Socio-Economic reflections on the Euro Zone

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1.Austerity Policy: Social Costs and Achievements

Is it possible for Europe's Mediterranean countries—considering the current and projected economic growth—to pay interest and debt amortization and, if so, at which cost? It would be interesting to be given an honest answer to that key question.

The EU implemented painful austerity measures to reduce the high level of government debt in many member states. But it was, *and still is*, a wrongly-conceived austerity plan. In fact, despite years of austerity, in various European Mediterranean countries—for example Greece, Portugal and Spain—the debt to GDP ratio has been going onto a firm upward trajectory creating a potential risk of default—the situation in Greece was, *and still is*, a good case in point.

In addition, austerity measures are likely to have contributed to:

1. Higher unemployment rates or, at best, with only cyclical and insignificant downward variations
2. Greater social inequalities [1]
3. Greater tax burden on households, while multinational companies quoted on the stock market and great fortunes experience less fiscal pressure
4. Drop in consumer spending—less purchasing power due to low wages and higher taxes
5. Precarious and poorly-paid work
6. Reduction of social security contributions—as a result of precarious/poorly-paid work and higher unemployment
7. Drastic spending cuts in core government functions such as education, research and development, health, etc.

These negative effects, arising from the application of wrongly-conceived austerity measures [2], have led to the EU socio-economic stagnation. Therefore, what have the real successes of austerity policy been?

Paradoxically, in some Euro Zone countries affected by chronic crises, specific public spending increased continuously and significantly throughout these years of austerity. Some examples of this are:

1. Monumental public structures [3], which are unproductive because they are not able to perform the task for which they were created for. This means a significant waste for the public purse as a result of high costs of construction and maintenance.
2. Waste of public funds on unnecessary public works contracts, which are awarded to entrepreneurs arising from political clientelism [4] — politicians can favour their family, relatives and friends in public or private jobs and, thus, in this way be able to create lobbies that ensure them a large number of unconditional voters — while, at the same time, development expenditures and social assistance were, *and still are*, falling drastically — for example education, research & development and healthcare.

Thus, as the result of policy implications, the budget cuts are not being carried out on the necessary items and there is a significant level of government debt that is useless for the productive economy.

Reducing unproductive public structures — e.g. bureaucratic wastage — rather than cutting key government functions — e.g. education, public health, social security, unemployment support, etc. — may signify one step towards progress and equity.

When, where, and how the government invests its resources are core questions of public policy. In fact, government revenues can be invested either in development or non-development projects. Development projects are productive (they boost human and physical capital) and, therefore, they are the ones which boost a country's socio-economic progress. On the contrary, non-development projects are a weight on government budgets.

In addition to the above, a badly understood policy of austerity and structural adjustments is leading towards a reduction of government spending in core functions. The simultaneous effect of these factors — reduction in consumer and government spending together with lack of investment — leads to a sharp drop in aggregate demand. Thus, exports are, in some cases, the sole possible growth factor. At the same time, however, we see a deep decrease in imports due to lack of domestic demand and this points, once again, towards economic stagnation.

The reduction in consumption and lack of investment are highly alarming factors of a continuing economic stagnation on the Euro Area

Reduction in consumption is a result of several factors:

1. Less purchasing power (purchasing power in Europe grew a little during 2015, but it was only a cyclical and insignificant variation in the Eurozone) due to low wages and higher taxes
2. Precarious and poorly-paid work
3. Higher unemployment rates

Lack of investment, instead, is mainly a result of the following factors [5]:

1. Weak demand
2. Over-capacity
3. Poor outlook
4. Policy uncertainty
5. Labour regulation

In addition to this, I would add that the following factors are also responsible for lack of investment (mainly) in the Mediterranean countries:

1. Lack of effective measures to encourage core productive sectors
2. Competitiveness based mainly on tourism/construction
3. Enterprises/entrepreneurs arising from political clientelism (i.e. cronyism), which often means waste of public funds on unnecessary public works. These are completely disappointing factors for the "real" entrepreneurial spirit (i.e. good business practices)

