Changing Economic Policy to Bring Europe Back: The Proposal by Economistas Frente a la Crisis

In its founding manifesto, *Economistas Frente a la Crisis* (Economists Confronting the Crisis) maintained that the European Union must champion the Welfare State for everyone. Otherwise, not only democracy would be dealt a blow, but the basis of the EU itself would be compromised. The Manifesto, written at the end of 2011, focuses on the economic and political repercussions of austerity measures on economic growth, unemployment and the model of social harmony that we, as European citizens, had built for ourselves. In the two years that have passed since then, we have witnessed how flawed economic policy has endangered the continuity of the Euro and has caused great human and social suffering. During the summer of 2012, strains in the financial markets led Spain to seek a bailout for the banking system, in view of an imminent systemic collapse which, due to contangion effects, would have had a devastating effect on the European project.

Nowadays, the European economy has a shriking growth potential, as reflected in the significant drop in real and potential GDP. This reduced potential implies that the short term measures needed to jump-start the European economy may have little impact due to the detrimental impact of the crisis on our industrial and human capabilities; i.e., the millions of unemployed, the loss of human capital due to weak investments in R&D+i and education, and the bankrupcy of thousands of businesses. Essentially, the foundations on which a robust recovery of the European economies could be built have been shaken to the core. The risk of entering into a jobless recovery, in the midst of a deflationary trend, threatens to hold back the already weak economic growth. Growing levels of inequality and poverty also jeopardise cohesion and the European social model. The crisis has been used as an excuse to cut back social and environmental rights, which Europe should by no means leave behind.

For Spain, Europe has always been a source of ideas for change and progress: the Republican ideals of the French Revolution, the social and political movements that grew after the industrial revolution, or the modern ideas that grew beyond our frontiers while we suffered from the Franco dictatorship, to name just three. Our entry into the European Economic Community was Spain's return to a place it should never have left. As Spanish citizens we cannot feel other than pro-European. Our education as economists and our professional background has given us the knowledge to uphold and consolidate the pro-European approach of Economistas Frente a la Crisis.

However, Europe's institutional structure and its economic response to the crisis have been so damaging to European citizens as a whole, that euroscepticism is now rife and on the rise. EU leaders have been partly responsible for this, having pushed Europe so far off its own project. Those are the same who paradoxically now warn against a return to national, unsupportive attitudes. In the face of a deep economic crisis, the European Union has failed its citizens. It has failed in its aim to create prosperity, jobs, equality and solidarity. It has failed because it has not defended its *raison d'etre*, the model proposed by Europe to Europeans and the rest of the world: the Welfare State.

This combination of an incomplete institutional framework and a flawed economic policy has caused the European project to fracture, causing wounds that will take a long time to heal. A legacy of 50 years of progress in European integration, cohesion and solidarity is now threatened by deep-seated divisions between the core and the periphery, between borrowing and lending countries, between eurosceptics and federalists. The response to this scenario must come from a stronger and deeper Union. A lapse into naïve, complacent Europeanism would be a fatal error. European economic policy is not set only by a select few countries. It is the rules of the game themselves that are eschewed by certain political interests, thus preventing the implementation of alternative economic policies intended to foster economic progress and enhance citizens' wellbeing. The time has now come for progressive European political organisations to review their position on the European integration process and the rules and institutions that were born out of Maastricht. Acknowledging this is by no means bad for the building of Europe, but rather the way out of this anti-european spiral.

The proposal of Economistas Frente a la Crisis for Europe is based around three key points:

Firstly, a change must occur in fundamental aspects of European economic policy, while at the same time tackling the social and economic repercussions of the crisis. Austerity policies imposed by the conservative majority that governs EU institutions have proven counterproductive since they have further depressed economic activity without achieving their primary goal of significantly reducing public debt and deficit. European economic policy must be recovered as a means to hand Europe back to its citizens. The way out of the crisis will not be complete if we leave aside those who have been mostly affected by it, as any such incipient recovery would be lame and lacking any legitimacy. European political forces of the left should champion proposals to foster growh and job creation without sacrificing workers' rights. Moreover, the necessary adjustment of EU internal imbalances should be more symmetrically shared, and solutions to the debt overhang must be found so that its burden does not drag down growth in the years to come.

Secondly, Europe's exit of the crisis must hinge upon a deliberate backing of a new, balanced, environmentally sustainable growth model, guaranteed by financial stability, and built upon the European Welfare State. Achieving this growth model requires the culmination of the Single European Market in sectors such as energy, telecommunications, services and the creation of a truly European labour market. Greater integration of EU markets and greater backing of strategies to innovate and foster good public education will help improve productivity and growth. An active industrial policy must also play a leading role in changing the productive model. It is important to also stress that sustainable and balanced growth cannot be achieved unless social inequalities are drastically reduced.

