The Great Recession of 2012–2014: The Monetary Union Challenged by National Egoisms

Pierre-Alain Muet

Abstract Eight years after the outbreak of the financial crisis, while the United States have for several years emerged from recession, Europe, after a long recession whose only precedent is the 30s deflation, has barely recovered the level of GDP per capita that existed before the 2008 crisis.

The argument developed in this article is that this crisis is inherent to a monetary union which has failed to build the political institutions necessary for its functioning. Coordination through rules is not enough. Without an "economic government" able to set up a discretionary coordination of fiscal policy, the monetary union has been unable to implement a policy mix suitable for the whole euro area and let deflationary policies develop, pushing the whole of Europe into depression.

1 Introduction

"No one should be surprised that the economy of the euro zone is once more going in reverse. This is an entirely predictable outcome of the misguided policies that European leaders stubbornly insist on pursuing, despite all evidence that they are exactly the wrong medicine." This New York Times editorial from August 2014 perfectly sums up how history will remember the absurd policies implemented by European leaders from 2011 to 2014—calling here and there for structural reforms and supply-side policies while the whole continent sank into a slump in demand caused by the generalization of austerity policies whose magnitude was never fully assessed.

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P.-A. Muet
Paris, France
e-mail: pam@pa-muet.com

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How did that happen? How have European nations been able to pursue policies so at odds with the history of European integration? How the principle of solidarity—a foundation of the European Union—could be so absent from our national economic policies?

2 Europe: From Financial Crisis to Deflation

In its scale, its roots and its consequences the crisis, which erupted in 2008, is comparable to the crash of 1929. Both are the outcome of two major phases of globalization and financial deregulation that preceded them. Both are born from the uncontrolled excesses of finance and an explosion of inequalities that fed artificial growth based on profitability requirements incompatible with the real economy.

The constant pressure on wages resulting from these profitability requirements has profoundly deepened inequalities between stagnating low incomes and exploding high incomes, leading to a tremendous accumulation of wealth in the hands of a small minority. On the one hand, the indebtedness of poor households took the place of increasing wages to maintain growth in demand, fueling an artificial growth based on debt. On the other, drifting high incomes fueled senseless risk taking, maintained by the proliferation of financial innovations, which led to a surge in asset prices until everything collapsed when market expectations turned sour.

Unlike the 1929 crisis, governments were able to extinguish the financial fire and prevent bank defaults through a massive injection of public funds, transferring bank debts to the states. They also took stimulus measures in all countries in 2009 to avoid a massive collapse in demand. But, as in the 30s, the crisis originated in the United States produced its most disastrous effects in Europe by triggering a sovereign debt crisis at the heart of the euro zone.

Yet the euro zone was much less indebted than the US and Japan, and the countries at the heart of the storm were—with the exception of Greece—countries which had in fact reduced their debt and deficits in the years preceding the crisis. But the continent was the most vulnerable to speculative attacks due to a monetary union without financial solidarity. Sovereign debt crises are self-fulfilling prophecies in the sense that when a country is attacked, its debt interest rates rise sharply and may make it insolvent. This vicious cycle can only be stopped in two ways: the default of the state in question or loans from other member states. But since the ECB cannot directly buy a state's securities and no solidarity mechanism existed between the states' debts due to the "no-bailout" clause of the Maastricht Treaty, the default of a state, never truly considered by financial markets during the first 10 years of monetary union, became credible. And if it was possible for Greece, it could become so for others. As Paul Krugman summed up, in establishing doubts about their supposed solidarity, European leaders have transformed the Greek bailout into a generalized crisis in the euro zone. It took indeed more than two years for the establishment of a European Stability Mechanism (ESM) to put an end to the speculative crisis.

Unable for several years to take steps to curb speculative attacks affecting some of its members, corseted in budgetary rules and economic policy principles of another age, Europe has imposed upon itself a dose of austerity whose main impact has been a massive collapse in production and employment and the longest recession ever known in Europe since the Second World War.

The appropriate response to the crisis was a policy implementing real financial regulations through the separation of banking activities, and a strong, national and European action in favor of employment and investment to come out of recession. In a way, these were the policies set out by Roosevelt in the 30s and whose generalization after the Second World War contributed to the long postwar period of financial stability and prosperity.

