

# CAN EUROPE RISE TO THE CHALLENGE?

EU POLICY RESPONSES TO THE  
GLOBAL CRISIS



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Education and Culture DG

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## FOREWORD

There are crises and crises. Some come and go without leaving any lasting trace but others signal a break with the past. You do not need to be much of a prophet to predict that the current global economic shock will go down in the history books as the end of an era. A growth period of almost 25 years has come to an end that has helped lift around one billion inhabitants of emerging countries out of abject poverty and enabled the top of the social pyramid to amass unbelievable riches not only in the old developed world but also in the new rich countries such as China, Russia, India and Brazil.

This growth was driven by the liberalisation of global markets, international trade that increased in leaps and bounds and, above all, by a feverish expansion of the financial sector. It was here that the big money was made and events set in motion that brought the global economy to the brink of destruction. Yesterday, Wall Street and the city of London were the beating hearts of capitalism. Today they are the epicentres of the crisis.

The crash began when the US property bubble burst. So-called sub prime mortgages, used to finance this bubble, had been rebundled as mortgage securities and sold worldwide. In the end this growth model collapsed under the sheer weight of both public and private debt.

Turbo-charged capitalism had finally gone too far. The time has now passed for making money out of ever changing financial products. In future, it will be more about producing value added sensible goods and services rather than indulging in get rich quick speculative activities. The key economic figure of the future will not be the investment banker but the entrepreneur making a contribution to society. It will no longer be about maximising short-term profits but rather establishing sustainable added value.

The capitalism of the future will be more moral – because in the long term only responsible actions will create prosperity.

## Global rules for global markets

Market economies are demanding systems that require transparency, competition to limit monopoly powers, effective price mechanisms, owner liability and a balance between profit and risk. If these checks and balances get out of kilter then the system spins out of control and this is exactly what happened.

If we are going to talk about failure of the markets we also have to consider the failure of governments. It is incumbent on the state to keep order in the markets but it was national governments that, in the race to attract business, relieved whole sectors of the financial services industry of any regulation. It is absurd that all forms of medication have to undergo an exhaustive authorisation procedure and every vehicle requires a technical certificate of worthiness while financial products that can leverage whole economies can circulate without any form of risk management being in place.

The crisis has revealed what is wrong with globalisation: lack of global regulation, the extreme imbalance between the world's economies and the unequal distribution of benefit and risk. Countries that, in recent years, have managed to lift themselves into a state of modest affluence are in danger of being cast back into their previous survival mode. A return to economic nationalism, or more popularly protectionism, would only make things even worse. De-globalisation is no utopia but rather a spectre of doom. Not just because it will mean a loss of wealth around the globe but also because economic fragmentation can foment political nationalism – remember the 1930s.

What is now needed is more cooperation and coordination. We need to strengthen the International Monetary Fund and the World Bank so that they can play the role of global fire fighters. This, however, is also not possible without political reform. There is no way that we can avoid emerging economies and developing countries

having a fair say in these institutions. The end has now come for western hegemony over the global economy. We will have to learn how to share power and wealth if we are to avoid everyone fighting everyone else.

The crisis has also cruelly exposed the shortcomings of the EU. We have a single market and a single currency but no European coordination of economic and financial policy. European economies, however, are, for better or for worse, interdependent. Standing by countries up to their neck in debt is not altruistic but a rational act.

What is also required is binding regulation that enforces fiscal discipline and ends the tax

competition that puts a burden on society. If the EU uses this opportunity it will emerge strengthened from the crisis. If European governments fail then the Union will be gradually destroyed and the euro zone will break apart.

The affect that the economic and financial crisis has had on the European Union and its policies is the central theme of this publication. The authors have looked at European policies from different angles. They have analysed and evaluated how the Union has dealt with the different aspects of the crisis: which measures have been successful, which have failed and what still needs to be tackled. We hope you enjoy reading these interesting and motivating articles.



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## INTRODUCTION

FABIAN ZULEEG<sup>1</sup>

# The Impact of the Global Crisis on the EU and on Europe's Role in the World<sup>2</sup>

### Risks and uncertainties

Talking about the next crisis presumes that the current crisis is over. This is far from clear. There are many continuing risks and uncertainties which are hard to assess at this stage. These risks include, for example, the possibility of a double-dip recession, further trouble in the euro zone or further problems arising in global financial markets. The performance of certain economies, which is often tied to business and consumer confidence as well as global markets, might turn down rather than continue on a tentative upwards trend. Overall, the balance of risks and uncertainties seems to point to a continuing downside risk.

But assessing the degree of risk is difficult, not least because the crisis has also had a profound impact on our ability to predict and forecast economic performance accurately. One lesson of the crisis is that economic models do not perform well in extraordinary times: for example, the speed of deterioration, the degree of global interdependence and contagion and the negative impact on the effectiveness of monetary policy were all underestimated during the crisis. This meant that there was significant uncertainty about the right policy response and the policy applied was not always responsive and quick enough to address the impact of the crisis, especially in the light of

rapidly rising unemployment, ever lower cohesion and social unrest in some countries.

### The policy response

In the developed countries, the policy response was an unprecedented level of intervention by governments. This took the form of massive increases in public spending as well as an expansion of credits and guarantees for example in the financial sector and for sovereign debt. The immediate effect has been deterioration in public finances, which will take years, if not decades, to address.

Much of the response has been characterised by a lack of effective coordination or common action at the European level. The tendency for most governments has been to focus on the problems within their own borders. Only when the effect threatened to spill over across borders, have attempts been made to work together as, for example, in the Greek crisis. The fiscal stimulus packages that were enacted were clear examples of this: in line with the national responsibility for government spending and taxation, these packages were only loosely coordinated at European level through the European Economic Recovery Plan.<sup>3</sup>

To some extent this was understandable: the scale of the response needed was unprecedented and there were no mechanisms in place at EU

1 The author is writing here in a personal capacity.

2 This paper has been written to give a first overview of the impact of the global financial and economic crisis on the EU and on its role in the world. In the author's view, this impact is profound. Not only has the crisis aggravated many underlying trends and challenges which Europe will have to deal with in the coming years but it has also added new challenges. More accurately we should talk about crises not crisis: the financial crisis was swiftly followed by an economic crisis and a public finance crisis. Arguably, we are now living through a currency crisis in the euro zone and, in the author's opinion, we will face a low growth crisis in the coming years.

3 <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/1771>

level to coordinate actions more effectively. But the key question will be whether the EU can now create structures to deal with future crises. The aftermath left by the policies used to deal with the economic and financial crisis also needs to be addressed: for example, the temporary distortions to the Single Market will need to be removed before they lead to more permanent damage.

The crises have demonstrated that, in an interdependent world, Member States acting in isolation is no longer a viable option for making economic policy. This recognition is starting to lead to change in certain policy areas: for example, the financial crisis has led to the recognition that more effective supervision and legislation of financial institutions is needed – and that this should be at least at the European level if it is not possible to reach an international consensus. At the European level, the expert group under De Larosière<sup>4</sup> has made a number of recommendations, which the European Commission will turn into legislative proposals. How these will be turned into reality will depend on the co-legislators, the Council of the European Union and the European Parliament.

## The world has changed permanently

Europeans must work together if they want to shape events rather than being swept along by them. The Greek crisis has not only demonstrated that smaller and economically weaker countries depend on others for support, it has also shown clearly that, for countries such as Germany, it is not feasible to leave a fellow euro zone country to fail without significant effects being felt by its own banks and the common currency.

This is the crucial lesson we can draw from all the crises we have endured so far: individual, country-by-country responses do not work. The financial crisis showed that in a world of cross-border banks and financial institutions,

individual national supervision and legislative systems, working in isolation, simply do not work. In the economic crisis, it became very clear that stimulating Europe's economies could only work if actions aimed at boosting the whole EU economy were carried out simultaneously, not by individual countries or sectors. And the public finance crisis is clearly a crisis for all EU countries, with specific interdependent problems in the euro zone.

## The current crisis

At the time of writing this contribution, the euro zone countries, together with the International Monetary Fund (IMF), had finally managed to come together and propose effective crisis management action. Greece was given access to the finances it needed to bridge public financing needs for the near future.<sup>5</sup> In addition, a protective umbrella was established to prevent contagion, with up to €750 billion in guarantees and credits (two thirds of which are coming from the EU and the remainder from the IMF).<sup>6</sup>

This level of support for Greece and for the other countries with public finance difficulties within the euro zone is likely to suffice in the short term to stop the speculative spiral threatening to lead to the disintegration of the euro zone.

The countries with public finance difficulties will now need to enact far-reaching reform, more closely supervised by the EU. For example, the recent commission proposal on the Europe 2020 strategy<sup>7</sup> has been accompanied by 'Integrated Guidelines',<sup>8</sup> which set out further scrutiny of Member States' public finances. While Europe 2020 and the governance of public finances are not integrated in a single strategy, the commission proposes much closer integration and simultaneity in the assessment of structural reform and public finances. Concerns have been raised about EU competence in this matter, but many

4 [http://ec.europa.eu/internal\\_market/finances/docs/de\\_larosiere\\_report\\_en.pdf](http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf)

5 <http://www.imf.org/external/pubs/ft/survey/so/2010/car050210a.htm>

6 <http://www.consilium.europa.eu/showFocus.aspx?id=1&focusId=478&lang=en>

7 [http://ec.europa.eu/eu2020/index\\_en.htm](http://ec.europa.eu/eu2020/index_en.htm)

8 <http://ec.europa.eu/eu2020/pdf/Brochure%20Integrated%20Guidelines.pdf>



would now argue that a tightened EU approach to overseeing public finance stability in all Member States is long overdue.

But relying on existing mechanisms and competences will not be enough to prevent further crises. An immediate consequence is that the EU must consider carefully how governance in the euro zone needs to be revised, not least to give a signal to markets that the weaker EU economies with public finance problems, such as Portugal, Italy or Spain, will be forced to enact far-reaching reform to address their structural weaknesses.

In addition to a more permanent crisis management mechanism there has to be closer scrutiny and a greater degree of European influence over national budgets as well as a revision of the Stability and Growth Pact with specific emphasis on more effective implementation. The commission proposals made in the spring of 2010<sup>9</sup> are based on the Lisbon treaty<sup>10</sup> (specifically Article 136 which allows for more coordination in the euro zone), proposing a permanent crisis management mechanism, a better-enforced Stability and Growth Pact and more budgetary supervision of Member States. The new permanent President of the European Council, Van Rompuy, has been charged with forming a task force to report by the end of the year on potential changes in governance, which might involve a treaty change but, given the urgency of the crisis, he intends to report in October.<sup>11</sup>

## The growth crisis

Even though a complete overhaul of the economic governance of the euro zone is a necessary step, it will not be sufficient. For example, in the case of Greece it will become increasingly clear in the next few months that a financial support package is not sufficient on its own. The Greek economy is taking a significant battering, which will make it even harder to repay the debt, especially since the

cuts in expenditure and the increasing taxes will further depress domestic demand. Since Greece has few opportunities to benefit from trade given its competitiveness position, it is likely that economic growth will permanently suffer, aggravating the public finance position.

The solution for Greece will have to be, implicitly or explicitly, a reduction in the level of debt burden relative to GDP through, for example, rescheduling of debt. This cost will be borne by Greece's creditors, including banks and insurance funds but also other euro zone governments.

While the Greek situation is particularly serious, in the medium to long term much of Europe faces a similar position: a weak growth rate and a continuing deterioration of public finances. In the absence of effective policy intervention, the impact of the crisis is likely to not only include a temporary reduction in GDP but also a reduction in the growth potential of EU countries.

The crisis has highlighted the structural weaknesses in the EU economies with few options other than fundamental reform to drive European growth. In the past, global economic development has helped Europe's economy but new competitors will make it difficult to use the international economy as Europe's driver for growth.

The long-term effect of the crisis is far from certain not least because policy can potentially change the trajectory of developments. Without radical and far-reaching change and reform, however, most European countries will stagnate economically. This will aggravate social problems – for example, labour markets are likely to stagnate – and this will lead to a continuing deterioration in public finances. In short, without decisive policy responses, most of Europe faces severe challenges to its economic and social model in the medium to long term.

9 <http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/10/237>

10 [http://europa.eu/lisbon\\_treaty/index\\_en.htm](http://europa.eu/lisbon_treaty/index_en.htm)

11 [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ec/114585.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/114585.pdf)

## Slow burning crises

The impact of the current set of crises must be seen in the context of Europe's long-term challenges, which will further threaten the sustainability of Europe's economic and social model. Europe is facing an unprecedented set of key challenges which threaten its way of life and standard of living.

The impact of globalisation, and in particular competition from emerging economies such as China and India, will challenge Europe's long-term economic and social future. European countries have, by and large, been major winners of the globalisation process, benefiting from global trade and investment opportunities, not only in terms of exports but also in terms of cheap imports, which have raised our standard of living. But the world will not stand still and the emerging economies have a huge labour force, which is willing to work at much lower wage levels than those prevalent in the EU. In addition, developing economies are increasingly investing in innovation and higher skills, increasing the pressure on European competitiveness.

Global competition for resources, including energy, food and commodities, will also continue. While the significant upward trend in oil and food prices was halted by the crisis, with a global recovery these trends are likely to return. Competition for other important factors of production – such as capital, investment and human capital – is also likely to intensify with Europe not in the best competitive position.

These external influences will also impact directly on European societies. Member State populations have become more diverse, but at the same time the challenge of achieving cohesion and integration has also increased. Not only are populations more heterogeneous, there are also significant differences in the opportunities available to the different groups in society. This social divide poses a real threat to Europe's social model and signals that significant efforts will be required to reinforce Europe's commitment to retaining a strong, socially responsible focus.

In future, demographic change and Europe's population will necessitate that not only are all groups integrated into the labour market – and for longer – but also the European labour force will increasingly have to be supplemented by migrant labour. The impact of the ageing society, however, goes much further, making a radical transformation of our economies and societies necessary. To accommodate the changes in our working population, our labour markets will have to look radically different with, for example, different career paths, remuneration, social security arrangements, levels of technology and work patterns.

Climate change also provides a significant impetus for the transformation of Europe's economic model. The need to move towards a much less carbon-dependent growth model will require radical change, with significant transitional costs, as well as an acceleration of the technologies, processes and innovation that will underpin this transition.

These challenges are complex and inter-related and none can be tackled in isolation. Europe, however, does have the resources to fall back on to help address these challenges – including a high level of technology and innovation, high levels of capital and human capital and a disproportionate influence in global affairs. Europeans have also attained a high standard of living, with a globally unrivalled level of social and environmental protection but the long-term impact of the crises will act as a brake on the level of public finances available to make long-term investments. In future, European societies will need to investigate new models of finance and delivery.

The implications of the recent crises together with these long-term challenges mean that Europe's economic and social model is under threat. Without decisive policy action, Europe will be facing economic stagnation. At the same time, Europe's relative weight in the world is declining. With a weaker economy this process will accelerate. But Europe still has an option: to pool its resources and speak with one voice. Only

by acting together can Europe avoid international marginalisation.<sup>12</sup>

## A role for Europe

There are many reasons why coordination and common action are necessary to deal with Europe's new and persistent challenges. These include rising economic interdependence, lack of economies of scale in individual Member States and international marginalisation.

This does not, however, mean that further economic and political integration is inevitable. Integration remains a political choice. While in the view of the author the rationale for integration has become stronger, this is not an assessment to which all are likely to subscribe. The critical question is whether some of the major EU powers have recognised that there needs to be change of sufficient scale and magnitude or whether the temptation is to return to business-as-usual.

Pursuing change is difficult: often reform involves unpopular political choices for future gain. In addition, the extent of reform required is very significant – and even harder for Europeans to swallow, given the effects of the recent crises. In the view of the author, returning to business-as-usual would be disastrous: it would condemn Europe to long-term stagnation with further crises to come and fewer tools available to deal with them.

## Assessing current EU policies

In the light of these challenges, how appropriate is current EU policy? And how far will current policy need to adjust post crisis?

Given space limitations, this article focuses on a single policy area to illustrate how policy needs to adjust to the post crisis reality: the Europe 2020 strategy.<sup>13</sup> This does not imply that this is the only policy area affected. Areas such as financial sec-

tor reform, climate change, the EU budget, euro zone governance, the Single Market or the representation of Europeans in international fora/organisations could equally well have been chosen. In fact, most EU policy areas need to be reassessed in the light of the crisis.

Europe 2020 has been chosen as a good example of how the crisis has impacted as well as the impact caused through the aggravation of some of the longer term challenges. This article does not claim to present a fully detailed reform plan for this policy area. Rather it shows in what broad direction policy will need to change.

The Europe 2020 Strategy, the successor to the Lisbon Strategy,<sup>14</sup> was due to be finalised in 2010. Its preparation thus fell in the midst of the financial and economic crisis and its aftermath. While this to some degree was taken into account in its design, for example through a greater emphasis on social inclusion, the author would argue that the proposed new strategy is not transformational enough to address Europe's post crisis challenges.

Most importantly, the strategy is insufficient to address the fundamental underlying problem of the European economy: low economic growth rates. As detailed above, the crisis has resulted not only in a lowering of the level of growth but also in the level of potential growth, at least in the medium term, leading to what many now term a future 'lost decade'.<sup>15</sup> This has to be seen in the context of the weak growth performance prior to the crisis and the downward impact of population ageing on future growth.

In addition, the impact of the crisis on public finances means that, in future, public investment will be harder to come by. This creates a vicious circle: lower economic performance in future means even tighter public finances. A continuing tightening of credit available from financial institutions, presents challenges for generating private

12 <http://www.epc.eu/PDF/SchuDec.pdf>

13 [http://ec.europa.eu/eu2020/index\\_en.htm](http://ec.europa.eu/eu2020/index_en.htm)

14 [http://europa.eu/scadplus/glossary/lisbon\\_strategy\\_en.htm](http://europa.eu/scadplus/glossary/lisbon_strategy_en.htm)

15 The 'lost decade' is an option, which the commission has referred to as one possibility facing Europe's economic future. See for example [http://ec.europa.eu/commission\\_2010-2014/president/news/statements/pdf/20102010\\_2\\_en.pdf](http://ec.europa.eu/commission_2010-2014/president/news/statements/pdf/20102010_2_en.pdf)

investments into future growth drivers. Given the difficulties in public finances, these investments will have to come from individuals/households and private sector firms, necessitating the creation of a legislative and support environment able to encourage this investment.

This also illustrates the interdependence of different policy areas. Europe 2020 must be seen in the context of the exit strategy from the crisis, the public finance crisis, monetary policy and the reform of euro zone governance. Structural reform, fiscal and monetary policy have to work together to ensure that the objectives of Europe 2020 can be met.

But Europe 2020 is, on its own, not enough to change the long-term growth trajectory sufficiently or to create the environment needed for further investment. A more radical approach will be necessary to drive growth, including, for example, comprehensive tax reform and prioritisation of investment in education, incentivising the commercialisation of research and innovation or the further development of the Single Market.<sup>16</sup>

In many relevant policy areas, however, the EU does not have the policy competences to act: be it in taxation, education or in the governance mechanisms to ensure that Member States stick to EU level targets. This does not necessarily mean that the EU needs new competences: one could equally argue that the EU should limit its ambitions in these areas. But in the opinion of the author, this would not be the most effective policy response.

The crisis has shown the high degree of economic interdependence which exists within the EU. Not only will low growth in one country limit the economic opportunities for the EU as a whole but economic trouble caused by a loss of competitiveness and economic performance and consequent deterioration in public finances will need to be dealt with collectively by Member States. In addition, a loss of growth potential in

significant parts of the EU and fragmentation will lead to international marginalisation. In short, the EU leaders can choose not to integrate but the price will be economic stagnation and international marginalisation.<sup>17</sup>

## Implications for future European policy

So what are the long-term implications of the crisis and their interaction with the other long-term challenges set out above? While it will take a number of years for the full extent of the crisis to become apparent, there are already a number of general conclusions which can be drawn:

1. Uncertainty and risk are higher than before the crisis. The implication is that much more attention needs to be paid to contingency and crisis management mechanisms. The EU's relatively poor performance in responding through contingency planning or crisis management must be addressed as a matter of priority for the future;
2. Investment in the future will be difficult to finance. More needs to be done to create an environment, which encourages investment by individuals/households and companies;
3. Public finances will severely limit the room for manoeuvre for government intervention. The degree of public finance difficulties implies a radical overhaul of spending, public service delivery and taxation. There needs to be a serious commitment among EU leaders to review and work with other financing and service delivery models in the future;
4. Low growth rates will undermine economic recovery and Europe's role in the world. Enhanced efforts will be required to encourage economic growth;
5. The level of interdependence implies that governments cannot act alone. But European governance mechanisms are lagging behind;

<sup>16</sup> <http://www.epc.eu/dsm>

<sup>17</sup> [http://www.reflectiongroup.eu/wp-content/uploads/2010/05/reflection\\_en\\_web.pdf](http://www.reflectiongroup.eu/wp-content/uploads/2010/05/reflection_en_web.pdf) and <http://www.epc.eu/PDF/SchuDec.pdf>

**6.** Credit will still be difficult to obtain for large sections of the economy. In many cases public authorities will have to step in, necessitating new and innovative approaches;

**7.** Growth will need to be sustainable in the long term – environmentally, socially and in terms of public finances. This implies radical change to the economic and social models which underpin Europe's *raison d'être*;

**8.** At European level, means and instruments need to be aligned with the common objectives which are set: too often the EU is asked by the Member States to do a job for which it is not equipped, due to lack of competence and/or a policy vacuum;

**9.** Europe requires a greater 'external' focus to really appreciate the state of change and its performance in the international context. Europe is becoming relatively less important in the world. In future, only through a single voice can Europe play a significant role in the world;

**10.** There is a significant threat that the long-term effects of the crisis will lead to greater social divergence and divisions. This will further perpetuate the unease, which Europeans feel about both national governments and the EU. Tough political choices will have to be made on where to focus scarce public resources.

While the environment is challenging, the worst effects can be avoided: policy does matter. Much of the appropriate policy response should come at the European level where the sum of Member State actions can be greater than its parts. But the key question is whether there is political will in the Member States to recognise that the world has changed. More European coordination, cooperation and common action are not inevitable. Without further integration, Europe is facing the toughest socio-economic challenges of its history and without adequate tools to address them.



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## 1. PASCAL CANFIN

# How the Absence of Economic Government has led to the Current Crisis

### A first crisis for the euro

A little more than ten years after its introduction, European monetary union sees its very existence threatened. A break-up of the euro zone could bring Europe to a political standstill. To avoid such a doomsday scenario, European leaders need to take action and set up a proper European economic governance. To do this, they will need to accept both more economic integration implying loss of some national sovereignty and more solidarity involving more transfers between states. This step is a long way from becoming reality for governments anxious to defend their prerogatives and respective national interests. The long-term durability of the euro zone, however, depends on bringing Europe up to date.

### Incomplete economic integration has led to the current crisis

European economic integration is a construction site that has ground to a halt. Of course belonging to the euro zone has required the introduction of economic policies to ensure that certain convergence criteria, notably concerning inflation, are met. For all that, signing up to the euro has become the end of economic convergence. Those countries that joined have forgotten that for a single currency to succeed, the process of convergence has to be properly maintained. With the removal of the devaluation option, all euro countries need to have a similar rate of inflation in order to maintain their relative competitiveness. The first ten years, however, have been notable for the fierce desire of countries to avoid the European Commission or their peers interfering in their domestic economic policies. In order to avoid any external look into their affairs, the euro countries actually preferred to

turn a blind eye to Greece's dubious budgets and statistics. The Greek government was thus able to undervalue its national debt with the help of bankers Goldman Sachs. Just as serious, they also did nothing to stop the credit expansion in Spain and Ireland that resulted in a property bubble of unprecedented proportions.

