CRISIS OBSERVATORY

Policy Paper

No 21_February 2014

Structural causes of the European crisis, ideas contested and the reluctant response of the European Social Democracy. Lessons learned and a progressive way forward.

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Abstract

This paper discusses the structural problems of the European integration that exposed the European system to the typhoon of the 2007 outbreak and still impede needed recovery. Consequently, it tries to shed light on the theoretical debate that has shaped the political discourse in Europe and has dictated certain policy responses. Finally, it examines the status and the role of Social Democracy in Europe in an effort to explain her inadequate response to the crisis and her recent electoral retreat. It concludes with a series of assumptions that provide the European progressives with a potential political and ideological weaponry in the context of the changing European society and the forthcoming European elections.

Key Words:

Crisis, European Union, Social Democracy

Introduction

The European banking (and in the case of Greece, sovereign debt) crisis has revealed Europe's vulnerability to economic developments and globalization. Europe suffers due to the banking crisis that took hold in the U.S.A. in 2008 and a series of structural political and economic pathogens at the national and at the supranational level that extend beyond the analysis of the current monetary structure of the Eurozone. Moreover, the problematic and spasmodic European response to the crisis has been an illustration of the dominant ideas and the weakness of the political elites to promote an alternative political and economic imperative for Europe.

Five years later, the fiscal crisis has turned into a recession, dramatically metastasized to the democratic institutions (extremism, populism, radicalization) and the social fabric (new poverty, unemployment) of the affected member states of the Union. It has also produced centrifugal and separatist tendencies, lack of solidarity and coordination between the member states, distinct visions or lack thereof about the next steps of the European integration and clashes over preferred economic policies, growth strategies or adequate institutional machineries to address the problem.

This paper discusses the structural problems of the European integration that exposed the European system to the typhoon of the 2007 outbreak and still impede needed recovery. Then we shed light on the theoretical debate that has shaped the political discourse in Europe and has dictated certain policy responses. Finally, we examine the status and the role of Social Democracy in Europe in an effort to explain her inadequate response to the crisis and her recent electoral retreat. We conclude with a series of assumptions that provide the European progressives with a potential political and ideological weaponry in the context of the changing European society and the forthcoming European elections.

The Crisis and Beyond

From the creation of the EMU in 1999 to the peak of the crisis in 2009, a single monetary policy, allowed its member states to exercise national fiscal policies. The desired alignment between divergent fiscal policies was dependent on the Stability and Growth Pact, according to which member states' deficit was not supposed to exceed 3% of GDP and debt not to exceed 60% of the GDP. Nevertheless, the Pact was systematically violated by the majority of the member states (Germany and France included), revealing the imperfect nature of the Economic Union and the absence of credible enforcement rules.

Second, the concept of the monetary union created imbalances. Low interest rates favored low borrowing costs. It was expected that the removal of the exchange rate risk would allow the capital to “move downhill, from the richer to the poorer countries that were offering higher rates of return” and that “in this way, the monetary unification was expected to foster income convergence” (Angeloni, Merler & Wolff). However, the peripheral states used capital flows for consumption rather than investment. While the Southerners were losing competitiveness and their industrial base, the “non-tradable sector was boosted by unprecedented inflow of capital from other euro area partners” (ibid). The outward looking and fiscally disciplined states of the North were creating current account surpluses at the expense of the expansionary fiscal policies of the less competitive Southerners for almost a decade. While Germany and France were driving the engine of the European economy, the European Central Bank managed inflation; hence investors and member-states confidence was unchallenged.

Arguably, fiscal fecklessness of the Southerners was the symptom rather than a cause; a more thorough look on the institutional asymmetries embedded in the Single European Market and the EMU, especially between the northern and the southern states, reveal significant differences in the capitalism models adopted. For instance, the coordinated continental economies of Germany, Belgium, Austria and the Netherlands follow different patterns of labor relations, collective bargaining, skills acquisition, inter-firm relations and competition, technology transfer, intra-firm relations with employees and stakeholder protection than the Mediterranean mixed market economy players (Greece, France, Italy, Portugal, Spain); what has driven export-led growth in the North (coordinated wage bargaining, sophisticated systems for skills formation and capacities for continuous innovation) was absent in the South (fissiparous trade unions, firms compete less on quality and more on cost, little focus on skill formation) (Hall, 2013).

