

European Economists for an Alternative Economic Policy in Europe

– EuroMemo Group –

Prospects for a popular political economy in Europe

– EuroMemorandum 2019 –

Dedicated to Elmar Altvater, long-standing participant in and major contributor over many years to the EuroMemo Group, bringing distinct and innovative perspectives, and Professor of Political Science at the Otto Suhr Institute in Berlin, who died on May 1st 2018.

Introduction: deepening divergence

1 Macroeconomic policies and EMU reform: a weakening economy

Excursus: Politics of structural reforms

2 Monetary and financial policies

3 The productive structure of the EU and the need for short and medium term transformation

4 Social policies in the EU and the Nordic welfare model

5 Authoritarian populism and the challenge of reconstructing a popular political economy for the EU

This EuroMemorandum draws on discussions and papers presented at the 24th Workshop on Alternative Economic Policy in Europe, organised by the EuroMemo Group in cooperation with the University of Helsinki, from 27-29 September 2018 in Helsinki.

Summary

Introduction: deepening divergence

In 2018 all the economies of the European Union registered growth for the second year in succession, but projections for 2019 are being marked down amidst an uncertain international outlook for 2019, with the prospect of markedly lower expansion in the US and a dangerously high level of indebtedness in China. In this context, the Trump administration has responded to US trade deficits with demands for major partners to reduce their surpluses, and while modest changes were agreed with Canada and Mexico and with the EU, the conflict with China is far more deep-seated and could yet escalate in 2019. In the area of defence, the US has reacted negatively to European proposals to develop a limited independent capability. Although defence cooperation between the EU and Britain is set to continue, the terms on which Britain will leave the EU, scheduled for the end of March, remain highly contentious in Britain. In the Euro area there has been a deepening productive divergence between the countries of the North and the South. In particular Italy, which has registered virtually no growth since joining the Euro, has been required by the European Commission to scale back proposals initially advanced by the new coalition government. In many countries, however, unemployment and rising social discontent have led to a worrying rise in support for right-wing parties and, despite modest advances in Spain and Portugal, progressive movements in Europe remain weak.

1. Macroeconomic policies and EMU reform: a weakening economy

The Euro area and the EU economy are expected to continue the recovery. However, growth forecasts have been lowered noticeably for 2018 and 2019, mainly due to less favourable external demand conditions as world trade growth is slowing down. The geopolitical situation, above all the US-China trade conflict, 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 the rising levels of debt and bubbles fed by the extremely expansionary monetary policies carry increased risks of new financial crises. The political conflict surrounding Italy's government budget deficit may lead to tensions in the financial markets which might ultimately lead to government bankruptcy in Italy, a new financial crisis and the end of the common currency. Last but not least, the very uncertain prospects of Brexit are a further burden on the economic outlook for the EU.

Notwithstanding the need for much more fundamental long-term reform, all current proposals for Euro area reform should be pragmatically evaluated with regard to three criteria: whether implementation of the proposal would: 1. protect national government bonds from financial market pressures and reduce the risk of government bankruptcy, instead of subjecting them to the control of speculative financial markets (e.g. Eurobonds, Euro Area Safe Asset, any sort of stabiliser or rescue fund at the European level); 2. upgrade fiscal policy so that it can better fulfil its role as macroeconomic stabiliser both at the Euro area level in case of symmetric shocks and at the national level in case of asymmetric shocks, at the same time leading to stronger and more steady public investment in (ecological) infrastructure as well as research and education (further reinterpretation of SGP to provide more leeway, Golden Rule of public investment, European investment programme, fiscal capacity, any sort of stabiliser on the European level); 3. contribute to reducing the macroeconomic imbalances between the member countries and between the EU and the rest of the world, including closer macroeconomic coordination, regional and industrial policies and potentially transfers from the centre to the periphery.

Given the fundamentally different views about macroeconomic policies, it is very unlikely that Germany or other countries where similar ordoliberal macroeconomic ideas dominate, would accept any real progress in terms of macroeconomic stabilisation, because they would always see the measures involved as undermining national responsibility and the no bail-out principle. It is therefore

very probable that any potentially progressive reform would come at the cost of strict conditionality and serious additional restrictions and requirements for national fiscal and economic policies, thereby rendering them counterproductive. Therefore, not much can be expected from the current reform debate, and it is all the more important to make sure that monetary and fiscal policy react in a pragmatic and stabilising way to the next economic downswing. Failure to do so would raise a serious challenge to the future viability of the Euro.

2. Monetary and financial policies: the failure of financial integration

Although EU leaders continue to attach great importance to financial integration, in reality little progress is being made. As usual, the solution is seen in the reinforcement of market processes through the Banking Union and Capital Markets Union projects. However, the main advantage offered by such integration would be risk-sharing, but the Council, heavily influenced by the German and like-minded governments, rejects most effective measures to share risks – either macroeconomic or microeconomic – across the Euro area.

In reality, the key difficulties can only be overcome by a change in policies and in the political orientation of the EU. Thus, the EU's financial sector, in spite of its present stability, is threatened by policies which block any move to a more coherent and coordinated structure and by an ideological hostility to the role of the public sector. A financial system that serves the needs of society and of the planet, that is democratically governed and that is stable is a common demand.

3. The productive structure of the EU and the need for short and medium term transformation

The productive divide in the EU has been widened during and after the great crisis. The core countries shifted consequences and adjustments largely to the de-industrialised South of the EU. In the core countries and the industrialised Central-East European periphery around Germany, the recovery has been relatively swift and often led by exports. In the de-industrialised South and Southeast of the EU, the crisis was deeper and more lasting. The austerity policies have weakened the manufacturing fabric even more. The Mediterranean EU economies have become even more reliant on tourism and real estate.

There is a need to counter the uneven development patterns in the EU. One way to tackle uneven development is to take FDI as a point of departure. (Industrial) FDI contributes significantly to the uneven productive pattern. An 'FDI Imbalance Procedure' should be created. In order to re-balance the productive patterns, a levy of up to 10% on FDI (depending on the size) should be paid into a rebalancing fund. Regulations should permit a ceiling on foreign investment in companies, at least in strategic sectors, in order to retain local control. Specific industrial policies have to be developed at the EU, national and subnational level. They should particularly target peripheral regions and the conversion of ecologically problematic industries. Industrial policies should not be primarily targeted at exports, but also promote inward-looking industries. Production-consumption circuits should be fostered at smaller scales. This is an ecological imperative. These policy alternatives challenge the Single Market pillar 'free movement of capital' and EU competition rules.

4. Social policies in the EU and the Nordic welfare model

Ten years after the manifestation of the financial and economic crisis in Europe, it is becoming increasingly clear that crisis management in the form of widespread austerity governance has resulted in entrenching inequality and social exclusion. The increase in poverty and social exclusion has gone hand-in-hand with policies that prioritise disciplining debt, accommodating monetary policies and fiscal austerity. Social policies have become subordinated to the primacy of balanced public budgets. This comes against the background of broader, overall trends within social and labour market policies across Europe, such as the pronounced shift towards supply-side labour market policies. At the same time, through an intensification of means-testing for social provisions,

solidaristic and universal notions of welfare are increasingly undermined, not least in reference to migrant and refugee communities.

The EuroMemo Group insists that the focus of the European Union should be working on a policy framework that engenders a Europe of inclusion, ecology, and solidarity. Now more than ever it is clear that social policies cannot simply be a flanking measure to mitigate the worst effects of the relentless push for competitiveness across Europe. Overarching objectives guiding the considerations of alternative policies, as they have been put forward in the previous EuroMemorandum, include strategic decommodification of social policy and labour markets, with a focus on non-market principles as key dimensions. This means recalibrating social policy towards reciprocity and trust, and safeguarding local and municipal initiatives.

5. Authoritarian populism and the challenge of reconstructing a popular political economy for the EU

One of the most worrying developments since the outbreak of the global financial crisis in 2007 has been the re-emergence of nationalism and authoritarian populism in the EU. Right-wing nationalism has exerted a growing influence on, if not dominated, public discourse and the general thrust of politics, particularly with respect to the migration issue. Nationalist parties have increased their vote share since the early 2000s to some 20% of the EU electorate, are members of governments in nine EU countries (e.g. Austria, Italy), or govern alone (e.g. Hungary, Poland). Their style of politics is patently populist, if not authoritarian. Amongst these are a marked cult of (male) leadership, contempt for the institutions of representative democracy, in particular parliaments, courts and the liberal media, as well as militant campaigning against feminism, and Muslims and other groups. In terms of their economic ideology, positions stretch from straightforward neoliberalism to more conservative nationalism.

Empirical work has recently documented a strong correlation between crisis-induced economic insecurity and voting support for authoritarian-populist parties in Europe. Support for the parties of the political centre as the home base for the petty bourgeoisie after World War II has been marked by a steady decline over the last three decades. This observation holds true particularly for social democracy.

The creeping crisis of political representation in contemporary Europe is grounded in both a feared deterioration of the living standards of the middle classes and a real deterioration for the working class. Though this indeed indicates the demise of the traditional party system, as institutionalised in the post-World War II welfare state, it should not be interpreted as foreshadowing the straightforward transition to authoritarianism. Given that the relationship between capitalism and democracy is highly contingent, no straightforward forecasts are possible. A key question at the current conjuncture is thus whether a recovery of a socially inclusive democracy by way of promoting an alternative political project is feasible. Proposals for achieving this are put forward at the end.

Introduction: deepening divergence

In 2018 all the economies of the European Union (EU) registered growth for the second year in succession. However, this is projected to weaken in 2019 in the face of wide-ranging political, social and economic tensions within the Union and an uncertain international outlook. The world's two largest economies both face challenges which will have a major international impact. Strong growth in the United States was boosted in 2018 by the Trump government's tax cuts but the impact of these cuts is projected to decline from 2019. The US expansion, which began in mid-2009, is already unusually long and there are signs that it could be drawing to an end – profitability and investment appear to have peaked and the stock market is, by historical standards, highly overvalued. Meanwhile, in China, where annual economic growth ranged around 10% for many years, the authorities have striven to establish a more sustainable regime and the official figure for growth in 2018 was around 6.5%. But as a result of huge spending by the government to counter the impact of the international recession and the very high level of borrowing built up by firms and households prior to and since the crisis, overall indebtedness remains dangerously high.

