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"Is there a need for more cooperation on fiscal policy in the eurozone?"

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The four challenges of the EU

The European Union is currently facing four severe challenges, and it is not in a position to meet them in a convincing, democratic and appealing way. The first challenge is the prolonged economic stagnation with mounting unemployment and social polarisation. The second is the coming enlargement, i.e. the accession of ten countries, which will strongly increase the heterogeneity in economic performance, social welfare and political culture within the greater EU. The third challenge is the European constitution which is currently under deliberation and which aims at the formation of a democratic European identity. To these three must be added the fourth challenge of strong geopolitical pressures which were created by the increasingly unilateral and hegemonistic policy of the United States and which have generated deep political divisions also within the EU.

Stagnation

Restrictive "deflationist" policies were proved to be very ineffective in the conjuncture of economic stagnation, which hit the world economy since the turn of the century. Most European economies, following the restrictive course of the Commission's guidelines were suddenly in jeopardy of getting caught in a deflationary spiral. The declarations made at the Lisbon summit in March 2000 – the EU economy should become "the most competitive economy of the world" within a decade, with an average growth rate of 3% during the current decade– have been dramatically refuted: The GDP growth rate in the Eurozone declined from the average annual level of 2.1% in the decade 1991-2000 to 0.4% in 2003, while growth rate of investment (Gross Domestic Capital Formation –GDCF) declined from 2.0% in 1991-2000 to –2.6% in 2002 (Statistical Annex of European Economy, Autumn 2003).

At the same time, and despite cuts in the systems of unemployment benefits and social welfare, the 3% of GDP limit for public deficits was proven a difficult target to be met in a conjuncture of weak growth and stagnation, followed by policies of tax reductions for corporate profits, capital gains and higher incomes.

In November 2002, EU finance ministers voted to discipline Portugal for missing deficit targets. However, at the same time the German finance minister warned the Commission that his country was also likely not to comply with the SGP deficit target for 2002. Actually, the German public deficit surged from 1.4% of GDP in the year 2000 to 2.8% in 2001, 3.6% in 2002 and 4.2% in 2003, while it is expected to remain above the 3% of GDP limit until the year 2006. The situation developed in a similar pattern also in France, the second largest economy in the EU, as the country's public deficit ran over the 3% limit and reached 4.2% of GDP in 2003. As the two major EU economies involuntarily violated the SGP rules, the Commission declared, in March 2003, that Iraq war provided exception to EU deficit rules. However, after the protests by some of the smaller EU countries, claiming that "sound" policies will lose their public credibility if not followed by all countries, the Commission began a sanctions process against the two countries which could have led to fines of as much as 0.5% of each country's GDP. This process was though finally abandoned by EU finance ministers, meeting on November 25, 2003 in Brussels, who rejected the Commission's recommendations that France and Germany should immediately undertake deeper cuts in spending to comply with the SGP rules, or otherwise face sanctions. The European Central Bank immediately dispraised this decision of the Council of finance ministers, claiming that it "risks undermining the credibility of the institutional framework and the confidence in sound public finances" of the EU countries.

The SGP has not been renounced; it was simply broken as a consequence of stagnation, aggravated by restrictive policies. By not taking punitive measures against France and Germany, European countries reasserted their national authority over their own budgets. However, they still insist on following the same course, despite the fact that it was proven to aggravate stagnation and thus to be a major obstacle to more employment and growth.

However, amongst the great number of problematic and backward oriented developments one may see a positive step in the Italian proposal "A European Action for Growth". It is based upon the recognition of the fact that the share of public investments in GDP has fallen in the 1990's to 2,3%, half a point less than in the previous decade (lagging well behind the US performance). Thus an urgent need is seen to accelerate the volume of public investments in infrastructure, bringing them to the pace initially targeted by the Delors Plan in 1993. The July 2003 Ecofin Council has given a mandate to the European Commission and the EIB to present a proposal for implementation and financing of such a programme, which should be discussed and adopted at the 2003 December summit. The fact that the Council has at last taken the initiative for an immediate emergency programme to stimulate growth and employment and to finance this through the European Investment Bank shall be welcome as a positive measure aiming at deepening economic and fiscal cooperation among EU countries.

