EuroMemorandum Group

Democratic transformation of European finance, a full employment regime, and ecological restructuring – Alternatives to finance-driven capitalism

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Content

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Summary

In the second half of 2008 the EU has faced the biggest financial crisis since the end of world war 2, and at the same time is confronted with the prospect of a serious recession. EU institutions and governments have been highly active, organising one summit after the other to prevent a breakdown of the financial system. But it is questionable whether the huge programmes to bail out and recapitalise the banks will really help even in the short term, and it is certain that the solutions presented are not sustainable in the long run. Meanwhile the growing problems of unemployment, poverty and precarious employment, rising inequality, energy provision, and climate change have been largely crowded out by the desperate attempts to prevent a financial break-down.

The financial crisis originated in the US but has now spread to financial centres in other parts of the world. European banks and other financial institutions have been deeply involved in untenable loan policies and irresponsible financial speculation driven by the pressure of financial investors. In the past few years the financial industry has expanded beyond reasonable limits, and profits from financial investment and speculation have soared as never before. European policies have done nothing to prevent this development. On the contrary: the disregard of the European Central Banks for systemic financial market stability and the obsession of the European Commission with liberalisation, market opening and deregulation have actively contributed to the crisis in Europe.

While the EU is still grappling with the financial crash an economic recession has been building up which, although exacerbated by the financial crisis, has home-grown roots. It is primarily a result of the neo-liberal economic policies adopted by both the European authorities and of most member governments. In the past few weeks these have revealed a striking contradiction: While they have been able to agree rapidly on raising huge resources to support ailing banks, not even a fraction of such resources has been made available to fight a regular recession and protect the employment, income and living standards of the majority of people. By the same token the declared intention to set up a new energy and climate regime has been undermined by intra-EU conflicts and a failure to come through with financial commitments. The rest is rhetoric. In the meantime the Commission (supported by the European Court of Justice) has continued to pursue the programmes of liberalisation and privatisation as clearly demonstrated by the recent initiatives for more 'flexicurity' in the labour market and for more liberalisation in the health sector as well as the alarming decisions by the ECJ.

The financial crash shows again that the current European regime based on private competition without a firm basis of democratic rules is not sustainable and is prone to economic and political failure. The EU needs a regime change aimed at promoting a new democratic framework for economic activity. We propose the following decisive steps in this direction.

1. Democratic transformation of European finance

- The *nationalisation* of relevant parts of the leading banks in the member states should create a permanent and reliable basis for securing deposits, the payment system and credit provision
- The most *destabilising activities* and structures of the financial sector – securitisation, highly leveraged loans, complex structured products and hedge funds should be *prohibited* in Europe; offshore centres should be closed or isolated from the European market.
- *Bank reforms* should concentrate banking activities on taking deposits and extending loans to firms and households. The Basle II framework should be corrected to remove its polarising and pro-cyclical nature. Capital requirement ratios should be raised.
- *Capital market reforms* should aim at lowering the volume and speed of trading in securities, currencies and all kinds of derivatives; to this end, investments by pension funds should be restricted, struc-

tured products should be curtailed and standardised, and financial transactions should be taxed. Rating agencies must be restructured so as to separate consulting and rating businesses.
- Further steps to transform the financial system must address the underlying roots of the exorbitant growth of financial assets – the long-term trend towards more inequality of income and wealth and the privatisation of social security systems; and they must embed finance into the framework of a comprehensive democratic economic policy.

2. Macroeconomic policy: Immediate anti-recessionary measures and regime change for full employment and social inclusion

Immediate measures to fight the impending economic recession should include
- a *relaxation of monetary policy* via further reductions of interest rates,
- the adoption at the European level of a *'European Investment Programme* for Sustainable Development, Employment and Social Inclusion' of at least 1 % of EU GDP,
- a *European fund for assistance* to the weaker economies of the Union, and
- the organisation of *public investment programmes* of a similar dimension at the member state level.

Such programmes could be financed through
- a shift in budget lines in the European budget from unsustainable to sustainable expenditure,
- an increase of the EU budget which should be raised gradually to about 5% of EU GDP. For this purpose European taxes should be introduced on financial transactions and on primary energy, CO_2 emissions and on aviation fuel, and
- an enhanced use of the financing potential of the European Investment Bank and the European Bank for Reconstruction and Development.

A macroeconomic policy regime change must go further and change the mission and the institutional structure of *monetary policy* and the ECB: Its mission should include responsibility for employment, growth and financial market stability; and instead of acting in complete independence it should be embedded in an environment of tightly coordinated policies. Similarly the *fiscal policy* regime incorporated in the Stability and Growth Pact must be terminated and replaced with a more comprehensive and differentiated approach for double co-ordination – between member states and between member states and European institutions.

Macroeconomic regime change must also put the *redistribution of income and wealth* much higher on the European agenda. The political support for downward pressure on wages must be ended and substantial wage raises should be supported as a key step to a better life for the people in Europe. The Commission should underpin its rhetoric against poverty and exclusion with concrete activities and financial resources to this end.

3. Energy and climate policies will be able to make a significant contribution in their own fields while also helping to counter the impact of the financial crisis. An alternative European energy and climate package will be able to benefit from synergy by using investments in energy saving, general resource efficiency and sustainable renewable sources for reducing unemployment. A redefined EU emissions trading system will be accompanied by differentiated transition support programmes for the member states and a common Energy Strategy relying upon new regulatory tools.

Introduction

Less then one year before the next elections to the European Parliament the EU is facing on the one hand the shock of the largest financial crash since 1929, and on the other hand the sombre prospect of a homemade recession.

The continuing financial crisis demonstrates to an increasing number of people the deep irrationality and destructive dynamics of a finance driven capitalism which not only dominates the USA but has increasingly also shaped the rules of economic and social development in most parts of the EU. Short-termism, financial speculation and shareholder value orientation are replacing a long-term strategic orientation in corporations and governments. Inequality in income and wealth, social insecurity and precarious employment and working conditions are rising. The liberalisation and deregulation of core parts of the financial system has failed to fulfil a single one of the numerous promises and expectations which accompanied its introduction in the EU: Instead of greater efficiency, transparency and benefits for the economy it has produced social polarisation, chaos and crisis. The collusion between banks and financial speculators has now broken down and many former heroes of Wall Street, the City and other financial centres have been discredited and come to be seen as irresponsible gamblers. But the system needs more than a change of CEOs and small piecemeal repairs. It needs a deep and comprehensive transformation and democratic control.

Although the financial crisis originated in the USA, its policy base is not alien to the EU and has not been imposed on it. On the contrary, the continuous obsession with market opening, liberalisation and deregulation on the part of the European authorities, in particular the European Commission, has paved the way for the arrival of finance as an ever stronger determinant of European development. The rejection of macroeconomic policies for full employment, the establishment of a fundamentalist monetary and fiscal policy framework and the transformation of citizens social rights into marketable commodities – all these are core parts of the Lisbon strategies of 2000 and 2005. It would therefore be mistaken to assign the causes of the coming recession in the EU exclusively or even primarily to the fallout from the US-generated financial crisis. The European recession is basically homemade. It will be exacerbated through the financial crisis, but it would have come even without it. The financial crisis and the EU’s own Lisbon strategy together form a hybrid which is particularly explosive and highly dangerous for economic development and social cohesion.

Most member governments as well as the EU institutions have been taken by surprise by the financial crisis. They are now organising one summit after the other and issuing statements calling for a stronger regulation and supervision of financial markets. The proposals put forward and the measures taken in the course of the last month may rescue the financial system but they will not prevent the further expansion of finance-driven capitalism in Europe – and it is clear that this is not what is being promoted by the EU and the powerful corporate interest behind it.

Contrary to repeated official statements there are alternatives to such counterproductive policies. They consist on the one hand in energetic steps to first stabilise and then thoroughly transform the financial sector in Europe with the aim ensuring it fulfils its basic functions of providing a smooth payment systems, sufficient credit and secure deposits. On the other hand the EU needs strong macroeconomic and structural policies and a strong public sector as the basis for full employment, good working conditions, the elimination of poverty and an efficient ecological restructuring.

The current crisis opens an opportunity for a stronger public critique and the development of proposals which go beyond demonising the greed of speculators and managers to address the structural pressures which drive individual and corporate misbehaviour. In this Memorandum we will attempt to go beyond analysing and criticising the dismal and counterproductive policies of the EU, and set out concrete proposals for a democratic alternative.

Although finance-driven capitalism has suffered a severe blow and neo-liberalism in general has become seriously discredited by the recent crisis, neither has collapsed or been defeated as a result of these events. The essence of neo-liberalism is not deregulation but redistribution from the bottom to the top together with the process of privatisation in favour of the rich and powerful. Without strong social movements and political pressure for more democracy in the economy these processes will continue, possibly in modified forms.

1. Europe under pressure: Financial meltdown and economic recession

1.1 The financial meltdown: Background, perspectives and impact

The 2007-2008 financial crisis which, according to the IMF chief Dominique Strauss-Kahn, was on the point of causing a global financial collapse, had its origins in the US. The roots can be traced back to at least three important developments. Firstly, from the late 1960s big US banks, which had been tightly regulated since 1933, began to seek ways of evading regulations through innovation – developing new instruments which had not been anticipated in existing laws – and through internationalisation, notably by opening branches in London, where US regulations did not apply. Secondly, with the end of the post-war boom in the mid-1970s, the owners of money capital wanted to ensure that their capital was not tied-down in any particular type of fixed investment, but rather that it could be moved easily to wherever it could obtain the highest return. For the next 30 years huge sums flowed first into Latin America, and later into Asia and other so-called emerging markets, only to pull out when returns flagged, precipitating serious crises in the countries concerned. Thirdly, following the election of Ronald Reagan in 1980, the US government initiated a process of deregulation, eliminating restrictions on the financial sector, and this was continued under the Clinton government which in 1999 completely repealed the 1933 measures.

As a result of these developments, a new phase of capitalism has developed in the US since the 1980s, sometimes referred to as ‘finance led capitalism’. Banks and other financial institutions expanded strongly, and between 1980 and 2006, the financial sector increased its share of corporate profits from 10% to over 30%. At the same time, economic growth in the US became closely dependent on major expansions of credit and associated asset-price bubbles. In the 1990s, the so-called new economy was closely linked to a bubble in share prices. When this bubble burst in 2000, the Federal Reserve sought to prevent a major financial crisis by dramatically lowering interest rates, from 6.5% at the start of 2001 to a mere 1% in 2003. This was followed by a further huge expansion of lending. One area that grew rapidly was leveraged loans, mainly to private equity funds, to finance takeovers. The other main area was mortgage lending, including sub-prime mortgages to low income households with poor credit records, which between 2004 and 2006 accounted for around 15% of new mortgages. The scale of the lending for mortgages resulted in a boom in house building, but it also led to a sharp rise in house prices and between 2002 and 2006 these demonstrated all the features of a classic bubble. This bubble played a significant macroeconomic role because, as real wages were stagnating, households borrowed against their rising house price to finance increased consumption, and this was the main factor that drove economic growth during the period.

Two factors played a particularly important role during the most recent expansion. One was securitisation – the practice by banks of bundling together a number of loans to create a bond which they could sell on the capital market, and thereby avoid having to keep capital against such loans as required if they remained on the banks' own books. In the case of bonds backed by riskier loans, such as sub-prime mortgages, investment banks took the process a step further and created a new set of highly complex bonds ('collateralised debt obligations'), which hid the risks involved, and which were highly attractive to investors since they appeared to offer higher returns than other bonds with a similar rating.

The other significant factor was the emergence of what has been termed the shadow-banking system – investment banks, off-balance sheet 'structured investment vehicles' set up by commercial banks, and hedge funds, all of which were engaged in highly risky operations with widespread implications for the financial system, but which were not regulated as banks by the Federal Reserve. In particular, they all employed what is known as leverage, using large amounts of borrowed capital which jacked up their profits when they were successful, but which also dramatically multiplied losses when they were unsuccessful. The big New York investment bank Lehman Brothers, for example, operated with 33 borrowed dollars for every one dollar of its own.

This pattern of finance driven growth in the US has involved an important international dimension. Since the 1980s, US domestic demand has exceeded the country's output, leading to a current account deficit which has been financed by capital inflows from the rest of the world. In recent years there have been two major international financial circuits that have made this possible. One involves the US and Asia: it is driven by the US trade deficit, and the corresponding trade surplus of China, Japan and other Asian manufacturing exporters has been invested in US financial assets, largely safe government bonds. The other principal circuit is between the US and Europe: this is driven by capital flows, responding to small changes in expected returns. By far the largest capital flows in the world are those between the US and Europe.[1] Although the net flow of capital from Europe to the US is smaller than that from Asia, it is the outcome of very large flows in both directions. As a result, banks and other financial institutions in Europe have become deeply intertwined with the US financial system, a development which began in Britain in the 1980s and in most of today's Eurozone countries in the 1990s, and which has accelerated strongly since the turn of the century. In this way, European banks also acquired significant holdings of risky US assets.

The US was able to sustain the pattern of consumption-led growth and an increasingly overextended financial system so long as house prices were rising. But in 2006 the house-price bubble burst and in 2007, as house prices fell, the value of mortgage backed securities began to decline. The crisis which has since unfolded has involved four main stages:

The crisis first broke out in August 2007, when confidence between banks broke down as a result of uncertainty about other banks' exposure to losses from mortgage-backed securities. The money market dried up in the US, the Euro area and Britain, and the Central Banks responded by pumping large amounts of liquidity into the markets and, in the case of the US, by

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[1] See McKinsey Global Institute, *Mapping Global Capital Markets*, January 2008, especially the map on p. 64.

reducing interest rates. Overnight money market interest rates were brought down, but those on one and three month loans remained unusually elevated.

The crisis deepened in December, when banks began to publish details of their third-quarter losses. As money market rates surged again, the main Central Banks staged coordinated interventions involving injections of huge amounts of liquidity, with European banks also lending dollars made available in a swap arrangement with the Fed.

