Europe: Sink or Swim?

The German Approach to the Crisis May Prove to Be Economic and Political Dynamite for the EU

BJÖRN HACKER

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The crisis in the Monetary Union continues. Rearranging a few deckchairs on the flagship Europe will not do the job. With every ad hoc measure European integration threatens to be blown off course. The first prophecies of doom already warn of the EU project running aground on a sandbank. A visit to the engine room to readjust the motor of integration is therefore unavoidable. But the blueprint for this cannot simply serve the interests of the German government alone. Since debtor and creditor countries are in the same boat only a common effort will refloat the vessel.

Fiscal Union »Lite« Based on German Rules?

After some initial hesitation and manoeuvring Germany last year assented to the rescue package for Greece and, subsequently, financial assistance for Ireland and Portugal under the umbrella of the newly established European Financial Stability Facility (EFSF). The German government approved the abolition of the so-called »no bailout« clause of the Lisbon Treaty, advocating the establishment of a permanent European Stabilisation Mechanism (ESM) from 2013. It takes seriously – as documented in its plans for a »competitiveness pact«, which was transformed into a »Euro Plus Pact« at the March summit in 2011 – the fact that this crisis is no mere accident or something temporary that can be waited out, but the result of far-reaching socio-economic differences between the member states.

However, Germany will have European neighbours pay up for pushing through these steps along the arduous path to overcoming the crisis, although they are the right ones. This is because Berlin considers those states responsible for the debt misery whose competitiveness lags considerably behind that of Germany. Centrestage stand in particular the so-called GIPS: Greece, Ireland, Portugal and Spain, which reportedly lived beyond their means for a long time, thereby putting the common currency in jeopardy.

- Financial assistance in the form of loans and guarantees should accordingly be granted only under strict conditions. Permanent new national programmes for austerity, wage cuts and privatisation are the consequence.

- The economic policy autonomy of the states covered by the rescue package is significantly curtailed; the key decisions are taken in Brussels and only implemented locally.

- Interest rates on emergency loans are horrendous. Any country wishing to borrow from the EU can count on stiff surcharges. The transaction is supposed to reward the creditor.

- Hopes of preventing future crises are pinned on a stricter stability pact. Even the ten-year growth strategy »Europe 2020« is being subordinated to the criteria of budgetary control over the so-called European semester.

The background to this list of measures lies in the understanding of the EU as an area of permanent competition between the member states for investment, jobs and production locations. Thanks to its export-oriented industrial base, its wealth of innovation and high productivity Germany is in a good position. That is a fact. Another fact, however, is that Germany has achieved this position to a considerable extent through the below average development of real wages over the past 15 years, weak domestic demand and the creation of a low wage sector.

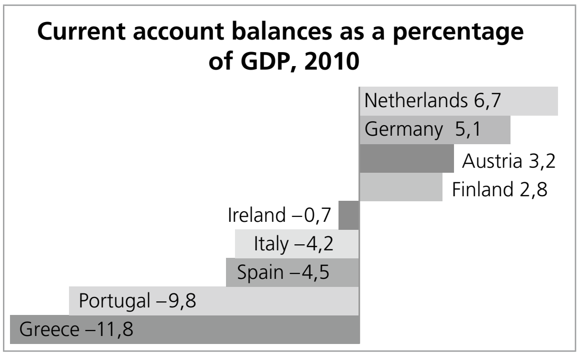
Germany regards itself as a solvent country which has successfully weathered the global financial crisis and whose economic boom entitles it to wag an admonishing finger at the countries of the European periphery. At the end of the vale of tears consisting of permanent austerity, social security cuts and loss of economic policy sovereignty these countries have the prospect – whether realistic or not – of falling in line with the German model based on thrift and exports. Even more than before the introduction of the euro Germany, in its role as lender and pacesetter with regard to a specific approach to crisis scenarios, is becoming Europe's economic policy hegemon. Nobody likes hegemons, but especially not a German one.

The Logic of Competition and Austerity Puts the European Project in Jeopardy

The German government's prescription for overcoming the crisis in the Eurozone is unacceptable. For over a year Greece has hung on from one emergency loan to another, while the oft declared uniqueness of the Greek tragedy has proven to be a false assumption. In any case, the half-life of political declarations of intent, rhetorical drawing of lines in the sand and final rescue packages has diminished considerably in the course of the crisis, together with political legitimacy and credibility. The only thing that seems certain in summer 2011 is the durability of the crisis, the volatility of financial markets and, in the face of necessary change, the deficient conception of the EU's economic-policy architecture.

