European governance as a dangerous trade-off: More discipline in exchange for more instability

John Milios

Professor of Political Economy,

National Technical University of Athens.

1. The Economic and Monetary Union and the Euro-Area

- 1979, European Exchange Rate Mechanism (ERM) and European Monetary System (EMS)
- 1986, adoption of the *Single European Act* (SEA): "European Single Market" (ESM) until the end of 1992
- February 1992, the *Treaty on European Union*, signed in Maastricht. Convergence Criteria:

(a) government debt no higher than 60 per cent of gross domestic product (GDP),

(b) budget deficit no higher than 3 per cent of GDP.

The Economic and Monetary Union and the Euro-Area

- The "Maastricht criteria" legitimize austerity as means of "convergence"
- 1992–1993: The crisis of the EMS showed that exchange rates depend on financial market volatility, with foreign exchange derivatives potentially creating destabilizing effects to the ERM
- A single currency area is not identical with a zone of fixed exchange rates
- Blanchard/ Dornbusch/ Fischer/ Modigliani / Samuelson/ Solow*", FT*, July 29, 1993: "European monetary policies and exchange rate arrangements are profoundly counterproductive".

"Fiscal discipline" by elevating default risk

- January 1, 2002: The euro enters into circulation and, ever since, *is* the national currency of each and every member state of the EA.
- It is a currency without traditional central banking. The European Central Bank (ECB) does not play the role of a lender of last resort.
- This was a political decision.
- Austerity and fiscal discipline in exchange of default risk.
- 2007: Lisbon Treaty: "No bail out clause".

The catching-up process before the 2008 global economic crisis

Change [%] of GDP and domestic demand in *real* terms
for various countries during the period 1995-2008

	Greece	Germany	Italy	Spain	Holland	Ireland
GDP	*61,0%*	*19,5%*	*17,8%*	*56,0%*	*42,0%*	*124,1%*
Private consumption	*55,7%*	*12,3%*	*19,6%*	*55,3%*	*33,1%*	*104,5%*
Total gross fixed capital formation	*102,8%*	*18,8%*	*31,6%*	*95,2%*	*56,3%*	*130,5%*
Public consumption	*51,1%*	*14,7%*	*21,5%*	*74,8%*	*41,4%*	*97,3%*
Export volumes	*131,4%*	*159,0%*	*34,0%*	*115,1%*	*114,1%*	*232,3%*
Import volumes	*123,1%*	*115,5%*	*56,7%*	*174,1%*	*117,8%*	*222,4%*
Consumer price indices	*66,4%*	*22,2%*	*37,3%*	*47,5%*	*33,1%*	*47,2%*
Current acc. bal. (2008) % GDP	*-14,6%*	*+6,7%*	*-3,4%*	*-9,6%*	*+4,8%*	*-5,2%*

Source: OECD *(2009) [our calculations]*

The 1st period of the EMU and the EA: Financial imbalances?

- Persistent capital account surpluses and current account deficits in the fast growing countries of the EA "periphery"
- Capital imports and REER appreciation mostly for countries with capital account surpluses and current account deficits
- Before 2008, current account deficits and capital account surpluses were celebrated as basic means to accommodate the growth differentials in the EA. They were *not regarded as imbalances*:
- "The fundamentals of the euro area economy remain sound and the euro area economy does not suffer from major economic imbalances" (J.-C. Trichet, 03/2008).

