The Appalled Economists

Europe MisTreated

Saying no to the Budgetary Pact, and exploring other approaches in Europe

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INTRODUCTION: WHY A NEW TREATY?

“A useless treaty”: this is how, in a statement approved by an overwhelming majority on 18th January 2012, the European Parliament described the new “Treaty on Stability, Coordination and Governance (TSCG), also known as the “Budgetary Pact”[1], which was ratified on 9th December 2011 and signed on 2nd March 2012 by the euro zone’s Heads of State and Government. For members of the European Parliament, “this Treaty is totally unnecessary. Everything is already featured in the European laws that we adopted last year, primarily via the reform of the Stability Pact and the boosting of economic and budgetary policy coordination included under the “Six-Pack”.

Technically, this is not wrong. From a democratic standpoint, however, it is an altogether different story. Paradoxically, European citizens ought to thank Angela Merkel, the German Chancellor, for having imposed on her European partners a Treaty that at least has the merit of prompting a real political debate in Europe, even if it does not add much to the jumbled heap of laws and directives that were discreetly adopted by the European Authorities in 2011. Should we ratify this “Budgetary Pact” as it stands? Amend it? Renegotiate it, or throw it out completely? The issue is being hotly debated in many European countries, starting with Germany. In France, the 2012 presidential elections saw a good deal of skirmishing over the Treaty. In contrast to Nicolas Sarkozy, who had signed it and sung its praises, François Hollande made a solemn commitment to “renegotiate the Budgetary Pact” by “supplementing” it with a “pro-growth element”, which he did not succeed in doing, as we will show.

[1] This description is a misnomer, as the “Budgetary Pact” is merely one section of the Treaty, although undoubtedly the most important one (Title III). For the sake of convenience, we use “Budgetary Pact” in this publication when referring to the Treaty on Stability, Coordination and Governance (TSCG).
[2] We will return to this legislation later in this publication.

Obviously, Mrs Merkel did not suggest this Treaty, with the complicity of Nicolas Sarkozy, with the intention of encouraging public debate. On the contrary, she used all her country's economic and political firepower to ensure that the so-called balanced budget "Golden Rule" was irreversibly enshrined in Member States' National Constitutions or in "binding and permanent provisions". In so doing, however, she opened the Pandora's Box of a democratic debate that could thwart her intentions.

The so-called "Golden Rule", which is also known as the "balanced-budget" rule consists of an irrevocable commitment by signatory States "whose currency is the euro" (according to the Treaty), to balance their budgets in perpetuity, i.e. with a structural deficit that never exceeds 0.5% of GDP. The entire process is in the name of the categorical imperative of "financial stability", i.e. reassuring the financial markets at any cost.

Unlike the late 2005 European Constitutional Treaty and its successor, the 2009 Treaty of Lisbon, the Budgetary Pact is short, and almost comprehensible, even if some provisions are hidden behind cross-references to other European legislation.

The Pact's key articles (numbered from 3 to 8) are dedicated to the following goals:

- strengthening the constraints arising from the 1991 Maastricht Treaty, which were consolidated by the Stability and Growth Pact in 1999, i.e. a maximum budget deficit of 3%, and a cap on government debt equivalent to 60% of GDP. The budget deficit rule becoming a rule that restricts the *structural* deficit, where the maximum limit is set at 0.5% of GDP. An automatic correction mechanism will be introduced to guarantee compliance with this rule. Non-compliance with the debt rule will attract heavy sanctions;
- turning these new restrictions into "constitutional" rules: indeed, the signatory States are committing themselves to incorporate them into their National Constitutions, or into binding legal provisions that are equally powerful;
- introducing rapid convergence programmes towards this "balanced budget" rule, which has become the be-all and end-all of economic policy, in all the signatory countries, that are now slaves to this goal.

The remainder of the new Treaty consists of a series of provisions aimed at organising the application of these rules by introducing automatic enforcement principles, in order to remove from the European Union and Member States' budgetary policies any elements of discussion, decision, and political choice that might have survived. This is why "automatic correction mechanisms" and quasi-automatic sanctions have been incorporated into the treaty, in the event of non-compliance with the new rules. These mechanisms significantly increase the power of the European Commission and of judges (in this instance the judges of the European Court of Justice) over Parliaments.

This short Treaty is therefore of paramount importance. Following Maastricht and Lisbon, it amounts to Act III in the history of the euro, and radicalises the neo-liberal, or rather ordo-liberal principles - but we'll come back to that - that have dominated the building of the single currency since the beginning.

At this point, an initial question arises. What was it that did not work in Europe? And why is a further revision of the Treaties necessary? This short Treaty illustrates the lessons that the signatory governments are claiming to have learned from the 2008-2010 financial crisis, and from the catastrophic situation into which that crisis plunged the euro zone.

What are these lessons? Even if we look for them, we won't find a word on finance or on the way in which it heightened the imbalances of a capitalist system that thirty years of systematic deregulation have surrendered to erratic market forces. We won't find anything about the constant blackmail and recurring crashes that markets inflict on our societies. We won't find anything about the absurd situation where the European Central Bank, which is prohibited from funding public deficits directly, floods private banks with over a trillion euros in very low rate (1%) loans, so that the banks can then lend a portion of that amount to Governments at 3%, 5% or 10%, but only if they feel like it, as nothing compels them to do so. We won't find anything about the dramatic rise in social inequality, unemployment, insecurity and economic instability that has resulted from the growing importance of financial capitalism. We won't find anything about the tax giveaways that boosted tax exemptions and emptied the public coffers, resulting in deficits and debt. We won't find anything about the freezing of investments that are essential to an ecological transition, without which there is a risk of general chaos world-wide.

No we won't: the be-all and end-all, the only issues that are worthy of interest, and deserve criteria and sanctions, are "excessive" public deficits and "unsustainable" sovereign debt, which are considered as curses, and on which the Pact places its exclusive focus.

This deliberate blindness is more than disconcerting, it is revolting. Are our governments so blind that they ignore that the government debt crisis is first and foremost a direct result of the financial crisis that preceded it, as well as of the mechanisms aimed at weakening public budgets that are the result of thirty years of lower taxes and tax competition?

[3] The ordo-liberalism doctrine, which is widespread, and highly influential in Germany, can be viewed as the main inspiration for key aspects of the European construct, and especially of the euro zone construct, is described in more detail in the following sections of this publication.

Or else, are they so cynical that they pretend not to see, even though they know full well that finance is the root cause of the crisis? If so, what goals are they pursuing? What is the Budgetary Pact's "hidden agenda"? Can it be amended or supplemented by growth measures, as maintained by what appears to be a rising chorus of voices in Europe, in view of the deepening recession caused by the austerity plans that are being implemented everywhere?

These are the questions that this publication intends to answer. Its aim is not to repeat, or replace the Appalled Economists' previous publications on the issue of the euro zone crisis[4]. In this publication, our goal is to add to that research and update it, by turning now our focus to the new Treaty, which is at the core of a debate on the end-goals and the future of the euro that has finally begun in Europe.

We want to warn the public about the huge dangers to which the adoption of this Treaty would expose the European people, if it came to be ratified by the 25 countries whose leaders signed it on 3rd March 2012. This is because the implementation of the Treaty would amount to both a form of perpetual austerity, and to a significantly increased risk of the euro zone exploding. Moreover, it would amount to a fatal shrinking of democracy in Europe, which is no less serious. Such a development would give a huge boost to the xenophobic and authoritarian movements that are visibly becoming more powerful in many countries, beginning with France.

In the first section, we will begin by defining exactly what we believe to be the substantial gist of the economic policy measures included in the Budgetary Pact. We will then show how the Treaty aggravates the democratic deficit that has afflicted the European construct for decades, to the point that it has turned it into a black hole into which democracy disappears.

A third section will show why, in our opinion, the Treaty will accelerate the break-up of the euro zone and of the European Union. Lastly, we will explain why we believe that it is totally unrealistic to hope to amend this treaty via additional provisions; indeed, it is actually a new treaty to recreate the euro that is the live issue.

In accordance with the tradition that we have made our own, this publication will conclude with "positive" proposals in response to what we believe are the real questions asked, once we have highlighted all the disputable assumptions and foreseeable dangers of the Treaty.

In any event, the magnitude of the changes introduced by the Budgetary Pact is so enormous that we are adding our voices to those that have already been heard on this point,

4 *Manifeste d'Économistes atterrés* (*The Appalled Economists' Manifesto)* (2010), and *Vingt ans d'aveuglement : l'Europe au bord du gouffre* (*Twenty years of blindness: Europe on the edge of the abyss)* (2011)

in order to demand the launch of an extensive public debate everywhere in Europe. It is vital that this debate is sanctioned by referenda on whether the Pact should be ratified in every country, including France. We cannot pretend to build Europe without, and *a fortiori* to the detriment of the people who represent it, now less than ever.

It is up to the citizens to decide if they want this Europe, which was concocted by the Merkel-Sarkozy axis. By writing this opuscule, and putting their research up for discussion, the Appalled Economists are pursuing their calling, namely giving the citizens analytical criteria that enable them to take control of the debate, and to make themselves heard, so that no one decides their future for them.

Part 1

A Pact for perpetual austerity

"The more it fails, the better our chances of it working"55

The current crisis, which began in 2007, has highlighted the dangers of the European construct, which is currently dominated by neo-liberalism. In early 2012, the governing classes, like the European technocracy, are incapable of finding a way out of the crisis. Worse still, they are using it to achieve what has always been their goal, namely to lower public spending, weaken the European social model and labour laws, and deprive the people of any say in the matter.

The outcome is a disaster. As the European Commission itself admits, the euro zone is expected to see GDP contract by 0.3% in 2012. In March 2012, the unemployment rate in the euro zone hits 10.9%. The crisis has resulted in the loss of around 9% of GDP. Nevertheless, the Commission is continuing to impose austerity policies, which are driving Europe deeper into a recession where there is no end in sight. Although the crisis was caused by the blindness and greed of financial markets, it is public spending and social welfare that are being hit.

The Commission, the ECB and Member States are allowing the financial markets to speculate against government debt. They are letting creditors impose exorbitant interest rates on Italy and Spain. Three of the member countries – Greece, Portugal, and Ireland – are seeing their economic policies decided directly by the Troika (the Commission, the ECB, and the IMF).

The new step that the Commission and the Heads of Members States are currently taking consists in attempting to impose a Treaty that would set these suicidal economic policies in stone on the people, without consulting them. Is the aim of these policies really to save the euro, or do they have a "hidden agenda"? It is the aim just to "reassure the markets", or else to impose a major structural adjustment on the European people, in order to restore Europe's competitiveness in the global economic war against China and emerging countries where wages are low? These are the questions raised by this Pact, and which we will try to answer in this publication.

To do so, we need to begin with this key proposal: the Budgetary Pact is based on an erroneous assessment – or should we even say an untruthful assessment, given how difficult

[5] A famous Shadok saying.

it is to believe that our governing elites are blind. Indeed, the implicit underlying analysis in the Pact is that it is *the lack of budgetary discipline that is responsible for the euro zone's problems*. European governments have allegedly been "lax", and have allowed public spending to soar, in order to fund a bloated and obsolete social model. However, the data flatly contradict this theory. Before the crisis, the euro zone countries were not characterised by particularly high public deficits: during the period between 2004 and 2007, the average public deficit in the United States was 2.8% of GDP, while it was 2.9% in the United Kingdom and 3.6% in Japan, at a time when the euro zone's deficit was only 1.5%. Government debt in the euro zone was not rising as a percentage of GDP. Only Greece was showing an excessive deficit. However, countries like Ireland or Spain, which are currently struggling, did not have a public deficit at all.

The Stability and Growth Pact is a failure…

As a matter of fact, the European Authorities were fixated on blindly complying with the arbitrary standards set out in the Maastricht Treaty (1991) and in the Stability and Growth Pact (1999). These agreements enabled widening imbalances between Northern European countries, which were piling up competitiveness gains and trade surpluses, and Southern European countries, which were riding the wave of a property bubble and rising private debt. They did not see the risks posed by both the divergence of real economies and by financial deregulation.

Instead of acknowledging this blindness, and making up for it, the Budgetary Pact's fundamental philosophy is to continue along the same path by tightening further, and by carrying to the extremes the Stability and Growth Pact that has been in force since 1999, that very pact that has led to the current disastrous situation. Let us remind you that the Pact included three main elements:

- Prohibiting public deficits that exceed 3% of GDP; the limit applies to the current balance (unadjusted for economic fluctuations). This limit was the only one subject to sanctions in the event of an overrun. the Excess Deficit Procedure (EDP) forced the "guilty" country to introduce a restrictive budgetary policy, to account for its budgetary decisions to the Commission and the Council, and finally, if necessary, to pay a fine;
- Prohibiting government debt exceeding 60% of GDP. Beyond that limit, "offending" countries were required to implement corrective policies. However, this constraint did not result in sanction procedures;

- Every country had to present a 4-year stability programme at the end of the current year (the budget voted for the following year and a forecast budget for the next 3 years), the aim of which was to achieve a "structural"[6] budget position that was almost balanced over the medium term. If the structural balance was a deficit, it had to be reduced by at least 0.5% of GDP every year. Once a balance had been reached, countries had to maintain it. They could let their balance fluctuate depending on the economic cycle (which is what is known as automatic stabilisers), but could not take discretionary measures to support economic activity.

As defined, the Stability and Growth Pact resulted in continual tensions and was ultimately not really complied with. In fact, *five of the 12 countries in the euro zone had a deficit that exceeded 3% of GDP* in 2005. Countries never complied with their four-year stability programmes, inasmuch as they cannot commit themselves to following a predetermined budgetary policy over four years, independently of the economic cycle. Governments threw these rules on the scrapheap during the crisis. *All countries (except Finland) exceeded the 3% deficit and 60% government debt limit levels in 2009.*

Despite these setbacks, the Commission wants to "reinforce the SGP" rather than reconsider the way the euro zone's budgetary policy is organised. The new Treaty reiterates a series of measures that the Commission proposed in 2010 and 2011, most of them having already been adopted by the European Council and Parliament, such as the Euro Plus Pact or the "Six+Two" Pacts (see Appendix 3).

… but the Budgetary Pact just makes it more radical

The main provisions in the new Treaty extend and radicalise the previous treaties, especially the Stability and Growth Pact.

In Article 1, the Treaty uses the European Authorities' usual approximations. The rules are apparently "*intended to strengthen the coordination of economic policies*". However, numerical constraints on government debt and deficits, which take no account of different economic situations, cannot amount to a real coordination of economic policies. Likewise, the Treaty claims that it is strengthening "*the economic pillar of the EU by supporting the achievement of objectives for sustainable growth, employment, competitiveness and social cohesion*". Aside from words, however, no practical measures have been specified to make achieving such targets easier; in fact, the opposite is true.