The differences in policy models and in institutions were exacerbated rather than generated by the fixed exchange rate system of the late 1990s and the 2000s. While the northern economies achieve growth through exports, coordinated wage bargaining and sophisticated educational and vocational systems for skill formation and capacities for continuous innovation, their southern counterparts social dialogue is undermined by polarized and divisive labor unions, skill formation is not a priority and their firms compete less on quality and more on cost (Hall, 2013). When we focus on the welfare-state models, it is also evident that for instance, the ‘continental-conservative’ model (France, Germany, Austria) addresses poverty through effective redistribution, provides generous unemployment benefits combined with strict employment protection legislation. Workers and their families enjoy a credible insurance system in contrast to the “Mediterranean model” (Greece, Italy, Spain, Portugal) were entitlements are segmented, the system is poorly redistributive with small impact on poverty reduction and employability and unemployment benefits are both low. In other words, the Southerners have preferred to protect jobs rather than workers by creating more rigid and less competitive labor markets. Moreover, scholars like Vivien Schmidt and Peter Hall distinguish between coordinated market economies (CMEs), liberal market economies (LMEs) and state-influenced market economies of the Mediterranean region

(SMEs). Despite that these distinctions contribute to the understanding of the institutions or the degree of market liberalization and – in the case of the SMEs – to the centrality of the state in domestic economy and the importance of family ties, different manifestations of the crisis might occur even among the states of the same category; crisis in Italy hit the small and medium-sized enterprises, the housing bubble burst in Spain while mortgage defaults surged and Greece suffered contraction due to the huge deficits of its ailing public sector.

Similar studies highlight that every state constitutes an individual case despite the effort to form groups for the sake of the academic analysis. To this, one-size-fits-all or crafty blueprints of 'imposed' structural reforms might overlook the complexity of the European societal and economic universe whilst they might also precipitate or prolong recession, as harsh reality in Greece demonstrates.

Addressing the issue as a pan-European malaise, Roberto Unger has argued that the Europeans have failed to grow the 'innovative-friendly sectors' (education and research institutions) and associate them with the rest of the production and the economy. On one hand, he attributes the problem on the heavy burden placed on public finances; traditional tax and transfer patterns followed by the Europeans since 1945 restrict the states' necessary political economy shift to new institutional arrangements that engage with new economy actors on the basis of new funding tools (eg. venture capital) in order to reallocate public resources in new fields of investment and education, broaden opportunity and create a symbiotic partnership with the world of innovative SMEs. Within a similar hermeneutic framework, it could also be argued that the lack of a true economic union has doomed similar initiatives, like the Lisbon Agenda, to failure. Institutional variety between member states, especially in the field of public expenditure on innovation, research and education created a universe of a few winners and a majority of losers that cannot compete with the Nordic social innovation model. The issue of centralization or de-centralization of certain European policies as an institutional response to the crisis will be analyzed further in the context of the social-democratic challenges.

The ideological polemic on the European crisis

A heated debate was generated during and after the Eurozone crisis. National economic doctrines dictated different diagnoses and responses to the problem. One claim is that a major cause of the crisis is the difference in productivity among the EU economies (as presented above) which is sustained by the institutional machinery of the European Union which forbids currency depreciation. Another position is that the member states of the EU find themselves in an ambivalent status to choose either less or further economic integration. The latter also implies that the architects of the European project foresaw that this instability would create the stage for a political union. However these claims are limited to the extent that they do not answer to the question «what follows».