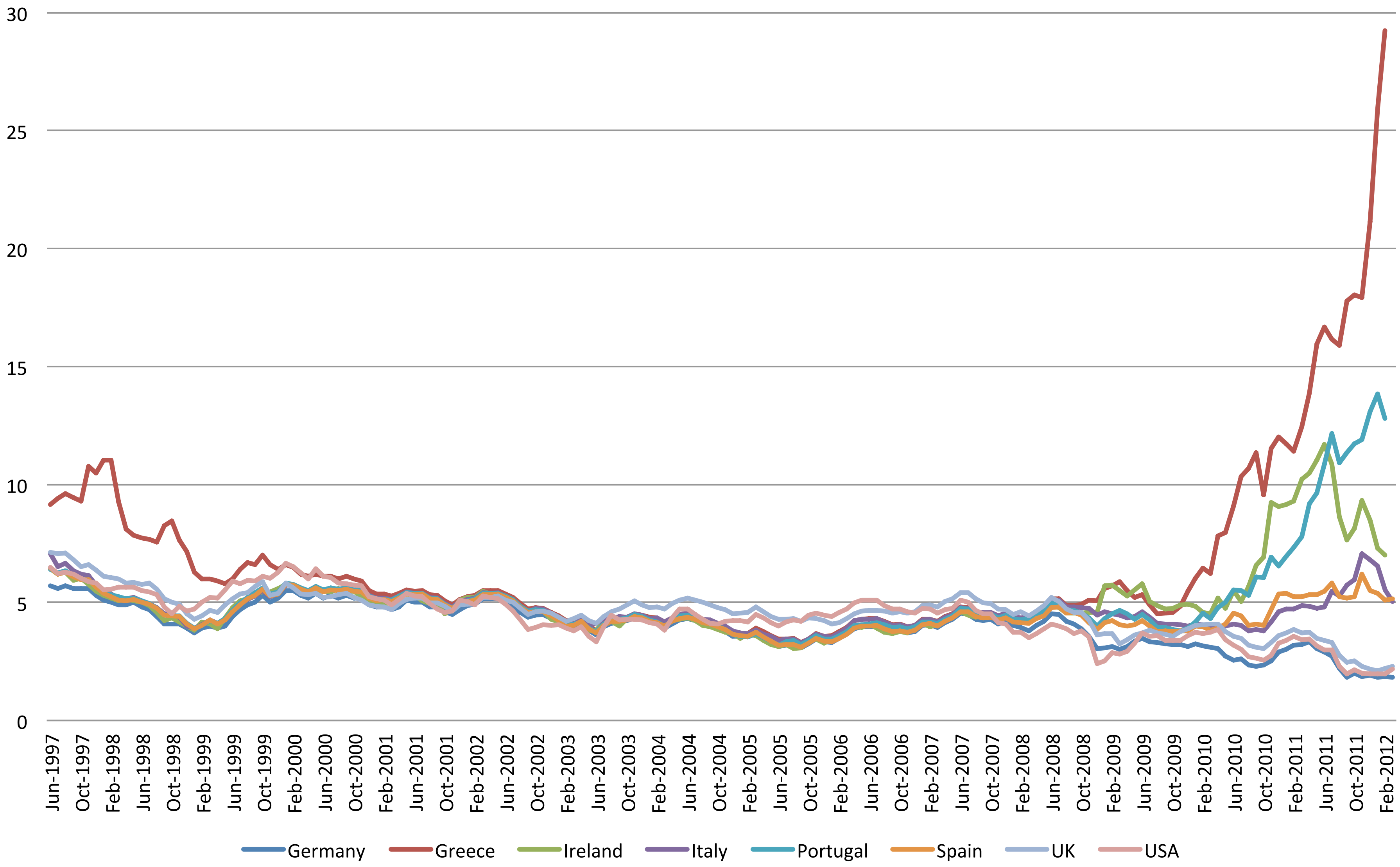
After the 2008 financial meltdown

- The EMU, by abolishing traditional central banking, has become more vulnerable to crises (elevated sovereign default risk for certain governments)
- Re-pricing of country risk and bank risk in the conjuncture of crisis: certain member states were unable to serve their sovereign debt. They were unable to avoid default by their own means
- The new mainstream narrative: the roots of the crisis are to be found in the "imprudent" domestic behaviours and policies both in private (firms and households) and public sectors.

