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# CRISIS AND DEBT IN EUROPE: 10 PSEUDO "OBVIOUS FACTS", 22 MEASURES TO DRIVE THE DEBATE OUT OF THE DEAD END.

## Introduction

The world economic recovery, permitted by a massive injection of public spending into the economy (from the United States to China), is fragile but real. One continent lags behind, Europe. Finding again the path of growth is no longer its priority policy. Europe has embarked on another path : the fight against public deficits. In the European Union, these deficits are certainly high - 7% on average in 2010 - but this is much less than the 11% in the United States. While American states whose economic weight is greater than Greece's, such as California, are virtually bankrupt, financial markets have decided to speculate on the sovereign debt of European countries, especially those of the South. Europe is in fact caught in its own institutional trap : states must borrow from private financial institutions, which obtain cheap cash from the European Central Bank. As a consequence, the markets hold the key to the funding of the states. In this context, the lack of European solidarity gives rise to speculation, all the more so when the rating agencies' game accentuates the mistrust. It took the downgrading, on June 15th, of the rating of Greece by the agency Moody's, to bring the European leaders to use the word "irrational" again, a word that they had used so much at the beginning of the subprime crisis. Similarly, we now discover that Spain is much more threatened by the fragility of its growth model and of its banking system, than by its public debt. In order to "reassure the markets," a stabilizing fund for the Euro has been improvised, and drastic as well as indiscriminate plans of cuts in public spending have been launched all over Europe. Civil servants are the first affected, including in France, where the increase of their pension contributions is a disguised cut of their wages. The number of civil servants falls everywhere, threatening public services. Social security benefits are severely reduced, from the Netherlands to Portugal, as well as in France, with the current pension reform. Unemployment and the lack of job security will necessarily increase in the forthcoming years. These measures are irresponsible from a political and social perspective, and even in strictly economic terms. This policy, which has temporarily brought down speculation, has already very negative social consequences in many European countries, especially on the youth, workers and the most vulnerable people. It will eventually stir up tensions in Europe and thereby threaten the European construction itself, which is much more than an economic project. The economy is supposed to serve the construction of a democratic continent, peaceful and united. Instead, a form of dictatorship of the market is being imposed everywhere, and especially today in Portugal, Spain and Greece, three countries that were still dictatorships in the early 1970s, only forty years ago. Whether it is interpreted as "the desire to reassure markets" on the part of frightened governments, or as a pretext to impose choices driven by ideology, this submission to dictatorship is not acceptable, since it has proven its economic inefficiency and its destructive potential, both at the political and social levels. A real democratic debate on economic policy choices must be opened in France and Europe. Most of the economists who participate in public debates do so in order to justify or rationalize the submission of policies to the demands of financial markets. Admittedly, all governments have had to improvise Keynesian stimuli plans, and even sometimes to nationalize banks temporarily. But they want to close this parenthesis quickly. The neoliberal paradigm is still the only one that is acknowledged as legitimate, despite its obvious failures. Based on the assumption of efficient capital markets, it advocates reducing government spending, privatizing public services, flexibilising the labour market, liberalizing trade, financial services and capital markets, increase competition at all times and in all places... As economists, we are appalled to see that these policies are still on the agenda, and that their theoretical foundations are not reconsidered. The arguments which have been used during thirty years in order to guide European economic policy choices have been undermined by the facts. The crisis has laid bare the dogmatic and unfounded nature of the alleged "obvious facts" repeated ad nauseam by policy makers and their advisers. Whether it is the efficiency and rationality of financial markets, or the need to cut spending to reduce debt or to strengthen the "stability pact", these "obvious facts" have to be examined, and the plurality of choices of economic policies must be shown. Other choices are possible and desirable, provided that the financial industry's noose on public policies is loosened. We offer below a critical presentation of ten premises that still inspire decisions of public authorities all over Europe every day, despite the fierce denial brought by the financial crisis and its aftermath. These are pseudo “obvious facts” which are in fact unfair and ineffective measures, against which we propose twenty-two counterproposals that we would like to bring into the debate. Each of the proposals is not necessarily unanimously supported by all the people who have signed this manifesto, but they have to be considered seriously if we want to drive Europe out of the current dead end.

