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Europe in the economic crisis: what we need to be “European”

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For a way out of the crisis another path is possible, if we still keep the single currency but if we change regulations and economic policies. And introduce more democracy, also in the economy.

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

It is now commonly thought that the economic crisis has hit a Europe which doesn’t stand on two pillars, but barely on one. That is, it stands on the pillar of an Economic Europe, which is incomplete and asymmetrical. The pillar that is missing is a Political Europe, which was supposed to evolve into the United States of Europe. Having replaced the prospect of a Europe of States with an intergovernative Europe is the clearest proof that the plan for Europe has lost impetus, and the non-approval of the European Constitution has contributed towards this, even if the “reform” Treaty of Lisbon was signed in 2007.

But the roots of this problem go back further. Due to the difficulties along the road towards a Political Europe in a period when the European Union was marching forward to expansion in the East, the single currency took on importance as an instrument of harmonisation and convergence of the economies of each nation, aiming to achieve political unity in the end (once the economies had been harmonised). As it was impossible to create a Political Europe by political means, the path towards an Economic Europe was followed in order to create a Political one, as second best.

However, the single currency needs two conditions in order to function: a similar inflation rate in each country, as well as low fiscal deficit and public debt. Above all, it needs harmonised and converging economic systems. Harmonisation and convergence also imply balanced management of the trade balances of each country and of intra-European trade flows.

This trend came into conflict with a consequence, partly endogenous, and an event, partly exogenous. 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 which 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, to a somewhat unequal extent among European member countries. In fact, the crisis has 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 tepid 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 on the labour market, on 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 market functioning regarding 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 non-intervention of the State in sustaining aggregate demand and welfare expenditures.
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, this meant spreading private market losses throughout society and offloading them onto public finance and the community, which has had to pay higher tax. This entails making everyone pay twice, also for the growth in deficit and public debt; with the introduction of austerity measures and reduction of welfare for the sake of rigour, and possibly also the transfer of a share of public welfare onto the markets with privatisation of welfare.

Obviously this trend is not proceeding 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.

First, the most important external reason is that in the USA the policy of economic austerity and market deregulation aimed at guaranteeing even more wealth to 10%, or even just 1% of the population is not so popular with the electorate. So expansionary monetary measures are being adopted, whereas regarding fiscal policy there is conflict between the liberal and non-liberal approach, as has happened concerning the fiscal cliff. 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. Then the economic scenario for the near future remains gloomy, as short-term forecasts by international institutions clearly show.

3. Two visions of Europe and how to tackle the crisis

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 European the 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 want to support the vision of a social and political European market economy. These actions would enable Europe, and therefore Italy rooted as it is in Europe, to once again find the path to growth, full employment and collective welfare. Only within the sphere of these key actions will there be the chance of undertaking specific instrumental policies to achieve growth and 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 as a last resort".

2) At a European level, public investments also as an anti-crisis measure financed on national budgets must be allowed, 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.

6) We must direct initiatives for coordination of economic policies of member States non only towards reducing national debt, the timing of which must be reviewed, but also towards reduction of imbalances in trade flows among member States. These imbalances constitute one of the major causes of tension concerning the single currency. Coordination policies must operate non only in 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 project for national economic policy, no matter how ambitious it may be, 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.

(A previous version of this comment has been published in www.Sbilanciamoci.info [2], an Italian community website on alternative economic policy. The complete version of this article is forthcoming in Economia Politica. Journal of Analytical and Institutional Economics, vol.30, no.1, 2013 http://www.mulino.it/edizioni/riviste/issn/1120-2890#presentazione [3])

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