Absence of economic government has led to the current crisis. By once more making a distinction between the sovereign debt interest rates of the euro members, financial operators formally noted the lack of budgetary integration. Unlike the United States there is no euro zone budgetary deficit but only the sum of 16 national Member State deficits. While the Greek debt is worrying, the German debt is one of the most sought after in the world with its very low long-term interest rates. Given the mistrustful attitude of the markets, a rapid return to balanced budgets is not a viable option for the European Union. The health of European economies still depends to a great extent on the drip feed of public spending. If there is little consumer or business demand, cutting public spending is likely to cause a new recession and make the current social situation even worse.

Beyond budgetary issues, one also needs to consider the question of the relative competitiveness of euro zone members. The relationship between pay and productivity has not evolved in the same way across the Union. Germany that has pursued a rigorous pay policy these last ten years has seen its relative competitiveness greatly advance. During the same period, Spain, experiencing a property boom, saw pay rise much faster. This does not pose a problem for an economic space in which the workforce can move freely but it does for the euro area. Spanish unemployed are neither able nor desirous of going to work in

Germany. The limited freedom workers have to move around the European Union because of linguistic and cultural barriers is an unavoidable reality that means we cannot rely on labour migration to regulate pay inflation. As a result a country that has lost competitiveness only has the choice of deflation: a solution that carries particularly high economic and social costs and is not without risk. In fact it could result in a deflationary spiral. If this is the case then deflation feeds the recession and unemployment and they in turn increase the rate of deflation. Spain's unemployment rate is already 20% and if some euro countries get caught up in such a spiral, there is a risk that their persistent underemployment rate will make staying in the euro socially intolerable. To avoid this, the European Union needs to have proper economic governance. To achieve this there will need to be a thorough revision of the Stability and Growth Pact (SGP) and a European budget, with its own resources, capable of financing more solidarity between members.

### **Create proper economic government by revising the SGP**

The rigidity of the SGP and its absurd concentration on national debt has rendered it obsolete as a means of economic governance: the majority of euro zone countries ignore it and its blind spots are obvious. Unless you are a demagogue, it is impossible to support the idea of a single currency without common criteria for financial regulation and therefore common agreement on budgetary deficits and managing national debt. The European Union therefore needs a new SGP that deals with the limitations of the current pact.

### **Make the SGP more flexible so that it will be better respected**

Making the pact more flexible in 2005 was a good beginning. National deficits are not themselves a problem as long as they do not result in inflation, which is what can happen during a recession when consumer demand is weak. The debt of a country should therefore be contained at a rate relative to its economic situation. There

is no longer any necessity to give definitive target figures but rather set down rules relative to the economic situation of each country (recession, overheated etc). Budgetary balance is therefore maintaining an average over a long period and does not forbid either a surplus or a deficit depending on the stage in the economic cycle. For all that a flexible SGP will require member countries adhere to flexible rules. These last few years, the European Commission has been unable to get countries to stick to the pact. Promises made in Brussels are quickly forgotten when governments return home. France lowered value added tax (VAT) on restaurant meals at a cost of €3 billion at a time when its deficit was already larger than allowed by the pact. A decision that completely undermined the authority of the commission, whose only means of enforcing the pact is to levy monetary fines and this risks making things worse in a country that is already in the red.

To get out of this situation of harsh non-compliance measures, the first step would be to oblige euro members to use common macroeconomic criteria when deciding income and expenditure thus avoiding unrealistic budgets. A more radical solution, proposed by Angela Merkel, is to remove voting rights from those countries failing to meet SGP obligations: an idea that would appear to be dubious. In fact it is difficult to imagine that France and Germany, the two countries that have been driving the pact for the last few years, could have their council voting rights removed without bringing the European Union to a standstill. Once again, we have a sanction that is too harsh to be properly effective. It would appear that neither fines nor sanctions are effective means of keeping member countries in line. You cannot use duress of this nature against sovereign states but the use of encouragement might be more effective. Offering countries respecting the pact the opportunity to issue Eurobonds, guaranteed by the other euro zone members, would be a strong incentive to conform. Such a system would enable European countries to borrow at the best rate, as they would be guaranteed by the zone's strongest economies. In addition, such a system of Eurobonds would increase market liquidity and

allow smaller member countries greater access to finance. Simply respecting SGP budget criteria, however, does not ensure economic stability. In the present situation, the only other criteria for running the euro zone are control of consumer price inflation, the responsibility of the European Central Bank (ECB). But neither the ECB nor the SGP had the ability to counteract the private credit explosion in Spain and Ireland. As it is, European economic governance consists of two blind spots and, to a large extent, this is why it is currently so ineffective. We need to establish two additional indicators for European Commission analyses: the level of private debt and relative competitiveness.

### **Get rid of the SGP's blind spots**

Blind spot number one – private debt. The euro zone countries that have the most dramatic economic problems are the ones that have seen private debt explode in the last few of years. Ireland and Spain for example have a private debt rate of more than 160% of GDP. This has inflated the prices of capital assets (essentially property) and financial assets. These blunders alerted neither the commission whose gaze was fixed on public debt, not the ECB concentrating on goods and service inflation. On the contrary, before the crisis Spain and Ireland were regarded as the good euro zone pupils because their public finances met SGP criteria. Since the beginning of this crisis, households in these countries that have taken on excessive debt to purchase their homes are seeing the value of their capital assets diminish and their incomes decline as unemployment rapidly rises. Their repayment obligations, however, have not gone down at all. As a result they have to cut back on private consumption but this in turn leads to more unemployment. The only way out is for public debt to support private consumption. But this in turn means a higher public deficit that will put the country outside what is allowed by the SGP. Given this situation, the ECB and the European Commission need to extend their analytical scope. The commission needs to jettison its dogma that the only destabilising factor is public debt and the ECB needs to look at capital asset inflation in order to head off speculative bubbles.

This new target presupposes that, in addition to interest rates, the ECB has new instruments of credit control that include adjusting capital requirements for banks depending on the economic cycle of the country they are in.

The second blind spot of the current economic governance concerns the relative competitiveness of euro zone members. Germany that has pursued a rigorous pay policy for the last ten years has seen its relative competitiveness clearly increase. What was not a problem at the beginning has become one with the creation of current account imbalances, principally in the area of goods and services. We cannot reproach Germany for being the world's number one exporter thanks to the quality of its products. On the other hand, it is unnatural that due to its weak consumption checked by pay restraints, Germany has not imported more. A more productive German economy is only good for the euro zone if it results in redistribution in the form of salaries. Pay deflation is no winning solution for the whole of the euro zone. In an economic area as integrated as the euro zone, surpluses on the current account of one country are to a large extent the deficits of others. This kind of policy only serves to lower demand and condemns the area to long-term underemployment. In order to avoid this situation, member country trading accounts for goods and services need to become a key indicator for the European Commission. Should either the surplus or deficit exceed 3% of GDP, the commission should look at the situation and make policy recommendations if necessary. These recommendations should be binding if the situation worsens and the figures reach 5% of GDP. Currently, Greece's current account deficit with other euro countries (14.4% in 2008) would require the government to take action. Germany's surplus (7% of GDP in 2008 and more than half of it with other euro countries) would also require a change of policy. The commission's announcement that in future it will look at relative competitiveness in the euro zone shows that it has realised what is at stake.

In concrete terms, excess savings in some countries could be reduced by a better redistribution of



wealth. The incomes of rich countries have rapidly risen in the last few years and this has led to growing inequalities: inequality of income that leads to excess savings of the better off and weak demand. A greater redistribution, especially in ecological investments (that in the end will lower mandatory expenditure of the poorest and middle classes) would reduce excess savings and therefore lower current account imbalances. Including such new criteria would, however, require member countries to give up some of the sovereignty over economic policy but this would be more symbolic than real. In fact, if individual economic policies are possible in the short term, being a member of a monetary union drives convergence in the medium to long term. Coordinating economic policies will allow for shared sovereignty on these questions. The success of the euro and, more widely, the European project depend on this.

### **Increase the Union's budgetary capacity**

If putting into place new rules will ensure the long-term viability of monetary union, they will not help Europe get out of its current rut. The more or less ordered responses produced by the pressure from the financial markets need to lead to lasting mechanisms for dealing with crises. The system of bilateral loans between euro members is a response to deal with the immediate financial problems of Greece. This emergency measure has avoided a probable Greek default followed by its exit from the euro zone. In the same way, the creation of a European financial stability fund, with members contributing €440 billion, is a guarantee for all the members of the zone. These funds represent the first form of solidarity that upsets the principle of no bail-out established at the creation of the euro. Even so, the conditions imposed on Greece by its partners are far from being advantageous and might well not be sufficient to avoid future insolvency. Above and beyond loans and guarantees, the European Union needs to accept greater budgetary solidarity.

The EU's budget today is limited to 1% of European GDP. The federal budget of the United States has an upper limit of 20% of GDP. The gap

is certainly the result of historical differences but it does show that the European Union is an economic dwarf. Member States are quick to disparage the commission for its lack of proper policies for industry, research and infrastructure and this criticism is justified but commission inaction is due to lack of funding. On climate change, for example, we should have a common research effort to develop techniques capable of radically reducing carbon emissions from our production and consumption methods. Negotiations for the European budget 2014-2020 commence in 2010. France and Germany should propose a progressive increase in the EU's budget from 1% to 5% of European GDP by 2020, partially financed by a direct EU tax.

### **Put an end to fiscal competition**

States will need to deal with fiscal issues in concert if they are to finance the European budget and have the sort of financial room for manoeuvre that can reduce deficits and public debt. The absurd fiscal competition that members have engaged in has led to a never-ending reduction in company tax in the EU. Regaining fiscal sovereignty, as in the case of monetary matters, will result from better coordination at European level. Europe needs to take back the fiscal control it has lost over mobile capital. A directive on the consolidated tax base of European multinationals, limiting their ability to relocate to lower tax areas, will allow for an increase in company tax. This is imperative for those countries most deeply in debt. The directive could also impose a European company tax, along the lines of the US federal company profit tax that could flow into the Union budget. This budget should also receive proceeds from a form of energy tax, if it is imposed at EU level that favours ecological means of production and does not distort Single Market competition. Finally, a financial transaction levy at the European level is desirable. This will tax the most speculative activities of the banks that make no contribution to the real economy and return to the state some of the profits from these activities that currently escape duty. Establishing this kind of fiscal cooperation means that there will need to be an improvement in European anti-fraud

measures. It is inconsistent to have free movement of goods and capital but tax authorities that are partitioned nationally. There needs to be automatic exchange of fiscal information between the national and EU authorities if fraud is to be tackled efficiently. This information exchange should also apply to all third countries, especially tax havens, wishing to participate in the Single Market.

The current situation has the potential to trigger a whole succession of European crises. Angela Merkel could block all reform of euro zone

governance. Germany will not accept an economic government unless it sees its interests best served by accelerated integration. In their time, De Gaulle and Adenauer, Kohl and Mitterrand knew how to make the sort of historical compromise that helped advance the construction of Europe. Let us hope that Merkel and Sarkozy will find the political courage to support a new equilibrium. If they do not, they will have to assume the risk that monetary union could fall apart and as a consequence set Europe back more than 50 years.



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## 2. STANY GRUDZIELSKI

# Limits to Subsidiarity: A New Pattern of Public Intervention for a Greener EU Internal Market

### The EU internal market: a zone for lawyers or for policy makers?

When Professor Mario Monti met a delegation of Green Members of the European Parliament, in the framework of his initial consultations for the preparation of his report on re-launching the Single Market<sup>18</sup> (commissioned by Jose Manuel Barroso), he expressed the view that the notion of 'internal market' should be replaced by 'Single Market'. The latter, he said, is based on the idea that national economic areas are brought together into a European one, whereas the former, whose meaning is very similar, risks giving the rest of the world the impression that the EU's economic area is closed.

This distinction between the two concepts is quite interesting especially when one reflects on the impact the financial and economic crisis has had on the EU internal market. Contrary to Monti's view, the global nature of the crisis and the difficulty, or even the impossibility, of addressing this challenge with global – multilateral – solutions, also provide good reasons to prefer the use of 'internal market'. With all its insufficiencies, the EU internal market has – at least theoretically – one big advantage over individual European countries operating in isolation in the global market: this advantage is an EU public authority capable of intervening in the EU market.

Since the 1980s, this public intervention capacity has not been fully used. For the most part, the last three decades have undergone a very imperfect transition from full national public

intervention to what has become shared EU and national public intervention. The imperfection of this transitional period arises from the fact that national states have not retained all their intervention instruments, while the EU has not had the capacity or the willingness to take over the responsibility abandoned by national authorities. As a result when the global crisis hit we found ourselves with a gap in ways to intervene and this gap is still far from being filled.

EU intervention in the internal market has, until now, mainly consisted, of regulation whose approval for the most part is subject to codecision procedure.<sup>19</sup> The EU, however, only has very few of the intervention instruments that are key tools for public authorities: fiscal instruments, control of public spending and redistribution of the means and services of general interest. Indeed, it is quite dramatic that, when facing the enormous challenges of the global crisis, the EU is mainly left with regulatory instruments that for the most part are designed to enforce legislation. The EU has a parliament and a council to approve legislation, a commission to propose and enforce legislation and a court to interpret the law, but no real other means of efficient intervention. It has the trappings of a state but it is not a state.

### The Monti Report: an overview

#### The Monti trade-off proposal

If there is one central message to be found in professor Monti's report "A New Strategy for the Single Market", then it is that a trade-off is

18 See M. Monti, 'A New Strategy for the Single Market at the Service of Europe's Economy and Society', *Report to the President of the European Commission*, 9 May 2010.

19 Codecision procedure is the legislative process which is central to the European Union's decision-making system. It is based on the principle of parity and means that neither institution (European Parliament or Council) may adopt legislation without the other's assent.

needed between deepening the Single Market and meeting the public's social and environmental concerns.

The first element of this trade-off consists of fostering Single Market integration, which, according to Monti, has been subject, in the recent years, to a double 'fatigue syndrome': 'integration fatigue', i. e. less support for the idea that the obstacles to the free movement of persons, products, services and capital should be removed or at least reduced and 'market fatigue', i. e. less support for market mechanisms and their self-regulatory capacity. According to the Monti report, these 'fatigues' have to be tackled because, more than ever, the EU needs to enjoy the economic benefits that the Single Market can bring, in particular the added economic growth that one can expect from more integrated EU markets.

The second element of the trade-off is more original, especially coming from a long-standing and strong advocate of the market economy. It consists of recognising that many of the concerns expressed by citizens and consumers vis-à-vis the Single Market are, if not completely justified, at least understandable and must be addressed properly. The report emphasises the following concerns: those of rent-seekers, consumers, citizens, social, environmental and business groups.<sup>20</sup>

In addition, Monti identifies a series of concerns about the Single Market that depend on the economic and social model favoured by the individual Member State. He sees Member States as belonging to one of the following models: the continental social-market economy; Anglo-Saxon; new Member State and Nordic. According to Monti, a trade-off needs to be found between these four different models, which have different perceptions and expectations regarding the Single Market.

### The need for more coordinated tax policies

At first glance, the trade-off proposed by the Monti report appears as a balanced, hence welcome and reasonable step towards reinforcing the EU's internal market while also answering social and environmental concerns in the manner of the 'social market economy' model. It should be noted, however, that the main, and perhaps only real concession towards translating citizens' and consumers' concerns into concrete measures, is its proposal regarding fiscal coordination. Other citizens' and consumers' concerns are extensively dealt with in the report but this model of the orthodox market economy is not questioned.

Monti's call for more fiscal coordination within the EU should not be underestimated. The report points out that *"the functioning of the single market - coupled with the wider globalisation process - places a growing challenge for the operation of tax systems and may erode in the long term their revenue raising capacities, as well as their ability to pursue social and redistribution policies at the national level"* and that *"addressing this underlying tension between market integration and tax sovereignty is one of the avenues for reconciling the market and the social dimension of the single market."*<sup>21</sup> Hence, the call to minimise harmful tax competition and remove the in-built bias towards taxation of less mobile tax bases.

Although the report does not go as far as proposing real EU tax harmonisation, which, according to Mario Monti, remains *"unnecessary and not very realistic"*,<sup>22</sup> it recognises that, in order to address the problem of the huge deficits and debts arising from the stimulus packages undertaken by governments to combat the economic and financial crisis, Member States will need not only expenditure cuts and fiscal discipline but also tax increases. Mario Monti therefore underlines the advantages of a more coordinated fiscal

<sup>20</sup> Idem, pages 25-28.

<sup>21</sup> Idem, Page 79.

<sup>22</sup> Idem, page 81.

policy, in particular the idea of targeting more mobile bases instead of focusing on less mobile ones such as labour. Monti proposes areas where there could be more tax coordination such as: corporate tax; consumption and environmental tax. At least the first and third of these areas are consistent with improving EU economic governance. It should also be pointed out, however, that the Monti proposals do not involve essential areas such as taxation of financial transactions, a bank levy or a more active fight against tax fraud.

### A change of paradigm, or mere window-dressing?

The rest of the report is mostly an attempt to sell the Single Market more effectively because Monti views it as having to be built on consensus. In the first part of his report, he explains that such a consensus is necessary because deepening the internal market would not be successful if the majority of citizens and consumers felt that this was being done against their and society's general interests. Therefore, the impression prevails that the Monti proposals to address citizens' concerns are a way of convincing the public that the Single Market is in their interest. He does not offer any real alternative approach to the logic that has been implemented so far in the EU internal market building process.

## A new shape for the EU's internal market

### The internal market in a globalised economy

In his report, Mario Monti repeats the classical view that there is no fundamental contradiction between the objective of achieving an EU internal market and the constraints of inserting the EU market into a globalised economy, in which most protection provisions ought to be removed. Although this view should not be confused with simple removal of any international trade regulation (as shown by the significant title of this chapter of the Monti report: *"open, but not disarmed: the external dimension of the single*

*market"*,<sup>23</sup> the fundamental belief remains that *"openness to global trade and investment is key for Europe's long term prosperity"*.<sup>24</sup>

This international trade orthodoxy is increasingly paradoxical in the context of the global economic and financial crisis and even more so if we consider the extreme difficulties encountered by some EU Member States facing the consequences of this crisis. The international crisis has shown that the absence of a strong regulatory framework for the international economy entails dramatic global consequences. The tensions among EU Member States also show that the internal market suffers from a lack of regulation. The internal market has long been seen as a success story due, in the main, to two factors: (i) significant protection of the internal market from the unfair competition from non-EU countries; (ii) the relative proximity of productivity levels among the founding Member States. The recent attacks against the weakest members of the euro zone show that productivity discrepancies among all EU Member States are perhaps now too wide and that stronger regulation is needed to avoid a further disintegration of the internal market.

Therefore, it is even more paradoxical to keep calling for more free trade at a global level where productivity levels can vary from 1 to 100 or even more! The defenders of global free trade, in their call for more of this model, often cite the positive factors experienced by a number of emerging economies and also the ability of some of the oldest industrialised countries to maintain positive trade balances under this system. They simply forget that (i) the key explanation for economic take-off in some emerging economies is the educational advances that have improved their productivity levels; and (ii) one country's trade surplus is another's deficit: there is simply insufficient worldwide demand capable of absorbing, at the per capita rate of Germany, the huge surplus created by demographic giants such as China or India. Therefore the German export economy model cannot be seen as viable at the global level

<sup>23</sup> Idem, page 89.

<sup>24</sup> Idem.

– and probably not even at the EU internal market level.

Hence, one *first pillar of an alternative organisation of the internal market* would be to get rid of the idea that the abolition of protection measures within the internal market could serve as a model for the worldwide abolition of economic protectionism. On the contrary, the most recent economic difficulties demonstrate the need for stronger regulation measures: both within the EU internal market (through a reinforcement of the legal social, environmental and consumer protection framework) and beyond for example through the establishment of various geographical zones outside the EU that have relatively homogeneous productivity levels.

### Growth, competition and monopoly

Another orthodox economic belief consists of a two-fold paradigm, in which (i) the purpose of a market economy is to boost economic growth and (ii) a well-functioning market economy requires more competition and less public intervention.

Looking at the ecological crisis into which the world has plunged there is ever less support for the idea that growth maximisation is a desirable aim. The debate is still open, including within the Green movement, as to the desirability of adopting a low growth policy or whether a redefined growth model could be compatible with a green transformation of the economy. It is already clear, however, that even adopting the second option, economic growth cannot be considered as an objective in itself. Supporters of economic growth as a solution to social problems (in particular the problem of economic redistribution) contribute to disseminating wrong expectations about the EU internal market. Indeed, even according to classical economic theory, the purpose of a market economy is not economic growth (although economic growth could come as a consequence of a well-functioning market) but rather to allow (i) better prices for products and services and (ii) more diversified consumer choice. A logical consequence of this is that market mechanisms are better suited when it comes to products or

services, for which there is a relative elasticity of demand (prices reflect demand and supply) and relative heterogeneity (consumers are able to express preferences). For products or services, for which elasticity is relatively low and which are relatively homogeneous (for example water), however, market mechanisms are not really justified.

One big mistake of the economic growth mantra is the tendency to ignore this distinction and promote market mechanisms in all areas of economic activity. As a consequence, the recent history of the EU internal market has been, to a large extent, the use of market mechanisms for sectors (water distribution, postal services for standardised mail and local transport networks) that would be better served by the use of public monopolies at local, regional, national or even European level.

Hence, a *second pillar of an alternative organisation of the EU internal market* would be a redefinition of the respective roles of market and competition mechanisms on the one hand and public monopolies on the other. Of course, such a redefinition would require calling into question a series of liberalisation measures that have already taken place, in particular in areas such as transport, postal services, water and energy. As a first step, an in-depth, multi-dimensional evaluation of these measures needs to be undertaken to assess how they will meet social and environmental objectives. In this context, it should be remembered that already the Treaty establishing the European Community explicitly allows for the precedence of general interest objectives over competition rules. A new article 14 of the consolidated EU Treaty provides EU legislative protection for public services.

### From regulation to action: the necessity of appropriate tools

Even in the context of economic activities that are not considered ‘services of general (economic) interest’, public authorities are entitled to pursue public policy objectives and adopt measures to ensure that the general interest prevails over sim-

ple implementation of market mechanisms. The nature of public intervention can vary and in the framework of the EU internal market the most common instrument has consisted of adopting legal provisions through EU directives and regulations using the codecision procedure.

Until the 1990s, there was a considerable amount of such EU internal market legislation in particular for products. One key feature of this legislation was that it set very detailed technical standards for such diverse sectors as children's toys and motor vehicles. The thinking behind it was that products needed to circulate in the internal market without obstacles and they must therefore adhere to a strict set of harmonised standards.

Since the 1990s, however, two quite significant developments have taken place. The codecision method for adopting even the most technical specifications has now often been replaced by the 'new regulation system' in which only the major regulatory measures are adopted by codecision and the more technical aspects are adopted via procedures in which the parliament and the council are not playing an active role, leaving it to the commission and to ad-hoc standardisation committees. The method for adopting specific (so-called vertical) legislation for each type of product has now sometimes been replaced with horizontal legislation covering a whole range of products or sectors – a good example being the General Product Safety Directive. But the most significant development in recent years has been the use of this legislative instrument in the services area with the adoption of the Services Directive.

These two developments raise difficult questions of democratic legitimacy (more difficult for legislative bodies to control standards) and legal issues as a one size fits all legislation covers very diverse products, services and sectors. The Services Directive has raised particular problems. The initial proposal from the European

Commission contained a very simple, but very dangerous provision, i. e. the 'country or origin principle,' according to which cross-border service providers had only to respect the national legislation of their own Member State and not the legislation of the Member State where the service was provided. Although this principle was removed from the final directive, it has not been replaced with a clear alternative. The directive is unclear and therefore poor legislation. Furthermore, the horizontal scope of the Services Directive is so wide that it includes sectors, which are of a pure commercial nature and those in which public interest concerns should prevail.

