INSTITUTIONAL CHALLENGES

A neoliberal EU by design?

Jordi Angusto


Margaret Thatcher durant una visita d'estat als EUA

While the far-right demonizes the EU for its lack of borders and the resulting ‘barbarian’ invasion, with too many immigrants ‘stealing’ jobs from ‘nationals’ and threatening local culture, the radical left argues that the EU’s institutional architecture is neoliberal by design, always favoring the interests of big business or, more generally, the ‘market’. To this end, the EU has emptied the Member States of the competencies required to guarantee social welfare without developing them itself and has reinforced the role of states as instruments for containing and repressing social unrest.

Hayek’s dream of the minimal state come true!

However, if what made the EU a tool of neoliberal doctrine were its design, not its political management, then redesigning it would be enough to put an end to this situation. The key thing would be to identify the characteristics of this ‘bad’ design and propose new and better ones. This is what Thomas Piketty and Yanis Varoufakis, among others, have done, offering interesting proposals to democratize EU institutions and provide them with the necessary budget to conduct economic policy, i.e. recover the social market economy and restore the currently threatened welfare state.

Both authors offer proposals to improve the EU as a common tool which would no doubt work, but they are unlikely to be implemented without first or simultaneously changing the pact among its members. A pact which is basic to EU architecture and may be defined by three key pairings: stability and growth; monetary centralization and fiscal decentralization; and no bailouts or fiscal transfers between states.

These three pairings are still in place, even though their intrinsic incompatibility has led to numerous instances of non-compliance by both individual and groups of states, such as the bailouts that proved inevitable, but not exactly out of solidarity with the states in question. Taken together, the three pairings reward opportunism (free-riding) and thus make social regression, or the race to the bottom, inevitable, as will be seen below.

Stability and growth

Stability and growth might appear synonymous with sustainable growth, and, as such, they would be difficult to oppose. However, stability in the EU is defined exclusively in terms of limits to the deficit (3%) and public debt (60%), below which a Member State is considered to be on the right path, and which effectively identifies public spending as the cause of all potential ills. With regard to growth, the unit of measurement is GDP, assuming that the higher it is the better this is for everyone. However, it is possible for GDP to grow without creating jobs or raising salaries, just favoring the few at the cost of the many.

This pairing thus has little to do with the idea of seeking socially inclusive and environmentally sustainable prosperity. Indeed, the idea of combining stability and growth, terms that are practically antonyms, is only intended to prevent growth in a Member State due to excessive public spending, which could harm other members by either causing a rise in interest rates, which are common to the eurozone, or because it could become unaffordable and end up requiring partners to respond, a possibility expressly excluded by the third pairing.

Consequently, the stability and growth pact aims to incentivize containment of public spending and compensate for the foreseeable lack of internal demand with external demand to generate growth. This would be perfectly feasible if the restraint on public spending was accompanied by and/or led to a drop in wages to increase competitiveness.

Figures confirm Germany as the winner in the eurozone by employing this very strategy: austerity, increased competitiveness and an enormous external surplus. By contrast, countries such as Spain, which up to 2007 was the example to follow and whose GDP growth and public debt reduction were well above the EU average, lost relative competitiveness to its ‘austere’ partners, built up a colossal external deficit and had no other choice than to accept, through a bailout, the conditions of the Troika, which were no other than the German strategy. Therefore: cuts in public spending and salaries, improved competitiveness and attractiveness to foreign demand.

All EU partners have had to apply this same policy as an inevitable consequence of the stability and growth pact, despite its very real and dangerous contradiction. Dangerous, to the extent that its reliance on external demand means a loss of autonomy and control, possibly generating an angry response from those who have to support a matching external deficit, as is the case with the USA under Trump. And contradictory, because all trade surpluses mean a lack of internal demand, which punishes both the citizens of today, through lower welfare, and those of tomorrow, through lower investment.

While the post-World War II social democratic pact used public spending to guarantee the welfare state and sufficient internal demand to ensure full employment, the stability and growth pact demonises public spending, while pulverising the welfare state and proving incapable of guaranteeing employment, which is only sustained by increasing precarity and through demand (or efforts) by other countries.

