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Redesigning the Euro area towards a social project

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As shown in detail in the recent e-publication (Herr et al, 2017) linked below[1] all countries in the European Monetary Union (EMU) were severely hit by the Great Recession in 2008 and 2009. The initial recovery was relatively quick, but the Eurozone slid into a double-dip recession in 2012 and 2013. Since then there has been a slow recovery. Germany became one of the best performing countries in terms of GDP growth. Greece, Italy, Portugal and Spain suffered massively from the crisis. Development in France also has been sluggish.

The lost decade for some of the EMU countries was caused by ill-advised policies. More fundamentally, the architecture of the EMU is not adequate to create a stable currency, in spite of some reforms after 2008, such as the steps towards banking union.

After the Great Recession, three polices were particularly damaging.

No lender of last resort

In contrast to normal nation states such as the United States, Great Britain or Japan, the European Central Bank did not take over as a lender of last resort for governments. When, in 2010, the sovereign debt crisis broke out in a number of EMU countries, to a large extent caused by the bail-out of banks, the Bank was not allowed to comprehensively help governments facing financial problems. Financial support came from EMU-member state government funds, especially from the now permanently established European Stability Mechanism. Only limited help was given, and only when the countries followed the requirements of the so called Troika (the European Commission, the International Monetary Fund and the European Central Bank) which dictated the conditions for help. Not until 2012 did Mario Draghi, the Bank's president, announce that the Bank would bail out governments without any limit if they got help from EMU funds and followed the requirements of the Troika. The Bank's commitment proved credible until today. Subsequently, monetary policy by the Bank became very expansionary also, to fight the increasing danger of deflation in the EMU. German representatives at the Bank strictly opposed policies allowing it to become at least a partial lender of last resort in the EMU.

Internal devaluation and neoliberal reforms

The relatively poor GDP growth until 2008 and low nominal wage increases in Germany compared to other EMU countries led to increasing German current account surpluses and high current account deficits in other EMU countries. The Troika was right to care for the competitiveness of current account deficit countries. But it did not in the slightest way push for a symmetric adjustment mechanism. It would have been functional to push current account surplus countries such as Germany towards substantially higher wage increases and fiscal expansion, and deficit countries like Greece, Spain or Portugal towards lower wage increases. Instead, deficit countries alone were pushed into enforcing nominal wage cuts to increase their price competitiveness. Wage cuts were combined with Washington Consensus-style policies, including flexibilisation of labour markets, privatisation and deregulation of public utilities.

The Troika sought to abolish sectoral bargaining, weaken trade unions, freeze or cut minimum wages, reduce social transfers and pensions, erode job protection, allow precarious employment, and so on. Indeed, its policies of bringing down nominal wages in the crisis countries were a kind of war[2] which led to extremely unfair and unjust results. The policy of internal devaluation implies – in addition to social injustice – deep economic contradictions. It is one of the great puzzles of European crisis management that it was not understood that deflationary policies permanently reproduce non-performing loans. It should not be a surprise that financial systems in crisis countries did not start working again and widespread over-indebtedness characterizes their economies. And the European Central Bank's role was in some ways schizophrenic: pushing for wage cuts and deflation in one half of the EMU and at the same time fighting deflation with very expansionary monetary policy.

Fiscal austerity

In 2010, fiscal policy in the EMU changed from an expansionary orientation towards strict austerity. Even current account surplus countries like Germany pushed for hard fiscal discipline. The Troika imposed fiscal austerity on countries dependent on its aid. Other countries, which were afraid to be punished by financial markets, also followed these policies. The outcome of this far-too-premature switch to restrictive fiscal policy was the

[1] Saving the Euro: Redesigning Euro Area Economic Government contains extensive analyses of the situation in the EMU as well as reform options proposed by an international group of experts. It can be downloaded for free-see link in reference.

[2] John Maynard Keynes used the expression 'war' when Britain went back to the Gold Standard in 1925 with an overvalued Pound Sterling, and nominal wages had to decrease to restore competitiveness.

second EMU recession in 2012 to 2013. A crisis can only deepen when shrinking government demand is added on top of shrinking investment and consumption demand when, at the same time, countries cannot easily increase exports (because they cannot devalue and trading partners are also in crisis). The Troika's hope that neoliberal structural reforms might trigger growth in a stagnating or even shrinking economy is built on sand. Even necessary structural reforms will not lead to spontaneous growth but can only have potentially positive effects in the medium and longer term.

If there are no demand drivers, stagnation can theoretically last forever even if required structural reforms are implemented. If investors' expectations are depressed and finance is not available, there will be no tendency for an economy to grow. And, of course, the question is *which* reforms are needed. The Troika interfered in a harsh way in the democratic institutions of countries and enforced reforms which were not accepted by the majority of the population and are certainly not linked positively to growth. In essence, the crisis countries, including those not under Troika control such as Italy, were forced to follow a policy comparable to that of US President Herbert Hoover from 1929 to 1933 and that of Heinrich Brüning, head of the German government from 1930 until 1932 – just before Adolf Hitler came to power. Austerity failed in all these cases.

Economic governance in the Euro Area has been inefficient and, in a sense, undemocratic, as national interests prevail over common interests. German hegemony is neither good for the hegemon nor for the other members, and Germany is not at all a blueprint for the Eurozone. Despite some reforms, the Euro system remains ill-prepared for the next severe economic or financial crisis. It is vital that economic policies **and** architecture established by the Maastricht Treaty of 1991, driven by the then prevailing neoliberal *Zeitgeist*, is reformed far more extensively that the limited measures already taken.

Breaking up the Euro would involve huge economic costs and would merely return us to the problems we had twenty years ago. A break up would, for example, lead to huge financial distortions, because cross-border private and public credit relationships are very extensive. Even a moderate devaluation of countries leaving the Euro Area would lead to an explosion of foreign debt and a huge financial crisis.

The status quo, incorporating the reforms that are underway, falls short of the steps needed to truly save the Euro and make it a success. Reforms are needed in different areas. In contrast to the proposals of Jean-Claude Juncker, the president of the European Commission, who argues for deeper integration of the European Union, the deepening should start with the EMU. Two key institutional elements of such reforms are:

- A strong fiscal centre is needed which can take over active discretionary fiscal policy in the EMU. Proposals of the French president, Emmanuel Macron, to establish a finance ministry at the EMU level go in the right direction. This implies a ministry collecting its own taxes and able to issue EMU bonds. Certain inter-regional transfers in a monetary union are needed as well. The tax system has to become more harmonised and basic social security nets have to be developed on an EMU level. Tax havens have to be closed in Europe.
- Central mechanisms have to be developed to prevent both inadequate and excessive nominal wage developments. For this, information sharing among trade unions and policy makers has to be strengthened, for example through a reformed and more powerful macroeconomic dialogue amongst institutions and social partners. Trade unions should become more active and try to achieve greater wage coordination and solidarity in the EMU. EMU minimum wages could be established - for example at 50% to 60% of a country's median wages - as well as extension mechanisms of sectoral wage bargaining in all EMU countries.

In addition an EMU or, even better, EU long-term infrastructure program is needed which restructures the economies towards a sustainable ecological and social development, and combines this with long-term employment creation. Such a program also can help to develop an EU- or at least EMU-vision for sustainable development including joint industrial policy.

Ultimately, integration towards a political union is needed. Without a democratic common government, adapted to the diversity of nations in Europe, a common currency cannot thrive.

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Reference

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