Tomasz Machelski
University of Białystok

EUROPEAN UNION FINANCIAL CRISIS – AUSTERITY OR POLITICAL SHORT-TERMISM TO BLAME?

…We used to think that you could spend your way out of a recession… that option no longer exists…

James Callaghan
British Prime Minister
Speech to the Labour Party Conference (1976)

1. Introduction

The current global economic and financial crisis has challenged the mechanism of economic policy coordination in the European Union.[1] Since 2008 all EU countries have been affected by this crisis,[2] most of them have been in recession, or close to it. The insolvent, in particular, PIIGS (Portugal, Italy, Ireland, Greece, Spain) cannot finance their deficits on their own in open credit markets. They are suffering from high government deficits and can keep on spending only by way of loans from international organizations.[3] Their debt ratings have been downgraded by various credit rating institutions and their unemployment rates are reaching record highs.[4] On the other hand, banks within wealthier EU member countries, such as Germany, hold PIIGS bond debt (notably that of Greece), and have had their central banks' credit ratings downgraded because of this exposure.[5]

1 J. Dinnage, J.L. Laffineur, The constitutional law of the European Union, San Francisco 2010, p. 109.
2 M. Carammia, A. Timmermans, S. Princen, P. Alexandrova, Analyzing the Policy Agenda of the European Council, "Perspectives on Europe" 2012, Vol. 42, p. 42.
3 P.R. Gregory, "Austerity" To Blame? But Where's the Austerity?, "Forbes" 2013, 26 May.
4 M. Masse , Is "Austerity" Responsible for the Crisis in Europe?, https://mises.org/MisesDaily (11.06.2013).
5 E.R. Vickstrom, Implosion in Greece? An analysis of the Greek debt crisis and its impacts on Europe and world markets, Urbana-Champaign 2012, p. 28.

In this respect, several attempts have already been made to explain the divergence between former economic plans and current financial outcomes, focusing mostly on the role of the economic cycle as an explanatory factor.[6] Nonetheless, the current economic crisis raises important questions about the future of the EU economy. Can the EU countries continue with public spending on such a grand scale? Can they continue generating deficits? Finally, can they really pay back their debt in full?

2. Austerity vs. anti-austerity

Austerity and anti-austerity have become hot-topics in the current economic debate.[7] First, there seems to be no doubt that the origin of public debt is closely associated with the existence of a long process of public sector deficit.[8] Some economists though see financial busts as largely unpredictable events that governments must prevent at all cost. Accordingly they demand that governments enhance (even profligate) their expenditure.[9] Against the crisis, in fact, many countries chose the way of borrowing to finance their public expenditures.[10] For one thing, a fiscal rule that is appropriate for the long term — for example a structural balanced budget rule — cannot be instantly enforced, some mainstream economists say, when the starting point is a deficit close to double digits.[11] Besides, the EU member states and the EU itself have provided financial support to a number of crises-stricken (not able to meet their international payment obligations) EU countries. Alongside the assistance programs and the temporary fund delivery vehicles, the eurozone member states have put together the permanent additional European Stability Mechanism offering assistance to countries facing difficulties financing their debt. On the other hand some economist explain financial crisis as the inevitable result of the unsustainable artificial boom provoked by government intervention in general and excessive expansion of credit in particular[12] and they recommend that governments slash their spending.[13]

6 L. Moulin, P. Wierts, How credible are multiannual budgetary plans in the EU?, http://ssrn.com/abstract=2005228, p. 983.

7 G. Erber, The Austerity Paradox: I see austerity everywhere, but not in the statistics, “German Institute for Economic Research”, Berlin 2013, p. 2.

8 K. Nizioł, The Problem of Public Debt in the Context of Multiannual Financial Planning, in: E. Ruśkowski, J. Stankiewicz, M. Tyniewicki, U. Zawadzka-Pąk (eds.), Annual and Long Term Public Finances in Central and Eastern European Countries, Białystok 2013, p. 275.

9 C. Leithner, Austerity, What Austerity? Europe and the U.S. Desperately Need Genuine Austerity: Not the “Faux Austerity” of the Past Several Years, a paper presented to the Mises Seminar, Brisbane, Queensland, Australia, on November 30, 2013, http://www.mises.org.au/leithner_bankruptcy.mainstream.economics.pdf, p. 7.