## “OBVIOUS FACT” n°1: FINANCIAL MARKETS ARE EFFICIENT

Today, one fact is obvious to all observers: the crucial role played by financial markets in the functioning of the economy. This is the result of a long evolution that began in the late seventies. However it is measured, this evolution constitutes a clear break, both quantitatively and qualitatively, with previous decades. Under the pressure of financial markets, the overall regulation of capitalism has deeply changed, giving rise to a novel form of capitalism that some have called “patrimonial capitalism”, “financial capitalism” or “neoliberal capitalism”. The theoretical justification for these mutations is the hypothesis of the informational efficiency of financial markets (or Efficient Markets Hypothesis). According to this hypothesis, it is important to develop financial markets, in order to ensure they operate as freely as possible, because they are the only mechanism allowing an efficient allocation of capital. The policies persistently pursued over the last thirty years are consistent with this recommendation. Their purpose was to create a globally integrated financial market, in which all actors (firms, households, states, financial institutions) can exchange all types of securities (stocks, bonds, debts, derivatives, currencies) for all maturities (long term, medium term, short term). Financial markets have come to resemble the “friction free” market of textbooks : the economic discourse has succeeded in creating reality. The markets being more and more “perfect”, in the mainstream’s meaning of the term, the analysts have believed that the financial system had become much more stable than in the past. The “great moderation” - this period of economic growth without wage growth experienced by the U.S. from 1990 to 2007 - seemed to confirm this view. Even now, the G20 still thinks that financial markets are the best mechanism for allocating capital. The primacy and integrity of financial markets remain the ultimate goals pursued by the new financial regulations. The crisis is interpreted not as an inevitable result of the logic of deregulated markets, but as the effect of the dishonesty and irresponsibility of some financial actors poorly supervised by governments. Yet the crisis has demonstrated that markets are not efficient, and they are unable to allow an efficient allocation of capital. The consequences of this fact in terms of regulation and economic policy are tremendous. The theory of efficiency is based on the idea that investors seek and find the most reliable information on the value of projects that are competing for funding. According to this theory, the price that forms on the market reflects investors’ appraisals and synthesizes all available information: it is therefore a good estimate of the true value of the securities. This value is supposed to summarize all the information needed to guide economic activity and social life as well. Thus, the capital is invested in the most profitable projects, and leaves the least efficient ones. This is the central idea of this theory : financial competition generates fair prices, which are reliable signals to investors, and an effective guide for economic development. But the crisis confirmed various critical works which had cast doubts on this proposition. Financial competition does not necessarily generate fair prices. Worse, financial competition is often destabilizing and leads to excessive price and irrational fluctuations, the financial bubbles. The major flaw in the theory of efficient capital markets is that it transposes the theory used for ordinary goods and services to financial markets. On markets for goods and services, competition is partly self-regulating under what is called the “law” of supply and demand: when the price of a commodity rises, producers increase their supply, and buyers reduce their demand. As a consequence, the price decreases and goes back towards its equilibrium level. In other words, when the price of a commodity rises, restoring forces tend to impede and reverse this increase. Competition produces what is called “negative feedbacks”, i.e. restoring forces that go in the opposite direction from the initial shock. The idea of efficiency arises from a direct transposition of this mechanism to financial markets. However, for the latter, the situation is very different. When the price increases, it is common to observe, not a decrease but an increase in demand! Indeed, the rising price means a higher return for those who own the security, because of the capital gain. The price increase thus attracts new buyers, which further reinforces the initial increase. The promise of bonuses pushes traders to further strengthen the movement. This is the case until the incident, that is unpredictable but inevitable, takes place. This causes the reversal of expectations and the crash. This herding phenomenon is a process of “positive feedbacks” which worsens the initial imbalances. This is what a speculative bubble consists of: a cumulative increase in prices that feeds itself. Such a process does not produce fair prices, but rather inadequate prices. As a consequence, the predominant place occupied by financial markets cannot lead to any kind of efficiency. Even worse, it is a permanent source of instability, as is evident from the uninterrupted series of bubbles that we have known in the past 20 years: Japan, South-East Asia, the Internet, emerging markets, real estate and securitization. Financial instability is reflected by the huge fluctuations of exchange rates and of the stock market, which are clearly unrelated to the fundamentals of the economy. This instability, arising from the financial sector, spreads to the real economy through many mechanisms. To reduce the inefficiency and instability of financial markets, we suggest the following four measures: **Measure 1:** To separate strictly financial markets and the activities of financial actors, prohibiting banks from speculating on their own account, in order to prevent the spread of bubbles and crashes. **Measure 2: To reduce liquidity and destabilizing speculation by controls on capital movements and taxation on financial transactions. Measure 3: To restrict financial transactions to those meeting the needs of the real economy (e.g., CDS only to holders of insured securities, etc.). Measure 4: Capping the earnings of traders.**