The most vibrant intellectual polemic takes place between the proponents of a neo-Keynesian style fiscal and monetary stimulus and the supporters of fiscal discipline and austerity who advocate for punitive measures against the «rogue states». According to Peter Hall, the former are represented by the French concept of demand-led growth that prioritizes active state intervention and active fiscal policies. The latter assumption is depicted at the German 'ordo-liberal state's rules' that guarantee the private economy through monetary stability and balanced budgets, promote the social economy by framework policies and empower the private sector to produce more jobs.

A form of neo-Keynesianism prevailed in the beginning of the EU crisis in 2008, illustrated by stimulus packages as the (insufficient) "European Recovery Plan" that was adopted in December 2008, committing the EU and the member states to a budgetary stimulus reaching 1.5% of the EU's GDP (Hodson: 177). Today, the voices of Keynesians have grown, arguing that structural imbalances and prolonged austerity call for the creation of a transfer union that will be able to compensate the weaker southern-European states in the form of a "Marshall plan" or a universal debt restructuring/haircut.

On the other hand, the prevalence of the fiscal consolidation approach has been evident in imposed fiscal austerity. The re-emerging doctrine has been "sweetened" with inefficient counter-cyclical reform packages (OECD) and unemployment benefits (IMF blueprints), strict fiscal monitoring and monetary interventions supported by Germany and the European Central Bank. Moreover, the newly introduced Budgetary Pact/Fiscal Compact 'straitjacket' illustrates the trend towards "healthier" balance sheets, although the member states' capacity to produce balanced budgets in times of zero or slow growth remains under question.

From 2009 to present, the spirit of retrenchment has prevailed over stimulus. The Europeans chose the path of fiscal consolidation as a response to the crisis and the subsequent slump. Worse, no institutional alternatives were put forward by progressive political powers. Social democrats in Europe aligned themselves with the general skepticism against the Keynesian stimulus as inadequate and a 'play for time' solution. No credible alternative for pro-cyclical growth combining fiscal prudence and targeted investment was promoted by the intergovernmental decision making system of the EU. The alleged worsening of an indebted state's position due to liquidity injection would entail the danger of a crisis of confidence in the Eurozone. A consensus was built on the "there is no alternative" dogma. Subsequently, the recent crisis accelerated the political discrediting of social democracy and its liberal forms.

"Humanizing the inevitable": Where were the Social democrats?

Social democratic parties have not gained electoral benefits out of the crisis. On the contrary, the more citizens are exposed to insecurity and unemployment, the more they consider the Social Democrats as part of an old picture they hate to look at. Surging Euroskepticism is a bitter acknowledgment of societies becoming more conservative, risk-averse and vulnerable to leftist or extreme-right populist rhetoric. Conservative or technocratic governments are projected as a less 'necessary evil'. And as the social democrats become more marginalized and trapped in the normative political and economic misperceptions of the previous century, their electoral base flows toward the opportunists, the populists or the Marxist statists. From France, Germany and the UK to the European South, the current crisis finds the European social democracy unprepared, hollowed out of its ideological and political standing and vacillating in search of a credible response to the current slump.

The mission of social democracy was to sustain and protect insiders against the instability of labor and capital markets; to protect the workers of large enterprises and stabilize the system of control; to institute arrangements to protect small business; to negotiate the social contract of income between big business and the organized labor; to protect societies from conflict and paralysis; to provide financial entitlements.

However, the commitments of the once "Rhineland model" succumbed to neo-revisionism, short-term electoral catch-allism, the uncontrolled expansion of the financial markets, de-regulation via gentleman's agreements, liberalization to favor the big business, surging inequality of opportunity, taxation burdens on the poorer, ambivalence towards the new asymmetries produced by climate change, organized crime, immigration, aging of the population and the unaffordability of the universal social entitlements. Social democrats found themselves in a deadlock of aspirations to "humanize the inevitable by refusing to re-organize the relation between finance and the real economy/production and by just trying to regulate finance" (Unger). In the context of the above, the legacy of the "Third Way" has been criticized as an unfortunate promoter of an impossible compromise, conciliating USA flexibility with imposed constraints on European-style social spending. However, the spirit of the Third Way is apparent in the consensual Nordic economies that generally succeed in balancing high levels of social protection with competitive labor markets and innovation.

