

# The Five Presidents' Report One Year On: More Of The Same

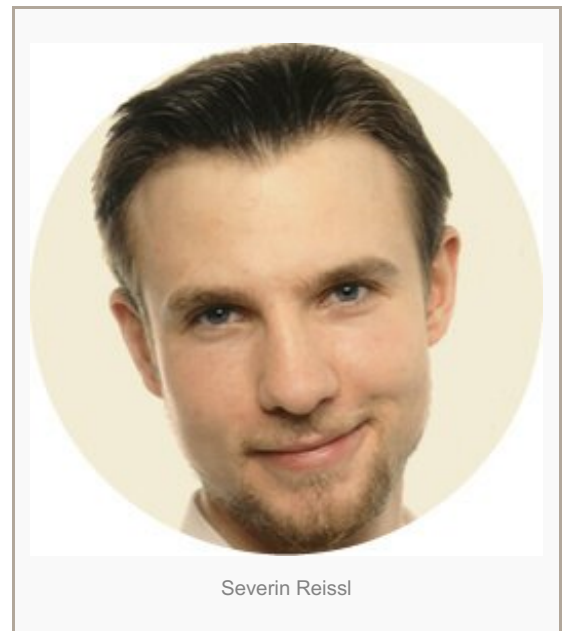
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The Euro crisis has painfully exposed the weaknesses of the European economic policy regime and the peripheral Euro area countries have been suffering a deep depression. So how do Europe's elites want to reform that regime? Are they questioning the neoliberal model or merely modernising it? To get a glimpse of the future of the Economic and Monetary Union (EMU) we take a detailed look at the [Five Presidents' Report on 'Completing Europe's Economic and Monetary Union'](#). Although this report is now one year old, it still represents the most comprehensive single statement by the European institutions thus far about the direction in which EMU should be heading.

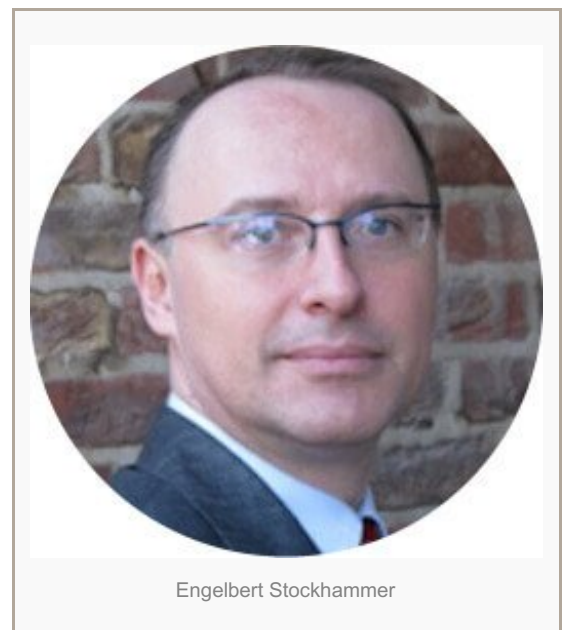
Our assessment is that the report sets out to permanently and institutionally codify the structural adjustment programmes which have been applied to the crisis economies whilst at the same time providing further impetus to cross-border financial speculation. It leaves unaddressed the problems posed by the [debt-driven and export-driven growth regimes](#) in Europe which lie at the root of the sovereign debt crisis, and in fact may serve to promote their continued existence. There is hence little reason to believe that the EMU's problems will be resolved by the implementation of the plans outlined in the report.



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## The Five Presidents' Report

The idea of establishing 'National Competitiveness Authorities' in all member states is a central proposal, and it is believed to be of such importance that it should be implemented as soon as possible. The focus of these authorities is clearly envisioned to be on a fairly narrow definition of competitiveness, related to prices and especially wages. Member states are expected "to converge towards the best performance and practices in Europe" (p. 7) which can easily be read as a euphemism for a race to the bottom in terms of labour standards. The ultimate aim of convergence is supposed to be a similar level of resilience against disturbances, without direct reference to the levels of employment or income at which this should be achieved. The original aim of convergence (i.e. 'convergence to the highest level of prosperity', p. 7) is apparently presumed to be an automatic outcome of supply-side reforms. The potential pitfalls of this approach are clear: the winners of this intra-European competitive race will continue to rely on the export-driven growth model which characterised a subset of Eurozone economies prior to the crisis. The Capital Markets Union (CMU), discussed below, on the other hand, will serve to strengthen the forces which led to the debt-driven growth model – the counterpart to the export-driven regime. These growth models emerged in a situation in which wage shares were falling in Eurozone economies and [growth had to come from sources other than domestic demand out of wage-income](#). Competitiveness authorities would likely contribute to a continuation of this trend. While progress on the establishment of competitiveness