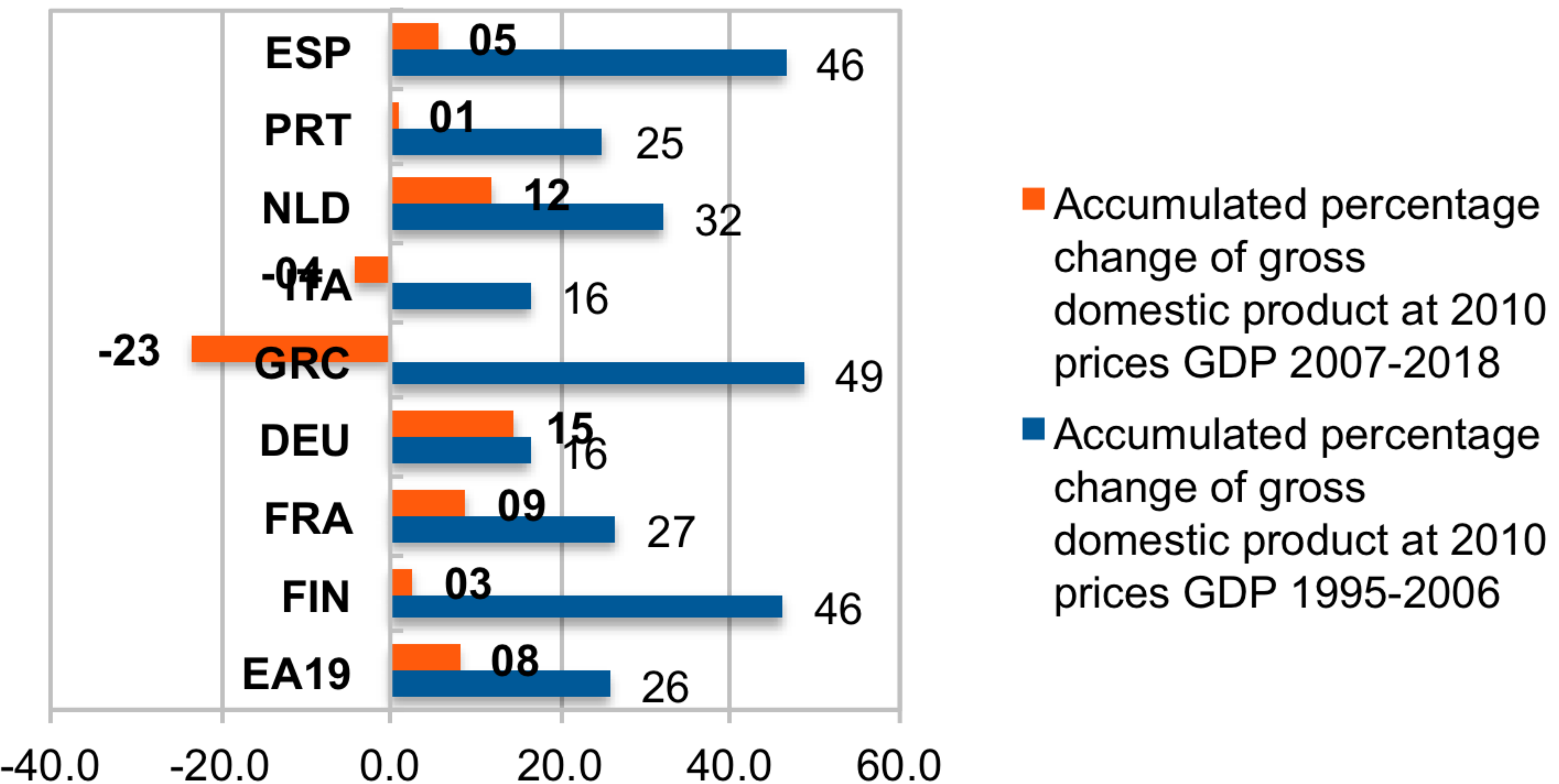
Imbalances were the result of the workings of the EA

- The after 2008 mainstream interpretation of the crisis is politically motivated, and is false.
- Current account imbalances were neither the result of imprudent borrowing nor the outcome of economic weaknesses.
- On the contrary, they reflect the significant capital inflows and the domestic credit surging in the countries with significant growth prospects
- Both these factors boosted domestic demand deteriorating the trade balance and putting upward pressure on the real exchange rate
- Risk re-pricing and the surge on interest rates was an outcome of the global crisis and the EA architecture (absence of a lender of the last resort).

Long term interest rates for several countries



Accumulated percentage change of gross domestic product at 2010 prices



Elimination of “moral hazard” as the exemplary form of European Governance

- The responses to the crisis have necessarily to be complementary to the functioning of the markets
- Political decisions must impel the neoliberal agenda of redistribution of income, wealth and power in favour of capital, without violating the functioning of the markets
- The “no bail-out clause” was forgotten: Greece, Portugal, Cyprus, and Ireland were bailed out
- Member states should accept the “rescue package”, under conditions, that the financial markets would also demand: austerity-cuts-privatizations.

The public debt overhang

- The debt ratios in the EA increased in recent years, especially for the higher indebted countries (Greece, Italy, Portugal, Belgium, Cyprus, Spain France)
- The strategy of EU is not to deal with the sovereign debt overhang, but to reassure neoliberal policies
- In the institutional framework of the EA, member states should not succumb to any policy that supports the interests of the working class, or promotes the welfare state, especially on the basis of social expenditures that rely on public borrowing
- Japan, the most indebted of all developed capitalist countries, does not face any solvency problem in serving public debt. (Role of the Bank of Japan).

Public Debt as % of GDP

	2007	2012	2017
AUT	64.7	81.7	78.6
BEL	87.0	104.3	103.8
CYP	53.5	**79.7**	**103.0**
DEU	63.7	79.8	64.8
FIN	34.0	**53.9**	**62.7**
FRA	64.3	**89.6**	**96.9**
GRC	103.1	**159.6**	**179.6**
IRL	23.9	119.6	69.9
ITA	99.8	**123.4**	**132.1**
PRT	68.4	**126.2**	**126.4**
ESP	35.6	**85.7**	**98.4**
EA19	64.9	91.4	89.3
GBR	41.9	**84.5**	**86.6**
USA	64.0	**102.5**	**108.2**
JPN	176.6	**228.6**	**239.6**

The ECB after the 2008 financial meltdown

- The ECB has expanded its balance sheet by taking on long-term refinancing operations. However, a strong intervention of the ECB, comparable with that of the Fed or the Bank of England, was only initiated after the crisis of Spain and Italy, i.e. as late as 2014 and 2015
- *This intervention will end, however, at the end of 2018*
- The response of the ECB to the Euro-crisis in the years 2015-2018 has shown that, technically, the ECB can become a “proper” central bank, strongly intervening in the sovereign debt market
- The decision for the opposite is political.

