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Turkey	<b>Social Investigations and Cultural Development Foundation (TAKSAV) *</b> www.taksav.org   e-mail: info@taksav.com

\*observers

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# transform!

european journal for alternative thinking and political dialogue

– **EuroMemo Group** –

**European Economists for Alternative Economic Policy in Europe**

## The Deepening Divisions in Europe and the Need for a Radical Alternative to EU Policies

# EuroMemo 2014

## Editorial

Dear reader,

2014 will be a crucial year in the development of the European Union. The elections for the European Parliament taking place in May will offer the possibility for the European populations to give their verdict on the policies by which the European Union has responded to the crisis. The language reflected in objective figures is very clear and cannot be mistaken: the policies of austerity inspired by a neo-classical approach have resulted in an exacerbated social polarisation in Europe, both within societies as well as between states. We are living a Europe in which not only the numbers of those unemployed are surging, but also poverty and lacking security are spreading and where the gulf is widening further between the poor and the rich, but also a Europe in which an irritating hierarchy is manifesting itself between the member states of the European Union. In the European south the crisis has triggered particularly drastic effects, bringing some societies to the very brink of a humanitarian catastrophe.

A Europe that is deformed by such outrageous social inequality and unsymmetrical distribution cannot function.

The political consequences of these developments can be seen in all the countries in spite of them taking different shapes everywhere: An increasing level of frustration vis-à-vis the process of European integration is accompanied by a shaking of trust in democracy in general and its capacity to guarantee social control of economic processes.

Thus Europe finds itself at a crossroads. What we are witnessing today is a crisis of trust between major parts of the populations and the institutions. Putting an end to European integration would not only mean abandoning the idea that there is a way-out but also conjure up the danger of renewed sharp nationalist rivalries. Bringing that back to our minds 100 years after the outbreak of World War I is by no means irrelevant.

Yet, both European integration and the policies of the governments of the member states require a change of direction in the sense that priorities have to be given to questions of democracy and social issues as presented in this Euro-Memo of 2014.

Like last year, *transform! europe* has taken on the responsibility for the production of the printed versions of EuroMemorandum in English, French, German and Greek.

Thus we hope not only to provide a useful contribution to the European debate on social, economic and ecological alternatives but also to help the development of a broad political movement towards another Europe and a change of the balance of power in its favour.

Walter Baier  
Co-ordinator of *transform!europe*

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European Economists for an Alternative Economic Policy in Europe – EuroMemo Group

## The deepening divisions in Europe and the need for a radical alternative to EU policies – EuroMemorandum 2014 –

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This EuroMemorandum draws on discussions and papers presented at the 19th Workshop on Alternative Economic Policy in Europe, organised by the EuroMemo Group, from 20-22 September 2013 in London. The text is based on written contributions from Judith Dellheim, Trevor Evans, John Grahl, Jeremy Leaman, Mahmood Messkoub, Mario Pianta, Dominique Plihon, Werner Raza, Suleika Reiners, Catherine Sifakis, Henri Sterdyniak, Frieder Otto Wolf.

## Summary

### Introduction

The European Union (EU) is set to exit from recession, but parts of Europe are beset with depression-like conditions; unemployment is exceptionally high in the peripheral euro area countries and not expected to decline appreciably in the near future. Harsh austerity policies have led to a widening social polarisation in Europe and to a process of industrial restructuring in which the position of Germany and other Northern countries has been strengthened while productive capacity in Southern Europe is being weakened. The crisis has also led to a significant shift in the distribution of income. In most countries outside the euro area core real wages have declined, and strongly so in the euro area periphery and much of Eastern Europe. At the same time the hierarchy between member states has been attenuation with the position of Germany and other Northern states being strengthened, while the position of Southern states has been weakened and wide areas of economic policy effectively dictated by Brussels. The activities of the European Commission continue to be characterised by a serious democratic deficit and a lack of transparency. Key decisions are made in closed meetings which are not accountable either to national parliaments or the European parliament, but where powerful business lobbies exercise substantial influence. In a number of countries right-wing – and in some countries neo-fascist – parties have been able to capitalise on widespread disaffection with the European Union and the policies that Brussels is imposing on member states.

### 1. Fiscal and monetary policy

The economic downturn in the EU is set to end but output is still below 2008 levels and the situation is highly polarised with high unemployment and reduced real wages in many countries. The acute financial crisis has been stemmed but the financial system remains highly fragile, and banks actually reduced their lending in 2013. The highly restrictive fiscal policies imposed on many member states made it even more difficult to meet strict deficit targets. While the ECB stabilised the banks with around €1 trillion in unconditional three-year loans, lending to governments continues to be prohibited. Given the EU's rigid adherence to neoclassical principles, it is wages that are expected to bear the full weight of adjustment. While real wages have begun to decline in some countries, this is fuelling deflationary forces which are sweeping much of Europe. In place of austerity, government policy should focus on promoting employment in socially and environmentally desirable jobs. The regressive impact of cuts in public expenditure should be ended and public education and health services should be strengthened. Higher levels of spending should be fi-

nanced by reversing the repeated cuts in taxation in the last 20 years. Budgetary policy at a European level should be increased towards 5% of EU GDP in order to have a meaningful impact on output and employment. The financing of government deficits should be mutualised through the issue of jointly issued euro bonds so that speculators cannot pick off weaker countries. The existing public debt in a number of member states is unsustainable; it cannot be fully repaid and should be subject to a debt audit to determine which debts are legitimate and which should be cancelled. The relentless downward pressure on wages should be replaced by encouraging a spread of collective bargaining. An orderly rise in wages can contribute to overcoming the weakness of domestic demand in Europe, as well as promoting greater social justice. In order to combat unemployment and establish conditions in which people's lives are not dominated by waged work, the normal working week should be reduced towards 30 hours with no loss of pay.

## 2. Financial and banking policy

Five years after the bankruptcy of Lehman Brothers, the financial and banking crisis is unresolved in the EU. In most EU countries, the banking system is still fragile in spite of the huge amount of liquidity provided by the ECB. The situation of the banking sector is very critical in some countries like Spain. In mid-2012, the Banking Union (BU) was proposed by the Commission as a new European project to solve the crisis. In spite of its ambitious organisation, the BU does not change the dominant paradigm of banking in the EU. Reforms proposed by the Liikanen report on banking structure are reinforcing the role of universal banks in the EU instead of pushing for a strict separation between retail banking and investment banking. The reforms also raise questions about democracy and governance in the EU as they increase the role of the ECB, which is in charge of the single supervisory mechanism of banks. Yet the ECB is partly responsible for the depth of the sovereign debt crisis in the euro area, as it refuses to lend directly to governments on the primary bond market. The slow pace and weakness of financial reforms has been exacerbated by the strong influence of the financial lobby which has succeeded in keeping effective regulation at bay. The European institutions should adopt the clear objective to reduce the weight of finance in the economy. Speculative activities should be prohibited. Retail banks must be isolated from financial markets and should focus on their core business: lending to the non financial sector. The Financial Transactions Tax directive proposed by the Commission must be implemented quickly. The ECB should be subjected to effective democratic control and give priority to social and ecological goals.

## 3. Governance in the EU

The coming into force of the Treaty on Stabilisation, Coordination, and Governance and the 'Two Pack' Directives mean that economic policy in euro-zone countries is now subject to comprehensive central control. Although the powers of member state parliaments over economic policy have been radically reduced, there is no corresponding increase in the powers of the European parliament. The multiplication of crude arithmetic limits on government spending and borrowing is likely to be as dysfunctional in the future as such exercises have nearly always been in the past. These simplistic rules display a distrust of democracy and an overestimation of the capacity of market processes to stabilise economic life. The rhetoric of competitiveness used by EU leaders to justify both a generally restrictive approach to economic policy and immense pressure on weaker member states also works to limit democratic control over the economy. The legal restrictions on economic policy are now so severe that effective alternative policies will require either the abrogation of the new governance measures or their explicit subordination to other priorities – for employment, ecological sustainability and social justice.

## 4. Taxation

The economic and political relevance of taxation has become increasingly apparent as Europe's crisis has gripped more deeply into the finances of most of the EU's member states and the lives of their citizens. Global and regional advocacy groups, concerned with issues of justice in taxation and in fiscal affairs, have gained an increasing audience within European civil societies, reinforced by the revelation of widespread tax avoidance by global corporations and wealthy individuals. In response both to the growing outrage of European citizens over industrial-scale avoidance of tax liabilities and to the haemorrhage of tax revenue as a result of recession and stagnation, European governments have given much greater emphasis to the prevention of tax avoidance and 'unfair tax competition'. The European Commission, with the strong encouragement of the European Parliament, has approved a set of taxation reforms aimed at increasing the transparency of cross-border tax affairs. These reforms include information exchange in relation to The European Savings Tax Directive, the establishment of a Common Consolidated Corporate Tax Base and, within the euro area, a Financial Transactions Tax. While such initiatives are welcome in the confused landscape of European taxation systems, they will be insufficient to put an end to the beggar-thy-neighbour taxation policies which have continued during the current crisis; they will also not contribute to a reversal of the growing income inequalities and poverty in Europe. Only a radical harmonisation of direct taxation on the basis of progressivity in all EU member states, the removal of flat tax regimes in central and eastern Europe and the convergence

of tax ratios Europe-wide will ensure the survival of a culture of social solidarity in the region.

## 5. Employment and social policy

The financial and economic crisis has had a deeply regressive social impact for many people in Europe, with high unemployment, poverty and even a lost future for many young people. According to the latest EU figures one in four of the EU population is in poverty and one in eight of its work force is unemployed. Levels of youth unemployment are especially disturbing: for the EU as a whole the figure is one in four, and in Southern crisis-hit countries like Greece, Spain and Italy it rises to one in two or one in three. High unemployment and poverty have weakened the bargaining position of the work force vis-à-vis employers and this has been reflected in more precarious working conditions: one in five contracts in the EU are not permanent positions and short-time work and involuntary part-time work have increased since the onset of the crisis. The EU response has failed to provide resources to alleviate the impact of poverty and youth unemployment. Its own institutions, such as the DG for Employment, Social Affairs and Inclusion, have also failed to monitor and offer support to member states which are in economic and increasingly social crisis. As an immediate measure, EU institutions should assess the social impact brought about by impact of the spending cuts it has imposed on member states. It should then provide support in key areas, in particular health care, and ensure the provision of support for the children and young people who are bearing the brunt of unemployment and poverty. To protect the working population from the rising tide of precarious working conditions, the benefits of social insurance programmes should be urgently extended to all workers, irrespective of their type of contract. The EU should also initiate legislative programmes to bring European labour laws in line with a fast changing labour market.

## 6. Industrial policy

The urgency of an industrial policy in Europe is beginning to be acknowledged by the European Commission. But its proposals remain confined to the narrow framework of competition policy geared exclusively to the aims of short-term market performance. An alternative is required which links the objective of long-term industrial performance with concerns for a socio-ecological transformation. This should involve six major dimensions:

- (1) a Europe-wide public investment plan for socio-ecological reconstruction to boost European demand;
- (2) a reversal of the major loss of industrial capacity in Europe;
- (3) an urgent drive to developed new environmentally sustainable, knowledge intensive, high skill and high wage economic activities;

- (4) a reversal of the massive privatisations of recent decades and substantial public-sector support for new activities at the EU, national, regional and local level;
- (5) the setting of a new trend towards a different kind of 'security' connected with disarmament, greater cohesion and reduced imbalances within the EU and individual countries; and
- (6) the creation of a major new policy tool for an ecological transformation of Europe. Specific activities that could be targeted by the new type of industrial policy include:
  - (a) the protection of the environment and renewable energy;
  - (b) the production and dissemination of knowledge, applications of ICTs and web-based activities;
  - (c) the provision of health, welfare and caring activities;
  - (d) support for initiatives for socially and ecologically sustainable solutions of food, mobility, construction, energy, water and waste problems.

## 7. The EU-US transatlantic trade and investment partnership

The EU has in recent years negotiated numerous bilateral trade agreements. This has been topped by the announcement in early 2013 that the EU and the US had agreed to enter into negotiations on a bilateral trade agreement, the so-called Transatlantic Trade and Investment Partnership (TTIP). The proposed agreement is not only intended to reduce tariffs between the world economy's two biggest trading blocs; its primary aim is to dismantle and/or harmonise regulations in areas such as agriculture, food safety, product and technical standards, financial services, the protection of intellectual property rights, and government procurement. Investment liberalisation and protection also will be central issues. The European Commission, based upon commissioned studies, claims that the deal will boost growth and jobs in the EU. The economic case for the TTIP is, however, unimpressive. Income gains are estimated at less than 1% of EU GDP, and will be phased in over a transition period of 10 years. Increased unemployment and adjustment costs due to trade liberalisation are downplayed or neglected altogether. The deregulation involved in the trade deal will threaten public health, labour rights and consumer protection. The proposed investor-to-state-dispute settlement will privilege investor rights over public policy autonomy. The TTIP is no less than a frontal attack on democratic decision-making in the EU. Major revisions to the proposed negotiating agenda are urgently needed. At the moment, it is highly dubious whether the trade agreement will deliver any net economic and social benefits to EU citizens. A comprehensive impact assessment with detailed studies on the many critical issues involved and a radical break with the prevailing lack of transparency are necessary first steps for a much-needed democratic debate on the TTIP.

## Introduction

The European economy is set to exit from recession at the end of 2013 according to official projections. But while the decline in economic activity might have been checked in many countries, output in the European Union in 2013 remained below the level reached before the onset of the crisis in 2007. While a few countries in Northern Europe are slowly pulling ahead, parts of Europe are beset with depression-like conditions and unemployment, which is exceptionally high in the peripheral euro area countries, is not expected to decline appreciably in the foreseeable future.

The financial crisis in the euro area has been stabilised, at least temporarily, by the European Central Bank's commitment to do 'whatever it takes' to defend the euro. But it was the deeply conservative economic response of the European Union to widening fiscal deficits which caused the current economic malaise. In the United States, the government and the central bank sought to strengthen economic growth – albeit by adopting policies of so-called quantitative easing which led to destabilising inflows of short-term capital to many developing countries. By contrast, the European authorities have insisted on imposing harsh austerity policies which drove first the countries of the euro area periphery and then the countries of the euro area centre into recession. But even now, as the economic downturn appears to be drawing to a close, the European authorities are intent on continuing to pursue these same policies in the future.

The measures imposed by the European Commission have not only led to a widening social polarisation in Europe; they have also contributed to deepening a process of industrial restructuring. The introduction of the euro in 1999 posed a serious challenge to countries in Southern Europe which had previously been able to compensate for inflation above the German level through periodic devaluations. With this option closed, the introduction of the euro promoted a process of deindustrialisation in countries such as Italy, Spain and Portugal. This process of deindustrialisation has been accelerated by the current round of austerity policies which, by depressing local demand, has led to a further decline of industrial capacity. At the same time in Eastern Europe, where many industries were confronted by greatly intensified competition following accession to the EU in 2004, major German industrial concerns have been consolidating their supply chains to take advantage of cheaper labour. In 2013, German firms for the first time accounted for over 50% of the cars produced in Europe.

The crisis has also played an important role in securing a shift in the distribution of income in Europe. The European Commission insisted on public-sector wage cuts as a condition of providing financial support to member states. Meanwhile, higher unemployment weakened the bargaining position of employees in many countries. Consequently in most countries outside the euro area core real wages have declined, and very strongly so in the case of the

euro area periphery and much of Eastern Europe. As a result of EU conditions, member states have, in addition, been required to cut back welfare programmes and the number of people eligible for them.

The crisis has in addition been accompanied by an attenuation of the hierarchy between the member states of the EU. There has been a marked strengthening in the position of Northern states, in particular Germany, thanks to its large financial surpluses. Meanwhile the position of the Southern states has been weakened, with wide areas of economic policy now, in effect, dictated by Brussels. The Eastern states, for their part, continue to occupy a relatively marginal position.

The activities of the European Commission have continued to be characterised by a serious democratic deficit and a lack of transparency. Despite a certain habitual rhetoric about the need to promote openness, key decisions are made in closed meetings which are not accountable either to national parliaments or to the European Parliament, but where powerful business lobbies are able to exercise substantial influence. Where it is not possible to achieve agreement through the formal structures of the European Council, these are circumvented through the creation of new ad hoc groupings. Worryingly, many member states have experienced a shift to more right-wing governments in recent years and this is likely to be reflected in the choice of the new Commissioners who are sent to Brussels in 2014. Perhaps more disturbingly, in a number of countries right-wing – and in some cases neo-fascist – parties have been able to capitalise on the widespread disaffection with the European Union and the policies that Brussels is imposing on member states, and there are indications that the right will strengthen its position in the European parliament following the elections in May.

Internationally, the European Union has embarked on negotiations to establish a major new trade and investment agreement with the United States, an initiative which bypasses the stalled negotiations at the World Trade Organisation, where the EU and the US have confronted serious opposition from larger developing countries. Since tariffs between the EU and the US are already low it appears that the two sides are primarily seeking to overcome non-tariff social and environmental regulations and to establish new international standards which other countries will subsequently be under pressure to accept. Nevertheless, there remain a significant number of contentious issues on which the two might be unable to agree.

In November 2013 the United Nations conference on climate change resumed its deliberations in Warsaw. Although large swathes of the Philippines had just been destroyed by a devastating typhoon – the most severe to make landfall on record – there is little indication that a serious commitment to reducing global climate change will be agreed at the climate summit due in 2014. As in previous years, this EuroMemorandum provides a summary of key economic developments in Europe in 2013, a critique of the official policy respons-

es adopted by the European Union and the member states, and an outline of the basis for progressive policy alternatives. In addition to the regular chapters, this year's EuroMemorandum includes an in depth analysis of tax policy in Europe and the proposals for an EU-US Treaty of Trade and Investment.

## 1 Fiscal and monetary policy

### 1.1 Europe faces weak growth and high unemployment

Following the global economic and financial crisis in 2007-2008, economic activity in the European Union (EU) registered a brief period of expansion in 2010 and 2011, but the onset of the euro area debt crisis led to a renewed downturn towards the end of 2011. In the course of 2013 the economic downturn in the EU appears to have come to an end but output is still below that in 2008, and the process of polarisation within Europe has continued apace, with employment and earnings continuing to deteriorate in many countries.

