European Economists for an Alternative Economic Policy in Europe

– EuroMemo Group –

Can the EU still be saved?
The implications of a multi-speed Europe

– EuroMemorandum 2018 –

This EuroMemorandum draws on discussions and papers presented at the 23rd Workshop on Alternative Economic Policy in Europe, organised by the EuroMemo Group in cooperation with the Department of Geography at Harokopio University and the Nicos Poulantzas Institute, from 28-30 September 2017 in Athens.

Summary

Introduction

Nearly ten years into the crisis, after the EU opted for austerity and deregulation, the member states are still looking for the way out. In vain has the EuroMemo Group warned against the dangers that are inherent in the architecture of the Economic and Monetary Union (EMU).

The repercussions include the rise of ultra-right wing political forces across Europe which feeds into the anti-European popular sentiment they cultivate. Exiting the EU has been gaining ground and will soon be the case for Britain. This represents a turning point in the history of the EU, against an 'ever closer union'.

Can the EU still be saved? This is a difficult question indeed. The *White Paper on the Future of Europe* produced by the European Commission details five scenarios. However, these tend to overlook inherent tensions in Europe, e.g. heightened insecurity relating to labour markets, the role of finance in the post-crisis era, and the rise of a subaltern class across Europe.

The Franco-German axis in European politics would appear to be re-emerging, although their leaderships do not share a common vision. President Macron's idea to take a big leap towards a euro area fiscal union, enabling permanent fiscal transfers to countries disadvantaged by the EMU, is opposed by the German leadership. From our perspective, a likely compromise solution that enshrines the fiscal compact in EU law and does not provide a euro area treasury with real fiscal resources, must be clearly avoided.

Further, such discussion needs to take into account that the EU is a composite polity manifesting many state characteristics but also significant asymmetries among its member states, evident multiculturalism, and varying trust in the European institutions. In this context, the current crisis has challenged the democratic capitalist compact within which the EU is historically embedded. The Community method, emphasising the role of the supranational bodies, has given way to increased inter-governmentalism.

German interests have been shifting away from Southern Europe and towards Eastern Europe and the emerging markets. This poses severe obstacles for strategies aimed at progressive Europe-wide productive development. The rise of the far right across Europe and especially in Germany will have a negative influence on European developments, as governments will be under pressure to take nationalistic positions, while relations with Southern European countries recovering from the crisis will become more difficult.

The economic system imposed in the aftermath of the crisis must be changed through a shared European process. A multi-level governance model combining action at the European scale with that of individual governments is needed. The main challenge will be to identify key elements of such a strategy and to build the necessary alliances. The future of European integration will depend on the deepening of democracy in the interests of stability, solidarity and social justice.

1. Macroeconomic policies: debt overhang and sustainable growth & development

Since last year's EuroMemorandum the recovery in the euro area and the EU has strengthened and broadened substantially. The growth and employment forecasts for the EU and many of the euro area's crisis countries – with the shocking exception of Greece – have been raised considerably. Although far from being satisfactory – and far from making up for the catastrophic economic, social and political damage since the onset of the crisis – the economic situation in the euro area and the EU is undoubtedly improving. While those positive changes must be acknowledged, the downsides consisting of high economic and political risks should not be overlooked. The geopolitical situation carries large risks of a decrease in global demand growth and therefore in external demand for the EU. The failure to reregulate the global financial system in combination with bubbles fed by

extremely expansionary monetary policies have increased the risk of new financial crises. At the same time the attempt to withdraw monetary stimulus by the European Central Bank (ECB) may pose new risks for member states' public finances and/or the recovery. Furthermore, the problem of the current account imbalances has not been properly addressed. The notorious surplus countries – most importantly Germany – have not initiated any rebalancing, and the rebalancing of the former deficit countries may prove to be short-lived as it is mainly caused by lower import growth in the wake of the crisis. The by now very high current account surplus of the euro area as a whole and the associated global economic imbalances implied by it are not likely to persist.

A convincing alternative policy strategy requires at least five important changes. (1) The balanced budget requirement should be replaced by a balanced economy requirement which includes the objective of high and sustainable levels of employment. (2) In the long-run a substantial EU-level budget is required in order to finance EU-wide investment as well as public goods and services and establish a counter-cyclical European-level fiscal policy which is able to support national fiscal policies. (3) Instead of focussing only on overall growth, a successful strategy should also give priority to overcoming disparities between different regions and sectors. A long-run European investment strategy should therefore be developed, addressing European, national and local development. (4) The deflationary strategy of competitive devaluation should be replaced with a strategy of wage growth, which ensures the fair participation of workers in national income growth and stable inflation. (5) Effective measures should be taken against tax competition.

2. Monetary and financial policies: mounting problems

The current extremely accommodating monetary policies of the ECB are a logical but inadequate response to the dysfunctional macroeconomic framework of the euro area and to the dogmatic and damaging pursuit of austerity. The use of quantitative easing in particular may be reaching its limits. Meanwhile there are strong pressures from the banks and big financial corporations to undermine the regulatory structures put in place since the global financial crisis. Brexit may aggravate these pressures if it is followed by a race to the bottom in a scramble to attract financial business away from London. Meanwhile, the failure to build a strong, stable financial system in the euro area, based more on public and less on private-sector financing, has led to a process of creeping dollarisation in the euro area which will tend to limit the autonomy of EU economic policies.

3. Inequality and social crisis

The EuroMemo Group has been consistently critical of the trend towards increasing inequality in Europe and, in particular, of the policies that have either encouraged or tolerated that trend in the name of 'trickle-down' economics. Almost four decades of deregulation and privatisation have seen marked shifts in the distribution of income and wealth in European and other advanced economies within the Organisation for Economic Co-operation and Development (OECD) at the expense of wage- and salary-earners and of the non-working population, and to the advantage, above all, of incorporated, globally active enterprises.

The rise in inequality has been undeniable and dramatic. Both the personal and functional distribution of income – the overall 'labour share' of national income – have seen marked shifts away from the majority of citizens dependent on wages and salaries towards those who derive their income from capital. What is new in the debate surrounding inequality is that practically all the institutions of the neoliberal consensus (International Monetary Fund, World Bank, OECD) are now saying that rising inequality does have a negative effect on growth and development. However, it has come very late in the day and after decades of evidence indicating that policy choices, political neglect and the stubborn rejection of alternative economic policies have been co-responsible for the social and economic damage of inequality. In particular, the unreflecting, pro-cyclical persistence with budgetary austerity has not simply stunted recovery but left irreversible scars on wide sections of the Europe's population.

While the EU has sought to embed a social dimension into its policy-mix, it imposes no sanctions on the non-fulfilment of policy targets, as is the case with 'excessive deficits'. There are no benchmarks for levels of social expenditure, which vary dramatically within the EU. The potential to improve social welfare is affected by weak fiscal systems in several member states, notably in the member states in central and eastern Europe with flat tax regimes. States with weaker taxation systems tend to be characterised by weaker expenditure on social welfare and by higher levels of inequality.

The EuroMemo Group recommends therefore that social protection should be ensured by agreed benchmarks of fiscal viability (adequacy of revenue) and social needs; accordingly that flat tax regimes should be abolished in favour of harmonised levels of progressive taxation; that the disparities of economic and social performance among the EU28 should be addressed through financial transfers from richer to poorer member states, on condition, however, that the states concerned commit themselves to minimum standards of taxation and social protection.

4. The EU in a fragmenting international order

During the past few months, several events have had a major impact on the European political and geopolitical stage, including the legislative elections in France, Germany and the Netherlands, the beginning of the Brexit negotiations and the Catalan referendum. However, the statements of the new US president have arguably struck the most. Donald Trump advocates the break-up of the European Union, calling it a vehicle for Germany. He rejects the US commitment to open trade and favours a return to protectionism. The hostility displayed by the new US President to the EU – which on the substance does not in fact mark a break with the policy of the previous US administration – constitutes a major threat to EU stability. Indeed, the US hostility to the EU manifests itself at an inconvenient time for the EU, which faces increasing disgruntlement about its functioning as well as a number of major crises which have not yet been solved. In addition, the persistence of structural failures in the institutional framework of the European currency union leaves it open to the risk of a new crisis. Moreover, the new protectionism advocated by Trump, if confirmed, would mark a profound fracture in the liberal order and this could weaken the EU's position in the world. It could also force the EU – and this is particularly true for Germany, the second largest world export economy – into some painful reconsiderations. Trump's statements are an embarrassment to the EU. European reactions are marked by a desire for appeasement (regarding European contributions to NATO's financing) and an effort to depart from the most aggressive positions of the new US administration (its renunciation of the Treaty with Iran). EU reactions also aim to uphold a certain image of the Union, that of a bastion of liberal order which is threatened by Trump. The US challenge has undoubtedly influenced the development of the Commission's White Paper on the Future of Europe as well as Macron's proposal to 'refound Europe'. A multi-speed Europe is advocated by the three largest European states for some areas, but this reinforces divisions between the 'core' and East European countries and makes more distant the prospect of a more integrated Europe.

