



A CALL FOR CHANGE

FROM THE CRISIS TO A NEW EGALITARIAN IDEAL FOR EUROPE

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INTRODUCTION



Despite more than fifty years of European integration, today's European Union is still a vulnerable and unfinished construction, which has drifted out of touch with the concerns of its citizens and, even, is increasingly seen as a direct source of those concerns - the number one being mass unemployment.

The EU's political fragility has been made worse by the damage the on-going crisis has inflicted and continues to inflict on its citizens, on its economies and welfare systems, and increasingly, on the quality of its democracies. The lack of both political will and broad public support for further political integration and in favour of cross-country solidarity, together with the ill-conceived economic policy strategies pursued since the outset of the crisis, have raised the possibility of a collapse not only of the Eurozone, but of the entire European Union.

These difficulties are associated with the dysfunctional nature of today's global market system, which produces both great wealth and vast inequality. The EU will not regain strong support unless it embraces, and is seen to embrace, a new and more equal system.

Europe needs to stand for sustainable growth, quality jobs, fairly shared prosperity and an equal opportunity for all children, regardless of nationality, inspired by a new egalitarian ideal. Today, it stands for none of these.

We address this call for change to those who will bear political responsibility across all of the EU's institutions after the forthcoming European elections, and more widely to all of those who can help to promote such change.



FIRST CHANGE:

End this crisis and re-launch sustainable growth and jobs



Years of devastating austerity policies did not limit or shorten the downturn; they made it deeper and longer than it would otherwise have been. How do we know this? Simple: we can compare the rapid stabilisation that happened in the United States, where austerity did not take hold quickly, with the prolonged recession of the Eurozone and the deep depression in the crisis countries.

The IMF, the European Commission and many European governments together imposed mistaken policies based on flawed beliefs and simple-minded ideas. These policies stabilised the European banks, and little else. They made conditions in the crisis countries worse. We note that the research department of the IMF now largely supports this conclusion.

Having failed to protect the citizens of Europe from needless damage, Europe's policymakers have fostered deep mistrust in Europe itself. The obvious consequence is the rise of nationalist, xenophobic and anti-European forces in certain countries. This is the latest development in a sequence of events that may take Europe over the brink of economic, social and political disaster.

European policy makers failed to grasp the full severity of the financial debacle that emerged from the United States in late 2008. They failed to stop the speculative attack against the Eurozone bond markets in 2010. Then in 2011 and 2012, they imposed severe fiscal austerity, deepening the recession in most of Europe and driving some countries into depression.

The policies imposed in the crisis countries have been growth reducing and socially unjust. They include sharp reductions in public investment, unprecedented cuts in wages and pensions, reductions in social expenditures that affected the most vulnerable, and excessive increases in taxation of wage earners, all leading to rising unemployment and the destruction of core social institutions.

Credible analysis by independent economic institutes,¹ and more recently by the European Commission's own economic services,² has shown that a different approach would have avoided the double-dip recession in most countries and the very severe depressions in the crisis countries. Furthermore, it would have led to the same debt to GDP ratios in the longer run.

Specifically, a comprehensive policy involving income stabilisation, a more considered and growth-oriented approach to fiscal consolidation, increased social and infrastructure investment, debt restructuring, and social support would have produced both stronger economic performance and a better debt and financial outlook.

The depressing transformation of the European Union into an "Austerity Union" was driven by at least five factors:

- a. Flaws in the design of the European Economic and Monetary Union, including the lack of a banking union with strong Eurozone institutions and a minimal fiscal backstop.³
- b. Bad advice given by the European Commission to national policymakers over the years.
- c. Spill-over effects from the United States to Europe, and across European countries, notably due to simultaneous fiscal contraction in highly interdependent national economies, which European policymakers have consistently ignored.
- d. A rules-based and largely undemocratic economic policy making process within the EU and the Euro area, with strongly pro-cyclical effects.
- e. A failure to react, as the national social and political repercussions of austerity policies became even more severe.

The results are clear today. Unemployment has exploded, and has hit young people hardest. About one-third of the unemployed are already trapped in long-term unemployment, increasingly suffering from its multiple negative consequences on their livelihoods. Poverty and social exclusion have reached absolutely shocking proportions.⁴ Cohesion and solidarity, once cornerstones of European integration, have vanished from the discourse. Deflation threatens. Debt-to-GDP ratios continue to rise. Falling investment alongside emigration of the skilled will impair productivity growth in many European countries. Inequality is on the rise through a range of channels.⁵

Profound change is needed, from the actual conduct of economic policy to the teaching of economics and public policy in our universities.⁶ Ultimately, this should lead to changes in the structure of European institutions. A misguided approach to economic policy is found not only in Europe, but the crisis in Europe means that it is in Europe that change is most urgently needed.

