PANOECONOMICUS, 2014, 5, Special Issue, pp. 543-569
Received: 25 September 2013; Accepted: 08 April 2014.

UDC 338.124.4:336.74 (061.1EU)
DOI: 10.2298/PAN1405543M
Original scientific paper

António Mendonça

Centre for African, Asian and Latin American Studies, School of Economics and Management, University of Lisbon, Portugal
✉ amend@iseg.ulisboa.pt

The European Crisis and Global Economy Dynamics: Continental Enlargement versus Atlantic Opening

Summary: The fundamental idea we discuss in this paper is that the failure of Europe to deal with the international crisis is due, first and foremost, to the deepening of a more specific crisis that affected the very process of European integration and developed through two main channels: one, broader, linked to the erosion of the original driving forces underpinning integration in Europe; another, more circumscribed, linked to the malfunctioning of the euro as an internal adjustment mechanism of the currency zone. To deal with these structural dimensions of the crisis, we put forward a model of a Global Europe against the model of Continental Europe that has dominated the integration process until now and in this alternative framework we discuss the potential role of Portugal and of the Community of Portuguese Speaking Countries.

Key words: Economic crisis, Euro crisis, Economic integration, Globalization, Community of Portuguese speaking countries.

JEL: F15, F40, F50.

The crisis gripping present day Europe, beyond being a particular expression of the more general international crisis, also presents a specific structural dimension that has been shaping up for some years and has gained momentum, above all, from an inability to respond in a timely way to the factors that caused the asymmetric shock which ushered in the so-called sovereign debt crisis. The fundamental idea we discuss in this paper is that the failure of Europe to deal with the international crisis is due, first and foremost, to the deepening of a more specific crisis that affected the very process of European integration and developed through two main channels: one, broader, linked to the erosion of the original driving forces underpinning integration in Europe; another, more circumscribed, linked to the malfunctioning of the euro as an internal adjustment mechanism of the monetary zone. After presenting some references for the ongoing debate about the crisis in Section 1, we discuss the first channel introducing, in Section 2, what we have called the identity crisis of the European integration project. The second channel, the failure of the euro as an adjustment mechanism, will be the focus of discussion in Section 3.

A discussion of the European response to the crisis, in its double dimension, will be the focal point of Sections 4 and 5. In Section 6, which is a development of the structural approach, we discuss an alternative model to the current dominant view of how European integration is shaping up: we put forward a model of a Global Europe against a model of Continental Europe that has been dominant until now.

Finally, in Section 7, we conclude the discussion with a consideration of the potential of the Community of Portuguese Speaking Countries (CPSC) and the role of Portugal in the context of the *Atlantic opening* scenario that gives support to the alternative Global Europe approach.

1. European Crisis and Global Crisis: Recent Discussions

One of the most important dimensions of the global economic and financial crisis undoubtedly lies in the debate that has been waging on its causes, about the way the contagion developed and how the cross-border transmission mechanism worked. At European level the debate has focused on the relationship between the so-called sovereign debt crisis and the functioning (or dysfunctioning) of the euro system, including the effects of the lack of the exchange rate mechanism. We would refer, in particular, the works of Barry Eichengreen and Peter Temin (2010), Paul de Grauwe (2011), Philip R. Lane (2012), and Michael D. Bordo and Harold James (2013). The debate also focused on the relationship between growth and austerity, deserving reference, for purposes of our own work, the contributions of Carmen M. Reinhart and Kenneth S. Rogoff (2010, 2011, 2014), James B. Delong and Lawrence H. Summers (2012), Paul R. Krugman (2012), Reinhart, Vincent R. Reinhart, and Rogoff (2012), and Thomas Herndon, Michael Ash, and Robert Pollin (2013). And, at a more structural level, it's important to refer the discussion on the viability of both the single currency and the European Union (EU), in a context of increasing heterogeneity of the currency area, increasing asymmetries within the Union and breaking of internal political solidarity. An interesting digest of these discussions can be found on two publications, Organisation for Economic Co-operation and Development (OECD 2011, 2012), the former dedicated to the responses that have been given, at different levels, to the crisis, the later more oriented to the debate on the so-called structural reforms. A select set of papers produced by International Monetary Fund (IMF) researchers, analysing the financial crisis, its causes, consequences and policy responses, both in historical and theoretical perspective, can also be found on Stijn Claessens et al. (2014).

If it is true that several authors point out the specifically global nature of the current crisis by focusing on the deeply flawed institutions and practices of what is often referred to as the New Financial Architecture (see, e.g. James Crotty 2008; Thomas I. Palley 2014), others focus more on the particularities of the European crisis regarding it as a generator of a own and specifically dynamics that is not only at origin of the so-called sovereign debt crisis but also relayed to the global crisis, deepening it and creating additional factors of instability (Jean-Paul Guichard and Antoine Brunet 2009; Eckhard Hein and Achim Truger 2014). Sill others, point out the rise of competitive imbalances within European Monetary Union (EMU) countries due to systemic differences, mainly at the level of wage governance institutions (see, Alison Johnston, Bob Hancké, and Suman Pant 2013).

Analyzing the causes of the specifically European crisis we would refer the works of Jean-Paul Fitoussi and Francesco Saraceno (2010), Casimir Dadak (2011), Jorge Uxó, Jesús Paúl, and Eladio Febrero (2011), Angelos A. Antzoulatos (2012), and Harris Dellas and George S. Tavlas (2012). They discuss the fragilities of the institutional architecture of the EU and the more political than economic based decision to move to the euro. The global crisis emerges in this context as the detonator element of a structural crisis that had long been latent and only waiting the right moment to explode. The enlargement to the central and eastern countries acted as an enhancer factor of asymmetries and a catalyst of internal contradictions (Irena Radović 2009).

Concerning the European Central Bank (ECB) there is a relative consensus on the stabilizing role it has played in the crisis management, mostly when it follows the way of intervention of its American counterpart, the Fed, trying to act as lender of last resort (De Grauwe 2011; Hansjörg Herr 2014). The interventions of the ECB and the Fed, principally the so-called ECB's non-standard monetary policy measures, avoided the collapse of the financial system by cutting interest rates, relaxing the requirements in terms of collaterals and holding financial institutions with insolvency problems (see Philippine Cour-Thimann and Bernhard Winkler 2013; Carlo Altavilla, Domenico Giannone, and Michele Lenza 2014), but there is still a need for more integrated policies in order to take into account the interdependent nature of problems (Jay C. Shambaugh 2012).

However, measures taken to deal with the financial system are far from what would be necessary to go to the root of the problems, namely the regulation and supervision deficit (Már Guðmundsson 2011; Christine Cumming 2012) and, above all, the lack of a systemic vision of policies and institutions (C. Randall Henning and Martin Kessler 2012). On the other hand, we can devise many hesitations and inability on the field of the economic policy management that have weakened the sustainability of the timid recover signs. For that reason, the markets continue to believe the fracturing of the euro has a material probability (Adrian Blundell-Wignall 2012). At a more global level, the spectrum of secular stagnation linked to the prevalence of recessive policies concerns a growing number of economists and researchers who strive to draw attention to the aggregate demand problem (see Coen Teulings and Richard Baldwin 2014).

Still on this subject it's important to mention the speeches of the President of the ECB, Mario Draghi (2014), and of the Chair of the Fed, Janet L. Yellen (2014), made at the Annual Central Bank Symposium in Jackson Hole, Kansas City, on August 22nd, 2014. Both converge on the importance of the non-standard monetary policy measures to deal with the weakness of the recovery, the high levels of unemployment and the threat of deflation, especially in the euro zone. Yellen emphasizes the need for monetary policy to be conducted ultimately in a pragmatic manner, relying not on a particular indicator or model but reflecting instead an ongoing assessment of a wide range of information in the context of the ever-evolving understanding of the economy. Draghi, in turn, stresses the need for aggregate demand policies in order to deal with the prevailing uncertainty and to help insure against the risk of hysteresis effects provoked by the weakness of the economy. Going ahead on his thinking, the President of the ECB clearly points out to the need for the central bank to act as a backstop for government funding, including to ensure both an appropriate aggregate position and a large public investment programme in EU. This proposal moves forward in line with the more active intervention that has been characteristic of the ECB in the context of the crisis developments and that has been theorized at several levels by the ECB staff (see, e.g. Víctor Constâncio 2011; Cour-Thimann and Winkler 2013) but also in increasing detuning with the dominant German position as expressed by the Deutsche Bundesbank (see Ambreas Dombret 2013). In the debate between austerity and growth, the later clearly scores.

Following previous works (António Mendonça 2006, 2008, 2012), in this paper we want to situate ourselves in this debate adopting the view that the European crisis is an expression of the global crisis but, simultaneously, an expression of the conjunction of this global crisis with a particular and specifically European crisis of structural nature. Of course we have in presence the entire going on discussions but we aim to build our own explanatory model by integrating the three dimensions referred (global, European structural and European cyclical) but also integrating a discussion about the ways Europe can exit an even more deeper structural crisis that affects the more deep dynamics of its own integration project.

