BEYOND AUSTERITY.
A EUROPEAN RECOVERY POLICY
IS FEASIBLE.

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AIMS AND MEANS OF EUROPEAN ECONOMIC POLICY

Ambitious aims proclaimed

LISBON TREATY: gap
(2007)

Deplorable state of Union's economy

- <u>The REASONS for the failure of the Union's economic policy</u>

  - 1957 Common Market (but only for commodities!)
  - Today: there isn't a single market for services

Each national government maintains its own energy sector and deals directly with foreign suppliers.

- Now: pitiful degree of economic, social and territorial cohesion among member states.

LACK OF SOLIDARIETY!

- **MAASTRICHT TREATY (1992):**

  to set up a Monetary Union *without an Economic Union!*
  (despite the name EMU)

It can't be achieved without a common Government.

2012 European Commission : «A blueprint for a deep and genuine EMU»

- European Fiscal Union

2013 European Council : to reduce EU Budget by 3,5%

REASONS:

- ❖ Each thinks of his/her own national interest
- ❖ EU budget is thought of as a safe, not as an instrument of economic policy

NOBODY proposed increasing the EU budget a little in order to combat the economic downturn.

NEOLIBERALISM, KEYNESIANISM AND THE NATION STATE

- Economic History:

  Neoliberalism: free market

  Keynes: necessity of state intervention in the market

  Economic Theory does not only establish itself in the forefront of thinking through logical consinstency, but also through its ability to explain and lead social forces.

- Civilization is founded on <u>INSTITUTIONS</u> (such as family, the sports Club, Church, Trade Union, State)

  They are the glue that holds human societies together.

- Bretton Woods (1944): its system was based on the prohibition of the free movement of capital internationally; national governments had a certain national margin of manoeuvre for fiscal policy and control over effective demand, output and employment.

- After Bretton Woods system collapsed: the New Dollar Standard (based on floating axchange rates) open the way for an unstoppable world wide movement of capital, the rise of multinationals and the flow of cheap labour towards the most affluent nations:

GLOBALIZATION

The increasing dominance of the *world market* over the nation state, whose power to control the economy has become inadequate.

❖ European integration was originated in the political desire to overcome bloody divisions among national people; to prevent further wars in Europe.

❖ The founding fathers of European Unity sought to build a federal union or, more precisely, a Supranational Federal Union.

THE EUROPEAN UNION: FROM NEGATIVE TO POSITIVE INTEGRATION

European integration was not based on an actual federation but supranational European institutions were given sovereign power in some sectors of the economy.

2 types of integration

- **negative**: removing the barriers between the countries
- **positive**: the core was the project for monetary union

Maastricht Treaty (1992) established the EMU.
It presented two inconsistencies:

- a monetary union would require an increase of the European budget because a coordination at the European level was necessary to provide cohesion and growth;

- the choice to maintain a national fiscal sovereignty, while the monetary policy was entrusted to the ECB.

In 2000 the European Council proposed the **Lisbon Strategy**, based on the idea that European growth was possible to achieve thanks to the COOPERATION between the national governments.

BUT so far the only growth policies implemented within the EMU are the structural reforms (rendering the labour market more flexible, lowering labour costs, curtailing social rights…)!

Therefore, after the crisis it is necessary to consider a

SUPRANATIONAL MACROECONOMIC APPROACH TO EUROPEAN RECOVERY

and it is also important to adopt policies to stimulate supranational effective demand.

CRISIS, DEBT AND AUSTERITY

Government deficits and debts did not cause the financial crisis:

Before 2008 the **deficit/GDP ratio** was generally decreasing, and the **debt/GDP ratio** was on average higher than 60% but it reached the satisfactory level of 59% just before the crisis.

It is interesting to observe the situations of the PIIGS group:
Spain had a government surplus, Ireland had met the Maastricht parameters, Italy was able to cut the deficit/GDP ratio to 1.6% in a few years, while Portugal and Greece had big problems in public finances before the crisis.