[6] We will return to this concept. See also Appendix 1 on the concept of "structural balance", which plays such an important role in the new Treaty.

Article 3.1, which is the focal point of the Budgetary Pact, restricts economic policies once and for all. It specifies that "*the budgetary position of public authorities shall be balanced or in surplus; this rule is deemed to be respected if public authorities' annual structural deficit is below 0.5% of GDP*. *Countries shall ensure rapid convergence towards this objective. The time-frame for this convergence will be proposed by the Commission. Countries can only deviate from their objective, or their adjustment path in exceptional circumstances. An adjustment mechanism shall be triggered automatically if major deviations are observed; it will include the obligation to implement measures in order to correct these deviations over a given period of time*."

This means that the principle of virtually balanced public finances is enshrined in the Treaty, although there is no economic justification to it. On the contrary, the real "Golden Rule of public finance", which is taught in all economy textbooks (see Appendix 4), asserts that *public investments may be financed by government debt, due to the fact that they will be used over many years*: the deficit finances investments creating wealth that will subsequently enable the debt to be stabilised or repaid. In the case of France, this rule allows an ongoing deficit of around 2.4% of GDP.

In fact, the level of public balance should be viewed as legitimate not on the basis of a predetermined fixed quantitative rule, but when it enables a satisfactory level of demand, resulting in a level of output that generates neither mass unemployment, nor an acceleration in inflation. Nothing guarantees that this desirable public balance should be the right one. Especially in the euro zone, where they no longer control interest or exchange rates (which depend on the ECB's policy and on financial markets), countries need to be able to use the room for negotiation offered by budgetary policy to handle difficult situations. Prescribing a balanced budget in the Constitution is as baseless as prescribing that men should take size 8 shoes and women size 7.

A balanced budget does not make any more sense from an empirical standpoint. For instance, if we consider the 10 years before the crisis, namely between 1998 and 2007, and use the OECD data, Germany, Italy, France, and Japan have always had a structural deficit greater than 0.5% of the GDP, while the United Kingdom and the United States exceeded that limit in seven out of 10 years. In fact, the imposed constraint was never complied with on a long-term basis.

The Budgetary Pact imposes a path of rapid convergence towards a balanced budget, as defined by the Commission, on countries without taking their economic situation into account. The countries are therefore likely to lose all freedom of action.

An “automatic mechanism”, an additional precaution, is expected to be introduced in order to reduce the deficit. For instance, if the Commission decrees that a country has a “structural deficit” equivalent to 3% of GDP, that country will have to show a “structural deficit” limited to 2% of GDP the following year, and so lower the demand (either through reducing expenditure or raising taxes) by 1% of GDP, regardless of the unemployment level. A country that has been hit by an economic slowdown would no longer have the right to implement an economic support policy. Yet, the Commission itself had asked all European countries to implement such support policies in 2008 and 2009.

Undoubtedly, as for the SGP, a temporary deviation would be possible in the event of exceptional circumstances, such as a “negative growth rate, or a cumulative fall in output over an extended period”; nonetheless corrective measures will still need to be planned, and implemented quickly.

When a country has gone off the rails and finds itself subject to an Excessive Deficit Procedure (EDP), it must submit a structural reform programme to the Commission and to the Council, which will have to approve it, and monitor its implementation (Article 5). This article is just another weapon for imposing liberal reforms on the people. Almost every country in the EU (23 out of 27) is currently subject to an EDP. In addition to pension reform plans (lowering the amount, or increasing the entitlement age), they have to cut down the minimum wage (Ireland, Greece and Portugal), to reduce social benefits (Ireland, Spain, and Greece), and redundancy protection (Greece, Spain, and Portugal), replace collective branch negotiations by company negotiations, which are more favourable to employers (Italy, and Spain, etc.), and deregulate closed professions (taxi drivers, notaries, and architects, etc.). The neo-liberals’ belief is that these “structural reforms” will release a new growth potential over the long term. Nothing is less certain. What is certain, however, is that, from this very day, these reforms are increasing inequality, job insecurity, and unemployment. Unfortunately, the term “structural reform” never involves measures aimed at breaking the dominance of the financial markets, increasing taxation for the wealthiest and for the larger companies, organising and financing an ecological transition...

The aim of the Treaty is actually to achieve the neo-liberals’ lifelong dream, i.e. completely paralysing budgetary policies, and removing all possible discretionary power from economic policies.

A debt reduction machine…which will increase debt

Article 4 of the Budgetary Pact reinforces the rule according to which each country’s debt must remain, or return below 60% of GDP. This rule had already been included in the

Stability and Growth Pact, although the Commission had no means to impose compliance with it.

From now on, the sanctions will be identical to those scheduled for excessive deficits: a country where the debt-to- GDP ratio exceeds 60% of GDP will be forced to reduce this ratio by at least one twentieth of the difference with 60% every year; otherwise it will first have to deposit funds with the ECB, which could turn into a fine ranging from 0.2 to 0.5% of the GDP of the country in question.

This rule raises three issues:

- it assumes that a 60% ratio is an optimal result every country can achieve. In Europe, however, countries like Italy or Belgium have had government debt levels amounting to 100% of GDP for a long time (without even mentioning Japan, where the ratio is 200%), with no imbalances, as this debt corresponds to high national household savings levels;
- it forces countries to put on the brakes all the harder as economic activity has already slowed down: this is what is called a "pro-cyclical" policy. This is because a one point reduction in the government debt ratio requires efforts that are all the more intensive as economic growth is weak. Even worse, this effort to reduce the ratio will then weigh on economic activity, thus aggravating the difficulties.
- In fact, the balanced budget rule ignores its effect on economic activity, which can lead to absurd consequences. Let us imagine, for example, a country where GDP is worth 100, the debt is 100% of GDP, the growth is 4%, and the deficit amounts to 4% of GDP. Under these conditions, the debt ratio remains stable at 100%. However, if the country is required to reduce its debt ratio and to lower public spending by 2 points, in order to comply with the debt ratio reduction rule, its activity will drop to 98, and tax receipts will fall by 1 point. In the end, the deficit, and therefore the debt, will be reduced by one point. GDP then amounts to 98 and the debt to 99; far from decreasing, the debt ratio has increased to 101%. Wanting to reduce the debt through austerity policies is therefore not self-evident! The current examples of Greece and Spain illustrate what we have just stated. The implementation of austerity policies has not contributed to reduce the government debt ratio, but to increase it.

A "coordination" that is driving Europe into the abyss

The coordination of economic policies mentioned in Articles 9, 10, and 11 does not include any quantified commitment in terms of unemployment or external trade balance. There are no plans at all for countries with trade surplus, like Germany with its hyper-competitiveness policy, one of the main reasons for the current crisis, to be made to increase wages, social spending or their public investment, in order to contribute to a rebalancing process.

There is no mention of real economic policy coordination, i.e. of a common economic strategy that uses European monetary policy and national budgetary, tax, social, and wage policies in order to bring the various countries closer to full employment by promoting an ecological transition. The Budgetary Pact does not set out the construction of a real European budget, with a real European tax programme, that would enable the rebuilding of social solidarity, and convergence of economies towards a higher level.

The Treaty has no other aim than to hamper national budgetary policies. Each country has to take restrictive measures by itself, including lowering pensions and social benefits, reducing the number of civil servants, reducing their wages, and increasing taxes (primarily VAT, which affects the poorest households). No account is taken of the country's specific economic situation, or of social investment and employment needs, or of policies in other countries. Nowadays, this implies that all countries are implementing austerity policies, although the cause of the deficits lies in the recession resulting from the bursting of the financial bubble and the increasing imbalances created by the lopsided architecture of the euro zone[7].

A recent study performed by three independent economic institutes, IMK (Germany), OFCE (France), and WIFO (Austria), has assessed the impact of the budgetary policies introduced by the Budgetary Pact[8]. *Between 2010 and 2013, the impact of these measures will be a decrease of almost 7 points in the euro zone's GDP.* In countries in crisis like Ireland, Spain, Portugal, and Greece, the downward pressure is even higher, ranging from 10 GDP points for Ireland to 25 points for Greece. "The Greek economy has completely collapsed" the researchers write. But growth will also slow in Italy, France, and even in the Netherlands, due to the austerity measures. The austerity measures decided in Germany are less stringent than elsewhere (1.5% of GDP); however, due to the country's close economic ties with countries in crisis, Germany's growth over the period between 2010 and 2013 will be 2.7% lower than in an austerity-free scenario. Overall, the institutes write, "the generalised austerity policy implemented as part of the Budgetary Pact will enlarge the gap in the euro zone between Southern European countries on the one hand, and Germany and the other Central and Northern European countries on the other. This policy is not solving the crisis, but making it worse".

7 See *Vingt ans d'aveuglement*, *l'Europe au bord du gouffre* (*Twenty years of blindness: Europe on the edge of the abyss), 2*011

8 www.ofce.sciences-po.fr/blog/?p=1671.

The disturbing and unfathomable mysteries of “structural deficit”

The Budgetary Pact introduces a highly controversial concept into a European treaty. In fact, public authorities’ structural balance is defined as the “*annual cyclically adjusted balance net of one-off and temporary measures*” (Article 3). However, this concept poses problems both at the theoretical and empirical level. Can an economic concept that is so controversial be inserted into a Treaty or into the Constitution?

To explain what is involved, in an accessible way, we will limit ourselves in this instance to a scenario where the public accounts balance is negative. In this case, the “structural balance” is a “structural deficit”. Why introduce this concept? The aim is to design an indicator that allows us to judge whether the country’s budgetary policy is sound or “lax”. To do so, we need to assess whether the public deficit – the difference between income and expenditure in a given year – is “normal” in view of the economic cycle, or whether it is “excessive”.

How can we judge whether a deficit is “normal” or “excessive”? In the absence of economic fluctuations, a current deficit would be “normal” if it did not exceed 0.5% of GDP, according to the Budgetary Pact. The current deficit would have to remain within that limit year after year. According to the Commission, the deficit would reflect a “neutral” budgetary policy, which is neither expansionary (via injecting income into the economy) nor recessionary (via increasing public savings).

However, there is an economic cycle, which has good years (booms) and bad ones (recessions). Even if the budgetary policy is “neutral” and stable, the current budget deficit contracts or disappears automatically in good years. This means that there is a “cyclical surplus”, as income increases (more growth means the distribution of more revenue, hence more tax collected and more inflows into the public coffers), and expenditure (unemployment benefit, for instance) decreases. Conversely, the current deficit increases mechanically in bad years, supplemented by the “cyclical deficit”.

Let us assume that a calculation performed by an independent economic institute establishes that the impact of the recession on the deficit was 4% of GDP in 2009 (“cyclical deficit”). If the current public deficit (the only one that is actually recorded) amounts to 5%, the actual structural deficit is estimated to be 5% - 4%, i.e. 1%. The country is not quite on track. Its structural deficit of 1% is higher than the famous 0.5%, so it is therefore excessive according to the meaning of the Budgetary Pact. An adjustment (a reduction in expenditure and/or an increase in tax) of around 0.5 GDP point is required. This is possible without too much damage.

Now let us assume that the Commission experts, using their own calculation method, assess the cyclical deficit not at 4% but at 1% in 2009. In this case, the structural deficit is not 1%, but 5% - 1%, i.e. 4%. It no longer needs to be reduced by 0.5 GDP point but by 3.5 points, which is altogether quite different!

Moreover, we would remind you that this 0.5% limit is completely arbitrary; a deficit of less than 2.5% of GDP would be enough to stabilise the debt-to-GDP ratio. We would also remind you that a country can legitimately have a so-called structural deficit during a recession, if that deficit corresponds to specific measures that were taken to support economic activity.

This situation is not a piece of political fiction, and we are already seeing its premises. For example, the Danish Government is now positively disputing the Commission's calculation, according to which Denmark's structural deficit was 3% in 2011. Danish experts actually estimate it at 1%. Given the Commission's proportion – which the Budgetary Pact will impose – the country should have set up a pension system reform even harsher than the one actually realised, though already a draconian one.

Why are the assessments so different? Because you need a theory to assess what the deficit would be in the absence of a recession or a boom. What would the output level – i.e. what economists call "potential output" – be if the situation were "normal"? The greater the difference between actual output – which is accurately measured – and potential output, which is assessed using an economic model – the higher the percentage of the deficit that is viewed as cyclical, and the lower the deficit that is deemed to be structural. However, in contrast to what neo-liberals would have us believe, there is no unquestionable and consensual economic theory.

To establish this idea, we can draw contrasts between a liberal and a Keynesian approach. According to the liberal approach, the market is always right. If the output has fallen, it is because of supply problems (inadequate productivity or competitiveness, wages that are too high, or a labour market that is too rigid, etc.). It is not possible to achieve a much higher output given the current state of the economy, so "structural reforms" are required. Potential output is close to recorded output. The cyclical component of the deficit is therefore small, and most of the crisis deficit is structural.

In contrast, according to the Keynesian approach, a recession is often caused by a lack of effective demand. For instance, following a stock market crash, companies do not invest very much and reduce their workforce, salaries do not rise very much, and households, who are either unemployed or threatened with unemployment, reduce their expenditure. There is no spontaneous stabilisation mechanism to support economic activity. Output can fall very sharply, and to well below its potential level. The cyclical component of the deficit may be significant.

The Budgetary Pact clearly specifies that it is the Commission's method that must be used. However, this method, which is based on the liberal approach, tends to underestimate the gap between actual and potential output, especially during a recession. In this way, the capital stock used to calculate potential output is the actual stock, which does not take into account the fact that it has actually been affected by a fall in economic activity; any underlying technical progress is limited to the rate recorded, although it could be more significant if greater amounts had been invested; the labour force that is supposedly available is the labour force recorded, although many young people, for instance, have chosen to go on studying rather than enter a depressed "labour market". All these assumptions inevitably lead to a potential growth rate that is scarcely above the actual growth rate. According to the Commission's estimate for 2012, France's structural deficit would be 2.9% of GDP, therefore requiring an adjustment of public accounts equivalent to 2.4 GDP points, which is significant. According to our estimate, the structural deficit is only 0.3%, so below the alleged fateful 0.5% limit; there is no need for austerity in order to comply with a 0.5% limit. Unfortunately, the Budgetary Pact enshrines the fact that the European Commission has the only valid economic theory into Constitutions, and stifles all debate.

The success of the neo-liberal project

The Budgetary Pact marks a new stage in a combined attack on the independence of national budgetary policies, and on the economic policies that had been adopted almost everywhere in the world, and were largely based on Keynesianism.