But it meant leaving the neoliberal dogma that dominates the European continent and led to austerity policies that plunged Europe into depression. This reasoning was, in the space of a presidential campaign, carried out by the French President François Hollande. But having failed to influence European policies, France's economic policy eventually merged into the prevailing European dogma, reflecting the inability of our continent to think and even build a relevant macroeconomic policy at the right scale: that of the monetary Union.

3 National Egoisms, Recession and Deflation

Coming out of the 2009 recession, almost all European countries faced increased public deficits and rising debts, to which was added the chronic lack of competitiveness of half the Eurozone countries. In applying an economic policy cocktail of massive cuts in public spending and reduced labor costs, which can be effective when a only one country is doing so, but leads to disaster when all do the same, Europe sank into recession and deflation; a replica, 80 years later, of the deflationary policies of the 30s.

When one single country undertakes to reduce public spending, the recessive effect is partly offset by the growth of its partners, so that tax revenues are not reduced too much and the end result is indeed a lower public deficit. But when all do the same, especially in a situation where growth is limited by demand, the depressive effect is so high that revenue losses offset spending cuts and the deficit is not reduced, or only slightly. The main result is to accentuate the recession.

The same pattern happens with labor costs. A country can actually improve its competitiveness by lowering labor costs, but it improves its situation while complicating that of its partners. If everyone did the same thing in Europe, the result would be nullified in terms of intra-European competitiveness; there remains only a general decline in prices, that is to say deflation! As for its effect on Europe's competitiveness as a whole, it would have been possible without deflation (and that was made in 2014) by devaluating the Euro.

The result is that we miss the three targets we had fixed: unemployment rises, the public deficit is only slightly reduced, the impact on the external intra-European

deficit is negligible, and as there is neither growth nor inflation, the debt ratio increases.

4 The Negation of Europe's Fundamental Values

It is little wonder that people are moving away from Europe and nationalisms rise everywhere. What happened in recent years on our continent is the very negation of what was the European construction. The constraints imposed on Greece by the Troika were as absurd as the reparations imposed on Germany with the Treaty of Versailles—which Keynes denounced at the time. The lesson had been learned by the Allies after World War II: instead of overwhelming the vanquished country, they reached out and it was instead a Europe of solidarity that emerged from the rubble of the war. A solidarity that went as far as to clear 60 % of the German debt at the London conference in February 1953 to allow West Germany to recover.

How can we accept that Europe, which for decades has managed to pull up all newly-joined countries, has done the exact opposite over the past three years? When Spain and Portugal joined the EU, many feared that wage competition would draw the wages of most developed countries down or generate strong relocations. This would probably have occurred if Europe had only been a large market. But fortunately there were solidarity mechanisms such as the structural funds that have encouraged the investment and modernization of new entrants so that convergence went upwards.

The hallmark of austerity budgetary policies or competitiveness by lower wage costs is to be non-cooperative, in that they will improve the situation of one country by damaging those of others. And it is the opposite for policies of demand stimulus or supply stimulation through innovation that also benefit partners by disseminating rising demand or innovation. Where cooperative policies generate an upward adjustment, non-cooperative policies engender a downward adjustment. One might think that after the deflation of the 30s, Europe would be terminally cured of non-cooperative policies. But the shortsightedness of the prevailing economic thought that has dominated Europe in the last decade has proved unfortunately boundless. And in the absence of a federal power worthy of the name—something the Barroso Commission never was—national egoisms have always prevailed over solidarity.

5 More Favorable Circumstances

When nations are unable to take control of their common destiny, a more favorable conjunction of stars can sometimes get us out of a recession. This is what fortunately happened with the oil price decline that loosened fiscal policy constraints and allowed broadly neutral policies across the EU in 2015. To this was added an

appropriate policy of quantitative easing from the ECB, the depreciation of the euro and the investment plan of the new Commission, which, although still modest given the needs in investment and growth, reflects a more favorable change in the direction of European policies.

If we want to prevent a downward adjustment from happening again, we must outlaw non-cooperative policies and favor competitiveness policies through innovation that benefit all; establish minimum wages differentiated by countries to link social progress and productivity gains and develop solidarity mechanisms that are desperately needed in the monetary union. Finally, Europe must once again become an area of solidarity and not a large market making states compete against each other.