With reference to this proposal, three additional recommendations can be formulated:

1. The size of the programme should at least reach the upper figure of the proposal, i.e. 1% of EU-GDP, i.e. about € 90 billion.
2. An additional programme should be launched for the new member countries. It should be relatively larger than the one for the EU15 to enable new members to catch-up to the current EU members; and it should be financed via the EIB and the European Bank

for Reconstruction and Development (EBRD) with interest subsidies from the EU budget.

3. In addition to the infrastructure projects in the Council proposal the whole area of environmental protection, repair and clean-up should be given high weight to reconcile economic growth and ecological restructuring and bring the European economy onto a path of sustainable development.

Further to the above, economic and social policies in the EU shall be restructured into a consistent economic policy pattern for steady and sustainable growth, aiming at full employment, social cohesion and general welfare. There are at least six cornerstones for such a necessary macroeconomic policy change:

1. *First*: The mission and structure of the *European System of Central Banks* should be broadened to include the objectives of sustainable growth, full employment and social cohesion.

2. *Second*: The *Stability and Growth Pact should be abandoned* or at least be changed in a way that leaves fiscal policies of member states the flexibility to act in a way which promotes these agreed objectives.

3. *Third*: The *EU budget should be considerably increased* to give the EU room for manoeuvre to counteract asymmetric shocks and strong regional inequalities within the EU. In order to finance this expansion European taxes should be introduced, e.g. a tax on financial market turnovers or ecological taxes.

4. *Fourth*: *Tax competition should be terminated* and replaced by a high level of tax harmonisation and strong tax policy co-operation where and as long as complete harmonisation is not possible.

5. *Fifth*: *Economic policy co-ordination* should acquire a more systematic, broader and more binding character than today; the concept of a legitimate European economic government as a counterpart to the ECB could be advanced. The European Parliament should play a greater role in decisions about economic policies including fiscal policies.

6. *Sixth*: The ongoing formation of a single *European financial market* must focus on ensuring systemic financial stability and consumer protection as main objectives and in this sense enhance the scope of financial supervision on the European level through harmonisation, closer co-operation and regulation. These reforms are all the more necessary with regard to the upcoming enlargement of the EU. Without a more expansionary monetary policy the new members will have no chance to catch up.

The above guidelines aiming at deepening economic and fiscal co-operation, as well as solidarity among EU countries, may be also applied to reform the "philosophy" of the *Broad Economic Policy Guidelines (BEPGs)*.

The Commission's Recommendation with regard to the BEPGs for the 2003-2005 period was endorsed by the Thessaloniki European Council in June 2003. They are considerably more comprehensive than previous BEPGs in two respects: For the first time they cover a three-year-period, and they represent an attempt to provide a comprehensive, consistent and more balanced policy framework, built around the central policy objectives set by the Lisbon Agenda.

To this effect, 23 guidelines are specified. These are divided into 3 groups:

a. Macroeconomic or short-term policies (3 guidelines);

b. Structural or medium-term policies (11 guidelines);

c. Sustainability or long-term policies (9 guidelines).

Furthermore, the Report contains a special section devoted to the Euro area.

Contrary to the aspirations of the Commission the new BEPGs do not represent a more balanced approach to the economic and social problems of the Union by comparison to the previous BEPGs. They remain characterised by a strong asymmetry between the "stability" aspects of policy on the one hand and the social and environmental ones, on the other. In particular, "confidence" appears to be a key concept, directly related to the need to secure a stable environment, fostering investment and therefore growth. According to this linear type of argument, business and consumer confidence constitute significant determinants of policy. This concern leads to a constant preoccupation with price stability and that, in turn, to the recommendation that wages adjust downwards, as productivity falls. The downward adjustment of wages is further deemed necessary for employment to increase. Lastly, long-term sustainability is linked to the so-called "impact of ageing", which is expected to exert "increasing pressure on public finances" (p. 10). Hence, the need for the reform – i.e. downsizing and privatisation - of pension systems appears to be more or less unquestionable.

