

The Existential Crisis of the European Union: reasons and solutions



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The Existential Crisis of the European Union: reasons and solutions

Stiglitz et al: focus of the EU crisis → Eurozone crisis (EMU: Monetary Union of 19 of the 28 EU member states which have adopted the euro)

Reasons:

1. The failure of prosperity and convergence
2. Something wrong in the integration process
3. Ineffective and cynical management of the crisis

Solutions:

1. Rethinking UE's policies
2. Structural Reforms for the Eurozone
3. Alternatives to the current Euro-system

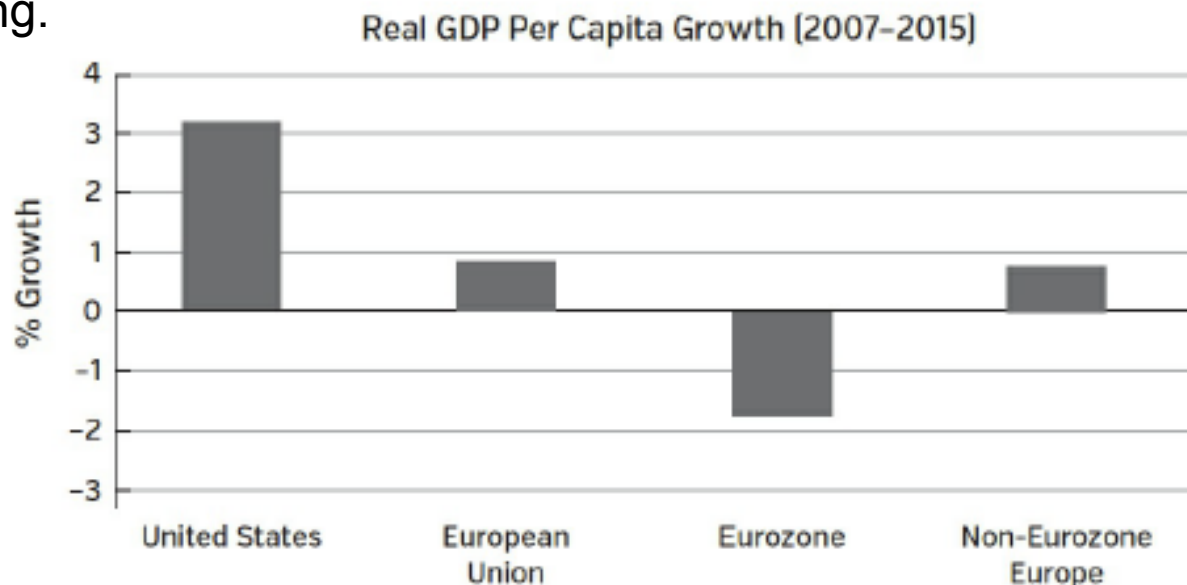
Mainly based on *“The Euro: How a Common Currency Threatens the Future of Europe”*, by the Nobel Prize Joseph Stiglitz (2016), *“The Battle for the Europe”* by Fazi&Iodice and on Emiliano Brancaccio's works on EU's crisis.

1st REASON: The failure of prosperity and convergence

Euro had two main goals:

- 1) Economic prosperity and integration (→ Convergences)
- 2) Political integration and stronger european identity

Failure: these goals are now more distant than they were before the creation of the eurozone. On every criterion by which performance is usually measured, the eurozone has been failing.



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→ negative effect of Eurozone structure in impeding adjustment to shocks, in particular the shock of the global financial crisis

1st REASON: The failure of prosperity and convergence

1) Economic Prosperity and Integration

Empirical Evidence on divergences and social and economic decline:

