1 The Eurozone as a Political Economy Field

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1.1 Introduction

The Eurozone's vicissitudes highlight multiple interfaces between economics and politics. More specifically, they reveal the manifold interdependencies at work within and across the domains of the European economy and political space.

For example, an external shock in the financial sphere (a financial crisis that started outside the Eurozone) interacted with longer-term developments in the real sphere, and especially the divergence of productive structures across different areas of the Eurozone and European Union more broadly, which resulted in the build-up of external imbalances and foreign debt positions. The ensuing crisis was also reflected in the sphere of public finance, with sovereign debt crises in several countries. The institutional architecture of the Eurozone proved unable to adequately respond to the crisis, and attempts at response caused a deep economic downturn in several Eurozone countries.

Such economic developments had dramatic effects in the political sphere, generating deep conflicts between and within countries. For example, creditor countries pushed for an 'austerity agenda' while debtor countries advocated forms of debt relief and emphasized the need to support growth. Within countries, both creditor and debtor, conflicts emerged as to which sectors or socio-economic groups (e.g. financial sector or taxpayers) should bear the burden of debt relief. Such tensions were also reflected in the electoral sphere and resulted in social unrest in some countries and widespread political instability.

In summary, the crisis has highlighted the interdependencies between different economic and political domains, as well as conflicts of interest within and across levels of aggregation (supranational, national, sectoral). Overall, the crisis has exposed serious internal tensions in the constitution of the Eurozone and the EU as a whole.[1] It has also shown the need to investigate, over and above the inevitable conflicts between political economy actors, which elements of common interest underlie monetary integration.

1.2 The Eurozone as a Political Economy Field

This volume studies the Eurozone as a political economy field, by which we mean a system of interdependencies that span the economic and political spheres at different levels of aggregation (e.g. countries, regions, and sectors). The contributions in the volume show features of this field, propose analytical tools to study it, and explore policy frameworks that fit those features.

Attention for multiple levels of aggregation has key implications for how the internal differentiation of the Eurozone is understood. In fact, the latter is usually conceptualized in terms of national macroeconomies (e.g. 'Northern' vs. 'Southern' countries). This level of aggregation is associated with specific constraints for policy-making, such as the sustainability of external accounts and sovereign debt. However, exclusive focus on macroeconomies might hide from view other constraints and possibilities, and especially those which emerge at the sectoral level of aggregation. In particular, economic analysis shows that proportions between sectors must remain within a range that is compatible with the 'viability' of the system. For example, this has to

[1] Tuori and Tuori have highlighted the multidimensional character of the European constitution, which they describe as 'process-like' in nature, that is, 'not a temporarily and substantially clear-cut normative entity but, rather, a continuous process of constitutionalisation' (Tuori and Tuori, 2014, p. 4). This view of the European constitution also applies, with qualification, to the Eurozone, and entails the co-existence of 'a number of dimensions which evolve pursuant to diverging temporal paces' (Tuori and Tuori, 2014, p. 14). The asymmetry inherent to the European constitutional settlement reflects some of the original ('functionalist') features of that settlement (Moravcsik, 2005; Scharpf, 2010) as well as some internal transformations of European polities from classical nation states to 'sectoral states' conducive to fragmentation of national policy domains (McCormick, 2007). Responses to the Eurozone crisis reflect temporal asymmetries inherent to the European constitutionalisation process and highlight significant further steps in that process (Chiti and Teixeira, 2013; Scicluna, 2012). At the same time, those responses may have enhanced the decoupling between different policy domains within the Eurozone and jeopardized its systemic coherence (Scharpf, 2010, 2012; Iversen and Soskice, 2013; Basevi and D'Adda, 2014; Majone, 2014; Soskice, Hope and Iversen, 2016).

do with assuring that inputs are produced in sufficient quality and quantity, and at appropriate timings. Further constraints are posed if we consider interdependencies within and across countries, hence the need to import required inputs and export outputs.

The foregoing argument suggests that each level of aggregation is associated with different causal mechanisms, which often work at the same time, although some mechanisms may be more relevant than others at any given moment. In general, in order to be viable, the system must satisfy different constraints (e.g. the macroeconomic and sectoral conditions just discussed), each of which also affords different opportunities for policy. An important consequence is that, in order to understand what causal mechanisms are at work in a given situation, and to gauge constraints and opportunities for policy-making, we need analytical tools that make it possible to visualize different levels of aggregation, understand which ones are more relevant at a given moment, and understand which causal mechanisms are associated with each.

