
News

Headline News**Press Review****Comment****Agenda****Political Affairs****Foreign Affairs****Economic Affairs****Social Affairs****Justice & Home Affairs****Defence****Enlargement****EU Constitution**

Subscribe for news

Enter your email

 News -----

 Headline News

 Political Affairs

 Foreign Affairs
Send out frequency
 Twice daily

 Daily

 Weekly

Logout

[My account page](#)

[Comment] A referendum on the Brussels consensus?

27.05.2005 - 15:40 CET | By George Irvin

EUOBSERVER / COMMENT - Those on the French Left who vote non to the Constitution cannot simply be dismissed as loony-lefties, nostalgic for France's pivotal role in Europe or clamouring against the evils of globalisation and neo-liberalism.

They have a serious point to make about alternative economic visions of Europe. The main Eurozone economies have experienced low growth, high unemployment and shrinking social benefits for the better part of a decade. At present, French unemployment stands at 10%, Germany's growth was negative in the fourth quarter of 2004, Italy is in recession and the 'Dutch miracle' has collapsed. Little wonder voters are disillusioned. Rekindling an economic debate about the future of Europe is an urgent task; it will last well beyond the referendum and needs far wider public discussion.

Economists may agree the Eurozone's record has been dire, but they disagree about why. The orthodox explanation, popular amongst many US-trained economists and often echoed by the OECD, is that Europe suffers from bloated budgets, inflexible labour markets and high taxes. Remove the welfare state everyone will get back to work. The alternative explanation, favoured by post-Keynesians, is that the balanced budget corset imposed by the Stability and Growth Pact (SGP) is paralysing the Eurozone.

In contrast to Britain and the US where growth is fuelled by rising asset prices, private debt and public spending, in Germany, France and Italy, both government and household savings have risen over the past decade. Public and private frugality not only depresses aggregate demand, but under conditions of very low inflation it leads to 'deflationary expectations'; ie, the darker the economic climate, the more one must save for a rainy day. In short, the Eurozone suffers from deficient aggregate demand. A devalued dollar, enabling the US to postpone its adjustment, makes European prospects even bleaker.

Disagreement about why Europe is in the state it is in

To choose between these contending views, one needs to revisit briefly the major contours of the debate. Several years ago, Joseph Stiglitz's best-seller on globalisation popularised the notion of the Washington Consensus, an orthodox policy recipe of government financial stringency and market deregulation applied by the IMF to developing countries, the roots of which lie in the monetarist doctrines of the 1970s given



"The economic arc is asymmetric and the problem is that it will continue to stay" (George Irvin)

Toolbox

[Print article](#)[Send article](#)



prominence during the Thatcher-Reagan years. Today, economists are asking whether this consensus has not crossed to Brussels and Frankfurt? In broad-brush terms, the story goes as follows.

When the economic architecture of the EU was being devised in the late 1980s and early 1990s, orthodox economics was ascendant. In 1982, international financial markets had thwarted the attempt by France to reflate the economy along Keynesian lines, following which the French adopted a Bundesbank-style stance of defending the currency by raising interest rates. Inflation and growing indebtedness, particularly in southern Europe, further discredited Keynesian demand management. Maastricht gave birth to a highly orthodox model of financial prudence in which monetary competence was assigned to a fully independent, EU-level Central Bank whose sole brief was to keep inflation below two percent.

Fiscal competence remained at member-state level; to qualify for joining the euro, member-states were required to limit public indebtedness and balance the budget over the business cycle; other than in extreme circumstances, the annual budget deficit could not exceed 3%. The Maastricht limits, originally rules for euro entry, were transformed into permanent rules by the SGP signed in 1997; in short, they form the cornerstone of the Brussels Consensus.

The reader may well ask 'what's wrong with a bit of financial prudence; or for that matter, making labour markets more flexible?' Understanding what's wrong needs a further brief explanation of orthodox theory, so bear with me. Textbook theory tells us that an economy can only grow in a stable, non-inflationary environment where unemployment is at its 'natural' rate. (The 'natural' rate is often called the 'non-accelerating inflationary rate of unemployment', or NAIRU for short.)

In consequence, attaining stability is of prime importance. Leaving the task of targeting inflation to the central monetary authority can best do this. By contrast, fiscal policy (taxation and government spending) is of minor importance and best left to the operation of fiscal stabilisers built into the tax system. On this view, a combination of wise monetary policy and fiscal prudence must produce eventually growth. If not, it is because of institutional rigidities such as national wage bargaining, employment protection legislation, expensive benefit schemes and the like; in short, too much welfare.

The Brussels architecture fits this picture extremely well. The European Central Bank (ECB) is a monetary giant, surrounded by member-states constrained by the SGP and reduced in size to fiscal dwarves. The Brussels budget is tiny---just under 1% of combined European GDP compared to 25% in the USA---and since it must balance by law, it is useless as a fiscal instrument. Unlike the US Fed, which attempts to strike a balance between inflation, employment and growth, the ECB focuses entirely on inflation. If the core Eurozone countries are not growing, it is because they continue to flout the SGP rules, while maintaining unaffordable levels of employment benefit, excessive protection and so on.

Two elements complete the picture. The SGP zero-deficit rule means that in the long term, government borrowing must fall to zero. No room here for publicly funded pensions health; the State is reduced to pure night watchman. Add to this an EU Competition Commissioner whose role is to see that 'uncompetitive public enterprise' (eg, transport, energy and telecoms) is privatised and one gets a Thatcherite dream. This is what the French mean when they speak of sacrificing the European Social Model to Anglo-Saxon free-market economics.

Europe's economic structure deeply flawed

The alternative is to widen the remit of the ECB to make it more like the Fed and to scrap the SGP, leaving more room for member-states to follow discretionary fiscal policy. Equally, some form of 'fiscal federalism' will need to be adopted, if only to achieve an acceptable degree of co-ordination between monetary and fiscal policy and room for counter-cyclical investment. This might ultimately take the form of a greatly expanded EU budget along the lines originally proposed by the MacDougall report in 1977.

Meanwhile, the EU should at very least have the power to raise funds in the international capital market, a power delegated to the low-profile European Investment Bank, in order to fund much needed expenditure on social and economic infrastructure. Such a fund was first proposed in the 1993 Delors White Paper, and more recently as a 'rainy day' fund in the 2003 Sapir Report; the latter, incidentally, recommended redirecting finance used for the Common Agricultural Policy towards promoting growth in the new accession states, but Sapir's report to the Commission was ignored.

Little matter that I happen to think rejecting the Constitution will be a dreadful blunder and deeply harmful for building a more social Europe. The economic architecture of Europe is asymmetric and deeply flawed; unless the problem is addressed, the Eurozone will continue to stagnate, and under such conditions the Lisbon goals cannot be met, confidence in the euro will be undermined and popular discontent will rise. Those Euro-sceptics in Britain who feel vindicated should remember that over half of Britain's trade is with the Eurozone. If only for this reason, the 'French debate' is of vital importance to us all.

George Irvin is Professorial Research fellow at the International Centre for European research (ICER) in Turin; his book 'Europe at the Crossroads' is forthcoming.

[Back](#) [To the top](#)