- **GDP** (Portugal, 1990s - 2015: GDP p.c 57%→49% of Germany's), (Italy 08-16: -10%)
- **Productivity (GDP per working-age person)**: 2007-2015: increased by just 0.6%
While for non-eurozone European Countries: 3.9% increase
- **Industrial Production** (Italy 08-16: -25%)
- **Unemployment** (Eurozone, 2016: 11%) [EU: 9.5%]
 - Greece: 25%; Germany: 4.5%
- **Youth Unemployment** (Eurozone, 2016: 22,5%), (Greece: 49,5%), (Germany: 7%)
(South Italy: 60%)
- **Skilled labor flows** (e.g. Italy, 2017: 1/3 of graduates leaves the Country)
- **Inequality** (Gini coefficient):
 - Spain, 2014: 9% over its 2007 level
 - Greece, 2014: increased by 5% from just 2010
- **Poverty**:
 - Greece, by 2012: 1/3 of Greeks are below the poverty and from 2008 to 2012 the proportion of Greek children in poverty increased from 23% to 40.5%. (Oxfam)

(Stiglitz 2016, Eurostat 2016, Fazi&Iodice 2016)

1st REASON: The failure of prosperity and convergence → Germany as a successful story?

Has grown by 6.8% since 2007 → average growth rate of just 0.8% a year

Productivity (output per worker) 07-15 → decreased by 0.7% [US: increased by 7.9%]

Hartz reforms in the early 2000's → real wages fell an average of 1.6% a year from 2002 to 2012 (Oxfam)

The price of competitiveness:

→ share of low-paid workers increasing from 16% to 20%

→ gap bottom/middle classes increased by 9%

→ 1992-2010: income share of top 1% increased by about 24%

→ 1991-2010: income share of bottom 10% decreased by 11.2%

→ mid-1980s – mid-2000s: inequality (Gini) and poverty rates climbed steadily,

→ 2013: poverty level at 16.1% of total population and 69% of the unemployed.

(Schmid&Stein 2013, Stiglitz 2016, Fazi&Iodice 2016, World Wealth and Income Database)

1) It is a “success” only by comparison with the other countries of the eurozone.

2) The achieved competitiveness came partly at the expense of those at the bottom (see AfD voters) and of other eurozone countries, adopting **competitive devaluation**, “(beggar-thy-neighbour” policies).

3) Its growth is based in part on strong trade surpluses (larger than in China), which are not achievable for all countries: usually if some country has a trade surplus, some other country has to have a trade deficit.

1st REASON: The failure of prosperity and convergence

2) Political Integration and stronger european identity?

- climate of social unrest both in “loser” and in “winner” countries and an outburst of nationalistic resentment (mostly directed against Germany);
- rise of many nationalist movements against euro

Evidence on loss of trust in EU:

- “Trust in the institutions has plummeted from a beginning-of-the-century high of nearly 60% to just above 30%” (Eurostat, 2017)
- “Since the beginning of the euro crisis, trust in the European Union has fallen from +10 to -22 percent in France, from +20 to -29 percent in Germany, from +30 to -22 percent in Italy, from +42 to -52 percent in Spain, from +50 to +6 percent in Poland, and from -13 to -49 percent in the United Kingdom” [see Brexit] (Torreblanca&Leonard 2013)

2nd REASON: Something wrong in the integration process

What does economic theory say about?

What are the conditions in which a group of countries can easily share the same currency?

→ Mundell's theory on “**optimum currency area**”(1961)



R. Mundell, (Nobel, 1999)

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Given the idea that in Europe social, cultural and political conditions to deal with asymmetric shocks of demand (fiscal transfers or mass migrations) don't subsist, for a long time Mundell and many others believed that an european monetary union was an impracticable choice.

Moreover his analysis made clear that european countries were too diverse to easily share a common currency.

2nd REASON: Something wrong in the integration process

1990: “pessimistic” view of Mundell contested by the European Commission, arguing that the productive systems of the different European countries are very similar among them and little differences can be solved with *convergence criteria* on deficits (less than 3% of GDP) and debts (less than 60% of GDP)

→ Maastricht Treaty

Moreover they believed the common currency would subsequently reduce asymmetries so that there would be growth and stability throughout the eurozone.

The evidence is now saying that those beliefs were wrong: even countries with no government deficits and low public debt (Spain, Ireland) had crisis and many eurozone members still have not adjusted well to the shock of the 2008 global crisis. There has been neither growth nor stability, and the countries of the eurozone have diverged rather than converged (Stiglitz, 2016).