The volume tackles this problem from different perspectives and disciplinary viewpoints. For example, through the lens of comparative historical and institutional analysis, it is possible to understand the levels of aggregation and causal mechanisms that were relevant in particularly significant cases of sovereign borrowing and in previous monetary unions, as well as understand the elements of fiscal union that the latter required. Moreover, political theory can provide categories to understand the constitutional dynamics that have shaped multi-level interdependencies in the Eurozone. These categories make it possible to characterize the social structures that embed states and markets, and to study how such structures frame the forms of conflict and cooperation that take place within the economic and political spheres.

In addition to history and political theory, an important contribution to the development of appropriate categories derives from economic analysis. In fact, the modern developments of analytical traditions whose initial statements go back to Political Arithmetic, Physiocracy, and Classical Political Economy, make it possible to decompose the economy in different ways at different levels of aggregation, each of which could be suited to the causal mechanisms that are more relevant in a given situation. Such analytical tools also make it possible to consider different levels at the same time, for example by highlighting both macroeconomic and sectoral conditions. By building on these traditions, it is possible to devise analytical tools that overcome the dichotomy between micro and macro analysis, which characterizes much policy and received wisdom on the Eurozone.

Once the internal differentiation of the Eurozone is characterized at multiple levels of aggregation, it becomes clear that policies have a different impact on different parts of the Eurozone as characterized above (e.g. countries, regions, and sectors). We can expect that the political actors connected to these parts will attempt to influence policy-making in order to obtain more favourable outcomes, and that coalitions will form to support different policy measures. The complicating factor for the analysis is that coalitions are likely to depend on the issue at stake. For example, when it comes to policies concerning external imbalances, the conflict is likely to be between tradable and non-tradable sectors. When it comes to the write-off of foreign debt, the conflict is likely to be between real and financial sectors. Moreover, the two cleavages need not coincide: a given firm may well find itself in one coalition for a certain policy, and in another for another policy. A further conflict of interest may have to do with liquidity policies. In fact, not only is it unlikely that a common macroeconomic liquidity policy will fit all countries, as usually discussed; policy will also have different effects on different sectors within each country, which can result in complex coalitions at different levels.[2]

The foregoing analysis points to the potential, in a system as complex as the Eurozone, for a significant degree of fragmentation of interests. However, the volume stresses that, because of interdependencies between the constitutive parts of the system, there should also be an interest in keeping the system as a whole viable, which could result in constraints to the pursuit of sectoral interests, or even in changes in the policy stances of relevant actors once it becomes apparent that systemic viability is at risk. The category of 'systemic interest' is presented for this purpose. It is argued that the Eurozone crisis may have acted as a catalyst of systemic interest, showing the

[2] One important point in this connection is the configuration of cleavages within any given set of social interdependencies. Cleavages may exert a disruptive or a stabilizing influence depending on whether they are, respectively, mutually reinforcing or mutually offsetting (see, in particular, Ross, 1938; Lipset and Rokkan, 1967; Hirschman, 1968, 1970; Rae and Taylor, 1970; Rogowski, 1987; Cardinale and Coffman, 2014). Tibor Scitovsky called attention to the co-existence of cross-national and cross-sectoral patterns of interdependence during the early stages of European economic integration (Scitovsky, 1958).

unsustainability of external imbalances and the need to satisfy viability requirements at the sectoral and macroeconomic level.

The volume shows that the overlap of different divisions of interests (among sectors conceived as outlined above, and countries) and its interplay with systemic interest has great explanatory power when it comes to understanding the origins of the European Monetary System, the dynamics leading to the Eurozone crisis and the policy responses it has elicited, and the constraints and opportunities that the Eurozone faces.

The overlap of causal mechanisms and varying configurations of interests provides a theoretical rationale for a central argument of the volume, which is that, in order to be effective, policies must fit the context. For example, historical analysis of fiscal systems and monetary unions suggests that the sustainability of borrowing depends on various causal factors, and macroeconomic fundamentals may work differently depending on economic and social interdependencies as well as institutional arrangements and the availability of alternative transmission mechanisms. Moreover, the effectiveness of rules and policy arrangements varies over time and across different parts of the system. Under certain conditions, flexible rules may work better than rigid rules; more generally, monetary policy must fit the architecture of the monetary system at any given point in time.

Attention to the internal configuration of the Eurozone, and hence to differences in contexts and in the appropriateness of policy frameworks, highlights the connection between policy-making and structural change. A notable example is the restructuring of EU manufacturing that has taken place since the crisis, which is in turn likely to lead to a further reconfiguration of policy stances and of the relative weight of sectoral interests.

The foregoing discussion emphasises the opportunities and constraints afforded by the economic and institutional architecture of the Eurozone. But in order to understand the multi-layered decision-making in the Eurozone, it is necessary to also consider how political-economy actors visualize those opportunities and constraints. The volume suggests different possible origins for actors' visualizations. For example, they can result from policy beliefs, notably those deriving from policy traditions such as the ordo-liberal and neo-mercantilist views that have been particularly influential in Germany. More generally, actors' visualizations can be theorized as being influenced, yet not univocally determined, by the political economy structures within which they act. It then becomes important to study the matches and mismatches between changes in political economy structures and changes in actors' visualizations thereof.

