The EU at the Crossroads

The multiple crises of the EU and perspectives of emancipatory solutions

Peter Wahl, December 2011

SUMMARY

The EU as a unique project of supra-national integration is in an existential crisis. It is not only a crisis of sovereign debt, although this problem is the most spectacular at the moment. Behind the debt crisis, and closely interconnected with it, are problems such as a financial system that has run out of control, but is still dominating the real economy and society. Even when in turmoil, financial markets and their satellites such as rating agencies still have an overwhelming influence on policy-making and crisis management. The main reason why the Euro zone is being targeted permanently by speculative attacks is the lack of a lender of last resort, as the ECB is prevented by statute from playing this role, and internal heterogeneity leading to over-complex decision-making.

Less visible but just as important as the financial system are underlying factors of the crisis, such as dramatic imbalances in trade and current accounts inside the EU as well as sharpening social asymmetries. The financial crisis also has a dimension related to distribution. For a decade, the main surplus country, Germany, has had stagnant labour unit costs and is hence improving its competitiveness at the cost both of German working people and the deficit countries.

The crisis management reveals that neither the supra-national structures nor the intergovernmental cooperation have been able to adequately deal with the situation by now. One hectic summit after another is held, while the situation worsens continuously. At the same time, the democratic deficit of the EU, which was already a problem before the crisis, is increasing as fast as Greece's budget deficit.

After the December summit 2011, when the contradictions between the UK and the continent openly surfaced, the entire process of future integration was put into question.

This paper analyses the different dimension of the crisis and their interaction and suggests key proposals for emancipatory alternatives.

Content

Imprint

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Publisher: Weltwirtschaft, Ökologie & Entwicklung, WEED e.V., Eldenaer Str. 60, 10247 Berlin

Note: This publication has been financed with the support of the European Commission and the Ford Foundation. The views expressed are those of the author, and cannot be attributed to the EU Commission or the Ford Foundation.

FORDFOUNDATION www.weed-online.org

1. The future of European integration at stake

The EU is a unique phenomenon in history. It is different from other types of major integration processes like nation building, alliances of nation states or empires. It is the attempt to establish supra-national governance of (currently) 27 nation states, which continue to exist as such. At the same time, there is an ongoing transfer of sovereignty to the supra-national level. As there is, unlike in an empire (and often in emerging nation states), no formally leading dominant force, the integration is a complex process of consensus building among relatively equal actors.

Of course, there are also considerable asymmetries in terms of power, but among the group of larger countries[1] none had reached the critical mass as a clearly dominant power – at least until before the crisis.

By now, both the supra-national structures as well as intergovernmental cooperation between the member states has proved to be insufficient to deal adequately with the crisis. And it is uncertain whether they will be able to cope with it in the future. Thus the very existence of the experiment is being put into question.

1.1. More than a common market

From its very beginning in 1951, European integration was a political-strategic project, which used economic instruments for its purposes - until 1990 mainly a free market zone. It is important to keep the politico-strategic dimension and its interconnectedness with economic factors in mind if one wants to understand the present situation.

Under the impact of World War II, the first purpose of integration was to stabilise peace on the continent. However, this was not a pacifist undertaking, but followed the rationale of traditional geopolitical power politics: Germany was to be domesticated through political cooperation and economic integration. The winners of the war thus drew consequences from the failed strategy after World War I, which had aimed at weakening and humiliating Germany. With the emergence of the Cold War it was, in addition, useful to make West Germany a part of the Western block.

The new strategy matched very well with the interests of German elites, who had been completely discredited by the Nazi regime. European integration was the only way for the country to be accepted as part of the international community. Therefore Germany accepted restrictions on its sovereignty. Since then, European integration has been a pillar of the German raison d'état.

This approach worked relatively well until the nineties. Outside Europe, the Union was seen as a major player in the international arena.

1.2. The neo-liberal turn

Since 1990 the situation has changed substantially: the Cold War ended, Germany was unified and received full sovereignty.

At the same time, the EU made a qualitative step forward in the integration process by establishing a single market and, ten years later, a single currency. However, the speed of integration was so high that some ten countries wanted or could not join the euro zone.