As a result, if the European Union (mainly the eurozone) continues to follow the same policy rhetoric… — which consists of: a) Budget cuts on core government functions such as education, school meals, healthcare, etc….; b) Creating precarious and poorly-paid jobs; c) Greater tax burden on households and SMEs — *…it is perfectly clear that we will be facing a future of economic stagnation, greater unemployment and inequality, increase in fiscal deficit* *and public debt.* In my view, this situation can lead Europe to an unending vicious circle.

A key issue for European policy-makers should be to carry out necessary investments to promote human development with greater equity. As the 2013 Human Development Report claims (page 20) : *"Investments in human development are justified not only on moral grounds, but also because improvements in health, education and social welfare are key to success in a more competitive and dynamic world economy"*.

In light of this, I think some important questions need to be considered: What kinds of investments in human development are being carried out in the Euro Zone? Isn't it a short-sighted policy? Isn't it necessary a shift in attitudes? Can we say that we are on the path of progress?

2. The Greek Situation: Is there a possible solution?

A few months ago Greece was considering the possibility to link interests on government debt to GDP growth. That would allow the government to make lower payments to creditors throughout rough economic periods and higher "compensatory payments" in buoyant times. I use the term "compensatory payments" because, as a result of this approach, public debt issuers (i.e. borrowers) transfer credit risk to lenders, therefore creditors (i.e. lenders or investors in debt) are going to demand higher interest rate (i.e. supplementing premium) in return. Precisely the transfer of risk and premium makes this framework of public debt management particularly original and uncommon.

Do Mediterranean countries have the necessary competitive economic sectors to develop enough sustainable GDP growth to justify the use of this framework for public debt management? Personally, I don't believe so. Mediterranean countries need to promote sustainable economic development and, for that purpose, they need to create and/or strengthen core productive sectors, fostering new start-ups and innovative projects rather than fostering competitiveness based only on tourism or construction. Austerity measures and low-paid employment are no miracle cure for current, and future, economic malaise.

"Unemployment is worse than low wage jobs" or *"Low pay employment is better than no employment at all"* [6] is a constantly-repeated mantra within the European Union. This is a powerful argument used by politicians, especially Conservative-Liberal politicians, in order to justify precarious and poorly-paid jobs. But, in my view, such a situation can be an option in only a few very specific cases, only for short periods of time, and in economies in transition. They can never, therefore, be a measure for formulating long-term economic policy.

Wages must be high enough to improving living conditions of people because this will lead to the creation of middle classes, which will in turn strengthen purchasing power, domestic business structures and, crucially, aggregate demand. The EU should compete through quality and added value of differentiated products rather than trying to gain competitiveness through a strategy of low wages. Here labour productivity is key. In fact, countries with high labour productivity have lower unemployment rates, fewer working hours, higher wages, greater investments, higher degree of competitiveness, and witness strengthening social solidarity [7].

3. Bailouts within the Euro Zone:

A bailout country [8] is forced to:

1. increase taxes, which means greater tax burden on households and SMEs, when, on the contrary, it would be necessary to impose a progressive taxation and to reduce or prevent a greater tax burden on households, low-income families, severance pays and SMEs;
2. and spending cuts, which are not carried out on the necessary items —as for example unproductive public structures, and waste of public funds…—but in core government functions such as education, research & development, school meals, and healthcare.

These bailout policies generate abject poverty, child poverty, precarious and poorly-paid jobs, higher unemployment rates, enormous social inequalities and socio-economic conflicts. They also hurt the country's economy so much that the bailed-out country can't raise money (because of a drop in consumer spending as a result of less purchasing power due to low wages and higher taxes, weaker domestic industry and closure of firms) to pay off its debts on its own, and will keep needing bailout money. Within the Euro Area countries can't handle their monetary and this can lead countries into an endless destructive circle.