Indeed, since 1936, the Keynesian theory had imposed a new concept of economic policy. Keynes' central message is that, given the inherent instability of capitalist economies, governments needed to implement a proactive economic policy, in order to maintain a constant growth, and thereby enabling full employment to be maintained, by using budgetary policy, monetary policy, wage policy, social policy, and industrial policy. In particular, budgetary policy was meant to support economic activity, by accepting a bulging deficit in periods where demand fell, automatically resulting from falling tax revenue, and possibly inflated by discretionary measures to boost the economy.

This Keynesian method supported economic activity in developed countries during the post-war economic boom. However, in the 1980s, the ruling classes decided to do away with this theory, as these practices, imposed by a balance of power in favour of the workers so far, had resulted in the increased importance of the public sector in the economy and society, due to growing public intervention. The liberal counter-revolution aims at reversing these trends, starting with restricting, or prohibiting counter-cyclical public interventions.

The aim is to put an end to the economic policies that resulted from Keynesianism, which were considered to be responsible for inflation, and above all for the falling share of profits in national wealth; the aim is to make the citizens accept giving up the goal of full employment for good, on the pretext that it is allegedly inflationary. Economic policy must now be imagined and designed in order to combat inflation, to reduce costs dramatically (and especially the famous “wage costs”), and so recover, and then maintain the share of profits. To do so, this policy needs to be implemented in order to guarantee the “free” operating of the market. Meaning mainly free from the regulations and political or social counter-powers that were supposed to have blocked the investors and capitalists’ power in the post-Second World War years.

This is why the neo-liberal doctrine intends to take economic policy out of the hands of governments that are subject to a democratic electoral process. *Economic policy must be entrusted to independent bodies made up of experts and technocrats, who don’t have to justify themselves to nations and citizens.* Economic policy must be paralysed through restrictive rules[9]. For instance, the main aim of the Central Bank, described as “independent”, is to keep inflation below 2% per year. Moreover, future budgetary policy will be entrusted to independent committees under the auspices of the Pact and the Commission, with the sole aim of maintaining a balanced budget.

This ideological project is by far unachievable. The capitalist economy instability induces that it needs a proactive policy. In that way, the US Federal Reserve has lowered interest rates to almost zero, and purchased huge amounts of private and government securities, contrary to all orthodox thinking: the public deficit exceeded 10% of GDP between 2009 and 2011 without setting off any alarm bells. Within the EU itself, governments had to take major budgetary measures in 2008 and 2009, in order to avoid economic collapse.

Despite all this, European authorities reiterate their goals tirelessly, continually recalling and pursuing their credo. We need to impose major “structural reforms” on Europe, and bring a social model that has now been declared obsolete to an end[10].

As these reforms are obviously very unpopular, the tactic, for which the new Treaty is an essential tool, consists in having them imposed, and in imposing them via “automatic”

[9] Chapter 2 of this publication, “A Pact against Democracy”, returns to this state of affairs in detail, by showing how the Pact establishes a series of “automatic” mechanisms and sanctions, as an alternative to collaborative decision-making processes, and to discussions between players who are responsible to those who appointed them.
[10] See Mario Draghi, the Chairman of the ECB’s statements along these lines.

policies, which use limits that trigger iniquitous measures. With this Treaty, Europe is taking another step towards the neo-liberal goal of “stripping democracy” from economic policy.

Part 2

A Pact against democracy

The actual essence of the Treaty is to lessen the small amount of democracy that remained within the Union. Its aim is to restrict the areas for discussion and possible choices, open to politicians answerable for their actions to their constituents.

The Treaty is introducing new rules, which are all aimed at weakening or suppressing the powers of elected representatives. The aim is to reduce economic policy to the application of a balanced budget rule, which, although it has no economic basis, as we have shown, is now acquiring the highest legal foundation, i.e. enshrinement in Constitutions. Indeed, everything is happening as if the goal sought was to put the Monetary Union's economic policy on "auto-pilot". As the rule (the 0.5% limit) has been set, the aim is to ensure that the road roller trundles on unhindered, regardless of the cost.

Reviving the "budget stability community"

This is undoubtedly the main change, and actually the major act of force that the Pact intends to introduce. This provision is written in Article 3, the first of the five articles dedicated to the Pact as such. The terms of the Treaty are unambiguous. Once paragraph 1 of Article 3 has stated the rule (which reforms the Stability and Growth Pact, hereinafter the SGP), paragraph 2 provides that: "*the rules set out in paragraph 1 will take effect in the national laws of the contracting parties (countries whose currency is the euro) [...] through provisions of binding force and permanent character, preferably constitutional […]…*"

Yes, you did read: *"of binding force and permanent character"*. Away with debate, discussion, reason, and everything that makes democracy what it is. From now on, no more thinking is necessary, just applying the constitutional rule.

We could legitimately wonder about the reason for such a provision. As we see it, its brutal confirmation can only be understood if we go back to the discussions (and opposition) that characterised the creation of the Economic and Monetary Union and the adoption of the euro. In the late 1990's, at a time when the design of the euro zone was being debated, everyone knew that there could be no Monetary Union between countries with features as diverse as those of the Greek, German, and Irish economies *without a proactive coordination of economic policies*, i.e. *without a real common budget*, and *without transfers* between regions and countries within the monetary zone to be created.

Despite these obvious facts, a decision was directly made to restrict this common budget to the minimum (and in reality well below the minimum, at about 1% of European GDP), to leave economic coordination with no status or effectiveness, and to limit transfers to amounts well under the real needs.

From that point, under pressure from Germany, which was strongly defending this viewpoint, the idea that stood out, and materialised through the signing of the SGP, was, due to the lack of coordination and of a real budget, *to make each Member State bear by itself the weight of a balanced budget*. The implicit syllogism was that if every Member State had a balanced budget, then neither coordination, nor a budget, or transfers, were necessary...QED. *A monetary area is being created, but through this balanced budget rule transferred to each Member State, they think it possible to do without the conditions necessary to its existence.* This is the pipe dream imagined by the euro zone's architects.

In Eurospeak, this pipe dream had a name: the aim, it was said at the time, following a German proposal, was to build a "budget stability community". It said a "Community" because the euro is the single currency for all the members, and "budgetary stability" because each Member State is responsible for building its own balance budget. This is the vision that the SGP was supposed to embody. The double rule it imposes on each Member State (a maximum deficit of 3%, and of 60% for government debt) was intended to guarantee the stability of the euro zone, while exempting it of any real economic coordination.

And, as expected, it was this vision that exploded in mid-air during the financial crisis. If it had not exploded at that point, and with such a bang, the outcome would have been the same, and unavoidable. This is because, as we have already mentioned, the disparities between regions and countries within the euro zone went on increasing, without any real correcting mechanism being put in place. From that point, countries where competitiveness has deteriorated (when it hasn't simply collapsed), and that were deprived of the adjustment tool represented by the devaluation of their national currency, could only go under.

In fact, the financial crisis only accelerated a trend that was already underway. You cannot build a monetary zone without economic coordination, with no common budget, and without a proactive transfer policy, in order to work towards the convergence of the regions and countries in the zone concerned.

The paradox of the Budgetary Pact is that, instead of recognising the failure of the implicit concept on which the zone was built, and seeking to rebuild Economic and Monetary Union on a different basis, European governments seized the opportunity offered by the crisis not only to reaffirm a rule that has clearly shown itself to be useless, but to tighten it further by moving from a 3% deficit rule to a 0.5% "structural deficit" rule, and by assigning enormous power to that rule, due to its new rank as a constitutional rule. On the face of things, the new Treaty does not hide its origins and its roots. The tightening of the rules to include a structural deficit of 0.5% is presented as contributing to "Stability"[11]. The late "budgetary stability community" that the SGP allegedly imposed, and that was shattered by the financial crisis, is therefore re-emerging with the new Treaty, like a phoenix from the ashes. This time, however, the phoenix has shrunk to 0.5 %, and no more.

Distrust institutionalised

As if everything depended on the Member States' goodwill (or lack of it) and not on the widening of pre-existing asymmetries, made inevitable by the lack of coordination and of a common economic policy, the Pact sets up supervision and distrust mechanisms between Member States, by introducing "*the power of each State to sue any other State*", even if the Commission itself has found nothing wrong. It is paragraph 1 of Article 8 that establishes this wonderful fraternity between Member States: *"When a contracting party considers, independently of the Commission's report, that another party has failed to comply with Article 3(2), it may also bring the matter to the Court of Justice. In both cases, the judgement of the Court of Justice will be binding on the parties […]*" The aim here is to check that the provisions listed in Article 3 (structural deficit of 0.5% and rapid convergence of national budgets towards budgetary balance), have been embodied in constitutional, or equally powerful rules.

Article 8 confirms the Commission's role in monitoring Member States: it has the power to issue a certificate of good behaviour. In contrast, if the Commission does not approve of the way in which Article 3 is transposed into national law, it waves a big stick: *"If the European Commission, after having given the contracting party concerned the opportunity to submit its observations, concludes that such contracting party has failed to comply with Article 3(2) the matter will be brought to the Court of Justice […]".*

This is killing two birds with one stone. The Commission itself is established as the supreme arbitrator. In the event of dispute, the judges will decide, by referring to the community treaties. Economic policy has been turned into a rule of law, which must be blindly applied, and compliance with which is handed to the judges. In the event of non-compliance with the judgement delivered, the Court is authorised to pronounce and enforce financial sanctions that may amount to up to 0.1% of the GDP of the country concerned.

[11] We must remember that this new treaty is pompously called "Treaty for *stability*, coordination, and governance", "stability" being the first of the stated aims.

To sum up: two precautions are better than one. Even if the Commission finds nothing wrong with the way in which *the golden rule* has been enshrined in the stakeholder's constitution, any State may revisit the Commission's assessment, and bring the matter before the Court of Justice. As for the latter, it is entitled to apply severe financial sanctions if the State that is deemed guilty is reluctant to execute its obligations.

Automatic coercion

Based on the same intent to limit areas for deliberation and democratic political choice, another pillar of the Treaty is to make the measures and provisions automatic. This principle of automatic enforcement is clearly enshrined in the Pact where the triggering of corrective measures is concerned, if the fact that a State was departing from the golden rule or the path leading to it made such measures necessary.

The provision is introduced within Article 1 (the main article of the Treaty), in Paragraph 1, Point e. The Article provides that, in the event a country departs from the 0.5% rule "…*a correction mechanism will be triggered automatically […]. The mechanism includes the obligation for the contracting party (i.e. the country concerned) to implement measures to correct the deviations over a defined period of time*". The article ends, hypocritically, with "*Such a correction mechanism fully respects the prerogatives of national Parliaments*." However, those Parliaments will be forced to approve budgetary austerity measures in an amount determined by the Commission's questionable calculations.

In order to guarantee this automatic enforcement, the Pact refers to "the rule of reversed qualified majority". What does this involve? In many of the conventional provisions of Union Treaties, the so-called qualified majority rule is applied to votes within the European Council (the summit for Heads of State and Government). Every State has a number of votes proportional to its population and economic weight. The majority is said to be qualified when it reaches 74% of the votes (255 votes out of 345 for the whole Union, with an additional condition according to which the States must account for at least 62% of the Union's population). But the *reverse* qualified majority rule, which was introduced in order to ensure the automatic enforcement of corrective measures, is particular in that the measures are enforced automatically, except if an explicit (with a qualified majority) vote decides that the corrections should not apply, with the delightful additional detail that the country in question cannot take part in the vote.

The wording of the rule, in all its beauty, is: When a country deviates from the deficit rules, that country will commit to following the measures proposed by the Commission to return to a balanced budget, except if *"...This obligation will not apply if it is established among the contracting parties [...] a qualified majority of them [...], without taking into account the* *position of the contracting party concerned, are opposed to the decision proposed or recommended"* (by the Commission) (Article 7).

Let us consider, for instance, a resolution that concerns Italy. There are 213 voting rights in the euro zone, 27 of which belong to Italy. The qualified majority is 72%. The Commission therefore only needs 52 favourable votes to impose its will. France and Germany have 29 votes each … What a lovely democracy, where the Commission, supported by these two large countries, can impose its law on any other country! Likewise, it would be enough for the Commission to have the support of the four Northern countries (Germany, Austria, the Netherlands, and Finland) to impose its will on any other country.

Governance: adding still more opacity to the opaque

Improving the "governance" of the euro zone is one of the new Treaty's explicit aims. The aim is presented as so important that the term *governance* is included in the actual title of the new Treaty.

There is no doubt that the European Union requires new and better governance. A little history is called for at this point. As everyone can remember, one of the so much vaunted advances made by the European Constitutional Treaty (which has now become the Treaty of Lisbon) was the creation of a position of President of the European Union, which bore the official title of President of the Council of Europe. At long last, the Union's partners (and especially the United States, who saw this issue as a joke…) would be able to have a telephone number to call Europe! However, before the ink on the Treaty was dry, the Heads of States steadfastly sought out, and then appointed the greyest and most transparent of all the potential candidates: the honourable Mr Van Rompuy. His appointment left no room for doubt. Every precaution had been taken so that nothing would change. The President would be a ghost, an advocate at best, and things could continue along the chaotic lines that characterise the governance of the EU. With one difference however, namely that henceforth (at least) Mr Van Rompuy's name had to be added to that of the acting President of the Heads of State (who is replaced every six months, as we know) and to that of the President of the Commission.

The bursting out of the financial crisis in late 2007, and the urgency of the measures required showed how costly this governance vacuum could be to the European people.

Messrs Barroso and Van Rompuy's complete lack of authority and political initiative gave free reign to Mrs Merkel's beating about the bush and then to the Merkel-Sarkozy combinations, which were able to impose their "solutions", and resulted in the TSCG-Budgetary Pact.

On the subject again, there is nothing to be found in the new treaty. Articles 12 and 13 are devoted to this issue. To say what? This: "*The Heads of States or Governments of the contracting parties [...] will meet informally in Euro Summit meetings"*, which will take place *"at least twice a year"*, and also this: that in addition to the various Presidents already present in the EU, there will be another one: "*the President of the Euro Summit […] appointed by a simple majority vote by Heads of States or governments…at the same time as the European Council's presidential election, and for the same term of office*", i.e. two and a half years, the length of Mr Van Rompuy's current term of office.

One further detail is still required, as it says a lot about the deplorable state in which the Union finds itself from the standpoint of democracy, and about the way in which the TSCG is contributing to make matters even worse. In fact the text specifies that the "the European Commission's President" may "participate" (therefore as his right) in euro summits (1). Likewise (2), "the Chairman of the European Central Bank is invited to attend these meetings". On a regular basis, if we understand correctly. In contrast, where the President of the European Parliament (who is the only person actually elected by European citizens) is concerned, the text specifies that he "*may be invited to give his opinion*"! Yes, these are the very words. The only member who has any democratic legitimacy may only be "invited", for just enough time "to give his opinion", if this is deemed useful by the members of the Summit, before he disappears. In short, he cannot sit, or take part in the discussions. All he can get, at best, is an occasional and temporary folding seat!