As a side effect, disintegrating effects were also created, such as the contradictions between the Euro zone and non-Euro zone, between old member states which were more homogenous among themselves and new member states, between bigger and smaller countries. While in some areas competences were transferred to the supra-national level, others remained under national control. A typical example is the contradiction between competition policies and taxation. Whereas the EU was literally obsessed in creating a level playing field, many useful nation regulations in the financial sector had to be abolished. At the same time, taxation was national, which allowed for regulatory arbitrage. Harmonisation at the one end created new contradictions on the other, or, as it is called in EU jargon, a *Europe of different speeds*.

In parallel, a shift in the socio-economic paradigm had taken place. While Western Europe had been famous for its model of relatively fair relations between capital and labour, for prosperity and welfare state ("*Rhenish capitalism")* in the post-war era, the EU now turned increasingly towards neo-liberalism. With the Maastricht treaty liberalisation, privatisation, deregulation and competition between member countries became the main concern of supra-national governance. Harmonisation came as a race to the bottom. Social concerns and labour interests took a back seat. Consequently, the arch evils of a deregulated capitalism returned: mass unemployment, social polarisation, erosion of social security, precarisation and poverty.

1.3. The Euro and the dream of the super power

The establishment of the Euro accelerated these trends. Countries lost the sovereignty over two strategic prices: the exchange rate and the interest rate. Thus they lost the capability to use these prices to absorb economic shocks and to support adjustment.

This would have been no problem if the single currency had been accompanied by further political

[1] France, Germany, UK, Italy, Spain, Poland

integration and the establishment of common wage policies, social security systems, etc. The logic of the single currency would have required further steps towards what could be called the *United States of Europe*. But this did not happen. Consequently, even before the crisis, asymmetries deepened, imbalances accumulated (see chapter 3) and contributed to the depth of the crisis.

Along with the single market and the Euro, hopes among elites emerged that the EU would be on its way towards a global superpower. The Euro would become a strong currency, which would even be able to challenge the US Dollar as a global lead currency. Master plans and road maps were prepared, like the so-called *Lisbon Strategy*, with which the EU wanted to become "*the most competitive*" region in the world by 2010.

With the reconfiguration of the international system, the rise of China, India, Brazil and other emerging countries and a relative weakening of the US, the aspiration of the EU to play the game of the big global powers became an additional motivation.

A further motive came from member countries that had been big powers in the past, such as the *British Empire, la Grande Nation* or the *Reich.* They are too weak as a single nation to play the role of a major power in the 21st century. Hence, they are attempting a second-best solution, and the EU is considered to be the vehicle that could enable them to be on equal footing with China and the US.

However, the Lisbon Strategy failed even before the crisis began. The crisis itself revealed the particular vulnerability of the EU and the Euro zone. And finally, the crisis management disclosed that the capacity of supra-national structures to deal with extraordinary challenges is more limited than expected. As a kind of *emergency brake,* the Euro zone adhered to traditional instruments of inter-governmental cooperation. Immediately the informal hierarchies came through. First the axis Berlin-Paris emerged, which soon proved to also be burdened with conflicts of interests. But when France came under pressure from the rating agencies, Sarkozy chose the option "*if you can't beat them, join them!"*

Today the standing of the EU in the international arena is heavily tarnished. Actually, the issue is not how to become a superpower, but how to survive, and to at least maintain the chance of not being relegated to the second league in the future.

2. The crisis of public finance

Almost all industrialised countries have to bear a huge burden of public debt. The absolute frontrunner is Japan with 233% debt to GDP ratio. Greece is only second with 160%, followed by Italy (120%) and the US (100%). France (84%), Germany (82%) and the UK (80%) are in the "middle class." The average EU ratio is 87%.[2]

2.1. The root causes of public debt

The EU summit in December 2011 assumed – voluntarily or not – the German[3] interpretation of the causes for the debt crisis: according to that view, public debt has been caused by a lack of budgetary discipline; governments have spent money they did not have, in particular for social benefactions. As a consequence of such a diagnosis, the therapy is clear: budget discipline has to be imposed and austerity measures have to be implemented, cuts in public expenditure have to be made. They aim first and foremost at wages and social expenditure, such as pensions, health care support for the unemployed and the poor. The distribution of the burden is unequal and hits the weaker strata more heavily than the rich, banks and business.