In March 2008 the crisis deepened for a third time. Market values of mortgage backed assets had fallen precipitously – indeed in many cases there was no active market – and investment banks were required to write down the value of assets on their books. Amidst this, Bear Stearns, one of the major New York investment banks collapsed, and the Federal Reserve orchestrated a rescue by JPMorgan, which it provided with a loan of $29 billion. In the following months many US banks raised new capital, often by turning to investors they would probably not have considered in the past, including sovereign wealth funds from the Middle East and China. By the summer some commentators were asking if the worst had passed.

The crisis deepened for a fourth time in September. At the start of the month the US Treasury put up $200 billion to rescue the two semi-official mortgage giants, Fannie Mae and Freddie Mac. The decisive event, however, was the bankruptcy of the New York investment bank, Lehman Brothers on 15 September. The decision of the US authorities to allow this was a major policy error, and set off a chain of events in the US and Europe that led to a dramatic deepening of the crisis. First, a series of financial institutions that were directly or indirectly linked to Lehman Brothers collapsed. In the US this included AIG, the largest insurance company, Washington Mutual, a savings bank whose collapse was the largest bank collapse in US history, and Wachovia, one of the country’s major commercial banks. In Europe it included Bradford & Bingley, a British mortgage bank, Fortis, the Belgian-Dutch bank, Hypo Real Estate, a large German mortgage lender, and virtually the whole of the Icelandic banking system. Second, the money market almost completely dried up, and even overnight rates rose to prohibitive levels as banks effectively ceased to lend to each other. In turn, bank credit to firms and households began to be sharply curtailed, with even the strongest companies in the US and Europe unable to borrow for working capital. Third, the crisis spread to the stock market, with shares falling in the US, Europe and major Asian markets by some 20% in the second week of October.

The US government initially reacted to the chain of failures by announcing the $700 billion Troubled Assets Relief Programme (TARP) to buy up bad assets, but this was widely criticised by economists. Initially rejected by Republican members of Congress, it was only passed after adding $149 billion of additional tax cuts for members’ pet projects, and even then it failed to stem the unfolding collapse. A coordinated half per cent reduction in interest rates by all the major banks also failed to stem the crash in share prices. Finally, on Friday 10 October, the G7 finance ministers, in Washington for the annual IMF-World Bank meeting, met and issued a five point plan which, although weak on detail, committed them to coordinated action to inject capital into banks and to provide guarantees for inter-bank lending in order to try and reactivate the money markets. This followed the broad lines of measures introduced a few days earlier in Britain following a major policy reversal by the British government. Over the weekend, Euro area heads of government meeting in Paris agreed a more detailed plan, and the US authorities let it be known that they were reallocating part of the $700 billion TARP for capital injections into banks.

When financial markets opened on Monday 13 October, for the first time since Lehman Brothers had collapsed, the downward momentum was broken. But the neo-liberal financial model was in ruins and the spiral of financial collapse had only been broken by nationalising important parts of the banking systems in both the US and Europe.

Table 1.1: Main policy measures announced October 2008

	Buying bad assets	**Recapitalisation of banks**	**Guarantee new bank lending**
Britain		£50bn	£250bn (against fee)
Germany	€10bn	€70bn	€400bn (€20bn allowed for losses)
France		€40bn	€320bn
Spain	€30-50bn		€100bn
Austria		€15bn	€85bn
Netherlands		€20bn	€200bn
Switzerland	$60bn	€3.9bn	
US	$700bn	$250bn*	$1.500 bn

* To be financed out of $700bn for bad assets.

Box 1: The role of corporate limited liability in the current financial crisis

Beyond the analysis of its immediate triggers and the actual unfolding of events, the current financial crisis highlights an important structural problem: No economic system that privatises gains and socialises risk can survive in the long run. While the economic and social fall-out from the collapse of Anglo-Saxon inspired 'money manager capitalism' is still far from clear, the response by governments, led by Henry Paulson in the US and Gordon Brown in the UK, has consisted in assuming unlimited liability for the failure of money and financial market players to assess risk properly. As of now, governments appear much less keen to extend these terms to the unwitting victims of this market failure.

That financial markets have so spectacularly failed to assess risk properly is no coincidence of 'irrational exuberance' or a sudden epidemic of 'mania'. The legal form of the dominant players in these markets – large corporations – is such that it actively encourages irresponsible behaviour by combining limited liability with full control rights in the legal figures of shareholder limited liability and the 'separate corporate personality'.

Historically, shareholder limited liability arose in response to 19th century pressure groups promoting the interest of an increasingly wealthy middle class who wished to invest their growing financial wealth without becoming entrepreneurs. Limited liability here also meant a loss of control. This rested with the owner-entrepreneurs, who welcomed the emerging 'rentier' interest as a valuable source of equity finance, but kept control of their companies, taking the risks and assuming full liability for the consequences of their decisions. Today, corporate limited liability means the accountability of a Board of Directors to their owner-shareholders. With the introduction of the 'separate corporate personality' risk was shifted from shareholders to creditors: Shareholders were liable only to (the now separate legal entity of) the company and creditors had to direct their claims to this entity. Subsequently, this logic was extended to the separation of parent companies from their subsidiaries: A parent company is not generally legally liable for its subsidiaries' decisions (and the risks these imply), even if the parent company has complete control of the subsidiary and its directors are the same as those of the subsidiary.

This combination of limited responsibilities (liabilities) with full control or ownership rights for owner-shareholders is a rare and arbitrary exemption of an influential interest group (the wealthy middle classes) from a basic principle of democratic capitalism: The idea that rights come with duties, and that all are equal before the law. As it stands, every citizen is legally obliged to take out insurance to drive a car on the road, while the owner-shareholders of large corporations can take far bigger risks with only a very limited legal obligation to take responsibility for their actions. More importantly perhaps, this capture of a whole system – market economies – by a small interest group is at the heart of the current crisis. Whatever excesses of de-regulation have taken place, their impact would have been less disastrous had company law implemented mechanisms that match ownership and control rights with responsibilities. This applies not only to the financial but also to the so-called 'real' sector, shortly to be hit by the fall-out from its 'financial' counterpart.

The answer to this conundrum is not the introduction of unlimited shareholder liability. This will only render investment finance more difficult than it already is. There is, in principle, nothing wrong with wealthy middle-class rentiers investing in the economy. Rather, what is required is an equitable match between risk-taking and ownership rights. If the risk is to be socialised, so should control and the gains associated with it.

1.2 Oncoming recession: The macroeconomic situation

The year 2008 is the year of repeated downward corrections of growth forecasts for the world economy, and particularly the advanced countries. The most recent update by the IMF in November 2008 expects that in 2009 the advanced countries will experience 'the first annual contraction during the postwar period'.[2] It foresees the largest declines of macroeconomic growth next year in the UK (-1.3%), Germany (-0.7%) and Spain (-0.7%) (see Table 1.2); and it warns that the risk that actual developments may be even worse is higher than the chance of a better outcome. The European Commission, which in its Autumn 2007 forecasts had announced a solid growth of 2.4% for the EU (2.2% for the Euro area) for 2008 and 2.4% (2.1%) for 2009, had also to revise its forecasts. It now expects only 1.4% (1.2%) growth rate for 2008 and 0.2% (0.1%) for 2009. But these figures, too, must – like the ones published by the IMF in October 2008 – already be regarded as outdated. The recession has begun, it will deepen in 2009 and it is unclear when it will end.

Table 1.2: GDP annual rate of growth in EU27, Euro area and selected countries (%)

	2004	2005	2006	2007	2008	2009	2008/IMF	2009/ IMF
EU27	2.5	2.0	3.1	2.9	1.4	0.2	1.2	-0.2
Euro area	2.2	1.7	2.9	2.7	1.2	0.1	1.2	-0.5
Germany	1.2	0.8	3.0	2.5	1.7	0.0	1.7	-0.8
France	2.5	1.9	2.2	2.2	0.9	0.0	0.8	-0.5
Italy	1.5	0.6	1.8	1.5	0.0	0.0	-0.2	-0.6
Spain	3.3	3.6	3.9	3.7	1.3	-0.2	1.4	-0.7
Sweden	4.1	3.3	4.1	2.7	1.4	0.0	1.2	1.4
UK	2.8	2.1	2.8	3.0	0.9	-1.0	0.8	-1.3
Poland	5.3	3.6	6.2	6.6	5.4	3.8	5.2	3.8
Hungary	4.8	4.0	4.1	1.1	1.7	0.7	1.9	2.3

Sources: EC Economic Forecasts, Autumn 2008, Statistical Annex, Table 1; IMF World Economic Outlook, Update November 2008, p. 5; IMF, World Economic Outlook, Oct. 2008 (for Sweden, Hungary and Poland).

The downturn in economic activity in the EU is due to a number of factors both at the global and the European level. At the global level, the financial crisis has meant that credit became more difficult to obtain and the cost of borrowing increased perceptibly. This weighed heavily on both enterprises and households. The impact was particularly marked due to the high level of borrowing, in particular household borrowing. In the enlarged EU27, total borrowing corresponded to 126% of GDP in 2003, and this figure rose to 157% in 2007 (from 113% to 136% in the Euro area), while household borrowing rose from 89% of GDP to 112% over the same period (from 71% to 86% in the Euro area).[3]

Although the EU27 has not had a housing crisis of the scale and intensity as the US, the downturn in residential real estate is expected to have a significant short-run impact in certain countries – Ireland, Spain and the UK – which were exposed to a housing boom. The fact that floating-rate mortgages indexed to short-term interest rates are especially common in these three countries further exacerbates the financial pressure that households will face.

[2] See IMF, *World Economic Outlook Update*, Washington D.C., 6 November 2008, p. 1 (www.imf.org).

[3] See ECB, *Banking Structures Report*, 2008, Tables 4, 6 and 14.

The near doubling of crude oil prices and the significant increase in the price of raw materials was a further shock for the EU economy.[4] It compounded the impact of a falling global demand for European goods and services as a result of the slowdown in economic growth, most notably in the USA, where the financial turmoil originated. In addition, European exports suffered a further shock as a result of exchange rate development. From the start of 2007 until July 2008, the Euro appreciated by an average of around 14% against its main trading partners, and this came on top of a protracted appreciation over the previous five years. As a number of commentators have pointed out, this occurred because the ECB, the Euro area monetary authorities, allowed it to happen.[5] In other words, the ECB has shown a 'benign neglect' with regard to developments in the foreign exchange market. This partly accounts for the slowdown especially in the Euro area economic activity. The depreciation of the Euro against the dollar in the second half of 2008 came too late to counter the decline in macroeconomic growth.

But the main causes for the recession which has now begun in Europe are not external shocks but domestic ones: The ECB's fixation on price stability led it to increase its main interest rate from 3.5% in 2006 to 3.75% in 2007 and to a very harmful 4.25% in July 2008. It was only when the financial system was on the edge of a meltdown that the ECB finally begun to reduce rates, to 3.75% in October and to 3.25% in November. This reduction came much too late, and it is not enough, since the interest rate in the Euro area is still substantially higher than that in the USA. This policy is based on the ECB's hypersensitivity to rising inflation, despite the fact that inflation has remained close to the 'sacrosanct' level of 2% since the mid-2000s. In fact, for the period to come, the risk of deflation appears to be more serious than that of inflation.

Thus, the main practical implication of the ECB's dangerously narrow understanding of its role has been to further worsen the conditions under which the EU economy operated in 2007 and 2008. A similar restraining attitude was shown by the EU governments with regard to fiscal policy, acting within the framework of the Stability and Growth Pact, as public deficit was driven down from 1.4% of GDP in 2006 to 0.9% in 2007 in the EU27 (from 1.3% to 0.6% in the Euro area). Also, the public debt of EU27 declined from 61.3% of GDP in 2006 to 58.7% in 2007 (from 68.5% to 66.4% in the Euro area).

Table 1.3 shows the annual change in GDP and in its growth components in the EU27. As we can see, exports are the main driver, followed by investment (gross fixed capital formation), which follow the typical pattern of the business cycle: big rises in the upswing and steep falls in the downturn. The largest component, private consumption (which amounts to more than half of GDP) is however almost stagnant. The slightly increased government consumption remains too small to be able to counter the general macroeconomic slow-down. Generally, over-reliance on external trade and a weak domestic demand, both in the private and in the public sectors, are the most important ills that plague the European economy and which will prove crucial at the present juncture of a looming recession in the world economy.

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[4] Between 2004 and 2008, oil prices rose by 217% for Brent and by 122% for raw materials (in US$). See Henri Sterdyniak, 'The economic and social state of the Union', paper presented at the 2008 Annual Conference of the Euro Memo Group.

[5] See Paul de Grauwe, 'The twin shocks hitting the eurozone', *CEPS Commentary*, 16 September 2008.

Table 1.3: EU27 GDP growth and growth components (annual percentage change)

	2005	2006	2007	2008	2009
GDP	2.0	3.1	2.9	1.4	0.2
Private consumption	2.0	2.3	2.2	1.0	0.2
Gen. Gov. consumption	1.6	2.9	2.1	1.8	1.3
Gross Fixed Capital Formation	3.6	6.1	5.4	1.2	-1.9
Exports	5.9	9.2	5.0	3.4	1.5

Source: EC European Economy, Economic Forecasts, Autumn, 2008, p. 36.

The EU economy is steadily moving into recession. Technically, two consecutive quarters of negative growth is regarded as one definition of a recession. This point has already been reached by Germany – which contracted by -0.5% in the second quarter and by -0.2 in the third quarter of 2008 – and by Spain, which contracted by -0.1% in the third quarter and is expected to contract by a further -0.3% by the end of 2008. Forecasts indicated that France and Italy are also likely to face a recession. The social implications of recession will be dire. Joblessness will rise and has already started to do so in some countries. For example, in France the number of unemployed persons rose by 40,000 in August 2008, the fastest increase in 15 years.[6] The UK also recorded its 'biggest one month jump in unemployment for more than 17 years'.[7] Similarly, Italy's unemployment rate has climbed to 6.8% of the labour force in the second quarter of 2008, compared with 6.6% in the first one. Table 1.4 shows the unemployment rate in the EU27, in the Euro area and in selected member countries. As may be observed, the anticipated increase in unemployment is not yet discernible in the data for 2007, due to the lag with which developments in the economy influence employment.