One of the key drivers of the Trump government's economic policy has been an aggressive focus on reducing bilateral trade deficits with its main trading partners. After much bluster, in 2018 the US settled for relatively modest changes in the trade regime with Canada and Mexico; it also backed down on its threat to raise tariffs on cars from the EU, although recent tariffs on steel and aluminium remain in place, and the US farm lobby continues to push for greater access to European markets.

In the case of China, however, the US is pursuing a far more aggressive approach to trade. In both Republican and Democratic circles China is seen as a strategic competitor and the Trump government is demanding a deep and fundamental change in China's strategy of state intervention. As a first step the US has imposed duties of 10% on \$200 billion Chinese imports, with the threat of rapid escalation. At the same time, the Pentagon has expressed concern at US dependence on imports of high technology products and is pushing for greater domestic sourcing. According to the International Monetary Fund, the possibility of deepening trade conflict between the US and China is one of the key shadows over the international economy.¹

The European Union has echoed concerns about China, but in other areas there are signs of tensions between it and the US. In 2015, the US together with Russia and several European governments had reached an agreement with Iran which committed the country to limiting nuclear enrichment and research to peaceful ends. After Trump announced in 2018 that the US would withdraw from the agreement and insisted that other signatories follow suit, the EU sought to maintain lucrative trade deals with Iran by establishing a financing channel which bypassed US banks. However, Swift, the main international bank messaging system which is based in Belgium, has bowed to US demands, and the launch of a new European payments channel has been delayed as potential hosts were wary of incurring US wrath.

The EU's Common Security and Defence Policy is another area of potential conflict with the US. This attempt to strengthen the Union's combined military capability was launched in 2016 and, according to European Commission president Jean-Claude Juncker, should be fully in place by 2024. Claims that the EU is attempting to establish greater autonomy from the

¹ International Monetary Fund, World Economic Outlook, October 2018.

US-led NATO command were played down by Juncker. In June 2018, at French President Emmanuel Macron's initiative, nine European countries agreed to form a rapid deployment force. Concerns about its relation to NATO were waved aside by the organisation's general secretary, Jens Stoltenberg, who said he welcomed the initiative. The new command is formally outside the structures of the EU, something which will permit the British to participate when it leaves the EU.

Britain is due to leave the EU in March 2019. However, the ruling Conservative Party remains deeply divided on the issue. The government was exceptionally late in preparing concrete proposals and has sought to find fudges for central conflicts, most notably over the position of Northern Ireland. While a major constitutional crisis in Britain cannot be ruled out, a more likely scenario is that Britain will limp ahead with an associate status which will require it to abide by EU rules and contribute to the budget, but stripped of its ability to promote the poisonous neoliberal policies which it has championed in the EU since the 1980s.

Deepening divergences

In the Euro area, economic developments since the crisis have been marked by a deepening productive divergence between the Northern countries and those in the South, with France balanced somewhere between the two. Even Germany's finely-honed industrial machine is faced with the challenge of adapting to changing patterns of motorised transport and its over-dependence on exports leaves it vulnerable to a downturn in the global economy. Nevertheless, it is in the countries of the South that the economic and social challenges are most pressing.

Long-running differences over the role of the state in macroeconomic policy have been brought to a head by the newly elected government in Italy. For almost two decades there has been virtually no economic growth in Italy and unemployment is deeply entrenched, especially in the South and among the young. Following the elections in 2018, an unlikely coalition government formed by the populist Five Star Movement and the right-wing League advocated a more expansive economic policy, but they were required to trim their initial proposals after they were firmly rejected by the Euro area authorities. In Spain, the minority Socialist government has also proposed a more modest expansionary stance. But, as yet, there is no apparent move by the countries of the South to jointly challenge the suffocating grip of the monetarist policies which continue to dominate economic governance in the Euro area.²

Meanwhile, proposals to strengthen the Euro area's banking system have made only limited progress. Concern at the fragmented supervision of banks in Europe led to the launching of a European supervisory mechanism in 2014 and the largest banks are now directly supervised by the European Central Bank. A European procedure for winding up failed banks has also been established. But a key proposal to create a European deposit insurance scheme has been resisted, most importantly by Germany. More generally, compared with the United States, only limited steps have been taken to strengthen banks' balance sheets since the crisis and there are widespread doubts about the position of a number of key banks, notably in Italy and Germany.

² For an analysis of the partial challenge by Portugal, see Lopes, L. and M. Antunes (2018), 'The alternative nature of the Portuguese economic policy since 2016', *EuroMemo Discussion Paper* No. 02/2018.

The protracted levels of high unemployment in some countries, together with the growing prevalence of low-wage jobs and insecure patterns of employment, have contributed to rising social discontent in many Euro area states. This has been accompanied by rising support for right-wing nationalist parties in a number of countries, many of which are hostile to the Euro and even to the EU. Developments in Italy could present a major challenge to the Euro area's governance. However, the interests of large sectors of European capital are so closely linked to the Euro, and any attempt to withdraw from the Euro would provoke such financial dislocation, that the continued existence of the Euro is unlikely to face a serious challenge.

In most of Europe, progressive movements are in a weak position. Trade unions have been severely weakened and traditional social-democratic parties have lost support as a result of their complicity in promoting neoliberal policies. More radical challenges have faced a major defeat, most notably in the case of Greece. Modest initiatives have been able to make some advances in Portugal, where the Socialist Party government governs with the support of the radical Left Bloc and the Communist Party, while in Spain the minority Socialist Party government is attempting to move beyond the country's severe austerity policies with parliamentary support from Podemos.

Against the background of the increasing influence of right-wing nationalist and populist forces, this EuroMemorandum aims, as in previous years, to contribute to the development of a progressive economic policy for Europe. More than ever, it is necessary to reconstruct the project of political integration in Europe in a way which is responsive to the economic and social needs of the great majority of men and women and the ecological needs of the planet. In particular it is necessary to address the needs of those who have been negatively affected by the impact of the protracted crisis which began in 2007-08: the workers faced with intensified workloads, the rising numbers in precarious employment, the unemployed, migrants and other vulnerable groups. It is in this sense, that we argue in favour of a popular political economy for Europe, as outlined in the following chapters.

1 Macroeconomic policies and EMU reform: a weakening economy

An incomplete recovery threatened by increasing political and economic risks

The Euro area and the EU economy are expected to continue the recovery that set in from 2014 and that had substantially accelerated and broadened in 2017, even slightly exceeding the European Commission's expectations in its Autumn 2017 forecast. However, while the Commission still expects the recovery to continue in 2019 and 2020 in its recent autumn 2018 forecast, it lowered its growth forecast noticeably for 2018 and 2019 mainly due to less favourable external demand conditions, as world trade growth slowing down. The geopolitical situation, above all the US-China trade conflict, 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 the rising levels of debt, along with asset bubbles fed by the extremely expansionary monetary policies, carry increased risks of new financial crises. The political conflict surrounding Italy's government budget deficit may lead to tensions in the financial markets which might ultimately lead to government bankruptcy in Italy, a new financial crisis and the end of the common currency.

Last but not least, the very uncertain prospects of Brexit are a further burden to the economic outlook for the EU.

Table 1 Macroeconomic Indicators for the EU countries

Country	GDP growth 2018 % (forecast)	real GDP (2007 =100)	Unemployment Sept. 2018 (2007) %	Unemployment male Sept. 2018 (2007) %	Unemployment female Sept. 2018 (2007) %	Youth unemployment Sept. 2018 (2007) %	Real wage growth 2018 %	Real wage growth 2010-18 %	Real wage growth 2007-18 %
Euro area	2.1	109	7.9 (7.2)	7.5 (6.3)	8.3 (8.4)	17.3 (15.5)	0.6	3.7	7.8
European Union	2.1	111	6.6 (6.9)	6.4 (6.3)	6.9 (7.7)	15.4 (15.9)	1.0	3.9	7.0
Northern Europe									
Denmark*	1.2	108	4.8 (3.8)	4.6 (3.4)	5.1 (4.3)	10.7 (9.1)	1.0	3.0	6.3
Finland	2.9	103	6.3 (6.4)	5.6 (6.0)	7.0 (6.8)	14.2 (13.3)	0.3	-1.6	0.2
Sweden*	2.4	119	6.0 (5.6)	5.7 (5.4)	6.5 (5.9)	14.9 (18.1)	1.0	11.5	13.5
Western Europe									
Austria	2.7	113	5.0 (4.4)	4.8 (3.8)	5.2 (5.0)	9.8 (7.6)	0.4	0.7	2.6
Belgium	1.5	112	6.5 (7.5)	6.5 (6.4)	6.4 (7.7)	19.8 (20.3)	0.0	1.5	3.1
France	1.7	110	9.1 (7.6)	9.1 (7.2)	9.1 (8.0)	21.6 (19.2)	0.6	6.7	11.9
Germany	1.7	115	3.3 (8.1)	3.6 (7.6)	3.0 (8.7)	6.4 (11.7)	1.1	10.6	12.4
Ireland	7.8	161	5.3 (4.7)	5.6 (4.9)	4.9 (4.5)	12.9 (8.5)	1.3	0.2	8.5
Luxembourg	3.1	122	4.8 (3.9)	4.5 (3.1)	5.2 (5.0)	11.0 (16.1)	0.6	7.1	9.9
Netherlands	2.8	113	3.8 (4.0)	3.6 (3.2)	3.9 (4.9)	7.8 (9.3)	0.7	2.4	8.0
United Kingdom*	1.3	113	4.2 ^b (5.5)	4.2 ^b (5.7)	4.0 ^b (5.2)	12.1 ^a (15.8)	1.1	0.2	-0.4
Southern Europe									
Cyprus	3.9	108	6.6 (3.5)	6.5 (2.9)	6.6 (4.1)	17.9 ^c (9.1)	0.5	-8.2	-6.0
Greece	2.0	76	18.8 ^a (7.7)	14.9 ^a (4.7)	23.8 ^a (11.9)	35.1 ^a (22.1)	0.2	-15.2	-18.6
Italy	1.1	96	9.9 (6.0)	9.2 (4.8)	10.8 (7.9)	32.3 (20.8)	0.9	-3.1	1.1
Malta	5.4	159	3.8 (6.3)	3.8 (5.5)	3.8 (7.9)	9.5 (12.4)	1.7	14.6	16.0
Portugal	2.2	101	6.6 (9.0)	6.0 (8.4)	7.2 (9.5)	20.1 (20.7)	0.4	-6.7	-2.5
Spain	2.6	105	14.7 (8.1)	13.3 (6.3)	16.3 (10.6)	34.2 (18.3)	-0.4	-4.7	2.6
Central and Eastern Europe									
Bulgaria*	3.8	125	4.9 (6.4)	5.5 (5.7)	4.3 (7.3)	12.8 (16.0)	5.2	59.1	101.3
Croatia*	2.8	101	7.2 (9.1)	6.8 (7.9)	7.6 (10.5)	19.5 (23.6)	0.3	-7.3	-10.6
Czech Republic*	3.4	120	2.3 (5.1)	1.8 (3.8)	2.8 (6.7)	8.3 (12.8)	5.5	18.2	19.3
Estonia	4.3	111	5.3 ^a (4.1)	5.1 ^a (4.7)	5.4 ^a (3.5)	16.6 ^a (10.1)	3.3	23.1	21.3
Hungary*	4.0	122	3.8 ^a (7.2)	3.4 ^a (6.7)	4.4 ^a (7.8)	10.7 ^a (18.6)	1.4	12.3	13.7
Latvia	3.1	105	7.1 (5.4)	8.0 (5.7)	6.2 (5.1)	10.0 (10.1)	4.3	42.5	31.0
Lithuania	3.1	118	6.2 (3.8)	6.7 (3.7)	5.7 (3.8)	11.9 (8.6)	5.4	41.2	24.5
Poland*	4.3	146	3.4 (8.9)	3.6 (8.2)	3.3 (9.8)	11.0 (20.3)	4.5	22.7	36.7
Romania*	4.5	133	3.9 (5.7)	4.5 (6.6)	3.2 (4.6)	15.5 ^c (18.8)	9.1	41.4	61.4
Slovakia	4.0	132	6.8 (11.4)	6.0 (9.9)	7.7 (13.2)	16.6 (24.1)	2.4	13.2	23.5
Slovenia	4.8	111	4.9 (4.3)	4.7 (3.6)	5.2 (5.1)	7.5 (8.7)	0.8	4.5	9.8
Non-EU countries for comparison									
USA	2.9	119	3.6 (4.6)	3.5 (4.4)	3.6 (4.6)	8.4 (11.0)	0.8	6.3	7.1
Japan	1.1	106	2.2 (4.1)	2.5 (3.9)	2.2 (4.1)	3.6 (8.6)	0.3	2.8	2.1

