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Governing by Panic: The Politics of the Eurozone Crisis

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Abstract

The Eurozone's reaction to the economic crisis beginning in late 2008 involved both efforts to mitigate the arbitrarily destructive effects of markets and vigorous pursuit of policies aimed at austerity and deflation. To explain this paradoxical outcome, this paper builds on Karl Polanyi's account of how politics reached a similar deadlock in the 1930s. Polanyi argued that democratic impulses pushed for the protective response to malfunctioning markets. However, under the gold standard the prospect of currency panic afforded great political influence to bankers, who used it to push for austerity, deflationary policies, and the political marginalization of labor. Only with the achievement of this last would bankers and their political allies countenance surrendering the gold standard. The paper reconstructs Polanyi's theory of "governing by panic" and uses it to explain the course of the Eurozone policy over three key episodes in the course of 2010-2012. The prospect of panic on sovereign debt markets served as a political weapon capable of limiting a protective response, wielded in this case by the European Central Bank (ECB). Committed to the neoliberal "Brussels-Frankfurt consensus," the ECB used the threat of staying idle during panic episodes to push policies and institutional changes promoting austerity and deflation. Germany's Ordoliberalism, and its weight in European affairs, contributed to the credibility of this threat. While in September 2012 the ECB did accept a lender-of-last-resort role for sovereign debt, it did so only after successfully promoting institutional changes that severely complicated any deviation from its preferred policies.

Keywords: Euro, European Central Bank (ECB), austerity, lender of last resort, Ordoliberalism, gold standard

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Governing by Panic: The Politics of the Eurozone Crisis

Introduction

The manifold efforts made by Eurozone leaders to deal with the aftermath of the world financial crisis that began in 2007-2008 displayed a fundamental, and quite puzzling, contradiction. On the one hand, both the Eurozone as a whole and individual European states sought to prevent the transformation of crisis into catastrophe by evading the onset of well-known vicious circles. To combat bank runs and the downward spiral of debt deflation, governments offered deposit guarantees and bailouts, while the European Central Bank (ECB) provided liquidity to the financial sector on an unprecedented scale.[1] To avoid a fall in consumer prices that would reduce incentives to spend and and thus put further downward pressure on prices, the ECB sought to cut market interest rates and increase the money supply. Against the tendency of recession to breed more recession as spending and investment retrench in reaction to reduced demand, governments deployed expanded spending on unemployment support and other automatic stabilizers and—in 2009, at least—explicit demand stimulus. Later, Eurozone leaders did not simply stand aside in the face of an accelerating feedback loop between falling bond prices, higher government interest costs, and the prospects for budget balance. Instead, they worked to ease financing constraints for affected

[1] In a "debt deflation," debtors liquidate assets to cover their debts; this drives asset prices down and tightens credit availability for other debtors, who must then liquidate their assets, etc. Fisher 1933.

national governments. In short, national and international policy responses to the Eurozone crisis were replete with measures premised on the belief that it would be too costly to allow assets to find their own price on markets where pessimistic expectations could feed on themselves.

On the other hand, accompanying this impulse to reject the sovereignty of the price mechanism and to build bulwarks against price collapses was a contradictory impulse—one that sought to enforce the sovereignty of the price mechanism and dismantle bulwarks against deflation. Above all, a number of governments, pushed by the ECB and other European institutions, made efforts to fight high levels of unemployment through promoting declines in wages—for instance, by reducing minimum wage rates, by decreasing public sector salaries, by reducing unemployment benefits, by weakening and decentralizing collective bargaining, and by forcing renegotiation of labor contracts in recessionary conditions.[2] Meanwhile, fiscal demand stimulus that would have moderated downward pressure on wages and other prices was short-lived, and from 2010 states across Europe pursued austerity, seeking to balance budgets through tax rises and spending cuts. Eurozone members also adopted new treaty obligations intended to make austerity in reaction to budget difficulties effectively mandatory.

Thus, Eurozone governments and institutions pursued policies designed at once to protect societies from markets and to subject them more fully to them. They used both fiscal and monetary policy instruments to ward off vicious circles of declining growth or financial implosion, yet did not turn these same instruments to promoting virtuous circles of expansion. Rather than a comprehensive victory for the point of view that prices cannot safely be left to

[2] OECD 2014; Sapir et al. 2014.

find their own level, or for the rival claim that maximal price flexibility assures rapid adjustment and resumption of growth, one finds a deadlock between contradictory impulses.

To explain this stalemate is the purpose of this paper. My explanation builds on Karl Polanyi's 1944 masterwork The Great Transformation, henceforth TGT. Polanyi traced the interwar European catastrophe to a similar deadlock, one which likewise kept the widely shared impulse to protect the social fabric against arbitrarily destructive markets from growing into a successful recovery program. Key to this deadlock was the shadow of financial panic, used by bankers to keep democratic politicians in check. As Polanyi wrote,

> Under the gold standard the leaders of the financial market are entrusted, in the nature of things, with the safeguarding of stable exchanges and sound internal credit on which government finance largely depends. The banking organization is thus in the position to obstruct any domestic move in the economic sphere which it happens to dislike, whether its reasons are good or bad. In terms of politics, on currency and credit, governments must take the advice of the bankers, who alone can know whether any financial measure would or would not endanger the capital market and the exchanges. … The financial market governs by panic.[3]

On Polanyi's argument, the gold standard endured as long as it did, despite the tremendous difficulties it entailed, because financial interests feared the political consequences of unorthodox policy by labor governments and wished to retain the capacity to govern by panic. The end of the gold

[3] Polanyi 1957, 229.

standard, by making a currency panic impossible, meant "the political dispossession of Wall Street." No longer constrained to heed the counsel of bankers, governments could launch innovative attacks on economic crisis, as the United States did in the New Deal. However, FDR's unilateral decision to take the dollar off gold was exceptional. Elsewhere, financial leaders retained their veto, and would only agree to abandon the gold standard when labor had been politically neutralized.[4]

When a particular gold-backed currency was under threat, Polanyi notes, finance used the prospect of panic to push for austerity and deflation as solutions. These were intended achieve the adjustment of international relative prices, restoring competitiveness and ending the drain of gold that threatened convertibility. However, these efforts came up against Polanyi's famous "countermovement," animated by "the principle of social protection aiming at the conservation of man and nature as well as productive organization."[5] Workers resisted decreases in wages, agriculturalists decreases in food prices, and enterprises the destructiveness of a general deflation. "Authoritarian interventionism" in service of "vain deflationary efforts" weakened democracy but did not achieve its aim.[6] What efforts there were to abandon the deflationary ambition and embrace deficit spending—as in the 1936 "Blum experiment" in France—were doomed to frustration as long as the gold standard was in place.[7] The result was a deadlock between the popular principle of social protection and the wish of financial interests to maintain political leverage. Economically, this led to an incoherent policy premised on

[4] Ibid., 228-229.
[5] Ibid., 130, 132.
[6] Ibid., 233-234.
[7] In more contemporary language, stimulus (autonomous macroeconomic policy) was constrained by the combination of fixed exchange rates and the free flow of capital, as described in the Mundell-Fleming trilemma. On this trilemma in the gold standard context, see Bordo and James 2013. For Polanyi's version, see Polanyi 1957, 229.

deflationary aims that could not be attained (and were destructive to the limited extent they were). Politically, the direct opposition between economic and political power meant an undermining of democracy. Only the demise of the gold standard could break the stalemate.

With appropriate but remarkably limited modifications, this paper contends, Polanyi's arguments about the political and economic consequences of the gold standard offer powerful explanations of the course of the Eurozone crisis. That this should be so might well have surprised Polanyi himself. After all, the euro was not linked to gold standard nor even fixed to any external currency. At no point in the crisis was the prospect of a generalized flight from the euro remotely on the agenda. Moreover, Polanyi's account of the agenda motivating the bankers of the Great Depression era to deploy the panic weapon was comprehensively archaic by the early 21st century: parties of the mainstream left with not the slightest inclination to set the foundation-stones of capitalism a-tremble simply could not provoke the kinds of anxiety among capitalists he diagnosed.

Despite these important differences, two factors make Polanyi's analysis of the interwar crisis pertinent to the Eurozone. First, financial panic remains an endemic possibility under capitalism. A currency panic, in which investors race to sell a currency first amid fears over its exchange rate or convertibility into gold, is only one species of the more general phenomenon. As Eurozone sovereign borrowers and their creditors had repeated occasion to observe in 2010-2012, any fungible, widely held asset such as a government bond is vulnerable to a panic if investors believe an imminent general shift in expectations of its value is probable. By itself, the absence of a gold standard does not ensure such panics will not take place. A fiat currency does, however, enable a central bank to deploy a powerful, indeed almost invincible weapon against panic: the use of money creation to buy up assets and coordinate investor expectations about prices. Most students of central banking consider this "lender of last resort" role to be a fundamental advantage of the institution.[8]

But even without the constraint of the gold standard, last-resort lending does not take place on its own. The second reason Polanyi's theory proves relevant to the Eurozone crisis is that in its course politicians and technocrats were able to use the prospect of financial market panic for political leverage. The European Central Bank (ECB), as demonstrated below, repeatedly threatened to refuse to serve as a lender of last resort for government bonds unless certain policy prescriptions were met. These prescriptions aimed to promote the "Brussels-Frankfurt consensus," which substantially recapitulated the financial orthodoxy of the 1920s and 1930s in its support for austerity and promotion of the price mechanism.[9] Because with the move to the euro national governments had no capacity of their own to serve as lender of last resort, they acceded to these demands.

This new deadlock between social protection and panic-enforced fiscal orthodoxy had effects similar to its 1930s analogue. Economically, the Eurozone pursued an incoherent effort to at once induce deflation via austerity and to fend it off. Politically, what in Polanyi's case was a split between political power and economic power became, in the Eurozone case, a split between nationally organized political power and transnational economic power channeled by the ECB, again with severe consequences for democracy. Even the ECB's eventual acceptance of a lender-of-last-resort role

[8] De Grauwe 2013.
[9] For a description, see Jones 2013 and below.

(in mid-2012) paralleled one path to the demise of the gold standard Polanyi described: it happened only after opposition to austerity had been politically neutralized, in this case via the drastic curtailment of the budgetary autonomy of national states.

The balance of this paper is organized as follows. The first section sets out Polanyi's analysis of the economic background of the Great Depression, and of the role of "governing by panic" in the political deadlock that ensued. In the second section, I discuss some of the difficulties of making use of market panic as a form of political leverage, focusing on the strategic difficulties central banks face in credibly threatening to let a market panic rage in the absence of a gold standard. The third section examines the Eurozone crisis, describing both a protective reaction and the emergence of an austerity agenda enforced through panic. It suggests that the capacity of the ECB credibly to refuse to serve as lender of last resort depended crucially on the influence of Ordoliberalism on German policy makers and institutions, and discusses the political circumstances under which the ECB came to accept a lender-of-last-resort role. The conclusion situates the Polanyian explanation in relation to other approaches.