## PSEUDO "OBVIOUS FACT" n° 2: FINANCIAL MARKETS CONTRIBUTE TO ECONOMIC GROWTH

Financial integration has hugely increased the power of finance because it unifies and centralizes capitalist property globally. It determines profitability standards which are required of all capital. The idea was that financial markets would replace the financing of investments by banks. But this project has failed, since today; on the whole it is firms that fund shareholders instead of the contrary. Corporate governance was nevertheless profoundly transformed to meet the standards of market profitability. With the rise of shareholder value, a new conception of the firm and its management has emerged, where the firm is being conceived as an entity at the service of the shareholder. The idea of a common interest of the different stakeholders of the firm has disappeared. The operators of publicly traded companies now have the primary and exclusive mission to satisfy the shareholders' desire to enrich themselves. Consequently, they no longer behave as wage earners, as they witness the excessive surge in their incomes. As argued by « agency » theory the aim it is to ensure that the interests of managers now converge with those of shareholders. An ROE (Return on Equity) of 15% to 25% has now become the standard imposed by the power of finance on companies and employees. Liquidity is the instrument of that power, as it allows unsatisfied investors to go elsewhere in no time. Faced with this power, the interests of wage earners as well as political sovereignty were marginalized. This imbalance leads to unreasonable demands for profit, which then hamper economic growth and lead to a continuous increase in income inequality. Firstly, the profitability requirements greatly inhibit investment: the higher the required return, the more difficult it is to find projects that are competitive enough in order to meet these requirements. Investment rates remain historically low in Europe and the United States. Secondly, these requirements cause a constant downward pressure on wages and purchasing power, which is not favourable to demand. The simultaneous curbing of investment and consumption leads to low growth and endemic unemployment. This trend has been thwarted in the Anglo-Saxon countries by the development of household debt, and by asset bubbles that create fictional wealth, allowing for a growth of consumption without wages, but ending up with crashes.

**In order to eliminate the negative effects of financial markets on economic activity, we propose the following three measures: Measure 5: To strengthen significantly counter-powers within firms, in order to force the management to take into account the interests of all the stakeholders. Measure 6: To increase significantly the taxation of very high incomes to discourage the race towards unsustainable returns. Measure 7: To reduce the dependency of firms vis-à-vis financial markets, and to develop a public policy of credit (preferential rates for priority activities on the social and environmental levels).**

## PSEUDO "OBVIOUS FACT"n°3: MARKETS ASSESS CORRECTLY THE SOLVENCY OF STATES

According to the proponents of efficient capital markets, market operators take into account the objective situation of public finances in order to assess the risk of taking out state bonds. Take the case of Greek debt: financial operators and policy makers rely exclusively on financial assessments in order to assess the situation. Thus, when the required interest rate for Greece rose to more than 10%, everyone concluded that the risk of default was high: if investors demanded such a risk premium, this meant that the danger was extreme. This is a profound mistake if one understands the true nature of the assessment by the financial market. As this market is not efficient, it very often produces prices disconnected from the fundamentals. In these circumstances, it is unreasonable to rely exclusively on the financial market assessments in order to assess a situation. Assessing the value of a financial security is not comparable to measuring an objective magnitude, like, for example, estimating the weight of an object. A financial security is a claim on future revenue: in order to evaluate it, one must anticipate what this future will be. It is a matter of appraisal, not of objective measure, because at the instant t, the future is by no means predetermined. In trading rooms, it is what operators imagine it will be. A financial price is the result of an assessment, a belief, a bet on the future: there is no guarantee that the assessment of markets is in any way superior to other forms of assessment. Above all, financial evaluation is not neutral: it affects the object it is meant to measure, it initiates and builds the future it imagines. So, rating agencies play an important role in determining interest rates on bond markets by awarding grades that are highly subjective, if they are not driven by a desire to fuel instability, a source for speculative profits. When agencies degrade the rating of a state, they increase the rate of interest demanded by financial actors in order to acquire securities of the public debt of this state, and thereby increase the risk of bankruptcy they have announced.