On the other hand, the social aspect of policy is explicitly mentioned only in relation to the long-run. In this respect, the main concern seems to be about poverty and social exclusion, linked to unskilled and low-skilled workers and to less-developed regions. The relevant guidelines are however very general in nature, as no specific thresholds or measures are presented. Thus, what constitutes an "adequate level of social protection", how this is to be financed, or what kind of public support should be given to regions lagging behind are some of the issues left unspecified.

Enlargement

In May 2004 ten new Member States will enter the EU, i.e. Cyprus, Malta and eight Central and Eastern European Countries. To be accepted as EU member-states, these countries already follow the restrictive policies connected with the Maastricht criteria and the SGP, despite the fact that some of them face major macroeconomic imbalances and a high unemployment rate (e.g. 19% in the Slovak Republic and 20% in Poland). The accession of two more countries (Bulgaria and Romania) is planned for the year 2007 or 2008.

The entry of the new members will increase the population of the EU by 75 million persons, i.e. one fifth of the current population. The per capita income of the newcomers (in purchasing power parities PPP) is less than half (47,7%) of that in the old EU. The share of agricultural employment in total employment is more than one fifth (21.5%) against less than one twentieth (4,3%) in the EU-15, and the productivity of the agricultural sector of the EU-15 is five times higher than in the CEECs. Even if one assumes the very favourable but rather unlikely case of growth rates of 2% per year in the EU-15 and 4% in the CEECs, the new members would need about two decades to reach on average 60-70% of EU-15 per capita income.

After enlargement (including the accession of Bulgaria and Romania in 2007 or 2008) three groups of countries will exist in an EU of 27 in terms of GDP per head: The present EU-15 members without Spain, Greece and Portugal, form the first group of 12 countries with GDP per head of 120% of the EU-27 average, i.e. one fifth above the new average (which is about 90 % of the present EU-15 average). The second group of seven countries will consist of the three remaining countries of the current EU plus Cyprus, the Czech Republic, Slovenia and Malta, with GDP per head between 68% (the Czech Republic) and 95% (Spain) of the EU-27. The third group will be formed by the remaining eight accession countries, with a GDP per capita on average of 40% of EU-27 (56-58% for Slovakia and Hungary).

Enlargement will more than double the population living in regions with GDP per head of less than 75% of the present EU average from 71 million to 174 million, or from 19% of the EU-15 total to 36% of the EU-27 total. So regional disparities will double with enlargement. From these data it should be obvious that enlargement will change many parameters for economic and fiscal policy in the larger EU, and these changes affect not only the new but also the old members. But the EU is not prepared to deal with these changes by a corresponding adjustment of its economic policy orientation. Instead it is maintaining the current very restrictive macroeconomic policy framework and is set to impose an even more rigid and restrictive pattern for structural policies.

This marks a complete change from previous enlargement rounds which were accompanied by a substantial expansions of the Structural Funds. Similar measures were also taken after the adoption of the Maastricht Treaty: A Cohesion Fund was created to help the poorest countries mitigate the pressures of increased competition on the way to monetary union. Nothing of this kind will happen this time, although the scale of the enlargement is the largest ever. Not only will the Structural Funds not be expanded to cope with rising disparities; the German government has even proposed to reduce the upper limit for the EU budget from the presently 1.27 % to less than 1.1 % of EU-GDP. This extremely restrictive approach is likely to generate deep economic, social and perhaps even political crises in large parts of the EU.

Two further scandalous forms of discrimination against the new members aggravate the situation: Firstly, it was decided that new members would, at the beginning of their membership, only receive 25% of the agricultural subsidies to which they were entitled as regular members of the EU, and that this share would be increased slowly to reach 100% after ten years. Secondly, in order to participate in the European Monetary Union (EMU), new members must fulfil the Maastricht Treaty's convergence criteria, although the majority (seven out of twelve) of the present members of the EMU currently fail to meet these criteria. To cope successfully with the challenges set by this enlargement thoroughgoing changes are necessary in both the macroeconomic and structural policies of the EU.