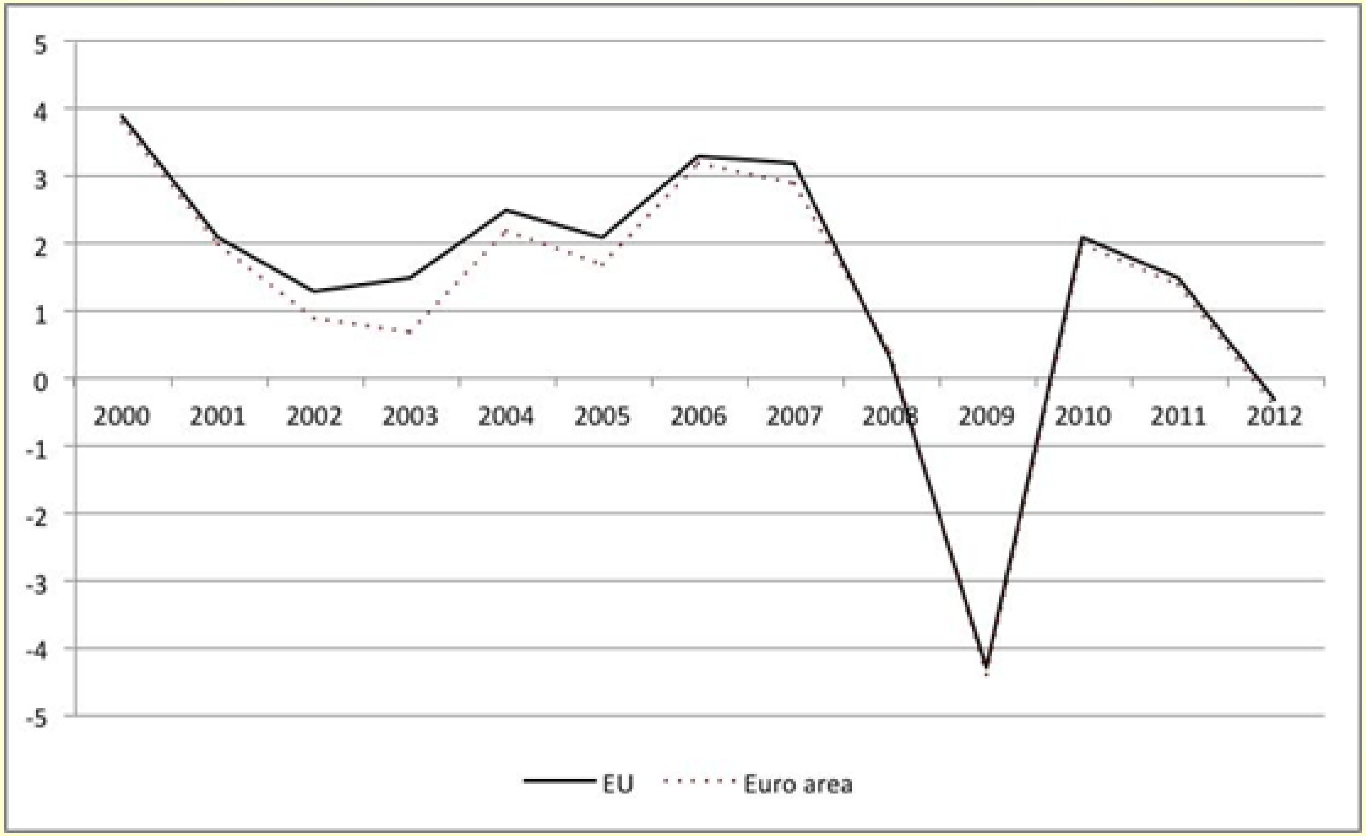
Government deficit/GDP ratios

	2003	2004	2005	2006	2007	2008	2009	2010	2011
EU (27)	-3.2	-2.9	-2.5	-1.5	-0.9	-2.4	-6.9	-6.5	-4.4
Germany	-4.2	-3.8	-3.3	-1.6	0.2	-0.1	-3.1	-4.1	-0.8
France	-4.1	-3.6	-2.9	-2.3	-2.7	-3.3	-7.5	-7.1	-5.2
UK	-3.4	-3.5	-3.4	-2.7	-2.8	-5.1	-11.5	-10.2	-7.8
Italy	-3.6	-3.5	-4.4	-3.4	-1.6	-2.7	-5.4	-4.5	-3.9
Ireland	0.4	1.4	1.7	2.9	0.1	-7.4	-13.9	-30.9	-13.4
Portug.	-3.7	-4	-6.5	-4.6	-3.1	-3.6	-10.2	-9.8	-4.4
Spain	-0.3	-0.1	1.3	2.4	1.9	-4.5	-11.2	-9.7	-9.4
Greece	-5.6	-7.5	-5.2	-5.7	-6.5	-9.8	-15.6	-10.7	-9.4

