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CORONAVIRUS: NAVIGATING A NEW STORM WITH AN OLD BOAT?

How the fiscal and financial architecture of the EU can be changed in order to protect the rights of citizens and the social welfare state in situations of economic crisis

Summary

This paper analyses how the financial reforms undertaken by the EU after the 2008 crisis have legally and financially limited the State in its ability to intervene in many areas as well as raising barriers to its protective role.

It explores how the macroeconomic and financial architecture that was implemented subsequently placed the financial system and macroeconomic stability on the highest pedestal of European objectives, relegating the rest of the social objectives provided for in the Treaties of the Union to a second category of importance, always subordinated to the achievement of the former.

Based on the apparent consensus that currently exists regarding state and European intervention in times of crisis, the essay highlights the reforms that should be undertaken in order to put social rights and welfare systems at the forefront of public policy in Europe. This essay outlines what type of mechanisms are necessary for the EU to be the overarching protector of peace, stability and the wellbeing of citizens.

These proposals suggest putting into practice a system in which the Stability and Growth Pact is balanced to resolve its fundamental contradictions in terms of social and ecological justice. Ultimately, political will is the missing element in the equation in order to establish a new order that stops the bleeding of unsustainable public debt through tax justice and fair redistribution policies.

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1. Introduction

There are ways to emerge alive from the turbulent and raging waters of an ocean storm. There are also ways to perish. For that reason, we must not forget from where we have come nor where we want to go. We must have a clear idea of the structure of our boat and the course of the storm. We have already navigated similar storm waters in the past, and therefore will have higher probabilities of saving the boat and coming out alive. Finally, we must remember the answer to the following question: "When has a calm sea ever created expert sailors"? The answer: never.

From the analysis of political action and the economic and social consequences of this coronavirus 'storm' (crisis), it quickly becomes clear that this situation closely resembles that of the crisis of 2008. The Wall Street crisis is still fresh in our memory, partly because we still hadn't completely overcome the suffering caused by the social and economic disaster. However, in our postmodernity, we have lost our collective memory. So, let's first reassess the framework imposed, the fiscal and macroeconomic structure that was implemented in the EU to lay the foundations for an exit from the 2008 crisis and from future ones.

We should revisit those events that determined the structure of the boats that we are now using to navigate this new crisis. Such an analysis would help us to determine whether our economic and social rescue boats are sufficiently robust to handle the storm or if we should make structural changes in order to weather the storm and emerge not only alive, but victorious.

Let us not fall into a postmodern forgetfulness

The crisis of 2008 began as a financial crisis, but quickly became an economic and social crisis as well. Even worse, for countries like Spain, Italy, Ireland, Greece, the crisis saw the onset of a public debt crisis. The Wall Street crisis set off a series of bankruptcies across the entire financial sector, with its origins in the bursting of the real estate and "subprime" mortgage bubble. In turn, this put into risk the global financial and banking system. Some countries, like Iceland, decided not to rescue its banks and allow them to fail. In the majority of countries, however, from the EU to the U.S., the mantra of "too big to fail" dominated the crisis response, arguing that without massive bailout packages, the crisis would have spread to exorbitant levels and destroyed the entire global economy. In the end, it was assumed that a mass-scale financial bailout was the only option.

As a result, enormous sums of public money were allocated to saving banks on the verge of failure, leading then to a sovereign debt crisis for many EU Member States. The sovereign debt crisis originated from the downgrading of public debt securities in many countries to the level of "junk bonds", exposing these countries to a high financial risk in the markets. The fact that many banks were themselves creditors of this sovereign debt led to a high level of worry about the solvency of the banking system.

In this context, a series of financial assistance measures was implemented in 2010 in the EU and the Eurozone countries in order to settle the situation. Other measures were designed to calm the markets and reinforce the banking system. These bailout measures offered to, but sometimes almost imposed on some Member States, came with macroeconomic conditionality and fiscal discipline to provide legal guarantees for the repayment of debt.

Finally, a reinforcement of the banking system through the establishment of 'stress tests' was established as well as coordination and economic governance through the European Semester. Going forward, it is important to remember that all of these decisions were taken in the context of a 'democratic deficit' at the European level. The European Parliament and many national parliaments were deprived of their mandated decision-making and control mechanisms in response to the crisis.