Table 1.4: Unemployment rate as % of labor force

	2004	2005	2006	2007	2008	2009
EU27	9.0	8.9	8.2	7.1	7,0	7,8
Euro area	9,0	9,0	8.3	7,5	7,6	8,4
Germany	9.7	10.7	9.8	8.4	7,3	7,5
France	9.5	9.2	9.2	8.3	8,0	9,0
Italy	8.0	7.7	6.8	6.1	6,8	7,1
Spain	10.6	9.2	8.5	8.3	10,8	13,8
Sweden	6.3	7.4	7.0	6.1	6,1	6,8
UK	4.7	4.8	5.4	5.3	5,7	7,1
Poland	19.0	17.8	13.9	9.6	7,3	7,3
Hungary	6.1	7.2	7.5	7.4	8,1	8,6

Source: EC Statistical Annex of European Economy, Economic forecasts, Autumn 2008, Table 23.

It is generally accepted that 'the response of wages has remained generally subdued … reflecting structural reforms and improved policy frameworks.'[8] Furthermore, it is expected that 'Together with rapidly cooling activity and rising unemployment fears, these factors should help contain wages over the coming year.'[9] In other words, labour is once again expected to pay for the excesses of capital! As shown in the graph below, the share of wages in GDP has been constantly falling both in the EU27 and in the Euro area, denoting increasing inequality, weakening domestic demand - to the extent that wages constitute the main source of income for the vast majority of Europeans - and decreasing social cohesion. This is a worrying phe-

[6] See *Financial Times*, 2 October 2008.

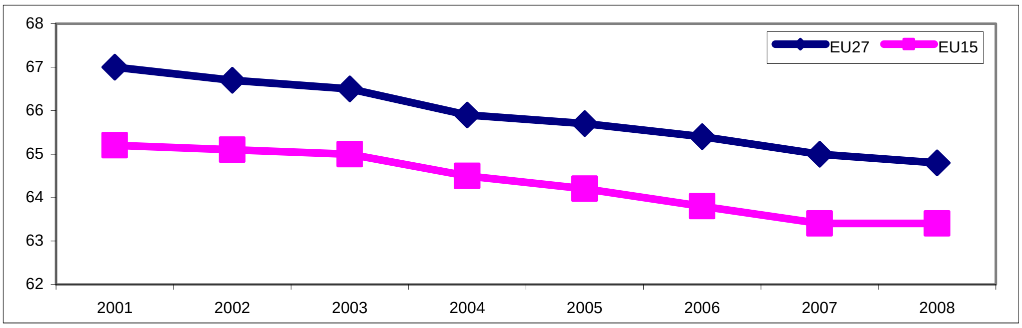
[7] *Financial Times*, 16 October 2008.

[8] IMF, *Economic Outlook*, October 2008, p. 53.

[9] Ibid, p. 53.

nomenon both in economic and in social terms. Even the European Commission concedes that this is giving rise to 'distributional concerns',[10] while we would argue that it raises much broader issues regarding the democratic legitimacy of EU economic policy.

Graph 1.1: Adjusted wage share in EU27 and in the Euro area (% GDP)



Source: EC Statistical Annex of European Economy, Spring 2008.

The effects of financial crisis in Central and Eastern Europe

CEE countries are extremely exposed to the financial crisis and even more so to a recession in the EU. These are small economies (except Poland) with export demand higher than 50% of GDP, mainly concentrated in exports to the EU15. The high external vulnerability of the CEE countries is a by-product of a transition based on the Washington consensus, an addiction to foreign direct investment, and too rapid convergence of standards of living to the EU average. In particular, the result of rapid privatisation and the liberalisation of imports in the early nineties was a destruction of the manufacturing sector (in Baltic countries) or a selling of the best productive assets (in Visegrad countries) to foreign multinationals. Foreign banks acquired the banking sector and other financial institutions. A structural current account deficit caused by a trade deficit (because of the initial destruction of the manufacturing sector) has become more and more fueled by an income account deficit (outflow of profits) which in 2005 surpassed the total current account deficit of CEE countries. High growth based on foreign rather than domestic savings led to a negative net foreign financial position that is larger than the CEE countries' GDP.

Table 2.2: The Exposure of CEE Countries at the Beginning of the Crisis

	GDP per capita to GDP per capita EU27 average 2007	export/ GDP ratio 2007	foreign banks % of assets	Return on equity of banks 2007	loan/deposit ratio July 2008	current account/ GDP 2007	net financial position/GDP August 08
Czech Rep	81.3	0.69	83	25	0.77	-3.3	-36.6
Estonia	70.6	0.51	99	29	1.62	-17.3	-75.0
Latvia	58.0	0.30	63	26	2.90	-22.9	-79.6
Lithuania	61.0	0.44	92	29	1.53	-13.7	-49.9
Hungary	63.5	0.68	83	20	1.32	-4.4	-109.9
Poland	53.8	0.32	70	23	1.15	-3.7	-45.9
Slovakia	68.6	0.76	97	19	0.86	-5.7	-49.7
Slovenia	90.9	0.59	36	19	1.60	-4.9	-21.9
Bulgaria	38.1	0.40	80	24	1.29	-21.5	-113.3
Romania	40.6	0.24	88	26	1.27	-14.1	-45.8

Sources: Eurostat, ECB Statistical data warehouse, CEE – still the right bet, UniCredit Group, New Europe Research Network, July 2008; IMF Regional Office for CE and Baltics.

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[10] *Quarterly Report on the Euro Area*, Vol. 7, No. 3, 2008, p. 42.

The global financial crisis, and particularly the credit reduction, is hitting CEE countries with large external financing needs particularly hard. Foreign banks, very much involved in banking in CEE and until 2008 enjoying rates of returns on equity which were twice the rates of return on equity in their home countries,[11] started to talk about their exposure (at the end of 2007, for example, 42 % of the assets of the Austrian banking sector were exposed to CEE countries). As banks recapitalise, they are shrinking balance sheets in CEE subsidiaries rather than at home.

Recent measures taken by Euro area countries (liquidity provision, deposit insurance, state guarantee schemes, recapitalisation of distressed banks, and flexible treatment of accounting rules) put the CEE countries with weak fiscal credibility at a disadvantage. ECB steps to boost liquidity took over the allocative role of inter-bank markets and led to a drying up of inter-bank foreign-exchange liquidity. Increased foreign-exchange risk causes problems in managing the foreign-exchange positions of CEE banks, while debt securities issued by non-Euro area member states are also affected by exchange-rate risks.

Indeed, what can central banks and governments in CEE countries do if the whole banking system is foreign owned? They cannot recapitalise banks through nationalisation. They cannot provide deposit insurance or state guarantee schemes for foreign banks and, if they did so, these would be subject to exchange-rate risks. Most important they cannot ensure the credits needed to prevent a further decline in economic activity. In the short run, CEE countries face two issues: how to secure external financing and deal with the downturn in the real sector, and how to safeguard external sustainability in the long run. Indeed, in addition to Hungary, the three Baltic countries and Bulgaria are practically bankrupt; they have no products to export and create the surpluses to repay their debts. For other CEE countries the effect of the financial crisis will be felt less through any direct effect than through the indirect effect resulting from the decrease in export demand linked, in particular, to the car industry.

1.3 Polarisation and precarisation; poverty and wealth: The social situation

High levels of unemployment, the ongoing deregulation of labour markets and the introduction of rigid provisions for unemployment benefits if ‘reasonable’ jobs are refused, have led to an increase in precarious employment and living conditions over the past years:[12] In the EU27, the share of temporary employment has steadily increased during the past five years and reached 14.5% of total employment in 2007. More than half of all employees with fixed-term contracts were employed fixed-term *involuntarily* and mainly because they could not find a permanent job (see Table 1.5). Almost half of the women and men employed in fixed-term jobs involuntarily had contracts for less than six months.[13] At the same time, the share of employees working part-time has increased from 15.7% in 2002 to 17.6% in 2007. Here

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[11] In 2007, the average share of profits of five major players (Erste Group, Unicredit, Raiffeisen, KBC, Intensa Sanpaolo) in CEE amounted to 30.5% of profits while asset share was 22.5%.

[12] Employment is considered to be ‘precarious’ when specific characteristics of ‘standard’ employment conditions are not met, such as very short durations of temporary contracts, insufficient protection against dismissal, and low pay. Although temporary and part-time jobs are not necessarily *precarious*, men and women employed on a fixed-term or part-time basis are in a more precarious position than those with long-term or full-time contracts.

[13] See Eurostat, *Statistics in focus*, No. 98, 2007: Men and women employed on fixed-term contracts involuntarily, retrieved October 2008, from http://epp.eurostat.ec.europa.eu/.

again, the share of part-time employees that are working part time *involuntarily* has increased even more stongly, from 17.1% in 2002 to 22.5% in 2007. One third of male and one fifth of female part-time employees worked part-time because they could not find a full-time job. Additionally, the number of Europeans that are self-employed as well as the number of employees having a second job has increased significantly within the past five years. These developments reflect the growing dependency of employees on taking part-time or temporary jobs, even if they are not well paid, in order to have a job at all.

Table 1.5: Insecure Employment in EU27

	2002	2007	Maximum Value 2007	Minimum Value 2007
Temporary employees [1] in % of total employees, 15-64 y.	12.4	14.4	Spain 31.7 Poland 28.2	Romania 1.6 Estonia 2.2
Part-time employment [1] in % of total employment, 15-64y.	15.7	17.6	Netherlands 46.3; Germany 25.4; Sweden, UK 24.2	Bulgaria 1.5; Slovakia 2.5; Hungary 3.9
Involuntary part-time employment [1] in % of total part-time	17.1	22.5	Bulgaria 60.6; Romania 53.1 Greece 45.2	Netherlands 5.1; Luxembourg 5.2; Slovenia 5.8

Main reason for temporary employment [2]	Total	Males	Females
Could not find a permanent job	60.2	59.2	61.3
Did not want a permanent job	12.5	11.9	13.1
In education or training	18.6	19.6	17.5
Probationary period	8.7	9.3	8.1
Main reason for part-time employment [2]	**Total**	**Males**	**Females**
Could not find a full-time job	22.5	30.6	20.4
Own illness or disability	4.2	8.1	3.2
Other family or personal responsibilities	17.1	8.2	19.5
Looking after children or incapacitated adults	24.5	4.1	30.0
In education or training	12.0	25.3	8.5
Other reasons	19.6	23.6	18.5

Source: Eurostat database (October 2008); [1] = employees aged 15-64 years; [2] = distribution in % in 2007.

79 million Europeans living in poverty

Despite the lip-service paid by European institutions to the effect that the 'fight against poverty' constitutes a key objective of European policies, monetary poverty[14] and material deprivation remain major threats for large parts of the European population. Since 1998, the poverty rate in the European Union remains at unacceptably high levels of 15-16% of the population. In absolute terms, 79 million people were poor in 2006, i.e. every sixth European lived with an income below the poverty threshold (60% of national median income). Table 1.6 shows that monetary poverty is distributed unevenly across different groups of the population and that households and individuals without a regular income – especially children, juvenile and elderly persons, and single parents – are particularly exposed to poverty.

While the poverty rate of the unemployed is more than five times higher than that of people in employment, in absolute figures however, the number of the so-called 'working poor – employees who receive wages below the poverty threshold – is more than twice as high as the number of 'unemployed poor'. The increase of in-work-poverty is mainly the result of deteriorations on the labour markets due to the expansion of low-paid jobs, and the increase of

[14] The definition of poverty at EU level is a relative measure, that refers to individuals, that live with an income below the threshold of 60% of the national equivalised median income. The decision for a 60%-threshold is conventional, but neither a necessary nor a sufficient condition poverty. Therefore, the EU refers to this indicator as a measure of *poverty risk*.

precarious, involuntary part-time and short-term employment (see above, Table 1.5) The poverty rate of employees with temporary contracts is three times higher than the poverty rate of employees with permanent contracts, while shifting from full-time to part-time employment increases the risk of employees becoming poor from 7% to 11% (Table 1.6). The increase in the proportion of people in employment having a second job, mentioned above, is principally due to the fact that the earnings from *one* regular job do not suffice in many cases for a decent standard of living.

Table 1.6: Monetary Poverty in the EU (Poverty rates in %, 2006)

	EU25*	Maximum Value	Minimum Value
Total	16	Latvia 23	Czech Rep., Netherlands 10
Women	17	Latvia 25	Netherlands 10
Men	15	Latvia 21	Czech Republic 9
Adults 25-54 years	14	Poland, Latvia 19	Netherlands 8
Children <16 years	19	Latv. 25; Spain, UK, Italy, Lith. 24	Finland 9; Denmark 10
Juveniles 16-24 years	20	Denmark 28	Slovenia 9
Elderly people >65 years	19	Cyprus 52; Spain 31; UK 28	Czech Rep., Netherlands 6
In-Work-Poverty >18 years	8	Greece 14; Poland 13	Cz.Rep. 3; Belg., NL, Dm 4
With permanent contract	4	Luxembourg 10; Latvia 9	Belgium, Finland 2
With temporary contract	12	Lithuania 24; Cyprus, Sweden 22	Malta, Netherlands 5; UK 6
Full-time employment	7	Greece 13; Poland 11	Czech Republic, Finland 3
Part-time employment	11	Portugal 29; Greece, Latvia 26	Belgium 4; Netherlands 5
Unemployed >18 years	41	Latvia 64; Lithuania 61; Estonia 60	Sweden 23; Denmark 25
Households without children	15	Cyprus 27; Latvia 25	Czech Rep. 6; Slovakia 8
Households with children	17	Greece, Italy, Poland 23	Denm. 8; Slovenia, Finl. 9
Households with two adults and three or more children	24	Latvia 52; Romania 45; Lithuania, Spain 42	Denmark, Finland 12; Germany, Sweden 13
Single Parent with children	32	Luxemb. 49; Ireland 47; Lith. 44	Finland 18; Denmark 19

Source: Eurostat-Database (October 2008); *= averages for EU27 are not available yet.