In today's emerging multipolar world, Europe should maintain its distance from US foreign policy which it demonstrated during the recent Iran nuclear deal crisis, particularly regarding relations with Russia. Moreover, instead of taking the dangerous path of the arms race, the EU member states should use their resources to contribute to the economic development of the Eastern and Southern neighbours.

5. Alternative visions for socio-ecological transformation

The planet's boundaries are being approached at speed on numerous fronts, due especially to emissions of greenhouse gases and the depletion of natural resources. Several of these developments are both irreversible and urgent. Carbon emissions appeared to decrease slightly in the rich countries and the EU from 1990 to 2007; however, if the offshoring of high-emitting industrial processes to low-cost countries is taken into account, i.e. the footprint, we observe a significant increase instead. A range of alternative proposals argues that a major socio-ecological transformation is needed both to stay within the planetary limits and achieve good quality lives for all. International bodies such as the OECD propose green growth as a solution to the environmental challenges, and groups at European and national levels put forward a Green New Deal with an investment and employment stimulus to directly address key environmental problems. In contrast to green growth, a range of alternative visions takes issue with what they see as an obsession with exponential growth in public policy and in most economics, questions both its feasibility and often its desirability, and focuses on the development of alternatives. These include 'the steady-state economy', 'prosperity without growth', and 'degrowth', as well as the 'post-development' approach in non-OECD countries. Various proposals include a focus on quality instead of quantity in the production of goods and services, 'sufficiency' approaches, a major role for the commons, and the development of local and regional economies including local exchanges.

EU policy generally takes the green growth approach, but with limited investment stimulation. The very low climate and energy ambitions for 2030 agreed by the member states in November and December 2017 will, if carried through, put way off track the trajectory for achieving even the EU's own limited decarbonisation objective for 2050. The precautionary principle, needed for the regulations required in almost all these areas, is under severe threat from the introduction as proposed by lobbyists of an 'innovation principle' expressly to counter it. Alternative policies include much sharper cuts in emissions with longer-term commitments by the member states, accompanied by concrete plans to achieve these; transformation of the economy to much lower use of energy and materials; support for local economies; taking advantage of the potential of public services to promote sustainability and transition; major reform of transport and mobility policies; shifting from the bias increasingly introduced into the EU regulatory system against regulations in the public interest to a fair assessment of the benefits of regulations instead; and reorientation of the Juncker plan and European Investment Bank (EIB) funding generally towards much more investment in climate change mitigation and adaptation.

Introduction

Nearly ten years into the crisis, the member states of the European Union and especially the euro area are still looking for the way out. The global financial crisis of 2007/2008 morphed into a prolonged economic crisis, as the EU – under the influence of the German anti-inflation obsession – opted for austerity and deregulation, especially of the labour market, to deal with the crisis.

In vain has the EuroMemo Group warned against the dangers that are inherent in the architecture of the Economic and Monetary Union and which have been exacerbated by the response of the EU to the crisis. In fact, it is these very dangers that prompted the founding of the EuroMemo Group in the mid-1990s, while the annual reports of the Group have consistently argued against the prevailing policy dogmas, particularly when they persisted after the onset of the crisis. However, European leaders appear to be almost impervious to reason.

Not surprisingly, the failings of the prevailing economic policies have had clear social and political repercussions, as shown by recent developments in the EU. In particular, the talk of exit from the EU, culminating in the Brexit decision of 2016, has become louder. Further, the rise of ultra-right wing political forces across Europe, as witnessed by the electoral results in major European countries in 2017, feeds into the anti-European popular sentiment cultivated by these forces. Thus exiting the EU has become both an idea gaining ground and a reality soon to be put into effect in the case of Britain. This represents a turning point in the history of the EU, which rests on the premise of an 'ever closer union'.

Can the EU still be saved? This is a difficult question indeed, demanding an urgent answer. Jean-Claude Juncker, ever the optimist, argues that 'Europe has always been at a crossroads and it has always adapted and evolved'. In fact, the *White Paper on the Future of Europe* produced by the European Commission details five scenarios: (i) carrying on; (ii) nothing but the single market; (iii) those who want more do more; (iv) doing less more efficiently; (v) doing much more together.

Interesting as these may be, they tend to overlook inherent contradictions and tensions in European societies and economies, e.g. heightened insecurity relating to labour markets, the role of finance in the post-crisis era, increasing poverty and inequality, and the growth of a 'subaltern' class across the EU.

Furthermore, the dynamics of the 2017 electoral results in France and Germany need to be factored in. In particular, the Franco-German axis in European politics would appear to be re-emerging, although the leaderships of the two countries do not share a common vision. President Macron's ambitious idea is to take a big leap towards a euro area fiscal union, with a common treasury and a single finance minister. This would enable, in his view, permanent fiscal transfers from the stronger countries to countries that are disadvantaged by the Economic and Monetary Union (EMU). The euro area budget would be financed by contributions from member states' tax receipts. A separate euro area parliament would provide political oversight and accountability.

However the German leadership begs to differ. Thus Angela Merkel congratulated Macron on his election, but stated that she would not consider changes in euro area fiscal rules, while Germany's former Finance Minister Wolfgang Schäuble is openly in favour of a

'Stability Union', whereby the fiscal compact would be incorporated into EU law, and the European Stability Mechanism transformed into a European Monetary Fund, monitoring compliance of the member states with clear fiscal rules, and without its own fiscal capacity in a euro area treasury. Although the outcome of the two approaches is at present indeterminate, it may well be expected that the Franco-German proposals will set the terms of the discussion in the near future. From our perspective, a likely compromise solution that enshrines the fiscal compact in EU law and does not provide a euro area treasury with real fiscal resources, must be clearly avoided.

Further, such discussion needs to take into account both the particular nature of the EU and the underlying trends among its leading political actors. More specifically, the EU is a composite polity manifesting many state characteristics but also significant asymmetries. Such state characteristics are its legal personality, specific territory and citizens, a directly elected parliament, a common currency for 19 member states, a common legal system directly applicable to its member states and symbols including an anthem, flag and motto, 'United in Diversity'. On the other hand, it also displays significant economic and social asymmetries among its member states, evident multiculturalism, as well as varied levels of trust in the European institutions.

In this context, the current crisis has challenged the democratic capitalist compact within which the EU is historically embedded. In view of the fact that the Community method, emphasizing the role of the supranational bodies in the decision-making process, has given way to increased inter-governmentalism during the crisis, the particular interests of its main political actors are going to carry special weight in the future shaping of the EU.

Whereas Macron has a special interest in pursuing his European agenda, the success of which will be decisive for the prospects of his domestic policies, this is not the case for Germany. In particular, German interests within the European division of labour have been shifting away from Southern Europe and towards Eastern Europe and the emerging markets. This poses severe obstacles for strategies aimed at progressive Europe-wide productive development.

Furthermore, the rise of the far right across Europe and especially in Germany is going to have a negative influence on European developments, as governments will be under pressure to take nationalistic positions into account, while relations with Southern European countries recovering from the crisis will become more difficult.

Overall the road ahead for the EU is going to be even bumpier than in the past. However, disintegration is not integration in reverse. Its ultimate trajectory would depend upon the strategies of the political, economic and social actors engaged in the European project and the dynamics of the ensuing political struggle.

While not negating the significance of national structures and processes, the economic system that became imposed in the aftermath of the crisis must be changed through a shared European process. A multi-level governance model combining action at the European scale with that undertaken by individual governments is needed. The main challenge is going to be to identify key elements of such a strategy and to build the necessary alliances in order to put that strategy into effect. From our perspective, it is evident that the future of European integration will depend on the deepening of democracy in the interests of stability, solidarity and social justice.