2nd REASON: Something wrong in the integration process

Many economists were sceptical of the EMU, e.g.: Meade (1957), Mundell (1961), Fleming (1971), Godley (1992), Feldstein (1992,97), Dornbusch (1996), Goodhart (1998)... And many Nobel winners: Krugman, Friedman, Stiglitz, Sen, Mirrless, Pissaredes, Tobin.



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N. **Kaldor** (1971):

“It is a dangerous error to believe that monetary and economic union can precede a political union. For if the creation of a monetary union and Community control over national budgets generates pressures which lead to a breakdown of the whole system it will prevent the development of a political union, not promote it.”

The dynamic effects of the common market, The New Statesman

Instead, The **Werner Report** (1970): monetary and economic union will act “as a leaven for the evolvement of a political union”

→ Economic and Monetary integration as a path towards Political Integration

→ Euro as the natural and necessary step in the European Integration process.

This was the political mainstream view on the european integration project.

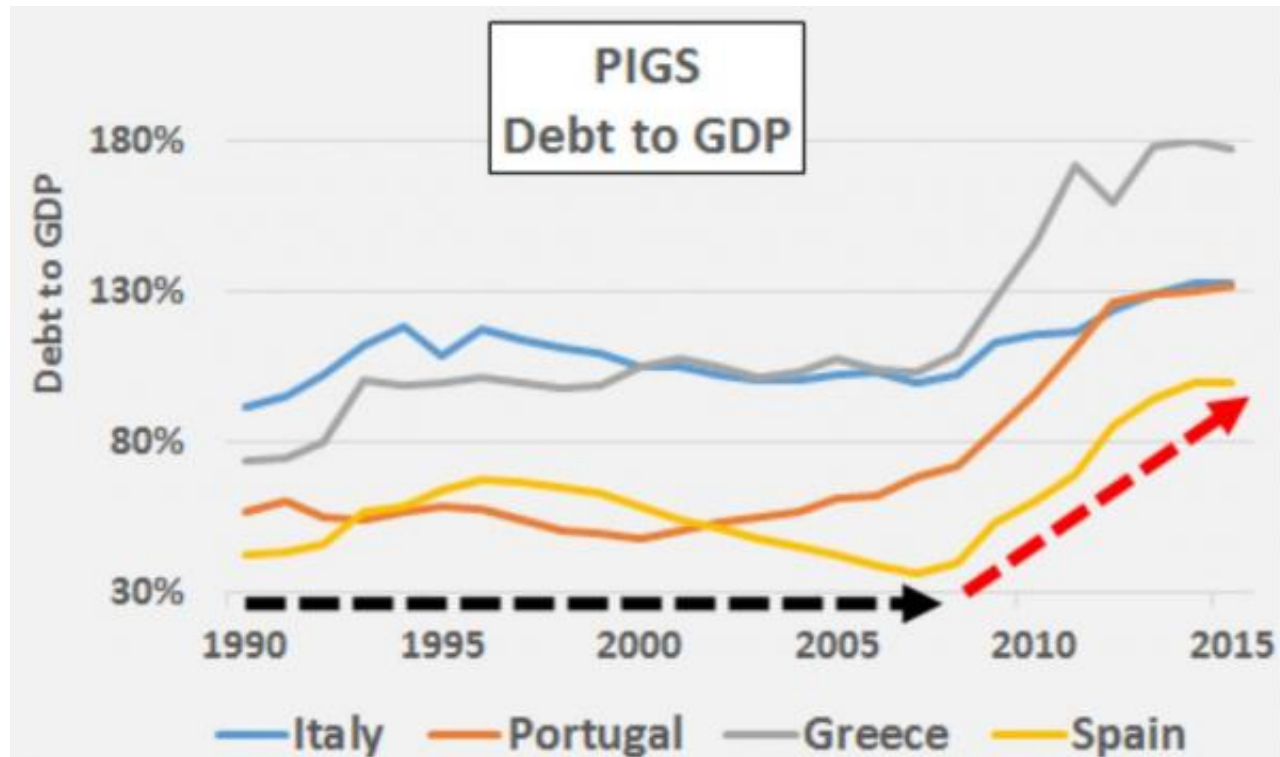
3rd REASON: Ineffective and cynical management of the crisis

Idea: main cause of eurozone crisis is the excessive public debt of peripheral countries (PIIGS), caused by excessive public spending (Schauble, 2010).