Monetary centralisation and fiscal decentralisation

Before the euro, the imbalance in competitiveness between EU partners, which produced matching external deficits and surpluses and was the ultimate cause of the subsequent bailout, could be limited through monetary policy, by interest rates set to suit the economic situation in each country, or adjustments to exchange rates through devaluing/revaluing currencies. It was thus possible to prevent German austerity from dragging down all other members. Indeed, from 1945 to 1999, the Deutsche mark multiplied its value compared to currencies such as the drachma, escudo, and peseta. And although devaluation is painful, it is less so than a cut in salaries, as the former shares the cost with those whose currencies are revalued.

Thus, the inevitable and accursed austerity might seem to have been due more to the single currency than the stability and growth pact. However, EU austerity has had an equal impact on countries with their own currency, such as the UK and USA, while differences in interest rates or a devaluation have failed to prevent them building up external deficits compared to German surpluses. And if austerity in the EU has profoundly undermined faith in the European project among citizens bearing the brunt of it, it does not seem have affected UK or US citizens any less: the former have voted to leave the EU and the latter for Trump.

The single currency might have accelerated the process of regression within the EU, but it is not the cause. Furthermore, in theory, Member States could use fiscal policy to prevent loss of competitiveness. But in practice, such fiscal policy may only be contractionary; an expansionary one, which would be obligatory for states with ‘excessive’ competitiveness, would breach the stability pact.

Theoretically, this should not necessarily affect members’ welfare states, as they have sovereign powers to set taxes and redistribute wealth. In practice, though, in an area of free and total movement of capital, who would dare raise taxes without risking flight of taxable capital? Moreover, who could resist lowering them to attract such capital? Clearly no one, given how taxes on corporate profits and capital in general have been cut.

Consequently, the route to avoiding or reducing public deficit has been reducing public spending and not increasing income, as the latter is limited by fiscal competition among the Member States.

Thus, fiscal decentralization, which in effect represents an explicit refusal of the EU to conduct fiscal policy, has brought about a race to the bottom in taxation, which is impossible to stop due, precisely, to fiscal sovereignty among the Member States and the need for consensus to change it.

No bailouts or fiscal transfers between states

Panic at the idea of turning the EU into a 'transfer union', where the wealthiest regions repeatedly transfer tax to the poorest, is the basic reason for the stability pact. Is this a selfish lack of solidarity among those who would be forced to transfer? Undoubtedly it is, but no more so than the selfishness of candidates for receiving the transfers. Furthermore, there are solid arguments against becoming a 'transfer union' besides morality, the main one being that it is a mechanism which can easily freeze regional disparities rather than reducing them, as shown by the examples of Italy and Spain.

The no bailout clause included in EU founding treaties is the ultimate obstacle to the 'transfer union', as it forbids them even in cases of extreme necessity. Indeed, the bailouts for the countries whose economies collapsed were not really made by the EU, but rather through a mechanism created alongside it, the European Stability Mechanism, established by intergovernmental agreement and, to make it even clearer, with the participation of the International Monetary Fund (IMF).

However, if the ultimate purpose of the stability pact was to avoid bailouts, the fact that they were required, and not even strictly speaking outside the EU, is proof of its absolute failure. Nevertheless, while a badly designed transfer mechanism can strengthen disparities, as is undoubtedly the case in Spain and Italy, it is also true that a well-designed one can help reduce them, as with German recovery after World War II thanks to financial aid from the Marshall Plan.

Secondly, those who want to maintain a permanent external surplus have to permanently finance those with a deficit. And whether this is in the form of loans or fiscal transfer, the results are similar. Would it not be much better to use surpluses to encourage others into eliminating their deficits?

Recovery

Defenders of the current EU *statu quo* praise the recovery seen in the bailed out countries, especially Greece, thanks to the pill of austerity: internal devaluation to gain competitiveness and external demand. Yet the fact is, based on their own indicators, their policy cannot be considered a success: GDP growth has been anaemic since the crisis, well below the USA, and public and private investment is still below pre-crisis levels.

After all, growth depends on investment, not external demand! This is the reason for the growth in China, whose external surplus has dropped, and the USA, which maintains a deficit. The world economy as a whole has no external demand but this has never prevented it from growing.

But ‘their’ recipes appear even worse in social and political terms. Socially, inequality and poverty have reached levels unheard of since the ‘Belle Epoque’ and real salaries and disposable family income in the bailed out countries, including Catalonia, are lower today than in 2000. Can anyone consider this a success?