2. The Identity Crisis of the European Integration Project

The first channel or component of the structural dimension of the European crisis is what we call the *identity crisis* of the European integration project and this links directly to the erosion of the original driving forces underpinning the European integration process (Mendonça 2008, 2012).

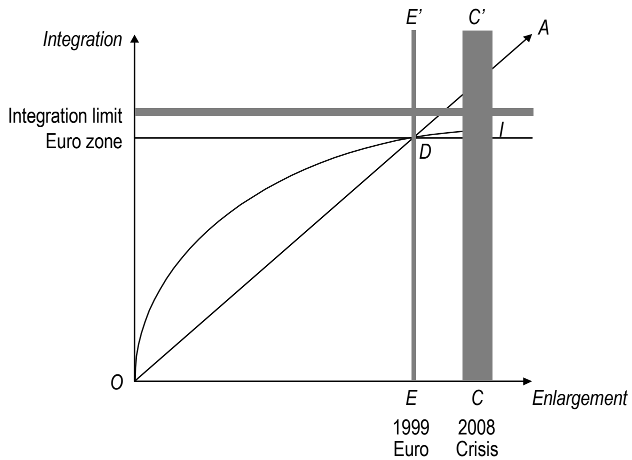
Indeed, from its very first beginning until now, the development of the European integration process was the result of the combined action of two particular dynamics. First, an *integration-deepening dynamic* that drove the participant countries from a single form of sectorial integration aiming at the collective and integrated management of the coal and steel industries - then the two strategic industries - to the sophisticated Monetary and Economic Union of our days, with its target being Political Union. Second, an *integration-enlargement dynamic*, which meant that new groups of countries came in, building on the six founders (France, Germany, Italy, Belgium, Holland and Luxemburg), and reaching twenty-eight member states to date. It is a process that has developed until now on a geographic extension basis, inside the boundaries of the European continent, though it looks as if it could break these limits with the upcoming prospect of Turkey joining, or even other Asiatic or Maghreb countries. It is important to remember, also, as an expression of the positive interaction between deepening and enlargement dynamics, that two of the most important jumps forward of the European integration process have combined, precisely, new country membership and qualitative progress in the integration process: the Single European Act (entry into force in 1987), with the membership of Portugal and Spain; and the Maastricht Treaty (entry into force in 1993), which paved the way for the EMU and preceded the adhesion of Austria, Sweden and Finland.

This reality changed, however, with the specific process that led to the single currency. The United Kingdom, Sweden and Denmark opted out of membership of the euro zone, though for different reasons (but convergent in the sense that they didn’t want to share all the common responsibilities of the single currency), and, from that moment, the multi-speed Europe institutionalized *de facto*, notwithstanding the possibility of future entry of those countries that did not want to join at the start.

In any case, the start of the single currency in these circumstances signalled that the European integration process had reached a critical phase, heralding the exhaustion of the original reference point - the model established in the Treaty of Rome. Looking back, and weighing up everything that happened to the European economy, both on external and internal levels, it is not difficult to accept the hypothesis that it was specifically the decision to move to the single currency, without all the requirements for an optimal monetary zone, particularly those concerned with the levels of fiscal and budget integration, that led to the current asymmetries, hindering (at least until the present moment) a coherent strategic answer from the European authorities.

The later revisions of the Treaty of Rome (Amsterdam and Nice) represent less of a "jump forward", in terms of deepening integration, and more of a defensive reaction from dominant countries, faced with the uncertainties and risks that stemmed from increased asymmetries and from changes in power relations in the Union. This "stagnation" in the plan for deepening integration was a clear expression of the exhaustion of the former European integration model and the entry of a new phase, which we call the *identity crisis of the European integration project*. This was a particular crisis that became deeper with the failure of the Treaty of the European Constitution and its replacement by the Treaty of Lisbon, itself then replaced by the new Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, which entered into force on January 1st, 2013, and set the standards for those countries that complete the ratification process.

The interaction between the two dynamics (enlargement and deepening) that drove and shaped the development of the integration process in Europe can be better understood using the diagram below (Figure 1).



Source: Author.

Figure 1 The European Integration Process

The horizontal axis represents the historical development of the European integration process with its successive enlargements. The vertical axis represents the uniform or inclusive *integration-deepening*, specifically the process where the successive levels of integration development are shared by all member states. The origin of the axis, *O*, is taken as the beginning of the European integration process, with the creation of the European Coal and Steel Community (ECSC) in 1952.

The *OA* line is the 45-degree line of the quadrant and represents the balance between the deepening and enlargement dynamics of the integration process. Above the 45-degree line, priority is given to the deepening of integration: the deepening dynamics outweigh the enlargement dynamics; uniform or inclusive integration prevails. Below the 45-degree line is the opposite: the enlargement dynamics outweigh the deepening dynamics, intensifying the asymmetries and creating, as a result, obstacles to the transition to new and more developed levels of integration.

The *OI* line represents the path of the integration process. The concave shape it assumes results from the interaction between the enlargement and deepening dynamics and from the progressive development of a particular trade-off. As the enlargement develops, there appear more difficulties with the move to higher levels of integration or, simply more difficulties in maintaining the levels already reached. We cannot even exclude the hypothesis of integration levels receding, in which case the *OI* line slope becomes negative.

Between ECSC creation and the introduction of the euro, the deepening dynamics clearly outweigh the enlargement dynamics. The central concern of the authorities has been to create all the conditions needed for all the member states to participate equally in the move to higher levels of integration. This process is represented by the *OD* section of the *I* curve, above the 45-degree line, *OA*.

After the creation of the single currency (represented in the chart by the *EE'* line), the deepening dynamics run out of steam. The new levels of integration are no more shared equally by all member states: the United Kingdom, Sweden, Denmark and Greece, though for different reasons, all stay out. On the other hand, the enlargement dynamics accelerate, with twelve more countries coming in. They are from Central and Eastern Europe, along with the Mediterranean islands of Cyprus and Malta. This brought the number of countries in the EU to twenty-seven (and this became twenty-eight after July 1st, 2013, with the incoming of Croatia). The heterogeneous levels of development in these new countries, between them and between them all and the old countries, accentuated the difficulty of sharing higher levels of integration, above all in terms of the single currency. The single currency vector stays out, though participation in the euro zone must occur in timely fashion, given the end of the “opt-out” clause. In any case, a two-speed Europe has become institutionalized: there is one zone with more restraints (the single currency zone, or euro area); and another broader zone (EU). This new reality is represented in the chart by the move of the *I* curve to the zone below the 45-degree line and by its reduced slope, meaning the arrival to a state near stagnation in terms of integration deepening possibility, either as a result of the recent countries coming in, or as a result of anticipate future incomings.

The introduction of the single currency is the critical turning point. It represents the transition to a high level of economic integration, implying the transfer of monetary sovereignty to a supranational Community and the consequent loss of national autonomy of monetary policy. At the same, however, fiscal policy remains at national level, albeit formally highly restricted by the terms of the Stability and Growth Pact.

These restrictions, however, are not real restrictions, for two fundamental reasons: firstly, because they are not based on uniform fiscal conditions - in reality, despite the monetary union, there continues to be a disparity in tax situations, acting as instruments of economic competition between countries that belong to the same monetary zone, a fact which is counter-intuitive; secondly, because they do not emanate from a situation of symmetry between the economic conditions of different countries, and are therefore extremely vulnerable to any disruption of the economic cycle, particularly larger ones like those resulting from the current economic and financial crisis. These two types of asymmetries produce economic inefficiencies in that they hamper the integration of monetary and fiscal policies in a unified monetary zone, and may even lead to considerable turmoil, as was the case with the sovereign debt crisis.

Fiscal policy arises in the context of the discussion of optimal currency areas, as a key response to asymmetric shocks in the absence of sufficient flexibility of wages and prices or factor mobility. However, given the limitations of monetary policy in the financing of public deficits, fiscal policy also becomes an instrument that is at one and the same time extremely sensitive and extremely vulnerable, taking into account the rigidity that exists in the structure of public budgets and increased pressure in situations of economic recession. Fiscal policy, which germinates as an essentially anti-cyclical concern, becomes a pro-cyclical instrument in the context of monetary union, and its effects have been exacerbated, given the depth of the current recession.

Fiscal integration is a process that evolves according to the circumstances and is associated with processes of political unification (Bordo 2004; Bordo, Agnieszka Markiewicz, and Lars Jonung 2011). In Europe there is no political unification, nor any prospect of this goal being reached in a reasonable time to influence the current economic situation, hence the difficulties in advancing towards greater fiscal integration, either through the strengthening of the Community budget or through the harmonization of rules. There is no “federal spirit” in Europe, although it could be brought about by the need to respond to the crisis. This, however, does not seem to be the case in the current euro zone climate.

