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A NEW PATH OF GROWTH AND SOLIDARITY

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Anna Diamantopoulou participated to the annual meeting of *Notre Europe – Jacques Delors Institute*'s European Steering Committee on 24 November 2012. This Tribune is based on her intervention. According to her, the European recovery equation is unsolvable without measures for growth.

The European periphery has entered recession, the core economies are slowing down and so does the European economy as a whole.

Global economic conditions are not favourable either. Chinese growth is slowing down. The US is still on a growth path but has to deal with its "fiscal cliff". The congressional jury is still out and its verdict may very well provoke a recession across the Atlantic.

A concerted international action is needed in order to ensure a steady recovery path for the global economy.

The prevailing European policy is leading to a deepening of the crisis, while it does not yet provide a scenario for recovery which cannot be produced by austerity alone, especially under unfavourable global economic conditions.

1. Measures and funding for growth

Three years into the crisis and although Europe has done a lot, its action has proved to be insufficient, the crisis persists, there is no sign of hope.

The abundant recent literature on growth boils down to an equation: **FA + SR + GR = Recovery** *(FA= Fiscal Adjustment; SR=Structural Reforms; GR=Growth).*

For the economy to attain a sustainable recovery we need 3 things: fiscal adjustment, structural reforms and growth. Looking at the countries of the periphery we observe that till now there is good progress in fiscal adjustment in most cases. Structural reforms have also been implemented be it at a lesser pace. On the growth front we are at zero or more precisely at subzero level.

An economy that achieves the two elements only without growth gets unemployment, poverty, brain drain, breakage of social cohesion and unrest all of which render structural reforms a mere legal paper trail, an empty shell. At the same time they hinder reform while they lead to a crisis of political representation that substitutes parties in power for anti-European forces and anti-systemic political parties.

By inducing recession the financial adjustment becomes a Sisyphean task: Data show that every reduction of the Greek deficit reduced more than proportionally Greek GDP and thus added to the increase of the debt to GDP ratio.

A return to growth for peripheral economies necessitates certain conditions. I will mainly take Greece as an example case. It presents greater complexity. Other periphery economies face subsets of the Greek problems.

2. A stable outlook

The eventuality of a country exiting the euro puts a constant strain to its banking system as deposits seek secure placement abroad. Besides, no new investment can be envisaged in an economy that presents a high probability to exit the euro and proceed in devaluation.

The answer to this concern is a credible commitment and a credible plan for Europe as a whole. The important steps taken so far, came often so late that seemed insufficient; they were characterized by a wait and see attitude often influenced by various national electoral considerations and even a will of domination.

3. Debt sustainability

Debt sustainability is crucial if there is to be any hope of recovery. Take the example of Greece. The Greek debt is unsustainable. Most analysts' projections agree on that and so does the IMF. It will have to be cut at some point. The major part of the Greek debt is now held by Eurozone governments. They have their own political considerations but as recent experience proves, postponing a difficult decision might prove costlier in the future, and could mean greater pain for millions of people. A haircut of the Greek debt at the onset of the crisis in 2010, as proposed by several economists, would have saved the Eurozone and Greece a lot of money and pain.

The decision taken by Eurogroup ministers on 26 November 2012 does not seem to give a permanent solution to the sustainability of the Greek debt. The targeted 124% Debt/GDP (or even 120%) threshold hardly ensures sustainability. Its attainment would anyhow require the strict realization of all the variables targeted in that scenario, among them growth rates that cannot be guaranteed in a prediction that covers a ten year period.

A non-decisive solution was found for the Greek debt sustainability, since an intermediate solution was privileged only to overcome short-term political obstacles. It is not a surprise that important protagonists of that solution hinted that they envisage a hair-cut of the Greek debt in a foreseeable future.

While one could understand the political constraints that prevented an outright haircut, it is disappointing that a decisive alternative solution that would substantially reduce the Greek debt was not chosen. European leadership is maintaining its "wait and see" stance living for tomorrow what can be done today which has proven disastrous.

There were other alternative solutions. One comes from Bruegel. An interesting alternative solution to an OSI haircut was proposed by Bruegel research fellow Zsolt Darvas[1]. It was publicly supported by Jean Pisani-Ferry. He proposes a combination of measures: In that Bruegel Policy contribution, Darvas estimates that we could reduce the Greek debt to GDP ratio below 100% by 2020 even if the Greek economy deteriorates further. Indexing the loans to Greek GDP would benefit official creditors if Greek growth is better than expected.

This could have been a viable solution if it were decided now. The continuing decline of Greek GDP might necessitate bolder action later.

The method of recapitalizing European banks is also relevant. The June European Council decided that the ESM (European Stability Mechanism) will proceed to a direct recapitalization of Spanish (and possibly other) banks so as not to burden further the Spanish public debt. Since June this EU commitment has been lost in the clouds mainly because Germany disagrees.

While the Eurogroup was trying to find ways to alleviate the Greek debt so as to make it sustainable, a further €23.5 bn from the Greek bailout program are destined to the recapitalization of Greek banks and will further increase the Greek debt. This could be avoided if they were lent directly to the banks, if the June decision was maintained and extended.