10 S. Cukurcayir, K. Tezcan, *I*nvestigations on the Euro Area Public Debt Crisis: the Case of PIIGS, “European Scientific Journal”, June 2013, p. 314.

11 O. Blanchard, C. Cottarelli, How to Bake a (Cr)edible Medium-term Fiscal Pie, iMFdirect Blog (http://blog-imfdirect.imf.org/2010/11/04/how-to-bake-a-credible-medium-term-fiscal-pie).

12 C. Leithner, *op. cit.*, p. 6.

13 *Ibidem*, p. 7.

Today's politicians usually denigrate austerity. They say it has gone too far and is preventing an economic recovery.[14] But taking a somewhat closer look at the actual statistics available from Eurostat on the, in particular, PIIGS-countries, one finds in fact little empirical evidence that the European governments there have *de facto* reduced their total public expenditures.[15] In other words, government spending has never really stopped rising in the EU as a whole since the beginning of the financial crisis. Spending grew during the period when so called "austerity" policies were supposed to have been applied. Whenever budget cuts were announced, it usually meant actually not total reductions in spending, just simply spending increases that were lower than what was previously planned. Governments maybe have not been borrowing as much, although still heavily and in the end public debt kept increasing. Instead, these governments tax their citizens more to fund their growing expenditures. France, where "austerity" has been most strongly criticized is a good example here. Finally, European governments are now usually as large as they were when the crisis struck in 2007.[16] Unlike genuine austerity, which shrinks the state's income statement and balance sheet, false-austerity, which is typically financed by borrowing, creates an ever-bigger state expenditure.[17]

3. Sound economic principles and spirit of the EU Treaties

Some countries have developed explicit links between the level of public investment and the public debt level. This may include the so called "golden rule", that increases in the amount of public debt should not exceed net public investment, conventions limiting the budget balance or conventions limiting the total level of public debt. The "golden rule" and budget balance are, for example, specified in the German Constitution. The Netherlands also used to apply this rule. The United Kingdom introduced a policy in 1997 under which the budget is balanced over the economic cycle, with no exceptions.[18]

EU monetary policy is also an issue here. This policy is now determined solely by the European Central Bank. The ECB was insulated from political interference and given a mandate to focus on price stability. The eurozone monetary mechanisms were similar to those of the former gold standard.[19] In this respect European Monetary Union countries face sometimes hard choices on their budgets.[20] The arrival of the

14 M. Masse, *op. cit.*
15 G. Erber, *op. cit.*
16 M. Masse, *op. cit.*
17 C. Leithner, *op. cit.,* p. 11.
18 M. Spackman, Multi-Year Perspective in Budgeting and Public Investment Planning, Draft background paper for discussion at session III.1 of the OECD Global Forum on Sustainable Development: Conference on Financing Environmental Dimension of Sustainable Development OECD, Paris, 24-26 April 2002, p. 13.
19 J. Singleton, The Euro: An Economic Disaster Unfolds, Paper for the SPERI conference "Beyond Austerity vs Growth: The Future of the European Political Economy", University of Sheffield, 1-3 July 2013, p. 2-3.
20 M. Carammia, A. Timmermans, S. Princen, P. Alexandrova, *op. cit.*, p. 41.

crisis of 2007/2008 has even further revealed the disciplinary nature of the euro. For the first time, the eurozone countries have had to face an economic downturn without monetary policy autonomy. In other words, with the euro, despite all its errors and weaknesses, irresponsible fiscal behaviour has no longer been possible.[21] Finally, establishing a multi-annual fiscal framework in the EU proved to be very important as a basis for efficient planning of public expenditure and to achieve compatibility with EU procedures.