In the core euro area countries of Northern Europe, most economies returned to growth in 2013 and, with the exception of Finland and the Netherlands, achieved levels of output above those reached before the onset of the crisis (see Table 1.1). Unemployment was below the EU average of 11% everywhere except France, although youth unemployment was twice this in some of the countries. Real wages also began to rise in most countries. The recovery has been most notable in Germany, where the official unemployment rate has fallen to just above 5%.<sup>1</sup>

In the peripheral euro area states, by contrast, output contracted yet again in 2013 in every country except Ireland, with Greece registering its sixth successive year of decline. Output is below pre-crisis levels in all this group of countries, having fallen by 5% in Ireland, 6% in Spain, 8% in Italy and Portugal and 23% in Greece, with comparable declines in real wages. Official unemployment rates are very high in all these countries, reaching over 25% in Spain and Greece, where youth unemployment is above 55%.

Amongst the smaller new euro area states, Cyprus was forced to turn to the EU for financial support in March 2013 due to a crisis in its greatly overextended banking system and, following the imposition of strict conditions, output and real wages declined by almost 9% in the course of the year, with a sharp rise in unemployment. Slovenia, which also faced a severe banking crisis in 2013, introduced sharp cuts in spending, resulting in a further decline in output in 2013 and bringing the total decline since the onset of the crisis to some 10%.

In the non-euro countries in Eastern Europe, most economies registered growth in 2013, but output is still below 2008 levels everywhere except Poland. Unemployment is around the EU average, and although real wages began to recover in 2013, they remained between 10 and 15% below their pre-crisis level in half the countries in this group. The non-euro countries of Northern Europe registered some growth and below average unemployment in 2013, but only Sweden achieved levels of output and real wages that were higher than before the crisis.

<sup>1</sup> The official German rate obscures the emergence in the last ten years of a significant low-paid sector, now estimated at just over 20% of the workforce, and many workers involuntarily working only part-time.



**Table 1.1: Indicators of EU output, unemployment and wage growth**

		GDP growth 2012-2013,%	GDP growth peak-2013,%	Unemployment, July 2013, %	Youth Unemployment, July 2013, %	Real wage growth, 2012-2013, %	Real wage growth, peak-2013, %
	Euro area (17)	-0.4	-1.9	12.0	23.8	0.3	-0.7
	EU (28)	-0.1	-1.5	10.9	23.4	0.2	-0.4
Euro area core	Austria	0.6	2.3	4.8	9.1	-0.2	-1.9
	Belgium	0.0	1.1	8.7	23.7	1.0	1.0
	Finland	0.3	-2.8	8.3	20.0	1.3	1.4
	France	-0.1	0.5	11.0	25.8	-0.3	0.5
	Germany	0.4	2.9	5.2	7.8	0.8	2.5
	Luxembourg	0.8	0.8	5.9	18.2	0.5	-1.0
	Netherlands	-0.8	-2.8	7.0	11.5	-0.8	-2.3
Euro area periphery	Greece	-4.2	-23.4	27.6	57.3	-6.2	-22.1
	Ireland	1.1	-5.0	13.7	28.5	-1.0	-3.5
	Italy	-1.3	-8.1	12.1	39.7	-0.4	-3.6
	Portugal	-2.3	-7.9	16.6	37.3	2.6	-6.4
	Spain	-1.5	-6.4	26.3	55.9	-0.3	-6.9
New euro area	Cyprus	-8.7	-10.9	16.4	38.6	-8.3	-9.1
	Estonia	3.0	-1.9	7.9	15.7	2.3	-2.4
	Malta	1.4	4.6	6.4	13.4	0.0	-1.8
	Slovakia	1.0	5.5	14.1	32.6	-0.2	-4.4
	Slovenia	-2.0	-10.1	10.4	25.0	-1.9	-4.2
Northern non-euro	Denmark	0.7	-3.6	6.9	12.0	-0.1	-2.2
	Sweden	1.5	6.6	7.8	23.0	1.9	3.0
	UK	0.6	-1.9	7.6	20.9	0.6	-3.2
Eastern non-euro	Bulgaria	0.9	-1.7	12.9	28.8	1.8	7.8
	Croatia	-1.0	-11.8	16.9	52.0	0.9	1.2
	Czech Republic	-0.4	-2.1	6.9	18.6	-0.4	1.3
	Hungary	0.2	-5.4	10.2	27.7	-3.1	-13.7
	Latvia	3.8	-8.8	11.4	19.7	1.2	-8.9
	Lithuania	3.1	-2.1	12.2	23.1	2.1	-14.8
	Poland	1.1	13.6	10.4	26.2	1.2	-0.1
Romania	1.6	-3.5	7.5	23.2	1.7	-11.8	

Source: GDP & unemployment: Eurostat (October 2013); Real wages: Ameco (May 2013). Peak is highest year after 2007.

Projections by the European Commission and the International Monetary Fund anticipate a resumption of economic growth in the EU in 2014 but this is expected to be weak and unemployment is not projected to fall to any significant degree. The countries that were most severely hit by the euro area crisis now have exceptionally high levels of public debt that will be a major burden on reactivation.<sup>2</sup> The prospect for many of the EU's economies is consequently, at best, for a protracted period of low growth and high unemployment, with the most stricken countries, such as Greece and Cyprus, facing an especially bleak future.

The large current account imbalances which played an important part in provoking the crisis in the euro area were considerably reduced in 2013.<sup>3</sup> The deficits of Greece and Portugal were virtually eliminated while Italy and Spain actually generated a surplus. However, with the partial exception of Portugal, this was primarily because of a decline in imports due to the steep falls in output, rather than to a significant reactivation of exports. In Germany, by contrast, economic growth was again strongly driven by exports, and the country continued to generate a very large current account surplus, expected to reach some €170 billion (6.3% of GDP) in 2013, around half of which was accounted for by trade outside the EU. The EU as a whole is expected to generate a surplus of over €200 billion in 2013 (1.6% of GDP), roughly twice as large as in 2012. This marks a sharp break with earlier years when the EU current account was roughly in balance. It is partly explained by the strongly export driven economies of Germany, the Netherlands and Sweden, but it is also in large part due to the highly depressed level of internal demand in much of Europe.

In the financial sector, the acute crisis which developed in the euro area in 2012 was stemmed in 2013, principally due to the European Central Bank's (ECB) programme of Outright Monetary Transactions. Originally announced in September 2012, this proposed to undertake unlimited purchases of the bonds of any euro area state threatened by speculation. Although the ECB has not yet actually intervened, its apparent willingness to do so led to a significant decline in bond interest rates of all the peripheral euro area states in the first half of 2013, although they remain considerably higher than rates in Germany and France.<sup>4</sup>

The financial situation, however, has remained extremely fragile. Cross-border purchases of government bonds have declined and there has been a significant fragmentation of euro area financial markets along national lines.

<sup>2</sup> According to OECD figures from June 2013, the outstanding public debt was equal to 97.8% of GDP in Spain, 129.3% in Ireland, 142.8% in Portugal, 143.6% in Italy and 183.7% in Greece (OECD Economic Outlook, No. 93, database).

<sup>3</sup> AMECO, Balance of current account with the rest of the world, May 2013.

<sup>4</sup> Even Greek bond yields, which had stood at 29.2% in early 2012 had declined to 9.1% by May 2013; Portugal's fell from 13.8% to 5.5%; Spain and Italy's rates, which had been scraping the critical 7% level, declined to around 4%. (Eurostat)

In several peripheral euro area countries, most notably Italy and Spain, new government bond issues have been taken up almost entirely by nationally-based banks. If banks are again forced to turn to the state for support, as is still quite possible in some countries, this will greatly heighten the likelihood of a dangerous interaction between a banking crisis and a sovereign debt crisis. Meanwhile, banks in Europe continue to be constrained by their large holdings of non-performing loans, estimated to total at least €1 trillion.<sup>5</sup> According to the Bank for International Settlements, banks continued to reduce their lending in 2013, not only in the euro area, but also in Eastern Europe where much of the banking system is owned by institutions based in Western Europe.<sup>6</sup>

Financial conditions in Europe have also been affected by developments in the US. In May 2013 the Federal Reserve indicated that it was considering ‘tapering’ its large-scale programme of securities purchases, officially known as quantitative easing. The news provoked an immediate reaction in financial markets and long-term US interest rates, which had been exceptionally low, began to rise. This, in turn, has had an impact on long-term rates in Europe. The German bond rate increased from an all-time low of 1.2% in April to reach 1.9% by September, and rates in other euro area countries moved up in step.

As financial tensions in the euro area eased somewhat in 2013, the prospect of Greece – or even Spain – leaving the monetary union receded, although Cyprus was reported to have been threatened with effective exclusion if it did not yield to EU conditions at the time of the country’s banking crisis. But the impact of the harsh conditions imposed on the peripheral countries, together with the strict budgetary rules which are being imposed on all the euro area states, has led to a noticeable rise in social discontent with the project of monetary integration. This has reached the point where even some progressive economists who formerly supported the project are now questioning whether, under current conditions, continued membership of the monetary union is tolerable.<sup>7</sup>

## 1.2 EU policies are a key obstacle to recovery

The downturn in the euro area economies which followed the onset of the debt crisis in 2010 was primarily due to the highly restrictive fiscal policies imposed on member states by the European Union. These policies have been promoted in particular by the governments of Germany and a small group of Northern countries including the Netherlands and Finland, but as a result of

5 According to PwC, the largest holdings of non-performing bank loans in 2012 were in Germany (€179bn), Britain (€164bn), Spain (€167bn), Ireland (€135bn), Italy (€125bn), France (€125bn), Netherlands (€57bn) and Greece (€56bn). (PwC, European Portfolio Advisory Group, Market Update, October 2013).

6 Bank for International Settlements, BIS Quarterly Review, June 2013, pp. 15–19.

7 See, for example, Jacques Mazier and Pascal Petit, ‘In search of sustainable paths for the eurozone in the troubled post-2008 world’, *Cambridge Journal of Economics*, 2013, Vol. 37, pp. 513–532.

the actions of the European Commission, many national governments have been obliged to implement cuts in spending for which they would not have been able to secure political support at home. Any hopes that President Holland’s government in France would lead an opposition bloc with Spain and Italy proved quite groundless.

Fiscal deficits increased right across the European Union in the aftermath of the 2007–2008 crisis as a result of three main factors: large outlays to rescue banks, increased government spending to counter the sharp downturn in output and a steep decline in tax revenue. Especially stringent fiscal cuts have been imposed on countries of the euro area periphery as part of the conditions associated with the EU’s rescue packages—money that was largely used to service debts to banks in Northern Europe. However, tough new EU budgetary rules (see chapter 3) have also forced governments in other member states to cut back their spending.

The widespread downturn in economic activity which followed the fiscal cuts led to reduced tax revenues, making it even more difficult for countries to meet deficit targets. Amidst rising political resistance to further cuts in many member states, in April 2013 even the Commission President, José Manuel Barroso, warned that austerity was nearing its political limit. Somewhat unexpectedly, and much to the chagrin of the EU’s commissioner for finance, an evaluation by the International Monetary Fund of its joint lending with the EU to Greece concluded that it had seriously underestimated the negative effects that the conditions would have on the country’s economy.<sup>8</sup>

In practice, countries have frequently been unable to meet the targets for reducing their deficits. In 2013 extensions had to be granted to Greece and Portugal in April, and to Spain, France, the Netherlands and Belgium in May. But the EU authorities’ fundamental commitment to imposing adjustment based on fiscal consolidation remained unchanged. Indeed, the new chair of the euro group finance ministers, the Dutch finance minister Jeroen Dijsselbloem, has argued that countries should in future only be granted more time to meet deficit targets if they implement EU demands.<sup>9</sup>

The emphasis on fiscal constraint has also led to the first ever cut in the EU’s own long-term budget. At the insistence of spending hawks led by Britain and Germany, heads of government agreed at a summit in February 2013 that the EU’s Multiannual Financial Framework for the seven years from 2014 to 2020 should be reduced from €1,033 billion, as proposed by the Commission, to €960 billion. The main reductions were to be borne by big cuts in infrastructure projects that were intended to boost growth. The EU summit in June 2013 did agree that €6 billion should be dedicated to combating the alarmingly high level

8 International Monetary Fund, ‘Greece: Ex post analysis of exceptional access under the 2010 Stand-By arrangement’, IMF Country Report 13/156, June 2013.

9 ‘Eurozone budget leniency criticised’, *Financial Times*, 29 October 2013.

of youth unemployment in the EU, but this involved a reallocation of existing funds rather than additional spending.

The ECB's programme of Outright Monetary Transactions played a key role in stabilising government bond markets when it was launched in 2012 and this continued in 2013, as noted above. However, the proposal agreed in June 2012 to break the vicious link between the banking crisis and the sovereign debt crisis by allowing banks to recapitalise by borrowing directly from the European Stability Mechanism (ESM), was effectively abandoned in January 2013. Germany and other countries successfully pushed for a requirement that national governments contribute alongside the ESM or guarantee the ESM against any losses; they also established that ESM support to banks should be limited to a maximum of €60 billion.

The ECB reduced its main lending rate from 0.75% to 0.5% in May 2013 and to 0.25% in October 2013 although, as on previous occasions, the two German members of the monetary policy committee reportedly opposed the moves on both occasions. However, the euro area is facing strong deflationary pressure. In October 2013, the annual rate of inflation in the euro area fell to 0.7%, well below the official target of 2%. Bank lending is falling, and even the IMF has called for the ECB to consider a further cut in interest rates.<sup>10</sup> More fundamentally, while the ECB provided banks with some €1 billion in low-interest three-year loans with no conditions at the end of 2011 and the start of 2012, it is still constrained by the deeply conservative prohibition on lending directly to governments – something that has played an important role in promoting economic reactivation in the US and Britain.

Given the EU's rigid adherence to the neoclassical principles that the government budget should be balanced, and that monetary policy should focus exclusively on price stability, it is wages that are expected to bear the full weight of adjustment. Under the pressure of high unemployment, unit wage costs have declined in some countries, most notably Greece and Ireland. While so-called wage flexibility is strongly promoted by EU policy makers, and welcomed by many employers, it is further feeding the forces of deflation which are already sweeping across much of Europe.

### 1.3 Towards full employment with decent work

The introduction of the euro and the creation of a joint monetary space in Europe offers the possibility of establishing greater democratic control over economic policy and of countering the dominance of the giant banks and non-financial corporations which have come to dominate private financial markets. The key problem is not that there is a single monetary policy for countries that are in some ways quite diverse. The problem is, rather, the ECB's deeply con-

<sup>10</sup> International Monetary Fund, World Economic Outlook, October 2013, p. 20.

servative approach to monetary policy, and the complete absence of an active European approach to budgetary, wage and industrial policy.

Budgetary policy has been dominated by the mistaken claim that, in the absence of a budget deficit, the market system will itself adjust to generate growth and employment. In place of spending cuts, the focus of government policy should shift to actively promoting employment in socially and environmentally desirable jobs with what the International Labour Organisation describes as decent work. In order to pursue this, governments in the euro area should be released from the highly restrictive constraints imposed by the fiscal compact. The socially and economically regressive impact of cuts in public expenditure should be ended, and the provision of high quality public education and public health services should be strengthened. Higher levels of government spending should be financed by reversing the repeated cuts in taxation that have taken place throughout Europe in the last 20 years.<sup>11</sup>

The current account imbalances which exist between European countries, especially those in the euro area, should be reduced. The current reduction in deficits is a temporary result of the downturn in output rather than a sustainable shift to more balanced relations. As part of a shift towards more balanced current accounts, the pressure to adjust should not apply just to the countries with a deficit, as is at present the case. Rather, countries with a surplus should also be required to adjust by adopting more expansionary macroeconomic policies.<sup>12</sup>

Budgetary policy must be strengthened at a European level so as to complement the common monetary policy. To this end, the EU budget should not be reduced as is currently planned but rather increased. In order to have a meaningful impact on managing the level of output and employment in Europe the EU budget should be increased from its present level of around 1% of the EU's GDP to at least 5%.

The financing of government deficits in the euro area should be mutualised through the creation of jointly-issued Eurobonds. At present, each national government confronts the euro as if it were a foreign currency over which it does not exercise sovereignty. This marks a serious retreat from the position in the post-war years when governments for a time obtained a greater ability to manage their national economies. Commonly issued Eurobonds will eliminate the ability of financial investors to speculate against weaker country's bonds, something which pushed their interest rates up to prohibitive levels, and forced them to turn to the EU for support. At the same time it generated large capital flows from countries in the euro area periphery to core countries, in particular Germany, which, consequently benefitted from unprecedentedly low long-term interest rates.

<sup>11</sup> This point is examined in more detail in chapter 4.

<sup>12</sup> In November 2013, the European Commission announced plans to investigate Germany's current account surplus for exceeding EU agreed limits, but there is little expectation that this will have any serious consequences.

The existing public debt in a number of member states is unsustainably high; it acts as an insurmountable brake on economic development and can in any case never be fully repaid. In order to relieve those countries that are burdened with exceptionally high levels of public debt, a debt audit – as pioneered in Ecuador – should be held to determine which of a country's debts are legitimate, and which should be cancelled.

The monetary policy of the European Central Bank must be brought under democratic control and integrated into the policy making process of the EU. At present, the renowned independence of the ECB applies to government institutions, but it is not independent of private financial institutions, with which it interacts on a daily basis, and whose survival was its highest priority throughout the most critical phases of the financial crisis. In place of its obsession with price stability, ECB policy should be directed at ensuring an adequate provision of credit at low interest rates so as to support investment and employment.

In the field of wage and employment policy, the relentless downward pressure on wages in many countries should be replaced by a policy of encouraging the spread of collective bargaining. The gap between the growth of labour productivity and the growth of real incomes that has occurred in many European countries since the 1980s – France is one of the few exceptions – should be closed. An orderly rise in wages can contribute to overcoming the weakness of domestic demand in Europe, as well as to promoting greater social justice. In particular, the widespread growth of precarious and low-paid jobs should be reversed. In order to combat unemployment, but equally to facilitate a shift towards a way of life that is not dominated by waged work and where child care is more equally shared between men and women, the normal working week should be reduced with no loss of pay, initially towards a target of 30 hours a week.