Whatever the outcome of the on-going discussions, it would seem that we have reached a limit situation where it becomes necessary to take a decision on the continuation of the integration process in Europe. And two fundamental hypotheses seem to be on the table:

- Either to accept the current situation, and adjust integration to the reality of different idiosyncrasies and needs of countries members;
- Or to keep the current requirements of integration and then accept that there will have to be a reduction in the geographical space of their application.

In either hypothesis there is a range of possibilities that tend to close as indecision persists. The first hypothesis will worsen the cost of the chosen solution, and that will necessarily require deeper integration in monetary, fiscal, and budgetary and, of course, political aspects, with increased transfer of sovereignty (which cannot fail to be considered as a cost). In the second case, the risk of dissolution and even disorderly implosion of the euro zone will increase exponentially.

The arrival of the EU at this critical point is represented in the chart by the bar *CC'*. What is decided will determine the future shape and slope of the curve *OI*, which represents the integration process.

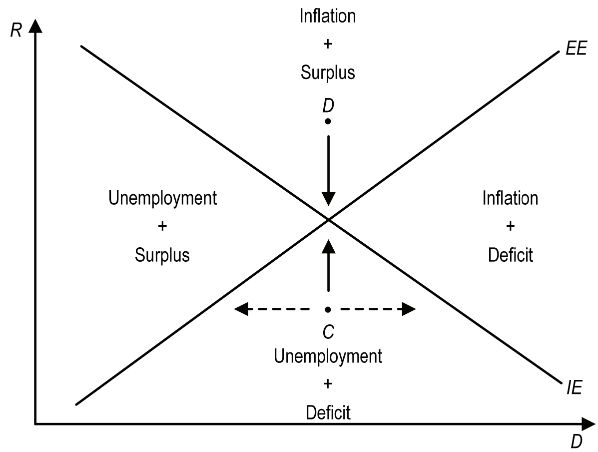
3. The Adjustment Problem in the Euro Zone

The second channel of the European structural crisis has to do with the *adjustment problem* in the euro zone in the presence of fundamental imbalances, either at national level internally or at the level of international relations.

Looking back, we can conclude that this mechanism has not only been inefficient during all the life span of the euro but also, having eased the current account constraint, has encouraged the temporal accumulation of cyclical imbalances beyond all acceptable limits, giving rise to increasingly explosive situations.

The accumulation of these macroeconomic imbalances has also given rise to a new type of imbalance, this time of a structural nature - the increasing asymmetry between the euro zone countries. Far from having produced endogeneity, as the theory would have us believe, the euro area favoured the development of idiosyncrasy among the countries that created all the conditions for the eruption of asymmetric shocks, and the sovereign debt crisis is the major expression of this (Mendonça, João Silvestre, and José Passos 2011).

To better understand the importance and dimension of the adjustment problem, we will use the Swan diagram (Trevor Swan 1963; De Grauwe 1989) as presented below (Figure 2).



Source: Swan (1963) and De Grauwe (1989).

Figure 2 The Adjustment Problem

On the vertical axis we represent the real exchange rate *R*. On the horizontal axis we represent the level of total spending (absorption) in the economy *D*. Two equilibrium conditions are represented in the diagram. One, by the line *EE* (external equilibrium), which represents the combinations between real exchange rate and expenditure levels that leave the trade account balanced. The slope of this line is positive, reflecting the simple idea that an increase in competitiveness (increased *R*), leads to a trade surplus, with the associated increase in domestic expenditure to keep the trade account balanced. Thus, the points below the line *EE* represent external deficits situations and the points above the same line represent surplus.

The line *IE* represents the other equilibrium condition (domestic equilibrium). This line represents the combinations between real exchange rate and expenditure levels that ensure an unemployment level corresponding to the so-called natural rate of unemployment. The slope of the line is negative, reflecting the idea that increased competition leads to increased exports, and this fact, in turn, leads to increased domestic output, reducing unemployment to a level below the natural rate, depressing wages and generating inflationary pressures. To keep the balance it becomes necessary, therefore, to reduce spending. Thus, the points below line *IE* represent unemployment situations and points above the line represent inflation situations.

By combining imbalances, we can define four standard situations: (i) *unemployment with external deficit*; (ii) *unemployment with surplus*; (iii) *inflation with surplus*; (iv) *inflation with deficit*. The point *E* - the intersection of the lines - represents the combination of internal and external balance.

Consider now two typical imbalance situations: *a loss of competitiveness* as a result of a relative increase in domestic prices (*domestic shock*); and *an increase in competitiveness* resulting from a relative increase in external prices (*external shock*).

3.1 Domestic Shock: Loss of Competitiveness

In the diagram, this situation is represented by the shift of the economy from the equilibrium point *E* to point *C*: the loss of competitiveness generates a decrease in exports and an output breakdown with negative consequences in terms of employment. We reach a situation in which an external deficit is associated with unemployment above the natural rate. If it is not possible to use the exchange rate mechanism (the nominal exchange rate is fixed), rebalancing can only be achieved by a reduction in domestic prices. This reduction requires, however, flexibility in prices and wages.

In this hypothesis, the original discussion supposed the activation of two mechanisms.

First, the rise in unemployment would reduce the level of wages and this reduction, in turn, would cause a decline in the price of domestic output.

Second, the external deficit would force the monetary authorities to intervene in the foreign exchange market by selling foreign currency against the local currency. As a result, we would have a contraction in the domestic money supply, with rising interest rates, reduced domestic spending and, in consequence, a fall in price levels. To be effective, this mechanism clearly requires the authorities to let the “rules of the game” come into play, i.e. the external deficit is expected to be transmitted to the money market.

The combined effect of these two mechanisms would lead the economy back to point *E*: increased competitiveness, reduced unemployment, and the deficit would be eliminated. The way all this would work is dependent, however, on several factors and, in particular, on the speed of adjustment of prices and wages. We could have different paths for the restoration of equilibrium.

But now suppose that prices and wages are not flexible, as the adjustment hypothesis requires. How would the economy behave?

It is evident that the adjustment mechanism loses effectiveness and we find ourselves on the dashed line in the diagram. If the authorities give priority to unemployment, increasing spending, the economy moves to the right along the line, increasing the external deficit. If the authorities give priority to reducing the external deficit, cutting spending, the economy moves to the left, increasing unemployment. The authorities have fallen into the so-called Meade dilemma (James E. Meade 1951): if they reduce the external deficit, they increase unemployment; if they reduce unemployment, they increase the external deficit.

We thus come to the inevitable conclusion about the essence of the problem of adjustment in a context of price and wage rigidities. Whatever the choice of the authorities (reduction of unemployment or reduction in the external deficit), the recourse to devaluation becomes a necessity and, inevitably, ends up happening. If the option is the reduction of unemployment, the accumulation of external deficits becomes untenable for the simple reason that the exhaustion of foreign exchange acts as a limit to this policy. Similarly, the option of reducing the external deficit is faced with the social and political limits of internal deflation, leading the authorities to opt for the "lesser evil" of devaluation.

In summary, the exchange rate is an alternative to sticky prices and wages that characterizes most developed economies, in particular within the euro zone. Obviously, we are reasoning under extreme assumptions and, in reality, several variants may exist regarding the rigidity of prices and wages. But the essence of the problem does not change.

But how are things supposed to work in the *absence of the exchange rate mechanism*, as is the case of the euro zone?

The answer brings us to another type of problem that has to do with verification of the optimality conditions of the currency area. According to the theory of optimum currency areas, it is necessary to verify at least one of three conditions so that we can dispense the use of the exchange rate instrument in the adjustment process: flexibility of prices and wages; financial transfers to the countries / regions affected by asymmetric shocks; and factor mobility between countries / regions, particularly regarding labour.

But consider also a particular hypothesis: *the relaxation of the balance of payments constraint through the use of external financing*.

In the situation described for point *C* in the diagram, the economy could overcome the problem of loss of competitiveness and continue to ignore the pressure of the external deficit by recourse to external financing. External financing would work as a substitute for foreign exchange reserves, allowing the postponement of adjustment beyond any limit.

The disappearance of the balance of payments constraint, or exchange restrictions, considered one of the benefits of the participation in the single currency, ended up working in a perverse way, acting as a factor in building up imbalances beyond what would be possible if there were a national currency. In a situation of effective economic and monetary integration, with fiscal integration and effective political solidarity, the problem would be considered as internal to the monetary area and solved as such. In a context of incomplete monetary integration - as is the case of the euro area - the deepening of inequalities, as a result of the successive enlargements, and the weakening - or even loss - of a political common denominator, as a result of the assertion of a particular hegemony, the disappearance of the balance of payments constraint, which would have been a factor favouring structural convergence and deepening integration, in a theoretical framework, ended up working as a magnification factor of asymmetry, turning a crisis of the euro system as a whole into a sovereign debt asymmetric shock.