Here again, we see that the aim is to keep the "governance" of the euro zone and its Pact far from the sound and fury of democratic debate. Is this justified at least by a possible additional economic effectiveness? Certainly not, since, as we will now see, the Budgetary Pact will drive the euro zone over a cliff.

Part 3

A Pact that is leading to the implosion of the euro

"Abandon all hope, ye who enter here"[12]

As we have seen, the euro zone was built on quicksand. This situation primarily manifested itself, even before the beginning of the financial crisis, in substantial trade imbalances between countries. In 2007, for instance, some "central" euro zone countries were already exporting much more than they were importing, like the Netherlands (trade surplus of 8.1% of GDP), Germany (7.9%), Finland (4.9%), Belgium (3.5%), and Austria (3.3%). Others, known as peripheral countries, had large trade deficits: Portugal (8.5% of GDP), Spain (9.6%), and Greece (12.5%).

These unsustainable imbalances are explained by two series of factors. First, the central countries, and those on the periphery, had adopted antagonistic macro-economic strategies. Secondly, no adjustment mechanism allowed countries having a deficit to make up for the disappearance, once the single currency had been in operation, of the essential tool represented by currency devaluation.

The "central" countries (Germany, Austria, the Netherlands, and Finland) had followed so-called "neo-mercantile" strategies, consisting in squeezing wages and social security spending in order to achieve competitiveness gains and accumulate substantial surpluses. From 2000 to 2007, the share of national wealth represented by wages fell by 4 points in Germany and by 5 points in Austria. The small amount of internal demand in these countries, and their competitiveness gains weighed on the growth of all their partners in the euro zone. Furthermore, the "peripheral" countries (Spain, Greece and Ireland) were betting on low interest rates (relative to their growth rates) and letting housing bubbles inflate. In Ireland, this process was accompanied by a tax dumping policy. These countries accumulated substantial external deficits, which meant that the 230 billion euros surplus in the central countries was creating and financing the 180 billion euros deficit in the peripheral countries.

By opting for the single currency via the Maastricht Treaty in 1992, Europeans gave up their exchange policy, i.e. a possible devaluation of their currency. As a result, the lack of adjustment mechanisms intended to compensate for macroeconomic imbalances led to a dramatic increase in the differences between them.

The 2007-2008 financial crisis, and its repercussions on real economy have established the failure of these strategies. The peripheral countries are now facing a major government debt

[12] Dante, *The Divine Comedy, Inferno*.

crisis, recession, and an unprecedented rise of their unemployment rate. By implementing drastic austerity programmes, they are depriving the central countries of customers, and accelerating their entry into a crisis. In such a situation, it would have been necessary to arrange a top-down convergence between Member States. The Budgetary Pact does not meet these expectations in any way. On the contrary: instead of introducing mechanisms that would enable greater convergence between States, the Pact is reinforcing centrifugal trends. Combined with the European Stability Mechanism (ESM), the Pact is paving the way for the most vulnerable countries to be placed under supervision, and accelerating the partition between the economic paths of the countries that are members of the euro zone.

These centripetal arrangements are thus likely to result in the explosion of the euro zone, rather than contributing to closer ties between its member countries. It is all the more worrying as, like in the 1930s, increasing unemployment is accompanied by the Far Right's electoral success. For instance, Far Right parties obtained a large share of the vote during the last parliamentary elections: 15.5% in the Netherlands, 28.5% in Austria, 19% in Finland, 13.9% in Latvia, 12.7% in Lithuania, 16.7% in Hungary, 12.3% in Demark and 9.7% in Greece (including 6.9% for an openly neo-Nasi party). In the first ballot of the French presidential election on 22nd April 2012, the French Far Right received 17.9% of the vote, its absolute record for all elections.

The ESM and the TSCG: twin treaties

As we know, Article 125 of the Maastricht Treaty forbade any financial assistance between the euro zone States (the so-called "no-bail out clause"). The aim was to force each Member State to stand alone before the court of financial markets in order to finance its deficits. In this way, those who imagined the European Treaties hoped to force States to adopt budgetary "virtue".

Unfortunately, the 2007-2008 financial crisis has laid bare the absurdity of entrusting the task of sanctioning States to irrational and erratic markets. On the contrary, it was the States that had to save the markets when they went adrift! But, as some of the more vulnerable countries had been hit particularly hard by the crisis and then by financial speculation, which caused unsustainable interest rates, the euro zone had to resign itself to ditching Article 125 and to setting up in emergency a European Financial Stability Fund, followed by a European Stability Mechanism (EMS) in early 2012.

The link between the European Stability Mechanism (ESM), which was introduced by an inter-governmental treaty signed on 2nd February 2012, and the TSCG-Budgetary Pact, which was signed on 3rd March, is not easy to find, despite their close timing.

Nonetheless, it appears in Article 10 of the TSCG, which mentions that the "*contracting parties stand ready to make active use, whenever appropriate and necessary, of measures specific to those Member States whose currency is the euro, as provided for in Article 136 of the Treaty on the Functioning of the European Union*". Well, this article was amended at the European Council meeting of 25th March 2011, via the addition of a third paragraph that provides for the setting up of the ESM, and is worded as follows: "*The Member States whose currency is the euro may establish a stability mechanism, which will be activated if indispensable to maintain the stability of the euro area as a whole*. *The granting of any required financial assistance under the mechanism will be made subject to strict conditionality*." Article 10 of the TSCG therefore provides that the countries that ratify the TSCG will be able to use the ESM in the event of problems, and that "conditional ties" will be implemented (we will return to this point).

As for the treaty establishing the ESM, it is more explicit about the links between both arrangements, since "Consideration 5" of the ESM specifies that *"[…] the granting of financial assistance in accordance with the dispositions of the new programmes under the ESM will be conditioned, from 1st March 2013, to the ratification of the TSCG by the ESM Member concerned and [...] compliance with the requirements of the aforesaid article*". The ESM is therefore making its assistance available only to countries having ratified the TSCG. The idea that a country might benefit from the ESM's assistance without having ratified the TSCG, as some observers[13] suggested, on the basis that the TSCG merely appears as a "consideration" of the ESM and not in a formal article, is baseless. Both treaties are indeed inextricably linked. To benefit from the ESM, you need to have ratified and complied with the Budgetary Pact.

Now that we have established these links, we can pay closer attention to the ESM. At first sight, it involves an embryonic European solidarity, since the ESM will enable euro zone countries that are facing a government debt crisis to benefit from its assistance. In fact, the ESM will be able to make direct loans to a State in financial difficulties, buy that State's Government Treasury Bills on the primary market (when the State in question issues the security) or on the secondary market (from financial institutions that hold the securities), or grant preventive assistance, or a sum intended to recapitalise financial institutions. The ESM is thus introducing a novel form of solidarity between Member States.

[13] Daniel Cohn-Bendit, Jean-Paul Besset, Alain Lipiets, Yann Moulier-Boutang, and Shahin Vallée: "*Mécanisme européen de stabilité : la bourde historique de la gauche (European Stability Mechanism: the Left's historic blunder*"*)*, Le Monde, 25.02.2012,lipiets.net/spip.php?article2708.

The ESM confirms that government debts will be left in the hands of speculators

Some observers concluded that the ESM would mark a major step towards the building of a federal Europe with a real budget. Unfortunately, this idyllic vision is contradicted by the facts. The ESM is an inter-governmental body by nature; it is not in any sense a community body. As for the Community's budget, it remains capped at 1.2% of GDP, and the issue of increasing that cap has not arisen at any time during the negotiations that resulted in setting up the ESM. To put it bluntly, an increase is impossible to obtain in the current European environment, where 10 European Union Member States do not want to adopt the euro as their national currency, and are therefore refusing, quite logically, to pay for a body that is supposed to help the euro zone survive. Even if these countries were to adopt the euro, the 1.2% GDP cap is much too low to act as a guarantee in case of a State default. Given the current state of the Treaties, obtaining an increase of this cap requires the unanimous agreement of the 27 Member States of the European Union, which is usually impossible to obtain, all the more so in the current economic and political context.

The ESM specifically states that countries will have to continue to finance themselves on financial markets. At the same time, it says that private creditors may be asked to pay up in the event of problems. The Treaty establishing the ESM states that the amounts due to the ESM will have priority over the amounts due to private investors. Government bond issues ought to include a class action clause: in the event that the Commission and the IMF declare the issuing country insolvent, it will need to negotiate an amendment of the payment conditions with its creditors, and the agreement will apply to all of them if a qualified majority of the creditors accept it.

This means that euro zone countries' government debts will become even riskier assets, permanently subject to the assessment and speculation of the financial markets, just like emerging countries' debt. The euro zone countries will therefore be condemned to "virtue" (i.e. austerity) contests in order to appear as "well-behaved" as Germany in the markets' eyes. Government debts will become a permanent risk factor, since States will be at the mercy of the irrationality of financial markets, that Keynes (1936) called their "animal spirits". However, as the Appalled Economists already emphasized in their Manifesto, financial markets have no macroeconomic skills at all. They impose austerity policies during recessive periods, and then, when they realise the increasing imbalances resulting from austerity and recession, they complain about the lack of growth, and lower sovereign debt ratings even further…Governments, under the pressure applied to them in this way, finally decide to lead still harder liberal reforms, such as reducing social welfare or the number of civil servants, or liberalising the labour market.

The social and economic instability created by these policies raises new concerns. As a result, the interest rates on government debts rise, become more volatile and less controllable. Did we need to build the euro zone if this is the result?

“Solidarity” that is conditional on further progress in dismantling the Welfare State.

Any solidarity obtained under the terms of the ESM will be paid for very dearly, as the countries that benefit from assistance will need to submit to the conditional ties imposed by the Troika (the Commission, the ECB, and the IMF). The Troika will negotiate a plan with the State requesting assistance; this plan will then have to be approved by the Finance Ministers of the euro zone. The ESM, as such, will therefore have no power to impose such or such condition on a country: it is the governments of the euro zone who will decide. Practically, it is the Troika that will define and implement the conditions.

In principle, these conditions are aimed at assuring the creditors of the “assisted” countries that everything will be done to repay the debt, by correcting the imbalances that led to the country requesting assistance from the ESM. Article 12 of the Treaty on the ESM specifies that “*this conditionality may for example take the form of a macro-economic adjustment programme*”. The ESM conditions will therefore be similar to the “structural adjustment programmes” that the IMF has imposed since the 1980s, or else to the structural adjustment programme that has already been implemented in Greece or in other European countries since the beginning of the sovereign debt crisis. The austerity policy implemented in Greece is a good indication of the price that has to be paid in order to benefit from “European solidarity”, namely privatisations, budget cuts, and “internal devaluation” (see below). The Greek example shows that this kind of plan, far from enabling countries to find a way out of the crisis, simply makes it worse. In fact, the real goal is different: via the ESM, the European elites actually have a new tool to add the finishing touches to the dismantling of the Welfare State that liberal governments and the markets did not manage to achieve over the past three decades.

The “European Stability Mechanism” (ESM)

The European Stability Mechanism (ESM) was created to succeed the European Financial Stability Fund (EFSF), and the European Financial Stability Mechanism (EFSM), two systems that had been created on 7th May 2010, in the middle of the government debt crisis. The European Financial Stability Fund (EFSF) is an inter-governmental body that is authorised to borrow 440 billion euros from the markets with the euro zone Member States’ guarantee. The European Financial Stability Mechanism (EFSM) is a financing programme managed by the Commission, which can raise up to 60 billion euros (guaranteed by the Community budget) on the markets.

The plan from the outset was that the EFSM and the EFSF would disappear on 30th June 2013, as, in accordance with the spirit of the Treaties signed since Maastricht in 1992, any financial assistance between euro zone States is strictly prohibited. Moreover, a permanent mechanism could have turned out to be contrary to the German Constitution.

The European Stability Mechanism (ESM) was scheduled to enter into force on 1st July 2012. Its real intervention capacity should be 800 billion euros, and could be raised to 940 billion if required. Nonetheless, the appearance of the ESM will not result in the immediate disappearance of the EFSF, meant to continue until the Irish, Portuguese, and Greek programmes have been wound up. The EFSF is therefore not about to disappear (repayment of Greece's debt is scheduled over a 30-year period).

Legally, the ESM will be a public limited company based in Luxembourg, which is also home to the European Investment Bank (EIB, in order to be able to benefit from this bank's expertise) and the EFSF. Unlike the EFSF, which depended on a guarantee from the States, the ESM will have its own capital, which has initially been set at 80 billion euros, but could amount up to 700 billion (the authorised capital). The ESM proprietary capital will be subscribed by the euro zone countries between now and 2014. The existence of this proprietary capital is meant to make the ESM independent from the ratings the agencies will attribute to the States. This capital will be used as a guarantee to borrow from the markets, and will enable the ESM to lend even before borrowing, in the event of an emergency. Unlike the EFSFs' debt, the ESM's debt is supposed to remain within the organisation, and not aggravate the States' debt. The ESM will have several intervention methods. It will for example be able to lend directly to a State in financial difficulties, buy Treasury bonds on the primary or secondary markets, or also grant preventive assistance or an amount meant to recapitalise financial institutions. However, the ESM will be prohibited from refinancing itself with the ECB, which would have enabled it to get around the ban on the ECB guaranteeing or buying government debt. In fact, the ESM remains in line with the liberal concept of the European construct, which consists in making States' financing dependent on the financial markets.

The ESM is an inter-governmental and non-community body: it is therefore the euro zone Member States who have ratified the ESM that are supposed to make decisions on its behalf. In the event of an emergency, the ESM will be able to intervene if the States representing 85% of its capital shares accept it. Germany, France, and Italy therefore have each a right of veto.

Like the overwhelming majority of the systems implemented by the European Union over the past three decades, the ESM will be subject to very limited democratic control. Thus, only the euro zone Member States' Finance Ministers (the Council of Governors formed by Eurogroup ministers) will be allowed to approve the plans prepared by the Troika. The European Parliament will have no control over the ESM: it will neither be allowed to decide on whether it intervenes, nor prevent it, nor intervene in its operation, nor give its opinion on the conditions or adjustment plans that will be attached to the ESM's intervention. National Parliaments' powers will be strictly limited to controlling their own Finance Ministers' actions. National Parliaments will not be allowed to either approve or disapprove of the plans as such.