This situation reveals a major gap in the EU internal market framework: not only has the way in which legislation is made taken a dangerous direction with its democratic deficit and legal uncertainty but public authorities also encounter increasing difficulties in finding appropriate means of action. In particular, their capacity to use public services for general interest purposes is more and more contested. Similarly, in the public procurement field, public authorities' capacity to include general interest purposes in their calls for tender is under threat.

Hence, *a third pillar of an alternative organisation of the EU internal market* would be a reinforcement of public intervention instruments, not only as law-makers in the framework of the EU codecision procedure but also as 'action-takers,' in the organisation of services of general interest. These services should be seen as cornerstones of sustainable development as they touch all three of its dimensions (social, environmental and economic) via sectors such as health and social services, energy, transport, education and financial services. Burkard Eberlein in his paper on the Regulatory State in Europe<sup>25</sup> said that the liberalisation processes have tended to limit the role of public authorities to that of market regulators, which entails the risk that they will lose their capacity to pursue social and political objectives.

25 See E.Burkard, 'L'Etat régulateur en Europe', *Revue française de science politique*, 49<sup>ème</sup> année, n°2, 1999, pages 205-230.

### Harmonisation, subsidiarity, substitution

Finally, in addition to the relations of the internal market with the globalised economy, the respective roles of market mechanisms and public monopolies and the nature of the instruments of public intervention, another central issue at stake for an alternative internal market model is the appropriate level of intervention of public authorities.

Traditionally, this issue is presented with EU harmonisation supporters on one side and those favouring the subsidiarity principle on the other. The former insist on the need for common rules for the sale of products and the provision of services. The latter emphasise the need for elected representatives at lower levels of power to take into account local, regional or national interests in regulating economic activities.

If we admit that the role of public authorities should not be limited to that of market regulators

but should also have ways of intervening in the public interest, it becomes clear that a reconciliation of these two options is possible if the 'subsidiarity principle' is complemented by a 'substitution principle'. The notion of subsidiarity, now firmly enshrined in euro jargon had its origin in the social doctrine of the Catholic Church. It does not mean that the correct level of organisation is always at the lowest level but rather the most appropriate one. The substitution principle means that when a problem exceeds the capacities of a smaller entity a higher one has an obligation to intervene.

In the context of an alternative model for the organisation of the EU internal market, a correct combination of the subsidiarity and substitution principles would certainly make for better-shared responsibility between the different levels of public authority intervention.



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### 3. JOSÉ BOVÉ

## The Financial and Agricultural Crises

### The financial bubble has left the poor starving and small farmers ruined

The crisis in agriculture is a consequence of the collapse of international financial markets and the loss of political control over global monetary movements. Against the background of a 'bull market' caused by a rising demand for agricultural commodities, driven to a great extent by increasing consumption of biofuels in the rich countries, significant change in the food consumption habits of developing countries and long term droughts in some cereal producing regions such as Australia, the search for short term financial gain provided the spark that ignited the powder keg. Some experts in world markets have spent nigh on three years trying to determine exactly how far the price surge was the result of speculation. While their findings differ, the majority now agree that speculation was an important, not to say crucial factor.

During 2005, 2006 and 2007, non-commercial actors (banks, insurance companies, pension funds, guarantee funds and sovereign funds) became massively involved in raw materials markets, particularly derivatives based on futures contracts. Their objective was not to be involved in issuing futures contracts nor the demand for agricultural products and neither was it to facilitate a more transparent view of medium to long-term prices. They wanted to protect those financial interests that looked endangered as the first indications of the sub-prime crisis appeared in the United States: the speculators now began their assault on the food sector.

In Europe, the big banks such as Credit Suisse, Deutsche Bank, HSBC, Rabobank, USB and the Crédit Agricole, followed the example of American

institutions like Lehman Brothers, Goldman Sachs, JP Morgan, Bank of America, Citigroup and Morgan Stanley<sup>26</sup> and did not hesitate to set up call centres to encourage their clients to profit from the surge in prices. Tens of thousands of investors were persuaded without even realising that their actions would, quite literally, provoke starvation. The prices of the three most important cereals, wheat, corn and rice reached levels never before seen and completely disconnected from all economic reality. For the hundreds of millions of people in southern countries, who already spent 80% of their income on food, all this stock market activity had catastrophic effects: instead of eating twice a day they now had to be satisfied with just a single meal. This misery underlined once more the need to have access to food. Food is absolutely vital; an empty stomach and it is impossible to work and earn money to provide the bread for the next day. Hundreds of food riots broke out, especially in the poor areas of mega cities. In Cameroon at the end of February 2008, desperate people demonstrated against the high cost of living and their inability to feed themselves and their families. The army and police opened fire with terrible consequences: more than 40 fatalities.

The cynical indifference of financiers and investors speculating on life is intolerable. The French Revolution in 1789 came about after successive bad harvests and bouts of speculation. The grain merchants stockpiled grain thus removing it from the market in order to sell when they could get the maximum price. At least in the eighteenth century, the dealers were able to see the consequences of their acts. Nowadays, decisions are made in air-conditioned rooms full of computers and the traders are not even able to establish a direct link between their actions and the images they see on television in the evening. The mon-

26 See 'Financing Food – Financialisation and Financial Actors in Agriculture Commodity Markets', SOMO paper April 2010.

strous disconnect between the virtual world of finance and reality is now total.

### **The multinationals advocate *laissez-faire* - but the people don't!**

In December 2008 the European Commission estimated the value of private derivative contracts that escape all form of governmental supervision to be \$4037 trillion.<sup>27</sup> Some \$4.4 trillion of these contracts were in raw materials (metals, oil and agricultural products). These figures are so difficult to grasp that they are meaningless. A trillion is a 1000 billion, as a reference, the French budget for 2010 is €550 billion.

World production of wheat is about 660 million tons, with the price being around \$160 per ton. This implies that the value of global wheat production for an average year is about \$105.6. In addition only about 19% of this amount is traded on the world market. The value of wheat traded between countries is only \$20 billion per annum, or expressed in financial jargon €0.02 trillion – an insignificant sum!

The above example demonstrates just how far derivative markets are no longer based on anything tangible. They are contracts based on other contracts, guaranteed by contracts and can be exchanged, bought or sold by financial institutions. Just before the crash of September 2008, Lehman Brothers held more than 138 000 assorted derivative contracts that lacked sufficient collateral.

The attitude of *laissez-faire* towards financial and raw material markets is the result of a long process of voluntary disengagement by political authorities and today we are reaping the consequences.

From the first appearance of the futures market some 150 years ago in the 1880s,<sup>28</sup> the US

Congress has endeavoured to control the stock market and fight speculation. Regulations introduced in 1910 were criticised by large commercial enterprises such as Cargill and, little by little in the 1920s, these companies managed to rob them of their effectiveness. In February 1927, the Secretary of State for Agriculture removed the obligation that required the principal brokers to declare their interests. That was the end of openness and the Crash of 1929 was just around the corner. It needed years of crisis and for the world to teeter on the edge an abyss for the Roosevelt administration to take things in hand. The Commodity Exchange Act entered into force on 15 June 1936 imposing new regulations on raw materials markets. It also declared option markets illegal but this was repealed in 1981. Regulation was maintained by successive US administrations both Republican and Democrat. Regulation did not, however, prevent the 'great grain robbery' by the Soviet Union in 1972. In the wake of a catastrophic harvest, Soviet leaders made very discrete contact with the main trading houses (Cargill, Louis Dreyfus) for the purchase of almost three million tons of grain, a colossal volume representing 30% of US grain production and 80% of US domestic consumption. During this period, world prices for all primary agricultural products shot up. Between August 1972 and August 1973<sup>29</sup> the price of wheat went up threefold, corn and barley twofold. Food prices for the American consumer registered a rise of 50%. This shock that came a few months ahead of the oil shock was one of the major unrecognised causes of 1970s inflation.

The market panic and the speculative bubble of 1973/74 resulted in the creation of the US Commodity Future Trading Commission (CFTC), an independent federal agency to regulate agricultural futures and options markets in the United States. It was Nixon, not exactly sympathetic to ideas in favour of the Third World, who was responsible for this decision. The lesson is

27 SEC (2009) 905 final, 7 July 2009 – table 4.

28 See <http://www.cftc.gov>

29 See D. Morgan, 'Merchant of Grain: The Power and Profits of the five Giant Companies at the Center of the World's Food Supply', 1979.

clear: without political control multinationals will do what they are programmed to do, namely make profits. Public interest is the least of their concerns.

The election of Margaret Thatcher in 1979 and that of Ronald Reagan in 1981 marked the advent of a new ideology, that of neoliberalism. The state should disengage from the economy, markets were supreme and multinational enterprises should have the power to expand without constraint or control. The expansion in speculative derivatives linked to basic agricultural products would never have been possible if the rules that had been created had been upheld. In the US the Commodity Futures Trading Commission (CFTC) became less and less active as the financial markets grew exponentially. The CFTC progressively reduced the limits imposed on the number of derivative contracts that could be held by a company. At the same time, it opened up the possibility for banks and hedge funds to buy futures directly on the commercial stock exchanges.

The development of a futures market for agricultural products was not at first as popular in Europe as it was on the other side of the Atlantic. In providing a price framework for important products, the Common Agricultural Policy (CAP), instituted at the end of the 1950s, offered farmers and food processors a clear medium term view of prices. Price variations were less sudden and more predictable. The CAP allowed risks and uncertainties associated with agricultural activities dependent on climate to be taken on by the state.

Regulation and stockpiling allowed for the temporary removal of large quantities of agricultural products thus stabilising prices but they also did something we have always condemned; they subsidised exports. These intervention policies have gradually been reconsidered as the European Commission has come to regard liberalism as the incontrovertible economic dogma, the sole way of thinking. Following the example of the US and prodded by some Member States led by the United Kingdom, the European Union began, in the mid 1980s, to dismantle its agricultural policy.

From 1982 to 1995 our leaders were active in the creation of the World Trade Organisation (WTO). The opening up of global markets has become the norm. The European Commission has since recognised on a number of occasions that agriculture in the international context had been only considered a simple means of exchange to be bartered for unlimited access for service sectors (banks, insurance companies, health, education, environment, energy, transport, tourism, intellectual property...) to emerging economies and poor countries. The successive reforms of the CAP in 1992 and then in 2003 aligned EU and global prices. The 2008 CAP 'bill of health' confirmed this trend, as did the decision of the European Council to get rid of milk quotas, the last real vestige of regulation.

As in the US, this policy of *laissez-faire* has had disastrous consequences for the European Union. The financial crisis, in particular, has had a violent impact on the two most fragile links in the food chain, namely the producers and the consumers.

The rise in prices for agricultural products has sent misleading signals to farmers. In 2007, the price of wheat and other major cereals shot up. Prices for milk and meat products followed the same upward curve. The rising standard of living, the appearance of a middle class, especially in China and India, created the impression of stable, up and coming, rich international markets.

The European agricultural machine had to get itself fighting fit to capture new business. The illusion did not last long, barely more than a year. But it was sufficiently long to intoxicate the spirits. It is worth noting what cereal producers did. At the Paris agricultural shows in 2007 and 2008 they flocked to the stands with the latest models of giant tractors and enormous combine harvesters, their purchases putting them into heavy debt for many years. Why would they have done any different given that the agroindustry, the seed and fertiliser multinationals and farm machinery manufacturers were all pushing then in this direction? In addition, the signals from the French government and the European Commission were doing their best to get rid of any remaining hesitations.

Dairy producers were subject to the same brain washing. The ending of milk quotas was presented as a godsend, an opportunity not to be missed. The most 'enterprising' were encouraged to invest in milking machines, to increase their productivity, boost production. As in the cereal sector, the market reversal was brutal. From the beginning of 2009, EU prices were no longer enough to meet production costs. In 2009 small farm incomes collapsed: at least 12% on average in Europe and at least 20% in France.<sup>30</sup> The bankruptcies caused by the financial crisis and then the bursting of the agricultural speculation bubble were innumerable. In the space of one year, Hungary lost 30% of its jobs in agriculture. The number of small farmers in France able to claim the minimal subsistence income distributed by the state reached 75 000 or one in eight. The shock wave emanating from the demise of Lehman Brothers swept from Cantal to Silesia via Yorkshire.

The big food processing companies such as Danone, Nestlé and Unilever were quick to pass on the price rises of 2007 and 2008 to retail customers, who were already feeling the effects of the crises. As commodity prices started to drop at the end of 2008 and the beginning of 2009, these same companies suddenly became blind to the signals sent by the markets. Their prices stayed up, their margins increased greatly and profits hit record levels. In October 2009, Danone in a financial report on its internet site said that its shareholders had done particularly well that year as a result of the exceptionally low prices it had had to pay for agricultural commodities. This scandalous comment, published as producers were pouring milk onto their fields, has since been altered.

### **Towards global governance: taking control of our food**

We have struggled for years to denounce neoliberalism and oppose the politicians, who in creating the WTO tied our hands behind our back and left the field free for finance and food industry

multinationals. In 1992, the union of small farmers in France (Confédération Paysanne) and the international peasant movement Via Campesina demonstrated at the headquarters of the WTO in Geneva against the 'steamroller' that was being put into place. Demonstrations against the WTO were held at Seattle in 1999, Doha in 2001, Cancun in 2003, Hong Kong in 2005. Other demonstrations in Rome at the Food and Agriculture Organisation of the United Nations (FAO) in 1996 and 2002 called for more credible alternatives and food sovereignty (the right of people to take control over the supply of food). World Social Forum meetings have provided essential points of contact. During these years, we have been up against an economic and political brick wall. Today, this wall is cracking and the cracks are now gaping. The ideas of the social movement that were the origin of this fight must now be taken into account when reshaping economic, social and political policies.

The Greek crisis in the spring of 2010 demonstrated that speculation will not cease until finance comes under proper political control. Having torn apart tax payers and shattered agricultural markets, the financial speculators are now directly attacking countries and their public debt. Anything is good that makes a profit. Within a few hours on Friday 7 May, Wall Street plunged almost 9% as the result a computer data typing error that caused things to spiral out of control. Man has been overtaken by the financial technology he has created. He is no longer in charge.

This seems to have at last been accepted by most people even if there is little agreement as to how to put things right. In January 2010, Michel Barnier, the new EU Commissioner for the internal market said: "Speculation in food products is a scandal as long as we have a billion people suffering starvation." These words are a first step. They are unfortunately not sufficient to counteract the markets. Reform of CAP gives us the opportunity to reconstruct European and global agriculture with a single aim: to be able to feed 6 billion today and 9 billion in 2050.

The challenge is immense. The Chicago Merchandise Exchange, a private organisation, listed on the New York stock exchange, fixes the world price of wheat. This is a bad system and should be got rid of! One of the essential factors to get things changed is to give back some reality to the economic world that surrounds us. The prices of agricultural goods should reflect reality. They need to cover the costs of production and offer a reasonable return to the producers. They are of necessity different from one region to the other due to farming methods, the nature

of the terrain, climate variations and other social factors. Speculation will end when there is supervision of production, consolidation of quotas and the setting of price floors and ceilings that allow farmers to make a living and consumers to have access to affordable food. In other words we will have control over our food.

All these urgent reforms will, just as the struggle against climate change, have to lead to a new global governance based on cooperation and solidarity rather than competition and profit.



**José Bové** was born in 1953 in Talence, France. At a young age he became involved in the civil disobedience movement. He became a sheep farmer and helped set up Confédération Paysanne, a union for small farmers, in 1987, where he later became a member of the national secretariat and spokesman from 2000 to 2003. José Bové has campaigned against the industrialisation of agriculture and the liberal commercial policies of the WTO. In August 1999, his participation in a demonstration at the building site of a MacDonald's restaurant to raise awareness about the multinational's use of hormone-treated beef resulted in a prison sentence of four months. Fiercely opposed to the use of genetically modified organisms (GMOs) in agriculture he has participated in numerous actions to destroy GMO crops that led to a further prison sentence in 2003. He was a candidate in the French presidential elections in 2007 and became a key figure in the creation of Europe Ecologie. José Bové was elected to the European Parliament in June 2009 where he is now the vice-chairman of the Committee on Agriculture and Rural Development.

#### 4. REBECCA HARMS AND SILKE MALORNY

## Climate Change Policy and the Economic Crisis

Before Copenhagen, the conference to end all climate change conferences, something akin to euphoria swept through the international climate change movement. It was hoped that with an excess of 190 countries and more heads of government than ever before in attendance a catastrophe could effectively be headed off before it actually happened: politicians and scientists from around the globe poured into the summit. Decisiveness, solidarity and reasonableness were hoped for. Above all, people hoped for a binding agreement to protect the climate. The actual result of the summit was therefore all the more sobering. Instead of the hoped for historical treaty binding all nations, there was the Copenhagen accord whose goals are neither binding nor wide ranging enough to tackle catastrophic climate change. In addition, this politically weak document was not even agreed by the conference but merely 'taken note of'.

After the failure of Copenhagen there were, into the bargain, headlines proclaiming errors in a report from the UN's Intergovernmental Panel on Climate Change (IPCC). At the same time, Europe disappeared under a blanket of snow and experienced a cold and very long winter. The errors in the IPCC report did not really call into question either the basic causes of global warming or its consequences and while the winter in Europe and the US was cold, the period from January to March in other parts of the world was as warm as it had rarely been. As a result, slowly but surely, the feeling grew, (one could even say it was banded about) that climate change was not really as serious as previously thought. The urgency for common action and the readiness to make the cuts necessary to protect the world from a catastrophe simply disappeared from public debate.

While this was going on, the effects of the international economic crisis were becoming

ever clearer. Old established companies went out of business, thousands of people lost their jobs and whole countries teetered on the brink of bankruptcy. The fear of losing one's job, pension or hard won savings overlaid fears about climate change whether in the future or in far away countries. The media and public interest moved away from the climate crisis - there were more important or at least more urgent matters to deal with. The industrial lobby and all those for whom European climate change policy had long been a thorn in the side, now found an ideal situation in which to demand that such ambitious policy be put to one side. Increasingly loud voices said that European industry was already overly burdened by the crisis and the unilateral goal of meeting a 20% cut in CO<sub>2</sub> emissions (compared to 1990) by 2020, especially as the latter did not apply worldwide. Currently the most energy intensive industries are the ones lobbying national governments, the European Commission and Parliament. This well funded campaign aims, inter alia, to ensure that the conditions for meeting emission reduction goals are as industry friendly as possible: energy intensive industries should, for the most part, receive free emission trading certificates. In addition, they wish to avoid at all cost any rise in the EU's CO<sub>2</sub> emissions reduction goal to 30% by 2020.

### The Connie Hedegaard paper

In this atmosphere of climate scepticism and global warming fatigue, the European Commissioner for climate change, Connie Hedegaard set about strengthening European CO<sub>2</sub> emission targets. On taking up office she commissioned a study on how much it would cost to increase emissions reduction targets. When European heads of state and government agreed in 2007 to a target of a 20% reduction by 2020 the cost was reckoned to be around €70 billion. Since then, however, a number of factors have

changed. During the economic crisis, industrial emissions have dropped significantly. In 2009, European emissions fell about 12% compared to 2008. The commission has calculated that this reduction in emissions means that costs have dropped by around one third. In other words, with the same budget one could achieve far more in the current circumstances. Achieving a 20% reduction today would cost €22 billion less than calculated at the time the agreement was signed. Raising the reduction target to 30% would cost about €33 billion. In other words, a further 10% cut in CO<sub>2</sub> emissions would only cost an additional €11 billion, a sum we should in any case be investing in climate change projects. These calculations do not include the fact that greater climate protection measures today will save money on environmental damage and energy imports in the future. Above all, a greater emissions reduction today will mean enormous savings in the future. Any delay today will mean that climate change measures will be more complicated and therefore more costly if we are to meet the 2050 target of 80-95% emissions reduction. At a time when we our heads swim with the countless billions that have gone to rescue the banks, saving the world appears to be relatively cheap.

## Complaints from business

The Climate commissioner's paper came under heavy fire even before it had been published. Other commissioner as well as industry lobbies took to the barricades. The most important industry associations in Germany, the BDI (employers' association) and the DIHK (trade and industry association) absolutely rejected a unilateral raising of the emissions reduction target. The industry lobby message was that such a target could only be met by cutting production and this would lead to massive job losses. The chairman of the European Parliament's industry committee, German conservative Herbert Reul, even accused the commissioner of pursuing a strategy of de-industrialisation. At the end of

May, the commissioner presented her document with very few changes. Curiously, the figures that clearly demonstrated that raising the emissions reduction target was financially feasible, good for the climate and good for European business were preceded by a text making it clear that this should in no way be interpreted as a proposal for an immediate rise to 30% – at least a partial victory for the influential industry lobby.

Before one joins in the chorus of complaints from business, one needs to look at what kind of burden this target actually places on industry. One complaint is that the current reduction rate and emissions trading system make European companies less competitive than their Chinese, Indian or American counterparts. At the moment, however, the situation looks somewhat different. The British non-governmental organisation Sandbag, recently published a study that looked at ten 'carbon fat cats' or companies that had made enormous profits from emissions trading.<sup>31</sup> Strangely this list includes, of all things, some of Europe's largest emitters of CO<sub>2</sub>. Steel concern ArcelorMittal and cement company Lafarge and Co have, during the economic crisis collected emissions trading certificates worth around €3 billion. The majority of these certificates cost them nothing. During 2009, 70% of companies in the emissions trading scheme received more certificates than they needed for their own production. A smaller number was bought by firms during the time CO<sub>2</sub> emissions were cheaper. This surplus of certificates needs to be carried over into the next trading period. During the next few years therefore emissions trading in these sectors will not lead to a reduction in CO<sub>2</sub> production but rather an increase. No way can we speak of an unbearable burden for industry here!

Another recent study by the Dutch institute, CE Delft, came to the conclusion that even the most energy intensive industries had passed CO<sub>2</sub> costs onto the consumer, even though they had received free emissions certificates.<sup>32</sup> This sort of

31 The Carbon Rich List: Companies profiting from the EU Emissions Trading Scheme, Sandbag, February 2010.

32 Does the energy intensive industry obtain windfall profits through the EU ETS? Sander de Bruyn et al. CE Delft, April 2010.

practice has resulted in millions in profits for the energy industry, which is why they will need to sell their emission rights on the stock market during the next negotiating period. Energy intensive industries on the other hand have always used the argument that they would be unable to pass the cost of CO<sub>2</sub> onto their customers, as this would make them uncompetitive on the global market. According to the study there are indications that this was at least not the case for refineries, iron and some steel and synthetic products. From 2005-2008 the free distribution of emission trading certificates allowed these industries to make a financial gain of up to €14 billion.

The British and Dutch studies demonstrate the weaknesses of the European emissions trading system. It was not introduced to drive industry away. It was and is, however, not to allow the major polluters to pocket additional billions in cash. International agencies and the European Commission predict a poor future for this trading scheme. They both conclude that, if we keep to our 20% reduction target, sectors participating in the scheme will be at about the same level in 2020 as they were in 2008. One of the main reasons for this is the current oversupply of carbon certificates. Connie Hedegaard has indicated that reduction targets that are too low mean that carbon trading, the most important instrument of European climate change policy, remains ineffective. The commissioner has said that the current CO<sub>2</sub> price of €15 per ton is too low to prompt innovation. Commission investigations have shown that it would need a price of at least €30 per ton to get industry moving on the sort of aspirational innovation that would make it clean and climate friendly. A higher reduction target and a proper auction system for carbon trading certificates, rather than the current free distribution, would do the trick.