But this is only one side of the problem. It is important to consider the other side, the competitiveness gain.

3.2 External Shock: Competitiveness Gain

In the diagram, this is represented by the shift of the economy from equilibrium situation *E* to *D*: the gain in competitiveness, as a result of the relative increase in external prices, produces a trade balance surplus and unemployment below the natural rate.

In a conventional situation, the same two channels allow the economy go back to equilibrium.

First, an unemployment rate below the natural rate produces a rise in wages and, in this way, a rise in domestic prices.

Second, the external surplus forces the monetary authorities to buy foreign currency against the local currency, increasing the stock of money in circulation.

As a result, spending increases, and this also contributes to the rise in prices. Note that in this case it is assumed that the monetary authorities follow the “rules of the game” by not sterilizing the monetary effects of the external surplus.

The combined effect of these two mechanisms will bring the economy back to point *E*. The economy loses competitiveness, employment will be reduced to levels consistent with the natural rate and the external surplus will be eliminated.

In comparison with the former situation of competitiveness loss, in this case there is an easier operation for the adjustment mechanism. This is the result of the greater flexibility of prices and wages to a rise than to a fall. Theoretically there is an asymmetry in the operation of the adjustment mechanism, as the economy faces a problem of external deficit or surplus differently, the second case being less troublesome to deal with. But, in reality, everything can be very different.

In the hypothesis of *exchange rate existence*, the authorities may pursue a policy of price stability, sterilizing the monetary effects of the external surplus, thus preventing the second mechanism from working. Regarding the first mechanism, it can be prevented from working by resorting to revaluation of the exchange rate bringing the economy back to point *E* and without causing domestic prices to rise.

But how do things work in the *absence of a national currency* and thus in a context where it is impossible to use the foreign exchange instrument as an adjustment variable?

It is obvious that the imbalance can only be corrected if there is an increase in domestic spending. This will lead to rising domestic prices and competitiveness loss (lower *R*). But here too we face the question of priority to price stability. If the authorities are reluctant to accept inflation, they simply impede the working of this mechanism through restrictive policies, contributing to the maintenance of the imbalance. They may even accept a reduction in employment to levels more compatible with the natural rate, pushing the economy to a situation close of the one represented by line *IE* in the diagram. This is a situation where everything is easier than in the case of competitiveness loss.

Let's now combine the two situations in the context of a single currency area. On one side we see an accumulation, beyond all bounds, of the imbalances resulting from competitiveness loss: *unemployment and external deficit*. On the other side, we see an accumulation of the imbalances of opposite sign: *labour shortage and external surplus*. In the absence of an exchange rate instrument, fulfilment of optimality conditions of the currency area, and in presence of resistance to competitiveness loss on the part of the surplus economy, the tendency will be for an adjustment by the weaker side, i.e. through the contraction of spending in the less competitive economy, thus reducing internal prices and restoring competitiveness.

This is, in general terms, what is supposed to be happening with the present adjustment within the euro zone, between the surplus countries, with Germany at the head, and indebted and deficit countries, including Portugal. The stronger side countries could do the adjustment, if they accept a loss of competitiveness. Because they do not accept, the adjustment has to be done by the weaker side, and they must bear unilaterally the consequences of restrictive policies.

We should, however, consider other consequences of unilateral adjustment by deficit countries.

As seen before, in the context of the Meade dilemma, the external rebalancing priority produces a rise in unemployment. However, the adjustment by means of spending cuts implies the hypothesis of flexible wages and prices. The rise in unemployment to very high levels creates the conditions for a wage reduction, which, in the reference theoretical framework, will act as a competitiveness recovery factor *via* the effects on prices.

The reality, however, is more complex than the mechanism described here. Firstly, the impact of wage reduction on the fall in prices is not linear and depends on many factors related with the structural characteristics of the deficit economy. Moreover, in a context of deep recession, it is not expected that lower wages, by themselves, can work as an increase employment factor. On the contrary, it can work as an additional factor of increased unemployment through reduction of spending and consumption. In this respect we would like to bring in here the results of a study on the effects of changes in unit labour costs on economic dynamism (Mendonça and Passos 2013). This study concluded, with reference to a panel of 32 OECD countries for the period 1993-2009 that these effects are not significant and, moreover, are not symmetrical. Economic activity, measured by exports and output, seems to react negatively to a rise in unit labour costs, but the reverse reaction does not seem to exist when we are in the presence of a fall in labour costs. This reflects a transmission chain effect more complex than that considered by the theory.

In summary, the euro system throughout its existence has proved be deeply inefficient in terms of internal adjustment, revealing that it is not an entirely credible substitute for the traditional foreign exchange instrument. Not only has it allowed for the accumulation of imbalances over time, which turned into structural asymmetries between economies and countries - as we saw in the current financial and economic crisis; it has also proved unable to respond effectively - *as an internal adjustment mechanism* - to the disruptions provoked by the impact of this same crisis in its own area.

The sovereign debt crisis is just one of the dimensions of the malfunctioning of the euro area. Not only by letting things run on but, by letting countries be exposed as autonomous entities, as if they still had their own economic policy instruments to be used, the euro zone brought into play centrifugal forces that could well jeopardize the very existence of the currency zone, at least in the way it was built.

4. The European Response to the International Crisis

Despite all the hesitations, the euro zone was forced to confront its own structural weaknesses and took some initiatives that sought to meet solutions to deal with the problems of adjustment. Regardless of the results already reached, it is a process that has dragged on painfully and in zigzags, being once again determined by the interests of the dominant economies, Germany in first place. In fact, despite all the weaknesses of the single currency architecture highlighted throughout the development of the so-called sovereign debt crisis, the spirit of national policies interests was maintained and, perhaps, reinforced continuing to rely on any idea of ensuring overall consistency and responsiveness in the single currency system.

Here it is important to highlight three key decisions: (a) the revision of the Lisbon Treaty, with the signing in early March 2012 of the new Treaty on Stability, Coordination and Governance in the EMU (TSCG); (b) the creation of the European Stability Mechanism (ESM); (c) ECB opening up to the use of so-called unconventional measures of monetary policy. Together, they constitute a package whose comprehensive coherence and potential effectiveness in preventing and responding to economic imbalances in the euro area should be examined.

4.1 The New Treaty

The so-called "fiscal compact" is the substantial part of the new treaty and defines the rules to be applied in managing the deficit and debt: 0.5% of structural deficit, compulsory debt reduction at a 1/20 average annual rate, structural reform programmes for indebted countries, penalties for non-compliant countries, and European *ex-ante* macroeconomic coordination enhancement.

Also with the aim of strengthening the coordination of economic policies and convergence, the treaty includes provisions for the commitment of different countries to the smooth functioning of Economic and Monetary Union, notably through *ex-*

ante discussion and coordination of major reforms to be implemented within each country individually considered. This discussion should involve the Community institutions themselves.

The new treaty has intergovernmental features to facilitate its adoption by the signatory countries and seeks to deepen the Stability and Growth Pact, setting tighter rules for the management of fiscal policy. This is part of a particular view that considers what is important in the current situation is to give signs to markets of commitment to limiting behaviours, transferring responsibilities for the crisis to country level. In this sense the treaty has, primarily, a preventive and deterrent character that cannot in any way, be regarded as an answer to current problems. On the contrary, it can in the short term accentuate the contraction dynamics of the European economy.

4.2 The European Stability Mechanism

The decision to create the European Stability Mechanism was taken at the European summit of December 7, 2010, assuming the tasks of the European Financial Stability Facility (EFSF) and the European Financial Stability Mechanism (EFSM) to provide financial assistance to member states of the euro whenever necessary. It stayed under wraps, however, pending the conclusion of the Treaty on Stability, Coordination and Governance EMU to finally see the light of day on February 2, 2012. The ESM and TSCG are complementary: financial assistance requires adherence to TSCG. Taken together, they can be viewed as instruments for strengthening economic coordination within Economic and Monetary Union to prevent and cope with crisis situations such as that currently faced within the euro zone.

The ESM has the status of an international financial institution and its mission is to raise funds and provide stability support to member countries facing financing problems. This support is subject to strict conditionality, according to the chosen financial instrument. For this purpose, the ESM is authorized to raise funds by issuing financial instruments or by agreements or other financial arrangements with ESM members, financial institutions or other third parties.

The European Commission, in liaison with the ECB, negotiates the conditionality of support. The aid application gives rise to a Memorandum of Understanding that includes the terms of conditionality that accompanies the instrument of financial assistance. These terms reflect, in turn, the seriousness of the problems that gave rise to this request for help. It is for these two institutions, where possible in conjunction with the IMF, to monitor compliance with agreed conditionality.