Ordo-liberalism's swansong

In reality, the ESM and the TSCG are two sides of the same system, which shares in the same view of the links between State and economy. This is not a liberal view in the usual sense of the term, as it does not confide into the "invisible hand" dear to Adam Smith, or into markets automatically adjusting in order to reach a balance. That view in question should rather be described as "ordo-liberal", after the name of the post-Second World War neo-liberal German school of thought[14]. In this manner to view things, the way the market works does not enable spontaneous convergence towards a balance; there is no "natural harmony of interests". For the market to be able to operate, and a balance to be reached, States must introduce and maintain a restrictive institutional and legal framework that enables market mechanisms to operate. As ordo-liberals believe in the experts' wisdom, they entrust the drawing up of the rules of the game to them.

According to Michel Dévoluy[15], "the economic policies inspired by ordo-liberalism are based on four founding principles: respect for private property, which is based on fundamental law; free access to the markets, which implies a whole series of regulations, especially including fighting financial forces (cartels, oligopolies and monopolies), and distrust of public companies; price stability, which concerns monetary policy, and, specifically, a great importance attached to the independence of monetary policy in spite of governmental pressures; the need for balanced public finances, through fighting any budgetary "laxism".

According to the ordo-liberal view of the euro zone, shared by Angela Merkel and her coalition, to which Nicolas Sarkozy finally rallied, monetary Union must be achieved without pooling or transfers. The stability of the euro zone is ensured by each State's capacity to guarantee the balance of its own public finances by itself, under the constraint of strict institutional rules of constitutional value. The famous concept of a "community of financial stability", which was presented earlier (Part 2), advocated then imposed by Germany, is

[14] Pierre Dardot, and Christian Laval, *La Nouvelle raison du monde. Essai sur la société néolibérale* (*The New Global Logic: An Essay on Neo-Liberal Society*) Paris, La Découverte, 2009.
[15] Michel Dévoluy, *L'Euro est-il un échec ? (Is the euro a failure?)*, 2nd edition, La Documentation Française, 2012.

therefore a concentrated expression of this view of economy and the role of public authorities. The so-called “golden rule” included in Article 3 of the TSCG is the new avatar for this very odd concept of the Union.

As, in the current situation, most euro zone countries are a long way from this balanced budget position, the ESM has therefore been conceived in a way that is fully complementary to the TSCG, as a new disciplinary tool aimed at forcing States to remain in balance. The ESM recreates in the euro zone the pressure of financial markets which had proved incapable of “disciplining” each State individually. Everything can be understood as if we were watching a desperate attempt to keep the obviously obsolete concept of the European construct alive for a few more years.

This means that what the ESM is introducing is not real solidarity under any circumstances. It is, by its very design, a brutal corrective instrument. The ESM only intervenes, using forceps if necessary, as shown by the Greek tragedy, to bring countries that have deviated from the straight and narrow of the maximum 0.5% structural deficit back in line. The ESM and the TSCG, with its so-called “golden rule” are the instruments, and European structural adjustment is the goal pursued.

“Internal devaluation”, a new adjustment variable

In this context, which convergence mechanisms are likely to enable the euro zone to avoid breaking up? Having ruled out establishing real solidarity via a substantial European budget, advocates of the ordo-liberal view, who are fully conscious that a coordination mechanism is required to make up for the disappearance of exchange rate adjustments between euro zone countries, no longer leave any solution except strenuous “internal devaluations”. Behind this technocratic term, presented as going hand-in-hand with “necessary structural reforms”, the aim is to make the “labour market” even more flexible (by making laying off workers easier), to weaken trade unions’ negotiation powers (by decentralising collective bargaining), and especially to lower the cost of labour significantly (by lowering salaries and social contributions).

Advocates of “internal devaluations” begin with the unquestionable observation that the deficits of the peripheral countries are unsustainable, and will need to be corrected despite the impossibility of devaluing their currencies due to the existence of the euro. But the crasy bet they are making is that internal devaluations will enable “competitiveness” to be restored, and thereby unsustainable trade imbalances to be reduced. In the absence of a rapid rise in these countries’ productivity, the aim is therefore to lower all prices, and above all wages, by 10% to 30%, depending on the case, in order to gain competitiveness, in comparison with Northern countries, and particularly with Germany.

The impact of these wage and price reductions would be the economic equivalent of devaluation: after a few months, devaluation of the national currency enables a country to restore its competitiveness, by stimulating exports and simultaneously restricting imports.

Hence the choice of the term “internal devaluations” to describe these policies, aiming at devaluing output costs, in the absence of any possibility to devalue a national currency. The people affected by these policies would accept lower wages and pensions, as the price of internal goods and services would fall proportionately, whereas only the price of foreign goods would be supposed to rise. To its advocates, this solution appears more equitable and acceptable than austerity policies, as this option would avoid recession and unemployment.

Unfortunately, adjustment via internal devaluations makes no sense. Theoretically, it assumes that it is possible to reduce all salaries and prices in exactly the same proportion (10, 20, or 30% for everyone). In that case, the distribution of revenues between social groups would keep unchanged, and the relative demand from economic agents would not move. Therefore consumers and producers would not alter their consumption, and would not substitute one product for another. That is only possible in the smooth, glossy, imaginary world of neo-liberal model builders. In the real world, which is characterised by the social groups’ battles of wills and strategies, lower salaries and prices will *always* result in incidences of redistribution and substitution. Dominant groups do not lower their income as much as the others, and so increase their share of the cake.

Besides, when faced with a general price reduction, economic players freeze their investments and reduce their consumption: why buy today if prices are likely to be lower tomorrow? Price deflation always leads to a collapse in output and to depression. You need to have completely forgotten the lessons of the 1930s, which is unfortunately the case for our European “experts”, to ignore that.

Lastly, like “conventional” devaluations, internal devaluations can only work if a very small number of countries implement them. The higher the number of economically-linked countries that use them at the same time, the more global demand will be affected by these policies, and the deeper the recession will be. In the same way that currency wars are unproductive, the internal devaluation war that is breaking out in Europe is also a dead end. As we have seen, the strategy of the central euro zone countries, and first of all, Germany, has long consisted in squeezing salaries. If all countries adopt that method simultaneously, the recession now beginning will get deeper and deeper. These strategies will not result in competitiveness gains in the South except if the Northern countries agree to be more inflationary than them. This would require coordinating wage policies in Europe, which is not provided for in the Treaties. Under these conditions, it is therefore not surprising to observe that these strategies, which have already been implemented in Greece, Portugal, Italy, and Spain, are only aggravating the recession. These internal devaluations, depriving the countries implementing them of tax revenues, are thus making their deficits, and therefore government debt worse, thereby justifying the implementation of new austerity programmes and new internal devaluations. All they do is contribute to the austerity and recession spiral which is at work everywhere in Europe.

Although the "internal devaluation" strategy is not explicitly mentioned in the Treaty, it appears implicitly in Title IV, called "*Economic Policy Coordination and Convergence*". Articles 9, 10 and 11 are supposed to describe the mechanisms that will enable the convergence of European economies. Article 9 mentions "*an economic policy that fosters the proper functioning of the Economic and Monetary Union, and economic growth through enhanced convergence and competitiveness*". This involves "*fostering competitiveness, promoting employment, contributing further to the sustainability of public finances, and reinforcing financial stability*". This is the way in which the two aspects of the current European strategy, internal devaluations and "structural reforms" are implicitly mentioned.

Part 4

A Pact that is beyond reform

Given the massive reductions in public spending that are already planned, the application of the Budgetary Pact will have a significant recessionary effect. Deficits will therefore not be significantly reduced, and the disparities between Northern and Southern Europe will become considerably wider.

At this point, an increasingly urgent question arises: can the Budgetary Pact be amended by adding provisions on growth and employment? We are told that this is an option that is defended by an increasing number of European leaders, including François Hollande in France, who are concerned about the recessionary consequences of generalised austerity. Although they are austerity enthusiasts, the financial rating agencies regularly mention the risk that it could result in an economic depression that would prevent deficits from being reduced. The Financial Times has even expressed its wish for "a growth agenda for the euro zone", and views the call of France's Socialist President as "encouraging" (09.04.2012). Even Mario Draghi, the very liberal Chairman of the European Central Bank (and a former employee of Goldman Sachs), wanted to introduce a "European Growth Pact", in order to counter the effects of the Budgetary Pact. However, are all these supporters of European growth really talking about the same thing?

Liberal "growth"

Up to now, conservative European leaders have refused any new role for European institutions. On 30th January 2012, the 27 Heads of States and Governments published a surrealistic declaration on "*Towards growth-friendly consolidation and job-friendly growth*" (sic). By way of growth initiatives, they recommend "reforming the labour markets by acting on the cost of labour in relation to productivity", a "reduction of indirect wage costs and tax pressure", and the rapid signing by the EU of new free trade agreements, including with the US. In short, this means more and more reductions in labour costs, more and more free trade and flexibility, and more and more ultra-liberalism, despite the shattering failure of these policies. In fact, these were the policies that had already been imposed by the "Euro Plus Pact", as adopted by the European Parliament on 23rd June 2011.

For Mario Draghi, the "Growth Pact" means a massive further dose of structural reforms: even if they "clash with major interests" and "hurt", declared Mr Draghi, "they must be pursued in the future" (25th April 2012). Following these elliptical declarations, the ECB's spokesman told the AFP that what was in question was to manage reforms such as increasing the flexibility of the labour market, in order to improve the States' competitiveness, and not a public spending fuelled recovery, to which the ECB is firmly opposed. It was Angela Merkel who drove the point home: “we need growth, growth in the form of sustainable initiatives, not just in the form of cyclical programmes, which would increase government debt even further, but growth programmes in the form of structural reforms, as Mario Draghi said today”. In short, the dogmatic blindness according to which more liberalism amounts to more economic growth has reached its pinnacle.

However, the Social Democrats and other leaders in Brussels or Europe want to assign a more active role to European institutions. The idea is as follows: austerity measures are undoubtedly required to reduce deficits urgently, and this is likely to have a recessionary impact; however the Union can counterbalance that effect by introducing growth initiatives. According to this concept “the role of Europe is to provide the growth that the States cannot stimulate by themselves, due to a lack of budgetary resources”[16].

The European recovery: puny tools

Thus the Commission, whose political influence has been reduced to almost nothing since the beginning of the financial crisis, is trying to retake control by putting forward two ideas to boost European growth. The first idea is to “reprogram” the structural funds in the European budget that have not yet been spent, i.e. 82 billion euros. In reality, this is more of an advertising campaign than a new initiative: these funds are nothing new; they have already been programmed in the 2007-2013 budget; the Commission plans to use them by the end of 2013 and States have until 2015 to make use of them. The “reprogramming” would consist in diverting the funds towards supposedly more targeted expenditure on youth employment, but would not provide a single additional euro for growth.

The second proposal *initially* seems a little less hollow: the aim is to create “bond loans focused on projects” (project bonds), intended to finance European investments. At a time when national States’ public investments are set to be substantially reduced by austerity policies, the aim is to counterbalance this recessionary impact with an incentive to increase long-term European investments in projects in priority areas, like energy or transport. However, the investments encouraged in this way are exclusively private investments. As we have already mentioned, the European budget is capped at 1.2% of the Union’s GDP, and the EU can neither run a deficit nor borrow. *Project bonds* are therefore loans to private investors, but which enjoy a guarantee from the European Union. The European Investment Bank finances these projects, which enjoy more favourable ratings (the famous AA or AAA) from rating agencies due to the fact that they are guaranteed by the EU. They will therefore

[16] François Hollande, in an interview with *Médiapart*, on 13.04.2012

be able to obtain favourable interest rates. Not only “will European financing minimise the risk of investors losing money” as Göran Färm, the Socialist MEP responsible for the initiative in the European Parliament underlines, but it will offer these investors reduced interest rates thanks to the Union’s signature.

In fact, this is a European variation on the famous and juicy “PPPs” (public-private partnerships), via which government authorities guarantee the profitability of private investments in infrastructures for the public benefit: the State (in this case the Union) takes on the risk and private investors take on...the profits. The project is still at the experimental stage, but is expected to develop from 2015. At this stage, there is no chance that it will reach a very significant dimension, as it assumes an investment by the European Union (300 million euros for the current experiment), and the Union’s budget is strictly capped by the European Council’s decisions.

The euro-bond mirage

The two options proposed by the Commission are therefore in no way equal to the size of the challenge posed by the Budgetary Pact’s austerity shock. Are there currently other credible “budgetary federalism” options that would enable Europe to provide a boost to growth? If we believe a number of European commentators, introducing the famous “euro bonds” is our last hope.

Euro bonds should not be confused with “project bonds”. The aim of “euro bonds” is not to finance private investments, but issues of government debt securities. This is a proposal backed by the European Socialist Party, and by the Greens, as well as by the European Parliament and some conservative leaders, like Jean-Claude Juncker or Mario Monti, the Italian Prime Minister. It is firmly opposed by Angela Merkel, who sees it as a major risk of incitement to “laxism”.

The Commission’s “Green Paper” on “stability bonds” (as it calls them in its inimitable doublespeak) describes the projects that are currently in discussion. Aside from the various possible scenarios (“euro bonds” entirely replacing national debt, or not, or a mutual guarantee for all the securities issued, or not, etc.), the idea is to enable the various countries in the euro zone to borrow jointly from the financial markets, in order to finance their deficits. Italy or Greece would therefore enjoy the same interest rate as Germany.

However, for Germany or the ECB to agree to this budget federalism, national budgets would have to be under very tight European control beforehand. They want to ensure that the risk of a country going it alone, and letting its deficit soar in the hope of finding cheap financing at the end of the day thanks to the European umbrella is completely eliminated. This is what economists call “moral hazard” in their flowery jargon.

In fact, the risk of moral hazard exists because the Budgetary Pact is not yet in force, and because long-term compliance with it is not yet established. “Euro bonds” will only become a credible option, in the current euro zone environment, once national budgets have been finally constrained by the “golden rule” and the markets are finally “reassured”. The full weight of the word “finally” applies here: it is necessary to ensure that submission to the budgetary discipline desired by the financial markets is irreversible. According to the wording of the Commission’s Green Paper, it is necessary to guarantee “increased supervision of and interference in national budgetary policies”, regardless of the social crises and the political spasms that may shake European societies…. In short, European countries would only obtain financing at a satisfactory rate if they gave up asking for it…

In any event, the “euro bonds” imagined by the Commission would be used to pool issues of European government debt for the most part, in order to make financing current deficits easier. At this stage, there is no question, for the Commission, of significantly increasing the use of bond issues in order to finance public investments on the European level, which is, for instance, the European Green Party’s request. This would indeed require a substantial increase of the Community budget, in order to be able to guarantee these European bonds. But none of the governments currently in power is ready to agree to such an increase, which is expressly prohibited by the Union’s “2013-2020 Financial Framework”.