Differences in the distribution of poverty do not only exist within European member states, but also among the member states. Since data on monetary poverty refers to *national* income relations, similar poverty rates of member states actually reflect very different standards of living. The poverty threshold for a household with two adults and two children in the EU15 expressed in purchasing power standards (PPS) is more than twice as high as in the new member states, ranging from 5,734 PPS in Latvia to 36,136 PPS in Luxembourg. Additionally, information on ‘material deprivation’ within the European Union shows that large parts of the European population suffer under severe material constraints due to a lack of resources and access to basic goods. Some examples with regard to ‘economic strain, enforced lack of durables and problems with housing’ reveal massive differences of living conditions within the European Union.[15] In six out of the ten new member states, more than every second household cannot afford a week’s annual holiday away from home, while amongst the old member states this rate only exceeds 50% in Spain and Portugal.

The access to basic necessities varies significantly too. As a result of their economic situation, over one third of the households in Latvia, Lithuania, Hungary and Slovakia are not able to eat meat, poultry or fish every second day. In the old member states, by contrast, the highest figure for this form of economic deprivation is in Spain, where it is 13%, while in the other

[15] The following data refer to 2003. See Eurostat, *Statistics in focus*, No. 21, 2005: Material deprivation in the EU, retrieved October 2008, from http://epp.eurostat.ec.europa.eu/.

old member states it is at or well below 9%. Housing conditions also reveal tremendous differences in living standards across the EU: while almost every household in the old member states has a home with an indoor flushing toilet, in of the new member states, especially in the Baltic countries, this is not true for more than 20% of the households. Furthermore, the proportion of households living in bad or unhealthy homes characterised by a leaky roof, rot in the window frames, or damp walls is twice as high in the new member states as in the old ones.

3.1 million European millionaires

Contrary to the continuing high degree of poverty and uncertain employment conditions in the EU, 200,000 private households reached the status of millionaires in 2007.[16] Despite the beginning of the financial crisis in 2007, the number of Dollar-millionaires in Europe has increased by 3.7% from 2.9 million in 2006 to 3.1 million in 2007. Slovakia and the Czech Republic had the highest growth rates of millionaires (an increase of, respectively, 16% and 15%). The growth of the wealth of millionaires was even more marked than the increase in the number of millionaires, which indicates the continuing concentration of wealth at the very top of the income scale in Europe. From 2001 to 2007 the wealth of millionaire households in Europe increased by more than 20%, rising from a total of 8.4 trillion US-$ in 2001 to 10.6 trillion US-$ in 2007. What is more, the wealthier the millionaire, the larger the increase, as the increase in wealth was even larger for households with assets of more than 5 million dollars.[17]

Taken together, the social situation in the EU is marked by a deepening social polarisation both within as well as across member states. While the living and working conditions of large parts of the population have not substantially improved in the course of the integration process, it can be expected that the redistributive effects of the financial crisis will deepen the gap between wealth and poverty and intensify the widening social inequality in Europe. The increase of precarious employment, together with the increasing polarisation of income and wealth is a major factor in accounting for the alienation many Europeans feel towards the institutions of the EU, and to the scepticism, if not even outright rejection, of the Europeanisation of the economic and social aspects of their lives.

1.4 Alarming developments pushed to the background: The ecological situation

It is almost certain now that humankind has already reached the 2 degree increase in temperature at which climate change may become irreversible. In any case, climate change is happening more quickly than has been thought so far, especially in the Arctic, and the frozen soils in the region are supposed to contain a lot more stored carbon than has been assumed in the models which have been used so far. This raises the urgent question of whether strategies coping with climate change may still be sufficient to avoid catastrophic outcomes and will therefore have to be revised towards still more ambitious objectives. In the scientific climate debate the issue of 'tipping points' has become unavoidable, i.e. the point where a small increase in temperature or other change in the climate could trigger a disproportionately larger

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[16] Eurostat does not publish data on wealth. The following figures are extracted from Merrill Lynch and Capgemini 2008: World Wealth Report 2008, retrieved October 2008, from http://www.de.capgemini.com/.

[17] See The Boston Consulting Group, *Global Wealth 2008 – A Wealth of Opportunities in Turbulent Times*, 2008, retrieved October 2008, from http://www.bcg.com/.

change in the future which will then become irreversible (see Table 1.7). Instead of being 'lulled into a false sense of security by smooth projections of global change',[18] human societies will have to find far more radical and more rapid reactions to dramatic developments: 'Our synthesis of present knowledge suggests that a variety of tipping elements could reach their critical point within this century under anthropogenic climate change.'[19]

Table 1.7: Potential tipping points of the global climate

Tipping elements	**time expected for major transition**
Melting of Arctic sea-ice	approx 10 years
Decay of the Greenland ice sheet	more than 300 years
Collapse of the West Antarctic ice sheet	more than 300 years
Collapse of the Atlantic thermohaline circulation	approx 100 years
Increase in the El Nino Southern Oscillation	approx 100 years
Collapse of the Indian summer monsoon	approx 1 year
Greening of the Sahara/Sahel and disruption of the West African monsoon	approx 10 years
Dieback of the Amazon rainforest	approx 50 years
Dieback of the Boreal Forest	approx 50 years

Source: Table based upon Lenton, T. M.; Held, H.; et al. 2008: Tipping elements in the Earth's climate system, in: Proceedings of the National Academy of the Sciences, February 12, 2008, vol. 105, No. 6, 1786-1793.

A rapid reduction of greenhouse gas emissions will therefore be of vital importance for the future of human societies. The urgency of the situation still has to be fully addressed by politics. Proposals for reducing emissions, which so far have been more occasional than substantial,[20] are urgently required; the expected recession will not lead to a reduction. In the face of the emerging financial crisis and a looming recession a Carbon Market Report by Deutsche Bank based on business-as-usual-assumptions predicts clearly: 'A credit-crunch induced recession implies lower emissions over 2008-10 but also higher coal-fired electricity output over the entire 2008-20 period as planned investments in new renewable capacity are put on hold'.[21]

Table 1.8: Impact of the anticipated recession on emissions

	2008	**2009**	**2008-12 per year**	**2013-20 per year**	**2008-20**
Old scenario	2227Mt	2238Mt	n.a.	n.a.	n.a.
New scenario: BAU (= business as usual) emissions	-30Mt	-60Mt	-52Mt	-60Mt	-57Mt
Adjusted emissions*	2210Mt	2205Mt	-46Mt	-7Mt	-22Mt
ETS abatement requirement (old optimal compliance schedule)	-77Mt	-71Mt	-65Mt	-163Mt	-39Mt
Required scenario (revised optimal compliance schedule)	-95Mt	-58Mt	-65Mt	-100Mt	-86Mt

Source: Table based upon Deutsche Bank 2008: Carbon emissions. Emissions in remission? Looking at – and through – an EU recession; Global Market Research, Emerging Themes, 15. October 2008; * = BAU emissions minus the emissions avoided via higher renewable-energy production.

[18] See T. M. Lenton, H. Held, et al., 'Tipping elements in the Earth's climate system', in *Proceedings of the National Academy of the Sciences*, 12 February 2008, Vol. 105, No. 6, pp. 1786-1793.

[19] Ibid.

[20] See H. J. Ziesing, 'Weiteres Warten auf Rückgang der weltweiten CO2-Emissionen', in *Energiewirtschaftliche Tagesfragen*, Vol. 58, No. 9, pp. 62-73.

[21] See Deutsche Bank, 'Carbon emissions. Emissions in remission? Looking at – and through – an EU recession; Global Market Research, Emerging Themes', 15. October 2008.

A recession is expected to prolong the use of high-emission fossil fuels, especially coal, and also to slow investment in infrastructure for renewable energy such as wind farms (and in the expensive and still unproved CCS technologies). This highlights the urgency of leaving the well-trodden path of 'business-as-usual' and of acting on all levels of politics to promote integrated strategies for boosting the 'real economy' on the basis of sustainable investment and of giving a clear priority to achieving rapid and significant climate gas emission reductions before catastrophic developments begin to emerge. In this sense, the looming recession could be seized upon as a major opportunity for profound changes in climate politics.

Likewise, the expected reductions of demand due to the anticipated economic downturn have begun to ease the external pressures on the energy policy of the EU. In spite of all predictions – in 2007 OPEC still aimed to maintain production at a level that would stabilise the oil price at around 50 to 60 USD per barrel – the price of oil exploded in the first half of 2008. No provider country seemed to have the capacity to increase production in order to lower prices. And companies' investment behaviour clearly indicated their belief in the end of easy oil.

The recent decline of the oil price should not obscure the fact that the EU is doubly concerned, as a net-importing area and as a group of countries especially exposed to oil scarcity because of their energy systems. Despite the recent fall in price, it is essential for the EU states to reduce their the oil dependency while at the same time building stable and reliable exchange relations with the main supplier countries of oil and gas, which will be needed for a long period of transition. Here again, an integrated strategy will be called for, combining technological improvement and technological change. One aspect of this is improving energy efficiency. But, at the same time there needs to be an increasing emphasis on the sustainability of production, a restriction on private and petrol or diesel transport, together with a serious reduction in all forms of carbon emission. This must be combined with a long-term trade policy towards energy exporters that goes beyond market creation and market regulation, and which aims politically at achieving a mutually beneficial provision of essential goods. Such an integrated EU energy strategy would be capable of activating the significant potential of alternative and renewable energy production existing within the EU.[22]

2. Promotion of crises: Critique of European policies

2.1 The disaster of financial market policies

The ECB

Two EU institutions have a measure of responsibility for financial stability: the European Central Bank and the European Commission, especially the Directorate-General for the Internal Market. The mandate of the ECB does not give it major responsibilities for financial stability. It is required to promote the stability of the payments system; this function is so closely related to the operation of monetary policy that it could hardly be avoided. Beyond that there are officially two potential roles for the ECB: to advise on questions of stability and to participate in the prudential supervision of commercial banks and other financial businesses (although, currently, this is left to national central banks). Nevertheless, the ECB has to pay a great deal of attention to stability issues because monetary policy requires it to interact with

[22] See http://www.iea.org/textbase/stats/renewdata.asp?COUNTRY_CODE=37 for data on renewables and waste in EU27 in 2005.

the banking system and the financial markets – the smoother the workings of the banks and the markets the easier it will normally be to implement the interest changes on which monetary policy is centred. Given that it has very limited competence to act on issues of stability, the ECB has, quite logically, concentrated on building up systems of communication among the national regulators and central banks, with a view to facilitating coordinated action should this become necessary.[23]

As with other central banks around the world, the ECB (together with national central banks in Europe, both in and out of the Eurozone) failed to detect the huge dangers building up as banks and other financial corporations adopted more and more leveraged positions. This does not necessarily mean that interest rates were held too low - rather than higher interest rates direct measures to restrict the expansion of banks' balance sheets would have been the best way to reduce systemic risks - banks and other financial corporations should have been required to raise more capital, to hold more reserves, to calculate their risks in a more prudent way, to move off-balance sheet liabilities back onto their accounts, etc. Since the banking crisis began in August 2007, the ECB has followed what are today standard policies of providing abundant liquidity and it has co-operated with other major central banks in coordinated reductions of interest rates. Nevertheless, as the crisis has deepened it has become apparent that the ECB does not have enough power or enough resources to respond in a satisfactory way. By summer 2008 serious concerns about bank solvency had arisen. The ECB has absolutely no competence here. After a series of interventions by individual member state governments, some attempt at a coordinated response by the largest of them emerged, but this action was taken on an *ad hoc* basis, without a clear responsibility of the EU to react to the crisis.

Basel II

Very recently, both the EU and the US introduced the Basel II capital adequacy rules into their regulatory structures, in spite of numerous warnings that the way capital requirements were specified risked aggravating cyclical fluctuations. This is exactly what then occurred: a huge effort to raise additional capital for major banks has had to be made even as the world economy slows down and many developed economies move towards recession. Today, the Financial Stability Forum of the leading developed economies is prepared to recognise that fluctuations might be a real problem. They are examining 'the impact of Basel II on the cyclicality of capital requirements, and will explore measures that can be taken to strengthen capital buffers in good times and enhance banks' ability to dip into them during adverse conditions.'[24] Similarly, many warnings have been given about the role assigned to credit rating agencies in the Basel II framework. The conflict of interests which distorts the assessments made by these companies is now obvious, but the necessary recognition is still not being made that credit ratings have, inescapably, the nature of a public good.[25] The dogmatic rejection of any reconsideration of these reforms, until things had gone very wrong indicates the deep irresponsibility of key regulatory authorities in recent years.

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[23] For an account of these arrangements see ECB 'The EU Arrangements for Financial Crisis Management', *Financial Stability Review*, December 2006.

[24] Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience: Follow-up on Implementation. www.fsforum.org.

[25] For the disastrous role played by credit rating agencies in the assessment of sub-prime mortgages and the collateralised debt obligations based on them see, IMF, *Financial Stability Report*, April 2008, chapter 2, box 2.2, 'When is a AAA not a AAA?'.

The Commission

However, it is the European Commission which has played the most questionable role in the financial debacle. Since 1999, and as a key component of the subsequent Lisbon strategy, the Commission has pursued a policy of financial integration centred on the security markets. European financial integration in itself is a reasonable response to the emergence of a globalised financial system centred on the US. However, it was clear from the start that the Directorate General for Internal Market and Services aimed only at replicating the US financial system and in no way at dealing with its weaknesses. As the propaganda surrounding Lisbon, with its absurd objective of making Europe 'the easiest place to do business in the world' suggested, financial integration was understood only in terms of a drive to lower the costs of financial transactions.