## Carbon leakage

Especially during this time of economic crisis, politicians shudder when they hear the

words carbon leakage. Carbon leakage describes the danger that some industries in Europe will no longer be competitive if EU requirements to tackle climate change become much stricter than what is required in other countries. As a consequence, some companies or even whole industrial sectors in Europe might migrate to countries where there are less demanding regulations. This would weaken Europe's industrial base, lead to unemployment and not even protect the climate. Nobody really wants to see this happen. It is, however, irresponsible that as soon as the first companies threaten to move exceptions are made, the emissions trading system is demonised and massive numbers of free CO<sub>2</sub> certificates are thrown around. The Green Group in the European Parliament commissioned a study that put carbon leakage under the microscope. The scientists at the Climate Strategies Institute came to the conclusion that some 13 sectors would be seriously affected by carbon leakage.<sup>33</sup> The list of endangered industries prepared by the European Commission currently encompasses some 164 sectors. In other words, more than ten times the number mentioned in our recent study. The reason for this is that the criteria used to define what constitutes 'endangered' actually lead to an overestimation of the problem. These criteria were put together at the last stages of the climate change negotiations but not by scientists. They were rather the result of pressure from politicians in certain Member States and powerful industrial lobbies. The Climate Strategies study also came to the conclusion that free distribution of CO<sub>2</sub> certificates for many in the less 'endangered' sectors is not even a good way to head off the danger that they might leave the EU. On the other hand, the disadvantages of free certificates (they hold down the price of CO<sub>2</sub> and provide industry with windfall profits) have been known for a long time. The problem of carbon leakage is much less dramatic and much more manageable than many in industry pretend. From the Green point of view, it would be more sensible and practical to look at the problems of those sectors affected and find appropriate solutions. The possibilities

33 S. Dröge und S. Cooper, 'Tackling carbon leakage in a world of uneven carbon prices', *Climate strategies*, May 2010.



are manifold. Alongside free certificates we could also consider import duties and state aid. What is important is that carbon leakage is not hyped up to be the basis of a strategy that will put a break on ambitious climate change policy and provide competitive advantage for domestic industries.

## Resistance from industry

Resistance from industry unfortunately comes as no surprise. The sob story that measures to tackle climate change will either lead to industrial ruin or mass migration of firms has pretty much accompanied all environmental legislation in Brussels. To give one example: during negotiations to fix the level of car emissions the auto industry painted the nightmare scenario of an industry on the verge of collapse. They threatened the loss of thousands of jobs if emission levels were too strict. Their complaints did not fall on deaf ears. In the council, environment ministers and heads of government fought for exceptions, delays and a loosening of the draft legislation, ostensibly to help industry and employment in their home countries. Even in the European Parliament the Germans were looking after the interests of the big heavy automobile producers, the French and Italians were protecting the makers of smaller cars and the British were especially concerned with niche manufacturers. The net result is legislation that will prove, for the most part, ineffective with its unambitious emissions reduction target, countless exceptions and feeble penalties. Scarcely had this awful piece of legislation been approved than an expensive European car manufacturers' marketing campaign began proclaiming the efficiency of their new models. Many of these cars had emission rates below the CO<sub>2</sub> standards against which they had fought so hard. The conclusion to be drawn from this is that we should never underestimate industry's innovative powers. Industrial research and development departments are far better prepared for the challenges of climate change and efficiency than those heading up the board rooms. The auto industry is also a prime example of misguided lobbying. The industry had already signed up to a self-regulating system of fuel consumption reduction in the 1990s but then failed to do anything

and fought tooth and nail against any binding regulation from Brussels. While European auto manufacturers continued to bring bigger, faster and heavier cars onto the market, the Japanese, realising which way the wind was blowing, had switched to producing efficient vehicles. During the crisis, the gas guzzlers have stayed firmly in the showrooms as consumers have preferred smaller more economical models. In the end, it was not strict environmental standards that caused the industry problems but their own inaction. They simply failed to innovate. EU regulations to protect the climate and promote efficiency need to be about modernisation so that, in future, Europe can produce cars for the global market.

## New ideas in times of crisis

Ambitious climate change policy will not mean less employment. During the crisis, green industries have done better than many traditional ones. In Germany in 2009, renewables increased their contribution to energy supply, attracted more investment and saw a rise in employment. There are now more than 300 000 jobs in renewable energy in Germany. Green industries are often more labour intensive than traditional ones and the sector will, in future, provide the more secure and crisis proof job opportunities. Greenpeace Europe and the European Council for Renewable Energy came to the conclusion that if investment in the energy sector was switched to renewables, for every job lost in coal or the atomic industry, seven could be created in the renewable sector. Even the commission assumes that raising the emissions reduction target to 30% would create more employment in the EU. Investment in efficient energy production, better use of resources, better-insulated houses and sustainable traffic systems will pay for themselves several times over. There will be lower emissions, costs of raw materials will fall, there will be less reliance on imports and more secure employment will be created.

Modernising our society in an ecological way will neither be for free nor come without effort but the opportunities this step will offer have never been better. Of course, we should not expect that ambitious plans for protecting our climate

will be greeted enthusiastically by those who make good profits from coal power generation. We should not, however, allow those unwilling to change to make a fool of our policy. It is now time to overcome opposition: not just talk about sustainability strategy but actually get on and do it. The demands on the industry of the future will be different to those of the past. In a world where raw materials are limited and fought over, energy costs are on the rise and climate is changing. Only those companies meeting these new challenges will be successful. Some countries are already in the starting blocks. What is certain is that the future belongs to technologies that are intelligent, economical and efficient. It is, however, uncertain that these technologies will come from Europe. Deindustrialisation and job losses will be a threat if we do not change. If the EU wants to be successful in green and climate technologies it needs to set very clear parameters so that its products will be of interest to these future markets. We will require all the tools that policy can offer. Clear ambitions and binding targets are just as important for the market as intelligent inducements and regulatory specifications.

The economic and climate change crises should not be viewed as independent phenomena. Tackling one does not necessarily mean neglecting the other. Instead of paddling backwards into the economic crisis in the hope that we can soon return to what we had before, we need to learn how to use this opportunity to institute change. The economic crisis is forcing us to change our industry. We must ensure that we emerge from this crisis in better shape than before. We need a green new deal that can tackle the economic and climate crises together. The efforts we are now making need to help us overcome both these crises. Only when we have intelligent, clean and cost conscious industry will we have secure employment for the future. The EU has what it takes to be to the forefront on climate change technology. Half way between Copenhagen and the next climate change summit in Cancun, the question is: does the European Union have the kind of politicians who have what it takes to try out new ideas in times of crisis?



**Rebecca Harms** is a qualified landscape architect. As a joint founder of the initiative to stop nuclear waste being stored in Gorleben she was active in the anti-nuclear movement. She began working closely with the Green party in 1984 as assistant to MEP Undine von Blottnitz. From 1994 to 2004 she was a member of the Lower Saxony state parliament where she headed the Green parliamentary party. At the elections in 2004 Rebecca Harms entered the European Parliament as top of the Green list and was co-chair of the parliamentary Greens. Re-elected in 2009, she is currently a substitute member of the Committee for Industry, Research and Energy and of the Committee for Environment, Public Health and Food Safety.



**Silke Malorny** has a Master's degree in Biology from the University of Göttingen. Before becoming Rebecca Harms' adviser on energy and climate change issues, she was adviser to Michael Hustedt, Member of the German Parliament and energy spokesperson for Bündnis90/the Greens. Silke Malorny's special areas of interest in recent years have been EU climate change policy and its international dimension, EU energy policy and vehicle regulation.

## 5. REINHARD BÜTIKOFER & RODERICK KEFFERPÜTZ

# To be Green or not to be – Tackling the Triple Crisis

It's *déjà vu* all over again. Once more the European economy finds itself in turmoil. Having been for the past two years in the midst of the worst economic recession since the 1930s, many hoped we were finally entering the upward curve of a V-shaped recession. While in June 2009, year-on-year industrial production plunged by roughly 20%, latest Eurostat data show a 6% increase (March 2009-2010).<sup>34</sup> This has given rise to some optimism. Then 'Greece' happened. The Greek debt crisis and its contagion effect on other major European economies such as Italy, Spain and others have shattered market confidence and are putting the overall recovery at risk.

While as recently as a year ago, governments were scrambling to provide financial assistance to the banking sector, they are now scrambling to finance their own debts. In the meantime, major European industries continue to struggle. The car and shipbuilding sectors in particular are facing difficult times. Orders for vehicles have collapsed and are now just slowly beginning to recover while Asian competitors are busy securing the next round of orders in the shipbuilding industry. This is having ripple effects on other sectors such as second and third-tier suppliers, resource producers, as well as the manufacturing sector in general. Subsequently, foreclosures have increased and the European unemployment rate has risen from an average of 7% in 2008 to almost 11% this year.<sup>35</sup>

The credit crunch and economic recession, however, have not been the only factors adversely affecting European industry. The European economy has also had to come to grips with increasing competition for scarce resources such as fossil fuels, rare metals as well as the need to lower carbon emissions in order to combat climate change. The former, demonstrated by the oil price shock of 2008, which precipitated the recession, as well as the overall increase in resource prices, is a particular burden as the cost of materials, largely based on the production of resources, represents almost 40% of the cost structure in the manufacturing sector. In addition, with almost three tonnes per capita per year Europe has the highest net imports of resources in the world, making it particularly vulnerable to future supply constraints.<sup>36</sup>

The aforementioned three pressure points – the economic crisis, rising energy and resource prices, and the climate crisis – are all interrelated and have created a difficult context for Europe's industry, Europe's industrial policy and European policy-making more generally. The financial and economic crisis in particular has had an immense influence on the energy and climate change challenge. In the short term, it has actually provided a respite in a number of ways; while in the medium to long term it has been, quite to the contrary, undermining the necessary model shift.

34 'Europe industrial production declines by record 21.6%', *Bloomberg News*, 12 June 2009.

See: <http://www.bloomberg.com/apps/news?pid=20601087&sid=aik2bxsFFvWM>

'March 2010 compared with February 2010 Industrial Production', *Eurostat News Release – Euroindicators*, 12 May 2010.

See: <http://europa.eu/rapid/pressReleasesAction.do?reference=STAT/10/68&format=HTML&aged=0&language=EN&guiLanguage=en>

35 *Economic Crisis in Europe: Causes, Consequences and Responses*, European Commission, July 2009.

See: [http://ec.europa.eu/economy\\_finance/publications/publication15887\\_en.pdf](http://ec.europa.eu/economy_finance/publications/publication15887_en.pdf)

36 'Overconsumption: Our use of the world's natural resources', Study by Friends of the Earth Europe (FOEE) and the Sustainable Europe Research Institute (SERI), September 2009.

The economic recession, by decreasing output, has also reduced the demand for energy, thereby bringing down prices and providing some form of comfort to industry and consumers. The oil price dropped from its high of \$150 per barrel (bbl) to \$40/bbl and is now recovering at \$80/bbl, while gas prices, due to a glut in LNG supplies and unconventional gas in the United States, have plummeted from \$15 per million British thermal units (mmbtu) to \$4/mmbtu.

The crisis has simultaneously led to a reduction of carbon dioxide. Emissions decreased by 11% in 2009 not only due to reduced industrial production but also because it was more profitable for energy utilities to switch to cheaper and cleaner-burning natural gas.<sup>37</sup>

### Major drawbacks

These short-term benefits, however, mask some major drawbacks. The fact of the matter is that the financial and economic crisis is also an obstacle to the long-term structural changes that are needed to revitalise the economy and insulate it from future energy price shocks, as well as put European industry on the sound path to sustainability thus retaining its industrial competitiveness.

The economic recession has not only put a strain on important climate change measures, with the December 2008 European Council watering down the climate and energy package. It has also had an adverse effect on the EU's flagship emissions trading system (EU-ETS). Having reached a high of €32.90 in April 2006, the price for carbon permits tumbled nearly 70% to €10 in January 2009 and is currently trading at €15 as reduced industrial output has led to an excess

of permits. This coupled with the possibility of banking emission rights for future use is negating incentives to cut emissions.<sup>38</sup> Crucial investments in energy efficiency and green technologies are thereby being delayed. This is important given the fact that according to the 2006 Stern Review, failing to take action now will cause future economic losses in the range of 5-20% of global GDP, while the annual costs of climate mitigation would be around 1% of global GDP.<sup>39</sup>

In addition, the credit crunch is leading to a sizable underinvestment in research and development, innovation, and particularly energy infrastructure, most notably in renewables. According to the European Bank for Reconstruction and Development (EBRD) a whole range of projects, such as wind farms and gas-fired power plants have had to be put on the back burner due to a lack of liquidity.<sup>40</sup> In the first quarter of 2009, investments in renewable energy, for example, dropped by 53% compared with the same period in 2008. This is eroding Europe's leadership in the renewables industry with China and the United States giving us a run for our money. The US has already outstripped Germany to become the largest producer of wind energy while China is set to even surpass the US and has overtaken the EU in the production of photovoltaics. Commissioner Hedegaard recently said that the European Union is in danger of losing its competitive advantages in this sector.<sup>41</sup> This will also have a significant knock-on effect on the manufacturing industry.

Furthermore, reduced investments in energy are raising the spectre of a future energy supply crunch when the economy begins to pick up again. Although the reduction in demand is providing some breathing space, the necessary energy investments are, as mentioned above, more

37 'EU's carbon pollution drops record 11% as recession cuts output', Bloomberg News, 1 April 2010. See: <http://www.bloomberg.com/apps/news?pid=20601130&sid=aadYdhUVdquI>

38 'Carbon price raises fears of renewables lag', *Business Green*, 30 January 2009.

See: <http://www.businessgreen.com/business-green/news/2235485/carbon-price-raises-fears>

39 'Summary of conclusions', *Stern Review: The Economics of Climate Change*, see: [http://www.hm-treasury.gov.uk/stern\\_review\\_report.htm](http://www.hm-treasury.gov.uk/stern_review_report.htm); while the costs of climate change will be higher than 1% of GDP, it is given that the costs will be lower than delayed costs will be.

40 'Freeze risks energy future of Europe', *Financial Times*, 18 June 2009.

41 'EU needs green boost to stay competitive', *European Voice*, 15 April 2010.

difficult to make as capital has dried up. Instead of building new energy infrastructures, companies are embarking on a strategy of minimising operating costs, cutting capital expenditure and reducing capacities – in short they are sweating their assets; and this at a time when many of the existing power stations are coming to the end of their operational lifetimes and need to be replaced. By 2020 more than 100 GW (gigawatt) will need to be replaced and 200 new GW capacity will need to be constructed if the commission indeed moves to a 30% greenhouse gas (GHG)-abatement scenario. The commission's Green Paper *A European Strategy for Sustainable, Competitive, and Secure Energy* estimates that up to 730 GW will need to be installed by 2030 in order to meet the increasing demand for electricity and replace retiring plants. The risk of lack of investment is that it could lead to a future supply crunch, which would potentially lead to another bull run on energy prices, adversely affecting the European recovery and costing industrial as well as household consumers dearly.

### Short- and long-term policies

As such, there is a need to address the economic, energy and climate crises together rather than separately. In this vein, the European Union needs on the one hand a short-term integrated policy that relieves immediate pressure from this triple crisis and on the other a coherent long-term strategy that lays the foundations for a broad transformation of its industry. The first has failed to adequately materialise, however, and discussions surrounding the second do not look promising.

In their immediate response to the financial and economic crisis, European governments have, regrettably, failed to address the energy and climate challenge sufficiently. A study by HSBC, looking at the economic recovery measures taken by over 30 countries, came to the conclusion that

while South Korea and China invested respectively 80 and 37% of their stimulus funding into sustainable measures such as energy efficiency and renewables, the EU average was a paltry 8.5%.<sup>42</sup> In terms of hard cash, this translated into \$221 billion by China, \$112 billion for the US stimulus, \$31 billion by South Korea and \$23 billion by the governments of the European Union.<sup>43</sup>

While some of the EU's financial institutions, such as the European Investment Bank (EIB), have attempted to provide more finance during the credit crunch, the bank's record in supporting sustainable measures is not encouraging. According to a report from CEE Bankwatch the European Investment bank invested nearly 50% of its energy portfolio in fossil fuels in the period 2002-2008 while only 16% were dedicated to renewables.<sup>44</sup>

### European Economic Recovery Package

The European Commission has also put forth its own stimulus package, the European Economic Recovery Package (EERP), amounting to €5 billion. This money has essentially been split three ways, with €3.98 billion earmarked for fossil fuels and electricity interconnections, €1.05 billion for carbon capture and storage projects (CCS), €1 billion for broadband infrastructure and projects working with the common agricultural policy (CAP) and €0.57 billion for offshore wind farms.

What is most worrying about this stimulus package, besides the relatively low level of financing provided for renewables, is its spectacular failure to give adequate attention to concrete energy efficiency measures. Originally, €500 million were earmarked for the 'smart cities' initiative, which supports cities and regions to reduce greenhouse gases by 40% by 2020, which would, inter alia, also provide energy security and socio-economic advantages in terms of quality of life and local

42 *A Climate for Recovery*, HSBC Global Research, 25 February 2009, found in: 'Low Carbon Jobs for Europe – Current Opportunities and Future Prospects', WWF, June 2009.

43 'Green stimulus spending by country', World Resources Institute, 2009.

44 *Change the lending, not the climate*. CEE Bankwatch, November 2009. See: [http://bankwatch.org/documents/changing\\_the\\_climate.pdf](http://bankwatch.org/documents/changing_the_climate.pdf)

employment.<sup>45</sup> European Commission President Barroso, however, decided in a last-minute change of heart to cancel this crucial funding.

Following pressure from our Green Group in the European Parliament, the European Commission finally ceded to a compromise agreement whereby it would direct any unspent stimulus funding towards energy efficiency. Commissioner Oettinger acknowledged this as recently as May 2010 at a hearing, stating that this money would go to energy efficiency and in particular the smart cities initiative. These funds, however, are expected to be rather small in volume (€115 million) compared with the funding dedicated to other portfolios.

The European Union is therefore missing a great opportunity as energy efficiency is one of the most relevant and cost-effective tools providing numerous advantages to European industry as it simultaneously cuts costs, increases energy security, decreases emissions, and creates employment opportunities.

In terms of costs, the International Energy Agency (IEA), for example, estimates that, on average, every additional \$1 spent on more efficient electrical equipment, appliances, and buildings avoids more than \$2 in investment in electricity supply. A study by the McKinsey Global Institute (MGI) has calculated that an annual global investment of \$170 billion in energy efficiency improvements over the next 13 years, (a figure far lower than the size of the bank rescue packages) would yield up to \$900 billion annually by 2020.<sup>46</sup> For the European Union in particular, the European Climate Foundation concluded that realising the EU's 20% energy efficiency target would result in savings of €107 billion per year by 2020, translating into over €600 per household.

## Energy efficiency

In terms of energy security, a report by Cambridge Energy Research Associates (CERA) states that the European Union could cut back its natural gas consumption by 125 bcm per annum – equivalent to the combined consumption of Germany, France and Spain – by 2030 using existing technologies to increase energy efficiency.<sup>47</sup> In addition, a 2005 study by the European Commission entitled *Doing More With Less*, found that energy efficiency investments to save 20% of EU energy consumption could create up to one million direct and indirect jobs in Europe.

Energy efficiency measures could also play an important and innovative role in the long-term stability of financial markets. A robust financial framework with adequate regulation and oversight for trading in energy efficiency certificates and the creation of energy efficiency funds, for example, could provide the requisite security for those institutions that need assets to match their long-term liabilities, such as insurance companies, pension funds or even sovereign wealth funds.

It is therefore particularly unfortunate that the European Council still refuses to make the 20% energy efficiency target mandatory, especially when current trajectories show that the EU will only achieve an 11% energy consumption saving by 2020.

Had the European Commission and the national governments proposed more sustainable measures in their stimulus packages, particularly focusing on industry-friendly support for energy efficiency, their aim to bring some temporary relief to European industry and consumers from the economic, energy and climate crises would have been more promising. This would particularly have been the case if the European Commission

45 'European Initiative on Smart Cities', European Commission Website.

See: <http://setis.ec.europa.eu/initiatives/technology-roadmap/european-initiative-on-smart-cities>

46 *Curbing global energy demand growth: The energy productivity opportunity*, McKinsey Global Institute (MGI), May 2007.

47 'EU energy curb strategy hailed', Financial Times, 24 April 2009.

See: <http://www.ft.com/cms/s/0/2992fcde-3067-11de-88e3-00144feabd0.html>

had employed its €5 billion European Economic Recovery Programme to leverage funds from the private sector. This could have had a multiplier factor of 5 to 15, as indeed the Green Group in the European Parliament recommended.

## Europe 2020

With regards to the European Union's long-term strategy to address the multiple challenges faced by industry, the EU is now in the process of adopting a new 10-year strategy entitled 'Europe 2020', which aims at creating "smart, sustainable and inclusive growth". This strategy follows the failure of the Lisbon Agenda, which aimed to make the EU the "most competitive and dynamic knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion". While the Europe 2020 strategy includes numerous points that deserve merit, such as the flagship initiatives on innovation, resource efficiency and industrial policy, the overall strategy lacks ambition as well as coherence.

First and foremost, the current EU budget proposal by the European Commission that is being discussed in the European Parliament does not foresee any adequate financing for the Europe 2020 strategy. This begs the question how this strategy is supposed to have any chance of success if it lacks the necessary resources?

Second, the strategy lacks ambitious targets and indicators for some of its key policies. The commission speaks at length about increasing resource efficiency but fails to put a number on it, such as an annual 3% increase in resource efficiency as suggested in the Greens/EFA resolution on EU2020. In this context, it is even more regrettable that the European Council adopted a position on energy efficiency without any mention of overall resource efficiency, particularly given the fact that resources and their costs are

such an important issue for European industry. Furthermore, while the commission likes to use the 'green jobs' and 'green public procurement' rhetoric, it is unwilling to put a target on either, even though, particularly with regard to the latter, numerous organisations, such as the European Environmental Bureau, have called for a 100% green public procurement target to be set.

While the Europe 2020 strategy naturally does not look beyond the horizon of 2020, the European Commission will sooner or later also have to come up with targets and policies taking into account a 2050 timeline. Here, a long-term renewable energy target of 100% in the electricity sector by 2050 will be absolutely crucial. This is particularly the case given that numerous studies by organisations such as PricewaterhouseCooper (PwC) and the Heinrich-Böll-Stiftung have illustrated that, contrary to common belief, 100% renewable energy in the electricity sector by 2050 is achievable.<sup>48</sup> In addition, new analyses by McKinsey have come to the conclusion that the EU can fully expand its renewable energy without leading to a rise in electricity prices.<sup>49</sup> This is due to the fact that, while the initial up-front investment for renewables is higher than their fossil fuel counterparts, the running costs of renewables are significantly lower. An ambitious and comprehensive roll-out of renewables in the European energy sector would boost employment across the European Union and insulate the economy from rising energy prices while simultaneously addressing the climate change challenge.

## New green deal

As set out at the beginning of this article, the European Union is facing the immense challenge of providing future economic dynamism in the context of increasing competition for scarce resources while simultaneously greening its economy in order to combat climate change. This challenge is taking place under increasingly

48 100% Renewable Electricity, PricewaterhouseCoopers, 26 March 2010.

See: [http://www.pwc.co.uk/eng/publications/100\\_percent\\_renewable\\_electricity.html](http://www.pwc.co.uk/eng/publications/100_percent_renewable_electricity.html) ;

Schreyer, Michael and Mez, Lutz. *ERENE: European Community for Renewable Energy*.

Heinrich Böll Foundation, 2008. See: <http://www.boell.de/downloads/ecology/ERENE-engl-i.pdf>

49 See: <http://www.roadmap2050.eu/>

difficult circumstances. The financial and economic crisis has dried up bank lending, exhausted public coffers and increased Europe's unemployment rate. At the time of writing, and in the context of the Greek debt crisis, it is even calling into question the very foundations of Euro and European solidarity. In addition, the EU has to deal with increasing global competition from emerging players such as China, India and Brazil.

