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Using Interdisciplinary Analysis to Shape a Policy Agenda

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ABSTRACT: This conclusion uses an interdisciplinary approach to the crisis to contribute to the debate on EMU governance and EU institutional reform. It begins with stocktaking based on the Five Presidents Report (2015). It then identifies policy priorities for the short and medium term. It uses these priorities to shape a longer-term agenda for a sustainable Europe. And it concludes with suggestions for further research. If any economics window on an interdisciplinary crisis may shed some light, perhaps a political science window could shed more.

KEYWORDS: Crisis, EMU governance and EU institutional reform, policy priorities, agenda for a sustainable Europe

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This collection of essays came together alongside two developments that will have a lasting impact on the euro area – the 'Five Presidents Report' (2015) on 'completing Europe's economic and monetary union' and the events surrounding the end of Greece's participation in the second bailout programme. These developments underscore why we believe the crisis in the euro area can only be understood at the juxtaposition of insights from different disciplines. They also illustrate why we chose to highlight themes related to multilevel governance, policy ideas, distributive bargaining, and popular legitimation in our introduction. The goal of the 'Five Presidents Report' is to strengthen the European Union by drawing the right lessons from the crisis and then implementing them in a manner that will reinforce action taken at the member state level while shoring up popular support for European integration. The situation in Greece, even if it is a rather particular case among all Eurozone countries, suggests that we are still far from achieving that objective.

The purpose of this short conclusion is to show how the essays in this collection can move us in the right direction. Along the way, we hope to underscore what useful progress has been made and where more attention should be directed. As we announced in the introduction, this is not a definitive exercise. Often we can only point to problem areas or raise useful questions. That is useful nonetheless. When we say European integration is a work in progress, we should probably underscore the importance of 'work' as much as 'progress'. Much remains to be understood and then put into action before anything substantial can be accomplished.

This conclusion has three elements. It starts with an assessment of where things stand based on the analysis provided in the preceding essays. The second section looks at priorities for action. Here we admit that there is room for contestation, even among our own contributors. The third section extends those immediate priorities into a longer-term agenda. The final section offers suggestions for further research based on this analysis.

Taking Stock

The recent events in Greece have cast a pall over the European project. The details have been widely reported in the media. A bare-bones outline might go like this. Negotiations between Greece and its creditors dragged on for months after the election of a Syriza-led coalition government. During the period of uncertainty that surrounded those negotiations, the Greek economy continued to contract and the balance sheets of the Greek banks worsened. Events

came to a head toward the end of the second bailout program in June 2015. Nevertheless, the Greek government and its creditors could not come to agreement. Instead the Greek government called for a yes-or-no referendum on whether to accept the terms offered by its creditors (even though that offer lapsed in the interim). The situation with the banks continued to worsen and the Greek government had to impose capital controls as a consequence. This forced the Greek economy into an even deeper contraction. The Greek people rejected the offer made by Greece's creditors and yet the Greek government had few alternatives to stabilize public finances or the country's banks. As a result, it agreed to enter into negotiations over a new bailout program that was at the same time more generous (because it involved larger sums of assistance) and more rigorous (because it placed greater constraints on Greek policy-makers).

This situation is revealing because it shows the tensions built into Europe as a multilevel governance framework. As Mongelli and his colleagues reveal, there has been much progress made on many different dimensions of the European project. Nevertheless, important gaps remain. Some of these gaps, like a lender of last resort facility for governments and sovereigns, have long attracted attention from the community of policy analysts. That is the point that Giavazzi and Wyplosz make. Nevertheless, the framework remains dangerously inadequate. Although the EU has put together some institutions to act as a firebreak in the event of crisis, it continues to underestimate the fragility of the European financial system and so it continues to overburden the European Central Bank. This point is underscored by De Grauwe and Ji. It is also central to the Jones essay.