No public goods were recognised in the Commission's view of financial integration. The dangers to households from liberalisation were disregarded and in fact the households and small and medium enterprises which use financial services were not consulted until the whole integration programme was virtually complete. Although there is now an enormous accumulation of evidence as to the poor performance of retail finance in Britain,[26] the relatively deregulated British financial sector, closely linked to the securities markets, became the model for retail finance throughout the EU. Economic and financial stability were two further public goods which the Commission found it difficult to perceive. All that mattered was the reduction of transactions costs.

No less a figure than Alexandre Lamfalussy, former Director General of the Bank for International Settlements has testified to the Commission's disregard of stability issues. Lamfalussy, of course, was called in to head an advisory committee on the reorganisation and relaunch the financial integration strategy when it was mired in technical problems. The strategy was completed largely on the basis of his committee's report. He testifies that the Commission did not want him to mention questions of stability. The report had argued that 'greater efficiency does not necessarily go hand in hand with enhanced stability … Increased integration of securities markets entails more interconnection between financial intermediaries on a cross-border basis, increasing their exposure to common shocks … there is an urgent need to strengthen cooperation at the European level between financial market regulators and the institutions in charge of micro and macro prudential regulation.' This was not the sort of thing D.-G. Internal Market wanted to hear. 'It was politely but firmly suggested that we drop the subject.'[27] With the Commission's drive to transform the European financial system as quickly as possible and with no thought for the public goods – of stability, equity and consumer confidence – it was putting at risk, the politics of market-driven integration seem to reach a dead end.

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[26] Many reports from the Treasury Select Committee of the House of Commons deal with these issues.

[27] See Alexandre Lamfalussy, 'Creating an Integrated European Market for Financial Services,' in Philip Booth and David Currie (eds.), *The Regulation of Financial Markets*, IEA, London, 2003.

Box 2: Mortgages – an embarrassing initiative

The shallow and mechanical approach to financial policy in the Commission is well illustrated by its abortive initiative on mortgages. When the legislative programme designed primarily to integrate wholesale securities markets was virtually complete, D.-G. Internal Market began to look for new market integration projects. It decided to press for integration of the mortgage market (*Green Paper: mortgage credit in the EU*, COM (2005) 327). US practice was in the background here. One example was the view that with improved 'risk assessment', the risk capital required in the mortgage sector could be reduced (p. 11). Another was the belief that a big secondary market in mortgages was the way forward: 'Many … express the view that the further integration of the EU mortgage markets could be considerably enhanced by the emergence of a pan-European funding market' (p. 13). There is no hint in this document that a continent-wide secondary market in mortgages might pose certain informational difficulties and the word, 'stability' does not appear in the *Green Paper*. The usual tame contract economists were hired to give their blessing to this fatuous proposal. Their report (London Economics, *The Costs and Benefits of Integration of EU Mortgage Markets*, August 2005) sang the praises of the US system, including its sub-prime component:

> US experience suggests that
> - Legal or other restrictions to banks' geographical expansions will reduce the efficiency of the mortgage-lending industry.
> - Steps to create a single EU mortgage market would increase incentives to develop automated systems to process loan applications, which would reduce origination costs.
> - Removing restrictions on maximum mortgage interest rates would **allow a subprime mortgage market to develop**, thus expanding total mortgage lending.' (p. 168, emphasis added)

The long processes of development which have adjusted housing markets in different member countries to their specific social conditions and social priorities mean nothing to the officials of D.-G. Internal Market, who would sweep everything aside to build another, quite pointless, pan-European market. As late as February 2007, the mortgage proposal was still being promoted, but by the time of the *White Paper: on the Integration of EU Mortgage Credit Markets* (COM (2007) 807) at the end of the year there were signs of a reappraisal. The *White Paper* made the breath-taking assertion that 'recent events in global mortgage markets have confirmed the pertinence of the approach proposed' (p10). Of course, the opposite is the truth – the whole D.-G. Internal Market argument was based on the supposed desirability of more product diversity although product diversity was a key factor making US mortgage-backed securities opaque and risky. In 2008, the theme of mortgage market integration has been quietly dropped – one has to look very hard to find it on the Commission's web-site.

2.2 The counterproductive macro-regime

The slow decline of unemployment in the EU as a whole, from 9% in 2004 to 6.8% in 2008 is now threatened by the contractionary consequences of the credit crisis. Big gaps have opened up between the interest rates set by the ECB and other central banks and the rates which commercial banks charge for credit to households and businesses. Large injections of liquidity by the central banks have not succeeded in closing these gaps. Thus a 0.5% cut in the ECB's key lending rate in October 2008 led to a reduction of less than half that amount in the Euribor interbank rates which act as benchmarks for interest rates in the economy as a whole. Many governments, however, have taken capital stakes in their commercial banks. It may be necessary to use the influence this gives to governments to ensure that commercial banks do not aggravate the economic slowdown by restricting credit. There are also both internal and external reasons to relax EU, and especially Euro area, fiscal policy. Internally, the latest economic forecasts show a marked weakening of activity, with an actual recession in some countries, such as Britain. Externally, it seems likely that a lower value for the dollar and recession in the US will tend to slow down economic activity around the world. The Euro area is very well placed to support general levels of demand by running at least a temporary current account deficit. Under existing conditions, such a deficit would be very easy to finance, and might even strengthen the Euro as capital was attracted from outside investors. However, a general change in macroeconomic policies must also be accompanied by measures to coordinate policies across countries and to reduce internal imbalances. The gap between costs in Germany and in other members of the Euro area is widening and threatens to create severe tensions in the area, since it is no longer possible to restore competitiveness by currency depreciation.

Table 2.1: Money Wage Costs per Unit of Output (2000 = 100)

	2008 estimate	2009 forecast
Germany	102.3	103.6
France	117.2	119.3
Spain	124.7	127.4
Italy	125.9	128.4
Netherlands	118.9	122.3
Belgium	115.4	117.5
Ireland	132.0	134.5
Finland	134.8	140.9
Cyprus	125.7	127.3
Malta	121.0	123.2
Greece	134.8	140.9
Portugal	120.8	122.7
Slovenia	138.0	142.4
Austria	108.0	109.5

Source: European Economy: Statistical Annex, Spring 2008

This situation arises from a continuing compression of German wages, which will have only risen *in money terms* by 1.8% per annum between 2000 and 2008 as against real productivity growth of 1.4% per annum and an inflation rate for consumer goods and services of 1.6% per annum. One consequence is a continuing drop in the share of wages in German incomes; another is a widening polarisation of Euro area economies: Germany, with Austria and the Netherlands, has a huge and widening current account surplus: France, Italy and most other countries in the zone have widening current account deficits, which in 2008 exceeded 10% of GDP in Portugal, Spain and Greece. Although the Euro area as a whole could easily finance an increased current account deficit, this is not necessarily the case for the weaker member countries. The danger is that deficits in, for example, Greece, Spain and Portugal will become very difficult to finance because of the credit crisis and that they will be narrowed only by a drastic decline in economic activity and employment.

2.3 Dismantling of workers rights: Labour market policy

Flexibility

For over two decades now labour market policies in EU member states have centred on a drive for 'flexibility'. This has mainly taken the form of permitting 'atypical' employment contracts which give workers fewer rights. Key examples are short-term contracts, the supply of workers through agencies and other types of sub-contracting, part-time or even 'zero hours' contracts and the use of supposedly 'self-employed' workers instead of employees. The European Commission reports that 'the share of total employment taken up by those engaged on working arrangements differing from the standard contractual model as well as those in self-employment has increased since 2001 from over 36% in 2001 to almost 40% of the EU-25 workforce in 2005.'[28]

Although these policies certainly work to the advantage of employers and especially of the most ruthless among them, there is little evidence that they contribute either to fuller employment or to general economic development. A key aspect of the 'atypical' contract is that it removes or reduces employment protection. This supposedly encourages employers to hire more workers. The OECD reports, however, that 'the effect of Employment Protection Legislation on overall unemployment is probably small', and that 'the net effect on total employment is a priori ambiguous and apparently small in practice'.[29] There is no doubt, on the other hand, that the use of flexible contracts increases wage inequality. It is usually the weakest and most vulnerable workers who are obliged to accept atypical contracts – this by no means prevents these same workers also suffering from the highest rates of unemployment.[30] However, it is certainly not established that such inequalities contribute anything to development. The OECD again reports that even stringent employment protection for regular contracts has only very small negative impact on long-run productivity growth.[31]

There is a great deal more evidence that the effects of this kind of flexibility on economic development are, by the weight of evidence, negative. The cost of some categories of labour falls, but the incentive to raise productivity is thereby reduced. At the same time low wages and poor conditions tend to undermine the performance of the workers concerned. In fact, the sectors of European industry with the best productivity records make almost no use of atypi-

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[28] European Commission, *Green Paper: Modernising Labour Law to Meet the Challenges of the 21st Century*, COM (2006) 708 final, p. 7.

[29] OECD, *Employment Outlook 2006*, Paris, 2006, pp. 96 & 98. Similar conclusions are found in many other sources.

[30] See for example, Andrew Glyn, 'Inequalities of Employment and Wages in OECD Countries', *Oxford Bulletin of Economics and Statistics*, 2001.

[31] Estimates suggest that if OECD countries liberalised provisions for regular contracts to reflect those of the United States, labour productivity growth would increase, on average, by as few as about 0.02 percentage points per year. It is worth noting that this value represents only a very small fraction of the probable error in measuring average productivity growth. (*OECD Employment Outlook 2007*, chapter 2, p. 71. Estimation for a sample of 18 OECD countries over the period 1982-2003.)

cal contracts.[32] Several studies by Alfred Kleinknecht point to similar conclusions – these are significant because they include studies of the Netherlands, supposedly a leader in the combination of labour flexibility with security.[33]

'Flexicurity'

Recently the European Commission has attempted to reformulate the principles of its labour market strategy in terms of 'flexicurity'.[34] Some recognition of the social costs of atypical contracts lies behind this shift but the basic goal remains the same – to lower employment standards and reduce job protection.[35] The Commission does not seem concerned about the lack of a convincing rationale for this drive and this may lead one to suspect that the main impulse behind it is lobbying by the big corporations. The Commission's concept of flexicurity seems to involve what is basically a change of tactics. Pressure on labour standards and job security is to continue but this is no longer to be primarily through the multiplication of atypical contracts – rather, there will be a drive to weaken the protections offered by standard contracts. It is implied that this approach would be less inequitable than the previous one. This seems quite implausible – it is once again the weakest and most vulnerable employees who are likely to suffer most from the removal of protections.

Nevertheless, several member states, including France, have adopted the flexicurity agenda by revising their Labour Codes in order to reduce the level of protection and to limit workers rights.[36] Frequently, the examples of Denmark and the Netherlands are invoked in the Commission's discourse with the suggestion that these countries are models of flexicurity. There are good reasons to believe that even in these countries, measures to reduce job security have had negative effects.[37] Of course, it is true that both these countries have relatively advanced and well-funded social protection systems. However, there is no intention of extending the advanced social models of these countries to other member states – on the contrary, flexicurity strategies are to be adapted to national circumstances in ways which will always tend to undermine existing labour standards.

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[32] J. Anderson, J. Grahl, S. Jefferys and A. Tasiran: 'Labour Market Flexibility and Sectoral Productivity: a comparative study', *Employment Relations Research Series*, No. 66, Department of Trade and Industry, 2006.

[33] On the Netherlands see, for example, A. Kleinknecht and C.W.M. Naastepad: 'The Netherlands: Failure of a neo-classical policy agenda', in *European Planning Studies*, Vol. 13, 2005, No. 8, pp. 1193-1204. For the more general argument, J. Grahl & A. Kleinknecht: 'Employment through labour market flexibility? A critical appraisal of the European Employment Strategy', in J. Huffschmid (ed.), *Economic policy for a social Europe. A critique of neo-liberalism and proposals for alternatives*, Palgrave, London, pp. 82-94.

[34] See European Commission, *Communication: Towards Common Principles of Flexicurity*, 2007.

[35] The suggestion now is that a lack of job security does not matter provided there is adequate employment security – that is, provided that a worker losing his or her job can find another. There are many objections to this substitution of employment for job security – it would be necessary first to have a clear solution to the problem of 'unemployment scarring', the tendency of workers becoming unemployed to be reintegrated into the labour force only when they accept lower wages and worse conditions. See, for example, the symposium introduced by Arulampalam et al. in the *Economic Journal*, November, 2001. No such solution has been proposed.

[36] See Gérard Filoche, 'Tornade patronale sur le Code du Travail', *Le Monde Diplomatique*, March 2008

[37] See, for example, T. Anderson and M. Svarer, 'Flexicurity – Labour Market Performance in Denmark', CESifo working paper, 2108, October.2007. These writers argue that Denmark's high levels of employment are due simply to job creation by the government, not to 'flexicurity' measures. See also Hartmut Seifert and Andranik Tangian, 'Globalization and deregulation: Does flexicurity protect atypically employed?', WSI Discussion Paper No. 143, March 2006, They conclude that, in Sweden and Denmark, flexicurity measures imposed serious losses on workers with standard contracts but failed to produce significant gains for those on flexible contracts.

Recent Legislation

The definition of labour contracts is within the competence of member states, not the EU so that the flexicurity agenda has not, as yet at least, had a big impact on policy at EU level. However, there has been a clear change in the direction of EU employment legislation. In the past, EU law worked towards a certain levelling up in labour standards and protections – this has been the case in such fields as health and safety, gender equality and consultation of employees. As regards the flexibility agenda, the EU certainly pushed for more and more atypical contracts but at the same time it tried to impose some minimum standards for the workers concerned – agency workers, part-time workers and so on.