## 2 Financial and banking policy

### 2.1 The financial crisis is unresolved

Five years after the bankruptcy of Lehman Brothers, the financial crisis is unresolved in the EU. The banking system is still fragile in spite of the huge amount of liquidity provided by the European Central Bank (ECB). European banks continue to be undercapitalised. The situation of the banking sector is very critical in some countries, in particular Spain.

#### The banking union project: a new rush forward?

In the middle of 2012, at the very height of the crisis in the euro area, with doubts about the robustness of Spanish banks and fears that Greece or Spain might exit the euro area, the proposal for a banking union emerged from the Commission as a new European project which could contribute to solving the crisis.

The proposal for banking union involves three pillars:

- The Single Supervisory Mechanism (SSM) gives the ECB responsibility for the supervision of the biggest and most important European banks and is to become effective in November 2014. The arguments in favour of such a supervisor were the same as for an independent central bank. Banks, like money, must escape from the national and political domain and be entrusted to European experts. The implementation of the banking union will allow the European Stability Mechanism (ESM) to directly recapitalise banks, thus breaking the vicious circle between banks and sovereign debt. A Supervisory Board and independent services will be created within the ECB to avoid a conflict between banking supervision and monetary policy objectives.
- The Single Resolution Mechanism (SRM) was proposed by the European Commission in June 2012 and agreed by the Council in June 2013, but still required approval by the European Parliament. The scheme has five pillars. Banks should put in place wills, i.e. strategies for recovering, or even for dismantling, in the case of a crisis. The European banking authorities are to have the power to intervene to implement recovery plans and to change bank managers if a bank does not meet minimum capital requirements. National resolution authorities will be able to take control of a bank in trouble and to use instruments of resolution such as the transfer of activities, the creation of a bad bank or a 'bail-in' by which losses will be supported first by shareholders, then by subordinated bonds, followed by bonds of higher categories and by deposits above €100,000. Banks would be required to maintain sufficient own funds and eligible liabilities expressed as a percentage of the total liabilities of the institution. Member states are to set up a resolution fund, which must reach 0.8% of the covered deposits. Thus, in principle, taxpayers would not have to pay for insolvent banks. In July 2013, the Commission proposed

a further centralisation of the SRM through the creation of a Single Resolution Board (SRB).

- A European deposit guarantee scheme (EDGS) should provide a guarantee for deposits of up to €100,000. The crisis has shown the contradiction between the international structure of banks and the national nature of deposit guarantees. This is a problem which was particularly acute for countries like Ireland or Cyprus, where the banking systems were very oversized. There were two ways in which this could be approached: by establishing a common deposit guarantee system at the European level, or by setting limits to the size of each country's banking sector. The Commission preferred the first solution.

### The Cyprus banking crisis

The bankruptcy and bailout of banks in Cyprus in March 2013 led to chaotic decisions by the European authorities. Cyprus is a fiscal paradise with an extremely over dimensioned banking sector which served as a huge money-laundering machine for the Russian oligarchy. It was initially proposed to bail-in investors and to enforce losses on all depositors without negotiations and loopholes. However, the decision to penalize the deposits of ordinary people, among them many Greek small savers, who had transferred their money to Cyprus was widely criticised. Originally the European authorities proposed that depositors below €100,000 would have to take a loss of 6.75%, while those with deposits above €100,000 would have to take a loss of 9%. This, however, could well have destroyed confidence in banking systems across Europe as it failed to respect the principle of a guarantee for deposits below €100,000. In the event, the Cypriot parliament rejected the proposals of the Troika and deposits of less than €100,000 were subsequently excluded from the package.

### EU-US free trade agreement: a threat for financial stability

Bilateral negotiations for a EU-US free trade and investment agreement (TTIP) started in June 2013. The liberalisation of financial services, which is part of the negotiations, is something that could have dangerous implications for financial regulation, tax collection and the fight against illicit financial flows. The proposals would give more rights and protection to the financial industry, while weakening the protection of financial stability and of consumers. It is likely that negotiations will lead to the lowest common denominator in financial regulation. A particularly controversial issue is the proposal to grant far-reaching protection rights to financial investors. This would allow investors to bring a request for compensation before a dispute settlement mechanism for damages to their interests (for a fuller discussion of the TTIP, see chapter 7).

## 2.2 Reforms do not change the dominant paradigm of finance

There is a long list of policy proposals on which decisions need to be made. Yet, the speed with which EU governments imposed austerity measures to calm financial markets stands in sharp contrast to the slow pace at which important financial reforms in the EU are proceeding.

### The Liikanen Report on bank regulation: universal banking protected

The Liikanen Report issued in October 2012 at the request of Michel Barnier, the Commissioner for the Internal Market, addressed the issue of banks being too big to fail. The 15 biggest European banks, which are listed by the Financial Stability Board as global Systemically Important Financial Institutions (SIFIs), hold assets equal to 160% of the EU's GDP. The issue is not only the sheer size of banks, but also the interconnectedness and complexity of banks and financial conglomerates together with their business models. The overall aim of the Liikanen Report is to make commercial banking safer and to reduce the possibility of contagion. The core proposal is the mandatory separation of particularly risky business activities into a legally separate entity, e.g. an investment firm, while keeping both the investment firm entity and the entity for basic financial services under the roof of the same universal bank. The Report sticks to the European tradition of universal banking and does not draw the most obvious conclusions from its analysis: to split big banks into much smaller entities so that a default will not affect the entire sector and indeed the economy. It also fails to acknowledge that the US Glass-Steagall Act of 1933, which imposed a strict separation between deposit banks and investment banks, was a key pillar of financial stability in the US for more than 60 years. Despite their limited scope, however, the reforms proposed by the Liikanen Report have been delayed and blocked by the financial industry. Some national governments – notably the French and German governments – have adopted their own banking reforms which are even more timid than the Liikanen proposals. Such minimalist national reforms, which have been implemented under the influence of strong lobbying by the banking sector, will make an ambitious banking reform at the EU level more difficult.

### Banking union drawbacks

The banking union is a new step towards federalism with a strong centre and a de-politicisation of Europe with a transfer of competence from the member states to the European authorities. It cannot offset the major drawbacks of the monetary union: the absence of a 'lender of last resort', thereby allowing financial markets to speculate on the possible bankruptcy of states; the absence of mechanisms to ensure solidarity, control or coordination which has resulted in the insecurity of the single currency; and the inability to implement a viable exit strategy from the crisis, thereby leading several countries into deep and

continuing recessions which have further weakened their banking systems.

In theory it certainly would be easier and more legitimate to rescue banks under a single supervision. But this prospect is hardly useful in the current crisis, where the problem is to help banking systems already in trouble in Spain, Cyprus, Ireland, or Slovenia.

Under the current proposals, governments will lose their ability to influence the distribution of credit by banks. This is considered desirable by some ('no political influence on credit supply') but it will mean that governments will lose an important instrument of industrial policy that could be used, for example, to support small and medium size firms, or to promote the ecological transition.

Banks are encouraged to diversify internationally to reduce their risk. But the crisis showed the dangers of diversification when banks venture into foreign markets. Local, regional and even state authorities will no longer have dedicated banks.

The SRM project deprives the national authorities of all powers. They would be obliged to obey the Single Resolution Board instructions. The losses of a bank would be supported by all countries belonging to the banking union, thereby justifying a single, centralised control. According to the project, the Commission and the SRB would be able to impose a resolution plan on a bank without the agreement of the relevant governments. This proposal, which involves an important step towards European federalism, was not accepted even by the German government which, in the past, has been in favour of constitutional reforms leading to greater political union.

It is, furthermore, not certain that the SRM could prevent the need for taxpayer protection, if banks remain interconnected and very big. If a systemic bank is in financial difficulty, it will be hard to transfer the losses onto other credit institutions without resulting in contagion. The alternative would be to first reduce the size of banks and to enforce a strict separation between financial market activities and credit activities.

### **The financial transactions tax blocked by lobbies**

In February 2013, the European Commission (EC) published a new draft of the Financial Transactions Tax (FTT) directive. While the first version of the FTT directive issued in September 2011 was for the EU27, this second draft is now negotiated in the framework of 'enhanced cooperation', i.e. a coalition of the willing of just eleven EU member states. This new directive has two interesting features. First, the EC has presented a new approach to counter tax avoidance, the so-called AAA – all instruments, all markets, all actors – approach which applies the tax to institutions residing in the participating member states, and to instruments issued in those member states even when traded outside the FTT area. A second important feature is that it proposes to include the taxation of repo activity, a systemic market previously ignored in regulatory proposals. The finance industry mobilised strongly against this new and more radical draft

of the FTT directive. Some governments, notably Britain, even threatened to take legal steps against the EC directive if the interests of their financial industry were infringed. The French government raised new objections against the EC directive, claiming that its' bond markets would lose its liquidity. A FTT could make a significant contribution both to reducing government deficits and to limiting speculation in financial markets, but agreement has yet to be reached.

## **2.3 Alternative policy proposals to put finance at the service of society**

### **Banks reforms: an alternative proposal**

The euro area needs a strong banking system that is able to finance economic recovery. However, Europe has to make a clear choice between two options. The first option, as planned, would involve direct competition between all the banks in the euro area. This implies cutting the links between the borrowers of a country (government, local authorities, firms and households) and national banks. For this view, banks must be able to intervene freely on financial markets: they must be able to provide complex investment and hedging tools. But this involves risks. The first risk is that banks might prefer to focus on activities in financial markets if they are more profitable, rather than the provision of credit. The second risk is that banks could reduce their credit activities in order to meet higher capital ratios and as a result of the higher risks for their creditors if the bank runs into difficulty. The third risk is that, as a result of the continued link between banks and financial markets, instability in financial markets could spread into the real economy.

In the second option, which we support, European institutions should adopt the clear objective of reducing the weight of finance in the economy. Speculative activities should be prohibited in the banking system; such activities should have to be confined to specialised institutions that are not guaranteed by the government. The cost of their financing would be high, which would reduce their profitability and their operations.

Retail banks should be isolated from financial markets and focus on their core business (credit based on a detailed expertise to the firms, households and local authorities of their countries). A limit should be placed on the size of private banks. Public and cooperative banks should be promoted. The solvency of banks should be strengthened, by prohibiting speculative operations, and introducing a guarantee by nation states, whose debt would in turn be guaranteed by the central bank. A bank could face trouble if its country were in a recession and if companies or households encountered difficulty in repaying their debts. But states could come to the rescue, especially in cases where the credit supplied by the bank was in line with the country's – or European – economic strategy.

Banks must develop a strong capacity to finance projects and take productive risks, according to industrial, ecological and employment criteria. Projects may

be regional, national or European. Besides their key role in money creation, the objective of banks must be to collect a large part of European savings, and to compensate them at low but guaranteed rates. Banks must develop simple and short circuits between household savings and loans to productive sectors, to local authorities, and to housing projects. This would give another dimension to the banking union.

The choices about the organisation of the banking system cannot be left to the ECB, which is more concerned with the proper functioning of financial markets than with activities in the real economy. Southern euro area countries' current difficulties seem to condemn the entire euro area to a complete centralisation of banking regulation, the consequences of which will appear in a few years. There is a serious risk that the emergency measures introduced by the euro area countries involve embarking on a dangerous path, since many of the implications have been as little analysed as was the case before the introduction on the single market or the fiscal treaty.

#### The ECB should contribute to the funding of real needs

The ECB should broaden its policy targets to include growth, employment and financial stability. The refinancing of banks by the ECB should be conditional and selective and should favour priority investment in sectors such as renewable energy, housing, public transport, communication infrastructure, and climate protection. Furthermore, the ECB should assume the role of lender of last resort with respect to governments, in the same way as the US Federal Reserve and the Bank of England.

#### A scalable financial transaction tax (FTT)

The FTT must not be watered down. It should be extended to include currency trading and high frequency trading, and the tax rate should be scalable. This would enable the tax to efficiently contribute to preventing bubbles.

Besides the FTT, regulators must take measures to *limit leverage in the financial sector*. An effective policy would be a preventative testing of financial innovations – something comparable with road safety tests for cars, or for the tests which new drugs are subjected to. The purpose of some financial innovations – such as collateralised debt obligations and credit default swaps – is to stretch the available collateral further and to obscure the risk they involve.

Finally, there is a need to take effective measures to *curb the influence of the financial lobby* in Brussels by closing the door between the Commission and the finance industry, and to introduce new rules that would introduce *personal liability for bankers and financiers* who are responsible for scandals, fraud and criminal activities such as money laundering and tax evasion. Banks should never be 'too big to jail'.

## 3 Governance in the EU<sup>13</sup>

### 3.1 The new surveillance system for economic policy

The Fiscal Compact (Treaty on Stabilisation, Coordination and Governance, TSCG) and the Two Pack regulations, now accepted by the European Parliament and the Council of Ministers, have completed the introduction of much more restrictive central control over all aspects of member state economic policy in the euro area.

The 'Merkel method' through which many of the governance changes have been brought about completely subverts the division of competence established between the EU and member states.<sup>14</sup> For example, the Maastricht Treaty makes it clear that issues of wages and of collective bargaining are the preserve of the individual member states.<sup>15</sup> To circumvent such provisions governments have been persuaded or pressured to sign away economic powers by inter-governmental agreements or by treaties which in fact consolidate a regime of central surveillance and control.

The new rules concern both the procedures and the substantive content of economic policy formation. Their clear intention is to deprive elected representatives of the power to choose the economic policy they consider is best for their countries and to impose instead crude arithmetic targets. Thus the TSCG adds to the existing rules of the Stability Pact (public sector deficits of no more than 3% of GDP; total public sector debt of no more than 60%) a new rule limiting the structurally adjusted deficit (the deficit corrected for the effect of short-run economic fluctuations) to 0.5% of GDP.

Although the TSCG pays lip-service to 'the prerogatives of national parliaments' it makes it clear that the fiscal policy rule overrides them. Transposition of the rule into member state law is to be 'through binding, permanent and preferably constitutional provisions.' Not only do member states have no choice about this rule, they are to have no choice about how to correct any deviations from it. The TSCG specifies that fiscal tightening to bring the deficit back to this target is to be 'triggered automatically.' Certain of the procedural changes imposed on member states must also have the effect of restricting par-

<sup>13</sup> This section draws on a critique of the Treaty on Stability, coordination and Governance in Les économistes atterrés, L'Europe mal-traité: Refuser le Pacte budgétaire et ouvrir d'autres perspectives, LLL, 2012. Thanks to Klaus Dräger for comments on an earlier draft and help with documentation.

<sup>14</sup> Key elements of the 'Merkel method' are: strengthening intergovernmental proceedings in negotiations during the crisis; an insistence that only the proposed strategy is feasible; and especially extracting political and economic concessions in exchange for monetary aid.

<sup>15</sup> The broad economic policy guidelines of 2011 already required specific 'reforms' in member state labour markets – these interventions have been strengthened and extended in subsequent governance changes. It should be recognised, however, that many member state governments have welcomed the EU's drive to reduce employment rights and intensify labour market competition. For a survey of recent changes in labour market regulation see Isabelle Schömann and Stefan Clauwaert, 'The Crisis and national labour law reforms: a mapping exercise,' ETUI Working Paper 2012.04.

liamentary influence on economic policy. One aspect of the Two Pack regulations is that member state governments will now be required to submit their draft budgets to the Commission each October, prior to budget discussions in member state parliaments. The Commission will then comment in November. This new procedure is imposed on top of the existing cycle of policy surveillance (the 'European semester') whereby each member state submits a Stability or Convergence Plan (covering macroeconomic policies over the next four years) and a National Reform Programme (covering privatisations, regulatory changes and so on) every spring leading to an assessment by the Commission and 'country-specific recommendations,' endorsed by the Council thereafter. The recommendations insist remorselessly on further fiscal consolidation but also cover every aspect of public policy with pressure for opening up service sectors and public utilities to external competition, more 'activation' of the unemployed, 'efficiency' drives in hospitals and local government and so forth.

No fewer than twelve countries in the monetary union are currently subject to an excessive deficit procedure (EDP) which, if there is insufficient compliance with Commission 'guidance,' can lead to sanctions. The Two Pack tightens up the EDP procedures and links macroeconomic restrictions to 'structural reforms' by requiring states subject to an EDP to enter into 'economic partnership programmes' which specify measures considered as 'instrumental to an effective and lasting correction of the excessive deficit.' The policies concerned are unlikely to relate to the EU's formal 'Europe 2020' targets on poverty reduction or ecological sustainability since these would not contribute to medium term fiscal consolidation. The measures promoted by the economic partnership programmes will be continuations of the squeeze on labour, public services and social provision.

Although the new surveillance regime is essentially complete, there are ongoing efforts to reinforce control. For example Jeroen Dijsselbloem, Dutch finance minister and chair of the euro group of finance ministers, proposes to tie any extension of deadlines under the EDF to the acceptance of recommended 'structural reforms.' Again, the Commission is trying to make disbursements by the EU's structural funds more conditional on the acceptance of macroeconomic targets. The Two Pack legislation also specifies that sanctions for member states which fail to observe the reinforced rules are to be made as automatic as possible. If the Commission decides to pursue a member state government for fiscal transgressions a qualified majority of member states will be required to block litigation. This implies that a simple agreement between France and Germany could force the otherwise unanimous countries to accept such legal action; similarly Germany together with the Netherlands, Finland and Austria would have sufficient votes to do so.

The drastic restriction on the powers of member state parliaments which is embodied in the new euro area regime is in no way compensated by any reinforcement of the European Parliament. The TSCG foresees meetings of heads

of state and government to discuss its application and associated economic 'reforms.' The president of the ECB must be invited to these discussions; the Treaty specifies, however, that the president of the European Parliament 'may be invited' to attend, and if in attendance 'may be invited to be heard.' A report of the meeting is to go to the EP and there is to be a conference of member state and EP parliamentarians to discuss budgetary issues. The majority in the EP in fact acquiesced in this diminution of its own role and actually fought to make sanctions under the excessive deficit and excessive imbalance procedures more automatic.<sup>16</sup>

For countries subject to the Troika (that is, the European Commission, the European Central Bank and the International Monetary Fund, which together negotiate loans to crisis-struck countries) after having received emergency finance there are no limits whatsoever to interference with their social and economic systems. For example the last (2012) 'Memorandum of Understanding' between Greece and the Troika does not just specify the overall scale of public spending reductions to take place: it gives minute details about which items are to be cut and by how much, about how many and which public sector employees are to be dismissed, about reorganisations of public administration, about the privatisation of state assets and much more.