The German interpretation of the causes of public debt is inspired by the general neo-liberal view on the issue. But this perspective ignores the dimensions of reality:

a. the public debt jumped dramatically after governments had bailed out banks. According to official EU sources, 2.3 trillion Euro (= 19,5% of the EU-27 GDP in 2009) were spent in the EU to rescue the financial sector;[4]

b. the stimulus programmes applied in order to mitigate the consequences caused a second and considerable increase in public expenditure.

All in all, these measures caused an increase in public expenditures of 0.9% of the GDP in 2007 to 6.4% in 2010. Public debt jumped from below 60% of the GDP in 2007 to above 80%.[5] In other words, without the financial crisis the public debt would be approx. one third less and for most EU countries in a sustainable range.

Furthermore, the focus on budgetary discipline ignores the structural roots of the debt, which existed before the financial crisis; in particular the imbalances between deficit and surplus countries inside the EU (see chapter 3).

All this does not exclude the fact that in some countries specific problems exist, such as an ill-functioning tax system (Greece), which allows wealthy people to avoid taxes. More than 40 bn. Euro have been transferred from Greece to Switzerland and other fiscal paradises. Inflated administrations, clientelism and corruption are also

[2] Sources: Bloomberg, IMF

[3] And in their wind shadow some others like the Netherlands, Finland and Austria.

[4] http://eur- lex.europa.eu/LexUriServ/LexUriServ.do?uri=SEC:2010:1462:FIN:EN:PDF

[5] European Commission, 2011 Spring Economic Forecast

problems in some countries. However, this is not a general phenomenon and comes as an addition to the problems described above.

Finally, long-term trends also play a role, like a general shift in taxation to indirect taxes and the erosion of the principle of progressive taxation; and partly linked to this, an increasing dependency of public finance on financial markets.

2.2. The receipts of the Scottish housewife

The EU's answer to the debt problem follows the logic of a Scottish housewife. If she has debts she can reduce them by cutting expenditure, while her income remains the same. Public finance, however, does not work like a household. The state can influence its income by increasing taxes or spend money for investment during a crisis (deficit spending), and this will stimulate growth and in return generate higher tax revenues.

Nevertheless, under the title *fiscal rule,* the receipt of the Scottish housewife will now be implemented in the EU.[6] In the German debate, this rule is called the "debt brake". It is the core element of a fiscal union, which will transfer fiscal policies to a large extent to the supra-national level.

Already the Maastricht Treaty had already foreseen upper limits for public debt. But violating the rules will now be sanctioned de facto automatically. Member states are obliged to quasi permanently report to the Commission and allow it to intervene when it deems it to be necessary. In cases of conflict, the European Court will be allowed to sentence. All in all a substantial loss of sovereignty.

Sanctions can go up to 0.5% of the GDP. In the case of Germany, with a GDP of 3.37 trillion USD, this would be 168 bn. USD. For France it could be 133 bn.

2.3. The fiscal union will not solve the debt crisis

The first effect of the fiscal rule will be to shrink demand. The cuts in state expenditure will trigger contraction and growth rates will sink. Already at the end of 2011, all indicators point to a downturn in Europe with an upcoming recession.

As there will be a general downturn in the world economy in 2012, the global economic environment will aggravate the situation.

Under these circumstances, the fiscal union will not solve the debt problem, but worsen it. Greece has already experienced the results of the procedure. The first support package from the spring of 2010 was accompanied with such strict austerity measures that the country sank even deeper into recession. If all EU countries cut expenditures, the effect is procyclical. Demand will go down, nobody will buy from the others and all might end in a deflationist spiral. And this time, even China will not save the world economy, as its growth rates are shrinking too

All this will not only create to problems in the EU but would have negative impacts on the entire world economy.