European Constitution

To solidify the enlarged Union of 25 (and soon 27) member states, a "European Convention" was formed, which elaborated the draft of a "Constitution for Europe", currently being negotiated among the EU member states. The Constitution aims at "finalising" the institutional framework of the EU for the decades to come, so that the "deepening" of the process of European (economic, political and social) unification may be facilitated. The draft Constitution has been adopted by all member-states, with the exception of the clauses registering the weighting of votes in the European Council and the Council of Ministers. In December 2003, the Council of European leaders failed to conclude on a final version of the Constitution, as Spain and newcomer Poland insisted on keeping the voting system crafted in 2000 that gave each of these countries almost as many votes as Germany, which though has a much larger population as either. Germany and France insisted on reforming this voting system.

However, it is not difficult to understand that the "Constitution" actually aims at making restrictive economic policies irreversible" in the enlarged EU:

The "Draft Constitution" ascribes the character of "constitutional order" to the ideas of deregulated markets ("Article I-3: The Union's objectives: a single market where competition is free and undistorted").

More specifically with regard to economic and social policies, after some "progressive" formulations concerning the economic and social "objectives" of the EU in part I of the Draft, which seemingly reproduce the general attitude of the 1948 UN *Universal Declaration of Human Rights* [i], disinflation, the main motto behind all restrictive policies, is acclaimed as major "constitutional" end: "The primary objective of the European System of Central Banks shall be to maintain price stability" (Article I-29). If one takes into account that in EU-15 the inflation rate (consumers' index) fell from 10.6% on average in the 1970s to 6.5% in the 1980s and to 2.1% in 2000, to remain practically constant ever since, one can only reach the following conclusion: By choosing to further suppress inflation, European governments declare that they insist in the same restrictive policies that have troubled the majority of the working people up to date, and that other goals, like promoting growth, fighting unemployment, improving the welfare state, etc. are set aside for the whole historical period of "consolidation" of the enlarged Union.

[i] E.g. Article I-3: "The Union shall work for a Europe of sustainable development based on balanced economic growth, a social market economy, highly competitive and aiming at full employment and social progress, and with a high level of protection and improvement of the quality of the environment". However, even at that general level, the European "Draft Constitution" falls clearly behind the 1948 *Declaration* in concern with most social and human rights. With regard, for example, to the "right to engage in work", we read in the "Draft Constitution": "Everyone has the right to engage in work and to pursue a freely chosen or accepted occupation" (Article II-15) and "*Every worker has the right to protection against unjustified dismissal*, in accordance with Union law and national laws and practices" (Article II-30, emphasis added). For comparison, we quote the respective article of the 1948 *Universal Declaration of Human Rights*: "*Everyone*

has the right to work, to free choice of employment, to just and favourable conditions of work and *to protection against unemployment*" (Article 23, emphasis added).

In spite of any positive elements, however, in the draft Constitution persists a strong and harmful imbalance between the principle of the internal market and free competition on the one hand and the need for democratic policies that serve the public interest, including the provision of public goods and public services on the other hand.

Article I-14 provides for the coordination of economic and employment policies (by the traditional channels of the Broad Economic Policy Guidelines and the European Employment Strategy) and opens the door for a coordination of social policies. No mention is made of the European Sustainability Strategy. Here the Convention has missed the opportunity to explicitly establish a coherent design for the coordination of economic, employment and social policies - putting them all on an equal footing and reconciling conflicting targets between them, instead of giving priority to the Broad Economic Policy Guidelines (BEPGs).

Positive and progressive formulations about objectives of the EU in part I of the draft are in no way given concrete expression and developed in part III. Instead, the anachronistic and harmful design of the Maastricht and Amsterdam Treaties remains fully intact: economic and monetary policies are set in the framework of an "open market economy with free competition". Employment policy aims at a "high level of employment" instead of full employment; the BEPG keep their primacy over the European Employment Strategy (EES). The very restrictive provisions regarding the ECB and the priority given to price stability, the deficit rules and the convergence criteria for EMU etc. – all remain unchanged. The position of the European Parliament in matters of socio-economic governance is as weak as before: It only has the right of "information" with regard to the BEPGs and of “consultation” in employment and social policy coordination processes.