An illusory Growth Pact

The new French Government’s goal of renegotiating the TSCG resulted in a Pact for Growth and Employment on 29th June 2012. Despite its title, it is not equivalent to the Budgetary Pact. It does not include any precise targets either for employment or growth, or in terms of national or European strategy. For the most part, it merely reiterates projects that are already under way, mainly inspired by liberal policies: the Europe 2020 strategy, the need to guarantee the viability of retirement systems (i.e. by delaying the retirement age or reducing pension levels), to improve the quality of public spending (which often means the so-called unproductive welfare expenditure, but increasing assistance for companies), to increase youth employment, to encourage workers’ mobility, and to open up competition in the services, energy, and public market sectors.

The Pact recognises that there is no general agreement on a financial transactions tax in Europe, but opens the door to increased cooperation, i.e. an agreement between some countries, but without the United Kingdom and Luxembourg, which will significantly reduce its range.

Strictly speaking, the recovery measures are limited, not to say non-existent. An amount of 120 billion euros, i.e. 1% of the euro zone's GDP is involved, but the measures apply over an indefinite period of time, whereas national austerity programmes amount to 240 billion euros per year. These 120 billion break down between a planned 60 billion increase in the EIB's lending capacity, via a 10 billion increase in its capital, a planned 5 billion bond issue aimed at financing infrastructure projects, and lastly, an allocation of 55 billion in structural funds that were already available, to "measures aimed at boosting growth". In all three cases, there is no guarantee that funds will actually be released.

The Pact therefore looks like a sham concession, which enables the French Government to save face and ratify the Budgetary Pact.

We could cruelly observe that the European economic analysts' growth forecasts for the euro zone in 2013, as published by *Consensus Forecasts*, fell from 0.7% in early June to 0.5% in early July. They were hardly convinced by this so-called revival.

The euro zone needs to regain the 8 GDP points lost because of the crisis. Furthermore, these are not any 8 points, when the aim is to start an ecological transition. Member countries' government deficits would be sustainable if the lost economic activity was regained. Giving up this goal means accepting that mass unemployment will continue. The European Authorities ought to present a consistent crisis exit scenario. Imbalances should be absorbed in a coordinated manner: countries with a surplus ought to implement expansionary policies, i.e. wage and welfare spending increases, etc. to make up for the Southern countries' restrictive policies, which should to be lightened. A vast European programme should start the ecological reconversion of European economy, and encourage re-industrialisation in Southern European countries. The Growth Pact is a long way from fulfilling that requirement.

Banking union: the leap forward

The euro zone crisis has highlighted a dangerous echoing effect between the situation of a country's finances and that of its banks. Lowering a country's government debt rating makes its banks more vulnerable, as they hold a lot of that debt; they suffer losses and the quality of their balance sheet deteriorates. In return, the financial markets think there is a risk that the Government would have to rescue its banking system, thus justifying another downgrading. The European Summit of 29th June has launched a new project, namely a banking union. Is this a necessary complement to the Monetary Union, or is it another leap forward?

This Banking Union is supposedly based on three pillars: a European Authority responsible for centralised supervision of the banks, a European deposit guarantee fund, and a joint plan for solving banking crises. But there are many obstacles, some of them in relation with the complexity of the EU's functioning, others in relation with the structural choices that need to be made regarding how the European banking system operates.

In the very short term, the pending issue is whether the deposit guarantee will cover the euro value of Southern European banks deposits. This is essential if Europe wants to stem the current flight of Greek of Spanish depositors to German banks. However, Northern European countries do not want to take the risk of having to compensate Greek depositors, if Greece leaves the euro zone. So we're back to square one.

A European supervision, as well as a European guarantee, implies a common approach to banking system regulation. An agreement is needed on crucial issues, such as: should retail banks be split from investment banks? Should banks be prohibited from intervening on financial markets on their own account? Should the development of public, cooperative, or regional banks, fully integrated in their own countries be encouraged, or on the contrary, that of large "financialized" international banks? There is a significant risk that entrusting these issues to the ECB turns out to be a new step towards depoliticising Europe and financializing its economies. Governments will lose their ability to influence the way in which banks distribute loans, which is desirable for liberals, (no political interference in lending), but seems dangerous to us (governments will lose a potential industrial policy tool).

The issue of the supervision quality also arises. Can heterogeneous banking systems be supervised in a centralised manner? Can the same criteria be imposed on banks in countries that are at different stages of their development?

In theory, a Banking Union would enable the correlation between the sovereign debt crisis and the banking crisis to be broken. National banks would be invited to diversify, and to buy fewer of their own country's securities. However, this would increase Governments' dependence on financial markets, as countries could no longer rely on their banking systems to purchase securities. There is therefore a significant risk that a Banking Union would be a new step towards financialization, towards Nation States losing control of their economies, and towards the markets taking control of the banks.

The proposed plan to solve banking crises (failures would be paid for by the shareholders and then the creditors) is likely to make banks more vulnerable, and to increase the cost of credit, while reducing its quantity. The banks' solvency will primarily depend on their equity capital, therefore on the markets' assessment, and we well know how blind markets can be.

In fact, the opposite strategy would be required, namely a restructuring of the banking sector, where retail banks would focus on their country and on their core business (local lending to companies, households, and national communities), where they would enjoy stable low-cost resources, by gathering households' savings, where their solvency would be guaranteed by a ban on carrying out risky or speculative transactions, like lending to speculators, on the one hand, and by the States and Central Banks on the other, so that the markets would have no say in the matter.

The ECB holds the reins…

On 6th September 2012, the ECB announced a purchase programme of countries in trouble's government securities from the secondary market, but only short-term securities, i.e. maturities of one to three years. It did not set any quantitative limits on these purchases. On the other hand, it did not mention any objective in terms of interest rate levels, or acceptable interest rate spreads. To show that it was taking the same risks as private creditors, it waived its priority creditor status for these securities.

In fact, these interventions will be subject to strict conditions. Countries will need to have negotiated an adjustment programme with the Commission and the European Stability Mechanism, and the programme will have to be controlled by the IMF. At the same time, the ESM will have to help the country through purchases from the primary market. Assisted countries will have to make commitments regarding budgetary adjustment and structural reforms. As short-term securities are involved, the ECB will always be able to stop these purchases if the assisted countries do not fulfil their commitments.

Will Spain (or Italy) agree to being placed under this triple supervision? Will these countries agree to lose their sovereignty? In any case, there will be strong pressure to agree on these countries.

In early September 2012, Germany was borrowing at 1.5% for ten years, while Italy was borrowing at 6% and Spain at 6.5%. The markets' expectations are self-fulfilling: they pretend to fear that Spain could fail; therefore, they refuse to lend to the country, or impose high rates on it, which increases the risk of default. As these rates are also imposed on Spanish companies, this contributes towards plunging the country into recession. By not fixing a limit for its interventions, the ECB is able to reassure the markets regarding the risk of these countries defaulting, and on the risk of the euro zone breaking up. It can shatter self-fulfilling expectations, so that it is not required to intervene on a massive scale. Falling interest rates can contribute towards reviving economic activity.

Conversely, countries will have to maintain strict austerity policies. The strict conditionality is problematic: markets could always pretend there is a risk that Spain would not fulfil its commitments. The rate imposed on Spain fell from 6.5% to 5.5% on 12th September, but it is still an unbearable rate.

More fundamentally, the ECB is imposing its views on the economic strategy to follow. It is imposing structural reforms on the labour and goods markets, strict compliance with balanced public finance targets, despite the recession, as well as the rapid application of the Budgetary Pact. There is a risk that this generalised austerity plunges the entire euro zone into a long-term crisis. The euro will be saved, but Member States will be on their death beds, and their people will suffocate.

Budgetary discipline, yes…but for the benefit of the people

The Appalled Economists are not fans of deficits, and even less opponents of coordinated economic policies in Europe. On the contrary, it is obvious that, for a single currency shared by several States to be viable, their budgetary policies must be harmonised and coordinated. Being granted that public investments need to be financed by loans, yet States' current expenditure, public services, and social benefits should be financed for the most part by taxes and contributions, aside from inevitable cyclical deficits. It is therefore desirable that revenue distribution should not be distorted for the benefit of the wealthiest people and big companies to such a degree that household consumption suffers, which makes the accumulation of deficits necessary.

What makes the budgetary deficit rules imposed by the Pact unacceptable, aside from their automatic and anti-democratic nature, is that they are part of an institutional context of aggravated tax, social, and ecological competition, and dominating financial industry, which almost automatically conveys insecurity, unemployment, and less social welfare for the people. Euro zone States are supposed to harmonise their deficits -expected to tend to sero- but they are currently obstinately refusing to harmonise their government revenues. By continuing to engage in tax dumping, which eats up their revenues, at a time when the European budget itself remains capped at the ridiculous level of 1.2% of GDP, they are condemning themselves to endlessly[17] cut off their expenditure.

Moreover, as they do not benefit from the unconditional guarantee of a Central Bank as a lender of last resort, they must continually "reassure" their lenders, i.e. banks and investment funds that decide on the public debts' interest rates, and therefore submit to their demands.

Thirdly, given the totally free movement of capital, they must endure the repeated shocks of financial crashes, which result in unemployment and public deficits. Even worse, they must keep guaranteeing the capital owners, i.e. the big industrial and financial groups shareholders, stable and high, or even unsustainable rates of profit, like the famous 15% (or even higher) annual return on investment. Otherwise, the capital would flee to more friendly skies.

[17] This state of affairs and its consequences were presented and discussed in great detail in our previous publication, *Changer d'économie (Changing our Economic system)* (op. cit.)

Lastly, due to the free movement of goods and to the abolition of customs duties, to free trade rules and lower transport costs, etc., States are forced to put increasingly heavy pressure on salaries and payroll costs, in order to face up to the competition from emerging countries where productivity and salaries are rising fast, but are still much lower than in Europe.

As long as these four pillars of neo-liberalism – tax competition, mandatory financing via the markets, freedom to speculate, and unlimited free trade – support the architecture of the euro zone, it will only be able to survive, in fact only temporarily, through repeated attacks on the Welfare State and public investment. Economic policies will be coordinated on the lowest level basis, via the lowest amounts in terms of tax and social security. The prospect of an ecological transition will fade away for good.

This is why the Budgetary Pact is beyond reform. Indeed, saving the very idea of the European construct implies undertaking a complete overhaul of the euro zone's architecture. We need to work on a new European treaty, which frees economic policies from the financial markets' domination, and establishes a European policy aimed at solidarity and sustainable development. We can realise how far our current leaders are from such a treaty by observing, with consternation, that, for the Commission, the future tax on financial transactions, if it ever sees the light of day, will be used…not to increase the Community budget in order to finance public investment and jobs, but to reduce Member States' contributions by 50%, in order to help reduce their deficits[18]! In other words, this means taxing finance on the European level in order to satisfy it on national levels…

To conclude

Is Europe going down a "post-democratic road" with the "Budgetary Pact", as Jürgen Habermas, the great German philosopher says, (though he was one of the fiercest supporters of the European Constitutional Treaty in 2005)? Our own analysis confirms and clarifies this assertion. Not only do the provisions of this new treaty further marginalise Parliaments and people; not only, by radicalising the ordo-liberal theories that have led Europe to a dead-end, are they leading to the dislocation of the euro zone, and beyond that, of the entire European construct we inherited after 30 years' neo-liberal policies. The

[18] As Manuel Barroso, the President of the European Commission, stated on 22.03.2012, "the financial transactions tax could reduce Member States' contribution to the European Budget by about 50%".

economic and social chaos that would result from this dislocation would have incalculable consequences, only comparable to those experienced in the 1930s. The political effects we can expect are, no doubt, the inexorable rise of the Far Right.

The comparison with the 1930s is not a matter of form or a rhetorical device, but an actual fact for historians, as well as for economists like us. “The systematic choice of austerity, the slimming diet and the race for price competitiveness within the euro zone are dangerous reminders of the 1930s, when the members of the “gold block” (Belgium, France, Italy, the Netherlands, Poland and Switzerland), who remained faithful to the gold standard, competed via deflationary policies, whereas their trade partners recovered from depression, one after the other, through devaluations, expansionary monetary policies, and strenuous Government interventions in weakened economies”[19]. Fetishes - yesterday’s gold standard and today’s ordo-liberal concept of the euro zone - are long-lasting, and the people could well pay for them.

The Budgetary Pact will have such an enormous depressive effect that it could not be counterbalanced through simple “corrective” measures, taken alongside it, and “in the opposite direction” on a European scale. Such measures would obviously be insufficient, given the current meagreness of the European budget, which is capped at 1.2% of GDP. A Vitamin C tablet cannot save a terminally ill patient, who has also just been given a lethal dose injection. There is no alternative but to seek a real alternative. Economic solutions have emerged implicitly throughout this publication; however, it may be useful to summarise them briefly as a conclusion.

Proposals to open new perspectives

The euro zone will not recover from the crisis by accumulating austerity plans aimed at “reassuring” financial markets. Other policies are necessary to give the European Union and the euro zone a chance. To be effective and sustainable, a crisis exit scenario implies the implementation of different policies.

The measures we are presenting here do not pretend to be a panacea. They are only intended to show that alternatives are possible, and that those alternatives can materialise in specific provisions. To give Europe a chance, we must be determined to take new directions, the basis of which consists of the following proposals.

[19] Pierre-Cyrille Hautcoeur, “*Le Pacte budgétaire, un choix de vieux” (The Budgetary Pact, an old people’s choice)*, Le Monde, 13.02.2012

Proposal 1: disarming financial markets by prohibiting speculative transactions (especially on derivatives held without real counterparty, so that it would no longer be possible to speculate on a State's bankruptcy);

Proposal 2: making the ECB guarantee government debts, so that all countries could finance themselves at 2%, a risk-free rate, for ten years' terms. If necessary, making the ECB intervene and buy public securities in order to keep interest rates low, as the United States and United Kingdom's central banks are currently doing;

Proposal 3: renegotiating the excessive rates at which some countries have had to borrow since 2009, and restructuring obviously unsustainable government debts. Calling into question the States' responsibility for bank debts; and in the same spirit, not refunding assets accumulated by tax evasion;

Proposal 4: stopping tax competition, and undertaking a vast tax reform instead, in order to make the financial sector, financial transactions, exorbitant salaries, multinational companies, and private property inflated by financial or housing bubbles, pay for the crisis;

Proposal 5: prohibiting European banks and companies from doing business and having subsidiaries in tax havens;

Proposal 6: carrying out a thorough reform of the banking system, by refocusing banks on credit distribution, prohibiting them from speculating and financing speculation, separating retail and investment banks, and by building a powerful European financial unit, under social and democratic control;

Proposal 7: setting up Public Sustainable Development Banks (PSDBs), that would gather households' savings;

Proposal 8: ending austerity policies, boosting economic activity and starting an ecological transition instead, partly with the sums gathered by the PSDBs;

Proposal 9: building a real European budget, for instance through a tax on financial transactions and a green taxation, in order to organise the resource transfers required for real economies' convergence;

Proposal 10: implementing a strategy for social and eco-friendly growth, based on four main stages: an upgrading of the Common Agricultural Policy (CAP), tight regulations on finance, an industrial policy organising the essential ecological transition, and establishing a social Europe based on a sound and shared basis;

Proposal 11: ensuring real coordination of macroeconomic policies, and a coordinated reduction of trade imbalances between European countries. In this context, countries with significant surpluses would have to finance countries with deficits via direct investment or long-term loans;

Proposal 12: democratically drawing up a real Treaty for coordinating the economic policies of EU countries. The treaty would include targets for real economic convergence, employment, and ecological transition. It would introduce an economic strategy using monetary, budgetary, tax, social and wage policies, as well as a euro zone' exchange policy, in order to bring countries closer to full employment.