In political terms, social discontent has been the trigger of growing xenophobia and populism and the rise of authoritarianism and illiberal capitalism, with forces of the far-right occupying ever more space in all European countries. This is also true in the rest of the world, but is that any consolation? Worse still: to what extent has the EU assisted its rise elsewhere? After all, what Trump so rudely demands today, in relation to the huge European trade surplus, Obama also demanded, but more politely and with no success, although China did take note and has switched to implementing an economic model less dependent on external demand, so that this year it has lost its trade surplus, even if it remains in Trump’s crosshairs.

Keynes versus Hayek

To a large extent, the social democratic pact that held sway in the West after the Second World War up to the 1970s had an empirical precedent in the New Deal, by which Roosevelt responded to the Great Depression after the 1929 Crash, and had its theoretical foundations in J. M. Keynes and his fear, shared by conservatives and social democrats alike, of the situation predicted by Marx: capitalism would continue to impoverish workers until communist revolution was inevitable, a destination Keynes considered as bad as revolution itself, inevitably stained with blood. To avoid it, his recipe consisted of making the state a guarantor of sufficient aggregate demand to ensure full employment, which would, in turn, facilitate growth in wages alongside productivity.

If this strategy facilitated the longest sustained period of high growth and social equality in history, why did it end with Hayek’s dream replacing that of Keynes? There is definitely a political answer, which includes the Reagan-Thatcher conservative revolution on both sides of the Atlantic. But there is also an economic reason, which undoubtedly underlies the political one. It is called ‘stagflation’ and it appeared in the 1970s and 80s when Keynes-based demand-side policies created only inflation rather than maintaining or creating employment. The economy had gone global and expansionary policies in a given country, which generally drives up prices before employment, ended up generating more activity and jobs in other, more competitive countries.

Welcome to supply-side policies to increase competitiveness! This proved the perfect excuse for taking the economy out of the hands of states and achieving wage cuts through offshoring or its threat. Along the way, through the Cold War with Russia and the hot one in

Vietnam, the USA lost the trade surplus with which it had forged its 'empire' and which allowed it to maintain dollar-gold parity. Without this parity, the international monetary architecture agreed on at Bretton Woods at the end of the Second World War disappeared.

The world becomes multilateral: a globalized economy with no rules and no equivalent world government. A paradise for transnational corporations with more power than most states. The EU arose out of this very context as a common European market, a big enough area to allow the emergence of corporations with the ability to compete with the Americans, governed by rules common to all associations of economic interests or cartels. This explains the 'pairings' described above and why the optimum strategy, as in all cartels, is the most opportunistic one.

Is there no alternative?

There is no such thing as society, said Thatcher; there is nothing except competing individuals. And if this was valid for a state like the UK, why would it not be so for a group of states? Yet the truth is precisely the opposite: the individual is not viable outside society and becomes less so by the day. Specialization at work has produced remarkable economic growth, but at the price of equally remarkable interdependence on a planetary scale. Exponential growth in world GDP, which only considers exchange in organised markets, gives an indication of how markets have absorbed all self-production and self-consumption which was possible outside markets: in remote places or in the family home.

The same right-wingers that previously claimed there was no such thing as a society now calls for the state to 'regain control'. The left does so too, although for different reasons. Not only was it false to claim there was no alternative to austerity and dismantling the welfare state to boost competitiveness, but such an alternative urgently needs to be implemented. The supposed virtues of the market make no sense without adequate regulation and, whatever the case, markets will never include negative externalities, such as pollution, nor drive actions and investment with positive externalities, such as health, education, and basic research.

Today's legacy of the neoliberal paradigm of competitiveness is climate emergency, lack of antibiotics, power more firmly in the hands of a few companies, an outrageous concentration of wealth, growing world desertification, the threat of extinction of hundreds of thousands of species and massive migration flows. All these challenges require actions from the state that no longer has such capacity, making multilevel world government that respects the subsidiarity principle a necessity; i.e. a strong government as close to the people as possible, which sends 'upwards' everything that requires action with a higher reach.

To a certain extent, this already exists. In 1820 there were 125 independent states, in 1914 there were 54 while today there are 190. As in earlier times, the nineteenth century was a century of conquest, of metropolises growing and absorbing ever more peoples. But in a finite world, outward expansion could only end in a world war, as was the case in two phases between 1914 and 1945, or in a single world government, as also partly happened with the creation of the United Nations. And the result of both things, wars, and relative world government, is that the world since then has seen the emancipation and secession of a multitude of peoples that have now become states.