A new macroeconomic strategy

A new macroeconomic strategy is possible. Such a strategy should have five major elements:

- a) growth-oriented public finances,
- b) a new strategy toward public debt,
- c) resolution of insolvent banks,
- d) a truly active and inclusive employment policy and
- e) a new European programme of social solidarity.

a. A more balanced approach to public finances and sufficient public investment are the two pillars of a growth-oriented fiscal policy.

The EU urgently needs to develop a new growth-oriented approach to public finances. While fiscal responsibility is indispensable among member states, even more so for those in monetary union, the way in which it is exercised must be re-thought. In the short run, a more considered and growth-oriented approach to fiscal consolidation should be permitted on a country-specific basis and national budget policies must be encouraged to provide once more for necessary investments in infrastructures (with particular attention paid to environmentally-friendly infrastructure investments), research, and social investments (that, for example, focus on health, childcare, education, and training). As a first step in this direction, the European Commission should at last start to take due account of government's productive public investment expenditures when conducting surveillance of government finances.⁷ In the longer run, improved EU procedures and rules on the conduct of national budget policies must avoid any pro-cyclical bias, such as the one that has prevailed during this crisis. They will need to provide for a more positive policy environment for social and infrastructure investment as well as for sufficient responsiveness against unexpected economic shocks.

With regard to public infrastructure investment, the EU needs an approximate annual 200 billion euros until 2020 according to independent research and to the European Commission's own estimates. A significant part of this investment is essential to pursue Europe's ecological transformation - including its contribution to the global fight against climate change. This amount covers identified public investment needs in transport, energy efficiency, and renewable energy and network integration. One path is to expand the use of project bonds by leveraging the EU budget. Another path is to further boost the European Investment Bank's (EIB) paid-in capital. An additional increase of 10 billion euros

can finance increased investment for innovation, especially but not only in the countries suffering most from the crisis, as well as target SME financing more forcefully. Alongside the EIB, the European Investment Fund can provide resources to support investment and innovation by business firms in the private sector. Within its mandate, the European Central Bank can support both institutions.

b. Problems in sovereign debt markets must be addressed via new instruments and approaches. While the European Central Bank has contained sovereign bond yields for now, this alone cannot solve the sovereign debt problem, and new steps are now essential. In recent years, several proposals have been worked out, which aim at stabilising the market for public bonds. Important proposals include the Modest Proposal's argument for ECB-bonds, and the recent proposal for Basket-Eurobonds.⁸ The search for a politically viable plan must continue, despite major resistance. In the meantime, the excessive debt burden of the crisis countries must be reduced through timely and effective debt restructuring.

c. Where banks are insolvent, they must be resolved. European banking strategy must break the toxic link between national governments and national banks, and permit EU institutions to resolve failed banks wherever they may be found. The recent agreement on 'banking union' leaves national decision-makers responsible for the resolution of national banks, and that is a formula for problems. An effective banking union or case-by-case process must have a common recapitalisation fund and resolution authority empowered to restructure insolvent banks and return them to competent private hands. The key is to have efficient, workable and apolitical institutions and procedures.

d. A truly active and inclusive employment policy must be deployed across member states. The crisis has put renewed pressure on the social dimension of Europe's labour markets. It is argued that mass unemployment - which most dramatically affects young people and which is increasingly long-term in nature - can only be fought by reducing labour protections and labour costs. This ignores evidence of the positive impact of collective bargaining and good employment conditions on productivity. Positive experiences in certain countries have long demonstrated that labour markets can be both socially sound and economically well-functioning. This experience should not be forgotten during

the crisis, but should become a model across member states. This application of best practice should include the promotion of collective bargaining at all levels, sufficiently high social investment in education, training and re-training, active labour market policies to support the unemployed in re-entering the labour market rapidly and in good conditions, and decent pay.

e. Stabilizing the incomes and social conditions of Europe's most vulnerable populations is a vital economic policy measure. The model of reserving social insurance solely to nation-states in Europe has failed the test of crisis. This model must be changed. We propose, below, to begin by creating a social solidarity fund, to provide food assistance where it is most needed. Further steps along similar lines should follow in due course.

Once a new macroeconomic strategy has started to re-launch the economy and job creation, the EU will need to take a fresh look at its existing rules and institutions in the field of European economic governance. A thorough re-design is unavoidable - making rules less cumbersome, less pro-cyclical and more prone to respond quickly and effectively to economic shocks, and making decision-making processes more democratic. Important improvements are possible within the existing Treaties.



THE SECOND CHANGE: A new egalitarian ideal



Inequality is now a threat to Europe as a whole

Inequality has risen dramatically over three decades. Thanks to a wealth of new research, we now have a much better understanding of the evolution of inequality and of its drivers.⁹ We also know which policies work well, especially where inequality has been held in check, as in parts of Scandinavia, and where it has been reduced successfully in recent years, such as in Brazil and Chile.