Bailouts and macroeconomic conditionality

Within this landscape, many EU Member States were financially rescued by 'The Troika', composed of the European Commission (representing a group of 14 Eurozone countries), the European Central Bank (ECB) and the International Monetary Fund (IMF). The bailout conditions designed by the Troika for these Member States were reflected in the 'Memorandum of Understanding', which included the obligation of each country to implement macroeconomic adjustment programmes as a condition of access to financial assistance (macroeconomic conditionality). Spain, although not officially rescued by the Troika, was given access to a bailout programme of the European Stability Mechanism for the recapitalization of various banking entities, which was not considered to be national financial assistance.

The conditions imposed by the Troika to guarantee loan repayments implied, among other things, cuts to public spending, employment and salary cuts in the public sector, a further deregulation of the private sector and of labour markets (including the dismantling of the collective bargaining systems and restrictions on the right to strike) and an increase in regressive taxes and privatisations. Collectively, these measures were encapsulated under the technical title of "structural reforms for the programmes of macroeconomic adjustment". As a result, rescued Member States were obligated to implement a system of 'efficiency' in relation to their public spending, and to raise funds (through indirect taxes and privatizations, amongst others) that would be destined to the distinct loan tranches in question.

The consequences of these (now) infamous austerity measures are very well-known: an increase in unemployment levels, precariousness in the labour market, millions of people in poverty (including more than 22 million children in the EU), a lack of access to basic services and millions of housing evictions, to name a few. In sum, a record rise in inequality, with political consequences in the form of the emergence of new and oftentimes extremist political movements and parties throughout the whole of Europe.

Greece, for instance, was forced to decentralise collective bargaining, which caused the collapse of its system, leading to wages being cut up to 40% and the prevalence of individual contracts, leaving millions of Greek workers and their families in or at risk of poverty. Back in 2016, experts and progressive forces warned that the reforms implemented in Greece were neither in compliance with the European Charter of Fundamental Rights nor with the core ILO Conventions.

Economic governance: the European Semester

The structural reform programs for the macroeconomic stabilisation were applied across the board to all EU Member States through the European Semester mechanism. The mechanism aimed to assure budgetary discipline and fiscal consolidation, to prevent macroeconomic imbalances, to develop structural reforms and to promote investment. As evidenced, protecting European people and reinforcing social protection systems were never among the priorities of these programmes. The country specific recommendations between 2010 and 2017 were practically always cut from the same cloth: to reduce public spending, through cuts and privatisations, and to increase productivity, through precariousness in the labour market. And the Member States were all good students. Some were obliged through bailout conditions, others through the pending risk of bailout and finally, the rest through an ideological alignment with the dogma of austerity.

As such, a squandering of social policy without precedent was witnessed throughout the EU, already progressively dwindling since the beginning of the 1990s, in the interest of a dominating liberal austerity. This has entailed salary reductions (including to minimum wages), the reduction and freezing of pensions and budget cuts in healthcare, education, culture and the socio-sanitary field, as well as for the rest of basic social services. In addition, massive job cuts to the number of public sector employees and a flexibilisation of dismissals, as well as a decentralisation of collective bargaining (leaving millions of workers without collective agreements) have all been elements of an ever-worsening climate of social welfare in general.

Budgetary Discipline

While the dismantling of social welfare systems became a reality in many European countries, two other measures were implemented in order to "calm the markets": the Fiscal Compact was approved and stress tests were established within the banking system.

In 2012, the Treaty on Stability, Coordination and Governance of the Economic and Monetary Union was approved (e.g. the Fiscal Compact, or Budgetary Pact), with the objective of reinforcing the economic pillar of the Economic and Monetary Union. Fiscal discipline was introduced via the obligation of signatory States to integrate the rule of budgetary balance into their national legal framework – and preferably into their constitutions. This effectively prohibited Member States from approving any budgetary deficits, forcing public accounts to be squarely balanced and limiting a policy of public investment or a reinforcement of the social welfare state in times of need. What defined this pact was the prioritisation of creditor interests above the interests of the European people. In effect, this implied a reduction in spending in order to pay outstanding debts, despite leaving unattended the needs of the most vulnerable members of society – precisely those most in need of the assistance and support provided by public policies.

Stress Tests of the Banking System

As the culmination of the measures taken to protect the financial system, the banking system stress tests were established in 2011, coordinated by the European Banking Authority –EBA- and ECB. These tests analyse the resilience of the financial institutions in adverse market conditions and contribute to a global analysis of systematic risks in the financial system of the EU. Through these tests, the EBA and the ECB evaluate whether the banks have a sufficient amount of capital to continue being solvent, as well as to what extent their assets would deteriorate. The recapitalisations, rescue packages and funds loaned by the ECB have guaranteed the solvency and strength of the European banking system. In addition, the stress tests have been essential for the restoration of confidence in the EU banking sector.