Europe's industry is at the heart of these matters and is struggling. Without substantial reform and the right mid- to long-term political support

that shifts the currently unsustainable mode of operation to a sustainable one, the EU's economy risks a steady decline and loss of competitiveness. A green new deal based on renewable energy, innovation, efficiency and green technologies with vast investments in job-intensive infrastructures can revive our economy and put into place the foundations that will create wellbeing and prosperity for our society and future generations. The European Union has already missed a valuable opportunity with its stimulus funding. Let's hope its long-term strategy can do better, in spite of the fact that its outlook does not look promising.



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## 6. CLAIRE CHAMPEIX

# What Future for Social Protection after the Crisis?<sup>50</sup>

The financial and economic crisis that began in 2008 had immediate social consequences but we are only now starting to see its long-term impact. The visible and obvious effects include rising unemployment, increased poverty, growing homelessness and over-indebtedness. There are other less obvious effects such as worsening working conditions, more mental health problems and growing feelings of despair. NGOs and their services are increasingly unable to alleviate the scourge of poverty and social isolation. It is Member States' exit strategies, however, with threats to cut social protection, minimum income schemes and public services and without the slightest guarantee of support for the unemployed to find work that will have the most damaging long-term impact.

The crisis has had a two-pronged impact on social protection. On the positive side the role of social protection as an automatic stabiliser has been recognised and some countries have taken short-term ad hoc measures to reinforce policies aimed at those, who have been hit hardest. Some governments have initiated reforms likely to improve the efficiency of national social protection systems.

On the other hand, because of the enormous sums used to bail out the banks and ever growing public deficits, Member States have started to make big cuts in public expenditure, cutting education and social protection budgets. This has made the situation even more difficult for the people concerned.

## 1. Serious economic crisis, tremendous social consequences

The consequences of the crisis in terms of rising unemployment are well known. The number of people who have lost their jobs, however, is only the visible part of the unemployment iceberg. The consequences of the crisis are many and often not immediately obvious. The crisis is far from being over and consequences will continue to emerge.

### Unemployment and the deterioration of working conditions

High unemployment in some countries has been one of the first and most visible consequences of the economic crisis. In April 2010 the number of unemployed in the EU was 7.1 million (or 44%) higher than in March 2008 when unemployment was at an all-time low. In 2009, the unemployment rate for the EU-25<sup>51</sup> was 9% compared to 7,2% in 2007. Some countries have been particularly badly affected: in Spain e.g. unemployment in 2009 was 18%.

However disturbing these figures are, they underestimate the reality of unemployment. In many countries, a dramatic increase in unemployment has been partly avoided by widespread use of part-time and/or short-time employment and a reduction in the number of hours worked. This means that many people, without being made redundant, have lost part of their income. Some self-employed people have lost their businesses and may not appear in the unemployment statistics because they are not entitled to benefits

50 The present article is based on the report 'Social Cohesion at stake, the social impact of the crisis and of the recovery package', drafted by Claire Champeix and Sian Jones and published by the European Anti-Poverty Network (EAPN) in December 2009 ([www.eapn.org](http://www.eapn.org)). An updated report will be published at the end of 2010.

51 Without the new Member States Bulgaria and Romania which had joined in 2007.

and therefore may not register as unemployed. Informal workers, including undeclared migrants and those working while on benefit (some of the first to suffer) also do not appear in unemployment statistics.

Working conditions have also suffered a negative impact. In some cases, cuts in wages are implemented without any reduction in working hours and working conditions have deteriorated as some companies have also cut non-wage costs in a bid to improve competitiveness.

### **Housing exclusion and homelessness**

As people can no longer pay their mortgages or rent, housing eviction is growing. There has been an increase in the number of repossessions, evictions and other collection procedures related to credit. Migrants and ethnic minorities face growing discrimination in accessing affordable housing. Homelessness is an increasing reality, notably in Spain, the Netherlands, Sweden, Germany and Ireland and there is a growing number of homeless families in Latvia.

### **Indebtedness and financial exclusion**

There are increasing problems of over-indebtedness in Spain, Ireland, the Czech Republic, Sweden, the Netherlands, Denmark and the UK. In Germany and Finland, massive over-indebtedness is expected to be part of the delayed impact of the crisis. In other countries people living on limited incomes are no longer in a position to deal with daily expenses. This results in greater demand for NGO services to provide basic goods like food, clothing and shelter.

Financial exclusion is a serious problem. It is difficult to understand why credit is still so difficult to access for ordinary people as well as for small enterprises, despite millions of euro of public money being used to bail out the banks. The lack of access to fair credit is making the poor easy prey for loan sharks who charge exorbitant interest rates, often using unscrupulous and aggressive collection methods.

### **Pensions under threat**

Pensions have also been affected by the financial crisis both through reductions in money paid out and the wider impact the crisis has had on the value of pension funds. The trend to reform pension schemes through a gradual shift of responsibility from the state to the individual citizen has left people's savings for their old age at the mercy of economic fluctuations and financial market speculation. This will reduce incomes in old age and create a group of 'new poor' older people.

### **Workers with little job security the first victims**

Clearly, those workers with the least secure jobs (agency workers, workers on short-term and temporary contracts, on-call workers etc.) have been the first victims of the economic crisis. The first to lose their jobs, they are also the last in line when seeking employment in the current difficult labour market. These workers share similar problems in that they are often poorly trained/educated, suffer from long-term sickness or a disability or are migrants. What will happen to these groups, who may now be permanently left without any chance of a decent job?

### **Further deterioration in living conditions and social cohesion for the poorest**

People with no or limited income and with little chance of finding support are more and more deprived. Demand for food, shelter and clothing is often on the rise in groups that previously did not need these kinds of services. With increasing poverty there is often growing insecurity – stress levels rise, mental illness and suicide are more common. Vulnerable people compete for scarce jobs and limited support in the context of ever increasing demand. This tension is responsible for growing racism and xenophobia as well as increasing domestic violence within families. There are strong feelings of hopelessness, a lack of trust in the future and a loss of confidence in the ability of society to challenge growing inequalities and ensure social cohesion.

### Impact on women

The impact of the crisis on women has been under-reported. Women in the service sector, on insecure contracts, have been very vulnerable to dismissal and are big losers in the area of undeclared work, particularly in community services. Often, when a man loses his job, women, who bear the primary care burden are pressurised into getting full-time jobs. In many cases this leads to major challenges in the work/family balance as well as new poverty traps. Women who have migrated to the EU on the basis of family reunification now face reviews of their residence permit when their husband/partner becomes unemployed.

### Children

Children are directly affected by the unemployment of their parents and experience increased poverty, as well as a tense and anxious atmosphere in the home. Family stability can also be jeopardised with parents unable to afford to raise their children and having to let them be taken into care. In some eastern European countries – where emigration can involve leaving children in the care of relatives – the need for child protection is on the rise.

## 2. Social protection and good social policy – key factors to help societies in difficult times

In the recent turmoil at least one thing is clear: social protection plays a key role as an automatic stabiliser. Social protection not only prevents the dramatic rise in poverty associated with unemployment but also sustains the functioning of the economy through guaranteeing a minimum level of consumption. This link was recognised in June 2009 by the heads of state and government during the European Council. *“Social protection systems and social inclusion policies play their role as automatic economic stabilisers and as effective mechanisms for cushioning the social impact of the downturn and for helping people back to the labour market.*

*Particular attention must also be given to the most vulnerable and to new risks of exclusion.”*<sup>52</sup>

Not all Member States, however, have social protection systems generous enough to fully execute this role. The capacity of such systems to address a rapidly growing demand, both in terms of administrative capacity and budget, is also an important consideration.

Holes are clearly appearing in social security safety nets at the very time when they are needed most. Social protection schemes ensuring minimum income and specific support for the most vulnerable are proving insufficient to cushion the impact of the crisis. There is clearly an issue concerning the adequacy of minimum income and social benefits, at a time when eligibility rules have been tightened in a number of countries. So called ‘activation policies’, tightening sanctions imposed on the unemployed to get them back to work at any price, are being pursued even more rigorously even though there are fewer jobs available. Increasing housing difficulties caused by the crisis only serve to highlight the insufficiencies of public housing policies in providing access to affordable housing for all. In addition, existing policies are threatened by cuts as governments seek to address their budget deficits.

### Some positive responses to help the poor

Some countries, however, have taken a number of good additional ad hoc social measures. For example, Spain has introduced a moratorium on 50% of the mortgage payments of those made redundant. In Ireland, where many houses built by developers are now empty, the government, at the request of homeless organisations, has provided local authorities with funding to rent out some of these houses and address some of the needs of those on the housing waiting list.

Improvements in employment benefits have also been made, for example in Belgium where a social fund has been created that provides an

income supplement to unemployment benefits. Improvements in the guaranteed minimum income have been announced in Spain and in Finland. Measures to improve pensions have been made in Finland, with the introduction of a guaranteed pension in 2011.

Some governments have decided to allow extra support for households, especially families with children, in the form of a one-off allowance (France), an increase in children benefits (Germany, Czech Republic), a noticeable improvement in health care packages (Malta), fiscal policy (Austria) and payments to alleviate energy bills (Greece, Cyprus). In the Czech Republic, Sweden and Finland education and training have been given a renewed boost as a tool against unemployment. In the UK, the Future Jobs Fund has been launched that aims to provide 'real jobs' for 150 000 young people aged between 18 and 24. The Swedish government has given local and regional authorities funds to avoid a decline in the quality of the health and social sectors.

### 3. Management of the crisis in EU Member States puts social protection systems at risk

#### The question of public budget management

The reality is that national budgets have been jeopardised because governments first chose to bail out the banks and major industries. As a result, many governments have now very little room for manoeuvre. There has been discussion as to the amounts spent on the bailouts and the efficiency of such a choice. Some Member States point to the huge amounts of public budgets engaged to safeguard the demand side in the worst hit sectors.

Several factors are contributing to widening public deficits. There are drastic reductions in public revenue as expenditure continues to rise.

This is to be expected as the private and corporate tax base shrinks and unemployment and social benefits rise and governments have financed 'extraordinary measures'. In 2009, public deficits were: 5-6% of GDP in Spain; 13% of GDP in the UK, where the total amount of public debt is 80% of GDP, with a corresponding figure for Ireland approaching 34%.

#### Belt-tightening spreads

The current trend, supported by the EU Stability and Growth Pact, however, is to reduce these deficits through belt-tightening policies. The Spanish and Irish governments, hit particularly hard by the crisis, have already made significant cuts in the education and social sectors, including benefits and pensions. These cuts have been bewildering and deeply disturbing. Other countries are also doing the same thing. Public housing projects are being abandoned at a time when they are most needed. In Ireland, deflation is used by the government to reduce rental allowance, making it even more difficult for people to manage.

#### Threats to social rights in some new and potential Member States

As a direct consequence of the crisis, the credit crunch and the dramatic fall in their currencies, the debt burden of some eastern European countries has become unsustainable. Hungary, Iceland, Latvia, Serbia and Romania have taken up International Monetary Fund (IMF) and European Commission loans. They now have to comply with budgetary and structural reform requirements and this has led to massive cuts in social services and public administration. Voices have been raised in defence of social rights in recovery and exit plans. In the European Parliament, a written declaration (0056/2009)<sup>53</sup> requested that social conditionality become an integral part of any financial assistance and that the commission and Member States evaluate the

53 <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+WDECL+P7-DCL-2009-0056+0+DOC+PDF+V0//EN&language=EN>

social impact of all anti-crisis measures on a regular basis and report back.<sup>54</sup>

### Progressive taxation

An option adopted by a number of governments is to increase public revenue by introducing new taxes. The majority, however, have shown little concern as to how these measures will impact social issues. Instead of using the opportunity to ensure that the poor do not pay for the crisis (i.e. higher tax rates for the rich, lower for the poor), they prefer flat tax increases or indirect taxes (e.g. VAT) that proportionately hit the poor the hardest. There is little attempt to shift the tax burden from labour to capital or to make use of the polluter pays principle.

### Attacks on social protection financing

As a way to boost the economy, support business and limit unemployment, some governments have chosen to reduce employers' social security contributions (France, Czech Republic and Finland). This raises questions concerning the future of our social protection system. Will solidarity remain a core principle? Apart from loss of funding, what will be the long-term impact of these reductions on social protection?

### State budgets disengage from social activities

NGOs are assuming an increasing role as public authorities disengage and public services are cut. In some cases, budget cuts are also applied to services they provide on behalf of public authorities, with preventative services the first to go.

In response to the crisis, the EU has taken significant steps to re-channel EU structural funds mainly towards stimulating growth and maintaining employment. In some Member States negatives changes are noticeable as there has been a focus on maintaining employment at the

expense of those least able to participate in the labour market or benefit from equality policies.

The majority of NGOs are concerned not just about maintaining the quality of the support they provide to people in need but they are also finding their advocacy and networking work even more difficult as further cuts bite.

## 4. Minimum income and social protection central in the fight for recovery

### What should be done?

Initiatives have been taken at EU level to trigger a coordinated approach among Member States and a number of EU instruments have been used to help overcome the effects of the crisis, including the Stability and Growth Pact, the economic recovery plan of November 2008 and the Europe 2020 strategy.

But this approach will not lead to the sort of change that we need if we are serious about putting people first. Current measures are likely to make the situation even more difficult for those worst off. Given the key role they are playing in the management of the crisis through their services and advocacy, NGOs, together with other stakeholders including trade unions, should be part of the process shaping and implementing exit strategies, within a structured dialogue. A commitment to a sustainable recovery, which ensures inclusion and reduces poverty and inequality, should be the objective of all exit strategies.

Against this backdrop, the EAPN (European Anti-Poverty Network) has proposed the following:

■ Tackling the causes as well as the consequences of the crisis is a top priority. The current model of growth is questionable and a link should be made with the unfair distribution of wealth and growing inequalities. Not all EU countries

54 At the time of writing, the Greek budget crisis was unfolding with help being offered by the IMF and the EU to reassure financial markets. This help will require dramatic belt tightening. Drastic measures are also planned by France, the UK and Spain.

are affected to the same degree. Those with a better-developed universal services and social protection models have done better.

- Alternative strategies for tackling the crisis, based on a more flexible approach to public deficits and a more redistributive and alternative tax system ensuring the poor do not pay for the crisis, reduces the inequality gap as well as the burden on labour and makes sure that the polluter pays. It is time to reinforce minimum income and social protection schemes and invest in universal services not only as ‘automatic stabilisers’ but also as the most effective and efficient way to reinforce social cohesion and build a more sustainable model of prosperity.

- The most vulnerable should be the most protected: increased budgets should be devoted to emergency support, as well as social policies, including the delivery of services.

- Unemployment should not be solved by creating insecure jobs. The promotion of good jobs is needed more than ever and public initiatives in partnership with social and economic actors should be developed to this end.

- Governments should put values and rights at the centre of their approach to the crisis, ensuring that short-term options dictated by the strongest interests, do not undermine a long-term vision.

### How sustainable social recovery can be boosted at EU level

Member States have not been equally hit by the crisis, but their economies are interdependent. Coordination is not only needed in the financial and economic fields but also in the employment and social fields. This is to prevent social dumping and avoid damaging the foundations of the European Social Model. Such damage would result in some people losing their ability to participate fully in society.

Although the subsidiarity principle applies to social protection in the EU, the new Lisbon treaty, with the Charter of Fundamental Rights as a binding instrument, enhances the social objectives and mission of the EU and confirms its key coordination role in social policy. A series of measures have already been put in place at the EU level to ensure coordination of employment and social policies. It is now time to use them more effectively to avoid the financial and economic crisis becoming a long-term social crisis.

The new framework strategy Europe 2020 which replaces the Lisbon strategy for Growth and Jobs was adopted in June 2010.<sup>55</sup> The EU Member States agreed to work to pull 20 million Europeans out of poverty and gave their political endorsement to the Integrated Guidelines for economic and employment policies. Progress and impact should be publicly and transparently debated in national and the European parliaments and lead to tangible change for people living in poverty.<sup>56</sup>

The current dramatic situation, however, requires more than the good will of governments to work together. We need to create binding instruments at the EU level, such as a framework directive on adequate minimum income, which would guarantee that all Member States implement minimum income schemes at a level compatible with human dignity and at least above the agreed poverty threshold (60% of the national median income).

Today, the capacity of EU governments to shift up a gear in the building a ‘Social Europe’ will demonstrate their political willingness to put the needs of people before the needs of business and banks. How governments choose to deal with the crisis will in the end be of paramount importance to those threatened by poverty.

Lessons need to be learnt from the mismanagement of the crisis. Defending and strengthening social protection and minimum income schemes must be a core priority. Otherwise, the crisis will

55 [http://www.consilium.europa.eu/ueDocs/cms\\_Data/docs/pressData/en/ec/115346.pdf](http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ec/115346.pdf)

56 More detailed proposals for EU instruments can be found in EAPN policy papers accessible on [www.eapn.org](http://www.eapn.org)

lead to a significant long-term weakening of our social model, increasing poverty and a widening of the inequality gap. The fight against poverty and

social exclusion is crucial if we are to ensure that the recovery is built on sound foundations. The EU should lead the way to a sustainable recovery.

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## 7. HELGA TRÜPEL

# The Financial and Economic Crisis and its Effect on European Education Policy

We still find ourselves in one of the most serious economic and financial crises we have ever faced. It is a crisis whose shock waves have impacted all aspects of national and international policy. Naturally it has also had an effect on education and training in many European countries as they struggle to face funding cutbacks.

The European Union has no formal competence in education policy: in accordance with the principle of subsidiarity Member States are responsible for the form and content of their own systems. As all Member States, however, face similar problems as for example an aging population and the necessity to remain internationally competitive; they have common goals that guarantee there is a coherent European policy.

The European Union funds a number of programmes that enable adults and young people to study or train some of the time in another European country. In parallel there is also a special programme of lifelong learning. In total the European Union will invest some €1.1 billion in education and training in 2010.

### Examples from the Member States

If one looks at developments in education policy in the last few years in the EU one can see how much it has been affected by the financial crisis. There have been drastic funding cuts especially in the eastern Member States. For example, in the last two years Latvia has reduced its 35 000-strong teaching force by 6 000. In addition salaries in the education sector were reduced by 20% in April 2009. In the same period Spain, France and Sweden have closed state schools to reduce government spending.<sup>57</sup>

Greece is in a similar position especially now with the current crisis. In recent years there have been successive cuts in funding so that in 2008 only 2.9% of GDP was spent on education, the lowest figure in the European Union. In Germany, education is the responsibility of the individual states although the federal government provides an annual budget of €10.9 billion for education and research. Despite the crisis the Federal Ministry for Education and Research saw its budget increase by 6.5% from 2009 to 2010. It would appear that Germany, in comparison with other European countries, has maintained stable budgets in this area. The state of Bremen for example has escaped cuts in education in the last couple of years with the 2009 education and training budget (€232.9 million) showing a small increase over 2008 (€223.9 million). These figures are, however, misleading as increasing numbers of universities have too little funding and even kindergarten places have become ever more expensive. The plan that, by 2013, 35% of all young children in Germany should be able to attend day care will be difficult to achieve. In the area of the old Federal Republic some 300 000 places will need to be created to meet this target.

It is therefore clear that the global economic and financial crisis has had a significant impact on European Union education policy. Education budgets have not been so directly affected but the general savings cuts have impacted all policy areas. This is serious, especially when investment in so-called human capital is so vital for our future economic development. Today, success and competitiveness are more and more dependent on know-how and service provision and these require investment in education and training.

57 See J. A. Douglass, 'Higher Education Budgets and the global Recession, Tracking various National Responses and Their Consequences', *Research & Occasional Paper Series* CSHE, Berkley, Nr 4, 2010.



## European education policy

There is recognition at the European level that something must be done to counteract negative developments in some Member States. Brussels cannot interfere or regulate national policies but it tries to encourage and support life long learning by means of various European Union programmes. In this way it can make recommendations and provide a lead without direct involvement at national level.

The idea of lifelong learning is that learning is not just for young people in school but for all ages and at all stages of life. The idea of a European life-long learning programme is that people should be free to move between education and employment throughout the Union to make the most of their professional and other skills. This is especially important given our current demographics, as we need to take into account the needs of an aging population. In the near future, when we will have an increasing percentage of pensioners, it is essential that we provide educational opportunities for the less qualified up until old age.

The European Union education budget for 2010 is 4.4% higher than in 2009. Around €1 billion is for the most part invested in life long learning; this includes the Erasmus student exchange programme that has helped more than two million students study in another European country; the Leonardo Da Vinci programme that enabled 68 000 trainee exchanges in 2008 and the Comenius Programme to organise exchanges for pupils and school teachers.

The Leonardo Da Vinci programme aims to bring theory and practice together in the area of vocational training. Young trainees undertake part of their course in a partner organisation in another Member States thus bringing about better cooperation between EU training institutions. At the same time, participating companies are able to exchange best practice and develop their employees' skills. This not only allows Europeans to gain new knowl-

edge and experiences but it also helps dispel the often negative image of vocational education.

Comenius is also a programme to improve mobility within the EU. It is designed for school pupils and teachers and aims to increase understanding and appreciation of Europe's rich cultural heritage. Its promotion of school partnerships allows young people to acquire better life skills and develop into active European citizens. Comenius exchanges also give an extra dimension to teacher training and professional development.

## Education and Europe's 2020 Strategy

At the beginning of March 2010, the European Commission presented its new 2020 Strategy that, in straight response to the current financial crisis, provides guidelines for the coming ten years. A major focus of this strategy will be education and training. It mentions efforts to reduce the number of school dropouts, ways to increase the number of graduates as well as an overall improvement in tertiary education throughout the EU. Such a strategy, however, is just a beginning and needs to be complemented by concrete actions at national level.

Commission President Barroso recognised the importance of this and at a meeting in April 2010 the majority of European Education ministers declared themselves in favour of the 2020 goals. But the European Council took its final decision in June – and took on a far less ambitious strategy.<sup>58</sup>

This is simply not enough. The Greens think that Europe needs a new strategy to secure a future for our young people. A stronger focus on inter-cultural exchange and lifelong learning is absolutely vital. In July 2006, the European Parliament approved a report I had prepared on the key significance of lifelong learning. The Commissioner for Education and Culture, Androulla Vassiliou, has taken a first step in improving mobility and intercultural exchange in the EU with her Youth on the Move programme.

58 The strategy had already come into conflict with Germany's federal structure. Chancellor Merkel and the federal government were reluctant to be subject to aims set by the EU and pressured the council to remove more homogenous education targets from the from the Europe 2020 strategy agenda.

Such cultural exchanges allow European citizens to develop their skills further and equip them to make a meaningful contribution to the debate on European integration. In addition, the economic potential of the EU is maximised as knowledge and experience are exchanged.

Youth on the Move will enhance other EU programmes. Existing universities and other institutes of higher education will be reinforced not just because they will guarantee a high level of education but also because they will ensure that their graduates are better prepared for employment. Eleven years after the introduction of the Bologna Process<sup>59</sup> we are on the right track but there is still a lot of work to be done. Universities must, as a matter of urgency, create a better system of mutual recognition of diplomas, more room for development and, by means of real reform, reduce the burden on students.

One of the goals of the 2020 Strategy is that 40% of all people between 30 and 34 years of age should be university graduates. But this is not enough. We will only be able to talk about a successful strategy when conditions for students and teachers have been improved and course content is appropriate to the time allowed. In addition we need to ensure that the number of pupils who drop out of school before obtaining any qualifications is less than 10%.

