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for Innovation and Societal Change

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Public Policy Brief

Whitaker Institute

The year 2013 marks the fifth year of the Eurozone crisis. With the Eurozone unemployment rate at record levels, 11.7 per cent as of September 2012, and social unrest in many member states, it is time to reflect and critically examine the economic austerity policies that were introduced to overcome the crisis. It is very clear from the emerging economic data that the austerity measures are not only ineffective in the peripheral countries but they also are beginning to hurt the healthy (trade) surplus core countries like Germany.

With the growing discontent to the Austerity policies in Europe, there is also a growing demand for seeking alternative policies for solving the crisis. The alternative policies would only come about by recognizing the dynamic interplay between the financial sector and the real sector where the trade imbalances were accruing before the crisis, and more importantly by seeking alternative economic theoretic basis for analyzing and solving the crisis. It is in this context, Whitaker Institute in NUI Galway in collaboration with the Economics Discipline at the School of Business and Economics organized a three-day workshop titled "Finance, Sovereign Debt and Eurozone Crisis" in early November in 2012. The outcome of the workshop is this public policy brief that articulates an alternative vision for solving the Eurozone crisis.

The policy brief, jointly written by the signatories below and endorsed by several leading economists and social scientists from all over Europe and beyond, outlines an alternative vision for solving the Crisis. The Alternative Vision Statement has been disseminated in Europe and beyond. So far it has been published in Il Manifest in Italy, Publico in Spain, Pagina 12 in Argentina and Economic and Political Weekly (EPW) in India. It is also published in various websites and blogs around the world.

Whitaker Institute is delighted to publish the alternative vision statement as a policy brief and we hope the brief would generate diverse debate both in academic and policy circles. We also feel that the publication of this policy brief is timely. With the upcoming Irish term for European Presidency, Ireland could use the Presidency to articulate an alternative vision for solving the Euro crisis. The policy brief could provide one such alternative to engage and further the debate in Europe.

Dr. Srinivas Raghavendra

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NUI Galway
November 2012

An Alternative Vision for the Eurozone Crisis

The Eurozone crisis has been reduced, according to the mainstream diagnosis, to a fiscal crisis caused by excessive public spending and a competitiveness gap between North and South. The mainstream solution is to close this gap by means of 'expansionary fiscal austerity' and wage reductions. This has been admitted even by the IMF to be a dead end.

In our opinion the root of the Euro crisis lies in both the inadequate institutional set up of the Eurozone, which lacks a genuine lender of last resort and sufficiently coordinated fiscal and wage policies, and on an over-liquid and under-regulated international financial market that was more than happy to finance any imbalance - no matter how unsustainable it was.

What we had in Continental Europe were mutually dependent models of growth. The mercantilist export-led growth of the North could not have been sustained without a (remarkably easy-to-finance) debt-driven model in the South, accumulating trade deficits and private and public debt. In the aftermath of the financial crisis, the private debt was turned into sovereign debt. The Irish case is an extreme example of this process. The ensuing austerity policies enforced upon the governments increased unemployment to a socially unacceptable level. If continued these policies will lead to a prolonged depression and even more social unrest.

European institutions were and still are not able to deal with such structural imbalances in an adequate way. Mass unemployment and social deprivation resulting from austerity policies is threatening the survival of democracy in the European Union.

Alternative perspectives

On the basis of our diagnosis we are convinced that Europe should reverse the current austerity policy regime. This would require profound institutional and policy change.

In terms of monetary policy, we believe that ECB should act as a credible lender of last resort to relieve the sovereign debt crisis. Strict regulation of financial markets is a further step, and it is necessary to separate investment banking from commercial banking.

In terms of fiscal policy, the link between the ECB and fiscal conditionality should be fundamentally changed. Monetary policy should support and accommodate progressive fiscal rules aiming at employment creation and growth. Budget deficits can only be consolidated in a growing economy.

These growth stimulating policies are consistent with the desired long run stabilization of debt-to-GDP ratios. In the present situation of mass unemployment, these policies do not carry a significant risk of inflation.

We also believe that the adjustment has to be supported by stimulation of consumption via higher wages starting from the core surplus countries (like Germany) where wage restraint policies have considerably contributed to the growing income inequalities and current account imbalances in the Eurozone.

If the German finance minister believes in what he said, that no country can live forever beyond its means, then it must also be clear that no country can live indefinitely below its means. This implies that the change in the wage policy in Germany has to be an important part of the solution.