It goes without saying that these 12 proposals are not enough. They need, and will need to be supplemented. However, we believe that they are sufficiently clear and consistent as they stand to fuel the essential public debate, which is now open on the future of Europe and of the euro zone.
We, the Appalled Economists, can but observe the European elite's hopelessly repeated blindness, locked in as they are in that neo-liberal autism which only consider economic policy as an endlessly repeated attack on social compromises and democratic choices. Our hope rests on the collective awakening of the European people. Despite the fact that its architecture is lopsided, and unsustainable in the long term, the euro currently provides the European people with a reason to take action together, with a common interest to reclaim their institutions - and especially the European Central Bank- that hold their destiny in their hands. The collapsing - not unlikely at all - of the euro in the coming years might lead to economic and political chaos, with incalculable consequences.

It is through a common process of rebuilding the euro on the basis of social solidarity and democracy that it will be possible to avoid the worst in Europe. This process will have to be based on European social and civic mobilisation, inasmuch as the leaders who are in control of European institutions seem to be riveted to their dogma, and a thousand miles away from what is required now.

By issuing this publication, and making this research available to the public, in collaboration with our fellow critical economists in other European countries, we wish to contribute, from where we stand, towards highlighting the possible paths for the urgent and essential re-foundation that Europe needs.

Appendix 1

The mysteries of structural deficit

“Structural balance” is undoubtedly one of the more esoteric concepts ever to appear in an international treaty. It corresponds to the public deficit that would be achieved if the GDP of the country in question reached its potential level, i.e. the level corresponding to a normal economic cycle.

This method implies that it is possible to define potential growth, i.e. a output trend that only depends on supply factors (productivity trend, capital stock, potential labour force, and unemployment equilibrium rate). In reality, the European Commission’s method, i.e. the method that the Treaty forces us to use, means that its estimate of potential output is always very close to actual output, particularly during a recession. Thus, the capital stock used to calculate potential output is the actual stock, diminished by a fall in economic activity; the available labour force is the force recorded, minus those who have withdrawn from the labour market (in a period of unemployment, young people keep studying, and senior people give up looking for a job), technical progress trend is estimated via smoothing the rate observed, which is weakened by the recession, and the unemployment equilibrium rate is always close to the rate recorded, again according to the Commission’s method.

As shown in Table 1, regarding France (but the same is true for the whole euro zone), the potential growth rate estimated by the Commission matches the evolution of the rate recorded. Thus, potential growth would have fallen from 2% to 1% because of the crisis. Also, according to the Commission, the gap between potential and real output (known as the “output gap”) would have only been -2.3% in 2011.

Conversely, if we suppose that the crisis did not affect potential output growth, the gap between real and potential output amounts to -7.6%., which means that the “output shortfall” likely to be made up by a sound economic policy is three times as high.

The consequences for the structural deficit estimation are significant, all the more as the Commission, regardless of common sense, includes in structural deficit the expenditure relating to economic recovery programmes, despite the fact that such programmes are purely cyclical. Thus, the Commission’s estimate for 2009 is -6%, and ours is -2%. For France, in 2012, the Commission expects a -3% output gap, compared with -8.3% according to the stable potential growth scenario. According to the Commission the structural deficit is therefore -2.9 %, therefore requiring an adjustment of public accounts equivalent to 2.4 GDP points, which is significant. According to our estimate, the structural deficit is only -0.3 %, so inferior to the alleged fateful 0.5 % limit; there is no need for austerity,(especially, as we would remind you, that a deficit of around 2.4% of GDP is enough to stabilise government debt, or to ensure that the deficit only finances investment).

Another very serious flaw is the fact that the Commission makes significant revisions to its past estimates depending on the economic trend. For instance, in the spring of 2008, it estimated that the gap between real and potential output in the euro zone was -0.2%; today it estimates that gap at +1.4%. In other words, according to the current estimation, the euro zone was overheating in 2006, when it recorded a 1.4% GDP growth, therefore inflationary! For France, the estimate has likewise risen from -0.2% to 2.3%. Just as strange, in 2008, the estimated potential growth rate for the euro zone in 2009 was 1.8%; it has fallen to 0.9% today (for the same year, i.e. 2009!).

In 2007, the unemployment rate in France was 8.4%, and there was no inflationary pressure. The Commission judged that France was only 0.3% below its output capacity. That was already highly questionable, as it meant considering that the 8% unemployment rate could not be reduced. So what could we say when, two years later, the Commission revised its calculations, and then stated that France was in fact 2.8% above its potential output level and therefore taken away by an inflationary acceleration! In fact, according to the Commission's wild imaginings, the unemployment equilibrium rate (which prevents inflation accelerating) would have been 12.4% that year!

Table1. France's "structural deficit" varies significantly depending on the calculation method adopted

	2006	2007	2008	2009	2010	2011	2012
GDP growth		2.3	-0.1	-2.7	1.5	1.7	0.4
Public balance as a % of GDP	-2.3	-2.7	-3.3	-7.5	-7.0	-5.2	-4.4
Commission							
Potential growth	1.9	1.8	1.6	1.2	1.3	1.3	1.1
Output gap	2.3	2.8	1.1	-2.8	-2.6	-2.3	-3.0
Commission structural balance	*-3.6*	*-4.2*	*-3.9*	*-6.0*	-5.7	-4.6	-2.9
Our method							
Potential growth	2.1	2.1	2.1	2.0	2.0	2.0	2.0
Output gap	*0*	*0.1*	*2.1*	*6.8*	*7.3*	*7.6*	*8.3*
"Appalled Economists"' structural balance	*-2.3*	*-2.8*	*-2.3*	*-1.9*	-2.2	-1.4	-0.3

The estimates are particularly delicate for the last few years, the current year, and the years to come.

And it is precisely these estimates that should be used to implement budgetary policy. The Commission will be able to condemn a country, on a certain estimate basis, and two years later, once the estimate has been revised that condemnation will appear unjustified(or vice versa).

The conclusion is simple: all these uncertainties cast doubt on the potential growth concept, and mock the very idea of enshrining the structural deficit concept in a Treaty or a Constitution. The Commission's estimates of potential growth are likely to be self-fulfilling, if, as soon as growth exceeds 1%, restrictive policies are implemented out of fear of inflation!

Appendix 2

From the Stability Pact to the Treaty for Stability, Coordination and Governance: a brief history

The European Monetary System, which operated between 1979 and 2009, was characterised by the predominance of Germany. The Bundesbank set its monetary policy in accordance with Germany's situation, and the other countries were forced to follow. The day after the Berlin Wall came down, François Mitterrand obtained the introduction of a single currency, the euro, from Germany's leaders. However, Germany would only agree to it if the currency was built according to the principles of ordo-liberalism, i.e. with competition as the supreme rule, and the neutralisation of political power over economic decisions. The Neo-Liberals therefore took advantage of Germany's authority to impose a Maastricht Treaty that was in line with their wishes.

The three pillars of the ordo-liberal plan for the European construct are: an independent Central Bank, the sole aim of which is price stability, automatic budgetary policies that are constrained by strict budget balancing rules, structural reforms aimed at liberalising goods markets, deregulating financial markets, and lightening employment law as much as possible.

- **1st pillar: The ECB's independence**

According to the Maastricht Treaty, the European Central Bank is independent of governments. Its "main aim is to maintain price stability. As long as this aim is not called into question, the Bank provides its support to the Union's general economic policies. It acts in accordance with the open market principle, where competition is free." Its independence allows it not to care about growth or employment, and to devote itself to fighting inflation. In fact, according to the neo-liberal version of its role, the Central Bank must convince workers that it will not hesitate to create unemployment if they receive excessive salary rises, in order for the workers to resign themselves to wage stagnation.

The Treaty specifies that the "*ECB and national Central Banks do not have the right to finance States directly*".

"*The ECB defines and implements the Union's monetary policy, performs foreign exchange transactions, holds and manages foreign exchange reserves, and guarantees the proper operation of payment systems*". It is not only responsible for implementing the euro zone's monetary policy, but also for defining it. The ECB, which controls the implementation of monetary policy, could have received detailed instructions regarding the inflation target, arbitration between inflation and output, these instructions being revised if necessary in cooperation with the Council, the Commission, or the Parliament. This was not the choice they made.

The ECB has therefore set the price stability target itself, price stability, as measured by the euro zone's Harmonised Consumer Price Index (HCPI), where the annual increase must be inferior to 2%. This is a medium-term target. The ECB acknowledges that it cannot control very short-term price volatility. However, it does not clearly specify that it is only looking at an underlying inflation indicator (excluding raw materials price shocks).

The euro fluctuates freely. The Treaty specifies that "the Council, on the Commission's recommendation, can draw up general exchange policy guidelines in relation to non-community currencies. These guidelines must respect the ECB's independence, and not threaten price stability". In fact, the Council has never given the ECB any instructions on foreign exchange policy.

The ECB is managed by a Council of Governors that includes a Chairman, a Vice-Chairman, four members "whose authority and professional experience in the monetary or banking area is recognised", appointed by the Council after consulting the European Parliament and the Council of Governors, as well as the national Central Banks' governors. Insofar as that the ECB's role is not to manage the monetary and banking sector, but to ensure macroeconomic management, and arbitration between inflation and employment, we can only regret that it does not include any trade unionists, or politicians. This inevitably gives the ECB a one-eyed viewpoint.

This organisational structure poses a large number of problems, which have gradually appeared since 1999:

- It does not enable a coordinated strategy between monetary and budgetary policies.

- The ECB is not responsible for banking or financial systems supervision, which is still ensured according to national procedures. Besides, the ECB, which is obsessed by inflation, has not been concerned about the risks brought about by financial deregulation and financial bubbles.

- A common monetary policy in terms of interest and exchange rates cannot be appropriate for countries with greatly different growth and inflation rates.

- No external balances adjustment mechanism for has been provided for: that is why, until 2008, the central countries were able to accumulate surpluses, whereas the peripheral countries were accumulating deficits.

- The Treaty clearly specifies that the EU is not responsible for Member States' government debts, and that there is no financial solidarity between them. Given that the ECB is prohibited from financing them, the States' ability to finance themselves is becoming problematical. The financial markets realised that in early 2009.

- **2nd pillar: The Stability and Growth Pact**

The signatories to the Maastricht Treaty's other obsession was to control budgetary policies. The argument they put forward was that a country that implemented an over-expansionary policy would harm its partners: this would cause a rise in inflation (which would result in an interest rates rise), and in external deficit, damaging the euro's value. However, the link between public deficit and the "over-expansionary" nature of economic policy is not obvious: a country experiencing an economic depression needs a certain amount of deficit in order to support its economic activity; this does not harm its partners, on the contrary, as it avoids its depression spreading to them. A country may experience high inflation and a significant external deficit without a public deficit, in the case of a property bubble, for instance. Conversely, no sanction has been provided for against a country practising an over-restrictive policy, bringing about a fall in economic activity, and a rise of its partners' external deficits.

In June 1997, European countries adopted the Stability and Growth Pact (SGP). This Pact included three provisions:

- Countries are not entitled to run public deficits exceeding 3% of GDP; this limit applies to nominal balances (unadjusted for cyclical fluctuations). This limit is the only one that can be sanctioned; a country that exceeds it is submitted to an Excess Deficit Procedure (EDP), is forced to introduce a restrictive budgetary policy in order to return below this limit, and is forced to account for its budgetary decisions to the Commission and to the Council; lastly, it may be subject to a potential fine.

- Countries must not have a government debt exceeding 60% of GDP. If they exceed that limit, they must reduce the amount of their debt significantly.

- Each country must present a stability programme at the end of each year, including a 4-year budget programming plan (the budget voted for the following year and a forecast budget for the following three years). This programme must include a macroeconomic forecast, and all the budgetary measures that are planned; it must aim for the medium-term goal of a budgetary position close to balance.

These rules have no economic justification at all: the 3% and 60% figures are completely arbitrary, as is the goal of a balanced budget in the medium term. It is not possible for a country to set its budgetary policy for the four following years, without taking account of the cyclical trend.

The SGP is not a process for coordinating national budgetary policies, as it imposes arbitrary rules, without taking the economic situation of the euro zone and of each member country into account.

The SGP has resulted in continual tensions in Europe since the 2001 economic crisis. Member countries needed a certain deficit to support their economic activity, while the Commission intended to prohibit them from having one. In 2005, 5 of the 12 countries in the euro zone had a deficit that exceeded 3% of GDP: Greece (which joined by massaging its data, has never managed to get below 3%), Germany and Italy (five years above 3% between 2001 and 2005), Portugal and France (four years above the 3% mark).

These problems led to continual reforms to the Pact. In July 2001, the countries agreed to set themselves a target of balancing their structural balances in the medium-term; once that balance had been achieved, they would have to allow the automatic stabilisers to play their part without implementing any discretionary policies. In this way, budgetary policy would have become automatic, as governments would have lost all room for manoeuvre, even in the event of a recession. In March 2003, the Council decided that countries that had a structural deficit had to reduce it by at least 0.5 GDP point per year. Instead of seeking to design an effective coordination process for their budgetary policies, governments therefore got into the habit of making unrealistic economic commitments at European Councils, under pressure from the Commission, and then not fulfilling them in their budgetary decisions.