4. The Euro is in danger of losing global confidence

Eurozone's citizens should ask themselves what advantages they gained since they adopted the Euro currency. While respecting all opinions that have been expressed on this, in my view, European policy-makers have made the Euro-area looking like an experiment in progress rather than a strong socio-economic union based on socio-cultural diversity. For instance, one might wonder how it is possible that a currency backed by the central banks of the Euro Zone depreciated so much and so fast against the U.S. dollar, simply because of the Greek situation (even considering the fact that Greece could exit from the Euro). In my view, the answer is a result of disorganization and lack of true leadership in the Euro-area.

Quantitative Easing (QE)was necessary around one and a half years ago, when the exchange rate was about USD 1.38 per Euro, straining the socio-economic situation in the Euroarea [9]. Now it is a big mistake which will be extremely damaging to the Euro Zone. It is of little help to exports because they have already reached the maximum level and leads to more expensive imports needed to support the domestic economy/SMEs. Additionally, it devalues household savings and encourages dollarization of the European economy putting the Euro in danger of losing global confidence.

Why does the ECB carry out Quantitative Easing at the worst possible moment (i.e. since mid-December 2014 the Euro continues to fall, Greece/eurozone's troubles, Finland Euro referendum, FED raised interest rates and it will continue to rise them in 2016, at least twice, Brexit referendum and its consequences on the Euro area, particularly in Ireland)? How is it possible that the ECB has held an overvalued euro with respect to the U.S. dollar basically since its creation, and now it is dropping to parity, or even below (QE was high priority when the exchange rate was about USD 1.5858 in July 2008 straining the socio-economic situation in the Euroarea [10])? What kind of monetary policy management is this? Once again, I believe that ECB policy-makers have made the Euro looking like an experiment in progress rather than a reliable currency.

5. European Mediterranean Countries

In my view, the socio-economic revitalization of the Eurozone's Mediterranean countries should come from a combination of fiscal consolidation and other kind of structural reforms. Such as, for example,:

1. Reduction of unproductive government expenditures and public structures [11].
2. Implement real measures to prevent the creation of unproductive state structure and patronage networks. What kind of policy in particular may achieve this goal? — A possible answer could be that the EU should only give money to member states for infrastructure projects once the investment need has properly been assessed and demonstrated—. In my view, a public policy must take, as a guiding principle: *"the construction of a public good is justified if the cost of the construction is less than the benefit that it grants to the community"*
3. Effective measures to fight against fraud and tax evasion.
4. Impose a progressive taxation and to reduce or prevent a greater tax burden on households, low-income families, severance pay and SMEs.
5. Effective measures to reduce high unemployment rates, huge social inequalities, child poverty, and abject poverty.
6. Effective measures to encourage core productive sectors because these are the main driver of economic growth rather than subsidize unprofitable areas. To foster "real" entrepreneurial spirit (i.e. genuine

enterprises) and avoid enterprises/entrepreneurs/businesses arising from political clientelism (i.e. cronyism [12]).

7. Effective measures to avoid excessive charges for banking services and bank loans to sectors more prone to economic bubbles.
8. Effective policies promoting sustainable and equitable economic growth.
   Moreover, it is necessary to be aware about which GDP components lead to economic growth, because a same amount of GDP does not necessarily mean identical situations—GDP takes into account all income no matter how it is generated and some GDP components may harm human health and/or the natural environment. For instance, one should think about a country in which its government is forced to set lower environmental standards to maintain the country competitiveness. This would probably lead to factories freely polluting several zones or inclusive part of the country. However, this way of manufacturing would generate high economic growth and employment and the country competitiveness would be based on this way of production. From an economic point of view, the economic growth would improve the living standards of citizens but at the same time pollution would makes its inverse contribution to citizens' quality of life—. Thus, two countries with a same amount of GDP can have very different socio-economic situations (i.e. different components of GDP).
9. A fairer distribution of wealth.
   This is the most important factor for a country's well-being, because large social inequality destroy a country's progress— Concentration of wealth in the hands of a reduced number people leads to sharp socio-economic inequalities. This socio-economic imbalance destroys or prevents the creation of middle classes. This in turn weakens demand and domestic business structures. The majority of the country's population has weak purchasing power and goods manufactured and/or services provided are bought by a small group of domestic consumers, while the rest is exported. Therefore, a reduced amount of people of a country can economically progress at the expenses of impoverishment of the vast majority. Huge economic and social inequalities indicate a setback in the progress of a country's people [13]. Such a situation is indicative of a reduction in the Human Development Index (HDI). Obviously, this situation cannot be understood as progress of a country because economic growth has to be a vehicle that supports human development.