This type of legislation has now been dropped in favour of a straightforward drive for employment deregulation. The draft Bolkestein Directive on Service Provision[38] indicated the new strategy: in the name of an open market for services, employers would be permitted to move workers into another member state without observing the employment laws and regulations of that state (or indeed its standards of service provision). The outcome would be severe pressure on regulatory standards and intense regime competition as corporations regime shopped for the least constraining regulatory systems. Although the European Parliament only adopted a much amended version of the Directive, the Commission, with its habitual lack of respect for the Parliament, never gave up its ambition for a comprehensive deregulation along the lines of the original Bolkestein proposals (in this it is now receiving strong support from the Court of Justice – see the box 3).

There are several examples of this deregulatory drive: attempts to weaken the Working Time Directive; to weaken the Posted Worker Directive, which establishes some minimum standards for workers temporarily sent to other member states; to bring health care directly into the EU's competition regime with serious dangers for the employment standards of health care workers (see the box 4). All these initiatives are directly contrary to the position adopted by the European Parliament when it considered the Bolkestein proposals.

This is a destructive strategy which can only serve to undermine employment standards without promoting either higher levels of employment or improvements in productivity. Given the very serious crisis of political legitimacy which the EU now faces the strategy is also extremely dangerous because it may provoke increased popular hostility to EU institutions and to European construction.

[38] See Klaus Dräger and Sarah Wagenknecht, *Der Bolkesteinhammer muss weg! Europa braucht zukunftsfähige Dienstleistungen*, GUE/NGL group, European Parliament, *archiv2007.sozialisten.de/download/informationsmaterial/bolkestein/0601_guengl_bolkesteinbroschuere.pdf.*

Box 3: Alarming decisions by the European Court of Justice

It is not only the European Commission which has adopted a harsher stance towards workers. Several recent decisions by the European Court suggest that it now gives EU competition rules absolute priority over employee rights:

- A ferry company operating between Finland and Estonia re-registered its ships as Estonian rather than Finnish, in order to reduce wages. When the Finnish seamen's union – supported by the International Transport Workers Federation – threatened to take industrial action against this, the company applied for a restrictive injunction against this action, and the ECJ ruled that in this case industrial action would be an infringement of an undertakings right of establishment guaranteed under Article 43 of the EC Treaty.
- The Swedish town of Vaxholm had commissioned the Latvian company Laval to carry out a refurbishment of a school building. Laval was not prepared to pay Swedish wages for the work carried out on site. When the Swedish unions blockaded the worksite with the aim of forcing the Latvian company to negotiate a collective agreement, the ECJ ruled that in this case the union action would infringe the right of undertakings to provide services, as guaranteed under Article 49 of the EC Treaty, and that it was therefore unlawful. It further ruled that under the freedom to provide services it was no longer permitted to force a non-resident company to pay more than minimum wages that need to be laid down in collective agreements which have been declared as generally binding at national level by public authorities.
- Following these lines of argument, the Court also judged it legal for Polish workers to be employed on a German building project at less than half the relevant minimum wage (Rueffert) and it found for the Commission when it sued the Luxembourg government for insisting that posted workers receive nationally established wages and conditions.

These and similar judgements indicate that, although the notorious Bolkestein Directive on service provision was severely amended by the European Parliament, the Court is acting as though it had been passed in its original form. Workers are moved into other member states without receiving the minimum wages and conditions established in those states. Any challenge to this situation is outlawed as an interference with 'the right to provide services' and the 'right of establishment'.

Box 4: **Patients' rights in cross-border healthcare: 'Bolkestein' through the backdoor**

On 2 July 2008, the Commission submitted a proposal on the application of patients' rights in cross-border healthcare. Despite the title, the draft directive concerns the same aspects of health-service provision as those addressed in the 2004 draft directive on services, and can be regarded as an attempt to reintroduce the Bolkestein directive 'through the back door'. The legal base for the draft directive is Article 95 of the EC Treaty ('establishment and functioning of the internal market'). The Euromemorandum Group completely rejects this approach: health is not a matter for competition and the EU internal market, but falls within the scope of public services of general interest and social protection systems.

The proposal seeks to codify the judgments of the European Court of Justice according to which access and recourse to health services are fundamentally governed by the rules of the EU internal market, even though the way health systems are organised and financed is a matter for the member states alone. In particular, the Commission wishes to base access to health services - and the payment of treatment costs - in EU member states other than the patient's own on the reimbursement principle. Patients will have to pay the cost of such treatment out of their own pockets, but will be reimbursed by the health insurance system in their own country up to the level of the costs it would have assumed for comparable treatment in that country.

The Commission's proposed rules on the reimbursement of health costs exacerbate the trend towards a two-tier healthcare system. They would help establish EU-wide mobility for wealthy patients, thus enabling them to avoid waiting lists at home by shopping around Europe for the best specialists. This kind of EU-wide patient mobility, however, is anathema to the principle of 'equal access for all' to health services and the principle of equal treatment regardless of patients' income and treatment costs. An ordinary sales person, steel worker or low-paid worker would be unlikely to be able to take advantage of the Commission's much-vaunted 'internal market freedom' in view of the high cost of travel and accommodation, and because language barriers and uncertainty over the legal situation in other EU countries would make the risks of shopping around for health services too daunting. And a Romanian or a Bulgarian citizen is hardly likely to obtain treatment in Germany or France on this basis, as their own health insurance scheme would pay only a small fraction of the costs of any such treatment.

The draft directive proposes Europe-wide reciprocal recognition of medical prescriptions. This would enable patients to obtain medicines which are authorised in another member state but not their own. Prescriptions could also be issued in electronic form. That would be a green light for dubious Internet transactions (with operators organising the issuing of prescriptions in other member states for drug addicts or for medicines which cannot be prescribed in the home state) and unleash fierce competition in relation to prescription charges and additional payments. The proposal would give the Commission additional powers in the field of health policy ('telemedicine' services, EU reference networks and information centres on rare diseases, the definition of hospital services, etc.) without, in many cases, providing for adequate European Parliament supervision.

2.4 Continuing weakness of climate and energy policies

The climate and energy strategies of the EU are not fully co-ordinated, either between different sectors or between the EU and its member states. The Common Agrarian Policy continues to operate in the direction of energy intensive agriculture. At the same time, it does not really address the issue of agrarian climate gases and it pushes aside the issue of meat consumption as a climate problem factor. Major member states like Germany and the UK insist on prolonging their strategies for coal-based energy production into the distant future, while France is likewise insisting on maintaining its nuclear option, which has long since proved risky, inefficient and costly. The Lisbon treaty has given an institutional guarantee to the Euratom treaty which will continue to bind scarce resources to an unsustainable energy option. In its energy security strategies, the EU still relies primarily on geo-political ideas of areas of monopolistic control, externally, instead of building relations of long-term mutual trust and advantage with its present and potential main provider countries. Internally it continues to bind long-term investment to big technology projects, often with dubious prospects and low ecological quality, like CCS technology, nuclear fusion, or to gigantic solar (Sahara) or wind park (North Sea) projects. Instead, it could maximise effectiveness, security and quality by prioritising decentralised energy saving, cogeneration, as well as the decentralised production and use of renewable energy.

The EU has not escaped the neo-liberal fascination with state-created ‘market instruments’. The Emission Trading System (ETS), initiated by the EU at the start of 2005 and which is to be reviewed at the December 2008 summit, is – like other flexible market instruments – clearly incapable of achieving the reductions in emissions required to combat climate change. The problems of stabilising market prices for emission rights and the difficulty of de-linking ETS markets from the volatility of financial markets mean that these instruments are highly dubious means of achieving emissions reductions. The limitations of the ETS policy is also brought out by the empirical evidence on the progress of the European ‘cap and trade’ system, which indicates that the goals of the policy will not be reached.[39]

The initiatives launched by the International Energy Agency (IEA) are not likely to be very effective in promoting a global advance in the use of renewable energy sources. It is not enough simply to urge governments to adopt effective policies to accelerate the exploitation of the large potential for renewable energy. The EU, which is due to finalise its strategy for renewable energy by the end of 2008, is unlikely to champion a leap forward, since it has been meeting opposition from those member states who have not embarked on this route.

The International Partnership for Energy Efficiency Cooperation (IPEEC), conceived at Heiligendamm in June 2007 and created at Aomon, Japan, in June 2008 by the G8 countries, China, India, South Korea and the EU, is still no more than a ‘flexible forum’ for discussion. The Summit on Sectoral Co-operation to be held at Warsaw in November 2008 will not be more than a technical exchange between energy-intensive sectors of industry focusing on the transfer and implementation of new technologies, and cannot be expected to give the necessary impulses to global climate negotiations. A more important forum for the future of global climate politics will be the 14th Conference of Partners in Poznan at the beginning of December 2008. The EU, which has due to internal difficulties been unable to formulate a common

[39] See, for example, Reiner Musier and Clare Breidenich, ‘Cap and Trade: From All Sides Now’, APX, 2008, www.apx.com/documents/APX-Cap-and-Trade-Overview.pdf

response to the financial crisis, is at present also incapable of providing a dynamic impetus in the field of global climate policy. It will therefore be very difficult to implement a global climate policy regime effectively capable of coping with the global climate crisis.

The EU is participating in the UN's Clean Development Mechanism/Joint Implementation (CDM/JI) which is supposed to make climate protection less costly and to promote a more systematic use of the potential of CO_2 sinks. However, this is flawed by its political construction. By failing to recognise the hierarchical relations and patterns of dependency between states, it provides the developed industrialised countries with an excuse for not transforming their own industry. The problems and weaknesses besetting EU climate and energy policies and the prospect of recession do not justify the short-term, nationalistic response of countries, such as Poland and Italy, which have opposed any real European effort in the field of climate politics, obstructing even the limited proposal for the introduction of an ETS. It is, rather, essential that member states rise above their divisions and overcome the real problems which exist in order to advance an ambitious climate strategy for the EU.

3. Proposals for alternatives to finance-driven capitalism

Our proposals for an alternative economic policy to counter the financial crisis and the looming recession in Europe start from John Maynard Keynes' famous notion that public policy must envisage the 'euthanasia of the rentier'. More than ever it is necessary to overcome speculation and an untenable 'shareholder value' orientation through a democratic transformation of finance (see section 3.1). A democratic transformation of the economy will also require addressing the vast concentration of power in the hands of giant corporations (section 3.2). In an alternative scenario, credit should not be employed for short-term financial gains but rather for encouraging productive investment so as to promote full employment and good work and to contribute to the fight against poverty and exclusion (section 3.3). At the same time it must contribute to ecological sustainability, particularly to the resolution of the problems of energy provision and climate change (section 3.4).

3.1 Democratic transformation of European 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 call for further reaching policies which transform the financial system and embed it into a framework of democratically controlled economic and social development. Four levels should be distinguished:

On the ***first level*** of immediate measures the smooth functioning of the ***payment system,*** the provision of the economy with ***sufficient credit***, and the safety of ***deposits*** and savings of the people must be secured. For this purpose stronger and different measures are needed than those which several big EU member states initiated in a more or less concerted action n October 2008. Large subsidies, huge bail-out guaranties and re-capitalisation of banks via the injection of state capital with no or very little voting rights or control maintains with very little modification the existing financial mechanisms and structures. It continues to subordinate the stability of the financial system to the same profit-oriented perceptions and decisions of bank managers which caused the present crash. Under these conditions, it is very questionable whether banks will fulfil their necessary functions for the economy and society. They might well fail to do so, either as an act of blackmail in order to get yet higher subsidies or as a result of continuing mutual mistrust and fear of real – or fictitious – risks.

To secure the basic functions of the financial system a regime change is necessary. We propose that the states should take over relevant parts of the leading banks in their countries, and thereby create a strong and permanent basis of public or semi-public banks over which they should exert efficient control to secure the fulfilment of the basic functions of the financial system. 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. This requires of course more than just the shift from private to public ownership but a change of the regulatory framework for banks and financial markets.

The ***second level*** of financial market reform should permanently ban from the EU the most harmful practices which have triggered and ex-acerbated the recent bubble and crash.

- ***Securitisation*** of loans and trade in loan packages should be prohibited for European banks and on European markets, because they are, on the one hand, a circumvention of legal capital requirements and, on the other hand, a driving force for speculation. Exceptions to this rule should be subject to permission and oversight through national and European supervisors.
- Credit provision for ***leveraged take-overs, acquisitions*** and other financial investment should be severely restricted, require higher minimum capital holdings and made subject to special supervision.
- The business model of ***hedge funds*** – not only short selling – has been demonstrated to be much more destabilising than stabilising, and therefore it should be terminated. Hedge funds should not be permitted to operate – from inside or outside – in the European Union, and European financial institutions should not be allowed to invest in hedge funds or operate such funds outside the EU.
- Special ***incentives for managers*** to engage in short-term speculation and/or boosting market capitalisation of their firms – like stock options – must be abolished. Bonuses should be restricted and linked to service quality and employment of the firm.
- ***Offshore centres*** with insufficient or no financial supervision and low or no taxes have been important bases and allies for the destabilising activities of financial investors and speculators. They should be closed down and where this is not possible direct and indirect business with such centres should be prohibited for financial institutions' operations in the EU.

Measures on this level can be adopted and implemented immediately, and some are already on the way. Where it is not possible to agree on them globally, the EU could and should take the necessary steps, and it could protect itself against capital flight via article 59 of the EU Treaty, which explicitly allows capital controls under certain circumstances. To push the European authorities in this direction member countries like Germany or France can and should play a pilot role in adopting the proposed measures.

The ***third level*** is a thorough revision of the rules for both the European ***banking system*** and European ***capital markets***.

With regard to the ***banking system*** transparency should be increased by setting up a European credit-register, but this is by no means sufficient. The whole business model of banking needs reform with the aim of concentrating activities on taking deposits and extending loans to nonfinancial institutions. Trading in securities should be strongly restricted and trading on their own account should be excluded from banks' activities. What is also needed is a thorough reform of the Basle II system and its replacement through a ***Basle III*** framework, which includes at least three points: First, the polarising and pro-cyclical character of the Basle II regime should be corrected through built-in stabilisers, like varying capital requirements at different phases of the business cycle. Second, the quasi-privatisation of bank supervision through the admission of 'internal risk models' of banks has been a great mistake and should be corrected. Risk assessment should therefore be re-transferred to public supervisory authorities on the European and on the national level. Third, the regular capital requirement rate of 8% is too low to restrain banks from excessive credit creation. It should be raised to 20%, and could be modified, e.g. to 10% for SME and to 30% for financial investors.