In this year's EuroMemorandum, the EuroMemo Group takes a close look into the main developments in the European economic, social and political landscape over the past year and proposes alternatives to the prevailing views and policies. It is our aim to contribute to the on-going debate on the future of European integration as well as to offer a succinct overview of developments and their implications, from a progressive point of view.

1 Macroeconomic policies: debt overhang and sustainable growth & development

Stronger and broader recovery underway, but economic and political risks remain high

Since last year's EuroMemorandum the recovery in the euro area and the EU has strengthened and broadened substantially. The European Commission, in its latest autumn 2017 economic forecast, expects GDP growth in the euro area to reach 2.2% in 2017 and 2.1% in 2018, which is a cumulative increase of 1.1 percentage points as against the autumn 2016 forecast. The unemployment rate for the euro area is expected to decrease to 8.5% in 2018 as against 9.2% in the autumn 2016 forecast but, even with a further decline, is still expected to be 7.9% in 2019. The growth and employment forecasts for many of the euro area's crisis countries – with the shocking exception of Greece – have been raised considerably. Inflation is picking up; however, core inflation is still expected to be quite moderate, at not much above 1%. Although far from being satisfactory – and far from making up for the catastrophic economic, social and political damage since the onset of the crisis – the economic situation in the euro area and the EU is undoubtedly improving.

Tailwinds from external demand apart, most of the improvement over the last few years can clearly be attributed to the timid but nevertheless noticeable shift of official EU economic policies away from strict austerity and towards providing more leeway for member states' fiscal policies accompanied by the European Central Bank's (ECB) extremely expansionary monetary policy stance, which led to a recovery of domestic demand. In terms of political developments, another small, but undeniable improvement consists in the fact that the European Commission has abstained from calling for more restrictive fiscal policies and is somewhat unusually calling for higher wage growth in order to support the recovery. Additionally, both the president of the EU Commission Jean-Claude Juncker calling for a European Monetary Fund and a European finance minister in his state of the union address as well as French president Emmanuel Macron calling for a fiscal capacity at the European level have started initiatives for institutional reforms that ostensibly improve the euro area's macroeconomic framework.

Whereas those positive signs must be acknowledged, the downsides consisting of high economic and political risks should not be overlooked. Even though the risk of an imminent downswing has decreased, the macroeconomic situation is far from stable. The geopolitical situation carries large risks of a decrease in global demand growth and therefore in external demand for the EU. The failure to reregulate the global financial system, in combination with bubbles fed by policies of extreme monetary expansion, have increased the risk of new financial crises. At the same time the attempt to withdraw monetary stimulus by the ECB may pose new risks for member states' public finances and/or the recovery, particularly in the crisis-ridden countries of the periphery. Furthermore, the problem of the current account imbalances has not been properly addressed. The notorious surplus countries – most importantly Germany – have not initiated any rebalancing, while the rebalancing of the former deficit countries may prove to be short-lived as it is mainly caused by lower import growth in the wake of the crisis. The very high current account surplus of the euro area as a whole and the associated global economic imbalances are unlikely to persist.

In terms of political developments, it must be stressed that the small progress with respect to less restrictive fiscal policies has been the outcome of a highly pathological learning process, which may very well be reversed in the case of a new economic crisis with deteriorating government finances. Prospects for developing a fiscal capacity at the euro area level and the outlook for a really beneficial solution are quite bleak. It is very unlikely that Germany or other countries with similarly ill-informed macroeconomic ideas would accept any real progress in terms of macroeconomic stabilisation through – even temporary – fiscal transfers without strict conditionality and serious restrictions on national fiscal and economic policies. Jean-Claude Juncker's formulation in his State of the Union address is quite telling in this respect as 'a European Minister that promotes and supports structural reforms in our member states' may also be interpreted as a permanent institutionalisation of something very similar to the Troika at the European level in order to force member states into adopting further neoliberal policies of deregulating the labour markets and dismantling the welfare state in exchange for some short-term financial transfers.

Alternative macroeconomic policies

Macroeconomic policy in the EU obviously needs a different approach that will both support a stronger and self-sustaining recovery in the short-run as well as securing full employment and equitable growth and, in the long-run, promoting an even development, curing the persistent macroeconomic imbalances. A convincing alternative requires at least five important changes.

1. The replacement of balanced budget requirements by a balanced economy requirement including the objective of high and sustainable levels of employment, and fiscal policy used as one key instrument to aid the achievement of that objective both in the short- and the long-run. One important aspect of the necessary reforms of the fiscal framework should be the introduction of the distinction between current government spending and investment spending where the latter should be debt-financed. In the short-run the substantial unused leeway within the existing framework (e.g. alternative method of cyclical adjustment) should be actively used to achieve a positive fiscal stimulus for several years to strengthen and broaden the recovery. Co-ordinated reflation rather than general austerity must become the policy. It is important that the European Central Bank (together with, for non-euro area countries, the national central banks) gives its full support to fiscal policies for prosperity and abandons its continuous calls for fiscal consolidation.

2. Although increasing the leeway for national fiscal policies is of key importance, in the medium- to long run a stronger role for fiscal policy at the European level is also important. A substantial EU-level budget should be used in order to finance EU-wide investment as well as public goods and services, and to establish a counter-cyclical European-level fiscal policy so as to support national fiscal policies. A federal-level budget with substantial tax raising powers and an ability to run deficits and surpluses has long been recognized as a necessary complement to a single currency. Federal fiscal policy can be used to cushion economic downturns and would provide for fiscal transfers between the richer regions and the poorer regions. At present the EU budget is around

1% of EU GDP and it has to be balanced. To have an impact for stabilisation purposes the budget would have to be substantially increased (to at least 5% of EU GDP), to be capable of running deficits or surpluses as required by economic conditions and designed in a progressive manner. Federal-level taxation and public expenditure would replace some parts of national taxation and expenditure. The construction of federal fiscal policy is a long-term project, and would bring further elements of de facto political union. It is, however, a project which would be necessary for the successful functioning of a single currency. Tendencies to misuse an EU 'fiscal capacity' to further weaken and constrain national fiscal policies and/or implement neoliberal structural reforms must be resisted.

3. A long-run European investment strategy is required to promote public investment and support private investment in key economic, social and environmental areas and to develop productivity growth through strategic industrial policies in the periphery. These policies are required to rebuild productive capacity and to improve the competitiveness of the deficit countries. The regional and structural policies of the European Union should be strengthened and expanded, and a new industrial policy based on a major programme of public and private investment is required. These structural and industrial policies should be particularly geared towards making manufacturing, transport and energy systems more ecologically sustainable. Programmes from the European Union to support private investment in the deficit countries (and more generally in EU states with comparatively lower levels of income) are also required. These policies would facilitate the reduction of current account deficits without resorting to deflation.

4. The current deflationary strategy of competitive devaluation should be ended and replaced with a policy of wage growth that ensures both a fair participation of workers in national income growth and stable inflation. As a rule of thumb, national wages should on average grow at the rate of average productivity growth plus the ECB's target inflation rate. However, as there had been a general widening of the disparity in current account positions prior to the financial crisis and increasing deficits in many member countries of the Economic and Monetary Union (EMU), some deviations from this general rule, above all in the surplus countries will be necessary. Starting from the mutual recognition that surplus countries have as much responsibility as the deficit countries to resolve the imbalances, surplus countries can aid that resolution through intensified policies of internal reflation. This will help expand export demand for the deficit countries and, through faster wage increases in the surplus countries, reduce their excessive export competitiveness.

5. Effective measures against tax competition should be implemented. Whereas national leeway for progressive and equitable taxation is still given, in the long-run international tax competition erodes the revenue side of the public budget. Tax competition creates a huge injustice whereby large sections of the population cannot avoid being taxed, while big corporations and wealthy individuals enjoy ample opportunities for tax avoidance and evasion; furthermore, tax competition erodes the willingness to pay taxes and therefore to finance the welfare state and social solidarity. EU measures to limit tax evasion should therefore be considerably reinforced. At the same time there is a need for tax harmonisation, at least for taxes on corporate profits and capital income, the internationally most mobile parts of the tax base. A common tax base for corporation tax should be accompanied by minimum tax rates that could be differentiated for pre- and post-2004 member states. Alternatively, a uniform corporate profits tax could be introduced in order to provide tax revenue for the EU budget; in the context of a

currency union with labour and capital mobility, this would help to address the bidding down of corporate tax rates between countries and limit the use of corporate tax rates to attract inward investment at the expense of other member countries. Another key instrument for EU tax policies is a financial transaction tax applied in all the member states, which could serve to diminish the scale of financial markets.