2.4. Why is the Euro target of speculative attacks?

Why are Japan, the US and the UK not threatened by unsustainable interest rates for their bonds? The US has even been downgraded by the rating agencies, but there was no effect on the US treasury bonds. Of course, there are important issues in the structure of debts. Japan, for instance, has as main creditors Japanese households and hence the lion's share of its debt in its own currency. But there is one thing common to all of them: They all have a central bank, which can do what central banks have been invented for, i.e. to intervene in times of crisis and to provide unlimited credit as the *lender of last resort* in order to prevent bankruptcy of public finance. It is like a fire brigade that puts out the fire when a house is burning. The US Federal Reserve Bank plays this role; as does the Japanese central bank and its UK counterpart.

The European Central Bank (ECB), however, is the unique case of a fire brigade that is only allowed to prevent inundation but not to extinguish fire. According to its statutes, the ECB's role is the prevention of inflation. Financing governments is not allowed. Under the pressure of the crisis, the majority in the ECB uses a trick in order to provide at least indirect relief by buying bonds on the secondary market. The German representative, Axel Weber, and the former chief economist of the ECB, Jürgen Starke, have therefore resigned from their posts under protest.

It is not surprising that under these circumstances the pyromaniacs on the financial market continue to make speculative attacks against countries under stress. The Euro zone is the weakest and most vulnerable link and as long as its position is not strengthened by giving the ECB the right to serve as the lender of last resort, the situation will not change.

3. Imbalances – a root cause of indebtedness

Between 2000 and 2010, Germany accumulated a net balance of payments surplus of 1.02 trillion Euro. This is an increase of 41%. At the same

[6] With the formal exception of the UK. But independently from the EU, the UK is implementing already a strict austerity programme.

time, Portugal accumulated a deficit of 168 bn. Euro (+98%), Greece 209 bn. (+91%), Spain 615 bn. (58%) and Ireland 41 bn. (+26%). The Netherlands and Austria also have surpluses, although to a lesser extent than Germany.

Having a balance of payment deficit means at the same time, having debts. If a country's own exports are not enough to pay for the imports, they must be financed through credit. If this situation continues over years, the debt burden becomes unsustainable. This is not the only, but one of the major causes of debt in crisis countries. On the other side, the surplus country (or its banks) becomes a creditor. If this imbalance is not stopped, it inevitably ends in the bankruptcy of the debtor.

This is why Keynes already proposed after World War II to regulate such imbalances (the so-called *clearing union*). The responsibility to avoid imbalances is not only the duty of the deficit country. The surplus country has to contribute by reducing its surplus as well. This is even more the case in an economic community like the EU and under the roof of a common currency.

Theoretically, the problem has been acknowledged. In the framework of the new economic governance – a set of proposals for closer economic cooperation (the so-called "six pack") – the imbalances have also been identified as a problem.

But the practical measures are very soft and do not really imply a change of policies. Germany and the other surplus countries argue that their surplus is the result of high quality, advanced technologies, qualified labour and so on. However, while differences in productivity, technology and qualification of labour have not changed significantly between the surplus and the deficit countries in the last decade, the reasons for the increase, rsp. loss, in competitiveness must be found somewhere else.

And in fact, there is another factor where the parity has changed substantially: the unit labour costs.[7] The unit labour costs are an important indicator of the competitiveness of an economy. Among the 19 biggest EU economies,[8] Germany's unit labour costs increased only by 1.7% p.a. between 2000 and 2010, which is the lowest rate of the nineteen countries. Portugal had an annual increase of 2.9%, Italy 3.2%, Greece 3.4%, Spain 4.1% and Ireland 4.4%.[9] If such rates persist throughout an entire decade, a considerable gap in competitiveness emerges, should there be no compensation in other areas. The fiscal union does not change anything.

The price for the increase in German competitiveness has also been paid by German workers. Their real wages have been stagnating more or less during the last ten years and social services, which had previously been partly paid for by employers, have been reduced, abolished or privatised. At the same time, the strength of German trade unions has been restricted by labour laws. All this was part of a series of "reforms" (the so-called *Agenda 2010*) implemented by the Schröder government.