Some international bodies are forecasting significant growth in some Euro area countries but I believe they are not taking into account the negative impact of the ECB's QE and the appreciation of the US Dollar against the Euro:

1. The advantage deriving from lower oil price is being negated by the abrupt depreciation of the Euro against the U.S. dollar [14]
2. More expensive imports needed to support domestic economy/SMEs [15]
3. A rise in prices of services and goods considered basic necessities. This situation is going to increase poverty (e.g. energy poverty, abject poverty)
4. Airlines buy fuel months or years in advance, therefore, many European international airlines are now paying a higher price for fuel—despite the plunge in oil prices. This situation will lead to more expensive air tickets and less touristic traffic in the near future
5. SMEs — import companies — have debts denominated in U.S. dollars

In my view, all these facts are going to impact negatively on development prospects in the European Mediterranean countries.

Sources:

[1] OXFAM International, (2015), "Increasing inequality plunging millions more Europeans into poverty"

[2] The Guardian, (2015), "Europe's leaders must end this reckless standoff with Greece"

[3] The Guardian, (2011), "Spain's extravagant City of Culture opens amid criticism"
El Pais, (2011), "Monumento a la incoherencia"
The Guardian, (2015), "Ryanair to become first airline to fly to Spain's ghost airport" ,

[4] EUROPP/LSE blog, "Lower levels of clientelism in Portuguese politics explain why Portugal handled austerity better than Greece during the crisis"

[5] ECB Economic Bulletin, Issue 8 / 2015 – Box 2, "What is behind the low investment in the euro area? Responses from a survey of large euro area firms" – Chart D-**:**

[6] These are quotes which has been raised in many speeches/statements/working papers. For example: Balfoussias, S., Hatzipanayotou, P., Kanellopoulos, C. (2011), "ESSAYS IN ECONOMICS Applied Studies on the Greek Economy", pp. 22-349,**:**

[7] Advanced economies (people living in more equal countries) have better quality of life, higher opportunities, best indexes related to social progress and, therefore, this kind of socio-economic environment generates a greater solidarity between citizens.
Social Progress Index ; Legatum Prosperity Index ; Human Development Index

[8] Vox (2015), "The Greek financial crisis, explained in fewer than 500 words"

[9] The Economist, (2013), "If the European economy is so shaky, why is the euro so strong"

[10] SPACE DAILY, (2008), "Walker's World: The EU's euro power-grab"

[11] EURACTIV (2015), "EU millions wasted on white elephant airports, say auditors"

[12] The Economist, (2015), Inside jobs: "Research suggests that government cronyism may cripple Spain's economy"
The Economist, (2010), Charlemagne-European Politics-:" Germany versus Greece"
The Economist, (2000), from print edition, Spain's Election: "A new Golden Age", pp.26

[13] The Guardian, (2015), "OECD: changes must cut inequality, not just boost economic growth"

[14] REUTERS, (2015), " German chambers of commerce fear weak euro could have negative effects"

[15] DW Made for minds, (2015), "The weak euro's inherent dangers" —The Yellen effect—

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Note: This article gives the views of the author, and not the position of the Euro Crisis in the Press blog nor of the London School of Economics

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