Note that, within the ESM, the need for close collaboration with the IMF is officially recognized. The countries requesting financial assistance under the ESM are expressly advised to submit an identical request to the IMF. Provision is thus what has been the practice in the case of the sovereign debt crisis, where there has been a refusal to see the financial problems of euro member countries as a matter for the whole currency area, even with the argument that the international financial markets need to be mobilized.

4.3 The "Non-Standard" Monetary Policy of the European Central Bank

The third component of the European response to the crisis has a more practical dimension and immediate effects and concerns the intervention of the ECB.

Since the end of 2011, the ECB has been pushing down interest rates and responding to liquidity problems with an additional set of financing measures that, at a minimum, can be considered unconventional in terms of the practice and culture of its own monetary policy management. The main rate of interest is currently 0.5%, and since the end of 2011, the ECB has injected all the liquidity necessary to manage the problems of bank financing and the needs of sovereign debts management. Simultaneously, the ECB decided to decrease the reserve ratio from 2% to 1% and ease its collateral acceptance conditions. In practical terms, we can consider that the ECB has adopted behaviour of lender of last resort although it has not assumed this as regards commitments to price stability. On the contrary, the whole argument goes towards justifying the non-standard measures with the need to ensure the functioning of the transmission mechanism of monetary policy (see, in particular, Constâncio 2011; Cour-Thimann and Winkler 2013).

In reality, given the current crisis, there are economies facing a liquidity shortfall problem that cannot be solved merely through the normal functioning of financial markets. There is a need for ECB intervention in order to assure that liquidity reaches the economy, in a context where there is no danger of inflation and the rate of interest has lost effectiveness. The unconventional measures are justified, given the lost of effectiveness of traditional monetary policy and the need to make a by-pass around the disruptions of the financial system as a whole. In accordance with this view, the ECB reinforced its intervention in 2012 and 2013, notably with the launch of the Outright Monetary Transactions (OMT) program, in an attempt to offset the recessionary effects of austerity policies and increase the room for manoeuver as countries came to grips with the sovereign debt crisis.

4.4. Effects on the Structural Crisis Mechanisms

In the table below (Table 1) we summarize the effects of the three key decisions discussed above over the two main channels of development of the structural crisis in Europe. A positive sign (+) means a positive contribution to the problems resolution. A negative sign (–) means a negative contribution. A positive and a negative sign together (+ –) mean an undetermined effect. One or two signs (positive or negative) serve to quantify the relative magnitude of the effects.

Table 1 Effects on the Structural Crisis

	Identity crisis	Adjustment mechanism of the euro
New treaty	– –	– –
ESM	– +	+
Non-standard monetary policy	+ +	+

Source: Author.

The new treaty is, in our view, the most disruptive decision in that it is a potential amplifier of asymmetries and, consequently, it contributes to the reversal of endogeneity in the euro currency area. The overall effect is to enhance the multiform integration dynamics, including the possibility of disintegration.

On the opposite side, we have the non-standard monetary policy of the ECB. The effect of what is effectively the bank acting as lender of last resort has been to limit the most negative effects of the crisis and widening the scope for national policies.

The effects of the ESM are more undetermined though potentially positive in terms of euro zone internal adjustment.

The overall effect of the European response to the crisis is clearly undetermined to date. The structural crisis dynamics have not been yet reversed or even contained and continue developing.

5. The Development of the Structural Crisis in Europe

With regard to Europe's own specific European structural crisis, developments in the international crisis and contradictions in the European response to the local effects have combined to push the integration process to a higher critical stage of trade-off between *Continental enlargement* and *integration-deepening* dynamics.

The *first critical stage* was reached, as we have already discussed, with the United Kingdom, Denmark and Sweden opting out of the euro zone. This, in practice, instituted a multi-speed Europe and broke with the principles of inclusion and uniformity in the path to integration. It also opened up the possibility of having a regression in the level of integration, and ultimately the possibility of exclusion from the euro zone if the countries concerned do not reach compliance with agreed principles and rules, such as those which arise from the application of the Stability and Growth Pact or those resulting from the latest requirements in the new Treaty on Stability, Coordination and Governance in the EMU.

It should be noted, by the way, that monetary integration has always been one of the greatest generators of centrifugal forces, demanding more complex resolution throughout the history of European integration. Also during the term of the Bretton Woods system, the development of German economic hegemony in the European context and its preferred alignment with the United States limited the potential of the European Payments Union as the embryo of an independent European monetary system. In the context of the international monetary system crisis, European monetary snakes always clashed in their operation with asymmetries and different priorities in economic policy between the different participating countries. They really did not work as factors of increased monetary integration and, finally, ran into the sand. And the very birth of the European Monetary System (EMS) in 1979 occurred without the effective participation of the United Kingdom, despite its participation in the joint project of integration since 1973. Interestingly, the EMS resisted the crisis of the early 90s crisis with the introduction of greater flexibility through the widening of the Exchange Rate Mechanism (ERM) fluctuation margins to ± 15%, becoming, in practice, its opposite - that is, a system of ultra flexible exchange rates. In fact, this helped respond to the asymmetries between countries, facilitating differentiated adjustments - a thing that today would prove to be impossible. It is not surprising therefore that the monetary vector continues to be a source of instability and production of increased difficulties in the current phase of the European integration process.

The passage to a *second critical stage* of the trade-off, in turn, was a direct consequence of the changes introduced by the fall of the Berlin wall in 1989. It starts with German reunification in 1990, even before the euro, but it starts to have a real impact with the enlargement, from 2004 onwards, to the countries of Central and Eastern Europe, setting a new community economic space, qualitatively very different from the previous - a space with substantially expanded asymmetry, leading to the displacement of old axes of economic and political interests and the creation of new ones, enhancing the basis for internal disagreements. This in fact came about, thereby introducing additional factors of instability and locking out endogeneity of the integration process.

The development of centrifugal forces in Europe, caused by the greater size and diversity of the space of integration, was magnified by all the events triggered by the eruption of the international financial and economic crisis, pushing the trade-off *enlargement-deepening* feature to a *third stage* of action, where the very functioning of the European institutions begins to skid. This is particularly visible in: (1) a loss of initiative and power in the face of national interventions, especially from Germany; (2) the start of disharmony or even contradiction, as is the case of the European Commission and the ECB; (3) an abdication of their own capacity and autonomy in the international crisis context, with the request for IMF involvement in the design of the adjustment programmes of member countries which, in principle, should have been an internal affair of the euro zone.

The erosion of the role and importance of European institutions goes parallel with the strengthening of German hegemony, as it has increasingly imposed its vision of the European project and has overridden the so-called Franco-German axis that shaped the current configuration of the Union. We can clearly see a process involving the adumbration of a union of Northern countries, pushing aside a number of Southern countries, forced into asymmetric economic adjustment processes, heavily penalizing their economic activity and their ability to assert themselves within the euro zone. At the same time, the United Kingdom has strengthened its position as an outsider, looking at Europe increasingly as a commercial zone and less as a common place or a community that shares broader economic and political goals. The chosen model seems, in this case, increasingly outside Europe and more on a transoceanic global scale in the space where the United Kingdom built its historical and traditional political and economic links.

If we go back to the central question of the *identity crisis* in the European integration project, we need to ask seriously if the uniform and inclusive dynamics are still driving the integration process or if this process is already being conditioned and shaped in its development by distinct dynamics. Our hypothesis is that we are already in the presence of new dynamics and, in contrast to what has gone before, what is driving the process now is *Multiform or exclusive integration* dynamics.

Returning to Figure 1 above, we can represent the way the European integration process (*OI*) has progressed in the period following the crisis (represented by the bar *CC'*) by a change in the slope of the curve: the horizontality condition would seem to have been exhausted, and is on the verge of moving from a positive to a negative slope. In other words, everything seems to indicate that the current configuration of the EU economy, and its foreseeable developments, has ceased to be compatible with a shift to deeper common levels of integration, favouring instead the production of *Multiform or exclusive integration* dynamics. Nor can we exclude regression shifts in this plan, including the implosion of the entire system if the current financial and economic crisis deepens and austerity policies, currently underway, prove impractical.

6. The Crisis and the Scenarios for Development of the European Integration Project

Given what has been said, how can we foresee the future of the EU and of the euro zone in particular? Many authors have tried to answer this question but there is no consensus about the way Europe can face its current dilemmas. There seems to be greater convergence around the diagnosis than around the possible ways out (Kosta Josifidis, Alpar Lošonc, and Novica Supić 2010). Without claiming to give definitive answers, because the current situation is far from having exhausted all its possible developments, we believe that some hypotheses for the move towards integration in Europe can be formulated. We are convinced, however, that whatever effectively happens will be largely determined by developments in the European and the euro crisis.