I The deadlock of the 1930s

Polanyi's account of the political economy of the interwar period relies on two intersecting causal processes, which he summarizes as follows: "The one was given by the clash of the organizing principles of economic liberalism and social protection which led to a deep-seated institutional strain; the other by the conflict of classes which, interacting with the first, turned the crisis into a catastrophe."[10]

However, in this formulation Polanyi mixes together multiple issues, and to get at the root causal mechanisms he postulates, some untangling will be necessary. Polanyi's account of the interwar years, I submit, is best understood as centering on the contradictory place of the gold standard. Policy and institutions ensured that the price-specie-flow adjustment mechanism central to the gold standard's economic rationale did not operate, but the gold standard was nevertheless maintained in many countries. In the context of this line of argument, the "economic liberalism" Polanyi mentions in the quote above effectively means the price-specie flow gold-standard adjustment mechanism, and "social protection" anything that interferes with it. The role of the "conflict of classes" was to block any coherent response to depression. Working-class influence in the political system blocked a deflationary response, but the strength of the "trading classes" in the economy, and in particular the threat of market panic, forestalled a stimulationist one. This protracted "deadlock" led to fascism, which was avoided only if the gold standard was abandoned before the collapse of democracy.

At the core of this narrative is the "price-specie flow" gold standard adjustment mechanism initially articulated by Hume. It presumes a close connection between trade, money supply, and price formation. Prices at an uncompetitive level lead to a trade imbalance, which gives rise to gold outflows, a consequent decline in the money supply, and thence a fall in prices that restores competitiveness and the trade balance.

[10] Polanyi 1957, 134.

However, Polanyi recognized a point also emphasized in more recent scholarship: this adjustment mechanism rarely, if ever, operated as described in practice.[11] One reason for this, Polanyi argues, is that the institutions block falling prices. His discussion of the consequences of deflation is similar to that advanced by Keynes in the 1920s: in a context of falling prices, sales may fail to cover costs (such as labor) fixed by contract.[12] As a result, protracted deflation would leave enterprises ("industrial, agricultural, or commercial")[13] "in danger of liquidation accompanied by the dissolution of productive organization and massive destruction of capital."[14] In this context, a central bank capable of affecting the general price level through monetary policy prevents unnecessary and arbitrary damage.[15] Central bank policy, though, is not the only barrier against falling prices. A second barrier applies specifically to the price of labor, where "social legislation, factory laws, unemployment insurance, and, above all, trade unions …[interfere] with the mobility of labor and the flexibility of wages."[16]

Successful prevention of deflation in the context of a trade deficit means the gold-standard adjustment mechanism cannot operate. Since competitiveness is not restored, the trade deficit and associated gold drain persist.[17] Polanyi notes two related responses. The first was trade protectionism, whether direct or via various forms of exchange restriction. The path from a fixed exchange rate to an overvalued currency to trade protectionism is a familiar one.[18]

11 Flanders 1993
12 Keynes 2000, 36.
13 Polanyi 1957, 131.
14 Ibid., 192.
15 Polanyi is especially concerned to show that the relevant destruction would not be creative, but indiscriminate, even if the necessity of deflation is conceded. For deflation could affect not only exporters and potential exporters, whose cost competitiveness determine the balance of trade, but also other firms "according to their fortuitous business dealings." Ibid., 194.
16 Ibid., 177.
17 For reasoning along these lines, see Ibid., 197,210,217; Polanyi 2002a, 124.
18 Polanyi 1957, 27,214; Woodruff 2005.

Polanyi would have noted it as he followed Britain's currency crisis in the summer of 1931, for during this period Keynes was advocating a protective tariff to avoid abandoning the gold standard.[19] Thus, "the incubus of self-sufficiency haunted the steps taken in protection of the currency,"[20] and this had cumulative effects in reducing international trade.[21] The second response to blocked deflation Polanyi emphasizes is the spread of international credit, used to finance the balance of payments deficit.[22] The joint result of these two responses was a waxing of international capital movements as international trade waned. "Payments, debts, and claims remained unaffected by the mounting barriers erected against the exchange of goods; the rapidly growing elasticity and catholicity of the international monetary mechanism was compensating, in a way, for the ever-contracting channels of world trade."[23] However, this "perpetual borrowing"[24] was doomed to be temporary. Internationalized finance transmitted the effects of the U.S. stock market crash to the rest of the world, and international credit dried up.[25] "The interdependent deficit economies went into an irreversible slide, and the whole stabilization structure collapsed."[26]

Without credit available to cover the balance of payments deficits, national authorities faced a choice between deflation and exit from the gold standard. It was this set of circumstances, Polanyi argues, that led to a perilous political deadlock: in most nations, neither effective deflation nor exit from the gold standard proved politically feasible. The political character of his explanation

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[19] Skidelsky 1994, 293
[20] Polanyi 1957, 27
[21] For a similar contemporary position, see Eichengreen and Irwin 2010.
[22] Polanyi 1957, 206,232; Polanyi 2005, 351.
[23] Polanyi 1957, 206.
[24] Polanyi 2005, 351.
[25] Polanyi 1957, 233. For a recent account of this "sudden stop" see Accominotti and Eichengreen 2013.
[26] Polanyi 2005, 351

bears some emphasis. The political vulnerability of deflationary policies in a democracy is clear enough. But Polanyi argues that abandoning gold to obviate deflation faces political difficulties as well. Certainly, these political difficulties alone do not explain the gold standard's persistence. Polanyi suggests that with the exception of the US and UK ("masters, not servants, of the currency"), leaving the gold standard "involved no less than dropping out of the world economy."[27] He hints that international loans may also have bound countries to the gold standard, insofar as going off gold would have reduced the gold-denominated size of the domestic economy and made repayment of loans difficult.[28] Finally, Polanyi also emphasized the powerful ideological sway of the gold standard, "the faith of the age."[29]

Still, the importance of these factors should not obscure Polanyi's argument for the *political* resilience of the gold standard. Though this political argument can be detected in a number of points in *TGT*, it gets its fullest exposition Chapter 19, "Popular government and market economy." The argument needs to be understood in the frame of the above-mentioned "conflict between classes," in particular between labor and capitalists.[30] For capitalists, the existence of the gold standard served an important political purpose. Though national currencies were backed by gold reserves, the coverage was not 100%. If a sufficient number of currency holders demand conversion of their notes into gold, convertibility would have to give way. Under the gold standard, then, currency was vulnerable to collapse in a panic. This circumstance, as Polanyi argues in the passages quoted at the outset of this paper, gave capitalists substantial political influence. When labor parties were in power--

[27] Polanyi 1957, 234,230.
[28] Ibid., 232.
[29] Ibid., 25.
[30] I am grouping under the term "capitalists" what Polanyi refers to as "trading classes," "employers," and the "financial market" more or less interchangeably.

as in Britain in 1929-1931 and France in 1936-1937, the prospect for capital flight (via conversion of currency) offered capital-holders a veto over radical measures. As long as labor was politically potent, Polanyi contends, capitalists insisted on the maintenance of the gold standard for political, not just economic reasons.

Polanyi offers some hints as to why gold standard as a source of political leverage was so fundamentally important to capitalists: their fear that labor's political power represented an existential threat. This was not because a repetition of the Bolshevik revolution in Europe was in any regard likely.[31] Instead, capitalists feared that labor "might disregard the rules of the market which established freedom of contract and the sanctity of private property as absolutes." The consequences of this lack of what nowadays would be termed credible commitment to capitalism Polanyi describes in dire terms that would do any market liberal proud: moves along these lines "must have the most deleterious effects on society, discouraging investments, preventing the accumulation of capital, keeping wages on an unremunerative level, endangering the currency, undermining foreign credit, weakening confidence and paralyzing enterprise." This was the source of "latent fear which, at a crucial juncture, burst forth in the fascist panic."[32]

The argument comes through more clearly when Polanyi's compact discussion of the French and British cases is fleshed out with the contextual details he assumed readers would have at their fingertips. In 1936, Polanyi writes, the socialist Blum took power in France "on condition that no embargo on gold exports be imposed."[33] Blum's premiership relied on a coalition that

[31] Ibid., 190.
[32] Ibid., 190. Compare also Ibid., 234-236.
[33] Ibid., 229.

also included the middle-class Radicals, who were opposed to capital controls.[34] The explicitly political character of the capital control issue seems to have been widely understood at the time: many of those who transferred funds abroad from France even signed the relevant forms with Blum's name.[35] Although Blum did devalue the currency after coming into office, he maintained a tie to gold via a specified trading band. However, even this was abandoned shortly after Blum resigned in the summer of 1937 and a new government formed by the Radicals took power.[36] This is the background to Polanyi's claim that "once labor had been made innocuous, the middle-class parties gave up the defense of the gold standard without further ado."[37]

Polanyi asserts that this last statement applies to Britain as well, where he has in mind the fall of the Labour government (in August 1931) and the subsequent abandonment of sterling's tie to gold (in September). The proximate cause of the fall of the Labour government was negotiations over balancing the budget deficit, which had been swollen by unemployment support expenditures.[38] Trade unions and many members of the government wished to accomplish this by raising taxes. Prime Minister MacDonald, as well as the Bank of England and the opposition parties, wanted to cut unemployment payments (the dole) instead. These discussions took place on the backdrop of strong speculation against sterling that left Britain in urgent need of international loans, which were solicited from New York bankers Morgan Grenfell on the basis of MacDonald's proposal. The bank replied that it could arrange a short-term loan only if the budget-cutting proposal could be expected to pass Parliament and if its announcement would reassure the

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[34] Gourevitch 1984, 125.
[35] Mouré 2002, 233.
[36] Ibid., 235.
[37] Polanyi 1957, 229
[38] For two detailed and careful histories on which I rely, see Williamson 1984; Morrison forthcoming.

City and the Bank of England. Told of this, Labour ministers who opposed MacDonald's proposal resigned, claiming that the government was cutting unemployment benefits at the insistence of bankers. MacDonald formed a new "national government" with the opposition and pushed unemployment cuts through Parliament. The incident became known as the "bankers' ramp" (with ramp being used in the obsolete sense of a market manipulation).[39]

In *TGT,* Polanyi pointedly affirms the existence of the "ramp," but focuses on Labour's effort to maintain incompatible commitments to high social spending and the gold standard.[40] An analytically parallel but much fuller account can be found in the journalism he wrote as these events were unfolding, in which he argued that "no immediate danger threatened the pound in August,"[41] and traced the financial panic almost entirely to politics.[42] The purpose of the political deployment of market panic was to enforce the deflationary solution to the problem of international adjustment under the gold standard:

> [Chancellor of the Exchequer] Snowden and the City had resolved to reduce unemployment support and to improve the English balance of trade through a general reduction in wages and increased export. This was their long-range program for defending the pound's gold parity. In order to carry it through, the dangers threatening the pound needed to be painted on the wall as luridly as possible, in order that the stabilization of state finances—including, to be sure, curtailed

[39] Ahamed 2009, 428.
[40] Polanyi 1957, 228.
[41] Polanyi 2002a, 125. This was a plausible conclusion from publicly available data, although policymakers had a different attitude; see Williamson 1984, 786. Nonetheless, different reactions to market difficulties were still possible, and in illuminating the path chosen Polanyi's analysis retains its force.
[42] Polanyi 2002a; Polanyi 2002b.