As a counter-approach to the priorities of the draft Constitution, the following social and economic policy *objectives* can be formulated:

- The protection of public goods and the provision of high quality public services and services of general interest (socio-cultural, economic) should be included in the objectives of the Union (Article I-3); serving the public interest and democratic decision making should have priority over the principles of the Internal Market and competition rules as guiding principles for the provision of services of general interest (Article II-6);

- The specification of the single market in Article I-3 should be changed to “a single market with a high degree of economic efficiency, an adequate level of competition, a high degree of social standards and of environmental and consumer protection”;- “Full employment with high quality of work” should be an objective of the Union (Article I-3) and carried forward to Part III of the constitution, replacing “high level of employment”, e.g. Articles III-99, III-103);

- The goal of a “high level of social protection” should be reinstated as an objective (Article I-3);
- The objectives of a “social market economy”, “social progress” and “balanced growth” in part I should be carried on into part III replacing that “open market economy with free competition”, etc. Articles III-69, III-70, III-77);

- The objective of high social standards should be included in the constitution and it should explicitly be declared that no measure by the European authorities could reduce the current social rights in member countries.

Social and economic policy *coordination*:

- *Employment and social policies should have the same weight and status as economic and monetary ones* in the constitution. Also, there should be provisions for the coherent coordination between them with economically, socially and ecologically sustainable development as an overarching objective (Article I-14).

- With regard to the *European Central Bank* (ECB) the objectives of monetary policy (Articles I-29, III-77) should be extended to include "price stability, balanced growth, social cohesion and full employment". The democratic accountability and transparency of the ECB must be clearly pointed out: as an institution of the European Union it should be bound by the "principle of participatory democracy" like all other institutions listed in Part I of the constitution. The independence of the ECB should be operative independence, while in the definition of price stability and in the assessment of the respective economic situation and need for political action the ECB should act in co-ordination with other policy actors.

- The EMU convergence criteria should be redrafted towards real economy convergence criteria (Article III-92) and the definitions of an excessive deficit (protocol on the excessive deficit procedure) should be dropped.

- For the adoption of international agreements on commercial treaties, especially those concerning trade in services and agreements on investments (Article III-217) the previous principles of "shared competencies" and unanimity voting should be re-introduced. - The proposals of European environmental organisations on the insertion of the objectives of sustainable development in the provisions of Part III should be followed.

International instability – terrorism

The draft European Constitution seems to give priority to state security over human rights and to promote “militarisation” of the Continent in accordance with the post-9/11 US standards: “Article I-40: The common security and defence policy (…) shall provide the Union with an operational capacity drawing on assets civil and military. The Union may use them on missions outside the Union for peace-keeping, conflict prevention and strengthening international security in accordance with the principles of the United Nations Charter”).

It also provides for the establishment of a European Armaments, Research and Military Capabilities Agency and obliges Member States “progressively to improve their military capabilities”.

These provisions (Article I-40, Articles III-210 to III-214 on Common Security and Defence Policy) tend to propel the Union towards an increased reliance on military means to resolve conflicts or to protect and enforce the Union’s assumed “strategic interests“: “A European Armaments, Research and Military Capabilities Agency shall be established to identify operational requirements, to promote measures to satisfy those requirements, to contribute to identifying and, where appropriate, implementing any measure needed to strengthen the industrial and technological base of the defence sector, to participate in defining a European capabilities and armaments policy, and to assist the Council of Ministers in evaluating the improvement of military capabilities” (op. cit.).

I consider the above to be a politically dangerous development. Apart from this, the orientation towards improving military capabilities will unavoidably lead to higher expenditure for armaments in Europe, and as all experience shows such an increase will be financed through deep cuts in social spending and public investment by the Member States.