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authorities seems fortunately to have [stalled](#) in the meantime, there has been substantial development in the concrete implementation of another central and equally problematic proposal of the report, namely the CMU.

The proposition for the CMU is framed as providing an opportunity for channelling financing into productive investments, particularly of SMEs. However, the report makes no practical suggestions as to how this would be achieved. Rather than helping SMEs the most likely effect of CMU [in its proposed](#) form is to further increase the power of large banks. For instance, the so-called 'Simple, Transparent and Safe Securitisation' (STS) scheme clearly favours market participants with superior resources and analytical capabilities. The whole proposed regulatory framework to a significant extent [reflects the interests of the financial sector](#) and will facilitate the emergence of a renewed era of credit-led booms. The report argues that the CMU will increase financial stability by "provid[ing] a buffer against systemic shocks" (p. 12). This appears highly naïve in light of the experiences of the peripheral countries during the crisis and those of developing countries with capital market liberalisation. Both examples show that international capital flows tend to be highly volatile and *pro-cyclical*. They tend to aggravate rather than alleviate difficulties during times of crisis and uncertainty. More financial liberalisation will not solve the problem of financial instability. Nevertheless, CMU seems to be the one issue addressed by the five presidents' report on which action has been taken most swiftly. Worryingly, the [first status report](#) and further action plan on CMU issued by the Commission accords least priority to a review of the EU macro-prudential framework and continues to place too little emphasis on the danger of financial instability. At present, it remains to be seen whether the resignation of Commissioner Jonathan Hill after the Brexit referendum, and the prospective departure of the City of London from the EU, will have any impact on the shape which the CMU will eventually take, but it appears certain that the project [will be taken forward](#).

Perhaps surprisingly, the report also attempts to address the shortcomings of the European fiscal framework, but remains vague in this respect. It reaffirms the commitment to the rules binding national fiscal policies and makes suggestions for stricter implementation, yet it raises the prospect for fiscal policy at the Eurozone level. However, its understanding of the role of fiscal policy is extremely narrow: fiscal policy should only take the form of automatic stabilisers without scope for discretionary policy. However, the crisis has shown that active, discretionary fiscal policy [is very effective especially during recessions](#). Moreover, the fiscal policy framework is only envisioned to be implemented at the second stage of the reform process, whilst action on this front is far more urgently needed than elsewhere. The framework is not viewed as a tool to promote convergence and is hence a far cry from the fiscal and welfare policy proposal we outline below.

Fiscal orthodoxy is thoroughly entrenched in Europe and the priorities set by the report are strikingly at odds with what is necessary to return growth and prosperity to all of Europe. While the report makes some unspecific comments about setting up a Euro Area treasury, overall it reaffirms that "[t]he Stability and Growth Pact remains the anchor for fiscal stability and confidence in the respect of our fiscal rules" (p. 18). In other words, the report provides more of the same rather than a change of course, an assessment we share with numerous other evaluations from [progressive institutions](#) and [commentators](#). To formulate an alternative, however, we must first understand how the EU policy regime at large is linked to the Eurozone crisis.

## **The EU policy regime and the sovereign debt crisis**

The Five Presidents' Report provides little hope for a change of the EU policy regime. This is characterised by a strong belief in the efficiency of the market system, a distrust of state activity and an anti-labour bias. These characteristics are also discernible in the report. It does not at all touch upon the ECB, which is modelled on the archetypical example of an ordoliberal central bank, [the German Bundesbank](#). The crisis has shown that the ECB's current institutional setup is not workable in serious economic downturns.

