Towards a European Spring

by Philippe Legrain

Europe is in a mess. Our economies are failing to deliver higher living standards for most people – and the fortunate few who are thriving don’t always deserve to. Unemployment is scarily high, especially among young people. A lost generation is in the making. With zombie banks, crushing debts, poor productivity growth, inadequate investment, dismal demography and looming deflation, Europe seems set for prolonged stagnation. Depressingly, most Europeans think younger generations will lead a worse life than they do.

The present pain and fear of the future are poisoning politics, too. Social tensions within countries are multiplying, as are political frictions between them. Understandable anger at the injustice of bailouts for rich bankers and budget cuts for poor schoolchildren overlaps with a despicable scapegoating of outsiders, notably immigrants. Scots almost voted to split from Britain last month and Catalans seek to do so from Spain next month. Old stereotypes have been revived and new grievances created. Bombs go off when Angela Merkel visits Athens. And nasty nationalism is on the rise again. Support for the project that binds Europeans together – the European Union – has never been lower; Britons may even vote to leave. The EU’s crowning achievement, the euro, is increasingly seen as a sadomasochistic straightjacket. Most Europeans now associate the EU with austerity, recession and German domination, with undemocratic constraints on what they can do, rather than how we can all achieve more together. People have lost faith in the competence, motives and even the honesty of establishment politicians, EU technocrats and elites in general, who failed to prevent the crisis, have so far failed to resolve it, and bailed out banks and their creditors while inflicting pain on voters (but not on themselves). This anti-establishment, anti-EU and anti-foreigner mood is fertile ground for extremists and charlatans, who did exceptionally well in the recent European elections. Threatened from within by xenophobes, and from outside by Putin’s Russia, our open societies – post-war Europe’s most amazing achievement – are at risk.
Europe has many longstanding problems and longer-term challenges. But it is the catastrophic mistakes of eurozone policymakers – primarily Chancellor Merkel’s government in Berlin, the ECB in Frankfurt and the European Commission here in Brussels – that have transformed the financial crisis that began seven years ago into a much deeper economic and political crisis. So let me first explain what has gone wrong and then how we might put it right.

The crisis in the eurozone was caused by the reckless lending of dangerously undercapitalised German and French banks. They gambled on US subprime mortgages and lent too much, badly, to Spanish and Irish homebuyers and property developers, Portuguese consumers and the Greek government, both directly and together with local banks, abetted by the complacency and sometimes the complicity of central bankers, regulators, supervisors and politicians. When the bubbles burst and banks began to fail, governments decided to bail them out, protecting banks’ creditors. Those initial bank losses were often related to American subprime mortgages, over which the German and French governments had no control. But when it became clear in early 2010 that Greece could not pay its debts, Merkel – together with a French trio of Jean-Claude Trichet at the ECB, Dominique Strauss-Kahn at the IMF and President Nicolas Sarkozy – took a different approach. To avoid losses for French and German banks, they decided to pretend that Greece was merely going through temporary funding difficulties. And under the pretence that the financial stability of the eurozone as a whole was at risk, they decided to breach the legal basis on which the eurozone was formed – the “no-bailout rule” – and lend to the Greek government so that it could repay those banks. Now it is understandable that German and other Northern European taxpayers are angry at this. But they should really direct their anger at the banks that their loans bailed out and the policymakers who made it happen. In the case of Ireland, Portugal and Spain, the EU loans were primarily to bail out local banks that would otherwise have defaulted on their borrowing from German and French banks. As a result of these bailouts, the bad lending of private banks has become obligations between governments. Thus a crisis that could have united Europe in a collective effort to curb the banks that got us into this mess has instead divided it, pitting creditor countries – principally Germany – against debtor ones, with EU institutions becoming instruments for creditors to impose their will on debtors. The eurozone has become, in effect, a glorified debtors’ prison.