Mutual prosperity of the Eurozone countries and their citizens through demand expansion, rather than demand contraction through fiscal consolidation for the benefit of high finance, must be recognized as the imperative for the political viability of the Euro project. We must have the intellectual honesty and courage to act accordingly.

Signatories

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4. Martin Riese (2012) "The Euro Crisis is a crisis of divergent competitiveness", unpublished draft.

5. Nadia Garbellini and Ariel Luis Wirkierman (2012) "Coordination of Effective Demand Expansion in the Euro Area: A World Input-Output Database (WIOD) Analysis", Unpublished draft.

6. Rune Skarstein (2012) "Some data on the Euro Crisis", unpublished draft.

7. Sergio Cesaratto (2012) "Controversial and novel features of the Eurozone crisis as a balance of payment crisis", Working paper no.640, di Economica Politica E Statistica, University of Siena.

8. Sergio Cesaratto (2012) "Notes on the Economic Meaning and Sustainability of TARGET2", Unpublished draft.

9. Srinivas Raghavendra (2012) "Economics, Politics and Democracy in the age of Credit Rating Capitalism", Forthcoming in Economic and Political Weekly (EPW).

10. Torsten Niechoj and Till van Treeck (2012) "Policy responses to the Euro debt crisis: Can they overcome the imbalances that caused the crisis?" *Intervention*, Vol. 8 (2): pp-245-266.

Reference to Newspapers and Blogs (selective list)

- This statement has been published in several newspapers and on webpages in different languages:
- Pagina 12 (http://www.pagina12.com.ar/diario/economia/2-208112-2012-11-19.html)
- Publico (http://blogs.publico.es/dominiopublico/6120/por-una-condicionalidad-keynesiana/)
- Il Manifesto (http://www.ilmanifesto.it/area-abbonati/in-edicola/manip2n1/20121110/manip2pg/06/manip2pz/331506/)
- http://www.economy4youth.com/en/ (Spanish website, in English)
- Naked Keynesianism (Blog, in English)
- Triple Crisis (Blog, in English)

Whitaker Institute for Innovation and Societal Change at NUI Galway

The Whitaker Institute for Innovation and Societal Change at National University of Ireland, Galway, is inspired by the legacy of pioneering statesperson Dr. T.K. Whitaker, and aims to adopt a similarly innovative, multidisciplinary and transformative approach to the challenges currently facing business and society, both in Ireland and internationally.

Over 200 members make up the faculty, creating the largest critical mass of business and social science researchers in Ireland, with expertise spanning across the College of Business, Public Policy and Law and the College of Arts, Social Sciences and Celtic Studies. Subsuming the University's Centre for Innovation and Structural Change (CISC), the Whitaker Institute builds on a decade of research excellence and policy-focused contributions supported by over €11 million in competitive national and international research funding.

About the Whitaker Institute

The Whitaker Institute for Innovation and Societal Change applies a multi-perspective research approach to business and social issues, with an impact-led focus at the core of its endeavours. One of its key values is the promotion of a sustainable and inclusive society, influenced by the broad dissemination of rigorous and relevant research. Furthermore, the Whitaker Institute seeks to continue the tradition at NUI Galway of critically pursuing knowledge discovery that stimulates academic debates and opens public conversation to advance the greater good.

The Institute is named in honour of eminent economist and former Secretary of the Department of Finance, Dr. T.K. Whitaker, who played a central role in devising the economic plan that set Ireland on the road to regeneration in the early 1960s. Drawing inspiration from his unparalleled service to Ireland, the newly formed Whitaker Institute has over 200 members and serves as the country's largest research body focused on contemporary and relevant business, social and policy issues.

Dr. T.K. Whitaker

Dr. T.K. Whitaker is regarded as a pivotal figure in the economic and social development of modern Ireland. During his long and illustrious career, he was Secretary of the Department of Finance, Governor of the Central Bank of Ireland, and founder of the Economic and Social Research Institute. He was also a member of Seanad Éireann from 1977 to 1982 and Chancellor of the National University of Ireland from 1976 to 1996.

The Institute houses twelve Research Clusters grouped under six Priority Research Themes:

- Business Performance, Agility and Governance
- Conflict and Collective Action
- Environment, Development and Sustainability
- Gender, Equality and the Knowledge Society
- Health and Well-Being
- Innovation: People, Place and Society

For more information, please visit www.nuigalway.ie/whitakerinstitute

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