

**Economic policy in the EU.
Prevailing tendencies and possible alternatives.
Is there a political economy of the left?**

Paper for the Seminar

The Left in Europe: What strategies and what tasks for left politics in the European institutions and in the European societies

organised by Rosa-Luxemburg Stiftung and Associazione Culturale Punto Rosso

Oct.31/November 1, 2008 in Milan

Jörg Huffschmid*, Bremen

The EU is presently facing the biggest financial crisis in Europe since about 80 years and at the same time the dark outlook of a new economic recession which will be exacerbated by the financial turmoil. Both demonstrate (again) that an economic and financial system based on private competition without a framework of stabilizing rules and political intervention is not sustainable in the long run. However, change is not in sight. It is not only questionable whether the hectic activities, huge guarantee, bail-out and re-capitalisation programmes which the EU has organised during the last weeks will work even in the short term, and it is even more questionable whether the officially declared intentions to reform the financial systems will be implemented and contribute to the necessary regime change of economic policy in the EU. In spite of the financial crisis the basic underlying principles of economic policy in the EU appear to be resilient against changes, and one major reason for this is that the crisis is regarded as something imported from the US and not inherent in the present system of capitalism, not to speak in the construction of European economic policy. It is the intention of this paper to show that this view is not true, that the prevailing economic policies of the EU have adopted a widely neo-liberal orientation (section 1) and become more and more integrated into the global pattern of finance-led capitalism (sect. 2), and that alternative conceptions are necessary and possible (sect. 3).

1. Prevailing tendencies of economic policies in the EU

Basically there are three dominant tendencies in European economic policies which have been gradually developed in the single market project of 1985 (which led to the “European Single Act in 1987), the Maastricht Treaty of 1992, the Lisbon strategy adopted in March 2000 and reconfirmed in 2005, and the “Global Europe” strategy of 2006.

1.1 Market radicalism: Competition, deregulation and privatisation

The common European market was one of the two pillars of the European communities from the beginning onwards. The other one was the development of common rules and interventionist economic policies. From the mid-1980s onwards this second pillar was largely dropped and competition in open and largely unregulated markets made the governing principle. The original concept of *competition within a common framework of rules* (for taxation, work and consumer protection, social standards etc) was replaced by the concept of “mutual recognition” and *competition of rules between member states*, leading to tax competition, social dumping, privatisation etc.

Major areas of application of this principle are

* EuroMemorandum Group, www.memo-europe.uni-bremen.de

- **Services**, The famous Bolkestein-draft for the services sector aims at establishing a free market for services all over Europe and establishes the principle of *country of origin*, which means, that a firm is free to offer services in all member countries at the conditions which prevail in its own country.

- **Financial markets** are regarded as one of the centre pieces of liberalisation, and in the *Financial Services Action Plan of 1999*, a series of about 40 measures were proposed to this end most of which were adopted until 2005. They opened European markets for all kinds of financial activities including speculation, hedge funds, securitisation etc., in other words for just those practices which have attracted financial pundits and speculators who have caused the present financial crash.

- **Labour markets** were and are a particular target for the deregulatory ambitions of European institutions. Labour is regarded mainly as a cost factor which has to be kept low to enhance European competitiveness in the world. Recent initiatives in this directions include the proposal to raise “flexicurity”, to further deregulate working time arrangements, and to make illegal collective actions of employees and trade unions against employers.

Social and health care services: Although these were excluded from the general services directive the Commission behaves as if they were included and requires the application of the internal market and competition rules in all cases where such services are given for money, regardless who pays. Provider of public services (or “services of general interest”) therefore have to behave like private firms, and this is a strong pressure for privatisation of such services. In the health care sector the concern of the EU is not the provision of a regionally comprehensive quality services but the guarantee of the right of patients to buy their health care services wherever they want.

1.2 Macro-economic fundamentalism

The second main element of economic policy in the EU is fundamentalism in monetary and fiscal policies. This is logical in the sense that if the concept is that the market should be the overarching principle then there is no or very little room for active state policy and intervention. Both have made European economies relatively weak and vulnerable – with regard to financial speculation and to economic downturns.