Eurozone policymakers have behaved outrageously, trampling on democracy to achieve their misguided ends. They forced the prime ministers of Italy and Greece out of office. The unaccountable Troika abused crisis-hit countries’ need for liquidity to impose inappropriate policies on them. And policymakers threatened to deprive the Greeks and the Irish of the use of their own currency, the euro, unless their government
accepted punitive conditions. Like Weimar Germany, Greece has been forced to accept brutal austerity measures in order to continue to service an unbearable debt burden. Irish taxpayers have been lumbered with a €64 billion bill, €14,000 per person, for banks’ bad debt. Taking advantage of other Europeans’ desperate desire to be part of Europe and their fear of being forced out of the euro to impose iniquitous conditions on them is the very opposite of the solidarity on which the European project is meant to be based. It is tragic – but hardly surprising – that as a result Germany and EU institutions are now resented so much. And the upshot is that European taxpayers now have an incentive to resist the debt relief that Greece needs to recover. They would also lose out if the €64 billion bank debt unjustly imposed on Irish taxpayers were written down. By putting the interests of the banks ahead of those of ordinary citizens, Merkel and other eurozone policymakers have set Europeans against each other. It’s not just the Troika countries that have suffered from policymakers’ catastrophic mistakes, it’s the eurozone as a whole. By failing to clean up the banks, refusing to write down unbearable debts, both public and private, and prioritising collective, excessive austerity and wage cuts instead of policies to boost growth, they have caused such deep recessions that, perversely, public debt has soared. Their successive mistakes also caused a panic which almost destroyed the euro, to which they responded by demanding ever greater austerity – until finally the ECB, after long insisting it was legally unable to act, intervened in the summer of 2012. Now that the panic that policymakers created has abated, austerity has been eased off somewhat and economies have stabilised, they falsely claim success. But the truth is: the eurozone has suffered an unnecessarily long and deep recession, a longer and deeper recession than the United States, which has been growing since 2010. A longer recession than Europe in the 1930s. And in the case of Greece, a longer and deeper recession than Germany in the Great Depression. And now the eurozone economy is still not recovering, it’s stagnating and sinking into a deflationary debt trap.

**Democracy has also been compromised along the way.** The eurozone is now locked into a stifling and undemocratic straightjacket: much tougher EU fiscal rules as well as the fiscal compact. These tighter rules were unnecessary, because the EU’s original Stability and Growth Pact did not fail, except in not spotting the Greek government’s lying. The crisis was caused by failures in the eurozone’s financial, not fiscal, governance. But because Merkel agreed to breach the no-bailout rule, German taxpayers suddenly feared they were liable for everyone else’s debts. So she demanded much greater control over other countries’ budgets – and the Commission was delighted to grab new powers. This is economically dangerous, because countries that share a currency need greater fiscal flexibility, not less. And it’s politically poisonous, because when voters in a country throw out their government, Olli Rehn and now his successor Jyrki Katainen pop up on television to insist that the new government stick to the old one’s failed policies.
That remote, unelected and scarcely accountable officials in Brussels should deny voters legitimate democratic choices about tax and spending decisions alienates people from the EU. And if voting for mainstream politicians doesn’t lead to change, it’s no surprise they turn to the extremes.

**It is clear that eurozone policymakers have made and continue to make catastrophic mistakes.** It is also important to understand why. Their mistakes are the result, in part, of ignorant incompetence, as I witnessed first hand during my time as economic adviser to President Barroso: fiscal specialists at DG ECFIN and lawyers at the German finance ministry who know nothing about finance; economists who know no history; Europeans too arrogant to try to learn from experience elsewhere: the Latin American debt crisis, the Asian crisis or Japan’s lost decades. Ideology also plays a part: conservative governments that had long wanted to shrink the state and technocrats who had long pushed for particular reforms seized on the crisis as an opportunity to advance their agenda. So do bad ideas: the false belief that the eurozone as a whole faces similar problems to those Germany faced at the turn of the century for which the solution was to embrace austerity and suppress wages as Germany did, and the moralistic tale that blames the crisis entirely on southern sinners, with the corollary that supposedly prudent and virtuous northerners need not adjust their ways or bear any of the costs of resolving the crisis. Incomplete and flawed institutions also had a big influence: notably, the fact that the ECB is not mandated to act as a lender of last resort to governments, unlike central banks around the world and throughout history; and more broadly, the fact that decision-makers in Berlin, Frankfurt and Brussels are detached from the people who suffer the consequences of their decisions and unaccountable to them for their mistakes. Last but not least, the power of vested interests, above all the banks, which policymakers view as national champions, political piggybanks and a source of lucrative future employment, and which bully and blackmail even recalcitrant policymakers into line.