### 3.2 The 'constitutional' straitjacket

The insistence of EU elites on constitutional or quasi-constitutional constraints is deeply misconceived. Economic history is strewn with attempts to impose arbitrary arithmetic limits on both fiscal and monetary policy. When the limits bite the results are usually very dysfunctional because capitalist economies require both an elastic credit supply and discretionary state interventions. An early example of such dysfunction was the Bank Charter Act in Britain in 1844 which specified a limit to the supply of fiduciary banknotes by the Bank of England. Suspension of the Act became almost routine in subsequent crises because it threatened to block lender of last resort operations by the central bank. The turmoil in the US in October 2013 as an arbitrary borrowing limit was approached provides a very recent example of the same phenomenon and only similar disorganisation can be expected when the German *Schuldenbremse*, inspired by the same type of thinking, comes into effect.<sup>17</sup>

<sup>16</sup> See Klaus Dräger, *Sado-monetarism rules ok?! EU economic governance and its consequences*, available on the EuroMemo website: 'The only directly elected institution of the European Union does not push for co-decision or veto powers of the Parliament on economic governance. Instead, this Parliament calls for increased powers of the European Commission and more 'automatic' procedures and sanctions in order to curb what it calls 'political horse trading' in the Council.'

<sup>17</sup> 'Germany and the debt brake are currently in the middle of a major fiscal policy experiment with a very uncertain outcome. The successes noted for the time being are mainly due to an unexpectedly strong and lasting economic recovery and the technically successful manipulation of figures by the federal government, whereas the real test lies ahead.' Achim Truger, 'Austerity in the euro area: the sad state of economic policy in Germany and the EU,' *Intervention*, vol. 10, no. 2, 2013.



The notion that economic policy can and should be written into constitutional documents in this way is sometimes traced to neo-liberal thinkers such as the German ordo-liberals or Friedrich Hayek. Hayek's preference for strong constitutions and weak parliaments derives from two positions: a deep distrust of democracy<sup>18</sup> and a vast over-estimation of market processes and of their capacity to adapt to change and to stabilise economic life.

Because the governance changes in the EU have been introduced with so many assertions about their necessity and effectiveness one should make a simple point. After the global financial debacle of 2008, the avoidance of complete economic collapse, and the present precarious achievement of an inadequate stability in some western economies, owes less than nothing to Hayekian constitutionalism or to fiscal squeezes. They owe everything to extremely accommodating and activist monetary policies. Major central banks have torn up the rule books on monetary policy which would have required them to confine their activities to short-run credit markets and to continue to subordinate all other objectives to the pursuit of price stability. Had central banks not done this a widespread crash in asset markets and a complete paralysis of bank lending would have been impossible to avoid.

Besides the new fiscal constraints, central control over wage determination and over the functioning of labour markets is a key target in the governance changes. The predominant theme in official policy discussion is 'competitiveness.' For the crisis-struck economies of the southern and eastern periphery, the pursuit of competitiveness, that is lower wages, deregulated labour markets and reductions in social provision, is seen as the only response.<sup>19</sup> For the monetary union as a whole again competitiveness is the first priority – social and economic development within the EU is to be subordinated to the supposed imperatives of globalisation.

Thus the current 'Broad Economic Policy Guidelines' state: 'Member States should encourage the right framework conditions for wage bargaining systems and labour cost developments consistent with price stability, productivity trends over the medium-term and the need to reduce macroeconomic imbalances. Where appropriate, adequate wage setting in the public sector should be regarded as an important signal to ensure wage moderation in the private sector in line with the need to improve competitiveness. Wage setting frameworks, including minimum wages, should allow for wage formation processes that take into account differences in skills and local labour market conditions and respond to large divergences in economic performance across regions, sectors and compa-

18 For critiques, see Andrew Gamble, *Hayek: the iron cage of liberty*, Cambridge, 2006; and Jacques Sapir, *Quelle économie pour le XXI<sup>e</sup> siècle*, Paris, 2005.

19 The drastic consequences for workers, in the case of Greece, are summarised in Christos Laskos and Euclid Tsakalotas, *Crucible of Resistance*, pp 91-112. Ironically the drive for 'internal devaluation' in Greece has also wiped out over 100,000 SMEs. So much for the EU's commitment to the flexible economy.

nies within a country.<sup>20</sup> The multiplication of wage differentials and inequalities called for here must threaten undermine solidarity among wage-earners.

As far as the EU as a whole is concerned the competitiveness theme is very difficult to justify. The euro area has a flexible external exchange rate which, together with the scale of the economy and the fact that external trade linkages are limited, should enable it to avoid macroeconomic disturbances arising from a loss of competitiveness. Obviously there could still be acute sectoral or regional problems arising from external trade but interventionist measures could deal with these. If the Commission (and the governments of dominant member states) were not so dogmatically committed to free trade, it would also be possible to prevent or attenuate the kind of import surge which gives rise to such problems.

At the level of the weaker member states, the theme of competitiveness is used to justify massive downward pressure on wages, employment conditions and social protection. Competitiveness pursued through internal devaluation weakens workers' organisations thereby reinforcing the dominance also at a national level of those forces which act as global competitors. Far from being a coherent response to divergent economic performance across member states, these pressures will, in the medium term, aggravate divergence because they deepen the asymmetries and inequalities inscribed in existing trade and investment patterns.

Although EU leaderships have been stressing competitiveness for more than twenty years, the actual nature of the threat they invoke has changed. At the turn of the century, the problem was presented as a challenge from the US which, it was then thought, enjoyed a much more rapid rate of productivity growth, supported by what was seen as a highly efficient financial system. Both these assumptions were wrong. Productivity growth in the US was much slower than the official figures claimed<sup>21</sup> and the US system of corporate finance was about to be struck by the collapse of the high-tech bubble and a series of corporate scandals such as that surrounding the collapse of ENRON.

Today the competitiveness discourse is more likely to refer to China and emergent economies, but the same exaggerations and simplifications prevail. For example, in the EU's 2020 strategy, supposedly the key to policies for the present decade, it is claimed that failure to 'regain competitiveness' would condemn Europe to 'relative decline on the world scene.'<sup>22</sup> The theme of competitiveness coincides with the quasi-constitutional constraints on economic policy; the attempt in both cases is to narrow the range of democratic decision-making and to rule out any ambitious proposals for social advance or for effective limitations on corporate power.

20 European Council, Recommendation for a COUNCIL RECOMMENDATION on broad guidelines for the economic policies of the Member States and of the Union, 11646/10, Brussels, 7 July 2010.

21 See Tyler Cowen, *The Great Stagnation*, New York, 2011.

22 European Commission, *EUROPE 2020: A strategy for smart, sustainable and inclusive growth*, COM(2010) 2020 final, pp 8-9. Of course any successful pattern of economic advance in emerging and developing economies would imply the 'relative decline' of the EU which, under those circumstances, would be highly desirable.

### 3.3 Re-foundation?

It is impossible to put forward meaningful alternative economic strategies within the governance regime which has now been put in place. A market-fundamentalist regime has now been enshrined in EU Treaties, inter-governmental agreements, regulations, 'memoranda of understanding,' and other policy constraints which have been rendered as binding as possible precisely to narrow the scope of democratic decision-making.

In a democratic society economic institutions and forms of economic co-ordination must be determined by democratic decisions. Otherwise compromise between opposed interests and opposed social forces will not result in legitimate institutions. There has never been anything approaching an electoral endorsement for the overriding priority given to competition rules, budgetary restrictions and labour market deregulation. Largely in consequence of this the European Union which embodies these priorities is increasingly seen as illegitimate by the European peoples.<sup>23</sup>

The legitimacy crisis could lead to the further rise of chauvinistic, nationalistic political forces questioning the whole project of European integration as we can see in Greece, Hungary, France and elsewhere. The rigidity of the present regime provokes a search for loopholes. For example, it is sometimes pointed out that the European Investment Bank is permitted to borrow on a large scale and suggested that debt-financed expenditures by the EIB could be used to circumvent the limitations on the European budget. Again, it is clear that the mandate of the ECB has recently been interpreted in a wider way than previously (leading to the resignation of a German representative from the ECB board). Such limited margins for manoeuvre will no doubt be used again to moderate some of the extreme dysfunctions of the regime. This kind of device, however, is inconsistent with democratic principles which require open decision-making by accountable representatives.

These governance developments raise the question of how, and in what context, the EuroMemo Group's proposals could be implemented. Only a radical transformation of the present governance regime would permit the coordi-

<sup>23</sup> The recent document, *Strengthening the Social Dimension of the Economic and Monetary Union*, (Brussels, 2 October 2013, COM(2013) 690 provisoire), indicates that the Commission is to some extent aware of growing legitimacy problems. However, the document contains no genuine response to these problems. A lot of it simply concerns more monitoring and surveillance of social indicators. The references to 'social partnership' are belied by labour market measures in the periphery directly aimed at undermining trade unions. The 'Youth Guarantee,' an initiative from D.-G. Employment and Social Affairs, is positive but inadequately funded: in Greece for example the €517 million provided by the EU will not go far for the 350,000 young people who are being targeted – it corresponds to about two months employment for each of them at the newly reduced minimum wage. The figure of €517 million can also be compared to the reduction of €18 billion in Greek annual public expenditure between 2009 and 2012. Mention is also made of unemployment indemnities at EU level, but only to add that these must be designed to avoid permanent transfers among member states and would, in any case, require a completely hypothetical treaty change.

nated but differentiated recovery that is needed. Therefore all the new rules, regulations and treaties have either to be abrogated or explicitly subordinated to other priorities – for employment, ecological sustainability and social justice. This would amount to a re-foundation of the union but the EU has now deviated so far from its original methods and purposes that only such a radical step can begin to rebuild its legitimacy.<sup>24</sup>

In the absence of such a drastic reversal, proposals for a further centralisation of power in the EU must be treated with great suspicion. A 'leap towards federalism' might in principle be compatible with a shift to economic policies focussed on employment and social provision but in practice the centralisations which have taken place have all tightened the pressures on employment, working conditions, social services and social protection. For example a banking union could in principle relieve governments in the economically weakest states of some of the responsibility for re-capitalisation of their banks. In practice it seems that such relief will be granted with such strict conditions that member states will lose control over their banking sectors with no corresponding reduction in their potential liabilities. The Cypriot case does not testify to any strong commitment to the interests of EU citizens in the crisis-struck countries. A report published by Herman Van Rompuy, president of the Council, together with the presidents of the Commission, the euro group and the ECB, in December 2012 argues for a further substantial centralisation of decision-making in the EU.<sup>25</sup> However, the content of their proposals addresses neither the widening divergence in economic performance across member states nor the damage being done to the EU as a whole by austerity policies.

The proposals of the Van Rompuy report include a rapid move towards a banking union but with no commitment to the mutualisation of existing liabilities. The problems of the EMU are still presented as supply-side weaknesses resulting from market rigidities: 'In the absence of exchange rate adjustments, a well functioning EMU requires efficient labour and product markets. This is essential to fight large scale unemployment, and to facilitate price and cost adjustments that are key for competitiveness and growth.' The proposed euro area 'fiscal capacity' would offer only short-term and highly conditional support to the weaker economies, in which 'structural reforms' would be driven forward by contractual agreements giving member state governments financial incentives to take the prescribed measures. Mention is made of the role of

<sup>24</sup> Although they by no means speak for the German Social-Democratic leadership, a group of SPD members have been prepared to call for such a re-foundation. See Nida-Rümelin, Dierk Hirschel, Henning Meyer, Thomas Meyer, Almut Möller, Nina Scheer, Gesine Schwan and Hermann Schwenkel, 'We Need a Europe That is Truly Social and Democratic', 'The basic social rights, enshrined as directly applicable EU law, must be given precedence over competition rules. In the Treaty texts it must be clearly spelled out that the EU exists to promote not only economic growth, but also social progress.', November 2013, [www.social-europe.eu/wp-content/uploads/2013/10/OccPap3.pdf](http://www.social-europe.eu/wp-content/uploads/2013/10/OccPap3.pdf).

<sup>25</sup> 'Towards a Genuine Economic and Monetary Union', [www.consilium.europa.eu/uedocs/cms\\_Data/docs/pressdata/en/ec/134069.pdf](http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ec/134069.pdf).

parliaments at both state and EU level but parliaments would essentially be confined to considering the implementation of economic strategies, with no influence over their design.

An ETUI researcher comments on the report: ‘Long and patient reconstruction work is required to restore confidence to nations and citizens in the European project that should belong to them, a confidence that has been eroded – and that is putting it mildly – over the past three years and without which this project is doomed to failure.’<sup>26</sup>

Unless centralising proposals commit the union to major redistributive transfers, to convergence strategies based on active industrial interventions and to well-funded social policies taking precedence over competition rules, further centralisation can only deepen the problems resulting from the existing imbalances and dysfunctions of the EMU. In these circumstances it is logical to relate our economic proposals both to an inter-governmental and to a federal governance structure, based on voluntary cooperation and coordination as well as on unitary institutions, and involving as many countries as possible rather than always aiming for unanimity.<sup>27</sup> Policy implementation must include security for trade unions and respect for real agreements on wages and working conditions. If the EU were unable to relate positively to such recovery efforts it would only further alienate itself from European citizens.

To close this section it can be suggested that the damage done to democracy in Europe by the illegitimate imposition of a misconceived policy regime in fact reacts back on economic performance. At present economic recovery in the EU is held back, not by ‘rigidities’ or market ‘inefficiency,’ but by massive uncertainties obscuring the nature and the direction of future economic development. A strong democracy can reduce these uncertainties by setting down clear priorities which promote certain types of development (such as sustainable energy systems or upward convergence of the peripheral economies) and by constraining some others (such as the hypertrophy of financial sectors or the penetration of private capital into the field of social services). Thus the present multiplication of restrictions, sanctions and prohibitions on the democratic process is obstructing the path to renewal.

<sup>26</sup> Christophe Degryse, ‘The new European economic governance,’ ETUI Working Paper 2012.14

<sup>27</sup> See Catherine Mathieu and Henri Sterdyniak, *Redemption?* [http://www.euroframe.org/fileadmin/user\\_upload/euroframe/docs/2013/EUROF13\\_Mathieu\\_Sterdyniak.pdf](http://www.euroframe.org/fileadmin/user_upload/euroframe/docs/2013/EUROF13_Mathieu_Sterdyniak.pdf)

## 4 Taxation in the European Union

### 4.1 Signs of a will to reform tax systems in the EU

**T**axation reform has recently emerged as a significant issue for European policy-makers, firstly because of intensified lobbying by advocacy groups like the Tax Justice Network and Global Financial Integrity, but secondly because policy-makers have become aware of the effect of tax avoidance/ evasion on state revenues, compounding the effect of major trade worldwide recession in 2009. The leaders of the EU, the G8 and the G20 have not only ramped up the rhetoric against corporate tax avoidance but have advanced a number of concrete tax reform proposals, including at EU-level; few of these have come into force formally, most are being heavily promoted but are still aspirational:

- The European Savings Tax Directive, involving the automatic exchange of information on interest income, has been in force since 2003, albeit without the full participation of Belgium, Austria and Luxembourg and therefore ineffective up until 2013; however, Belgium became fully compliant in 2010, Luxembourg (now set to become fully compliant by 2015) and Austria (to maintain its withholding tax on foreigner’s interest income) are no longer blocking the Directive’s progress. After the ECOFIN meeting in May 2013, several dependent territories of the UK (Guernsey, Jersey, the British Virgin Islands, Isle of Man) and of the Netherlands (Curaçao, Bonaire) are now also committed to full information exchange, albeit only on simple savings accounts, not on trust income or dividends. Nevertheless, the revenue potential of taxing interest payments to citizens of EU member states in foreign savings accounts, hitherto concealed from their tax authorities, is considerable; in 2007, before the Crash, EU statistics recorded that over €40 billion of concealed savings interest was revealed to EU states through the operation of information exchange.
- The EU also now has a fully worked out proposal for a Common Consolidated Corporate Tax Base (CCCTB), developed by the Commission after a decade of consultation with business representatives and specialists. It was approved, with some amendments, by the European Parliament in April 2012, and since then has been under consideration by the Council of Ministers. The proposal could certainly be improved, but if adopted it would go a long way towards dealing with many avoidance devices, e.g. the use of entities in Ireland, Luxembourg and the Netherlands as conduits for low-taxed income flows. It is not surprising that such member states have opposed the proposal, but it is regrettable that others, including successive UK governments, have been sceptical or hostile. It has some defects, but the argument that national states would lose the power to define the corporate tax base is weak: harmonising tax base definitions would have significant advantages, as well as restoring national powers of effective taxation. A successful CCCTB,

particularly if it included Combined and Country-by-Country reporting of consolidated profits as well as sales, assets, employees and taxes paid in each jurisdiction, would make company transactions much more transparent. It would also make it much more difficult for corporations to avoid paying a fair level of tax to cover the cost of the public goods on which they depend for their commercial success. Adoption of the CCCTB should be seen as a step towards, and coordinated with, the efforts at reform of the international tax system initiated by the G20 world leaders and being developed through the OECD.

- Following the 2008 crash and popular uproar over high-speed trading of financial securities, several European states urged the EU to introduce a Financial Transactions Tax, despite the failure of the G20 to agree to an equivalent global levy. The original draft proposal of 2011 has been considerably watered down after objections from the UK and other member states, and the compromise FTT is now set to be introduced, subject to national ratification, in January 2014 in just 11 member states of the euro area; the initiative is likely to be further delayed because of legal challenges but it nevertheless, like the STD and CCCTB, is indicative of a new determination on the part of fiscal authorities of key EU states to achieve both greater transparency and real revenue gains from a coordinated approach to the taxation of cross-border economic activity.
- Since the outbreak of the 2008 crisis, a number of European politicians have also highlighted the damage inflicted by ‘uncooperative’ jurisdictions (‘tax havens’). How earnest their resolve was to exclude such jurisdictions ‘from the international community’ (Sarkozy in November 2011) remains to be seen; however, the momentum generated recently by the International Consortium of Investigative Journalists in its *Offshore-Leaks* initiative<sup>28</sup> is likely, by the sheer volume of the data collected, to increase pressure on states to combat tax haven abuse; the sudden willingness of state authorities in Switzerland, Liechtenstein, Monaco, San Marino and elsewhere to consider including automatic exchange of information in their bilateral treaties with European states can also be explained by explosive potential of the ICIJ’s ongoing revelations.