European Social democracy also failed to modernize the institutional apparatus of the public sector services and seek productive alternatives away from fiscal realism. Following the Maastricht Treaty and especially in the late 90's when a social democratic majority in the EU passed a series of institutional reforms at the EU level (Lisbon Agenda, Charter on Fundamental Rights) and the introduction of the common currency facilitated expansionary policies, the social democrats did not invent new means of redistribution beyond traditional tax and transfer. They failed to systematically promote the transition to a post-Fordist model of production that would channel financial gains to productive entrepreneurial activity and socially inclusive innovation. This “institutional dogmatism” (Unger) has been a widespread malaise in the contemporary history of halted major progressive reforms.

In the 2008 crisis, the social democratic camp was skeptical towards a stimulus package. It was only after the second year of the crisis and a series of bailout packages that the Party of European Socialists referred to the necessity of a new “Marshall plan”. However, none of these approaches was convincing and credible. The first reason relates to the sinful past of Social democratic parties as “partners in crime” with financial deregulation. The second relates to the skepticism towards neo-Keynesianism. Despite expansionary efforts in the form of public investment, tax reliefs or benefits, these programs are of temporary nature and insufficient, according to Unger & Lothian, as they cannot guarantee recovery, sustainable investment and visible impact on real economy after a major slump; they also threaten real interests and especially, new ideas. Not accidentally, the alternative to an obsolete populist Left in denial of cosmopolitanism, is a compromised social democracy that propagates for financial regulation, tax and transfer tools and a compensatory redistributive model without distancing herself from the tired orthodoxies of post-war welfare. While the financial hypertrophy – namely the detached or episodic relationship of the financial sector with the real economy breeds excess, erodes the social fabric and halts productivity, the progressives did not distance themselves from the mainstream polemic (stimulus versus austerity) and failed to put forward a new institutional arrangement that would integrate finance in the service of the real economy, it would provide more opportunity through education and democratize entrepreneurship through innovation.

A progressive response to and after the crisis

Is the current crisis the long-awaited opportunity for the social democrats to restore their lost prestige, reconnect with the shrinking middle class, and encompass the aspirations of the self-employed, the educated youngsters of the ‘Erasmus generation’, the opportunity-seekers and the immigrants? The answer depends on the capacity of the social democrats to address a series of fundamental challenges listed below:

a. Governing the relation between finance and the real economy by democratizing the market economy and channeling of the savings in the real economy, not the world of finance. Finance should serve the purposes of competitive and participatory real economy in the form of the access to new forms of credit for the small and medium enterprises that constitute the backbone (99.8%) of the European economy.
b. Promoting social services of high quality and moving away from bureaucratic Fordism. A new re-organization form is needed to decentralize and outsource or ‘lease’ services that the state cannot afford or cannot provide effectively. These new services could be provided by new organizations, not necessarily the civil society, but private providers of high competence and skills. The role of the government should be to monitor and encourage partnerships. The other role of the government

is to act as “a vanguard, developing experimentally new services or new ways of providing the old services” (Unger: 87): neither via bureaucratic imposition nor consumer choice in the market.