Rising inequality has resulted in an explosion of poverty and social exclusion. One European adult out of four is at risk of poverty or social exclusion. That is 125 million people, and the numbers keep rising. Among children, the figure is moving close to one in three, which is both a moral scandal and a tragic waste of human capital. Nearly 30% of Europe's working age adults living in jobless and poor households receive no support from social transfers (nearly 70% in Greece today). Over 40 million people are suffering from food poverty, limited access to health services and associated health inequalities. Europe's shameful poverty is most concentrated in Eastern and in Southern European regions, but there is significant poverty in most other member states.

Inequality has been rising in a number of European countries even more rapidly than in the USA. Since the early 1980s, the share of national income captured by the top 1% has more than doubled in Portugal. Other countries, such as Sweden or the UK, have experienced similar increases in inequality, while in some other countries such as France, rises appear to have been more contained (15%).¹⁰ Wealth distribution is likely to be even more skewed than income distribution.

Recent increases in the concentration of wealth are associated with rent-seeking and predatory behaviour, which depress aggregate demand and undermine social investment. Inequality generates large costs for society in multiple ways (health, crime, social cohesion), while huge concentrations of wealth in a few hands undermines democracy. There is no evidence that reducing today's inequality will reduce a nation's growth performance. On the contrary, current levels of inequality have been shown to generate economic instability and to contribute to the building up of financial bubbles. They make middle and lower earners, experiencing squeezed purchasing power, vulnerable to financial sector strategies which encourage them to accumulate excessive private debt.

It is time to act. Europe's governments need to reduce inequality before it destroys the fabric of our societies.

The EU should declare a new egalitarian ideal. All member states and the EU as a whole will reap political, economic and social benefits from fighting inequality. Pursuing such an ideal credibly and effectively on the ground will strongly help to re-connect Europe with its citizens - and reduce the risk of another financial crash.

Towards a new egalitarian strategy

a. Taxation

Taxation, if properly used, can make a decisive contribution in reducing inequality. EU policy should favour progressive taxation of incomes, stiff taxation of inheritance with a strong philanthropic incentive, and taxation of real property and rents. The current reliance on VAT is excessive, regressive, and should be reduced. A range of additional measures are necessary: implementing the financial transactions tax to curb speculation and raise funds for investment, reinforcing transparency obligations, eliminating tax-evading transfer pricing, closing loopholes in national tax systems, putting an end to tax havens.

b. Wages

Wages. Sustainable gains in competitiveness can and should be achieved through increases in productivity, not reductions in wages and precarious labour conditions. The EU and its member states should favour strong trade unions, collective bargaining, and high minimum wages. In particular, the evidence of the beneficial effects of a high minimum wage is now everywhere very strong.

c. Social Insurance

The EU and its member states should work toward expanding social insurance at the European scale, beginning with food security, and moving on as occasion permits to common unemployment insurance, a European pension union, and a topping-up of low wages along the lines of the Earned Income Tax Credit in the United States.

Europe has the means to guarantee access to nutrition, to health and to basic energy needs for all Europeans. This could at least partly be achieved through an Emergency Social Solidarity Programme.¹¹

d. Regulations

European policies and regulatory means should be mobilised to reduce inequalities, including those in the fields of employment and social rights, a vigorous gender equality agenda and a child equal opportunity programme, as developed in our next section, as well as reinforced action against tax evasion, avoidance and fraud, and equality-enhancing rules in the field of corporate governance.

e. Goals

The EU should set goals for the reduction of inequality within countries and convergence of income levels across EU member states. These should be monitored and pursued within a reviewed 'European semester' process, including national equality reports.¹²

These measures will pave the way towards a proper European Social Union.¹³ Such a social union would support national welfare states on a systemic level in some of their key functions (such as macroeconomic stabilisation) and guide the substantive development of national welfare states - via broad social standards and objectives – adapted to the needs of the hour.



THE THIRD CHANGE: Equal opportunity in practice



The proportion of children in poverty or at risk of poverty across the EU is Europe's darkest reality. Currently, nearly one child in three is at risk of poverty or social exclusion, and in most EU countries one child in five lives in poverty. Several million children are faced with food poverty and associated health inequalities.

Rising income inequality and, more recently, the impact of the crisis on public spending in education, health and social programmes, has made the lives of millions of children very difficult. Life chances are more unequal today than at any time in the last thirty years, and this inequality is on the rise. When children from disadvantaged families have good access to quality childcare and education – and to food while at school – equal opportunity becomes a realistic goal.

Recent research indicates that richer parents spend an increasing amount of money on their children, while the trend is stagnant in poorer families. In the USA, this has already reached a proportion of 1 to 7. This spending relates primarily to the quality of childcare, of schools and of health care.