There is therefore progress of sorts on the European taxation front which the EuroMemo Group welcomes. However, the kind of tax coordination currently under discussion is inadequate in the overall struggle for social justice and sustainable development. Greater transparency of accounting processes and marginal levies on financial services will not in itself alter the underlying thrust of fiscal policy and of the broader processes of employment, wage formation and redistribution within European societies. The very unequal distribution of burdens in the current processes of European crisis management and the

extreme levels of inequality that neoliberal policies had produced in many member states in the decades before the crisis makes these issues more urgent. Although transparency in tax affairs is *one* important precondition of social justice, we have to ask whether such transparency might in fact be compatible with the reconstitution of the neoliberal paradigm and the further worsening of income and wealth distribution.

## 4.2 Transparency is only a first step towards fair taxation in Europe

Scepticism about the recent half-wave of taxation reform and reform proposals in Europe is justified because the measures only involve the harmonisation of the *procedural principles* (for calculating tax liabilities), information exchange between national tax authorities and agreed *common standards* of what constitutes taxable income. Transparency and shared understandings of what can and cannot be taxed within a highly mobile trade and investment environment would certainly help prevent corporations indulging in *regulatory arbitrage* and concealment, and exploiting the quirks of national tax laws to their advantage. What is missing in the official harmonisation agenda is any agreement on the *rate at which the more strictly defined and visible direct tax bases are taxed*. It would not therefore prevent a continuation of *tax arbitrage* by companies that encourages weak states to indulge in destructive *tax competition*. In contrast to the taxation of commercial transactions (through turnover taxes and excise duties) where the EU’s *acquis* require minimum standard rates (e.g VAT at 15%), the taxation of private and corporate income in EU member states is subject to neither minimum rates, nor to the simple principle of progressive taxation, i.e. of tax rates rising incrementally with rising levels of income.

The exclusion of floor rates of income and corporation tax and of the very *principle of progressive taxation* in the *acquis* represents a critical failure of the EU’s programme of deepening and widening. The non-harmonisation of direct taxation is justified piously in terms of the fiscal subsidiarity and tax sovereignty of individual member states, indeed of the democratic legitimacy of taxation and expenditure (no taxation without representation). This is particularly relevant in the context of the states that either share a common currency (EU17) or are indirectly influenced by the monetary policy of the European Central Bank, where one key sphere of macroeconomic policy is centrally managed by an unelected institution, while budgetary policy remains the one sphere of economic policy that is answerable to voters. However, the invocation of national tax sovereignty is disingenuous for several reasons. Firstly, the monetarist conditions imposed on both EMU members/ candidates (Maastricht, Stability and Growth Pact) and other members of the EU (Fiscal Compact) demand a fundamental negative harmonisation of fiscal policy in the *setting of arbitrary ceilings on annual state borrowing* (3% of GDP), balanced ‘structural budget’ and overall debt

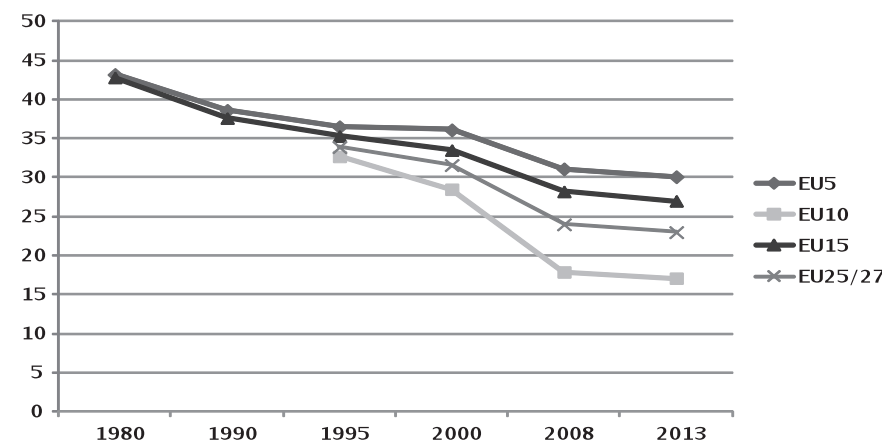
<sup>28</sup> ICIJ Offshore Leaks Database, at [offshoreleaks.icij.org/search](http://offshoreleaks.icij.org/search).

(60%). These ceilings, compounded by ‘debt brakes’ and by the commitment to balanced budgets in the medium term, are not simply counter-productive in the context of Europe’s emerging second Great Depression; they belie the historical experience of countless states that maintained far higher levels of debt (Japan, Italy, Belgium), particularly in periods of recovery and reconstruction after World War Two (UK, Netherlands). The Rogoff/ Reinhart hypothesis of a 90% debt threshold – beyond which fiscal affairs become unsustainable – has been shown to be both fallacious<sup>29</sup> and astonishingly damaging to the recovery of both output and fiscal balances. European states have thus been wrongly encouraged by such economic ‘wisdom’ to persist with austerity as the only means of restoring state finances. Secondly, arbitrary ceilings on borrowing generate *artificial triggers for credit ratings agencies* to question the solidity of sovereign bonds and for associated widening of bond spreads, further narrowing states’ fiscal room for manoeuvre. Thirdly, subordination to ECB limits *encourages states to use ‘competitive’ rates of direct taxation* as lures to companies and individuals to shift their assets and their investments from higher tax jurisdictions.

The disastrous beggar-thy-neighbour competition in corporate tax reductions between EU member states, which accelerated after 2000, has been maintained since 2008, albeit at a slower pace (see Figure 4.1 below). The chart also reveals the marked disparity between groups of member states within the EU. The Commission, in its otherwise extensive annual survey of *Taxation Trends*, chooses not to compare corporation tax (CT) rates in newer member states – notably in Central and Eastern European Countries (CEECs) – and in the old EU15 in its statistical database, or between smaller and larger states. The differences, however, are telling, with significantly lower rates in both CEECs and smaller states like Ireland. A comparison also shows that the acceleration of the downward trend coincided with eastern enlargement; Ireland’s now notorious 12.5% CT rate was only announced in 1999 and implemented in 2003, that is only after the CEE rivals for inward investment (and profit-shifting) had themselves introduced sharply lower rates of both capital taxation and personal income tax. By 2007, seven of the ten CEECs had adopted *flat rate* (non-progressive) systems of personal income tax (PIT); Slovakia reintroduced a higher marginal rate for top incomes in 2012 and the Czech Republic levies a 7% surcharge on top incomes, but all CEECs remain more reliant on regressive indirect taxes. The toleration by the Santer Commission of the first flat tax regimes in the Baltic States in 1995/96 represented a critical and *damaging non-decision* of the region’s policy-makers. It strengthened the ability of corporations to play one member state off against another and reinforced tax competition. After 2013 further reductions in the (top) CT-rate are planned by Denmark, Slovenia, the UK and Greece; the damaging race-to-the-bottom goes on.

<sup>29</sup> Thomas Hernden, Michael Ash & Robert Pollin, ‘Does high public debt consistently stifle economic growth. A Critique of Reinhart and Rogoff’, Political Economy Research Institute, Amherst, Working Paper 322, 2013.

Figure 4.1: Rates of corporation tax within the European Union 1980-2013 in %



Source: World Tax Database; Taxation Trends in the European Union (2013). EU5: F, G, It, Sp, UK; EU10: Bul, Cz, Est, Hu, Lat, Lit, Pol, Rom, Slovakia, Slovenia; EU15: Aus, Bel, Den, Fin, Fra, Ger, Gre, Ire, It, Lux, Neth, Por, Sp, Swe, UK.

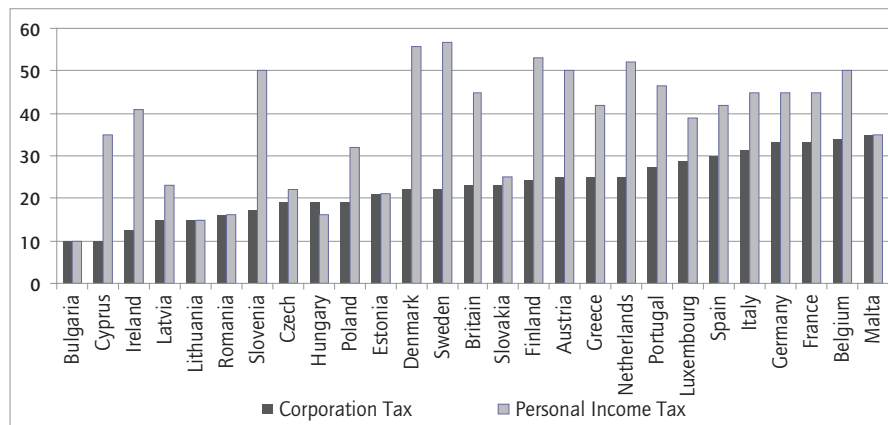
Figure 4.2 indicates, firstly, that the lowest corporation and personal income tax rates apply in the new member states of CEE (nine of the bottom 11 countries for CT); with the exception of Slovenia, the EU10 also have lower PIT rates. Low rates of (progressive) direct taxation are correlated with *lower potential for redistribution and the reduction of income disparities*. Table 4.1 indicates a hierarchy of redistributive fiscal potential, with the EU15 considerably better placed on average than CEE member states and with a markedly tapering potential in the Baltic group of EU member states and the aspirant member states of the Western Balkans; Montenegro’s top CT and PIT rate is a mere 9%.

Figure 4.2 also shows a marked disparity between a low rate of corporation tax (applicable notably to mobile TNCs) and a higher top marginal rate of personal income tax (applicable to less mobile non-incorporated companies/ mostly SMEs). This has unsurprisingly produced a trend of ‘incorporation’ on the part of smaller companies, keen to avoid the tax penalty evident in the average EU15 disparity of 20 percentage points between a PIT-rate of 47.61% and a CT-rate of 27.47%.<sup>30</sup> The distortionary effect of this disparity/ anomaly is fundamentally anti-competitive, favouring larger transnational companies, even before they deploy further ‘tax efficiency’ programmes. *Tax avoidance* through

<sup>30</sup> Ruud A. Mooij, & Gaëtan Nicodème, ‘Corporate Tax Policy and Incorporation in the EU’, CPB Netherlands Bureau for Economic Policy Analysis, The Hague, 2008; Joanna Piotrowska & Werner Vanborren, ‘The corporate income tax revenue paradox: evidence in the EU’, European Commission/ Taxation and Customs Union: Working Paper No 12 – 2007.

the ‘income shifting’ facility of incorporation *within* one tax jurisdiction can (and frequently is) supplemented by ‘profit-shifting’ *from* a high- to a lower-tax jurisdiction.<sup>31</sup> The obvious contradictions of company taxation within and between countries, as members of a common economic space, thus feed directly into a process of tax.<sup>32</sup> This in turn forces states to shift the burden of taxation to less mobile tax bases, namely domestic consumption and wage income. In the context of a *greater inequality of market incomes* in advanced economies over the last three decades, it is unsurprising that *net income inequality* in those economies has increased at an unprecedented speed.<sup>33</sup> The EU’s toleration of both the abandonment of the principle of progressive income taxation and the erosion of progressivity in the real management of tax affairs thus strikes at the heart of the region’s social policy traditions and ambitions. The chaos of tax competition within Europe also gives the lie to the Commission’s confident statement that the ‘EU provides a framework and offers instruments to effectively handle cross-border tax issues’!<sup>34</sup>

**Figure 4.2: Standard rate of corporation tax & top marginal rate of personal income tax EU27 2013**



Source: European Commission, Taxation Trends in the European Union 2013

31 Alfons Weichenrieder, ‘Profit-Shifting in Europe: Evidence from Germany’, *International Tax and Public Finance*, 16, pp. 281–297, 2009; Sol Picciotto, ‘Is the International Tax System Fit for Purpose, Especially for Developing Countries?’, *International Centre for Tax and Development*, Working Paper 13, 2013.

32 Philipp Genschel, Achim Kemmerling & Eric Seils, ‘Accelerating Downhill: How the EU Shapes Corporate Tax Competition in the Single Market’, *Journal of Common Market Studies*, Vol. 49, Issue 3, 2011.

33 Özlem Onaran & Georgos Galanis, ‘Is aggregate demand wage-led or profit-led?’, *National and global effects*, ILO, Geneva, 2012.

34 [ec.europa.eu/taxation\\_customs/taxation/tax\\_fraud\\_evasion/role\\_of\\_the\\_eu/index\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/tax_fraud_evasion/role_of_the_eu/index_en.htm)

**Table 4.1: Average rates of direct taxation by European regional groupings**

Country Group	Average CT Rate %	Average (Top) PIT Rate %
EU15	27.47	47.61
EU27	22.8	37.37
EU10 (CEECs)	17.4	23
Baltic States+	17	19.6
Western Balkans*	10.8	11.6

Source: Taxation Trends in the European Union 2013. + Latvia, Lithuania, Estonia; \* Albania, Bosnia-Herzegovina, FYR Macedonia, Montenegro, Serbia.

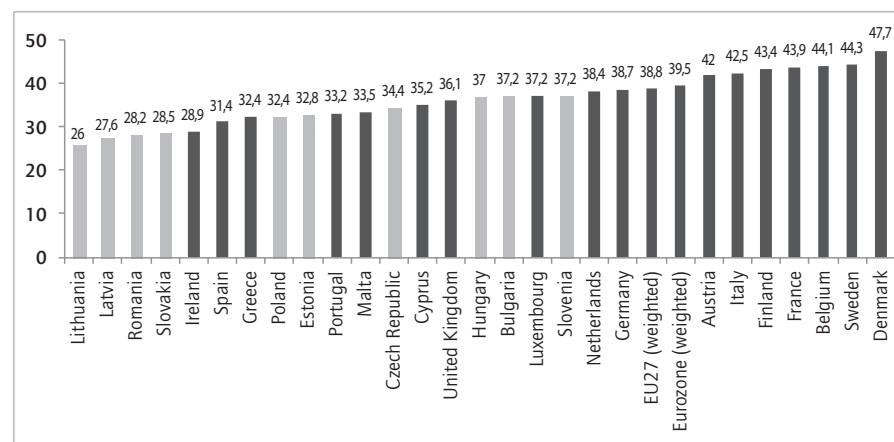
Parallel to this neglect of the principle of progressive taxation in EU enlargement policy was the neglect of any guidance over the fiscal requirements of the modern/ modernising European capitalist state or the need for new member states to converge with the norms of fiscal potential typical of older member states, in particular the approximate levels of taxation as a proportion of GDP that are necessary to sustain/ ensure the provision of public goods (physical and social infrastructure) that are the precondition of self-sustaining civilized societies and productive political economies.

Despite some clear differences between the tax ratios of the older member states, most maintained state/ tax ratios of 40% or more of GDP up until 2000. The states of the EU15 had, in the main, already achieved levels of public goods provision considerably higher than CEECs before that date. The newer member states of southern Europe (the former dictatorships of Greece, Spain and Portugal) displayed lower tax ratios than the EU15 average (CEECs shown by light columns in Figure 4.3). These were less the result of disparities in nominal tax rates – all three had similar marginal PIT rates and CT rates to other members of the EU15 – than of poor tax governance and worse compliance cultures.<sup>35</sup> In all three cases the fiscal vulnerability of a low tax ratio was compensated by both the fiscal transfers of the EU’s Structural Funds and the healthy rates of economic growth that accompanied their transitions to democracy. After the outbreak of the 2008 crisis, however, this vulnerability (see Figure 4.3) was evident in the more drastic transfers associated with bank bailouts, and the austerity conditions imposed by the Troika; Greece and Portugal, along with Ireland, did not enjoy the critical mass of revenue that could either finance independent crisis management programmes or guarantee at least adequate medium-term revenue-flows to hold speculative bond-traders at bay.

35 See Yiorgos Ioannidis, ‘The peculiar distributional character of the Greek taxation system (1995–2008) and the reform that never took place’, *Conference Paper, EuroMemo Group*, London, September 2013.

The fiscal challenge for the CEECs in their transition process was arguably more daunting than for the joiners in the 1980s, particularly if they wished to retain some kind of sovereign control over that process. This would have meant modernising their infrastructure and productive apparatus, adapting these to the competitive conditions of the regional and global market AND ensuring the welfare of their citizens sufficiently to retain the (territorial) loyalty of a (generally skilled) workforce and prevent large-scale emigration. However, in the context of a dominant neo-liberal paradigm and a complacent western triumphalism over marketisation, the reality of CEE transition proved to be entirely different.<sup>36</sup> Thus, the agency for guiding and sustaining CEE transition was not to be the democratically legitimated public sector but the ‘market’ or rather the preferences of major European transnational corporations, in particular financial corporations. The EU and its member states played a facilitating rather than a directing role, hindering a sovereign state transformation, in particular by maintaining a monetarist hegemony and imposing arbitrary limitations on sovereign borrowing (Maastricht, Stability and Growth Pact), and by encouraging extensive privatisation of both productive and infrastructural assets – where west European corporations were the primary buyers. In the absence of strong domestic capital markets, CEECs had little option but to accept the primacy of imported capital and the internationalisation of their banking institutions.<sup>37</sup>

Figure 4.3: Ratio of tax revenue to GDP in the EU27 2011 in %



Source: Taxation Trends in the European Union 2013

36 Joachim Becker & Rudi Weissenbacher, ‘Berlin Consensus and Disintegration. Monetary Regime and Uneven Development in the EU’, in W. Dymarski, M. Frangakis & J. Leaman (eds.), *The Deepening Crisis of the European Union: The Case for Radical Change*, Poznan, 2013.