A second aspect of the programme is to improve student mobility. In 2009 the Erasmus programme made it possible for some 200 000 Erasmus students to study in another European country but of course this still is only a small percentage of the total number of students in Europe. The Greens are of the opinion that we need to redouble our efforts to make it possible for all students, regardless of their social origins or income, to be able to study abroad. Other programmes, such as Comenius for school pupils or Leonardo Da Vinci for those in vocational training, are also unfamiliar to the majority of the population and therefore reach only a small number. All young

people, regardless of their qualifications, should be able to study or work in another EU country. Equally, school and college teachers should also have the opportunity to improve their professional qualifications by working in another part of the EU. Only in this manner can we achieve high educational standards in Europe and guarantee access to lifelong learning.

Unfortunately the goals of the European Commission and Commissioner Vassiliou are not quite as ambitious as we would like. Many of the aims that can be found in the 2020 Strategy were already in the Lisbon Strategy in 2000. It is not just about having things on paper – they need to be implemented. We need concrete benchmarks and mandatory objectives for Member States.

Youth on the Move goes some way in the right direction but there is the danger that, given the integration of so many programmes, adults and young people alike will find it difficult to understand. Even today, there are many complaints about lack of information and clarity concerning the various funding opportunities. There needs to be better communication between the EU and its citizens on educational matters. To this end, better use could be made of the EU's structural funds, the European Centre for the Development of Vocational Training (Cedefop) and the European Training Centre as information conduits. We also need to provide European citizens with the means to have a better understanding of both traditional and new electronic media. It is not just a case of understanding the content but also having the ability to look at what is behind it. An effective education system needs to encourage a critical approach to the media and therefore the European Commission has recommended that Member States undertake the necessary measures to ensure this.

In the forthcoming reform of national education systems attention must, above all, be paid to efficiency and fairness. In many countries the educational system often does little to remove injustice. Indeed in some cases the system promotes it. Of

59 The Bologna Process to create a single European university system takes its name from the Italian town where, in 1999, European education ministers signed a declaration to this effect.

particular concern are those with few qualifications or the poorly educated, who clearly do not have the same opportunities as the highly educated and qualified. We cannot afford to shut the disadvantaged out of lifelong learning. Every EU citizen should have access to decent education and training throughout his/her life. One way of tackling under achievement is to improve preschool education. Preschool education has a positive influence on later achievement and helps reduce the school drop out rate. Member States should take note of best practice in other countries in order to create an EU education system that constantly adds value.

One factor that is of special importance is the ability to speak another language as this plays an important role in facilitating social and cultural integration in the EU. If we can understand our neighbours, we will be better able to live with and learn from them. Pupils in the EU should, in addition to their mother tongue, learn at least two foreign languages.

The European Qualifications Framework (EQF) agreed by the European Parliament and the European Council in 2008 is another initiative designed to assist integration. The EQF aims to relate different countries' national qualifications systems to a common European reference framework. Individuals and employers will be able to use the EQF to understand better and compare the qualification levels of different countries and different education and training systems thus promoting more mobility. The implementation of the EQF, however, requires Member State willingness to fit their national qualifications into the 8-point framework reference. In future, job seekers will be able to use the appropriate EQF grade (corresponding to their national qualification) and a standardised form for their curriculum vitae

(Europass CV) thus making their application more easily understood in other countries.

## Redistribution of the European budget

Developing and improving all these projects will not be possible with the current level of funding. We can only guarantee that every pupil, student and apprentice will have equal access to education and be equally mobile when the EU budget is redistributed.

The 2020 Strategy requires Member States to devote a least 3% of their GDP to research and development in the next ten years. But we are far from achieving this. We have a very lopsided budget when 40% goes on industrialised agriculture and an ever-decreasing sum goes to education and training.

Alongside the reform of formal education there should also be better integration of non-formal and informal education. It is important that the contributions youth organisations and non-governmental organisations (NGOs) make to developing young people are given proper recognition. Partnerships with such bodies will only serve to strengthen the system. This kind of cooperation could lead to forms of learning more attractive to certain groups. This area could well focus more on European values such as solidarity, sustainability and the importance of culture.

A good education system and its resulting well-qualified work force have a positive effect on a country's economy. If we recognise this positive relationship we must also accept the reverse, namely that without proper investment in our 'human capital' we will not find our way out of the current economic and financial crises.



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## 8. STEFANI WEISS

# The Effects of the Crisis on the EU's Foreign and Security Policy

“Cela est bien dit, mais il faut cultiver notre jardin,” *Candide*, Voltaire.

The current economic and financial crisis is the most serious for 75 years and is as critical as the Depression of the 1930s whose political consequences are only too well known. Its impact and repercussions were only really properly resolved after the Second World War in the process of European integration and the later process of reunification. There is now a certain unavoidable air of tragedy as the process of integration, Europe's greatest achievement in foreign and security policy, is now itself coming under increasing pressure.

Historical comparisons can fool. It is, however, important to see that the current crisis has its epicentre once more firmly in the West. It has not been imported. It is clearly marked ‘made in USA’ and is a crisis of capitalism and its ideology of growth. Even if one does not wish to go so far as to see this crisis as an existential one for the West, one has to admit that such a serious amount of economic damage could only happen in a system, epitomised by the US, that rejects state paternalism and has unshakeable faith in the markets.

This is no excuse for the Europeans. The European banking and financial sectors were active players in the events that led to the crisis. The unimaginably large profits that this casino capitalism made possible over many years were just as happily and recklessly pocketed in Europe. The self-styled financial masters of the universe created a new version of the magic words ‘open Sesame’ with liberalisation and deregulation. The City of London enjoyed a boom that was little different to that of Wall Street and provided 20% of Britain's gross domestic product (GDP) until the Lehman Brothers' crash marked an abrupt return to reality.

The current crisis finds the West in a fundamentally different geo-political situation to that of the 1930s. Even if it were able, the West can no longer solve this crisis, neither on its own nor acting purely in its own interests. For some time there have been other major actors on the world stage. China and India have closed the gap with the West to such an extent that they now confidently lay claim to seats in global organisations, a reflection of their growing economic strength. Both countries have so far withstood the crisis astonishingly well and have even been able to expand their economies. China has posted a growth rate of nearly 10% for the first quarter of 2010. This is a significant boost for the global economy and has created preconditions that could help both Europe and the US to get back on their feet. In addition, the state coffers of these emerging markets are well filled. They now have the liquidity that the West so urgently needs for investment and to close increasingly large budget deficits. China's reserves alone are worth around €2 trillion.

### Far-reaching consequences

The effects of the current crisis on the EU's foreign and security policy can, without exaggeration, be described as far-reaching. They are so dramatic because the crisis has come at a time when the world is changing and recent events have accelerated this change. China's self-proclaimed ‘peaceful rise’ is in no way guaranteed and will only be done according to Chinese specifications that may well go beyond the pain threshold of other countries. Russia, equally badly affected by the crisis, has shown itself to be moderate but it is a long way from finding a role in the new constellation. It is likely that, for some time to come, Russia will continue to swing between overestimating its position and depression. Whatever its mood, it is a difficult partner for

Europe. Even if in the post Cold War period there was a unipolar moment in US history, in the classical sense of an economic, military and cultural super power, this has now vanished. The dream of a Pax Americana is now over. In the wake of the Iraq invasion, this might not come amiss for many Europeans. There are no signs anywhere that the emerging new world order will be influenced by Europe. The crisis has not brought the world any closer to Kant's famous concept of '*perpetual peace*'. In the current difficult economic situation the predominant reaction is to look to save oneself. This was clearly demonstrated at Copenhagen. Concerns about the alarming consequences of climate change were thrown to the wind. Individual states are far from seeing themselves as a community able to deal with common challenges in a collective way. Soon some 8 billion people,<sup>60</sup> the majority of them in Asia, will seek to make a livelihood and find happiness around the globe. Conflicts about water, food, fuel and land are already pre-programmed without any sign of binding and effective regulation to deal with them peacefully. The EU's first security strategy in 2003 entitled 'Europe in a Better World'<sup>61</sup> would therefore appear to be an unfulfilled, perhaps never to be fulfilled, promise. Post crisis, the world will be different for Europe, but in no way a better one.

## Alarming state

It is not only the geo-political situation that is not looking good for Europe. The EU finds itself in an alarming state. The banking crisis, so painfully averted, was actually only the beginning. As a consequence, Europe is now experiencing a deep depression from which there will be no swift phoenix-like rising from the ashes. The signs point in another direction – long and difficult. Given Europe's demographic development<sup>62</sup> as well as its reliance on imports such as oil and gas

there are fears that full recovery may never happen and Europe will be decoupled from the more powerful economies. For some time, other adversities have been awaiting us. Comprehensive packages to rescue banks and stimulate the economy alongside sinking tax revenues have further increased budget deficits that were already high pre-crisis. Europeans are caught in a debt trap. The situation in Spain, Italy, Portugal and Ireland is especially bleak. For the moment, Greek bankruptcy has been averted but it is in no way certain that the EU's €800 billion rescue plan of May 2010 will be sufficient to calm things down. It does not look much better in other Member States outside the euro zone. Hungary, Rumania and Latvia for example have, for a long time, depended on a drip feed from the International Monetary Fund (IMF) and EU emergency credits. Some European investment banks that in the past were happy to earn money buying government bonds from euro zone member states are now edging dangerously close to the abyss. And if bank, economic and debt crises were not enough, Europe now has to face a currency crisis to boot. Speculators are betting that the euro will fall. These developments will, in every way, prove fatal for the EU.

## Testing European integration

First of all, the crisis presents European integration with its severest test to date. It is still not clear if the EU will emerge successfully. The debt crisis and the euro's weakness cut to the quick of the EU. The Union is paying the price of not having followed the original policy of working towards proper political union but rather of pursuing European integration almost exclusively by integrating markets.

Member States so far have only surrendered that amount of sovereignty required to complete

60 2030 figure estimated to be 8.308.895. United Nations Population Division, World Population Prospects: The 2008 Revision, United Nations 2009, <http://esa.un.org/unpp>

61 A secure Europe in a Better World, European Security Strategy, Brussels, 12 December 2003, <http://www.consilium.europa.eu/uedocs/cmsUpload/031208ESSIIDE.pdf>

62 By 2030 almost 30% of Europe's population will be older than 60. In Asia it will be 16%. At the same time Europe's population is declining – by 2030 it will be -0.16%, while in Asia the rise will be 0.6%, United Nations Population Division: <http://esa.un.org/unpp/p2k0data.asp>

the various stages of the Single Market. In actual fact, even in this area they have only transferred some powers to supranational decision-making areas. In this respect the rules that govern the functioning of the Single Market, both internally and externally, form the real core of the EU. The Single Market is controlled and administered by the European Commission, with the accent being on administrated. The financial and economic crisis has made it absolutely plain that the Union does not operate at this level. In spite of the Single Market, the Member States only allow their economic policies to be coordinated within the framework of the EU. Given the wide differences between the Union's now 27 members, this is practically an impossible undertaking. Even euro zone members' autonomy over their individual finance policies was in no way reduced with the introduction of the common currency. Just how negative an impact this could have has been clearly demonstrated in Greece's inability to pay its debts.

To the present there has been no transfer of sovereignty from the Member States to the EU in the area of security and defence policy and the Lisbon treaty has done nothing to change this. Lisbon has, however, created two new offices designed to give a better foreign policy profile. In addition, a new European External Action Service under a High Representative for Foreign and Security Policy will represent the EU internationally. But these treaty reforms are also based on the principle of cooperation and fail to take the final step. Foreign and security policy does not belong to the tasks of the European Community nor, as it is now known post Lisbon, the Union. All substantial decisions have to be made unanimously by the Member States. This is not only time consuming but, given the differing priorities and interests of the Member States, it also means that agreements are based on the lowest common denominator. You cannot conduct serious foreign policy in this fashion.

Economic success was able for a long period to mask the EU's lack of economic, fiscal and social policies. This success also provided significant cover for the fact that, apart from public

declarations, there was no real common foreign policy. Now that economic success appears to be on a downward slope, the Single Market has shown itself to be no substitute for a 'United states of Europe'. This particularly appears to be the case when the Single Market has not shown itself capable of closing the gap between Member State living standards. Also contrary to what one would expect from this policy, every round of enlargement has multiplied the different interests to such an extent that any agreement on common aims or methods is now totally impossible. This would now appear to be the situation we are in.

The history of European integration has always been marked by crises but they were never as significant as things are at the moment. A decisive factor in this critical and bleak picture is the current generation of European political leaders. Unlike their predecessors, who had been through the war, this generation does not seem to grasp the reasons for the integration process and why it needs to be advanced, regardless of circumstances or opposition. There is no other reason to explain why, throughout Europe, policy seems to be made on the basis of tabloid opinions, old prejudices, a know-it-all attitude and nationalist egotism instead of thought for the community. Politicians, especially in France and Germany, are irresponsibly suppressing the fact that even today European policy is still about peace on our continent. The level of normality and civility achieved in the last 60 years of European integration would appear (given European history and the challenges of globalisation) not to run so deep as to be irreversible. In the end, the EU could break apart or become what the British have always wanted: a large free trade area with London as the banking and stock exchange centre.

### **Gambling away soft power**

Secondly, a self-doubting EU with little confidence in its integration process has gambled away a large part of its soft power and seeks to shape international relations according to its normative values. The world listens to and takes notice of the EU not least because it has been successful in bringing Europe peacefully together using

the law, supranational organisations and the transfer of sovereignty. The EU therefore stands as a tried, tested and unique model as to how peace, stability and prosperity can be achieved through economic integration. This has, in the past, encouraged others to follow its example. Regional organisations such as Mercosur, ASEAN and the African Union were all created with clear reference to the EU model.

In the wake of the EU crisis and the manner in which the Member States have reacted, these organisations are now very unsure as to whether or not to continue with this European model of peace and reconciliation. With the best will in the world the EU would now have difficulty finding any new takers for its integration model in such crisis areas as the Black Sea or the Caucasus. A currency union on the lines of the euro is also currently not top of the bestseller list. Various Arab states are now drawing back from such plans. Estonia's recent decision to join the euro zone is hardly likely to convince them to change their minds.

Self doubt and disputes cause damage in a more fundamental way. In the debate as to strategy, Americans particularly like to accuse Europeans of not having any strategic vision. But this is incorrect. Europe most certainly has a very clear idea as to how, post Cold War, to create a new and stable world order. With enlargement to the east and the south east, the EU has demonstrated how such a concept can work in practice. Its neighbourhood policy follows the same logic. The European model is: stability through democracy.

History offers evidence to support this idea – and not just because the EU itself provides an example. In the past there have been hardly any examples of democracies going to war with each other. Being based on a constitution, their structures are non violent and are experienced at resolving disputes amicably and peaceably. Just because today's world is different and transforming unstable and authoritarian states requires patience and perseverance is no reason for the EU to forsake its ideals and give in to other models of world order. Globalisation is dependent on the European model and can only function on the

basis of properly functioning multilateralism and the primacy of politics.

The idea that there can only be stability in international relations if the strongest keep order (imperial system) or terror maintains a balance of power is now of limited use. There are now many more new actors with power and influence operating alongside sovereign states. One advantage of this is the increase in the influence of civil society but it also carries a downside. The world of global finance, quite capable of demolishing whole countries, cannot be controlled by the use of missiles but only by regulation applied by international legislation.

### **Losing influence in global affairs**

Thirdly, European influence in global affairs is, for the most part, due to the EU's economic productivity, not forgetting the attractiveness of its Single Market. Even using 2009 figures, the total GDP of the EU Member States puts it just ahead of the USA as the world's highest. The next best, China, India and Japan are some way behind. If the current crisis and shaky foundations cause the EU to decline economically, then it will lose its influence in global affairs.

Money is power, brings you loyalty and can buy good will. This was never really to the forefront in the EU. There was a preference to present the Union as a civilian power. This does, however, not change the fact that the larger western European powers, along with the USA, were for many years, able to shape global events to suit their needs because integration had made them so economically powerful. The Union's Member States were some of the world's leading economies, making up the core of the G7. Together with the USA, they have been able to dominate international organisations – especially the World Bank and the International Monetary Fund (IMF) where they hold a blocking minority.

Since the Pittsburg summit in September 2009 to discuss the financial crisis all that is now history. The latest form of global governance is the G20. Even though France, Britain, Italy, Germany

and the EU belong to this forum of global players, Europeans now only make up about a quarter of the members. Their influence has accordingly already visibly declined.

One could, however, argue that it is not predominantly about quantity but rather quality. But Europe does not have much of that either. Europeans have been totally unable to pool what power they still have for more efficient use. They are still overrepresented but rarely able to speak with one voice. Even when they can, they are easy to drive apart during negotiations. This always presents the other side with the advantage of being able to choose with whom they prefer to talk when they need to break down the common front. European politicians pursuing personal prestige manage to do the rest. What is also difficult to grasp is why EU Member States, in their current difficult situation have chosen such colourless personalities as their new foreign policy leaders.

The crisis has made the chance of any further, especially any swift, enlargement practically impossible. This is particularly critical for development and stability in the Balkans, where what little improvement in their standard of living has been achieved after the long years of conflict, is now threatened by the recession. Frustration is growing and in the Balkans this can explode at any time. It will be even more difficult for the EU to keep the Balkan countries on the path to democratic transformation if the reward for progress (requiring economic and social sacrifices), recedes too far into the future. Just how Turkey's EU membership will be possible given current economic and political conditions is something that not even its strongest supporters know how to deal with. It would seem that the EU has lost one of its most important strategic options, namely to bring within its borders a new global trading hub. It also misses its one long-term opportunity to show that a country with an Islamic background can also be a stable democracy in which human and women's rights are observed and minorities defended.

The uncertainties that the Europeans have about their most important strategic partner, the USA, have increased during the crisis. The new president, so enthusiastically welcomed in Europe has revealed himself to be a cool and calculating (too cool and calculating for many Europeans) pragmatist, for whom questions of status and cultural tradition are only marginal. For him, Europe is only the first port of call when it can help him solve a problem. It is on this point that the Europeans begin to have difficulties. Post Cold War, Europe is only a second rank geopolitical space for the Americans. Europeans are not even required to act as creditors. This role has now been taken over by China and Japan. On the other hand, the USA is still strategically relevant for the Europeans as it is only with American help that they can guarantee their own security. In addition, they are unable to implement any significant action within the framework of the Common Security and Defence Policy (CSDP) without the agreement of the USA, as they are dependent upon the leadership and intelligence structures of NATO. Finally, the way the USA chooses to get out of the current financial and economic crisis will determine the EU's room for manoeuvre. So far, it appears that the US speeded up deficit policy will only make it more difficult for the Europeans to agree a common agenda to tackle the crisis. An additional factor is the new division of the world into countries with trade surpluses (the bad) and those with trade deficits (the good). The USA's historical unipolar moment would appear, in the classical sense, to have passed. It has, however, for some time regained its status as the world's leading power not least because of its unimaginable \$1 800 billion deficit<sup>63</sup> that makes it more relevant to the working of the system than all the large banks in the world. Every country in the world would try to avert it going under.

During the last year and a half, Russia has shown itself to be very cooperative and anxious to improve its relations with the West. It is possible that this new policy is down to the crisis. After the

63 [http://www.treasurydirect.gov/govt/reports/pd/histdebt/histdebt\\_histo5.htm](http://www.treasurydirect.gov/govt/reports/pd/histdebt/histdebt_histo5.htm);  
[http://www.bundesfinanzministerium.de/DE/Presse/Reden\\_20und\\_20Interviews/01072009\\_\\_DGB-Fachkongress.html](http://www.bundesfinanzministerium.de/DE/Presse/Reden_20und_20Interviews/01072009__DGB-Fachkongress.html)



successful completion of the nuclear arms control treaty between the USA and Russia, Russian support on Iran and the thawing of Polish-Russian relations, it would appear that conditions are now favourable even for use of the reset button in EU Russian relations. Russia needs western know how to modernise its economy. Europeans could consume Russian raw materials, providing a key market. Both sides have an interest in expanding and deepening their relations that, given the new global order, also offer a new strategic outlook. Why should a stable and democratic Russia not become a member of the EU? And why should the EU do without a stable and democratic Russia as part of the Union?

### **Empty treasuries reduce options**

Fourthly, empty treasuries reduce political options at all levels. The EU is still the largest development aid donor. Nobody at the UN, however, still believes that Europe will be able to meet the agreed 2015 Millennium goals. As a result of the crisis both the EU and its Member States will be looking very carefully at other foreign and security policy areas. Programmes to advance human rights, democracy, a market economy, the rule of law and good governance will not escape the red pen. Funding for international cultural activities, not be underestimated as a means of furthering understanding between countries, will be even more difficult to come by than at present.

Defence budgets will be disproportionately slashed and this is already happening. The risk of war in Europe is as low as it has ever been but there is no similar feeling about security. Central and eastern European countries are suspicious of Russian intentions. As Europe is unable to defend itself without NATO assistance and is therefore dependent on the USA, we cannot rule out that American interests in eastern Europe, given Europe's ever decreasing military capability, will need to be taken even more into account. What this actually means for EU policy towards Russia is not only visible in the area of American missile defence planning. Pro-American calculations in some Member States will also repeatedly make

reaching a common EU position on other important foreign policy issues difficult.

The Greek military budget cuts could, however, have an overall positive effect. A relaxation in Turkish-Greek relations would unblock many issues in NATO and the EU and make it easier to find a solution to the Cyprus conflict. On average the EU spends less than 1.7% of GDP on defence. If there are further cuts, the EU will find it even more difficult than at present to participate in UN peacekeeping or peace enforcement missions and provide UN-mandated civilian military CSDP missions. We will therefore see fewer of these CSDP missions in future but those we provide may be restricted to training missions for military and police, whose value for the maintenance of stability has become even more important in recent times. In addition, for budgetary reasons the EU should shy away from becoming involved in crisis situations far from its area. This will primarily affect Africa which has most need of engagement from the international community and where the EU is especially in demand to assist with human rights, the protection of minorities and good governance. The EU's contribution to a more stable and secure world will therefore scarcely be much greater than at present. Less security and stability in the world will also mean less security and stability for the citizens of the EU.

One cannot anticipate if Europe's political class will finally find the strength and will to use the crisis as an opportunity to throw off the pettiness and bureaucracy of their usual policies and create a political union. The crisis is certainly big enough and Europe's future certainly looks dark enough.

For years, there have been plans (although given current problems they are only of minor significance), as to how more security/defence can be obtained with less money by means of common procurement procedure, pooling of resources and getting rid of duplicated structures. New foreign and security policy structures such as the European External Action Service (EEAS) will provide opportunities to save money without having to give up political goals. We could start by dismantling structures duplicated within the

EU's own bureaucracy, make more efficient and considered use of available instruments and finish with Member States saving money by using EEAS for their representation in third countries or international organisations instead of national embassies.

If, more than two hundred years after Kant's writings on *Perpetual Peace*, Europeans have no wish to follow one of their most enlightened philosophers and found a 'republican United States of Europe', then they should at least listen to his

colleague Voltaire. Voltaire's hero Candide, having seen enough of the world's misery, retreated to his garden that he looked after most carefully. Would this be sufficient for Europe to make its mark in a globalised world? We shall see. Certainly more attention paid to our own European garden would not do any harm. Today there is a lot of talk about the EU having to be a visible global player. This is possibly true but to do this it will be absolutely necessary for the Union to first cultivate its own garden.