**Now, seven years into the crisis, some of the earlier mistakes have been reversed, but new obstacles to resolving the crisis have also been created:** incipient deflation whose tackling requires exceptional policies that offend Germans’ monetary taboos; the new fiscal straightjacket which poses legal and political constraints to expansionary fiscal policy; the antagonism between north and south, broader resentment of a quasi-hegemonic Germany, institutional fatigue and corrosion of support for the EU that precludes desirable further integration; a complacency and lack of urgency among policymakers because today’s chronic misery seems less pressing than the acute financial panic that has abated for now; and the fact that northern taxpayers now have a vested interest to block the debt relief that the south – and the eurozone as a whole – needs to recover. It is tragic.
Europe urgently needs to change course. We need to resolve the crisis decisively and fairly and create a more dynamic, decent and democratic Europe. German Greens can play a crucial role in this, by challenging the consensus view in Germany and calling for a different approach. Germany needs to change, as well as the eurozone as a whole. The Merkel administration’s economic strategy – suppressing wages to subsidise exports – is bad for Germans and disastrous for the rest of the eurozone. Contrary to Wolfgang Schäuble’s claims that Germany’s economy is Europe’s most successful, it is not particularly dynamic: productivity growth averaged only 0.9% a year over the past decade, less even than Portugal’s. And the brunt of this stagnation has been borne by German workers, who now earn less after inflation than 15 years ago. Is that a successful economic model? Since compressing wages suppresses domestic demand, Germany can only grow by exporting – and now that the rest of the eurozone is stagnating and China is slowing, Germany is stagnating too. Schäuble prides himself on Germany’s vast current-account surplus, viewing it as a sign of its superior competitiveness. But if so, why are businesses not willing to invest more in the country? Investment has slumped from 22.3% of GDP in 2000 to only 17% last year. External surpluses are in fact symptomatic of a sick economy. Stagnant wages swell corporate surpluses, while subdued spending, a stifled service sector, and stunted start-ups suppress domestic investment, with the resulting surplus savings often squandered overseas. Far from being an “anchor of stability” for the eurozone, as Schäuble claims, Germany spreads instability. Its banks’ bad lending of its surplus savings inflated asset-price bubbles leading up to the financial crisis, and have imposed debt deflation since then. Nor is Germany a “growth engine” for the eurozone: in fact its weak domestic demand is a brake on growth elsewhere. As a result, German banks and taxpayers are less likely to recover their bad loans to southern Europe. Compressing wages has been bad for Germans; foisting wage cuts on the rest of the eurozone is disastrous. It’s a myth that wages in southern Europe are too high: they fell as a share of GDP in the decade before the crisis. Slashing incomes depresses domestic spending and makes debts harder to bear. And with global demand weak, the eurozone as a whole cannot rely on exports to grow out of its debts. For struggling southern European economies whose traditional exports have been undercut by foreign competition, the solution is not to slash wages, but to invest in moving up the value chain and produce new and better products for higher wages. Germany’s economy needs an overhaul. Policymakers should focus on boosting productivity, not “competitiveness”, with workers paid their due. The government should take advantage of near-zero interest rates to invest, and encourage businesses – especially start-ups – to do likewise. The country should also welcome more dynamic young immigrants to stem its demographic decline. This would be a better economic model for Germany. It would also set the right example for the rest of Europe. Fortunately, Portuguese shoemakers, the country’s biggest exporters, ignored the advice from Berlin and Brussels to slash wages. After years of losing sales to China
and Turkey, they invested in going upmarket. They’ve been so successful that exports have soared, while wages and employment have risen.