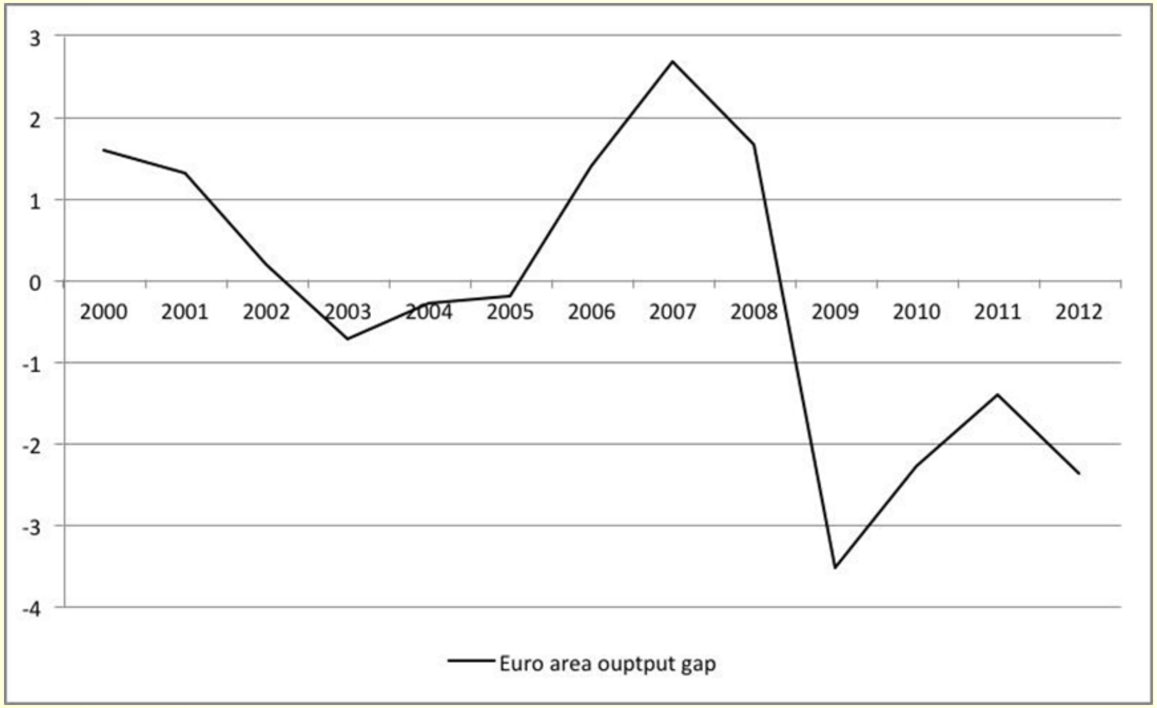
Source: Eurostat

After the crisis the parameters deteriorated: the real GDP growth rates in the European Union and in the euro area fell from 3.2% to -4.3%.

After 2008 the <u>average rate of growth</u> has been negative, while it was positive until 2007. The EU has not been able to recover output loss.



This is clearer if we look at **<u>output gap</u>**, which measures the percentage difference between the potential output and the actual output. It was positive (on average) until 2007, but negative later.



This means that there is <u>demand shortage</u> in the EU economy.

If we consider the individual components, the largest negative contribution to demand is given by investments, followed by private consumption, while exports give a positive contribution to EU aggregate demand.

During the recession, GDP losses make deficit/GDP and debt/GDP rise and also the bailout of the private banking system by Governments worsened these ratios.
(Ex: Ireland, where a private debt and banking crisis became a sovereign debt crisis).

The response by European authorities has been that of "**COUNTRY BY COUNTRY**" fiscal consolidation:
- government budgets must be balanced
- any country exceeding a 60% debt/GDP ratio must reduce it at 5% each year.

↓

These strategy is based on the assumptions that it is not necessary to have supranational economic policies and that the negative impact of restrictive fiscal policy is small, but it is important to consider that fiscal restriction cuts aggregate demand and output!

It is necessary to consider the FISCAL MULTIPLIER!