**To reduce the influence of market's psychology on the funding of the state, we propose the following two measures: Measure 8: Rating agencies should not be allowed to influence arbitrarily interest rates on bond markets by downgrading the rating of a State. The activities of agencies should be regulated in a way that requires that their ratings result from a transparent economic calculation. Measure 8a: States should be freed from the threat of financial markets by guaranteeing the purchase of public securities by the European Central Band (ECB).**

## PSEUDO "OBVIOUS FACT" n°4: THE SOAR IN PUBLIC DEBTS RESULTS FROM EXCESSIVE SPENDING

Michel Pébereau, one of the "godfathers" of the French banking system, described in 2005, in one of those official ad hoc reports, France as a country stifled by debt and which is sacrificing its future generations by engaging in reckless social spending. The state running into debt as a father who drinks alcohol beyond its means: this is the vision usually propagated by most editorialists. And yet, the recent explosion of public debt in Europe and the world is due to something which is very different: the bailout plans of the financial sector, and, mainly, to the recession caused by the banking and financial crisis that began in 2008 : the average public deficit in the euro area was only 0.6% of GDP in 2007, but the crisis has increased to 7% in 2010. In the same time, public debt increased from 66 % to 84% of GDP. But the rise in public debt, in France as in many European countries, was initially moderate, and prior to that recession: it mainly comes not from an upward trend in public spending – since, on the contrary, as a proportion of GDP, public spending is stable or declining in the EU since the early 1990s - but from the erosion of public revenue, due to weak economic growth over the period, and the fiscal counter-revolution led by most governments in the pas twenty-five years. In the longer run, the fiscal counter-revolution has continuously fuelled the swelling of the debt from one recession to another. Thus, in France, a recent parliamentary report estimated 100 billion Euros in 2010 as the cost of tax cuts granted between 2000 and 2010, even without including exemptions from social contributions (30 billions) and other "tax expenditures". As tax harmonization has not taken place, European states have engaged in tax competition, lowering corporate taxes, as well as taxes on high income and assets. Even if the relative weight of its determinants varies from one country to another, the rise of government deficits and debt ratios that has taken place almost everywhere in Europe over the last thirty years does not primarily result from an increase in public spending. This diagnosis obviously opens up avenues other than the reduction of public spending mantra, repeated ad nauseam, in order to reduce public deficits.

**To restore an informed public debate on the origin of the debt and therefore on the means to cure it, we propose the following measure : Measure 9 : To conduct a public audit of public debts, in order to determine their origin and to identify the main holders of debt securities, as well as the amounts held.**

## PSEUDO "OBVIOUS FACT" n° 5: PUBLIC SPENDING MUST BE CUT IN ORDER TO REDUCE THE PUBLIC DEBT

Even if the increase in debt was partly due to an increase in public spending, cutting public spending would not necessarily be part of the solution. This is because the dynamics of public debt have little in common with that of a household's: macroeconomics is not reducible to the economy of the household. The dynamics of debt depends, in all generality, on several factors: the level of primary deficits, but also the spread between the interest rate and the nominal growth rate of the economy. For, if the latter is lower than the interest rate, debt will increase mechanically because of the "snowball effect": the amount of interests explodes, and the total deficit (including the interests of debt) as well. Thus, in the early 1990s, the "franc fort" policy conducted by Bérégovoy, and maintained despite the 1993-94 recession, resulted in an interest rate higher than the growth rate, explaining the surge in France's public debt during this period. The same mechanism caused the increase in debt in the first half of the 1980's, as a consequence of the neoliberal revolution and the high interest rates policy led by Ronald Reagan and Margaret Thatcher. But the rate of economic growth itself is not independent from public spending: in the short run, the existence of stable public expenditures restrain the size of recessions (through "automatic stabilizers"); in the long run, public investment and expenditures (education, health, research, infrastructures...) stimulate growth. It is wrong to say that any public deficit further increases public debt, or that any reduction of the public deficit reduces debt. If reducing the deficit weighs down economic activity, this will make debt even larger. Neoliberal news analysts point out that some countries (Canada, Sweden, and Israel) have achieved very abrupt adjustments of their public accounts in the 1990s, followed by an immediate upturn in growth. But this is possible only if the adjustment regards an isolated country, which quickly regains competitiveness over its competitors. Obviously, the proponents of European structural adjustment forget that European countries are the main customers and competitors for the other European countries, the European Union being, on the whole, a rather closed economy. The only effect of a simultaneous and massive reduction of government spending in all EU countries will be a worsened recession, and thus a further increase in public debt.