For *monetary policy* the construction of the monetary Union with first 11 (now 15) members is flawed in two respects: First, the mission of the European Central Bank relates exclusively to price stability and disregards – in difference to the US – other macroeconomic objectives like growth and employment and a fair distribution of income. Second, the ECB acts in complete independence and is not embedded in a framework of democratic discussion and decision-making. While the former flaw is economically counter-productive, the latter stands in clear contradiction to democratic requirements.

For *fiscal policies* the same fundamentalism applies. Instead of using fiscal policies – i.e. public expenditure and taxes – to stimulate and shape economic development and to enhance social cohesion and justice, the exclusive concern of the EU with regard to public finance is whether or not public budgets are balanced or not. In combination with tax competition this extremely narrow rule for public expenditure exerts enormous pressures on public budgets

and this translates into strong pressure to privatise public services and get rid of the financial burden.

1.3 International expansionism

Because macroeconomic fundamentalism weakens the domestic forces of economic development the EU is increasingly looking for external compensation through increasingly aggressive international trade, development and foreign direct investment policies. It is applying the same strategy against the rest of the world as Germany does and did with regard to the rest of Europe: it tries to enhance its competitive position by keeping costs (especially wage costs) and prices low, and to generate current account surpluses to offset the weakness of domestic demand. However, this strategy is still not very successful, as the European current account of the EU is more or less in balance, but with huge differences within the EU. Germany is the big winner, France and Italy are big losers in this game. .

2. Background: Emergence of finance-led capitalism

The development of the economic policies of the EU is embedded in a broader trend of roll-back of the reform policies, which were developed after world war 2 and came under attack since the mid-1970s. In economic terms *two mega-trends* characterize the period since then: the *enormous accumulation of financial assets* and the rapidly increasing *internationalisation* of investment of these assets. There are basically four causes for these mega-trends:

The *first* and probably most important one is the almost continuous redistribution of income and wealth from the bottom to the top, clearly reflected in the falling wage share (see figure 3) in the three centres of capitalism: from 1975 to 2006 it fell by four percentage points (from 70,4 % to 66,3 %) in the USA, by ten percentage points (from 76,3 % to 66,2 %) in the EU-15 and by 15,6 percentage points (from 80,1 % to 64,5 %) in Japan.

This has led, on the one hand, to a massive concentration of financial wealth with a small group of individuals and firms and, on the other hand, to a lagging behind of salaries and wages and private consumption, and, as a consequence, to a slow-down in economic growth as a result of weak final demand.

The *second* background for the growth of financial assets is the trend towards capital funded pension systems. While these have been the dominant systems in the USA and the United Kingdom and in some smaller countries since long time, it was only in the last quarter of the century that the public PAYGO systems, which were prevalent in most other countries came under attack by financial institutions like the World Bank and the OECD. This thrust for “pension reform” channelled a larger part of pension contributions to the capital markets, where they were managed by pension funds and insurance companies. At the end of 2006, assets in pension funds (\$ 22,6 trillions) were almost five times higher than in 1992 (\$ 4,8 trillions) (figure 4)

A *third reason* for the build-up of financial assets was the relatively generous loan policy of banks. Although credit developed in clear waves along the business cycles, its overall extension was stronger than the overall growth of GDP.

The *fourth factor* relates to the dynamic internationalisation of financial flows and investments. These could obviously not have happened without the shift of the regime of capital

controls prevalent in the Bretton Woods world to a regime of *liberalisation of capital movements* since the mid-1970s.

These four factors which determined the thrust for the explosive growth and globalisation of finance were not a reflection of the “iron laws” and an inevitable “logic of capital”. Rather they were the result of changing social power relations (wage share) and political decisions (pension reform and liberalisation of capital accounts) which in turn were responses to economic and political difficulties and pressures

The extraordinary long-term accumulation and internationalisation of private financial assets has started to change the quantitative proportions between the financial and the productive sectors of the economies, and as a consequence the relationship between the driving actors and bottlenecks of capitalist development towards a more finance-driven pattern. (fig 5a-c).