Austerity as the "normality" of European economic policies

- Austerity works as a strategy of reducing labour costs. It increases profit per (labour) unit cost and thereon boosts the profit rate
- However, what is cost for the capitalist class is the living standard of the working majority of society. This applies also to the welfare state, whose services can be perceived as a form of "social wage"
- Austerity's recessionary effects function as "constructive destruction"
- Austerity's strategic target: The subjection of all forms of social life to the unfettered functioning of markets and the boost of profitability.

Austerity as class policy

- Austerity is, therefore, neither a ‘false’ nor a ‘correct’ policy. Primarily, it is a class policy
- It constantly promotes the interests of capital against those of the workers, professionals, pensioners, unemployed and economically vulnerable groups
- It aims at creating a model of labour with fewer rights and less social protection, with low and flexible wages and the absence of any substantial bargaining power for wage earners
- Being a class policy, austerity depends, first of all, on the correlation of forces *within a society*.

“Moral hazard” vs. “political risk”

- The strategic question for neoliberalism is to define the “optimal” balance between “moral hazard” and “political risk”. The two risks move in opposite directions. When “moral hazard” increases, political risk declines and vice versa
- Beyond certain limits, increasing discipline and austerity, and the dictate of profitability may trigger uncontrolled social upheavals (e.g. Greece 2012, France 2018)
- In such a political conjuncture, *increasing political risk means that a government (even a neoliberal one) may not be in a position to follow the austerity agenda*
- A historical example: “We know now that Government by organized money is just as dangerous as Government by organized mob.” (Franklin D. Roosevelt October 31, 1936).

Social distress and political results

- The persistence of austerity has increased the feelings of dissatisfaction among the working majority in EU
- Unemployment has risen since the 2008 financial meltdown in the EU. In October 2018: 8.1% in EA, 18.9% in Greece (as compared to 3.7% in the USA and 2.4% in Japan). Youth unemployment rate: 17.3 % in the EA, 36.8 % in Greece, 34.9 % in Spain, 32.5 % in Italy
- Political effects: Massive anti-austerity mobilisations in certain countries, the run-down of centre-left parties, increase of xenophobia, racism and the rise of far-right parties
- The far-right, xenophobic and anti-immigrant policies are not a threat to austerity and the neoliberal agenda
- The only threat to neoliberalism could be a mass democratic movement and the radical Left.

The fragile edifice of the Euro Area

- The EA, not possessing a lender in the last resort, is a rather fragile edifice. It cannot afford any exit from the single currency area.
- In such a case the EA will be transformed again to an area resembling to a zone of fixed exchange rates, which means that financial markets will start calculating the exit (parity) risk for the most vulnerable countries, creating foreign exchange derivatives to hedge it. The ghost of the 1992-1993 ERM crisis will haunt Europe again.
- Until now, the only case where "political risk" could exploit the vulnerability of the EA, to put forward an anti-austerity political programme, was Greece.

The Greek case as a negative example

- "Political risk" could have been a strong weapon in the hands of the Greek working majority, SYRIZA and the government formed in January 2015 in order to stop austerity and guarantee an agreement with the lenders that would not violate the electorate's mandate
- SYRIZA and the government did not stick to the class partisanship of their declared programme, compromising to the strategies of the Greek and European economic and political elites.

SYRIZA's Mutation (2012-15): Shift towards Centre-Left

- One example: *Austerity under the "stabilisation programme" is presented as a success story*:

"Greece has proceeded to an unprecedented economic adjustment aimed at improving budgetary consolidation on the one hand, and on the other to enhance the competitiveness of the economy [...] The shift to a development model with export orientation seems to have been achieved in the years 2013 and 2014, when the current account recorded a surplus of 0.6% and 0.9% of GDP respectively." *National Programme of Reforms* (Greek Ministry of Finance [Minister Y. Varoufakis], April 2015)

Austerity cannot remain undisputed

- After the capitulation of SYRIZA and the Greek government, neoliberal austerity policies seem undisputed all over the EU. However, the instability of the political edifice of the EA and the EU continues
- Extreme neoliberal austerity policies exacerbate social conflict and polarise the EU societies between the “labour camp” and the “camp of entrepreneurship”
- Two political strategies: Curtailing “labour cost” and “freeing entrepreneurship” from labour market regulations (“rigidities”) vs. protection of Labour’s rights and income and of the welfare state.

Austerity cannot last forever

- The dynamics of social antagonisms will most probably destabilise austerity policies and political elites, with unpredictable consequences for the EU and the EA.
- This is an aspiration, or rather a goal, which remains to be verified on the level of political action.

Thank you!