* Non-Euro area; ^a August 2007/2018; ^b July 2007/2018; ^c June 2007/2018.

Sources: GDP & real wage growth (compensation of employees, deflator: consumer price index) - Ameco, November 2018; Unemployment - Eurostat, November 2018.

The recovery therefore looks set to become weaker and more fragile, and might come to an end if some of the risks materialise. In any case, it has so far been incomplete and far from making up for the catastrophic economic, social and political damage since the onset of the crisis (Table 1). Although the growth rates for 2018 look satisfactory on average, real GDP in Italy and most notably Greece is still below its 2007 pre-crisis level. Portugal, Croatia, Finland and Spain have hardly surpassed their pre-crisis GDP levels, and in many countries of the European periphery unemployment is still very high compared to pre-crisis levels. As a general pattern, unemployment for females seems to be visibly higher than male unemployment. Youth unemployment tends to be much higher than overall unemployment and was over 10% in 24 of the 28 EU countries reaching levels above 20% in France and Portugal and over 30% in Greece, Italy and Spain. Real wage growth has been weak on average since 2010 and even negative in Finland, Cyprus, Greece, Italy, Portugal, Spain and Croatia.

In spite of a spreading disregard for the basic requirements of gender justice and ecological sustainability, the economic development of the EU member countries has not even had a measurable short term advantage with respect to their unqualified orientation towards statistical 'economic growth'.

Requirements and obstacles to pragmatic improvements

Whereas the macroeconomic policy debate in the immediate crisis years was focused mainly on how to overcome austerity and get the recovery under way through monetary policy and more leeway for national fiscal policies, it has shifted almost completely towards reforms at the Euro area or EU level, such as completing the Banking Union, a Euro area safe asset, a Euro area fiscal capacity, a European unemployment insurance, or a Euro area finance minister, sometimes in combination with changes in the Stability and Growth Pact, such as the adoption of the Golden Rule of Public Investment. As could be expected, all of the proposals are contested, and more ambitious proposals, such as those by the French president, Emmanuel Macron, are meeting fierce resistance from fiscal hawks in some countries, most particularly Germany. It is clear, therefore, that there cannot be an agreement which would really complete the economic and monetary union in a progressive way.

Nevertheless, all proposals should be pragmatically evaluated with regard to three criteria: Would implementation of the proposal:

1. Protect national government bonds from financial market pressures and reduce the risk of government bankruptcy, instead of subjecting them to the control of speculative financial markets (e.g. Eurobonds, Euro Area Safe Asset, any sort of stabiliser or rescue fund on the European level)?
2. Upgrade fiscal policy, so that it can better fulfil its role as macroeconomic stabiliser both at the Euro area level in case of symmetric shocks and at the national level in case of asymmetric shocks, at the same time leading to stronger and steadier public investment in (ecological) infrastructure as well as research and education (further reinterpretation of SGP to provide more leeway, Golden Rule of public investment, European investment programme, fiscal capacity, any sort of stabiliser at the European level)?
3. Contribute to reducing the macroeconomic imbalances between the member countries and between the EU and the rest of the world, including closer macroeconomic

coordination of regional and industrial policies and potentially transfers from the centre to the periphery?

As illustrated by some of the examples enumerated above, theoretically there are many proposals that could potentially bring pragmatic improvements for the macroeconomic governance of the Euro area, some of them at the central level, some at the national level. However, given the fundamentally different views about macroeconomic policies, it is very unlikely that Germany or other countries where similarly ordoliberal macroeconomic ideas dominate, would accept any real progress in terms of macroeconomic stabilisation, because they would always see the measures involved as undermining national responsibility and the no bail-out principle. It is therefore very probable that any potentially progressive reform would come at the cost of strict conditionality and serious additional restrictions and requirements for national fiscal and economic policies, thereby rendering them counterproductive.

Not much can be expected therefore from the current reform debate and it is all the more important to make sure that monetary and fiscal policy react in a pragmatic and stabilising way to the next economic downswing. A failure to do so would raise a serious challenge to the future viability of the Euro.

Long term goal: Fundamental change to macroeconomic policy framework

As sketched above there is room for a pragmatic improvement of the European macroeconomic framework and the need for a pragmatic reaction by monetary and fiscal policy in the next economic downturn. The catastrophic policy response during the Euro area crisis must not be repeated and can easily be avoided. Nevertheless, in the long run macroeconomic policy in the EU needs a fundamentally different approach that will secure full employment and equitable growth, as well as promoting an even development which overcomes the persistent macroeconomic imbalances. A convincing approach requires at least six important changes.

1. The replacement of balanced budget requirements by a balanced economy requirement including the objective of high and sustainable levels of employment. Fiscal policy should be used as one key instrument to aid the achievement of that objective both in the short and the long run. 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. In the long run, a stronger role for fiscal policy at the European level is also important. A substantial EU-level budget (in the order of at least 5% of EU GDP), capable of running deficits or surpluses as required by the economic conditions, 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 in order 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 recognised 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. The construction of a Federal fiscal policy is a long-term project, and would bring further elements of a de facto political union. It is, however, one 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 actively promote public investment and to support private investment in key economic, social and environmental areas. This should at the same time develop productivity growth through strategic industrial policies in the periphery. 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.
4. Ending the long-practised deflationary strategy of competitive devaluation, with wage growth with 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 Euro area countries, 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.
5. Effective measures against tax competition are required. 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 large corporations and the rich and wealthy 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 therefore should be greatly 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.
6. The mobilisation of over-accumulated surplus capital and over-capacities of productivity and new standards of productivity in certain sectors (especially digital industries) for developing new pathways of development and industrial policies – this includes not least the urgent quest for shortening working hours and for flexibilisation, while fully respecting and extending workers' rights.

Excursus: Politics of structural reforms

The Commission's Annual Growth Survey involves regularly a call for further structural reforms. In May 2018, the Commission proposed to create a Reform Support Programme as a part of its next long-term EU budget 2021-2027. The Reform Support Programme is meant to support reform priorities identified in the context of the annual process of coordinating and monitoring economic policy within the EU.

In the EU, structural reforms are understood as the opposite of short-term economic policy focusing on economic fluctuations. Their goal is to modify the institutional and regulatory

framework within which businesses and people operate. The focus of attention is on the long run, supply side, market functioning and fiscal balance. The structural reforms of the Commission have a close affinity to the heavily criticised structural adjustment policies (SAP) of the Bretton Woods institutions, later replaced by 'poverty reduction'.

Even though within the EU the term structural reform has potentially multiple meanings, scratching the surface of its different uses reveals common assumptions and background theories. These reforms have included privatisation, deregulation, cuts in public spending, cuts in marginal tax rates, attempts to increase labour supply for instance by reducing education-time, increasing 'flexibility' in labour markets, and attempts to reap the benefits of economies of scale by increasing the size of administrative units. Sometimes the assumption is that the optimal functioning of the market mechanism is hampered by regulations, practices or institutions. At times, the idea is rather that the sustainability gap, stemming from ageing populations and other changes, threatens the balance of public finances, and therefore production needs to be stepped up. Generally, the advocates of 'structural reforms' tend to assume the following three theoretical views and hypotheses:

1. Efficient market hypothesis broadly understood (free competitive markets allocate resources Pareto-efficiently, i.e. no-one can be made better off without making someone worse off)
2. Doctrine of balanced budgets (responsible financial management requires reducing public debt and balancing budgets over time)
3. General supply-side view of the economy according to which better and stronger incentives lead to various gains through improved efficiency (for example, the Laffer-curve, according to which the reduction of taxes and in particular marginal tax rate will increase tax revenue)

The concept of structural reforms thus presupposes the standard views of late 20th century economic liberalism about how free markets function and what the role of the public sector should be. Usually these views are based on textbook versions of neoclassical economics. There are also a number of specific ideas about supply-side economics, including the notion that economic growth can be most effectively supported by lowering taxes, decreasing regulation or reaping the benefits of economies of scale.