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## 9. DAVID KRÁL

# The Impact of the Economic Crisis on EU Enlargement and Eastern Partnership

Assessing the impact of the financial and economic crisis on EU enlargement is rather complex, as it is a long-term process that does not influence the day-to-day life of the Union. This article will argue that the short-term impact of the crisis on further expansion of the Union is limited, as enlargement does not represent an immediate challenge to the EU, except for the possible forthcoming accession of two countries – Croatia and Iceland still possible under this financial perspective (2007-2013). However, the long-term impact ultimately linked to the will of current EU members to pay for poorer members of the club and other associated risks, is potentially far more important. The crisis has certainly contributed further to scepticism of both the political leadership and public opinion across the EU and to ‘enlargement fatigue.’ These factors will potentially complicate the whole process, as it will be increasingly difficult to sell enlargement to the domestic electorate should the negative consequences of the crisis endure. The outcome of the recent crisis in the euro zone further exacerbates concerns about the future homogeneity of the EU and the sustainability of solidarity as Member States face serious problems. The main challenges to EU enlargement policy at the moment, however, lie equally in the political and economic domains as well as in the EU and those countries hoping to join it.

### Enlargement – the success story of EU external relations

Enlargement has been part of the EU agenda since as early as the 1960s. Since the first expansion

in 1973, the EU has grown gradually every decade: from the original six founding members to the current twenty-seven. Enlargement is not a separate policy area in the founding treaties. The basic legal framework is defined only in Article 49 (with a reference to Article 6) of the Treaty on European Union, which states “any European State which respects the principles set out in Article 6(1) may apply to become a member of the Union”. This article has been based on decisions adopted by various EU institutions, of which the most important are the European Council conclusions of December 1993, generally known as the Copenhagen criteria.<sup>64</sup>

Some pundits have argued that the EU does not have a foreign policy, only an enlargement policy. This ultimately expresses a widely shared assessment of the enlargement as a powerful tool through which the EU exerts its soft power and transformative potential. The Union using its normative influence pushes the candidate countries to adopt its *acquis communautaire* and undertake the reforms that will make it possible for a given country to function as an EU member. This was particularly important in the case of the southern enlargement to Greece, Spain and Portugal, as well as the ‘big bang’ enlargement to the former communist countries of Central and Eastern Europe. Enlargement, however, has caused concerns about the functioning of the Union which now includes more countries and precipitated a parallel process of reforming decision-making and adjusting EU institutional structures. Furthermore, the big bang expansion of 2004

64 The Copenhagen criteria lay down entry requirements for applicant countries. They were particularly designed for the former communist countries of Central and Eastern Europe. Politically, the candidate countries must be functioning democracies, have stable institutions and respect the rule of law and human rights, especially minority rights. Economically they must be functioning market economies and their companies must be able to withstand the competitive pressures of the EU internal market. The candidate countries must also adopt European legislation, known as the *acquis communautaire*. For its part, the EU has to be prepared (mainly institutionally) to accept new members.

has raised questions as to how far the enlargement process can go, as the founding treaties do not specify criteria allowing us to judge whether a country is European or not. The Union has so far made a political promise to integrate the countries of the Western Balkans and Turkey (the eligibility of Iceland, Norway and Switzerland is not being contested), while no promises have been made to eastern European countries such as Ukraine, Moldova or Belarus. Instead, the EU has conceived a new policy of the so-called Eastern Partnership (EaP), aimed primarily at a form of economic integration for the EU neighbours on the model of the European Economic Area (EEA) an organisation for developed European countries that are not in the EU).

### **Icelandic bid – uncomplicated only seemingly?**

Iceland is the only one of the current candidates whose accession aspirations are a direct consequence of the economic crisis. The sharp depreciation of the Icelandic króna (falling by half against the euro since January 2008), surging external debt (currently exceeding 100% of GDP), a growing budget deficit (around 18% of GDP in 2009) and the necessity of International Monetary Fund intervention, precipitated an early election in April 2009, in the aftermath of which the new coalition government decided to apply for full EU membership in July 2009.

It is generally assumed that the accession of Iceland will be a relatively easy exercise, as the country already fulfils most of the criteria. It is an established democracy (unlike other candidate countries) and despite the economic turmoil of the past two years and the sharp drop in GDP it is still wealthy and through its membership of the EEA has already adopted around two thirds of the EU *acquis*. Moreover, Iceland is a member of the Schengen Area and the European public opinion is relatively favourable towards it joining the EU.

But the Icelandic bid could still have negative repercussions. Firstly, there is the unsettled deal between Iceland, the UK and the Netherlands, who are seeking compensation for their citizens, who were Landsbanki Icesave clients. The agreement, enacted in December 2009, was massively rejected by the Icelanders in a referendum held in March 2010.<sup>65</sup> Both the UK and the Netherlands have been using EU accession as a bargaining chip to get better terms in the Icesave case. The result is an Icelandic public opinion that is increasingly anxious and, which despite its initial support EU accession negotiations, now views the pressure exerted on Iceland as unjust. By the time accession negotiations are completed, the memory of this case, along with that of the humiliating search for foreign aid to avoid sovereign debt default might well result in a repetition of the 'Norwegian scenario'. This is when a country, despite being totally ready for EU membership, cannot join because of a negative referendum outcome. One must also not forget that there is at least one very contentious issue to be negotiated – fisheries, which is extremely important for Iceland, accounting for almost half of its exports and roughly 10% of its GDP. There is the possibility that if the accession deal negotiated is not deemed satisfactory by the Icelanders, this will further contribute to a negative referendum outcome.

Likewise, one of the main incentives for applying for EU membership was the promise of early euro adoption, regarded as a safeguard against a repetition of the financial meltdown. With the huge budget deficit and external debt, however, it might be very difficult for Iceland to meet the Maastricht criteria in the near future. Moreover, the current crisis in the euro zone, the discussion on stricter measures against Member States breaching budgetary discipline and the commission proposals for an ex-ante review of national budgets will be factors that the Icelandic government and people might find difficult to accept. It remains to be seen whether the current proposals

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65 The referendum was held because President Grimsson refused to sign the requisite law and called a referendum on the issue. Only 1.5% voted in the referendum in favour of the deal.

will be accepted at all, as many EU Member States are already in flagrant breach of the Stability and Growth Pact rules and might thus not be ready to impose stricter sanctions on themselves. In any case, it will be much harder to accept countries with serious budgetary difficulties and Iceland might remain in that category for some time to come. All this suggests that the accession of Iceland, albeit seemingly only a technical exercise, might not materialise so easily, if at all.

### **Budgetary impacts – negligible at the moment, crucial in the long run**

The reason why the economic crisis has had a relatively marginal effect on enlargement policy is that the financing of the EU enlargement process has little impact on the EU budget and no direct consequence for national budgets, many of which are seriously affected by the crisis. Most of the pre-enlargement costs are financed through the so-called Instruments of Pre-Accession (IPA), which account for some €12.9 billion for the current financial perspective (2007-2013), around 1.3% of the EU budget annually. The eventual impact on the EU budget when the candidate countries join is difficult to predict at this moment. Currently, only two countries enjoy a realistic chance of joining in this financial perspective (2007-2013), namely Croatia and Iceland. In both cases, neither a major reshuffle in budgetary transfers nor any substantial rise in the EU budget is likely to be precipitated by their accession. Both countries represent relatively small economies compared to the rest of the EU. Iceland, despite the recent economic turmoil, will probably be a net contributor to the EU budget. Croatia, although currently economically in a fitter position than some EU members, is likely to become a net recipient that might eventually deprive the biggest current net recipients (namely Poland and Romania) of some of their regional funds. Due to the current stalemate in accession negotiations, it is becoming increasingly likely that the deal on the next financial perspective will be hammered out without these countries being on board. This is another reason why possible concerns vis-à-vis the EU budget will not significantly influence current EU enlargement dynamics.

However, thinking of possible long-term impacts of the economic crisis, the current budgetary crises in the EU could indeed prove lethal for enlargement. What is at stake is very much one of the very basic principles of European integration – solidarity. The lessons learnt from the massive rescue packages (committed from national budgets) to save the sinking economies of Greece and other European countries possibly facing similar problems will make it very difficult to increase the EU budget to finance the gradual convergence of acceding countries. Looking at the countries in the EU waiting room, they will all need, and indeed expect, big transfers from the EU budget as they are all relatively poor compared to the rest of the EU. In the case of the Western Balkan countries, their relatively small size will mean that their impact on potential future EU budgets will not be so dramatic. However, a big question mark hangs over the costs of future Turkish EU accession. In the past, Turkey has been growing at a much faster pace than the EU (and especially the euro zone). As its accession timeline is rather unclear, it is quite possible that the potential transfers to Turkey (e. g. within the framework of regional policy) will not be as high as currently feared by many Member States as it will be rapidly converging with the European economy. A lot will depend on the structure and size of the EU budget by the time Turkey is ready to join but heated debate can be expected in this respect.

In the context of the economic crisis it is becoming evident that the support of Germany for the enlargement process will be more crucial than ever before. This was already the case for the 2004 expansion, when Germany was the engine driving the process. Now, the voice of Germany as the biggest economy and the biggest paymaster to the EU budget is becoming even louder. Public opinion in Germany at the moment is outraged that Germans are paying so much for other countries' problems. This sentiment is also likely to spill over into enlargement and will make it very hard for any German government to maintain the same level of support for further expansion of the Union.

## Loss of political momentum as an outcome of economic problems?

Despite all the possible economic repercussions described above, the problem with future enlargement of the EU is largely – and perhaps mainly – political. The key problem is the lack of political backing for further enlargement on the part of both EU leadership and public opinion. Enlargement has lost much of the symbolism associated with the last wave, when it was viewed as the reunification of Europe, so long artificially divided by the Iron Curtain. This symbolism still somehow prevails in relation to the Western Balkans. The determination of the EU to bring them in – there is a relative political consensus on this – is viewed as part of Europe's responsibility for a region that suffered immensely from armed conflict in the former Yugoslavia in 1990s, while the rest of the continent was enjoying closer integration and embarking on eastward expansion. There is, however, not such symbolism vis-à-vis Turkey. The EU, despite all the political decisions and promises made, is trapped in endless debates as to whether the offer of full membership to Turkey was the right step and whether Turkey has sufficient European credentials to be able to meet the EU's conditions.

Much of the current doubts should have been removed by the entry into force of the Lisbon treaty. Much lack of enthusiasm for enlargement was due to the inability of the EU to function efficiently without the necessary institutional and decision-making adjustments. It was assumed that once the EU had sorted out its internal business, it would be able to focus more on its external functions, including a new boost to the enlargement process. The Lisbon treaty has come into force but there seems to have been little change in attitude. The crisis in the euro zone potentially endangers credibility of the single currency, as well as the much-expected economic recovery across the EU. Germany is already calling for the

need to rethink some of the ground rules of the founding treaties regarding economic and monetary policies. Potentially, other big issues will be on the table, such as the system of EU economic governance, as well as the size and the structure of the EU budget. Clearly, there is a risk that Europe will again become more inward looking and the necessary momentum for the enlargement process, expected to follow the adoption of the Lisbon treaty, will be lost. Unlike the past decade, enlargement is not at the top of the EU agenda and in the current context it is hard to imagine it will be there any time soon.

Sceptical public opinion across the EU is another major obstacle. Although it is not an entirely new phenomenon (there was opposition, particularly in some countries, to previous expansion), it has recently been growing considerably. The worrying trend is that even in the countries where there was relatively strong support for enlargement (like latecomers to the EU such as the Czech Republic) support is now more lukewarm. The economic crisis is likely to strengthen the opposition to enlargement even further. With the bleak prospects for economic recovery, high unemployment, falling social standards and the basic questions of certain countries assuming responsibility for the problems of others, it will be increasingly difficult to argue that countries, which are in general poorer and not-so-well governed, should be entitled to join in.

This process has also had consequences in the candidate countries. The political elites, as well as the public, are aware that enlargement is no longer a grand project for the EU. This is reflected in declining support in some candidate countries, namely Turkey<sup>66</sup> and Croatia,<sup>67</sup> for EU membership. Current internal squabbles and controversies in the EU as to how to tackle the economic and sovereign debt crises also make it a less attractive club to join. Messages from some EU leaders, namely Angela Merkel and Nicolas

66 Comparing the Eurobarometer 72 autumn 2009 to the Eurobarometer 62 autumn 2004, the support for EU membership in Turkey fell from 80% in 2004 to 45% in autumn 2009.

67 According to Eurobarometer 72 autumn 2009, only 24% of Croats believe that EU membership would be a good thing, while 37% believe it is bad, and 35% believe it would be neither good nor bad.

Sarkozy, contesting Turkish accession have led to declining enthusiasm among the Turkish leadership to pursue the process with the same vigour. They have also begun to explore alternatives to EU accession, although this has never been explicitly admitted by the Turkish government. In contrast, for many countries, particularly in the Western Balkans, EU membership still represents a beacon of hope and a stable anchor in the swiftly changing international environment, providing the only way forward to ensure future stability and prosperity.

There is another element that underlines the enduring stalemate in the enlargement process. It is not economic in nature and has become evident particularly in the last few years. The problem is that many EU members are using the accession framework as leverage for settling bilateral issues with candidate countries. Slovenia has been blocking the opening of new negotiating chapters with Croatia because of a dispute over maritime and land borders. Cyprus has been blocking negotiations of internal market chapters because of Turkey's failure to open its ports to Cypriot vessels and airplanes. Similarly, France has been blocking five key negotiating chapters (informally) because they allegedly imply full Turkish membership of the EU. Greece has blocked any prospect of opening accession negotiations with Macedonia because of the dispute over its name. While it has always been the case that Member States had bilateral disputes and issues with candidate countries, the overall accession process has never before been used to the extent we have seen recently. Not only does this contribute to a bleak outlook for further successful enlargement, it also undermines the very process, as it has become obvious that it is not exclusively about the fulfilment of the membership criteria.

### **Eastern Partnership – an offer not attractive enough?**

As already mentioned, the EU is not ready to promise membership to anyone beyond the Western Balkan countries and Turkey at the moment. However, it is in the EU's strategic interest to make sure that countries in its eastern (as well as southern) neighbourhood gravitate towards its model of political and economic governance. To this end the Union proposed a model of mutual relations with the eastern European countries, known as the Eastern Partnership, which includes approximation and integration in areas such as the economy (comprehensive free trade agreements), democracy and governance, energy security and people-to-people contacts. The idea is very much that the process will work like enlargement – i. e. offering the countries some incentives (such as integration with the EU market or a visa-free regime) in return for the adoption of EU regulatory standards. The strongest incentive in the enlargement process – the promise of eventual membership – is not, however, included in this policy.

This causes many experts to ask whether the incentives put on the table by the Union are sufficient to achieve what it wants. Integration with the European market will require major economic reforms and legislative adjustments, not to mention structural ones, which also often bear substantial financial costs. Similarly, in the energy domain, approximation to EU regulatory standards will require massive investments in energy infrastructure. Countries in the region, particularly Ukraine, have also been severely affected by the economic crisis.<sup>68</sup> It will be very difficult for these countries to cover the costs related to EU approximation in the context of collapsing budgets, when, for instance Ukraine is almost running out of cash to pay pensions and public servants' salaries.<sup>69</sup> Eastern neighbours expect the EU to help them bear these

68 In 2009, the Ukrainian economy shrank by 15% (see the Economist: [http://www.economist.com/world/europe/displaystory.cfm?story\\_id=15719286](http://www.economist.com/world/europe/displaystory.cfm?story_id=15719286)) and the budget deficit stands at around 12%.

69 The International Monetary Fund suspended its loan to Ukraine at the end of 2009 as public spending soared when the Ukrainian government failed to adopt restrictive measures to meet IMF demands. For more see [http://www.economist.com/world/europe/displaystory.cfm?story\\_id=E1\\_TVPPDQRJ](http://www.economist.com/world/europe/displaystory.cfm?story_id=E1_TVPPDQRJ)

costs by providing funds, currently included in the so-called European Neighbourhood Policy Instrument (ENPI). However, the finance committed until 2013 amounts to some €600 million for Eastern European countries. For countries like Ukraine this represents a very small investment for the amount of work that the EU requires. Moreover, there is competition as to how much money will go to eastern and how much to southern neighbours. This will surely become part of the internal EU debate when negotiations on the next financial perspective (2014-2020) start. But whatever the proportion between the two finally turns out to be, it is quite unlikely that for the present the EU will be willing to assign substantially more funds to the neighbourhood policy. Although one can argue that the EU's offer is more comprehensive than just providing funding, the governments of applicant countries, facing serious economic turmoil, cannot think too much beyond this at the moment.

On the other hand, the EU is not ready to move forward swiftly with issues such as lifting the visa requirement for the citizens of neighbouring countries. EU-citizens are largely concerned about the possible influx of illegal migrants from eastern Europe, aggravated by the current high unemployment rates in the EU. Although there might not be a discernible justification for postponing the visa liberalisation process (which still requires many adjustments on the part of eastern neighbours, such as improving border controls and passport safety), politically the Member States are not willing to get this process moving too swiftly. This removes another powerful incentive for eastern European countries to see the Eastern Partnership as an attractive project.

Moreover, the countries in the eastern neighbourhood, unlike the southern neighbours, have another powerful model towards which they can gravitate – Russia. At the moment, the EU's influence compared to Russia is limited by many factors – historical, cultural, and linguistic. Russia is consistently building up its soft power in the region through economic ties and media and, as the example of the Russian-Georgian conflict suggests, is ready to employ even hard power. Although the Eastern Partnership is definitely

not conceived as an anti-Russian project, it is often viewed so from Moscow and Russia is trying to counterbalance EU activities. Often it can provide stronger incentives than the EU, as the recent deal with Ukraine over the extension of the Russian Black Sea fleet base in Sevastopol in return for cheap gas has illustrated. Thus, the EU will have to think carefully about how to make the Eastern Partnership project attractive for Eastern European countries but at the same time not damaging its strategic ties with Russia.

### **What the EU could and should do**

There is no doubt that in order to enable enlargement to carry on successfully a lot needs to be done both on the part of the EU as well as the candidate countries. We will examine possible ways for the EU to achieve its part of the equation.

Broadly speaking, enlargement is again becoming a matter of strategic choice for the EU. It might try to keep up the momentum, in which case it has to take a much more pro-active role to show that it is still a part of its broad agenda. If it keeps sending mixed messages to the candidate countries, this will result in the loss of its soft power in the neighbourhood and, in cases like Turkey, might even lead to the consideration of alternatives. If the EU goes for the first option, it will have implications for all EU institutions. The commission has to use its mandate to show leadership in the same way it did in the late 1990s and early 2000s. The Member States need to stop abusing the accession talks for the settlement of bilateral disputes with the candidate countries – these need to be strictly decoupled. The European Parliament, as the only directly elected body, along with the European Commission and the Member States, should engage much more closely with EU citizens in discussing the pitfalls and opportunities of further enlargement, as undoubtedly one of the reasons for the current scepticism is the lack of constructive public debate in the Member States. The debate should also try to underline that enlargement is a long-term, strategic concept, which cannot necessarily be measured in terms of short-term balance sheets.



If the EU is sincere about continuing the enlargement process, it should strive to have the assessment of the candidate countries done by the commission as soon as possible (this is currently being blocked by some Member States) and strive for an early launch of negotiations. Lessons could also be drawn from the 2004 enlargement. Obviously, the countries will not be ready the moment they start the talks but most of the work can be done while negotiating, because the 'homework' for the candidate countries will be defined much more precisely. Moreover, having parallel negotiations with a number of countries will create a healthy competitive pressure – the famous 'regatta principle',<sup>70</sup> which worked in 2004 is currently badly missed. This is also one of the reasons why progress in the candidate countries is so slow.

A very important part of the question will also be how much the EU is willing to pay for future enlargement? In principle, the EU should not ask whether it will take in the countries of Western Balkans, as they undoubtedly are legally entitled to join (Article 49) or even Turkey, which has already been repeatedly recognised as eligible for membership, but solely how much of a cost it can carry. In the context of the recent economic meltdown and uncertain prospects of recovery, it is legitimate to expect that the European Union will not be as generous to future members as in the past. But a more open and sincere debate in this respect is certainly needed, as both parties will need to know what is on the table. The problem with this is multilayered: the accession timeline is absolutely unclear due to the stagnation of the enlargement process; the debates on the future structure and size of the EU budget beyond 2013 have yet to start and the eventual impact of the financial and economic crisis, which will certainly influence these debates is still unclear (with the sovereign debt crisis still underway). It is quite possible that the gap between the desired policy outcome, (integrating the candidate countries) and the lack of financial means to achieve this,

will open even further. Although the EU might not know the answer to this dilemma today, it will need to acknowledge it exists.

Things get even more complicated when one looks at the European Neighbourhood Policy and particularly the Eastern Partnership. As mentioned before, the EU is neither ready to provide an explicit promise of membership to eastern European countries nor to commit substantially more funds to help those countries functionally integrate into the EU. The basic problem lies in the fact that the European Union, convinced of the attractiveness of its own model, does not take into account the different political, economic and social contexts of current eastern neighbours compared to central European enlargement or even the Western Balkans. With limited financial commitments and a lack of political will to proceed quickly with integrating the countries into the EU market, the Union has to think carefully about its strategy and steps. One possible approach would be a strong engagement with and support for civil society in eastern Europe. Many of these countries (particularly Ukraine) have vivid, pro European nongovernmental organisations that can work as an engine of approximation with the EU and create bottom-up pressure on their respective governments to carry on with the European agenda. The EU is better suited to support civil society than Russia and this might give the Union a certain comparative advantage but it needs to commit more funds to civil society as part of ENPI. This would not necessarily be difficult, as the sums involved would still be relatively modest compared to the technical assistance provided to the governments. It also needs to make local NGO access to these funds as easy and flexible as possible. As for the incentives the EU is providing within the framework of Eastern Partnership, it is necessary that there are some tangible interim results before the long-term goal of creating the neighbourhood economic community is achieved. For instance, although the EU is not ready to lift visa requirements immediately,

70 The principle (advocated by some Member States at the December 1997 Luxembourg European Council) whereby accession negotiations with all applicants would begin at the same time.

it can make it easier for young people and students to visit and work in the EU during the summer and learn about the culture and language. Similar programmes such as ‘Work and Travel’ are successful in the USA, Canada and Australia. This will help enor-

mously to create a positive image among the young generation of Ukrainians, Moldovans or Georgians. This in turn could help create a new pro-European generation capable of pushing for better alignment with the EU.



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## 10. KARIN ULMER

## How the Global Economic Crisis has Impacted on EU Trade and Development Policy<sup>71</sup>

### Money, money, money, it's a rich (but confused) man's world

"What Europe does is no longer important", Prem Shankar Jha, an Indian economist and philosopher told ZEIT magazine earlier this year (Blume, 2010). Even if Europe wanted to impose climate change legislation on the whole world, he said, India and China would do what they thought necessary (or possible) with or without anyone else's say-so. It is now clear that the major player in combating climate change is not the EU, whose lack of collective political will, long a problem, has been exposed for all to see by the euro crisis. 'Chindia', as the economic shorthand goes, matters more, and increasingly so do emerging powers like Brazil.

None of this is entirely new. Even before the global economic crisis of 2009-10, the assumptions underlying the EU's way of doing things were starting to look questionable. But the EU seemed as complacent as ever about the well being of the global economic system and immune to doubts about its role in the world. Nowhere was this more evident than in EU trade and development policies, for long a matter for self-congratulation (the EU is the largest aid donor in the world) even as recipient countries expressed dismay and made deals with China in sub-Saharan Africa.

The main friction, as I will argue in more detail below, relates to the EU's strategy of bilateral Economic Partnerships Agreements, or EPAs, which are central to EU policy in the develop-

ing world. These agreements, and the thinking behind them, illustrate the incoherence and contradictions at the core of EU trade and development policy.

The most recent and articulate critique of EU trade policies in the developing world was set out by the UN Commission of Experts on the Financial and Monetary System, led by the US Nobel Prize-winning economist Joseph Stiglitz. One of its most significant findings is that developing countries bound by bilateral trade arrangements, not just with the EU, risk finding it more, not less, difficult to respond to crisis.