2 Monetary and financial policies: mounting problems

In the absence of effective coordination across other policy areas – above all, budgetary policy – the monetary and financial systems within the EU and especially the euro area face growing problems: quantitative easing and the other exceptional measures taken by the European Central Bank (ECB) are becoming less effective and failing to bring about serious and sustained reductions in unemployment; banks and other financial corporations are trying to dilute or eliminate many of the new regulations put in place since the global financial crisis; a creeping process of dollarisation can be detected in the euro area which is starting to threaten the zone's autonomy; the Brexit process has undermined the proposed capital markets union and is disorganising European finance; and the refusal of EU leaders to establish effective risk-sharing across member states has led to an acute shortage of safe assets which has impaired credit markets.

Limits of quantitative easing

Although the accommodating policies of the ECB have, to a limited extent, compensated for continuing restrictive budgetary policies across the EU, there are many signs that they are reaching their limits and even becoming in some ways dysfunctional. The rules governing asset purchases by the ECB tend to weaken their impact. For example, purchases of government bonds are required to be in proportion to the economic weight of the country – this means that there must be large-scale purchases of German bonds which already command premium prices while the support received by weaker economies is reduced. More generally, very low, sometimes negative, interest rates tend to promote speculation and asset price bubbles. There are also signs that the very low yields on safe assets are causing difficulties for pension funds and insurance companies.

It was announced on the 26 October 2017 that the ECB would halve its monthly purchases of securities to €30 billion per month from the beginning of 2018. This is supposed to signal optimism about the prospects for growth and inflation in the euro area. However, the markets remain dependent for their stability on the provision of cheap money in the US, and much of this intermediated through London. This credit flow may not survive the 'normalisation' of interest rates in the United States to significantly higher levels, and reduced access to the London markets as a result of Brexit. At that point the projects of a Banking Union and a Capital Market Union based on common regulation will be endangered in the absence of a genuinely integrated system of liquidity provision in Europe.

Both historical evidence and theoretical considerations suggest that both bank-based and security-market financial systems are more efficient and more stable when there is an adequate supply of safe public sector bonds. Yet the supply of such assets is being deliberately curtailed – by the *Schuldenbremse* (debt-brake) in Germany and 'austerity' across the EU, by the refusal to permit the European Commission or EU agencies such as the European Investment Bank (EIB) to borrow on a significant scale, and by the ECB's acceptance, as a matter of policy, of higher interest rates, signalling higher degrees of risk, on the debt of other member state governments.

Dollarisation

One consequence of this state of affairs is a chronic shortage of collateral which is impairing the functioning of EU credit markets and which led to massive disturbances in repo transactions at the end of 2016. Credit flows among banks and other financial corporations depend on the ability of borrowers to post collateral against the risk of default, and safe claims on stable governments are the most efficient form of such collateral as they do not require the detailed assessment of their value and status which is needed before private sector assets are used to back borrowing. When there is a shortage of good collateral the entire credit system is impaired.

A related development is a certain dollarisation within the euro area. This process at present only affects certain monetary functions and only to a partial extent. However, the process seems likely to continue because euro area banks are maintaining and even expanding their investments in the US and if it starts to impact other aspects of the monetary and financial system it will tend to constrain the autonomous determination of macroeconomic policy within the euro area. Prior to monetary union there were several occasions on which US policies seriously destabilised policy formation in European countries. The most obvious example is the drastic tightening of US policy in 1979-81, to which European governments found it impossible not to respond. One of the original goals of monetary union was to reinforce the autonomy of EU policy by challenging the 'exorbitant privilege' of the dollar. However, the failure to build a coherent and stable financial system in the EU may put autonomy at risk.

The global crisis in 2007-08 opened up an asymmetric advantage for the dollar in foreign exchange transactions in that agents borrowing dollars against euros have to pay a premium (the 'basis spread') over the interest rates prevailing in US credit markets. Although the premium is now much lower than during the crisis it persists and shows no signs of disappearing. In spite of the additional cost of acquiring dollars, dollars have become the most prevalent form of collateral offered on euro credit markets. The lack of sufficient euro-denominated collateral assets may be one factor behind this. A second monetary function subject to dollarisation is funding. Because of the basis spread, it is now increasingly the practice for investors outside the euro area aiming to purchase euro area assets to fund their purchases not with euro loans but by borrowing dollars and swapping them into euros.

European banks do not seem to have reduced their exposure to the US economy substantially since the crisis. They retain very high amounts of dollar-denominated assets which tie them into the US financial system. The Federal Reserve, central bank of the US, extends credit to the ECB, almost as though it was a branch office, in order to manage the dollar liquidity of the euro area banks. There could result over time a loss of control over liquidity within the euro banking system.

Pressure for deregulation

Following the financial crisis, the European Parliament and the Council enacted a large body of regulation in order to stabilise the financial system and prevent the abuses which had characterised many banks and financial corporations (such as Credit Suisse, HSBC and Deutsche Bank which were penalised for repeated violations of the criminal law). However, the new regulatory structures are threatened in several ways. There has been strong resistance from the financial sector to some reforms, such as the proposed separation of retail banking and security trading within banks, which has now been abandoned in the face of ferocious lobbying. National governments have been reluctant to implement some of the measures. In particular, the new French president, Emmanuel Macron, is only prepared to introduce the Financial Transactions Tax in a token form, which would generate hardly any revenue and would have little impact on the conduct of financial corporations. In addition the Trump presidency in the US may bring a substantial deregulation of banks and financial markets and reduce or nullify the Dodd-Frank reforms. This would threaten the EU with 'regulatory arbitrage' as activities and transactions are moved to the less regulated jurisdiction.

The drive to promote financial integration in the EU has, in recent decades, been based on a misunderstanding of US experience. The scale and liquidity of dollar-based finance have been interpreted by European political leaders as an essentially market-based phenomenon, ignoring the critical role played by public finance in the functioning of the financial system and the key role of US government bonds, as a globally recognised store of value. This over-estimation of market processes has prevented effective measures towards a coherent, unified financial system.

Brexit represents a big move back from integration. This is most obviously the case for security markets where the City of London occupied a central position, both linking buyers and sellers and clearing and settling their transactions. It is doubtful that the Capital Markets Union project will make much progress if Brexit actually takes place. London is also the most important node in the EU's networks of banking relationships, although Britain does not participate in the Banking Union. The Banking Union itself is still not working correctly as the persistent problem of bad debts in the Italian banks illustrates. It is not yet clear to what extent financial corporations will reduce their presence in London and move to centres on the continent, although some moves are already taking place and more are threatened. Brexit may well lead to increased competition between financial centres in Europe with a race to the bottom with respect to regulation. Recent statements by the French president Macron go in this direction. A new cycle of financial deregulation could also take place at the international level, boosted by the decision of the Trump administration to dismantle the Dodd-Frank act.

The danger must be that, in the absence of a strongly integrated and regulated financial system, the penetration of the EU by dollar-based finance will accelerate, tying each member state into reliance on US corporations for an increasing range of financial functions and rendering Europe as a whole increasingly dependent on US institutions and increasingly constrained by US policies.

The need for a greater use of public financing

Besides the question of regulation, the key problem in financial integration in Europe comes from the absence of a powerful public investment programme, addressing the disparities in economic performance in the EU, the need for effective environmental protection and the employment crisis for young people in Europe. Although EU elites claim that such a programme would lead to financial problems, the reverse is the case.

In 'free market' dogma public borrowing is always at the expense of finance for private sector investment. Of course, if weak governments, with limited ability to levy taxes, adopt reckless spending programmes in the context of inflationary pressures they can most certainly undermine private sector investment. But in advanced economies, where governments are seen as strong and central banks guarantee government debt, public and private finance become complementary. Holdings of government bonds stabilise the financial situation of banks and institutional investors and thus the economy as a whole. Such government debt is useful in many ways, for example to make the financial system more liquid and to facilitate the valuation of private sector securities. Thus the large-scale issue of safe claims on the public sector would strengthen and stabilise the EU's financial system and give Europe greater autonomy in the formulation of its economic policies.