The problem is that the neoclassical textbook model of competitive markets is not only unrealistic, but also irrelevant. As a result, 'structural reforms' tend to be counterproductive. The EuroMemo Group has repeatedly criticised, for instance, the ways in which the doctrine of balanced budgets and the related austerity measures function in practice. Similarly, historical experiments with supply-side economics have largely failed. For example, it is well-known that the Reagan era tax reductions in the US led to large public deficits and rapidly growing income and wealth inequalities. Other countries soon followed suit, but economic growth has not improved. During the post-war era and still in the 1970s, when marginal tax rate could be as high as 80-100%, economic growth was much faster than today, when maximum marginal tax rates have fallen to between 25% and 50%. This sluggish growth has not contributed to the reduction of the rate of ecological destruction either.

What is even more worrying are the effects of associated labour market reforms. In the context of wage and pension cuts, attempts to change labour laws under the euphemisms of 'flexibility' and 'flexicurity' not only reduce purchasing power and likely aggregate effective demand, but also have far-reaching social psychological and political consequences. Rising

unemployment, increasing uncertainty and dependence and widening social disparities tend to generate existential insecurity among the citizenry. Many detailed studies reveal how the lack of job security and decline of both social rights and trade unions have contributed to heightened existential insecurity in diverse locations across Europe. Existential uncertainty and insecurity can in turn trigger various social-psychological mechanisms, such as resentment and emotional distancing. Immigration adds to a volatile mixture. Particularly during times of heightened insecurity, nostalgia, nationalism and religion are sought as sources of meaning, identity and social reconnection. These meanings are not necessarily hostile to anyone, but when an economic crisis hits, the concerns and anxieties of everyday life can be mobilised for antagonistic politics in terms of frames, categories, and myths of a national or religious imaginary. The rise of nationalist populism in Europe comes as no surprise.

In other social sciences, the term 'structure' has a different meaning than in neoclassical economics. The term is used more descriptively and in a less charged way. The starting point is not a comparison with utopian 'efficient markets', but real social relations, processes and impacts. Structures emerge from rules that constitute and regulate identities, relationships, and practices. People's activities consist of practices where they follow rules and improvise on the basis of rules. In doing so, they renew and, from time to time, also shape social relationships. Internal constitutive and external causal relations form part of broader and multifaceted contexts, complexes and systems. Social wholes change with their parts. On the other hand, wholes condition parts and their possible changes; the functioning of parts is context-dependent. What we are depends also on our institutions.

Structures can be changed for the better, but they can also be made worse from any given normative vantage point. A variety of normative meanings can be ascribed to reform-proposals. Apart from effects on efficiency, changes may also purport to increase freedom, equality, justice or well-being or strengthen democracy or sustainability, or even further many values at the same time, although choices cannot be avoided. From this point of view, a structural change can mean, for example, changes to a set of rules defining a public organisation or an enterprise (e.g. purpose or ownership), or a change in power relationships (e.g. democratisation). Such changes are ethical and political. What kind of structural change increases, say, efficiency, well-being or fairness, is contingent, that is, depends on the specific circumstances of the change and on the wider socio-economic context.

For instance, flexibility may not be a bad thing as such. One possibility is the negotiated involvement model of relations of production, whereby employees intervene directly in the introduction of a process. This would provide functional flexibility of working practices instead of neo-liberal flexibility of wages and working conditions. Efficiency and innovations could be sought also in terms of bridging the gap between routine production and new emerging sectors of the economy and by means of deeper institutional experimentation. The possibilities for structural reform are endless.

A key structural change – changing the rules, principles and powers of the EU – would be to create full fiscal capacities for the EU. Also the ECB mandate could be changed to enable direct support for public expenditure. With access to new resources, the EU and its member states could also engage in selective reindustrialisation. An ambitious but feasible target would be to increase the average investment ratio within the EU by 5 percentage points, of which 3-4% would be coming from member states, 1-2% from the EU. The EU should focus

on those projects that require long time-horizons, continent-wide collaboration and large-scale investments.

Structural reforms can thus mean increasing the role of public powers in reconstructing the economy. As Mariana Mazzucato has argued in her highly acclaimed book *The Entrepreneurial State*,³ investments can generate new abilities and qualities. Strategic public investments and policies should aim at creating and shaping productive powers and markets. Public agencies should not only facilitate private sector investments by making them less risky, but also lead to the creation of new technological opportunities and qualitatively new markets. The making of new productive powers and markets can be achieved also on a grand scale through 'mission-oriented investments that led to putting a man on the moon and are currently galvanising green innovation'.

It is essential to avoid defending declining industries on the terms of established interests. Usually it is more reasonable to promote processes of path-dependent learning and viable prospects for the future, sometimes on an old, sometimes on an entirely new basis. A weak neoliberal state-formation is subordinate to the lobbying and pressure of the strongest interest groups, and especially those of the mega-corporations, while a self-sufficient, capable, and democratic public organisation can act autonomously and in a far-sighted manner. The point is to improve the quality and attractiveness of European commercial goods and services in world markets in a non-contradictory way, bearing in mind the generalisability of actions and global aggregate efficient demand. The focus of transformative innovation policy must be on anticipation, experimentation, participation, and directionality, aligning social and environmental aims with innovation objectives.

The aim of proactive economic policies would be to generate new investments, create capacity and increase output and thus reduce unemployment, which is a major source of existential insecurity. At the same time such policies will have to further gender justice, as well as ecological sustainability. The EU budget must be increased also in order to create redistributive systems such as proper regional policies, a European minimum wage, European programmes to fight ecological degradation and unemployment benefit schemes. A sufficiently high-level guaranteed minimum income for all European citizens would further decrease dependence of unstable markets. Also, democratic participation in processes of collective will-formation can generate trust and existential security. The idea is thus to democratise power-relations; make personal employment paths more secure; and actively shape economic developments in the desired direction by means of industrial and other policies. The goal would be to create a virtuous circle grounded in existential security and trust, encouraging hope for better futures.

2 Monetary and financial policies

Although EU leaders continue to attach great importance to financial integration, the ECB's annual Integration Report acknowledges that, in reality, little progress is being made. As usual, the solution is seen in the reinforcement of market processes through the Banking Union and Capital Markets Union projects. In reality, however, the key difficulties can only

³ Mazzucato, M. (2014), *The Entrepreneurial State. Debunking Public vs. Private Sector Myths*, revised edition, London: Anthem Press. See also Mazzucato, M. (2016), 'From market fixing to market-creating: a new framework for innovation policy', *Industry and Innovation*, 23 (02), pp.140-56.

be overcome by a change in policies and in the political orientation of the EU. On the one hand, an indispensable condition for effective integration is an agreed model of risk-sharing across member states and in particular among the Euro area countries which can no longer use exchange rate adjustments to mitigate the economic risks arising from external trade and capital flows. On the other hand the insistence of governing groups on market-based integration ignores or even denies the essential role of the public sector in securing the stability and the efficiency of the financial system: a role repeatedly demonstrated in financial history where public credit and public investment stabilise and orient private sector finance.

It should not be thought, however, that the failure of the current integration model means that member states can exercise a continuing autonomy in the financial sphere. Rather, the fragmentation of Europe's financial space will promote the penetration of dollar-based finance into the separated member states.

Since the main benefit of a more integrated financial sector would be the sharing of risks – both those affecting individual investments and those relating to asymmetric developments in the member states – the stubborn rejection of risk-sharing by some member state governments – in Germany and the so-called 'Hanseatic League'⁴ of smaller Northern and Baltic countries – contradicts their declared support for integration. The tight limitations which have been placed on the activities of the European Stability Mechanism, as regards both the scale of its loans and the conditions attached to them, provide one example of the problems arising from this rejection. Another is the insistence on long delays before the resolution- procedures of the Banking Union come into full force. In both cases the outcome is a failure to build a strong institutional framework for the EU's financial sector.

The German and like-minded governments tend to see any form of risk-sharing as threatening to promote a 'transfer union', which is itself seen as simply a loss to their taxpayers. It is true that the developmental gaps within the EU mean that southern and 'peripheral' economies are more likely to need help in dealing with economic shocks than the stronger economies of the 'core'. However, these gaps are a problem for the EU as a whole and EU bodies must, for both political and economic reasons, accept their share of responsibility in addressing them. The failure to deal with the financial crises of the last decade in a cohesive and organised way was, in the end, costly for all member states, not only the most vulnerable.

The affair of the Target-2 balances took the rejection of risk-sharing to absurd lengths. Excessive trade surpluses in northern member states and capital flight from southern states has led to central banks in the weaker economies of the monetary union acquiring substantial liabilities towards, in particular, the Bundesbank, and these are reflected in their balances in the Target-2 payments system. Some German commentators then suggested that the deficit countries' central banks should provide collateral for their debts to the surplus ones. Such a measure, in complete contradiction to the monetary union which makes all member central banks branches of a single system, would have put immense pressure on the banking sectors of the weaker economies. It would be as though the surplus branches of a commercial bank demanded collateral from deficitary branches: it would be impossible for the bank to function.

⁴ Brunsdon, J. and M. Acton (2017) 'The Hanseatic League 2.0' *Financial Times*, 7/11/2017.

The Quantitative Easing programme of the ECB has been distorted and impaired by the same political attitudes. The asset purchases decided on by the ECB have only to a very limited extent led to the purchased securities being held by the ECB itself. These securities are often held by the central bank of the country in which they were issued – once again pushing risk onto the weakest members and blocking effective integration.

A related set of problems in EU finance arises from the continuing reliance of EU leaderships on market competition and their failure to recognise the necessary dependence of private sector finance and investment on a strong and active public sector. Our Memoranda have repeatedly pointed to this dependence which has several dimensions, and which is discussed in more detail in chapter 1 above. Public investment can act as a macroeconomic stabiliser; the structure of public investment and the political commitments to certain patterns of development help to orient private sector investors and reduce the risks they face. The suppression of public investment by the arbitrary rules of the Stability Pact, reinforced by the Fiscal Compact, is therefore extremely damaging. It is also unreasonable: investments which are going to benefit several generations can, quite logically, be paid for by all those generations.

Equally important, although not always discussed, is the role of public borrowing and the issuance of government bonds in stabilising the financial sector as a whole and rendering the financial system more liquid. This applies to both bank-based and security-market based finance. (The ECB prefers security-market based development, largely on ideological grounds even though the Integration Report admits that '... the substitution of bank- financing by market- financing can give rise to new sources of risk and altered transmission channels that warrant careful monitoring from a financial stability perspective'⁵). Banks can use holdings of government debt and debt benefiting from government guarantee as liquid assets to cushion them against any run-off of deposits or other liabilities. In addition publicly owned banks permit both more social control over the activities of private sector banks and a public response to market failures in the banking sector, such as the inadequate financing of clean technologies. In security markets, government bonds fulfil several functions: they facilitate the pricing of riskier securities; they can be used as collateral for loans contracted in the private sector; they allow institutional investors such as pension funds to match their assets and liabilities more effectively.