The interplay between policy frameworks and the opportunities and constraints afforded by the economic and institutional architecture of the Eurozone is a key theme of the volume. Contributions in the volume reflect on policy frameworks that are mindful of the institutional and economic architecture of the Eurozone, recognizing interdependencies between financial and real spheres of the economy and between various parts of the system. A notable example is that of financing tools that meet both public finance and economic development objectives, and especially the stabilization of sovereign debt and the provision of systemically important infrastructure.

Taken as a whole, the volume aims to characterize the features of the Eurozone as an internally differentiated political economy field at multiple levels of aggregation; to provide analytical tools to understand these features, and especially to identify the domains, causal paths and sets of constraints and opportunities that are most relevant under given conditions; and to suggest policy frameworks that are compatible with the aforementioned features.

1.3 The Structure of the Volume

1.3.1 Comparative Historical and Institutional Perspectives

The arrangement of the volume is as follows. Part I outlines a comparative-institutional and historical framework for assessing the architecture and dynamic forces within the Eurozone. The focus of this part is on the experience of past monetary unions, on the relationship between monetary unions and federation processes, and on the conditions that led to consolidation, or disintegration, of past monetary unions.

The first chapter in this part is by D'Maris Coffman on 'Fiscal States and Sovereign Debt Markets: A New Paradigm for Apprehending Historical Structural Change'. This contribution takes the view that history is not about the past, but about thinking on the past. From this perspective, the analysis of the historical experience of sovereign bond markets illuminates similarities and differences relative to the contemporary experience, and suggests important questions concerning the latter. What historical experience highlights is that sustainable levels of sovereign borrowing are the product of different overlapping causal factors, such as macroeconomic fundamentals and policy, monetary and financial institutions, property rights and alternative transmission mechanisms. As Coffman points out, two hundred years of sovereign borrowing have supplied historians, economists and market analysts with a wealth of evidence (economic and market data, financial news and archival material) with which to debate the historical determinants of sovereign borrowing. This chapter explores the theoretical purchase of a variety of approaches, examines both causal and symptomatic elements (as defined by Schumpeter) that have been considered in those approaches, and assesses the extent to which policymakers have made use of such research findings in defence of a variety of positions. The chapter concludes with a plea for a revitalised 'fiscal sociology,' which is characterised by a 'non-Marxist structuralism', and that would be particularly attentive to sectoral interdependencies, relations between socio-economic groups, and economic dynamics. The development of sovereign debt markets since the 1688 'Glorious Revolution' has been the object of intense discussion initiated by North and Weingast's credible commitment thesis (North and Weingast, 1989; Coffman, Leonard and Neal, 2013), and remains an important area of investigation for comparative historical and institutional analysis. To properly assess that thesis it is necessary to move beyond the abstraction of the 'State' and to explore the complex web of social interdependencies supporting the State apparatus and making it more or less effective (credible) depending on historical conditions. Opening the black box of the State involves allowing for a *plurality* of causal triggers that may or may not be effective depending on the specific conditions in view. For example, property rights may or may not be central to the working of sovereign debt markets, and macroeconomic fundamentals may work differently in different historical and institutional contexts. Uncovering social interdependencies and/or cleavages calls attention to the multiple causal factors that may be relevant under different conditions. After providing a narrative account of the historical evolution of sovereign bond markets, this chapter considers the principal determinants of sovereign borrowing, which are often overlapping in practice. In this connection, Coffman warns about using historical comparison without proper attention to the specific features of the different historical episodes and contexts. For example, in discussing the contemporary relevance of the Latin Monetary Union and of the Scandinavian Union, she argues that in either case there was a currency union, but there was no central monetary authority to set the interest rate policy. Also, there was no compulsory coordination mechanism such as the one introduced with the Maastricht Treaty. In view of these limitations, Coffman argues for the need to delve deeper into the political economy of taxation and public borrowing in Europe past and present. The most urgent task for the political economy of the Eurozone is to understand the evolution of European fiscal regimes in the post–World War II period. More research into fiscal variation within the Eurozone is needed, but research of this type has been actively discouraged by the fiscal rules of the Maastricht provisions. In fact, to impose uniform fiscal rules across different member states is to adopt a policy of indifference to how they are followed. However, a given country's fiscal mix (the proportion of direct and indirect taxation), the economic incidence of indirect taxation (how successfully manufacturers are able to shift the economic burden), the strategies used by taxpayers to avoid (or, in some cases, even evade) taxation, let alone the non-fiscal effects (from welfare effects to broader sociological phenomena) are urgent areas of study. In societies where the state represents between a fifth and a half of the economy, it would be unwise to neglect the ramified sociological consequences of the strategies a country uses to tax and spend. This point calls attention to the central relevance of Schumpeterian fiscal sociology as heuristics for the investigation of the Fiscal State issue. Fiscal sociology would contribute to studies like those in Chapters 8 and 11.