**To avoid public finance policies that will cause social and political disaster, we submit the following two measures for discussion: Measure 10: The level of social protections (unemployment benefits, housing...) must be maintained, or even improved ; Measure 11: Public spending on education, research, investment in environmental conversion, etc., must be increased, in order to set up the conditions for sustainable growth and to bring about a sharp fall in unemployment.**

### PSEUDO "OBVIOUS FACT"n°6: PUBLIC DEBT SHIFTS THE BURDEN OF OUR EXCESSES ON OUR GRANDCHILDREN

There is another fallacious statement that confuses household economics with macroeconomics: that the public debt would be a transfer of wealth to the detriment of future generations. Public debt is a mechanism for transferring wealth, but mainly from ordinary taxpayers to shareholders. Indeed, on the basis of the belief (rarely documented) that lower taxes stimulate growth and increase government revenue in fine, European states have, since 1980, imitated U.S. fiscal policy. Tax and social contributions cuts have proliferated (on corporate profits, on the income of the wealthiest individuals, on property, on employer contributions...), but their influence on economic growth has been very uncertain. As a consequence, these anti-redistributive tax policies have worsened cumulatively both social inequalities and public deficits. These tax policies have forced governments to borrow from well-off households and financial markets, in order to finance the deficits created in this way. This might be called the "jackpot effect": with the money saved on their taxes, the rich were able to acquire (interest bearing) securities of the debt issued to finance public deficits caused by tax cuts... The public debt service in France represents 40 billion Euros each year, almost as much as the revenue generated by the income tax. This tour de force is all the more amazing given that political leaders then succeeded in persuading the public that the employees, pensioners and the sick were responsible for the public debt. Thus, the increase in public debt in Europe or in the USA is not the result of expansionary Keynesian policies, or expensive social policies, but, much more, of a policy in favour of the lucky few: "tax expenditures" (lowered taxes and contributions) increase the disposable income of those who need it least, who, as a result, can further increase their investments in treasury bills, which are reimbursed, with interests, by the state with the tax revenues paid by all taxpayers. On the whole, a mechanism of upwards redistribution has been set up, from the lower to the upper classes, via public debt, the counterpart of which is always private rent.

**To bring an upturn in public finances in Europe and in France, we propose the following two measures : Measure 12 : To restore the strongly redistributive nature of direct taxation on income (suppressing tax breaks, creating new steps, and increasing the rates of income tax...) Measure 13 : To suppress tax exemptions granted to companies, which have insufficient effects on employment.**

