Euro zone crisis and climate change: Addressing two targets with one instrument

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The threat of climate change requires a transition of society away from fossil fuels towards renewable energies. Such transition cannot be achieved in a context of economic stagnation. The deplorable state of the European economy is the direct consequence not of the financial crisis of 2008/09, but of the seemingly unsolvable euro zone crisis. This places the long-term challenge of climate change mitigation on the back burner. Questions of how to design a European ecological transition and how to reboot the European economy have been analysed in entirely separated strands of literature. The question is whether it is possible to address two targets with one instrument: reboot the European economy by mitigating climate change.

The 1992 Treaty of Maastricht, which led the basis for the euro, instructs government to not have public sector deficits of more than 3 per cent of GDP. The treaty does not specify an upper limit, the implication being that a surplus can never be too large. This is the main mistake: any surplus is always someone else's deficit. If some countries (or one in particular – Germany) consistently accumulate enormous public and current account surpluses, the deficits of others will eventually rise above 3 per cent. Urging deficit countries to implement austerity policies without asking the surplus countries to do the opposite is misguided policy. The "structural reforms" that the deficit countries need to run in parallel to fiscal prudency stifle growth, increase unemployment and end up increasing the budget deficit (Flassbeck).

In 2010 the German current account surplus was 5.5 per cent of GDP, now it is up to 8.5 per cent. Persistent current account surpluses of such magnitude are *de facto* mercantilism. The system cannot work without sanctions for countries exceeding a surplus guideline. In 2013, the recommendations of the European Semester should have become binding. A member state under the deficit procedure has the obligation to implement structural reforms. If the implementation of these rules turns out to be unsatisfactory, the country can be fined. The Macroeconomic Imbalance Procedure (MIP) has no teeth, as it only allows the Commission to monitor the economic development of the member states. However, the main reason for the German surpluses, wage dumping, is out of reach of the commission as Germany insists on the autonomy of its wage negotiating partners. Overall, the euro crisis is unsolvable as long as the Commission deals exclusively with deficit countries and not with surplus countries.

If the competitiveness gap in the euro zone cannot be dealt with directly, the only way towards a solution is a sea change in German fiscal policy. There is only one way to rectify this situation. The EU has to abandon its nonsensical rules about debt to GDP ratios and austerity. It has to force governments of surplus countries to stimulate public investments so that demand and employment rises and, with it, wages.

In Germany wages have to rise more than anywhere else. Germany has to lose part of its competitiveness because it is suffocating the European economy (see here). This would also be highly advantageous to the German economy itself. The German economy is close to stagnation due to the lack of domestic demand and German mercantilism is fundamentally unsustainable, as it threatens the foundations of Europe. The Brexit only showed a shimmer of what can be in the works. In Italy, a coalition between the Left and Right with the single purpose of taking Italy out of the euro zone has been in the making.

If German and European policy-makers would understand the dangers, the question of which road to follow would be trivial. Germany has acted to address climate change, but the results in terms of cutting back on fossil fuels remain meagre. The countries need to implement a series of policies that stimulate the reconversion of industry and the energy sector. In addition, Germany could fund The European Investment Bank, the European Investment Fund, the European Regional Development Fund and the Cohesion Fund to target crisis countries and regions according to need and potential (wind energy in the North and solar energy in the South). Loans from the European Investment Bank to leverage investments in debtor countries could be directed towards the deployment of renewable energy and an ecological transition in general. As a result, all countries would return to growth and the EU would efficiently mitigate climate change.

An overhaul of European economic governance and an end to German wage moderation are essential to put such plan into action. How will it be financed? The answer is obvious. Given zero or even negative interest rates and the need to spend additional money to revive the European economy, Germany has to engage in a Marshall plan-like injection of funds. It can get the capital that is needed for no interest on the capital market. If there is an opportunity to act, it is now. If economic governance is being overhauled and public investment takes place, the imbalances within Europe would disappear over time, new companies would create higher rates of profit, employment would rise and Europe would lead the transition towards low CO_2 emission societies. In the long term, 'goods' needs to be supported and 'bads' need to be taxed. A shift from labour taxation to carbon taxation (carbon tax) and natural resource taxation (land rents) would consolidate the fundamental structural change in our economies for the next decades to come.

In short, the trade-offs are clear: we can have economic crisis and climate change or we can have a functioning European economy and climate change mitigation. Either we are able to overcome some of the prejudices standing in the way of such a solution or the problems of today will turn out to be insignificant compared to those of tomorrow.

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Notes:

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Heiner Flassbeck is former German vice-minister of Finance, former chief economist of UNCTAD and professor of economics at the University of Hamburg. He is CEO of the consultancy firm Flassbeck-economics.

Will Denayer is research director at Flassbeck-economics.