37 See Jan Toporowski, ‘Neo-Liberalism: The Eastern European Frontier’, in Alfredo Saad-Filho & Deborah Johnston (eds.), *Neoliberalism: A Critical Reader*, London, 2005

Figure 4.3 above shows that all CEECs had lower tax ratios than the EU27’s weighted average of 38.8%. With the exception of Slovenia, but like Greece, Portugal and Ireland, none of the EU10 were in a position to finance crisis management programmes, even though CEE recessions were far more severe than in the EU15; nor, significantly, were the EU10 encouraged to adopt counter-cyclical measures by the EU-Commission; rather, all CEECs, with the exception of Poland (that narrowly escaped recession) were issued with excessive deficit warnings, often when their deficit/ debt levels were far lower than those of the EU15;<sup>38</sup> the Commission took an entirely different view of the stimulus measures adopted by the major EU15 states after October 2008, claiming – quite fraudulently<sup>39</sup> – a co-ordinating role in that process.<sup>40</sup> Apart from revealing the complete failure of the whole macro-economic policy architecture of the EU, the crisis exposed the historical failure of the Commission and Council, either to achieve any meaningful degree of harmonisation in member states’ systems of direct taxation or to avoid asymmetrical erosion of the fiscal state within the Union, as evidenced by the colossal disparities in revenue cultures, revenue ratios and fiscal ambitions since enlargement.

### 4.3 Halting European fragmentation and conflict through tax harmonisation

For all the rhetoric of the past five years about a ‘war’ against tax havens, tax evasion and tax avoidance by companies and individuals – resulting in the concrete proposals noted above – the core policy thrust of the Commission and the Council has remained deeply imbued with the spirit of neo-liberalism and a continuing rejection of the active state. Rather, the EU’s annual Report on Taxation Trends repeatedly asserts that the ‘EU remains a high tax area’<sup>41</sup>, with the implication that convergence downwards towards Japanese, US and Australian tax ratios would render Europe more competitive and boost its growth potential. Assertions like this confirm that, institutionally, the EU remains in thrall to the dangerous neoliberal myth that a high tax ratio is an obstacle to growth and prosperity. As the Tax Justice Network and others have shown, high tax ratios (as in Scandinavian states) by no means stifle growth and innovation.<sup>42</sup>

38 Jeremy Leaman, ‘The size that fits no-one: European Monetarism reconsidered’, in Eduardo Chiti, Agustín José Menéndez & Pedro Gustavo Teixeira (eds.), *The European Rescue of the European Union? The Existential Crisis of the European Union*, Oslo, 2012.

39 The Commission claimed credit for little more than convening a couple of summits; there were no coherent, Union-wide initiatives to harmonise crisis management of 27 member states.

40 Jeremy Leaman, ‘Weakening the Fiscal State in Europe. The European Union’s Failure to Halt the Erosion of Progressivity in Direct Taxation and its Consequences’, in: Chiti, Eduardo, Agustín José Menéndez & Pedro Gustavo Teixeira (eds.), *The European Rescue of the European Union? The Existential Crisis of the European Union*, Oslo, 2012.

41 European Commission, *Taxation Trends in the European Union*, 2013, pp. 21 & 23.

42 N. Shaxson & E.M. O’Hagan, ‘Mythbusters: A competitive tax system is a better tax system’, Tax

The current crisis provides ample confirmation of the frailty of states with low tax ratios and a high dependence on imported capital.

The last five years of crisis-mismanagement have failed both to address the underlying determinants of Europe's multiple crises and to initiate sensible reforms of fiscal policy, either within the euro area or in the wider EU. The disaster of the Fiscal Compact repeats the fiscal subordination of member states to arbitrary deficit and debt limits, while doing nothing to halt and reverse the trend of economic divergence within both EU17 and EU27.

Without fiscal convergence and strengthened public finances, the European project is doomed and, along with it, the chance of a genuinely transformative social agenda. The measures that are required to achieve the fiscal foundations of social progress and genuine civilisation in Europe, and to prevent beggarly-neighbour tax competition, tax-poaching and free-riding, can be summarised as follows:

1. All states of Europe should commit to the principle of progressive taxation as the foundation for a fairer distribution of income within states and between states.
2. There should be an approximate harmonisation of the scales of progression, basic allowances and marginal rates both at the bottom and the top of those scales for personal income tax.
3. There should be a closer correspondence of rates of corporation tax to the rates applying to assessed income tax for non-incorporated businesses, to avoid income- and profit-shifting and to ensure a fair contribution of capital to the public goods which benefit all economic agents.
4. There should be a coordinated system for corporate taxation with a strengthened version of the proposed CCCTB, to prevent the continued exploitation by transnational corporations of the opportunities for tax avoidance which greatly reduce their effective marginal tax rates, giving them unfair competitive advantages and resulting in significant losses of tax revenues.
5. All member states should commit themselves to transparency and automatic information-exchange on both personal and corporate incomes. The legislative initiatives already approved by the European Parliament on the Savings Tax Directive and a Common Consolidated Corporate Tax Base should be urgently promoted. The CCCTB should be deployed with Combined and Country-by-Country-Reporting to facilitate a comprehensive 'unitary' system of business taxation.<sup>43</sup>

Justice Network, 2013 at [www.taxjustice.net/cms/upload/pdf/TJN\\_NEF\\_130418\\_Tax\\_competition.pdf](http://www.taxjustice.net/cms/upload/pdf/TJN_NEF_130418_Tax_competition.pdf); see also ITEP, 'States with 'High Rate' Income Taxes are Still Outperforming No-Tax States', Washington D.C., 2013 at [www.itep.org/pdf/lafferhighrate.pdf](http://www.itep.org/pdf/lafferhighrate.pdf)

43 Sol Picciotto, 'Is the International Tax System Fit for Purpose, Especially for Developing Countries?', International Centre for Tax and Development, Working Paper 13, 2013.

6. Tax-avoidance facilities in European and overseas tax havens must be eliminated, along with the widespread use of 'brass-plate' shell companies by the financial services sector.
7. The trend towards a greater dependence on regressive indirect taxation should be halted with a better balance between progressive direct taxation and taxes on consumption.
8. The destructive dynamic of European tax competition needs to be eliminated in the interests of solidarity and sustainable frameworks of governance. A community of shared interests and values cannot tolerate the existence of fiscal 'free riders' that either poach the tax bases of other jurisdictions or fail to police compliance with agreed standards of taxation; the exceptionally low levels of corporation tax in several European countries defy the principles of solidarity required of a closely integrated group of nations.

Taxation – most notably direct taxation – is a key vehicle for reducing the disparities of income and wealth and for ensuring the social security of all its citizens. It is also the foundation for a culture of social solidarity, which acknowledges both the need for the collective funding and maintenance of public goods and the desirability of social equity, equality of opportunity, shared burdens and shared rewards as the guarantee of what Wendell-Holmes rightly termed 'civilization'<sup>44</sup>.

44 Oliver Wendell-Holmes, erstwhile Associate Justice of the US Supreme Court, is quoted as having said: 'I like to pay taxes. With them I buy civilization', cited by Government is Good, <http://www.governmentisgood.com/articles.php?aid=17>.



## 5 Employment and social policy

### 5.1 The worsening social impact of the financial crisis

The EU has entered its fifth year of sustained and deep economic crisis followed by unprecedented increases in unemployment and poverty across much of the EU.<sup>45</sup> There is very little sign of economic recovery, except very modest growth in the richer northern countries. Even here the economic recovery is very weak with no indication that fruits of recovery will be shared by the majority of population, and the share of wages in GDP has been declining steadily in several northern European countries. Centre right governments in many countries have legitimised their austerity programmes and the cuts imposed in public expenditure and the suppression of wages and living standards by falsely arguing that budgets have to be balanced lest a Greek style crisis and adjustment follow.

The unemployment figures give important pointers to the scale of the social crisis. According to the latest EU figures unemployment in EU27 stood at 26 million of whom 19 million were in the EU17 (the euro area).<sup>46</sup> They constituted 12% of the work force. More alarming is the number and percentage of those unemployed who are below the age of 25. In EU27 the young unemployed numbered 5.7 million of whom 3.6 million were in the EU17 area. These figures represented about 23% (nearly one in four) of the youth in these areas. High as the overall unemployment rates are, they conceal the wide variation in unemployment across the EU, as shown in Table 1.1. As noted in chapter 1, the EU has devoted €6 billion euros to tackle youth unemployment but this will be inadequate in view of the scale of the issue.

Rising poverty has been another social implication of the financial crisis. Based on an at-risk-of-poverty measure of 60 percent of the median of equivalised disposable income, the EU estimated that 16.4% in the EU27 were at risk of poverty in 2010, with some variation across different countries. The highest poverty rates were reported in the Southern and Eastern European member states, where one in five people were at-risk-of-poverty compared with a figure of about 10% in the Netherlands and Norway. It is important to point out that although the more developed welfare states of Northern Europe can provide better social protection than the Southern countries such as Greece it is in the crisis-struck peripheral countries that social conditions have most deteriorated.

<sup>45</sup> A recent study from Eurofound documents a comprehensive and multi-dimensional increase in inequalities following the crisis. Eurofound, 'Third European Quality of Life Survey – Quality of life in Europe: Social inequalities', Publications Office of the European Union, Luxembourg, 2013.

<sup>46</sup> The figures in this section are drawn from Eurostat, *Income distribution statistics*, 2013; Eurostat *Recent developments in unemployment at European and member state level*, 2013.

The latest data show a striking increase in poverty. At the level of the EU27 poverty has increased to affect 24% or one in 4 of the EU population. (See table 5.1) The impact has been recorded in the recent report of the International Federation of Red Cross and Red Crescent Societies (IFRC), which reveals increased referral to the local centres of member societies across the EU, in particular in the Southern and Eastern crisis countries, for food and medical support.<sup>47</sup>

<sup>47</sup> International Federation of Red Cross and Red Crescent Societies, *Think differently, Humanitarian impacts of the economic crisis in Europe*, Geneva, 2013.

**Table 5.1: At-risk-of poverty or social exclusion rate by age group, 2011  
(Percentage of population in each category)**

	Total	Children (0-17)	Adults (18-64)	Elderly (64+)
Euro area	22.6	24.9	23.2	18.2
EU27	24.2	27.0	24.3	20.5
Belgium	21.0	23.3	20.0	21.6
Bulgaria	49.1	51.8	45.2	61.6
Czech Republic	15.3	20.0	15.1	10.7
Denmark	18.9	16.0	20.5	16.6
Germany	19.9	19.9	21.3	15.3
Estonia	23.1	24.8	24.2	17.0
Ireland	–	–	–	–
Greece	31.0	30.4	31.6	29.3
Spain	27.0	30.6	27.1	22.3
France	19.3	23.0	20.1	11.5
Italy	28.2	32.3	28.4	24.2
Cyprus	23.5	21.8	20.8	40.4
Latvia	40.1	43.6	40.9	33.2
Lithuania	33.4	33.4	33.6	32.5
Luxembourg	16.8	21.7	17.6	4.7
Hungary	31.0	39.6	31.7	18.0
Malta	21.4	25.8	20.1	21.5
Netherlands	15.7	18.0	17.0	6.9
Austria	16.9	19.2	16.2	17.1
Poland	27.2	29.8	27.0	24.7
Portugal	24.4	28.6	23.2	24.5
Romania	40.3	49.1	39.0	35.3
Slovenia	19.3	17.3	18.7	24.2
Slovakia	20.6	26.0	20.6	14.5
Finland	17.9	16.1	18.0	19.8
Sweden	16.1	15.9	15.4	18.6
United Kingdom	22.7	26.9	21.4	22.7
Iceland	13.7	16.6	14.3	4.5
Norway	14.6	13.0	15.9	11.4
Switzerland	17.2	18.9	13.9	28.3
Croatia	32.7	32.2	32.5	34.0

Source: Eurostat (November 2013).

Unemployment is closely related to poverty. In 2010, 45% of the unemployed in the EU27 were at-risk-of-poverty. But employment has not been a guarantee against poverty, with 8.4% of the employed population across the EU27 being at risk. Another at risk group is the elderly. In 2010 14% of the retired people were at risk in EU27, but the rates were much higher in Cyprus (41%) and Bulgaria (30%).

The social policy ambitions laid out in the Europe 2020 programme are both limited and contradictory in view of the current trajectory of region-wide cut-backs. Even the modest objectives of a 75% labour market participation ratio for 20-64 year-olds, the reduction in school drop-out rates to below 10%, raising the proportion of school leavers in tertiary education to 40% and reducing by 20 million the number of those in poverty or at risk of poverty, look increasingly unobtainable.<sup>48</sup> The Commission's own surveys show 40 million people within the EU suffer from severe levels of deprivation; 80 million are below the poverty threshold of 60% of median income; in 2010 already 115 million were adjudged to be at risk of poverty, including 27 million children.<sup>49</sup> The EU 2020 'vision' of removing 20 million from the risk of poverty would still leave 95 million in that category; this is an unacceptable level of social deprivation in the world's most affluent region.

## 5.2 Precarious working conditions

The financial crisis and the ensuing economic downturn has heavily tipped the balance further against labour. Flexibility of labour and deregulation of labour market were on the agenda of the EU well before the crisis. It is almost ten years since the European Parliament considered any new social legislation. There now even seems to be a retreat from the employment standards established in the past: for example the European Federation of Building and Woodworkers reports that EU labour ministers have failed to agree on effective enforcement of the Posted Workers Directive. The financial crisis and continuing recession reinforced the trend towards more flexible contracts and other changes to working conditions that have greatly weakened labour's bargaining position vis-a-vis capital.

There is no agreed definition for precarious work, but according to one recent study the main indicators include: '... inability of individuals to enforce their rights, where social insurance protection is absent, where health and safety is put at risk and where work does not provide sufficient income to enable people to live decently. Insecurity is another key element of precarity. It encompasses work uncertainty, income insufficiency, lack of protection against

<sup>48</sup> European Commission, Europe 2020 Targets, 2011.

<sup>49</sup> Eurostat, 'Population and Social Conditions', *Statistics in Focus*, Brussels: Eurostat, 9/2012.

dismissal, an unknown length of employment and uncertainty about future employment. Another factor that promoted precarious work was the issue of the lack of qualifications or a mismatch between the qualifications that workers have and those required where jobs are available. Thus the issue is not just one of under-qualification but increasingly, in a Europe whose citizens are possibly in possession of higher formal qualifications than ever, of over-qualification in relation to the jobs on offer.<sup>50</sup>

The International Metal Federation succinctly counts as the characteristics of precarious work:<sup>51</sup>

- Direct hire on temporary labour contracts,
- Hiring of labour via employment agencies or labour brokers,
- Contracting out functions to other companies,
- Personal labour contracts for bogus 'self-employed' workers,
- Abusive probationary periods,
- Disguised employment training contracts,
- On call / daily hire,
- Illegal or involuntary part-time work,
- Home work.

In 2010 the European Working Conditions Survey reported that 80% of employment contracts in the EU27 were of indefinite duration, leaving 20% or one in five contracted workers in a different situation.<sup>52</sup> These are not all in precarious condition but recent studies have confirmed not only the precarious situation of this large cohort of workers but their worsening situation. Short-time work is another indicator of precarity. The number of short-time workers in the EU15 increased by 30% from 680,000 in 2006 to 980,000 in 2012.<sup>53</sup> A similar picture emerges if we consider the proportion of workers with indefinite contracts. McKay et al report that by 2010 only 57% of workers in Greece, 61% in Ireland and 68% in Spain had indefinite length contracts compared to 80% on permanent and 20% on temporary contracts for the whole EU27.

There is also a gender dimension to precarity – women are affected more than men. The crisis has accelerated the process of informalisation of work, especially in sectors where women are overrepresented. More recent figures for the population working in precarious conditions are difficult to obtain, because of the lack of agreed definition on precarity across the EU, but taking short-time work and part-time work as indicators it is clear that precarity has been on the increase since the crisis. According to a study by the European

50 S. McKay, S. Jefferys, A. Paraksevpoulou & J. Keles, *Study on Precarious work and social rights. Carried out for the European Commission* (VT/2010/084). Working Lives Research Institute, Faculty of Social Sciences and Humanities, London Metropolitan University, EU-Study Precarious Work Survey of 2010, 2012, pp. 8-9.

51 ITUC, *Living with economic insecurity: women in precarious work*, 2011.

52 McKay et al, *Precarious work and social rights*.

53 OECD Labour Statistics, 2013

Foundation for the Improvement of Living Conditions, between 2007 and 2011 part-time work increased in every EU27 country except Poland, while involuntary part time work increased in most countries, and dramatically so in Greece, Ireland, Spain and Italy.<sup>54</sup> The International Federation of Red Cross and Red Crescent Societies (IFRC) report provides ample evidence that precarious work is spreading in the EU with particularly devastating effects in the Southern European crisis countries.<sup>55</sup>

In many countries part-time or temporary work does not qualify for social security contributions and this in turn prevents access to social security support. McKay et al note that growth in the number of non-standard labour contracts across EU has led to the exclusion of many workers from welfare benefits.

### 5.3 What is to be done?

How can this trend to increasing poverty and vulnerability be addressed? In the short term EU bodies must change the financial rules and constraints which are having such disastrous social consequences. It should be noted that the social impact of stabilisation and adjustment policies are not part of the mandate of the EU 'Financial Assistance' programmes, nor that of its 'Task Force' that has been established to provide technical assistance to the Greek government.<sup>56</sup> It is imperative that such EU bodies as the 'Directorate General for Employment, Social Affairs and Inclusion,' with specific mandates and a wealth of expertise on social issues such as poverty and unemployment should be directly involved in assessing the austerity programmes. The use of structural funds to reinforce austerity programmes must cease – social needs, not compliance with 'fiscal consolidation' programmes, should determine expenditures.

The D.-G. Employment has promoted a useful programme to provide work experience or training to the young unemployed. This programme needs to be adequately funded, as do similar interventions to assist the unemployed and to relieve poverty. As a second step and in consultation with national bodies and international institutions the EU should provide contingency support to some key areas such as health care to assist the crisis countries to tide them over the short and medium terms.<sup>57</sup> In this regard the IFRC and its member

54 European Foundation for the Improvement of Living conditions, *Impact of the crisis on working conditions in Europe*, 2013.

55 International Federation of Red Cross and Red Crescent Societies, *Think differently, Humanitarian impacts of the economic crisis in Europe*, Geneva, 2013.

56 European Union, *Financial Assistance to Greece. EU Commission, Economic and Financial Affairs*, 2013: 'The purpose of the Task Force is to identify and coordinate the technical assistance that Greece needs to deliver of the EU/IMF adjustment programme and accelerate the absorption of EU funds. Its work focuses on economic growth, competitiveness and employment and it provides quarterly progress reports to the Greek authorities and to the European Commission. The Task Force is based in Brussels with an office in Athens.'