The European framework lacks two things in particular. One is a pre-established mechanism (and formula) for distributing adjustment costs in the event of a sudden crisis. This point is stressed by De Grauwe and Ji but also by Bini Smaghi. The other thing lacking is an institutional framework for exercising discretion in times of need. This is a concern raised by Gaspar. Without those two elements, it is almost certain that any significant shock will give rise to distributive bargaining (if not conflict). That is why large macroeconomic imbalances are so threatening, as outlined by Kincaid and Watson. Unfortunately, however, there is little political will to resolve this dilemma. The most powerful member states show no desire to build up large centralized financial arrangements or to establish automatic lender-of-last resort facilities. On the contrary, they are more concerned to emphasize national responsibility and to prevent moral hazard. Some of these inclinations arise from economic models that are popular in these countries. That is the point made by Vines in his

essay. Some, however, stems from a more general unwillingness to share resources across national boundaries (to which the amount of resources transferred to Greece by all the other Eurozone members, including poorer member states, has contributed) -- a point made by Kincaid and Watson but also De Grauwe and Ji.

The political requirements to overcome this reluctance have not been met and are unlikely to develop spontaneously. The European Union is a single framework for multilevel governance but it contains a multitude of discrete political communities. Begg and his colleagues make that point clearly. The implication is not that European integration is doomed from the outset or that political union will remain forever beyond reach. Rather it is that political community building is a slow moving process that requires constant nurturing. Unfortunately, the tensions that emerged at the end of the second Greek bailout program are pushing in the opposite direction. This is not a new phenomenon. The European Union has been struggling to forge a closer political community at least since the early 2000s. That is why the European Council issued its Laeken Declaration in December 2001. What the political crisis around Greece reveals is that little progress has been made in the interim; indeed, Europe may have moved in the opposite direction.

Priorities for Action

The Five Presidents Report is well timed in this respect. The report calls for action across four dimensions – economic union, financial union, fiscal union, and political union. The economic challenge is to create markets that are both efficient and convergent but also to reconcile growth, employment and competitiveness with the sustainability of EMU, while avoiding negative spillovers across national borders. The financial challenge is to strike a balance between systemic stability and moral hazard. The fiscal challenge is to share risks as well as resources in the face of oversized external shocks. And the political challenge is to establish the legitimacy of these new arrangements in order to shore up popular support. The Five Presidents report makes suggestions for policy in each of these areas. The problem is that Europe's heads of state and government are unlikely to be able to tackle all of these agendas at once. Hence they will need to establish clear priorities. The contributions to this collection have a number of suggestions.

For Vines, the emphasis must be on competitiveness and hence the establishment of efficient and convergent markets. The reason traces back to the original literature on optimum

currency areas. It is also reinforced by the experience of large macroeconomic imbalances, as per Kincaid and Watson. It is hard to see how a single currency can be sustainable if national economies interact in a destabilizing manner through movements in relative prices and national savings. Therefore, it is essential that European leaders work to reform their market institutions. This poses a two-fold challenge. To begin with, have to create the space for positive action. That is why Vines places such emphasis on using macroeconomic policy instruments to stabilize aggregate demand. However, the challenge now is to promote growth in a way that is compatible with fiscal consolidation and reduced indebtedness while at the same time ensuring long-term sustainability. As illustrated by the example of Puerto Rico within a financially integrated monetary union, a sustainable growth strategy with structural reforms at the national level seems necessary for a durable recovery.

For Jones, the priority should be completion of Europe's financial union. Again, the goal is to provide sufficient space for policy action in other dimensions. It is not to preclude improvements to competitiveness, but rather to facilitate their achievement over the longer term. The challenge is to provide sufficient resources to shore up European financial institutions – not just in Greece but also elsewhere. This will require moving beyond what is currently available in Europe either in terms of resolution financing or deposit insurance. That message is consistent with arguments made by Giavazzi and Wyplosz. It is also consistent with De Grauwe and Ji. The open question is how such resources will be financed. The answer is not immediately obvious.

For De Grauwe and Ji, the answer is fiscal integration. That answer fits with American experience, which is a point noted both by Gaspar and by Giavazzi and Wyplosz. It is controversial nonetheless. As mentioned above there is little desire among the wealthier European countries to create a mechanism to transfer resources automatically across national boundaries. If such a mechanism is essential to the smooth functioning of Europe's financial union, then Europe will have to continue to live with a suboptimal institutional arrangement across both dimensions. There are hints of this contradiction in the Five Presidents Report; De Grauwe and Ji place it front and center in their conclusion.

Paradoxically, the argument made by De Grauwe and Ji suggests that the priority for action should lie in efforts to influence the most slow-moving variable – which is the degree of political union or solidarity across countries. This brings us back to the analysis made by Begg and his colleagues. They stress that Europe's peoples will respond to a vision of integration that promises to resolve many problems and not just the current crisis.