3 Inequality and social crisis

The EuroMemo Group has been consistently critical of the secular trend towards increasing inequality in Europe and, in particular, of the policies that have either encouraged or tolerated that trend in the name of supply-side and 'trickle-down' economics. Almost four decades of deregulation and privatisation have seen marked shifts in the distribution of income and wealth in European and other advanced economies within the Organisation for Economic Co-operation and Development (OECD) at the expense of wage- and salary-earners and of the non-working population, and to the advantage, above all, of incorporated, globally active enterprises. This process was underpinned by a paradigm shift in mainstream economic thinking and supported intellectually by key institutions of global economic management, like the International Monetary Fund (IMF) and the World Bank, and by major research bodies like the OECD and the think-tanks associated with the major central banks, finance ministries and policy-makers within the European Union. The annual EuroMemorandum Reports pointed repeatedly to both the social injustice of rising inequality and, above all, to its negative economic effect on key factors of domestic demand in advanced economies and on their patterns of development, innovation and modernisation.

The trend towards greater levels of inequality has been undeniable and dramatic. Both the personal distribution of income, measured by the Gini Coefficient, and the functional distribution of income – the overall labour share of national income – have seen marked shifts away from the majority of citizens dependent on wages and salaries towards those who derive their income from capital. The average labour share of national income has fallen by around 10 percentage points in Europe by most measurements since the end of the 1970s, a trend that has been discernible for a long time.

What is new in the debate surrounding inequality, economic development and social exclusion is that practically all the institutions of the neoliberal consensus (IMF, World Bank, OECD) are now saying that rising inequality *does* have a negative effect on growth and development! This is clearly linked with the impact of the Financial Crisis of 2008 and the ensuing slump and with the failure of these institutions to predict the crisis and account for its scale and its extent. In a remarkable joint report by the IMF, World Bank, OECD and International Labour Organization (ILO) from 2015, commissioned by the G20, the 'negative impact on growth' of inequality is conceded explicitly: it 'occurs through various channels, including lowering consumption, under-investment by firms in the face of slack demand, less government revenue and less investment by low-income households in education and skills'.[1]

We should certainly applaud this radical shift in analysis by OECD, IMF and International Bank for Reconstruction and Development (IBRD) and their preparedness to make joint cause with the ILO. We can also welcome the degree to which the OECD is prepared to adopt the language of pioneers of egalitarian politics like Wilkinson and Pickett in their ground-breaking study, *The Spirit Level – Why More Equal Societies Almost Always Do Better*[2]; the OECD used almost identical rhetoric for the title of its 2015 study: *In it Together: Why Less Inequality Benefits All*! But, it has come very late in the day and after decades of evidence indicating that policy choices, political neglect and the stubborn rejection of alternative economic policies have been co-responsible for the social and economic damage of inequality. In particular, the unreflecting, pro-cyclical persistence with budgetary austerity has not simply stunted recovery but left irreversible scars on wide sections of the population of the world's richest region. Youth unemployment in the EU remains stubbornly high at 18.6%, with 11 member states still over 20% and Greece and Spain at catastrophic levels (47.3% and 44.4% respectively)[3]. Joblessness for school-leavers, skilled trainees and graduates has been a major factor in high levels of intra-EU labour migration from southern and eastern peripheries to the richer member states in the North-West. These major demographic shifts have been reinforced by marked levels of severe material deprivation (7.5% of the EU28 population or 38 million people)[4]. Increased levels of financial insecurity and growing numbers of homeless in all EU states, apart from Finland, have left levels of people 'at risk of poverty' virtually unchanged since 2008 with currently 23.8% of the population in that category. At a time when the poor and vulnerable needed extra support, austerity programmes were introduced. This was compounded by the very limited savings of poorer households and access to formal financial institutions to tide them over during the crisis. According to EU data, 7% of all adults in the EU15 and 34% of adults in the new member countries, a total of 30 million people, have no access to financial services and could therefore be considered as financially excluded. Moreover, those living below the EU poverty line of 60% of median income were twice as likely (22%) to have no bank account compared with those living above the poverty threshold (9.5%).[5] The poor have to resort to family and friends as well as loan sharks and pay-day lenders to finance their needs, whilst banks and financial institutions were rescued from bankruptcy at great cost to tax payers.

To its credit, the European Union has sought to embed a social dimension into its policy mix with the operation of its Social Fund, of its Cohesion Funds, with ambitious programmes of social 'investment' and, more recently, with the European Pillar of Social Rights, *Youth on the Move* and the *Youth Guarantee*. It has also committed itself to a core target of reducing the

[1] ILO, IMF, World Bank Group, OECD (2015) *Income inequality and labour income share in G20 countries: Trends, Impacts and Causes*.

[2] Wilkinson, R. & Pickett, K (2009) *The Spirit Level: Why More Equal Societies Almost Always Do Better*, London: Allen Lane.

[3] Eurostat (2016): Code: tesem140.

[4] Bulgaria (31.9%), Greece (22.4%) and Romania (23.8%) are dramatic examples of this critical indicator of poverty and exclusion.

[5] This is based on the three indicators of no bank account, no access to revolving credit and savings products. EU (2010) *Financial Exclusion in the EU. New evidence from the EU-SILC social module.* Research Note 3/2010. Table 1, p. 6.

number of people at risk of poverty within the EU by 20 million by 2020. However, it is extremely unlikely that this target will be achieved, for several reasons.

- In contrast to the deficit and debt targets of the Stability and Growth Pact, the EU will not sanction member states for failing to achieve such social targets.
- The EU has no benchmark minimum for social expenditure as a proportion of total state expenditure; the disparities are huge: the newer member states (post 2004) commit an average of 32.1% of total state expenditure to social welfare against the older EU-15 group of 39.8%, despite the fact that poverty and material deprivation are more evident in most new member states.
- While the EU imposes arbitrary limits on public deficits and debt, it has no benchmark minimum for 'fiscal viability', i.e. levels of state revenue that are sufficient to protect the population from economic shocks and to sustain progressive improvements to their productivity and welfare. Tax revenue ratios differ widely within the EU28, from 44.6% of GDP for the Scandinavian group of states to under 30% for Romania, Bulgaria, Latvia and Lithuania.
- The potential to improve social welfare and to reduce inequalities is further weakened by the EU's toleration of flat tax regimes in a majority of new member states and their disproportionate reliance for public revenue on indirect taxes placed on consumption . Indirect taxes tend to be regressive, because poorer households spend a greater proportion of their income on consumption.
- EU employment- and social policy remains biased towards promoting the integration of people of working age into (lightly regulated) jobs markets; the Commission acknowledges the trend towards increasingly precarious forms of employment like 'zero hours contracts' and the 'platform' economy, but has failed to halt the steady progress of casualisation and the emergence of an underclass of 'working poor', permanently reliant on welfare support.

The European Pillar of Social Rights contains many admirable ambitions but, in the absence of a strong regulatory framework of employment law, of minimum harmonised standards of taxation and strong incentives for poorer member states to improve social protection, the prospects for reducing inequalities, social exclusion and the scarring effects of poverty within otherwise affluent societies, are poor.

To transform the life chances of all EU citizens and their migrant communities, it is essential to establish a new framework of law and behaviour for all member states, in line with the historical recommendations of the EuroMemo Group over the past two decades.

- The welfare of all people in all member states must be placed at the centre of public policy and not subordinated to the primacy of market-driven growth or, worse, budgetary consolidation;
- Accordingly, the maintenance and improvement of social protection should be ensured by agreed benchmarks of fiscal viability (adequacy of revenue) and social needs;
- Flat tax regimes must be abolished in favour of harmonised levels of progressive taxation of private and corporate income;
- The wide disparities of economic and social performance among the EU28 must be tackled with a generously resourced system of financial transfers from richer to poorer

member states and regions; however, a condition for welfare-enhancing financial transfers must be that the states concerned commit themselves to minimum standards of taxation and social levies;

- In the short term, shared EU resources should also be utilised to provide additional support for receiving and integrating Europe's sizeable refugee community;
- Central importance must be given to the narrowing of income and wealth disparities within and between member states;
- Social investment programmes should contain commitments to both intergenerational equity and to ensuring environmental sustainability;
- A shared commitment to a European Pillar of Social Rights should be accompanied by equitable incentives, compliance-monitoring and sanctions in the case of non-compliance or, worse, social dumping; accordingly, citizens and other residents should enjoy an effective right to invoke social rights in law.