- Rigid labour market
- Prone to corruption
- Full of tax avoiders and lazy workers
- “They have lived beyond their means” (excessive public expenditure)
- High debt → Crisis

3rd REASON: Ineffective and cynical management of the crisis



→ Sovereign Debt Crisis

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2008-09: EU states gave 2000 billions to banks. Public → Finance and
Private Debt → Public Debt

Case of Greece: two rescues (2010, 2012) for 226 billions: 20% to cover State's necessary expenditures (hospitals, schools, police...), 80% to save banks again (most of them French and German).

3rd REASON: Ineffective and cynical management of the crisis

Peter **Bofinger**, economic advisor of German government, said clearly that the bail-out of Greece “does not really concern problems of Greece, but those of our banks which own many credits towards that country” (Der Spiegel, 2011).

LSE Professor Paul **De Grawue** stresses that one main reason of the greek debt crisis is the “reckless lending to Greece by Northern Eurozone banks. At no time the Northern bankers asked themselves the question of whether the Greeks would repay the loans. The European Union chose to resolve the debt crisis by punishing the Greeks and by saving the Northern banks.” (Social Europe Journal, 2015)

What is impressive is that **IMF** too suspected that the bail-out conceived by EC and ECB had the aim of saving banks instead of Greece. (“IMF Document Excerpts: Disagreements Revealed”, Wall Street Journal, October 2013)

Moreover, this “help” from Troika (IMF, EC and ECB) to Greece and other countries has been used to justify austerity and structural reforms.

3rd REASON: Ineffective and cynical management of the crisis

When a crisis country requires support, the Troika offers (imposes) the “programs”, which require strong conditions to meet

These program saved the banks and financial markets, but otherwise they have been a failure.

Each program is composed by two critical part:

- 1) Austerity = cutbacks in expenditure intended to lower the deficit
- 2) Structural Reforms = changes in the structure of the economy and in the individual markets to regain competitiveness.

Stiglitz 2016: The irony is that the effects obtained were just the opposite. At best, the magnitude of the reduction in the deficit was far less than hoped, simply because:

cutbacks → economic slowdown → reduced tax revenues and increased expenditure on unemployment benefits and welfare. Moreover, it increased the divide between creditor and debtor countries.

3rd REASON: Ineffective and cynical management of the crisis

→ **Austerity** Austerity policies do more harm than good, IMF study concludes (© The Guardian, 2016)

“The increase in inequality engendered by financial openness and austerity might itself undercut growth, the very thing that the neoliberal agenda is intent on boosting. There is now strong evidence that inequality can significantly lower both the level and the durability of growth.” (IMF Research Department, 2016)

“IMF, OECD, EC have all underestimated austerity effects”
Olivier Blanchard, *World Economic Outlook*, 2012

→ **Structural Reforms**

Create more flexible labor markets → “**internal devaluation**”: reduce the cost of labor to gain competitiveness and thus increase exports eventually restoring equilibrium to the current account and then restoring full employment and growth. IMF → “there is no evidence of a positive effect of flexibility on productivity potential” (*World Economic Outlook*, 2015).

Moreover → unemployment rates are still high, now workers have less rights and each country that undertook these programs went into recession or depression.

1st SOLUTION: Rethinking EU's policies

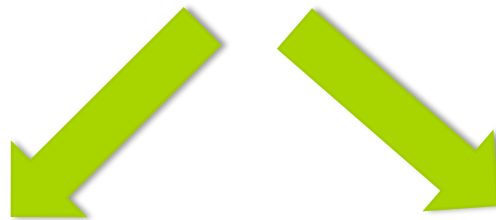
Stop blaming the euro crisis on countries' failures to enforce budgetary discipline. Several countries in Europe had maintained fiscal discipline and yet have been facing severe unemployment, even crises (e.g. Ireland, Finland).