Obviously there exist limits to government borrowing which it is imprudent to cross – for example the situation of the US after the recent tax cuts, not related to any investment programme, is far from healthy. But the exaggerated and unreasonable hostility of EU leaders to government borrowing impairs the functioning of private sector finance and renders the whole financial sector more fragile. The German *Schuldenbremse* restricts the issue of the only significant triple-A rated government bonds in the Euro area. At the same time, there has been intense resistance, from the German and like-minded governments, to any issue of bonds by EU-institutions, while it remains EU and ECB policy to maintain differential interest rates on government debt, supposedly to encourage tighter fiscal policies in the weaker economies. Thus, in spite of a certain narrowing of these differentials since the height of the financial crisis, the yield on Italian government bonds, at the end of November 2018, was some 2.78 percentage points higher than for German bonds, while the gap for Greece was 4.30%. The consequence is that the governments most in need of

⁵ ECB (2018), *Financial Integration in Europe*, p. 98.

finance find it most costly to raise it, and are hindered in doing so by the working of the ECB and other EU institutions.

The weakness of the EU financial system is one of the forces driving investors in Europe and around the world into the US financial system which is widely seen as the only major source of safe, liquid assets. The ECB's latest report on the international use of the Euro shows that in some key respects the dollar is gaining ground at the Euro's expense. 'This was particularly the case for outstanding amounts of international debt securities.'⁶ In fact, the attempts by investors around the world to hedge their growing US exposures have led to a significant premium for investors funded in dollars and a corresponding penalty for those funded in Euro. In the previous report⁷, the ECB recognised that the salience of dollar finance and the impact of fluctuations in the dollar zone have reduced the effectiveness of its monetary policy instruments. At the moment this is a small effect, but there is a distinct danger that current trends and policies will further impair the functioning of the monetary union. The failure of financial integration in the EU exposes all member states to increasing subordination to the dollar system.

Thus, the EU's financial sector, in spite of its present stability, is threatened by policies which block any move to a more coherent and coordinated structure and by an ideological hostility to the role of the public sector. The absence of any active policy towards external, global, monetary and financial problems is an important aspect of this failure which could result in a gradual loss of policy autonomy in the monetary union.

Last but not least, a financial system that serves the needs of society and of the planet, that is democratically governed and that is stable is a common demand, as put forward by the Change Finance coalition.⁸

3 The productive structure of the EU and the need for short and medium term transformation

The 'great crisis' of 2008 and the subsequent years has deepened the productive divide in the European Union. The industrial core countries around Germany managed to shift the burden of the crisis and adjustments to the deindustrialised periphery, mainly in the South and Southeast of Europe. In the Southern periphery, the productive structures have been weakened even more by the austerity policies. At the other side of the divide, the industrial core countries around Germany and the Central-East European industrial periphery that is closely linked to the German export complex have recovered relatively well after the crisis. In the core countries, GDP is generally at least 10% higher than in 2007 (cf. table 1). Open unemployment declined. After 2010, real wages rebounded relatively strongly only in Germany whereas they almost stagnated in the smaller core countries. The evolution of German wages can be viewed as a corrective movement to the decline of real wages in the pre-crisis years. The recent wage increases eased a bit the pressure on the wages of the other core economies, but not more than that. In the Central East European industrial periphery, GDP growth and real wage growth has been higher, though not in Hungary and Slovenia which had been particularly severely affected by the financial crisis and adopted

⁶ ECB (2018), *The International Role of the Euro: interim report*, June, p. 2.

⁷ Borio, C. et al. (2016) 'Covered interest parity lost: understanding the cross-currency basis', *BIS Quarterly Review*, September, pp. 45-64.

⁸ See <https://www.changefinance.org>.

strong austerity policies. The industrial sector of those countries is closely linked through foreign direct investment and production chains with the core economies, particularly Germany. These links are extremely concentrated in one manufacturing sector: the automotive industry. The share of cars and vehicles within the Visegrád countries' exports to and imports from Germany is between a third and two thirds.⁹ Particularly in the smaller economies, the share of the automobile industry in manufacturing and exports is extremely high. This narrow specialisation is extremely problematic. In addition, the future of the car industry is more than uncertain because cars contribute significantly to climate change and fossil-fuel based engines are increasingly questioned. A shift to electromobility, which would change the mix of required raw materials and energy resources and, thus, not resolve the underlying problematic of car transport, would massively hollow out the supplier functions of the Central East European economies. The regional patterns of FDI and industry in the Visegrád countries are extremely uneven and these regional disparities have tended to grow since the crisis. The limits of the FDI-based growth models are becoming increasingly visible, and they have started to become a topic of debate in the Central East European countries.

The rifts which have developed between and within member countries concerning gender justice and ecological sustainability have practically vanished from the general public debate, and been relegated to specialists' discourses. In order to reintegrate them into the debates on economic policy with an adequate weight, there should be a concerted taking stock effort of the EU and its member states concerning the present state and the possible scenarios of development of gender justice and ecological sustainability.

The position of France and Italy in the European division of labour had already become weaker in the pre-crisis years. The crisis and its aftermath have accelerated the relative decline. Italian GDP has not even recovered its to 2007 level. The South of Italy has suffered from particularly harsh socio-economic distress after the crisis.

The other Mediterranean countries have either barely recovered to the 2007 level of GDP or the GDP level is lower than before the crisis. The Greek real GDP has fallen by 24.5% (cf. table 1). For these economies, externally financed credit growth has ended. Austerity policies have depressed the domestic market. In most countries, real wages declined, particularly in Greece, Croatia and Cyprus. The collapse of domestic demand weakened manufacturing structures even more. Current account deficits declined or even vanished because of domestic demand and import cuts. In some cases, like Spain, exports have started to grow, but the export profile has deteriorated. For most of these countries, ground-rent based activities, like tourism, have been the main growth sectors. This is an extremely problematic profile with destructive social and ecological effects.

Even the European Commission acknowledges now that, coming out from a long and deep recession, a renaissance of the European industry is needed.¹⁰ The central role of manufacturing for economic growth and value creation has been recognised by several scholars that highlight its importance in sustaining productivity growth, employment and innovation. Such a role needs to be considered within a framework of increasing integration between manufacturing and services, as a road to construct long-lasting productivity gains. Looking at Knowledge Intensive Business Services (KIBS) integration in manufacturing is a way to analyse a brick of the overall 'tableau' of real convergence/divergence in EMU

⁹ Popławski, K. (2016), *The Role of Central Europe in the German Economy*, OSW-Report, Warsaw, pp. 25 f.

¹⁰ EU Commission. (2014), *Towards an industrial renaissance*, Industrial Policy Communication Update.

countries and to provide a perspective that contributes to inform specific dimensions of industrial policies.¹¹

The process of on-going transformation, when read through the lenses of manufacturing resilience and KIBS integration in manufacturing, presents a picture of increasing divergence of productive structures among Euro area countries. Real divergences can intensify the problems generated by asymmetric shocks, which have been recently experienced in the Euro area. From 2000 to 2014 the Krugman specialisation index increased for Euro area countries, driving the Euro area economy toward a model of production more vulnerable to asymmetric shocks. Such crises are hardly manageable within an incomplete monetary union as the Euro area. Among the Euro area countries, the best performer, Germany, is also the one that was able to develop a productive structure strongly based on manufacturing with a high level of KIBS integration, while the other larger economies (France, Italy and Spain) suffer from deindustrialisation (with different degrees all the three economies lost part of their manufacturing sectors), but differ in the degree of KIBS integration (higher in France and Spain than in Italy).¹² Despite the importance of the inter-linkages between manufacturing and KIBS in sustaining the industrial renaissance, this scenario shows a trend towards more specialisation and divergence in productive structure.

This uneven development of productive structures leads to a high transport intensity both in the production and distribution phases, contributing to an increase in the environmental pressure and an acceleration of the climate change. This contradicts the commitment of the EU countries to the Paris Climate Agreement.

To achieve both more even economic and social patterns and a higher degree of ecological sustainability, it is necessary to reduce the divergence in productive structures and to foster ecologically sustainable patterns of re-industrialisation in the periphery. In addition, transport, social and cultural infrastructure has to be re-established in rural areas, in particular in the periphery.

One way to tackle the uneven productive development patterns takes FDI as its point of departure. (Industrial) FDI contributes significantly to the spatially uneven development patterns both at the EU and the national level. An 'FDI imbalance procedure' could be introduced that would deal with the spatial polarisation of FDI and with negative tendencies of FDI such as a 'race to the bottom' in wages or labour conditions. The FDI imbalance procedure should be backed up by concrete action. In order to spatially re-balance investments, a levy of up to 10% on each FDI, depending on the size, should be paid into a FDI 're-balancing fund' which would finance investment in peripheral regions with hardly any FDI. Regulations should permit the imposition of a ceiling on the share of foreign investment in companies, at least in strategic sectors, in order to retain local control. Social 'conditionality' clauses should be attached to FDI. Thus, the Single Market pillar 'free movement of capital' has to be challenged.

¹¹ EU Commission (2013), *Towards knowledge driven re-industrialisation*, European competitiveness report.

¹² Antonioli D., C. Di Bernardino and G. Onesti (2018), 'Specialization in the Euro Area: A Vertically Integrated Sector Perspective and the Role of Knowledge Intensive Business Services', paper presented at the 24th Conference on Alternative Economic Policy in Europe, Helsinki, http://www2.euromemorandum.eu/uploads/antonioli_di_berardino_onesti_specialization_in_the_euro_area.pdf.

Specific industrial policies have to be developed at the EU, national and sub-national levels. Industrial policies should be ecologically selective: sub-sectors that are ecologically problematic may not be promoted. A conversion fund for ecologically very problematic sectors (e.g. car industry) should be considered. They should be targeted at particular on regions with a narrow specialisation in ecologically problematic sub-sectors (brown sub-sectors). Pro-active ecological conversion policies in production, energy, transport are necessary and technologically feasible.