> unemployment support—appeared as the only path to salvation. To impose this path on the country under the *diktat* of foreign bankers was the dominant political idea of the August situation.[43]

That the conflict over the terms of the Morgan Grenfell loan brought down the Labour government illustrated, for Polanyi, the fundamental conflict between government by panic and democracy. Alternative measures to address the crisis acceptable to Labour's political base—maintaining unemployment payments while balancing the budget by higher taxes—were unacceptable to financiers, and the threat of capital flight gave the latter's preferences political weight. "The removal of the Labour Party from office was meant, like that of the French Cartel in 1926, to lend the pound new stability as guarantee against a capital flight driven by tax policy, which would have been a completely new phenomenon for England."[44]

If in Britain and France financial markets dictated the scope of democratic governance, the U.S. case showed the opposite pattern. Polanyi argues that Roosevelt's decision to abandon the gold standard—which he appears to link to FDR's idiosyncratic economic views—was a crucial precondition for the success of the New Deal, as it accomplished "the political dispossession of Wall Street"[45] insofar as Wall Street's power rested on the possibility of politically motivated capital flight.

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[43] Ibid., 137. For a somewhat less categorical version of the argument, see Polanyi 2002a, 124.
[44] Ibid., 126. This new stability was, of course, short-lived. In his journalism, Polanyi argued that Britain's leadership chose to break the tie to gold because they were reluctant to bear the costs of higher interest rates to the budget and private finance. Polanyi 2002b, 138. This is consistent with the position in *TGT* that Labour's political marginalization allowed capitalists to stop retaining the gold standard as a political weapon. For an account of the gold standard exit decision that stresses the political motivations of the Bank of England's leadership, see Morrison forthcoming.
[45] Polanyi 1957, 229.

Thus, Polanyi discusses two paths to the preservation of democracy in the interwar period, both of which require exit from the gold standard but rely on distinct political formulas. In one, exemplified by the British and French cases, the political power of labor is broken via successful financial market pressure on elected officials, giving capitalists the political comfort they needed to allow the surrender of the gold standard and with it the powerful threat of capital flight. (Polanyi doesn't rate the "democratic" character of the resulting system very highly, but formal democracy was preserved.) The other possibility was the pre-emptive abandonment of the gold standard by democratic politicians, as accomplished in the United States. Democracy and the market economy were rendered compatible a radical reduction in the influence of either labor or capital.

When both labor and capital retained power, however, the result was "deadlock" and "a social catastrophe of the Continental type."[46] Polanyi describes this catastrophe only in relatively general terms, with little discussion of concrete cases. However, he includes Brüning (German chancellor 1930-1932) among politicians who pursued a deflationary policy to protect the gold standard,[47] and the German case clearly lies behind many of his more general descriptions. As Polanyi summarized, "in the course of these vain deflationary efforts free markets [were] not restored though free governments [were] sacrificed."[48] Brüning's use of Presidential decree power to back deflationary policies would, for Polanyi, have been a clear instance of the "authoritarian interventionism" that "resulted in a decisive weakening of

[46] Ibid., 229.
[47] Ibid., 228-229.
[48] Ibid., 233.

the democratic forces which might otherwise have averted the fascist catastrophe."[49]

To sum up, then, Polanyi's view of the gold standard crisis: given the downward rigidity of prices, the gold standard ensured persistent trade imbalances. These imbalances could persist so long as international credit was forthcoming. But once credit became scarcer after the collapse of the U.S. stock-market boom, either the gold standard itself had to give way or prices in trade-deficit countries had to fall. The gold standard, though, was strong, for reasons both political—by amplifying the danger of financial panic, it served as a bulwark against socialist policies—and economic, as the basis of international economic integration. When for these political or economic reasons the gold standard endured, the austerity agenda needed to push down prices could only happen if the vociferous objections of labor were suppressed. This undermined democracy and paved the way for fascist coups.

II Political Use of Market Panic

Polanyi's insights into the way the prospect of market panic can become a political weapon, I will argue below, shed a great deal of light on the course of the Eurozone crisis. Before turning to this argument, however, it is worth exploring in greater depth the preconditions for the 'weaponizing' of market panic and the circumstances in which these preconditions are likely to obtain.

[49] Ibid., 234; Patch 1998, 181,201-213.

Financial panic is often straightforwardly and convincingly described as a coordination dilemma between owners of some liquid asset.[50] If the asset owners maintain their holdings, the value of the asset remains stable. If they all try to sell it, the value sinks sharply. An asset holder who fears a general sell-off ought to try to sell first, but if all act on this logic they produce a price collapse as a self-fulfilling prophecy. As long as some sort of binding general agreement between asset-holders is not possible, each asset holder must regard apprehensively any information that could induce other asset holders to sell.[51]

That the prospect of financial panic stems from a lack of coordination among financial market participants indicates an ambiguity in Polanyi's claim that "the financial market governs by panic." Who, exactly, does the governing? An authoritative representative of asset holders tasked with ensuring their interests could presumably try to brake panic dynamics rather than pursue any sort of broader political agenda. There are two paths out of this analytical difficulty. One, on which Polanyi implicitly relies, is to suggest that asset holders have shared aversions to particular economic policies (such as taxation of the wealthy to fund unemployment insurance). Even without explicit coordination, they can be expected react in parallel ways to the prospect of the introduction of such policies, creating the preconditions for panic, which thereby becomes an effective political constraint.[52] Whether this causal mechanism is plausible depends on concrete circumstances, but certainly it is not always the case that policy preferences among asset holders

[50] For an example with currency as the relevant asset, see Oye 1985, 179-180.
[51] Keynes 1974, 155-156.
[52] For a discussion of the political power of businesses' non-coordinated action, though not in the context of panic, see Offe and Wiesenthal 1985, 79.

are always of a sufficiently general, coherent, and absolutist character for it to operate.[53]

There is, however, a second means of political instrumentalization of market panic. An actor (such as a central bank) with the capacity to coordinate expectations—to fuel or calm panic fears—may also attempt to derive political leverage from this fact. This possibility is indeed illustrated by the British case that Polanyi analyzed. As the sustainability of sterling's peg to gold came into question in the summer of 1931, the Bank of England had the task of calming market fears by selling gold reserves, and arranging international lending to supplement these reserves. However, Bank leadership, especially Deputy Governor Ernest Harvey (who ran Bank policy during much of the period), were not reticent in impressing on politicians a particular interpretation of what would calm the markets or make foreign credit available, stressing budget balance above all.[54] Eventually, Harvey shut down intra-Labour bargaining over how to deal with budget deficits by warning of an imminent exhaustion of gold reserves (while ruling out raising interest rates as an alternate way of preserving them), apparently deliberately seeking to bring about a government collapse.[55] This had the effect of strengthening the hand of those who favored spending cuts rather than progressive tax rises as a means to balancing the budget.[56] Even Harvey's final decision to abandon the gold standard was an effort to force the government to cancel an impending election he feared (incorrectly) that Labour would

[53] To take a pertinent example, financial markets have not displayed a consistent attitude to austerity in the course of the Eurozone crisis; Blyth 2013, 3.
[54] Morrison forthcoming; Williamson 1984.
[55] Morrison forthcoming.
[56] On the struggle between these approaches, see Williamson 1984, 796-797. Williamson downplays Harvey's political maneuvering, arguing that although Harvey did tell MacDonald that unemployment insurance cuts were crucial to reassure markets, "MacDonald simply obtained the advice he wanted" (797). Yet even providing this advice formed a way of mobilizing the threat of panic to promote a particular political outcome. Morrison's evidence on Harvey's activities tends to contradict Williamson's view that Harvey held himself outside the political process.

win.[57] This was very much an effort to "govern by panic," but an effort mediated through the specific institutional agency of the central bank.

Looking at the US experience, Polanyi believed that abandonment of the gold standard should eliminate mobilization of the prospect of financial panic as a tool of political influence. Insofar as the course of the Eurozone crisis illustrates that he was mistaken (a claim supported below), it is worth exploring the grounds for such a belief. Polanyi does not particularly expand on them. However, was most concerned with a panic about the gold value of a currency, and under a fully floating currency with no gold tie such a panic is impossible. However, a currency panic is not the only sort of financial panic that might become politically relevant. The most Polanyi has to say on the subject of other panics, such as the bank runs with which he would have been intimately familiar, is that the gold standard might mandate "fatal monetary stringency in a panic."[58]

Indeed, Minsky convincingly argues that capitalism will continually create the preconditions for panic. His argument, simplifying slightly, is that the search for an advantageous matching of liabilities and assets will tempt firms to use cheap short-term borrowing to finance longer-term investments.[59] But such an approach relies on a speculative bet: that short-term liabilities coming due may be readily and affordably refinanced. During a boom, this is so, encouraging speculative borrowing. Thus, a stable financial configuration, where balance sheets are constructed such that current income from assets

[57] Morrison forthcoming.
[58] Polanyi 1957, 138.
[59] Minsky 1977. Minsky provides a crucial supplement to Polanyi because of his much deeper exploration of the implications of the financial character of capitalism, emphasizing that capitalist economies are composed of entities with balance sheets, and that their ability to manage the relationship between assets and liabilities is crucial to their survival. While Polanyi demonstrates a clear understanding of this point in his account of the devastating implications of deflation for going concerns, he does not otherwise investigate it. Polanyi 1957, 192-193.

will allow the meeting of payment on liabilities, will regularly transform into a fragile one under the influence of straightforward incentives. This financial fragility exists because balance sheets become vulnerable to a change in *credit* market conditions (as opposed to product market conditions). Should credit conditions not permit refinancing, a debt deflation can ensue as firms liquidate assets to cover liabilities; the prospect of such a debt deflation can touch off panic.[60] While regulatory limits on leverage (borrowing to fund investment) may help to slow the emergence of financial fragility, the incentives Minsky describes are powerful enough to fuel financial innovation that can get around regulation.

Even if Polanyi had been convinced that the prospect of financial panic is endemic to capitalism, he might still have doubted the relevance of panic as a political weapon after the gold standard. Discussing the rise of self-regulating markets, Polanyi argues that capital-intensive industrial enterprise will be too risky to flourish unless factors of production (labor and the produce of land) are continually on sale.[61] The drive to protect these two fictitious commodities is rooted in the vulnerability of society to their destruction. One could easily advance a parallel argument regarding credit. In a situation where Minsky's 'speculative finance' is prevalent, the continued existence of productive enterprise depends on credit being on sale. Polanyi would not have had any particular reason to expect that the central bank, absent a gold constraint, would refuse to play a lender-of-last-resort role to preserve the availability of credit—after all, for Polanyi even under the gold standard, the central bank was an agent of the "protective countermove" that sought to avoid deflation.[62]

[60] On debt deflation, see Fisher 1933.
[61] Polanyi 1957, 41-42.
[62] For a suggestive formulation with a Polanyian flavor, see DeLong 2008.

One can make a parallel case from the perspective of strategic interaction between central bankers and politicians.[63] A central bank can use the prospect of market panic as a tool of political influence only if it can make a credible threat to allow the panic to happen.[64] Under the gold standard, the credibility of this threat comes from the fact that the central bank can in fact lose a battle to avoid a flight from the currency (though even in these circumstances shrewd central bankers may seek to maximize their influence by concealing the panic-fighting capacities they do have available, as Harvey probably did). Without the gold standard, allowing a panic would seem to have consequences too extreme to make it a credible threat.[65] That political deployment of the threat of market panic nonetheless became possible in the course of the Eurozone crisis is due to the emergence of a strategic substitute for the gold standard, as the next section will discuss.