57 The existence of drug shortages in Greece is indicative of the mismanagement of the financial crisis

organisations can provide valuable information and support.

But the impact of the crisis is not limited to the short term: the threat to the EU population lies in the fact that long term growth in many of the crisis countries could be compromised for a protracted period. Current pro-cyclical macro-economic policies look set to ensure that levels of deprivation will increase rather than recede. What is required is a radical and differentiated approach to state finances and the strengthening of social programmes to prevent further fragmentation and a re-commodification in the supply of public services.

Beyonds immediate measures, it is necessary to give legal force to a completely different set of values, giving the social rights of EU citizens priority over competition rules and fiscal constraints and requiring all member states to improve social conditions in parallel with economic development. The idea of a social contract between citizens and the state should be put at the heart of economic and social policies at European level in order not only to mitigate and eventually eliminate the negative social impact of the crisis but to move towards a more equitable, democratic and prosperous Europe.

## 6 Industrial policy

### 6.1 In and after the crisis. The need for industrial policy to shape the way out

Opening up a debate on industrial policy in Europe and especially in the European Union is an urgent task. The political obstacles facing a new industrial policy are indeed huge, and major changes will be required in order to implement it. But the results of such efforts could be very important – ending the depression, creating new high wage and/or poverty proof jobs where they are most needed, greater EU cohesion and public action, progress towards an ecological transformation of Europe, greater democracy in economic decision making.

The way out of the crisis in Europe will depend on the forces that will determine the reshaping of the economy that will take place. The dominant industrial players, at present, are large firms with transnational systems of production. They are operating under the pressure to give priority to short-term profit maximisation imposed by financial investors. Most of the large firms' strategies do not question the traditional industrial model based on technologies and production techniques with a heavy environmental impact and they prefer to be left alone, if not actively supported, by political powers in developing and implementing their own strategies. This is true in spite of campaigns that seek to promote corporate social and environmental sustainability.

If decisions are left to the big economic players, the aftermath of the crisis in Europe is likely to be marked by a permanent loss of productive capacity and jobs; by a reduced ability to develop new technologies and economic activities; and by a more internationalised and more polarised industrial structure, with a higher level of concentration in the hands of a few firms within industries, both globally and within Europe. The challenge of overcoming the crisis and building a 'greener', globally more just economy represent an opportunity for orienting economic change in a more desirable and sustainable direction. The tools for achieving such change seem to be simple, well known and effective – *industrial and innovation policies*. In many European states, such policies shaped the highly successful expansion of industrial production from the 1950s to the 1970s. In new industrial countries they are combining public and private efforts to develop knowledge, to acquire technologies, to invest in new activities, and to expand foreign markets.

The example of European states in which globally competitive, technologically advanced, mid-sized firms constitute an important driver of industrial innovation (Germany, Austria, Denmark, Finland, the Netherlands and Sweden) shows that the creation and development of productive structures that facilitate product-led competition and continuous innovation is possible. Current policies – imposed by the EU and national governments – aim at a 'supply-side'

growth policy where one of the main solutions to the ‘lack of competitiveness’ is an ‘internal devaluation’ – driving down prices and wages through austerity measures. Such an approach further destabilises the lagging economies of the European ‘periphery’, pushing them further into a depression. The alternative is a pro-active industrial policy that could help exit the crisis, reduce imbalances within Europe and drive a long-term socially and ecologically sustainable development in the regions and the member states.

## 6.2 Why the kind of industrial policy advocated by the European Commission is insufficient and misdirected

Industrial policy has for a long time played a marginal role in the policies of the European Union, not least due to the disrespect in which traditional corporatist (as in the European Coal and Steel Community) or statist (French ‘planification’) models had fallen since the crisis of the Fordist model of development in the 1970s. However, a new debate is now emerging on the role of politics, of EU institutions and of member states’ governments in shaping the dynamics of industries within the European market and, by increasing competitiveness, strengthening the global role of the EU.

European Union policies on the evolution of economic competitiveness and ‘security’ activities are now framed in the Europe 2020 strategy, approved in June 2010 by the European Council. It provides the new framework for economic policy in Europe, replacing an officially ‘improved’ Lisbon Strategy which was supposed to inspire Europe’s policies in the previous decade.

In the Lisbon Strategy the EU set the goal ‘to become the most competitive and dynamic knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion’. A comprehensive economic strategy was announced ‘preparing the transition to a knowledge-based economy and society by better policies for the information society and research and development (R&D), as well as by stepping up the process of structural reform for competitiveness and innovation and by completing the internal market; modernising the European social model, investing in people and combating social exclusion; sustaining the healthy economic outlook and favourable growth prospects by applying an appropriate macro-economic policy mix’.

The Europe 2020 strategy follows this same trajectory, identifying three priorities: ‘smart growth’: an economy based on knowledge and innovation; ‘sustainable growth’: a resource efficient, greener and more competitive economy; and ‘inclusive growth’ a high-employment economy with social and territorial cohesion. By 2020 the EU is supposed to reach five ‘headline targets’ through a wide range of actions at the national and EU level, but the specific policy tools

for achieving such goals appear limited. Eight ‘flagship’ initiatives are associated to priority themes for re-launching Europe.<sup>58</sup>

In October 2012 the Commission adopted another communication on industrial policy, an update of the industrial policy flagship initiative – ‘A Stronger European Industry for Growth and Economic Recovery’. In this communication the Commission launched a new partnership between the EU, its member states and industry. It focused its proposals on four pillars:

1. Investment in innovation, with a focus on six priority areas with great potential (advances manufacturing technologies for clean production; key enabling technologies; bio-based products; sustainable industrial and construction policy and raw materials; clean vehicles and vessels; smart grids);
2. Better market conditions, both in the internal market, with special reference to goods, entrepreneurship and intellectual property rights protection, and in international markets;
3. Access to finance and capital, by a better mobilising and targeting of public resources, including from the European Investment Bank, and by unlocking private funds; and
4. The development of human capital and skills, so as to promote job creation and better anticipation of, and investments in, the skills needed to promote industry’s competitiveness.

This partnership has been launched by the Commission in order to favour a recovery of industrial investment. It is intended that there should be a common commitment by all European industrial policy actors to reverse the declining role of industry in Europe from its current level of around 16% of GDP to at least 20% of GDP by 2020.

Current EU industrial policies, however, have two fundamental weaknesses. The first one lies in the basic approach, where market mechanisms remain dominant, major industry players are not challenged, and political priorities that could provide a long-term orientation for economic activities are not identified. In particular, there are three unduly neglected issues relating to European industrial policy which should have been given special prominence in the run-up to the European Council in December 2013:

- The ambivalent and dual use military dimension of industrial policy,
- The Connecting Europe Facility linked with the Europe 2020-Project-Bonds-Initiative, and
- Specific stakeholder negotiations on the aims and objectives to be pursued by an industrial strategy in the medium and long term.

These three issues are significant for the overall development of the EU, its global competitiveness and its global role. It is also significant for the EU’s approach to financialisation, as well as to the issue of ‘different speeds’ and to the

<sup>58</sup> European Commission, *Communication from the Commission: Europe 2020. A strategy for smart, sustainable and inclusive growth*, 2010.

EU's processes of 'peripheralisation'. There are several issues which they fail to address, let alone to correct:

- The distortion imposed by military expenditure, both on the development of productive capacities (by turning away knowledge resources and technological capabilities from other urgent, peace-related tasks), and on the structure of international politics (by giving an undue prominence to military capabilities);
- The neo-mercantilist orientation of the EU development model, which neglects the need for the internal development of the countries involved and which focuses on the possibility of importing goods and services from trade partners, instead of realizing possible synergies between different industrial sectors within the EU or indeed more widely;
- The long-standing trend towards polarisation between regions, as well as between member countries within the EU, which is leading to a concentration of industrial production in a some countries and to a destructive de-industrialisation in many others.

The second major weakness of current EU industrial policies is their inability to shape change in Europe's industries. They lack adequate resources and no significant EU-wide resources have been made available to member states. They are constrained by the priority given to anti-trust and open market policies (including the dangerous prospects opened up by the proposed EU-US free trade agreement discussed in chapter 7). EU industrial policies also lack an adequate governance mechanism, and industry lobbies are likely to continue to influence and to dominate outcomes. The lack of democratic processes and of broader participation in decision making has emerged as a major weakness of the present attempts at renewing European industrial policy, in which deregulated market competition is treated as the only alternative to the apparently discredited corporatist and statist models.

### 6.3 An alternative agenda for European industrial policy

Decisions on the future of the industrial structure in Europe have to be brought back into the public domain. A new European-wide industrial policy is required to overcome the limitations and failures of past experiences, such as the collusive practices between political and economic powers, the heavy bureaucracy, and the lack of accountability and economic initiative. Such policies should be transformative and selective. Decision making for selecting priorities should be based on democratic mechanisms that are inclusive of different social interests, and open to civil society and trade union voices. They have to introduce new institutions and economic agents, and new rules and business practices that may ensure an effective and efficient implementation of such policies.

There are six major dimensions to be addressed by such a new type of industrial policy:

1. Exiting the current depressed conditions requires a substantial increase in demand, that could be created by a Europe-wide public investment plan for socio-ecological reconstruction.
2. A pro-active approach to industrial development is urgently needed in order to reverse the changes in Europe's economic structure which have resulted from the dominant obsession with global competitiveness and 'security', and from the major loss of industrial capacity that occurred after 2008 as a result of the crisis.
3. Innovative large-scale economic activities that could offer useful new products and services, and provide new employment opportunities will not emerge spontaneously. An EU-wide industrial policy is required to drive the emergence of new environmentally sustainable, knowledge intensive, high skill and high wage economic activities.
4. The massive privatisations of past decades need to be reversed. New activities should be provided with substantial support from the public sector. Decision making should be democratised and re-oriented towards social and ecological sustainability. Investment priorities should be set at the EU, national, regional and local levels so as to create employment and to fight poverty, social exclusion and ecological destruction. Public action should provide direction and support for private-sector activities, including the development of competences and economic initiatives, access to capital, and the organisation of new markets. The public sector could also be harnessed to directly produce public goods, such as knowledge, environmental quality, well-being, social integration and territorial cohesion.
5. A new trend towards a different kind of 'security' connected with disarmament, greater cohesion and reduced imbalances within the EU and individual countries has to be established, concentrating action on the countries of the 'periphery' and on the less favoured regions of the 'centre'. Current changes in Europe's industrial structure open up a growing divide between a relatively strong 'centre' and a 'periphery', where a large share of industrial capacity is being lost and where the imbalances within the EU (and within individual countries) continue to deepen in terms of knowledge base, investment, trade, employment and incomes.
6. The urgent need for an ecological transformation of Europe requires a major new policy tool. Turning Europe into a sustainable economy and society – reducing the use of non renewable resources and energy, protecting ecological systems and landscapes, lowering CO<sub>2</sub> and other emissions, reducing waste and generalising recycling – goes well beyond the emergence of new environmentally friendly activities; it is a transformation which concerns the whole economy and society. A new EU-wide industrial policy could provide the framework for integrating the different policy tools needed for making Europe sustainable.

Specific activities that could be targeted include: (a) the protection of the environment and the promotion of renewable energy; (b) the production and dissemination of knowledge, applications of ICTs and web-based activities; (c) health, welfare and caring activities; (d) the support of initiatives for socially and ecologically sustainable solutions to food, mobility, construction, energy, water and waste problems.

EU procurements for domestically produced sustainable goods and services may be extremely useful for achieving both targeted short-run expansionary goals, and long-run improvements in productivity dynamics. The new industrial policy has to be firmly set within the European Union and – if required – within the institutions of the euro area. This is needed in order to coordinate industrial policy with macroeconomic, monetary, fiscal, trade, competition and other EU-wide policies. It is also necessary in order to realise the ‘common values’ claimed by the EU, providing full legitimisation of public action at the European level for influencing what is being produced, and how. Major changes are required in current EU regulations, in particular the ones that prevent public action from ‘distorting’ the operation of markets. The expansion of economic activities that markets are unable to develop should become an explicit objective of EU policy. The EU level is crucial also for funding sustainability policies. As this policy is likely to meet opposition from some EU countries, a ‘variable geometry’ EU policy could be envisaged, acting effectively without the countries that do not wish to participate.

A close integration should be developed between the European dimension, providing policy coherence, overall priorities and funding, the national dimension – where public agencies have to operate – and the regional or local dimensions, where specific public and private actors have to be involved in the complex tasks associated with the development of new economic activities.

Existing institutions could be renewed and integrated in such a new industrial policy, including – at the EU level – the Structural Funds and the European Investment Bank (EIB). However, their mode of operation should be adapted to the different requirements of the role here proposed. While in the short term adapting existing institutions is the most effective way to proceed, in the longer term there is a need for a dedicated institution – either a European Public Investment Bank, or a European Industrial Agency – coherent with the mandate of reshaping economic activities in Europe.

A system should be created according to which EU governments and the European Parliament agree on the guidelines and funding of industrial policy, and call upon the EU Commission to implement appropriate policy tools and spending mechanisms. This could be achieved by an inter-institutional agreement between the Council, the Parliament, and the Commission. In each country a specific institution – either an existing or a new one, either a National Public Investment Bank, or a National Industrial Agency – should assume the role of coordinating the implementation of industrial policies at the national

level, interacting with the existing national innovation system, policy actors, the financial sector, etc. More specific Agencies, Consortia or Enterprises, with a flexible status, but a strong public orientation, could be created (or adapted from existing European Agencies like CEDEFOP) for action at the local and regional level and for initiatives in particular fields. The institutions at the national and local level should take responsibility for spending decisions, identifying the private firms to be supported, the projects to be developed, the new public activities that are required. And they should have to be subject to strict democratic monitoring.

Funds for a Europe-wide industrial policy should come from Europe-wide resources. It is essential that troubled national public budgets are not burdened with the need to provide additional resources and that national public debt is not increased. Different arrangements could be envisaged. As suggested by the proposal of the German Trade Union Confederation DGB ‘A Marshall Plan for Europe’<sup>59</sup> – funds could be raised on financial markets by a new European Public Agency; it could obtain the Europe-wide receipts of a once-for-all wealth tax and of the newly introduced Financial Transactions Tax; such income could help cover interest payments for the necessary projects that are not profitable in market terms. An alternative may come from a deeper European fiscal reform introducing an EU-wide tax on corporations, thus effectively eliminating fiscal competition between EU countries. Perhaps 15% of proceedings could go to fund industrial policy, public investment, knowledge generation and diffusion at the EU level; the rest could be transferred to the countries’ treasury.

For the group of euro area countries, financing through EMU mechanisms could be considered. Eurobonds could be created to fund industrial policy; a new European Public Investment Bank could borrow funds directly from the ECB; the ECB could directly provide funds for industrial policy.

<sup>59</sup> German Trade Union Confederation DGB, *A Marshall Plan for Europe*, December 2012.

## 7. The EU-US transatlantic trade and investment partnership

### 7.1 External competitiveness as the solution to the economic crisis?

With GDP growth of around 2% p.a. in the period 2012-2013, the performance of the world economy has remained below long-term averages since the outbreak of the global financial crisis in 2007. Accordingly, global trade growth, which had been twice GDP growth during the last 20 years, slowed dramatically to around 2.0% in 2012. A good portion of this decline in global economic activity has to be attributed to the economic crisis in the EU. EU imports from the rest of the world have recovered only slowly from their fall in 2009, while EU exports to the rest of the world have quickly regained their momentum. As a consequence, in 2012 the surplus in the external trade balance of the EU of €255 billion (EU27, trade in goods and services) has grown by a factor of eight since 2008. For 2013, the surplus is projected to grow even further. With global trade growth stagnating, this development in the external economic position of the EU is remarkable. Firstly, it is attributable to stagnant import demand in the EU, particularly in the crisis countries. Secondly and more importantly, it has to do with the strong export growth not only by traditionally export-oriented countries around Germany, but also by crisis-hit countries like Spain and Greece. Germany had a trade balance of nearly €140 billion in 2012, having more than doubled its surplus with the rest of the world since 2008. Between 2008 and 2012, extra-EU exports grew by 43% in Spain and by 146% in Greece.<sup>60</sup>

These developments are a clear reflection of the prevailing crisis resolution strategies of the EU, which emphasize that the exit from the economic crisis needs a substantial increase in the external competitiveness of the EU economy. The export success of Germany has become the role-model for EU crisis-hit countries to follow. This is based on the idea that a contraction of internal demand via fiscal austerity policies, together with a severe reduction in nominal wage, will improve the cost position of EU export industries and thus have a positive impact on net exports.

In reality, the increase in EU net exports was clearly facilitated by the strong growth performance of the emerging countries, which were the main drivers of growth in the world economy. Thus, for instance, EU exports to Asia rose by more than 30% between 2008 and 2011, against a growth rate of 18% for total extra-EU exports over the same period. However, as trend growth in the emerging countries has been slowing down recently, particularly in Brazil, India and to some extent also in China, it is very unlikely that EU exports will be able to grow at the same pace in the near future. The EU focus on stimulat-

ing export growth as a crisis resolution strategy will eventually run into severe difficulty.

In order to support the export orientation of EU economies, efforts to increase market access for EU companies have been intensified by external trade policies. Already with the communication 'Global Europe: Competing in the World', from October 2006, as well as the 2010 sequel 'Trade, Growth and World Affairs', the European Commission signalled a clear shift in the direction of its trade policy, from multilateralism to an enforced use of bilateral agreements. In a first phase the Commission aimed, on the one hand, at a progressive liberalisation that would reach beyond existing World Trade Organisation (WTO) obligations or obligations from existing bilateral agreements (WTO+ agreements). On the other hand, it targeted countries with considerable economic dynamism and with extensive trade barriers in place against EU imports and investors. Thus, the EU entered into negotiations with four ASEAN countries (Malaysia, Thailand, Singapore, Vietnam), the negotiations with Singapore being the most advanced. A landmark Free Trade Agreement (FTA) was concluded with South Korea in 2011, while FTAs with five countries from Central America entered into force in late 2013. The EU and Japan launched formal negotiations for a comprehensive FTA in April 2013, while negotiations with Canada on a bilateral free-trade agreement (CETA) were almost finalised by the end of 2013. Negotiations on an agreement on investment with China are planned to start in early 2014.