Lastly, in order to prevent future crises, the EU must decisively move forward in the consolidation of European economic governance, in particular through the culmination of the Monetary Union. To bolster this move towards integration, there must be further structural reforms that encourage growth without resorting to de-regulation or sacrificing citizens' rights, whom have already been victims of mindless austerity policies. Structural reform means amending the Stability and Growth Pact to provide incentives to public investment, particularly in sectors with high added value, while avoiding the unproductive over-investment which characterised the boom years. Structural reform means financial risk mutualisation and strengthening solidarity in financial regulation. Structural reform means freeing monetary policy of the restrictions imposed by certain members states, who have prevented the ECB from adopting a more expansive and modern monetary policy, which would have required the use of tools aimed at diminishing deflationary risks and preventing the appreciation of the euro- yet another obstacle to economic recovery; in short, a monetary policy that contributes to economic and social cohesion. This new economic governance must be completed with progress towards the Political Union, that would rebalance powers within the EU, reduce the democratic deficit and foster cooperation between citizens who suffer from similar social and economic difficulties. This is an ambitious institutional reform that is essential in order to bring Europe back to its citizens.

Time is running out for Europe. Clinging on to policies that destroy solidarity between countries and citizens is a direct attack on the foundations on which Europe was built: the Welfare State – the proposal of the European Union for the whole world.

Economistas Frente a la Crisis is making an appeal for the recovery of economic policy and its application to progress and citizens. Only in this way may Europe be recovered.

Commandments for Europe[1]

1. Reducing unemployment must be the priority of economic policy [More information]

Although the recession in the European Union seems to have bottomed out, current unemployment rates of around 12% are still wholly unacceptable, particularly among young people. Europe cannot remain impassive to a scenario that threatens to wipe out the future prospects of a whole generation of young people, and hinders the reincorporation of the long term unemployed. European economic policy must take heed of the sharp disparity between unemployment rates and the harsh impact that they have had on public finances through automatic stabilisers.

What is the purpose of economic policy if not to create conditions for dignified work, which provides a living wage for everyone? The way out ofthe crisis must not entail the loss of labour rights and increased precarious working conditions. Progressive forces should champion proposals to fight unemployment and soften its economic and social repercussions without sacrificing workers' rights in the process. When striving to boost job creation, we believe it is fundamental (i) to complete the European internal market and to assure market competition, thus reducing oligopolistic powers in certain sectors that greatly limit job creation, and (ii) to legislate in favour of job stability, limiting temporary hiring to solely when properly justified.

It is in this context that we propose the creation of Eurozone-level unemployment insurance, to complement domestic subsidies with the capacity to stabilise economies against assymetric schocks. In conjunction with an enlarged European budget that leaves more scope for action, we propose implementing a minimum coverage for each country of 80%. Active employment policies must be strengthened, above all in economies with high unemployment rates, empowering the European Social Fund to target young people as well as older workers who have lost their jobs, to prevent them from falling into long-term unemployed. We also deem fundamental to culminate the creation of a truly European labour market, which would allow workers to work in any location in Europe without losing any of their rights. In order to do so, pension rights and employee contributions must become truly mobile throughout the European Union, and the Directive on Posted Workers must be amended to strengthen safeguards and controls that prevent social dumping and abuse of posted workers.

[1] For a more details of each proposal, please click on the link next to each point (in Spanish).

2. Efforts must be symmetrical in order to achieve balanced growth. [More information]

The outbreak of the global economic and financial crisis revealed the unsustainable nature of imbalances that had been building up in the euro area since its conception, resulting in intra-European capital flow grinding to a halt, and consequently forcing Member States to adjust internal demand to matchnational savings.

External re-balancing has thus far been an asymmetric process, with the majority of the adjustment falling to deficit countries. Effectively, countries needing financing have suffered high costs, downsizing of previously overgrown sectors, adjusting growth forecasts and undergoing a structural increase in unemployment. We reject wage devaluation solutions as they are economically inefficient socially unjust. In theory, such a process would boost exports and thus provide some external rebalancing. But in practice, wage moderation has not had a knock-on effect on prices, instead primarily benefitting companies' profit margins. Progress towards a sustainable external path allowing for a consistent build-up of current account surplus build-upshould avoid penalising wages, since salary devaluations weaken consumption even further, dampening internal demand, increasing inequalities, postponing job creation and ultimately hindering recovery.