Besides, membership of the EU imposes many legal obligations and requirements on member states. In the field of fiscal policy and budgetary management, these obligations mainly relate to compliance with fiscal policy targets, the provision of statistical data, anti-fraud procedures and regulations concerning financial control. For EU members, some kind of austerity is not just a promise: it's a treaty obligation. The Maastricht Treaty required that countries joining the Union should have budget deficits no higher than 3 percent of GDP and debt levels no higher than 60 percent. Next, the Stability and Growth Pact demanded that the EU countries aim for "medium-term objectives of budgetary positions close to balance or in surplus". In the face of debt crisis and the possibility of PIIGS default on a debt, the EU has modified its economic model. Adopted in March 2011 as the more stringent successor to the former SGP and using the EU's open method of coordination, the Euro-Plus Pact created concrete commitments in which the member nations of the EU are forced to abide to a list of fiscal reforms intended to enhance their fiscal strength and discipline.[22] There are also some relevant extra-community methods in this respect. In particular, The Treaty on Stability, Coordination and Governance – which have been adopted by groups of EU states outside of the treaty and legislative structures of the EU.[23] What is particularly new about the TSCG is that the balanced budget rule is to be embedded and enforced within national law.[24]

4. Void for vagueness...

An European constitution, agreed on by citizens, binding the member states would be probably the best answer to ensure fiscal discipline among EU member countries. Though the former proposed EU Constitution was in fact no real constitution[25] and deteriorated even before it was approved.[26] On the other hand, the framework for fiscal policy and the Stability and Growth Pact, although revised in 2005, as applied in the early years of the European Monetary Union, did not prevent

21 J.H. Soto, An Austrian Defense of the Euro, https://mises.org/daily/6069/An-Austrian-Defense-of-the-Euro.
22 E.R. Vickstrom, *op. cit.*, p. 24-25.
23 K.A. Armstrong, The New Governance of EU Fiscal Discipline, "Jean Monnet Working Paper" 2013, No. 29, p. 4.
24 *Ibidem*, p. 5.
25 A.R. Leen, *op. cit.*, p. 2.
26 J. Šíma, A Note On Mises's Vision of Social Harmony in (Central) Europe, "New Perspectives on Political Economy" 2012, Vol 8, No. 1, p. 7.

the accumulation of large fiscal deficits in the Union. For example, on January 1, 2001, Greece became the twelfth nation to join the eurozone. In order to qualify for euro membership, the Greek government was required to agree to adopt strict measures, mainly through some serious cuts in public expenditure. The Greek government hid the true level of its debt. Similarly, several other governments were able to cheat in fact to meet the Maastricht rules.[27]

Anyway, fiscal rules, at both EU and national level, have been so much flouted in most member states that ever-increasing government debt resulted from the lack of transposition of European good governance. [28] Indeed, few governments ever took "Maastricht criteria" seriously.[29] Now, by these criteria the average EU country doesn't qualify for admission into the EU![30]

Along with no respect for the rules of the Stability and Growth Pact, there is an unwillingness at EU level to impose sanctions for their breach.[31] Although the excessive deficit procedure was activated both for large and peripheral countries, the sanctions mechanism was not adequately implemented and the debt ratio standard was on several occasions just ignored.

In principle, then, "austerity" can thus cover all kinds of situations with differing economic impacts. Unfortunately, confusion over the meaning of the term impedes a better understanding of the current situation.[32] It seems to be universally taken for granted in current economic debate that austerity measures adopted in the EU have meant drastic spending cuts, coupled sometimes with some tax increases, the net effect being a downsizing of government. But is this really the case? [33] By the original Maastricht criteria, there is simply no "austerity" in Europe. Virtually without exception, member states of the EU aren't honouring their legal obligations.[34] The problems of the Pact on Stability and Growth are just as illustrative. The lack of authority in the Stability and Growth Pact led several member nations to stray from the minimum debt recommendations.[35] The German government broke the rules on budgetary deficits for up to five years. They did not, however, expect any serious financial punishment. By the outbreak of the current crisis, the Pact had ceased to be credible.[36] With the recently revised rules the member states can almost always get away with a larger deficit.[37] The same with EPP, the approval of the Euro-Plus

27 R. Wellings, Euro crisis: the dangers of fiscal integration, http://www.iea.org.uk/blog/euro-crisis-the-dangers-of-fiscal-integration.
28 P. Lampreave, The New Regulatory Framework in the European Union and the Role of the Independent Fiscal Authority, "Bulletin for International Taxation", November 2013, p. 592.
29 C. Leithner, *op. cit.*, p. 9.
30 *Ibidem.*
31 K.A. Armstrong, *op. cit.*, p. 2.
32 M. Masse , *op. cit.*
33 *Ibidem.*
34 C. Leithner, *op. cit.*, p. 9.
35 E.R. Vickstrom, *op. cit.*, p. 27.
36 G. Selgin, Incredible Commitments: Why the EMU Is Destroying Both Europe and Itself, "Cato Journal", Vol. 33, No. 1 (Winter 2013), p. 151.
37 A.R. Leen, *op. cit.,* p. 2.