In summary, the macroeconomic and financial architecture put into place as a response to the crisis of 2008 substantiates itself in a structural imbalance. In other words, it places the financial system and macroeconomic stability as the highest of European objectives, relegating the rest of the social objectives provided for in the Treaties of the Union to a second category of importance, always subordinated to the achievement of the former.

The Current Storm: The Coronavirus Crisis

A return to our initial metaphor begs the all-important question: Will we be able to navigate the storm waters of this new coronavirus crisis with the structural 'boat' inherited from the crisis of 2008? For us, the answer is certainly 'no'. Given that this health crisis will undoubtedly end up being – and already is – an economic and social crisis, Europe needs structural changes that fortify basic social rights and universal public services, that protect the public welfare and distribute the burden of its financing where economic power is concentrated. As such, European Social Democrats have already proposed ideas for such a fundamental and necessary change.

Rescues without Conditionality for Countries and with Conditionality for Multinationals and the Wealthy

In these current times of crisis, the European Socialists have already highlighted that macroeconomic conditionality is not acceptable in the rescue packages that will be necessary to stabilize the economy during this crisis. Member States have already done their budgetary discipline and fiscal consolidation "homework assignments". As this crisis is one of a social nature, governments must be able to utilise direct financial assistance to shore up the main social imbalances. This includes the ability to financially provide for unemployment claims, to help the self-employed not only through subsidies but via investment to reactivate and optimise their activity and to strengthen public and social services. We must guarantee that instead of growing levels of inequality and poverty, governments are able to come out of this crisis having strengthened not only the economy but social justice as well.

In addition, we have to guarantee that in *this* crisis, financing for big business will be subject to conditionality, in line with the measures already proposed and approved by the Democratic-controlled U.S. Congress. For example, the prohibition of share buybacks and dividend payments and the prohibition of bonuses for the executives of companies that gain access to government finance as well as restricting companies registered in offshore tax havens from accessing public financial aid. It also must be ensured that companies using public financial support will not lay off workers, reduce wages or undermine workers' rights and protections. In addition, such companies should be obliged to implement a package of measures to assure democracy in the workplace (in similar fashion to the practice of German co-determination: workers´ participation in companies' decision making).

Any package of measures must also include a tax increase for big businesses and the very wealthy on a pan-European level, in order to fence in tax avoidance at the transnational level. Finally, tax havens must be eradicated, especially *within* European borders. Interestingly, some of these tax haven countries are the same ones that, within the European Council, are opposed to solidarity measures such as the mutualisation of debt or the 'Marshall Plan', proposed by the Spanish government and backed by the European Parliament and the Presidents of both the European Commission and the European Council.

Another Governance is Possible: The Social and Sustainable Semester

Since its implementation in 2010, the Group of Socialists and Democrats in the European Parliament have criticised the European Semester for being a mechanism used to promote the policies of austerity throughout Europe – in particular, those of a social nature. The European Commission was urged to create a table of social indicators in order to predict the social impact that macroeconomic adjustment measures would have on society. Slowly, the Commission began to integrate social indicators alongside the macroeconomic indicators, culminating in the creation of the social scoreboard (although still incomplete). This measure, in turn, allowed us to demonstrate that the austerity measures championed as a result of the 2008 crisis were socially unsustainable and that the country-specific recommendations needed to include 'social' intervention strategies in order to alleviate poverty and improve the quality of employment.

From the ashes of economic imbalances and the terrible social consequences was born the call for a European social agenda, as a counterbalance to the absolute primacy of the Economic and Monetary Union above all other objectives clearly provided for in the Treaties of the EU. Following the successful proclamation of the European Pillar of Social Rights, a call was once again reissued for its principles to be integrated into the Social Scoreboard of the European Semester. The Commission heeded our call and aligned the social indicators with the European Pillar of Social Rights. Finally, during the 2019 European election campaign, the Socialist Group demanded that the Semester be converted into the *'Sustainable'* Semester and that its objectives be modified. These objectives entailed that the main task of the Semester should be the coordination of national economic and social policies in order to achieve the Sustainable Development Goals of the United Nations. In 2020, the Commission has already initiated this change.