The IMF was right in proposing a serious and clear-cut solution, a hair-cut of the Greek debt held by the official sector. This would have given both Greece and Europe a clear and positive perspective instead of postponing the necessary solution.

The European Union has been hesitant all along to face the present crisis decisively; it opted for gradual and temporary solutions that left essential problems unsolved. This approach is hardly acceptable but can be explained by the current political configuration in Europe.

But Europe is failing even in implementing its own half-hearted commitments while European leaders often criticize Greece for deficiencies in implementing its harsh adjustment program. Besides, Greece was often made a scapegoat for the current crisis while it is by now generally accepted that we are dealing with a systemic European crisis which needs to be addressed as such.

4. Liquidity and financing

Greek banks held a large amount of government debt. They have incurred large losses after last year's haircut. The percentage of unpaid loans is growing due to the recession. On top of all that Greek banks see their deposits migrate as depositors seek a safe haven abroad fearing a return to the drachma. Furthermore their ability to acquire funds in the free market has been curtailed.

The result is a lack of loans even for profitable Greek businesses. The Greek government tried to alleviate the problem by offering the EIB €500 mio. as collateral from unused EU funds allotted to Greece. The EIB would provide loans for the Greek private sector. After 8 months of discussions and the EIB agreeing to a meagre 1 to 1 leverage it has not yet provided those loans. This saddening story appeared on the Financial Times on 19 November 2012 where Johannes Hahn, European commissioner for regional development, reportedly "accused the EIB of being overly concerned about protecting its triple A credit rating".

An EU member state cannot devalue its currency. It cannot print money. Having to face an EIB that functions as a common commercial bank does not make things easier. It is obvious that the European Investment Bank should change its behaviour, as in times of crisis prompt reaction is of outmost importance and even more so since the European Commission is counting on the EIB to provide urgently needed investment funds to the European economy and thus proposed the increase of its capital.

5. Initiating investment

The Compact for growth and jobs and its touted €120 bn. package along with the project bonds should start the soonest and provide much needed funding.

Private capital is usually reluctant to invest in an economy in recession. The European periphery would not be an exception. New investment will have to come initially from the public sector.

As an indicative example one can envisage the following: Infrastructure and an enhanced grid for renewable energy transfer are two examples of appropriate areas. Reduced renewable energy costs would benefit the entire economy, while providing jobs. Investment in infrastructure targeted at enhancing the value of assets marked for privatization would be beneficial. Simplifying EU requirements and accelerating procedures that concern approval of private-public partnership investments is a must.

6. A framework to attract private investment

The most important structural reform, contained in the Greek adjustment program, is the reform of the public administration. It is progressing at inadequate pace while it does attract less attention of the troika than it should.

Reorganizing the maze of the Greek state and its regulations that burden the citizens and the economy, making it leaner and efficient would be the most precious contribution to the Greek economy.

Besides an unprecedented fiscal adjustment, one should not forget what Greece achieved, on the front of competitiveness, among other, by ameliorating the business environment, bringing flexibility in the labour market and reducing labour costs.

Apart from fast track procedures for large investment and the alleviation of administrative burden for businesses, action that is underway and can be accelerated, one could envisage special conditions for areas of high unemployment, a sort of positive discrimination.

7. Human resources policies

Addressing the immediate needs of the weaker members of society is a priority: the poor, long-term unemployed, pensioners.

I could go on enumerating a list of priorities. The EU is familiar with and has applied a series of relevant policies but when an economy is not creating new jobs, you are left with policies that depend on subsidies in an environment of scarce or no funds.

The EU structural funds for the next programming period should be adapted to the crisis situation departing from usual norms, to face the concrete crisis conditions in each country.

One should first face the humanitarian crisis; encourage labour intensive investments, innovative investment, start-up companies and young entrepreneurs.

Offering social economy jobs to young unemployed so that they acquire skills and enter the productive process till the economy provides more jobs is a must.

Redesigning and enhancing vocational training structures in collaboration with local businesses would help recovery.

Funding for research in selected sectors and providing more research positions in collaboration with businesses wherever possible, to mitigate the brain-drain is crucial.

Conclusion

The European economy will not return to growth with austerity and structural reforms alone. The evidence is there as even the core countries are slowing down. Europe has so far followed a policy imposed by Germany and some like thinking member states.

It was aimed and managed to give a lifeline to its banks while putting an unbearable burden on its citizens. Measures imposed were often cold-blooded, treating a country as if it were a private business, ignoring social implications and rooted inertias.

This plan is not only unjust, it is not working. It produces recession and poverty; it breaks the social cohesion and endangers democracy and the integrity of Europe. It does not lead to recovery.

We, who believe in the necessity of a united Europe, must take the initiative and guide to a path of growth and solidarity. We must break away from current European totems and taboos and opt for growth. We are not in lack of methods but do we have the will?

1. Zsolt Darvas, "The Greek Debt Trap: An Escape Plan", *Bruegel Policy Contribution*, Issue 2012/19, November 2012.

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