In any case, if we are trying to understand the current driving forces, it is possible to set out two major hypotheses or scenarios as a framework in which the integration process in Europe could evolve: a *continuity or a doing as usual scenario* and a *reconfiguration scenario*. Each of these two scenarios may be open to several sub-scenarios, or even variants.

The *first scenario* assumes that *continuity* will be the main driving force, even though it may entail situations of serious rupture. It assumes the maintenance of existing policies, and possibly some institutional adjustment in order to consolidate the current balance of powers in Europe. It could, however, accept deep changes in the shape of the euro currency area and the EU, depending on how the crisis evolves.

In an *optimistic variant*, Europe can overcome the crisis. The new mechanisms, created in the meantime, play their part, the euro keeps running, the banking union comes into operation, the public debts or, at least, some part of them are pooled through the issuance of Eurobonds, fiscal consolidation takes place concomitantly with growth, and the federal and political union project is taken up again. At the same time, the enlargement process continues, on a continental geographical basis, with the incorporation of other European countries that are not yet part of the EU, possibly with some extensions beyond the Asiatic frontier of Europe. The relationship with Russia is the great unknown in this scenario and it can change it radically.

Even though we may witness the "good behaviour" of all the variables involved, it is a scenario that does not exclude the transition to a new phase of the integration process, moving towards *Exclusionary or multiform integration*. In this context, German hegemony is likely to be consolidated, directly or *via* a hard core (with or without the participation of France), and this will increasingly tend to establish the operating rules of the Union and decide the inclusion or exclusion of different countries. It is a scenario that goes well with the rules of the new Treaty on Stability, and the Fiscal Compact, in particular, accepting the hypothesis of "detachment" of countries, which could go as far as altering the configuration of the Union and its relationship with the euro zone. In any case, there is now a recentering process with the EU expanding eastwards, and this means that the concept of Western Europe - which worked as the fundamental reference for the building of the European integration project - is definitely on the wane. This scenario, naturally, implies a dilution of the objectives and the references hitherto existing, with new ones added, and the countries on the Atlantic western fringe of Europe becoming increasingly peripheral, the extreme case being Portugal. This scenario assumes that the original European integration process will mesh with the new dynamics, resulting from German reunification and EU enlargement to the countries of Central and Eastern Europe.

In a *pessimistic variant*, this scenario implies a rupture with the traditional model, with a shift from the "detachment" stage to the institutionalization *de jure* of multi-speed Europe. Here, the implosion hypothesis cannot be excluded, at least at the level of the single currency zone. This variant implies the replacement of the *principle of collective responsibility* by the *principle of asymmetrical adjustment*, favouring a decline in the levels of convergence and cohesion. It is a scenario that will gain momentum in a context of deepening crisis, the decline of Europe in the global economy and the increasing asymmetries between Germany and the "Northern countries", on one side, and the "Southern countries", on the other. In an even *more pessimistic* version, this scenario may evolve into a complete reverse of the European integration process, with greater or lesser fragmentation, but in any case, with a loss of power in the traditional European supranational institutions. Compared with the optimistic variant, this pessimistic variant assumes the failure of the on-going policies in Europe, with the deepening of the economic crisis, the enhancing of conflicts and the pushing of countries to extreme situations of total inability to deal with the internal problems in the framework of the constraints and rules governing the relations in the EU and in the euro zone. It is a situation in which the costs of staying in the Union and in the euro outweigh the benefits, and it becomes impossible, objectively, for the weaker member states to stay in. In a *very negative* variant we can expect the implosion of the system. In a *less negative* variant, we can expect a separation, a downgrade, or an organized dissolution.

The *second main scenario* assumes a *deep reconfiguration* of the integration model and requires a reorientation of the integration project towards the abandonment of the exclusive model of *Continental enlargement* in order to integrate a different perspective: *the projection of Europe in the global world based on a valuation and empowerment of the historical relations the Europeans built in their expansion across the Atlantic Ocean*. This is a new perspective that favours an alternative approach. It represents an opening of Europe to the global economy, to the detriment of an old perspective that has privileged a continental view of Europe turned in on itself.

In this second main scenario, having in mind the fundamental objective of Economic and Monetary Union, the enlargement of the EU should consider in first place the effects on the consolidation of the euro zone, which implies, in the current situation, the priority to the resolution of the sovereign debt crisis and the effective functioning of the euro area as a single currency monetary area, i.e. as a currency area where there is a central bank that acts as a lender of last resort, and active policies that promote growth, employment and economic convergence, besides price stability and response mechanisms to asymmetric shocks. It implies, ultimately, a redesign of the euro system that may recover the perspective of internal economic convergence and reconcile it with the general objectives of currency area consistency. The scenario also assumes an active policy of expansion of the euro as an international currency, starting with the strengthening of the economic relations of the European countries with their traditional areas of influence outside Europe through the consolidation and diversification of cooperation experiences. It is a scenario in which the opening of the European integration process to other geographic areas is considered in terms of key strategic objectives, specifically through the establishment of free trade areas, the launching of limited economic integration spaces and strengthening of monetary cooperation in general. This seems to be in line with the recent perspective of building the *Transatlantic Trade and Investment Partnership*, between the EU and the United States. But is still too early to draw definitive conclusions. We need to see the final architecture and above all how it will work.

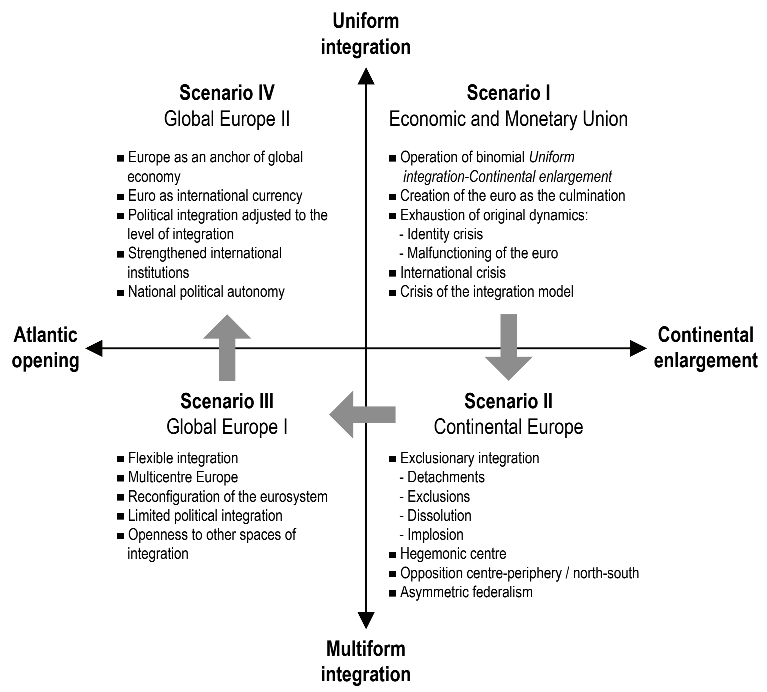
It is not difficult to see that this scenario does not contemplate the existence of a political-economic hegemony but rather a broadly-based autonomy among the countries that integrate the Union and the euro area when it comes to building new spaces for cooperation and, possibly for economic integration of a new type. Accordingly, the objectives of political unification in Europe must be seen from a minimalist and pragmatic perspective. All attempts at hegemony over European affairs by a restricted group of countries should be rejected. There should instead be a global strategy built on the integration of the strategic interests of the different countries in the Union.

The "softly-softly" approach to political integration, as considered in this scenario, is not in fact incompatible with higher levels of economic integration. Indeed, the consolidation of the euro zone and its use as an anchor for the opening up of Europe to the world requires a deepening of economic integration, particularly in terms of fiscal and macroeconomic policy management. This, in turn, must be reconciled with greater flexibility of policy management at countries level.

We have chosen the term *Atlantic opening* for this second scenario, in contrast to the first scenario, termed *Continental enlargement*. It dovetails more closely with the current trends of international economic integration that link to form economic areas of increased global vocation and tend to overlap increasingly the dynamics of regional integration. These trends seem to manifest themselves, particularly, in the case of the Anglo-Saxon bloc, formed by the United Kingdom, the United States, Canada, Australia and New Zealand, where factors of historical, cultural and linguistic proximity seem to foster the building of a common attitude in the context of ongoing global economic integration, with visible consequences in the attitude of the United Kingdom towards the project of European integration.

This is also a scenario that requires an appreciation of the geographical locations of countries, like Portugal and Spain, which are considered in light of current references as being on the periphery of European interests. These countries shaped their identities also outside Europe, building and projecting at the same time new relations with other continents and realities. The peripheral status they have now in the context of European integration, especially following enlargement to Central and Eastern Europe, could eventually become central in the new context of the *Atlantic opening* that would underpin the building of a Global Europe as opposed to the Europe that arises from the first scenario.