We cannot ignore that the efficiency of the Semester – in its origins of austerity – is based on the mandatory rules of the Stability and Growth Pact (SGP), which all Member States have to comply with. The Excessive Imbalance Procedure was put in place as the 'sword of Damocles', hanging over Member States in the form of sanctions against non-compliant countries. Obviously, such efficiency will never be the same in the social component if the objectives of the Social Pillar and of the Sustainable Development Goals are not made mandatory. That is to say, social and ecological objectives must be given the same legal enforceability as that of fiscal consolidation and financial stability. In order to do so, **EU countries should adopt a Sustainable Development and Social Progress Pact.**

In addition, in times of macroeconomic shock like the current one, the SGP has proven to be a 'straitjacket', not allowing Member States the necessary fiscal space they need to absorb the imbalances and cushion the social consequences. This was the reason for the activation by the Council of the general escape clause to freeze the adjustments that Member States must make in order to meet their fiscal targets and be allowed to spend "as much as they need". This overly restrictive nature of the SGP is the second reason why the Sustainable Development and Social Progress Pact is urgent, so that economic and financial objectives are made compatible with the goals of ensuring and protecting socio-ecological rights of citizens in the European Union architecture. Therefore, this pact should be adopted to complement the Stability and Growth Pact and resolve its fundamental contradictions in terms of social and ecological justice.

More Flexibility, Protection and Fair Taxation Instead of 'Debt & Discipline'

Naturally, the approval of a Pact of these characteristics would balance the SGP, that is, the necessity of establishing and maintaining healthy government accounts, with the obligation of protecting the social welfare state and the quality of life of its citizens. While the activation of the fiscal flexibility clause is essential for Member States to have fiscal space to pump money into their economies, it also means more public debt that will have to be repaid one way or another. What must be resolved, therefore, are the sources of revenue in order to deal with this debt in the medium and long term, while simultaneously reducing inequalities and pursuing environmental objectives.

Let us take a look at the following three observations (as a comparative figure, the GDP of Spain is €1.2 trillion, while that of the EU is €19 trillion):

1. According to 2016 estimations compiled by the International Monetary Fund (IMF)[1], there are up to **$36 trillion (USD) housed in tax havens**. According to research from the National Bureau of Economic Research, currently the amount of money sitting in tax havens is the equivalent of 10% of global GDP. For continental Europe, 15% of its GDP is estimated to be in tax havens. Interestingly, the countries with the smallest percentage of their GDP diverted to tax havens are the Nordic countries, precisely those that have the highest tax rates and best wealth redistribution systems in the world.

2. According to the ECB[2], **investment funds in the EU control €13 trillion** (more than 10 times the GDP of Spain), with the **total assets of non-banking financial entities being €42.3 trillion.** The ECB has warned that while these entities are much less regulated than the banking sector, their wealth has grown exponentially in the last decade (170%) – supposing a serious risk for the stability of financial markets. **In Spain alone**, the wealth deposited in funds and collective investment companies **is around €575 billion**, according to figures from Inverco (2018)[3].

3. The Netherlands and Luxembourg are the focal point of 50% of global "phantom investment". According to a recent IMF study (2019)[4], Luxembourg, a country of 600,000 inhabitants, houses €4 trillion in foreign direct investment (FDI), about €6.6 million per capita. This figure is equivalent to the amount of FDI received by the United States and much more than in China. The practice is composed of cross-border investments between companies that belong to the same multinational group, with many of the investments being "phantom" in nature. These investments come in the form of empty corporate shells without real business activities that are designed to evade taxes. The Netherlands, Luxembourg and Ireland are the epicentres of these phantom investments offering, for example, very reduced rates of corporate taxation, sometimes even 0%. In Ireland, the corporate tax rate has been reduced from 50% in 1980 to 12.5% at present. In addition, these practices erode corporate tax revenues across the rest of the EU Member States. While corporate tax rates have been lowered from 40% in 1990 to 25% in 2017 on a global scale, phantom investment is estimated at €15 trillion, or equivalent to the collective GPD of China and Germany, and continues to grow.

In addition to flexibilising public debt, accounts must be balanced through the practice of fair tax collection. The concentration of global wealth and tax evasion has been highlighted above. The missing element in the equation is the political will to put into practice a system to stop the bleeding of unsustainable public debt through tax justice and fair redistribution policies.