What, if anything, can be done to truly fix the flaws in the EU policy regime and the construction of the Eurozone? Several critics regard the fixed exchange rate regime as [the root of the problem](#). In this view the currency union is a vehicle for German/northern dominance through 'neo-mercantilist' economic policies. The Euro system allowed

Germany to pursue a growth strategy based on trade surpluses via wage suppression, with the root of the problem lying in fixed exchange rates which enabled this strategy. There is some truth in these arguments, but they miss out on the critical role that financialisation and real estate bubbles had in the build-up of the crisis. Trade deficits were not only forced upon southern Europe by improved German competitiveness. Southern European countries were growing faster than northern countries and their growth pulled in imports. This growth was fuelled by a credit boom based on a property bubble, enabled by liberalisation of capital flows and came with rising household debt, a financing structure which ultimately proved unstable.

The neoliberal macroeconomic policy regime of the Euro area plays the central role in the escalation of the crisis. It is the separation of monetary and fiscal space that explains the uniquely European transformation of the global financial crisis into a sovereign debt crisis. The reason why the USA and the UK outperform the southern European countries despite a similar debt overhang was that their central banks, effectively financing government spending under the mantle of quantitative easing, allowed them to run larger budget deficits than European countries while keeping interest rates low.

## **A Keynesian Alternative**

A [progressive Keynesian economic strategy](#) would aim to solve EMU's problems without the need for a break-up while still breaking decisively with the principles embodied in the report. It would use deficit spending for demand stimulation and have full employment as its overall goal. A Keynesian strategy aims for inflationary adjustment, which means higher demand growth in surplus countries.

First, wage policy should not aim at wage flexibility, but at an equitable income distribution that is consistent with relative trade positions. This would involve policies to create a system of transnationally coordinated wage bargaining that takes into consideration issues of equity, domestic demand, and trade balances. This would be an alternative to the current system in which deflationary pressure is put on the deficit countries, and it would contribute, along with the second element of the progressive Keynesian strategy, to lowering current account imbalances in Europe both by increasing demand growth in the north and by leading to a convergence of relative costs.

Second, a fundamental reform and shrinking of the financial sector is necessary, and debt overhangs in the Eurozone economy must be addressed. Debt restructuring will in some cases be necessary to make debt manageable, but in general a Keynesian strategy aims at raising income rather than deleting debt. An inflationary environment would facilitate a reduction of debt burdens. To counteract the regressive distributional effects of bank rescues, a substantial wealth tax would have to be introduced. Bailed-out financial institutions would be put under public control to ensure change in management practises. Financial regulation would lean against asset price bubbles to control credit growth. This would help to contain the credit-fuelled booms which were an important factor driving current account imbalances prior to the crisis.

Third, there needs to be a robust mechanism of redistribution across regions that does not rely on generosity and bail-outs. This would consist of two elements. On the one hand, crisis countries require a Marshall Plan-style investment programme to help them build up productive capacities and rebalance the structures of their economies away from sectors such as real estate. Such a programme could, for instance, be undertaken by a Eurozone treasury, or by the European Investment Bank which would however have to abandon its conservative stance on investments for this purpose. On the other hand, a European social security system should serve to redistribute income from prosperous to depressed regions without increasing debt levels. Both these measures would increase the resilience of the Eurozone at large against both symmetric and asymmetric shocks.

Fourth, the Keynesian policy package frees fiscal policy from the shackles of the present regime. Fiscal policy has to be used to ensure that aggregate demand is at a level consistent with full employment. This implies a strong anti-cyclical component. Part of this can be delivered by automatic stabilisers like unemployment benefits and a progressive income tax, but a substantial part will be discretionary policy. States need to be able to react if their

economy is facing a recession or high unemployment. Specifically, this means that the southern European countries should see large increases in government spending as their output levels are well below capacity. Ideally these expenditures would to come out of a European budget, based on Eurobonds and backed up by a reformed ECB mandate. Overall, the proposed programme would provide a change of course away from the current policy framework which both caused the crisis and is now preventing a recovery. The need for such a programme is all the more pressing in light of the potential impact of Brexit on the future cohesion of the Eurozone. In any case, unless the Eurozone is fundamentally reformed along the lines proposed, its disintegration will sooner or later become inevitable.

*This is an updated and abridged version of [The Euro Crisis and the Neoliberal EU Policy Regime: Signs of Change or More of the Same?](#)*