In the diagram below we try to systematize the discussion made above about the hypothetical scenarios depicting what we have called the identity crisis of the European integration project. In each quadrant we represent a possible stage in the integration process, starting with the current Economic and Monetary Union (Figure 3).



Source: Author.

Figure 3 Future Scenarios of the Identity Crisis

The vertical axis represents the qualitative development of the integration process. The upper half-axis represents *Uniform or inclusive integration*. The lower half-axis represents *Multiform or exclusive integration*. Notice that when considering the possibility that the scenario will evolve into a process of *Multiform or exclusive integration*, this does not necessarily means a downgrade of the levels of joint integration already achieved (although this could happen) but a differentiated progress to higher levels. In other words, it does not mean a replacement of integration by disintegration but a replacement of *Uniform integration* dynamics by multiform integration dynamics.

On the horizontal axis, there is a representation of the enlargement process of the space of integration. Two alternatives are considered: the *Continental enlargement* strategy, dominant until now, represented in the right half-axis; and the *Atlantic opening* strategy, represented in the left half of the axis. Also in this case, it should be noted that the *Atlantic opening* option does not necessarily imply an abandonment of European geographical integration or even a regression in the current spatial limits of integration, but rather a change in terms of strategic options: priority should be given to developing relations with other areas outside the European geographical area.

Combining the dynamics represented on the axis, two by two, we can bring out the scenarios discussed earlier.

In the first quadrant there appears the scenario Economic and Monetary Union, resulting from the action of the binomial *Continental enlargement - Uniform or inclusive integration*. It is the scenario that fits the European integration process up to the creation of the euro and from which the identity crisis of the European integration project has stemmed. It is still the scenario of the current euro system crisis.

In the fourth quadrant there is a combination of the forces of the binomial *Continental enlargement - Multiform or uniform integration* to bring out the scenario of Continental Europe. It is the "development through continuity" scenario, which may have optimistic and pessimistic variants, as discussed earlier. It represents the way out of the crisis by extending the current trends of *Continental enlargement* with hegemony of the German or Franco-German centre. It is also the multi-speed Europe scenario with a tendency to form a "centre-periphery" opposition within the Union. Ultimately, it is a scenario that could bring about the reversal of the integration process in Europe, either by the formation of a strong core with Germany as the hegemon, standing out from the others, or by paving the way to implosion of the EU. In any case, it is a scenario that implies the utter exhaustion of the original driving forces of European integration.

In the third quadrant are the forces of the binomial *Atlantic opening - Multiform or exclusive integration*, the scenario we have termed Global Europe I. It represents the opening of the European integration process to other geographic areas in the context of a multicentre, plural Europe, bereft of hegemony. It is a scenario that implies a reconfiguration of the euro system, with greater flexibility, greater adaptability to the asymmetries between countries and greater efficiency as an adjustment mechanism for internal imbalances. It is also a scenario that assumes a dynamic enhancing of the euro as an international currency, functioning as an anchor for opening up the EU.

Finally, in the second quadrant, there are the combined forces of the binomial *Atlantic opening - Uniform or inclusive integration,* leading to the Global Europe II. It is a *higher stage* of development in the Global Europe scenario. Europe can assert itself as the "core" of global economic integration. The euro becomes an international currency alongside the dollar at the same time as it becomes a reference for other currencies or currency areas outside Europe. The big difference between this and the scenario in the third quadrant lies in the development of political institutions of the EU that adjust to the strategy of *Atlantic opening*, excluding hegemonies made up of countries or blocs and favouring the production of an effective common European interest.

Viewed dynamically, these four scenarios can be considered as phases in the progress of the European integration process, including adjustment to the new conditions of economic globalization. This process can be summarized as: an *early stage of development* leading to the Economic and Monetary Union; an *exhaustion phase* of the original driving forces that led to the identity crisis and generated the dynamics of Continental Europe; a phase of *strategic reconfiguration* leading to *Atlantic opening*; and finally, a *fourth phase* that may give rise to a Global Europe, open to the world and driver of international economic integration. The arrows in the diagram indicating the passage from one quadrant to the following represent this evolutionary interpretation.

7. Concluding Remarks: Atlantic Opening and the Potential of the Community of Portuguese Speaking Countries

Portugal is one of the countries that are setting a lot of store on achieving the *Atlantic opening* scenario, taking into account the potential of its relations within the CPSC (Mendonça 2006). Seen from one angle, Portugal is faced with the prospect of becoming ever more peripheral, with the economic and political subordination implied in the scenario of *Continental enlargement*. Given this, it has decided advantages in being a member of an organisation of countries in an economic space with global features, as the CPSC undoubtedly is. A scenario of greater openness of Europe to the dynamics of the global economy could produce a recentralization of the country within the EU and lead to a status of prime importance in the relationships of Europe with the economic areas of which the countries of the CPSC are a part.

The first feature to be explored in the CPSC is precisely its vocation as *a player in the global economy* (see Figure 4 below). Indeed, it is a community of countries spread across five continents, with a combined population that exceeds 250 million people. All countries, without exception, are a product of the globalization process, and one of them - Portugal - is at the very origin of globalization.

The *first major challenge* for the CPSC is thus to build a space with a *collective identity*, endowed with self-awareness of its joint economic value potential and keen to find platforms to realize this potential. In the global economy as it is, the existence of expanded spaces of collective identity is a key driver to produce centralities and dynamics of attraction and anchorage of economic interests. This necessarily involves institutional progress and a common strategy of intervention in international organizations, economic but also political, military and others. This joint affirmation strategy does not necessarily clash with belonging to other regions of integration and may represent a particular vector of global relationship of these same spaces, overcoming the current limitations of this type of integration and giving each participating country additional instruments for insertion in the global economy.

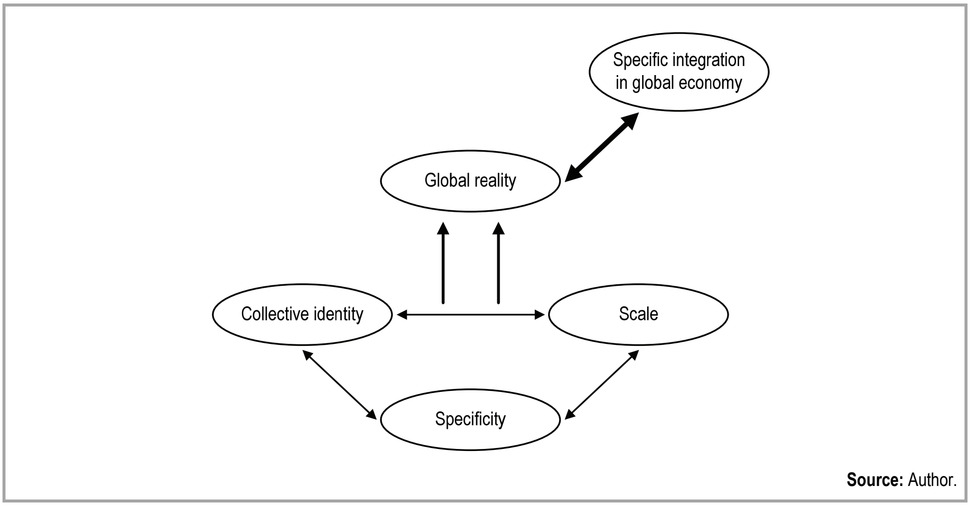


Figure 4 The CPSC in the Global Economy

There is also a *second dimension* to what that the CPSC can provide: *the introduction of a scale factor* in terms of international relations of each country, considered individually and as a member of the community. Effectively, the second major challenge facing the CPSC is to be able to integrate the particularities and strategic interests of each member country in a collective stance that empowers the community in the global economy.

A key factor of global identity acquisition and size appreciation of the group is the defence and promotion of the common language. This issue connects with the *third dimension* that the CPSC can enhance: *specificity*. In the phase of uniform globalization, the specificity factor acquires a new significance and can be instrumental in creating conditions attractive to international business flows and, simultaneously, in creating vectors of competitive empowerment of countries or groups of countries. It will have to start from revisiting and upgrading the values that derive from common history and language, from a distinct geographical situation pool, from the existence of a consolidated framework of institutional relations, from a developing process of economic integration and from what is already and can become even more extensive political cooperation.

References

Altavilla, Carlo, Domenico Giannone, and Michele Lenza. 2014. "The Financial and Macroeconomic Effects of the OMT Announcements." Centre for Studies in Economics and Finance Working Paper 352.

Antzoulatos, Angelos A. 2012. "Policy Responses to the European Debt Crisis Treating the 'Symptoms' or the 'Disease'?" *Panoeconomicus*, 59(5): 529-552.

Blundell-Wignall, Adrian. 2012. "Solving the Financial and Sovereign Debt Crisis in Europe." *OECD Journal: Financial Market Trends*, 2011(2): 1-23.