Income and wealth inequalities have worsened in Europe over the last twenty years; also, the Baltic states, Britain and Ireland and the whole southern periphery have even higher disparities of income and wealth than the rest of the EU. Inequalities have been made worse by ruinous policies of austerity and have in turn generated resentment and distrust along with a resurgence of right-wing nationalism. Reversing the forces of fragmentation must involve the implementation of courageous and imaginative programmes of redistribution both at the level of market incomes, with the restoration of secure employment relations, statutory minimum wages and tight controls of abusive exploitation of casual labour, and at the level of the political redistribution of national income via taxation and social levies by public authorities. The rhetoric of social rights must become the real practice of social investment, based in a strengthened spirit of international solidarity. Failure of the social investment project threatens the future of the European project as a whole. Moreover, the far-reaching and structural ruptures of employment patterns, growth trajectories and the global division of labour arguably necessitate at least two more radical policy shifts: firstly, the move towards decoupling socio-economic security and employment, and secondly, exploding the dangerous myths of trickle-down economic models, even if the Trump administration is embarking on a further reckless bout of supply-side tax reforms and the associated danger of even greater levels of social inequality.

4 The EU in a fragmenting international order

During the past few months, several events had a major impact on the European stage, and in particular the political and geopolitical scene. To mention just a few of the most prominent developments, there have been the parliamentary elections in France, Germany and the Netherlands, the beginning of the Brexit negotiations, as well as the Catalan referendum. In the midst of all this, Donald Trump, the incumbent US president, has hit the headlines by applauding an anticipated break-up of the EU which he sees as a vehicle for Germany.[6] He rejects the US commitment to free trade and favours a return to protectionism. Lastly, he has announced his intention to tighten US relations with Russia, to

[6] Sifakis, C. (2017), 'Broken United States – European Union Consensus', Paper presented at the 23rd Conference on Alternative Economic Policy in Europe, Athens, http://www2.euromemorandum.eu/uploads/sifakis_euromemo_conference_paper.pdf.

increase US military expenditures and calls for a larger European contribution to the financing of NATO.

The Trump administration's policy marks the EU's entry into a zone of turbulence and constitutes a major challenge to European construction. However, the EU has limited means to rise to the challenge.

The anti-EU position of the US threatens the EU's stability

Trump's positions regarding the EU do not indicate a basic departure from US objectives in European politics. The new president in his idiosyncratic manner expresses his vision of the EU and his notion of American policy for Europe which are not that different from the previous administration.[7] Under the Obama presidency, US hostility was muted whereas under the incumbent it is stated loud and clear and constitutes a major challenge for the EU.

The US challenge to the EU is the consequence of the mutations which have impacted the world order since the demise of the Soviet Union. These include the questioning of the exclusive US global dominance with the emergence of new powers, in particular China, and the strengthening of German power to which the European monetary unification powerfully contributed.

US hostility to the EU weakens the European edifice. The first reason is that the US influence in Europe remains very strong. This is conveyed through various channels: financial, military and monetary, among others. EU countries are dependent on the US notably in defence. US military power linked to a hostile foreign policy towards Russia is particularly attractive for Eastern European countries. This reinforces the negative impact of the US strategic and geopolitical priorities on the EU's stability.

The second reason is that US hostility to the EU manifests itself at an inconvenient time for the EU, which faces increasing disgruntlement about its functioning[8] as well as three major crises which have not yet been solved. The US has, as a matter of fact, contributed to the outbreak out of at least two out of three major EU crises: the refugee crisis in the Mediterranean Sea and the crisis in the Ukraine.

Last but not least, the persistence of structural failures in the institutional framework of the European currency union leaves it open to the risk of a new crisis: the European banking union is long overdue and the umbilical cord between the Italian government and banks has still not been cut.

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[7] Sifakis, C. (2017).

[8] Patomäki, H. (2017), 'Four Scenarios about the Future of the European Union', Paper presented at the 23rd Conference on Alternative Economic Policy in Europe, Athens, http://www2.euromemorandum.eu/uploads/patomaeki_four_scenarios_about_the_future_of_the_eu.pdf; Tolios, Y. (2017), 'Strategy of equal cooperation as a response by peripheral members of the EU to the 'globalization' and 'European integration' process', Paper presented at the 23rd Conference on Alternative Economic Policy in Europe, Athens, http://www2.euromemorandum.eu/uploads/tolios_strategy_of_equal_cooperation_as_a_response_by_peripheral_members_of_the_eu_to_the_globalization_and_european_integration_process.pdf; Giannone, C. (2017), 'The EMU in 2017: Too Large for a New Start? A Collective Action Approach', Paper presented at the 23rd Conference on Alternative Economic Policy in Europe, Athens, http://www2.euromemorandum.eu/uploads/giannone_the_emu27_too_large_to_have_a_future_notes_for_a_positive_approach.pdf.

The new US administration intends to implement a new economic policy, which represents another challenge for the EU. The awakening of protectionism advocated by Trump, if confirmed, would mark a profound chasm in the liberal world order and this would threaten the EU's global position. It would also force the EU – and this is particularly true for Germany – into some painful reconsiderations.

The return of the most powerful nation to protectionism would most certainly inspire others to follow suit. To reconsider the free market would undermine the globalisation of production, already slowing, and this in turn would favour a reconsideration of global finance – a major lever for US influence in the world – that Trump wishes to foster through his project of financial liberalisation.

The EU is fully compliant with the liberal world order put in place by the US in the wake of World War II. The European and especially the German economy are amongst the most open in the world. Faced with the saturation of the European market and the slow progression of market opportunities in North America, German companies are looking towards third country markets and particularly China.

A revised US foreign policy – if confirmed – would have equivocal effects. A rapprochement with Russia would open new possibilities for European economies. It would also soften the divide between East European countries and the other EU states regarding relations with Russia. But it would turn European defence policy on its head together with the system of alliances with the US. Finally, a new era of tension which recent US politics seem to herald, particularly in the Middle East, would constitute a destabilising factor in neighbouring European countries; also it and would jeopardise further globalisation should it affect China in one way or another.

How the EU intends to rise to the challenge

Trump's statements are an embarrassment to the EU. European reactions are marked by a desire for appeasement (regarding the US demand of an increased European contribution to NATO's financing) and an effort to depart from the most aggressive positions of the new US administration (questioning the Treaty with Iran). EU reactions also aim to uphold a certain image of the Union, that of a bastion of liberal order which is threatened by Trump. The policy of trade liberalization is continued and even accelerated: the conclusion of an agreement in principle with Japan, the upcoming signature of free trade agreements (with Mexico, Mercosur and Vietnam) and the provisional implementation of the Comprehensive Economic and Trade Agreement with Canada (CETA) since September 2017. Still, Europe is not without its own protectionist appetite. Macron is in favour of a Buy European Act. France, Germany and Italy have called for European legislation – rejected by the Council – which would allow the blocking of foreign investment in strategic companies.

The US challenge has undoubtedly influenced the development of the Commission's White Paper on the Future of Europe as well as Macron's proposal to 'refound Europe'.

The three largest European states are in favour of a 'multi-speed' Europe which would enable a coalition of willing countries in fields where at present a decision needs to be taken unanimously. As things stand, it reinforces divisions between the 'core' and East European countries and makes more distant the prospect of a more integrated Europe.

Recommendations

In today's emerging multipolar world, Europe should continue its distancing from the US foreign policy that it demonstrated during the recent Iran nuclear deal crisis, particularly regarding relations with Russia.

The increase of US military expenditure decided by Trump as well as the preservation of a hotbed of tensions in the European neighbourhood (Ukraine, the Middle East) constitute important challenges for the European authorities.

The EU member states should not take the path of the arms race. This choice would represent a high-risk headlong rush. Besides, the increase in military expenditure would certainly not help Europe exit from the multifaceted crisis with which it is confronted. Instead, they should use their resources to contribute to development of their Eastern and Southern neighbours, which is the best way for securing the Union's borders and curbing the flow of refugees.

