An alternative for the Eurozone. An end to austerity and a reform of European institutions

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The Eurozone crisis

The Eurozone is in the middle of a profound political, economic, and social crisis due to deep, structural deep issues. We focus on three of them.

First of all, from an institutional standpoint, the Eurozone has never been anything but an incomplete monetary union with severe design flaws. The aspiration of uniting economies with different productivity levels and industrial sectors under a common currency is hardly sustainable in the absence of a shared Federal Budget that stabilizes the Eurozone, or a symmetric adjustment mechanism for high external imbalances. Furthermore, the EMU lacks a central bank with a mandate to act as the lender of last resort of member states, which aggravated the sovereign debt crisis between 2010 and 2012.

The second issue is the European Commission and Eurogroup's enforcement of unprecedentedly harsh neoliberal policies. These measures have been driven by the initiative of creditor countries in the EMU (European Monetary Union), with the purpose of imposing strict financial discipline and guarantee external debt payments. These policies have produced disastrous results.

Fiscal austerity and wage devaluation have reinforced structural problems associated with the EMU's lack of aggregate demand and deflationary bias. Instead of guaranteeing aggregate demand through an expansionary fiscal policy, and in a context of strong balance sheet recession and high private sector debt, Brussels has imposed steep budget cuts, seriously eroding the fundamental services of the welfare state. Rather than guaranteeing a symmetric adjustment effort between countries with external deficits and those with surpluses, Brussels chose a path of wage devaluation that is both inefficient and unjust.

The third point of this analysis which has to do with political dynamics, is critical to understand our present juncture. The aforementioned strategy has been imposed upon the Eurozone with disproportionate economic interventionism. The influence of the Eurogroup and the European Commission on the member states' economic policy is decisive. The different treaties and intergovernmental agreements have established a series of straitjackets that limit all economic policymaking not based on fiscal austerity and wage devaluation. The consequences of these institutional constraints are the limitation of different political options and, ultimately, of democracy itself.

An alternative choice for the Eurozone

An alternative choice for the Eurozone must have two main goals. First and foremost, the political orientation of policy making must be changed. Secondly, it is imperative to promote deep institutional reforms that contribute to the democratization of the monetary union. These two main goals can be summarised in four initiatives.

1. Abandon fiscal austerity policies and wage devaluation

Europe must abandon fiscal austerity and wage devaluation. These policies have only deepened the recession. Currently, the Eurozone is flirting with deflation, its central bank is buying public bonds in secondary markets at a rate of € 80bn per month, and its deficit is 2.1% of its GDP. In this context it makes no sense for the Eurozone to prioritise the deficit reduction ahead of reducing unemployment.

There is a clear lack of internal demand in the Eurozone. This is blocking growth and stopping economic recovery. In spite of having a surplus in its joint balance of payments sheet, low inflation rates and negative interest rates, economic growth in the Eurozone has failed to get back on track. Monetary expansion alone is insufficient for recovery. In a situation close to a liquidity trap, Europe must unequivocally choose an expansive fiscal policy, especially in those countries with greater macroeconomic leeway.

Given that the monetary policy has been exhausted there is a risk of surplus liquidity without economic growth, which can pump new economic bubbles. For these reasons, we propose:

- A pan-Europan investment plan that directs at least 4% of the Eurozone GDP to new public investments aimed at bringing member states' infrastructures up to date, take their economies fully into the digital era, propel energy efficiency and building retrofit. This proposal could be channelled through the European Investment Bank and financed through the issuance of EIB debt bonds, backed up in the secondary markets by the ECB.
  The development of such proposal, unlike Juncker's current plan, would have a direct impact on the Eurozone and in particular on countries that are going through greater difficulties. It would translate into fast job creation and it would require no institutional change, allowing for a quick implementation.

- A Europe-wide programme to fight poverty, in the form of "European Unemployment Benefits" similar to the programme once proposed by the former Commissioner for Employment, Social Affairs and Inclusion, László Andor. Such a programme would guarantee social cohesion across the different regions in Europe.

- End competitive wage devaluations. We believe that the "Competitiveness Councils" proposed by The Five Presidents Report must be replaced by a different approach. The intra-European BOP imbalances must be resolved by increasing domestic demand in surplus countries. National collective bargaining systems must be autonomous and remain under the umbrella of national governments, not European policymakers.

2. Introduce deep institutional changes in the Eurozone in order to recover the democratic of control of our economic policy.