**The eurozone as a whole needs to change, too.** Instead of a eurozone caged by Germany’s narrow interests as a creditor, Europe needs a monetary union that works for all of its citizens. That requires a change of policies: We need to clean up the banks, write down excessive debts, both public and private, and combine increased investment with reforms to boost productivity (and thus wages). And it requires reforms to the eurozone’s institutions: instead of the bogus banking union that is being created, we need a genuine, robustly independent one that applies equally to all banks. To avoid future panics, we need to enshrine the ECB’s role as a lender of last resort to solvent governments. The no-bailout rule should be restored and with it much greater fiscal flexibility for elected governments, constrained by markets’ willingness to lend and ultimately by the possibility of default. And ideally, we should create a eurozone treasury accountable to both European and national legislators, with limited tax-raising and borrowing powers. Ultimately, the fairer, freer, and richer eurozone that would emerge is in Germany’s interest, too.

**Looking forward, we need to create lasting shared prosperity by making our economies more adaptable, dynamic and decent.** Break the power that banks have over our economies and politics, and build a smaller, simpler and safer financial system that serves the needs of the real economy and isn’t subsidised by taxpayers. Crack the stranglehold that some companies, big and small, have over cartelised markets. Open up labour markets to everyone, not least young people. Free up Europeans’ creative energies so they innovate more. Make it easier to start a business: there are millions of unemployed young Europeans out there who have nothing to lose and plenty to gain from becoming entrepreneurs. We need societies that provide security while also encouraging people to take risks. And we need a tax system that is fair and efficient, so we should shift tax off hard work and enterprise and on to unearned windfalls from land ownership and large inheritances, and provide every young person with a capital lump-sum and thus some financial security and the potential to build their own business or invest in their future. To combat climate change, we should be funding more research and taxing carbon consumption, not giving handouts to companies through the ineffective emissions-trading scheme. And as our societies age and workforces start to shrink, we need to be open to newcomers and capitalise on Europe’s biggest asset: the diversity of its people. Above all, we need to stand up for those locked out of the system, not in the hateful way that extremists do, but by opening up opportunities for everyone to get ahead.
To make it happen, our politics needs to change, too. We live in an era of technocratic mismanagement, of narrowly framed policy choices, short horizons and limited ambitions. Hemmed in by vested interests and bereft of big ideas, most politicians try to muddle through rather than shake things up. They nip and tuck, duck and dive, instead of painting a compelling vision of a brighter future and battling to achieve it. No wonder voters are unimpressed.

Europe needs bold leaders, political entrepreneurs and a grassroots movement for change. That’s why I’m setting one up, at Europeanspring.org. And we need to update our closed, clubby and class-based politics from a bygone industrial age with a more open politics fit for the internet age. To revitalise our politics and restore trust in politicians, we need a politics that is more open to new and different views, more open in how candidates are selected, and more open about the funding of political parties and lobbying. Policymakers should be paid better and banned from working for the banks and companies they regulated afterwards. We also need citizens' initiatives to address issues MPs neglect. New forms of deliberative democracy that engage citizens in informed decision-making. A more open, accountable and democratic European Union with genuine political choice.

A crisis can provide an opportunity for radical reform. The internet can be a fantastic instrument for mobilising it. And the fuel can be the power of ideas, as well as enlightened self-interest.

Stagnation, decline, disillusion and despair are not inevitable. Europe needs hope, a politics of genuine optimism, a prospectus for a better tomorrow. We need to put the mistakes of the past behind us and embrace the future and all its possibilities for progress. We need a European Spring: economic and political renewal.