The increasing number of bilateral initiatives has recently been topped by the announcement in early 2013 that the EU and the US agreed to enter into negotiations on a bilateral FTA, the so-called Transatlantic Trade and Investment Partnership (TTIP). Formal negotiations commenced in July 2013. The proposed agreement is intended not only to reduce tariffs between the world economy's two biggest trading blocs. Its primary aim is to focus on a very comprehensive set of regulatory issues and rules, with a view to dismantling and harmonising these in areas such as agriculture, food safety, product and technical standards, sectoral regulations in services, the protection of intellectual property rights, and government procurement. In addition, investment liberalisation and protection will be a central issue. With the WTO Doha round negotiations having been stalled since 2008, and all major advanced industrialised as well as emerging countries resorting to trade bilateralism in order to secure their respective economic interests, the TTIP has to be seen as a project with a geopolitical ambition. It is both a reaction to the growing economic and political influence of the BRIC countries, in particular China, and an attempt to construct a new global benchmark for the regulation of trade and investment.

<sup>60</sup> Own calculations, all data from EU Ameco Database.



## 7.2 Putting democratic governance at risk – a critique of the EU approach to trade policy

The Commission has recently devoted a great deal of effort to communicate the perceived political and economic benefits which the TTIP is expected to deliver to the EU. Several studies were commissioned which purport to show economic welfare gains. The most widely cited CEPR study claims annual income gains for the EU to be in the size of €120 billion per year in the best-case scenario of ‘ambitious liberalisation’.<sup>61</sup> This amounts to less than 1% of EU GDP (2012), and will only be realised after a transition period of 10 years. Of these welfare gains, 80% are expected to accrue from the removal of regulations as well as from the liberalisation of the trade in services and government procurement. Labour displacement, i.e. job losses, is estimated at 0.2% – 0.5% of the EU labour force or 0.45 – 1.1 million persons. The methodologies used for these kinds of estimations are deeply flawed (see Box 1 for a detailed discussion). But even on the basis of these figures, the economic case for the TTIP is unimpressive.

With average tariff barriers between the EU and the US already at a very low level (below 5%), the negotiations will focus on what is called regulatory convergence and cooperation. According to EU Trade Commissioner De Gucht this includes (i) designing a process on how to cooperate on regulations in the future, (ii) harmonising existing regulations, including through mutual recognition, and (iii) supporting work in both blocs with the appropriate regulatory institutions. At first sight this might appear to be a reasonable agenda, but it actually raises several serious problems. Firstly, regulatory standards in many areas are very different between the trading parties. This includes highly sensitive public policy areas such as food safety, human, animal or plant health, and environmental protection. Secondly, regulatory philosophies in some areas are diametrically opposed to each other. In the EU, the application of the precautionary principle has resulted, for example, in a ban on GMO food. By contrast, the US cost-benefit approach has resulted in the widespread employment of business-friendly methods such as GMO plants, the use of hormones for meat production, or the application of chlorine dioxide for the disinfection of slaughtered animals. The US side has made it very clear that it wants EU regulations in these areas to be removed or the US standards to be recognised via mutual recognition. Thirdly, there are major differences between the EU and the US approach to data privacy and the exchange of private data. There are diverging regulatory approaches, reflecting distinct social preferences, which have been enshrined in legal norms and regulations. Fourthly, it is therefore

61 CEPR, ‘Reducing Transatlantic Barriers to Trade and Investment: An Economic Assessment’, March 2013; ECORYS, ‘Non-Tariff Measures in EU-US Trade and Investment: An Economic Analysis. Final Report’, 2009

paramount that the TTIP does not impair the democratic debate over these issues in the future. What is particularly worrisome is that both sides plan to set up ‘an institutional basis for further progress’ on regulation.<sup>62</sup> The so-called ‘non-papers’ put forward by the Commission in June - ‘initial position papers’ for the TTIP – contain some information on this. One example is the proposal to establish ‘A streamlined procedure to amend the sectoral annexes of TTIP or to add new ones, through a simplified mechanism not entailing domestic ratification procedures.’<sup>63</sup> This announcement to foster cooperation between regulators through the TTIP thus presents a threat to the democratic prerogative with regard to public policy, in particular the competence of parliaments to define the direction and contents of public regulation.

Another problematic element in the TTIP relates to new privileges for investors. Apart from increasing market access to hitherto protected sectors, and measures that would reduce or forbid discriminatory treatment of foreign firms or the protection of strategic industries, the Commission seems ready to accept investor-to-state dispute settlement (ISDS) in the TTIP. While a regular feature of many bilateral and regional investment agreements, it has until recently not been included in EU trade agreements. ISDS gives investors equal status with governments and allows them to enforce their rights via suits before international private tribunals, where private-sector lawyers are empowered to take decisions which might order governments to pay unlimited compensation to investors, without appeal. The experience so far clearly shows that the ability of governments to enact legislation in the public interest may be severely curtailed by the threat of being confronted with compensation claims by big multinational firms. While ISDS was originally introduced into investment treaties in order to secure fair treatment for investors in foreign countries with supposedly low-quality legal systems, this argument cannot be cited for the EU and US themselves. Fair treatment and due process before courts is in general warranted.

Perhaps the most important criticism of ISDS concerns the impediments it will impose upon democratic decision-making in the public interest. The attractiveness of ISDS for business rests upon a very broad and totally unacceptable notion of expropriation that not only includes the damage that results from the investment costs incurred in the past (e.g. for setting up a nuclear power plant), but also the foregone profit of the investment during the remainder of its originally planned lifetime. For instance, if a government decides to phase out nuclear energy, which will force a foreign investor to shut down a power plant 20 years before its planned operating end, the investor is currently entitled to claim compensation for lost profits. This actually happened in the

62 High Level Working Group on Jobs and Growth, Final Report, 11 February 2013, p. 4. [http://trade.ec.europa.eu/doclib/docs/2013/february/tradoc\\_150519.pdf](http://trade.ec.europa.eu/doclib/docs/2013/february/tradoc_150519.pdf)

63 European Commission Non-paper, ‘TTIP: Cross-cutting disciplines and institutional provisions’, 20 June 2013.

case of the Swedish energy company Vattenfall, which sued the German government in 2012, seeking €3.7 billion in compensation for lost profits related to Germany's decision to phase out nuclear energy. As a result of such situations, ISDS has experienced a boom during the last two decades. According to UNCTAD, there were 514 known cases up to the end of 2012. Not surprisingly, 123 of these were filed by US investors, with EU investors from the Netherlands (50 cases), the UK (30) and Germany (27) following.<sup>64</sup> Given the vast amount of bilateral investment between the US and the EU, it is clear that investors will see ISDS as a welcome opportunity to discipline governments on both sides of the Atlantic.

Another central concern relates to the issue of the liberalisation of financial services, which is also an important part of the negotiations. Notwithstanding the lessons of the recent global financial crisis, the negotiations intend to give more rights and protection to the financial industry, while the safeguarding of financial stability and the protection of consumers do not seem to be taken adequately into account. Strikingly, the EU Commission seems to follow a more radical approach than the US. The Obama administration has so far issued reservations on two key EU demands, namely to include a regulatory cooperation framework on financial services in the agreement, as well as to opening ISDS to the financial industry.<sup>65</sup> Given this overall approach, it is quite likely that negotiations will lead to the lowest common denominator in financial regulation.

64 Seattle to Brussels Network 'A Brave New Transatlantic Partnership. The proposed EU-US Transatlantic Trade and Investment Partnership (TTIP/TAFTA) and its socio-economic & environmental consequences', Oct. 2013.

65 M. Vander Stichele, 'TTIP Negotiations and Financial Services. Issues and Problems for Financial Services Regulation', Centre for Research on Multinational Corporations (SOMO), 16 October 2013

### Box 1: A critique of the EU's assessment of the impact of the TTIP

The European Commission commissioned two impact studies on the TTIP, one completed in 2009 (ECORYS) and the other in 2013 (CEPR).<sup>66</sup> ECORYS produced calculations of the costs to be saved by the firms in each sector from either removing the regulations or having mutual recognition of regulations across the Atlantic, called 'non-tariff measures' (NTMs). The CEPR then used these results as an input to a model to predict the broader economic effects that removing regulations would have, depending on the degree to which they were removed. Some seemingly precise findings emerge, such as an overall gain for the EU of €119.212 billion from the 'comprehensive ambitious agreement-scenario'. A closer look at the impact

66 CEPR, 'Reducing Transatlantic Barriers to Trade and Investment: An Economic Assessment', March 2013; ECORYS, 'Non-Tariff Measures in EU-US Trade and Investment: An Economic Analysis. Final Report', 2009

assessment, however, leads to serious doubts about these findings. Just some of the major flaws are mentioned here.<sup>67</sup>

In the ECORYS study, the costs of the NTMs to exporting firms are established in a four-step procedure. First, a survey was carried out of 5,500 firms in a range of countries both inside and outside the EU, which were asked to rate between 0 and 100 'the overall level of restrictiveness of the US (EU) market for your export product (service) in this sector'. In a series of steps, this was turned into a percentage tariff equivalent. Upon this basis precise calculations are provided as to the level of benefits from removing the NTMs, a precision that seems to give scientific weight to the results. It however turns out that these are calculated from original data that have quite a high degree of unreliability. Basic issues include, firstly, what appears to be highly variable answers from different firms about the degree of 'restrictiveness' of the non-tariff barriers.<sup>68</sup> This fundamentally calls into question the reliability and accuracy of the basic data used for the subsequent steps. Secondly, while the benefits of removing the NTMs for firms are taken into account, the potential costs to society of, for example, a lower level of food safety standards are not considered. Thus, the cost/benefit analysis systematically neglects the benefits of regulation to society.

The CEPR study feeds the results from the ECORYS study into a computable general equilibrium model. This raises a number of further questions about the final results obtained, not least about who would gain from the new arrangement. *Firstly*, the changes in wages projected by CEPR, for both the EU and the US, are almost exactly the same as the changes in GDP, which means that labour (wages) shares proportionally in productivity gains with capital (i.e. gross profits). This would require a major historical change of direction, as it is entirely out of line with the historical experience over the last few decades. Both in the US and the EU the share of wages declined continually from the mid-1970s. In the EU, for example, the wage share declined from 67% of GDP to 57% just before the crisis.<sup>69</sup> *Secondly*, the study assumes that there is no long-term unemployment.<sup>70</sup> On this basis, it is assumed that all those who become unemployed as a result of the trade deal will find jobs in other sectors. This is completely unrealistic for a variety of reasons including the fact

67 An excellent critique of how CGE models are in fact used in trade impact assessment is provided by Lance Taylor and Rudi von Arnim, 'Modelling the Impact of Trade Liberalisation: A Critique of Computable General Equilibrium Models', Oxfam, July 2006.

68 The methodological note accompanying the study admits that 'Measuring the importance of NTMs on bilateral trade flows from a survey is subject to some uncertainty, which is also reflected by quite large standard deviations.' ECORYS, 2009, Final Report, p. 13 n. 27.

69 AMECO database, variable ALCD0. The figures are for the EU15.

70 European Commission, 'Impact Assessment Report on the Future of EU-US Trade Relations', SWD(2013) 68, March 2013, Annex 3: 'Main Aspects of the CGE Model', p. 3.

that there is a high and growing level of long-term unemployment in Europe, and that the new jobs may be, for example, in Eastern EU countries with much lower wage levels than in the countries losing jobs, and labour mobility to these countries is most unlikely. *Thirdly*, further assumptions in the model are that perfect competition is assumed in most sectors in the model, including, remarkably, in finance and insurance. Perfect competition means that any gains in costs are passed on to customers, and most of the gains from the deal as projected in the model are assumed to be in that form. Much more prevalent in modern capitalism, however, is oligopolies, including in the sectors mentioned above, where much of the savings through productivity increases are not passed on to consumers.”

Impact studies on the proposed deal also predict a substantial reduction in trade within Europe, with, among other shifts, trade being diverted across the Atlantic. Another impact study on the proposed agreement, conducted in Germany, projects a substantial decline in trade within Europe, including an approximately 30% decline in the trade of the GIIPS countries with the rest of Europe if there is a major fall in NTBs.<sup>71</sup> This raises rather basic questions about the effect it would have on the unity of the European Union.

71 G. Felbermayr et al, Ifo, ‘Transatlantic Trade and Investment Partnership: Who benefits from a free trade deal?’, Bertelsmann Stiftung, 2013.

### 7.3 An alternative trade agenda is urgently needed

As it now stands the TTIP negotiations are almost exclusively biased towards corporate interests. This has to do with the disproportionate influence of business lobby groups upon EU (and US) policy-makers. What has to change in the first place is therefore the intransparent and confidential nature of the negotiations. Both the European Parliament and civil society must be fully informed about the state of affairs in the negotiations, and all the relevant documents must be published. This is imperative, since the core substance of these negotiations relates to central public policy issues, which must be discussed in the public domain.

A second concern relates to the problematic nature of the EU’s impact assessment exercises. Well-constructed models, as opposed to ones that lead almost inevitably to particular desired outcomes, could be useful in helping to explore the consequences of a transatlantic deal, but must be complemented by a number of other approaches to considering the likely impact such a deal could have. Individual studies should look at the likely consequences for such issues as labour rights and conditions, the environment, the institutional set-up being

proposed for future regulation, transparency, and democratic control. On none of these issues has an impact study been produced, which leaves huge empty spaces in the overall impact assessment. Participatory impact assessment could lead to more realistic and well-founded results. Research organisations commissioned for executing these studies should be genuinely independent and not be dependent on corporate funding.

As relates to the substance of the negotiations, the guiding principle must be that the public interest must be safeguarded. In concrete terms this means *inter alia*:

- No lowering of standards with regard to public health, public safety, the rights of workers and consumers, as well as the protection of the environment;
- No de-facto transfers of regulatory competences from democratic institutions to unelected technocratic bodies;
- No investor-to-state dispute settlement. The Commission’s proposal to insert a safeguard clause against ‘frivolous claims’ by investors is insufficient in this respect;
- No liberalisation and/or regulatory standstill with regard to financial services as well as public services (services of general interest), in particular in sectors such as health, social services, culture and water;
- No reductions in policy autonomy in crucial areas such as using public procurement for purposes of local development, or other public policy goals. Similarly subsidisation of local cultural production or education activities must be safeguarded.

Sacrificing vital public interests for some minimal and dubious economic benefits will make no positive contribution to exiting the economic crisis in Europe. On the contrary, successful crisis management as well as the pressing challenge of the socio-ecological transition necessitate a political system that strengthens the democratic realm, expands regulatory capacities and re-embeds transnational private capital into society. It is absolutely clear that the TTIP negotiations in its current form will make no positive contribution towards these ends.

European Economists for an Alternative Economic Policy in Europe – EuroMemo Group

## The deepening divisions in Europe and the need for a radical alternative to EU policies – EuroMemorandum 2014 –

List of signatories (as of Jänner 2014)

**Ackermann** | Tim | Bochum | Germany  
**Acocella** | Nicola | Rome | Italy  
**Adelantado Gimeno** | José | Barcelona | Spain  
**Ainley** | Patrick | London | UK  
**Alexiou** | Constantinos | Bedford | UK  
**Altmann** | Matthias | Nohra-Obergrunsted | Germany  
**Altvater** | Elmar | Berlin | Germany  
**Altzinger** | Wilfried | Vienna | Austria  
**Álvarez Peralta** | Nacho | Segovia | Spain  
**Andersson** | Jan Otto | Turku | Finland  
**Antunes** | Margarida | Coimbra | Portugal  
**Appelqvist** | Örjan | Stockholm | Sweden  
**Bartel** | Rainer | Linz | Austria  
**Bartl** | Marija | Amsterdam | Netherlands  
**Baum** | Josef | Vienna | Austria  
**Becker** | Johannes M. | Marburg | Germany  
**Becker** | Joachim | Vienna | Austria  
**Bellofiore** | Riccardo | Bergamo | Italy  
**Benyik** | Matyas | Budapest | Hungary  
**Berres** | Peter | Horstmar | Germany  
**Biagioli** | Mario | Parma | Italy  
**Bianchi** | Annaflavia | Bologna | Italy  
**Bieling** | Hans-Jürgen | Tübingen | Germany  
**Bierbaum** | Heinz | Saarbrücken | Germany  
**Binder** | Bernd | Berlin | Germany  
**Birg** | Thomas | Sprockkövel | Germany  
**Bischoff** | Joachim | Hamburg | Germany  
**Bispinck** | Reinhard | Düsseldorf | Germany  
**Blaas** | Wolfgang | Vienna | Austria  
**Bömer** | Hermann | Dortmund | Germany  
**Bontrup** | Heinz-J. | Gelsenkirchen | Germany  
**Botta** | Alberto | Reggio Calabria | Italy  
**Braña** | Francisco-Javier | Salamanca | Spain  
**Brand** | Ulrich | Vienna | Austria

**Brandt** | Peter | Hagen | Germany  
**Buchegger** | Reiner | Linz | Austria  
**Burkert** | Sylvia | Düsseldorf | Germany  
**Burley** | John | Divonne-les-Bains | France  
**Buzaglio** | Jorge | Stockholm | Sweden  
**Cabrilo** | Belmiro Gil | Lisbon | Portugal  
**Castells** | Angels Martinez | Castelldefels | Spain  
**Chhachhi** | Amrita | The Hague | Netherlands  
**Christen** | Christian | Berlin | Germany  
**Clarke** | Linda | London | UK  
**Colletis** | Gabriel | Toulouse | France  
**Colom** | Agusti | Barcelona | Spain  
**Cordonnier** | Laurent | Villeneuve d'Ascq | France  
**Corsi** | Marcella | Rome | Italy  
**Coutrot** | Thomas | Montreuil | France  
**Csoba** | Judit | Debrecen | Hungary  
**Czeskeba-Dupont** | Rolf | Roskilde | Denmark  
**de Arriba** | Raúl | Valencia | Spain  
**De Masi** | Fabio | Berlin | Germany  
**Debruyne** | Michel | Brussels | Belgium  
**Dellheim** | Judith | Berlin | Germany  
**Deppe** | Frank | Marburg | Germany  
**Deppe-Wortmann** | Friedel | Bochum | Germany  
**Derksen** | Herbert | Kleve | Germany  
**Detje** | Richard | Ahrensburg | Germany  
**Devine** | Pat | Manchester | UK  
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