III The deadlock of the 2010s

The early 21st century plight of the Eurozone displays resonant parallels with Polanyi's description of the deadlock of the 1930s, but there are also significant differences. The economic prelude to the Eurozone crisis was a period of large intra-European trade imbalances. As in the 1920s, ample credit made these trade imbalances easy to fund. The analogy is not exact, though. Polanyi viewed international credit as disrupting the Humean self-adjusting mechanism the gold standard was designed to enable, slowing down relative price adjustment. In the Eurozone, international credit did not merely slow

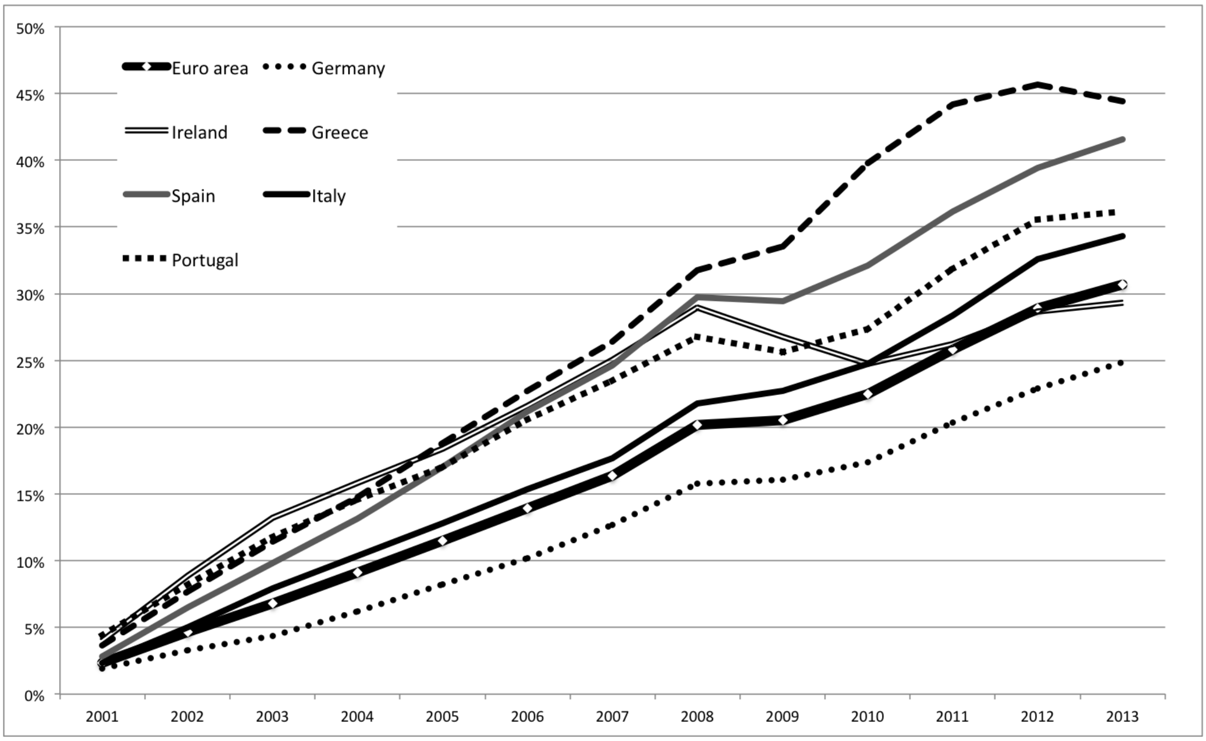
63 For discussion of the interaction between independent central banks and politicians in a strategic context (though one where only the bank's own policy is the subject of contention), see Keefer and Stasavage 2003.

64 On credible threats, Schelling 1960, 35-43 remains indispensable.

65 For instance, on these grounds Posner and Vermeule 2009 argue that Congress must concede to the executive's wishes in the context of a financial panic.

price adjustment, but actually exacerbated price disparities. The introduction of the Euro meant that the European Central Bank set a single interest rate for all Eurozone countries. However, cross-country distinctions in inflation rates did not disappear. This meant that real interest rates were different in different Eurozone countries. In low-inflation countries real interest rates were high, while in high-inflation countries real interest rates were low. Thus, the Eurozone's single interest rate had a pro-cyclical character—delivering monetary stimulus to the higher inflation countries, and monetary restriction to the lower inflation in countries.[66] Cross-country financial flows were one way these monetary effects worked themselves out. Credit flows thus not only compensated for trade imbalances, but actually drove relative price movements in a way that intensified, rather than relieving, these imbalances (see Figure 1).[67]

Figure 1: Cumulative consumer price level (HICP) change since 2000



Source: ECB

[66] Hancké 2013, 94.
[67] Hopkin 2013, 141-142.

Germany was central to these developments. For low-inflation Germany, the Euro's introduction was recessionary, exacerbating an already difficult unemployment situation. Germany did not react to the recession by seeking to launch a program of domestic fiscal demand stimulus. This was more or less out of the question under the Maastricht criteria: even the action of automatic stabilizers meant that Germany was breaching these criteria by 2003.[68] Instead of stimulus, Germany reacted by initiating labor-market reforms (the Hartz IV and Agenda 2010 initiatives) that facilitated the creation of low-wage jobs. At the same time, those parts of German industry subject to collective bargaining began a long period of wage restraint. In a closed economy, policies to hold wages down have limitations as a growth strategy, insofar as wages are also the source of demand. But in an open economy, wage restraint's damping effect on domestic demand may be compensated for by export demand—assuming export markets are growing.[69] But this was just the situation the pro-cyclical character of Eurozone monetary policy created: Germany's Eurozone trading partners were benefiting from substantial monetary stimulus, the magnitude of which grew with their inflation rates. Rising wages in parts of the Eurozone made the citizens more able to buy German exports, and at the same time made wage-earners less competitive compared to German ones. It is no surprise, then, that German exports surged and trade balances on the Eurozone periphery went sharply negative. Trade deficits were funded by lending from German banks recycling export earnings.[70]

This pattern of international financing came to an abrupt halt in the autumn of 2008, but it was to have an important legacy thereafter. The run-up to the

[68] Scharpf 2013, 2301.
[69] Ibid., 2304-2321. On the roots of wage restraint see Dustmann et al. 2014, 182 and *passim*.
[70] De Grauwe and Ji 2012b;De Grauwe 2013, 6-8.

Eurozone crisis saw the accumulation of multiple forms of Minskyian financial fragility fueled by international credit.[71] Borrowers in trade-deficit countries, including the governments of those countries, came to rely on the continued availability of incoming financial flows. Banks on the other side of these transactions could thus only be assured of receiving expected repayments as long as general credit conditions remained easy. In the same period in two Eurozone countries, Ireland and Spain, a boom emerged in housing markets. Low Eurozone interest rates were probably a facilitating condition in kicking off the booms, though not a sole explanation (Portugal and Italy did not see similar booms). They were fueled by the classic Minskyian collateral appreciation-credit easing cycle, backstopped by the recycling of German export receipts. The resulting economic growth brought tax receipts, and the fiscal position of the two countries became much stronger—but also more fragile, in that the positive fiscal balance implicitly relied on the speculative finance that was fueling the housing booms.[72]

From the crisis to a new deadlock

Thus when the "elastic band snapped,"[73] and international credit conditions tightened overnight, the financial fragility that had emerged over the course of the euro's first decade meant that the conditions for debt deflation and financial panic were very much in place. The effects of the financial crisis hit Europe in two stages. In the first, which began as early as 2007 but intensified massively after the failure of Lehman Brothers in September 2008, the crucial issue was financial fragility in the banking sector. Some European banks had

[71] For a convincing, clear, and concise statement of the intersection of the Eurozone's design with boom-bust cycles, see Ibid.6-11.
[72] Hay 2009, 463-468; Hopkin 2013, 149-150; Blyth 2013, 64-68.
[73] This is Polanyi's phrase to describe the sudden stop of international credit flows in 1929. Polanyi 2005, 351.

become heavily reliant on the US financial system both for liabilities and for assets, and the implosion of the markets for short-term credit and securitized sub-prime mortgages pressured both sides of their balance sheets and threatened their imminent financial ruin, which might well have led to a general collapse of the European financial system.[74] There was no "fatal monetary stringency" in the face of this panic, though. The ECB made ample credit available.[75] However, this dealt primarily with the liabilities side of balance sheets and had only a limited effect in stopping the collapse of asset values, whether of exotic mortgage-backed securities from the US or simply housing prices in Ireland and Spain. On this background, national governments across Europe took steps to bail out their banking sectors, such as Ireland's decision to offer a state guarantee of its banks' liabilities.[76]

Despite these measures, and parallel ones in other large markets like the US and UK, this first phase of the financial crisis was also accompanied by a huge fall-off in demand. Here, too, European governments were not passive. Late 2008 and early 2009 saw a significant expansion in deficit spending, including the operation of automatic stabilizers and some explicit demand stimulus; Germany's demand stimulus package was the most significant, though perhaps the least advertised.[77]

In broad, then, the Eurozone's initial reaction to the crisis was the sort of protective countermove that Polanyi would have expected. Rather than accepting the catastrophic consequences of letting labor, money, or risk find their price on an imploding market, fiscal and monetary policy sought to

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[74] Blyth 2013, 84-85
[75] See Irwin 2013, 280 for the beginning of this policy.
[76] Grossman and Woll 2014; Zimmermann 2012, 492-494; Zohlnhöfer 2011.
[77] Cameron 2012; Schelkle 2012; Vail 2014.

modify or reverse price pressures. Nonetheless, a second phase of the financial crisis began after the revelation of the extent of Greece's debt problem in late 2009. The hallmark of this new phase was a sudden and large jump in interest-rate differentials between Eurozone sovereign borrowers, with the so-called periphery (Greece, Portugal, Ireland, Spain, and Italy) paying dramatically higher rates.[78] The financial fragility facing fiscal authorities became manifest as refinancing of sovereign debt in the market on acceptable terms became difficult or even impossible. Because interest payments were an important component of government spending, the danger of self-fulfilling market predictions of debt unsustainability (pessimism breeding higher interest rates breeding deeper pessimism) became significant.[79] Meanwhile, weak sovereign debt prices created additional dangers for the financial system; holdings of peripheral debt were heavily concentrated in Germany and especially France.[80]

Again, Eurozone authorities did not simply step aside and watch asset prices reach levels that would have bred financial collapse via rapid debt deflation and sovereign defaults in the face of market panic. From May 2010, the ECB expanded lending to banks and began intervening in sovereign debt markets to hold down interest rates.[81] Concentrated in the peripheral countries where banks were facing the greatest difficulties, ECB lending served as an alternative source of financing for trade deficits in these countries, compensating for the "sudden stop" of private financing.[82] Multilateral arrangements, worked out in a large number of Eurozone or broader EU summit meetings, provided fiscal support, including for banking rescues, in

[78] De Grauwe and Ji 2012a, 866-867
[79] Ibid., 877-878.
[80] Thompson 2013, 7-8
[81] *ECB Decides on Measures to Address Severe Tensions in Financial Markets*.
[82] Accominotti and Eichengreen 2013.