Stiglitz tackles the root of the hitherto accepted Washington Consensus<sup>72</sup> about the best way of doing things – which is, in essence, free trade, and as much as possible of it. "Imposed conditionality, in particular macroeconomic conditionality means significant loss of economic sovereignty and needs *to be lifted*,"<sup>73</sup> the Stiglitz Commission argues. In other words, if there is a way out of the economic maelstrom, it is not the one currently being pursued.

A sine qua non of changing the EU's approach is a more candid approach to what has gone wrong in the EU itself. Europe has stopped soaring economically skywards; it is the victim of the same processes as everyone else. In the absence of a fiscal union and inadequate political will, the EU currently resembles a beached whale. It hoped for the best and avoided painful decisions. Faulty or downright fraudulent economic data,

71 The views expressed in this article are those of the author and do not necessarily represent the views of APRODEV (see footnote 77 and biography).

72 Describes a set of specific economic policy prescriptions that constitutes the standard reform package of Washington based institutions such as the International Monetary Fund and the World Bank. The term became a synonym for neo-liberal policies in support of an expanding role of free markets and constraints on states with its mantra of 'stabilise, privatise and liberalise'.

73 Draft report of the Stiglitz Commission, UNCTAD, 12 March 2009, Geneva. (Italics in text by the author).

for example, were apparently not too important between European friends. And there was, and is, no fallback strategy nor obvious exit from the monetary union.

The EU's lack of effective monetary policy stands in stark contrast to the EU's considerable unity in trade policy. But that unity is achieved at the cost of those supposedly being helped in the developing world. The community method of creeping, inflexible central control as the way of doing trade with poor countries is now well established; the curious thing is how far, in practice, it is on a collision course with diverse or resisting economic realities.

The end effect is a muddle, which does the EU little credit: what the EU gives with one hand, in aid, is taken by another with trade. This incoherence is nowhere more glaring than in the contrast between stated EU objectives of poverty reduction and the trade policies outlined in *Global Europe*.

### Getting the sums wrong

The WTO's Doha Development Round was based on the proposition that trade was the equation of subsidies and tariffs. But ever larger subsidies and more recently the huge market distortions created by bailing out companies and banks in developed countries have undermined global competition. And with it has gone the willingness or ability to take economic risks.

As is now familiar, incentives for partners and employees in the financial sector have been grotesque and occasionally verged on the criminal. To many at the bottom of the pyramid, it looked suspiciously like a monopolistic power shuffling money to itself at the top. The problem is that the whole system of corporate governance was allowed free rein for far too long.

The world's economic system was torpedoed by Wall Street and other markets exporting, in

disguised form, bad loans to the rest of the world – quickly provoking a disaster akin to an oil spill. It turned out there were no rules of the game to deal with this kind of problem.

The immediate effect of all this for aid and development has been obvious, though hardly headline news: a shortfall in financing,<sup>74</sup> expansion of lending and new debt problems and aid becoming increasingly politicised and conditional. Aid dependency, the problem that all actors some time ago learned had to be reduced and avoided in the future, is now likely to be perpetuated. So far there is little evidence of the EU, or donor countries, looking hard at better ways of doing things.

### Is aid for trade not, after all, the best development vehicle?

The OECD's Paris Declaration on Aid Effectiveness (March 2005) subjects aid recipients to a discipline of collective control by the donors right down to the village level (Mkapa, in Tandon: 2008). Aid for trade is tied to domestic economic and policy reforms, which in turn are locked into the dogma of 'free trade'.

It is and always has been routinely assumed that development will be achieved with aid and financial transfers of one kind or another and that the most relevant relations with developing countries are trade agreements, on the basis that development is growth plus wealth accumulation.

Such growth is to be achieved by the elimination of tariffs and subsidies, as much foreign direct investment and economic reform as possible, with the hoped-for result of a European-style business environment. The evident wealth accumulation in the private sector and ever wider gap between the very rich and the rest is assumed to be only temporary, the wealth destined to 'filter through' or 'trickle down' to the poor thanks to market forces.

74 Of the \$1.1 trillion in emergency funding that world leaders committed at the G20 summit in London in April 2009, only \$240 billion is expected to go to developing countries and \$50 billion to low income countries (Halifax Initiative, 2010).

There is also, in effect, an essential dishonesty about 'free trade' being foisted on poorer countries. In reality, it is nothing of the kind (APRODEV, 2008). The absence of the 'level playing field' held dear by European economists is becoming ever more obvious. As for the benign trickle-down of wealth, the mechanism is at best faulty and very slow. If anything, the rich get richer and the poor, and indeed-middle class, get poorer – whether in the US, China or India.

The economic, power and knowledge relationship between the western powers and the south is utterly asymmetrical. Aid for trade and technical assistance is conditional on tax reforms, harmonisation of import and export regimes, product standardisation, and so on; all of this is geared to fit a global trading system built by and for the world's strongest economies.

## **Reversing the relation between trade and economic policy**

Attention to incoherence in trade and development policy has up till now focussed principally on export subsidies for agricultural products. This is to identify only one policy instrument. Numerous other policy tools and import restrictions prevent fairness in trade.<sup>75</sup>

Nowhere is this more evident than in the EU's central development strategy, the negotiation of Economic Partnership Agreements (EPA) trade deals with African, Caribbean and Pacific (ACP) countries.

In effect this amounts to allowing the tail of trade policy to wag the political/economic dog. Ambassador Shree Baboo Chekitan Servansing, Mauritius' Chief Negotiator for the WTO Doha

Development Agenda, argued earlier this year: *"It is economic policy that has to shape and design the trade policy, not the other way round. What is needed is to reverse the relationship between trade and economic policy, which has not been the case for many ACP countries till today."*<sup>76</sup>

Growth and poverty reduction do not depend on more or less arbitrary exemptions from trade rules, or increased flexibilities or preferences here and there. First and foremost the way towards poverty reduction is in the domain of domestic socio-economic policy.

Significantly, the World Bank (Hoekman, 2010) confirms this view and argues that trade policy is not the most efficient development tool and that the logic of comparative advantages only applies to robust, larger economies. Small and vulnerable countries are simply not competitive nor of interest abroad. If that reasoning is accepted then larger economies need to shift their attention from wanting to do some good to at least avoiding inflicting harm on vulnerable economies.

This approach is much in line with APRODEV's<sup>77</sup> experience, and underlies our suggestion (APRODEV, 2005) that development benchmarks be included in the EU-ACP trade negotiations, a proposal unfortunately rejected by the European Commission's trade negotiators and its development services.

## **Straight forward but pointing in the wrong direction?**

No one could fault the consistency of EU trade policy with its global ambitions as set out in the 2010 work programme presented by EU Trade

75 For example, the Product Support Estimate as calculated by the OECD describes the value policy tools and state interventions in the market that range from safeguards, import tariffs, quality and food safety standards as well as technical barriers to trade, etc. to restrict imports of agricultural goods. Its total value is calculated by the OECD as 103 billion euro in 2008 and can represent for example up to 46% of the poultry industry profits coming from policy measures implemented by government.

76 Presentation at the Trade and Development Conference, Brussels, 16 March 2010.

77 APRODEV was founded in 1990 in order to strengthen the cooperation between the European development organisations, which work closely together with the World Council of Churches (WCC). At present, 17 development and humanitarian aid organisations cooperate through APRODEV.

Commissioner Karel de Gucht to the European Parliament.<sup>78</sup> The EU is committed to securing dynamic new markets with large numbers of middle-class consumers; it must access key resources for Europe's highly integrated economy, which depends on imports and exports alike for its value creation and high-tech industry.

Europe also aims to remain the top destination for Foreign Direct Investment – and ensure high-level security for investors. Every Free Trade Agreement (FTA) must, in acronym-speak, be 'WTO-plus' and aim to include services, investment treaties, public procurement and enforced intellectual property rights.

There is, in short, no question about the consistency of EU trade policy, only about whether it accords with stated development objectives.

### **How the EU forces open the doors of trade**

The EU gives top priority to bilateral or regional trade agreements with emerging markets. Currently, the EU has signed FTAs with South Korea, presented as the most ambitious trade agreement and thus *the* model, with Mexico, South Africa, Cariforum<sup>79</sup> and Central America. Negotiations with Mercosur were re-launched in May 2010. Following stalemate in regional trade negotiations with Asian and South-East Asian Nations (ASEAN), the European Commission has opened bilateral negotiations with Singapore and Vietnam. More negotiations are ongoing with India, Japan, Canada, China and Russia as well as Association Agreements in the framework of the Eastern Partnership. Interim and comprehensive Economic Partnership Agreements are still in negotiation with African and Pacific countries. It is difficult to square the EU's public and supposedly urgent commitment to the multilateral trade

system with policy, which is *de facto* the opposite – a sprawling proliferation of bilateral and regional FTAs.

Moreover, to ensure effective implementation of negotiated market access of these bilateral agreements, Market Access Advisory Teams have been set up in the 30 most significant markets to monitor and, where possible, remove barriers to trade inside the borders of the relevant countries. Businesses are working in close cooperation with EU delegations in these teams, have direct access to policy makers and are invited to play a role in designing and control of regulatory enforcement.

In line with the EU Raw Material Strategy, the European Commission has pushed for amendments to Economic Partnership Agreements prohibiting new or increased export taxes. Such provisions clearly violate a country's sovereign right to manage its own natural resources.<sup>80</sup>

What is more, the external mandate of the European Investment Bank includes reference to securing markets and access to raw materials for European companies: restricted access to these has caused major problems to some EU industries. The aim is that unless justified for security or environmental reasons, restrictions on access to resources should be removed. The relevant point here is that export taxes in some cases account for as much or more than 20% of government revenue. The EIB is in effect sanctioning, or even encouraging business actors to deprive people of their own means of substance which, properly managed, could become key domestic value-added products.

Increasingly, scarcity of natural resources is leading to targeted long-term investment, land speculation and acquisition and profit-seeking from future carbon trading. The impact is twofold

78 Presentation to the International Committee of Trade of the European Parliament, 5 May 2010.

79 The Cariforum was created in 1992 and counts the Caribbean countries of the Caricom as well as the Dominican Republic and Cuba as members. It is a signatory to the EPAs.

80 The International Covenant on Civil and Political rights, Part 1, article 1 and article 2.ic, Article 2 provides that "All peoples may, for their own ends, freely dispose of their natural wealth and resources without prejudice to any obligations arising out of international economic co-operation, based upon the principle of mutual benefit, and international law. In no case may a people be deprived of its own means of subsistence."

and wholly unpredictable: increased pressure on scarce natural resources through climate change, food and financial crises, while investment is (mis)directed into land acquisition.<sup>81</sup>

The business lobby is in full agreement with the explicit objective of DG Trade, the enforcement of Intellectual Property Right provisions and tougher control from now on. This is in the face of strong evidence (DCA, 2009) that better IPR, far from producing more innovation at local level, will choke it off.

A current public investigation at DG Competition provides evidence of the pharmaceutical industry using group patents to prevent other successful patents applications. Exclusive rights on knowledge and stricter IPR are counterproductive and do not square with improving technology transfer and closing the technology gap, including on renewable energy.

## Human rights slip off the edge of the table

One consequence of the proliferation of free trade agreements is the weakening of human rights standards. The Generalised System of Trade Preferences (GSP+) makes trade preferences conditional on the ratification and effective implementation of 27 human rights conventions. But the Association Agreement with Central America, concluded in Madrid in May 2010, will contain fewer human rights provisions than GSP+, with no mechanisms at all to guarantee the implementation of the agreed human rights, environmental and labour standards.

This signals a shift to trade deals and economic regulatory reforms over human rights and democracy – both key development issues in Central America. The ‘upgraded’ relationship of EU and Central America expressed in the conclu-

sion of the Association Agreement is, in reality, a step backwards on matters of democracy and human rights.

Back in 2002, when the first series of EC negotiating directives for bilateral free trade or association agreements were adopted, there were already obvious injustices, which were simply ignored. The Raw Material Strategy, for instance, denies third countries sovereign rights over their natural resources even though this is enshrined in numerous UN resolutions. Commercial interests are hidden under the guise of a ‘green economy’, unnecessary barriers being put in the way of necessary technology transfer to ease climate change. Central American or Asian governments may be sovereign enough to sign human rights or social clauses as part of the conditions to access EU markets, knowing that in case of conflict or human rights violation they will ‘get away with it’ – not least because of the signals from Brussels that they do not really matter. Africa, by contrast, is held hostage by the EU's threat to withdraw preferential market access and denounce its constitutive relationship with Africa.

## Economic Partnership Agreements – a litmus test?

The economic prescriptions integral to the partnership agreements are the creation of an “effective, predictable and transparent regulatory” framework for trade and investment” (EC, 2009).

The small print does not support this. What has actually developed is fragile and vulnerable to the present turbulence. While EU Member States like Germany unilaterally introduced tough measures to prohibit harmful cross-border transactions, the financial service industry was given the green light by the liberalisation commitments in the Economic Partnership Agreements signed in 2008. The effect was to limit seriously the

81 The EU has become the world's largest net importer of agricultural produce and therefore the largest user of agricultural land that is not its own. In 2008, the EU 27 exported \$127.6 billion of agricultural commodities, but imported produce valued at US\$ 173.1 – a net import of \$45.5 billion (OPERA, 2010). In 2008, 50% of harvested cereals were used for animal feed. Speculative investment in cereals went up from \$5 billion in 2000 to \$175 billion in 2007.

Cariforum's<sup>82</sup> capacity to regulate and deal with the present crisis.

Despite the advice that 'too big to fail is too big to exist', EPA Article 67 and 76 make it difficult to limit the size of financial institutions if liberalised under an EPA. The same articles prevent firewalls separating deposits and secure assets from risky investment banking. Even requiring banks to have sufficient capital reserves of their own (or set up a subsidiary to do this) seems to be prohibited under Art 67.2 (e), see footnote 80.

The EU business lobby can congratulate itself on how far it has penetrated the EPAs. For instance, the Cariforum contains an explicit provision to allow EU financial service suppliers to supply new services if the Cariforum countries own financial institutions are allowed to do so. This means that any Cariforum country that allows domestic hedge funds is actually *obliged* to permit EU hedge funds to operate as well, even though these are much larger and pose a risk to the domestic economy.

What is more, the wording looks deliberately vague. 'Financial services' are defined very broadly to include derivatives and other risky (and now notorious) new financial instruments. It is recognised that in times of financial crisis, capital control can be useful to prevent bubbles. But the Cariforum EPA is drawn up in such a way as not to permit effective use of capital controls. (Smith, 2010).

At the time of writing, EU Finance Ministers are considering the whole range of policy measures to re-regulate global finance and increase restrictions for cross-border FDI, hedge funds, compulsory capital reserves in the banking sector and taxes on financial transactions. Michel Barnier, European Commissioner for the Internal

Market, is presenting a proposal on how to prohibit dubious derivatives that risk destabilising the Euro. That kind of rigour needs to be brought to bear on the EU's trade and development model. Barely a year after their inception, the EPAs, with their wide-eyed commitment to liberalisation and deregulation, look painfully unrealistic and out of step with the times.

### Closing the policy space

EPA negotiations continue to be highly formalistic, involving a strict sequence of issues to be considered. Negotiations are tough, with little or no movement on the European Commission's side. Brussels insists on the inclusion of the Most Favoured Nation clause,<sup>83</sup> export taxes, standstill clauses<sup>84</sup> and rendezvous clauses for services and investment negotiations.<sup>85</sup> It rejects any meaningful concessions on community levy, on rules of origin, safeguards and development packages. Most of these provisions are intended to curb existing policy space or impose additional liberalisation commitments and the approach is 'either-or', lending an entirely artificial (and frankly manipulative) urgency to getting agreement.

Many ACP countries insist that any initialled or signed interim EPA cannot be notified, ratified or implemented unless contentious issues are resolved. For example, the Namibian Minister of Trade Development, Hon. Hage Geingob, in his Ministerial Statement on 19 May 2010 made plain that a bad agreement is no option; and that no friendly government could impose such an impossible choice: between EU market access or regional integration under SACU – the South African Customs Union (Geingob, 2010). This is one of many examples of the way aid is being politicised, with EC trade negotiators spreading blame, splitting and diverting, bullying and

82 Caribbean countries signatory to the EPA.

83 Clause obliges the Caribbean countries to give the other party (EU) the same treatment it gives to any other major trading partner (for example, the US, Japan, Brazil, China or India).

84 Clause requiring to freeze import tariffs at their current applied level.

85 Clause on the continuation of the negotiations on services and investment; however, this does not pre-judge the outcome of the negotiations.



patronising (ICCO, 2008) in a way, which speaks volumes about the level of aid dependency in ACP countries.

Extractive production models inherited from the colonial past have led to a non-diversified economy dependent on commodity exports to EU markets. Increasingly, financial resources from the European Development Fund and the European Investment Bank, and resources under aid for trade or bilateral aid, are earmarked for EPA-related adjustment measures. To rub salt in the wound, ACP countries are at best likely to recover 30% or less of lost tariff revenue from other taxation sources, following EPA liberalisation commitments (IMF Working Paper, 2005).

### **Poking a twig through the spokes**

The South Centre (2008) warns of the dangers of a 'hub and spokes' arrangement: developing countries as spokes essentially become the providers of input raw materials to European industry, whilst the bulk of the transformation in production takes place in the developed country. The alternative of expanding intra-African trade could yield significant benefits to African countries in terms of diversification and value addition (UNCTAD, 2009).

Similarly, the International Agricultural Assessment for Knowledge, Science and Technology for Development, IAASTD, highlights the need to build local markets and regional food systems. Its 2008 report draws attention to the risks of global markets and free trade policies, especially in the matter of long-term food security. Regulatory reforms are less important than re-establishing an atmosphere of trust between the EU and ACP countries.

Just how sour things have become was illustrated by the acrimony surrounding the EU negotiation of the WTO banana deal in 2009. This eroded ACP banana preferences even further and came just the day after the Cariforum states had signed their EPA. There was no prior consultation with Caribbean banana producers. Moreover, in

2010, the European Commission concluded the negotiations of a FTA with Peru and Colombia which would yield bananas at 75 Euro per tonne, lower than the 114 Euro on offer in the WTO banana deal.<sup>86</sup> The effect is likely to be not the eradication of poverty but of the entire banana sector in the Windward Islands.

One would hope that there is a genuine recognition in Brussels trade politics of the character of the political crisis it now confronts with the ACP. There is little evidence of this yet. Rather the opposite: a 'march of the elephants' (FES 2009) has begun involving aggressive/defensive regional blocks cutting their own path irrespective of their impact on the wider environment.

### **Where to go from here?**

It may be that we have to review the whole way in which we approach the question of how to build common ground and how to value our relationship as wealthy countries with poorer neighbours, and recognise that systems – social institutions, markets and economic actors – are organic, in some sense living things (Laske, 2010).

But for the time being EU trade policies and negotiations still involve a generally mechanical, formalistic approach which threatens rather than builds on the existing relationship. Change is seen as something that can be engineered, controlled and managed. This makes it easy to introduce and justify donor-driven policy reforms or a set of specific trade rules. An integrated dialectical approach would pay more attention to the key role of social process and of individuals in effecting change (Ulmer, 2010). Certainly, we need to get better and bolder at framing the relevant questions, and avoiding the kind of hollow public relations efforts of the current European Commission website campaign.<sup>87</sup>

A closer look at diverse economic realities challenges the universe of armchair economists in Europe's capital. To take pluralism seriously

86 The EU finally signed an agreement on trade liberalisation with Peru and Columbia on 19 May 2010.

87 <http://trade.ec.europa.eu/doclib/stories>

is to depart from a one-sided market-oriented liberal ideology based on unrelated free individual operation in an abstract perfect free market (Raveaud, 2009). The preferences of a free individual consumer in sub-Saharan Africa are not as a rule a matter of taste but of unavoidable constraints, choosing between bad and worse, and a background of grinding poverty.

“The three main assumptions of the development industry need to be re-examined: that development can be engineered by aid, that such aid is actually used for development, and that outside practitioners can implement development policies that work. ... All three are debatable”, says Patrick Chabal (2008), professor at King’s College in London, keen to improve capacity to revisit and communicate assumptions on which policies are made.

NGOs often have a strong affinity with the south, but may have an imperfect understanding of the structural problems of the aid architecture that is part of a broader historical and political process and may fail to question its basic consensus. It is also clear that recipient governments, especially in Africa, often lack coherent economic and development policies. Where this is so, they are left with few alternatives to externally designed and imposed aid and trade recipes.

### **Only those who think differently can run a different economy**

Many now question whether economic survival inevitably depends on expanding production indefinitely. But what does a balanced economic and ecological system look like? Can there be an equilibrium? Some initiatives point in promising directions.

It may mark an advance that there is now a general understanding that it is perfectly possible for something that is good for GDP to be bad for society and that the happiest societies are not the richest ones. It follows that if boosting GDP remains our only measure of success, we could easily end up doing more harm than good (Damas, 2009).

There are other straws in the wind, which suggest a shift in attitudes. Elenor Ostrom of Indiana University, who last year became the first woman to receive the Nobel Laureate in Economics, was honoured for her work on science of cooperation – not competition. Her *Governing the Commons: the Evolution of Institutions for Collective Action* examines the conditions in which communities organise themselves to solve common problems.

The Business Alliance for Local Living Economies has shown that independent, locally owned businesses can go beyond traditional measures of success, leveraging the power of local networks to build a web of local economies that are community-based and green.

Other ideas suggest that a fair and green economy, one that is not ‘too big to fail’ and does not burden the environment, really is feasible, reconnecting capital with the community and promoting self-correcting local economies (Korten, 2010).

The present writer hopes that the global crisis will challenge our thinking and in turn inspire a more human and imaginative approach for how we ‘do economics’. A new mode of operating must include models that look at the role of care and generosity in the functioning of the economy and the necessity of diminishing growth in order to preserve the planet.

In its pursuit not of happiness but of an impossible or lost race for regional competitiveness, Europe loses time to prepare itself for the new mindset of ‘co-petition’ – the transit from competition to cooperation for global fairness and a balanced ecology. “In a living system that has attained maturity, each part, entity or person pursues her/his personal interest in a way that does not compromise the well-being of the whole. Thus, it is based on the principle of collaboration that does not disturb the interests of its parts nor the equilibrium of the network as a whole.” (Luyckx, 2010).<sup>88</sup>

88 Idem, Luyckx (2010: 77), unauthorised translation by the author.

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The financial and economic crisis has revealed what is wrong with globalisation: lack of global regulation, the extreme imbalance between the world's economies and the unequal distribution of benefit and risk. Countries that, in recent years, have managed to lift themselves into a state of modest affluence are in danger of being cast back into their previous survival mode. A return to economic nationalism, or more popularly protectionism, would only make things even worse. De-globalisation is no utopia but rather a spectre of doom. Not just because it will mean a loss of wealth around the globe but also because economic fragmentation can foment political nationalism – remember the 1930s.

The crisis has cruelly exposed the shortcomings of the European Union. We have a single market and a single currency but no European coordination of economic and financial policy. European economies, however, are, for better or for worse, interdependent. Standing by countries up to their neck in debt is not altruistic but a rational act.

A little more than ten years after its introduction, European monetary union sees its very existence threatened. A breakup of the euro zone could bring Europe to a political standstill. To avoid such a doomsday scenario, European leaders need to take action and set up a proper European economic governance. To do this, they will need to accept both more economic integration implying loss of some national sovereignty and more solidarity involving more transfers between states. This step is a long way from becoming reality for governments anxious to defend their prerogatives and respective national interests. The long-term durability of the euro zone, however, depends on bringing Europe up to date.

In their time, De Gaulle and Adenauer, Kohl and Mitterrand knew how to make the sort of historical compromise that helped advance the construction of Europe. If Merkel and Sarkozy will not find the political courage to support a new equilibrium, they will have to assume the risk that monetary union could fall apart and as a consequence set Europe back more than 50 years.

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