In the following chapter ('Creating Stable Systems of Public Finance in the United States and Germany: Lessons for the Eurozone'), James Macdonald examines the historical experience of financial sovereignty pooling by contrasting the two cases of the United States and Germany since the nineteenth century. The histories of the United States and Germany are relevant because these countries are federal systems that evolved out of independent (or nearly independent) states. In both cases, the political systems that were initially created were financially decentralized. And in both cases the countries found themselves moving, slowly but ineluctably, towards greater levels of centralization in response to financial crises. The financially stable federal systems that the two countries eventually built, however, were based on different sets of underlying principles. In the United States, fiscal union involved the federal government taking over the debts of the states. However, the amounts outstanding were not evenly distributed, as some states had borrowed using paper money that had become worthless and other states had already settled much of their debt at a discount. In any case, debt restricting as engineered by the Treasury Secretary Alexander Hamilton was a success, and it was politically achieved not through 'collective action' rules, but through the substantive economic argument that only the restructured debt would benefit from the security of the new federal tax revenues. In the end, the new consolidated debt was funded at an interest cost of around 1.5 per cent of GDP, and helped to generate a liquid market that contributed to keeping yields down and to create a large body of public creditors with a financial attachment to the federal government. The subsequent US experience shows rising levels of State and municipal debt side by side with the emergence of a federal government as 'borrower of last resort' generally unwilling to contemplate bailouts of failed States or cities. The German experience was different. At unification in 1870, Prussia dominated Germany without the need for a centralized state. At the same time, decentralization allowed Prussia to maintain a number of privileges it might otherwise have had to give up. As a result, the central State was given limited tax powers consisting mainly of customs duties, certain tolls and excises and the income from the postal system. The subsequent evolution of the fiscal state in Germany exposed the weaknesses of a system whose initial stability was achieved through flow of funds from France (indemnity after the Franco-Prussian war of 1870) and the *de facto* preponderance of Prussia within the system. Increasing levels of debt both at the central and local levels were met with further central limits on the autonomy of local government starting a process that has continued to this day. The final outcome for Germany has been a federal system operating on principles substantially different from the American one. For instead of relying on self-contained areas of responsibility working primarily through market discipline, Germany developed a complex system of overlapping responsibilities kept in balance by formal rules. In Macdonald's view, the comparative historical experience of the United States and Germany suggests that the only currently plausible solution to the Eurozone problems may be to undertake the minimum further political integration that is compatible with financial stability.

The historical experience of an important European attempt at monetary unification in the absence of political integration is examined in the chapter by Luca Einaudi ('A Historical Perspective on the European Crisis: The Latin Monetary Union'). Einaudi moves from the consideration that attempts at monetary unification have a long tradition in European monetary history. He also argues for the need to assess each attempt in the light of the specific monetary architecture in place at any given time, and of the political economy conditions making that architecture to work in particular ways depending on context. Awareness of the relationship between monetary architecture and governance structure is of critical importance in interpreting attempts at monetary unification. And it is also essential in assessing the sustainability of the current monetary union in Europe. A historical heuristic allows assessment of alternative scenarios for what concerns the relationship between monetary architecture and monetary policy, and brings to the fore their mutual fitting, or incompatibility, under given conditions. The Latin Monetary Union (LMU) had its origins in a long-term historical heritage dating back to Napoleon's monetary unification of France, Belgium, and continental Italy. Some forms of monetary uniformity had been achieved, without explicit agreement, in the years preceding the start of LMU, partly as a result of modernization processes and increasing international trade. The crisis of bimetallism associated with massive gold inflows into Europe as a result of the Californian gold rush increased pressure towards policy coordination, which ultimately led to the establishment of a Monetary Union among France, Italy, Belgium, and Switzerland with the Paris Monetary Convention of 23 December 1865. The Convention established a one-to-one fixed exchange rate among coins of the participating countries, based on the intrinsic gold and silver content of the coins. The system's architecture was a partial monetary union in which multiple exchange rates developed: fixed exchange rate between the gold coinage of member states; fixed exchange rate for 5 francs silver écus associated with upper limits on new issues; fixed exchange rate between silver divisionary coins with a ceiling on total issues; and exchange rate between banknotes and gold coins fixed in ordinary times but fluctuating in times of temporary inconvertibility. Against the background of this monetary architecture, LMU showed considerable resilience, which was partly an outcome of its flexible membership and governance. The Papal State joined after lengthy negotiations but