Portugal, Ireland, and Greece.[83] This international response greatly exceeded the limited multilateral interventions that had sought to shore up the gold-standard system, and provided forms of support that had been all but absent in the earlier period.[84]

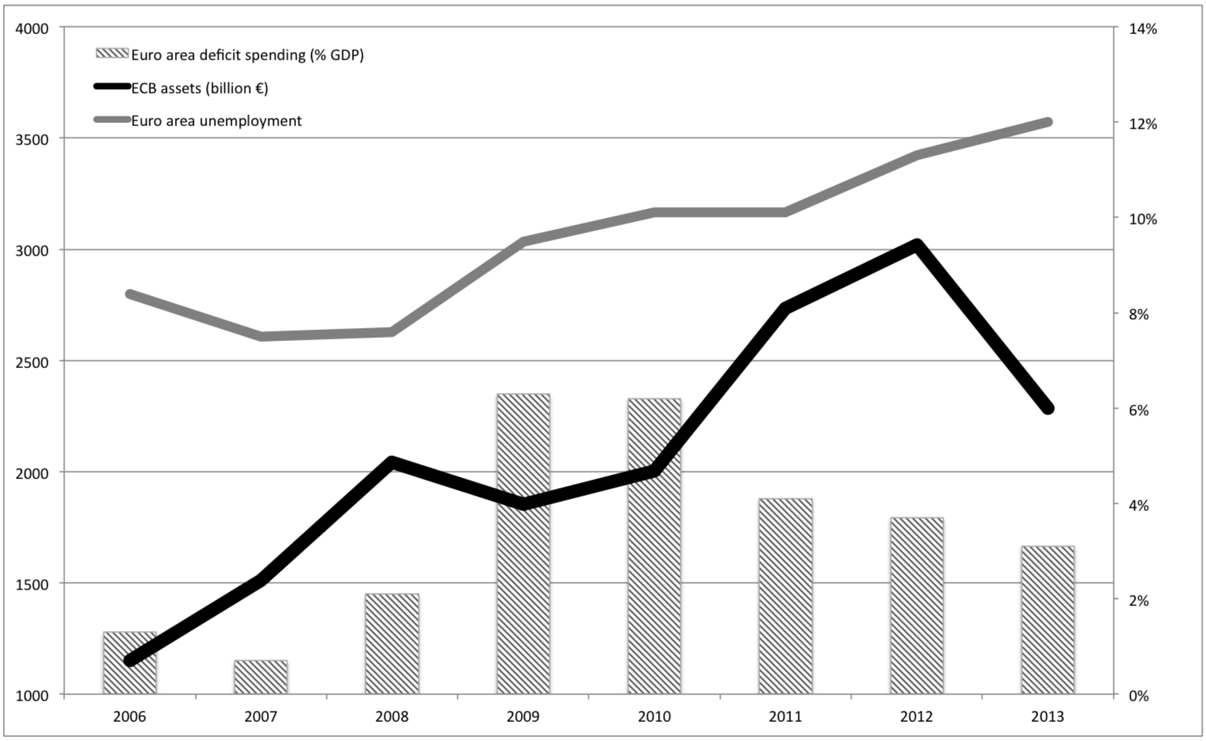
It is thus possible to trace a protective response from the Eurozone that in many ways exceeds its interwar predecessor in vigor. It involved a sustained and largely successful effort to ward off outright deflation, backed with a significant degree of international coordination. But this response was nonetheless limited and riven with contradictions in ways remarkably analogous to those Polanyi describes. Like the gold standard, the euro had no adjustment mechanism for international trade imbalances other than deflation—the very deflation protective measures worked against. As domestic demand in the peripheral countries shrank or stagnated, reducing trade deficits via increased exports was a requisite of growth. But such an expansion was difficult to achieve. If trade deficit countries could not regain competitiveness via downward price adjustment, then the only way their price levels could sink relative to those of the trade surplus states was if the latter's prices rose more quickly. However, there were no policies in place to promote this. ECB policy pushed against outright deflation, but remained very far from promoting a level of inflation that would facilitate the emergence of substantial cross-country differentials in inflation rates (see Figure 1). Indeed, the leaders of Germany, with by far the largest intra-European trade surplus, explicitly and repeatedly rejected this route to

[83] See Pisani-Ferry, Sapir and Wolff 2013 for a survey.
[84] Accominotti and Eichengreen 2013.

rebalancing.[85] By early 2014, only Ireland had seen any substantial adjustment of prices against the German benchmark.

The protective countermove was also limited by intensive efforts—described further below—to ensure that assistance of all sort was conditional on implementation of liberalization and austerity measures intended to promote competitiveness by increasing price flexibility, especially for wages.[86] Anti-deflationary monetary policy was thus combined with pro-deflationary fiscal and reform policy. The broad pattern can be seen in Figure 2. While the trends vary somewhat by country, a turn from fiscal stimulus to austerity was taking place as early as 2010, somewhat compensated by expansive monetary policy.

Figure 2: Evolution of Eurozone Budgets, Money Creation, and Unemployment



Source: ECB

[85] *Bundesregierung | Rede von Bundeskanzlerin Angela Merkel Beim BDI-Tag der Deutschen Industrie*
[86] Armingeon and Baccaro 2012; Blyth 2013.

Political roots of the new deadlock

The Eurozone, in sum, was experiencing a reprise of the deadlock Polanyi described between deflationary and protective impulses. His theory of the political origins of this deadlock, especially the role of governing by panic in bringing about a policy stalemate, also proves to have great relevance. The key moving parts of Polanyi's causal mechanism find functional substitutes in the 2010s. The role of capitalist fear of labor radicalism was played by the neoliberal "Brussels-Frankfurt consensus,"[87] strongly entrenched in the European Central Bank. By threatening to allow a self-sustaining market panic unless their conditions were met, ECB leaders were able to "weaponize" market panic to pursue their neoliberal agenda. This was possible because of a mechanism that provided a functional substitute for the gold standard in making such threats credible.[88] This functional substitute stemmed from a combination of two factors. First, the institutional structure of the Eurozone was such that Germany held an effective veto over many measures needed to promote the protective reaction. Second, the prospect that this veto would be used was in turn rendered credible by the thorough embedding of Ordoliberalism, the particular German variant of neoliberalism, in Germany's institutions and policy-making culture. The strategic power of Ordoliberalism derived from the central role of rule-bound action in this policy approach.[89] Because Ordoliberalism offered resources to justify even catastrophic consequences in an individual case by citing the broader benefits of rules, actors with a commitment to Ordoliberalism could credibly threaten to veto policies required to ward off market panic. Both the Brussels-Frankfurt

[87] Jones 2013.
[88] Under the gold standard, as argued above, such threats were credible because central bank intervention was necessarily limited in scale and could fail to stem a panic.
[89] On limiting discretion as a way of gaining a bargaining advantage, see Schelling 1960, 22-43. For a discussion of Eurozone reform as a chicken game in which inflexibility offers bargaining advantage, see Schimmelfennig 2014, 9-11.

consensus and Ordoliberalism have loomed large in a number of previous explanations of Eurozone crisis-fighting policy.[90] The distinctive contribution of a Polanyian interpretation is to show how the prospect of market panic was crucial to establishing the influence of these two closely related sets of ideas.

The Brussels-Frankfurt consensus can be compactly identified with attachment to stable money, sound finances, and efficient local-factor markets, especially labor markets.[91] Ordoliberalism, while it encompasses these three elements as well, has additional commitments that require somewhat longer description. Ordoliberalism is a specific variant of neo-liberalism that emerged in Germany in the inter-war period and received canonical formulation in the post-WWII era, especially in the works of Walter Eucken and Franz Böhm.[92] Like other market liberals, Ordoliberals extolled the role of the price system in coordinating economic action. And to make the price system work they advocated market competition: businesses and individuals struggling against one another to make sales to sovereign consumers. However—and the point is crucial to the entire Ordoliberal project—the economic system cannot be counted on spontaneously to evolve to ensure this outcome. Only state action will bring it about.[93] Thus, compared to the Austro-American version of neoliberalism more familiar outside of Germany, Ordoliberalism offers a much more unambiguous and less conflicted embrace of the role of the state in giving order to a market economy.[94]

Nonetheless, Ordoliberals, like other market liberals, sought to ensure that state powers necessary to underpin markets were not turned to purposes of which they did not approve. To this end, the economy should be governed by

[90] Eg Jones 2013; Dullien and Guérot 2012; Blyth 2013, 140-141.
[91] This follows Jones 2013, who perceptively analyzes these elements, as well as their ambiguity.
[92] Gerber 1994, 28-32; Vanberg 2001, 37; Ptak 2009.
[93] Eucken 1982b, 270
[94] Blyth 2013, 57,151; Foucault 2008, 133; Ptak 2009, 1319.

an "economic constitution" which should ensure that the state's actions are constrained to take the form of general rules, an *Ordnungspolitik* or ordering policy.[95] In this, the spirit of Ordoliberalism partakes of the continental or Roman approach to law (also known as civil law), which emphasizes the role of exhaustively codified rules and rejects the situational judgment characteristic of the common law approach.[96] The mandate for *Ordnungspolitik* and pre-codified rules, like the proscription of case-by-case decision, were intended to limit the scope of action available to democratic governments, complicating efforts at rent-seeking by ruling out exceptions for particular situations, industries, or professions.[97]

Ordoliberalism's legal philosophy did not enjoy unchallenged sway in post-war West Germany. Ordoliberal theory had to compromise with a corporatist praxis it could not fully encompass nor defeat, a compromise encapsulated by the well-known "social market economy" formula.[98] Nonetheless, its influence was far from negligible. For instance, a constitutional change was required before West Germany could begin a brief and limited experiment with contextually responsive demand stimulus in the late 1960s.[99] Ordoliberal ideas had particular (though not exclusive) influence in shaping West Germany's negotiating approach to European Monetary Union, and had much to do with

[95] Blyth 2013, 140; Gerber 1994, 46; Vanberg 2001, 39-42. Compare also Foucault's discussion of the importance of the "rule of law" to Ordoliberalism, Foucault 2008, 171.
[96] Cf. Gerber 1994, 47. For an outstanding discussion of the differences between civil law and common law, which emphasizes the fundamental importance of reacting to particular situations in the latter, see Curran 2001, 75.
[97] Vanberg 2001, 51; Ptak 2009, 1446-1469.
[98] Joerges 2013, 12; Joerges 2010, 396-398; Ptak 2009, 1340-1343; Manow 2001; Dyson 2001, 138-145.
[99] *Grundgesetz Für Die Bundesrepublik Deutschland (Geschichte, Hinweise und Verweise Zu Artikel 109)*; Tuchtfeldt 1982, 68; Allen 1989, 276-279; Dyson 2010, 296. It has been argued, however, that Ordoliberalism's strength in general lay more in West German private law than in public and constitutional law, the latter being more congenial to corporatism and the welfare state. Joerges 2010, 397-398.