The comprehensive character of the banking crisis suggests that the best prospect for sustainable reforms is a solid basis of state-owned and democratically controlled banks and that therefore underlines the proposal for ***nationalisation and democratic control*** of a relevant part of the banking sector.

With regard to European ***capital markets*** the main thrust of measures should be *deceleration*, i.e. lower volumes and velocity of trade in the secondary markets for securities of all kinds. This orientation contradicts the microeconomic logic of immediate response to perceived profit opportunities. But since such response often translates via herd behaviour and contagion into increased volatility, turbulence and boom-bust patterns the avoidance of these systemic disadvantages must have priority over microeconomic benefits. Measures to this end include:

- Strict ***limitation on the investments of pension funds*** to European government bonds, with no investment in hedge or private equity funds, foreign exchange, derivatives and equity.
- A substantial reduction of the number and complexity of so-called ***structured products*** and other derivatives and certificates. They should be standardised and not traded over the counter but on regulated and supervised exchanges.
- ***Financial transaction taxes*** on all currency and secondary securities transactions. The purpose of these taxes is primarily to make short-term speculation less attractive; therefore the rate of the tax must be sufficiently high to meet this objective, and could be modified in response to changing circumstances. The proceeds of such taxes should be assigned to the EU and contributed to the necessary increase of the European budget.
- ***Rating agencies*** must be thoroughly restructured. Private rating agencies must be licensed and supervised by public authorities. There must be a strict separation between the assessment and the consulting side; for that purpose rating agencies should not be paid by the firms which they assess but out of a fund to which the rated firms contribute.

Overall these reforms would lead to a shrinking of bank activities and profits, which is very appropriate in view of the excessive expansion of activities which largely served (and very successfully) the purpose of extracting profits from the economy and contributed to instability and chaos. The loss of employment in these activities could and should be compensated by the extension and improvement of the service quality in the retail sector.

The ***fourth level*** of reforms addresses the underlying roots of the financial crisis. These are not inherent human greed, a propensity to speculate or the excessive credit creation by the banking sector, although the latter undoubtedly contributes to the recurrent pattern of boom and crash. The measures proposed on the previous three levels are certainly useful in the present situation and in a medium perspective. But they would not take the pressure off the financial system. This pressure stems from the extraordinary and continuous accumulation of private financial assets during the last three decades. Some of these assets are regularly destroyed through the recurring financial crises, but the accumulation continues and reaches ever new records. Its main causes are, on the one hand, the redistribution of income and wealth from the bottom to the top during the last three decades, and, on the other hand, the fast growth of private pension funds as a consequence of the complete or partial privatisation of pension systems in many countries. The accumulated assets are seeking returns in an increasingly difficult environment and for this purpose financial investors as managers of this wealth take recourse to ever riskier strategies. Counter-measures like the prohibition of malpractices and bank and capital market reforms will have the effect of making certain strategies no longer feasible. But in the long run financial investors will search and eventually find other new, ‘alternative’ and ‘innovative’ strategies which after some time generate the same pattern of speculation, turbulence and crisis. To cope with these problems it is necessary to reverse the redistribution of income and wealth and shift towards a more egalitarian distribution. It is also necessary to stop the thrust towards the privatisation of social security systems and, instead, to favour public Pay-as-you-go systems, upon which financial markets have no influence. Such proposals go far beyond sector specific financial market policies and are part of a wider agenda of democratic economic policy for full employment, social cohesion and ecological restructuring. They would transform finance and embed the financial sector as an important and indispensable element into this new framework. This would not be end of capitalism but it would be the end of finance-driven capitalism.

Most of these proposals will be met with adamant resistance and rejection by the financial industry and most policy makers. One main argument will be that far-reaching reforms would, if at all, only be possible at a global level because, if they were implemented at a European level, it would lead to a wave of capital flight and thus destroy not only the financial system but the economy as a whole. Such objections are only understandable if the principle of free movement of capital is put above all other considerations. Not even the EU goes so far. The section of the EU Treaty establishing the free movement of capital includes a number of safeguards for exceptional circumstances. One of these is article 59 which states:

> Where, in exceptional circumstances, movements of capital to or from third countries cause, or threaten to cause, serious difficulties for the functioning of economic and monetary union, the Council, on a proposal from the Commission, may adopt European regulations or decisions introducing safeguard measures with regard to third countries for a period not exceeding six months if such measures are strictly necessary. It shall act after consulting the European Central Bank.

It can hardly be denied that we are living in exceptional circumstances and that the functioning of EMU would be severely threatened by capital flight as a response to thorough going financial reforms. When, if not under these conditions would be the time for adopting appropriate measures to protect the success of the necessary transformation of the European financial system?

3.2 Excursion: Reforming Governance in Transnational Corporations (TNCs)

Since the 1980s in the US and the 1990s in Europe, large publicly quoted corporations have undergone a radical inner transformation with deep consequences for the welfare of citizens and societies. Although well known in economics, their twin evolution towards financialisation and globalisation has not been sufficiently acknowledged from a social perspective and policy implications have not been drawn to ensure that these corporations would continue to serve society and positively contribute to social welfare.

The devastating social consequences of financialisation and globalisation

Financialisation means that strategic decisions at the top of large corporations are being made with the primary objective of increasing short-term returns on invested capital, placing shareholders and top management – whose interests have been 'aligned' with those of investors' thanks to skyrocketing salaries, financial performance bonuses and stock options – as the main legitimate recipients of wealth generated by the collective contribution of corporate stakeholders including not only employees but also suppliers and more indirectly, customers and local communities. Globalisation means that these stakeholders have become productive resources that can – or should, when sectors or countries are not fully liberalised – be freely mobilised and made to compete with one another on a world scale in order to serve short-term financial objectives. From a social perspective, these changes in corporate governance are promoting the rise of a transnational financial elite increasingly 'dis-embedded' from the local territories and communities where most people continue to aim at sustaining their life and family while submitted to increased pressures and uncertainty in doing so.

In response to public disarray, the rhetoric of global competition has played the North against the South, arguing that job creation and investments in lower-cost countries could compensate for job destruction and community dislocation in so-called developed countries. However, continuous relocation of production now takes place on a global scale, jeopardising development prospects even in poor countries that entered the world economy by serving the production needs of TNCs through participation in global – unregulated – subcontracting networks. Mobilising the moral argument of individual freedom, the rhetoric of global competition also played employees one against each other, praising individual performance achievements and wealth accumulation as core values in market-oriented human resource management (HRM) systems that destroy collective dynamics within the firm, increase pressures and uncertainty for all, and deepen inequalities in employees' capacity to adjust depending on their age, gender, family commitment, psychological and social resources, and more broadly, individual negotiating power. Increased stress, pathologies, and more recently, suicides[40] at work are signalling that fundamental needs for security, stability and social integration are being neglected in new management systems. Psycho-sociological drivers, once involving a sense of social progress through engagement in collective action, now draw on greed at the top and fear at the bottom of global corporations. Running against basic tenets in financial theory, risks and returns have become disconnected insofar as a transnational financial elite absorbs increased returns while the burden of adjustment is transferred to the firm and passed onto workers, suppliers, and local communities.

Re-embedding the economy

What can be done to stop this process of social dislocation inside and outside the firm? What kind of policy proposals could be made? No easy solution or partial, single-handed measure can do the job. The first and perhaps single most important measure, however, is that elected political representatives should serve the needs of the people rather than endorse the goals of a transnational financial elite as done over the last decades in the form of liberalisation poli-

[40] A wave of suicides at work has recently hit France, see A. Thébaud-Mony, 'Death at Work', *Le Monde Diplomatique*, English edition, 2007; S. Lauer, 'Souffrances et suicides au travail', *Le Monde Diplomatique*, 21 March 2008..

cies that made globalisation and financialisation possible in the first place. This being said, the key challenge in front of us is to 're-embed' the economy – production and consumption activities – within society by empowering stakeholders and giving them a voice in corporate governance, i.e., in the system by which resource allocation decisions are made within the firm. Given the tremendous imbalance of power between the global financial elite and other stakeholders, the primacy given to wealth accumulation by a few at the expense of the many will not be challenged unless a strong social and institutional infrastructure is established to regulate the flows of transnational activities. Therefore, formal mandatory devices for social dialogue are needed at all levels in TNCs: local, national, European, and international, and should be inclusive of a variety of stakeholders.

Giving employees a voice

First, the question of employee representation should be taken seriously. Resources need to be devoted to reinforce workers' voice that corporate strategies of externalisation, relocation, and individualised HRM have deeply weakened over the last decades. Communication campaigns are needed to stimulate and re-legitimate employee representation, among junior workers in particular. Union repression and discrimination towards union representatives should be sanctioned and work inspection, now diminished to an almost purely symbolic role, strengthened through a major increase in staff and greater enforcement capacity. Investments in information systems, training in foreign language, negotiation and management skills should also be made available to employee representatives. Capabilities for transnational organising of employee representation should be strengthened where they exist, and established where they do not. European Work Council (EWC), for instance, could become mandatory and follow specified operating rules. Nowadays, two thirds of 2700 multinationals meeting the size criteria to establish a EWC have not done so, although marketing, production, human resources management and employment policies are all designed at the European – or global – level in these corporations, meaning that these decisions are taken in the absence of any social dialogue with employee representatives.

Encompassing whole supply chains

Second, because TNCs have externalised and relocated substantial portions of the sequence of activities contributing to the design, manufacture and sales of their products and services, formal mandatory devices for social dialogue should not be limited to the legal entity of the firm but extend to its whole value chain, in transnational production networks where the quantity and quality of jobs is heavily dependent on decisions made by TNCs. In a North-South perspective, TNCs and their suppliers should not be allowed to maintain important volumes of activities in locations where basic human rights are being persistently violated at the workplace. This holds true for China, for instance, where export-oriented labour-intensive manufacturing relies heavily on young migrant women granted second-class citizen status, in Bangladesh, where union organising faces severe repression, and in many other countries where democracy has not reached the workplace. If TNCs and their suppliers are technically able to trace the flow of products in global just-in-time sourcing systems meeting tight product quality standards, then tracing respect for labour right in the form of local workers' independent organising and negotiating capacities is in the realm of the feasible, and only a matter of social and political will.

Raising consumers' information and rights

Third, customers should be allowed to play a role beyond that of feeding cash flows at one end of the pipeline – to be extracted at the other end in the name of shareholder value. In a global financialised system, consumers are induced to buy – and keep buying – by massive corporate investments in the construction of global brand identities and proliferation of product styles. These investments establish and maintain a social and cognitive barrier between the spheres of consumption and production that new social movements have sought to overcome through activist campaigns on work and environmental conditions in recent years. Consumers should thus be given much more information on product and service content and the social conditions under which product and services are being delivered. This would involve a major U-turn in global corporate policies currently aimed at minimising available information on products, production and employment. Even though some knowledge of the social conditions of production has started to spread in places of consumption, thanks to transnational civil society networks, this knowledge remains largely disconnected from the time and place of mass consumption, i.e., opening hours in the brand mega-stores, mass retail and discount stores operating at the market end of global production networks. Needless to say, the production and dissemination of such information should itself be democratically governed so as not to become another marketing artefact.

Sharing knowledge and information

More broadly, while TNCs engage in intense financial and marketing communication in the direction of financial and consumption markets, they also make it extremely difficult – for researchers, let alone the public – to access reliable and relevant information on the social and environmental conditions of production and employment, including volumes, location, quality standards as well as forecasts. Detailed quarterly information and estimates on cash flows at three, six, twelve months and more, are provided to shareholders whereas employee representatives can seldom obtain accurate information on current and future jobs within the company and local subsidiaries and suppliers are left in the dark with regard to plant closure risks or shifts in sourcing contracts. Here again, however, if companies are technically able to produce estimates of future cash flows, then sharing related forecasts on production and employment by geographic zone, country, and even subsidiary is in the real of the feasible, and only a matter of political will. Access to information and to a legally established arena for social dialogue are thus fundamental elements of a democratic governance systems that would provide a voice for the many stakeholders currently left with weak claiming and bargaining capacity in the production networks of global financialised corporations.

Promoting alternative governance patterns

Conversely, resources should be devoted at European, national and local levels to promote alternative governance patterns such as workers' cooperatives and consumer associations aiming to re-embed the economy in order to serve the needs of local communities and contribute to enhance social welfare. In such democratic and localised governance patterns, because management decisions are made collectively and because the people making them also bear their consequences at the local level, decisions can be more sensitive to social and environmental needs. By contrast, global decisions can be predatory on local communities when individuals making them do not have to face their social and environmental consequences. As a result, globalisation and financialisation might well have produced 'Frankenstein' systems erected in the name of corporate profits but that cannot be made accountable for human rights and the needs of communities. Re-embedding the economy would then possibly involve de-globalising and re-localising production and consumption activities.

3.3 A new macro-regime for full employment, social inclusion and security

The democratic transformation of finance in the EU must be accompanied by a thorough regime change in macroeconomic policy so as to support financial stabilisation, to counter the imminent recession and to bring the EU on a path of socially and ecologically sustainable development. Changes must include the monetary regime and fiscal policies for the member states and on the European level; they must also relate to a change of income distribution through higher wages and a more determined fight against poverty and exclusion.