EU external relations and the Iran Nuclear Agreement of 2015
It is no exaggeration that the 2015 Iran nuclear deal or Joint Comprehensive Plan of Action (JCPOA) which was signed by seven countries (Germany, Britain, France, Russia, China, US and Japan) and endorsed by the UN Security Council (resolution 2231) and was later enacted into law by the European Council, is a flagship EU external relations success of recent decades. It saved the Middle East from the threat of yet another destructive war and curtailed the nuclear ambitions of Iran. In the process it boosted the politically reformist and socially moderate factions of the ruling elite in Iran. The great majority of Iranians also support the JCPOA, which contributed to the re-election of President Rouhani. The EU played a critical and decisive role in securing this deal, yet all these achievements seem under threat following the election of President Trump and from continuing bellicose pronouncements about the anti-nuclear deal by the Israeli Right and some Arab states, most notably Saudi Arabia. Since the signing of the JCPOA, Iran's nuclear facilities have been subjected to the most stringent surveillance, monitoring and verification rules in the world. The International Atomic Energy Agency, which is mandated by the UN to regularly monitor Iranian compliance with the JCPOA, has declared that Iran is compliant. Yet, in October 2017 President Trump refused to certify the verification of JCPOA and has referred the matter to the US Congress with a view to decertifying and imposing further sanctions on Iran. The fate of the JCPOA hangs in the balance, because any new US sanctions, especially on trade and financial links with Iran by any company with interests in the US, would undermine the grand bargain of removing sanctions under the JCPOA for the curtailment and monitoring of Iran's nuclear programmes. Iran's response to President Trump's action has been to declare that they would stand by the JCPOA so long as the other signatories, in particular the EU, continued to support it. Most EU countries have now re-engaged, re-built and expanded their economic and political links with Iran. It is imperative that the EU continues its policy of re-engagement with Iran in relation to the JCPOA, and in support of reducing tension in the region, policies that the Iranian people support.

5 Alternative visions for socio-ecological transformation

The planet's boundaries are being approached at speed on numerous fronts, including climate change, the depletion of natural resources, the threat to biodiversity, soil degradation, and ocean pollution.[9] These changes are often irreversible within human timescales, and urgent if the planetary limits are not to be exhausted soon. The vital nature and urgency of the threats at stake fundamentally affects the nature of the responses required. A range of alternative visions and proposals argues that a major socio-ecological transformation is necessary in most of the world, both to remain within the boundaries and have good quality lives for all.

Approaching the planetary boundaries

There are increasing signs from the scientific research that a temperature increase of 2°C may well lead to very dangerous climate change, with a significant chance of some tipping points being passed, with, for instance, a rise of several metres in the sea level.[10] Using the emissions remaining in the global 'carbon budget', a drastic reduction in human-caused emissions from 2020 in a straight line to zero would give just 4 further years to stay below 1.5˚ (66% chance or greater); for 2˚ the figure is 34 years.[11] The Paris conference assumed enormous negative emissions during this century to extend the time available, through sucking several billion tonnes of CO_2 out of the atmosphere each year, but a number of scientists argue that there is no evidence that this will work at scale and that it would be foolish to depend on it.[12]

To avoid crossing the threshold in any of these cases would involve a dramatic change in how the society and economy operate. Some have argued that a shift to a service or a knowledge economy will make it possible to keep within those temperature thresholds, but this is strongly contested by others who point out inter alia that those rich countries with the greatest proportion of services have the highest emissions.[13]

The apparent slight reductions of carbon emissions in the rich countries from 1990 to the financial crisis in 2007, were in reality due to offshoring high-emitting industrial processes to low cost countries. The carbon footprint – a consumption perspective – indicates a significant increase in emissions over that period, including for the EU. Emissions declined considerably in these countries since the beginning of the economic crisis, though in the EU they have been static for the last four years.[14]

Biodiversity is essential for many of the features in nature on which humans depend. 40% of monitored species are under threat of extinction, and the rate of extinction is forecast to

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[9] Steffen, W. et al (2017), 'Planetary boundaries: Guiding human development on a changing planet', *Science*, 13 February 2015; 'World Scientists' Warning to Humanity: A Second Notice', *BioScience* 13, November 2017.
[10] Hansen, J. et al (2016), 'Ice melt, sea level rise and superstorms', *Atmospheric Chemistry and Physics*.
[11] Intergovernmental Panel on Climate Change (IPCC), *Climate Change 2014: Synthesis Report*, table 2.2. A recent paper by leading scientists in the field argues that for 1.5˚ there could be as much as 12 years (R. Millar et al, 2017); these findings are still under scientific debate.
[12] E.g. Anderson, K. and Peters, G. (2016), 'The trouble with negative emissions', *Science*, 14 October.
[13] Gadrey, J. (2008), 'La crise écologique exige une révolution de l'économie des services', *Dévelopment durables et des territoires*.
[14] Pan, C. et al (2017), 'Emissions embodied in global trade have plateaued due to structural changes in China', *Earth's Future*, 28 September, Fig. 1. Peters, G., Andrew, R. and Korsbakken, J. (2017), 'Global CO2 Emissions likely to rise in 2017', *CICERO*, 17 November.

increase by a factor of 10 this century. Further, at current rates of soil degradation, all of the world's topsoil could be gone within 60 years, according to the UN Food and Agriculture Organization, and with it the world's harvests too. Industrial-style farming is the main factor responsible in both cases, according to the UN.[15]

Alternative visions of change

Green growth has been promoted in concert by the Organisation for Economic Co-operation and Development (OECD), the World Bank and the UN Environment Programme from 2011-12, and taken up by the UN climate negotiations. Central to this is an 'absolute decoupling' of growth in GDP from carbon emissions and resource use, both of which would decline. It is to be achieved through technological innovation and low carbon investments, 'getting the prices right' including for carbon emissions (via emissions trading and taxes), and bringing nature into the market economy. Private finance would play a major role.

A second approach is a *Green New Deal*, emphasising in particular an investment and often employment stimulus that would also address key elements of the environmental crisis. Such proposals include, at the European level, that of the European Greens/EFA European Parliamentary group (2009), and at the national level, that of the Green New Deal Group of progressive economists in Britain.[16]

In contrast to the green growth approach, a range of alternative visions shares a fundamental perspective of questioning what they see as the obsession with growth in public policy and in most economics, and finding alternatives which are ecologically sustainable; for many this should also lead to a good quality of life for all. These include 'the steady-state economy', 'prosperity without growth', and 'degrowth', as well as the 'post-development' approach in non-OECD countries. Many are referring to growth of GDP in this context; others focus on the growth in throughput of materials and natural resources or on the promotion of 'human prosperity', while leaving the question of GDP growth open, though typically arguing that it would need to be very low indeed.

These approaches share the idea that the ecological and social developments are basic features of high-consumption capitalism and the extension of this to much of the world through the export of Western elite lifestyles. Linked to this on the production side are what is seen as an increasingly strong extractivist approach to the countries of the Global South, in natural resources and industrialised export agriculture, with low prices but many costs being externalised onto others and the environment. Others raise the extreme division of production, with global value chains often ending up as 'global poverty chains', accompanied by a great accumulation of wealth in a small number of hands.[17] Inequality is central to most contributions and is seen as both a consequence and cause of these developments.

'Prosperity without growth' is advocated by Tim Jackson, among others. In a broadly similar direction, Thomas Coutrot and Jean Gadrey argue for a trajectory based on increasing quality (of products, services and of life) and sustainability, as opposed to a predominantly

[15] Arsenault, C. (Reuters) (2014), 'Only 60 years of farming left if soil degradation continues', 6 December; FAO (2015), *Status of the World's Soil Resources*, December, p.XIX. UN Convention on Biological Diversity (2014), *Global Diversity Outlook 4*, p. 10.

[16] European Greens (2017), *Green New Deal,* https://europeangreens.eu/content/green-new-deal; New Economics Foundation (2008), *A Green New Deal*.

[17] Selwyn, B. (2016), 'Global Value Chains or Global Poverty Chains? ', CGPE Working Paper, University of Sussex.

quantitative approach, with a corresponding change in indicators, and strongly enhanced democratic involvement to define the social needs to be addressed.[18]

Others focus on *the commons*, understood as a self-governance of a shared resource or shared spaces. The commons may refer to nature or collectively-produced resources. A wide range of struggles around the world are trying to protect common resources against privatisation, such as in city centre development projects and the imposition of private intellectual property rights on indigenous knowledge and naturally-occurring life-forms.[19] Finally, other approaches include *sufficiency* approaches linked to 'good life for all' and the Latin American concept of 'buen vivir';[20] and the development of *local or regional economies*.