the rule-based character of the resulting Maastricht treaty.[100] In 1993, a decision by the German Constitutional Court (*Bundesverfassungsgericht*) on a challenge to the Maastricht treaty had the effect of entrenching an Ordoliberal interpretation of its meaning.[101] The decision defended the treaty against the claim that by denuding German voters of sovereignty it violated democratic principles by arguing, in the spirit of Ordoliberalism, that democratic governments were not well-suited to some aspects of economic management.[102] The court further argued that the provisions of the treaty were sufficiently well-specified to grant European institutions determinate authority, any exceeding of which would require treaty modification and thus a new democratic imprimatur. In the meantime, the court declared, European decisions found to supersede treaty authorizations would not be binding on German institutions.[103]

After the financial crisis, rules and institutions inspired by Ordoliberalism became entangled in a well-known dilemma. Strictly rule-bound behavior, it has long been recognized, runs the risk of producing perverse consequences in an individual case for which the rules are poorly suited. Ordoliberals do not seem to have grappled with the dilemma on this level of abstraction, but

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[100] Dyson and Featherstone 1999, 263,274-285 and *passim*. It bears noting, however, that some Ordoliberals felt that the treaty still left too much room for discretionary economic policy. See Sauter 1998, 46-56 for a summary.
[101] Joerges 2010, 403.
[102] Thus, in defending the creation of an independent European central bank, the court stated that such a measure takes account of the special characteristic (tested and proven--in scientific terms as well--in the German legal system) that an independent central bank is a better guarantee of the value of the currency, and thus of a generally sound economic basis for the state's budgetary policies and for private planning and transactions in the exercise of rights of economic freedom, than state bodies, which as regards their opportunities and means for action are essentially dependent on the supply and value of the currency, and rely on the short-term consent of political forces. To that extent the placing of monetary policy on an independent footing within the sovereign jurisdiction of an independent European Central Bank … satisfies the constitutional requirements under which a modification may be made to the principle of democracy. Bundesverfassungsgericht 2. Senat 1994
[103] Boom 1995.

their texts suggest they were "rule consequentialists."[104] Rule consequentialists resolve the perverse consequences dilemma by arguing that the consistent operation of properly chosen rules will have beneficial consequences that outweigh any undesirable outcomes arising from the application of rules to a particular case. In a political economy context, such reasoning is regularly encountered in the discussion of soft budget constraints and moral hazard, analyzed in Ordoliberalism as the problem of proper assignment of liability to market actors. In these arguments, the attractions of mitigating some particular economic disaster have to be balanced against the broader consequences of allowing market participants to expect such mitigation, which can promote profligacy and excessive risk-taking.[105] In the same vein, Eucken also makes a more general argument for "constancy in economic policy" to avoid discouraging long-term investment.[106] The beneficial consequences of rule-bound action are asserted and the possible situational advantages of policy change (for instance, preserving existing long-term investments, as Polanyi suggests) are not discussed.

Carried to an extreme, a consequentialist defense of a rule based on its general effect might be able to justify disregarding the unpleasant consequences of almost any individual application whatsoever.[107] But this is not the only way a rule consequentialist might react to a difficult case. Another possibility is to combine an exception in the individual case with an effort to craft a system of rules ensuring that such difficult cases do not arise in the future. Foucault ascribes to Ordoliberalism two key elements, the first being its attachment to

[104] Hooker 2011
[105] Eucken 1982a, 126-127; Eucken 2004, 280-285; Kornai 1986; Kydland and Prescott 1977.
[106] Eucken 1982a, 126-127. I have preferred to translated 'Konstanz' as 'constancy' rather than 'consistency' given the flavor of the argument; Eucken 2004, 285-289.
[107] Hooker 2011 explains how rule consequentialists have addressed this issue by introducing a higher-order "prevent disaster" rule that overrides any other rule, while conceding vagueness in what counts as a disaster.

the rule of law. The second element is its "policy of society," which Foucault portrays as an effort to diffuse the capacity to compete in markets through society, ensuring that society will generate demands to restrict market competition.[108] Conceiving of Ordoliberalism as a rule-consequentialist approach helps to understand the relationship between these two elements. The "policy of society" helps to ensure that that rigid rules implied by the Ordoliberal vision of the rule of law subordinated to markets will not give rise to intolerable consequences in practice.

A brief consideration of Germany's domestic policy response to the financial crisis in 2007-2009 can illustrate the insights made possible by understanding Ordoliberalism as involving an ambition to a form of market-promoting governance bound by rules but that avoids disasters. Germany faced both a demand crisis and a financial crisis. It reacted to the first with extensive demand stimulus, and the second by a mixture of guarantees, subventions, and nationalizations. These reactions did not in the least reflect the application of pre-existing policy rules, but were rather extemporized and legitimated by highly context-specific legislation.[109] In this light, it is tempting to see a gulf between Ordoliberal rhetoric and practical policies, with invocations of the former little more than a public-relations dodge.[110] This

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108 From the German *Gesellschaftspolitik*. It appears that the term was not necessarily generally employed in the sense that Foucault uses it, but I believe his argument is insightful nonetheless. Foucault 2008, 146,156n52,160. In a similar vein, Blyth Blyth 2013, 57 suggests that Ordoliberalism promotes "extra-economic institutions to allow labor to adjust skills to match market needs."

109 Dyson 2010;Zimmermann 2012;Schelkle 2012;Vail 2014;Zohlnhöfer 2011;Kickert 2013. For instance, when a voluntary nationalization of a large troubled bank proved impossible, a new law was passed to permit expropriation in a very limited time window Zohlnhöfer 2011, 232. On the long-standing ordoliberal hostility to discretionary demand stimulus (though not welfare-state "automatic stabilizers") see Allen 1989; Tuchtfeldt 1982.

110 Schelkle 2012 makes a strong case for this position. Winkler 2012 argues that Germany's successful fight with the financial crisis in 2009 ignored ordoliberal principles, while they dominate in German discussions of European problems. Vail 2014 also implicitly supports this case. He sees highly stimulative German domestic economic policy in this period as consistent with a tradition of "corporate liberalism" aimed at supporting favored social groups, but does not discuss the Ordoliberalism side of the social market compromise.

position, however, overlooks substantial changes in forward-looking rules that were bundled with contextual crisis-fighting measures. The most important of these was a constitutional "debt brake," sharply limiting federal budget deficits and banning provincial (*Länder*) governments from running deficits altogether.[111] This constitutional change eliminated the reference to "overall economic equilibrium" as an aim of budget policy that had been introduced in the 1960s to authorize Keynesian policies.[112] It ensured that demand stimulus would be limited in time, while also complicating explicit or implicit backstopping of the regional public banks (*Landesbanken*) by *Länder* governments. At the same time, aid to Landesbanken was conditioned on major restructuring.[113] These institutional changes were, then, entirely in the spirit of Ordoliberalism, restructuring rules and the actors subject to them in ways designed to facilitate the operation of a market economy and make further discretionary interventions both unnecessary and unavailable.[114]

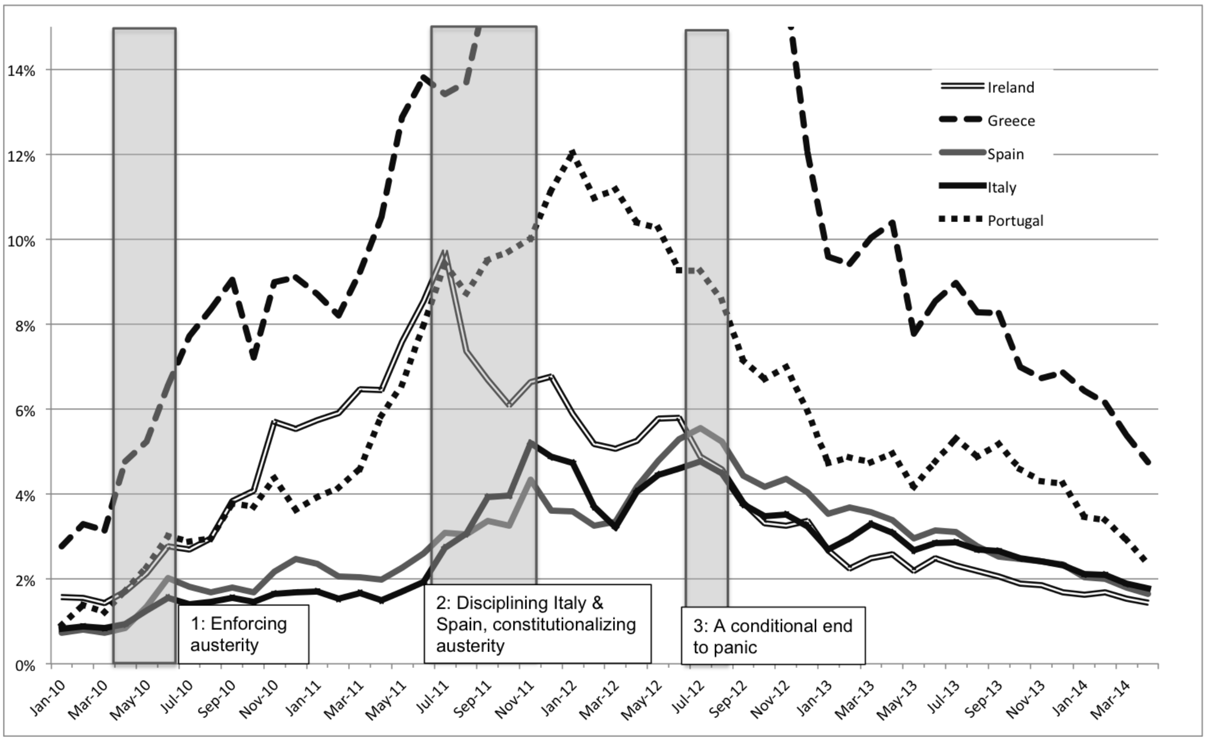
Panic and the Protective Countermove

It's now possible to analyze how Ordoliberalism intersected with European institutions and the prospect of market panic may to produce a deadlock between the protective countermove and austerity. Three crucial decision episodes—in April-May 2010, late summer through autumn 2011, and summer 2012—illustrate the relevant dynamic (see Figure 3). In each case, spiking interest rates on sovereign bond markets prompted a sense of crisis among European political leaders, who were well aware of the potentially

[111] Renzsch 2010; Turner and Rowe 2013.
[112] *Grundgesetz Für Die Bundesrepublik Deutschland (Geschichte, Hinweise und Verweise Zu Artikel 109)*; Tuchtfeldt 1982, 68.
[113] Dyson 2010, 403; Kickert 2013, 292.
[114] Compare Dyson 2010, 413. There is no space here to make a detailed case for the influence of Ordoliberalism on the decisions discussed; my purpose has been solely to show that these decisions do not offer a *prima facie* case for the irrelevance of Ordoliberalism.

disastrous impact on the banking system.[115] And in each case, the ECB eventually used its power to create money to help calm markets. First, however, the ECB leadership implicitly or explicitly threatened to withhold its help unless policy or institutional changes implementing Brussels-Frankfurt priorities (especially labor market liberalization and fiscal austerity) were adopted. These threats were made credible by the rigid rules on the ECB's independence and mandate, and the prospect of vigorous German political and legal opposition to exceeding that mandate.[116]

Figure 3: Rates on 10-year Government Bonds (monthly averages)



Source: ECB

[115] Thompson 2013

[116] In what follows, I do not offer references for facts easily verified from multiple public sources, but do seek to include detailed references for all potentially controversial assertions about empirical developments.