Pact made integrated fiscal policy within the EMU a recommendation and not a requirement.

In order to influence the Greek debt crisis, the ECB changed its monetary policy by readjusting collateral requirements to ensure that the Greek public remained eligible to take out loans. On May 3, 2010, the ECB suspended its minimal credit rating threshold for collateral eligibility and then it announced measures to address severe tensions in certain market segments.[38] As a result not only the commercial banks, but governments running huge public deficits could safely count on a bailout. What is worse is that the European commercial banks continue to have no incentives to rationalize their investment portfolio since they can always rely on the ECB's plans to secure "financial stability" in the EMU.[39] The ECB's policy was and is, to bailout the banking system through: credit to governments in distress and lower interest rates. This policy is bound to replicate in the future the problems of the past.[40] European governments seem very reluctant to give up their extended welfare programs, but at the same time they are usually unable to finance these programs through taxes. Nonetheless this feature of political landscape should not be allowed to become an excuse for forcing the ECB into a role beyond its proper legal limits.[41]

Besides, it is worth mentioning, EU treaties oblige most of its non EMU members to join the Eurozone at some point. But this formal obligation has little weight in practice, as Sweden has demonstrated.

What Europe really needs now is addressing long term issues. That means that decision-makers should overcome their pressing daily preoccupations to tackle problems that will determine the next years or decades.[42] As an American economist M.N. Rothbard stated, *if we immerse ourselves wholly in day-to-day affairs, we cease making fundamental distinctions, or asking the really basic questions. Soon, basic issues are forgotten, and aimless drift is substituted for firm adherence to principle.*[43] The problem is, that EU member countries in general prefer to exercise individual control over what their expenses are and will be and they are interested mainly in short term perspective.[44] Another problem is the temptation of governments to base these short or medium term plans on macroeconomic forecasts which reflect their politically driven aspirations, rather than objective analysis with long term perspective.[45] Besides, trying to integrate an individual EU member nation's fiscal policies still is a very sensitive subject area because it reduces national sovereignty. Then, the Community method is often treated, quite rightly, as a synonym for rules-

38 E.R. Vickstrom, *op. cit.*, p. 27.
39 M.G. Tsionas, The Greek Economic Drama: An almost perfect Austrian application, New York 2013, p. 5.
40 *Ibidem*, p. 16.
41 J.M. Buchanan, Constitutional Efficiency and the European Central Bank, "Cato Journal", Vol. 24, No. 1–2 (Spring/Summer 2004), p. 16.
42 Now for the Long Term "The Report of the Oxford Martin Commission for Future Generations", October 2013, p. 6.
43 M.N. Rothbard, What has government done to our money?, Ludvig von Mises Institute 2008, p. 7.
44 E.R. Vickstrom, *op. cit.* p. 25.
45 M. Spackman, *op. cit.* p. 5.

based governance in which 'supranational' actors have the leading role.[46] And maybe this is the only method to guaranty a strictly enforced fiscal stability rule which would force national governments to cut expenditure instantly, not in the indefinite future.

Conclusion

At the Spring summit, in March 2010, EU Heads of State endorsed the European Commission's proposal for a Europe 2020 economic strategy. José Manuel Barroso, President of the European Commission, urged national and local authority leaders to *make sure that culture is firmly anchored in the long-term development strategies*.[47] This should be used to attain the medium term objective and ensure long-term sustainability of public finances. Markets will only be reassured by credible, long-term plans to cut deficits and debt. Only then can sustainable growth resume.

