

# Europe In The Economic Crisis: What We Need To Be 'European'

05/02/2013 by Paolo Pini (<http://www.social-europe.eu/author/paolo-pini/>)



([http://www.social-europe.eu/?attachment\\_id=27846](http://www.social-europe.eu/?attachment_id=27846)) For the crisis to end, Europe has to change. As it stands, we have a Europe bogged down by economics and losing its political identity, where growth and employment are stifled by tight budgets. But the single currency can be salvaged. To do so, regulations and economic policies must be reformed and countries (and economies) opened to increased democracy.

## ***1. The supremacy of Economic Europe over Political Europe in the age of the Euro***

The EU was created for increased stability and prosperity and supported by two pillars of political and economic cooperation. Yet, when the economic crisis struck, it was a Europe just about balanced on one pillar: The incomplete and asymmetric pillar of an ***Economic Europe. Political Europe*** was missing. It was supposed to have evolved into the United States of Europe but, realistically, this prospect was foregone when the European Constitution was rejected for an intergovernmental Europe. Even the ratifying of the Treaty of Lisbon in 2007 has done little to combat this.

But the roots of this problem go back further. As the EU expanded eastward and political dissimilarities between nations emerged, the single currency became a tool for harmonisation and convergence of the economies, political unity was something that would be dealt with later. The best hope for a Political Europe became the chance that it would develop as a by-product of the creation of an Economic Europe.

However, the single currency has two necessary conditions to function: similar inflation rates in each country and low fiscal deficits and public debt. Above all, it requires harmonised and

The endogenous effect is the fact that adoption of the single currency did not lead to harmonisation of the economies of the various States in the Union. In fact, the single currency led to, or was utilised for, strengthening the gap between member States. Instead of convergence, there has been a divergence trend in growth rates as well as intra-state trade and finance flows.

Then, in 2008, came the economic crisis, imported at the beginning from the USA and partly endogenous in Europe. The USA saw the creation of a tepid but crucial and quantitatively substantial expansionary fiscal policy, alongside an undoubtedly expansionary monetary policy that led to zero interest rates. In Europe, fiscal rigour was initially loosened up and an accommodative monetary policy was adopted to satisfy demand for money for the banking system. Inflation rates however were kept down, as price stability was the key aim of the ECB. But the anti-crisis measures did not prevent balance deficits or public and private debt from worsening. Moreover, the effects of the crisis were not evenly spread, leaving aggravated debt in weaker countries.

As we know, this led to a situation where, not even having got over the crisis of 2008-2009 and with mild signs of recovery in 2010, European financial markets again plunged into a crisis, followed by the economic crisis and recession of 2011. While in the USA monetary policy was more expansionary and fiscal policy less harsh, in Europe the 2011 crisis was tackled by curbing public expenditure and restricting *welfare* systems in order to reduce the balance deficit and public debt. Harsh austerity measures were taken and the demand for structural reforms was stepped up: especially in the labour market, the goods market (though not excessively) and financial markets (rather little).

## ***2. The responses to the second crisis***

After the (brief) first phase of the crisis during which liberal and neo-liberal economic policies were blamed for their negative effects on growth and employment, it was especially in Europe that pressure on the markets convinced many to go back to old restrictive policies at all costs and reduce the role of the State in sustaining aggregate demand and welfare expenditure.

The response to the crisis in financial markets was a mixture of rigour and liberalism: losses were suffered by all, gains enjoyed by a few individuals. Applied to a financial system undergoing crisis,

of public welfare onto the markets with privatisation of welfare.

The trend has not proceeded in a linear way, nor with the same rigidity as some liberal and neo-liberal experts would wish. This is due to a series of reasons:

Firstly, the most important external reason is that in the USA, the policy of economic austerity and market deregulation, a policy most beneficial to the wealthiest 10%, or even just 1% of the population, is not popular with the electorate. So expansionary monetary measures were adopted instead. However, for fiscal policy, there is conflict between the liberal and non-liberal approach, as illustrated by the *fiscal cliff* saga. And what happens on the other side of the Atlantic translates into demand for less austerity and pressure for expansionary economic policy on this side of the Atlantic.

Secondly, in Europe the policy of austerity has produced serious damage: it stifles income growth and de-stabilises public accounts, as well as producing noisome effects at a political level. Due to enforced austerity measures, weaker countries are paying for the consequences, not only regarding loss in income and employment but also concerning the worsening of their deficit and public debt that they hoped to improve. What is more, there has been a notable slowing down of growth in the whole Euro area, the economic forecast for which is no longer positive. All this contributes to raising doubts as to the choice of austerity at all costs.

Thirdly, in Europe there exist institutions, political and social forces and also sharp economists that have softened the blow, though certainly not enough, of these austerity measures. Steps giving more power to the ECB have been brought in, with monetary operations influencing financial markets and the behaviour of financial and lending institutions.

However, we know that a large part of this liquidity injected by the ECB has gone to the banks (a) to finance themselves cheaply and to purchase public bonds with yields higher than the rate paid by the ECB itself, rather than catering for corporate and private loans needed to boost the real economy, and at the same time (b) to work towards the recapitalisation required by the review of the Basel agreements. There is no let-up in the negative effects brought about by austerity, although there has been relief on financial markets and the spread between state bonds issued in member countries. Economic prospects for the near future remain gloomy, as short-term forecasts

In Europe the policy of austerity has prevailed over that of growth, and a new term seems to become popular: “expansionary austerity”. This policy has been governed by a fundamentally liberal view of Europeanism, as opposed to a view interpreting Europeanism in terms of social market economy, as it was in the pre-Euro age when a stronger and more progressive vision of a Political Europe was on the agenda.