Bordo, Michael D. 2004. "The United States as a Monetary Union and the Euro: A Historical Perspective." *Cato Journal*, 24(1-2): 163-170.

Bordo, Michael D., Agnieszka Markiewicz, and Lars Jonung. 2011. "A Fiscal Union for the Euro: Some Lessons from History." National Bureau of Economic Research Working Paper 17380.

Bordo, Michael D., and Harold James. 2013. "The European Crisis in the Context of the History of Previous Financial Crisis." National Bureau of Economic Research Working Paper 19112.

Claessens, Stijn, M. Ayhan Kose, Luc Laeven, and Fabian Valencia, ed. 2014. *Financial Crisis: Causes, Consequences, and Policy Responses*. Washington, DC: International Monetary Fund.

Constâncio, Víctor. 2011. "Challenges to Monetary Policy in 2012." Paper presented at the 26th International Conference on Interest Rates, Frankfurt am Main.

Cour-Thimann, Philippine, and Bernhard Winkler. 2013. "The ECB's Non-Standard Monetary Policy Measures. The Role of Institutional Factors and Financial Structure." European Central Bank Working Paper 1528.

Crotty, James. 2008. "Structural Causes of the Global Financial Crisis: A Critical Assessment of the 'New Financial Architecture'." Political Economy Research Institute Working Paper 180.

Cumming, Christine. 2012. "Managing Crisis without Government Guarantees - How Do We Get there?" *OECD Journal: Financial Markets Trends*, 2011(2): 9-19.

Dadak, Casimir. 2011. "Political Economy of the Euro Area Crisis." *Panoeconomicus*, 58(Special Issue): 593-604.

De Grauwe, Paul. 1989. *International Money. Post-War Trends and Theories*. Oxford: Clarendon Press.

De Grauwe, Paul. 2011. "The European Central Bank: Lender of Last Resort in the Government Bond Markets?" Centre for Economic Studies and Ifo Institute for Economic Research Working Paper 3569.

Dellas, Harris, and George S. Tavlas. 2012. "The Road to Ithaca: The Gold Standard, the Euro and the Origins of the Greek Sovereign Debt Crisis." Bank of Greece Working Paper 149.

Delong, James B., and Lawrence H. Summers. 2012. "Fiscal Policy in a Depressed Economy." *Brookings Papers on Economic Activity*, 44(1): 233-297.

Dombret, Ambreas. 2013. "The European Sovereign Debt Crisis - Past, Present and Future." http://www.bis.org/review/r130827a.pdf.

Draghi, Mario. 2014. "Unemployment in the Euro Area." http://www.forexlive.com/blog/2014/08/22/full-text-of-draghis-speech/.

Eichengreen, Barry, and Peter Temin. 2010. "Fetters of Gold and Paper." *Oxford Review of Economic Policy*, 26(3): 370-384.

Fitoussi, Jean-Paul, and Francesco Saraceno. 2010. "Europe: How Deep Is a Crisis? Policy Responses and Structural Factors behind Diverging Performances." *Journal of Globalization and Development*, 1(1): 1-16.

Guichard, Jean-Paul, and Antoine Brunet. 2009. "Une crise qui n'en finit pas de 'rebondir'." *Panoeconomicus*, 56(1): 127-133.

Guðmundsson, Már. 2011. "The Fault Lines in Cross-Border Banking: Lessons from the Icelandic Case." *OECD Journal: Financial Markets Trends*, 2011(2): 85-93.

Hein, Eckhard, and Achim Truger. 2014. "Fiscal Policy and Rebalancing in the Euro Area: A Critique of the German Debt Brake from a Post-Keynesian Perspective." *Panoeconomicus*, 61(Special Issue): 21-38.

Henning, C. Randall, and Martin Kessler. 2012. *Fiscal Federalism: US History for Architects of Europe's Fiscal Union*. Brussels: Bruegel.

Herndon, Thomas, Michael Ash, and Robert Pollin. 2013. "Does High Public Debt Consistently Stifle Economic Growth? A Critique of Reinhart and Rogoff." Political Economy Research Institute Working Paper 32.

Herr, Hansjörg. 2014. "The European Central Bank and the US Federal Reserve as Lender of Last Resort." *Panoeconomicus*, 61(Special Issue): 59-78.

Johnston, Alison, Bob Hancké, and Suman Pant. 2013. "Comparative Institutional Advantage in the European Sovereign Debt Crisis." London School of Economics and Political Science "Europe in Question" Discussion Paper 66/2013.

Josifidis, Kosta, Alpar Lošonc, and Novica Supić. 2010. "Neoliberalism: Befall or Respite." *Panoeconomicus*, 57(1): 101-117.

Krugman, Paul R. 2012. *End this Depression Now!* New York: W. W. Norton & Company, Inc.

Lane, Philip R. 2012. "The European Sovereign Debt Crisis." *Journal of Economic Perspectives*, 26(3): 49-68.

Meade, James E. 1951. *The Balance of Payments*. Vol. 1, *Theory of International Economic Policy*. Oxford: Oxford University Press.

Mendonça, António. 2006. "A União Europeia face ao processo de globalização: alargamento continental versus abertura atlântica." In *Ensaios de homenagem a António Simões Lopes*, ed. António Romão, 467-484. Lisboa: ISEG/UTL.

Mendonça, António. 2008. "A natureza da crise económica actual." In *Crise 2008,* ed. Horácio Piriquito, 34-38. Lisboa: Bnomics.

Mendonça, António, João Silvestre, and José Passos. 2011. "The Shrinking Endogeneity of Optimum Currency Areas Criteria: Evidence from the European Monetary Union - A Beta Regression Approach." *Economics Letters*, 113(1): 65-69.

Mendonça, António. 2012. "As dimensões da crise económica e financeira atual: a economia global, a Europa e Portugal." In *Portugal, a Europa e a crise económica e financeira internacional*, ed. Joaquim Ramos da Silva, 81-158. Lisboa: Almedina.

Mendonça, António, and José Passos. 2013. "Efeitos das variações dos custos unitários de trabalho no dinamismo económico: um estudo econométrico preliminar para 36 países da OCDE no período 1993-2009." In *Estudos de homenagem a João Ferreira do Amaral*, ed. João C. Lopes, 287-302. Coimbra: Almedina.

Organisation for Economic Co-operation and Development (OECD). 2011. "Financial Crisis Management and the Use of Government Guarantees." *OECD Journal: Financial Market Trends*, 2011(2).

Organisation for Economic Co-operation and Development (OECD). 2012. *Economic Policy Reforms 2012: Going for Growth*. Paris: OECD Publishing.

Palley, Thomas I. 2014. "The Theory of Global Imbalances: Mainstream Economics vs. Structural Keynesianism." Paper presented at the XI International Colloquium Global Crisis and Changes of Paradigms: Current Issues, Brasília.

Radović, Irena. 2009. "Challenges for Monetary Policy in the Enlarged Monetary Union." *Panoeconomicus*, 56(1): 95-110.

Reinhart, Carmen M., and Kenneth S. Rogoff. 2010. "Growth in a Time of Debt." *American Economic Review*: *Papers and Proceedings*, 100(2): 573-578.

Reinhart, Carmen M., and Kenneth S. Rogoff. 2011. "A Decade of Debt." National Bureau of Economic Research Working Paper 16827.

Reinhart, Carmen M., Vincent R. Reinhart, and Kenneth S. Rogoff. 2012. "Public Debt Overhangs: Advanced-Economy Episodes since 1800." *Journal of Economic Perspectives*, 26(3): 69-86.

Reinhart, Carmen M., and Kenneth S. Rogoff. 2014. "Financial and Sovereign Debt Crisis: Some Lessons Learned and those Forgotten." In *Financial Crisis: Causes, Consequences and Policy Responses*, ed. Stijn Claessens, M. Ayhan Kose, Luc Laeven, and Fabian Valencia, 141-156. Washington, DC: International Monetary Fund.

Shambaugh, Jay C. 2012. "The Euro's Three Crises." *Brookings Papers on Economic Activity*, 44(1): 157-231.

Swan, Trevor. 1963. "Long-Run Problems of the Balance of Payments." In *The Australian Economy: A Volume of Readings*, ed. Heinz W. Arndt and Warner M. Corden, 384-395. Melbourn: Cheshire Press.

Teulings, Coen, and Richard Baldwin, ed. 2014. *Secular Stagnation: Facts, Causes and Cures*. London: Centre for Economic Policy Research Press.

Uxó, Jorge, Jesús Paúl, and Eladio Febrero. 2011. "Current Account Imbalances in the Monetary Union and the Great Recession: Causes and Policies." *Panoeconomicus*, 58(Special Issue): 571-592.

Yellen, Janet L. 2014. "Labor Market Dynamics and Monetary Policy." http://www.federalreserve.gov/newsevents/speech/yellen20140822a.htm.

THIS PAGE INTENTIONALLY LEFT BLANK