Poor children now suffer from a double sentence, as they have become exposed to reductions in both public and family spending, while richer parents are able to shield their children from lower public spending.

The fight for equal opportunity among children and against child poverty, including food poverty, is a fight against a profound injustice.

A European Child Equal Opportunity Programme

should tackle child poverty and re-build equal opportunity for children in all European states. Social investment in children should be brought immediately back to its pre-crisis levels, including in the crisis countries. To this effect, member states should be provided with explicit and dedicated fiscal assistance, under strict surveillance to prevent diversion of funds to other purposes. The effectiveness of targeted social investment and of supporting policies in increasing equal opportunity and upward social mobility should be measured on a regular basis. Quantitative targets should be established country by country on that basis. Developing early-age and high quality childcare coverage with focuses on children at risk should be a central feature of such a programme across the EU. This would both strengthen the development of children's human capital regardless of their social background, and it would specifically help single mothers to be able to work, thereby reducing family poverty.

Last, but not least, improving employment prospects and pay for women as well as men is an important plank in a policy to prevent child poverty, because one-earner families are at much higher risks of poverty.



The crisis has hit Europe's society hard and has revealed the weaknesses of its current political architecture; it has also been met by some of the most conservative and ineffective policy responses in decades.

We believe that there is a way forward, provided that the shortcomings of the current system, and the policy errors made, are honestly and properly identified and overcome. This could provide the opportunity for a new approach capable of building a more egalitarian, prosperous, ecologically responsible and stable European society. Such a model would, in turn, influence how the world as a whole will evolve in the decades to come.

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Notes

- ¹ Independent Annual Growth Survey 2014 (iAGS), November 2013, ECLM, IMK and OFCE.
- ² In't Veld J. Fiscal consolidations and spillovers in the Euro area periphery and core, October 2013, Economic Papers 506, European Commission.
- ³ INET Council on the Eurozone crisis: Breaking the deadlock: a path out of the crisis, June 2012.
- ⁴ Eurostat data indicates that, at the end of 2012, nearly 3 million more people were exposed to the risk of poverty as compared to 2008 in the adjustment countries Greece, Ireland, Portugal and Spain.
- ⁵ This is the case to varying degrees in different countries as a consequence of higher unemployment, of lower wages and pensions, of higher taxes and of lower spending on public services, including education and social services.
- ⁶ It has often been said that after the crisis economic textbooks have to be rewritten. However, as surveys show, standard modelling which presents the economy as an inherently stable system, which is only destabilized by wage rigidities and policy shocks continue to be widely used. Economic science should not continue to teach concepts, which neglect the inherent instability of the economy. This contributed to the widespread belief among economists in the years preceding the crisis that major macroeconomic fluctuations were a problem of the past and that due to an intelligent macroeconomic management the world economy had entered the blissful state of the "Great Moderation". Changing the textbook models is relatively easy, as existing flaws and inconsistencies are by now well identified and can be removed. The reinterpretation of the basic model would allow to formalise the inherent instability of the economic system and to open completely new perspectives for a sounder public debate on economic policy. Economic students have a right to demand teaching, which takes proper account of the complexities and realities of the world outside the classroom.
- ⁷ The European Commission already committed itself to this approach when the two-pack legislation was agreed (Letter by Commission Vice-President Olli Rehn).
- ⁸ Bofinger P. With Basket-Eurobonds the ECB could act like the FED, November 2013, Journal for a Progressive Economy.
- ⁹ The special March 2014 edition of the Journal for a Progressive Economy focuses on inequality and contains a selection of academic contributions on inequality from different perspectives (www.progressiveeconomy.eu). Several recent books provide ground-breaking analysis and commentary on developments in inequality and how to address them, including by Stiglitz J. (The price of inequality) and by Piketty T. (Capital in the 21st century).
- ¹⁰ Salverda W. Can income redistribution help changing rising inequality? March 2014, Journal for a Progressive Economy. Smeeding T., Morelli S. and Thompson J. Recent trends in income inequality in the developed countries, March 2014, Journal for a Progressive Economy.
- ¹¹ Varoufakis Y., Holland S., and Galbraith J.K. A Modest Proposal for resolving the Eurozone crisis, Version 4.0, July 2013.
- ¹² An overall inequality target could be based on Palma's ratio of the income share of the top 10% of a population to the bottom 40% . A potential target could be to halve national Palma ratios by 2030, compared to 2010. In addition, disaggregated indicators and targets in other goals should be defined to ensure equitable progress (for instance on the gender pay gap or on child poverty rates) across different social groups.
- ¹³ For a development of the concept of a European Social Union, notably refer to: Vandenbroucke F. European Social Union - a political necessity and an urgent research programme, November 2013, Journal for a Progressive Economy.



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