In the traditional pattern of capitalism the driving actors were individual *entrepreneurs* or corporate *managers* whose work was concentrated on the production and sales side of their companies. Finance was a bottleneck for corporate investment and economic development. (see figure 5a). This bottleneck was overcome not only through household saving but also and primarily through credit creation by the banking sector which was politically supported by the central banks. By contrast, in mature capitalist economies we have an abundance of financial assets for which profitable investment opportunities are becoming increasingly scarce (see figure 5b) - while at the same time credit creation continues at large scale as the source of profits for the banking sector. Under these circumstances of financial over-accumulation *financial investors* replace the individual entrepreneur or corporate manager as the leading actor. They collect and centralise large amounts of money from the ultimate asset owners and invest them in a broad range of activities of which production of goods and services is only one option. Capitalism becomes *finance-led capitalism*, at least in the developed centres. Privatisation is one prominent outlet for excessive capital (others are speculation, mergers and acquisitions, FDI et al.). (figure 5c)

The gradual emergence of this new configuration of markets and actors does not change the basic nature of capital, which is the exploitation of labour via the production of surplus value and its appropriation as profits on capital. The new group of capitalists – originally a service industry for the management and enhancement of financial assets – is much further away from the concrete production process than the traditional entrepreneur has been and also much further than the technocratic management of large industrial or service corporations. In this perspective one could say that finance-led capitalism is a further real mystification of the nature of capital: It eliminates all intermediate steps between money and more money ($G - G'$) as the purpose of capital, whereas capitalist manufacturing still follows the visible formula $G - C \leftarrow P \rightarrow C' - G'$

From the viewpoint of political economy the main problematic accompanying the growing importance of financial investors and their strategies is the enormous shift of economic and political power in favour of capital. Financial investors are not only claiming ever higher economic returns for their assets; they are changing the social framework and environment for all economic and increasing parts of social activity, putting them under enhanced competitive pressure and forcing them to subordinate every tradition, social relationship and activity under the imperative of rapid returns to investment. The – relative – balance of power between labour and capital which had been achieved in the post-war period and was the basis for the continental welfare states in all their diversities is increasingly undermined by the dominating role and strategies of the new generation of financial investors. Social security as an unconditional right of every member of society is increasingly replaced with insecurity and precarious

perspectives, the wealth of the upper classes increases and so does the number of poor people, even amongst those who have a job; social solidarity is replaced through individual competition – sometimes complemented by individual charity.

It is true that this finance-led capitalism originated in the USA and spread from there to the rest of the world. The EU did not only not resist the infiltration of this pattern into the Union but it welcomed and promoted it, because it was and is after all a powerful tool of economic and social counter-reform in the interests of the ruling classes. Although neo-liberalism and finance-led structures have not yet been firmly and definitely established in all member states the European Commission is a main proponent and militant partisan of this pattern of development in the world.

3. Left alternatives: Immediate responses and regime change

To be able to participate in the public debate about economic policy the Left has obviously to take up the most urgent problems and present answers which should on the one hand be realistic and feasible and, on the other hand, go beyond mere piecemeal and short-lived actions of repair of the system. Three important projects for intervention and policy transformation are explained here which should be cornerstones of a political economy of the Left in Europe..

3.1 Democratic transformation of finance

The course and depth of the financial crisis call on the one hand for immediate measures to secure the functioning of the financial system. On the other hand they require further reaching policies which transform the financial system and embed it into a framework of democratically controlled economic and social development.

To secure the basic functions of the financial system *a regime change* is necessary. States should take over relevant parts of the leading banks in their countries, thus create a strong and permanent basis of public or semi-public banks and exert efficient control in these banks to secure the smooth functioning of payment system, the provision of sufficient credit to the economy and the safety of savers deposits. This step is logical, since, first, during the last few months every government and the European authorities have repeatedly and correctly emphasised that the stability of the financial system is an important public good, and, second, the current crisis demonstrates again (after many crises in the past 20 years) that the private sector is not able to deliver this public good. *Nationalisations should therefore not be regarded as a temporary rescue action for private banks but as a decisive step towards a new and democratic banking and financial market regime.* Further immediate measures include the removal or prohibition of the most destabilising practices and structures of the financial sector: securitisation, high-leveraged loans, hedge funds. Rating agencies should be put under public control.