Reforms and Policies that really matters:

- Expansionary fiscal policies to sustain demand and restore growth (monetary policies as lower interest rate and QE can't solve depression alone);
- Industrial policies and public investments in infrastructure and technology;
- Fight against inequalities (improving the distribution of income), poverty and social exclusion (all these indicators increased in the last years);
- Fight against fiscal evasion;
- ...
- Deep debt restructuring (simply recognizing that money that can't be repaid won't be repaid). The severe Troika programs make little sense even from the perspective of the creditors: austerity have lowered GDP, thus making existing levels of debt less sustainable (e.g. Greece) Without a debt restructuring, overindebted countries can't return to health (IMF recognized this too).

There are structural problems and huge divergences in the Eurozone.

so?



MORE EUROPE?



“The optimistic view”

LESS EUROPE?



“The pessimistic view”

2nd SOLUTION: “More Europe”

Structural reforms for the Eurozone

Problem: the creation of a single currency without establishing a set of institutions and mechanisms that enabled the asymmetric union to function effectively.

Aim: building an economic system that can simultaneously achieve *full employment* and *robust growth* in each of the member countries with sustainable current account deficits in the absence of flexible exchange rates and independent monetary policies

Stiglitz suggests six structural changes:

- 1) **Banking Union**: not only common supervision, but also common deposit insurance fund and common resolutions with bank that can't meet their obligations;
- 2) **Mutualization of Debt** vs German (and others) position claiming that Europe is not a transfer union. But any system of successful economic integration must involve some assistance from the stronger countries to the weaker;
- 3) **Common Framework for Stability** → fundamental *reform of the Maastricht* convergence criteria; new *growth pact* supported by a European solidarity fund for stabilization; more *active countercyclical fiscal policies*...

2nd SOLUTION: “More Europe”

Structural reforms for the Eurozone

4) True Convergence Policy

- discouraging surpluses
- expansionary wage and fiscal policies (→ expanding internal demand) in surplus countries instead of competitive devaluation and beggar-thy-neighbour policy;
- “European Wage Standard” (Brancaccio 2011)

5) A eurozone structure that promotes full employment and growth for all Europe

- changing the mandate of ECB: from inflation to full employment, growth and economic stability (as FED)
- Making financial system serve society

6) A commitment to shared prosperity

- limit the race to the bottom (e.g.: Luxembourg on tax competition on capitals);
- limit free movement of capital vs centralization of capital in rich countries.
- EU level tax on all high incomes

However, the issue is not if the eurozone can become a functional currency area, but if it's possible to convince countries that take evident benefits from the current structure to accept the necessary reforms. → It's a political issue.

3rd SOLUTION: “Less Europe”

Alternatives to the current Euro-system

The persistent euro crisis and the conflict over how it has been managed makes it more difficult to develop a quick consensus on policies in any of the mentioned reforms, which would be extraordinarily difficult in any case.

That is why Europe needs also and urgently to begin thinking about alternatives to the single currency arrangement.

Idea: sharing a common currency should not be at the heart of the European project. Moreover, currencies come and go and the euro is just a 17-year-old experiment, poorly designed and engineered not to work. There is so much more to the European project than a monetary arrangement. As Stiglitz stresses in his book, the currency was supposed to promote solidarity, to further integration and prosperity. It has done none of these: as constructed, it has become an impediment to the achievement of each of these goals, and if the reforms to the eurozone discussed previously seem impossible to reach in the today eurozone, it is better to abandon the euro to save Europe and the European project.

Alternatives: Exit (PIIGS? Germany?) / Flexible Euro / “Amicable Divorce” (creation of 2-3 currencies)? Let’s start discuss them.

Conclusion

Given the fundamental necessity of improving the 1st Solution as soon as possible, we have to decide which strategy will follow it (2nd or 3rd Solution), keeping in mind that:

- 1) Given the structural nature of the crisis, we need structural changes
- 2) The TINA (*There Is No Alternative*) story is false

Otherwise, we let nationalist extreme right-wing movements decide for us and for all Europe, which will end up divided and disintegrated, rather than united and integrated.