This is even more necessary now that a Europe of 28 predominantly consists today of small countries for which non-cooperative strategies in a large market are more effective than participation in cooperative projects.

Since 2012, the annual diagnosis of three institutes (OFCE, IMK, ECLM)[1] has regularly fed the reflections of some political groups in Parliament (in particular the Socialists and Democrats group). It showed, in 2012, the risk of recession emerging in the Union because of the generalization of austerity policies and highlighted in the following years the deflationary risk facing the euro area. This had little influence over national economic policies, including in the states of the Union where social democratic parties were in power alone, or in large coalitions.

The euro crisis has shown that a monetary union with 18 different public debts on which markets can freely speculate, 18 tax and benefit systems in competition with each other and no executive worthy of the name, it does not work.

As noted by Joseph Stiglitz in a speech in Paris: Europe's main structural problem « is the problem of the structure of the euro-zone, not the structure of individuals countries ... The euro was a political project, where there was not sufficient political will to create an economic framework that would enable it to work ».[2]

6 A "Euro-Treaty" for a "Euro-Government"

The euro crisis has revived the debate on the political integration of the euro. In Germany, the Glienieker Gruppe's contribution, "Towards a Euro Union", emphasized Stiglitz's argument: "Europe has structural problems that require structural solutions. Even though this is not a popular view at the moment, we are convinced

[1]Independent Annual Growth Survey (IAGS) published yearly by the OFCE (Observatoire français des conjonctures économiques), the IMK Institute of the Hans Boeckler Foundation and the ECLM (Economic Council of the Labour Movement) Institute.

[2]Joseph Sitglitz: Speech to the French national Assembly, Paris, January 13, 2015 http://www.alterecoplus.fr/tribunes-debats/comment-sortir-la-zone-euro-de-lorniere-201502051824-00000762.html

that the monetary union needs deeper integration. More particularly, it needs a sufficiently powerful European economic government".[3] A converging reflection was published in France by the authors of the "Manifesto for a political union of the Euro",[4] whose proposals are widely echoed in this article. The Brexit debate and the disintegration of solidarity within the union of 28 make even more urgent a political response from the nations committed to the monetary union.

The first condition for change is a specific budget for the euro zone of around ½ percentage point to 1 percentage point of GDP, financed by own resources and with a borrowing capacity to boost recovery and investment initiatives. Powered by a European tax applying a lower rate to the corporation tax base, it would help to achieve within the monetary union the common consolidated corporate tax base, an essential tool to fight against the aggressive tax planning of multinational groups. The cohesion of the euro zone could be strengthened by a common unemployment insurance system that would complement national systems to cushion economic shocks affecting member states.

The need to vote a tax and euro zone budget would justify the creation of a parliament of the euro zone which could draw on the proposal for a European chamber made by Joschka Fischer in 2000,[5] bringing together some of the national parliamentarians of the monetary union's member states. It is indeed based on national parliamentary sovereignty that the monetary union may advance, since no national parliament would agree to relinquish its power to vote taxes. This new architecture would eventually lead to a true bicameralism, ending the fiction that the Council of Ministers can act as a second chamber representing the states. To move in due time to the majority rule on tax and spending decisions that countries in the euro zone would choose to share, it is indeed essential that the chamber representing the states should include all national political forces and not only national finance ministers. The Inter-parliamentary conference on stability timidly paved the way for such a development, that a treaty specific to the euro zone could further develop.

In short, as shown repeatedly over 60 years of European construction, it is in responding to crises that Europe was built. The euro crisis and Brexit may be the opportunity for a new start if the nations that constitute the heart of Europe feel so incline.

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[3] Glienicker Gruppe: "Towards a Euro Union", English version, original version published in German by Die Zeit, October 17 2013

[4] http://www.lemonde.fr/idees/article/2014/02/16/manifeste-pour-une-union-politique-de-l-euro_4366865_3232.html

[5] http://www.cvce.eu/obj/discours_de_joschka_fischer_sur_la_finalite_de_l_integration_europeenne_berlin_12_mai_2000-fr-4cd02fa7-d9days-4 cd2-91c9-2746a3297773.html