4. Financial reforms

Since the nineties, the EU has been liberalising and deregulating finance. In the name of *harmonisation* inside the Union and for the sake of competiveness on the global markets, the British type of *laissez faire* became standard. The Commission functioned like a service provider for the City of London and those on the continent who followed it suit.

After Lehman there were many statements made by politicians saying that business as usual in the finance sector would not be possible any more. In particular the Pittsburgh summit of the G20 made many proposals that went in the right direction. The EU took several of them on its agenda.

Some of the reforms have been adopted, such as a directive for a new architecture of EU supervision and the regulation of hedge funds, private equity funds and other shadow banks. Others are currently in the legislative process, such as regulation of capital requirements, of derivatives and rating agencies or a directive on a financial transaction tax (FTT). Still others have only been announced, such as a directive on the orderly insolvency of banks.

All these reform projects address important issues and the efforts of the EU to regulate finance are not for nothing. Thus it would be too simplistic to speak of business as usual. It is obvious that the crisis has had some effects on the elites. Nevertheless, the regulations have considerable deficits:

- they do not go far enough and are paper tigers from the beginning, such as the regulation of supervision, which still leaves too much space to national regulation and thus to regulatory arbitrage;
- they are watered down, as was the case for the regulation of hedge funds by the finance industry lobby and by some member states;
- they come too late, as is the case for the regulation of rating agencies and of derivatives, or the final implementation is only foreseen very late, as is the case of capital requirements, which have to be met only

[7] The share of total labour costs (incl. wages, taxes, social security etc.) in the production of a certain product. For instance the labour costs for the production of a car.

[8] Excluding Malta, Cyprus, the Baltic states Bulgaria, Romania and Slovakia.

[9] IMK Report N° 68, December 2011, Düsseldorf. www.imk-boeckler.de

in 2018. In the meantime, some new financial crises may arise;

- some important issues have not yet been addressed at all, for instance the separation or ring-fencing of investment banking and commercial banking.

All in all, the complexity of EU decision-making processes and the heterogeneity of interests made it impossible by no to implement an efficient regulation. The EU is now in the position of the sorcerer's apprentice: *"Master! I have need of thee! From the spirits that I called Sir, deliver me!"* Financial markets still have the power and possibility to speculate against EU countries and blackmail governments. For instance, as *credit default swaps* (CDS) are still not banned, they can be used as tools for speculation. Together with the rating agencies, speculators use CDS to stage the ping-pong of downgrading creditworthiness and against sovereign bonds.

The basic weakness of nearly all these reforms, however, is their reduction to stability. Of course, financial stability is for the public good and deserves to be supported. But stability is not enough. The issue is not to make the casino safer, but to close it down.

5. Crisis of democracy and legitimacy

Even the boldest defenders of the EU admit that there is a democratic deficit in the supra-national system. While the member states have fully developed democratic systems, the Brussels institutions do not meet the standards of a fully-fledged democratic system. This is not a leftist opinion, but among others part of an official sentence of the German Supreme Court.

The basic problem is that the transfer of sovereignty from the national level to the supra-national has not been accompanied by an equivalent democratisation of the European institutions. The Commission, as the gathering of governments, has received the most far-reaching rights, whereas the European Parliament has limited competences. For instance, it doesn't have the right to initiate law making. In most decisions, the Parliament must only be consulted by the Commission, but it has nothing to decide.

And as there is nothing like a European public – most people still live their daily lives in their national culture – it is very difficult and expensive to organise a popular counterweight from below. In spite of some progress in organising among European trade unions and NGOs, an integrated European civil society does not really exist yet.

As the corporate sector disposes of the financial resources to address the many practical challenges of international cooperation, it is also the most advanced in organising at the European level. This is why the influence of corporate lobbies in Brussels is even stronger than at the national level, as there is no counter-veiling power, or only a weak one. This is an additional factor contributing to the democratic deficit of the EU.

As a result, the acceptance of the EU among citizens is falling in all member states. Confidence in the European institutions is constantly eroding. As a side effect, nationalist and right populist trends in many European countries are growing.