[1] Nicholas Shaxson (2019), The billions attracted by tax havens do harm to sending and receiving nations alike, in "Tackling tax havens", IMF.
[2] Luis de Guindos, speech at the opening of the 21st Euro Finance Week, 12 November 2018, om "Coming to the forefront: the rising role of the investment fund sector for financial stability in the euro area"
[3] Inverco (2018), Las instituciones de inversión colectiva y los fondos de pensiones, Informe y Prosectivas.
[4] IMF (2019), The Raise of Phantom Investments, Finance & Development

Strengthening Social Welfare Systems through Investments and Stress Tests

The Social Welfare Systems guarantee to society and the European citizenship the services and economic benefits for a decent life, within the framework of a political, economic and social model of a welfare state. They include social security, healthcare, education, housing, employment, justice and social services for vulnerable groups. These schemes play a key role in achieving social sustainable development, promoting equality and social justice and realising the human right to social protection as it is enshrined in the Universal Declaration of Human Rights (1948). Thus, social protection policies are vital elements of national development strategies to reduce poverty and vulnerability across the life cycle and to support inclusive and sustainable growth.

In the current crisis, the social welfare systems are experiencing an unprecedented situation of stress and pressure. Public expenditure is exponentially increasing to attend the demands of some services like the healthcare system, social services, or to support the growing number of unemployed people. Resources are limited because they were not foreseen to cover the social demand in a context of healthcare and economic emergency. For the moment, this extra public expenditure is being covered through an increasing public debt, either through loans from financial entities or via debt purchases by the ECB in the secondary markets.

However, the financial and economic impact of the COVID-19 crisis must still fully materialize and Member States will need to come together in solidarity in order to pool the necessary monetary resources to maintain their welfare systems, while avoiding unsustainable increases in public debt. The general consensus is to do this through a combination of loans and grants, but not necessarily referring to investment in the social welfare systems. However, in order to fuel the recovery, the EU investment effort must be a social investment effort strengthening social welfare systems to combat the social impact of the crisis. For instance, the Revision of the MFF 2021-2027 will be a missed opportunity unless it contains a significant increase in the budget for social-related funds. The ESF+ is our best solidarity mechanism and the engine of upward social convergence in the EU. In order to make the ESF+ a real correction mechanism to reduce social divergences and reinforce national systems, its budget needs to be radically increased according to our current and future needs. It will be the most effective way to support vulnerable groups in the medium term in a sustainable way. However, the increase of the ESF+ has to be comparable to the amounts dedicated to other areas in the proposed EU Recovery Fund. In addition, the European Child Guarantee should be implemented as a matter of urgency, with sufficient budgetary resources and complemented by a comprehensive Anti-Poverty Strategy. Finally, on the social investments side, the Union Recovery Plan to be presented by the Commission should have "building a fair and social Europe" as one of its strategic objectives and dedicate a considerable amount to supporting the full implementation of the European Pillar of Social Rights at the national level.

Last but not least, Social Welfare Systems should be strengthened through a stress test mechanism. As highlighted above, the ECB implemented the stress tests in 2011 following the financial crisis, as a way of strengthening the banking system. However, the social welfare systems were not assessed in order to make them more resilient to future crisis. On the contrary, these services areas suffered continued budget cuts which made them even less capable of attending the growing social and health needs. Social Welfare Systems have to be designed and built in a way so that they can perform and assist the entire population, particularly in situations of crisis or systemic shocks. Therefore, it will be essential to design and agree on stress tests for social protection systems, in order to verify their degree of resilience in varying conditions and severity of crises. At the same time, such tests would allow for an analysis of the weaknesses of essential public and social services and permit us to see if they are sufficiently equipped in terms of budgets and resources. In case of economic difficulty, these social stress tests could also analyse what levels of poverty and unemployment could be handled through social protection mechanisms. The framework should encompass the universalistic objectives aimed at responding to the different risks experienced by the whole population with institutions focused on the specific assistance to the most vulnerable groups. These tests should not only assess the strength of social protection but should also strengthen public services and the role of the State as protector and guarantor of the welfare system.

4. Concluding Remarks

In the face of this social and economic shock in which we are living, all social groups, including the least affected and all companies, even the biggest of all, are claiming for a large-scale State intervention. However, the State, impoverished and trimmed down by the measures listed throughout this article, has been legally and financially limited in its ability to intervene in many areas. The same thing has happened at the EU level, where competencies in social policy are nearly inexistent. If a consensus truly exists about state and European intervention in times of crisis, we must therefore take full advantage of the moment and revise these limitations. We must analyse which of these limitations are, in reality, obstacles and barriers to the protective role of the democratic state that is now suddenly in such demand. Finally, we must analyse which mechanisms are necessary for the EU to be the overarching protector of peace, stability and the wellbeing of citizens.

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