Further reaching measures relate to thorough reforms of banks and capital markets. Banks activities should concentrate on the deposit and loan side, whereas on capital markets speculative and short-term trading should be downsized and heavily regulated. To take the pressure out of the financial system the underlying roots must be addressed: income distribution must be reversed from top to bottom and social security systems must be removed from capital market influence.

3.2 A strong and democratic public sector against the stampede of privatisations

A second major project of a left political economy in Europe should be to oppose the current wave of commercialisation and privatisation of public services. Since these take different forms in different countries resistance will focus on different areas and cases: health care, pensions, education, water, electricity, gas, railways postal services etc.

On the European level the ambition of the Commission to subordinate all public services to the competition and internal market rules – and then grant an exception here and there – must be opposed. The left conception should be that public services are not an exception but a genuine alternative to the organisation via competition, regardless whether they are supplied for money or not. The uniform conception of competition as the one and exclusive organisational pillar for economic activities should be replaced by a two-pillar model: Besides the pillar for profit production and provision of goods and services there should be a second equally strong pillar for not-for-profit activities.

Such a strong public sector is necessary to underpin sound economic development, to promote and ensure social equality and cohesion and to broaden the scope for political democracy. It should be noted, however, that it is necessary to organise the public sector in a way which really gives room for public participation and “ownership”.

3.3 A new macro-economic policy regime for full employment, sustainability and social cohesion

Macro-economic policy is on the one hand always under pressure to respond to the threat of recession through the organisation of immediate countermeasures like public stimulation programmes for the economy, interest rate cuts and the like. However, to bring the European economies on a path of socially and ecologically sustainable development more is necessary, which amounts to a macro-economic regime change.

The mission and institutional framework for *monetary policy* should be changed to assign to the ECB responsibility for employment, growth and financial market stability as well as for stable prices, and to embed monetary policy in an environment of democratic discussion and decision making on the EU level.

Likewise fiscal policies should be revitalised as potentially powerful instruments to stimulate the economy, soften regional and social disparities and contribute to more equality and justice. These objectives should be the benchmarks for public budgets and taxation. Therefore the counterproductive Stability and Growth Pact should be terminated and be replaced by a *tighter policy coordination*. At the same time the limitations imposed on the European budget (1% of EU GDP), which are obstacles for effective European activities and interventions must be removed and the budget raised gradually to about 5% of EU GDP. To finance such expenditure on the European level European taxes should be introduced on financial transaction, CO2 emissions and aviation fuel.

A new macro-economic policy regime must also relate to the question of *wages and distribution of income and wealth*. The long-term fall of the wage share in GDP of most member countries must be stopped and reversed. Although this is basically a matter of trade unions and employers associations, national governments and EU institutions have in the past exerted strong pressures for lower wages, precarious working conditions and to weaken the trade unions. This pressure must be ended and the role of high wages and good working con-

ditions be recognised not only as economic stimulus but also as a basic pillar of the often praised European Social Model.

4 Conclusion

The conceptions presented above are just three important examples for an left alternative to economic policy which combines immediately feasible policy measures with further reaching changes of policy regimes and paradigms. Other approaches are also possible and important:

- the fight against rising poverty and especially child poverty and the situation of the working poor;
- the fight for ecological restructuring and a new energy and climate policy based on energy saving, and the development of renewable energy sources.
- the establishment of cooperative and development friendly international economic relations to replace increasingly aggressive internationalisation strategies.

All these approaches have in common that relevant changes of the prevailing neo-liberal policy regime require a thorough redistribution of income wealth and power. Although this redistribution of income wealth and power from a small minority to a large majority of people is a necessary condition for a regime change it is not a sufficient condition for the sustainability of such change. For the latter new models of administration, transparency and participation are required.