If it is very small, the long run benefits of balanced governments budgets and low debt should exceed the small run effects of fiscal restriction

If it is greater than 1 (periods of recession), fiscal policy has strong effects on economic activity and GDP

This implies that the adoption of fiscal consolidation plans in countries hit by economic recession can become self defeating:

- recessive stimuli are transmitted from one country to the others;
- investors may judge that an effort to reduce government deficit is unstainable if the impact of policy on GDP is over-recessive

Ex: Greece was having problems before the crisis. When it asked for international help, the response of EU and IMF was to impose severe fiscal policy restrictions but this “austerity recipe” has been a fiasco (recession since 2008).

SUPRANATIONAL AGGREGATE DEMAND

The employment policy of the European Commission has boiled down to nothing more than a set of recommendations to national governments to reform their labour markets.

> <u>Tacit assumption</u>: European aggregate demand lies beyond the power of the commission to change.

Actually: within member states, the power to change aggregate demand is practically zero outside Germany.

❖EU institutions have no power to act and national governments can act only on the supply-side of the economic scoreboard.

> BUT if economy is depressed, it is needed a policy to spur aggregate demand.

2 STUMBLING BLOCKS:

1. **INSTITUTIONAL PROBLEM**: European Commission is not a Government in the ordinary meaning because it has no budgetary power to implement an aggregate demand policy.

   A European institutional reform is necessary for economic and political reasons. «State of Confidence» (Keynes) for example USA Vs EU bussiness man. The capability of the USA Federal Government to react to an international crisis.

2. THE KEYNESIAN MULTIPLIER: whereas in the EU almost all public expenditure is carried out by national governments and only 2% by the EU. <u>So a policy of effective demand based on EU budget is impossible.</u>

BUT European economy is not the arithmetic sum of nationals economies:

$$\sum \text{national economies} + \text{supranational Government}$$

- A European investment plan (amounting to the same total of national expenditures) cannot only provide public EU goods, but can also yield spillovers into national economies.

After investments a crucial part of aggregate demand is **CONSUMPTION**, it is a function of disposable income.

➢The present crisis of EU economy, axacerbated by austerity policies, has caused a serious drop in income and high rates of unemployment and poverty; because of long running trends in income distribution (which has weakened employees’ incomes and consumer demands).

«Business will not invest unless they are confident that there will be demand for whatever it is they produce» (Tilford 2012).

- The burden of taxation has shifted from *capital* to *labour.*
- It is required a new approach to taxation which should become a EU concern.
- The question of long and short term → it is impossible to launch a judicious plan of public and private investment without considering long term horizons.
- Deficit spending: after the sovereign debt crisis, fiscal consolidation is necessary.
- It is necessary and possible to propose policies bringing together the interest not only of capital and labour, but also of public and private finance in order to spur sustainable development within a supranational framework.
- → to allow the EU Commission to raise money in private financial markets in order to finance its «Euro 2020» plan.

AN INVESTMENT POLICY FOR RECOVERY AND SUSTAINABLE DEVELOPMENT

- In the last years European growth has been very slow and this is the effect of the lack of a European federal government, but a recovery plan is possible.

- A European government has to consider the DEPRESSED STATE OF CONFIDENCE of the citizens and the business community. The government must show that the European economy can compete with the other world economies

- The “**Europe 2020” plan** of the EC can be considered a starting point for a recovery policy. It plans 7 INITIATIVES:

  “Innovative Union”
  “Youth on the move”
  “A digital agenda for Europe” “Resource-efficient Europe”
  “An industrial policy”
  “An agenda for new skills and jobs” “A European platform against poverty”

❖ <u>“**Connecting Europe Facilities**” (CEF)</u> is a part of the “Europe 2020” and it sets out policies for investments in transport, energy and telecommunications sectors, because there is a strong relationship between public investment in infrastructures and growth. This project is crucial for European recovery but it is also very expensive (2.72 trillion euro).

- The plan must have a **shock effect** on state of confidence of European public opinion

- It is important also the **crowding-in effect**, which means that public investment may induce private investment

- The recovery plan must include also investment in **research and innovation**

- The bulk of the finance of this plan should come from the European budget, with only a minor share from national contributions.
  Project bonds (private debt issued by the project company) could, <u>in theory</u>, finance CEF investment project, but the EC admitted that it was not the best solutions. Therefore, the programme is now totally sponsored by the EU

⇨ The recovery plan should include also <u>**social initiatives**</u> **to increase employment**, because the citizens will justify the effort of the EU if it produces more jobs in the short run.