The fundamental question of how to ensure a sufficiently rapid transition has been addressed by Ian Gough, who argues for three stages.[21] First, green growth, driven by rapid decarbonisation and improvements in eco-efficiency of production; second, far more sustainable consumption and greater equity; and third, putting in place a steady-state world economy.

EU policies

The EU generally takes the green growth approach, but with limited investment stimulation. EU climate policy has an overall goal for emissions reductions from 1990 of 20% by 2020, 40% by 2030, and 80-95% by 2050, with progressively faster reductions. These include only production emissions, not consumption (the footprint). Half the reductions are to come from the EU Emissions Trading Scheme (ETS) and the rest from the 'Effort Sharing' (ESD) targets set per country according to GDP per capita. The ETS covers the energy supply and energy-intensive industrial sectors, and the ESD most other sectors.

The policy has three goals for 2020: a reduction in emissions by 20%, a 20% increase in energy efficiency, and 20% of energy to come from renewables. The member states' projections after 2020 are for slower emissions reductions, not faster; if this occurs, it would put the longer-term reductions way off track.[22] This highly dangerous approach was confirmed by the member states in the Council's series of decisions during November-December 2017 on the EU climate and energy package to 2030.

In the ETS, far too many emissions permits were handed out, notably to sectors claiming that they would face a competitive disadvantage from imports. As a result, the market price per permit (to emit a tonne of CO_2) has fallen to around €5. This is generally considered to have had virtually no effect on curbing emissions, and for some it presents a danger of locking in high emissions infrastructure for many years and subsidising coal-fired energy. Little

[18] Jackson, T. (2017), *Prosperity Without Growth: Foundations for the Economy of Tomorrow*, 2nd ed. Coutrot T. and Gadrey, J. (2012), 'Green' growth is called into question, ETUI Policy Brief, Feb; Gadrey, J. (2015), *Adieu à la croissance : Bien vivre dans un monde solidaire*, 2nd ed.
[19] Horvat, V. (2016), 'TINA, go home! The commons are here', *Green European Journal*, Winter.
[20] E.g. Schneidewind, U. and Zahrnt, A. (2014), *The Politics of Sufficiency: Making it easier to live the Good Life*.
[21] Gough, I. (2017), *Heat, Greed and Human Need: Climate Change, Capitalism and Sustainable Wellbeing*.
[22] European Environmental Agency (EEA) (2017), *Trends and projections in Europe 2017: Tracking progress towards Europe's climate and energy targets*, November, Fig. 2.1.

improvement in the ETS is expected in the future from the recent plans covering the period after 2020.[23]

Also, some other EU policies fall very short of what is required or act in the opposite direction. The Juncker Plan has been presented as a strong instrument in the fight against climate change. However, only 20% of its financing has gone to projects that contribute to combating climate change, even less than the European Investment Bank's (EIB) standard proportion.[24] Very problematically, the EU and member states have been handing out large fossil fuel subsidies, of around €120 billion per year.[25] Further, under current policies, transport activity – the sector with the greatest emissions at 27% of the total – is likely to continue growing, and related emissions are estimated to increase by 15% above 1990 levels by 2050, versus the targeted 60% reduction.[26]

The European Environmental Agency (EEA) has concluded that the EU's long-term decarbonisation objective (for 2050) can take place 'only in the context of a major transformation of the EU's socio-technical systems such as the energy, food, mobility and urban systems'.[27]

Regulation of one kind or another is essential for addressing each of the threats mentioned. However, on this front there are numerous problematic developments. With its Better Regulation/REFIT approach the current Commission has introduced mechanisms such as the Regulatory Scrutiny Board and extensive cost-benefit analysis done in a style that blocks regulations, especially on environmental issues. Furthermore, the *precautionary principle* is crucial for addressing the climate and the other areas mentioned, and is enshrined in the EU Treaties. However, it now appears that not only is there a failure to carry it through in practice under the key REACH chemicals directive,[28] but the application of the principle itself is under major threat. A body of chemical and tobacco companies had proposed a so-called 'innovation principle' explicitly aimed at constraining the precautionary principle;[29] it now appears that the Commission and the Council are doing preparatory work to introduce this.[30] This is despite detailed assessments that show the precautionary principle has not unduly interfered with beneficial innovation.[31]

[23] Joint NGO statement (2017), 'Being serious about the Paris Agreement: Stop the ETS funding coal, Start a meaningful carbon price', 8 November; Climate Action Network (CAN) Europe (2017), 'EU fails to deliver on Paris Agreement by setting its carbon market for another decade of failure', 7 November.

[24] CEE Bankwatch, Counter Balance, CAN Europe and WWF (2017), *Doing the same thing and expecting different results?*, November.

[25] During the period 2014-16. ODI and CAN Europe (2017), *Phase-out 2020: Monitoring Europe's fossil fuel subsidies*, September.

[26] EEA (2016), 'TERM 2016: Fundamental changes needed for sustainable mobility', December, p. 5.

[27] EEA (2016), *Trends and projections in Europe 2016*, p. 13.

[28] European Environmental Bureau (2017), 'EEB REACH REFIT position paper', 20 March.

[29] http://www.riskforum.eu/uploads/2/5/7/1/25710097/innovation_principle_letter.pdf (October 2013). The letter was not signed by the tobacco company members of the organisation and included a few non-members.

[30] Minutes of the Joint Meeting of the REFIT Platform's Government Group and Stakeholder Group, 21 September 2017, p. 4. https://ec.europa.eu/info/events/refit-joint-group-meeting-21-september-2017-sep-21_en

[31] EEA (2002, 2013), *Late lessons from early warnings*, 2 volumes.

Alternative proposals

To bring about a socio-ecological transformation in the very limited time available to stay within the planet's limits, approaches and steps such as the following should be undertaken without delay.

- For the *climate*, there should be much sharper cuts in emissions, longer-term commitments from the member states and concrete plans on how to get there. Further, the major historical responsibility of rich countries for cumulative emissions requires much sharper cuts than the global average. There should be a rapid phase-out of coal-fired power stations in the whole EU, accompanied by measures to achieve a just transition and alternative employment.[32] Subsidies for anti-climate projects should cease.
- The economy should be transformed to achieve *much lower use of materials and energy*. There should be stronger support for a circular economy including the extending of product life and manufacture for recycling. Greater account should be taken of rebound effects in policies to increase efficiency.
- *Local economies* should be supported, and trade deals no longer used to explicitly block public purchasing for local development. Bottom-up initiatives for local exchanges, including initiatives such as 'transition towns', should be facilitated, as should caring and social exchanges at a local level. More generally, bottom-up local and regional problem-solving in various spheres should be enabled.
- *Advantage should be taken of the major potential of public services* to promote sustainability and transition; the Single Market and austerity policies should no longer be used to force their privatisation. Adequate funding should be provided to local authorities, and taxation should be reformed to help with this.
- *Transport and mobility policies* should be reformed to encourage public transport, a shift from road to rail transport, less air transport, and locally to facilitate cycling and walking. The car and airline industry lobbying that has resulted in extremely unambitious climate goals for much of transport should be resisted.[33]
- *The regulatory system* should be reoriented away from an obsession with short-term costs to business to an approach where a fair assessment is made of the benefits of regulations, and the biased technique of cost-benefit analysis replaced with far greater use of multi-criteria analysis. Crucially, an 'innovation principle' should not be introduced as planned and initiated by lobbyists to undermine the precautionary principle.
- *In the area of finance*, the Juncker plan and EIB funding should be reoriented so that they are directed much more towards investment in climate change mitigation and adaptation. In the short term, the European Central Bank's quantitative easing programme, and in particular its Corporate Bond Programme, should be reoriented away from its current funding of finance-intensive high-carbon industry. (See also chapters 1 and 2).

[32] On a just transition, see Fiedler, M. (2017), 'A just transition', Rosa Luxemburg Brussels, 19 November. http://www.rosalux.eu/topics/social-ecological-transformation/just-transition/?L=0

[33] Transport & Environment (2017), 'Reconfirmed: Transport is Europe's biggest climate problem', 16 November, https://www.transportenvironment.org/newsroom/blog/reconfirmed-transport-europe's-biggest-climate-problem

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