The policy package demanded by the financial leadership of Europe has been, despite its rhetoric, severely anti-growth. The economic growth of the Euro zone has been faltering so much and even the GDP has been falling so firmly (it declined even in the fourth quarter of last year, 2011) that the recent report that there was zero growth in the Euro zone in the first quarter of 2012 has been widely greeted as "good news." And if Germany is taken out of the total, the result would be continued bad news of falling output for the rest of Euro zone. Spain, Portugal and Italy continued to decline in these months, and while Greece tempered its free fall from a previous minus 6 per cent (in 2011); the Greek economy has lost nearly a quarter of its production since 2008. While the economies and the people involved have suffered, the deficits have been quite resistant.

There is, in fact, plenty of evidence in the history of the world that indicates that the most effective way of cutting deficits is to resist recession and to combine deficit reduction with rapid economic growth. The huge deficits after the Second World War largely disappeared with fast economic growth in the post-war years. Something similar happened during the eight years of Clinton's presidentship, when Clinton began with a huge deficit and ended with none. The much praised reduction of the Swedish budget deficit during 1994-98 occurred in a period of fairly rapid growth of GDP. The situation is very different today for many countries asked to cut the deficit that are having zero or negative growth rates under an imposed discipline of austerity heaped on a recession.

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That austerity is a counterproductive economic policy in a situation of economic recession can be seen, rightly, as a "Keynesian critique." Keynes did argue - and argued persuasively - that to cut public expenditure when an economy has unused productive capacity thanks to deficiency of effective demand would tend to have the effect of slowing down the economy further and increase - rather than decrease - unemployment. Keynes certainly deserves much credit for making that rather basic point clear even to policy makers, irrespective of their politics, and he also provided what I would call a sketch of a "theory" - I won't go further than that - of explaining how all this can be nicely captured within a general understanding of economic interdependences between different activities (emphasizing in particular the fact that someone's expenditure is another person's income). I am certainly supportive of that Keynesian argument, and to the extent that Paul Krugman has made an excellent contribution in developing and propagating that important perspective in questioning the on-going policy of massive austerity in Europe, I am strongly appreciative of his work as well.

The Keynesian perspective remains important, and yet, I would argue, that the unsuitability of the policy of austerity is only partly so for Keynesian reasons. Where we have to go well beyond Keynes is in asking what public expenditure is for - other than for just strengthening effective demand, no matter what its content. As it happens, European resistance to savage cuts in public services and to indiscriminate austerity is not only not based on - at least not primarily based on - Keynesian reasoning, but more importantly, this resistance is making a constructive point about the importance of public services that is of great economic as well as political interest in Europe. There is a central issue of social justice involved here - that of reducing rather than enhancing injustice (the form that the theory of justice inescapably has to take, as I have argued in my book The Idea of Justice). The public services are valued for what they actually provide to the people, especially vulnerable people, and this is something for which Europe had fought. Savage cuts in these services undermine what had emerged as a social commitment in Europe at the end of the Second World War, and which led to the birth of the welfare state and the national health services in a period of rapid social change in that continent, setting a great example of public responsibility from which the rest of the world - stretching from East Asia to Latin America - would learn.

In order to understand the inadequacy of Keynes as a guide to solving the European economic crisis, we have to ask: what kind of an economist was Keynes in terms of his vision of a good society? Keynes did say - famously and again accurately enough - that paying labourers to dig holes and then to fill those up can be a very good thing, because of its impact on increasing effective demand to combat a recession or a depression. This is fair enough, but Keynes had extremely little to say on what social commitments a state should have - what should the public expenditure be for, other than just for strengthening market demand through state intervention.

Keynes said very little on economic inequality, was extraordinarily reticent on the horrors of poverty and deprivation, had little interest in externalities and the environment, and neglected altogether the subject that his rival and adversary A.C. Pigou concentrated on, to wit, "The Economics of Welfare," the title of Pigou's most famous - and certainly most profound - book. It was the allegedly rightwing Pigou who had initiated the measurement of economic inequality, spent time on analyzing the nature and causes of poverty, wrote extensively on externalities and on environmental degradation, and the need for public economics to aim at remedying what the allocational errors of the market economy.

So the need to question the on-going financial policies in Europe arise for economic reasons that go beyond Keynes (while incorporating some ideas of Keynes), in addition to political and social reasons to which I have also tried to point. This scepticism does not in any way question the need to recognise the importance of reducing, in an appropriate time table, the burden of public debt. But good economics is not only about what to aim at, but also about what can be effective, and how and when.

If we add to this economic argument the long-term concern in Europe about some form of social justice and the more immediate political worry about the undermining of the sense of European sense of solidarity, we can see what a disaster the recent European financial policies have been. This is not to say that commitments to social justice are always paramount, but it is surely is a serious concern that cannot be brushed aside by unilateral decisions of financial leaders – no matter how high or low their standing might be in their limited world. There is always a need for rational scrutiny and examination of what a country can afford and what it cannot (taking into account all relevant factors, including the changing age distribution of the population), but this is not the same question as checking what a country can afford with inefficient economic and financial management – of the kind that Europe has plentifully experienced recently - with fuzzy thinking on exchange rates and market demands and economic competitiveness.

The guiding principle has to be, rather, what Adam Smith specified with much clarity in The Wealth of Nations: how to strive for good functioning of the economy to be able to provide the public services that people agree are needed, along with enhancing the private means that people enjoy from employment and income. Good political economy, Smith argued, has to have "two distinct objects": "first, to provide a plentiful revenue or subsistence for the people, or more properly to enable them to provide such a revenue or subsistence for themselves; and secondly, to supply the state or commonwealth with a revenue sufficient for the publick services."

Finally – and importantly - serious consideration of the kinds of reform that are needed in Europe has, in fact, been hampered, rather than aided, by the loss of clarity on the distinction between (1) reform of bad administrative arrangements, and (2) austerity in the form of ruthless cuts in public services and basic social security. Europe does need many economic reforms of different types, such as the stopping of the evasion of taxes, preventing government servants from using favouritism in the exercise of the power that the society gives them, regulating banks that are tempted to work irresponsibly – or worse – in unrestrained pursuit of their own gains (sometimes biased heavily towards short-run profits), and changing unviable conventions about early retiring age that are economically hard to sustain. The requirements for alleged financial discipline have tended, in unclear analysis, to amalgamate the two, even though any scrutiny of the demands of social justice would view policies for necessary reform in an altogether different way from indiscriminate cuts in important public services. Even if that distinction may have been lost in rather crude financial thinking, opportunities for adequate public discussion, in "governance by discussion" could have brought out its relevance clearly enough.

Europe has been extraordinarily important for the world, which has learned so much from Europe. Europe can remain globally important by setting its own house in order - economically, politically and socially. This is important not just for Europe but for the world.