At this point of anaemic growth and desinflation, the process towards redressing external imbalances must follow two main principles: (i) future steps towards a sustainable external path in deficit countries should favour the redistribution of resources towards the most productive export sectors but without this being to the detriment of families and businesses; (ii) EU authorities must support symmetric adjustments, shared by creditor or surplus countries through policies fostering their internal demand in order to increase their potential output, whilst easing euro appreciation pressures and softening in the adjusting costs in debtor countries.

3. Facilitation of private sector deleveraging with a view of minimising its costs [More information]

The swift correction in financial and non-financial asset prices seen since 2008 (primarily in real estate assets) highlighted a clear imbalance in households' and firms' balance sheets, as their wealth could not match their stock of debt. Faced with excessive indebtedness, the private sector began to deleverage, which effectively shrunk economic growth due to falling consumption and investment. Minimising the impact of private deleveraging on the real economy would, on the one hand, require a positive numerator effect via positive net credit flows and, on the other, a positive denominator effect thanks to alternative sources of economic growth and greater inflation, which could erode the excessively high debt levels.

To do so, the following is needed: (i) reestablishing credit flows to the private sector, in order to finance viable projects in conditions that are affordable to businesses and homes; (ii) improvements in insolvency regulation for homes and businesses, fostering non-judicial proceedings and providing debtors and creditors with suitable debt restructuring mechanisms for viable projects at the pre-insolvency stage; and (iii) supporting measures for the external sector as an alternative source of growth, together

4. Financial stability for the real economy: Tackling financial fragmentation to help credit flow to SME. [More information]

Credit conditions have drastically deteriorated throughout Europe. Most recent data shows that more than five years following the outbreak of the global financial crisis, lending to non-financial corporates continues to fall. SME have been particularly affected by credit shortage. Thousands of them, particularly in Southern European economies, have been forced to close, not due to non-viable businesses but due to lack of financing, with devastating effects on the economic activity and thus on workers.

We propose that the fragmentation of financial markets in the EU and the decline in lending to the real economy should be approached in three ways: (i) Reduction of uncertainties about the quality of banks' assets by a thorough bank balance sheet repair and the inmediate implementation of a three pilar Banking Union; (ii) ECB credit facility to financial institutions, on the condition that they in turn boost lending to the real economy, and (iii) increase EIB funds to diversify financing sources for SMEs.

5. Environmental policies as a leverage for economic growth. [More information]

Faced with the false trade-off between competitiveness and environmental objectives, the European Union seems to be abandoning what was previously a determined fight against climate change. Yet environmental policies may be one of the most effective ways to achieve the necessary change in Europe's growth model. We propose that Europe strengthen its commitments towards emissions reduction and the deployment of renewable energy through more ambitious and binding targets at the Member State level.

The European Commission has advocated the Internal Energy Market as the core of its energy policy. Indeed, its effects on production efficiency and security of supply will potentially be remarkable. However, under the current regulation, the Internal Market will affect the distribution of surplus between consumers and producers and across member states, potentially leading to higher electricity prices across the board. As such, Europe must strengthen the integration of its energy markets through the development of cross-border inter-connections, but should not overlook the fact that a drop in energy prices will not take place unless profound changes to the current regulatory system take place.

Wherever competition forces cannot operate, we propose the establishment of transparent regulated tariffs. Instead, wherever competition is feasible (i.e., there are no significant barriers to entry and the exercise of market power by the incumbents is deemed difficult), we propose to use market-based prices set through public tenders.

6. The European architecture must be completed with a social pillar. [More information]

Budding European economic governance cannot solely focus on public deficit consoliation without considering the social effects this will have. Reducing social inequalities is a positive factor contributing towards sustainable and balanced growth. We call for the institutional framework of the Economis and Monetary Union to include a social pillar, guaranteeing the maintenance of the European social model based on a series of minimum standards across the Union. A social pillar that includes minimum wage for all EU countries, calculated based on the cost of living in each country; the strengthening of social dialogue and collective bargaining to guarantee decent jobs and balanced industrial relations with a positive effect on business efficiency; minimum pensions to provide the elderly with a dignified life; minimum insertion income per family, introduced gradually until 2020 to ensure that no family lives in poverty and a Social Floor in social expenditure for public budgets, which should sit at around 20%.

7. Reforms in fiscal governance: Fiscal policy for growth and employment. The EU budget as a means for stability. [More information]

The result of the last seventeen years of fiscal rules in the EU highlights/ proves that its imperfect design has exacerbated the economic cycle of Eurozone countries. In the/ a Monetary Union, where fiscal policy is practically the sole instrument available to stabilise output, the short-sightedness of the Stability and Growth Pact first failed to prevent many economies from overheating in the first half of the past decade, and then imposed strongly procyclical austerity in the following years. Both errors have wreaked economic and social havoc.