Production-oriented policies have to take the highly heterogeneous conditions in core and periphery countries into account. These policies should not be unilaterally oriented towards exports. On the contrary, it is necessary to develop inward-looking industries as well and to foster production-consumption circuits at smaller regional scales. This would be beneficial both for socio-economic development in peripheral regions and for ecological sustainability. Peripheral regions should be able to mobilise protective mechanisms (e.g. in tendering) in order to (re-)build productive capacities. Regarding infrastructure policy, the prevailing focus hitherto on Trans-European Networks of both the EIB and the European Commission needs to be abandoned.

Industrial policies should not only be targeted at major enterprises. Easing and promoting manufacturing/KIBS integration for manufacturing SMEs, which are not able to access to them because of a lack of skills, competencies, funds, etc., can be a viable and fruitful option. Indeed, several countries (e.g. Italy) have a strong prevalence of SMEs in their productive systems. Focusing attention on the technological dimension, the manufacturing/KIBS integration should be promoted both in high-tech manufacturing industries and low-tech industries, since the latter are less prone to develop such linkages, but could gain great advantages if stimulated by specific policies. Finally, targeted industrial policies for specific countries or regions to foster manufacturing growth in those sectors that better integrate KIBS are necessary (e.g. the already implemented 'Smart Specialisation Strategies' seem to be going in the right direction). Such policies have to be implemented while trying to avoid a polarisation toward leaders (e.g. Germany), encouraging the catching up of the lagging countries in terms of manufacturing or KIBS integration and taking into account sector inter-linkages and vertical integration processes that EMU countries' productive structures are experiencing.

Public investment banks with long-term financing could support industrial and structural policies. Their financing criteria should include ecological issues.

4 Social policies in the EU and the Nordic welfare model

Recent developments

Ten years after the manifestation of the financial and economic crisis in Europe, it is becoming increasingly clear that crisis management in the form of widespread austerity governance has resulted in entrenching inequality and social exclusion.¹³ In 2016, 118.0 million people in the EU, 23.5% of the population, lived in households at risk of poverty or social exclusion. This is, as Eurostat announces, equivalent to a 0.3 percentage point decrease in the share of the total population. Despite this modest decline compared to

¹³ Eurostat (2016) *People at risk of poverty or social exclusion* https://ec.europa.eu/eurostat/statistics-explained/index.php/People_at_risk_of_poverty_or_social_exclusion (last accessed 20 December 2018).

2015, the share of the EU-28 population that was at risk of poverty or social exclusion is at 'a level that had not been recorded since 2010'. Despite the programmatic focus of the EU2020 strategy on poverty alleviation, among other targets, it appears that the fundamental and rather tragic irony of such a statement is characteristic of the overall state of social policy in the EU.

A decrease in the share of Europeans at risk of poverty and social exclusion, however small, is surely to be welcomed. However, seeing this against the background of ten years of EU crisis management, it becomes clear that the increase in poverty and social exclusion has been concomitant with policies that prioritise disciplining debt, accommodating monetary policies and fiscal austerity. In particular, the divergence in levels of inequality (between as well as within member states) corresponds to the increasing macroeconomic imbalances between member states, corroborating the persistent critique of the EuroMemo Group that EU policies, in the absence of effective redistributive mechanisms, are not working towards fighting rising inequality in Europe. Part of this development is due to the lowering of standards against which the decrease in the share of Europeans at risk of poverty and social exclusion is measured. This chapter takes up this discussion of developments pertaining to social policies in the European Union. Since the presentations that contributed to this publication took place at the 2018 EuroMemo Group Conference in Helsinki, specific emphasis is here also put on the Nordic welfare model. In the following, some key themes and trends are discussed, and after outlining core points of critique, references to alternatives are put forward. As Zeilinger and Reiner show, the European Semester has led to a comprehensive decline in the annual growth rate of social expenditure.¹⁴ Basically, as was intended, social policies have become subordinated to the primacy of balanced public budgets.

This comes against the background of broader, overall trends within social and labour market policies across Europe, such as the pronounced shift towards supply-side labour market policies. At the same time, through an intensification of means-testing for social provisions, solidaristic and universal notions of welfare are being increasingly undermined, not least in reference to migrant and refugee communities. The endgame is competitiveness rather than social well-being. Where does that leave the discourse of a 'European Social Model', and which trajectories are there for possible change?

EU Competitiveness and the social model

While the 'European Social Model' and its vaguely progressive outlook once had offered the legitimising discourse to Third Way politics,¹⁵ after years of an ongoing constitutionalisation of austerity that has been negotiated, managed and implemented in response to the crisis, this European Social Model has become completely amorphous. What has long been the 'substitute collective horizon of the future'¹⁶ seems rather to have been turned into a mere rationalisation for austerity and neoliberal supply-side policies. The renaissance of 'social Europe' through the European Pillar of Social Rights (EPSR), an innovative but essentially

¹⁴ Zeilinger, B. and C. Reiner (2018) 'Trajectories of reforming European welfare state policies under the post-2008 socio-economic governance regime.' Paper presented at the 24th Conference on Alternative Economic Policy in Europe, Helsinki.

¹⁵ Bailey, D. (2016) 'The End of the European Left? Social Democracy, Hope, Disillusion, and Europe.' *Near Futures Online* 1 (March 2016).

¹⁶ Miró Artigas, J. (2017) 'European integration, social democratic Europeanism and the competitiveness discourse: a neo-Poulantzian approach to discursive policy analysis.' *Palgrave Communications* 3/2017, p.6.

non-binding framework invoking social rights, needs to be seen in conjunction with internal devaluation as a cornerstone of the EU's industrial policy;¹⁷ buying into a discourse that fundamentally undermines any chance for even remotely reconciling the economic and social objectives put forward, with competitiveness as 'master policy paradigm.'

The EPSR appears to place a strong emphasis on salvaging the European Social Model discourse, bolting it onto the industrial policy package. The Commission's position on this is rather clear in prioritising one over the other, arguing that, while 'economic and social progress are intertwined', social rights are, at the end of the day, means to the end of competitiveness: 'The establishment of a European Pillar of Social Rights should be part of wider efforts to build a more inclusive and sustainable growth model by improving Europe's competitiveness and making it a better place to invest, create jobs and foster social cohesion.'¹⁸ The EPSR is mainly meant for the Euro area, as 'a stronger focus on employment and social performance is particularly important to increase resilience and deepen the Economic and Monetary Union'. Perhaps not unintentionally, the Commission has here conveniently left out that part of the story where EU crisis management and austerity have contributed to, if not caused, the social crisis that the ESPR is now seeking to address. Surveillance and enforcement mechanisms are grafted onto the pre-existent EMU institutional frameworks incorporated into the multi-annual financial framework of the European Semester, aiming to increase the effectiveness of fiscal and macroeconomic surveillance to ensure fiscal discipline and coordinated action on key policy priorities at the EU level.¹⁹ The format and scope of these measures – as manifested in the 'Six Pack' (2011) and 'Two pack' (2013) as well as in the Euro Plus Pact (2011) and the Fiscal Compact Treaty (2012) – imply several ordoliberal elements, e.g. strict numerical thresholds and rules for national fiscal and macroeconomic policies as well as a comprehensive liberalisation strategy of all market-related policies.²⁰

The enhancement of macroeconomic surveillance provides the Council and the Commission with greater discretionary authority in addressing macroeconomic imbalances. The country-specific recommendations, adopted by the Ecofin-Council upon a proposal from the Commission, frequently stress the need for structural reforms of welfare regimes. Macroeconomic imbalances and rising deficits have exerted a growing pressure on national welfare budgets, as by 2016 the social expenditure of the EU-28 accounted for two-thirds of total government expenditures.²¹

Another pertinent example for how the EU's push for liberalisation interferes with social policy objectives at the national and local level is the area of state-aid regulation, which is

¹⁷ Wigger, A. and L. Horn (2019) 'The bed you made. Social democracy and industrial policy in the EU' In: Hay, Colin and Dan Bailey (eds) (2019) *Diverging Capitalisms: Britain, the City of London and Europe*, Routledge.

¹⁸ European Commission (2017) *Establishing a European Pillar of Social Rights*, COM(2017) 250 final, Brussels.

¹⁹ Zeilinger, B. and C. Reiner (2019) 'Trajectories of reforming European welfare state policies under the post-2008 socio-economic governance regime'. In: eds. Stefanie, Wöhl/ Elisabeth, Springler/ Martin, Pachel/ Bernhard, Zeilinger (2019) *The State of the European Union. Post-crisis Policy Responses?* Springer: Berlin.

²⁰ Zeilinger, B. and C. Reiner (2018) 'Trajectories of reforming European welfare state policies under the post-2008 socio-economic governance regime.' Paper presented at the 24th Conference on Alternative Economic Policy in Europe, Helsinki.

²¹ Eurostat COFOG (2016) *Government expenditure by function*, available at https://ec.europa.eu/eurostat/statistics-explained/index.php/Government_expenditure_by_function_%E2%80%93_COFOG (last accessed 20 December 2018).

increasingly used as mechanism for privatisation, as well as constraining public services. When public expenditure is increasingly interpreted as state aid, and hence per se as suspicious, it is mainly through exemptions that public services can be safeguarded. These come with high requirements in terms of expertise and documentation, putting in particular smaller local projects at risk, and hence potentially contributing to regional disparities.²²

Changes in Nordic welfare states

One of the core aspects of the discussions on social policies and the Nordic welfare model at the EuroMemo conference has been the transformation of the state: not only for setting the focus, format and scope of social policies, but also, as famously argued by Polanyi, the fundamental role of setting up the conditions for markets to function in the first place. What we see is not necessarily 'less state', but a *recalibration* of state involvement in specific policy areas. This becomes very clear when looking at developments in the Nordic welfare states. The Nordic countries arguably have the most advanced welfare regimes in the global economy. Financed by general taxation, the Nordic welfare model has traditionally been characterised by relatively extensive universality, underpinned by a commitment to decommodification.²³ However, already since the 1970s fractures in the welfare state model have become manifest.

The restructuring of the respective Nordic welfare state architectures since the 1990s towards more means-tested social provision based on active labour market policies, in particular flexicurity,²⁴ has been criticised for its social costs, ideological bias towards austerity and limited results in structurally changing unemployment and poverty.²⁵ Developments in Sweden are indicative of broader trends in this regard, seen against a background of increasing neoliberalisation.²⁶ The partial decommodification achieved during the early post WW II decades has been reversed; new areas such as health, education and welfare have been (re)commodified and financialised. Belfrage and Kallifatides here show the inherent unsustainability of a financialised model which is reliant on increasing levels of household debt.²⁷ They refer to Sweden as a critical case study for the sustainability of the finance-dominated growth regime in Europe, which risks jeopardising core Nordic principles such as gender equality, ecological sustainability and work-place codetermination.