### PSEUDO "OBVIOUS FACT" n° 7: WE MUST REASSURE FINANCIAL MARKETS IN ORDER TO FUND THE PUBLIC DEBT

At the global level, rising public debt must be analyzed in parallel with the process of financialization. During the last thirty years, due to the full liberalization of capital flows, finance has increased significantly its grip on the economy. Large firms rely less on credits and increasingly on financial markets. Households also see an increasing share of their savings drained to finance for their retirement, through various investment products or in certain countries through the financing of housing (mortgage). Portfolio managers seek to diversify risk invest in government securities in addition to private equity. These public bonds were easy to find as governments were conducting similar policies leading to a surge in deficits: high interest rates, tax cuts targeted on high incomes, massive incentives to the financial savings of households for pensions funds, etc. At EU level, the financialization of the public debt has been included in the treaties: since the Maastricht treaty, central banks are prohibited from directly funding states, which must find lenders on financial markets. This "monetary punishment" is accompanied by a process of "financial liberalization", and is the exact opposite of the policies adopted after the Great Depression of the 1930s, which consisted of "financial repression" (i.e. severe restrictions on the freedom of action of finance) and "monetary liberation" (with the end of the gold standard). The purpose of the European treaties is to submit states, supposedly too extravagant by nature, to the discipline of financial markets, which are supposed to be by nature efficient and omniscient. The result of this doctrinal choice is that the European Central Bank is no longer entitled to subscribe directly to the public bonds issued by European states. Deprived from the security of always being financed by the Central Bank, Southern European states have suffered from speculative attacks. Admittedly, in recent months, the ECB has bought government bonds at market interest rates to ease tensions on the European bond market, something that previously it had always refused to do, in the name of unwavering orthodoxy. But nothing says that this will suffice, if the debt crisis worsens and if market interest rates soar. That monetary orthodoxy devoid of scientific foundations may then be difficult to maintain.

**To address the problem of the debt we propose the following two measures :Measure 14 : To authorize the European Central Bank to directly fund European states at low interest rates, thus loosening the straitjacket of financial markets (or to require commercial banks to subscribe to the issue of government bonds).Measure 15 : If necessary, to restructure the public debt, for example by capping the service of public debt to a certain percentage of GDP, and by discriminating between creditors according to the volume of shares they hold. In fact, very large stockholders (individuals or institutions) must accept a substantial lengthening of the debt profile, and even partial or total cancellation. We must also renegotiate the exorbitant interest rates paid on bonds issued by countries in trouble since the crisis.**

## PSEUDO "OBVIOUS FACT" n°8: THE EUROPEAN UNION PROTECTS THE EUROPEAN SOCIAL MODEL

The European experience is ambiguous. Two visions of Europe coexist, without daring to compete openly. For Social Democrats, Europe should promote the European social model, which resulted from the post-World War II social compromise, with its welfare states, its public services and industrial policies. Europe should have been a bulwark against liberal globalization, a way to protect, sustain and advance this model. Europe should have defended a certain vision of the organization of the world economy, i.e. a globalization regulated by agencies of global governance. Europe should have allowed member countries to maintain a high level of public spending and redistribution, by protecting their ability to finance spending through the harmonization of taxes on individuals, businesses, and capital. But Europe does not want to admit and promote its specificity. The currently prevailing view in Brussels and in most national governments is rather that of a liberal Europe, whose objective is to "adapt" European economies to the needs of globalization. According to this view, European integration is an opportunity to undermine the European social model and to deregulate economies. This is evident through the domination, within the Single Market, of the rule of competition law over domestic regulations and social rights, which introduces more competition in markets for products and services, diminishes the importance of public services and organizes competition among European workers. Social and fiscal competition has reduced taxes, notably on capital income and companies (the "mobile bases" of taxation, opposed to the "fixed base" of labour), and has put pressure on social spending. The treaties guarantee the so-called "four freedoms": free movement of people, goods, services and capital. But far from being limited to the internal market, the freedom of movement of capital has been granted to worldwide investors, thereby subjecting the European productive structure to the exploitation of international capital. European integration thus appears as a way to impose neoliberal reforms on the peoples of Europe. The organization of the macroeconomic policy (i.e. the independence of the European Central Bank from political powers and the Stability and Growth Pact) is marked by distrust of democratically elected governments. This deprives European countries of their autonomy in monetary and budgetary policies. As fiscal balance must be achieved and discretionary stimuli are banished, only “automatic stabilizers” are allowed to play. No common countercyclical economic policy is implemented in the area, and no common goal is defined in terms of growth or employment. The differences between the situations of the different countries are not taken into account, as the Pact does not deal with national interest rates or current accounts deficits. Last, the EU goals for public deficits and debt do not account for national economic circumstances. The European authorities have tried to give impetus to “structural reforms” (through the Broad Economic Policy Guidelines (BEPGs), the open method of coordination, and the Lisbon Agenda), with a very uneven success. These orientations were adopted in a way that is neither democratic nor susceptible to grant adhesion and their neo-liberal orientation did not necessarily correspond to policies implemented at national levels, given the balance of forces existing in each country. These orientations did not immediately result in the kind of brilliant successes which would have legitimized them. The movement towards greater economic liberalization has been questioned (see the failure of the Bolkestein Directive). Some countries have been tempted to nationalize their industrial policy, while most remained opposed to the Europeanization of their fiscal or social policies. Social Europe has remained an empty word, and only the Europe of competition and finance has actually affirmed itself.