We propose a profound conceptual change to the EU fiscal framework which will allow fiscal policy to act as a countercyclical tool. Fiscal rules should be more flexible in order to allow public investment to stabilise the cycle. Moreover, we advocate a deep change in the so-called "Fiscal Compact": although we agree that budgetary stability should be preserved throughout the cycle, this should not unduly constrain the possibility for the signatory Member States to use the (for most of them) only economic policy tool at their disposal: fiscal policy. Therefore, the requirement to include a balanced fiscal balance as a constitutional provision should be eliminated. Additionally, the blatantly insufficient EU budget must be increased in order to complement efforts made at the domestic level at times of crisis, thus boosting its role as a countercyclical and cohesive instrument.

Swift and determined progress must be made towards greater harmonisation of tax policies and fiscal pressure levels. Specifically, we propose harmonising the consolidated tax base, completely eradicating banking secrecy and enhancing an automatic fiscal information exchange mechanism throughout the EU, including associated territories.

8. Reforms in Financial Governance for stability and growth: Banking Union and sharing of risk. [More information]

Europe needs to urgently implement measures to dissipate uncertainty in the financial sector, contribute to ensuring financial stability from which families and firms would benefit and foster economic growth.

We propose reforming financial regulation to enhance solidarity among Member States and to allow risk mutualisation, including through a Banking Union based on the three pillars of supervision, resolution and common deposit gurantee fund, and the introduction of Eurobonds as a means to reduce financing costs. We believe that it is possible to have a Common Resolution Fund inmediatelly operative, with borrowing capacity and supported by a credible, strong and flexible fiscal firewall. In this regard, this orderly resolution fund must have an additional credit facility granted by the ESM, in order to increase funds both in terms of size and availability, thus reducing doubts on potentially destabilising winding down of banks.

The distortion of the original concept of the Banking Union is not acceptable. We believe that blocking solidarity instruments, such as the direct bank recapitalisation by the ESM, is inadmissible. We understand the Banking Union to be a financial stability project for growth, that includes elements of solidarity and strict governance conditions for institutions that receive funds for their recapitalisation.

9. Reforms in Monetary Policy Governance: The ECB at the service of economic and social cohesion. [More information]

The ECB's currently passively restrictive monetary policy has created a serious risk of deflation, compromising the sustainability of public and private debt in the Eurozone and the incipient economic recovery. The ECB is demonstrably breaching its mandate, since current policy neither guarantees price stability, due to deflation risk, nor does it contribute to economic and social cohesion. Moreover, it has caused the Euro to appreciate, which has compromised efforts made to increase competitiveness in the Southern European conutries states.

This decidedly reluctance to act must stop immediately, in order to give way to modern monetary policy that combines traditional and unconventional instruments. In particular, the ECB must combine conventional instruments with unconventional policies like effectively expanding its balance sheet. In parallel to this, the ECB must adopt a more aggressive communications policy that shows the commitment to applying expansive policies until the Euro area inflation rate reaches its target value of around 2% or even higher, given the current deflation risk.

Monetary policy always has redistributive effects: A expansionary monetary policy transfers resources from creditor to debtors countries. As such, in the current context, a higher rate of inflation would also aid macroeconomic rebalancing of the Eurozone, sharing adjustment efforts among surplus and deficit countries. The pressure that surplus countries place on maintaining the return on their savings must not compromise current monetary policy for the Eurozone as a whole. We state that ECB monetary policy is facing more a political restriction rather than statutory limitations. Meeting the requirements imposed by Treaties, including price stability, demands an urgent, decisive change in the direction of monetary policy. Reforming the ECB's mandate in order for price stability and economic and social cohesion to be targets of equal importance must be the next step to avoid further situations such as the present one from occurring.

10. Reforms in Political Governance: Rebalancing powers to redress the democratic deficit. [More information]

Economic policy measures must be completed with a reform of the EU Political Governance. The growing recourse to intergovernmental agreements outside the Community framework (ESM, Fiscal Compact, Common Resolution Fund) is proof of the asymmetry of powers at the heart of the EU, which impose a certain vision of the economic and social model. Faced with this asymmetrical power among the Member States, EU institutions (such as the European Commission) must be strengthened, and cooperation must be fostered between European citizens that share social characteristics and economic difficulties.

The issue of the European Union's so-called democratic deficit must be tackled, which is understood as the degree of inclusivity of European citizens in the decisions that affect them, specifically in relation to the exit from the crisis. If Member States increasingly transfer more responsibilities and powers to the European institutions, then accountability must also be passed on to the decision making level. This necessarily entails strengthening the role of the European Parliament, placing it at the centre of the European project and improving its formal ties to and relations with national parliaments.

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