Episode 1: Enforcing Austerity, April-May 2010

After the revelation of the depth of Greece's budget problems in late 2009, European leaders debated whether and how to support the country throughout the spring of 2010. In the last week of April, with these discussions still uncompleted, a panic broke out on European sovereign bond markets in the aftermath of rating agency downgrades, with very large spikes in interest rates on Irish, Portuguese, and especially Greek debt, and noticeable spikes in rates for Spain and Italy. Falling bond prices raised major difficulties not only for the governments most directly affected, but also for banks, many of them French and German, which held these bonds as assets.[117] Given the serious prospect of a broader financial panic, in early May the leadership of the ECB took a contentious internal decision to use purchases of sovereign bonds to calm the markets. A second, simultaneous decision, though, was less contentious: to postpone announcement of the market intervention until after European leaders had created their own plan to address the bond crisis. The rationale for the delay, which was very explicitly advanced in the ECB's internal deliberations, was that were the ECB to act immediately it would remove the panic's pressure on Europe's leaders to come to an agreement on crisis measures of their own.[118]

At a meeting with European heads of state on May 7, 2010, ECB President Jean-Claude Trichet described the bond-market panic in dire terms, advocating a rescue fund financed by European governments and a program of budget austerity.[119] He also communicated that adoption of these measures

[117] Anonymous 2010; Thompson 2013
[118] Irwin 2013, 3957-3959,4082-4093; Bastasin 2012, 200,202-203.
[119] Barber 2010; Irwin 2013, 3967-3971

was a precondition for ECB market intervention.[120] The credibility of the implied threat that the ECB would sit on its hands if it did not get its way, despite a market situation Trichet had portrayed as desperate, was clearly tested during the ensuing discussion. Trichet flatly rejected the insistence of French president Nicolas Sarkozy and others that ECB begin intervention, affirming the bank's absolute independence of action.[121] The evidence strongly suggests that institutionalized Ordoliberalism was an important reason that this intransigence could seem more than bluff. German prime minister Angela Merkel invoked the Maastricht treaty in Trichet's defense, and (albeit apparently in another context) mentioned the possibility that the Bundesverfassungsgericht would reject any actions inconsistent with the treaty.[122] Two subsequent events illustrate how institutionalized Ordoliberalism—in particular, the shadow of the Bundesverfassungsgericht's Maastricht decision—meant the threat of ECB inaction might well have been viewed credibly. First, when the ECB did subsequently begin sovereign bond purchases the Bundesbank seriously considered refusing to implement the program on the grounds that it was not authorised by the relevant treaties.[123] Second, in 2014 the Bundesverfassungsgericht did indeed declare a later bond-market intervention program not authorised by treaty and thus at variance with the German constitution.[124] At a minimum, Trichet's interlocutors in May 2010 would have had every reason to suppose that the he would face a severe challenge in winning internal ECB agreement to bond purchases, and that achieving policy changes congenial to the Brussels-

[120] This wasn't done in so many words but the message was clear. Ibid., 3976-3978; Bastasin 2012, 208-209.
[121] Barber 2010; Bastasin 2012, 208; Irwin 2013, 3983.
[122] Barber 2010; Bastasin 2012, 208.
[123] Irwin 2013, 4124-4128. Recall that the Bunderverfassungsgericht had stated that decisions not authorized by the treaty would not be binding on German institutions.
[124] Lindseth 2014.

Frankfurt consensus that dominated within the Bank were necessary to overcome this challenge.

In the event, Eurozone leaders categorically affirmed their commitment to budget austerity, and pledged to create (with help from the IMF) a rescue fund, the European Financial Stability Facility (EFSF), to aid Greece and other distressed sovereign borrowers (with austerity conditionality a given). The ECB, in turn, launched direct bond market purchases to support prices and lower interest rates, and greatly widened its liquidity provision to the financial system in ways that served to ameliorate banks' losses on sovereign debt.[125] It bears noting that there is no plausible chain of reasoning under which the effectiveness of either of these monetary policy interventions depended on austerity. Their bundling with austerity was the result of a deliberate political decision on the part of the ECB leadership. Trichet was not the only actor pushing for this result; this was also the preferred approach of the German and some other governments. Nonetheless, the negotiating history sketched above strongly suggests that the ECB played a pivotal role in bringing about this outcome. The ECB's monopoly on money creation meant it was able to offer something that the governments participating in the negotiations could not.

Thus, in this episode, as in Britain in 1931, market panic facilitated central bank pressure on politicians for austerity policies. The most immediate effect was in Spain, where Prime Minister Jose Rodriguez Zapatero returned from the Brussels summit to announce sweeping new austerity measures, reversing a prior commitment to Keynesian stimulus.[126] For Greece, Portugal, and

[125] Thompson 2013.

[126] Aizpeolea 2010; Hardiman 2012. While the background to this decision is not described in a detailed way in the sources I have examined, it seems quite likely that had Zapatero not done

Ireland market panic abated only briefly after the ECB's May intervention. The restrictive rules under which the EFSF was created meant that the EU, ECB, and IMF "Troika" administering its programs had an even more manifest capacity to credibly threaten to abandon countries to the market maelstrom unless its demands were accepted. The contradiction of this form of policy-making with democracy was pronounced.[127] Both in Greece and in Portugal, EFSF programs were made conditional on pledges from parties not in government, to ensure that they could not be overturned by elections.[128] In Ireland, the government party that agreed to the ESFS package was all but destroyed in a subsequent election, but absent alternative sources of funding the new government found itself equally constrained.[129]

Episode 2: Disciplining Italy and Constitutionalizing Austerity, August-December 2011

The pattern set by the Eurozone's responses of 2010 was reiterated in the latter half of 2011. The evidence indicates that ECB leaders not only threatened to allow bond market panic to rage if their preferred policies were not adopted, but also in fact did carry out this threat.

Disciplining Spain and Italy

From the summer of 2011, Spain and Italy began to experience spiking interest rates (see Figure 4). On August 5, Trichet sent letters to the Italian and

this, he would have faced a slew of negative commentary from the Commission representatives and perhaps other leaders, which would have roiled the market further; instead, he won broad praise. In any event, it had become in Brussels clear that the powers of the ECB to tame panic would not be put at the service of any government eschewing consolidation. Dellepiane-Avellaneda 2014 concludes that Spain's shift to austerity was not due to ideological conversion, which is consistent with the idea that it resulted from coercion.

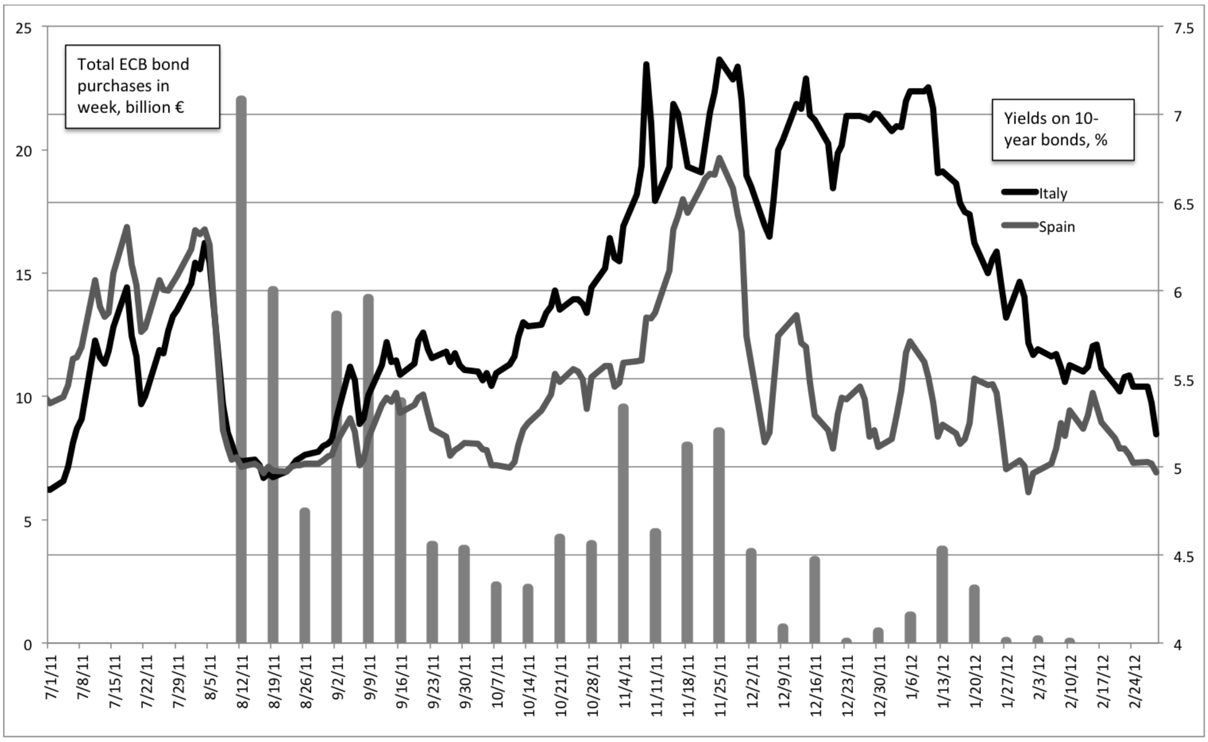
[127] Armingeon and Baccaro 2012, 3789.

[128] Ibid., 3475, 3564.

[129] Hardiman and Dellepiane 2012, 16-17.

Spanish governments describing what was needed to "restore the confidence of investors."[130] Both letters called for intensified austerity, labor market reforms, and a liberalizing reorganization of collective bargaining. Although neither letter mentioned the prospect of further bond-market intervention from the ECB, it was clear even from immediate press reports that the letters were widely being understood as setting out preconditions for such intervention.[131] In both cases, the governments responded with alacrity to the suggestions, quickly announcing efforts to implement the recommendations in their entirety, though without specifying their origins in detail.

Figure 4: Bond Prices and ECB Intervention, 2011-2012



Source: 10-year benchmark bond prices from Datastream; SMP purchases from ECB

Intervention in the market for Spanish and Italian bonds began on Monday August 8. Although the ECB clearly intended to calm the markets, it was

130 Trichet and Draghi; Zapatero 2013. The letters were co-signed in both cases by the ECB representative from the country in question. Their exact content was not immediately made public.