Further relaxation and regime change in monetary policy

The financial crisis has again shown that the narrow focus of the ECB on price stability and its neglect of employment, sustainable growth and financial stability provides no remedy, either against the financial crash or against the coming recession. It has on the contrary contributed to the weakness of the European economy. This could only happen because the ECB acts in complete independence and is not accountable to democratically elected political authorities. Under the current circumstances we welcome the fact that the ECB has embarked on interest rate cuts, although they are both too late and too little. As the inflation threat is already receding in all the industrialised countries and the task is turning to curbing deflationary pressures, the European Central Bank must continue to relax its monetary policy and embark on further steps to reduce interest rates and provide sufficient liquidity to supply credit for production and services. Such immediate measures to fight the financial crisis and recession should be regarded as the first steps towards the necessary regime change in monetary policy in the EU – something we have proposed in many previous memoranda. It should be based on two main pillars. The first is a broader mission for the ECB which should include responsibility for growth, employment and financial stability as well as price and exchange rate stability. The second is the embedding of monetary policy into a broader and democratic framework for coordinated economic policies.

Fiscal policies: Immediate anti-recessionary programmes and a new institutional framework

We propose that the Commission and the Council draw up a 'European Investment Programme for Sustainable Development, Employment and Social Inclusion' of at least 1% of EU GDP, which should be complemented by similar public investment programmes of the member states in order to stabilise the economy, counter climate change and promote full employment with quality jobs and social rights. Such a programme is necessary to fight the recession in the EU which has already begun and will be sharpened by the consequences of the financial crash. At the same time a common European fund should be set up to help the weaker members of the EU to deal with the crisis. It is a shame that this proposal has not even been discussed at the frequent recent summits. Such an approach is indispensable in order for the EU to take a more active part in shoring up the economies in trouble. We have in several previous memoranda argued for the setting up of funds to deal with common shocks – it is now more urgent than ever to act on this.

To finance such programmes at the EU level, three tracks should be followed. As a *first step*, possibilities for shifting budget lines in the existing EU budget from unsustainable expenditure (e.g. on military, nuclear energy or environmentally damaging infrastructure projects) towards sustainable ones need to be fully explored and exploited. *Secondly* the EU budget should be raised. Currently it represents a meagre 1% of GDP and it is likely to remain so given the clear lack of political will for anything more ambitious. We have long held the view that the EU budget should gradually rise to 5% of EU GDP. As a measure in that direction, the EU should introduce a Tobin Tax of 1% on currency transactions, a tax on stock exchange and Over-the-Counter financial transactions and agree on eco-taxes (e.g. a combined tax on primary energy and CO_2 emissions and a tax on aviation fuel). This would create wide scope to finance measures to improve living standards in the poorer member states and to steer investment towards environmentally and socially sustainable development throughout the European Union. Thirdly, the European Investment Bank (EIB) and the European Bank for Reconstruction and Development (EBRD) must be provided with the necessary resources to drastically increase credit lines at low interest rates for small and medium enterprises, ecological production and services, social and health services etc. on the condition these create quality employment with social rights together with decent working conditions and pay. A comparison with US Treasury Bond issues shows that the EIB remains far below its financing potential. The EIB finances operations by its own bond borrowing, thus shifting savings into investment. It is well placed and well equipped to undertake a macroeconomic role in an investment led recovery of the European economy. EIB lending is highly cost effective for the borrower. Being a public non-profit institution it lends-on at an administrative cost of only 0.25% and can do so for periods of up to 30 years or more. If the EU and member states financed their investment programmes via the EIB instead of the private capital market they would save money which they could use for further investments. An employment and income multiplier between one and a half and two for such investment can be reached if member states allocate their investments in the social area, especially for enhancing social services or reducing average school class size and patient waiting lists.

More far reaching reforms of EU fiscal policies should start by revoking the Stability and Growth Pact (SGP). This has always figured high in the neo-liberal ideological battle against interventionist policies aimed at promoting full employment and social cohesion. In practice it has never carried much weight especially with the larger EU partners. It was revised in 2005 in order to prevent it becoming obsolete, and in the endeavour to deal with the financial crisis it was simply brushed away. It is obvious that, with member states providing guarantees and financing for re-capitalising banks on a grand scale, it will be impossible to comply with the criteria on budget deficits, but nobody has objected. The budget rules have become obsolete and need to be abolished. The SGP has also played an important ideological function and it is time to do away with this: it should be formally revoked. A new system of double policy co-ordination – between the EU member states on the one hand, and, on the other hand between the member states and the European institutions (Council, Commission, ECB, EIB, EBRD) – needs to be instituted and a new pact needs to be agreed upon. It should serve the goals of full employment, social inclusion and protection and environmentally sustainable development.

Wages need to be radically increased

Wages have for many years been held back in the name of price and fiscal stability. This is at the root of deepening inequality, and is a major factor behind the present crisis. This cannot continue. Real wage growth is urgently needed, not only to boost income and consumption, but also to shift the distribution of income away from profits, which have risen rapidly over the past twenty years, and towards wages. Real wages in Europe now need to rise at a rate that reflects productivity increases plus inflation. In this way it can embark on a process of redistribution aimed at increasing the share of wages in Gross National Income.

End 'flexploitation' – promote full employment with 'good work'

In our 2007 Euromemorandum, we called for a drastic reorientation of current EU employment policies towards a 'good work' agenda. The 'good work' agenda encompasses the ILO core labour standards and the ILO and UN concept of 'Decent Work', to which the European Union has already committed itself. Going beyond this, the 'good work' agenda aims at social sustainability in all its aspects. It demands shaping working conditions in a way that the quality of employment is improved and that preventive and participation-oriented health and safety regulations at work create an environment which enables workers to stay fit and healthy up to and beyond their retirement age. The 'good work' agenda furthermore aims at enhanced participation rights of employees and guaranteed rights to education, further education, training and lifelong learning, also by way of strengthening collective co-determination rights. It aims at defending and renewing the standard employment relationship, based on equal workers rights, a high level of job and employment protection, the right to strike, to collective action and collective bargaining, a high level of social protection and decent remuneration, and full-time employment as the norm.

Good work requires adequate ***remuneration*** ('a living wage') and the abolition of the gender pay-gap ('equal pay for equal work or work of equal value'). Therefore, the EU and the member states must commit themselves to phasing out all forms of precarious employment by abolishing existing incentives (in-work benefits, tax and social security breaks) for marginal atypical forms of employment or for employment in the low wage sector. An instrument for this purpose could be a system of progressively rising social security contributions (or taxation) of employers, according to the principle 'the lower the employment status (short period, weak perspectives, high risks), the higher the contributions to social security'.

There is as well an urgent need for work organisation and ***working time*** organisation to support the reconciliation of employment and personal life for women and men. To this end there is a need for a new European working time standard aimed at shorter full-time employment for all. The EU must establish a clear limitation of the maximum working week at EU level (down from the present norm of 48 hours per week to 40 hours in a first step, abolishing all present derogations and loopholes of the existing EU working time directive), which would provide member states with an incentive for working time reduction at the national level. This also includes establishing norms for part-time employment, so that only assured and socially protected part-time work (15 - 25 hours weekly) will be offered to those who wish to work part-time.

Social protection systems must be re-oriented so as to provide better support for changes in the work-life cycle of a person. This should ensure that career breaks (e.g. while caring for children or dependents, or for education, training, lifelong learning etc.) and employment transitions (e.g. from education to employment, from full-time to part-time and vice versa, from self-employment to employment and vice versa, job rotation schemes etc.) are accompanied by measures that provide for the acquisition of decent pension entitlements, protection against health and other life risks, and adequate incomes during periods of transitions.

Strengthening the fight against poverty and social exclusion

We fully support the recent demands of the European Parliament to strengthen the EU strategy on Social Protection and Social Inclusion by improving its visibility and working methods and its interaction with other policies. The Parliament sent a strong message to the Commission and the Council to set clear targets within that social strategy, inter alia:

- targets for the ***reduction of poverty*** (in general, and for child poverty, in-work poverty and persistent long-term poverty), for a minimum level of income provided through pensions and for access to and the quality of health care (reducing infant mortality, improving health and increasing life expectancy, etc.), all of which should be differentiated by gender;
- a target to ***reduce child poverty by 50% by 2012*** and to enhance progress in meeting the existing 'Barcelona' target on the provision of childcare facilities across the Union for 90% of children from birth until mandatory school age and a sufficient level of care provision for other dependent persons by 2015;
- a target to ***end homelessness*** (of children and adults alike) by 2015;
- new targets on sufficient income to prevent poverty and social exclusion, such as an EU target for minimum income schemes and contributory replacement income schemes of providing income support of at least 60% of national median equivalised income and an EU target for minimum wages (statutory, collective agreements at national, regional or sectoral level) to provide for remuneration of at least 60% of the relevant (national, sectoral, etc.) average wage.

We also support the Parliament's demand that the member states should provide targeted additional benefits for disadvantaged groups (such as people with disabilities or chronic diseases, single parents, households with many children) which cover extra costs in connection, inter alia, with personal support, the use of specific facilities and medical and social care, establishing affordable price levels for medicines for less-favoured social groups and to ensure decent invalidity and retirement pension levels. Lower income individuals furthermore need to be especially supported as regards access to essential services. Therefore, member states should provide for social default tariffs for vulnerable groups for example in the fields of energy and public transport, as well as free healthcare and education for people having difficulties of a material nature.

3.4 A new regime on energy and climate

The financial crisis and the recession must not be allowed to 'crowd out' public attention, political action and the use of economic resources. At the same time, energy and climate policies cannot simply ignore the urgent demands created by the crisis of the global financial system which has led to massive state intervention around the globe. What is required are programmes that will strive to achieve synergies, addressing the immediate demands raised by the financial crisis and its impact on the global economy, while also promoting measures that will prevent catastrophic turns of other critical processes, including climate change, the loss of biodiversity and the impending absolute scarcity of oil and other fossil fuels.

With regard to *energy policy* this will require:

- an ambitious policy – at the EU as well as at the member state level – aimed at realising a leap forward in energy saving and energy efficiency (while minimising 'rebound effects'), and which would require a programme of loans and targeted subsidies, managed by the EBRD and based on Euro-Bonds; [41]

- a determined focus that cuts across all EU policy areas to promote the accelerated development and implementation of sustainable sources of renewable energy, and the phasing out of all support for non-sustainable energy sources;
- a common programme for the improvement of energy grids, especially for facilitating the decentralised production and use of renewable energy;
- a co-ordinated effort by member states (who should also activate their regional and local polities) to enhance rapidly energy saving, energy efficiency, and the use of sustainable renewables, something which could be supported by giving a similar focus to the structural funds and by using the open method of co-ordination to ensure this occurs in accord with a common energy strategy;
- a global energy security strategy for the EU which relies on long-term exchange relations based on the mutual interests of the EU and of provider countries.

First steps towards such an alternative European energy strategy bundle would be:

- the introduction of a primary energy tax complemented by social transfers to ensure that poverty is not exacerbated;
- a reduction of VAT for renewable energy supply and for cogeneration;
- the creation of a European Energy authority capable of protecting decentralised energy production and which can be used to counter the oligopolistic power of the major energy corporations;
- a targeted support programme for reducing energy needs in urban areas and in low-cost housing;
- using the possibilities of leverage given by the implementation of the Trans-European Nework (TEN) programme for energy and transport in order to improve the mix in transportation by giving clear priority to rail- and sea-bound modes;
- concentrating present support programmes for renewable energies on sustainable options, by withdrawing support from non-sustainable options, such as bio-fuels of the first generation;
- transferring funds from the Euratom budget to programmes supporting sustainable renewables, especially those produced in Europe;
- activating the important potential of gendered energy-saving by creating a common and coordinated programme for the EU and its member states addressing gender-specific energy needs;
- starting a common European Habitat programme for the EU and its member states focusing on urban improvement, combining social inclusion, cultural integration, and ecological/energetic quality;
- opening a new round of multilateral negotiations with oil and gas supplier countries for a long-term agreement on development perspectives and energy supply security.

With regard to *climate policy* this will require:

- Bolstering ambitious climate reduction objectives capable of ensuring that catastrophic ‘tipping points’ will not be reached in a few years (in six years according to the moderate estimates of the IPCC) by introducing support programmes for industrial and consumer

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[41] Rebound effects refers to the possibility that increased energy efficiency, if associated with lower costs, can lead to an increase in consumption.

demand in the member states strengthening the transformation capabilities of their main industries;
- ‘embedding’ the use of ‘economic instruments’ with regard to climate gas emissions into pertinent framework regulations capable of hindering ‘effects of perversion’, especially on employment and working conditions, and by clearly orienting the limits imposed on the reduction aims indicated by the IPCC;
- negotiating and implementing the EU emission permit trading scheme in a radically reoriented way in order so as to tie it to ambitious reduction targets; to make it a source of relevant funding for the transition towards the use of renewables (including the introduction of minimum prices to ensure that prices do not fall drastically in a recession); and to make it a dynamic factor of continuous progress in reaching the reduction targets proposed by the IPCC;
- changing the ambiguous role of the EU in the post-Kyoto-negotiations so as to take a clear position of giving absolute priority to avoiding catastrophic climate change.

First steps towards such an alternative European climate strategy bundle would be:
- Focusing all programmes addressing the needs for demand stabilisation which will be created and implemented in the next year on energy saving and the transition to sustainable energy sources;
- radically changing the present direction of the negotiations on the EU climate gas emissions trading scheme in the direction of imposing more ambitious reduction aims and of making it a tool for a dynamic reduction process;
- linking the proposed auctioning of emission rights for the electricity sector with targeted and differentiated transition programmes for the member states concerned;
- creating a EU investment programme for the prevention of climate gas emissions geared towards helping member states with the highest needs for improvement;
- introducing a framework programme for the improvement and stabilisation of working conditions in the new sectors of employment created in the change to a low and zero carbon economy;
- aiding other regional groups of states, such as Mercosur or ASEAN, to create ecologically effective schemes of climate gas emissions trading;
- a strengthening of the Johannesburg renewable energy initiative of the EU in order to become a relevant factor in combining and co-ordinating efforts between the EU and partner states among developing countries;
- the creation of an informal group of state governments interested in giving a higher priority to avoiding ‘tipping points’ in climate change.

In the context of such strategies it would be useful to maximise the synergies between energy and climate policy which can be realised at all levels – for example, by giving a strong priority to energy saving programmes facilitating the transition towards renewables.