European Economists for an Alternative Economic Policy in Europe

- EuroMemo Group -

Confronting the Crisis: Austerity or Solidarity

– EuroMemorandum 2010/2011 –

Summary

Economic growth resumed in the EU in the second half of 2009 but output in 2010 was below pre-crisis levels and the financial system remains fragile. Following the financial crisis and the subsequent economic crisis, EU states have been faced with rising fiscal deficits as a result of the cost of rescue packages for the financial sector, expansionary fiscal policies and lost tax revenue. The failure of the EU to respond promptly to Greek difficulties in refinancing its public debt led to speculation against the euro and created a crisis atmosphere in which first Greece and then Spain and Portugal were forced to introduce severe austerity programmes. At the end of the year Ireland, which had introduced a severe austerity programme in 2009, was forced to agree to an even more severe programme in return for financial support from the eurozone's Financial Stability Facility.

The difficulties in peripheral European countries are linked to a growing polarisation in the EU, especially the eurozone. Germany has for over ten years followed a policy of low wage growth and built up a large current account surplus. The peripheral eurozone countries, by contrast, have run up large current account deficits and are being forced to eliminate these deficits through adopting policies of deflation. It will be impossible to increase output and reduce unemployment in the EU without addressing these imbalances. Ultimately, the weakness of the deficit countries will hold back the surplus countries and a continuation of current policies will threaten deflation and risk a breakup of the eurozone.

Unemployment in the EU increased in 2010 although, due to the end of the recession, not as rapidly as in 2009. The situation is also polarised. While unemployment is very high in one group of counties, most notably in Spain and the Baltic countries, there is another group of countries, which includes Germany, Austria and the Netherlands, where unemployment is much lower. Throughout the EU, unemployment is higher among migrant workers, young people and those with lower levels of education. Following the widespread introduction of austerity programmes in 2010, unemployment looks set to rise further.

EU states have been vulnerable to the crisis partly due to the decline in revenues as tax competition has driven down personal and corporate tax rates over the last ten years, with particularly low rates in many Central and Eastern European states. There has also been an increase in the share of indirect taxes in the total tax take, which has a regressive impact on income distribution.

The long-term decline in the share of wages in national income was temporarily reversed in 2009, but only due to the collapse of profits. The dispersion of wages continues to increase nearly everywhere, even the Nordic countries, and is most marked in Britain and the Central and Eastern European countries. This unequal distribution of income has increased the risk of poverty. In total 84 million people in the EU live in poverty; scandalously 19 million are children. At the same time, both the number of wealthy and the value of their wealth have increased, reflecting the increased polarisation within countries.

Europe did nothing to prevent the failure of the Copenhagen conference on climate change at the end of 2009. If global warming is to be kept below 2^{o}C, global emissions must fall from 2011 and by some 90% by 2050. The destruction of biodiversity, which provides a buffer against climate change, must end. A belief in technological fixes has crowded out serious discussion of structural change, while market mechanisms have failed to achieve a significant reduction in emissions. A growing material flow from South to North has been accompanied by biopiracy in the form of intellectual property

rights. The developed countries of the North which are primarily responsible for climate change must honour their climate debt.

Critique of EU policy – Policy in the EU has reverted to a more nationally based approach. The debt crisis was presented as a Greek problem, although banks in Northern Europe were also exposed as a result of large loans to peripheral countries. The EU has introduced financial reforms but these are even weaker than those in the US. There is to be no restriction on banks' proprietary trading, and big financial institutions that operate across Europe will continue to be supervised by national authorities. While banks are once again making large profits, there is no effective mechanism to wind down systematically important institutions that go bankrupt. The so-called *Basel III* proposals rely on increased capital requirements for banks, but this will encourage regulatory arbitrage and make banks more dependent on capital markets.

The *Stability and Growth Pact* is the EU's only instrument for coordinating macroeconomic policy, but it is highly restrictive and is incapable of addressing the current imbalances in Europe. The call to exit from the emergency measures introduced to combat the recession, and return to deficits below 3% of GDP by 2013 is quite arbitrary. The only way forward is a budgetary union with fiscal transfers. Germany is opposed to this and its proposal to make bond holders share in losses led to an immediate increase in interest rates for peripheral countries and deprives weaker states of credit on the same terms as their European partners. By failing to deal with imbalances, Germany is exercising a powerful contractionary influence on the EU, and especially the eurozone, even though it is one of the euro's greatest beneficiaries.

The *European Employment Strategy* focuses on structural unemployment and is therefore incapable of addressing cyclical unemployment. The newest version, set out in *Europe 2020,* aims to increase the employment rate, but it is a step backwards from earlier drafts: it substitutes flexicurity for an active labour market policy, and gender mainstreaming has disappeared. There are 6.6 unemployed workers for each employment vacancy, but the EU does not recognise that it is deficient aggregate demand that is the key cause of unemployment.

Disparities in the EU meant that while some older member states could cut taxes as part of their response to the recession, many Central European Countries had to raise rates. In contrast to the EU's obsession with its target for fiscal deficits, it has completely failed to develop a programme for tax harmonisation. It has said little about the loss of revenue from tax avoidance schemes, tax evasion and the existence of tax havens within Europe. The zeal with which it has pursued excessive public borrowing is in complete contrast with its neglect of large-scale off-shoring by banks and global accountancy firms on behalf of their clients.