Economically, the course of extreme austerity is breaking the back of the GIPS states which are already up against it: despite the recovery of the global economy investment in these countries remains low, unemployment rates are climbing and they continue to be financially dependent on other countries. No country has been able to save itself out of the crisis. The option of growing out of the crisis, however, has been denied the GIPS by the prescribed austerity. Recognition of socio-economic heterogeneity in Europe as the background to unequal economic competitiveness has led to the false conclusion that Germany should be taken as a good example to follow for other Euro-states. Its co-responsibility for the high foreign indebtedness of the GIPS, on the other hand, is rarely discussed. The debate has lost sight of the fact that the current account deficits of some are nourished by the current account surpluses of others, and vice versa (see Figure 1). This is virtually inevitable in a tightly interwoven trading area such as the EU. The sum of the global trade balance is zero by definition. In terms of sheer mathematics there cannot be umpteen »world champion exporters« and a model based primarily on high current account surpluses cannot serve as role model for other states with completely different comparative advantages. The asymmetrical adjustment strategies – the crisis countries seeking to increase their competitiveness through permanent austerity, while Germany and other surplus countries, such as the Netherlands, Austria and Finland, do not have to compromise – therefore represent the wrong approach from a number of standpoints.

Figure 1: Current account balances as a percentage of GDP, 2010



Source: AMECO database.

Politically, this has led to a re-evaluation of the supposed rescue programme: in Greece and Spain in particular, people are no longer willing to accept incessant packages of measures put together in Brussels or implemented prematurely in anticipation of a negative response on the part of financial market actors. Anger over the harsh and one-sided adjustment conditions and sheer hopelessness have brought people out onto the streets to protest. This mood is only partly being vented in the punishment of the austerity policy's political executors at election time. After all, what choice did, for example, the Portuguese people have when they went to cast their votes at the beginning of June? Seeking refuge under the EU's rescue umbrella and thus subordination to macroeconomic adjustment programmes had already been agreed among the major parties. Conversely, the countries of central and northern Europe with current account surpluses and indubitable debt sustainability are becoming less and less willing to provide loan packages whose repayment is becoming less and less likely. The gains of the »True Finns« (*Perussuomalaiset*) in the parliamentary elections in Finland and critical utterances concerning the European Stability Mechanism (ESM) by the Slovakian government and among the ranks of the government parties in Germany are indications of growing dissatisfaction on the side of the »solvent« countries that must be taken seriously. The European project is therefore under fire from both sides.

This is just what the doctor ordered for all those who have always resisted European integration who have never made a secret of the national orientation of their policy programmes and who now, against all human, political and economic reason, wish to put up the barriers once again. Unfortunately, intellectuals and journalists are getting in on the act, at the peak of the crisis wheeling out tired clichés about the »bureaucratic monster« of Brussels and the »demon of Europe« that has got out of hand. This is all grist to the mill of both right-wing and left-wing populists who are now able to intone the swansong of European integration with impunity. And why not, when, besides the seemingly insoluble crisis in the Eurozone, disunity with regard to the intervention in Libya, national susceptibilities with regard to refugees and countries going it alone in energy policy furnish painful testimony of the internal limits of integration, which supposedly were overstepped long ago? Given this way of thinking, when it comes to possible alternatives to the EU, calls for »more Europe« are rapidly giving way to the siren-calls of a revival of the old-style nation-state. The gravediggers of the European idea are already at work. The European project is in jeopardy.

Debtor and Creditor States Are in the Same Boat

The crisis did not come out of the blue. It is the culmination of the fundamentally unsound design and structural deficiencies of the economic and monetary union. From the very beginning European integration was primarily an economic process. Its central projects – the single market and monetary union – are capable of increasing Europe's prosperity, but almost imperceptibly a system of European market states characterised by inter-state competition instead of solidarity was established. Instead of curbing existing socioeconomic heterogeneities economic asymmetries and social disparities within the EU have increased considerably.

What has gone wrong? The narrow focus on economic advantages has crowded out the need for political community. »Once economic union is established, political union will come of its own accord«: this was the credo or hope for many people. But it has not come yet, being thwarted by the resistance of nation-states unwilling to share sovereignty in key policy areas. The makeshift structure consisting of soft forms of political coordination over the past decade has not diminished the gulf separating the significant progress made with economic integration and the lack of progress beyond a minimalist political and social Europe. The crisis points up the urgency of changing the EU's economic architecture. Since the way back to the narrow boundaries of the nation-state is, for good reason and fortunately (at least from a rational standpoint), blocked in an interdependent and multipolar world, the only option is to go on.