The government of the European Union and particularly its economic policy has followed a conservative way of thinking. Even apart from the political setups in each country, what has emerged in Europe is closer to liberalism than reformism. The dominance of this conservative view has led to rigour in the economic field, the supremacy of the markets over the welfare state now being downsized and partly privatised, the introduction of stricter limits concerning fiscal policy, and above all deregulation of the labour market. Within this view, competitiveness is the winning card to play on foreign markets, as domestic markets are scaled down: competitiveness must be achieved by adopting all possible measures of flexibility in order to increase export capacity.

The fact that this implies limited growth, low and poor-quality employment, and increased inequality, is in a certain sense a side effect, which may be tackled by a minimal *welfare* system and by markets busy replacing *public welfare* with *private* health and pension insurance schemes. Thus the path traced out by modern liberalism is that presented as *true progressivism*, to be distinguished from the “wrong” one of those who aspire to maintaining a public *welfare state* (even though a reformed one) but are accused of conservatism.

It is clear that those who support a vision of Europe based on a social market economy, including the European social democracy movement, will find themselves in an unwelcoming climate; and if they don't go for a facile but ineffective opposition to the introduction of the Euro and reject any populist view, they will only find obstacles and restrictions along their path, as well as the reality of globalisation. In fact, the internationalisation of financial markets and resistance to world-scale (even to European-scale) regulation contribute to the adopting of austerity measures for national states in Europe now that there is a single currency. The context in which growth policies may operate has now changed, narrowing down dramatically.

The debate in Europe is open, and democratic and socialist parties and movements show how another *Way* is possible. Starting with Europe, at least **seven key actions** can be determined, if we

employment.

1) It is necessary to extend the powers of the ECB so that it may operate as an effective Central Bank with the primary task not only of controlling the dynamics of monetary variables influencing interest rate movements but also guaranteeing the strength and solidity of the single currency on international markets, protecting fiscal policies, and guaranteeing their efficacy, from speculation on financial markets. In other words, the ECB must be in a position to operate as “lender of last resort”.

2) At a European level, public investments financed on national budgets must be allowed (even if as an anti-crisis measure), and not limited by a rigid interpretation of the regulations laid down by the *Treaty on stability, coordination and governance in the economic and monetary union* passed in March 2012 (the *Fiscal Compact*) so that fiscal policy may be utilised to combat the crisis and encourage growth.

3) It is necessary to issue the various types of *Eurobonds*. Some of these will finance large-scale European projects leading to quantitative and qualitative growth of economies in Europe, such as those supporting the *digital economy*, the *green economy* and the *economy of knowledge*. Other types of *Eurobonds*, such as the *EuroUnionBonds* must be utilized to stabilize the management of national public debt and create a wide market of European bonds based on real guarantees, as many economists have been suggesting for some time.

4) The European public budget must be increased, as at present it accounts for only 1% of the GDP of all member States contrasting the view that has forced the debate on this issue to be frozen until June 2013 (the *Budget 6*). The raising of the European Commission budget, defying the policy of those who instead want it reduced, would make it possible to finance larger projects not just for the structural re-balancing of the member countries but also for infra-structural projects of a physical and intangible nature.

5) We need to speed up fiscal levelling throughout the Community, as this will enhance homogeneity of fiscal regimes within the Union. The fact that fiscal systems greatly differ clearly encourages the practice of competitive national policies that do not foster cooperation between member States and clearly reduce the efficacy of fiscal, industrial and labour policies.

countries with structural deficits, these countries having to carry out structural reforms of their internal markets, but especially in countries with structural surpluses in their trade balances, to induce them to sustain domestic demand and not entrust growth only to the expansion of foreign markets.

7) We must take actions on the banking system, increasing control over this sector in order to reduce systemic risk by fiscal means (taxing specific financial instruments and transactions) as well as regulatory means (prohibiting specific activities and transactions) relying much less on "risk weighting" instruments and "capitalization" which have proved largely ineffective or even counter-productive (introduced with Basel 2 and Basel 3). The banking system has lost its function as a complement to the real economy, failing to support companies and households, and has become practically self-referential, as the separation between commercial banking and investment banking introduced after the banking crisis at the beginning of the last century was abandoned decades ago. If the loan system is to become part of the real economy, we must re-create that separation in the current new climate.

We believe that each national economic project, must take into consideration the two pillars of Europe, *Political Europe* and *Economic Europe*, and the **seven key actions** outlined above, and face the need to intervene so as to reform the Europe we have now. The United States of Europe remain, and must still remain, the goal for our politics and economics. However, the Europe we have now is unfortunately a Europe in which the single currency, because of the intrinsic errors made at its birth, forces restrictions and rules which must be changed as soon as possible. It is a matter of economic growth, employment performance and social cohesion, and so it is also a matter of democracy.

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### **About Paolo Pini**

Paolo Pini is Professor of Economics at the University of Ferrara and member of the