**For Europe to truly promote a European social model, we propose a discussion based on the following two measures: Measure 16: To call into question the free movement of capital and goods between the EU and the rest of the world, by negotiating bilateral or multilateral agreements if necessary. Measure 17: To make “harmonization in progress” the guiding principle of European construction, instead of competition policy. To establish binding common goals in the social and macro-economic areas (with the creation of Broad Social Policy Guidelines, or BSPGs).**

## PSEUDO “OBVIOUS FACT” n°9: THE EURO IS A SHIELD AGAINST THE CRISIS

The Euro should be a protection against the global financial crisis. After all, the removal of exchange rates uncertainty between European currencies has suppressed a major element of instability. Yet, the Euro did not protect us: Europe is more profoundly, and for a longer period of time, affected by the crisis than the rest of the world. This is due to the way the monetary union has been created. Since 1999, the Euro area has experienced relatively poor growth and increased divergence between Member States in terms of growth, inflation, unemployment and external imbalances. The economic policy framework of the Euro area, which tends to impose similar macroeconomic policies on countries which happen to be in different situations, has widened the disparity in growth between the Member States. In most countries, especially the larger ones, the introduction of the Euro did not stimulate growth, contrarily to what had been promised. For other countries, growth did take place, but it came at a price of imbalances which prove difficult to sustain. Monetary and fiscal orthodoxy, which has been reinforced by the euro, has shifted the entire burden of adjustment on labour. All in all, labour flexibility and wage moderation have been promoted, the share of wages in total income has been reduced, and inequalities have widened. This race to the bottom has been won by Germany, which has been able to draw large trade surpluses at the expense of its neighbours, especially its own employees. Germany has established a low cost of labour and social benefits, which has given a commercial advantage to this country over its neighbours, who have not been able to treat their own workers so badly. The German trade surplus is detrimental to growth in other countries. Budget and trade deficits of some countries are only the inevitable counterpart of the surpluses of other Member States. Generally speaking, the Member States have not been able to develop a coordinated strategy. The Euro zone should have been less affected by the financial crisis than the United States or the United Kingdom. In the Euro zone, households invest much less on financial markets, which are less sophisticated. And, before the crisis, public finances were in a better situation: the deficit of the Euro countries reached only 0.6% of GDP in 2007, to be compared to almost 3% in the U.S., the U.K. and Japan. But the Euro area was suffering from widening imbalances : Northern countries (Germany, Austria, the Netherlands, and Scandinavia) were curbing their wage levels and their internal demand, thus piling on external surpluses, while the Southern countries (Spain, Greece, Ireland) experienced strong growth, driven by interest rates below growth rates, and accumulated external deficits. While the financial crisis started from the United States, the U.S. has implemented a real policy of fiscal and monetary stimulus, while initiating a movement of financial re-regulation. Europe on the contrary has failed to engage in a sufficiently responsive policy. From 2007 to 2010, the fiscal impulse has been limited to 1.6 percentage points of GDP in the Euro zone, versus 3.2 points in the United Kingdom, and 4.2 points in the United States. The production loss caused by the crisis has been much larger in the Euro area than in the United States. Rising public deficits in the area resulted more from the crisis than they were the result of an active policy. At the same time, the Commission has continued to launch excessive deficit procedures against Member States, to the point that, by mid 2010, virtually all states in the area were concerned. The Commission asked Member States to commit themselves to limit their deficits to 3% by 2013 or 2014, regardless of economic developments. The European authorities have continued to demand restrictive wage policies and challenged public pension and health systems, at the obvious risk of deepening the recession in the continent and increasing tensions between countries. This lack of coordination, and more fundamentally, the absence of an EU budget allowing for an effective solidarity between Member States, have encouraged financial actors to turn away from the Euro or even to speculate openly against it.