The year 2010 is officially designated the *European Year of Combating Poverty and Social Exclusion*. But the EU's new strategy document *Europe 2020* has just a single target for reducing poverty: to cut the number affected by 20 million. But it proposes no policies to achieve this, just a flagship programme which will rely on the so-called 'open method of coordination'.

Europe 2020 is ambiguous on environmental policy. It sets out various strategies but leaves decisions for the future. It stresses the importance of competition but also expresses concern for the environment and the depletion of natural resources. Most seriously, it does not recognise the need for structural changes in the model of unlimited economic growth. The 'greening' of economic policy must be linked to explicit discussions and policy decisions, not left to the play of market forces. The EU has set a target of halting the decline in biodiversity by 2020, but it is not clear that this will priority will be imposed on agricultural and trade policy. The ambitious 7th Environmental Action plan will provide the basis for mainstreaming environmental concerns in all areas of the EU's and member states policy, but progress is currently delayed by the European Commission.

Alternatives: Towards greater solidarity

Finance – The European Central Bank should be subject to greater democratic accountability and shift from its obsession with 2% inflation to focus on employment, the maintenance of purchasing power and the stability of the financial system. The new European Council for Systemic Risk must be equipped with binding powers. Control on banks should be tightened: instead of simply raising capital requirements, as in *Basel III*, banks should be subjected to stringent rules that prevent them from taking excessive risk and externalising risk to the shadow banking sector. Off-balance sheet transactions should be banned. Public sector and cooperative banks should be promoted with at least one major public bank to ensure financing for socially and ecologically desirable projects. Ratings agencies must be brought under public control. There should be a prohibition on bank lending to hedge funds; on off-shore financial centres; and on over-the-counter derivatives. A financial transactions tax should be introduced to curtail harmful speculation and to raise finance for social and ecological transformation.

Macroeconomic Policy – The discredited *Stability and Growth Pact* should be replaced by a commitment to expand macroeconomic demand to promote full employment. In the medium term this will require new institutions. In the short term existing institutions, such as the European Investment Bank and the European Financial Stability Facility can be used to finance EU-wide investment projects. Interest rates for credit-worthy borrowers are even lower than before the crisis, signalling that there is no general crisis in public finance. EU bonds guaranteed by all EU governments would signal a determination to reach a collective solution based on solidarity. Large scale investment projects should also be based on a coordinated use of national budgets and should be led by surplus countries. Transfers are economically necessary for the survival of the monetary union, and socially necessary to ensure social cohesion. The EU should take over and guarantee a percentage of each member states' debt. The public debt incurred in rescuing the financial sector should be recuperated from the private sector through a wealth tax.

Full employment and good work – The large gap between the job vacancies and the number of unemployed indicates that employment policy should focus on creating jobs. These should be what the ILO designates 'good jobs' and should promote ecological sustainability and gender equality. Public investment should create jobs especially for young people, the long-term unemployed and other vulnerable groups. A key component of employment policy is a reduction in working time, and as a first step the maximum working time in Europe should be reduced from 48 to 40 hours a week. The recent initiatives to raise the age of retirement should also be reversed.

Taxation and anti-poverty programmes – Tax rates in Europe should be harmonised to counter disparities. In particular, a minimum rate for personal and corporate tax should be introduced to stop the current downward spiral. Greater fairness should be introduced though making tax rates more progressive, and through taking steps to eliminate the tax avoidance industry. The marginal rate of taxation on higher incomes should be raised and flat rate taxes should be abolished. The top rates of personal and corporate tax should converge and wealth taxes in the EU should be harmonised. Tax haven should be closed and tax arbitrage by corporations should be prevented. An effective anti-poverty programme that targets specific groups (children, women, the elderly, the unemployed) should be implemented, and steps must be taken to counter in-work poverty. Countries with the lowest child poverty are those that have the highest taxes.

Sustainable development – A concerted approach is urgently required by the EU and its member states to reduce the EU's ecological footprint. This could also help to unblock the lack of progress in global negotiations. Action is required to reduce energy consumption, material flows, unnecessary transportation, and the negative international impact of the EU on developing countries. This should be accompanied by a broad pattern of consultation and extensive political participation in order to ensure that it results in a meaningful change in patterns of consumption and life styles. The European Investment Bank and the European Bank for Reconstruction and Development should be drawn on to meet the cost of the necessary investment. Market instrument have shown themselves to be unreliable and wasteful means of achieving ecological change. Instead there is a need for a strong public component in investing in infrastructure, public services, and employment that supports local and regional sustainability. The centrepiece of the policy should be a European Plan for Sustainable Development, which seeks to mainstream economic, social, and environmental sustainability in all areas of policy in the EU and the member states. This should be funded at a European level but outside the current limits on EU spending, and a competent public service should be established to implement its work.

The long version of this is available via email at euromemo@uni-bremen.de.

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Declaration of support

I support the general direction, main arguments and proposals in the

EuroMemorandum 2010/11

Confronting the Crisis: Austerity or Solidarity

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Name: ____

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I would like to be informed about the regular work of the working group and be invited to their meetings.

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