5.1. Size and complexity matter

When the EU was created, the first six members were not a homogenous group, but the heterogeneity was still limited. With the entrance of the UK and the enlargement first to the Mediterranean, and later to the Nordic countries, and after the end of the Cold War to Eastern Europe, the EU now consists of 27 member states. The enlargement strategy is also part of the geopolitical ambition of the EU to become a superpower.

However, under the conditions of such an enormous heterogeneity, governance structures and decision-making have become too complex and extremely slow. There are so many differences in economic development, political systems and cultures to be coordinated that the supra-national system is clearly unable to cope with it adequately. This is why more and more situations of blockades are occurring.

5.2. The crisis as a catalyst for authoritarian rule

While complexity is already a problem in normal times, under conditions of extraordinary crises and when the time factor plays a decisive role even the modest democratic standards of the European institutions can be overrun by informal agreements. An informal hierarchy has been established with Germany and France on top, and practices of authoritarian rule are emerging. This is particularly true for the Euro zone. The other countries and the top personnel of the EU institutions are not informed of decisions, but then have to applaud them. The same is true for the democratic institutions at the national level. National parliaments are no longer able to control their governments and the division of powers is eroding.

In the case of Greece the IMF, the EU Commission and the European Central Bank have already taken control of the budget. The implementation of the fiscal union will accelerate the erosion of democracy. National parliaments will lose control over the budget, one of the noblest among their rights.

6. Which future for the EU?

If the EU wants to have a future, it is time for substantial changes. The neo-liberal course and ambitions to become a superpower have failed.

6.1 Emergency measures

As a first step, emergency measures should be taken in order to end the pressure on the crisis countries and to stop speculative attacks. An emergency package would have to have the following elements:

a. the ECB has to take over the role of *lender of last resort;*

b. *Credit default swaps* and similar products, which are used for speculative attacks should be banned immediately;

c. downgrades of sovereign debtors by the rating agencies should be banned until the crisis is over;

d. strong progressive tax increases on high incomes, wealth and property, going up (as in Roosevelt's New Deal) to 90% for top incomes and billionaires;

6.2 Control over financial markets

Politics have to regain control over the financial markets. Therefore, a fast-track package of reforms has to be implemented, which follows the rationale of downsizing the financial sector and reducing its complexity and interconnectedness:

a. separation of investment and commercial banking;

b. rising capital requirements for all institutions in the investment sector to 15%, for systemically important financial institutions which are too big to fail to 20% and strict limits for leverage;

c. ending all forms of shadow banking including *over the counter trade*;

d. obligatory and independent impact assessment for all new products;

e. neutralizing fiscal paradises;

f. banning of credit certification and of highly speculative products;

g. implementing a financial transaction tax on trade with all asset classes;

h. enlarging rights and increasing capacities of supervisors, in particular for trans-border operation;

i. a trade register for commodity exchanges which gives market access only to commercial traders and not to institutional investors;

j. public and cooperative banks under stakeholder control have to be promoted.

6.3. Reducing the imbalances

A common and complementary strategy of surplus and deficit countries has to be established, with the following elements:

a. surplus countries have to increase domestic demand through public investment with focus on social and environmental investment and by increasing real wages above productivity for a certain period;

b. deficit countries should implement an austerity programme for the rich, with increasing taxes on high incomes and wealth, cuts to military expenditures and environmentally unsustainable subsidies. Wages should only grow at the same rate as productivity;

c. a *green Marshall Plan* for countries with problems of competitiveness has to be set up in order to stimulate sustainable growth and to end unemployment.

6.4. Social Europe and democratisation of the EU

The asymmetry between market integration and social integration must end. Social harmonisation as a race to the top has to be the guideline. Improvement of social progress must be the *hard law* and strictly enforced.

The European Parliament must become a full-fledged parliament, with the right to make laws, control the budget, elect and remove Commissioners. Voting has to be based on the principle of one person, one vote.

European referendums for important decisions must be introduced.

The EU is living at the point of a dramatic historic conjuncture. Only measures which are up to the mark will be efficient.