A crisis broke out in November 2003, when the European Council rejected the sanctions that the Commission demanded for Germany and France that refused to take restrictive budgetary measures to return below the 3% limit, due to the weakness of their growth rates. Romano Prodi, the President of the Commission, acknowledges that the Pact's rules are "stupid", but refuses to alter them without a further step towards federalism. The March 2005 agreement for "Improving the implementation of the Stability and Growth Pact", softens the rules of the Pact, by enabling countries to mention "relevant factors" to justify a limited temporary exceeding of the 3% limit, such as a very negative output gap, policies implemented as part of the Lisbon Agenda, R&D expenditure, public investments, or spending on global, European, or unification social solidarity. The Council will not decide to implement sanctions (contrary to the commitments made in 1997), on an automatic estimate, but on a political one. However, the principles of a medium-term goal of a balanced budget, and of the annual 0.5 GDP point improvement in the structural balance (if it is in deficit), are maintained.

From 2005 to 2007, the strong economic growth in the euro zone and the implementation of restrictive budgetary policies in Germany, Portugal, and Finland enabled all the countries to get their deficit below the 3% level. However, many countries were above the 60% debt limit (Greece, Italy, Belgium, Portugal, Germany, and France).

The SGP does not take any account of current balances, competitiveness, financial and property bubbles, or of private debt. Thus, Spain and Ireland, whose deficits and government debt complied with the SGP criteria, now find themselves among the States that are most exposed to sovereign risk due to the nationalisation of bank debts. Spain's government debt thus increased from 36% of GDP in 2007 to 60% in 2010, and Ireland's rose from 25% to 96% in 2010. The European Commission, obsessed with blind compliance with the SGP, and especially with the 3% rule, the only one for which it has a power of sanction, has not introduced a macroeconomic strategy that is coordinated and that will boost growth in the euro zone. It has allowed an increase in the imbalances between the central countries (Germany, Austria, the Netherlands, and the Scandinavian countries), which were restraining their wages and internal demand, accumulating external surpluses, and the peripheral countries (Spain, Greece, and Ireland), experiencing strong growth, boosted by interest rates that were low relative to their growth rates, and accumulating external deficits.

The financial crisis forced the Commission to recommend budgetary recovery measures in 2008 and 2009, (after proclaiming that they were harmful for 10 years). Every country (except Finland) exceeded the 3% deficit and 60% government debt limits. The SGP had to be (momentarily) forgotten.

3rd pillar: Structural reform programmes

The Commission set itself the target of implementing structural reform programmes, which, in reality, aimed at forcing the member countries to join in the same neo-liberal model. Under the various names of MEPGs (Major Economic Policy Guidelines), Guidelines, Lisbon Agenda, National Reform Programmes (NRPs), these structural reform programmes primarily consisted in liberalising goods markets, deregulating financial markets, weakening employment law, and reducing social spending and tax. The Commission put pressure on member countries into introducing these reforms, which enabled national governments to give that pressure as an excuse for imposing unpopular reforms.

Driven by industrial or financial pressure groups, compliance with the principles of competition, or the "four fundamental freedoms" (free movement of goods, services, capital and persons, free establishment of companies and people) has been continually invoked, in order to force States into implementing these reforms, with the European Court of Justice (EUCJ) coming to the Commission's rescue, if necessary.

According to the Commission, taxes harm economic activity, and public spending is not really efficient; the public sector therefore needs to be reduced, and its activities transferred to the private sector, in order to increase economic efficiency and be able to reduce tax. The Commission is thus fighting to reduce public health and retirement spending, to promote funded pension schemes and private insurance, in order to reduce the weight of public services, and to allow private companies to compete with them, regardless of the social cost. In fact, the aim of "making work more profitable" has been used as a pretext for recommending the "modernisation of social welfare". Conversely, the Commission has refused to see the risks incurred by tax competition and financial deregulation.

Appendix 3:

The many layers of the "new" EU governance system

Since the crisis, some of the most absurd clauses of the Maastricht Treaty, like the ban on euro zone States helping one another, have been smashed to pieces. The Commission and the Council have been forced to implement new schemes in order to support countries attacked by speculation, to organise support for banks that were threatened by the risk of the most heavily indebted States defaulting on their payments, and to tighten control over member countries' economic policies, without calling into question either the Stability and Growth Pact, or neo-liberal structural reforms. An intensive round of legal and regulatory activity therefore resulted in 2010 and 2011 in a number of innovations of which European citizens are unaware, that the TSCG is now consecrating.

A) The European Semester

On 30th June 2010, the Commission suggested introducing a "European Semester", during which Member States would present their budgetary policies, together with their plans for structural reforms (National Reform Programmes) to the Commission and the European Council, who would give their opinion, before national parliaments voted for them in the second semester. The European Council approved this proposal on 7th September 2010.

Undoubtedly, a process of this kind could be useful if it involved defining a coordinated economic strategy: the output gap for the whole euro zone, which means the overall budgetary policy to implement, would need to be estimated, as well as external imbalances, thereby identifying the countries that should implement more expansionary budgetary and wage policies, and those who, conversely, should implement more restrictive policies. The risk of this "Semester" is that the pressure in favour of liberal reforms and budgetary austerity policies will increase, with no concern for general consistency. This "Semester", a new technocratic process, will also have the effect of further distancing decisions from democratic debate.

In February 2011, the Commission suggested an initial framework for the first economic policy coordination semester. This framework is based on ten measures: a thorough budgetary "reorganisation" (the macroeconomic impact of which is not specified, as the state of public finances still keeps prior to that of employment), a correction of macroeconomic imbalances (which involves wage moderation in countries with a deficit, liberalising services and trade in countries with a surplus, and never involving increasing wages or social spending anywhere), the financial sector stability , making work more "attractive" (as if the current problem was employees refusing to work), reforming retirement schemes (i.e. making them less expensive and promoting pension funds), reintegrating the unemployed (via reforms, i.e. lower benefits), combining security and flexibility on the labour market, taking advantage of the single market's potential (more liberalisation of services and trade), attracting private capital in order to encourage growth (the aim is to establish public-private partnerships, at the risk of increasing the cost of public investments), and enabling access to affordable energy (but does this involve the proposed privatisation and free competition measures?). Macroeconomic strategy, ecological transition, industrial policy, and bringing the financial markets into line have been forgotten in this framework.

Lastly, the central guidelines are budgetary consolidation (i.e. reducing deficits through austerity policies), reforming labour markets, and supporting growth by liberalising markets.

In 2012, the five guidelines retained are: 1/ pursuing budgetary consolidation in varying manner, countries in trouble will have to meet their deficit targets, regardless of the trend in the economy, while countries with a surplus can let the automatic stabilisers come into play; 2/ restoring normal lending conditions; 3/ promoting growth and competitiveness (once again via liberal reforms); 4/combatting unemployment, by suppressing the index linking between wages and price, encouraging workers' mobility, abolishing pre-retirement benefit systems (the text however does acknowledge the necessity of creating "green" and "white" job); encouraging young people's employment (through training and apprenticeship, as well as by "lightening" labour laws, which offer too much protection to actually employed workers), protecting the most vulnerable; and 5/ "modernising" administration. The whole package is not equal to the economic environment (according to the Commission, growth is expected to be slightly negative in 2012) or to the structural challenges.

B) The Six Directives (or "Six-Pack")

On 29th September 2010, the Commission presented a package of Six Directives, aimed at strengthening economic governance, but in reality compliance with the SGP:

1. Countries may be sanctioned if public spending increases faster than the prudent GDP growth rate (except if is compensated by increased revenues, or if the country has a budgetary surplus). That would prohibit support measures based on an increase in public spending. Do we really need prudence in a period of economic depression? What would happen if households stopped consuming and companies stopped investing out of prudence?

2. Countries whose debt exceeds 60% of GDP would be subject to an excessive deficit procedure if the debt ratio had not decreased by at least one twentieth of the difference with 60% every year.

However, it is almost impossible to avoid the debt ratio increasing in a period of economic slowdown. This new rule is pro-cyclical: it reinforces the constraint on deficit during a period of low growth. For a country where debt is 90% of GDP and inflation is 2% per year, public deficit must not exceed 2% of GDP if its growth is 2%: it will have to be limited to no more than 1% if the country's growth does not exceed 1%.

3. Countries, where public spending is increasing "too fast", or subject to an EDP will need to deposit between 0.2% and 0.5% of their GDP, which may be confiscated if the required measures are not implemented. They may find themselves deprived of structural funds.

4. This project keeps the budget deficit limit at 3% of GDP, the medium-term balanced budget target, and the requirement for countries that have a structural deficit to reduce their deficit by at least 0.5% per year.

5. The Commission wants to force countries into including the European rules (the 3% and 6% limits and a balanced budget in the medium-term) within their budgetary framework and setting up control of their compliance with these rules via an "independent budgetary institution".

6. Henceforth, a qualified majority at the Council will be required in order to oppose the measures and sanctions recommended by the Commission, which should ensure that the sanctions are automatic.

The Commission's plan undermines the Member States' independence, forces them to comply strictly with rules that have no economic justification, and jeopardises their capacity to stabilise their economy. It will further increase tensions between the Commission and Member States.

The Commission is proposing to monitor excessive macroeconomic imbalances by following a management dashboard including relevant variables (competitiveness, external deficit, public and private debt). A warning mechanism will identify countries exceeding certain limits. A new excessive imbalance procedure will be introduced. Recommendations will be forwarded to countries where the situation is too imbalanced. Fines may be decided. But there is no indication that supervision will be symmetrical, or that countries that put pressure on others through over-restrictive budgetary and wage policies will be sanctioned. There is nothing to indicate that the Commission will recommend a coordinated strategy to combat imbalances.

The media remained silent when the Six Directives were adopted by the European Parliament, so that the people were kept in complete indifference. The Parliament has made the text worse: the Commission may automatically sanction a country that does not comply with the planned deficit path. The text has, however, specified that a country with too much external surplus may be sanctioned, and has added unemployment to the variables monitored.

The first review undertaken by the Commission has highlighted 12 countries where there is an imbalance, in addition to the three countries subject to a financial assistance programme. Quite naturally, countries having a large external surplus or over-restrictive wage or social policies (Germany, the Netherlands, and Austria), were free from all criticism.

C) The Two Directives (or "Two-Pack")

In November 2011, the Commission put forward two new directives, aimed at enforce its power of control.

- the first one would force countries to set up independent budgetary Committees; budgets should be based on independent macroeconomic forecasts; and the Commission will be entitled to request a country to modify its budget if it deviates from the SGP. The Commission will exert permanent control on the budget execution in countries subject to an EDP.

- the Commission will be entitled to decide to subject a country to closer monitoring, if it considers that the country is likely to run into financial difficulties. This means that the Commission could force a country to call for financial assistance from the European Stability Mechanism, which implies implementing a strict austerity programme.

D) The Euro Plus Pact

On Germany and France's instigation, the Euro Zone Council of March 11th 2011 adopted a "Euro Plus Pact", initially presented under the name of "Competitiveness Pact".

At the beginning of every year, Member States' Heads of States or Governments will have to make detailed commitments before their peers and the Commission, who will control these commitments being met. Here again, there is no coordination to encourage growth in Europe or to undertake an ecological transition. The commitments cover enforcing competitiveness, and liberal reforms.

This means that countries will have to improve their competitiveness by monitoring the labour unit cost trend, and review wage indexation mechanisms. There is no indication, that wages will have at least to match productivity or that any catch-up should take place in Germany or Austria, where wages have increased at a slower rate than productivity. Employees in each country will have to fight one another in order to be more competitive, by accepting lower salaries and less social welfare.

Countries will have to improve their productivity and liberalise trade and services. They will have to ensure their financial stability.

Promoting employment involves reforming the labour market, and increasing work "attractiveness", but it does not propose macroeconomic measures or industrial policy. Countries will have to improve their public finances viability via reforming the healthcare system, limiting pre-retirement schemes, and by adjusting retirement age to life expectancy. Countries will have to include the SGP rules in their Constitution.

This Pact could entitle European institutions to intervene directly in two areas that had been national prerogatives up until now, namely social welfare and wage negotiations.

Appendix 4:

The real "Golden Rule for public finances"

The French Government has called its plan to enshrine a nil public finance balance in the Constitution, an enshrinement that the Budgetary Pact would make mandatory, the "golden rule".

This has nothing to do with what economists call the "golden rule for public finances". That rule was identified by Paul Leroy-Beaulieu, a professor at the Ecole Libre des Sciences Politiques in the late 19th century, and states that the State is entitled to run a deficit inasmuch as that deficit finances public investment. It is legitimate that the cost of a public facility should be spread over the entire period in which it will be used. A deficit of this kind does not weigh on future generations, since they will benefit from the facilities that are built. In fact, this rule already applies to French local authorities. In France, the public finance deficit that is authorised under this rule is currently estimated about 2.4% of GDP, according to a limited definition of public investment; it would be even higher if future expenditure, like education and research, was included. In fact, from a conventional economic standpoint, the State is entitled to run a deficit. It must not seek a long-term balance.

Since Leroy-Beaulieu, Keynesian theory has taught us that budgetary policy should not be managed as an end in itself, but in order to ensure full employment, with a reasonable inflation rate and an interest rate that is roughly equivalent to the growth rate. It is therefore legitimate to have a deficit superior to the golden rule during a period of massive unemployment. Deficits should only be reduced when the unemployment rate gets nearer the full employment level.

There is therefore no reason to decide upon a balanced public finances standard. The State is not a household. It has control over its income, by setting the amount of taxes. It must not concern itself only with its financial balance, but mainly with the macroeconomic balance. As it is immortal, it can keep a permanent debt; it does not have to repay it, but only to guarantee that it will always be able to serve the interests. Private agents want to hold public debt for liquidity and safety reasons. Banks, investment funds, and life insurance companies need government debt securities to back their commitments. For government debt to be actually risk-free and for the interest rate that it bears to be controlled by economic policy, not dependent on financial markets' fears and speculations, it must be guaranteed by the Central Bank.

Three lessons can be drawn for our purpose:

- a government cannot make a five-year commitment, year after year, on the public finance balance amount . The necessary balance depends on the economic trend. For France, a 2.3% deficit corresponded to the real golden rule in 2006; a deficit of 7.5% of GDP was necessary in 2009, given the economic situation.

- in a situation where growth is slow, unemployment high, and interest rates already very low, the priority is not to reduce public deficit, but to support demand.

- the key issue is to understand why demand is structurally insufficient in developed countries, which need a public deficit. The answer is simple: companies have increased the share of profits in order to pay dividends; they are reducing their investments; employees are forced to reduce their consumption due to pressure on wages and social benefits, whereas the richest accumulate exorbitant salaries and dividends. Value-added sharing must be modified, in order to reduce the public deficit without harming economic activity.

Can a rule that is contrary to conventional economic theory, contrary to Keynesian theory, and with no economic foundation, a rule that would paralyse budgetary policy when it was needed, be enshrined in the Constitution?

Contenu