Articulating this vision is only the first challenge for policy action; building popular trust in such a conception of Europe will require more sustained effort. This is a very different argument from that made by Vines, Jones, or De Grauwe and Ji insofar as it suggests that the immediate priority is also the priority for the longer term. European integration is a political project with economic benefits as well as being an economic project with political implications. Once again we find ourselves looking through a prism with political legitimacy on one end and economic rationality on the other.

Longer term Consideration

To its credit, the Five Presidents Report does not shy away from this longer-term political challenge. Hence, while many of the contributors to this volume may disagree with specific recommendations either because of what they put forward or because of what they omit, there is general agreement on the broad thrust of the project. The difficulty lies in implementation.

That implementation requires action on many dimensions. First and foremost, it requires openness to new ideas. Giavazzi and Wyplosz stress the importance of allowing new ideas to penetrate into the policy process; Barta and Schelkle emphasize the penetration of new ideas into the markets; Vines emphasizes the impact of ideas on the world of high politics. These are all areas where Europe has been resistant to change. But the signs are that resistance is diminishing – particularly where the policy process and markets are concerned. The bigger concern is the political arena. Challenging fundamental assumptions is never easy, particularly when those assumptions are underpinned by great wealth and strong economic performance. It is nevertheless essential for Europeans to take a system-wide perspective if they are to tackle system-wide problems. To put not too fine a point on it, Europe cannot prosper as Germany writ large both because such an evolution would impose an unacceptably high cost of adjustment on a number of member states (as per Bini Smaghi) and because it would result in pushing the problem of macroeconomic imbalances to the global level (which is one of the implications of Kincaid and Watson).

Changing ideas is not enough on its own. Those ideas must be translated into functioning institutions for multilevel governance. The work by Mongelli and his colleagues shows us where that institutionalization has progressed and where more work is required. Giavazzi and Wyplosz emphasize that sequencing matters in economic terms. Begg et al. show how sequencing matters in the political process. The implication is that we need to

develop ideas not just about what to do but how it should be accomplished. Moreover, these ideas about the content and process of institutional reform must be consistent. This is a point that emerges in Barta and Schelkle. What they show is how difficult it is to achieve such consistency within a multilevel governance framework where the focus is on interaction between states and markets. European leaders have no choice but to rise to the challenge.

Finally, the longer-term agenda must tackle other problems that are likely to emerge. This is the point made by Begg et al. It is also the point revealed by Gaspar's more historical analysis. The advantage of the longer view is that it helps to put setbacks into perspective. Even major conflicts or changes in policy, like those experienced in the United States during the 19th Century, do not have to derail a sound policy agenda – particularly where there is broad based determination to succeed both politically and economically. The point here is not to suggest that the crisis surrounding Greece, or the political malaise that has affected Europe since the end of the 1990s, compares in any way to the traumas experienced in the United States. Recent events look dramatic but not in anything like the same way. Even so the goal for policy-makers should be to remain fixed on the longer-term horizon and to look for opportunities to introduce sound policies or innovations for which there is no support at the moment (or for which there may be outright opposition). The discussion of mutualized sovereign debt instruments (or Eurobonds) falls in this category. Fiscal union may fit in this category as well. These are important innovations that should be kept on the longer-term agenda even if the opportunity to implement them may never come.

Suggestions for Research

This allusion to the long term suggests an important research agenda that can be described in terms of the political acceptability of economic integration or the economic possibilities from political integration. The goal of this collection has been to focus attention on both sides of that problem. We have relied on insights from economists that we can make available to a wider community of political scientists or cognate researchers. But that is only half of the wider agenda. It is easy to imagine an exercise that opens the literature in political science to the community of economics. What is clear is that the two communities are addressing the same themes, albeit often with different language and drawing upon contributions from different communities. What is also clear is that the different disciplines of scholarship have a lot to offer one-another. Unfortunately, the barriers to entry in the conversation are so high

that it will always be easier to speak within a group than to initiate a dialog across communities. The incentives of academic publishing and career promotion reinforce that tendency. This is bad for policy and bad for Europe. We would not go so far as to argue that such Balkanized scholarship explains the current crisis; but we would not be unfair to suggest that it would explain the next crisis given the many different good ideas for strengthening European integration that are on offer.