²² Reegård, S. (2018) State Aid Rules- Restricting room for social policy and public service? Paper presented at the 24th Conference on Alternative Economic Policy in Europe, Helsinki, http://www2.euromemorandum.eu/uploads/reegard_a_nordic_perspective_state_aid_rules.pdf

²³ Esping Andersen, G. (1990) *The three worlds of welfare capitalism*, Princeton University Press; Kildal, N. and S. Kuhnle (2005) *Normative Foundations of the Universal Welfare State*. London: Routledge.

²⁴ Kvist, J., Fritzell, J., Hvinden, B. and O. Kangas (2012) *Changing social equality: The Nordic welfare model in the 21st century*. Bristol: Policy.

²⁵ Kananen, J. (2014) *The Nordic Welfare State in Three Eras: From Emancipation to Discipline*. Aldershot: Ashgate.

²⁶ Hollander, E. (2017) 'The contemporary relevance of Karl Polanyi – a Swedish case.' In: Hanappi, H., Katsikides, S. and M. Scholz-Wäckerle (eds) *Theory and Method of Evolutionary Political Economy: A Cyprus Symposium*. Abingdon: Routledge, pp. 54-72, available open-access at <http://hig.diva-portal.org/smash/record.jsf?pid=diva2%3A1071837&dswid=8183> (last accessed 20 December 2018).

²⁷ Belfrage, C. and M. Kallifatides (2018) 'Financialisation and the New Swedish Model' *Cambridge Journal of Economics*, 42(4), pp. 875–900.

Reflections on alternatives

The EuroMemo Group insists that the focus of the European Union should be working on a policy framework that engenders a Europe of inclusion, ecology, and solidarity. Whether this can ever fully be the case, given the constraints of an increasingly authoritarian neoliberal EU outlook, is indeed a question itself. None the less we call on EU actors and the involved social partners and organisations to take seriously the disastrous consequences of many years of austerity governance; now more than ever it is clear that social policies cannot simply be a flanking measure to mitigate the worst effects of the relentless push for competitiveness across Europe. Overarching objectives guiding the considerations of alternative policies, as they have been put forward in the previous EuroMemorandum, include strategic decommodification of social policy and labour markets, with a focus on non-market principles as key dimensions. This means recalibrating social policy towards reciprocity and trust, and safeguarding local and municipal initiatives. To achieve this, a better balance between monetary and fiscal policy mechanisms is needed. Free movement of capital and services should not be prioritised over collective bargaining and labour rights. EU State Aid regulations should not be used as a general mechanism of privatisation and its use be restricted to substantial cross-country activities. Crucially, with regard to social welfare regimes, this also involves rethinking the valuation of non-market activities such as care work. There are important gender and class dimensions that need to be taken into account here. Moreover, even though it is a long-term goal rather than an immediate policy measure, wealth redistribution should be within the focus of policies addressing inequalities within Europe. In order to prepare Europe for the urgently needed energy transition, a rebuilding of reciprocity and trust is also vital.

In this context, notably the restructuring of the welfare regimes concomitant to broader changes in the organisation of work and technological change, universal basic income has once again resurfaced as a potential redistributive social policy instrument, in Europe and beyond.²⁸ The recent Finnish basic income pilot project, under which a select group of unemployed welfare recipients received a guaranteed monthly income of €560 over a two-year period, has received particular attention and interest.²⁹ It is also an interesting example of the politics and discursive embedding of basic income discussions, with an increasingly politicised debate. Within the EuroMemo Group, there is an awareness that UBI is a pertinent proposal for alternative policies, but that there is also a need for nuanced discussion of the promises and pitfalls of concrete suggestions; all the more, since they come from both the left as from the right. This shows the centrality of the issue, particularly at a time of ecological transition, when issues like decommodification and the emergence of new forms of cooperation are crucial. As for the affordability of such schemes, one should not only take into account financial means but also free provision of basic services and support for local complementary currencies. UBI debates should not crowd out other proposals such as universal basic services.³⁰

²⁸ Haagh, L. (2018) *The Case for Basic Income*. Cambridge: Polity; Standing, G. (2017) *Basic income: and how we can make it happen*. London: Pelican/Penguin.

²⁹ For an overview see e.g. De Wispelaere, J., Antti Halmetoja and Ville-Veikko Pulkka (2018) 'The Rise (and Fall) of the Basic Income Experiment in Finland' *CESifo Forum* 03/2018 (Autumn).

³⁰ Social Prosperity Network (2017) *A proposal for Universal Basic Services*, available at https://www.ucl.ac.uk/bartlett/igp/sites/bartlett/files/universal_basic_services_-_the_institute_for_global_prosperity_.pdf (last accessed 20 December 2018).

On a broader level, it is imperative to ask which social forces are continuing or might be mobilised to join the struggle against austerity and social erosion in the EU. As the discussion in the introduction has made clear, a popular political economy in the EU is a complex question. Rather than an easy answer often given by progressive forces of pointing to the usual suspects, a realistic understanding of the concrete relationship of forces and balances of power at EU, national and local level is essential; even more so in the coming elections for the European Parliament. Even if a progressive majority should be able to constitute itself, there is no guarantee that their programmatic focus for social policies would indeed contribute to the *radical* transformation necessary to contribute to a Europe where the fight against social exclusion and poverty is not a means to an end, but a fundamental priority.

5 Authoritarian populism and the challenge of reconstructing a popular political economy for the EU

One of the most worrying developments since the outbreak of the global financial crisis in 2007 has been the re-emergence of nationalism and authoritarian populism in the EU. Right-wing nationalism has exerted a growing influence on, if not dominated, public discourse and the general thrust of politics, particularly with respect to the migration issue. Nationalist parties have increased their vote share since the early 2000s to some 20% of the EU electorate, are members of governments in nine EU countries (e.g. Austria, Italy), or govern alone (e.g. Hungary, Poland).³¹ Their style of politics is patently populist, if not authoritarian. Amongst these are a marked cult of (male) leadership, contempt for the institutions of representative democracy, in particular parliaments, courts and the liberal media, as well as militant campaigning against feminism, and Muslims and other groups. In terms of their economic ideology, positions stretch from straightforward neoliberalism to more conservative nationalism.³²

Do cultural or economic factors explain the emergence of nationalist authoritarian populism?

Unsurprisingly, the discussion differs on the causes for the emergence of nationalist authoritarian populism. While in particular the liberal press attributes its root cause to emotions and subjective fears not grounded in the facts,³³ a strong current in mainstream political science emphasises cultural factors. Indeed, prominent scholars like Ronald Inglehart and Pippa Norris go so far as to suggest that support for populism does not pose an existential threat to democracy, but is probably a transient cultural phenomenon rooted in the conservative values and lower educational level of an older, mostly male and rural population.³⁴ For the case of Europe, the available evidence indeed suggests that support for

³¹ See Timbro Authoritarian Populism Index 2017, <https://timbro.se/allmant/timbro-authoritarian-populism-index2017/>

³² See Becker, J. (2018), 'Neo-Nationalismus in der EU: sozio-ökonomische Programmatik und Praxis', *Materialien zu Wirtschaft und Gesellschaft* 179, Arbeiterkammer Wien, <https://emedien.arbeiterkammer.at/viewer/ppnresolver?id=AC15181468>

³³ De Vries, C. and I. Hoffmann, (2016), 'Fear not values. Public opinion and the populist vote in Europe', *eupinions* 2016/3, Bertelsmann Stiftung. Available at: https://www.bertelsmann-stiftung.de/fileadmin/files/user_upload/EZ_eupinions_Fear_Study_2016_ENG.pdf

³⁴ Inglehart, R.F. and P. Norris (2016), 'Trump, Brexit, and the Rise of Populism: Economic Have-Nots and Cultural Backlash', *Faculty Research Working Paper Series*, RWP16-026, Harvard University, Cambridge.

populism is generally stronger among the older generation, men, the less educated, as well as religious and ethnic majorities. On that basis, they forecast that populism will not make a long-term impact upon the viability of liberal democracies.

Though the diverging cultural orientations across different social groups are evident, we doubt that time alone will solve the problem of nationalist authoritarian populism. Alternative empirical work has documented a strong correlation between crisis-induced economic insecurity and voting support for non-mainstream, and in particular 'populist' parties in Europe.³⁵ Thus, a more profound analysis of the social dynamics at play is necessary. Interestingly, Inglehart and Norris themselves note in their study that it is not the working class, but what they refer to as the petty bourgeoisie, i.e. small company owners and farmers, which accounts for the highest voting shares for populist parties in Europe. Some evidence show also that women are more and more involved in authoritarian populist parties, especially because of fear of immigration (see Box 1). These results underline the importance of analysing the behaviour of distinct social groups and how they have been affected by neoliberal economic policies.

Box 1: Women and authoritarian populism in Europe

A consolidated literature reveals that men are more likely than women to vote for parties of the populist radical right (PRR).³⁶ The programmes of these parties are usually biased massively against gender equality. They advocate policies that aim at restoring 'traditional' gender roles, e.g. in the realm of social policies. Many of those parties take a stance against LGTB rights and try to tighten abortion legislation. In Poland, the possibly broadest protest against the PiS government was organised mainly by feminist and women's groups against the proposed further tightening of the legislation on abortion. However, recent evidence seems to signal a reduction of the voting gender gap in Europe.

Results of the last Italian parliamentary elections (March 2018) show that women voted for the populist radical right League to a slightly higher extent than men (17.6% of women compared to 17.1% of men). Moreover, the other party in the current populist Italian governing coalition, the 5 Star Movement,, exhibited a slightly greater share of women voters (32.9%) compared to men (32.8%).³⁷

More generally, according to 2017 Eurobarometer data, women show a greater propensity to a combination of anti-immigration attitudes (negative feelings about migration, disagreement on increasing support to refugees and dissent about the actual contribution of migrants to the host country) and authoritarian views (request for stricter punishment of criminals).