   As we have seen, the current design of the Eurozone is counterproductive from a macroeconomic standpoint. It reinforces trade and finance imbalances within the EU and hinders the application of countercyclical policies, centering all adjustment mechanisms on the devaluation of labor income. Furthermore, Eurozone mechanisms significantly constrain the very essence of representative democracy. For these reasons, we propose:

   - Introducing deep reforms to both the Stability and Growth Pact (SGP) and the Fiscal Compact, removing the structural budget balance goal and increasing the flexibility of deficit targets, in order to better adapt to both the needs of each member state and to economic cycles.
     The goal of structural budget balance lacks economic common sense: the average structural deficit of the EU-15 between 1995 and 2007 was 2.7%, which was nevertheless compatible with a reduction of the debt to GDP ratio from 68% to 60%.
     However, while our proposed reform is carried out, governments should be able to use existing political leeway to accomplish a smoother deficit reduction. This measure would be justified by the Eurozone's macroeconomic situation—low growth and deflation risk—and that of of many of its member states. In the case of Spain, for instance, the fact that the unemployment rate is 21% and 29% of the population are at risk of poverty and exclusion requires slowing down the deficit reduction rate in order to solve these pressing problems.
     Moreover, the SGP already includes investment clauses that should be used to allow specific public investment programmes with a positive effect on growth in the near future. There is some margin available, and it should be used. Even under the current deficit reduction path, member states should be given the autonomy to decide whether to reduce spending or increase tax revenues.

   - Introducing a «Golden Rule» into both the Stability and Growth Pact (SGP) and the Fiscal Compact which takes into consideration an appropriate level of public investment so that the latter is not included in the deficit computation when applying the preventive and corrective measures contemplated in these agreements.

   - Introduce changes to the ECB Statute so that the bank safeguards not just price stability but also financial stability within the Eurozone. The ECB's legal and judicial frameworks must be reformed in order to sanction its role as lender of last resort to both the financial system and member states (as central banks in other OECD countries do).

   - Allow for bank recapitalisations to take place directly from the European Stability Mechanism (ESM) to private banks. With this measure, all credits necessary to solve the balance problems of the financial sectors would not impose a particular economic policy over the affected member states. The ESM must have the backing of the ECB as lender of last resort in order to stop banking crisis from becoming a problem for the public budgets of the member states.

- Make progress towards the development of a real European fiscal policy: the need for a common budget is becoming of paramount importance. Its funding could come from Eurobonds in order to avoid transfer of surpluses within each territory, which is difficult for northern member states. A common budget requires a more articulate coordination within the Eurozone.

3. Tackle the public debt problem within the Eurozone

- Summon a European Debt Conference that focus on coordinated public debt restructuring of the Eurozone into the political agenda. The ECB should restructure public debt of all the Eurozone economies which exceeds of 60% of the GDP. In order to do so we propose an extension of the due date of existing sovereign debt through a bond exchange that facilitates the replacement of old bonds by new ones. The ECB should purchase old bonds at their nominal value in exchange for new ones at an interest rate of 0% with the goal of keeping them in the ECB balance for perpetuity. This restructuring process does not imply transfers of rent in between the different territories.
  We cannot forget that many European countries benefit from debt restructuring in the past (including Germany in the 1950s). These policies played an important role in the development of European integration, and they created the conditions for a successful postwar growth strategy.

4. Democratise economic policy to regain democratic sovereignty

- We consider introducing reform of the European institutions which democratises political and economic decision making within the Eurozone. The *de facto* government of the Eurozone —the Eurogroup— is an entity which is not forced to any check and balance mechanism by any democratically chosen institution, not even the European Parliament. Democratising decision making implies ending this *de facto* government. To do so, we will support the creation of a Eurozone Parliament consisting of representatives of national parliaments elected according to population and territorial criteria. Unlike the European Parliament, a Eurozone Parliament would have actual legislative and policy control powers.

- The legitimacy of the monetary policy in the Eurozone must reside in a democratically elected institution (either the European Parliament or the aforementioned proposed Eurozone Parliament). This institution would grant the autonomy of the monetary authority whose president should be appointed by this parliamentary institution to which he or she should be held accountable (as happens with the FED and Congress in the United States). A monetary policy that grants the fiscal autonomy of member states must also unconditionally grant stable public debt purchase of the member states in the secondary markets, according to their different economic weight.