131 Blackstone 2011; Irwin 2013, 5657; Bastasin 2012, 299.

pursuing two contradictory goals. For investors seeking a new focal point, the predictability of ECB bond purchases would have facilitated coordination. However, predictable purchases—for instance, committing to a target interest rate for bonds by analogy with successful interventions into currency markets—would have made modulating interventions to discourage unwelcome policy developments impossible.[132] In the event, the ECB did not take even minimal steps to offer a credible commitment to support bond prices.[133] Facing a choice between mollifying markets and intimidating politicians, the ECB opted for the latter.[134] This conclusion is supported not only by the ECB's public statements, but also by patterns of its bond purchases. (Figure 4 shows the volume of ECB purchases, which are available only as weekly totals and are not broken down by country.) For three weeks through October, the bank did little intervention, despite a sustained run-up in prices, during a period when Berlusconi's government was having trouble winning parliamentary accession to the measures announced in August.[135] When prices jumped in early November, interventions intensified but remained well below the volumes that had proved effective in the summer. It may be, as one observer believes, that the dip in purchases in the second week of November was intended to allow bond prices to reach levels ensuring Berlusconi's resignation, first promised on November 8.[136] In any event, evidence is strong that domestic politicians who wished to install a technocrat congenial to the Brussels-Frankfurt consensus arranged Berlusconi's

[132] Ibid., 328.
[133] De Grauwe 2011.
[134] See Trichet's response to a question on the ECB's potential role as a lender of last resort on bond markets in Barber and Atkins 2011 and a report of a recognition of the contradiction in letters to Sarkozy and Merkel in July 2011 Bastasin 2012, 292.
[135] Ibid., 318-319.
[136] Irwin 2013, 6174. In the immediate aftermath of Berlusconi's resignation, ECB board member Jens Weidmann claimed that bond buying was "not about helping Italy or penalising Italy." However, he added that it was important that bond buying not "mute the incentives that come from the market. Recent experience has shown that market interest rates do play a role in pushing governments towards reforms. You have seen that in the case of Italy quite clearly." Atkins and Sandbu 2011.

defenstration.[137] And it is unarguably the case that the ECB leadership did not pursue bond market intervention aggressively when bond prices were at their highest level, and made clear its desire to deploy its resources only to support those governments that adopted its desired policies. Meanwhile, the resignation of another German ECB representative in September highlighted political conflict over even the limited bond-buying that was done, reinforcing the prospect that the ECB would indeed stand aside despite market panic if its demands were not meant.[138]

Constitutionalizing austerity

Through the same period, Eurozone leaders debated other issues as well, including how to reform and expand the EFSF. Germany's institutionalized Ordoliberalism again played an important role, especially in a struggle between France and Germany over potential alternate means by which the power of money creation could be harnessed to tame market panic. Sarkozy suggested that the European Stabilization Mechanism (ESM) that was to succeed the EFSF be given a bank license; this would allow it to borrow from the ECB. Germany resisted the proposal on the grounds that it would amount to monetary financing of governments. In September, the German Constitutional Court ruled that while German participation in the EFSF was legal, any further extension of German commitments required parliamentary approval.[139] By late October, Sarkozy abandoned the bank license plan, ending his insistence the measure be included in an agreement that Merkel would have to take to the Bundestag.[140] Sarkozy tried a different approach in early

[137] Friedman 2014; Anderson 2014.
[138] Bastasin 2012, 310.
[139] Ibid., 308-310.
[140] Details of the arguments presented in the October negotiations are scarce, but the timing is suggestive. Ibid., 326-334. Schild 2013, 18 suggests that Sarkozy's successor should not expect to achieve revision of the fiscal compact or other priorities because "Berlin can very credibly play two-level games, as the odds of getting domestic support in Germany for the French wish list are

November, proposing with US backing that the IMF use its money-creation powers to create Special Drawing Rights, some of which could be contributed to the EFSF via European countries. Again Germany objected; Merkel cited Germany's constitution in refusing to overrule the Bundesbank's objection to the plan.[141]

Thus, the ECB maintained its autonomy to decide when and whether newly created money could be used against market panic. Mario Draghi, who took over as head of the ECB from November, publicly specified a precondition for intervention: adoption of a "fiscal compact" proposed by France and Germany.[142] This would tighten budget deficit targets, and also require governments to give these targets a maximally constitutional character involving automatic correction, on the model of the German "debt brake." For the Germans, it represented "the extension of the ordoliberal paradigm … across the EU."[143] Heads of government agreed on the outlines of the compact at a summit on 8-9 December. The compact itself made use of the threat of market panic as a disciplinary mechanism, since countries that did not ratify it would not be eligible for ESM support.[144] As the leaders were meeting, Draghi announced plans for a massive expansion of cheap long-term loans to EU banks on 8 December. Banks could pledge sovereign bonds as collateral for these loans, of which nearly €500 billion were made at the end of December, allowing them to serve as an alternative to direct ECB bond purchases.

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very low." Note that European leaders in the course of the crisis have taken decisions without domestic support; the credibility here is at least in part tied to institutional factors.

141 Spiegel 2014.

142 Irwin 2013, 6222-6232. For some evidence that the French and German governments conceived the fiscal compact as a way to convince the ECB to intervene more aggressively see Dams and Hildebrand 2011.

143 Crespy and Schmidt 2014, 1095.

144 Fabbrini 2013, 1019-1020.

Episode 3: A conditional end to panic

As noted above, Polanyi argued that when the political leverage afforded by panic was no longer necessary, financiers and their political allies could abandon the gold standard. By the summer of 2012, advocates of the Brussels-Frankfurt consensus had reached an analogous situation. The fiscal compact and other changes in European arrangements had sharply limited the autonomy of governments. Meanwhile, indirect support via lending to banks had proved insufficient to restrain a new spike in interest rates on Italian and Spanish bonds (see Figure 3). It was at this point that Draghi positioned the ECB to become a true lender of last resort for the sovereign bond market, pledging to deploy unlimited resources against speculators betting on the exit of any country from the Euro.

The political context and significance of this decision are clearly revealed by the history of its development.[145] Although the Open Monetary Transactions (OMT) program allowed for unlimited bond market intervention, this could only be done on behalf of countries that had agreed to a rescue program under the ESM and accepted the associated conditions. Defending the proposed plan to a German audience, ECB director Jorg Asmussen promised that it would be more effective than the preceding bond purchases precisely because it would involve tighter conditionality. "The failure with Italy in summer of last year, when the ECB bought Italian government bonds and the time was unfortunately not used for the necessary reforms, should not be repeated."[146] This conditionality was key in winning the backing of German leaders for the plan.[147] At the same time, Draghi noted that the plan was

[145] Carrel, Barkin and Breidthardt 2012; Blackstone and Walker 2012
[146] von Heusinger and Sievers 2012
[147] Carrel, Barkin and Breidthardt 2012; Blackstone and Walker 2012

directed "a 'bad equilibrium,' namely an equilibrium where you may have self-fulfilling expectations that feed upon themselves and generate very adverse scenarios."[148] Thus, OMT embodied a contradiction between creating certainty for markets (promised unlimited intervention to prevent self-fulfilling expectations) and uncertainty for governments (threatened that intervention would end if conditions were not met). Nonetheless, the potentially unlimited character of OMT and Draghi's statement that bond markets could be driven not only by expected fiscal and economic developments but also "fear and irrationality" amounted to a significant new commitment to combat market panic.[149] The introduction of the OMT was the moral equivalent of the end of the gold standard: an explicit rejection of the sovereignty of financial markets. The dramatic subsequent decline in Eurozone bond prices (see Figure 2) strongly suggests that bond purchasers themselves welcomed this rejection.

Conclusion

At the end of 2013, economic output in the Eurozone was at 1.7% below its level in 2007, and expected by the ECB to exceed it by a miserly 1.2% only in 2015. These lost eight years compared unfavorably even with the Great Depression. During this period, policy-makers used both fiscal and monetary policy instruments to ward off vicious circles of declining growth or financial implosion, yet did not turn these same instruments to promoting virtuous circles of expansion and avoid austerity. As late as 2014, Draghi found himself at once announcing deflation-fighting measures and defending deflation's

[148] Draghi 2012a
[149] Draghi 2012b

necessity for adjustment.[150] In short, there was a very deep intellectual incoherence at the core of the Eurozone's reaction to the crisis.

The virtue of a Polanyian analysis is that it accounts for this paradoxical outcome, illuminating its political roots in the use of market panic as a tool to eliminate the space for democratic choice about economic policy. Despite the operation of institutions and attitudes reflective of Polanyi's protective countermove, the joint effect of the Brussels-Frankfurt consensus and German Ordoliberalism, politically empowered by the irreplaceable role of the central bank as a tool against market panic, was to push austerity and deflationary adjustment. "The market" did not demand these policies. (A particularly revealing incident in this regard occurred in early 2012, when the credit rating agency Standard & Poor's downgraded the bonds of a number of European states because of fears that austerity could become "self-defeating" due to the contraction of demand.)[151] The collapse in Eurozone interest rates after the introduction of OMT decisively illustrated once again what had long been obvious: there was no direct connection between data on budget deficits and growth prospects and the mood of the markets. Eurozone debt as a share of GDP continued to grow even as interest rates plummeted. There is no sense in which the austerity agenda was imposed by market forces; it was a political choice that governing by panic was used to implement.

Of the traditional explanatory triumvirate of ideas, and institutions, interests, this explanation emphasizes the first.[152] If the thinking behind the Brussels-Frankfurt consensus had been less deeply embedded in European institutions, if Ordoliberalism's rule-consequential style of thinking were less prevalent in

[150] Draghi 2014
[151] Standard & Poor's 2012
[152] Thus showing the imprint of Blyth 2013. On the triumvirate, see Hall 1997.

Germany, a deadlock could have been avoided and breakthrough to sustained stimulus would have been possible.

Institutions were not irrelevant. Treaty provisions and the veto power Germany held over many potential actions at the European or Eurozone level contributed to the credibility of the ECB threat to stand aside in the face of market panic. However, these institutions only facilitated the pursuit of particular aims; they did not specify these aims. Flexibility was possible. The extensive creation of new treaty arrangements (such as the fiscal compact) in the course of the crisis, as well as the ECB mission creep involved in its detailed policy recommendations and adoption of a lender-of-last resort role, illustrate the potential flexibility of the rules. The possibilities for approving more extensive deficit spending created by treaty references to "structural" deficits could have been exploited to a much greater extent than they were.[153] There is no sense in which the austerity agenda was imposed by European or Eurozone institutions; it was a political choice.

As for interests, this was certainly a case where they did not "come with an instruction sheet."[154] Consider two of the relevant interests often cited. The politicians of creditor countries, such as Germany, could have focused on the benefits of stimulating demand for exports rather than on the costs of bailouts. And the taming of the bond market panic after 2012 suggests that the options for addressing financial-sector difficulties were certainly not limited to austerity.

The reader will recall that Polanyi described three possible resolutions of the gold standard deadlock. Two preserved democracy while abandoning the

[153] Cohen-Setton 2013
[154] Cf. Blyth 2003.

gold standard: the American "instinctive gesture of liberation"[155] by FDR, and the British version subsequent to labor's sidelining. The limited and conditional way in which Europe has "gone off gold" by broadening the scope for ECB action may mean that the Eurozone will most closely resemble Polanyi's British case.

However, there are also ominous echoes of Polanyi's third case, the continental outcome, when "economic liberals … in the service of deflationary policies, supported authoritarian interventionism, [which] merely resulted in a decisive weakening of the democratic forces which might otherwise have averted the fascist catastrophe."[156] The rise of Golden Dawn in Greece and the unprecedented success of right-wing extremists in the European Parliament elections of 2014 suggest the continuing relevance of this analysis. That these developments also underscore the enduring genius of *The Great Transformation* would have been cold comfort to Polanyi, as it is to those who share his values.

155 Polanyi 1957, 26
156 Ibid., 233-234.

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