The role of the media system has been crucial in determining the electoral success of some populist radical right (PRR) European parties (FPÖ in Austria, the League in Italy, Front National in France, and

³⁵ Algan, Y., S. Guriev, E. Papaloannou and E. Passari (2017), 'The European trust crisis and the rise of populism', *Brookings papers on economic activity*, BPEA Conference Drafts, September 7-8. Available at: https://www.brookings.edu/wp-content/uploads/2017/09/4_alganetal.pdf

³⁶ Differences in the gender distribution of structural characteristics such as education, occupation, class and other predictors of PRR support have been advanced in order to explain diverging voting patterns of men and women. See Hartevelde, E., W. Van Der Brug, S. Dahlberg, and A. Kokkonen (2015), 'The Gender Gap in Populist Radical-right Voting: Examining the Demand Side in Western and Eastern Europe', *Patterns of Prejudice*, 49 (1-2), pp. 103-134.

³⁷ See Heino, A.J. (2017), '2017 Timbro Authoritarian Populism Index'. Available at: <https://timbro.se/app/uploads/2018/01/populism-index-2017.pdf>

the Swedish Democrats in Sweden), especially by providing extensive coverage of the issues of migration and crime.³⁸ Progressive responses should counter this by attempting to highlight the positive effects of migration, e.g. its potential positive fiscal impact (improved tax base and welfare coverage in the long run).

The decline of the middle-classes and its implications for democratic politics

Various studies indicate that it is not only workers who vote for populist parties but even more so the middle classes, here understood as the intermediate classes of craftsmen, small businesses, professionals and technicians, and public sector employees situated between capital owners (the bourgeoisie) and the working class.³⁹ Empirical research has shown that the social consequences of neoliberalism including the adoption of key neoliberal policies by many centre-left parties have resulted in mass abstention from voter participation by low-skilled workers, and that the voting behaviour of the middle classes has become more important for determining the distribution of political power. It is well-recognised in the literature, that the ambivalent political orientations of the middle classes are prone to change during periods of crisis.⁴⁰ While the authoritarian inclinations of the petty bourgeoisie have been more or less held at bay during the period of the post World War II welfare state by a social contract, which provided a basic safety net for small producers and supported upward social mobility, more pronounced forms of support for authoritarian regimes might re-emerge in response to (perceived) threats to the social status of the middle-classes.

Support for the parties of the political centre as the home base for the petty bourgeoisie after World War II has been marked by a steady decline over the last three decades. This observation holds true particularly for the centre-left, with social democracy losing almost 20 percentage points or half of its 2000 vote cast by 2017 in core EU countries like Germany, France and Italy.⁴¹ Thus, the party political system is increasingly characterised by a weakening ability of traditional mass parties to accommodate the interests of both the middle classes and the working class with the interests of capital owners. As a result, substantial segments not only of the working class, but also of the middle classes have voted for political outsiders, and in particular right-wing nationalist parties.

The disenchantment of both the middle-classes and the working class is not based on misinformation or irrational sentiments, but by the fact that their interests are not taken into account by governments, as shown by a growing body of empirical research, both for

³⁸ See Manucci, L. (2017), 'Populism and the Media'. In: Rovira Kaltwasser, C., P. Taggart, P. Ochoa Espejo, and P. Ostiguy (eds), *The Oxford Handbook of Populism*, Oxford: Oxford University Press.

³⁹ See e.g. Arzheimer, K. (2012), 'Electoral Sociology: Who Votes for the Extreme Right and why – and when?' In: Backes, U. and P. Moreau (eds.): *The Extreme Right in Europe. Current Trends and Perspectives*. Göttingen: Vandenhoeck & Ruprecht, 35-50; Hilmer, R., B. Kohlenrausch, R. Müller-Hilmer, and J. Gagné (2017), 'Einstellung und soziale Lebenslage. Eine Spurensuche nach Gründen für rechtspopulistische Orientierung, auch unter Gewerkschaftsmitgliedern', *Working Paper Forschungsförderung*, 44, August 2017, Hans-Böckler-Stiftung.

⁴⁰ See Algan, Y., S. Guriev, E. Papaloannou and E. Passari (2017), 'The European trust crisis and the rise of populism', *Brookings Papers on economic activity*, BPEA Conference Drafts, September 7-8. Available at: https://www.brookings.edu/wp-content/uploads/2017/09/4_alganetal.pdf

⁴¹ See Pauly, M. (2017), 'European social democracy extinct?', *Social Europe Blog*, 26 January 2018. Available at: <https://www.socialeurope.eu/pauly>

the US and for Europe.⁴² The growing exclusion has, however, apparently not dynamised the militancy of the working class. Instead, empirical studies have found that political activism and protests decline with rising levels of inequality.⁴³

The rising share of the vote for right-wing nationalist parties all over Europe is nevertheless signalling a creeping crisis of political representation grounded in both actual and feared deterioration of the living standards of both the middle classes and the working class. Though this indeed indicates the demise of the idea of social democracy as institutionalised in the post-World War II welfare state, it should not be interpreted as foreboding the straightforward transition to authoritarianism. Given that the relationship between capitalism and democracy is highly contingent, no straightforward forecasts are possible. The decisive question at the current conjuncture is thus whether a recovery of a socially inclusive democracy by way of promoting an alternative political project is feasible.

Prospects for a popular political economy in the EU

More than ten years after the outbreak of the global financial crisis, European politics currently finds itself at a crossroads. Assuming that a further muddling-through will sooner or later become untenable, three markedly different future development trajectories can be envisaged: a further deepening of authoritarian nationalism, the emergence of a liberal-cosmopolitan model or the reconstruction of a democratic regionalist model.

The authoritarian-nationalist model aims at sustaining neoliberal economic policies while strengthening the nation state, but can achieve this only with recourse to increasingly authoritarian forms of governance. Such a model would essentially rest upon a political alliance between the export-oriented sectors, in particular the middle bourgeoisie (medium sized entrepreneurs) and the petty bourgeoisie, potentially with support from working class segments. The economic feasibility of the model depends on the external competitiveness of the economy. The high social costs of the model, coming in the form of wage depression, high levels of unemployment as well as poverty, will have to be managed politically by the fragmentation of the subaltern social classes. Clearly, the model strengthens the power of the government and its repressive apparatus at the expense of the parliament and the judiciary. Though not a straightforward necessity, the dynamics might eventually lead to more pronounced forms of authoritarian rule. With respect to European integration, the model approves of the single market and its neoliberal form of regulation, but opposes further political integration and federalism.

The liberal-cosmopolitan model aims at strengthening global institutions in order to democratically manage globalisation. Though global governance can be imagined as operating by a purely technocratic process, in terms of attaining a minimum dose of democratic legitimacy, the model would need to involve some form of global federalism and be supported by extensive stabilisation and redistribution mechanisms as proposed by concepts of Global Keynesianism.⁴⁴ Except for the technocratic version, which fits well with Hayekian conceptions of the constitutionalisation of the economic order, political support

⁴² For the US see Gilens, M. (2012), *Affluence and influence: economic inequality and political power in America*, Princeton. For Europe see Schäfer, A. (2015), *Der Verlust politischer Gleichheit. Warum die sinkende Wahlbeteiligung der Demokratie schadet*, Frankfurt a.M.

⁴³ See Solt, F. (2015), 'Economic inequality and nonviolent protest', *Social Science Quarterly*, 96(5), pp. 1314-1327.

⁴⁴ See e.g. Patomäki, H. (2013), *The Great Eurozone Disaster. From Crisis to Global New Deal*, London.

for a democratic project of global federalism would probably exclude the transnational factions of capital and the upper strata of the new petty bourgeoisie. Whether support could be organised amongst the middle classes and the working class is an open question, though some initiatives have been emerging recently.⁴⁵ The preponderance of nationalism for legitimising political rule in most of the important countries of both the advanced and emerging world might also present an impediment to its political feasibility for the foreseeable future.

The democratic-regionalist model, combines the strengthening of democratic governance at all three levels: local, national, and EU, with a move towards selective de-globalisation of economic activity. Its realisation will depend on an alliance of the working class with important segments of the new urban middle classes (small-scale entrepreneurs, the precariat, and the traditional petty bourgeoisie including small-scale farmers and public sector workers). Forging such an alliance of heterogeneous social actors will not be easy. In the short-to medium term, this calls for a looser and associational form of cooperation, which respects the identity of each actor within their own field of action, but unites them under the general framework of a 'mosaic-left' in concrete political campaigns.⁴⁶ In the longer-term however, via a process of joint political struggle, a new progressive identity uniting the alliance members will have to be formed, in order to pursue a common and shared political agenda, particularly at the EU level.

Which of the three strategic trajectories outlined above will unfold in the time to come, is obviously anyone's guess. The only conclusion that we can draw with some certainty is that the next phase of capitalist development will be marked by heightened levels of conflict and crisis. History suggests that in such periods societal trajectories are comparatively more open, which eventually offers opportunities for progressive political change. In their efforts to hold back the renaissance of authoritarian populism, progressives should thus focus on struggles and agendas that promote the *Good Life for All*.

Such a popular agenda should comprise three basic elements. Firstly, the fight against the widely perceived injustices of the model of neoliberal capitalism not only with respect to the distribution of income and wealth, but of other inequalities of recognition and representation more generally.⁴⁷ Fighting the basic existential insecurities that have been sharply increased needs to be central. A second point refers to the need for protection against the negative impacts of corporate sector-driven globalisation and the quest for an alternative architecture of international cooperation. The latter's focus should be on addressing issues of financial regulation, taxation, public health, environmental policies, the rights of migrants including climate refugees, and development cooperation.⁴⁸ A third point relates to the urgent need for advancing the socio-ecological transformation of our resource and energy-intensive production and consumption models. This must be complemented with policies to promote local economies and solidary forms of economic production and consumption. The social inclusiveness of the model must be secured through an employer of last resort function of the public sector and the further development of the universal welfare system.

⁴⁵ See e.g. the Progressive International, <https://www.progressive-international.org/open-call/>

⁴⁶ Urban, H.J. (2009), 'Die Mosaik-Linke. Vom Aufbruch der Gewerkschaften zur Erneuerung der Bewegung', *Blätter für deutsche und internationale Politik*, 5/2009, pp. 71-8.

⁴⁷ Fraser, N. (2008), *Scales of justice. Reimagining political space in a globalizing world*. Cambridge and Malden.

⁴⁸ Nölke, A. (2017), *Linkspopulär. Vorwärts handeln statt rückwärts denken*. Frankfurt am Main.

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