In the short term, it is clear that without a high degree of internal European solidarity the crisis will not be overcome. Debtor and creditor states are in the same boat. If one fails, sooner or later the others will too, whether through the loss of assets abroad as a result of debt restructuring measures or the collapse of sales markets. The following measures therefore suggest themselves:

- A **symmetrical adjustment strategy** of current account imbalances must also oblige surplus countries, such as Germany, to provide fresh economic policy impetus. In the European Scoreboard of macroeconomic supervision, accordingly, current account balances, investment and savings rates, the employment situation and private debt repayment status must be reflected as indicators. Its importance must be equal to that of the debt rules agreed on in the Stability Pact.

- The interest charges on loans from the EFSF and – from 2013 – the ESM must be much smaller in order to ensure that the states affected receive genuine help. At the same time, repayment should be lengthened and buyback the State's own debt instruments should be subject to scrutiny. In contrast to these forms of »**soft« debt restructuring** the talking up of debt restructuring on a grand scale should cease if renewed panic among creditors is to be avoided.

- **Eurobonds,** as a bond guaranteed jointly by the member states and issued at a uniform interest rate, could be an appropriate instrument for sustainable refinancing. A limit on incurring debt in Eurobonds of 60 per cent of GDP makes sense in order to promote budgetary discipline. The introduction of the Community bond is inevitable whatever the form of restructuring.

- In order to get a sustainable growth and investment strategy under way in the crisis-fraught countries the austerity programmes must be moderated and stretched out. At the same time, the financing instruments of the European Investment Bank should be expanded. A crisis fund for investment, innovation and education in the European periphery should also be considered, funded by ring-fenced solidarity contributions by the Euro-countries. This **»Euro solidarity tax«** could take the form of an asset levy in order to ensure that private persons co-responsible for the outbreak of the global financial crisis pay their share of the costs.

Naturally, a little bit more European solidarity will not clear up all the shortcomings of the EU economic architecture. Even if it proves possible in the coming years to overcome the most acute crisis phenomena, nevertheless, work should commence immediately on a comprehensive institutional realignment. The Lisbon Treaty will not suffice as a basis for the regulation of all the challenges manifest in the crisis because a European fiscal equalisation mechanism, European competence with regard to taxation and the adequate democratic legitimation and political organisation of these instruments will have to be debated. In the eye of the storm, however, what we need first is joint European efforts to return to calmer waters as soon as possible.

Further Reading:

Annelie Buntenbach, David Begg, Erich Foglar, Agnes Jongerius, Wanja Lundby-Wedin, Yannis Panagopoulos, Joao Proenca, Jaroslav Zavadil (2011): Solidarity in the Economic Crisis: Challenges and Expectations for European Trade Unions, http://library.fes.de/pdf-files/id/ipa/08073.pdf

Klaus Busch and Dierk Hirschel (2011): Europe at the Crossroads: Ways out of the Crisis, http://library.fes.de/pdf-files/id/ipa/08066.pdf

Arne Heise und Hanna Lierse (2011): Budget Consolidation and the European Social Model: The Effects of European Austerity Programmes on Social Security Systems, http://library.fes.de/pdf-files/id/ipa/07891.pdf

Werner Kamppeter (2011): International Financial Crises in Comparison: Lessons for Managing the Current Crisis, http://library.fes.de/pdf-files/id/ipa/08081.pdf

Rainer Lenz (2011): Crisis in the Eurozone: Financial Management without a Financial Policy, http://library.fes.de/pdf-files/id/ipa/08169.pdf

Nick Malkoutzis (2011): Greece – A Year in Crisis: Examining the Social and Political Impact of an Unprecedented Austerity Programme, http://library.fes.de/pdf-files/id/ipa/08208.pdf

Toralf Pusch (2011): Wage policy coordination in the Eurozone: A Robust Concept for Greater Macroeconomic Stability?, http://library.fes.de/pdf-files/id/ipa/08072.pdf

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About the author

Dr Björn Hacker is a political analyst at the International Policy Analysis unit of the Friedrich-Ebert-Stiftung in Berlin.

Friedrich-Ebert-Stiftung | International Dialogue | International Policy Analysis
Hiroshimastr. 28 | 10785 Berlin | Germany | Tel.: ++49-30-269-35-7745 | Fax: ++49-30-269-35-9248
E-Mail: info.ipa@fes.de | www.fes.de/ipa