c. New institutional arrangements towards the New Economy. Government should focus on the productive potential of private savings (e.g. venture capital on a large scale) and develop a model of decentralized coordination between government and private enterprise (Nordic model). Given the current economic restraints, the government should support the development of alternative forms of funding, e.g. venture capital, seed capital and micro financing, to encourage clustering and export-driven growth, trans border cooperation and synergies among the small and medium sized enterprises. The concept is not to suppress, moderate or re-regulate through compensatory redistribution and more taxation. The role of education is crucial to the extent that it incubates the new economic innovations. Lifelong learning and vocational training should facilitate labor mobility in production and services, for instance, the promotion of self-employment and the extended use of technical/scientific innovation in production, the ‘portfolio worker’, or the ‘self-entrepreneurial agent’ in the Rawlsian property owning democracy. To this, the labor unions should develop a new role as networking and developing human capital agencies in cooperation with the state and the market, to encourage flexible models of employment, subcontracted and temporary employment in the form of transitional markets (e.g. the workers sign contracts with several firms and training agencies, moving securely and maintaining the right of choice and security against any kinds of crises). To this, the EU should have a more decisive and effective role in coordinating national policies. The intergovernmental decision-making model in educational policies can no longer serve drastic policies towards human, social and economic development
d. Pursuing social cohesion and solidarity that do not rely on ethnic or national homogeneity but are deployed around family needs. Equality should not be an end in itself but a means to empower people with skills. Likewise, social insurance cannot serve as social cement. Unger proposes a system of a caring economy, where the able individuals will dedicate part of their working life in the provision of human care, assisted by the dynamism of the Civil Society and the government services.
e. Re-organization of democratic politics and the empowerment of the ordinary citizen can be achieved through the combination of progress and equality with the advance in the capabilities and in the self-affirmation. Political parties at the national and at the supranational level should endorse more forms of interaction and new spheres of politicization.
f. Articulation of a new economic alternative. First, a clear denouncement of austerity based on ideological and material reasons is needed: “austerity has been applied with exceptional vigor during the ongoing European financial crisis, and it has produced exactly the same failures one would expect if its previous intellectual and natural histories had been investigated’ (Blyth, 2013: 230). The debate between recovery and redistribution is another point of consideration for the progressives. As manifested above, the expansion of credit and debt in the form of popular credit

capitalism contrasts the popularization of purchase power that requires progressive redistribution of wealth, opportunity and capability.

g. Social democracy needs to reconnect with her cosmopolitan values and articulate a bold vision for Europe. Social democrats should eradicate the distance between the young populations, the shrinking middle class, the marginalized and the euro-centric technocrats or the Brussels 'epistemocracy'. They should be ready to respond to the call for a multi-speed Europe and bold enough to propagate in favor of more integration in the sectors of education, research, innovation in the market and the institutions. A change of their audience and social base is mandatory; a connection with the productive forces of the EU, the incubators of knowledge and the hidden potential of the new economy and the labor: the small-medium enterprises and the self-employed should be offered a progressive political agenda that express their aspirations for a good cooperative society and a competitive European market based on trans border mobility, education and opportunity. The maintenance of federalist-type laments in today's Europe just widens the gap between the Social Democrats and the growing Euroskepticism of the middle class. Instead of advocating a European Moorean Utopia, the acknowledgement of a poly-centric community in which "different policy communities have different rules and different degrees of integration for their members" (Schmidt) would provide space for the peripheral countries to establish new cooperation zones where labor mobility, tax regulation, health care systems, labor markets and education would be harmonized to produce jobs, opportunity and growth. The abandonment of the holistic vision of Europe does not mean departure from the vision of United Europe to the vision of centrifugal or fragmented Europe. It will be celebrated through an institutional innovation that will foster regional integration with more partners, peripheral and non-member states that will enable all parties to benefit from growth, stability and cultural interaction. The southern member states should ally to reform the nature of the Union. The central vocation of the EU could be the insurance of the endowments of all its citizens and the mitigation of the transaction costs to create a transfer union of citizens.

Epilogue

The sovereign debt crisis followed by prolonged recession highlights the diffuse of national social and economic realities, the battle of ideas in Europe and the relevant crafted responses to the crisis. Contemporary social democracy remains politically dismantled, as it pays the price of neo-revisionism and transformation that disabled her from articulating a progressive alternative beyond the obsolete schema of 'Keynesianism versus austerity'.

Despite the crisis, Europe remains the most favorable terrain for socially inclusive projects, institutional experimentation, and the incubation of new ideas that await to be expressed by a new progressive political narrative. Should the European social democrats embrace the dynamics hidden in the new challenges, they will be able to free themselves from their erratic perceptions, their ideological ambivalence and their current electoral retreat.

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