The EU should take the side of the losers of globalization

How should the European Union react to the decision of the British people to withdraw from the union? This is the question that is at the center of the political debate in Europe.

The starting point in trying to answer this question is the observation that the European Union has a very negative image today, not only in the UK but also in other parts of the EU, leading to dissatisfaction about the European project. I will argue that this dissatisfaction has to do with the inability of the European Union to set up a mechanism that protects the losers of globalization. Worse, the EU has reduced the capacity of national governments to take on the role of protector, while little has been done to create such a mechanism at the EU-level.

Free trade creates an incredible dynamic of innovation and material prosperity. That prosperity, however, does not benefit everyone. Many are better off thanks to globalization. But many others are not. Some even see their welfare decline because they lose their jobs or because their incomes fall.

As globalization creates material welfare in the countries that participate in it, it is in principle possible to compensate the losers from globalization. That is the argument that most economists find strong enough to defend globalization. But the political obstacles against organizing redistribution towards the losers of globalization are large. This is a problem in most industrialized countries, but it is made even more intense in the EU.

The European institutions have become major promoters of globalization. The single market and the trade agreements reached by the European Commission have widely opened up the European gates to globalization. There is nothing wrong with that per se. Except that there is a complete failure to organize the necessary compensation towards the losers of the globalization. The European institutions have no power over social policy, which has been kept in the hands of the national authorities. However, the hands of these authorities have been shackled by the same European institutions' fiscal rules.

The European fiscal rules not only make it extremely difficult to compensate the losers from globalization. What is worse, they have amplified the hardship of the losers from globalization. Since at least five years the European Commission has pushed all member-countries of the Eurozone into an austerity straightjacket that has produced economic stagnation and rising unemployment mainly of those who had already been hit badly by globalization. It will be no surprise that many turn their backs towards the European institutions that are seen as cold and ready to punish when millions live in hardship.

Not only the fiscal rules but also the structural reforms that have been imposed by the same European institutions are to blame for the rejection of the European Union by millions of people. European policy makers have adopted the neo-liberal discourse. According to this discourse, workers must be flexible (read: they should be happy when their wages fall, when they can be dismissed quickly and when they receive less unemployment benefits). The neo-liberal policymakers that now dominate the European Union preach that social security is unproductive and should be downsized. These policies are euphemistically called structural reforms. They are imposed on millions of people, mostly the losers of globalization, by European institutions and national governments alike.

The problem of the European Union today is that, instead of helping those who suffer from globalization, it has set up policies that hurt these people even more. It is no surprise that the losers revolt. If the EU continues with austerity and structural reforms, revolt will spread and will take the form of attempts to exit the Union. It is time the European Union takes the side of the losers of globalization instead of pushing for policies that mainly benefit the winners.

This can be done in two ways. The first one is to stop imposing structural reforms on the member-states. The rationale for these structural reforms has been that they promote economic growth and therefore should benefit everybody. The empirical evidence of a positive link between structural reforms and economic growth, however, is very weak. Recent econometric analysis of the OECD countries fails to find evidence that reforms in the labour markets and in the product markets boost economic growth (De Grauwe and Ji(2016), IMF(2015)). These studies, however, find that investment, both private and public, has a strong positive effect on economic growth.

The latter result points the way to the second change in economic policies that the European policymakers should initiate. This should consist in boosting public investment. The latter have suffered severe collateral damage from the ill-conceived austerity programs imposed by the European institutions.

A boost in public investment can only be achieved by changing the fiscal compact that imposes structural budget balance in the member-states of the Eurozone. This compact has the unfortunate implication that public investment can only be financed by current revenues. A more destructive rule for economic growth has rarely been imposed. When politicians are told that the cost of public investment should be fully borne by present taxpayers (voters) while the benefits will accrue to future taxpayers (voters) it will not surprise that the political incentives to engage in public investment will be weak. This is what happens today. Thanks to an ill-conceived rule, public investment in the Eurozone is at a historic low level.

It is often said that allowing public debt to increase will saddle our children with an unbearable debt burden. This criticism confuses gross and net debt. When productive public investments are undertaken by issuing government bonds, our children will inherit both productive assets and government bonds. Today the cost of issuing government bonds is close to zero in many Eurozone countries. If governments manage to invest in productive assets that have a return higher than zero, our children will inherit assets that create revenues exceeding the cost of borrowing. As a result, their net debt burden will have declined. They will not understand why we have not increased public investment when borrowing was so cheap.

I am a proponent of more political integration in Europe. But today grand schemes for “more Europe” should be put on the back burner. Instead European politicians should change their economic policies and, in so doing, show in the facts that the European Union can produce welfare, also for the losers of globalization.

References:

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