Balance of competencies

Before the referendum on leaving the EU, the United Kingdom carried out an extensive assessment of competencies handed over to and/or shared with the EU. The conclusions suggest the ‘devolution’ of some and the strengthening of others. Depending on how one sees it, Brexit is the result of British proposals falling on deaf EU ears. As did French and Italian proposals not much later, not to mention those of the so-called Visegrád Group.

The EU is also a construction project arising from a process of multiplication of states (still unfinished, as sooner or later Catalonia and Scotland, among others, are likely to become states themselves) and the need for higher-level governance. And the question is clearly not whether to be in or out, but what balance of competencies there should be between the Union and the Member States: a federal union, which the aborted European constitution aimed to achieve, or a confederation, as manifested in current intergovernmental prevalence.

But whatever the balance, which in the end translates into the volume of resources and competencies granted to the Union, both scenarios need a new pact among partners that prevents opportunistic behaviour, such as fiscal dumping, abuse of dominant positions, or the ‘beggar thy neighbour’ approach of internal devaluations, which is after all what Germany did to gain EU hegemony.

Prosperity pact

Given that the stability pact and its fiscal rules were incapable of preventing the eurozone crisis, in which Spain serves as a paradigmatic example, and that when it came to correcting it, the cost was paid for entirely by the weakest, all of which led to the current economic dystopia, the first thing to do is to repeal it. There is no need to seek improvements to the current fiscal rules, as is being proposed by a growing number of think-tanks, it just needs to be repealed.

In its place, there needs to be an inclusive and sustainable prosperity pact, with the following characteristics: symmetric penalization of external surpluses and deficits; integrated fiscal policy; and regional convergence policy.

Symmetric penalisation of external surpluses and deficits

Realizing that adjusting exchange rates would not prevent abuse by a dominant country determined to maintain a surplus and finance its deficit through debt, Keynes proposed that the function of the IMF should be to compensate external imbalances whereby surpluses would be penalized twice as much as deficits. Because a surplus requires expansionary policies and job creation, while a deficit requires the opposite: contractionary policies and job destruction.

Unfortunately, this failed to happen and the IMF became the scourge of countries with external deficits. The EU is a similar case: the European macroeconomic imbalance procedure (MIP) includes limits to surpluses (6% GDP) and deficit (4%), but on a lower hierarchical level than the stability pact and with no mechanisms to enforce it. As a result, some countries have not paid the slightest attention to recommendations to reduce their surpluses, while fiscal austerity has been imposed on other countries to reduce their deficits. Thus jobs have been destroyed instead of created.

Without the stability pact, control of external balances would have been a coercive priority with a minimum degree of symmetry and equal limits and penalties for deficits and surpluses. Retrospectively, the EU should not have faced the international financial crisis with the center-periphery imbalances that existed at the time: countries with strong growth and external deficit, such as Spain, should have applied preventative containment measures and countries with lower growth and external surpluses, such as Germany, should have applied expansionary measures.

Thus this mechanism does not mean easing economic discipline among the Member States but allowing a country to do what it wants 'as long as it does not negatively affect' others. The impact of one country on another is not caused by fiscal balance but through external balance: public deficit can be compensated by private surplus within a country and vice versa, yet external surplus or deficit, as a sum of public and private demand, necessarily requires external compensation, a debt or loan which, by definition, cannot be simultaneous.

This is a preventive mechanism that also respects subsidiarity, and which needs to be applied between states and between regions, to prevent differences from leading to dependency and becoming chronic, as in the case of Italy and Spain, where fiscal deficits and trade surpluses have established vicious circles, thereby freezing disparities.

It is also a mechanism that requires gains in productivity to be converted into well-being, preventing it from leading to improvements in competitiveness or, in other words, abuse of a dominant position. Consequently, it is a basic part of the prosperity pact, not only for the country in question but also for other partners and the world, as it would reduce the competitive pressure created by the current EU external surplus.

Integrated fiscal policy

The largest beneficiaries of the European single market, multinational corporations, also contribute the least. According to European Commission figures, thanks to fiscal competition between the Member States, corporations avoid taxes to an amount equivalent to the whole EU budget: over 100 billion euros a year.

Both the European Parliament and Commission have repeatedly made proposals to end this, basically revolving around a common consolidated corporate tax base (CCCTB). Yet this has constantly come up against rejection among the states and the current need for consensus on fiscal issues, which needs to be changed immediately through the ‘new pact’. Indeed, the only serious proposal involves placing corporation tax in the hands of Europe and making it the EU’s main source of income. It would provide around 3% of GDP, three times the current EU budget, and would permit current state contributions to be eliminated, thereby giving the EU greater autonomy.