**For the Euro to effectively protect European citizens from the crisis, we propose the following two measures: Measure 18: To ensure effective coordination of macroeconomic policies and a concerted reduction of trade imbalances between European countries. Measure 19: To offset payments imbalances in Europe by a Bank of Settlements (that would organize loans between European countries)Measure 20 : If the Euro crisis leads to the end of the Euro, and pending the reviving of the EU budget (see below), to establish an intra-European monetary system (with a common currency such as the "Bancor") which would organize the unwinding of imbalances in trade balances in Europe**

## PSEUDO "OBVIOUS FACT" n°10 : THE GREEK CRISIS WAS A SPRINGBOARD TOWARDS AN ECONOMIC GOVERNMENT OF EUROPE AND EFFECTIVE EUROPEAN SOLIDARITY

From mid-2009 onwards, financial markets have begun to speculate on the debt of European countries. Overall, soaring debts and deficits in the world have not (yet) resulted in higher long term interest rates: financial operators believe that central banks will keep real short term interest rates near zero for a long time, and that there is no real danger of inflation or of default of a large country. But speculators have seen the flaws in the organization of the Euro area. While the governments of other developed countries can still be supported by their central bank, Euro zone countries have abandoned this option and are totally dependent on markets to finance their deficits. As a result, speculation was triggered on the most vulnerable countries in the area, i.e. Greece, Spain, and Ireland. European authorities and governments have been slow to respond to this issue, as they did not want to give the impression that Members States were entitled to unlimited support from their partners. They wanted to punish Greece, guilty of having hidden – with the help of Goldman Sachs – the true size of its deficits. However, in May 2010, the ECB and the Member States had to create an Emergency Stabilization Fund to show markets that they would bring unlimited support to threatened countries. In return, these countries had to announce programs of unprecedented fiscal austerity, which will condemn them to a downturn in the short term and to a long period of recession. Under the pressure of the IMF and the European Commission, Greece had to privatize its public services, and Spain had to make its labour market more flexible. Even France and Germany, which have not been attacked by speculation, have announced restrictive measures. But overall, there is no excess demand in Europe. The fiscal situation is better than that of the U.S. or Great Britain, leaving room for fiscal manœuvre. We must correct imbalances in a coordinated manner : Northern and Central Europe countries with trade surpluses should pursue expansionary policies – higher wages, social spending, etc. – in order to offset the restrictive policies of the Southern countries. In total, fiscal policy should not be restrictive on average in the eurozone, as long as the European economy does not come close to full employment. But supporters of automatic and restrictive fiscal policies in Europe today are unfortunately reinforced today. The Greek crisis allows them to make us forget about the origins of the financial crisis. Those who have agreed to financially support the Southern countries want to impose in return a tightening of the Stability and Growth Pact. The Commission and Germany want all member countries to include the goal of balanced budgets in their constitutions, and to have their fiscal policy monitored by committees of independent experts. The Commission wants to impose on countries a long cure of austerity, as long as their public debt is higher than 60% of GDP. Ironically, if there is a step towards a European economic government, it is towards a government which, instead of loosening the grip on finance, imposes further austerity and structural "reforms", at the expense of social solidarities, within and between countries. The crisis provides financial elites and European technocrats an opportunity to implement a "shock strategy", by taking advantage of the crisis to push further for a radical neo-liberal agenda. But this policy has little chance of success : - The reduction of public spending will undermine the effort needed at the European level to fund spending on needed areas (such as research, education, or family policy) and to help the European industry to maintain itself and to invest in the areas of the future (green economy). - The crisis will make it possible to impose deep cuts in social spending, a goal relentlessly pursued by the proponents of neo-liberalism, this will come at the risk of undermining social cohesion, reducing effective demand, and leading households to save more for their pension and health plans, thus contributing more to the private financial institutions which are responsible for the crisis. - Governments and the European authorities are unwilling to put in place the fiscal harmonization that would allow for the required increase in taxes on the financial sector, wealth and higher incomes. - European countries are currently establishing long lasting restrictive fiscal policies that will weigh heavily on growth. Tax revenues will fall. Thus, public balances will hardly be improved, debt ratios will not diminish, and markets will not be reassured. - Because of their diverse political and social cultures, not all European countries have been able to bend under the iron discipline imposed by the Maastricht Treaty; not all of them will bend to its current reinforcement. The risk of creating a dynamic where each country will turn towards itself is real.