MORE SOLIDARITY FOR A SUPRANATIONAL COMMUNITY OF CITIZENS

The Lisbon Treaty and the Charter of Fundamental Rights states the values upon which the EU is based.

The Charter says: *"the Union is founded on the indivisible, universal values of human dignity, freedom, equality and solidarity; it is based on the principles of democracy and the rule of law."*

More solidarity among states and citizens is necessary,

but **Solidarity ≠ transfers of money!**

→ In the EMU, fiscal policies cannot be left to national governments.

If there is not cohesion in the Union, a sovereign debt crisis could jeopardize monetary union.

The <u>DEGREE OF SOLIDARITY</u> within a supranational community of citizens is different from the degree of solidarity within a nation state.

In every country a form of **WELFARE STATE** exists and it guarantees basic services to citizens, such as health, pensions and education for children. Of course, it has a cost, which is covered by national taxation. Its aim is to ensure solidarity among citizens within the same nation, but the same degree of solidarity does not exist among citizens of different European nations.

A common home is necessary because globalization places the survival of the national welfare state in Europe at risk!

Prof. Fiorentini and Prof. Montani suggest <u>two changes</u> in the allocation in the MFF 2014-20:

1. **European globalisation adjustment fund**: its aim is to reintegrate workers into the labour market providing services (assistance in job-searching, careers guidance, tailor-made training..). It adds the solidarity of the EU to the support provided by member states at national level. One problem of this fund is the shortage of financing, but it could be transformed into a European Stabilisation Fund to face emergencies.

2. **Economic, social and territorial cohesion policy**: the proposal is to increase the allocation to €360 billion (instead of 325). "*Cohesion policy*", as EC says, "*is an important expression of solidarity with the poorer and weakest regions of the EU*". The increase is necessary for four reasons:
- the aid for the most deprived should be increased in the wake of the crisis
- the Youth Employment Initiative is likely to be insufficient
- to strengthen territorial cohesion (environmental, cultural and social initiatives)
- the need of a minimum income (it exists in every state of the Union, except Italy and Greece)

➢ <u>**A reform for the creation of a society based on fundamental rights would create more solidarity among European citizens.**</u>

THE EUROPEAN FISCAL GAP AND THE EUROPEAN BUDGET

•In all federal states the bulk of financial revenues is raised by the federal government.

THE OPPOSITE happens in Europe!

•The bulk of financial revenues are raised by national governments

VFI (Vertical Fiscal Imbalance)

→The subordination of EU budget management and budget policies to the will of national governments and the subordination of EU interest to national interests.

«Each government should be accountable to its citizens and that is possible only if the government's budget clearly indicates where the money comes from and how it is spent»

2 KIND OF IMBALANCES ARE POSSIBLE:

1) VFI = if federal government is able to collect more taxes than regional/state governments are responsible for more expenditure than the revenues they can collect.
2) HFI = in a situation of sub-federal government some regions/states might be able to finance their expences from their own resources.

Lesson:

in a multilevel system of public finance some form of vertical transfer from the federal government towards regions/states and some form of horizontal transfer from rich to poor regions/states is unvoidable.

- ✓ <u>COHESION POLICIES ARE NECESSARY ONLY TO ATTAIN A MORE PERFECT UNION.</u>

- → EU should double its budget to provide more public goods and services to the citiziens because too many unproductive and inefficient expenses are located within national budgets.

- → National governments prefer to maintain all fiscal revenues within their jurisdiction.

Authors’ proposal is : a EU recovery policy of 2% of GDP.

CONCLUSIONS: PUBLIC FINANCE AND DEMOCRACY IN EUROPE

•Public finance is one of the pillars of a democratic community.

•European political parties and leaders are concealing from their citizens that year after year global finance wears away the power to tax of nation states (thriving tax havens and decreasing trends in the corporate tax rate are significant index of a reality beyond the reach of national government).

•Merely by assigning the power to tax to the European Federal Government, European citizens could recover some of the money desappearing from national accounts. By postponing the creation of a European government and a federal budget, European parties and leaders are causing the most severe recession in Europe after WWII and imposing unnecessary pain on their citizens.

•The Union will have a federal budget only if the European parties and their leaders are able to convince citizens that some public goods can be provided by federal governemnt at a lower cost than they pay for the same public goods (or the illusion of them) to their national governments.