It became crucial that an appropriate reform of fiscal frameworks within the EU should be instituted.[48] In the Spring of 2013, a period of sustained legislative activity to strengthen EU economic governance seemed to come to an end. With it, 'six pack' and 'two pack' enter into force, completing the budgetary surveillance cycle and further improving European economic governance. Comprising a total of seven regulations and one directive, the 'six pack' and 'two pack' have been visible symbols of the EU's attempt to respond to an economic crisis.[49] In particular, Council Directive 2011/85/EU of 8 November 2011, on requirements for budgetary frameworks of the Member States, includes these requirements: 1/ there is a need to build upon the experience gained during the first decade of the economic and monetary union; 2/ medium-term budgetary frameworks shall include procedures for an assessment as to how in the light of their direct long-term impact on general government finances, the policies envisaged are likely to affect the long-term sustainability of the public finances.

High levels of public debt cannot be sustained indefinitely. What happens if nothing is done? What happens if we forget about long term perspective and still focus on and stick to current issues? Clearly, as public debt rises, eventually default becomes likely. More likely, a break-up would take place amid plunging share prices, maybe runs on banks. Capital controls are illegal in the EU and the break-up of the euro system is outside the law, so the whole system would be cast into legal *limbo*.[50] Changes in EU economic governance cannot meaningfully be understood

46 K.A. Armstrong, *op. cit.,* p. 1.
47 European Commission, Long-Term Financing of the European Economy, "Green Paper" 2013, p. 2.
48 P. Lampreave, *op. cit.*, p. 592.
49 K.A. Armstrong, *op. cit.* p. 1.
50 "The Economist", The choice. A limited version of federalism is a less miserable solution than the break-up of the euro, May 26th 2012.

as mere switches from *soft* to *hard* legal rules or from *intergovernmentalism* to *supranationalism*.[51] Long term perspective taken into account by decision makers seems to be *sine qua non* condition in this respect. It is a cliché today that if we do not study the past we are condemned to repeat it.[52]

51 K.A. Armstrong, *op. cit.*, p. 3.
52 T.E. Woods, The Forgotten Depression of 1920, http://mises.org/daily/3788 (27.11.2009).

UNIJNY KRYZYS FINANSOWY – WINNE PROGRAMY OSZCZĘDNOŚCIOWE CZY POLITYCZNA KRÓTKOWZROCZNOŚĆ?

Podejmowane w ostatnich latach próby naprawy sytuacji ekonomicznej w państwach członkowskich UE łączy wspólna właściwość – brak stabilności obowiązujących norm prawnych, które tym samym nie były w stanie gwarantować rozwiązań długoterminowych. Stabilność prawa nie stanowiła niestety w UE priorytetu politycznego, czego dobitnym przykładem jest choćby funkcjonowanie przyjętej 17 czerwca 1997 r. rezolucji Rady Europy o przyjęciu Paktu Stabilności i Wzrostu. Pakt gwarantować miał obok zapewnienia trwałego wzrostu gospodarczego i wzrostu zatrudnienia, również zadowalający stan finansów publicznych i stabilność finansową. Państwa członkowskie UE w momencie tworzenia regulacji ekonomicznych nie były najwyraźniej gotowe do przyjęcia jakichś wiążących postanowień dotyczących sposobu prowadzenia i koordynacji polityk gospodarczych ani też środków realnie wymuszających na płaszczyźnie narodowej dbałość o ekonomiczne podstawy funkcjonowania wspólnego pieniądza. Cały więc system musiał z konieczności działać w oparciu o mające faktyczny status *lex imperfecta* normy dotyczące dyscypliny finansów publicznych poszczególnych państw członkowskich. Dzisiaj więc fundamentalne znaczenie dla wyjścia z sytuacji kryzysowej i utrzymania stabilnego rozwoju gospodarczego ma w możliwie największym stopniu związanie politycznych decyzji wiążącymi konstrukcjami prawnymi prawa unijnego, zapewniającymi w szczególności ich długoterminowe oddziaływanie. Innymi słowy, polityka fiskalna państw członkowskich opierać się powinna raczej nie na decyzjach podejmowanych w ramach często chaotycznych politycznych reakcji na każdorazowe problemy, ale na podstawie trwałych norm prawa unijnego.

Słowa kluczowe: programy oszczędnościowe, polityka budżetowa, kryzys finansowy

Keywords: austerity, fiscal policy, financial crisis