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Europe’s Japanese Winter: A Brussels view

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Attending the Euro Reform 2014 Conference in the capital of Europe proved to be an interesting experience. A panel of politicians as well as scholars presented their not so optimistic views on the Eurozone’s current situation and future. The panel was presided by Mr Paulo Casaca, former Portuguese MEP and consisted of Mr Guy Verhofstadt former Belgian Prime Minister and candidate for the European Commission’s Presidency, Professor Christoph M. Schmidt, Chairman of the German Council of Economic experts, Dr Zsolt Darvas, Senior Research Fellow at the Brussels-based think tank Bruegel and Commissioner for Employment, Social Affairs and Inclusion, Laszlo Andor. The debate was particularly interesting as it consisted of mixing pure Brussels’ politics with academia, observing that they more or less follow the same line.

In fact, all four panelists seem to disagree with the statement of former European Commission President Barroso that the crisis belongs to the past now. On the contrary, there is a general sense that the crisis is far from being over yet and that it has three main branches; it is a government debt crisis, a banking crisis and a competitiveness crisis. EU’s current status is metaphorically identified as the beginning of a Japanese winter; A long period of economic stagnation where Europe will have to face an extremely slow economic growth for a whole decade more or less. This is definitely a deeply skeptical prediction for the future of the European project. In this article we present the current trends that are being discussed in the heart of Europe in order to avoid the so-called Japanese winter. Here is an overview of what Brussels considers as options and possibilities to tackle the issue.

First, what became obvious is a clear rejection of the Lisbon Treaty’s strategies. From a Brussels’ perspective, they led to divergence as a result of being too weak. Thus, in order to achieve convergence among the Eurozone countries further integration is needed. How do we get there? By making people part of the process. However, not everyone considers this a plausible scenario. Some believe that this is a very romantic approach. If we want to be politically realistic, we cannot predict further major integration initiatives in the following years. Notably in fiscal matters, EU States show no willingness to give up their national sovereignty contributing to both the aggravation and the extensiveness of the crisis.

EU decision-making process is too focused on inter-governmental negotiations when it should be focusing on creating mechanisms on a European level managed by European authorities and therefore avoiding national conflicts of interest. The European Council is the institution that is resisting the idea of a truly European mechanism especially with regard to the Banking Union. The Court of Justice of the European Union seems to agree with this view. In fact, the judge of Luxembourg has recently reversed[1] the famous "Meroni doctrine"[2] established in the 1950s, which gave exclusive competence to the Council concerning European fiscal policies. According to the newly established legal position, certain powers on fiscal policies can be attributed to other European authorities.

Regarding the necessity of a Banking Union, the idea of simple consolidation is considered insufficient. Banks should be brought down or recapitalized and they should also be the object of equal treatment, in the sense that no bank should be excluded or privileged from the mechanism. Otherwise there will be no growth. A feasible Banking Union is one including *all healthy* European banks. Moreover, the Single Resolution Mechanism should not be an inter-governmental treaty in order to be operative. It should rather be formed and managed on a European scale, an element which adds to the previously mentioned idea.

Coming back to the concept of a Japanese winter for Europe, the general idea is that coming out of recession is not good enough with the current conditions. If the Euro Area rests on this year's Greek prime surplus, a number of risky scenarios may come true with disastrous consequences.

Referring to the failure of austerity policies adopted so far, it is argued that they achieved to turn the Europeans against the Union causing a major legitimacy loss for European institutions and procedures. It is crucial to show that the EU can perform. If not, Europeans will completely turn their backs on Europe and this is a visible risk with the rise of populism in several EU States that have obviously had a decisive impact on the recent European elections. Structural reforms are absolutely necessary and exiting the recession period should not slow them down, especially since the financial fragmentation issue is yet to be solved. But the recovery, even if not impressive, is a sign that structural reforms are working and that they will deliver even better results on a long-term perspective.

Nevertheless, these structural reforms shouldn't take their toll on societies. When referring to the cohesion issue of the EU, the fact that certain countries have paid a much higher price than others, largely contributed to the current significant asymmetries observed among EU States. The asymmetries in the EU did not appear alongside with recession, they were already present but they were severely accentuated by the crisis. The social dimension of the European Monetary Union is directly linked to the issue of legitimacy and this is the main reason why it is urgent to revisit the current functioning of the EMU as it contradicts the EU 2020 objectives. A first step in that direction would be a reform of the internal devaluation concept. In fact, the Euro exchange rate is too strong making it harder for some countries to recover.

The steaming hot problem of European unemployment rates can also be translated in Japanese-winter terms through what we call a jobless recovery. On one hand, numbers indicate that labor mobility in the EU is very limited with only 2.8% of the European citizens moving around Europe for professional reasons at a time when the need of skilled workers' immigration is more indispensable than ever in the European Union's history.

At the same time, Brussels seems to completely ignore or to turn a blind eye on the brain-drain phenomenon which constitutes a major issue for peripheral countries mostly struck by the crisis. Strong criticism is coming from Brussels towards these countries whenever they raise a voice in this regard. On the other hand, this particular aspect of the problem points out better than any other the need for sustainable growth. At this point, the essential nature of structural reforms is obvious. Euro Area states should make sure that the reforms they are implementing supply sufficient labor demand. What is more, the possibility of a "Marshall Plan for

[1] ECJ, 22 January 2014, *United Kingdom of Great Britain and Northern Ireland v European Parliament and Council of the European Union*
[2] ECJ, 13 June 1958, *Meroni and Co, Industrie Metallurgiche SpA v High Authority of the European Coal and Steel Community*

Southern Europe" is currently on the table, embodying the idea of more investment directed from the North to the South of Europe in order to create more jobs in the countries with the highest unemployment rates such as Greece, Spain and Portugal.

Another key issue emerges from the fact that the crisis is not only due to public debt but also private debt. The European Central Bank data show that inflation is low and it will stay low for quite some time. Low inflation, according to Dr Darvas is dangerous. Based on an IMF study, countries coming from deficit to surplus in a low inflation environment present the risk of stepping back into a new debt. This is why he suggests that the ECB should implement more policies in order to avoid low inflation and to ensure smoother economic cycles in the future.

To sum up, the growth forecast of 1% presented by EUROSTAT for 2014 does not reassure Brussels. The slight recovery is not translated as the end of the crisis. However, the long recession period seems to have taught Brussels a lot. The European Union needs an economic governance, it needs it fast and it needs it to be efficient and realistic unlike the Maastricht architecture. Moreover, there seems to be a shift in the European approach moving towards a more flexible one, where instead of setting *"standards"* and expecting all EU Member-States to live up to them, the term *"ranges"* aiming to facilitate the respect of States' differences appears more and more in the European discourse. Furthermore, it is made clear that for the European project to move along, the EU motto "United in diversity" must concretely be translated into European policies. The new policy trends presented at the conference show a shift towards an enforcement of the European Parliament and Commission's role vis-à-vis the European Council in order to overcome the consensus issues and try to regain the lost legitimacy. But most importantly, new policy trends are aiming for sustainable solutions. They recognize the necessity to find a balance among all EU Member-States and to implement policies that are much more socially sensitive. The danger of a Japanese winter can still be avoided if the correct policies are implemented in time.

Europe has been through a lot these last years and the storm is not totally over yet. But Europe has a long tradition of overcoming obstacles and learning from its own mistakes. Let's hope that this time Europe will live up to the *standards* history has set for it throughout the centuries and instead of a Japanese winter, a European spring awaits ahead.

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