The situation is similar with the tax on wealth and large fortunes, where a lack of fiscal harmonization between countries means such wealth flees from where it is taxed highest to where it has to pay the least, including both community and extra-community tax havens, which only an institution such as the EU can combat. To do this, it must first break off all relations with countries involved in fiscal dumping and then implement a Europe-wide tax on large fortunes.

Both cases mean bringing a halt to the fiscal ‘race to the bottom’ that harms everyone; thus it represents a benefit to all, except for those who focus only on the very short term. It would also increase the European budget and reduce state contributions while facilitating an obligatory common fiscal policy. This would include: the capacity for stabilization of the economic cycle, raising or reducing debt as required; investing in community public assets, with energy transition as a priority; and funding a regional convergence plan to the benefit of all.

To the extent that the EU does not provide any public services, the provision of which should remain as decentralised as possible except for defence, which should be centralised, most of the European budget would continue to be used on transfers to the Member States and their regions, which would require the establishment of a transparent, fair and efficient distribution mechanism. Thus, such a mechanism would, over time, have to guarantee no region or state is a net receiver or giver, as it switches from one to the other depending on its economic cycle.

Regional convergence policy

The four countries that received the most community money before expansion to the east were Greece, Ireland, Portugal, and Spain. In other words, the four countries that later needed bailing out. Coincidence or cause? It is true that all external transfers increase internal demand and, if internal supply is not simultaneously increased, this leads to loss of competitiveness and the need for further transfers. In these four countries, the subsequent larger transfers were loans to the private sector, hence it is not clear which ones started the process and which ones caused the most harm. Whatever the case, without an external balance control mechanism, which could have prevented the loss of competitiveness, the result was inevitable.

This is also the case with interregional transfers in Italy and Spain, compensated by trade balances in the opposite direction, that have not helped reduce disparities. In both cases, both the European cohesion policy and interregional fiscal transfers are justified in terms of poorly understood solidarity, as it represents a non-existent benefit if the receiver is dependent on it or has to pay back much more at a later date.

The logic needs to change, applying the economic intelligence behind the Marshall Plan, where there was a benefit to both the European recipient and the American provider. After all, the least developed regions also have the greatest potential for development. This is particularly evident today when the climate emergency demands a search for renewable energy sources, most of which are found in the periphery: land, sun, wind, and forests. So let's develop the South to the benefit of all!

Conclusions

The EU is undoubtedly a child of its time and there is no doubt that as such it is not best suited to the present. However, its ability to change, or what will happen if it does or fails to do so, are not set in stone. For better or worse, its current perimeter is clear to all: little more than an association of economic interests in which each member looks to its own interests, without caring whether this harms others. Being fully aware of the EU's nature, different actors know full well how to treat it.

Financial markets have learned to apply different premiums to different countries, given the fragility of the union and the fact that no one wants to cover the debts of others. With regard to citizens, their expectations have adapted to reality. Thus, they expect little from it, though nor would they have it abolished. And as for the Member States, they have also learned to struggle with each other and with the Commission. They no longer blame Europe for anything, which means they do not expect much from it either.

Thus the EU could become something like the United Nations, whose existence is probably a good idea but which has little influence on either citizens or states' day-to-day business, and which no one has any plans to change or strengthen. Fortunately, the EU has elections which subject it to examination, unlike the United Nations. In other words, it is harder for it to go unnoticed and avoid being the subject of political debate.

With regard to the latter, this article argues that true reform of the EU requires a new 'pact between states', among all its current members or only those that want to go beyond the current situation. A pact the repeals the stability pact and replaces it with one for prosperity, which is inclusive and sustainable, not born out of fear and distrust and which puts citizens' interests first. A prosperity pact that restores and preserves the welfare state in Europe without threatening or ruining neighboring and third countries.

Jordi Angusto
Jordi Angusto is an economist, adviser to the Department of the Vice-Presidency and Economy and Finance of the Government of Catalonia and former vice-president of the Innovation Commission of the College of Economists. He is a specialist in public policy, and his career has focused on the city of Barcelona and the economic promotion of scientific and technological issues. He has been a professor at the Autonomous University of Barcelona and an economic advisor to the European Parliament.